Property sector will continue to remain challenging

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PEFINDO is of the view that the property sector in 2019 will continue to remain challenging, as rising political risk and regulatory uncertainty ahead of the presidential election in 2019, currency volatility, and rising mortgage rates may dampen demand. Despite the government's plan to help boost the sector through several deregulations (easing of loan-to-value or LTV rules, luxury and super luxury taxes), their impact, in our view, will likely be limited.

We expect subdued demand for property ahead of the presidential election in April 2019 as some potential buyers are now taking the wait-and-see approach common during election cycles. We are also of the view that a prolonged weakness in the rupiah may add another reason for potential buyers to delay purchases on top of a rising mortgage rate environment. Over the near-to medium-term, we expect property purchases will be driven by real-demand from end users, which in our view, are more susceptible to the aforementioned factors, instead of speculative buyers. Accordingly, we do not expect presales to reach the levels seen during the 2012-2014 property boom. Our view is further supported by increasing mortgage usage relative to cash and installments along with the growing contribution of low- and mid-end segments (<IDR3 billion per unit).

PEFINDO undertook a sectoral review of several rated and unrated developers. We are of the view that the slowdown in the property sector over the past few years has and will continue to put pressure on some of the developers' credit profiles, particularly capital structure and interest protection, as revenue recognition from presales vary from 6-12 months lag for land sales to up to 36 months for high-rise developments. Although we believe that developers with strong recurring income will have a better chance to withstand the deterioration in operating conditions, a decline in property sales will still be detrimental to credit profiles in the form of reduced revenues, EBITDA, and cash flows.

In this report, we observe eight private developers, five of which are rated by PEFINDO: PT Bumi Serpong Damai Tbk (BSDE: $_{id}$AA-/Stable), PT Summarecon Agung Tbk (SMRA: $_{id}$A/Stable), PT Agung Podomoro Land Tbk (APLN: $_{id}$A-/Stable), PT Modernland Realty Tbk (MDLN: $_{id}$A-/Stable), and PT Intiland Development Tbk (DILD: $_{id}$BBB+/Stable). The other three that are not rated by PEFINDO are PT Pakuwon Jati Tbk (PWON), PT Ciputra Development Tbk (CTRA), and PT Alam Sutera Realty Tbk (ASRI).

Table 1. Presales (IDR billion)

Company	2018 target	9M18	% of 2018 target	9M18 YoY	2017	2016	2015	2014	2013	2012
Bumi Serpong Damai	7,200	5,400	75.0%	12.5%	7,233	6,250	6,760	6,508	7,348	4,280
Pakuwon Jati*	2,600	1,700	65.4%	-4.8%	2,505	2,277	3,061	3,137	3,003	1,851
Ciputra Development*	7,722	5,147	66.7%	-2.0%	7,640	7,200	9,200	8,631	8,941	7,298
Summarecon Agung	4,000	2,223	55.6%	11.2%	3,560	3,005	4,350	4,601	3,725	3,873
Agung Podomoro Land	4,900	1,935	39.5%	-30.9%	3,458	2,728	2,461	6,000	6,400	5,800
Modernland Realty	3,500	3,209	91.7%	126.3%	1,970	4,478	3,168	3,767	2,907	1,088
Alam Sutera Realty*	4,000	3,620	90.5%	14.2%	2,213	3,385	1,926	4,254	4,813	3,648
Intiland Development	3,382	1,562	46.2%	-42.7%	2,935	1,319	1,619	2,538	2,535	1,650
Aggregate	37,304	24,796	66.5%	3.5%	31,514	30,642	32,545	39,436	39,672	29,488

*Source: PEFINDO and company data * Unrated companies*

Presales performance for the nine months ending September 30, 2018 (9M2018) posted an aggregate 3.5% year-on-year (YoY) increase to IDR24.8 trillion. Although the numbers look promising, we observed that there has been a growing trend towards block sales among several developers in the past two years to compensate for weak property demand as well as, to some degree, ease liquidity pressure. A total of nearly IDR6 trillion stemmed from block sales in 2017 and about IDR3.5 trillion in 9M2018. In 2018, MDLN sold 350 hectares of its land bank in Bekasi to a joint venture company with PT Waskita Karya Realty, a subsidiary of state-contractor PT Waskita Karya (Persero) Tbk, allowing its 9M2018 presales to grow by

