

REAL ESTATE INVESTMENT TRUST (REIT) – Key Success Factors

BUSINESS RISK ASSESSMENT

Asset Quality. Our analysis includes detailed assessments of the asset quality of the pool of properties in a REIT's portfolio. This includes its occupancy and base rental rates, as compared to its peers in a particular area and to the market average, which will primarily determine a REIT's operating cash flow. Our analysis also includes an assessment of the values of the REIT's assets, taking into account the latest valuation report available on each property from qualified appraisers, asset classification (grade A, grade B, or grade C), location and accessibility (primary vs. secondary, urban vs. suburban or rural), asset age (new vs. renovated), attractiveness and desirability to potential tenants, as well as the environment and surrounding facilities (traffic condition, vulnerability to flood, access to public facilities, such as school, places of worship, supermarket, shopping malls, entertainment center, and other infrastructures needed by the community). Construction quality, customer services and satisfaction, as well as the brand image of the property, are also examined for their competitive advantages.

Diversification and Operating Stability. Our analysis covers detailed assessments of a REIT's diversification profile, which includes concentration of assets in terms of type (commercial, retail, offices, serviced apartments, hospitals, warehouses, and/or industrial estates), geography, tenant profile, and industry. This diversity should reduce volatility and maintain the stability of cash flow throughout various business and economic cycles. Lease structures with tenants, the weighted average lease to expiry, tenants' financial health/creditworthiness, as well as tenant retention rates, which in turn will affect the operating stability of a REIT, are also assessed. The regulatory framework, including REIT structure, land permits, and tax assessments, are also assessed under this criteria.

Management and Strategy. Our analysis includes comprehensive reviews of a REIT's managers and of the performance of its property manager. REIT managers make the guiding decisions for the REIT, such as optimizing capital structure and identifying assets that can be acquired or sold, as well as planning initiatives that would enhance the value of the properties (Asset Enhancement Initiatives, or AEI). On the other hand, property managers provide the ground services, such as collecting rental payments from tenants, implementing marketing and promotional programs, as well as caring management services. We mainly assess the manager's ability to create a strong franchise and/or brand for its property chains, as well as to create and increase the value of the assets. In addition, we review the manager's ability to increase rental fees during a rent review period (positive rental reversion) and cost management efficiency to maintain a stable margin. Operating margins (EBIT and EBITDA) are assessed by comparing a REIT's ratios with other players in the same industry, or in other industries with similar characteristics, which is important in analyzing competitiveness. The analysis is helpful to measure operating efficiency. Marketing and tenant retention strategy, asset acquisition and divestment policy, as well as capital expenditure policy, are also assessed. We are of the view that a trend of success stories in implementing strategies consistently can enhance a REIT's credibility.

FINANCIAL RISK ASSESSMENT

Financial Policy. Our analysis includes a review of the management's philosophy, strategy and policies toward financial risks (historical, current, and future). In addition, we examine the management's financial targets (growth, leverage, debt structure, dividend policy), hedging policy, and other policies toward reducing the REIT's overall financial risks (historical vs. future). The REIT's track record in fulfilling its financial obligations is also examined to determine the degree of its commitment, willingness, and consistency to pay obligations on a timely basis.

Capital Structure. Our analysis includes careful examinations of a REIT's historical, current, and projected leverage (total and net-debt in relation to equity, total capital, and cash flow), debt structures and composition (rupiah vs. foreign currencies, short-term debt vs. long-term debt, fixed rate vs. floating rate, etc.). Management of liabilities is also thoroughly reviewed.

Cash Flow Protection and Liquidity. Our analysis covers thorough reviews of a REIT's cash flow generation and capability to meet its short-term and long-term financial obligations. The degree of debt-servicing capability level is measured by a REIT's interest and debt coverage ratios. The degree of the REIT's liquidity in fulfilling its short-term liabilities relative to its sources of cash is thoroughly assessed as well.

Financial Flexibility. The analysis covers combined evaluations of all the financial measures above to arrive at an overall view of a REIT's financial health. Other related factors or figures that are not specifically examined above, such as insurance coverage, restrictive covenants in loan/bond agreements or parental linkage and supports, are also covered. Other analytical tasks performed include the evaluation of a REIT's options under stress, including contingency plans and other capabilities and flexibilities to deal with various adverse scenarios. Sponsor support and commitment are also greatly considered.

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