TECNICAL ASSISTANCE FOR POLICY DEVELOPMENT

FOR ENABLING THE HOUSING MARKET TO WORK IN INDONESIA

By. THE HOMI Project Team

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# CHAPTER 1

## BACKGROUND TO THE HOMI PROJECT

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CHAPTER 1

BACKGROUND TO THE HOMI PROJECT

1.1 Housing Policy and Finance Problem

By standards of many of its Asian neighbors the housing and housing finance sectors in Indonesia are under-performing. Housing investment in Indonesia is approximately 1.5% of GDP, compared with a range of 2% to 8% in comparable countries. Similarly, mortgage finance equals 25% of GDP in Malaysia, while in Indonesia this figure is only 3%. Housing has the potential to be an important economic sector, contributing to job creation, expansion of the finance system and creation of household wealth. Housing can also be a powerful tool in redistributing income or wealth. Economically, financially and socially the sector could play a more prominent role in the recovery process.

Clearly, the low and uncertain household incomes are an important factor in the limited role housing plays in the economy. The weakness and inefficiency of the financial sector further hinder expansion of a healthy housing delivery system.

There is clear evidence that current housing policies and programs hinder the efficiency and expansion of the housing sector. Under the current housing policy system, the delivery of market produced non-subsidized housing units for low-and moderate-income groups has declined (although the slow economy has also contributed). Production is nearly entirely dependent on the KPR interest rate subsidy for loans for specific house-types, which is the corner stone of the current GOI housing policy. Yet only about 40 percent of the population can afford a 21 m2 RS house.

The system remained unchanged for at least 20 years until the economic and financial crisis of 1997. However, the 1997 collapse was just the final straw for a system that had become untenable and had an increasingly negative impact on housing market and housing finance sector development. It is unnecessarily costly, has a negative influence on market innovation and, because of a gradual hollowing out of the value of the subsidy due to inflation, houses are increasingly built on cheap land far away from services and infrastructure. This has a negative impact on urban development.

After the crisis, and as part of the IMF agreement, BI liquidity funding for KPR subsidies was ceased and MOF had to carry the subsidy on its RDI budget. This is supposed to be phased out by 2004.
The housing market can be characterized as follows:

- **Substantial housing shortage in urban areas.** Assuming continuation of present household trends, 700,000 – 750,000 new housing units are needed in urban areas per year.

- **Great variety in housing requirements of regions and local governments.** Existing backlogs and growth figures vary widely, as do the financial and human resource capacities of the regions and local governments.

- **Low housing affordability, both income and financial affordability.** This is demonstrated by the fact that 60 to 65 percent of households cannot afford an unsubsidized RS type house – the lowest price house currently produced in the market.

- **Lack of finance availability, as pointed by the fact that unsubsidized mortgage lending is only available for the top 25 percent of the urban income distribution.**

- **Insufficient serviced land, particularly for moderate and low-income housing.** This is exacerbated by the fact that local capacity for land administration is weak and also that there is an excess of idle land.

- **Uneven enforcement of land and housing regulations.** There is much uncertainty in the legal and regulatory environment related to land, land development, construction and housing finance.

### 1.2 The Homi Project as a response

In response to Indonesia’s housing policy and housing finance sector problem, the Directorate General of Human Settlements Development (DGHSD) decided to conduct a technical assistance project with World Bank support. The project was to focus on “policy development for enabling the housing market to work in Indonesia” or HOMI Project (Housing Market Indonesia). It was designed as a 9-month policy study from April – December 2001.

The objectives of the technical assistance are described in section 1.2.1, and a summary of the scope of services is shown in section 1.2.2 below.

#### 1.2.1 Objectives of The Technical Assistance

The objectives of the Technical Assistance are described here as shown in the Terms of Reference (TOR) for the Project:

“The broad objectives of the technical assistance are to promote further development of housing policy and strategy into policy instruments that facilitate the accomplishment of
the immediate policy objectives 2000 – 2005, taking into consideration policy direction to meet housing demand in Indonesia”.

The broad objectives in the TOR include the following specific tasks:

1. To provide assistance/advisory services to Director General of Human Settlements Development (DGHSD) in dealing with daily and/or operational as well as strategic issues on housing and human settlements covering the whole spectrum of policy development and action-oriented programs being pursued, with the ultimate goal to improve the human resources development and training of DGHSD.

2. To design detailed policies and related policy instruments to strengthen the housing market and housing finance sectors and to improve housing assistance/subsidy programs to expand access to housing finance for underserved middle- and low-income families.

3. To design detailed policies and related policy instruments to strengthen the implementation of slum upgrading program and its related housing improvements following the community-based housing approach.

4. To prepare the community based housing program development in Indonesia through the implementation of slum upgrading program and related housing improvement development.

To ensure the achievement of these objectives, the required technical assistances are split into four different components A, B, C and D. Component A addresses the assignment objective #1 above, while Components B and C relate to objective #2 above and Component D addresses objectives #3 and #4 above.

1.2.2 Summary of Scope of Services

While each component was originally staffed by an international expert, the international experts for Components A and D were removed midway during Project Implementation and Component A and D were integrated with Component B. Individual experts were originally assigned to each component, but as the Project progressed some of the dividing lines between components blurred – and authorship of some of the specific reports cuts across components. A summary of consultant inputs was given in Progress Report 2/3, and need not be repeated in this Final Report. Appendix No. 1 gives a Summary of the Scope of Services, as abstracted from the TOR.

Outcomes from the Project were delivered in several specific reports, national workshops and training sessions. The Outline of this Final Report is shown below. Following chapters
1 and 2, the remaining 11 chapters represent full presentations of all special reports produced by the HOMI Project.
CHAPTER 2
SUMMARY OF MAIN RECOMMENDATIONS

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CHAPTER 2
SUMMARY OF MAIN RECOMMENDATIONS

2.1 Principles And Strategies For Housing Policy

Based on the decentralization laws 22 and 25 of 1999, Propenas and earlier draft strategies by Kimpraswil, the HOMI team has formulated an outline of a comprehensive housing policy for the country. In formulating this policy, the following principles and strategies were identified.

It was proposed that all policy actions should follow the same guiding principles. These are:
- Partnership and participation
- Fairness and equity
- Quality and affordability
- Innovation
- Transparency and accountability
- Sustainability and fiscal affordability

The seven key strategies formulated by the HOMI team were the following:
- Stabilize the housing environment
- Mobilize housing credit
- Facilitate speedy release and servicing of land
- Provide subsidy assistance
- Support participation processes
- Rationalize institutional capacity and housing investment
- Coordinate government investment in development

The proposals for policy action and program development embedded in the individual chapters of this Final Report are all based on these principles and strategies which together should provide a sound road map to necessary housing sector reforms in Indonesia. An overview of these strategies – and indeed of the entire national housing policy proposal – is given in Chapter 3.

A summary of the specific policy and program recommendations contained in Chapters 4 – 9 follows in the sections below:
2.2. **SUMMARY OF MAIN ISSUES RELATED TO DEMAND FOR LOW AND MODERATE INCOME HOUSING (CHAPTER 4)**

2.2.1. **Drivers of Demand.** The analysis focused on factors influencing the demand for housing, i.e., the decision to buy a house rather than rent, in particular for first-time home-buyers, and the decision to pay for housing of a certain price and quality and in a specific neighborhood. The main factors that drive demand are:

- income level in relation to house-prices and cost of housing, and income stability
- savings and wealth constraints
- life-cycle factors
- housing preferences
- user cost of home-ownership, in particular financing cost
- housing risk (the variation of house-prices over time, absence of rent risk)
- neighborhood externality risk (variation in neighborhood quality/externalities over time).

2.2.2. **Housing Requirements.** Total population and household growth will be focused in urban areas, while rural areas will be stagnant. The urban growth rate for the next few years is estimated at 3.5 percent, of which approximately two-thirds is due to in-migration from rural areas. The overall requirement for new urban housing to house newly formed households for the next few years is estimated at 700,000 to 750,000 units per annum.

The high migration component of urban growth has major implications for local governments’ housing strategies. Migrants are less prone to be home-owners and want to decrease overall housing spending.

Urban growth differs in different regions. The highest urban growth rate is expected in the least urbanized regions. Housing assistance programs need to focus capacity building...
efforts towards those areas.

2.2.3. Household Incomes and Income Stability. The current median monthly household incomes (50th percentile) for urban areas with and without DKI Jakarta are Rp.950,000 and Rp.892,000, respectively. The median household income in rural areas is Rp.579,300.

The critical impact of the 1997 crisis has been in the decrease of real wages and not in aggregate employment, since many workers transferred to self-employment. Wage cuts have been greater in the urban sector and are concentrated at the bottom of the wage distribution.

Household incomes have shown far less volatility during the crisis period than individual wage incomes and overall GDP. Households have coped by having household members move to informal employment and by extending female labor force participation. As a result, the decline in household incomes is about half the size of the decline in individual earnings. Nevertheless, the crisis and the related fall in household income had a major impact on housing demand. One consequence of the crisis is an even higher percentage of self-employed and family workers (a total of 46 percent in urban areas), which will only gradually be re-absorbed by the labor market.

The large proportion of self-employed and family workers will make borrowing for housing through conventional KPR loans even more difficult. Also, an increased sense of insecurity of future income may have a negative effect on the willingness of households to borrow for housing and may influence tenure choice. At the same time, the high labor force participation will negatively affect possible direct self-help involvement by household members.

2.2.4. Cost Affordability of Housing. House-prices in relation to incomes are modest and housing standards are not the main concern in the affordability of housing. Low to moderate income households can buy a house for an average price of 3 to 3.5 times annual salary.

- **Median prices (approximate) for existing housing** in predominantly low-income neighborhoods converged around Rp.18 to 20 million in the 10 city survey. KIP areas, which are generally better located and are mostly mixed income neighborhoods, had a
median house-price of roughly Rp.44 million, with a median yearly income of Rp.10.7 million (HOMI 10 City Survey, 2001).

- **Cost analysis of new construction in non-complying, but legal areas** show that a 21m², self-constructed house on a 60m² plot priced in the order of Rp.80,000 to 100,000 per m² can be built for a minimum of Rp.20 million in main urban areas. Both land and construction prices depend, of course, on location and region of the country. Developer produced moderate income housing can be built for Rp.25 million and above.

- **The lowest cost “housing” solution** is a plot with a core house without infrastructure for Rp.13 to 15 million, depending on location (see Puslitbang 2001 regional construction cost data).

- **Households have a preference for self-built housing** and 50-70 percent of the houses in CBHP, KIP and unimproved slum areas is built in this manner.

Average housing expenditures dropped dramatically to a low of 14 percent as a result of the crisis, but are returning gradually to pre-crisis levels of 25 percent. Presently, owner households spend approximately 20 percent of household income on housing expenditures including utilities, while renters spend on average 16 percent.

### 2.2.5. Finance Affordability

The high interest-rates (20 percent) and high down-payment requirements (LTV of 70 percent) for mortgage lending pose critical limits to housing affordability. Lack of down-payment support may be the most important borrower constraint for mortgage lending. At the medium income level, urban households outside of Jakarta can afford Rp. 13 million in loans and with 30 percent downpayment they can afford a house of Rp. 18.7 million. If interest rates of 15 percent are assumed, the same household can afford Rp. 17 million in loans for a total house value of Rp. 24 million.

Lender constraints on extending housing finance focus on the high perceived risk of default for low income and non-fixed salaried borrowers, and the high occurrence and cost of foreclosure in case of delinquency. Additionally, the fee income for writing small mortgage loans is relatively low. Consequently, mainstream lenders typically do not make loans for houses with a value below Rp.40 to 50 million, affordable only to the 75th percentile of the urban income distribution. Second-tier regional banks, which have a better understanding of local conditions, make mortgage loans for properties valued as low as Rp.20 million, affordable to the 45th percentile. Liquidity constraints are a problem for some banks. When funds for lending are limited, long-term lending to risky customers on the basis of weak collateral will not be a priority. Lowering the risk of default and foreclosure and
insuring the cost of default may assist in getting lenders to move down-market and may increase their access to funds for housing loans.

Un-secured micro-finance for housing with current interest rates of over 30 % is important mostly as a borrowing option of last resort (a Rp.2.4 million loan can be afforded by a household at the 20th percentile earning Rp.511,000 per month). Micro-finance institutions can be assisted to improve efficiency and expand access to housing finance. A housing-for-savings program, coupled to incremental construction or improvement for housing may be a useful orientation for a housing program for the lowest 40 percent of the urban household income distribution (Rp.750,000). Self-construction is preferred by low and moderate income households over the smaller RS/RSS turnkey house types (HOMI survey).

Investment and savings preferences for housing are low relative to savings for reasons of security for the future and education for the children. These findings are an indication that the house is not considered as an asset that can be utilized to borrow against in case of need.

2.2.6. Housing and Neighborhood Risk. Willingness to invest in housing is related to the perception of the risk that the house will lose value. Current moderate and low-income housing programs often deliver housing that has a lower value than the cost of construction. In addition, a large proportion of houses in low-income housing areas do not have Hak Milik titles or formal permits. Resale of these houses is, therefore, more difficult and investment in housing is discouraged.

Much of the housing value is derived from neighborhood quality, i.e., location, availability of infrastructure and services, and social integration and security characteristics. The process of acquiring all development and building permits takes on average a year for low-income areas and is unpredictable. A lack of clarity as to when, or if services will be delivered increases neighborhood risk (i.e., the risk that house values are volatile because of unpredictable neighborhood factors). Investment by (potential) home-owners in more risky neighborhoods is negatively affected and so is lending by financial institutions, which further dampens demand.

In addition, lack of access to services (health and education) and infrastructure (safe water, adequate sanitation, access to transport and roads, electricity) are amongst the most critical aspects of poverty. Housing assistance programs need to provide housing
that maintains its value and provides a real asset to low and moderate income households. Medium-term implementation plans for the delivery of property rights and infrastructure by local government should be an integral part of low income housing programs. Greater attention should also be given to community strengthening programs.

2.2.7. **Consequences for Housing Assistance Programs.** First, housing assistance programs and particularly programs to stimulate new construction, need to focus on urban areas, since all household growth is expected to take place in cities.

Second, since urban growth will be made up predominantly of migrants, rental housing should be stimulated.

Third, the demand analysis shows two main types of constraints in extending demand for urban low and moderate income housing:

- **An affordability constraint related principally to the difficulty of accessing housing finance and the high cost of finance.** The housing market can effectively deliver housing for Rp.25 million or even Rp.20 million, which is considered sound collateral for a loan and sound investment for households, i.e., included in the price of the house are costs related to property titles, regulatory approvals, proper location and infrastructure and services. Housing in this category need not incur a mismatch between cost and value of the house, nor the risks that neighborhood factors impact house-value unpredictably. Financial incentives to households to address savings constraints or constraints related to income level and volatility, may under these market conditions be effective in stimulating both demand and supply of moderate income housing. Equally, assistance to banks to improve risk assessment and some specific credit enhancement incentives may facilitate down-market lending.

- **A housing affordability constraint caused by housing and neighborhood risk.** Real markets for low and moderate income housing below approximately Rp.20 million are “incomplete” and cannot yet price adequately for housing costs and risks, and neighborhood quality and externalities. Finance will therefore not be easily obtained and investments by households are risky since the housing asset has an uncertain value. Clearly, just providing financial incentives to households or lenders would either increase the investment risk for borrowers and financial institutions or would simply not result in new houses being constructed through the private authorized sector. For this segment of the market, a more comprehensive approach to housing assistance is
needed. A neighborhood based approach would be required that will provide more direct supply-side assistance, e.g., to provide property rights and regulatory clarity, land in adequate locations and social and physical infrastructure. Given that kind of support, demand for housing may be enhanced through financial incentives, if necessary. In other words, since markets for housing at the lower level do not work well, demand incentives alone will not work to increase housing production, but a neighborhood-based and supply-oriented approach would provide incentives by households and lenders to make further investments.

2.3 RECOMMENDED IMPROVEMENTS IN THE HOUSING FINANCE SECTOR (CHAPTER 5)

2.3.1. Recommendations

Consolidated Recommendations. This section consolidates the recommendations presented in the preceding sections. We have grouped them here according to the major issue the address in the overall process of strengthening the housing finance system: that is, credit risk, legal and administrative risk, expansion of the housing finance sector, and long-term funding and liquidity risk. Only the recommendations are noted in this summary, so please refer to each of the sections above to address the issues defining each topic. The recommendations are organized as follows:

2.3.2. Recommendations in Risk Management and Information Systems: Credit Risk, Legal Risk, and Administrative Risk

a. Establishment of a Credit Bureau
b. Automation and Risk Management: Credit Scoring
c. Legal Risk: Improving Foreclosure
d. Administrative Risk: Improving Standardization

2.3.3. Expanding the Housing Finance Sector

a. Expanding the Lending Institutions
b. Mortgage Default Insurance
c. Alternative Mortgage Products and Other Tools in the Downmarket Expansion
d. Eliminating the KPR/RSS Subsidy System
ad. 2.3.2. **Recommendations in Risk Management and Information Systems: Credit Risk, Legal Risk, and Administrative Risk**

### 2.3.2.a. Establishment of a Credit Bureau

- A Credit Bureau initiative has been begun by the Ministry of Cooperatives to assist the development of SMEs. The ADB has supported this effort. However, HOMI strongly recommends that the focus be broadened to the entire financial sector. An Inter-ministerial Task Force, or a Working Group, should be established as soon as possible to carry a broad-based Credit Bureau initiative forward. A single Credit Bureau in Indonesia will be developed to provide the information needed by all lenders for all relevant types of lending.

- The Credit Bureau issue will be raised by Bappenas at the Inter-Ministerial meeting now convened by Kimpraswil regularly (it is to meet every three months) in order to place it on the agenda and discuss the best approach to carrying the initiative forward and the most appropriate institutional home. In the opinion of HOMI, Bappenas (or MOF) is the logical champion for the Credit Bureau in order to structure it as a nation-wide initiative serving banks and non-banks in a broad range of lending activities.

- The HOMI team recommends that Kimpraswil support and join a Task Force and work to broaden the scope of the Credit Bureau effort beyond SMEs to include numerous types of lending in the information service, including especially mortgage finance. PERBANAS is now directly involved and must be a key player. It is also crucial that this Task Force have a representative from BI, as the DIS system can make important contributions to a credit bureau.

- The banks interviewed by the HOMI team were positive about the creation of the credit bureau. There is also a strong feeling that the Credit Bureau should be private. Capital could be sought from banks, donors, the IFC, and/or interested private sector rating or credit bureau management companies.

- The ADB study calls for a feasibility study to be undertaken as soon as possible. HOMII strongly supports this; continued funding should be sought from ADB. Assuming that the recommendations in the July 2001 ADB study are implemented, a feasibility study to address the administrative and structural issues noted above, should be carried
out. The initial ADB study stressed that it would be far more cost-effective for Indonesia if a private sector firm, specializing in credit bureau development be engaged to conduct the feasibility study and the development of the Credit Bureau infrastructure.

- Thus, following the completion of the Feasibility Study, HOMI recommends that private sector firms which specialize in credit bureau development in Asia and globally be invited to submit proposals with plans to assist development in Indonesia. As noted in the current ADB study, the development phase would be much less costly if experienced firms are involved. (Among other things, the identification and I.D. problems facing development of the Credit Bureau will be extremely challenging with regard to computer software able to uniquely distinguish households).

- The Task Force will determine the ownership of the Credit Bureau and the form of its operation and organize educational workshops and promotional campaigns.

- Finally, BI’s information system was not planned to function as a credit bureau. The Law on Bank Indonesia No.23/1999 specifically article 32 sub-article 1, stating that BI arrange and develop an inter-bank information system, should be revised.

2.3.2.b. Automation and Risk Management: Credit Scoring

- The first step in improving the information systems in the sector is to begin development of a Credit Bureau as discussed above.

- Simultaneously, HOMI recommends that the banks that plan to be heavily involved in mortgage lending, plan to implement specialized IT systems for mortgage finance, if this has not already been done. In addition, some banks would benefit from training in risk management and automation issues. The banks could coordinate their training requests through Perbanas. Examples of topics suggested by HOMI include IT systems, underwriting and credit scoring, and automated underwriting and servicing procedures..

- Next, banks should develop internal mortgage portfolio databases. Perbanas may also wish to develop an analysis database, on its own behalf and that of the smaller banks. Note that this step can take place whether or not the Credit Bureau is in place.
• When the Credit Bureau is in place, a Task Force should issue an RFP to invite a private sector firm to develop the debt scoring system - the “FICO” score - as discussed above. It is derived from Credit Bureau data; the process of its development, and the approach that might be used in Indonesia, can draw on extensive international experience.

• In the long-run, banks will be in a position to introduce automated credit scoring, combining their own underwriting models with Credit Bureau data to provide a complete and overall comparative assessment of would-be borrowers.

2.3.2.c. Legal Risk: Improving Foreclosure

• Foreclosure is too often costly and slow. The probability of a mortgage loan entering the default stage now varies considerably within the system; please refer to the NPL statistics in section 2.0. However, since so many bad loans were placed with IBRA, it is difficult now to predict what the “steady state” default rate might be on new mortgage portfolios. As noted, while the probability of entering into default may be reasonably low, the probability of sustaining major losses, once a default occurs is extremely high.

• The existing mortgage law is sufficient enough to accommodate foreclosure process. In addition, the new role of the Government Auction Agency, as a policy making body, should help streamline the auction process.

• However, the mortgage law and the Dutch law of 1848 (RID Art. 200) can come into direct conflict in case where the debtor is not cooperative, in which the case court action is required. If the debtor (or legal occupant) refuses eviction, he cannot be evicted without a court order. In the ensuing legal proceedings, the chief of court has the power to decide the outcome.

It appears that several types of issues need to be addressed because of this conflict. (1) First, education of all parties involved. Customer education as to their rights and responsibilities in undertaking a mortgage loan might improve cooperation in the early stages. DJPLN should prepare socialization program covering key actors, procedures and regulations. The workshop convened on foreclosure suggested that Perbanas should
(2) Second, the 1848 Dutch law may ultimately need revision.

(3) Third, technical assistance is required to speed up the auction process. If the debtor is not cooperative, the auction should be optional, not compulsory.

(4) Fourth, delays and lack of transparency within the Court offices must be seen as responsible for many of the foreclosure problems. As a practical matter, automation and better IT systems should speed up the process, but more thorny court improvement issues fall within the purview of the Department of Justice.

2.3.2.d. Administrative Risk: Improving Standardization

- **Standardization efforts are already underway.** Draft documentation has been prepared and submitted to a Task Force, which is addressing a number of issues. Perbanas and the existing Task Force should continue to address the standardization issues, including definition of key variable such as the income measure used in payment-to-income ratios, and the value definition used in the LTV.

- More attention needs to be given, however, to the rules and regulations for appraisal procedures, which is one of the most crucial support services in housing finance. A number of important appraisal issues need to be resolved through regulations established by BI for regulation and supervision, as discussed in sections 3.4 and 6.0. This should be coordinated through discussions with Perbanas, as well as with appraisal and regulation and supervision experts.

- To avoid legal problems in the future, the Supreme Court should confirm, in the form of a Circular or Guidance, that the standard credit agreement, having been mortgaged, properly meet the criteria: for foreclosure in accordance with article 6 of Undang-Undang Hak Tanggungan (UUHT; that the auction request can be addressed straight to the Auction Office).
2.3.3. Expanding the Housing Finance Sector

Recommendations to encourage expansion of housing finance to moderate income households include a mix of policies: redesign of subsidy policies, government assistance in design of appropriate loan procedures, incentives for involvement of a variety of lenders, and subsidy policies designed for compatibility with both housing finance and downpayment contributions by households. Recommendations include:

2.3.3.a. Expanding the Lending Institutions

- **Downmarket Lenders.** HOMI recommends Initiatives by GOI to seek broader participation by a broader group of lending institutions, including BPDs and smaller banks. Regional banks and a number of other state and private banks already provide KPR UMUM, although in very modest amounts, or, state that they are willing to go downmarket, (defined arbitrarily as loans of Rp. 25 million or less). These lenders should be encouraged. An assessment should be made of the financial condition of such lenders; sound lenders should provided with technical assistance regarding mortgage finance underwriting, servicing, loan products, and so forth.

- **Bank training** would be a key part of these efforts. HOMI recommends centralizing and coordinating all bank training through Perbanas (see above for the recommendation that Perbanas form a Subcommittee on Housing Finance). State banks, including the regional banks discussed here, are currently represented by HIMBARA. Fortunately, HIMBARA will soon be merged with Perbanas.

2.3.3.b. Mortgage Default Insurance

- **Mortgage Default Insurance.** An assessment of the feasibility of a credit enhancement via mortgage default insurance (MDI) is the topic of a HOMI special report “Risk Management and Mortgage Insurance”. MDI is developed as a key subsidy instrument in the HOMI report “Housing Subsidy Instruments for a Home-Owner Assistance Program”. MDI is mentioned in this report because it is a crucial aspect of the various incentives for banks to extend lending downmarket. It should be noted that MDI, potentially, can take two forms and play two complementary roles: a subsidized version can assist moderate income housing obtain funding, and encourage the housing market
to extend downmarket; a non-subsidized, borrower-paid version, a credit enhancement tool to help a somewhat higher income group obtain financing. In either case, HOMI considers that MDI has important potential as a subsidy and/or a downmarket mechanism.

2.3.3.c. Alternative Mortgage Products and Other Tools in the Downmarket Expansion

• A Tool Kit for Expanding Lending. HOMI recommends that training in alternative loan product and risk-based pricing “toolkit” be made available to lenders, ideally through the coordination efforts of Perbanas. As noted above, these topics follow directly from the issues discussed in section 3.0: formation of the Credit Bureau, the development of credit scores (FICO) scores, automation of underwriting (and the entire loan process), and mortgage default insurance (section 4.3). HOMI is not suggesting that Indonesian bankers eliminate the discretionary loan product, since this is what they are currently most familiar with. Rather, we suggest that mortgage bankers be provided more information on the various features of other loan products, why the features vary, why some products are better for some customers than others, and how different loan product features may be used to both control risk while satisfying borrower needs, and thus the principles for differential pricing.

• Bank Training. Cooperation with Perbanas in establishing a Subcommittee on Housing Finance. This subgroup would, first and foremost, determine which of the topics introduced in sections 3.0 and 4.0 of this report would be most useful for management of their loans portfolios, improving underwriting, expanding moderate income housing finance, and so forth. Examples of bank training topics include alternative mortgage products, as noted above, mortgage insurance, risk-based pricing and homeowner counseling. IT systems and credit scoring issues were already mentioned above.

2.3.3.d. Eliminating the KPR/RSS Subsidy System and Establishing a Role for BTN

• Mainstream banks and other lenders are not likely to lend downmarket until the KPR/RSS program is replaced with a market friendly subsidy approach and until the future of BTN is clarified and they can be assured of a level playing field in this segment of the market (see below). Mainstream lenders willing to go downmarket also can be
assisted in various ways, including via alternative loan products and credit enhancements, such as mortgage default insurance.

- A definitive decision taken by GOI to **phase out the KPR/RSS subsidy**. Housing suitable for the needs to modest income households has been too limited by the KPR/RS/RSS approach to housing. The supply of moderately-priced housing should reflect a broader continuum of typologies, augmented by low cost technologies. An improved continuum in the supply of housing should emerge once developers realize that finance is not locked into the RSS/RS system. This supply stream will better match the effective demand of moderate and modest income households.

- **The Future Role of BTN.** BTN, given its long experience in underwriting and administering the major share of the KPR/RSS interest rate subsidy, would seem to have a comparative advantage in lending downmarket to moderate income households. Under the scenario of phasing out the KPR/RSS subsidy by 2004, BTN might consider planning its commercial expansion into similar markets without this particular subsidy (and with or without another form of subsidy or credit enhancement such as mortgage default insurance). In contrast, however, BTN has tentative plans to expand into the upscale market and compete directly with banks such as Danamon, BII Lippo, Mandiri, and NISP. BTN planned to capture a major share of the market for loans on Rp. 100 million and above; there were no plans for loans of less than 50 million. *In sum, this approach seems not to take advantage of the middle market comparative advantage and methodologies that BTN has developed to date.*

### 2.3.4. Developing Low Income Housing Finance in Indonesia

Indonesia could benefit from more focused and widespread development of MFH, microfinance for housing. MFH is not a panacea for the low income but it *can become a significant stand-alone tool for loans for home improvement, home expansion, including for development of rental rooms, and for new construction conducted on an incremental basis.* In addition, when used together with other programs designed to address supply side constraints (land, infrastructure) and administrative constraints (land title, credit records of would-be borrowers, etc), and affordability constraints (direct voucher subsidies, for example) MFH can serve as one of the crucial inputs to low income housing development. Constraints posed by access to adequate funds will still need to be addressed. However,
Indonesia’s network of low income lenders could ultimately provide important support via enhanced savings generation.

- **Investigate a Capacity Building Role for BRI in Expanding an MFH Network.** We suggest that BRI would be ideally suited take a lead role in capacity building of the MFH sector, including further development of MFH loan products and underwriting policies. BRI could help promote MFH as an explicit component of microfinance. Most especially, BRI could expand its training programs to include MFH and assist in training other Indonesian MFI lenders in housing-related products. The networks of Bukopin, the Cooperatives, the BPD, the LKPD, and so forth, should be assessed under an expansion effort.

- **Develop more MFH Loan Products.** One key issue is whether to design and introduce loan products more specifically to support MFH. Some of the issues include:
  - Whether the housing loans be somewhat larger than the microenterprise loans?
  - Whether MFH loans could be somewhat longer term than the microenterprise loans?
  - Whether underwriting and collateral should be linked to prior savings programs, as an approach to self-insurance?

- **Increased Focus on Private Sector Rental Housing.** As discussed in the HOMI report on the housing market, rental housing for low income households is cited as a priority. We are concerned here with private sector, low income rental accommodations in owner-occupied housing. BRI already lends to homeowners for the purpose of building additions to their dwelling to be used for rental. BRI could assist other MFIs to develop rental housing loan programs.

- **Strengthen Commercially-based MFIs.** Credit programs offered by the existing network of MFIs should be undertaken at commercially-based rates. In the interests of strengthening MFIs and commercially-based lending, encourage GOI and donor programs to limit subsidized credit. Subsidies can be provided through other means, in both supply and demand side programs. In sum, do not allow subsidized credit programs to “crowd out” strengthening of commercially-based microfinance institutions.

- **Better Integration of Microfinance “projects” into microfinance “systems” and “institutions”.** This recommendation calls for helping to upgrade clients of microfinance “projects” to be clients of microfinance “institutions”. Cobild is a case in point. Clearly, valuable lessons are being learned from the Cobild project concerning community-
based endeavors, affordable building technologies, and so forth. But the credit aspects of the program are bringing the wrong message to those who wish to strengthen the institutional structure of MFIs and provide commercially-based credit. Integration of the Cobild process into the formal financial sector could include:

a. Use civic groups only as “transaction” intermediary with formal sector lenders
b. Use group loans in underwriting. If a household successfully completes this loan, then it could receive a “certificate” for a follow-on individual loan

- **Design Housing Programs Integrating MFH as a Component.** Finally, where appropriate, MFH should be integrated with broader programs for low income housing development, including land and infrastructure. This may also include a variety of subsidies to households, such as a direct transfer subsidy for assisting with downpayment.

- **Coordinate Findings with World Bank Pilot Project.** As described in section 1.0, and shown in the chart depicting the possible institutional structure of Indonesia’s mortgage finance sector, the World Bank Pilot Project on Microfinance is considering development of a liquidity guarantee fund to support housing microlenders. Efforts by Kimpraswil to expand housing lending downmarket should be coordinated with this pilot.

### 2.3.5. Long-term Funding for Mortgage Finance: Establishing a Secondary Mortgage Facility (SMF) in Indonesia

**Recommendations for Developing an SMF**

- Indonesia should concentrate at present on development of an SMF, rather than an SMM. The Inter-Ministerial Committee should designate a **Task Force** for development of an SMF. An institutional “champion” should be agreed upon as soon as possible. We suggest that the Task Force for development of an SMF should be headed by Bappenas as the institutional champion, with members including MOF, Kimpraswil, BI, and the Department of Justice.

- The Task Force should consider obtaining expert advice from at least two sources: **Cagamas and the U.S. Federal Home Loan Bank system.** As discussed above, the recommended Indonesian SMF has selected characteristics from each of these two systems, but does not replicate either in a direct manner. HOMI’s recommendations are that Indonesia’s SMF be as streamlined as possible and avoid non-market and/or
special requirements, such as mandatory investments in low income housing and below-market interest rates, such as those in effect for Cagamas.¹ A market-based approach to mortgage finance is especially important for Indonesia's banks to shed the legacy of the KPR system and proceed to expand the market-based system.

- Nearly all the current mortgage portfolio is relatively new. The pre-Krismon portfolios can offer some information, but a large portion of this portfolio was taken over by IBRA. (In turn, some of this was sold at discount simply as an asset, or a steam of income.) Thus, for the most part, it is the new, post-Krismon portfolio that will become the basis of future assets for use under an SMF. This portfolio must be further seasoned before its characteristics are fully clear to analysts. The Task Force should provide assistance for development of a database for analysis of the mortgage portfolio characteristics, perhaps centered in Perbanas.

- Detailed Feasibility Study of the SMF Structure and Regulations. Based on the preliminary set of recommendations discussed below, a thorough assessment of the SMF proposal should be undertaken as soon as possible, including the ownership structure and any special provisions designed to facilitate the competitiveness of the SMF debt instruments in the capital market.

- Capital Market Assessment. The capital market has suffered Krismon, leading to restructuring and recapitalization efforts, and is now dominated by GOI debt instruments. Even pre-Krismon, however, compared with some of its Asian neighbors, Indonesia's bond market was noted as being thin and weak.² A feasibility study should be undertaken for at least the following issues: (1) potential investors and the types of bonds they might invest in, (2) the comparative costs of raising funds for mortgage lending via an SMF as compared with other options open to the banks, (3) and the characteristics of the newly developing mortgage portfolio, including NPLs, will need to be undertaken to help ensure the success of an SMF.
2.3.5.1. Long-term Options: Development of SMF Lending without Recourse and Securitization Tools

- In the long-term, after successful operation of the SMF, the institution may wish to proceed as Cagamas has done, by examining the option for lending with little or no recourse.

- A Task Force should also continue to develop the legal and administrative infrastructure for securitization, as this can become a useful off-balance sheet tool for a variety of bank assets. Development of an SMM would require addressing a number of legal and regulatory issues, including the trust concept, bankruptcy remote, and mortgage registration in accordance with sales of securities.

- The steps already undertaken in this regard, and the outstanding issues are discussed in the Annex to section 7.0
2.4 RECOMMENDATIONS FOR STRENGTHENING THE EFFICIENCY OF THE LAND AND HOUSING MARKET (CHAPTER 6)

2.4.1. Conclusions And Recommendations

This section summarizes our recommendations on the key issues impacting efficiency and affordability in the land and housing market. These include:

- Land Titling and Registration
- Facilitating Increased Land Supply and Improving the Permitting Process
- Mixed Income Housing and the 1/3/6 Rule
- The Provision of Rental Housing
- Institutional Roles In Housing Market Assistance

2.4.2. Increased Efficiency In Land Titling and Registration

**Land Titling.** Although progress has been made in a number of areas, land titling issues remain a key stumbling block, presenting problems in efficiency, timeliness and the access to full title, especially for low income households. Our recommendations include the following.

- There are a number of issues relating to land title that make residential mortgages unduly risky, time-consuming and, therefore, expensive. Most of these issues require a sustained approach to reforming the legal structure on the part of BPN. The issues can and should be addressed in the first instance by the proposed Land Management and Policy Development Program, to be supported by the World Bank.

- One major issue of land titling is the time taken for a purchaser of housing from a developer to be issued with a mortgageable title (*Hak Milik* or HGB). We recommend that (a) BPN takes no action to prevent developers from initially splitting the title to the benefit of fictitious individuals; and (b) the Minister of Home Affairs be asked to declare housing developers as ‘permitted corporations’ under the Basic Agrarian Law, and thus able to hold Hak Milik in place of HGB rights.

- Converting Hak Girik to Hak Milik is currently costly, especially for lower income households. For this reason, many households choose not to make the conversion,
which unduly limits their access to formal sector housing finance, as many lenders will not accept HG title as collateral. A recent pilot program has shown that it is possible to reduce the costs of converting HG to HM, and these findings should be implemented more broadly.