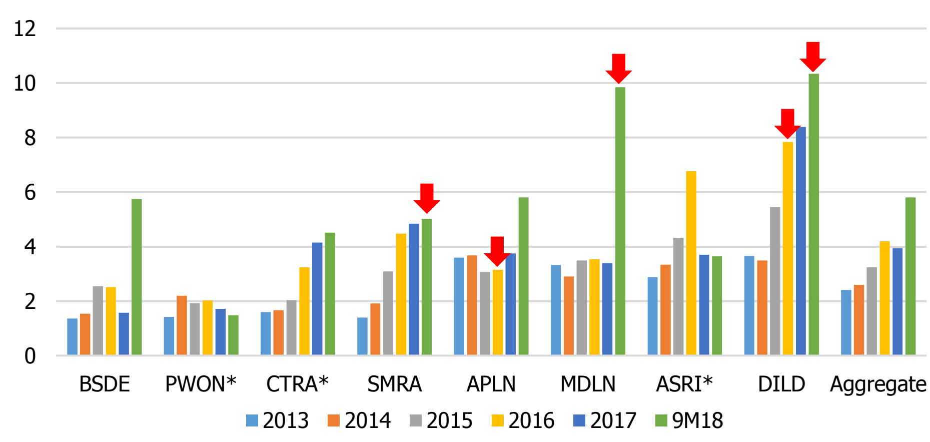
126.3% YoY —far better than its peers' average. Like MDLN, ASRI also booked significant presales from the sale of its land bank in Pasar Kemis, Tangerang, adjacent to its Suvarna Sutera development, to China Fortune Land Development (CLFD) for around IDR1.2 trillion. Besides land sales, bulk sales have also become a trend of late. CTRA sold its serviced apartments in Newton 1 to a joint venture company with Diener Syz Real Estate, a Switzerland-based investment firm, for IDR575 billion. In 2017, CTRA sold its serviced apartments in Ciputra World Jakarta 2 to Ascott Ltd (CapitaLand).

Although block sales will, to some extent, alleviate pressure on credit profiles over the short-term, they increase concentration risk, as a large portion of cash flow will depend on a single group of customers. This could result in a volatile operating performance, and therefore becoming too dependent on block sales will be viewed as a credit negative by PEFINDO.

Only three developers are on track to achieve their sales targets for 2018: BSDE, MDLN, and ASRI. The latter two of which were driven by land bank sales, while BSDE has continued to achieve strong presales through new project launches and the sale of commercial land plots, which reflect its established position as one of the largest developers in Indonesia with diversified projects and segments. For DILD, its lower presales achievement was due to the lack of new project launches in 2018, while it struggled to improve take-up rates on existing projects. It suffered from its exposure to the middle-and high-end segments, where demand – particularly at the higher-end – fell steeply after 2014. The biggest contribution to DILD's presales came from 57 Promenade, which was launched in 2017 with presales of IDR781 billion. For APLN, its lower presales were due to delays in permits and land sales to CFLD at its industrial park in Karawang. With developers' presales achievements below target in the past two years, we now expect a relatively flat growth in 2019. Hence, the credit profile of developers will continue to weaken until 2020.

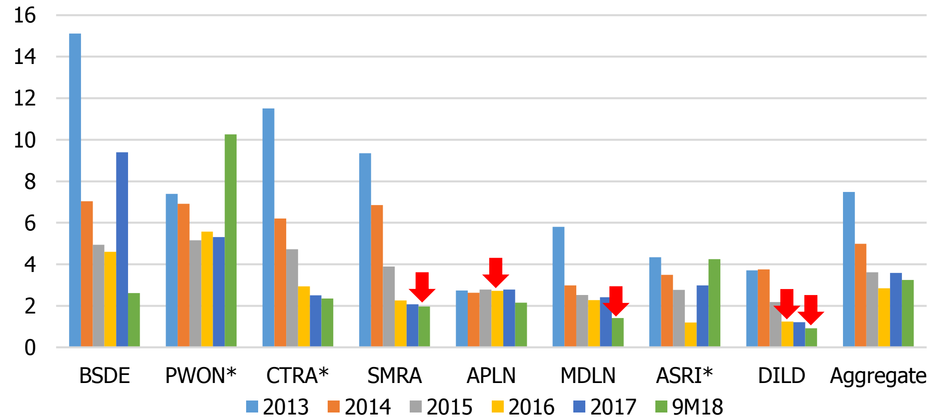
The weak property market since 2015 has resulted in several rating downgrades of rated developers by PEFINDO. Most of the downgrades were due to higher debt leverage, as the increase in their debt outpaced the increase in revenue. This is because of higher working capital needs since 2013 to fund the construction of properties, high-rise in particular, amid lower take-up rates as well as the depreciation of the rupiah. Before 2013, 100% of a mortgage could be disbursed by banks to developers within three months of signing the mortgage agreement. In 2013, Bank Indonesia issued tightening measures so that first mortgage disbursement was based on a percentage of completion, while funds for second mortgages onward could only be disbursed once the construction is completed. The recent relaxation of mortgage disbursement, in our view, should help developers improve their cash flows and leverage, particularly for developers with a high proportion of mortgage buyers, as developers will receive a portion of the mortgage faster.

Chart 1. Rising leverage – measured by debt/EBITDA (x)



*Source: PEFINDO and company data; *Unrated companies*
The red arrow pointing down shows that the rating of the rated developer was downgraded during the year

Chart 2. Weaker interest coverage – measured by EBITDA/interest (x)

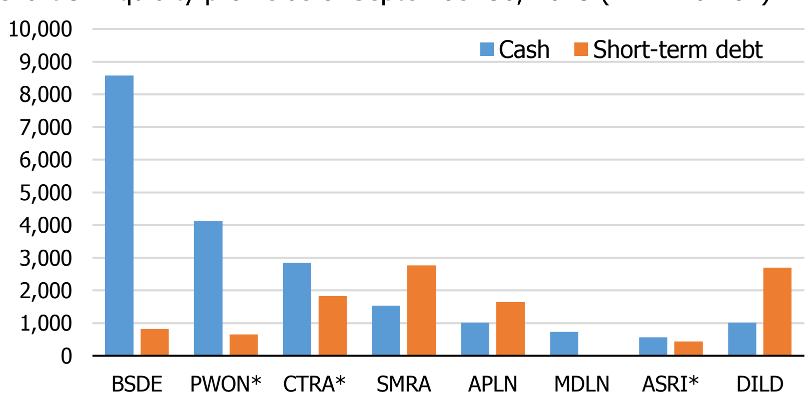


*Source: PEFINDO and company data; *Unrated companies*

We are of the view that most of the developers that we rated, except for BSDE, have limited headroom in their leverage and interest servicing capacity to absorb tougher operating conditions. We are also of the view that this will remain to be the case over the next 12 months. We believe that a further decline of 15%-20% in property sales in 2019 could trigger a rating downgrade for APLN, MDLN, and DILD, barring a substantial reduction in capital spending. For BSDE, its strong profitability, underpinned by its low-cost land bank and supported by a growing recurring income which accounted for 23% of revenue in 9M2018, should provide enough buffer in its credit metrics in the event of a sales shortfall. PWON is viewed to have the strongest credit profile in the group as it benefits from having a significant recurring income, which insulates it against volatility in the property market. In addition, we are of the view that SMRA has a moderate capacity to withstand a further deterioration in operating conditions, as it generates about 40% of its revenue from stable rental income. In 9M2018, revenue from its rental investment properties adequately covered 2.5x of its interest expenses.

In terms of liquidity, we anticipate that four of the developers that we rated and covered in this report have sufficient cash and cash equivalents on hand as of September 30, 2018, and committed bank facilities to cover debt coming due over the next 12 months. For DILD, we noticed that there is a potential liquidity risk as its cash of IDR1 trillion as of September 30, 2018, was insufficient to cover the IDR2.7 trillion in debt due over the next 12 months. However, we expect such risk to be partially mitigated as IDR2 trillion of its short-term debt are revolving facilities, which it has a track record of rolling over. In addition, DILD had about IDR750 billion of undrawn bank facilities as of October 31, 2018, to support its liquidity.

Chart 3. Liquidity profile as of September 30, 2018 (in IDR billion)



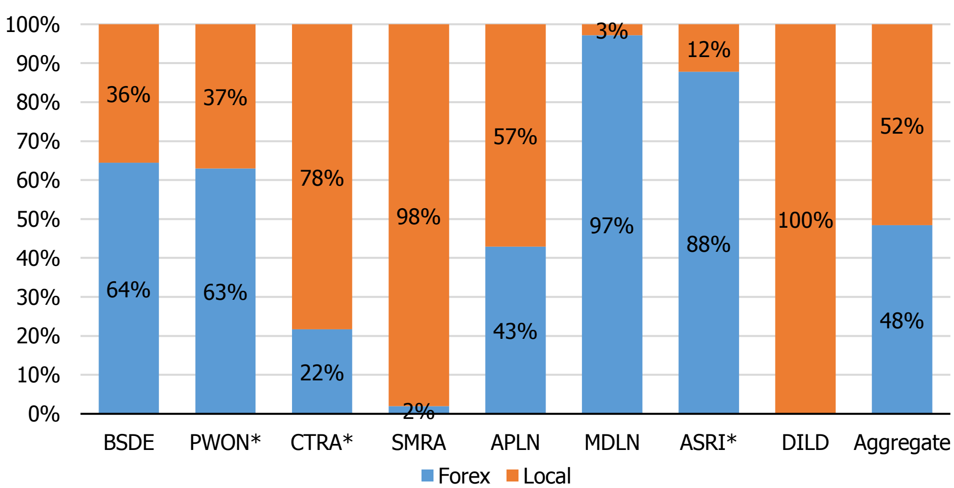
*Source: PEFINDO and company data; *Unrated companies*