- In order to improve timeliness, granting of land title should be executed by Land Office in Kab/Region if the location is within the area of Level 11 Local Government (kab/kotamadya). If the location is within several Level 11 Local Governments, granting of land title should be issued by the Governor upon the local governments’ recommendations. Central BPN sets up the guidelines and policy. Every granting of title are delegated to Level 11 Local Government with the exception of land located within several local governments.

**Registration.** Recent improvements have been made in registration procedures. Although there is still work to be done, HOMI concludes that improvement in titling and permitting issues are now relatively more important in increasing efficiency and land supply. Nevertheless, several recommendations are made to improve registration:

- Land registration can be made more effective by revising PP 24/1997 to achieve the following: (a) simplification of standardized forms of title evidence; (b) simplification of standardized forms of Deed of Mortgage, and Sales Purchase Deed; (c) enforcing the requirement that registration be undertaken within seven days; and (d) improving the services of the PPAT to comply with existing requirements. We recommend that BPN, together with the Ministry of Home Affairs (*Dalam Neger*) where relevant, should report on the feasibility of these reforms.

- There is a need for consistency in rules on the issuing date of Land Certificate. The form of registration receipt should be in 1 (one) sheet. The form of Deed of Sale and Purchase of Land and APHT should be simplified. If the APHT is registered or the Mortgage Certificate is simplified into just 1 sheet, there is no necessity in giving registration receipt for mortgage. Computerization of Mortgage (HT) Land Certificate and Land Rights should be increased. PPAT’s function as the assistant of land application process by giving sanction should be improved.

- Unregistered land is not acceptable security for bank loans, e.g. for house improvements. The Land Administration Project has recommended a number of detailed
ways in which householders would be able to raise credit on unregistered parcels; and we support those recommendations.

2.4.3 Increased Efficiency in Land Supply

2.4.3.1 Facilitating Release of Land to the Market. The land supply is more constrained than need be, especially for low income housing. Most of the land that could be developed for housing around Jakarta and, maybe, around other major cities, is not legally available. Because it does not form part of the supply of land for new housing, it may be expected that—-all other things being equal—the price of land is significantly higher than might otherwise be the case, and helps to keep house price high. Holding land out of development is also contrary to the spirit of Indonesian law. We therefore make some recommendations for stimulating the supply of land. These include:

- The procedures already developed for the disposal of IB@s assets should be followed for its land holdings, as for other classes of asset. That is, they should be sold by open and transparent auction, without restriction on the type of bidder, and within the time frames agreed within government and with the international community. Insofar as it may be possible to disaggregate some of the holdings into smaller parcels, this would be preferred. However, existing Location Permits should not automatically be transferred to new purchasers.

- Perum Perumnas, DKI Jakarta and other local governments, the military and, perhaps, BPN should review their land needs, and subsequently auction any land surplus to these needs. It would be appropriate for a sub-committee or task force working under BKP4N to develop methodologies and provide assistance as required.

- The law should be changed so that the Land and Building Tax (PBB) can be charged at differential rates on idle and productive land; it should be levied at a high rate on idle land, to encourage corporations and individuals with small holdings to release or develop it.

- Local governments should take the lead in reviewing land availability, especially for new lower income housing, with a view to assembling and promoting development packages. It will be necessary to acquire outside, impartial, expertise to assist local
governments to plan negotiate and, perhaps, implement land packaging in this form. Foreign donors would be receptive to financing advisory services of this nature, perhaps through one of the associations of local governments.

2.4.3.2. Land Supply and Permitting Issues

- **Permitting.** HOMI concludes that inefficiencies in monitoring and enforcing location permits have a negative impact on increasing the supply of land available for development. More streamlined permitting procedures are also available, especially under decentralization, as local governments can increasingly utilize “permit” by exception procedures.

- The time taken to obtain Location Permits can be reduced by limiting the number of members of the coordinating review committee.

- Although Location Permits are issued for a certain period of time, these restrictions are neither monitored nor enforced. As a result, land is effectively held out of development, and the land is thereby blighted. We recommend that the provisions of PP 36/1998 be invoked to encourage developers holding land under Location Permits, in excess of their immediate needs, to donate the surplus amounts to government for use for public projects in exchange for renewal of the residual Permits. All other Location Permits for land not required for development in the near term should be revoked if not used. All local governments should set up a simple system for monitoring compliance with residential Location Permits. A central body would be needed to assist them in establishing and maintaining the system.

- Location permits used to be seen to confer an exclusive right to the developers to whom they were issued, thus effectively prohibiting their sale to third parties. Although this reduced the price of the land to the developers, the restriction was seen as neither efficient nor just. Although this restriction has been revoked, this change is apparently not widely known. We therefore recommend that local land offices should ensure that all affected landowners understand the implications of the issue of a Location Permit covering their land.

- The permitting process is not well understood, either by developers or, in many instances, by land officials. As a result, both sides err on the side of caution by following
old, known, procedures rather than the new, more cost-effective procedures. We recommend that local land offices should clarify the status Inpres No. 2311998, which revokes the need to obtain an Iznin Prinsip.

- Although regulations have been issued regarding the maximum time to be taken by officials in completing certain processes, these regulations are often not observed. The time and the cost of obtaining permits therefore continue to be much higher than is officially allowed. We recommend disseminating the lessons learned from the land office in Jakarta Barat, with the Ministry of Home Affairs taking a lead in assisting local governments to draft decrees simplifying approval processes.

- Permitting by Exception. The granting of the Location Permit is actually not needed if the RegionaVLocal Spatal Plan(s) are clear and detailed.

- The resolution of many of these topics will be addressed by the World Bank-funded Land Management and Policy Development Program. The success of this program should be regarded as a very high priority for the success of a national housing policy. We recommend that it should be given full support by all relevant agencies and donors.

2.4.4 Mixed Income Housing and the 113/6 Rule

- The 1-3-6 rule is formulated sufficiently vaguely that it is easy to circumvent. Its implementation is rarely monitored by any government body, central or local. A rule that is neither monitored nor enforced is a rule that is ignored. Several alternative approaches to providing mixed housing could be adopted. Responsibility for implementation must be taken by local governments, and that they must accept the responsibility for monitoring and enforcing compliance.

- Our preferred alternative is to encourage the local sale of ‘certificates of completion”, a device which would permit developers to claim virtual compliance with the regulation. Thus, for example, a developer specializing in low cost housing could sell a certain number of certificates of completion of low cost housing to another developer; in possession of the certificates, the latter would then be able to obtain a permit for high cost housing.
2.4.5 The Role of Rental Housing

HOMI considers that rental housing can become an increasing important aspect of the urban housing supply. This includes private rental accommodation for lower income households, public rental housing, and, to a lesser extent, employer-sponsored rental housing.

2.4.5.1 Public Rental Housing. Although public rental housing can play a vital role in low income housing, especially in very large urban areas, effective management of low income public rental housing has been fraught with difficulties worldwide. Thus, we believe that it is difficult to justify that all local government should become providers of subsidized rental housing. Thus:

- Local governments should be assisted to make an informed judgment about the costs and benefits of providing rental housing, including an analysis of the cost and management implications, and an analysis of the need for such housing

- If local governments choose to proceed with a new rental housing scheme, they should be assisted in the process of designing a scheme, in aspects including costing, pricing and accounting techniques, the selection and retention of tenants, and rental management options (in-house and contracted out).

2.4.5.2 Employer Rental Housing. Employer-sponsored housing can play an important supplementary role in some circumstances.

- Local governments should be able to seek advice on incentive packages for sponsorship of employer housing. Tax issues - e.g. double taxation of employer housing benefits - should be examined and resolved.

2.4.5.3 Private Sector Rental Housing. Private sector provision of rental housing for low income households, including room rentals in owner-occupied dwellings, should be encouraged.

- The sector can be assisted with more streamlined legal approaches to codifying tenant/landlord rights and responsibilities and providing mechanisms for timely adjudication of grievances, preferably in special housing tribunals outside the regular court system.
BRI currently provides microfinance loans for homeowners to add rooms for rental. This could be an important means of expanding the low income rental sector. As discussed in the HOMI Report ‘Improvements in the Housing Finance Sector’, microfinance for housing should be the focus of major efforts to extend various types of housing credit to modest income households.

2.4.6 Institutional Roles In Housing Market Assistance

For a complete discussion of HOMI's recommendations regarding institutional roles, please see the HOMI Report 'Local Level Housing Assistance Programs and Institutional Arrangements'. In this section, we also briefly mention the important roles of Kimpraswil and Perumnas in a decentralized environment, especially as they impact the effectiveness of local governments in planning, establishing and monitoring land use, and assisting with housing and infrastructure supply decisions.

2.4.6.1. The Role of Kimpraswil under Decentralization.

- Kimpraswil should set up an internal working group to determine how best it can provide appropriate advice to local governments as facilitators of land regulation and use planning, public rental housing, infrastructure, and related services.

- Assistance to local governments on the provision of public rental housing should include the provision of manuals and one-on-one technical assistance. The Associations of Local Governments are best positioned to provide this type of assistance although they, too, will need initial help in establishing and training the staff of such a unit. Kimpraswil should offer to facilitate the start-up.

- As discussed in the HOMI report ‘Implementation of Kasiba/Lisiba’, Kimpraswil has an important role in assisting selected local governments assess the feasibility of the Kasiba/Lisiba approach to infrastructure and low income housing development.

- A useful approach to thinking about the gaps in housing condition, and how various government policies might lessen the gap, is to shift from ‘need’ per se to the concept of effective demand. ‘Effective’ demand might be described as the housing people can actually afford using their own resources, which are then augmented with various Government subsidies and/or with improved policies for delivering land title,
infrastructure, and housing finance at all levels of society. Please refer to the HOMI Report ‘Housing Subsidy Instruments for Home-Owner Assistance Programs’.

- We stress the importance both of pursuing a pro-active employment location policy, and of sound transport planning in facilitating appropriate housing policies.

- Many of the recommendations in the sections above involve not only Kimpraswil, but also other key agencies, especially BPN, Perum Perumnas, and Bappenas. Thus, it is important that Kimpraswil continue with its lead role in activating the Inter-Ministerial Committee.

- It is appropriate to involve donors in providing assistance that aims to develop and disseminate examples of good practice in local land offices. The donor role will need central guidance and coordination from Kimpraswil.

2.4.6.2. The Role of Perum Perumnas.

- Housing can be, and should be, built by the private sector. RSS/RS draws an ‘artificial boundary’ between formal and informal; more flexible and affordable supply options are available.

- Perumnas’ long experience and particular expertise can best be utilized in several important ways, including development planning assistance for local governments and Kasiba/Lisiba development. Under decentralization, these are now more important than ever.

- As discussed in the HOMI Report cited above -‘Local Level Housing Assistance Programs and Institutional Arrangements’ - Perumnas itself should be decentralized into Regional Offices, to bring its local experience in infrastructure to best use in the local government context.

- Although outside our Scope of Work, we emphasize the importance of infrastructure for land development for housing. It would be appropriate for local governments to use National Housing Fund resources, and Perumnas expertise in infrastructure planning, to complement other KIP funding sources to provide post-hoc infrastructure as necessary to areas of lower-income housing.
2.5 RECOMMENDED INSTRUMENTS FOR A HOUSING ASSISTANCE PROGRAM
(CHAPTER 7)

Executive Summary

2.5.1. The Demise of The Old Subsidy Programs

GOI’s housing programs are in disarray. The corner stone of the GOI housing policy, the KPR interest rate subsidy for moderate income households has proven to be unsustainable and will be phased out by 2004. Indonesia’s well known integrated and highly successful low-and moderate income housing projects like KIP and IUIP, were dependent on donor funding, did not receive budget funding and were not institutionalized. The Government of Indonesia now faces the difficult task of reforming the housing policy framework and developing programs that will provide the country with the continuous housing support systems it requires. Given the limited fiscal resources, the new policy and programs need to focus on leveraging private sector, NGO and household resources to increase authorized housing production.

2.5.2. Housing Concerns to be Addressed

GOI has to address severe constraints in the housing and housing finance market. Approximately 750,000 new households have to be housed in urban area each year. The cheapest low-income house produced in the market place (approximately Rp.25 million) can only be afforded by households at the 50th percentile of the urban income distribution. Without effective housing assistance systems, most of the housing requirements for the below median income groups (375,000 housing units per year) will be built in the illegal and non-compliant housing sectors. Current access to land titles, sanitation, water, roads and transport is already inadequate.

While housing costs appear reasonable in relation to incomes (3 times annual salary is on average required to buy a house) and building materials and labor markets work well, there are critical constraints in the finance and infrastructure markets that need to be addressed by housing assistance programs to expand housing production for underserved households. The main demand and supply constraints are:
• Housing finance is expensive and requires high savings, collateral and employment and income conditions.
• Unsecured lending for housing by credit unions and micro-finance lenders is costly and micro-finance lenders are funding constrained
• Land and infrastructure markets for low-income housing do not work well.
• Capacity at the local government level to address low and moderate housing problems is exceedingly limited

2.5.3. Goals and Design Criteria for New Housing Assistance Programs

Based on the analysis of housing demand and supply, three goals are proposed for new housing assistance programs:

1. **Alleviating crisis related and longer-term poverty concerns that can be addressed through housing programs.** Poverty can be expressed as a lack of access to adequate sanitation, safe water, access to roads, transport and electricity and other neighborhood services such as security.

2. **Addressing new frontiers to improve the efficiency of and access to housing and housing finance markets.** Well-targeted incentives for lenders and households may expand the regulated housing market.

3. **Enhancing the efficient development and improvement of urban neighborhoods through broad-based housing assistance programs in view of continued urban expansion.**

2.5.4. Three Complementary Housing Programs

Several housing assistance programs were formulated to fulfill these goals. The programs are based on the sound and internationally tested principles of GOI’s housing policy: fiscal sustainability, transparency, fairness and equity, partnership with market actors, NGOs and households. Programs are further incorporating the reality of decentralization.

1. Home-ownership assistance through the financial sector for those households who can, with assistance, use the regular housing market to obtain a house.

2. Home-ownership assistance through more comprehensive supply (services and infrastructure) support for households dependent on those parts of the housing market
that do not function well. Two types of programs are envisioned, block-grants for neighborhood/ home improvement programs, and mixed new development programs.

3. Support to increase the availability of low-cost rental housing, preferably through the private household sector.

We will analyze alternative approaches to the first set of programs in this report. Another HOMI report proposes local level programs.

2.5.5. Alternative Housing Finance-based Subsidy Instruments to Address Different Household and Market Constraints

*Household constraints.* Households that are currently unable to obtain a housing loan, but could qualify with some finance-based subsidies, have different constraints: Income constraints, income instability, savings constraint, collateral constraint.

*Lender constraints.* Lenders will only make loans for moderate and low income housing if some of their constraints are addressed: credit risk, limited access to funds, mobilizing long or medium term funds, administrative cost

*Alternative instruments.* There are several main types of subsidy instruments that can be used in combination with housing finance to address these constraints.

2.5.5.1. Instruments dealing with income constraints.

- **Interest-rate subsidy.** The interest rate on subsidized loans is reduced in order to make monthly payments more affordable.
- **Monthly payment buy-down subsidy.** Part of the initial total monthly payments or the interest-part of the monthly payments are paid for by a subsidy in order to make loans more affordable.
- **Up-front lumpsum subsidy towards the loan amount.** The loan amount is partly replaced with a subsidy in order to bring down the monthly payments.
2.5.5.2. Instruments dealing with savings constraints.

- **Up-front lumpsum subsidy towards the down-payment.** Part of the down-payment requirement is paid for by a subsidy in order to lower the savings requirements. Similarly, this up-front subsidy is completely transparent.

- **Mortgage insurance subsidy.** The down-payment requirement is lowered by paying for the increased risk to the lender through a mortgage insurance. Mortgage insurance deals with the savings constraint and not with monthly payment constraints.

- **A combination of mortgage insurance and upfront lumpsum subsidy towards the down-payment.** If part of the down-payment reduction is paid for by an up-front subsidy (e.g., 10 percent) and part can be brought down by mortgage insurance (e.g., 10 percent), the mortgage premium will be lower since the risk that the outstanding loan balance can not be recovered in case of foreclosure, is smaller.

2.5.5.3. Instruments dealing with income instability and collateral insecurity.

- **A subsidized pledged-account against default.** In cases where both the borrower and the lender fear a default situation (the borrower because of the fear of losing the house and lender because of the costs of foreclosure or, for unsecured loans, the fear of losing the cash-flow or even the outstanding loan amount) a pledge account can be set up with a multiple of monthly payments on the loan. This account can be accessed in case of default, in order to guarantee the lender’s cash flow and not have defaults accumulate for borrowers with unstable incomes.

2.5.6. Comparing Different Housing Finance Subsidy Instruments

We analyze several important dimensions of different instruments:

*Macro-economic risks.* The interest-rate and upfront buy-down instruments based on fixed interest-rate subsidies, are designed explicitly to offset the tilt problem (increasing current interest rates because of the expectations of future inflation). Mortgage insurance is vulnerable to down-turns in the real-estate cycle or other major events causing large scale defaults (e.g., massive lay-offs in one area, natural disasters).

*Capital market requirements.* In the near future, Indonesia needs to find ways for the mortgage sector to mobilize medium and longer term funds from the capital markets or directly from long-term investors. Mortgage insurance has great additional advantages for the lender and, even more so for the investor.
• The mortgage insurance underwriting process will have the effect of providing standardization in the market.
• Mortgage insurance companies provide a second review of the underwriting decisions by financial institutions.
• The mortgage insurer pays only the top percentage of the claim-for-loss submitted by the financial institution. This type of claim payment structure requires the bank to underwrite quality loans. In other words, the bank retains a moral risk.

**Default risk:** The up-front grant subsidy and mortgage insurance easen the savings requirements and discipline, but mortgage insurance compensates for it by insuring default. The default pledge account subsidy may create the impression that one can be lax in paying without repercussions. Incentives, such as the provision that the household may use the amount left over in the pledge account after several years, may prevent such an attitude.

**Transparency:** All these alternative subsidy instruments require an up-front subsidy payment by the public sector. This is in sharp contrast with the implicit and unbudgeted subsidy in the current interest-rate subsidy.

**Subsidy cost:** In an example that keeps the initial loan amount, term, down-payment requirement and market interest rate the same, we show the effects of different subsidy instruments on the size of the down-payment and monthly payment levels. We then compare these outcomes with the present value costs of the different subsidies. The following conditions were the basis of the calculations: Value of the house, Rp. 20 million; Loan term, 20 years; Interest rate, 20 percent; Down-payment, 30 percent of value of the house.
### Marja Hoek-Smit, Subsidy Calculations

#### 2.5.7. Recommendations for the Establishment of New Housing Finance Subsidy Programs

*Preferred Instrument(s).* Given the relatively low subsidy cost, its focus on default risk and savings constraint, its transparency and administrative easiness, and the additional institutional advantages of mortgage insurance based instruments, it is our recommendation to focus on mortgage insurance as the most promising policy direction for Indonesia. For non-mortgaged based lending, the pledge account subsidy is preferred.

*Institutional linkages within the housing sector.* The main institutional advantage of mortgage insurance subsidies is that it is an important step to further professionalize the housing finance sector and make it an attractive focus for long-term investors.

*Institutional Home.* Three types of institutions are required for such a new housing assistance program to operate well; a government agency to detail the principles, target groups and implementation mechanism and to regularly adjust program parameters, a

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#### Summary of Subsidy Instrument Comparison on Cost

<table>
<thead>
<tr>
<th>Loan Instrument and Subsidy</th>
<th>Savings Required</th>
<th>Monthly Income Required</th>
<th>Subsidy Amount</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Unsubsidized loan</td>
<td>Rp.6 million30%</td>
<td>Rp.793,000</td>
<td></td>
<td>Current market terms</td>
</tr>
<tr>
<td>2. Current KPR interest rate subsidy</td>
<td>Rp.4 million20%</td>
<td>Rp.550,000</td>
<td>Rp.4.5 million</td>
<td>The down-payment is only 20%; higher credit risk is not carried in a higher rate</td>
</tr>
<tr>
<td>3. Lumpsum down-payment subsidy</td>
<td>Rp.4 million20%</td>
<td>Rp.793,000</td>
<td>Rp.2 million</td>
<td>Covers 20 percent of down-payment and 10 percent of top of the loan</td>
</tr>
<tr>
<td>4. Mortgage insurance for 30 percent of top of loan</td>
<td>Rp.2 million10%</td>
<td>Rp.1 million</td>
<td>Rp.1.3 million</td>
<td>The subsidy covers 10% additional down-pmt and mortgage insurance over smaller exposure.</td>
</tr>
<tr>
<td>5. Mortgage insurance plus lumpsum down-payment</td>
<td>Rp.2 million10%</td>
<td>Rp.900,000</td>
<td>Rp.2,875,000</td>
<td>A 6 month pledge account was considered a sound time for default insurance.</td>
</tr>
<tr>
<td>6. Pledge account guarantee</td>
<td>Rp.4 million 20% (the lower down-pmt estimate relates to the guarantee)</td>
<td>Rp.906,000</td>
<td>Rp.1.6 million6xRp.27-2,000 (pmt/month)</td>
<td></td>
</tr>
</tbody>
</table>
mortgage insurance agency to implement the program and financial institutions to package the loan and subsidies.

- A special housing assistance agency is proposed supported by a housing fund and staffed by professionals in the critical areas.
- An existing credit insurance institution, Askrindo, can implement mortgage insurance.
- Many interested banks that want to move down-market, would welcome a new subsidy program. Equally, there are strong but few, and weak but many micro lenders who could be engaged in non-mortgage lending.

Other parts of the HOMI study propose strengthening of the banking sector, while a World Bank study is in the process of developing a support system for micro-finance lenders.

2.6 RECOMMENDATIONS FOR LOCAL LEVEL HOUSING ASSISTANCE PROGRAMS AND INSTITUTIONAL ARRANGEMENTS (CHAPTER 8)

The most important recommendations contained in this Special Report are the three proposals for housing assistance programs at the local level. These are as follows:

- Community-Based Housing Upgrading Program (CBHUDP)
- Mixed Income Housing Development Program (MHDP)
- Rental Housing Development Program (RHDP)

In the sections below, each of these three proposed programs are summarized, including a general description, program goals, targets and scope.

This Special Report also includes proposals for institutional development, capacity building and pilot projects. However, it is these three special programs that are most essential.

2.6.1 Introduction to Three Housing Assistance Programs

In the context of housing assistance programs, the HOMI team proposes that the following three types of programs be carried out at the local level:

(1) Community-based housing upgrading for existing low-middle income built-up areas;
(2) Mixed income development for new residential areas;
(3) Rental housing development in particular situations.
These three programs proposed by the HOMI Project to meet the needs of various low-middle income households have very different characteristics. Overall they can serve the majority of Indonesia’s urban population.

In the first program, namely “community-based housing upgrading”, the target groups are those who live in kampungs dominated by informal housing. The population consists of mixed groups from low and middle income classes.

The second program, namely “mixed-income development”, is focused more on those residents who need new housing in developing areas. This program must begin with the process of empowering those groups interested in participating in the program, including groups under CBHP, housing cooperatives, work based community groups or persons from the same professional community.

The third program is directed at those households who cannot yet purchase or build housing because their incomes are too low or because they do not yet require a house themselves, so they rent a house or room. This program is primarily aimed at industrial workers who up to now live close to industrial areas under conditions which are very poor.

Unlike previous efforts, these three programs are not a monopoly of government, but in principle can be carried out by a variety of organizations. With or without government involvement, the management system must be transparent and accountable. All of the programs are designed to have a high level of peoples’ participation in order to avoid the perception that they are simply limited to government subsidies or grants.

As to the question of who will develop housing generally for low-middle income households, the answer is that it can be any number of organization. We can begin with community groups on the basis of geography - or other communities based on similar work, or socio-religious organizations. Other possibilities include workers from the same non-profit organization such as hospitals, universities, educational foundations or cooperatives.

Certainly these organizations cannot all become housing developers overnight. Therefore, for an initial period of 5 - 10 years, the central government should carry out training and encourage local governments to implement pilot projects which can function as uliving
laboratories' for those institutions wishing to become developers, in particular non-profit developers.

2.6.2 Program 1: Community-Based Housing Upgrading Program

2.6.2.1 General Description

The Community-Based Housing Upgrading Program (CBHUD) is a program designed to empower community residents with the goal to improve the quality of housing and residential environments, in particular the kampungs by means Direct'Community Grants (or BLK). The priority use of BLK funds must be in accordance with local needs as determined through community groups, neighborhood organizations and other institutions involved in a participative implementation process.

2.6.2.2 Program Goals

CBHUD has the following goals:

- To assist local governments in formulating innovative programs for housing and residential development on the basis of community empowerment and participation.

- Within the framework of the decentralization process, the system of housing and residential development is delegated to local governments. One goal is to upgrade the general capacity of local government in dealing with problems of low-income settlements by means of developing an improvement program for housing and residential development through motivating, facilitating and upgrading people’s capability, both collectivity and individually, for improving their housing and environmental conditions.

2.6.2.3 Program Targets

CBHUD has the following targets

- To assist community residents living together in particular kampungs under belowstandard conditions to collectively improve their housing and residential environment.
• To assist community residents in improving their skills for mobilizing both their own resources as well as resources of the public and private sectors which can be used for planning and implementing upgrading programs.

• To assist local households to improve their capability for upgrading their homes.

• To assist residents in improving their skills in developing a good and efficient system for managing their community.

4.4.4.4 Scope of Program

The scope of CBHUP is divided into the following categories:

- Included in the first category is improvement in physical conditions, such as improvement in residential and social infrastructure related to immediate environment, and improvement and upgrading of housing.
- The second category includes improvement in productive economic activities, such as small and medium scale businesses and citizen’s cooperatives, coordination of marketing, and improvement in management skills, etc.
- The third category includes institutional development, such as the structure of local environmental management bodies, community fora, community support institutions, foundations and cooperatives.
- The fourth and final category includes legal - administrative support, such as improvement in status of land, processing of development controls as well as controls over business, cooperatives, etc.

2.6.3 Program II: Mixed-Income Housing Development Program

2.6.3.1 General Description

The Mixed-income Housing Development Program (MHDP) has as its goal improving the capacity of Local Government to assist and facilitate low-middle income households to develop their housing by means of efficient and integrated implementation within new residential areas. Assistance can be directly provided to household groups or to housing organizations formed specifically for this purpose, or indirectly through Local Government.
2.6.3.2 Program Goals

MHDP has the following goals:

- To assist local governments in improving their capacity to develop affordable new residential areas for needy household groups, especially for low-middle income groups.

- To assist actors involved in residential development at the local level, from private sector, public sector, NGOs or from other community-based organizations, to carry out development of residential areas efficiently and effectively, so that the needs of community groups desiring to own their own housing can be realized.

2.6.3.3 Program Targets

MHDP has the following targets:

- To facilitate and give assistance to low-middle income community groups desiring to develop their own housing to mobilize the necessary housing resources, including finances, land, infrastructure, house development and skills to organize and manage these resources.

- To assist local governments and related institutions to develop residential areas for low-middle income community groups through upgrading the capacity to facilitate the activities of these groups in the form of synergy between actors, so that productive housing is realized for an increasing share of the population.

- To facilitate a system of residential land preparation which is efficient and benefits most community groups in the region.

2.6.3.4 Scope of Program

The scope of MHDP can be described as follows: in principle this program takes the form of two types of incentives, namely direct assistance and supporting assistance. The focus of direct assistance is preparation of community groups and residential land, and the focus of supporting assistance is directed at implementation of residential development schemes.
The structure of this assistance is based on the assumption that the critical step in achieving results related to the internal capacity of local community organizations, combined with the capacity of local government to prepare reasonably priced 'serviced land,' among other factors. If this critical step can be completed reasonably, subsequent steps – namely development of supporting facilities and house construction – will be more easily carried out. Therefore, these final concerns of the assistance have a character which is more managerial and technical. Following is a more detailed description concerning the scope of assistance.

The first activity includes the category of ‘Group Preparation Assistance’ which is work to identify community groups with potential to be supported by organizational, financial and legal aspects. The goal of this preparation stage is to formulate a housing development plan to be agreed by all group members. This plan includes a plan for collection of funds together with a savings program, and a plan for cooperation with other parties (NGOS, private sector, government institutions, etc). MHDP can provide a kind of insentif for those who joint the saving program.

The second step includes ‘Assistance to Prepare Serviced Land’ which is affordable to low-middle community groups. This includes the category of assistance to form non-profit land development organizations at local government level. This organizations can take the form of housing foundation, cooperatives housing, housing development board, or other forms.

The third step involves assistance to land development implementation support in the form of technical, managerial and legal-administrative support given to non-profit land development organizations appointed to provide and prepare land.

The fourth step includes ‘Housing Development Assistance’ which is given in the form of support for access to finance / loans, support for the techniques of planning and construction techniques, etc.
2.6.4 Program III: Rental Housing Development Program (RHDP)

2.6.4.1 General Description

Rental Housing Development Program (RHDP) is aimed to increase the ability of local government in assisting and facilitating housing actors to develop rental housing for community groups who require housing, especially the low income groups and those who are unable to own a house.

Assistance could be given to groups of inhabitants or the inhabitant candidates or to individual investor, company, cooperation, or organization who would like to build or improve the condition of rental housing.

2.6.4.2 Program Goals

- Helping the local government in the extending its ability in planning and developing affordable rental housing for majority of the people who require them.

- Increasing the local government ability to facilitate housing actors who would like to develop rental housing.

- Motivating and assisting organization, worker, communities, company, cooperation or individual investor to build rental housing

2.6.4.3 Program Targets

- Helping local government in conducting arrangement and formulation of a conducive rental housing development system, as a base for other interested actors to increase investment in rental housing, by means of constructing affordable rental housing for those who require them, especially the low income groups.

- Facilitating and assisting rental housing investors in mobilizing housing resources needed, such as funding, land, housing infrastructure, buildings of rental housing and the ability to organize and manage those resources.
• Assisting housing actors, including local government in order to increase the ability in providing rental housing by forming synergy between actors, where local government, NGO or development consultant could function as mediator.

• Assisting rental housing owners or inhabitants who are not fulfilling certain minimum standard to improve the condition of the rental housing.

2.6.4.4 Scope of Program

The scope of program of rental housing development could be divided into four categories which are rental housing development for working community, rental housing development which is built by developer, quality improvement of existing rental housing and developing rental housing construction and management system.

• The development of rental housing for the working community is intended for factory or company workers on certain locations, where suitable housing is not available.

• The development of rental housing by developers is aimed primarily for rental housing organization who in cooperation with land owners intend to develop rental housing for the low income groups.

• The improvement of rental housing quality has an objective to improve the condition of rental housing inhabited by low income groups and located in a strategic area.

• Development of construction and management system of rental housing is firstly aimed to all rental housing actors (organization/company/institution/individual), who intend to build and manage rental housing. Secondly, it is concerning the local government institutions/organization with the roles of facilitator, mediator, assistant in the rental housing development, in relation with establishing a “rental housing coalition” as the motor of rental housing development.
2.7 RECOMMENDED INSTITUTIONAL ARRANGEMENT AND FUNDING MECHANISM PROGRAM (CHAPTER 9)

2.7.1 Introduction

Past housing subsidy programs, both KPR interest rate subsidies and local level and community-oriented subsidy programs like KIP, CBHP, IUIP programs, have all proven to be unsustainable, all-be-it for very different reasons. The KPR interest rate subsidies proved to be too expensive when their costs could not be hidden through soft loans by Bank Indonesia and MOF had to carry them on the national budget.

Local level subsidies were much more affordable and served low-income household needs. None of these programs received long-term budget support. They were discontinued because they were tied to donor funding and when funds disappeared, no sustained institutional home was found, no matter how excellent the programs were or how well these served household needs. The idea was that new donor funds would be found to do similar projects. Indeed, donors complied and continued project funding, rather than building up sustainable programs. Consequently, no institutional memory was built up on any scale. The accumulated knowledge, procedures and systems disappeared as well.

The disjointed management of the different housing assistance programs, and the difficult task to adjust the programs to changing market conditions and household needs, has led the HOMI team to propose to the Government of Indonesia (GOI) to consider creating a new, best practice system. It is a major task to create a well functioning replacement system that avoids the mistakes of the past, while achieving acceptable levels of production and improved levels of targeting. Below we outline, the role of a new Housing Assistance Agency and related funding mechanism.

2.7.2 The Role Of A Housing Agency And Housing Fund

2.7.2.1 Why Set Up a New Housing Agency?

In another study of the HOMI project we have outlined a comprehensive set of housing assistance programs that would serve a broad range of households and institutions, both through national level finance mechanisms and through local level neighborhood block
grants. Subsidies would be transparent, well-targeted, on-budget, administered in an efficient and effective manner, and tailored to meet the varied needs of lower-income households in differing circumstances. The new schemes will involve greater roles for private financial institutions and NGOs. They are designed to leverage household, community, financial sector and local government investment in housing development. This principle of incentive funding requires a close interaction with and knowledge of the financial and real sector.

We have also spelled out the need for continued central government involvement in the housing sector during the transition to decentralization. A focus on local level housing programs requires flexible and varied subsidy approaches, a combination of technical assistance, capacity building and investment support. Most of all these programs need to build up support institutions for housing.

Successful implementation of this new generation of housing assistance programs cannot be done in the scattered and stop-go fashion of the past. HOMI recommends that the GOI assess the feasibility of establishing a specialized housing assistance agency and a related fund to guide and implement approved subsidy and incentive programs. The assessment will need to weigh the cost of establishing a new agency against the greater efficiency of the use of limited housing resources and donor funds. The major objectives for the establishment of a new housing agency and a housing fund would be:

- **Creation of a stable environment for housing sector reform:**
  The importance of a stable policy environment is critical for that transition. A dedicated housing agency, less prone to short-term changes in ministerial environments, and with specialized staff, can provide such stability.

- **Improved coordination of programs and institutional development inputs:**
  A coordinated approach is required to gradually build up new institutions, regulations and capacities, and streamline different subsidy program inputs.

- **Pooling of resources for housing programs:**
  Housing resources from the national budget will be scarce. A housing fund, linked to the housing assistance agency, will facilitate the pooling of other available resources in order to maximize outputs for the housing sector.
• Need for program adaptation to “tease the market down” and respond to changing conditions:
The programs are designed to gradually increase the role of local governments, the private and NGO sectors. Incentives need, therefore, to be adjusted regularly to “tease the market down”, and get the priority inputs from local partners.

2.7.2.2 Specific Tasks of a Housing Agency

The tasks of the Housing Agency would be to:

- Develop priority housing programs for national and local level implementation with inputs from Kimpraswil, local governments, private and NGO/CBO housing actors.
- Set up selection and qualification criteria for financial institutions interested in participating in the financial subsidy programs.
- Set up a disbursement and monitoring system for financial subsidies.
- In collaboration with the Board, adjust rates and program parameters (income and other household indicators, loan amounts).
- Solicit and assist in preparing proposals by local governments or NGOs for neighborhood-based program funding.
- Select proposals with the assistance of a regional unit, facilitate planning and implementing of projects, carry out quality control and monitor the results.
- Coordinate program technical assistance and investment inputs by international development agencies.
- Review the allocation of funds to different programs and adjust according to regional and program related demand.
- Adjust program parameters and propose alternative programs when economic and housing conditions change.

2.7.3 Indonesian Experiences With Special Funds

There are several special fund experiences in Indonesia. The proposed NHA/NHF will face the problem of raising funds. That problem which must be solves, initially through making a case for government budget allocations, which explain the importance housing funding to be continued and the new reorientation of programs that ensure the effectiveness, efficiency and equity of housing programs. It should, then, be followed by deliberation of the government and the parliament to reach agreements.
The proposed NHA/NHF face complex allocation issues. The NHA/NHF deal with primarily how to encourage housing markets to work. The other funds deal with public infrastructures primarily regarding how to develop and maintain them in a sustainable manner. All of the funds need institutions that should be handled professionally. For the housing sector, the new institutions proposed should be able to mobilize the capacity of professionals who understand and promote housing markets.

2.7.4 Legal Issues

There are some legal issues concerning the set up of NHA/HAF and their operations. First, we should explore alternatives to the structure of an NHA. The NHA might be in the form of a non-departmental agency similar to BKKBN (The Coordination Agency for Family Planning) or LAN (National Institute for State Administration), etc. It might be in the form of a working group supervised under inter-ministerial committee such as TKPP (Coordinating Team for Urban Development). At the lowest, it might be in the form of an extended Project Management Unit attached to a technical ministry.

Based on the backgrounds, contexts, and objectives of a new housing agency mentioned earlier, we consider the TKPP-like unit as the most appropriate. A presidential decree is considered the most appropriate legal bases for the establishment of the NHA.

The NHA/HAF operations must comply with various legal aspects of state and local planning and budgeting. They must comply, among others, with the State Guideline (GBHN) mandated by the People Assembly, Law of Autonomy, Law of Fiscal Decentralization, Law of the National Planning Framework (Propenas), Law of Annual Budget (APBN), and Local Planning Framework (Propeda), etc.

2.7.5 What Might A Complete Housing Agency And Housing Fund System Look Like?

At the center of the new system would be a National Housing Agency (NHA) that coordinates all housing assistance programs that would be funded through a Housing Assistance Fund (HAF).
2.7.5.1 A Menu of Programs

Clearly, under a NHA, different subsidy schemes can be developed to cater to different target groups and regions. In addition, priorities must be set, explicitly or implicitly, among different groups and within groups, and regions or local authorities.

What would the subsidy channels look like? At a minimum, these channels can be similar to those that exist today, including loans at subsidized rates or explicit subsidies through BTN and other banks, slum upgrading and low-income housing subsidies. But mostly, new programs should be considered such as:
- a program to pay premiums for mortgage default insurance,
- upfront grants for down-payments, loan amount, or buying down the monthly payment in initial years,
- grants for small house improvements,
- a pre-purchase savings related subsidy in a pledge account, for default prevention, and
- subsidized infrastructure and services provision through local authorities or NGOs.

Also, institutional subsidies need to be considered such as subsidies to NGOs or other intermediary institutions, subsidies for capacity building. There are many questions about the design of each of these channels, some of which are explored in the two subsidy reports.

2.7.5.2 Allocation of Funds

A HF can be perceived as a pool of money, allocated through annual appropriations for housing programs by the government and international agency and donor funds. The HF administration would allocate those funds to various trust funds for different programs within the HF, specified by the government and approved by the Board and Interministerial Committee, but with substantial flexibility. All (or most) subsidizing activities of the government would be funded explicitly by the HF, thereby assuring that the subsidies are transparent. Even more importantly, the future flows of subsidies that are being committed currently, such as the present interest rate subsidies, should be accounted for and funds set aside to cover them.

The advantage of this arrangement is the rational allocation of subsidies. Subsidies that pay out over 15 years are compared explicitly with those that pay out fully now. Those that
involve no hidden risks or costs of collection are seen to be cheaper than those that do have hidden costs.

Putting housing subsidies on-budget can also mean that there may not be enough funding for everyone who wants a subsidy to get it immediately. In other words, in addition to targeting subsidies through defining eligibility criteria, there will may also need to be prioritization criteria saying who gets funded first if funding supply is less than demand. Prioritization will have two levels: local level project developers and individual households within projects.

The perceived disadvantage of a HF and related NHA is that individual ministries and state agencies will loose some of their autonomy in allocating funds. Agencies, finance institutions, local governments and NGOs would have to compete for funding under the HF. However, if staffed with housing industry professionals a HF/NHA has more flexibility to respond to rapidly changing conditions in the housing and housing finance system than the current divided ministerial allocation system. Much will depend on how the administrative unit of a HF is allowed to operate and whether it is led by housing market experts who can be trusted to make responsible and responsive decisions.

2.7.5.3 Who should control the Housing Assistance Programs and Fund?

The NHA controls the NHF substantively. NHA is controlled by the NHA board of directors that translates primarily the policies set up by inter-ministerial committee on housing into housing programs, but also takes into consideration the inputs from other stakeholders of housing development, into a set of programs. The NHA gives instructions to the NHF for housing program funding.

The Housing Fund is controlled administratively by a financial controller under the NHA Board. accounting controllers working under a board of directors of NHA / NHF (see diagram). The board of directors maintains a standard operation procedure (SOP). The main elements of the SOP are instructions given by the NHA and the internal management and operation system of the NHF.

In a broader sense the control over NHF/NHA is shared by the inter-ministerial committee, the source of fund agencies, and other stakeholders. Without inter-ministerial committee approval, NHF/NHA would not receive government funding, whether domestic origin or
international. Without the willingness of the source of fund agencies to channel funds through the NHF/NHA, it would not be able to operate. The stakeholders may alter the proposed national program framework prepared by the NHA/NHF, simply by withdrawing their support for the housing programs.

In practice, therefore, the core control rests with the NHA board of directors. The effectiveness of the NHA/NHF operation depends on whether the NHA board of directors is able to effectively influence stakeholders of the merit of the programs on the basis of professional criteria. In short, it is professional management and good governance that controls the NHA/NHF.

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1 Cagamas was incorporated in 1986, following discussions among the Central Bank, Malaysian financial institutions, and a consultant from a U.S. financial institution. Cagamas commenced operations in 1987. It should also be noted that the development of HKMC was a lengthy process that absorbed the time and energy of a considerable number of experts and staff. Similarly, a U.S. consultant with many years experience in Fannie Mae served as a senior staff member for HKMC for over two years.

CHAPTER 3

INDONESIA’S EMERGING HOUSING POLICY
Marja Hoek-Smit and Budi P. Iskandar

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CHAPTER 3

INDONESIA’S EMERGING HOUSING POLICY

Marja Hoek-Smit and Budi P. Iskandar

3.1 Introduction

By standards of many of its Asian neighbors the housing and housing finance sectors in Indonesia are under-performing. Housing investment in Indonesia is approximately 1.5% of GDP, compared with a range of 2% to 8% in comparable countries. Similarly, mortgage finance equals 25% of GDP in Malaysia, while in Indonesia this figure is only 3%. Housing has the potential to be an important economic sector, contributing to job creation, expansion of the finance system and creation of household wealth. Housing can also be a powerful tool in redistributing income or wealth. Economically, financially and socially the sector could play a more prominent role in the recovery process.

Certainly the low and uncertain incomes are an important factor in the limited role housing plays in the economy. The weakness and inefficiency of the financial sector further hinder expansion of a healthy housing delivery system.

However, housing policies and programs hinder the efficiency and expansion of the sector. Under the current housing policy system, the delivery of market produced non-subsidized housing units for low- and moderate-income groups has declined (although the slow economy has also contributed). Production is nearly entirely dependent on the KPR interest rate subsidy. Yet, only approximately 40% of the population can afford a 21 m² RS house.

The Government of Indonesia (GOI) through the Ministry of Kimpraswil, Directorate General Housing and Human Settlement, has decided to develop a new housing policy framework in line with the new development objectives for the country. This document is the Homi team’s contribution to the ongoing policy debate.
3.2 The Housing Policy Context

3.2.1 Past Housing Policy

3.2.1.1 The main KPR housing program

The cornerstone of the GOI housing policy was the KPR interest rate subsidy for loans for specific house-types. Lenders receive subsidized liquidity credit from Bank Indonesia for part of the loan amount and on-lend at fixed, below-market interest rates to qualifying households. The interest rates charged to borrowers and the proportion of liquidity credit to lenders varies per cost of unit. Developers, public and private, seek qualifying customers to whom they pre-sell the houses. They receive mortgage finance to the borrower directly from the bank and construct proto-type houses at set prices. No further appraisals are conducted and real values of the houses are not assessed, posing a risk to the lender. From the standpoint of the developer, this system is, of course, highly profitable since no construction credit is required.

Additional incentives were provided for developers to increase housing production, for example, through issuing preferential development rights (location permit). Developers were, however, required to build a mixture of house-types (1-3-6 rule). Since the set house-prices of the lowest costs units did not go up with increasing land and construction cost, the quality of the RSS house went down, both in terms of construction quality and location/neighborhood quality. No RSS houses can be built in Jakarta and other major cities because of land costs. Sometimes developers would cross-subsidize the low-cost units, a system that is not sustainable and will lead to fewer low-cost units being produced. The 1-3-6 rule has not been enforced on a regular basis, however.

The system remained unchanged for at least 20 years until the economic and financial crisis of 1997. However, the 1997 collapse was just the final straw for a system that had become untenable and had an increasingly negative impact on housing market and housing finance sector development¹.
After the crisis, and as part of the IMF agreement, BI liquidity funding for KPR subsidies was ceased and MOF had to carry the subsidy on its RDI budget. It is supposed to be phased out by 2004. Summarizing the main issues as follows:

- **Unsustainable cost of the system.** With rising interest rates, the cost of the subsidy increased. The high cost of the housing subsidy system became painfully clear when the BI off-budget low-interest funding was eliminated. MOF has to calculate the present value of the interest-rate subsidy, budget for it and disburse the amount to the banks. MOF and Kimpraswil are trying various ways to limit the cost of the current “on-budget” subsidy system. However, without changes in the entire system of fixed house-types and costs that can be subsidized (set out in Government Decrees), and a lack of incentives to lenders, this is a near impossible task. A more fundamental overhaul of the current housing subsidy system is required.

- **Negative influence on market expansion and innovation.** The subsidy system was meant to increase the role of private lenders and developers in moderate-income housing. It did succeed in doing so, but only for the allocated number of subsidized housing solutions. No innovations were stimulated in the market place beyond the KPR subsidy program. In fact, expansion and innovation were hindered because competition with the subsidized loans and houses was impossible. The current real market place and financial sector need new tools to expand moderate income housing production.

- **Negative impact on urban development.** The entire subsidy system has had a negative influence on urban development, since the incentive to developers is to build low-cost units on cheap land far away from infrastructure.

### 3.2.1.2 Successful projects without an institutional home

Indonesia has developed and implemented some the world’s most successful low-and moderate income housing projects. For example KIP, IUDIP, PPMK and varied community-based housing projects are acknowledged as highly effective approaches in improving the living standards of local communities. They coordinated different inputs and ministries, incorporated community participation and local capacity building. However, what these projects have in common apart from their success is that they were dependent on donor funding and died when the funding cycle stopped. When the project implementation units were closed, the accumulated knowledge, procedures and systems disappeared as well.
No continued budget allocation was afforded to these projects, and no institutional continuity was provided. The only long-term government support for housing came from the KPR interest-rate subsidy for moderate income households.

**It is widely understood that these limited and discontinuous housing policies and the high costs and risks of the regulatory environment have created an unnecessary gap in the housing market.**

### 3.2.2 Key Characteristics of the Housing Market

What are the key characteristics of the Indonesian housing market facing policy makers?

- **Housing shortage in urban areas.** Preliminary census 2000 data show that there are roughly 21 millions households living in urban areas and 28.8 millions in rural areas. The total population grew by only 1.19 percent during the last decade, down 1.95 in the previous decade. However, nearly all growth occurred in urban areas, which grew by more than 4 percent. If we assume these trends to continue during the next decade (estimating an urban growth rate of approximately 3.5 percent for the next couple of years) Indonesia needs to house roughly 735,000 new urban households per year. These figures do not include the housing backlog — the number of households currently living in overcrowded and unacceptable housing units. Comparing this requirement for new urban houses with the average formal sector, KPR financed housing production of 120,500 units per annum (between 1994 and 1998), the challenge facing the country is clear.

- **Different housing requirements of regions and local governments.** There are major differences between the housing needs of different regions. Existing backlogs and growth figures vary widely. Regions and local authorities also differ in their financial and human resource capacity to address their housing problems. Given these differences, varied policy responses are necessary.

- **Low housing affordability, both income and finance affordability.** Household incomes are low relative to land and housing costs. The median urban (outside of the DKJ Jakarta) household expenditures (a proxy for income) are approximately Rp.800,000 to Rp.900,000. With current high mortgage interest rates, 60 to 65 percent of households cannot afford an unsubsidized RS type house — the lowest priced house currently produced in the market. Moreover, lenders are reluctant to make loans for houses with a value below Rp.50 million. The difficulty of acquiring finance has escalated with the shift to self-employment as a result of reduction in wage employment after the crisis
• **Lack of finance availability.** Unsubsidized mortgage lending is only available for the top 25 percent of the urban income distribution. While unsecured micro-finance loans are widely available, the current micro-finance loan instruments are not suitable for new house construction. There are welfare costs related to the limited availability of housing finance and the inefficiencies and small scale of the formal housing production in general—(a) these costs and inefficiencies have a negative impact on affordability, (b) it takes households a much longer time than necessary to construct a decent house, (c) the entire real estate industry remains small and inefficient, and (d) with such a large proportion of households under-served by the market, the demand for subsidies and special requirements for the private sector grows.

• **Insufficient serviced land, particularly for moderate and low-income housing.** Local capacity for land administration is weak and hinders the local supply of land for affordable housing. Equally problematic is the fact that there is an excess of “idle land”—land suitable for housing development, which is held out of the market, creating unnecessary land shortages.

• **Fragmented housing policies, programs and administrative systems.** There are currently many departments and agencies dealing with housing, land, residential infrastructure, and housing finance, whose policies are not well integrated. The main housing law and related decrees no longer conform to the overall government development plan and need to be amended. Similarly, there are a multitude of housing, housing finance, residential infrastructure and urban poverty projects, with fundamentally different or overlapping types of subsidy systems.

• **Lack of housing capacity.** The predominance of the KPR subsidy system, prevented public and private sector experimentation and innovation in the sector. There is an urgent lack of capacity in housing and housing finance.

• **Uneven enforcement of land and housing policies and regulations.** There is much uncertainty in the legal and regulatory environment related to land, land development, and construction and housing finance. This drives up costs and risks of doing business in the sector and makes housing less desirable as an investment sector.

• **Well-developed housing market institutions.** The main formal market players – developers, contractors, appraisers and mortgage lenders are competitive and represented by strong trade associations. Moreover, a wide variety of micro-finance institutions exist in most regions. While the crisis has weakened both real sector and finance institutions, there are signs that the market is recovering. Also, as a result of the crisis, the structure of the mortgage sector has fundamentally changed. BTN is far less predominant and the environment is one of tough competition.
A culture of self-construction and mutual help. There is a strong tradition of households building their houses incrementally with a contractor or individual laborers. It is a main way of saving and wealth creation for households. The majority of the houses are built in this way. In rural areas the tradition of communities assisting each other with the construction of houses is preserved. A disadvantage of this system is that most of these self-constructed houses do not comply with the building code and other regulations.

The challenge for the new housing policy is to build and enhance the current strengths in the housing environment while vigorously addressing the weaknesses.

3.2.3 National Development Strategy

The transition to a rule-based democratic society requires dramatic institution reforms. The housing sector is both influenced by these transformations and can be an important catalyst for change. Particularly, the ongoing decentralization process and deepening of civil society participation will play a critical role in framing the new housing policy. The 1992 Housing Law will need revision in line with these new developments.

3.2.3.1 The decentralization laws No.22/1999 and 25/1999 stipulate a drastic increase in the regional share of government spending. These laws define housing as a function of local government. The requirements for decentralization decide the type of fiscal allocation to the housing sector at a national level, and have a profound influence on empowerment of communities and the provision of local housing resources. While there is not yet complete consensus on the specific terms of decentralization, and Law 22 and 25 are still under review, it is certain that the new housing policy needs to be based on the principle of decentralization.

Furthermore, the balance between the decision-making power and the fiscal resources is dealt with in Law 25, "in order to empower and improve the local economy, create a fair, transparent, participative, and accountable budget system." Law 22, section VIII, article 83.1, focuses on ways in which people engage in local governance. It specifies that participation is both the right and the responsibility of the people in order to create a sovereign state (section VI article 8). Thus, decentralization and participation are closely connected. In addition Law No.28/1999 (part of the anti-corruption measures) also stipulates the requirement for local participation.
3.2.3.2 Propenas.

Another major influence on the housing sector is the national development guidelines for the five year period 2000 to 2004 as laid out in Propenas. This development strategy emphasizes empowering of economic actors while at the same time decentralizing the government.

“...To fill the inter-regional and urban-rural disparities, to overcome the crisis’ impact, the central government devises new policies. The central government allocates more fund directly to local governments, boost efforts to alleviate poverty and stimulate economic activities. However, these efforts will be redundant unless the government successfully empowers economic actors, especially low-income people. In this respect, better access to economic as well as natural resources for low-income people should be improved.3

These, than, are the national development strategies that have to frame the new housing policy.

3.3 Principles And Strategies Of The National Housing Policy

The transformation in the political and development strategies of the country have not yet been translated into a coherent housing policy framework. The 1992 Housing Act does not reflect the basic development and decentralization changes and needs to be adjusted. Initial housing objectives were formulated in Propenas and in Kimpraswil documents. These need to be consolidated into consistent strategies by Kimpraswil. HOMI was asked to assist that process. Below we propose the fundamental principles and strategies for the housing sector in line with the national development goals.

3.3.1 Vision and Goals

Different visions for the housing sector are provided. A new housing law will have to state the vision for the housing sector and the overall goal towards which all implementers of the housing policy should work.

In a decentralized environment, central government will define broad national housing goals. In addition, central government must ensure that regional and local governments
set housing goals. These goals will include housing delivery targets—houses or serviced land delivered with central and local government assistance and housing delivery by private sector actors—as well as institutional development goals. However, visions and goals are only as good as their implementation strategies, to which we focus our attention.

3.3.2 Fundamental Principles

To guide the current transformation in housing policy, it is critical to formulate clear principles that need to govern policy development in Indonesia at all levels and to make it consistent with the development strategy of the country.

- **Partnership and participation.** Government is committed to have people participate democratically in the processes of housing policy decision-making. This principle calls on all housing partners to contribute their skills, labour, creativity, financial and other resources. Government’s role is to provide financial resources and the creation of institutions and support structures in a decentralized governance framework.

- **Fairness and equity.** The housing policy must promote fairness and equity among all Indonesians. Government programs will need to provide a wide range of support options and not discriminate in terms of location, income, gender, religion or creed.

- **Quality and affordability.** Housing must be built to an acceptable quality and at prices people can afford. Government will set basic quality standards particularly for housing assistance programs, including for residential and neighborhood quality, based on performance and future maintenance.

- **Innovation.** The housing policy should foster innovation, creativity and diversity, particularly in terms of the products provided and the environments that are created.

- **Transparency and accountability.** The housing policy should be implemented with transparency, particularly in terms of housing assistance programs and the flow of funds. It is vital that appropriate monitoring systems are implemented and that responsible authorities and implementers are held accountable for performance against clear standards.

- **Sustainability and fiscal affordability.** The government has insufficient resources to meet the need of all underserved households in Indonesia. Sustained and substantial
investment in housing from sources outside the government fiscus is essential. Thus a central focus of the housing policy is to create a normalized market that will attract maximum private investment.

3.3.3 The Seven Strategies of the National Housing Policy

Indonesia’s National Housing Policy is undertaken in terms of seven key strategies:
1. Stabilizing the housing environment
2. Mobilizing housing credit
3. Facilitating speedy release and servicing of land
4. Providing subsidy assistance
5. Supporting participation processes
6. Rationalizing institutional capacity and housing investment
7. Coordinating government investment in development

A wide range of policy initiatives, acts, and institutions has been created, or are proposed by the HOMI team, to implement these strategies. We will summarize these initiatives below and indicate in which HOMI reports details can be found.

3.3.3.1 Stabilizing the Housing Environment

The stability and transparency of the legal and political environment is critical for housing system development. It affect to a great extend the efficiency of the housing system, its ability to attract private and NGO partners and foreign funds. The following issues have to be addressed:

- Creating an effective public environment
- Lowering the perceived risk in the low and moderate-income sector of the housing market, by ensuring that contracts are upheld, regulations enforced, procedures standardized and executed in a timely fashion, and risks shared among appropriate partners.
- Ensuring good quality housing assets.

Creating an effective public environment:
- The current uncertainty in the level and type of funding for housing hampers participation of the private sector and other housing actors. A multiyear funding plan for new housing assistance programs needs to be put in place to provide sufficient confidence for private and NGO investment.
- The decentralization law and agrarian land law are being amended and the final outcomes are not yet known.
The Housing Law 4/1992 needs amendment before it could serve as the legal basic of the housing system. The law should be redrafted to define the new roles of central, regional and local government and civic society.

Equally, the new roles of the statutory housing agencies – Perumnas and BTN— are unclear. Assessments are still being conducted.

**Lowering the perceived risks of housing investments:**

- Impressive progress was made during the last decade in issuing property rights to residential plots-owners. This access to titles will facilitate the implementation of proposed strategies.
- Major title risks still exist in the process of land acquisition by developers, which hampers borrowing for servicing and subdivision, and even access to construction finance.
- Improvements are required in enforcement of land administration regulations such as the location permit system.
- Current planning and building procedures vary widely by local government, and delay development. We propose standardized procedures for local government land allocation, subdivision, permitting, and infrastructure agreements.
- In the housing finance system unnecessary risks exist because of unclear appraisal systems, mortgage contracts, servicing systems, and foreclosure procedures. Improvements are suggested by the HOMI team.
- Default risk and costs are hindering the lowering of LTV ratios and the perceived quality of mortgage portfolios. HOMI proposes instituting a mortgage insurance system and consumer education to mitigate the default risk to lenders.

**Ensuring good quality housing assets:**

- Property rights are critical to enhance the value and transferability of housing assets. Experiments are ongoing to facilitate the process of normalizing titling.
- Quality control will be required on housing produced by developers and contractors as part of government programs, in particular when the fixed RS/RSS types will be eliminated. HOMI will make proposals strengthen quality control.

Many of the issues can be addressed through the Inter-Ministerial Committee and its committees.
3.3.3.2 Mobilize Housing Credit

This strategy is closely linked to the strategy to stabilize the housing environment. It seeks to encourage lending to low and moderate income households at scale, by managing and mitigating commercial risk and sharing it between a range of players, including the borrower, lender, insurer and government. The HOMI team proposes this strategy to focus on three areas:

**Risk mitigation and risk sharing:**
- Assist in setting up a credit bureau.
- Improve appraisal and quality control methods and foreclosure procedures.
- Tighten the procedures guiding construction lending and the transfer to mortgage loans.
- Support by MOF to establish mortgage insurance and an institutional home for a MIP.

**Mobilization of credit:**
- Facilitate ways that will allow pension-funds, insurance companies and other institutional investors to make loans to mortgage lenders, possibly through the creation of a refinancing facility.
- Major progress has already been made in preparing the institutional infrastructure for mortgage securitization. When costs of funds and capital markets normalize, and the primary market is strengthened, a full-fledged secondary market for mortgages may become feasible.
- Support the creation of a liquidity facility and technical support function for micro-finance lenders.
- Last year the Government set up a revolving fund for micro-finance lending for home-improvement — Co-build. This pilot model of civic society/government based lending institutions has an uneven performance and is not tied into existing financial institutions. It needs to be evaluated and mechanisms to strengthen this model proposed.

**Strengthening the regulatory environment and creating a level playing field:**
- Improve regulation and other types of support for micro-finance lenders
- Drastically strengthen the cooperative credit and cooperative credit guarantee system and remove the deep hidden subsidies.
- Cease special treatment of BTN. Do not provide special privileges and monitor the recapitalization agreement. Equally, do not require BTN to make risky loans under the not-well-thought out new subsidy programs.
Other measures are proposed for implementation by the private sector itself. Government can assist in accessing technical assistance and training resources to facilitate private sector transformation.

3.3.3.3 Facilitate Speedy Release of Serviced Land

A well functioning housing system requires access to sufficient serviced land at an affordable price. There have been several recent positive changes to land administration regulations and practice. Nevertheless, several important constraints remain to the efficient functioning of the land market for housing. In turn, these restrict access to the housing market. There are also several positive actions by which the Government can make the housing market more efficient. We make the following recommendations. Most will require inter-ministerial coordination.

Kasisba/Lisiba, Law Number 4/1992:

- Although there may be little opportunity for creating new Kasibas, a pilot scheme is recommended. Ways of strengthening implementation are recommended by HOMI.

Strengthening local capacity for land administration:

- The HOMI project supports the principles of the proposed World Bank-funded Land Management and Policy Development Program, and will point out the areas critical to making the housing market more efficient. These include developing the capacity to monitor and enforce the expiry of Location Permits, in order to increase the local supply of land for affordable housing.

- The HOMI project proposes to develop a set of standardized land development procedures for local government.

Tax incentives:

- PBB should be increased on vacant land. Increased tax will increase supply and thus reduce prices, and enhance revenues for the development of affordable housing. This change should be promoted by the committee currently examining changes to the PBB law.
3.3.3.4 Providing Housing Assistance

We have assessed the need for housing assistance programs nationally and at local government level. While the housing function will be decentralized, a major central role for subsidizing housing remains.

The new housing assistance programs will be transparent, well-targeted, on-budget, administered in an efficient and effective manner, and tailored to meet the varied needs of lower-income households in differing circumstances. The most significant principle underlying this strategy is to reach the largest number of households with limited resources, based on the need for fiscal discipline. It is impossible to provide finance or subsidies for the vast majority of underserved households. Subsidies are designed to leverage household, financial sector and local government investment in housing. The allocation system conforms to future decentralization requirements.

We recommend that GOI continue to subsidize the following programs designed to address needs of varied households and varied supply constraints.

**Assistance to moderate income households to access housing finance and expand housing markets:**

- Mortgage insurance support for households with incomes around Rp.900,000 to Rp.700,000 (65th to 45th percentile of the 1999 urban expenditure distribution of urban households outside of Jakarta). Saving up for the down-payment is a major impediment for moderate-income households in obtaining finance. Mortgage insurance lowers down-payment requirements in a more cost-effective way than upfront subsidies. Second, default costs for lenders are high, because of high court-cost. Mortgage insurance can bring some discipline in this process. It spreads the risk of default among lenders, insurers and borrowers.

  Government support for mortgage default insurance may include subsidizing insurance payments for deserving households (the risks should however be properly priced and paid for), and institutional support by MOF to establish a mortgage insurance program.

- A flexible, upfront subsidy for households with expenditure profiles below Rp.700,000, who would not qualify for a mortgage loan even with mortgage insurance. Upfront subsidies could be applied to lower the down-payment, the loan amount or the monthly


payments during the initial years. We prefer a combination of down-payment subsidy and a default guarantee subsidy, which will protect the borrower against foreclosure and reduce foreclosure cost to the lender. Such a subsidy would be particularly helpful to expand lending to households with non-fixed incomes.

Upfront subsidies, when not properly implemented, can lead to housing being built without proper infrastructure or neighborhood amenities. Upfront subsidies are also easily misused. Initially, upfront subsidies should be neighborhood-based and NGO supported, like the projects we mention below. We would only recommend the introduction of upfront subsidies when a proper housing assistance agency and/or a quality control unit is in place (see below).

Upfront subsidies will require additional incentives for lenders to address default and collateral risks and to assist them to acquire funding for additional long-term loans. (See above).

Borrower education will be part of all programs.

**Neighborhood block grants to assist low/moderate income households and communities to improve housing conditions:**

- Two types of programs are envisioned, neighborhood/home improvement programs, and mixed new development programs. Income criteria need to be flexible since neighborhoods have mixed income profiles. It is estimated that the majority of beneficiary households would have incomes below the 50th percentile of the urban income distribution. Households in this category require a neighborhood or group-based approach to housing, because unaided land and housing markets do not yet work well at the low-income level. Simple credit related upfront subsidies would therefore not work.

- HOMI recommends flexible direct grants allocated on a per plot basis and calculated on the basis of the opportunity costs (market value) of the inputs provided. These subsidies could be applied to varied infrastructure investments (but not subsidize land per se), titling costs, or, upfront grants for home-improvement and construction that can be complemented by a micro-finance loan. The grants would be channeled through local governments or NGOs. NGOs will have to have local government approvals before being granted a subsidy. All programs would complement local government’s and NGO’s
own contributions and would be contingent upon these institutions’ fulfilling critical conditions.

**Public/Private partnerships to provide rental housing for employers:**
Rental housing construction, particularly for migrant labourers, is a high priority. While the provision of rental housing is mostly a local government and private sector function, national incentives to private employers may facilitate the development of selected rental housing in strategic locations.

The Government has existing subsidy programs for civil servants and military personnel and programs to provide emergency housing. Responsibilities for these programs are scattered across different ministries. HOMI did not analyze these programs.

### 3.3.3.5 Supporting Participation Processes

Many of the principles for the housing policy set out above can only be fulfilled if true participation by civic society is in effect. This strategy focuses on supporting and facilitating the process of participation in local level decision-making on housing policies and projects. Secondly, it supports self-building by individual households or communities. The participatory process should open the opportunity for low-income groups to organize their resources and use these to leverage other public and private resources available to them.

Two main constraints need to be addressed:

- There are few capable community-based and intermediary NGO institutions.
- There is unclarity about the possible process of participation by communities and civil society in general.

The strategy comprises the following institutional arrangements:

**Institutionalization and assistance to create local Development Fora:**

- Provide funding support to establish Development Fora, (initially focused on cities in which housing subsidy programs are developed).
- Assist in linking technical professionals with the Fora to improve their ability to provide input to housing and planning plans.
- Train urban Development Fora members in monitoring development activities.
Assistance to community support organizations as part of the housing assistance package:

- Fund and train housing related intermediary NGOs in housing and land development issues
- Assist Universities to develop housing and land development, short certificate programs.

3.3.3.6 Rationalizing Institutional Capacity and Coordinating Housing Investment:

The GOI, especially DGHS/Kimprawil, MOF, Bapanas and local governments need to be prepared to take a new leading role in the changing housing environment. This strategy seeks to clarify new roles and relationships in the public sector and addresses the capacity building requirements and the need to attract a specialized and well trained workforce.

The strategy further seeks to create a single, transparent and predictable housing funding process at the central government level.

Three initial proposals are prepared by HOMI:

**Clarifying public sector functions and relationships:**

- Specify functions for the three spheres of government, national, regional and local government
- Clarify the housing sector related functions of different ministries, and support the Interministerial Committee
- Establish a new housing statutory body to support the implementation of housing assistance programs.
- Create a housing and urbanization information system. We propose that a special unit is established to collect data on the housing sector. This should be the cornerstone information management system for housing.
- Create a dedicated unit to control infrastructure and housing standards for housing developed with government assistance.
- Clarify functions of statutory bodies such as BTN and Perumnas.

The next section of this report will deal with these issues.

**Creating a transparent national housing fund:**

National funds for special housing assistance programs will come from the central government housing budget, DAK, and, to a large degree, from donor loans and grants.
These funds will support technical assistance, capacity building and investments in housing programs. Flexible, coordinated and continuous allocations are required between regions, programs and types of institutional development, particularly during the transition period to decentralization and democratization.

### 3.3.3.7 Co-ordinating Government Investment in Development

We identified the need for a strategy that seeks to maximize the impact of overall government investment in (urban) development, through careful planning and co-ordination of activities. This strategy should be reflected in the new Housing Law. It does, however, go beyond the housing and residential infrastructure sector and is in the purview of Bappenas.

However, one of the requirements HOMI proposes for local governments' to receive housing assistance funding is the preparation of a housing development plan, which needs to be part of an integrated development plan. The lack of such a requirement under the current RSS/RS subsidy system has shown the negative impacts on urban development.

### 3.4 Suggested Changes In The Government Housing System

The national objectives of decentralization and democratization will guide changes in the government housing system. Equally, the current emphasis on market-strengthening approaches will influence the need for government action in the sector. This new focus means that new actors will be involved, new institutions should be founded and new ways to enable the market should be devised.

The Housing Law 1992 will have to be amended to reflect these fundamental changes. We have worked backwards, starting from new principles and strategies, rather than from the old Housing Law. We now make some suggestions on changes in the law, in particular as these pertain to the different roles and functions of government.
3.4.1 Roles and Functions of Government

Decentralization is the main strategy for all developmental activity. However, decentralization is more than transfer of decision-making power and control over resources. Decentralization policies should also be understood as a way to intensify the responsibilities of the local government to the people. In this light the decentralization of housing is regarded as decentralizing the responsibility for and investment in housing development.

However, the outcomes of decentralization for the housing sector are by no means clear.

- Local governments will not necessarily target housing as an investment priority, and in particular housing for low-income households. Indeed research showed that housing was not an important political issue.
- Local governments often lack housing related planning, financing and implementation capabilities.
- Local governments often lack a clear understanding of market operations and in dealing with private sector actors.
- National level housing institutions and instruments, affecting local housing systems, still need considerable strengthening (see above).

There is, therefore, a clear role for central government in a decentralized environment:

- Central government could define incentives to stimulate use of local resources for priority housing programs.
- Central government could allocate resources for housing to balance regional differences.
- Central government needs to improve capabilities of national, regional and local housing institutions.

Given these concerns, we outline the requirements for a decentralized approach to housing policy and program development, and the funding and implementation of housing programs. The following is a preliminary view of government responsibilities under a decentralized system.

3.4.1.1 Central government functions:

- Develop the legal housing framework.
- Develop National Housing Policy.
- Set national multi-year policy goals and objectives guided by an Inter-ministerial Committee on Housing (see below).
- Develop and monitor national housing assistance programs. Prepare guidelines and conditions for local governments, targeting and allocation systems, prioritization criteria and disbursement procedures. Regularly, adapt program parameters when incomes and market conditions change.
- Establish a funding framework for housing development and negotiate and secure an allocation from the national budget for housing, DAK funds and seek international agencies’ loans or grants. Allocate funds to different regional governments and financial institutions so that national programs can be implemented.
- Provide technical support for emergency housing in conjunction with other ministries and regional governments and institutions.
- Manage the (civil servant) public housing stock, and historic building program.
- Promote housing finance, land and infrastructure sector reforms important to improve the efficient and equitable functioning of housing markets.
- Assist regional and local government to strengthen their housing planning and implementation capabilities, and their governance abilities and use of participatory planning approaches.
- Develop guidelines to standardize local government housing institutions, and planning and approval procedures to facilitate housing delivery.
- Develop and maintain standards and norms.
- Compile and maintain a National Housing Data Bank and Information System, carry out analyses and dissemination of housing data, publish best practice examples, encourage teaching and research on housing issues at the national and regional level.

3.4.1.2 Regional government functions:

- Coordinate and integrate regional housing and residential infrastructure programs.
- Provide training to local governments in technical and governance issues related to housing and residential infrastructure.
- Provide funding or coordinate funding sources for selected housing programs.
- Assess applications received from local governments for national housing programs and monitor the performance of local government housing programs.
- Support regional intermediary NGOs working in the housing sector.
- Publish and disseminate relevant housing information; conduct building technology research.
- Provide emergency housing in conjunction with central government.
3.4.1.3 Local government functions:

- Develop local housing goals and delivery strategy.
- Facilitate housing developments within its boundaries, guided by the national level policy and regulatory framework.
- Set aside, plan and manage land for housing development. Enforce location permit requirements.
- Provide trunk infrastructure services when there are no other service providers.
- Implement, administer or support national housing programs if accredited to do so.
- Create a financial and socially viable environment conducive to housing development.
- Support and develop a participatory housing planning system that will help to maximize efforts by households, CBOs, NGOs and the private and public sector to jointly address the low and moderate income housing challenges.

3.4.2 Government Housing Institutions

The changing government functions and policies require a rationalization of government housing institutions. Most of all, the government sector needs to be professionalized in order to play a lead role in modernizing and democratizing the sector. While HOMI did not conduct a detailed institutional study, we want to suggest the most critical changes required in the current housing institutional framework in order to implement the policy recommendations.

3.4.2.1 Inter-Ministerial Committee for Housing.

The central housing policy function is divided across various ministries, government agencies. Decentralization will make the policy context even more complex. Yet central government policy guidance will remain critical in the foreseeable future in many key parts of the housing system.

The Homi team recommends that the Inter-Ministerial Committee will be activated to coordinate the housing policy function. We further recommend that subcommittees would be set up reflecting different components of policy and program work; i.e., land, finance,
infrastructure, special housing assistance programs, and decentralization concerns. The committee would be supported by an administrative unit.

The committee could extend temporary membership to financial sector representatives, trade groups from the real sector and major NGOs involved in community-based housing. Alternatively, these groups could participate in the sub-committees or task-forces.

The World Bank has pledged financial support for the operation of the Inter-Ministrial Committee.

3.4.2.2 Kimpraswil and DGHS

We propose that the main housing functions of policy development and implementation at the central government level be carried out by different agencies. Policy making, capacity building, regulation and support provisions for housing should be carried out by Kimpraswil, and implementation support, fund disbursement, coordination, monitoring and adaptation of special housing programs should be tasked to a special agency. We believe this separation to be important in order to improve professionalism in program administration and to increase the distance between the legislative and administrative parts of government as it relates to housing, since civic society institutions are still weak.