Increasing exposure to foreign-currency risk is a credit concern

Over the past few years, we have seen developers issuing US dollar-denominated bonds, taking advantage of the cheaper financing costs despite the cash flow mismatch (coupon rate ranges between 6.0%-12.75% per annum, including hedging costs of 1.3%-3.5%, compared to 11%-14% funding costs from banks and/or the onshore debt capital market). As of September 30, 2018, foreign currency debt from developers covered in this report made up about 48% of total outstanding debt. With the rupiah depreciating 10% against US dollar year-to-date, the balance sheet and profitability of some of these developers with exposure to foreign currency debt have weakened, offsetting the cost advantage that was originally sought. This is shown in chart 1 and chart 2, where we saw a significant spike in leverage and a sharp decline in interest coverage in 9M2018 from developers with exposure to foreign currency debt. Earnings have also deteriorated, with BSDE, PWON, MDLN, and ASRI recording foreign currency losses of IDR404.5 billion, IDR284 billion, IDR407.7 billion, and IDR516.6 billion, respectively in 9M2018. We believe that a prolonged weakness in the rupiah will severely hurt developers' interest and debt repayment capacity.

Nonetheless, most of the developers, except BSDE, at least partially hedge their US dollar bonds by using a call spread option to protect against the downside risk of exchange rate volatility. However, interest expenses, except for APLN, were left unhedged. APLN, being the most prudent in hedging in our view, recorded a gain of IDR103.9 billion and IDR69.6 billion from hedging its principal and interest obligations, respectively, in 9M18. Without any hedging options on US dollar bonds, we believe that developers' profitability and cash flows are at risk, given the rupiah's volatility. Nonetheless, for BSDE, the currency risk is partially mitigated by the long-dated maturities of its US dollar bonds, with the closest one worth USD79 million due in 2020. ASRI, on the other hand, faces significant refinancing risk in the event of a tight liquidity market owing to its sizable USD235 million notes due in March 2020. This could eventually force ASRI to take on higher funding costs, as was done recently by MDLN, which issued US dollar bonds of USD150 million with a coupon rate of 10.75% (not including hedging cost). Part of the proceeds of this issuance will be used to refinance the its USD57 million bond due in August 2019.

Chart 4. Foreign currency debt vs local debt as of September 30, 2018



*Source: PEFINDO and company data; * Unrated companies*

Table 2. Developers' credit summary

Company	Rating	Outlook	Presales (IDR bn) 9M18	Presales YoY (%)	Revenue (IDR bn) 9M18	Revenue YoY (%)	Recurring (IDR bn) 9M18	Recurring YoY (%)	Recurring % to Rev	Leverage (x)	Interest Cov. (x)
Bumi Serpong Damai	AA-	Stable	5,400	12.5	4,787	-18.9	1,113	13.5	23.2	5.7	2.6
Pakuwon Jati	NR	NR	1,700	-4.8	5,229	19.0	2,562	19.1	49.0	1.5	10.4
Ciputra Development	NR	NR	5,147	-2.0	4,691	7.9	1,276	6.2	27.2	4.4	2.4
Summarecon Agung	A	Stable	2,223	11.2	4,023	0.7	1,601	9.5	39.8	5.0	2.0
Agung Podomoro Land	A-	Stable	1,935	-30.9	3,803	-30.3	1,203	-6.0	31.6	5.8	2.1
Modernland Realty	A-	Stable	3,209	126.3	1,691	-10.0	84	5.9	5.0	9.9	1.1
Alam Sutera Realty	NR	NR	3,620	14.2	3,203	1.0	311	12.7	9.7	3.5	3.3
Intiland Development	BBB+	Stable	1,562	-42.7	2,419	40.1	431	24.5	17.8	10.3	0.9

Leverage = Total adjusted debt/EBITDA
Interest coverage = EBITDA/IFCCI
EBITDA = Earnings before interest and tax (EBIT) + Depreciation + Amortization
IFCCI = Interest expense + Other financial charges + Capitalized interests
Source: PEFINDO and company data