We suggest that Kimpraswil will focus on and strengthen the following functions:

**Develop the legal and policy framework for housing and the National Housing Policy:**

- Amend the 1992 Housing Law and bring it in line with the overall development direction of the country.
- Change the Housing Decrees required to implement the new programs.
- Develop the national multi-year policy goals and objectives guided by an Inter-ministerial Committee on Housing (see below).
- As a member of the Board of Directors of the Housing Agency, guide program implementation and adaptation and the development of new housing programs.
- Lobby government for housing budget allocations and seek donor funds for housing, and MOF support for borrowing for housing.
• Work closely with the Inter-Ministerial committees to promote reforms in the housing finance, land and infrastructure sectors, and in collaboration with professional staff of the proposed Housing Authority.

**Building housing capacity for the approximately 400 local governments, NGOs and other housing providers:**

• A dedicated unit within Kimprasarwil needs to be created for this purpose.
• Provide a training menu for local governments to improve their skills in the a variety of areas including: housing planning, financing and implementation capabilities, governance abilities and use of participatory planning approaches.
• Develop guidelines to standardize local government housing institutions, and planning and approval procedures to facilitate housing delivery.

**Set standards and norms for housing:**

• Develop and maintain housing and residential infrastructure standards, jointly with local governments.
• Establish a unit for quality control on housing developed with support from government subsidies. This unit could be part of an existing technical agency. It could establish a list of bona fide developers and contractors to support housing project implementation.

**Compile and maintain a housing data bank and information system:**

• Establish a dedicated unit for data collection and analysis
• Collect, analyse and disseminate housing data: financial data and real production data.
• Publish successful practice examples.
• Encourage teaching and research on housing issues at the national and regional level.

**Provide technical support for special housing programs in conjunction with other ministries and regional governments and institutions:**

• Emergency housing
• Civil servants housing
• Historic buildings

**3.4.2.3 New Statutory Housing Authority**

The transition to a sound market-based housing system will require specialized government support. Equally, sustained approaches are needed to improve the living conditions for those households who need special support. We propose to establish a
special Housing Authority for the development and implementation of housing assistance programs for the following reasons:

**Reforms require a long-term horizon.**
Reforming the housing sector requires long-term strategic objectives and implementation strategies. The importance of a stable policy environment is critical for that transition. A dedicated housing agency, less prone to short-term changes in ministerial environments, and with specialized staff, can provide such stability.

**Improved coordination of programs and institutional development inputs.**
Past subsidy programs were managed on an ad hoc basis. BTN administered the KPR subsidy on behalf of government. Responsibilities for program adjustments and the development of alternative programs have become increasingly vague. Other donor funded subsidy programs are managed by individual project units that are not coordinated and often do not know what other programs are doing. Effective decentralization is impossible to implement under these circumstances. A coordinated approach is required to gradually build up new institutions, regulations and capacities, and streamline different subsidy inputs. HOMI has developed a matrix of necessary institutional development issues and programs to assist in this process.

**Need for program adaptation to “tease the market down” and respond to changing conditions:**
The dynamic subsidy systems we propose will need continuous adaptation during this time of economic, fiscal and financial sector transition. The programs are designed to gradually increase the role of local governments, the private and NGO sectors. Incentives need, therefore, to be adjusted regularly to “tease the market down”. Once the market is comfortable making loans to a selected segment of the market, subsidies and target groups should be adjusted to include other risky groups. Similarly, incentives to local government and the NGO sector need to be adjusted regularly. Also, the mix of programs will need adaptation in accordance with local level demand for lower-income housing.

This process requires highly specialized professional staff, who understand the interface between the market and government policies and programs. Housing finance professionals are needed for the finance related subsidies. Low- and moderate income housing and micro-finance specialist are required for other programs. In addition, program adjustments will need some independence of legislative decision-making. Lastly, close
coordination of donor investments and technical assistance must occur to implement the menu of priority programs and institutional reforms. These conditions are hard to meet within the context of varied and changing government Ministries, with limited authority.

The tasks of the Housing Authority would be to:

- Develop priority housing programs for national and local level implementation with inputs from Kimpraswil, local governments, private and NGO/CBO housing actors.
- Set up selection and qualification criteria for financial institutions interested in participating in the financial subsidy programs.
- Set up a disbursement and monitoring system for financial subsidies.
- In collaboration with the Board, adjust rates and program parameters (income and other household indicators, loan amounts).
- Solicit and assist in preparing proposals by local governments or NGOs for neighborhood-based program funding.
- Select proposals with the assistance of a regional unit, facilitate planning and implementing of projects, carry out quality control and monitor the results.
- Coordinate program technical assistance and investment inputs by international development agencies.
- Review the allocation of funds to different programs and adjust according to regional and program related demand.
- Adjust program parameters and propose alternative programs when economic and housing conditions change.

The Board of Directors would consist of members from Kimpraswil, Bapenas, MOF, and, if possible, from the private financial and NGO community on a rotating basis. The HA will be required to stimulate consultations with civic society, both centrally and at the regional and local level.

HOMI recommends that the GOI assess the feasibility of establishing a specialized housing assistance agency to guide and implement approved subsidy and incentive programs. The assessment will need to weigh the cost of establishing a new agency against the greater efficiency of the use of limited housing resources and donor funds.

When local governments are better able to implement housing programs on their own and housing market institutions are well established, this Housing Authority could be phased out. A clear exit clause could be provided in its statutes.
3.4.2.4 National Housing Fund

The funding mechanism for the Housing Authority needs to be stable. Multi-year allocations are critical for the finance subsidies in particular. The funding mechanism needs to allow for flexibility of program choice and adaptations. The existing system of individual Program Implementation Units with their own funds, and their own terms and systems of subsidies will not allow this flexibility. Some pooling of donor funds and programs is required. For these reasons we suggest that a National Housing Fund is established. The proposal and alternatives are detailed in a separate report.

A HF can be perceived as a pool of money, allocated through annual appropriations for housing programs by the government and international agency and donor funds. The HF administration would allocate those funds to various trust funds for different programs within the HF specified by the government, but with substantial flexibility. All (or most) subsidizing activities of the government would be funded explicitly by the HF, thereby assuring that the subsidies are transparent. Even more importantly, the future flows of subsidies that are being committed currently, such as the present interest rate subsidies, should be accounted for and funds set aside to cover them.

With the HF at the center, the spokes of the HF wheel would channel funding to various programs in an explicit tradeoff between alternative modes of subsidy delivery. The advantage of this arrangement is the rational allocation of subsidies. Subsidies that pay out over 20 years are compared explicitly with those that pay out fully now. Those that involve no hidden risks or costs of collection are seen to be cheaper than those that do have hidden costs. This also encourages the redesign of subsidy schemes to avoid extra risks, costs and inefficiencies. By the same token, this approach does not allow for running up future commitments of subsidies or mountains of bad debt without recognizing those costs today.

3.4.2.5 A Special Housing Finance Unit in MOF

The finance sector—mortgage lenders, micro-lenders, pension funds, insurance companies, mortgage insurance, capital markets—will play a critical role in extending the reach of the housing market. It is critically important that the government attracts qualified and dedicated staff in this area. HOMI recommends that a core housing finance unit be established in MOF to coordinate housing finance related reforms.
3.4.2.6 Regional and Local Government Housing Departments.

Local government should establish a dedicated housing department that will combine all housing functions for moderate income housing. It should help to establish sustainable participatory decision-making structures that include a broad representation of civil society. One of the tasks of Kimpraswil would be to assist local governments to develop well trained and effective housing departments.

3.4.3 The Role of Existing Statutory Housing Institutions

While not tasked to evaluate the existing statutory housing institutions, we considered the role of BTN and Perumnas in the new housing environment.

3.4.3.1 BTN

BTN was by far the largest mortgage lender in the country until the 1997 crisis, controlling more than three quarters of the market. As a result of the redistribute effects of IBRA’s mortgage sales, the market is now more evenly distributed. BTN is now competing with other equally large mortgage lenders for new market share and for the same type of borrowers. In the current mortgage market place, there is no clear need for a government mortgage bank. The question is whether BTN can develop a special niche in which it can successfully compete with other, more diversified lenders, and be gradually privatized. There are several constraints to overcome.

BTN was recapitalized in 1999 and required to focus on its core business – KPR loans, subsidized and non-subsidized, to moderate income households. The uncertainty of subsidy allocations and disbursements has created major problems for BTN in recent years. Consequently, it tries to increase non-subsidized lending and decrease subsidized lending (see attached table). However, without subsidized liquidity funding, it has to raise its funds in a competitive market place. With low interest income on their government bonds (they were recapitalized mostly with 12.5 percent SBIs) and burdened with a large bureaucracy, fundamental weakness still plague the institution. Competition has forced it into increasingly risky lending, — lower LTV ratios, lowering rates, increasing construction lending. These risks are not appropriately assessed and priced for. At the same time government is looking at BTN to take on the bulk of its new subsidy program. The structure of the subsidy poses extreme credit risk for BTN when the subsidy is phased out in 2004.
A new evaluation of BTN will be done in the near future and new strategies will be proposed.

### 3.4.3.2 Perumnas

A main assessment of the future functions for Perumnas is currently undertaken. The HOMI-team did not make a detailed analysis of Perumnas, but several discussions were held with senior staff. The following observations may contribute to the current debate.

- Perumnas, like BTN, was established at a time when developers were not interested yet to deal with the lower end of the housing and infrastructure market. When the new KPR housing subsidy scheme was initiated, Perumnas was to play a critical role. However, over the years the housing development market has changed. Both large scale and small scale developers and contractors construct moderate income housing. New incentives are proposed by HOMI to strengthen and expand that market. A government owned housing developer will not be required and may hamper market expansion. The only possible housing role may be in the construction of emergency housing, although the private sector could be contracted to construct such housing more efficiently.

- In a decentralized environment, a much scaled-down Perumnas may have a role to play as an infrastructure developer or development consultant for local governments, which do not have access to developers. In the same vein these regional offices could provide capacity building to local governments, and possibly assist in quality control for government assisted housing programs. The emphasis of Perumnas’ operations would be regional, infrastructure and support oriented.

These combined approaches for private and public sector improvements, implemented in a planned sequence, and assisted by donor funding, should begin to show early and positive effects in different parts of the housing sector and increase the overall production of low and moderate income housing.

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1 Other reports by the Homi team provide a detailed analysis of the subsidy system.
2 Depending on the CPI inflation ratio applied.
CHAPTER 4

EFFECTIVE DEMAND FOR LOW AND MODERATE INCOME HOUSING

Marja Hoek-Smit

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CHAPTER 4

EFFECTIVE DEMAND FOR LOW AND MODERATE INCOME HOUSING

Marja Hoek-Smit

Summary of Main Issues Related To Demand For Low And Moderate Income Housing

4.1 Drivers of Demand. The analysis focused on factors influencing the demand for housing, i.e., the decision to buy a house rather than rent, in particular for first-time homebuyers, and the decision to pay for housing of a certain price and quality and in a specific neighborhood. The main factors that drive demand are:

- income level in relation to house-prices and cost of housing, and income stability
- savings and wealth constraints
- life-cycle factors
- housing preferences
- user cost of home-ownership, in particular financing cost
- housing risk (the variation of house-prices over time, absence of rent risk)
- neighborhood externality risk (variation in neighborhood quality/externalities over time)

4.1.1 Housing Requirements. Total population and household growth will be focused in urban areas, while rural areas will be stagnant. The urban growth rate for the next few years is estimated at 3.5 percent, of which approximately two-thirds is due to in-migration from rural areas. The overall requirement for new urban housing to house newly formed households for the next few years is estimated at 700,000 to 750,000 units per annum. The high migration component of urban growth has major implications for local governments’ housing strategies. Migrants are less prone to be home-owners and want to decrease overall housing spending.

Urban growth differs in different regions. The highest urban growth rate is expected in the least urbanized regions. Housing assistance programs need to focus capacity building efforts towards those areas.
4.1.3 Household Incomes and Income Stability. The current median monthly household incomes (50th percentile) for urban areas with and without DKI Jakarta are Rp.950,000 and Rp.892,000, respectively. The median household income in rural areas is Rp.579,300.

The critical impact of the 1997 crisis has been in the decrease of real wages and not in aggregate employment, since many workers transferred to self-employment. Wage cuts have been greater in the urban sector and are concentrated at the bottom of the wage distribution.

Household incomes have shown far less volatility during the crisis period than individual wage incomes and overall GDP. Households have coped by having household members move to informal employment and by extending female labor force participation. As a result, the decline in household incomes is about half the size of the decline in individual earnings. Nevertheless, the crisis and the related fall in household income had a major impact on housing demand. One consequence of the crisis is an even higher percentage of self-employed and family workers (a total of 46 percent in urban areas), which will only gradually be re-absorbed by the labor market.

The large proportion of self-employed and family workers will make borrowing for housing through conventional KPR loans even more difficult. Also, an increased sense of insecurity of future income may have a negative effect on the willingness of households to borrow for housing and may influence tenure choice. At the same time, the high labor force participation will negatively affect possible direct self-help involvement by household members.

4.1.4 Cost Affordability of Housing. House-prices in relation to incomes are modest and housing standards are not the main concern in the affordability of housing. Low to moderate income households can buy a house for an average price of 3 to 3.5 times annual salary.

- **Median prices (approximate) for existing housing** in predominantly low-income neighborhoods converged around Rp.18 to 20 million in the 10 city survey. KIP areas, which are generally better located and are mostly mixed income neighborhoods, had a median house-price of roughly Rp.44 million, with a median yearly income of Rp.10.7 million (HOMI 10 City Survey, 2001).

- **Cost analysis of new construction in non-complying, but legal areas** show that a 21m2, self-constructed house on a 60m2 plot priced in the order of Rp.80,000 to 100,000 per m2 can be built for a minimum of Rp.20 million in main urban areas. Both land and
construction prices depend, of course, on location and region of the country. Developer produced moderate income housing can be built for Rp.25 million and above.

- **The lowest cost “housing” solution** is a plot with a core house without infrastructure for Rp.13 to 15 million, depending on location (see Puslitbang 2001 regional construction cost data).

- **Households have a preference for self-built housing** and 50-70 percent of the houses in CBHP, KIP and unimproved slum areas is built in this manner.

Average housing expenditures dropped dramatically to a low of 14 percent as a result of the crisis, but are returning gradually to pre-crisis levels of 25 percent. Presently, owner households spend approximately 20 percent of household income on housing expenditures including utilities, while renters spend on average 16 percent.

### 4.1.5 Finance Affordability

The high interest-rates (20 percent) and high down-payment requirements (LTV of 70 percent) for mortgage lending pose critical limits to housing affordability. Lack of down-payment support may be the most important borrower constraint for mortgage lending. At the medium income level, urban households outside of Jakarta can afford Rp. 13 million in loans and with 30 percent downpayment they can afford a house of Rp. 18.7 million. If interest rates of 15 percent are assumed, the same household can afford Rp. 17 million in loans for a total house value of Rp. 24 million.

Lender constraints on extending housing finance focus on the high perceived risk of default for low income and non-fixed salaried borrowers, and the high occurrence and cost of foreclosure in case of delinquency. Additionally, the fee income for writing small mortgage loans is relatively low. Consequently, mainstream lenders typically do not make loans for houses with a value below Rp.40 to 50 million, affordable only to the 75th percentile of the urban income distribution. Second-tier regional banks, which have a better understanding of local conditions, make mortgage loans for properties valued as low as Rp.20 million, affordable to the 45th percentile. Liquidity constraints are a problem for some banks. When funds for lending are limited, long-term lending to risky customers on the basis of weak collateral will not be a priority. Lowering the risk of default and foreclosure and insuring the cost of default may assist in getting lenders to move down-market and may increase their access to funds for housing loans.

Un-secured micro-finance for housing with current interest rates of over 30 % is important mostly as a borrowing option of last resort (a Rp.2.4 million loan can be afforded by a
household at the 20th percentile earning Rp.511,000 per month). Micro-finance institutions can be assisted to improve efficiency and expand access to housing finance. A housing-for-savings program, coupled to incremental construction or improvement for housing may be a useful orientation for a housing program for the lowest 40 percent of the urban household income distribution (Rp.750,000). Self-construction is preferred by low and moderate income households over the smaller RS/RSS turnkey house types (HOMI survey).

Investment and savings preferences for housing are low relative to savings for reasons of security for the future and education for the children. These findings are an indication that the house is not considered as an asset that can be utilized to borrow against in case of need.

4.1.6 Housing and Neighborhood Risk. Willingness to invest in housing is related to the perception of the risk that the house will lose value. Current moderate and low-income housing programs often deliver housing that has a lower value than the cost of construction. In addition, a large proportion of houses in low-income housing areas do not have Hak Milik titles or formal permits. Resale of these houses is, therefore, more difficult and investment in housing is discouraged.

Much of the housing value is derived from neighborhood quality, i.e., location, availability of infrastructure and services, and social integration and security characteristics. The process of acquiring all development and building permits takes on average a year for low-income areas and is unpredictable. A lack of clarity as to when, or if services will be delivered increases neighborhood risk (i.e., the risk that house values are volatile because of unpredictable neighborhood factors). Investment by (potential) home-owners in more risky neighborhoods is negatively affected and so is lending by financial institutions, which further dampens demand.

In addition, lack of access to services (health and education) and infrastructure (safe water, adequate sanitation, access to transport and roads, electricity) are amongst the most critical aspects of poverty. Housing assistance programs need to provide housing that maintains its value and provides a real asset to low and moderate income households. Medium-term implementation plans for the delivery of property rights and infrastructure by local government should be an integral part of low income housing programs. Greater attention should also be given to community strengthening programs.
4.1.7 Consequences for Housing Assistance Programs.

First, housing assistance programs and particularly programs to stimulate new construction, need to focus on urban areas, since all household growth is expected to take place in cities.

Second, since urban growth will be made up predominantly of migrants, rental housing should be stimulated.

Third, the demand analysis shows two main types of constraints in extending demand for urban low and moderate income housing:

- **An affordability constraint related principally to the difficulty of accessing housing finance and the high cost of finance.** The housing market can effectively deliver housing for Rp.25 million or even Rp.20 million, which is considered sound collateral for a loan and sound investment for households, i.e., included in the price of the house are costs related to property titles, regulatory approvals, proper location and infrastructure and services. Housing in this category need not incur a mismatch between cost and value of the house, nor the risks that neighborhood factors impact house-value unpredictably. Financial incentives to households to address savings constraints or constraints related to income level and volatility, may under these market conditions be effective in stimulating both demand and supply of moderate income housing. Equally, assistance to banks to improve risk assessment and some specific credit enhancement incentives may facilitate down-market lending.

- **A housing affordability constraint caused by housing and neighborhood risk.** Real markets for low and moderate income housing below approximately Rp.20 million are “incomplete” and cannot yet price adequately for housing costs and risks, and neighborhood quality and externalities. Finance will therefore not be easily obtained and investments by households are risky since the housing asset has an uncertain value. Clearly, just providing financial incentives to households or lenders would either increase the investment risk for borrowers and financial institutions or would simply not result in new houses being constructed through the private authorized sector. For this segment of the market, a more comprehensive approach to housing assistance is needed. A neighborhood based approach would be required that will provide more direct supply-side assistance, e.g., to provide property rights and regulatory clarity, land in adequate locations and social and physical infrastructure. Given that kind of support, demand for housing may be enhanced through financial incentives, if necessary. In other words, since markets for housing at the lower level do not work well, demand incentives alone will not work to increase housing production, but a neighborhood-
based and supply-oriented approach would provide incentives by households and lenders to make further investments.

4.2 The Drivers of Housing Demand

4.2.1 Introduction

By any measure, the financial and economic crisis in Indonesia has been extremely severe—far more severe than in any of its South East Asian neighbors. Real estate, including residential real estate, was a fundamental cause of the crisis and was at the same time deeply affected by it—aggregate demand for housing has dropped, housing asset prices have decreased, bank lending moved to less risky assets and excess housing stock constrains new supply. There are signs that the real estate sector is gradually reviving, but real improvements will be contingent on economic recovery.1 This study tries to evaluate what the impact of the crisis has been on the low-and moderate income housing demand and what factors will shape the short and medium term demand for low and moderate income housing. More specifically, we will identify the constraints to effective demand for housing that may need to be addressed in new housing assistance programs.

The basic facts of the crisis have been widely documented at the macro-level and the causes and appropriate macro-economic remedies have been the subject of considerable debate. Substantially less is known about the magnitude and distribution of micro-economic impacts on the lives of ordinary Indonesians. Research in this area has focused narrowly on the extent of poverty in relation to safety net programs. Little attention has been given to the effects of the crisis on the household economy, wages and employment, the differential impact on urban and rural labor markets, urban migration patterns and the impact on household savings, debt and investment priorities. It is these factors that are of critical importance in understanding the demand for housing, whether for ownership or renting.

The BPS household expenditure survey provides some indication of total household expenditures and specific investment and spending patterns for housing, typically the largest component of household expenditures. Its labor market studies offer some insight in the coping strategies applied by households. Lastly, the housing market studies conducted by HOMI provide some qualitative and quantitative insights in the current housing conditions, expenditures and preferences of moderate and low-income households.2 We
do not, however, have access to data that directly connect household income and the household's housing conditions and prices. It is from these data sources that we try to compose a picture of housing demand for low-and moderate income households.

4.2.2 What drives demand?

From the outset we have to distinguish demand for home-ownership and for rental housing. While we analyze the different demand characteristics for renters, the focus is on the demand for home-ownership. The reason is that the majority of households aspire to own their house. Urban home-ownership in Indonesia is relatively high at 84 percent nationally, —71 percent of households own their house in urban areas and 91 percent in rural areas (BPS, Susenas 1998). Remarkably, these figures are similar for the low-income housing areas included in the 10-city survey conducted as part of the HOMI project (see Tables 4.3 and 6.2).

Housing represents many different aspects, —land, infrastructure and the house itself. Its desirability (and value) is influenced by its location and the type of services provided in the neighborhood. For (potential) home-owners, the decision to buy a house rather than rent, or improve the house, and the household’s willingness to pay for specific housing characteristics is related to:

- income level and income uncertainty,
- user cost of home-ownership (e.g., production cost, financing cost and availability, maintenance cost, taxes, absence of rent risk, etcetera),
- household wealth or lack thereof (indebtedness),
- life-cycle factors (migrant status, household composition and phase of household development),
- housing risk (the variation of house-prices over time) and neighborhood externality risk (variation in neighborhood quality/externalities over time). These factors relate particularly to the decision to buy in a specific housing sub-market or neighborhood.

For renters, the decision to rent rather than own and the willingness to pay for a certain quality of house, is driven by much the same factors. However, neighborhood characteristics influence renters differently from home-owners and investors in rental housing.
The neighborhood externality risk factor is often overlooked, but is of critical importance for programs intended to expand home-ownership to lower-income households. Home-owners generally over-invest in housing. In other words, relative to their overall wealth, most moderate income home-owners have a relatively large proportion of their wealth tied up in their house and cannot adequately diversify their investments. If the value of this investment in housing is not secure, because of neighborhood and house value changes, low and moderate income households will lose much of their wealth built up in the house. Indeed, owner-occupiers have a stronger incentive than tenants to avoid neighborhoods with high externality risk. Yet, low-income home-ownership programs are currently implemented mostly in risky neighborhoods.

Demand for housing is influenced by the availability of (serviced) land and other supply factors. If supply is inelastic, measures to increase demand will remain ineffective and will put pressure on prices. Housing supply issues in Indonesia will be detailed in the “Housing and Land Market in Indonesia” HOMI report.

Housing assistance programs to improve demand for home-ownership will be successful only if they are based on an understanding of these underlying factors determining home-ownership and the specific constraints households face in purchasing a house. Similarly, housing assistance programs to facilitate production of rental housing need to appreciate demand factors for rental housing. In this paper we analyze some of these potential bottlenecks, and preferences.

4.3 Population Growth, Urbanization And Mobility

Before moving to the analysis of demand, we need to briefly note the overall requirement for new housing in the country. The requirement for new housing is driven by household growth in urban and rural locations. Some measure of new construction is also needed to gradually replace dilapidated structures. However, the main concern for the short-term is to house newly formed households and find ways to improve existing houses.

4.3.1 Urban and Rural Household Growth and the Requirement for Housing

How many households are formed in urban and rural areas for the next few years, and, therefore, how many new houses will need to be constructed to keep up with household growth?
Unfortunately, this is the most difficult time to produce precise figures on population or household growth. The new census 2000 data is not yet out and the projections based on the 1990 census and Susenas updates are increasingly imprecise. The discrepancy in figures is likely related to short-term population movements back to the rural areas as a result of the crisis. Approximately 4 million workers were added to the agricultural labor force in the aftermath of the crisis. However, for our purpose, the precise figures are less important than the major trends.

Susenas 1999, provides an urban population figure of 81 million households or 39.4 percent of total households. It estimates a national growth rate of 1.5 percent for the years 1990 to 1999. Susenas 2000, gives a much higher urban population figure of 42%. It shows a national growth rate of 1.19 percent for the years 1990 –2000; a negative growth rate for the rural areas (-0.58%) between 1990 and 2000 and an urban growth rate of 4.23 percent. However, Susenas 2000, did not include Aceh and Maluku. While final growth projections have to wait until the census data are analyzed, a total household growth rate of 1.9 percent will be assumed for the next few years, given that household size is declining. All household growth will be concentrated in urban areas and we assume an urban household increase of roughly 3.5 to 3.75 percent or 700,000 to 750,000 households per annum for the next few years. Housing programs for new house-construction should, therefore, focus on urban areas, while home-improvements would be an appropriate orientation for rural housing programs. We use both 1999 and 2000 Susenas estimates in table 2.1 below.

There is great variation between regions, and between rural and urban growth figures. Some parts of the country, like South and Central Sulawesi, East Nusa Tenggara and Lampung, are predominantly rural. The transmigration movements earlier in the decade have contributed to the high growth figures in some of these areas, however. So while more rural, the urban growth problems in some of these areas may be most severe. They will also be the least able to handle the provisions for urban growth. See Appendix 1 for detailed population growth figures.
Table 2.1  Population and Household Figures, 1999, 2000

<table>
<thead>
<tr>
<th></th>
<th>Urban</th>
<th>Rural</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total population, '999</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Total population</td>
<td>61.3 million</td>
<td>125.2 million</td>
</tr>
<tr>
<td>- Total # households</td>
<td>19.8 million</td>
<td>30.6 million</td>
</tr>
<tr>
<td>- Percentage of households</td>
<td>39.4%</td>
<td>60.6%</td>
</tr>
<tr>
<td>- Average household size</td>
<td>4.1</td>
<td>4.0</td>
</tr>
<tr>
<td><strong>DKI Jakarta, 2000 Susenas</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- # of DKI households</td>
<td>2.2 million</td>
<td></td>
</tr>
<tr>
<td>- % of urban population</td>
<td>11%</td>
<td></td>
</tr>
<tr>
<td>- 1990-2000 growth rate</td>
<td>0.14%</td>
<td></td>
</tr>
<tr>
<td><strong>Population growth</strong></td>
<td></td>
<td>Stagnant</td>
</tr>
<tr>
<td>- National population growth</td>
<td>1.93 % (1989 - 1990)</td>
<td>Stagnant</td>
</tr>
<tr>
<td></td>
<td>1.5 % (1990 - 1999)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1.2 % (1990 - 2000)</td>
<td></td>
</tr>
<tr>
<td>- Estimated urban growth rate</td>
<td>3.5% to 3.75%</td>
<td></td>
</tr>
<tr>
<td>2001-05 (prelim. estm. HOMI)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Approx. estimate of new annual household formation</strong></td>
<td>700,000 to 750,000 households</td>
<td>Stagnant</td>
</tr>
</tbody>
</table>

*Assuming a further decline in household size to 3.8

Greater Jakarta has been a major destination for permanent and circulatory migrants in the last three decades accounting for a quarter of inter-provincial in-migrants, even though it represents less than 5 percent of the total population. Growth of DKI Jakarta has, however, slowed to 0.14 percent during last decade (Susenas 2000). Interestingly, despite high urban growth rates, Indonesia is still predominantly agricultural. The next decade will likely see Indonesia reach the 50 percent urbanization point though.
### 4.3.2 Migration, Tenure and Mobility

This brief overview of demographic trends shows the overwhelming role migration plays in urban growth as opposed to natural growth. If natural growth is 1.2 and urban growth is estimated to be 3.5, migration to urban areas accounts for 2.3 percent of urban growth. Migrants have particular housing problems. Many will not have their families with them in the early years and will need to save money to maintain the rural household. Moreover, they may have a low preference for housing investment or home-ownership. They are more likely to be renters than owners.

The 10-city survey data showed that the majority of tenants (not all migrants), would like to continue renting and had no desire to become home-owners, even if they would like to move to a better or cheaper house. To remain mobile and move to where jobs are available is a high priority for recent migrants. Rental housing for that reason is critical for the functioning of the labor market at large. A rental strategy has to be part of any housing strategy, even if by simply encouraging private home-owners to build additional rooms for renting. The HOMI survey showed that this is already a common practice in low-income neighborhoods.

*Summarizing, household growth, estimated at 700,000 to 750,000 households per annum, will concentrate entirely in urban areas, and is mostly driven by migration. This has major implications for local governments, who have to develop housing strategies to deal with the influx of migrants as well as the growth of their own populations.*

### 4.4 Household Income Levels And Household Income Stability

Household income in relation to the cost or price of housing (including financing cost) is the single most important indicator for a housing demand analysis. Yet, reliable income data are notoriously difficult to obtain, since households have many different sources of income.
and do not readily provide income information. Income figures are particularly critical when utilized to outline new housing assistance programs. The income distribution has to be in accordance with macro-economic data, poverty figures and wage levels in the country.

4.4.1 Household Incomes and Income Distributions

Household income calculations were based on the 1999 Susenas consumption/expenditure figures from the Susenas special module, and were updated for inflation. We decided that Susenas’ household expenditure data would provide a better indicator of household income than the Susenas income data, because of problems with income reporting. Moreover, the 2000 general Susenas consumption data, although they are more recent, proved unreliable since they were based on a limited basket of goods to assess consumption and because of survey problems.

Once we calculated the income distribution deciles for 1999, we corrected the figures for inflation. Not all consumption items increased equally in price since 1999. Rice, the staple food and largest consumption item for low-income households, decreased in price. We, therefore, applied a lower inflation rate to below median household consumption figures and a higher inflation rate to above median consumption figures in order to compensate for the differential increase in prices of consumption baskets for low and high income households (See Appendix for the work-out sheets).

In Indonesia, incomes differ greatly per region and even more so by type of settlement, urban and rural. The frequent movement back and forth between urban and rural areas may make these differences less absolute than they appear. Nevertheless, we cannot use national income figures for our analysis and we have broken down the household expenditure data for urban and rural areas. We further separated DKI Jakarta from the rest of the urban areas, since DKI Jakarta’s household incomes/expenditures are considerably higher. The four “income” distributions are shown in Tables 3.1.1 and 3.1.2.
### Table 3.1.1 Household Income Distribution Based on Consumption Data, BPS Susenas, 1999

<table>
<thead>
<tr>
<th>Percentiles</th>
<th>Rural Household</th>
<th>Urban Household</th>
<th>DKI Jakarta Household</th>
<th>Urban W/o DKI Household</th>
</tr>
</thead>
<tbody>
<tr>
<td>10th percentiles</td>
<td>238,000</td>
<td>355,600</td>
<td>661,900</td>
<td>343,800</td>
</tr>
<tr>
<td>20th percentiles</td>
<td>315,100</td>
<td>474,500</td>
<td>846,700</td>
<td>452,000</td>
</tr>
<tr>
<td>30th percentiles</td>
<td>372,300</td>
<td>577,600</td>
<td>1,037,800</td>
<td>551,000</td>
</tr>
<tr>
<td>40th percentiles</td>
<td>426,600</td>
<td>680,000</td>
<td>1,238,800</td>
<td>644,800</td>
</tr>
<tr>
<td>50th percentiles</td>
<td>486,800</td>
<td>797,200</td>
<td>1,439,900</td>
<td>749,400</td>
</tr>
<tr>
<td>60th percentiles</td>
<td>556,300</td>
<td>952,500</td>
<td>1,711,300</td>
<td>870,300</td>
</tr>
<tr>
<td>70th percentiles</td>
<td>640,100</td>
<td>1,183,500</td>
<td>2,022,000</td>
<td>1,071,100</td>
</tr>
<tr>
<td>80th percentiles</td>
<td>757,800</td>
<td>1,447,500</td>
<td>2,500,000</td>
<td>1,345,700</td>
</tr>
<tr>
<td>90th percentiles</td>
<td>972,200</td>
<td>2,169,700</td>
<td>3,187,900</td>
<td>2,326,912</td>
</tr>
</tbody>
</table>

### Table 3.1.1 Household Income Distribution Based on Consumption Data, BPS Susenas 1999, adjusted to October 2001

<table>
<thead>
<tr>
<th>Percentiles</th>
<th>Rural Household</th>
<th>Urban Household</th>
<th>DKI Jakarta Household</th>
<th>Urban W/o DKI Household</th>
</tr>
</thead>
<tbody>
<tr>
<td>10th percentiles</td>
<td>231,800</td>
<td>391,160</td>
<td>728,090</td>
<td>378,180</td>
</tr>
<tr>
<td>20th percentiles</td>
<td>356,063</td>
<td>536,185</td>
<td>956,771</td>
<td>510,760</td>
</tr>
<tr>
<td>30th percentiles</td>
<td>428,145</td>
<td>654,240</td>
<td>1,193,470</td>
<td>633,650</td>
</tr>
<tr>
<td>40th percentiles</td>
<td>499,122</td>
<td>795,600</td>
<td>1,449,396</td>
<td>754,416</td>
</tr>
<tr>
<td>50th percentiles</td>
<td>579,292</td>
<td>948,668</td>
<td>1,713,481</td>
<td>891,788</td>
</tr>
<tr>
<td>60th percentiles</td>
<td>673,123</td>
<td>1,152,525</td>
<td>2,070,673</td>
<td>1,063,953</td>
</tr>
<tr>
<td>70th percentiles</td>
<td>787,323</td>
<td>1,455,828</td>
<td>2,487,060</td>
<td>1,317,453</td>
</tr>
<tr>
<td>80th percentiles</td>
<td>947,250</td>
<td>1,809,375</td>
<td>3,125,000</td>
<td>1,682,125</td>
</tr>
<tr>
<td>90th percentiles</td>
<td>1,244,416</td>
<td>2,777,216</td>
<td>3,326,912</td>
<td>2,326,912</td>
</tr>
</tbody>
</table>
The median incomes (50th percentile) for urban areas with and without DKI Jakarta are Rp.950,000 and Rp.892,000, respectively. The median income in rural areas is Rp.579,300. Interestingly, household incomes have shown far less volatility during the crisis period than individual wage incomes and overall GDP. We come back to this point below.

4.4.2 Other Income Indicators

How do these expenditure data compare to other income indicators? In other words, are we comfortable to use these figures as proxies for household incomes?

Poverty rate: In the two decades leading up to 1996, poverty levels dropped from 60 percent to less than 12 percent in 1996. Many households, however, were just above the poverty line. When the crisis hit and the per capita GNP dropped to US$580 (compared to nearly US$1100 in 1997), the poverty rate (as measured by per capita expenditures) increased dramatically, reaching a peak of 27 percent in late 1998. Since that time, poverty rates have dropped because of increasing real wages, gradually improving employment and the sharp decline in food prices, in particular rice (World Bank, February 2001). Coping strategies of households had much to do with this rather quick normalization as well. In 2000 the poverty rate had come down to 1996 levels of 15 to 16 percent; 20.7% in rural areas and 7.3% in urban areas (World Bank 2000).7

Table 3.2 Poverty Levels

<table>
<thead>
<tr>
<th></th>
<th>1996</th>
<th>1999</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>15.7%</td>
<td>27.1%</td>
<td>15.2%</td>
</tr>
</tbody>
</table>

Another indicator of poverty is the percentage of households living on less than $2 per day (or Rp.625,000 per month at current exchange rates). This figure was 50.5% in 1996; 65.1% in 1999, and 57.9% in 2000 and comprises both urban and rural areas. With the median incomes for rural and urban areas estimated in 1999 at Rp. 486,800 and Rp.750,000 respectively, these data are in accordance with the expenditure profiles we calculated above.

Poverty is unevenly distributed. Most of the poor live in rural areas. Close to two-third of the poor live on Java. Susenas data show that the poorest areas include part of Irian Jaya, East Nusa Tenggara, Maluku, and West Nusa Tenggara. Also Southeast Sulawesi,
East Java, Lampung, West Kalimantan and Central Java. Housing assistance programs may take this poverty profile into consideration.

**GNP per capita**: Another very rough measure of income/consumption levels is the private consumption component of GDP or GNP. In 1999, GNP per capita was $600. Household consumption comprises 65 to 70 percent of GNP. Converting this figure to a monthly median household income shows figures roughly between Rp.700,000 and 800,000.8

**Minimum wages**: Minimum wages vary widely by region. Jabotabek and Riau have the highest minimum wage of around Rp.420,000 per month. When the DKI Jakarta Governor recently made a proposal to increase the figure to close to Rp.600,000, employers staged a major protest and the decision has been shelved for the moment. Most other regions have set the minimum wage around Rp.250,000. These are, of course, individual wage figures that cannot be compared to household incomes. A rough estimate of the number of working persons per household is 1.74.9

**Other wages**. We further explored other wage level figures, both for the public and private sector. All real wages collapsed as a result of the crisis by an average of 40 percent, back to 1986 levels. For example, urban hourly wages for male workers dropped from Rp.1578 in 1997 to Rp.1104 in 1998 (BPS, Sakarnas, 1999). This shock was felt across the wage distribution, although lower wage earners were hit harder than higher wage earners. Since then, wages have gradually normalized. In 1999, average wages for industrial workers were still only Rp.320,000 per month. However, it is deceptive to only consider market wages. Studies other than Sakernas showed that payments in the self-employment sector did not change at all as a result of the crisis (IFLS panel data 1998).

**Civil servant wages**. We looked at relative wage levels of civil servants and private sector employees. Civil servants in civilian government are 2 percent of the population and roughly 4 percent of the labor force. The perception exists that civil servants are underpaid and, therefore, need a relative larger share of housing subsidies and other provisions. However, public servant salaries went up recently through several large pay-increases. A recent World Bank study showed that there is no longer a major differential between public and private remunerations, including salaries and additional income (World Bank, 2000).
In summary, it appears that the household income distributions we prepared from the 1999 Susenas data is in line with other income indicators of poverty, market wages and minimum wages. The interpretation of individual wage figures has to take into account the fairly high labor force participation rates, which are an indication that most households have more than one income earner.

4.4.3 Employment Patterns and Household Income Stability

In addition to income levels, the stability of income is a critical factor in determining demand for housing, particularly in relation to the decision to own or rent a house. Furthermore, income stability is a requirement for most mortgage borrowing. Households with unstable incomes are more prone to be renters. Income stability is both influenced by the type of employment and the chances of losing one’s job. Self-employed and agricultural workers often have a less stable income stream than employed people. However, the crisis has made everyone aware that employed people in formal sector employment can be more at risk of losing their jobs than the self-employed.

Employment trends: With the growth of industry and the service sector, the relative importance of agriculture declined (from 55 percent in 1986 to 41 percent by 1997). Over the same years, industrial employment more than doubled from 8 percent to 19 percent. Not surprisingly, employment in the formal wage sector expanded, rising from a quarter to a third of all jobs during that period. The quality of the labor force improved as well, because of education, health improvements etcetera. Consequently real wages have risen over the last three decades and in particular during the boom years of the pre-crisis period.

The crisis played havoc with the increased confidence and optimism. From September 1997 to September 1998 real wages in the formal sector dropped sharply and came down to 1986 levels. However, real individual wage trends cannot be equated with trends in household income as measured by consumption data. And interestingly, household consumption figures remained relatively stable and the negative differential between household consumption and manufacturing wages grew dramatically. Households have been more resilient than expected in coping with the crisis. What happened?

Shift to non-formal employment. A detailed analysis of labor market trends shows that the main impact of the crisis was a shift of male employment out of the wage sector and into
self-employment, a trend that had already begun before the crisis. In addition, women took on additional work. Across sectors, male employment during the crisis dropped by 3.5 percent in the wage sector, while increasing in self-employed and family jobs. Furthermore, the agricultural sector, absorbed many urban workers (4 million additional workers were recorded in agriculture occupations during this period; Smith et. al., 2000). In 1999 close to half of the urban labor force was self-employed or family worker. In other words, the highly flexible labor market in Indonesia was able to absorb some of the worst consequences of the crisis. This softening of the shock was further aided by the household economy.

Table 3.3 Composition of Employed Persons by Work Status, 1997 – 1999

<table>
<thead>
<tr>
<th>Work Status</th>
<th>Urban</th>
<th>Rural</th>
<th>Urban + Rural</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self Employed</td>
<td>23.1</td>
<td>24.5</td>
<td>25.1</td>
</tr>
<tr>
<td>Self Employed Assisted by Temporary Worker</td>
<td>11.6</td>
<td>12.1</td>
<td>11.6</td>
</tr>
<tr>
<td>Employer</td>
<td>2.3</td>
<td>2.4</td>
<td>3.2</td>
</tr>
<tr>
<td>Employee</td>
<td>54.9</td>
<td>51.9</td>
<td>50.8</td>
</tr>
<tr>
<td>Family Worker</td>
<td>8.1</td>
<td>9.0</td>
<td>9.2</td>
</tr>
</tbody>
</table>


Unemployment. *Given the above analysis, unemployment figures must be considered quite deceptive. The 2000 rate of 6.4 percent is almost certainly incorrect, since it does not account for the shift to informal employment. Few workers can afford to be unemployed, since no social provisions exist for unemployment and individual pension accounts are extremely small. Pension savings amounts could not sustain an individual or household for a long period.*
Table 3.4 Labor Force Participation Rate and Open Unemployment Rate 1997 – 1999

<table>
<thead>
<tr>
<th>Area</th>
<th>Labor Force Participation Rate</th>
<th>Open Unemployment Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban</td>
<td>59.8</td>
<td>59.6</td>
</tr>
<tr>
<td>Rural</td>
<td>70.6</td>
<td>71.9</td>
</tr>
<tr>
<td>Urban+ Rural</td>
<td>66.3</td>
<td>66.9</td>
</tr>
</tbody>
</table>


Labor absorption into the formal sector. How quickly will the returning labor force from the agricultural and self-employed sectors be reabsorbed into the formal and fixed-income sectors? This will depend on economic growth rates. Labor force growth was only 2.7 percent in 2000 (roughly 2.5 million people). This is insufficient to absorb the returning labor force and new entrants at the prevailing wage (World Bank, 2000). Current economic growth projections are even more insecure. Experts believe that the economy needs to grow by 7 percent per annum to absorb labor force growth. The economy grew by 4.8 percent last year and is expected to grow by only 3.5 percent this year. We can assume that the self-employed sector will remain relatively large for the near future.

In summary, the critical impact of the crisis is in the decrease of real wages and not in aggregate employment. Wage cuts have been greater in the urban sector and are concentrated at the bottom of the wage distribution. Households have coped by having household members move to informal employment and by extending female labor force participation. As a result, the decline in household incomes is about half the magnitude of the decline in individual earnings. A consequence of the crisis is an even higher percentage of self-employed and family workers, which will only gradually be absorbed by the labor market.
What are the consequences for a housing strategy? The large proportion of informal workers will make borrowing for housing through conventional KPR loans even more difficult. Also, an increased sense of insecurity of income may have a negative effect on the interest of households to borrow for housing and may influence tenure choice. At the same time, the high labor force participation will negatively affect possible direct self-help involvement by household members.

4.5 House Prices, Housing Expenditures And Incomes

How do the income distribution figures relate to moderate and low income house-prices in urban areas? And what house prices should we compare to which income levels to understand housing affordability? How much are people now paying for housing in absolute terms and relative to total consumption?

4.5.1 House prices

Several separate housing markets can be distinguished in urban Indonesia:
- **Authorized market** in which developments comply to the planning and building laws,
- **Non-complying market** in which developments do not comply to subdivision, planning, or infrastructure requirements (either from the time of the original establishment of the area or as a result of later developments), but owners can receive titles,
- **Squatter areas**, that are illegal and would require special upgrading programs for property rights to be legalized.
- **Rental areas**, mostly owned or managed by local and central government.

House-prices in these distinct housing sub-markets, are guided by different factors and cannot be compared directly.

Although no detailed research has been done since 1988 on the relative scale of each sub-market, the non-complying market is considered by far the largest, because of the weak regulatory and enforcement systems. The large size of the non-complying market, while not desirable, adds flexibility to the housing market as we will discuss below.
No house price/sales data are collected on a regular and comprehensive basis in Indonesia. The real estate industry only collects data on the top end of the market. Obtaining meaningful new house-prices for the non-complying and illegal sector is of course extremely difficult. Moreover, “second-hand” markets for low and moderate-income housing are not well developed and therefore market prices are not well established. Mobility amongst home-owners is low and when owners move, they often keep the house and rent it out. Real house prices are, therefore, not easily assessed.

4.5.1.1 Price and value estimates of existing low and moderate income houses

The 10-city survey conducted for the HOMI project researched housing characteristics in five distinct types of low- and moderate income housing areas:

- Kampung areas that had been included in the former KIP improvement programs
- Community-based Housing Programs
- Non-improved slum areas
- RSS/RS areas
- Rental areas.

Factors that may influence the price of housing include housing characteristics, such as size and building materials, sanitation and water access and quality, access to electricity, neighborhood infrastructure and location in relation to access to work and transport.

The predominant building materials used varied by type of area. In CBH, KIP and RS/RSS areas, most houses were built of brick and baked brick. In unimproved slum areas wood was most prevalent. Not surprisingly, houses in these areas that were occupied by renters were of a poorer quality than owner-occupied houses.
The location of the different low-income areas varied, but the great majority of neighborhoods were well beyond even the outskirts of the cities. Affordable land that is accessible to transport and other infrastructure facilities is difficult to acquire, and low-cost housing, authorized or illegal, has been built increasing farther away from urban areas. Unauthorized areas are often built on the side of cities where employment opportunities are available. Therefore, the average travel time to the work-place for most households was not more than 40 minutes. The RSS/RS neighborhoods and unimproved slum areas had the worst location record, with more than 30 percent of household heads having to travel more than 40 minutes (and often more than 60 minutes). See table 4.2

### Table 4.1 Household and Housing Characteristics Low Moderate Income Urban Neighborhoods

<table>
<thead>
<tr>
<th>Housing Characteristics</th>
<th>CB HP N = 147</th>
<th>KIP N = 242</th>
<th>Unimproved Slum Areas N = 310</th>
<th>RS / RSS N = 371</th>
<th>Rental N = 148</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Mean # rooms (mean)</td>
<td>3.75</td>
<td>4.15</td>
<td>2.99</td>
<td>3.13</td>
<td>2.43</td>
</tr>
<tr>
<td>2. Age of house (mean)</td>
<td>8.7 years</td>
<td>17 years</td>
<td>16.5 years</td>
<td>7.8 years</td>
<td>10.8 years</td>
</tr>
<tr>
<td>3. Plot size sq. m (mean)</td>
<td>236 m²</td>
<td>177 m²</td>
<td>108 m²</td>
<td>103 m²</td>
<td>75 m²</td>
</tr>
<tr>
<td>4. House size m² (mean)</td>
<td>98 m²</td>
<td>96 m²</td>
<td>67 m²</td>
<td>49 m²</td>
<td>63 m²</td>
</tr>
<tr>
<td>5. Proportion Owner Household</td>
<td>93 %</td>
<td>75 %</td>
<td>72 %</td>
<td>74 %</td>
<td>32 %</td>
</tr>
<tr>
<td>Owners Only</td>
<td>N = 135</td>
<td>N = 196</td>
<td>N = 375</td>
<td>N = 273</td>
<td>N = 56</td>
</tr>
<tr>
<td>5. Median house-price</td>
<td>18 mill</td>
<td>14 mill</td>
<td>13.5 mill</td>
<td>17 mill</td>
<td>22 mill</td>
</tr>
<tr>
<td>Renters Only</td>
<td>N = 10</td>
<td>N = 69</td>
<td>N = 158</td>
<td>N = 100</td>
<td>N = 124</td>
</tr>
<tr>
<td>11. Median Rent mean rent</td>
<td>Rp. 38.750</td>
<td>Rp. 50.000</td>
<td>Rp. 50.000</td>
<td>Rp. 36.000</td>
<td>Rp. 75.000</td>
</tr>
<tr>
<td>12. Mean Housing Expenditures</td>
<td>Rp. 95.500</td>
<td>Rp. 179.760</td>
<td>Rp. 151.100</td>
<td>Rp. 342.700</td>
<td>Rp. 187.400</td>
</tr>
</tbody>
</table>

Source: 10 cities HOMI Survey, 2001

The location of the different low-income areas varied, but the great majority of neighborhoods were well beyond even the outskirts of the cities. Affordable land that is accessible to transport and other infrastructure facilities is difficult to acquire, and low-cost housing, authorized or illegal, has been built increasing farther away from urban areas. Unauthorized areas are often built on the side of cities where employment opportunities are available. Therefore, the average travel time to the work-place for most households was not more than 40 minutes. The RSS/RS neighborhoods and unimproved slum areas had the worst location record, with more than 30 percent of household heads having to travel more than 40 minutes (and often more than 60 minutes). See table 4.2
Table 4.2 provides some indicators of level of services and location by neighborhood as well. There is a marked difference between the different neighborhoods in access to piped water. The unimproved (and mostly illegal) neighborhoods mostly have no access to piped water and depend on public wells or vendors for their drinking water. In the authorized areas, compliant and non-compliant, the majority of households have access to piped water, or a private well. Sanitation is provided mostly through traditional latrines in all areas, although a considerable proportion of households in illegal slum areas do not have access to any toilet.

**Table 4.2  Services and Location, Low/Moderate Income Neighborhoods**

<table>
<thead>
<tr>
<th>Housing Characteristics</th>
<th>CBHP (%) N = 147</th>
<th>KIP (%) N = 242</th>
<th>Unimproved Slum Areas (%) N = 510</th>
<th>RS / RSS (%) N = 371</th>
<th>Rental (%) N = 148</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Water Source Dry Season</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- PAM</td>
<td>45</td>
<td>49</td>
<td>20</td>
<td>71</td>
<td>66</td>
</tr>
<tr>
<td>- Private Well</td>
<td>28</td>
<td>21</td>
<td>7</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>- Public Well</td>
<td>11</td>
<td>8</td>
<td>13</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>- Water Vendor</td>
<td>3</td>
<td>7</td>
<td>18</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>- Spring</td>
<td>8</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>4</td>
</tr>
<tr>
<td>- Rainwater</td>
<td>1</td>
<td>7</td>
<td>11</td>
<td>8</td>
<td>20</td>
</tr>
<tr>
<td>2. Type of Toilet</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Flush Toilet</td>
<td>3</td>
<td>14</td>
<td>2</td>
<td>5</td>
<td>16</td>
</tr>
<tr>
<td>- Traditional Latrine</td>
<td>80</td>
<td>79</td>
<td>66</td>
<td>91</td>
<td>82</td>
</tr>
<tr>
<td>- Ventilated Pit</td>
<td>17</td>
<td>4</td>
<td>18</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>- No Toilet</td>
<td>-</td>
<td>2</td>
<td>12</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>- Others</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>3. Time to Workplace</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- &lt; 20 Min</td>
<td>63</td>
<td>53</td>
<td>49</td>
<td>37</td>
<td>50</td>
</tr>
<tr>
<td>- 20 - 40 Min</td>
<td>24</td>
<td>32</td>
<td>21</td>
<td>32</td>
<td>26</td>
</tr>
<tr>
<td>- 40 - 60 Min</td>
<td>9</td>
<td>6</td>
<td>6</td>
<td>19</td>
<td>14</td>
</tr>
<tr>
<td>- &gt; 60 Min</td>
<td>4</td>
<td>9</td>
<td>24</td>
<td>12</td>
<td>10</td>
</tr>
</tbody>
</table>

Source: 10 Cities HOMI Survey, 2000
Table 4.3 shows how most of the houses in each neighborhood were acquired and the type of land title and owner-certification home-owners have. Only the RS/RSS neighborhoods were developer-built and, of course, the rental areas. In the other neighborhoods the majority of households built their own house (70 percent in slum areas, 64 percent in KIP and 53 percent in in CBHP) or built jointly with community members (CBHP; 22 percent).

A fairly high number of households have Hak Milik title, e.g., 51 percent in KIP, 39 percent in CBHP, and, of course, households in RS/RSS areas will receive title only when the loan is repaid. The flip side is that, in CBHP and slum areas, more than half of the households do not have a title or certification.

Table 4.3  House Acquisition and Property Title Low/Moderate Income Urban Neighborhoods

<table>
<thead>
<tr>
<th>Housing Characteristics</th>
<th>CBHP N = 135</th>
<th>KIP N = 196</th>
<th>Unimproved Slum Areas N = 375</th>
<th>RS / RSS N = 273</th>
<th>Rental N = 56</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Way the house was acquired</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Developer</td>
<td>17 %</td>
<td>4 %</td>
<td>1 %</td>
<td>82 %</td>
<td>77 %</td>
</tr>
<tr>
<td>- Self-build</td>
<td>53 %</td>
<td>64 %</td>
<td>70 %</td>
<td>3 %</td>
<td>12 %</td>
</tr>
<tr>
<td>- Inherited</td>
<td>8 %</td>
<td>19 %</td>
<td>23 %</td>
<td>1 %</td>
<td>2 %</td>
</tr>
<tr>
<td>- Employer</td>
<td>-</td>
<td>5 %</td>
<td>-</td>
<td>1 %</td>
<td>-</td>
</tr>
<tr>
<td>- Other</td>
<td>22 %</td>
<td>8 %</td>
<td>6 %</td>
<td>13 %</td>
<td>9 %</td>
</tr>
<tr>
<td>2. Land title</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- No title</td>
<td>47 %</td>
<td>25 %</td>
<td>38 %</td>
<td>-</td>
<td>18 %</td>
</tr>
<tr>
<td>- SH milik</td>
<td>39 %</td>
<td>51 %</td>
<td>24 %</td>
<td>19 %*</td>
<td>7 %</td>
</tr>
<tr>
<td>- HGB</td>
<td>-</td>
<td>5 %</td>
<td>1 %</td>
<td>7 %</td>
<td>9 %</td>
</tr>
<tr>
<td>- Hak Pakai</td>
<td>4 %</td>
<td>2 %</td>
<td>23 %</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>- Girik</td>
<td>1 %</td>
<td>12 %</td>
<td>7 %</td>
<td>1 %</td>
<td>4 %</td>
</tr>
<tr>
<td>- Receipt</td>
<td>1 %</td>
<td>3 %</td>
<td>1 %</td>
<td>4 %</td>
<td>-</td>
</tr>
<tr>
<td>- In process</td>
<td>8 %</td>
<td>2 %</td>
<td>6 %</td>
<td>69 %</td>
<td>67 %</td>
</tr>
<tr>
<td>3. Ownership certification</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- None</td>
<td>9%</td>
<td>26 %</td>
<td>8 %</td>
<td>7 %</td>
<td>2 %</td>
</tr>
<tr>
<td>- IMB</td>
<td>-</td>
<td>7 %</td>
<td>2 %</td>
<td>3 %</td>
<td>7 %</td>
</tr>
<tr>
<td>- Apartment certificate</td>
<td>34%</td>
<td>17 %</td>
<td>30 %</td>
<td>46 %</td>
<td>59 %</td>
</tr>
<tr>
<td>- Purchase Receipt</td>
<td>1 %</td>
<td>8 %</td>
<td>9 %</td>
<td>13 %</td>
<td>2 %</td>
</tr>
<tr>
<td>- Others</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: 10 Cities HOMI Survey, 2001*
* Hak Milik titles are retained by the bank until the loan is repayed

Home-owners in different low-income housing areas were asked what the sales price of their house would be if they would put it on the market now. While figures differed by city, there was some congruence between neighborhoods. Table 4.1 shows a compilation of house-prices and rental payments across the ten cities by neighborhood types. Interestingly, median house-prices for the predominantly low-income neighborhoods such as CBHP, unimproved slum areas, RS/RSS areas and rental areas, converged around Rp.18 to 20 million. KIP areas, which are in general better located and are mostly mixed income neighborhoods, had a median house-price of Rp.44 million. Focus groups with KIP residents in four cities revealed that KIP residents believed that house-prices in their area had increased after KIP project implementation.

Interestingly, rental payments in KIP areas were similar to the other neighborhoods. This may reflect the fact that renters occupy the less desirable houses or room rentals in KIP areas.

We have not yet conducted a detailed demand analysis on housing attributes in relation to house-prices, but a cursory overview would suggest that house-prices appear to be driven mostly by the quality of the location, title, lot-size, and infrastructure. Age, size and other house characteristics appear less relevant. The data emphasize the importance of neighborhood characteristics. The main supply constraint appears to be access to land with basic infrastructure services.

4.5.1.2 Cost estimates for new moderate and low-income housing

New house prices for the moderate income formal housing sector are dominated by the government KPR subsidy system which develops cost estimates for some twenty well defined house-types. The prices are set irrespective of location and the availability of infrastructure and are, therefore, of limited use to understand real market values of houses. Developers appear, however, to deliver housing of the specified price, and lenders make loans based on these prices. Needless to say that this has caused problems in case these loans have to be foreclosed upon and the real market value of the properties appears less than the outstanding loan balance.

Table 4.4 provides recent estimates by Perumnas for the most basic house in the KPR subsidy system. It shows that a 21 m² house on a 60 m² lot costs Rp.13 to 19 million.
mention is made, however, of taxes and permit costs, which can be considerable and can add 35 percent to a low-cost house. Appendix 3 shows other allowable total house-prices under the KPR subsidy program, ranging from Rp.10 for a simple 21m2 house to 50 million for a 36m2 house in a more expensive region such as DKI Jakarta.

Discussions with developers and other professionals revealed that the lower-end units are impossible to construct for the given cost estimates. Both land price estimates and construction estimates are unrealistic in the current market place. Only the Rp.19 million unit could be constructed by developers for that price in most urban areas outside of Jakarta and only if cheap land was used. The low-cost housing developers only produce these units on land they already own, but they could never afford to build them on newly acquired land (Apersi interview). And, of course, these units could not be built in areas were land is expensive, like in Jakarta.

More realistic land price estimates for low-cost development converge around Rp.80,000 to 100,000m2. The estimate for simple construction cost is around Rp.800,000m2. A 60m2 plot with a 21m2 house without infrastructure and additional permit and legal fees would cost Rp.20.5 million based on these figures.
Table 4.4. Construction Cost (RSS 21/60, 2001)

<table>
<thead>
<tr>
<th></th>
<th>Activities</th>
<th>Bandung/ Sukabumi</th>
<th>Tangerang</th>
<th>Mataram</th>
<th>Banjarbaru</th>
<th>Solo</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Land price/60 m²</td>
<td>Rp. 1,816,000</td>
<td>Rp. 3,416,000</td>
<td>Rp. 1,361,000</td>
<td>Rp. 1,098,000</td>
<td>Rp. 2,145,000</td>
</tr>
<tr>
<td></td>
<td>Land price/m²</td>
<td>Rp. 30,300</td>
<td>Rp. 56,933</td>
<td>Rp. 22,683</td>
<td>Rp. 18,300</td>
<td>Rp. 36,750</td>
</tr>
<tr>
<td></td>
<td>% total construction</td>
<td>14.3%</td>
<td>17.9%</td>
<td>10.7%</td>
<td>7.7%</td>
<td>13.88%</td>
</tr>
<tr>
<td>2</td>
<td>Legal Process</td>
<td>180</td>
<td>240</td>
<td>141</td>
<td>242</td>
<td>235</td>
</tr>
<tr>
<td></td>
<td>% total construction</td>
<td>1.4%</td>
<td>1.3%</td>
<td>1.1%</td>
<td>1.7%</td>
<td>1.5%</td>
</tr>
<tr>
<td>3</td>
<td>Infrastructure</td>
<td>1,074</td>
<td>2,530</td>
<td>295</td>
<td>493</td>
<td>70</td>
</tr>
<tr>
<td></td>
<td>% total construction</td>
<td>8.5%</td>
<td>13.3%</td>
<td>2.3%</td>
<td>3.5%</td>
<td>0.4%</td>
</tr>
<tr>
<td>4</td>
<td>Building construction/21 m²</td>
<td>Rp. 9,603,000</td>
<td>Rp. 12,888,000</td>
<td>Rp. 10,911,000</td>
<td>Rp. 12,445,000</td>
<td>Rp. 13,098,000</td>
</tr>
<tr>
<td></td>
<td>Building construction/m²</td>
<td>Rp. 475,300</td>
<td>Rp. 613,700</td>
<td>Rp. 519,600</td>
<td>Rp. 562,500</td>
<td>Rp. 633,700</td>
</tr>
<tr>
<td></td>
<td>% total construction</td>
<td>75.8%</td>
<td>67.5%</td>
<td>85.9%</td>
<td>87.2%</td>
<td>84.2%</td>
</tr>
<tr>
<td></td>
<td>TOTAL</td>
<td>Rp. 12,673,000</td>
<td>Rp. 19,074,000</td>
<td>Rp. 19,740,000</td>
<td>Rp. 14,278,000</td>
<td>Rp. 15,547,000</td>
</tr>
</tbody>
</table>

Source: Regional Annual Business Plan, Regional Office, 2001
Infrastructure includes: bridges & road, drainage, clean water, electricity, open space, and public facilities.
We asked the Bandung Institute for Research and Development for Human Settlement, to prepare cost estimates for new core houses for different regions, using local building materials. Different options are calculated ranging from Rp.6.9 to 9 million, excluding land. The core units are basic expandable units of 21m2, using brick, wood and bamboo. If we include land costs of Rp.4.8 to 6.0 million, a core unit on a 60m2 plot, could be built for Rp.13 to 15 million when very simple materials and building construction methods are used, and depending on location.

Price estimates of serviced lots. Prices of serviced sites, which were part of the KPR subsidy program in the past, range from Rp.3 to 4 million. Again, our inquiry shows this to be a very low estimate. More realistic prices for a land plot in an area with some basic access to infrastructure are Rp.5 to 6 million.

We can summarize these anecdotal pieces of housing costs information as follows:

- The lowest cost “housing” solution is a plot with a core house without infrastructure for Rp.13 to 15 million, depending on location.
- A simple 20m2 house, built by contractors, in a “non-complying” neighborhood would cost approximately Rp.20 million.
- Developer produced moderate income housing could only be produced for prices above Rp.20 million, and more realistically above Rp.25 million.
- We will show below that a self constructed core house is preferred by low-income households over the turn-key RS/RSS houses.

4.5.2 Income-to-house-price ratios.

We can now calculate the relationship between incomes and house-prices for urban low and moderate income. It appears that both home-ownership and rental housing would be highly affordable in Indonesia. A low-income house can be produced in the compliant housing market for Rp.25 million. A household earning Rp.550,000 per month or Rp.6.7 million per year (the 25th percentile of the income distribution for urban areas outside of Jakarta), has to spend 3.5 times their annual income to afford a Rp.25 million house. Equally, an urban household at the median income level only has to spend 3 times its annual income in order to pay for a Rp.32 million house. Similarly, rents of Rp.100,000 can
easily be afforded by the 20th percentile of the urban income distribution. Even for households below the 10th percentile rental options are available in CBHP and unimproved slum areas.

These income-to-house-price ratios show that the housing markets, both compliant and non-compliant, are flexible and have adjusted to the income levels in the country. In fact, the ratio is similar to the highly efficient Thailand housing market, and, although less relevant because of higher incomes, the ratio is similar to that in the efficient US market. There is one major caveat in that comparison, however. The cost of finance in Thailand is a small fraction of what it is in Indonesia. If we add the cost of financing to the Indonesian house-prices, the affordability picture changes drastically. In other words, it is the financing cost that make housing unaffordable in Indonesia. We return to that point below.

It appears, therefore, that the perceived housing problem in Indonesia does not lie in the cost of materials and house production and land costs per se (exclusive of some extremely expensive land markets). Standards of both housing and infrastructure are flexible and performance based and should not be lowered. The main affordability problem relates to the high cost of finance.

4.5.3 Housing Expenditures

The next issue to understand in relation to housing demand is how much households are actually willing to pay for housing and whether housing expenditures are related and elastic with income. In other words, how strong is the correlation between household incomes and housing expenditures? The most reliable way to answer these questions is to look at the current and historical spending patterns for housing. Households may be interested to pay more for a new house than they now pay, or, they may want to pay more for home-ownership than for renting. It has proven difficult, however, to collect reliable data on future willingness to pay for alternative housing options. We focus here on current and past housing expenditure patterns.

4.5.3.1 Housing expenditures for owners and renters, and urban and rural areas

Generally, home-owners are willing to pay a “premium” for home-ownership. As a home-owner one feels secure and is not dependent on the whims of landlords to set restrictions on the use of the house. Owners will not be hit by unexpected increases in rent (rent-risk).
In poor countries with large informal housing markets, home-ownership can be a cheaper solution than renting. But how can we reliably measure spending for housing?

For renters we simply calculate rental payments and payments for utilities. For owners, the picture is more complicated. We can only directly assess utility and tax payments and for those owners who have housing loans, we can include the monthly payments on those loans. However, not all owners have loan payments connected to their house, and others have repaid their loan. In order to find a more homogeneous measure for ownership costs, imputed rent is often used, — i.e., the rental value of the house or that part of the house which the owner households occupies.

The 10-city survey (Table 4.1) shows that owners in low- and moderate income housing areas have considerably higher housing related expenditures than tenants. No imputed rent was used, however, and the figures in the table show only direct payments for utilities, taxes, maintenance and loan payments.

- **Mean owner payments** for housing range from Rp.175,000 in CBHP to Rp.360,000 in RS/RSS areas. The higher RS/RSS area payments show the higher proportion of households with mortgage loans and related monthly payments. In slum areas and CBHP areas, housing is more often financed through savings.

- **Mean rental payments** (including utilities) in low-income areas range from Rp.100,000 in CBHP to Rp.200,000 in RS/RSS neighborhoods.

Although these figures show the actual payments made by households for housing, one has to be cautious using them in a comparative way as a measure of actual housing consumption.

Susenas uses imputed rent to establish a more homogenous measure of housing consumption. This allows for a more direct comparison of actual housing consumption among tenure groups and rural and urban households, by estimating the cost of actual housing consumption. Interestingly, the two types of data show similar levels of expenditure/consumption; around Rp.100,000 for tenants and Rp.140,000 for owners in urban areas. Rural households, whether owner or renter, pay on average less than Rp.50,000 per month. See Table 4.5.
4.5.3.2 Income and Housing Expenditures

We now turn to the question of the relationship between income and housing expenditures. We correlated housing expenditure figures with total household expenditures for the year 2000 (Susenas, 2000, consumption data). We disaggregated the data for urban and rural areas. Table 4.6 shows that home-owners in urban areas consume more housing relative to “income” than renters; 20 percent of household expenditures for owners and 16 percent for renters.

Tabel 4.5. Housing Expenditures by Tenure and Urban/Rural 2000

<table>
<thead>
<tr>
<th>Tenure</th>
<th>Rural household's Average Monthly PMT</th>
<th>Rural household's % of Average HH Expenditures</th>
<th>Urban household's Average Monthly PMT</th>
<th>Urban Household's % of Average HH Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner</td>
<td>Rp.46,100</td>
<td>11%</td>
<td>Rp.137,300</td>
<td>20%</td>
</tr>
<tr>
<td>Lease</td>
<td>Rp.60,400</td>
<td>12%</td>
<td>Rp.124,900</td>
<td>19%</td>
</tr>
<tr>
<td>Rent</td>
<td>Rp.49,200</td>
<td>11%</td>
<td>Rp. 89,100</td>
<td>16%</td>
</tr>
<tr>
<td>Official</td>
<td>Rp.68,500</td>
<td>10%</td>
<td>Rp.169,000</td>
<td>19%</td>
</tr>
<tr>
<td>House</td>
<td>Rp.40,000</td>
<td>10%</td>
<td>Rp.111,600</td>
<td>19%</td>
</tr>
<tr>
<td>Free Rent</td>
<td>Rp.38,100</td>
<td>10%</td>
<td>Rp.105,900</td>
<td>20%</td>
</tr>
</tbody>
</table>

Source: SUSENAS 1996,1999 BPS
As expected, rural households, who generally have lower incomes, spend a smaller proportion of total household expenditures on housing (10 to 11 percent) and the expenditure differential between owners and tenants is much smaller in rural areas. This pattern is nearly universal. Poorer households have to spend a larger proportion of income on basic food requirements and will tend to minimize housing expenditures. Rural households spend approximately half of what urban households spend for housing as a proportion of total expenditures.

Housing expenditures and the crisis. How has the crisis impacted housing consumption levels? Has the drop in incomes been reflected in changes in housing expenditures?

Comparing housing expenditures as a proportion of total household expenditures for 1996 and 1999, we see a dramatic downward shift in housing expenditures relative to other consumption items. While urban households spent nearly 25 percent of “income” on housing in 1996, this proportion dropped to 14 percent in 1999. Relatively more was spent on food and other non-food items. So while total household expenditures decreased as a result of the crisis, housing expenditures decreased as a proportion of total expenditures. The real drop in housing expenditures is, therefore, considerable. See table 4.6.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>47.7</td>
<td>53.0</td>
<td>63.2</td>
<td>67.6</td>
<td>55.2</td>
<td>59.3</td>
</tr>
<tr>
<td>Housing</td>
<td>24.2</td>
<td>14.3</td>
<td>14.3</td>
<td>6.5</td>
<td>19.4</td>
<td>10.7</td>
</tr>
<tr>
<td>Clothing</td>
<td>5.0</td>
<td>5.2</td>
<td>5.7</td>
<td>5.6</td>
<td>5.3</td>
<td>5.4</td>
</tr>
<tr>
<td>Education</td>
<td>4.1</td>
<td>3.4</td>
<td>1.8</td>
<td>2.5</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Health</td>
<td>1.8</td>
<td>1.7</td>
<td>1.6</td>
<td>1.5</td>
<td>1.7</td>
<td>1.6</td>
</tr>
<tr>
<td>Other non-food</td>
<td>17.2</td>
<td>22.4</td>
<td>13.5</td>
<td>18.3</td>
<td>15.4</td>
<td>19.5</td>
</tr>
</tbody>
</table>

Source: SUSENAS 2000, BPS
We can only speculate what the reasons are for this decrease. Households may have deferred maintenance on their houses, decreased utility expenses, joined housing quarters with relatives, and applied other coping strategies. One thing we know for certain is that many households stopped paying their housing loans. Many banks were closed, mortgage portfolios were transferred and it was hard for households to know whom to pay.

The 2000 Susenas data shown in Table 4.6 indicate, however, that the proportion of housing expenditure is gradually returning to pre-crisis levels (16 percent for tenants and 20 percent for owners). The sale and normalization of mortgage portfolios is contributing to this trend.

The housing expenditure analysis shows that urban home-owners spend approximately 20 percent of total expenditures on housing. In the longer term we may assume that housing expenditures will return to pre-crisis figures of 25 percent on average. Short-term urban renters can be expected to spend 16 percent on housing. These figures are critical inputs in an affordability analysis, particularly for home-ownership options financed by loans. Next, we will turn to that analysis.

4.5.4 Housing Preferences

So far we have looked at housing choices households have made. What can we say about housing preferences, and the willingness to pay for alternative housing options? Although we do not have detailed information on housing preferences, the HOMI survey and focus groups discussions, provide some pertinent information worth sharing here.

Housing preferences. Dissatisfaction with the house focused on the condition of the house for most housing areas. One-fifth of the households in the RS/RSS areas are dissatisfied primarily with the size of the house, an equal proportion as in rental neighborhoods. The focus group discussions showed that households in RS/RSS areas would not have constructed an RS/RSS house if they had been given a choice to construct the house themselves according to their own specifications. A larger and simpler, self-constructed house would have been preferred.
Neighborhood dissatisfaction focused on the condition of infrastructure and services. Not surprisingly, fewer households viewed in KIP neighborhoods viewed infrastructure conditions as the main problem. The major area of dissatisfaction in KIP areas was related to social interaction in the community. Distance to work was a main reason for RS/RSS households to be dissatisfied and was less of an issue for the other neighborhoods.

Investment priorities for housing are closely related to the household cycle. Young households often start out as renters and buy a house when the household grows. Migrant workers have a preference for cheap rentals and buy or build a house when they can afford to have the household live with them in town. Investment decisions by homeowners to improve their house or move to a better neighborhood are often related to income, life-cycle and neighborhood characteristics. One of the most consistent of the focus groups findings on possible housing investments by either first-time house-buyers or for home-improvements was, that currently housing investment is a low priority. Nearly universally, households with school-age children prioritize investment and savings for education of their children and to provide fore unforeseen circumstances. Many households in the focus group discussions mentioned that it was their lack of education that made them poor and live in slum areas. The best thing they could do for their children would be to educate...
them. Young couples and those whose children are out of school show a higher propensity to invest in housing.

Summary of findings on house-prices and housing expenditures and preferences:

- Estimated median prices of existing houses in low-income neighborhoods are converging around Rp.18 to 20 million, for CBHP, slum areas and RS/RSS areas. Estimated median house prices in KIP areas are Rp. 44 million.

- Prices of new construction in non-complying, but legal areas show that a 21m2, self-constructed house on land priced in the order of Rp.80,000 to 100,000 per m² can not be built for less than Rp.20 million.

- House prices appear to be related mostly to the quality of location, the title to the land, the quality of services and infrastructure and sized of the plot

- House-prices in relation to incomes are modest (on average low to moderate income households have to spent 3 to 3.5 times their annual salary to buy a house) and building material prices and housing standards are not the main concern in the affordability of housing.

- Owner households spend approximately 20 percent of household income on housing expenditures including utilities, while renters spend 16 percent. Average housing expenditures dropped dramatically as a result of the crisis, but are returning gradually to pre-crisis levels of 25 percent (owners spend a higher proportion than renters).

- Investment and savings preferences for housing are low relative to education for the children and savings to build up a security buffer.

- Self-construction is preferred over the smaller RS/RSS turnkey house types.

4.6 FINANCE AFFORDABILITY

4.6.1 Financing Costs and Ability to Get a Mortgage Loan

One of the main components of the user-cost of home-ownership is the cost of housing finance. How high are these costs relative to average housing expenditures of 20 to 25 percent of income? Is housing finance available for most housing offered in the market? Is housing finance a deterrent for demand for home-ownership?

4.6.1.1 Affordable Loans
Loan affordability is driven by three main parameters; the payment-to-income ratio, the loan-to-value ratio, and most importantly, interest rates and terms.

- **Payment-to-Income Ratios.** Lenders use different household characteristics, including income types, security of employment and credit history to calculate the maximum loan amount they want to extend to a borrower in relation to their income. These ratios differ by lender and by type of loan. Mortgage lenders in Indonesia allow a maximum of 25 to 33 percent of household income for mortgage payment. This figure appears in line with the proportion of income spent on housing by home-owners in the pre-crisis years.

For non-secured housing loans (loans not secured by collateral of land and housing), the percentage of income that is allowed for maximum mortgage payments varies. Consumer loans used for housing do not generate an immediate income (unless used for a rental extension to the house). Lenders will, therefore, be careful not to overextend the payment capacity of a lower-income household with a housing credit burden. We assume, therefore, that lower income households using non-secured loans will be allowed a lower income-to-payment ratio than used for households qualifying for a mortgage loan.

- **Loan-to-Value Ratios.** If the loan is fully secured by property, the loan-to-value ratio applied by lenders in Indonesia is 70 percent. In other words, a borrower can only receive a loan up to 70 percent of the price or construction cost of the house. Only under special circumstances is an 80 percent ratio applied (among others by BTN). This means that the borrower has to save 30 percent or 20 percent of the total value or cost of the house in order to get a loan.

For non-secured lending for housing, different rules apply. The lender is entirely dependent on income security of the borrower and his/her willingness to pay the loan rather than on the actual value of the house since the lender cannot sell the property in case of default. So, payment to income ratios and character criteria will be more important to determine the size of the loan than the loan-to-value ratio. The crisis has made lenders more weary about income security, even of fixed-income earners since many lost their jobs. There is resistance to make unsecured housing loans. Our discussions with BRI showed that house collateral would be required or preferred even for micro-finance type loans for housing.
From interviews with housing finance institutions it became clear that the down-payment requirement is the main stumbling block for households to qualify for a loan, particularly for first-time home-buyers. Saving for the down-payment while paying rent is difficult. The down-payment on a modest house is high relative to income levels, and savings periods required are, therefore, long.

Since the high LTV ratios reflect real risk in the market place because of inefficient foreclosure procedures in the country, increasing the LTV ratio increases real risk to the lender. Addressing down-payment requirements would appear to be a sound focus for a housing assistance program.

- **Interest rates and terms.** Mortgage lending rates are high at 19.5 to 20 percent. High interest rates reflect inflation (approximately 10 percent per year) and high cost of funds, high operation costs of financial institutions and high risks of default and foreclosure costs and losses. Maximum terms are 20 years.

While risk-based pricing is not well developed in Indonesia’s banking circles, some banks dealing with more risky customers or collateral, charge higher interest rates and allow shorter terms. For example, Bank Bukopin charges up to 24 percent for mortgage loans. Non-secured micro-loans carry an interest rate of 30 to 32 percent for much shorter terms in BRI. Contrary to these trends, BTN has lowered its mortgage rates in order to match the competition. Yet the lower rates do not reflect risk and cost reductions.

Based on these lending parameters and using the income distributions shown in section 3, we can now calculate the affordable loan sizes for the different income groups and different regions;—rural, urban, DKI Jakarta and urban areas without Jakarta. We include the tables for Urban households outside of Jakarta in the text. The same calculations for Rural, all Urban, and DKI Jakarta can be found in the appendix.
### Table 5.1 Urban without DKI Jakarta 2001

<table>
<thead>
<tr>
<th>affordable House Prices for Household Income/Expenditures Percentiles, Using Different Loan Terms</th>
<th>Urban Households wo DKI Jakarta 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>10th%</td>
</tr>
<tr>
<td>Monthly income, Based on</td>
<td>378,200</td>
</tr>
<tr>
<td>Borrowing capacity</td>
<td>10%</td>
</tr>
<tr>
<td>Monthly prnt.capacity</td>
<td>37,800</td>
</tr>
<tr>
<td>Affordability - term</td>
<td>2</td>
</tr>
<tr>
<td>Affordability - interest rate</td>
<td>30%</td>
</tr>
<tr>
<td>Affordable loan</td>
<td>676,410</td>
</tr>
<tr>
<td>Savings: effort/down-payment</td>
<td>10%</td>
</tr>
<tr>
<td>Afford w/Urban alone</td>
<td>676,410</td>
</tr>
<tr>
<td>Afford w/Savings</td>
<td>751,557</td>
</tr>
</tbody>
</table>

Household expenditure distribution derived from BPS, National Socio-economic Survey (Susenas), 1999. We adjusted the figures for inflation (an average inflation of 19 percent YOY, applied such that a lower inflator is applied for low-income groups and higher inflator is applied for high-income groups). Food, in particular, which is the main food expenditure of low-income groups, has not increased in price, hence the differential adjustment.

The total number of urban households is 20,976,564 or 2.01 million in each decile group. 42.2% of all households.

If an urban household growth rate of 3.5% is assumed, approximately 751,000 new urban households will be formed this year, 73,400 in each decile group if the income distribution remains the same (it is likely, however, that the lower-income deciles will show a higher growth rate because of immigration and slower than predicted economic recovery).
<table>
<thead>
<tr>
<th>Monthly income, based on</th>
<th>10th%</th>
<th>20th%</th>
<th>30th%</th>
<th>40th%</th>
<th>50th%</th>
<th>60th%</th>
<th>70th%</th>
<th>80th%</th>
<th>90th%</th>
</tr>
</thead>
<tbody>
<tr>
<td>378,200</td>
<td>540,800</td>
<td>633,700</td>
<td>754,400</td>
<td>891,800</td>
<td>1,064,000</td>
<td>1,317,500</td>
<td>1,682,100</td>
<td>2,326,900</td>
<td></td>
</tr>
<tr>
<td>Borrowing capacity</td>
<td>10%</td>
<td>15%</td>
<td>20%</td>
<td>25%</td>
<td>26%</td>
<td>26%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>Monthly prnt. capacity</td>
<td>37,820</td>
<td>75,620</td>
<td>126,740</td>
<td>150,000</td>
<td>222,950</td>
<td>266,000</td>
<td>395,250</td>
<td>504,330</td>
<td>696,070</td>
</tr>
<tr>
<td>Affordability - term</td>
<td>2</td>
<td>5</td>
<td>7</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Affordability - interest rate</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Affordable loan</td>
<td>676,410</td>
<td>2,369,221</td>
<td>5,707,415</td>
<td>11,458,171</td>
<td>16,931,331</td>
<td>20,200,616</td>
<td>30,016,185</td>
<td>38,322,752</td>
<td>53,013,026</td>
</tr>
<tr>
<td>Savings effort/down-payment</td>
<td>10%</td>
<td>10%</td>
<td>20%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>Afford without loan</td>
<td>676,410</td>
<td>2,369,221</td>
<td>5,707,415</td>
<td>11,458,171</td>
<td>16,931,331</td>
<td>20,200,616</td>
<td>30,016,185</td>
<td>38,322,752</td>
<td>53,013,026</td>
</tr>
<tr>
<td>Afford with Savings</td>
<td>751,567</td>
<td>2,531,357</td>
<td>7,134,269</td>
<td>16,368,815</td>
<td>24,167,815</td>
<td>28,856,036</td>
<td>42,880,265</td>
<td>54,746,788</td>
<td>75,732,894</td>
</tr>
</tbody>
</table>

Household expenditure distribution derived from BPS, National Socio-economic Survey (Susenas), 1999. We adjusted the figures for inflation (in average inflation of 19 percent YoY, applied such that a lower inflator is applied for low income groups and higher inflator is applied for high income groups). Food, in particular rice, which is the main food expenditure of low income groups, has not increased in price, hence the differential adjustment.

The total number of urban households is 20,976,564 (Susenas 2000) or 2.01 million in each decile group, 42.2% of all households.

If an urban household growth rate of 3.5% is assumed, approximately 734,000 new urban households will be formed this year, 73,400 in each decile group if the income distribution remains the same (it is likely, however, that the lower income deciles will show a higher growth rate because of immigration and slower than predicted economic recovery).
These affordability calculations show that at the median urban (without Jakarta) income level of Rp.892,000, households can afford a house of Rp.16 million, using current conditions of a 20 percent interest rate, a 20 year term and a 30% down-payment. This example shows that a median income household cannot afford the lowest cost house built in the market place by developers. The financing cost are a critical factor in this mismatch.

Nothing would help housing affordability more than a lower interest rate. We show the same urban household affordability table, but use an interest rate of 15 percent. Under this scenario median income households can afford a Rp.21 million house, which is within the market produced price range.

The limitations imposed on housing demand by finance terms becomes painfully clear. The interest rate example of 15 percent reflects rates of the early nineties. When macro-economic conditions and lending risks improve, rates of 15 percent may be feasible again, depending, of course, on demand and supply of credit.

For non-secured lending we assumed interest rates of 30 percent and loan terms of 2 to 5 years. These conditions, while realistic, show the limitations of micro-credit for housing. The 20th percentile of the income distribution can only afford a Rp. 2.6 million loan under these terms. Interest costs on these loans are very high and the loan does not provide additional income, as is the case for micro-finance for businesses ventures. Combined with the low preference for borrowing for housing, a savings incentive program for housing may be more appropriate than a credit program at this income level. At the same time, micro-finance institutions could be assisted to improve their performance and eventually lower their rates.

4.6.1.2 Lender constraints

Finance affordability per se may not be the only factor that determines whether a household gets a loan for a house. The underwriting criteria lenders apply set other types of limits.
• **Limits on the value of the property.** Lenders currently only accept houses valued at approximately Rp. 30 to 50 million as collateral for mortgage loans. This means that only urban households at the 70th percentile and above have access to mortgage loans.

Banks differ considerably in their minimum loan requirements, however. For example, BPD’s generally make mortgage loans for new housing costing Rp.20million, while for mainstream banks this figure is Rp.40 to 50 million. Small loans in the order of Rp.5 to 6 million are made for home-improvements by several banks. The reasons for the loan limits are two-fold:

- The administrative cost to make small loans relative to larger loans are very high, while the fees are small since these are charged as a percentage of the loan. There is therefore little fee income connected to small loans.
- Moderate to low costs properties are perceived to carry a higher collateral risk; the house values are not as secure as higher cost properties in more established neighborhoods. If the lender has to foreclose on the property, he may receive less than the outstanding loan balance if the market value of the property has dropped.

• **Limits on income of the borrower.** Apart from limitations on the value of the properties for which they lend, banks often set minimum income brackets for potential borrowers. Mainstream banks do not make mortgage loans to households with incomes below Rp.700,000 and some banks only make loans to households with incomes above Rp.1.5 million. These figures are not rigidly applied and depend on other borrower characteristics, however. Also, compared to the limitations imposed by interest rates and down-payment requirements, the income limits are irrelevant at this point. In other words, low-income borrowers with incomes less than Rp.800,000 to 900,000 do not qualify for loans based on the other parameters.

Other lender constraints to extend housing finance are related to funding mobilization (see the housing finance report in the HOMI series).

### 4.6.2 **Savings and Indebtedness**

The down-payment requirements pose a serious constraint to the extension of mortgage lending. With current low incomes and job insecurity, the propensity to save for moderate and low-income households is limited. Hard data on savings habits and amounts and on the level of indebtedness are, however, difficult to come by.
A recent BPS savings survey of moderate income households showed that urban households with income between Rp.2 and 2.5 million save approximately 6 percent of their income, while households with incomes above Rp.2.5 million save 15 percent of income. The sample was not representative for lower income groups, however.

The HOMI 10-city survey asked questions on savings behaviour. The data showed that about half of the interviewed households had savings. Most households saved in order to build up some security for the future and one third of households saved for the education of the children. Education was also mentioned as the highest priority for saving by households during the focus group interviews. Only 11 percent of households saved to improve their house or buy land or a house. Interestingly, this was true for both owner and renter households.

A new housing program for the country will have to deal with the savings constraint and low priority for housing savings. Home-owner assistance programs should be structured in such a way that they offer both incentives to save, while at the same time decreasing the total amount of savings required to obtain a loan. Currently, no savings for housing programs exist. However, micro-finance programs supported by BRI and other desa units have proven successful in stimulating savings by moderate and low-income households. In fact, households continued to save throughout the crisis period in the BRI Simpedes program.

In the US and other countries, research has shown that housing programs that remove “wealth” or savings constraints (i.e., allow higher LTV ratios and assistance with down-payment) increase demand for home-ownership more than programs addressing the income constraint (i.e., allowing a higher proportion of income for mortgage payments, assisting with mortgage payments) (Linneman, Megbolugbe, Wachter and Cho, 1997).

### 4.6.3 Finance Affordability and Total Housing Requirements

If we connect the income distribution and loan affordability figures with the urban household growth data from chapter 2, we obtain an indication of the new housing requirements for the next few years across income groups. The affordability tables provides a sobering picture on the type of houses the nation needs in order to house newly formed households in the next few years. Approximately 75,000 new houses in urban areas are required for each decile group per year, i.e., a total of 375,000 new units for the below median income
groups. Assuming that finance is used to house newly formed households with incomes between the 50th and 30th percentile (Rp.890,000 to 634,000 per month), 225,000 units are required in urban areas ranging in price from Rp.18.7 million to Rp.6.2 million.

We summarize our findings on finance affordability as follows:

- The high interest-rate and high down-payment requirements pose important limits to finance affordability and, therefore, to housing affordability. Down-payment support may be the most critical constraint for mortgage lending.
- Lender constraints affecting demand focus on the high risk of default for high risk borrowers and the high occurrence and cost of foreclosure in case of default. Lowering the risk of default and foreclosure and insuring the cost of default may assist in getting lenders to move down-market, and may increase their access to funds for housing loans.
- Micro-finance for housing with current rates is mostly important as a borrowing option of last resort. Micro-finance institutions can be assisted to improve efficiency and expand access to housing finance. A housing-for-savings program, coupled to incremental construction or improvement for housing may be a useful orientation for a housing program for the lowest 40 percent of the household income distribution.

4.7 Housing And Neighborhood Risk

Low- and moderate income households investing in home-ownership will typically tie up most of their wealth in their house. Their decision to own a house will therefore take into consideration how cost effective and risky that investment will be relative to the cost and risk of renting. Similarly, the decision to buy a house or improve an existing house will be made on the basis of the risk factors imbedded in the neighborhood in which households invest. A critical factor is whether the house will maintain its value. Indeed, not all home-ownership is a good investment for low-income households. Government programs to stimulate low-income home-ownership in urban areas, should, therefore, be designed to provide housing that has real value for program beneficiaries.

Lenders too, will assess the risk that low-cost housing in undesirable areas will have an uncertain value or will lose value quickly relative to the cost/loan amount. Value changes could make it difficult for them to recover the outstanding loan in case the borrower does not pay and the lender has to foreclose on the loan. Of course, if properly appraised and in stable neighborhoods, most house values should not be very volatile, but move normally with real estate cycles. The perception of housing risk (unpredictability/volatility of housing
values) and risk of investing in specific types of neighborhoods will determine to a large
degree whether housing assistance programs that depend on private lenders and private
households to invest in home-ownership, will be successful.

Renters’ housing decisions focus more narrowly on rent expenditures in relation to housing
characteristics. No long-term investment risks are encountered by renters.

We discuss some of the main factors that add to housing and neighborhood risk in low
income areas in Indonesia.

Insecure asset value of housing. Typically, at the bottom of a real estate cycle, investment
reactions of developers and individual home purchasers alike are more conservative than
rational assessment of the market would warrant. In the past, housing was seen as a
good investment asset for the future with values rising faster than inflation and other
investments, and the bust in prices has shaken that assumption. So current reluctance by
lenders to move down-market is understandable. However, even in the boom years,
subsidized low-income housing was often an unnecessarily risky investment, because of
uncertainty of property rights and the mismatch between the cost and value of low-income
housing.

- Property rights, permits and other approvals. Risk related to property rights pertain
particularly to CBHP and unimproved slum areas, and to a lesser degree to KIP areas (see
table 4.3). The time it takes and the costs incurred in obtaining title and being in compliance
with other regulations is uncertain. The regulatory environment is weak and a serious
impediment to housing demand. The HOMI survey showed that it had taken households in
CBHP on average 12 month to gain all the permits required, and this does not include hak
milik title to the plot. While the legal status of the property is unclear, it is difficult for
households to get a regular loan based on the collateral of the property. They would be
unnecessarily dependent on more expensive micro-loans in case they would need finance.
Great improvements have been made in the process to get more people title to their plot.
However, there is a lack of transparency, accountability and enforcement of rules that
creates the perception of risk in housing investments in low-income areas. Moreover,
most local level institutions responsible for permitting and titling of low and moderate housing
areas, are unresponsive to low-income groups.
- **Housing costs and housing values.** We have already alluded to the fact that developer produced RS/RSS housing, carries the risk that the market value of the houses will be lower than the cost of producing the house. In particular the smaller units are prone to this mismatch. Why then were these houses produced? Developers built such RS/RSS housing because the subsidy system decreased their risk exposure. A system of pre-sales, that provided developers with construction funds directly from the mortgage loans carried by beneficiaries, decreased the risk to developers and put the risk of a mismatch between house value and loan amount or cost of the house onto the home-owners and lenders, particularly BTN. It was only as a result of the crisis, when lending and borrowing for housing stopped abruptly, that developers were left with houses for which the loan agreements were voided and which they, therefore, could not sell. Real market values of these houses depend mostly on location in relation to employment and on the availability of social services and infrastructure. When these houses are produced in areas where the extension of services and infrastructure would take a long or uncertain time to be provided, the housing risk of the investment increases.

The second issue related to the danger of a mismatch between cost and value is that house-designs of the RS/RSS units made improvements and, in particular, expansion of the houses by home-owners difficult. Value enhancing improvements by owners were, therefore, not easily implemented.

*Neighborhood externality risk.* Neighborhood risk is similar to housing risk when house prices fluctuate mostly because of neighborhood factors. In the section on housing risk we mentioned that house-price volatility in Indonesia depends to a large extent on neighborhood characteristics and change. It is important, however, to distinguish neighborhood risk here because it is such a critical factor in the housing market and one that needs to be addressed by any new housing assistance program. And as we showed, these neighborhood externality risks are not entirely capitalized in the house-prices based mostly on cost of construction.

There is evidence that price instability is greater in neighborhoods with uncertain infrastructure and services delivery and uncertain social characteristics (interview with Perumnas). Indeed, security and social factors play an increasingly important role in the desirability (and possible price risk) of urban neighborhoods (see table 4.7 and focus group discussions of HOMI research). Neighborhoods with the highest social and physical infrastructure risk have the highest vacancies. Yet, it is to these neighborhoods that past special stimulus programs were directed. Inflation gradually decreased the quality of neighborhood and house that could be delivered under the RS//RSS program. Lenders currently in the market have understood this neighborhood risk and only finance new residential developments in
“developed” areas, i.e., stable neighborhoods, well situated in relation to existing infrastructure (personal communications by lenders).

Current attempts to provide RS/RSS subsidies to assist developers to dispose of their vacant RS/RSS houses (estimated at 10,000 units) are misguided because of the investment risks these units pose to lenders and potential home-buyers alike. A more comprehensive approach, based on enhancing neighborhood stability, is needed to increase demand for current vacant units.

In summary, new housing assistance programs need to incorporate housing and neighborhood risk factors into project design. Programs need to provide housing that is likely to maintain its value and provides a real asset to low and moderate income households. Much of the housing value is derived from property titles and neighborhood quality, i.e., location, infrastructure and services, and social integration and security concerns. Indeed, poverty can be measured in many ways, not just household expenditures. Lack of access to services (health and education) and infrastructure (safe water, adequate sanitation, access to transport and roads, electricity) are amongst the most critical aspects of poverty. Poor households expressed this very clearly during the focus group discussions. Medium-term implementation plans for the delivery of property rights and infrastructure by local government should be an integral part of low income housing programs.

In addition, much greater attention should be given to community strengthening programs. The HOMI surveys showed that the great majority of households in low income neighborhoods, not only felt that community involvement was important for neighborhood quality, but that neighborhood improvement programs were the joint responsibility of communities themselves with local government assistance. A housing assistance program for low income households needs to be based on this understanding.

4.8 Implications For Housing Assistance Programs

This brief analysis of potential demand for housing shows that 700,000 to 750,000 new housing units will be needed per year. Housing requirements for below-median income households that are potential homeowners are approximately 225,000 units per year. Housing affordability is currently low, mostly because of the cost of, and savings
requirements for housing finance. Housing costs per se are not high relative to income, however. Finance support is therefore an important part of a housing assistance program. But it is clearly insufficient as a single measure to stimulate demand for housing and therefore low- and moderate income housing production. Other constraints and risks faced by low- and moderate-income households relate to job insecurity, the current low priority to save for housing in comparison to other saving goals (e.g., general safety buffers and education of children), and the housing and neighborhood quality and risk factors related to currently available low-cost housing.

Housing assistance programs need to be based on specific demand constraints for different groups of households.

First, housing assistance programs, and particularly programs to stimulate new construction, need to focus on urban areas, since all household growth is expected to take place in cities. Second, since urban growth will be made up predominantly of migrants, rental housing should be stimulated.

Third, the demand analysis shows two main types of constraints in extending demand for urban low and moderate income ownership housing:

- **An affordability constraint related principally to the difficulty of accessing housing finance and the high cost of finance.** The housing market can effectively deliver housing for Rp.25 million or even Rp.20 million, that is considered sound collateral for a loan and sound investment for households, i.e., included in the price of the house are costs related to property titles, regulatory approvals, proper location and infrastructure and services. Housing in this category need not incur a mismatch between cost and value of the house, nor the risks that neighborhood factors impact house-value unpredictably. Financial incentives to households to address savings constraints or constraints related to income level and volatility, may under these market conditions be effective in stimulating both demand and supply of moderate income housing. Equally, assistance to banks to improve risk assessment and some specific credit enhancement incentives may facilitate down-market lending.

- **An affordability constraint related primarily to housing and neighborhood risk factors.** Real markets for low and moderate income housing below approximately Rp.20 million are “incomplete” and cannot yet price adequately for housing costs and
risks, and neighborhood quality and externalities. Finance will therefore not be easily obtained and investments by households are risky since the housing asset has an uncertain value. Clearly, just providing financial incentives to households or lenders would either increase the investment risk for borrowers and financial institutions or would simply not result in new houses being constructed through the private authorized sector. For this segment of the market, a more comprehensive approach to housing assistance is needed. A neighborhood based approach would be required that will provide more direct supply-side assistance, e.g., to provide property rights and regulatory clarity, land in adequate locations and social and physical infrastructure. Given that support, demand for housing may be enhanced through financial incentives if necessary. In other words, since markets for housing at the lower level do not work well, demand incentives alone will not work to increase housing production.

4.9  Summary of Main Issues Related To Demand For Housing

4.9.1  Drivers of Demand. The analysis focused on factors influencing the demand for housing, i.e., the decision to buy a house rather than rent, in particular for first-time home-buyers, and the decision to pay for housing of a certain price and quality and in a specific neighborhood. The main factors that drive demand are:

- income level in relation to house-prices and cost of housing, and income stability
- savings and wealth constraints
- life-cycle factors
- housing preferences
- user cost of home-ownership in particular financing cost
- housing risk (the variation of house-prices over time, absence of rent risk)
- neighborhood externality risk (variation in neighborhood quality/externalities over time)

4.9.2  Housing Requirements. Total population and household growth will focus on urban areas, while rural areas are stagnant. The urban growth rate for the next few years is estimated at 3.5 percent, of which approximately two-thirds is due to in-migration from rural areas. The overall requirement for new urban housing to house newly formed households for the next few years is estimated at 700,000 to 750,000 units per annum. The high migration component of urban growth has major implications for local governments’ housing strategies. Migrants are less prone to be home-owners and want to decrease overall housing spending.
Urban growth differs in different regions. The highest urban growth rate is expected in the least urbanized regions. Housing assistance programs need to focus capacity building efforts towards those areas.

4.9.3 Household Incomes and Income Stability. The median household incomes (50th percentile) for urban areas with and without DKI Jakarta are Rp.950,000 and Rp.892,000 respectively. The median household income in rural areas is Rp.579,300. The critical impact of the crisis has been in the decrease of real wages and not in aggregate employment, since many workers transferred to self-employment. Wage cuts have been greater in the urban sector and are concentrated at the bottom of the wage distribution.

Household incomes have shown far less volatility during the crisis period than individual wage incomes and overall GDP. Households have coped by having household members move to informal employment and by extending female labor force participation. As a result, the decline in household incomes is about half the magnitude of the decline in individual earnings. A consequence of the crisis is an even higher percentage of self-employed and family workers (a total of 46 percent in urban areas), which will only gradually be re-absorbed by the labor market.

The large proportion of self-employed and family workers will make borrowing for housing through conventional KPR loans even more difficult. Also, an increased sense of insecurity of future income may have a negative effect on the interest of households to borrow for housing and may influence tenure choice. At the same time, the high labor force participation will negatively affect possible direct self-help involvement by household members.

4.9.4 Cost Affordability of Housing. House-prices in relation to incomes are modest and housing standards are not the main concern in the affordability of housing. Low to moderate income households can buy a house for an average price of 3 to 3.5 times annual salary.

- Median prices (approximate) for existing housing in predominantly low-income neighborhoods converged around Rp.18 to 20 million in the 10 city survey. KIP areas,
which are in general better located and are mostly mixed income neighborhoods, had a median house-price of roughly Rp.44 million (HOMI 10 city Survey, 2001).

- **Prices of new construction in non-complying, but legal areas** show that a 21m², self-constructed house on a 60m² plot priced in the order of Rp.80,000 to 100,000 per m² can be built for a minimum of Rp.20 million in main urban areas. Both land and construction prices depend, of course, on location and region of the country. Developer produced moderate income housing can be built for Rp.25 million and above.

- **The lowest cost “housing” solution** is a plot with a core house without infrastructure for Rp.13 to 15 million, depending on location (see Puslitbang 2001 regional construction cost data).

Owner households spend approximately 20 percent of household income on housing expenditures including utilities, while renters spend 16 percent. Average housing expenditures dropped dramatically as a result of the crisis, but are returning gradually to pre-crisis levels of 25 percent.

### 4.9.5 Finance Affordability

The high interest-rates (20 percent) and high down-payment requirements (LTV of 70 percent) for mortgage lending pose critical limits to housing affordability. Down-payment support may be the most critical borrower constraint for mortgage lending.

Lender constraints focus on the high risk of default for low income and non-fixed salaried borrowers, and the high occurrence and cost of foreclosure in case of delinquency. Additionally, fees for writing small mortgage loans are relatively low. Consequently, mainstream lenders typically do not make loans for houses with a value below Rp.40 to 50 million. Second-tier regional banks make mortgage loans for properties valued as low as Rp.20 million. Liquidity constraints are a problem for some banks. When funds for lending are limited, long-term lending to risky customers on the basis of weak collateral will not be a priority. Lowering the risk of default and foreclosure and insuring the cost of default may assist in getting lenders to move down-market and may increase their access to funds for housing loans.

Un-secured micro-finance for housing with current interest rates of over 30 percent is important mostly as a borrowing option of last resort. Micro-finance institutions can be assisted to improve efficiency and expand access to housing finance. A housing-for-
savings program, coupled to incremental construction or improvement for housing may be a useful orientation for a housing program for the lowest 40 percent of the household income distribution (Rp.750,000). Self-construction is preferred by low and moderate income households over the smaller RS/RSS turnkey house types (HOMI survey).

Investment and savings preferences for housing are low relative to savings for security reasons and education for the children. These findings are an indication that the house is not considered as an asset that can be utilized to borrow against in case of need.

4.9.6 Housing and Neighborhood Risk. Housing assistance programs need to provide housing that maintains its value and provides a real asset to low and moderate income households. Current moderate and low-income housing programs often deliver housing that has a lower value than the cost of construction. In addition, a large proportion of houses in low-income housing areas do not have Hak Milik titles. Resale of these houses is, therefore, difficult.

Much of the housing value is derived from neighborhood quality, i.e., location, availability of infrastructure and services, and social integration and security characteristics. The process of acquiring all development and building permits takes on average a year for low-income areas and is unpredictable. When there is no clarity when or if services will be delivered, neighborhood risk (the risk that house values are volatile because of unpredictable neighborhood factors) increases. Investment by (potential) home-owners in more risky neighborhoods is negatively affected and so is lending by financial institutions.

In addition, lack of access to services (health and education) and infrastructure (safe water, adequate sanitation, access to transport and roads, electricity) are amongst the most critical aspects of poverty. Medium-term implementation plans for the delivery of property rights and infrastructure by local government should be an integral part of low income housing programs. Greater attention should also be given to community strengthening programs.
4.9.7 Consequences for Housing Assistance Programs. First, housing assistance programs and particularly programs to stimulate new construction, need to focus on urban areas, since all household growth is expected to take place in cities. Second, the demand analysis shows two main types of constraints in extending demand for urban low and moderate income housing:

- **An affordability constraint related principally to the difficulty of accessing housing finance and the high cost of finance.** The housing market can effectively deliver housing for Rp.25 million or even Rp.20 million, that is considered sound collateral for a loan and sound investment for households, i.e., included in the price of the house are costs related to property titles, regulatory approvals, proper location and infrastructure and services. Housing in this category need not incur a mismatch between cost and value of the house, nor the risks that neighborhood factors impact house-value unpredictably. Financial incentives to households to address savings constraints or constraints related to income level and volatility, may under these market conditions be effective in stimulating both demand and supply of moderate income housing. Equally, assistance to banks to improve risk assessment and some specific credit enhancement incentives may facilitate down-market lending.

- **A housing and neighborhood risk constraint.** Real markets for low and moderate income housing below approximately Rp.20 million are “incomplete” and cannot yet price adequately for housing costs and risks, and neighborhood quality and externalities. Finance will therefore not be easily obtained and investments by households are risky since the housing asset has an uncertain value. Clearly, just providing financial incentives to households or lenders would either increase the investment risk for borrowers and financial institutions or would simply not result in new houses being constructed through the private authorized sector. For this segment of the market, a more comprehensive approach to housing assistance is needed. A neighborhood based approach would be required that will provide more direct supply-side assistance, e.g., to provide property rights and regulatory clarity, land in adequate locations and social and physical infrastructure. Given that support, demand for housing may be enhanced through financial incentives if necessary. In other words, since markets for housing at the lower level do not work well, demand incentives alone will not work to increase housing production.
Bibliography

BPS, 1997, *IFLS*, Jakarta, Indonesia

### APPENDIX CHAPTER 2

Table 2.1A Population Indicators

|-------------------|-------|-------|-------|-------|------|------|------|------|

**Note:** Including non-permanent resident persons

### Table 2.2A  Annual Population Growth by Province and Rural Urban

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
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<td>DI Aceh</td>
<td>2.72</td>
<td>-</td>
<td>0.59</td>
<td>-</td>
</tr>
<tr>
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<td>2.73</td>
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<td>4.75</td>
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<td>1.95</td>
<td>1.19</td>
<td>5.18</td>
<td>4.23</td>
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Source: BPS, SUSENAS 2000
# APPENDIX CHAPTER 3

## Table 3.1A Monthly Expenditure per Capita by Food and Non-food Group (Rp), 1990 – 1999

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<th>Year</th>
<th>Food</th>
<th>Non-food</th>
<th>Total</th>
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<td>1990</td>
<td>18,272</td>
<td>11,999</td>
<td>30,271</td>
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<tr>
<td></td>
<td>(60.4)</td>
<td>(39.6)</td>
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<tr>
<td>1993</td>
<td>24,772</td>
<td>18,793</td>
<td>43,565</td>
</tr>
<tr>
<td></td>
<td>(56.9)</td>
<td>(43.1)</td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>38,723</td>
<td>31,339</td>
<td>70,062</td>
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<tr>
<td></td>
<td>(55.3)</td>
<td>(44.7)</td>
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<td>1999</td>
<td>93,215</td>
<td>55,691</td>
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<tr>
<td></td>
<td>(62.6)</td>
<td>(37.4)</td>
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Note: Figure in bracket indicates the percentage of expenditure
## Table 3.2A

### Household Income Distribution Based on Consumption Data, BPS Susenas 1999

<table>
<thead>
<tr>
<th>Percentiles</th>
<th>Rural Household</th>
<th>Urban Household</th>
<th>DKI Jakarta Household</th>
<th>Urban Households w/o Jakarta</th>
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<td>10th percentiles</td>
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<td>355,600</td>
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<td>577,800</td>
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<td>40th percentiles</td>
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<td>680,000</td>
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<td>80th percentiles</td>
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<td>90th percentiles</td>
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### Household Income Distribution Based on Consumption Data, BPS Susenas 1999, adj. to

<table>
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<tr>
<th>Percentiles</th>
<th>Rural Household</th>
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<th>DKI Jakarta Household</th>
<th>Urban Households w/o Jakarta</th>
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<td>391,150</td>
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<td>20th percentiles</td>
<td>356,063</td>
<td>536,135</td>
<td>966,781</td>
<td>510,760</td>
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<td>30th percentiles</td>
<td>428,145</td>
<td>664,240</td>
<td>1,193,470</td>
<td>633,260</td>
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<td>795,000</td>
<td>1,449,396</td>
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<td>579,292</td>
<td>948,668</td>
<td>1,713,481</td>
<td>891,786</td>
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<td>60th percentiles</td>
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<td>1,152,525</td>
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<tr>
<td>70th percentiles</td>
<td>767,323</td>
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<td>2,487,060</td>
<td>1,317,453</td>
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<td>1,809,375</td>
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### Adjustment Inflation Rate

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<tr>
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<td>80th percentiles</td>
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<td>90th percentiles</td>
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### Table 4.1A  KPR Interest Rate Subsidy Program 2001

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<th>Jenis Rumah</th>
<th>MAX HOUSE PRICE IN MILLION RP</th>
<th>Min Down Payment (%)</th>
<th>Interest Rate per Year (%)</th>
<th>Credit Period</th>
<th>MAX CREDIT IN MILLION RP</th>
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<tr>
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<td>Region of The Country</td>
<td>I</td>
<td>II</td>
<td>III</td>
<td>IV</td>
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<td>KSE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>P4 m2</td>
<td></td>
<td>2.10</td>
<td>2.70</td>
<td>2.90</td>
<td>2.90</td>
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<tr>
<td>80 m2</td>
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<tr>
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<td>RSS</td>
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<td>(Rumah+ Tanah)</td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>T.21</td>
<td></td>
<td>9.81</td>
<td>10.00</td>
<td>10.00</td>
<td>10.00</td>
</tr>
<tr>
<td>T.27</td>
<td></td>
<td>11.77</td>
<td>12.00</td>
<td>12.00</td>
<td>12.00</td>
</tr>
<tr>
<td>T.36</td>
<td></td>
<td>13.81</td>
<td>14.00</td>
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<td></td>
<td></td>
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<tr>
<td>(Rumah+ Tanah)</td>
<td></td>
<td></td>
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<tr>
<td>T.27</td>
<td></td>
<td>20.35</td>
<td>24.00</td>
<td>25.04</td>
<td>34.02</td>
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<td>T.36</td>
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<td>20.41</td>
<td>32.64</td>
<td>32.94</td>
<td>43.66</td>
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<td>Monthly income, based on</td>
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<td>20th%</td>
<td>30th%</td>
<td>40th%</td>
<td>50th%</td>
</tr>
<tr>
<td>------------------------</td>
<td>--------</td>
<td>--------</td>
<td>--------</td>
<td>--------</td>
<td>--------</td>
</tr>
<tr>
<td>Borrowing capacity</td>
<td>10%</td>
<td>15%</td>
<td>20%</td>
<td>20%</td>
<td>25%</td>
</tr>
<tr>
<td>Monthly prnl.capacity</td>
<td>26,180</td>
<td>35,610</td>
<td>42,810</td>
<td>49,110</td>
<td>57,310</td>
</tr>
<tr>
<td>Affordability - term</td>
<td>7%</td>
<td>5%</td>
<td>7%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Affordability - interest rate</td>
<td>30%</td>
<td>30%</td>
<td>25%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Affordable loan</td>
<td>488,229</td>
<td>1,650,968</td>
<td>3,382,634</td>
<td>5,875,827</td>
<td>8,525,012</td>
</tr>
<tr>
<td>Savings effort/down-payment</td>
<td>10%</td>
<td>10%</td>
<td>20%</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>Affordable loan alone</td>
<td>488,229</td>
<td>1,650,968</td>
<td>3,382,634</td>
<td>5,875,827</td>
<td>8,525,012</td>
</tr>
<tr>
<td>Affordable w/Savings</td>
<td>520,254</td>
<td>1,834,429</td>
<td>4,226,292</td>
<td>8,394,039</td>
<td>12,178,598</td>
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</table>

Household expenditure distribution derived from BPS, National Socio-economic Survey (Susenas), 1999. We adjusted the figures for inflation (an average inflation of 13 percent YOY, applied such that a lower inflator is applied for low income groups and higher inflator is applied for high income groups). Food, in particular rice, which is the main food expenditure of low-income groups, has not increased in price, hence the differential adjustment.

The total number of rural households is 28.8 million or 2.88 million in each decile group; 57.8% of total households. Rural growth was negative during the 1990-2000 census period.
<table>
<thead>
<tr>
<th></th>
<th>10th%</th>
<th>20th%</th>
<th>30th%</th>
<th>40th%</th>
<th>50th%</th>
<th>60th%</th>
<th>70th%</th>
<th>80th%</th>
<th>90th%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly income, based on</td>
<td>391,200</td>
<td>636,200</td>
<td>864,200</td>
<td>975,600</td>
<td>9,487,600</td>
<td>1,452,600</td>
<td>1,466,800</td>
<td>1,809,800</td>
<td>2,777,200</td>
</tr>
<tr>
<td>Borrowing capacity</td>
<td>10%</td>
<td>15%</td>
<td>20%</td>
<td>20%</td>
<td>25%</td>
<td>25%</td>
<td>30%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>Monthly net capacity</td>
<td>22,120</td>
<td>30,430</td>
<td>35,280</td>
<td>31,120</td>
<td>23,717</td>
<td>25,125</td>
<td>25,125</td>
<td>426,740</td>
<td>542,820</td>
</tr>
<tr>
<td>Affordability - term</td>
<td>2%</td>
<td>5%</td>
<td>7%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>30%</td>
</tr>
<tr>
<td>Affordable interest rate</td>
<td>30%</td>
<td>30%</td>
<td>25%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
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<tr>
<td>Affordable loan</td>
<td>699,861</td>
<td>2,486,863</td>
<td>5,246,178</td>
<td>9,467,478</td>
<td>13,011,123</td>
<td>13,960,252</td>
<td>20,708,363</td>
<td>31,852,881</td>
<td>40,043,321</td>
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<tr>
<td>Savings effort/down-payment</td>
<td>10%</td>
<td>10%</td>
<td>20%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
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<tr>
<td>Afford w/loan alone</td>
<td>699,861</td>
<td>2,486,863</td>
<td>5,246,178</td>
<td>9,467,478</td>
<td>13,011,123</td>
<td>13,960,252</td>
<td>20,708,363</td>
<td>31,852,881</td>
<td>40,043,321</td>
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<tr>
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<td>13,808,680</td>
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<td>24,228,937</td>
<td>36,720,233</td>
<td>45,846,807</td>
<td>70,061,887</td>
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</table>

Household expenditure distribution derived from BPS, National Socio-economic survey (Susenas), 1995. We adjusted the figures for inflation (an average inflation of 19 percent YoY, applied such that a lower inflation is applied for low-income groups and higher inflation is applied for high income groups). Food, in particular, rice, which is the main food expenditure of low-income groups, has not increased in price, hence the differential adjustment.

The total number of urban households is 20,976,004 or 2.01 million in each decile group, 42.2% of all households.

If an urban household growth rate of 3.5% is assumed, approximately 724,000 new urban households will be formed this year. 73,400 in each decile group if the income distribution remains the same (it is likely, however, that the lower income deciles will show a higher growth rate because of immigration and slower than predicted economic recovery).
### Affordable House Prices for Household Income/Expenditures Percentiles, Using Different Loan Terms

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<th>DKI Jakarta Households 2001</th>
<th>10th%</th>
<th>20th%</th>
<th>30th%</th>
<th>40th%</th>
<th>50th%</th>
<th>60th%</th>
<th>70th%</th>
<th>80th%</th>
<th>90th%</th>
</tr>
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<tbody>
<tr>
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<td>728,100</td>
<td>956,800</td>
<td>1,193,500</td>
<td>1,449,400</td>
<td>1,713,500</td>
<td>2,070,700</td>
<td>2,487,100</td>
<td>3,125,000</td>
<td></td>
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<tr>
<td>Borrowing capacity</td>
<td>10%</td>
<td>15%</td>
<td>20%</td>
<td>20%</td>
<td>25%</td>
<td>25%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
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<tr>
<td>Monthly pmt. capacity</td>
<td>72,010</td>
<td>143,520</td>
<td>236,700</td>
<td>299,060</td>
<td>426,375</td>
<td>517,675</td>
<td>746,130</td>
<td>937,500</td>
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<tr>
<td>Affordability - term</td>
<td>2%</td>
<td>5%</td>
<td>7%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>Affordability - interest rate</td>
<td>30%</td>
<td>30%</td>
<td>25%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
<td>20%</td>
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<tr>
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<td>17,063,563</td>
<td>25,215,964</td>
<td>30,472,540</td>
<td>43,920,367</td>
<td>55,185,214</td>
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<tr>
<td>Savings effort/down-payment</td>
<td>10%</td>
<td>10%</td>
<td>20%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>Afford w/loan alone</td>
<td>1,302,206</td>
<td>4,436,010</td>
<td>9,430,445</td>
<td>17,063,563</td>
<td>25,215,964</td>
<td>30,472,540</td>
<td>43,920,367</td>
<td>55,185,214</td>
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<td>43,532,199</td>
<td>62,743,381</td>
<td>78,836,020</td>
<td>0</td>
</tr>
</tbody>
</table>

Household expenditure distribution derived from BPS, National Socio-economic Survey (Susenas), 1999. We adjusted the figures for inflation (an average inflation of 19 percent YoY, applied such that a lower inflator is applied for low-income groups and higher inflator is applied for high income groups). Food, in particular rice, which is the main food expenditure of low-income groups, has not increased in price, hence the differential adjustment.

The total number of urban households in DKI is 2,208 million or 220,000 in each decile group; 10.5% of all urban households.

If an urban household growth rate of 3.5% is assumed, approximately 77,300 new households will be formed in DKI Jakarta this year, 7,730 in each decile group if the income distribution remains the same (it is likely, however, that the lower income deciles will show a higher growth rate because of immigration and slower than predicted economic recovery).
CHAPTER 5
IMPROVEMENTS IN THE HOUSING FINANCE SECTOR
Sally Merril and Erica Soeroto

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</tr>
</thead>
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<td>5.2.1 Structural Changes in the Banking Sector</td>
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<td>5.3 Strengthening Mainstream Housing Finance</td>
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<td>5.3.1.1 Benefits of a Credit Bureau</td>
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<td>5.3.1.3 Changes in the Pipeline</td>
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<td>5.3.2 Some Tools for Increasing Efficiency and</td>
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<td>Risk Management: Automation and Credit Scoring</td>
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<td>5.3.2.1 Current Practice and Key Issues</td>
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<td>5.3.2.2 The Requirements of Credit Scoring</td>
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<td>5.3.2.4 Recommendations</td>
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<td>5.3.3 Foreclosesure</td>
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<td>5.3.4 Standardization</td>
</tr>
<tr>
<td>5.4 Downmarket Expansion of Mortgage Lending</td>
</tr>
<tr>
<td>5.4.1 International Experience in Moderate Income Housing Finance</td>
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<tr>
<td>5.4.2 Moderate Income Housing Finance in Indonesia</td>
</tr>
<tr>
<td>5.4.3 Mortgage Default Insurance</td>
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<tr>
<td>5.4.4 Alternative Mortgage Loan Products and Risk-Based Pricing</td>
</tr>
</tbody>
</table>
5.4.5 Moderate Income Housing Finance in the U.S:
   A Tool Kit of Loan Products and Incentives for Lending Downmarket

5.4.5 Conclusions and Recommendations

5.5 Developing Microfinance For Housing

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5.5.2 Defining Microfinance for Housing

5.5.3 Indonesia’s Network of Microfinance Institutions

5.5.4 International Examples of Microfinance for Housing

5.5.5 Recommendations

5.6 Regulation And Supervision

5.7 Developing a Secondary Market Institution in Indonesia

5.7.1 International Practice and Key Issues in Indonesia

5.7.1.1 Secondary Market Funding Worldwide

5.7.2 The Current Indonesian Context for Development of an SMF

5.7.3 The Benefits of an SMF in Indonesia and Financial and Economic Barriers

5.7.4 A Comparison of Liquidity Facilities: Cagamas, FHLB, and Recommendations for an SMF for Indonesia

5.7.5 Interim Steps for Indonesia

5.7.6 Recommendations for Secondary Market Development
   In the Medium- and Long-term

5.7.6.1 Recommendations for the Medium-Term Strategy:
   Develop an SMF

5.7.6.2 Long-term Options: Development of SMF Lending Without Recourse and Securitization Tools

5.8 Recommendations

5.8.1 Recommendations in Risk Management and Information Systems: Credit Risk, Legal Risk, and Administrative Risk

5.8.1.1 Establishment of a Credit Bureau

5.8.1.2 Automation and Risk Management: Credit Scoring

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CHAPTER 5
IMPROVEMENTS IN THE HOUSING FINANCE SECTOR
Sally Merril and Erica Soeroto

5.1 Introduction and Summary

5.1.1 The Importance of Housing Finance. The health and strength of the financial sector are important to both long-run development and to more immediate efforts to alleviate poverty. A large body of recent research suggests that development of the financial sector contributes significantly to economic growth.\textsuperscript{1} It also contributes to poverty reduction in two ways: first, indirectly through its impact on economic growth and second, directly through the improved access to credit of lower income households.\textsuperscript{2}

Most importantly for the discussion in this report, it should be stressed that mortgage finance will become an increasingly important part of the financial sector. This pattern has long been observed in emerging, transition, and developed economies alike, and it is already occurring for some Indonesia’s neighbors, such as Malaysia and Thailand. In Indonesia, however, the housing finance sector is smaller than it should be. First, the sector has suffered severely in Krismon. Second, it has not yet recovered, and banks are pursuing very risk averse policies.\textsuperscript{3} Furthermore, we feel that expansion of the housing finance market has been inhibited by a housing subsidy policy that is detrimental to incentives for downmarket growth. This situation should begin to change as Indonesia recovers from the financial crisis and economic growth reasserts itself over the medium term. But a larger and more effective housing finance sector will primarily depend on a combination of GOI policy initiatives and bank efforts to manage and measure risk, improve efficiency, and development capital market funding capabilities.

Housing finance has a number of extremely important roles to play in both the housing market and the broader economy. First, it clearly must assist in making the demand for housing an effective demand by providing financing of housing over time. And, not only higher income households, but also those of moderate and modest income must be able to take advantage of this credit. Housing finance also has an important role to play with regard to deepening of the banking sector and the links of the banking sector to the capital market. Housing is the major asset of most or many households in the developed nations. Mortgage debt is also the major debt of the majority of households. Mortgage debt is also of major importance in the capital markets of developed economies, and increasingly of emerging nations. Mortgage debt products can provide a major alternative to Government...
paper, which tends to dominate immature capital markets; both Malaysia and Chile are testimony to this deepening.

**Effective Demand for Housing.** Indonesia is still recovering from the devastating effects of Krismon. Demand for high and moderate income housing is currently depressed, and reportedly, over-supply exists in some segments of the market. New construction is depressed; construction finance is limited or not available and interest rates are high. The banks’ credit crunch behavior was noted above. The need for improved housing for many households, and the need for production of more affordable housing, still remain major issues. However, **effective demand for housing** must be distinguished from need for better housing – that is, the ability to pay for improved housing is currently stifled by limited access to housing finance, and by **rigidities and inefficiencies in the housing sector and land market which make housing more expensive than it needs to be.**

Indonesia’s housing finance system has both notable strengths and serious weaknesses.

**Strengths:**
- An active mainstream banking sector, where both private and public banks are commercially oriented;
- Competition for consumer finance and mortgage finance business, an important ingredient in improving efficiency;
- Improved oversight, regulation, and supervision by BI, with consolidated supervisory initiatives in the pipeline;
- A well-developed group of organizations and institutions which support real estate functions overall, including PERBANAS, REI, APERSI, and the appraisal associations;
- An extensive network of regional banks, microfinance institutions, coops, credit unions, and rural banks.

**Weaknesses.**
- Housing finance is largely limited to high income households. This is an unnecessary limitation given the potential offered by the low and moderate income lending network noted above;
- Risk management of many types must be greatly improved;
- Bank risk management and Information systems must be improved to support an investment quality portfolio;
- The KPR/RSS subsidy system has constrained the downward expansion of housing finance; this subsidy system should be replaced and a market-based role found for BTN;
• No system of access to long-term funding from the capital market is yet in place.

5.1.2 Expanding Housing Finance in Indonesia.

We distinguish three types of housing finance for Indonesia. While the definitions may be somewhat arbitrary, it is nevertheless useful define these three distinct housing finance sectors because the goals, the institutional structures, and the loan products and practices all differ.

• **Mainstream housing finance**, which provides unsubsidized mortgage finance to high income households, with loans typically ranging from Rp. 100 to 300 million, with many higher than that but few lower than Rp 50 million;

• **Moderate income housing finance**, with loans of roughly Rp.10 to 25 million. Currently, this is primarily limited to the KPR/RSS subsidy system and a few smaller loans from regional banks and other banks;

• **Microfinance for housing**, a non-mortgage finance approach to housing credit characterized by small loans – for example, Rp.10 million or less - used for incremental building, improvement and expansions, often associated with improving the dwelling to support income generation activities.

All “bankable” households should have access to lending for housing. This is not presently the case in Indonesia, as only higher income households have adequate access to credit. A major theme of both this report and the HOMI Report “Improvement in Housing and Land Market Efficiency” is that we must end the divide in policy making between the “formal” and “informal” markets in housing, land, and housing finance. All households need affordable housing, infrastructure, land, land title, and credit appropriate to their resources. Thus, ending the formal/informal divide in the availability of credit for housing suggests the following broad approach:

• The current housing finance system in Indonesia now serves only a fraction of the households that both need housing credit and that are “bankable, that is, could utilize credit offered on a commercial basis if the structure of the loan terms and products better matched their ability to pay. Mainstream banks are generally reluctant to offer loans below Rp.50 or even Rp.100 million. They thereby limit themselves to roughly the upper 10 percent of urban households and an even smaller proportion of rural groups.
• the KPR/RSS system reaches only a fraction of the eligible households. More importantly, the KPR/RSS system stifles expansion of low cost housing and availability of housing finance for modest income households. As discussed at length in other HOMI reports, the KPR/RS/RSS system should be replaced with a subsidy approach which encourages expansion of commercially-based mortgage lending;

• although only about 30 percent of households can afford an RSS house with a formal mortgage loan, many more households could afford other types of housing, including incremental construction. If credit were available to these households, the process would proceed far faster and more efficiently;

• for many households, long-term financing is appropriate; for more moderate income households, medium-term or shorter-term financing and/or repeat loans are more suitable. New loan products, and alternative approaches to underwriting, including non-mortgage credit for housing-related purposes, will help end the divide.

Overview of the Future Housing Finance System. Chart 1 present a schematic representation of our vision of an expanded housing market, and the potential flows of loan funds in both the primary market and the so-called secondary market, whereby a Secondary Mortgage Facility help banks obtain long-term funds from the capital market.

The “pyramid” used to represent the distribution of income indicates the broad group of moderate and modest income households who could potentially benefit from housing credit. Similarly, note that in the primary market, a greatly expanded group of financial institutions would be involved in making housing loans, including regional banks, selected state and private banks, and a wide range of microfinance institutions, BPR, LDKP, cooperatives, and so forth.

The chart includes several new institutions and policies which are being proposed by HOMI in order to enhance the effectiveness of risk management, long-term funding, credit quality, and downmarket expansion of the system. These include the following:

• a Credit Bureau, which is a debt information center which would serve banks and non-banks alike in determining whether loan applicants are good credit risks. The Credit Bureau would expand on BI’s existing DIS system, providing data are loans much smaller than the DIS limit of Rp.50 million;
- a **Secondary Mortgage Facility (SMF)**, which is a liquidity facility providing lenders with long-term funds from the capital market. The SMF would issue bonds backed by investment quality mortgage portfolios, to be purchased by investors such as pension or insurance funds;

- **mortgage default insurance**, which is a credit enhancement mechanism enabling banks to share the risks of lending to customers who have higher loan-to-value ratio loans in order to increase the affordability of purchasing a home; and

- a **liquidity guarantee fund** to assist in the expansion of microfinance for housing. This effort is currently being addressed as a pilot project by the World Bank.

**CHART 1.0**
**FLOWS OF LOAN FUNDS:**
**PRIMARY & SECONDARY MARKET**
5.1.3 **Overview of the Housing Finance Report.** These proposed institutions and our analyses of the institutions and lending policies in the existing are discussed in the remaining sections of this report.

- Section 2.0 provides an overview of the banking and housing finance sector in Indonesia, and also addresses the current “credit crunch” problems being experienced in the post-Krismon recovery;

- Section 3.0 addresses improvements to mainstream housing finance, especially various aspects of risk management. An overview of the numerous types of risks and funding issues that face housing finance systems worldwide introduces section 3.0. As noted, we have focused primarily on credit risk, legal and administrative risk, and liquidity risk. This “framework” is then addressed via establishment of a credit bureau (section 3.1); development risk management procedures such as automated underwriting and credit scoring (section 3.2); improvements to the foreclosure process (section 3.3); and improvements proposed for standardization and underwriting (section 3.4).

- An expansion of mortgage lending downward toward households of moderate income, but still “bankable” households is the topic of section 4.0. Sections 4.1 and 4.2 discuss moderate income housing finance internationally and in Indonesia. Tools and incentives for going downmarket might come in the form of alternative loan products and risk-based pricing (section 4.3) or a credit enhancement such as mortgage default insurance (section 4.4).

- Microfinance for housing for modest and lower income households. is addressed in section 5.0. Micro finance for housing (MHF) is a relatively new discipline, combining elements of microfinance, consumer, and housing lending. Based on its extensive low income lending network, as noted above, Indonesia has the potential to expand MFH.

- Regulation and supervision of housing finance is discussed in section 6.0. As housing finance becomes a more important part of bank portfolios, it warrants special regulatory parameters and supervisory procedures to help insure that this “relatively risky” sector is prudently monitored.

- Finally, an assessment of options for long-term funding via the capital market is discussed in section 7.0. We describe HOMI’s recommendations for an SMF and the structure that it might take to become an effective long-term funding mechanism for housing.
5.2 The Banking Sector And Mortgage Banking In Indonesia

Overview. Although Indonesia’s real economy is staging a modest recovery from Krismon, the financial sector is still struggling with its aftermath. In particular, the Indonesian banking sector was very severely affected by Krismon and its recovery is far from complete. The recovery process is witnessing major bank restructuring, newly emerging players in housing finance, a virtual hiatus in construction lending, a dramatic drop in residential mortgage finance, and an especially dominant role played now by GOI debt instruments in the financial sector. Added to these factors is a housing subsidy policy, the KPR/RSS interest rate subsidy policy, which hinders rather than facilitates market expansion. The severe downturn besetting real estate finance is yet one more example of worldwide evidence implicating this sector in financial crises. Together, all these factors have a major impact on the recommendations presented in this report, which focus on a variety of recommendations aimed primarily at improving risk management.

This chapter first provides an overview of the structural changes in the banking sector and the very severe drop in lending. Overall, total bank credit as a share of GDP has fallen precipitously. We then discuss mortgage finance, which has also experienced a dramatic decrease. Relatively, unsubsidized KPR (KPR UMUM) has fallen more severely than overall credit, when compared with GDP. Total KPR (including KPR/RSS) has fallen proportionately with overall credit. However, KPR/RSS, now mostly offered by BTN, has increased its share of the total. Construction finance, however, has nearly ceased.

In order to understand better the present condition of (unsubsidized) mortgage finance and the banks currently active, or likely to be active, in this market, HOMI has carried out two bank surveys. The first survey, and the one primarily addressed in this section, is a survey of private banks, all of whom provide KPR UMUM (unsubsidized mortgage loans). The second bank survey has focused on banks, other than BTN, offering KPR/RSS and also more likely to have an interest in downmarket lending to moderate income households; these results are featured in section 4.0. The issues we sought to address include the following:

- What is the status of the overall financial health of these banks?
- What factors are influencing their mortgage and other lending?
- What are the main characteristics of their mortgage lending? Risk management? Loan products? Desired market segment?
5.2.1 **Structural Changes in the Banking Sector.**

The restructuring of the banking sector has resulted in very major changes in the landscape. An overview is provided in Table 2.1 below. The number of private banks has fallen dramatically, while the number of state-owned banks increased. Bank credit outstanding fell precipitously between 1997 and 2000, dropping nearly 40 percent. In addition, the shares of deposits and credit outstanding at state, private and foreign banks changed markedly during Krismon. State-owned banks now dominate deposits and have increased their share of loans outstanding. As the share of credit from foreign banks has also increased, private banks have suffered a major loss, both absolutely and relatively, in both deposits and credit outstanding.

The merger process is apparently not yet completed. GOI has decided to consolidate five previously private banks that were nationalized in 1999 (Bank Bali, Bank Universal, Bank Patriot, Bank Prima Express, and Bank Artha Media). The merger was decided upon because four of these banks are not likely to meet the CAR ratio of 8 percent. While a major restructuring of the sector was no doubt overdue, especially with regard to the number of inadequately capitalized private banks, in the long-run, it would be preferable to see private banks regain their dominance, as is being encouraged for emerging nations worldwide.

**Table 2.1 Changes in Banking Sector Structure**

<table>
<thead>
<tr>
<th>Type of Bank</th>
<th>Number of Banks</th>
<th>Share of Deposits (percent)</th>
<th>Bank Credit Outstanding (bil.)</th>
<th>Share of Bank Credit Outstanding</th>
</tr>
</thead>
<tbody>
<tr>
<td>State-owned*</td>
<td>34</td>
<td>43</td>
<td>37%</td>
<td>70%</td>
</tr>
<tr>
<td>Private</td>
<td>160</td>
<td>79</td>
<td>57%</td>
<td>18%</td>
</tr>
<tr>
<td>Foreign*</td>
<td>43</td>
<td>39</td>
<td>6%</td>
<td>12%</td>
</tr>
<tr>
<td>Total</td>
<td>237</td>
<td>161</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Sources: BI; Indonesia: Accelerating Recovery in Uncertain Times, World Bank, October 2000

The aftermath of Krismon has seen a tremendous transfer of banking system loan assets to IBRA,, but even though this has reduced NPLs, they were still 30 percent of the loan
portfolio in mid-2000. Banks’ balance sheets are now dominated by recap bonds and SBIs (BI bonds). Compared with 1996-1997 benchmarks, only relatively minor portions of bank assets are currently in loans. The share of recap bonds is major or dominant at many banks. Thus, normalization of the bond market, now flooded with GOI debt instruments will be difficult.

The banks’ CAR position is problematic; it appears adequate in some cases only because of the zero risk weight of the GOI debt. As a consequence, as the recap bonds are retired, there will be great pressure on CAR for some banks. For banks now holding variable weight recap bonds, the incentive to quickly expand their lending may be small. Other banks, holding fixed rate recap bonds, may struggle to minimize capital losses.

**The Recovery Plan and Housing Finance.** The situation in the banking sector, and Indonesia’s policy response to the problems, has important implications for the development of housing finance. Based on Indonesia’s own “Ten Point” restructuring program, recommendations have been set forth for increasing the strength and soundness of the financial sector. We note several of the points that pertain to the financial sector and comment on the particular relevance to housing finance:

- *Improvement of the regulatory and supervisory oversight of the entire financial sector.* Housing finance, including commercial and construction lending, can benefit from regulatory parameters designed specifically for this sector. We present some recommendations in section 6.0 Furthermore, a major conclusion of a comprehensive study of the micro lending sector is that regulation and supervision of these lenders is urgently needed to help improve their safety and soundness and consequently their ability to better serve their clientele.

- *Market-based consolidation, divestment policy for state banks, and redefinition of state bank roles.* The dominance of state banks is a cause for concern in Indonesia, as state banks have historically had weak controls and excessive operating costs. BTN is no exception. The role of BTN has been closely tied to the KPR/RSS subsidy policy and its financial position has frequently been precarious. If this subsidy policy is phased out, as is the recommendation of HOMI, BTN’s future role should be clarified. If BTN remains the state-owned housing bank lending on an “unsubsidized basis”, every effort must be made to see that this is actually the case. A level playing field must be maintained. BTN must not undercut the commercially viable rates of other housing lenders on the assumption that it will shored up with state capital if its difficulties continue. Neither should the government place demands on BTN that decrease its viability or competitiveness. Ideally, BTN might be privatized and target the moderate income housing market with appropriate mortgage products.
• **Broadening of access to financial services.** Among the points in Indonesia’s restructuring plan is rationalizing the roles of thousands of rural banks and integrating the roles of finance companies and pawnshops which provide important sources of credit for micro borrowers. Since, as discussed in sections 4.0 and 5.0, one of our key goals is to help housing finance expand to moderate and lower income households, and to involve more lenders in this market (including perhaps the regional banks, microfinance institutions, credit unions and other micro lenders) this would be a major step forward.

### 5.2.2 Real Estate Finance in Indonesia

As noted, residential mortgage lending has fallen sharply during Krismon and construction credits even more sharply. Table 2.2 indicates the changes since 1996 in both the amount of mortgage credit outstanding and its position relative to total bank credit and GDP. The table provides figures through 2000, but as of April 2001 little progress had been made. KPR (residential mortgage credit) outstanding totaled Rp.12,016 billion, up only slightly from that in 2000, while construction credit, at Rp.191 billion, was entirely stagnant. The total was thus Rp. 12,207 billion, up only marginally from Rp. 11,912 at the end of 2000.

Following Krismon, not only has total real estate credit fallen, but it has also changed structure. Unsubsidized residential credit – KPR UMUM - fell by 41 percent between 1997, its high point of Rp. 13,185 billion, to 7,762 in 1999. As a consequence, subsidized lending, KPR-RSS, has risen as a percent of total KPR lending from 19.2 percent of the total KPR in 1996 to 33.6 percent in 1999. Correspondingly, the number of KPR-RSS borrowers remained fairly steady through 1999, while the number of KPR borrowers has fallen steadily since 1997. Construction credit has fallen relative to total KPR from 17.54 percent in 1996 to 1.67 percent in 2000.

Various comparisons to GDP help provide an overview of the sector’s situation. Between 1996 and 2000, the relative fall in total real estate lending – all KPR lending and construction credit – fell from 3.32 percent of GDP to 0.92 percent of GDP. In the same period, total bank credit fell from 55 percent of GDP to 20 percent. Thus, although both comparisons are alarming, the relative demise of real estate credit was greater than for total credit.

More to the point, KPR-RSS lending has to some extent supported the sector during this period. If KPR-RSS is removed from the calculation, unsubsidized real estate finance fell from 2.78 percent of GDP in 1996 to 0.74 percent in 1999.
As indicated in Table 2.2, state-owned banks, notably BTN, and private commercial banks together conduct the vast majority of mortgage lending, with foreign banks and regional banks contributing only marginally. Reflecting the situation in the banking sector overall, the share of mortgage lending by private banks fell during Krismon from a 43 percent share in 1996 to 33 percent in 2000.11

Table 2.3 provides more detail: type of real estate lending by type of bank. In 1999 separate totals are available for KPR/RSS and KPR UMUM lending. State banks clearly dominate
KPR/RSS lending, providing 92 percent of the subsidized credit; this is, of course, mostly due to dominance of BTN in KPR/RSS. Private banks provide 32.7% of KPR UMUM, on the other hand, as well as 16.5 percent of construction lending. In 2000, the private banks’ share of construction lending had risen to nearly 36 percent (of a falling total). The role of regional banks in KPR lending has always been small; nevertheless, it declined markedly in 2000 to 2.3 percent of total real estate lending, down from 5.4 percent in 1999.

### Table 2.3 Total Mortgage Lending by Type of Bank

<table>
<thead>
<tr>
<th>Type of Bank</th>
<th>1999</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>KPR/RSS</td>
<td>KPR UMUM</td>
</tr>
<tr>
<td>Total</td>
<td>36.19</td>
<td>4.440</td>
</tr>
<tr>
<td>% of Column</td>
<td>92.2%</td>
<td>57.2%</td>
</tr>
<tr>
<td>CONST. LOAN</td>
<td>445</td>
<td>6504</td>
</tr>
<tr>
<td>% of Column</td>
<td>77.3%</td>
<td>69.4%</td>
</tr>
<tr>
<td>GRAND TOTAL 1999</td>
<td>8509</td>
<td>7,109</td>
</tr>
<tr>
<td>% of Column</td>
<td>63.3%</td>
<td>55.9%</td>
</tr>
<tr>
<td>TOTAL KPR</td>
<td>7,400</td>
<td>109</td>
</tr>
<tr>
<td>% of Column</td>
<td>63.2%</td>
<td>0.5%</td>
</tr>
<tr>
<td>CONST. LOAN</td>
<td>109</td>
<td>36.2%</td>
</tr>
<tr>
<td>% of Column</td>
<td>55.9%</td>
<td>55.9%</td>
</tr>
<tr>
<td>GRAND TOTAL 2000</td>
<td>7,529</td>
<td>36.2%</td>
</tr>
<tr>
<td>% of Column</td>
<td>63.2%</td>
<td>55.9%</td>
</tr>
<tr>
<td><strong>Private Banks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>172</td>
<td>2,542</td>
</tr>
<tr>
<td>% of Column</td>
<td>4.4%</td>
<td>32.7%</td>
</tr>
<tr>
<td><strong>Regional Banks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>136</td>
<td>452</td>
</tr>
<tr>
<td>% of Column</td>
<td>3.4%</td>
<td>6.0%</td>
</tr>
<tr>
<td>SUBTOTAL &amp; Grand Total</td>
<td>3926</td>
<td>7,762</td>
</tr>
<tr>
<td>% of Column</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Foreign Banks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>-----</td>
<td>318</td>
</tr>
<tr>
<td>% of Column</td>
<td>-----</td>
<td>4.1%</td>
</tr>
<tr>
<td>SUBTOTAL &amp; Grand Total</td>
<td>3926</td>
<td>7,762</td>
</tr>
<tr>
<td>% of Column</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td><strong>Grand Total by Year</strong></td>
<td>12,245</td>
<td>11,910</td>
</tr>
<tr>
<td>% of Annual Grand Total</td>
<td>32.1%</td>
<td>63.4%</td>
</tr>
<tr>
<td>% of Annual Grand Total</td>
<td>4.7%</td>
<td>100%</td>
</tr>
<tr>
<td>% of Annual Grand Total</td>
<td>98.4%</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

Source BI, Indonesian Financial Statistics, September 2001

* less than 0.5 billion

#### 5.2.3 Key Findings from the Bank Surveys and Interviews

In order to gain a more in depth understanding of the banks’ situation with regard to mortgage lending, HOMI conducted a survey of a sample of banks with a questionnaire distributed through Perbanas. Follow-up interviews were also held with each bank to better understand their plans regarding housing finance; their conduct of mortgage finance, including origination, underwriting, and servicing; their IT systems for mortgage finance, and the major problems they face.\(^\text{12}\) Table 2.4 lists the banks completing the survey and summarizes their key indicators. Table XXX in the Annex provides more detail concerning the change in some of the key bank indicators between 1996 and 2000.
Technical Assistance For Policy Development For Enabling The Housing Market To Work In Indonesia

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Table 2.4 Summary Descriptions of Banks in HOMI Bank Survey I.

<table>
<thead>
<tr>
<th>Bank</th>
<th>Total Branches</th>
<th>Assets (millions)</th>
<th>Capital</th>
<th>CAR (%)</th>
<th>NPL (%)</th>
<th>Profitability</th>
<th>Liquid</th>
<th>NIM (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>ROA</td>
<td>ROE</td>
<td>LDR</td>
</tr>
<tr>
<td>BCA</td>
<td>798</td>
<td>36,188</td>
<td>7,005</td>
<td>35,10</td>
<td>4,24</td>
<td>1,81</td>
<td>31.42</td>
<td>9,49</td>
</tr>
<tr>
<td>EUKOPIN</td>
<td>140</td>
<td>9,104</td>
<td>420</td>
<td>15,42</td>
<td>1,50</td>
<td>2,21</td>
<td>42.63</td>
<td>60,28</td>
</tr>
<tr>
<td>NISP</td>
<td>68</td>
<td>5,261</td>
<td>379,3</td>
<td>9,94</td>
<td>6,11</td>
<td>1,52</td>
<td>20,10</td>
<td>59,26</td>
</tr>
<tr>
<td>UPPO</td>
<td>357</td>
<td>22,627</td>
<td>2,633</td>
<td>21,08</td>
<td>4,11</td>
<td>1,10</td>
<td>13,20</td>
<td>18,26</td>
</tr>
<tr>
<td>BUMIPUTERA</td>
<td>22</td>
<td>1,215</td>
<td>182</td>
<td>17,74</td>
<td>4,40</td>
<td>1,01</td>
<td>5,04</td>
<td>66,77</td>
</tr>
<tr>
<td>HAGA</td>
<td>33</td>
<td>1,582</td>
<td>62,6</td>
<td>8,14</td>
<td>19,02</td>
<td>0,68</td>
<td>17,16</td>
<td>46,35</td>
</tr>
<tr>
<td>DANAMON</td>
<td>490</td>
<td>16,168</td>
<td>4,528</td>
<td>57,97</td>
<td>8,59</td>
<td>0,49</td>
<td>3,21</td>
<td>18,38</td>
</tr>
<tr>
<td>NIAGA</td>
<td>95</td>
<td>18,669</td>
<td>1,096</td>
<td>21,34</td>
<td>13,13</td>
<td>0,51</td>
<td>(1,77)</td>
<td>43,86</td>
</tr>
<tr>
<td>ARTHAAGRAHA</td>
<td>63</td>
<td>3,706</td>
<td>119</td>
<td>0,90</td>
<td>2,42</td>
<td>0,15</td>
<td>2,1</td>
<td>87,90</td>
</tr>
<tr>
<td>BAI</td>
<td>275</td>
<td>11,700</td>
<td>384</td>
<td>13,60</td>
<td>2,74</td>
<td>(11,87)</td>
<td>3,28</td>
<td>12,51</td>
</tr>
<tr>
<td>UNIVERSAL</td>
<td>12,000</td>
<td>209</td>
<td>4,48</td>
<td>12,34</td>
<td>0,03</td>
<td>1,34</td>
<td>54,54</td>
<td>3,3</td>
</tr>
<tr>
<td>INDOESIAN AVERAGE</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>0,53</td>
<td>9,15</td>
<td>44,00</td>
</tr>
</tbody>
</table>

Data for 2000
Source: Banks Annual Reports 200: HOMI Bang Survey I

Private banks rather than public were selected for the survey. It was also assumed that the banks already have, or are expected to have, a keen interest in developing consumer finance, including mortgage finance. Beyond that, the selection was designed to provide a wide variation in level of assets, branch network, and current situation with regard to mortgage lending. Not all banks likely to be involved in mortgage finance in the future were included. For example, the banks likely to be active include BNI, Mandiri, and Citibank as well as BCA (Bank Central Asia), Danamon, Arthagraha, and NISP, which were among the surveyed banks.

The surveyed banks had also had very different experiences under restructuring. Bank Danamon re-emerged as one of Indonesia’s designated core banks, along with BCA in the private sector and Bank Mandiri and Bank BNI in the public sector. Also, with regard to mortgage finance, the surveyed banks illustrate the very different stories emerging from the impact of Krismon and the recovery process. For example, for Bank Bali, outstanding residential lending in 2000 is only about 30 percent of the level reached in 1997, and construction lending has also fallen significantly. For Bank Haga, in contrast, after an abrupt fall in 1999, residential lending has now recovered to just above 1997 levels; construction lending is still stagnant. (The mortgage portfolio is quite small at Bank Haga, however.) Finally, Bank Danamon, which currently has the largest mortgage portfolio...
among our sampled group, purchased a substantial share of the residential mortgage portfolio held by IBRA, and has as a consequence more than recovered from the precipitous fall in its mortgage loans which occurred in 1999. (It should be noted, however, that the bank regards some of the portfolio purchased form IBRA as a general investment rather than a mortgage asset per se.)

**CAR.** There is a wide variance in the CAR position of the surveyed banks. Several of the banks barely meet, or do not meet, the international standard of 8 percent, while others show quite high CAR. However, the data are somewhat misleading for banks that have recently been restructured, as the current CAR may not be indicative of a longer-term steady state. To some extent, CAR position reflects asset size, as BCA, Danamon, Lippo, and Niaga all show CAR in excess of 20 percent.

The trends over time in CAR position also show a mixed picture. See table 2.5; the change in CAR position is between 1996 and 2000 unless otherwise noted in the table. Overall, CAR has fallen for four of the surveyed banks (NISP, Bumiputra, Bali, Universal), improved for five of them (BCA, Lippo, Danamon, Niaga, Bukopin), and remained about the same for two (Arthagraha and Haga). The general feeling among Indonesian banking experts, however, is that CAR positions are weak.

**NPL.** The NPL position is also extremely mixed. For Haga, Niaga, Universal, and Danamon, NPLs are currently quite high. For Bukopin, Bali, and Arthagraha, on contrast, the NPL levels are more modest. Relying again on the trend over time to provide more insight, the NPL situation has improved at Danamon and Bumiputra, but worsened at BCA, Lippo, NISP, Haga, Niaga and Universal (see tables 2.4 and 2.5; also, NPL for KPR lending in selected banks is discussed in section 2.4 below.)
Table 2.5 BANK INDICATORS OVER TIME

<table>
<thead>
<tr>
<th>BANK INDICATORS OVERTIME</th>
<th>Loans as % of Total Assets</th>
<th>GCI Bonds as % of Total Assets</th>
<th>CAR</th>
<th>LDR</th>
<th>NPL</th>
</tr>
</thead>
<tbody>
<tr>
<td>BCA (1995) (2000)</td>
<td>64.2%</td>
<td>N/A</td>
<td>8.49%</td>
<td>73.96</td>
<td>0.85</td>
</tr>
<tr>
<td></td>
<td>8.5%</td>
<td></td>
<td>44.43%</td>
<td>9.49</td>
<td>4.24</td>
</tr>
<tr>
<td>NSP (1999) (2000)</td>
<td>73.1%</td>
<td>48.3%</td>
<td>14.05</td>
<td>79.33</td>
<td>2.55</td>
</tr>
<tr>
<td></td>
<td>57.5%</td>
<td>27.4%</td>
<td>9.91</td>
<td>59.36</td>
<td>6.11</td>
</tr>
<tr>
<td>Lippo (1996) (2000)</td>
<td>n/a</td>
<td>n/a</td>
<td>13.28</td>
<td>85.94</td>
<td>n/a</td>
</tr>
<tr>
<td></td>
<td>15.1%</td>
<td>26.9%</td>
<td>21.03</td>
<td>13.28</td>
<td>35.75</td>
</tr>
<tr>
<td>Bumiputra (1998) (2000)</td>
<td>n/a</td>
<td>n/a</td>
<td>27.58</td>
<td>40.0</td>
<td>10.37</td>
</tr>
<tr>
<td></td>
<td>n/a</td>
<td>n/a</td>
<td>17.74</td>
<td>66.77</td>
<td>4.44</td>
</tr>
<tr>
<td></td>
<td>45.2%</td>
<td></td>
<td>8.14</td>
<td>46.35</td>
<td>13.02</td>
</tr>
<tr>
<td>Danamon (1999) (2000)</td>
<td>137.0%</td>
<td>49.0%</td>
<td>-7.75</td>
<td>240.2%</td>
<td>63.13</td>
</tr>
<tr>
<td></td>
<td>9.1%</td>
<td></td>
<td>57.97</td>
<td>18.4%</td>
<td>8.59</td>
</tr>
<tr>
<td>Naga (1997) (2000)</td>
<td>82.9%</td>
<td>N/A</td>
<td>9.44</td>
<td>124.02</td>
<td>2.47</td>
</tr>
<tr>
<td></td>
<td>33.7%</td>
<td>50.0%</td>
<td>21.34</td>
<td>43.66</td>
<td>15.96</td>
</tr>
<tr>
<td></td>
<td>n/a</td>
<td>n/a</td>
<td>-13.60</td>
<td>7.85</td>
<td></td>
</tr>
<tr>
<td>Universal (1996) (2000)</td>
<td>77.3%</td>
<td>43.4%</td>
<td>8.58</td>
<td>88.69</td>
<td>2.55</td>
</tr>
<tr>
<td></td>
<td>49.4%</td>
<td>31.8%</td>
<td>4.48</td>
<td>54.54</td>
<td>12.34</td>
</tr>
</tbody>
</table>


*with DIT

**CAR and NPL Position Together.** To get a broader picture of financial health, we assessed the joint distribution of CAR and NPL. A relatively “good” position would be CAR greater than 8 percent and NPL (arbitrarily) below 5 percent. Six banks meet this criterion: BCA, Bukopin, Lippo, Bumiputra, Arthagraha, and Bank Bali. Only Bank Universal fell into the unhealthy position of CAR less than 8 percent and NPL greater than 5 percent. (see table XXX in the Annex.)

**ROA, ROE and NIM.** Return on assets (ROA), return on equity (ROE), and net interest margin (NIM) correspondingly also show a mixed pattern, with several banks still in a very tenuous position. Bank Bali and Bank Niaga, for example, are still in the process of restructuring and liquidity support.
5.2.4 Lending Operations for KPR UMUM: Unsubsidized Mortgage Lending

The housing finance sector is now faced with the task of rebuilding its portfolios. The level of effective demand is uncertain, and, as discussed below, a credit crunch seems to be prevailing. Nevertheless, to assure its long-term health, the sector must address risks, most especially credit risk, but also administrative and legal risks, as discussed in subsequent sections. Key features of the lending operations are discussed below.

**Loan Products.** The most common loan product is a discretionary variable rate mortgage (VRM). Common adjustment periods are 3 and 6 months, although the banks note that the adjustment could be made at any time. Adjustments are made at the discretion of the lender and there are no annual or other limits (caps) that define the size of the periodic adjustments nor the life-of-loan total adjustment.

The typical term is generally 8 to 10 years; 15 years is the most common maximum. Loan-to-value ratios (LTV) generally range from 50 to 80 percent, with 70 percent being quite typical. Payment-to-income ratios are generally between 30 and 35 percent. It should be noted, however, that it is very difficult to compare LTVs and payment-to-income ratios across the banks because of very different approaches to defining these terms. For example, some banks adjust income for various living expenses before calculating the ratio, while others do not. Similarly, the “value” used in the LTV has no common definition. In some circumstances, a sales price quoted by the developer is utilized, without reference to appraised value. These differences in approach pose problems with regard to standardization, which is further discussed in section 3.4.

**Alternative Loan Products.** There are a wide variety of loan products commonly used by countries with more mature, and more automated, mortgage systems, including a wide variety of adjustable rate mortgages (ARMs), “combination fixed and variable, balloon mortgages, and so forth. Several alternative loan products, some of which may be more suitable for lending downmarket to more modest income households, are discussed in section 4.0. Similarly, fixed rate loans are often used in micro lending for housing as discussed in section 5.0.

Let us simply note here, however, that there are advantages and disadvantages to the type of discretionary VRM loan product used by all the mainstream banks in Indonesia. From the perspective of the lender, a discretionary VRM places the interest rate risk on the borrower – potentially entirely on the borrower. While this approach may be suitable for
higher income borrowers, those of more modest income could potentially suffer from “credit shock” if large increases were made at one time, thereby increasing the risk of delinquency and default. One of the key mortgage lenders in our bank survey (Bank Survey I) also notes that there are problems of financial management with the discretionary VRMs. In addition, although VRMs are now securitized in Australia, it is a far more complex process than with certain other loan types, which is something to be kept in mind for the long run development of securitization in Indonesia.

**KPR Market Segment of Mainstream Banks.** KPR UMUM mortgage lending (unsubsidized) by the surveyed banks is now concentrated at the very high end of the market, with the major share of loans centering around Rp. 200 – 500 million. Only three of the banks had made any KPR UMUM loans of less than Rp. 50 million, and these represented a very small share of the portfolio. In contrast, there was a much more significant focus by the surveyed banks on loans of Rp. 300 million and above, including loans of over Rp. 1,000 million.

The KPR/RSS programs of a number of these banks were noted to be unsuccessful or problematic; in any event, this type of lending by banks other than BTN is now very limited. Despite the potential for a wide spread in the cost off funds for these loans, there have apparently been frequent delays in receiving the requisite funds from MOF.

There was a wide mix of opinion as to whether these surveyed banks would go downmarket in the future with an unsubsidized loan product, with smaller loans, and less affluent clients. On one hand, there was little desire expressed by some surveyed banks to consider going downmarket primarily because they considered that the returns were not worth the increased risk and transaction costs. One bank noted that it would go downmarket to Rp.30 million if payroll deduction was in place. Another of the surveyed banks, which now targets the Rp.100 million to 1 billion market, is apparently thinking about going downmarket, and is reportedly working with a subprime lender from the U.S.

In part, however, the downmarket decision largely depends on the future of the KPR/RSS system and the role of BTN. As discussed elsewhere in HOMI reports, a crucial step en expanding the market downward is to replace the KPR/RSS subsidy system with a non-market-distorting subsidy model. Second, a “level playing field” that provides assurance that BTN becomes a market player, is also required. BTN has indicated that its business plan calls for 80 percent of its lending to be on a commercial basis by 2003 and be fully
commercial by 2004. BTN plans to target two market segments: 50 – 100 million, and 100 – 200. If there is truly a level playing field with regard to BTN, a number of banks indicated that they would also consider going downmarket.\textsuperscript{13}

**Underwriting, Risk Management, Appraisal, and IT for Mortgage Finance.** The extent and quality of underwriting varied widely from bank to bank. Bank IT systems for mortgage finance seem generally weak. Some are not automated, and others do not have IT systems connected with the main bank systems. Many are not staffed with personnel with KPR experience. This is, in part, due to small KPR portfolios most banks.

A credit scoring system had been developed by only two of the surveyed banks. None of the banks had automated procedures for application and underwriting. At least half the surveyed banks made use of BI’s DIS (debt information service), which is very useful for a limited type of check – loans of at least Rp. 50 million made by banks. However, given that Indonesia does not have a credit bureau it is not possible to verify the total debts owed by households – the so-called gross debt ratio – nor to determine debt payment behavior. While it is fortunate that there appears to be good use of BI’s database on bad debts, development of a full-fledged credit bureau is one of our major recommendations (see section 3.0 below).

Only one of the surveyed banks is introducing risk-based pricing (in this one case, the interest rate will fall with lower LTV). Overall, it appears that risk management needs significant improvement. As testimony to the need for better IT systems, the IFC has invested in one of the key banks surveyed here and is also providing technical assistance on IT.

As noted above, calculation of the payment–to-income ratio varies widely by bank according to the way income is defined. Similarly, the LTV is defined differently not only on the basis of the value calculation, but also based on treatment of closing and other costs. Closing costs range between 4 and 8 percent of the loan value, and may or may not be included in the bank’s LTV. Thus, a better distinction between LTV and CLTV (closing loan to value) needs to be made.

Much more importantly, however, appraisal practices present a mixed picture in Indonesia, and the quality of the valuations may vary widely. The LTV is a crucial element in risk management. As discussed further in subsequent chapters, an accurate, consistent, and
standardized LTV is crucial to risk management: to evaluation of default probabilities, to determination of the interest rate in a system of risk-based pricing, and to assessment of the need for mortgage insurance and/or calculation of the charges for mortgage insurance.

Indonesia is a member of the ASEAN Groups, the Asian Association of Appraisers. We have been informed that, generally, both knowledge of the appraisal methodologies and appraisal training are adequate. The problems appears to lie with bank practices on (1) selecting the “statistic” used to represent value, and (2) whether or not an independent appraisal is conducted. In practice, rather than an appraised value, some banks base the loan amount on either “cost” or the developer’s sales price, and do not conduct an appraisal. For RSS housing, this may be standard practice, and the deviation between cost and market value may not be large (although there are sure to be exceptions in certain markets). Especially for higher-priced housing, however, the correlation between cost and sales price may be considerably weaker. To the extent that banks use a “value” offered by the developer, without independent valuation by an accredited appraiser, the risks are magnified. Thus, it is not clear whether the LTV lending criteria are generally conservative or not. Although most banks cited an LTV of .70, neither the LTV nor payment-to-income ratios can be effectively compared across lenders.

KPR Lending: Non-Performing Loan Status. Table 2.6 summarizes the NPL status of all real estate lending from BI’s statistics through April 2001. In this table, loans classified as “doubtful” or “loss” are presented as a percent of total lending for KPR and construction loans (note again that after 1999, BI classifies KPR and KPR/RSS together).

**Table 2.6 Post-Krismon NPL Status in Real Estate Loans (Doubtful/Loss)**

<table>
<thead>
<tr>
<th>Bank/NPL Status</th>
<th>1999</th>
<th>2000</th>
<th>2001 (April)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>KPR/RSS</td>
<td>KPR</td>
<td>Construction</td>
</tr>
<tr>
<td>Government Banks</td>
<td>1.02%</td>
<td>2.13%</td>
<td>15.22%</td>
</tr>
<tr>
<td>Private Banks</td>
<td>1.64%</td>
<td>3.01%</td>
<td>16.24%</td>
</tr>
<tr>
<td>Regional Banks</td>
<td>1.76%</td>
<td>3.59%</td>
<td>13.72%</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>0.00%</td>
<td>0.71%</td>
<td>0.00%</td>
</tr>
</tbody>
</table>

Source: data provided by BI

* Doubtful = 180-270 delinquent; Loss > 270 days delinquent
Table 2.7 provides detailed NPL data from the HOMI Survey data. Doubtful and loss figures are provided for 6 state banks, primarily regional banks and for six of the private banks that offer KPR/RSS loans. The data represent the status as of March 2001. With the exception of BPD Jateng among the state banks, and Kesejahteraan among the private banks, the doubtful and loss ratios are both quite low.

<table>
<thead>
<tr>
<th>Bank</th>
<th>KPR Loans</th>
<th>KPR/RSS Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Rp. Mil.)</td>
<td>% Doubtful or Loss</td>
</tr>
<tr>
<td>State Banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BPD Jabar (West Java)</td>
<td>1,190</td>
<td>0.0%/0.0%</td>
</tr>
<tr>
<td>BPD Jateng (Central Java)</td>
<td>5,119</td>
<td>1.8%/4.30%</td>
</tr>
<tr>
<td>BPD Jatim (East Java)</td>
<td>None</td>
<td>n.a.</td>
</tr>
<tr>
<td>BPD Sumatera II (South Sumatra)</td>
<td>1,279</td>
<td>0.0%/0.0%</td>
</tr>
<tr>
<td>Antara Daerah (Sumatera)</td>
<td>None</td>
<td>n.a.</td>
</tr>
<tr>
<td>Bank DKP (Jatim)</td>
<td>35,920</td>
<td>3.67%/0.96%</td>
</tr>
<tr>
<td>Private Banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kesejahteraan</td>
<td>None</td>
<td>n.a.</td>
</tr>
<tr>
<td>Swissarmindo International</td>
<td>None</td>
<td>n.a.</td>
</tr>
<tr>
<td>Artha Graha</td>
<td>666,159</td>
<td>0.03%/0.15%</td>
</tr>
<tr>
<td>Bank Niaga</td>
<td>907</td>
<td>0.0%/0.0%</td>
</tr>
<tr>
<td>Bank Bul opin</td>
<td>22,278</td>
<td>0.40%/0.53%</td>
</tr>
<tr>
<td>Bank Bumiputra</td>
<td>30,079</td>
<td>0.02%/1.27%</td>
</tr>
</tbody>
</table>


* 2000

First, by 2000, the post-Krismon portfolios of KPR lending exhibited acceptable loss levels. In 1999, private banks were still experiencing a relatively high loss level on KPR/RSS. By 2000, total KPR lending overall had a doubtful (delinquent 180-271 days) rate ranging form less than 1 percent in the state banks to 2.27 percent in the regional banks, and a loss (delinquent > 270 days) of only 1 to 2 percent. However, even post-Krismon, construction lending has continued to exhibit serious loses of 10 to 20 percent; in April 2001, regional banks experienced a particularly serious loss rate of 44 percent. Several points should be noted, based on observations from both tables.

Second, however, it is not al at clear that these NPL figures are representative of the ratios that would occur in a more “steady state” picture. The vast majority of bad loans were transferred to IBRA. Also, many of the portfolios represented in the tables above are relatively recent, and have not had a chance to season. And, as discussed below, banks are lending in an extremely risk averse manner. Thus, in the next several years, a somewhat
more seasoned, or long-term, picture of the delinquency and foreclosure rates is likely to emerge.

5.2.5 Liquidity, Asset/Liability Management, and Mortgage Lending. The surveyed banks, with three exceptions, were reluctant to provide information on their current portfolios of mortgage loans. We have been guided in our assessment of the present position of banks with regard to long-term lending, including mortgage lending, by the banks’ comments and qualitative assessments by experts with regard to the current liquidity position and the outlook for long-term lending.14

There are several issues here:

- The extent of the term mismatch between assets (loans) and liabilities (deposits);
- The banks’ liquidity position; and
- The reasons underlying the very low rate of mortgage loan origination.

As noted above, although the maximum term for the mortgage loans is 15 years, the loans are generally let for about 8 to 13 years. The average real life of the mortgage loans is somewhat less, however., research carried out by Bank Pappan in 1997, calculated that the real life of the mortgage loans was between 5 and 8 years. This figure was calculated in order to help frame Bank Pappan’s bond issuances. (Most post-Krismon portfolios are too new to provide this type of information.)

Table 2.8 Deposit Structure by Type of Deposit and Type of Bank
Rupiah Deposits in Billions of Rupiah

<table>
<thead>
<tr>
<th>Bank / Type of Deposit</th>
<th>Demand Deposit</th>
<th>Savings Deposit</th>
<th>Time Deposit 1 month</th>
<th>Time Deposit 3 month</th>
<th>Time Deposit 6 month</th>
<th>Time Deposit 12 month</th>
<th>Time Deposit 24 month</th>
</tr>
</thead>
<tbody>
<tr>
<td>State</td>
<td>46270</td>
<td>77250</td>
<td>77,576</td>
<td>43,002</td>
<td>12,623</td>
<td>6510</td>
<td>14259</td>
</tr>
<tr>
<td>Regional</td>
<td>21427</td>
<td>5231</td>
<td>41,23</td>
<td>1247</td>
<td>566</td>
<td>468</td>
<td>21</td>
</tr>
<tr>
<td>Private</td>
<td>34562</td>
<td>81259</td>
<td>91373</td>
<td>20,058</td>
<td>3372</td>
<td>1364</td>
<td>51</td>
</tr>
<tr>
<td>Total</td>
<td>112,094</td>
<td>167,146</td>
<td>179,032</td>
<td>66,342</td>
<td>17,186</td>
<td>88,110</td>
<td>14,362</td>
</tr>
</tbody>
</table>

Source: BI, data are for August 2001, total includes foreign banks

Table 2.8 indicates the extremely short-term nature of the banks deposit liabilities. Almost all the savings deposits are withdrawable at any time. The time deposits are overwhelmingly concentrated in one and three month deposits. The smaller amount of 12 and 24 month time deposits are nearly all deposited in state banks, and are said to be dominated by the
deposits of various pension funds. Thus, the term mismatch between the real loan life of 5 to 8 years, and the short-term profile of deposits is one of the main arguments presented for supporting means of access to the capital market. Although individual banks can issue bonds, CDs, and even MBS (as was in planning by Bank Pappan), calls for a secondary mortgage market market continue. As not market issues are discussed in section 7.0.

**Liquidity.** Despite the sense that banks in Indonesia are currently making few mortgage loans because they lack long-term funds, many expert observers suggest that liquidity is not the main problem. While it is felt that a few banks may face some pressure on liquidity, in general the liquidity position overall is adequate, and is not the main reason for the lack of recovery in mortgage lending. It is felt, for example, that Bank Danamon, Bank Bali, and BCA are reasonably liquid. However, while some banks have increased lending, it is not clear whether this is “new” lending, or purchase of assets from IBRA’s portfolio. The relative dearth of mortgage lending overall has resulted from many factors, including a fall in effective demand. Furthermore, banks are still recovering from Krismon and are extremely cautious.

In addition, the dominance of Government paper in the bond market, and the high yield of government (SBI) paper have let to a situation in which the public sector could be “crowding out” both lending and private initiatives in bond issuance. SBI are risk-free investments, and do not impact CAR. Making mortgage loans, on the other hand, requires putting aside the required provisioning to meet CAR requirements. Furthermore the recap bonds, which are fixed rate, are generally at 12 percent, which would cause large losses if sold for liquidity.

The NIS Annual Report for 2000 has perhaps stated the current position most distinctly: “Although the majority of banks in Indonesia have excess liquidity only a few have sufficient capital to initiate large scale loan expansion. Consequently, the excess liquidity at theses banks tends to be used to purchase securities, particularly Bank Indonesia CDs (SBI)”.

The statistics on this “crowding out” are noted below.

**LDR and the Dominance of Government Bonds.** For the banking sector overall, loan-to-deposit ratios (LDRs) are extremely low. Recap bonds make up 50 percent of bank assets at present. The ratio is similarly low for most of the surveyed banks, and their assets also now tend to be dominated by Government Bonds.
The trend in LDR overtime is especially revealing, as noted in table 2.5. In the last several years, LDR has fallen very dramatically for most of the surveyed banks. For example, for Bank Danamon, LDR has fallen from 245 percent to 18 percent; in 2000, 70 percent of Danamon's portfolio was in held in GOI bonds. For BCA, the LDR has fallen from 74 percent to 9.5 percent, and GOI paper represents 62 percent of the portfolio. As one more example, data for Niaga indicate a fall in LDR from 124 percent to 44 percent, and an asset position with 50 percent GOI bonds. Only for Arthagraha has the fall in LDR been moderate and only for Bumiputra has the LDR position recently improved.

**Conclusions.** This section has reviewed mainstream KPR lending. Partially as a result of the economic downturn, and partially as a result of “credit crunch” behavior, KPR UMUM lending is currently in a serious slump. Sections 3.0, 6.0, and 7.0 present our recommendations for improving the performance, prudence, and funding for this sector.

**5.3 Strengthening Mainstream Housing Finance**

**Overview.** The long-run benefits of an improved housing finance system will be substantial. In large part, the improvements rest on better risk management, prudent regulation and supervision, and access to adequate long-term funding via the capital market. Our recommendations in this report focus primarily on three types of risk: credit risk, legal risk, and funding/liquidity risk.

On overview of the numerous types of risk facing housing finance is presented in Table 3.1 to help provide a backdrop to the specific recommendations detailed in subsequent sections. Worldwide, in every type of housing finance model, there are numerous types of risk that must be addressed to provide a sound, and efficient system. This matrix was initially designed address risk issues in developed country housing finance systems. Although this typology has become one of the standard approaches to risk assessment, it must be made specific to the circumstances of the particular country; refer, therefore, to columns 3 and 4, which summarize our areas of concern and recommendations. This overview matrix will assist the reader in assessing where HOMI has placed its energies in making recommendations for Indonesia: the key sections of the table are highlighted.

The benefits of addressing these long-term issues include the following:
• Improving the investment quality of the mortgage finance portfolio through attention to credit risk and legal and administration risk, ultimately enhancing a bank's competitive position and profitability as well as the ability of the system to withstand shocks;

**TABLE 3.1 RISK TYPOLOGY FOR HOUSING FINANCE**

<table>
<thead>
<tr>
<th>CRITERIA</th>
<th>ISSUES FOR EMERGING ECONOMIES</th>
<th>ISSUE FOR INDONESIA</th>
<th>RECOMMENDATION FOR INDONESIA</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Credit Risk</strong></td>
<td>Appropriate systems crucial to realizing collaterals. Credit bureau access, improved underwriting and credit scoring, appraisal quality, and credit enhancement procedures are important. Computerization and specialized IT are important.</td>
<td>Improving credit risk is, in our opinion, the most important and crucial issue facing the housing finance sector in Indonesia</td>
<td>The majority of our recommendations focus on credit risk, including a credit bureau, automated systems, risk analysis through credit scoring, and so forth</td>
</tr>
<tr>
<td><strong>Legal &amp; Administrative</strong></td>
<td>Need clear rules for ownership, titling, transfer, and information systems that support the analysis of risk. Specialized regulation and supervision.</td>
<td>Improving legal risk issues is the second most important step in Indonesia</td>
<td>Improved foreclosure, titling, transfer, and registration systems, standardization of underwriting &amp; appraisal</td>
</tr>
<tr>
<td><strong>Cash Flow Risk</strong></td>
<td>Loan product design is important. Interest-rate risk shared by borrowers and lenders. Volatile and/or high inflation remains a serious risk.</td>
<td>With discretionary VRMs, interest rate risk is born by borrower. Credit risk should also be considered via other loan products.</td>
<td>Loan products to include alternatives which share interest rate risk, to help downmarket expansion</td>
</tr>
<tr>
<td><strong>System Risk</strong></td>
<td>Important for bank's borrowers, and government to learn to share systemic risks. Need regulation and supervision for housing finance.</td>
<td>DL not now focusing explicitly on housing finance. Should be done in medium-term.</td>
<td>Stronger regulation and supervision for housing finance.</td>
</tr>
<tr>
<td><strong>Agency Risk</strong></td>
<td>Avoiding moral hazard from government systems (such as mortgage or deposit insurance). Managing agency risk is a problem worldwide.</td>
<td>Will be an issue in designing mortgage default insurance, or other guarantees. And new housing subsidy systems.</td>
<td>Both a revised housing subsidy system and mortgage default insurance are being recommended</td>
</tr>
<tr>
<td><strong>Political Risk</strong></td>
<td>Need a stable reform environment with consistent vision of the long-term goal, and consistent efforts to improve the legal administrative framework.</td>
<td>This is actively being sought in Indonesia by Kiprasal, BI, and MOF, especially following Krismon</td>
<td>Improved macroeconomic performance &amp; lower interest rates support housing finance</td>
</tr>
<tr>
<td><strong>Market-based System</strong></td>
<td>Subsidy policies consistent with development of market-based housing finance. Competition and a level playing field.</td>
<td>The KPR-RSS subsidy system inhibits downmarket expansion of housing finance and limits the supply response in building types</td>
<td>Elimination of the KPR-RSS housing subsidy system and a commercially-based role for BI</td>
</tr>
<tr>
<td><strong>Support Functions for the Primary Market</strong></td>
<td>Credit bureau, association of banks and mortgage lenders, appraisal rules and practices,</td>
<td>PERBANAS plays an important role.</td>
<td>A credit bureau, and bank training organized through PERBANAS</td>
</tr>
<tr>
<td><strong>Funding &amp; Liquidity Risk</strong></td>
<td>No &quot;best&quot; funding system worldwide. Need cost-effective, well-regulated access to long-term funds. Competition, a level playing field, &amp; financial deepening will help bring long-term funds to housing.</td>
<td>Long-term funding is not available. A secondary market/liquidity facility will be increasingly important as housing finance expands</td>
<td>Undertake primarily market improvements &amp; other steps necessary to Formation of an SMF in the medium term</td>
</tr>
</tbody>
</table>
• Providing incentives for housing finance to expand downmarket. Use of risk-based pricing methodologies, including establishing a “subprime” market as discussed in section 4.0, will allow banks to safely underwrite loans for more moderate income households. With improved risk management, banks’ margins can be reduced, increasing the affordability of mortgage loans and thus the group of households that can afford loans;

• Preparing the way to enable long-term funding through a secondary market facility (SMF). The investment quality of the mortgage portfolio is probably the single most important factor underlying the ability to use the portfolio as backing for long-term funds, either through a bank’s issuance of its own mortgage-backed debt instrument, or to collateralize its borrowing from an SMF;

Credit Risk. Our approach to improving the investment quality of the mortgage portfolio is summarized in table 3.2, the often-utilized “Three Cs” chart. Again, the classic chart – which addresses Collateral Risk, Credit Reputation, and Capacity to Repay — has been modified to fit the housing finance circumstances of Indonesia. We stress the Three Cs chart, however, because it is a convenient way to summarize credit risk concerns and note our recommendations.

Credit Risk is a major problem in all markets worldwide. Some Indonesian banks are developing their own models of underwriting and credit scoring for assessing housing finance loan applications, but others have much more to accomplish. Some of the ways in which Indonesia can reduce credit risk include:

• Collateral Risk:
  • improving foreclosure and security of land titles;
  • expanding the use of independent appraisals, and including appraisal rules in regulatory parameters;

• Credit Reputation:
  • establishing a credit bureau with both positive and negative information;
  • determining total debt, use of debt, and debt repayment behavior;
  • determining the source of downpayment in a mortgage loan

• Capacity to Repay:
  • automating underwriting and assembly of improved data;
  • development of credit scoring models;
  • development of additional mortgage loan products, sharing risk between borrower and lender;
• development of risk-based pricing; and
• assessment of mortgage default insurance.

TABLE 3.2 THE THREE CS OF UNDERWRITING IN MORTGAGE FINANCE

<table>
<thead>
<tr>
<th>INVESTMENT QUALITY OF THE MORTGAGE PORTFOLIO</th>
</tr>
</thead>
<tbody>
<tr>
<td>COLLATERAL QUALITY</td>
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<tr>
<td>BORROWER CREDIT WORTHINESS</td>
</tr>
<tr>
<td>COLLATERAL</td>
</tr>
<tr>
<td>CREDIT REPUTATION</td>
</tr>
<tr>
<td>CAPACITY TO REPAY</td>
</tr>
<tr>
<td>House value</td>
</tr>
<tr>
<td>Repayment history</td>
</tr>
<tr>
<td>Borrower income</td>
</tr>
<tr>
<td>Stability of house value</td>
</tr>
<tr>
<td>Age of loan accounts</td>
</tr>
<tr>
<td>Total debt</td>
</tr>
<tr>
<td>Quality of appraisal</td>
</tr>
<tr>
<td>Number of loans</td>
</tr>
<tr>
<td>Gross debt-to-income ratio</td>
</tr>
<tr>
<td>LTV: size of downpayment</td>
</tr>
<tr>
<td>Effectiveness of Foreclosure</td>
</tr>
<tr>
<td>Number of credit accounts</td>
</tr>
<tr>
<td>Payment-to-income ratio</td>
</tr>
<tr>
<td>Quality of appraisal</td>
</tr>
<tr>
<td>Recent new accounts/inquiries</td>
</tr>
<tr>
<td>Cash Reserves</td>
</tr>
<tr>
<td>Capacity to repay</td>
</tr>
<tr>
<td>LTV: Bank decisions on LTV (and interest rate)</td>
</tr>
<tr>
<td>based on credit scoring</td>
</tr>
<tr>
<td>Underwriting by the bank:</td>
</tr>
<tr>
<td>Foreclosure: more effective and less costly foreclosure process needed to realize adequate % of collateral</td>
</tr>
<tr>
<td>Credit Bureau: information on all types and amounts of debt and uses of debt</td>
</tr>
<tr>
<td>Credit Bureau: information on repayment history and current and historical loan and credit information</td>
</tr>
<tr>
<td>Credit Scoring: overall credit worthiness based on bank data, Credit Bureau data, and bank credit scoring model</td>
</tr>
</tbody>
</table>

Overview of Section 3.0. Section 3.0 addresses a number of issues dealing with both credit risk and legal and administrative risk. More generally, we note procedures and tools for improved risk management and increased efficiency of the housing finance system. Addressing these various issues will require a combination of Governmental, private sector, and joint public/private initiatives.

• Section 3.1 presents our discussion regarding development of a Credit Bureau, perhaps the most important of the recommendations addressing credit risk. A GOI policy initiative is required to begin the steps toward a Credit Bureau formation, but ultimately the Credit Bureau may rest in the hands of the private sector;

• Section 3.2 notes some tools for efficiency and risk management, including the need for IT systems; automation of the mortgage loan process, especially for underwriting and servicing; and the benefits of credit scoring, based on Credit bureau information, and
mortgage credit scoring, based on both bank and Credit Bureau information. These topics are largely the responsibility of the private sector; hopefully donor assistance can be obtained for in funding sector-wide training events arranged through Perbanas;

- Legal risk is addressed the importance of improving foreclosure is discussed in section 3.3;

- Standardization, which addresses administrative risk, is discussed in section 3.4.

5.3.1 Establishing a Credit Bureau in Indonesia

Overview. A Credit Bureau can be extremely instrumental in the improvement and expansion of the housing finance market in Indonesia. It is needed first of all, to help adequately assess total debt and debt behavior for use in underwriting. Research in the U.S. suggests that debt variables can account for 60 to 70 percent of the probability of default. The Credit Bureau information also helps develop parameters for risk-based pricing, support automated credit scoring, and provide better information for downmarket expansion.

Establishment of a world-class Credit Bureau is among the highest priority recommendations of the HOMI housing finance team. It is an information bureau that collects data on all types of outstanding debts, large and small, and payment performance over time. The data are made available to prospective creditors to evaluate the financial performance and discipline of prospective debtors. The member institutions would provide data on their loans, both large and small and on repayment performance. Members would include not only the banks but also all major classes of creditors, including non-bank financial institutions and leasing companies. Ultimately, the members could include certain microfinance institutions, credit unions, cooperatives, and so forth. Ideally, the Credit Bureau would first draw from Bank Indonesia’s current DIS (debt information service), which has many valuable features and information on larger loans. However, the DIS was never intended to be a full service credit information service.

Discussions regarding establishing a credit bureau is now underway in Indonesia. An initial study, supported by ADB, was undertaken as part of an effort to improve SME (small and medium enterprises) lending. The study, completed in July 2001, was conducted on behalf of the State Ministry of Cooperatives and SME, whose concern rests primarily with
SMEs. The Ministry continues to be supported in this effort by the ADB, which sponsored the study. PERBANAS is coordinating the effort on behalf of the banks. A Task Force was previously convened, which included the State Ministry of Cooperatives, the State Ministry of Trade and Industry, Bappenas, and MOF. The focus of this group was solely on the health of SMEs, however, and the Credit Bureau was just one of a number of issues being addressed.

The Credit bureau effort should be supported and greatly broadened to include all types of credit, in order to support the financial sector overall. The Credit Bureau needs the support of a much larger group of public and private entities, as the information supports risk analysis in consumer and mortgage finance as well as for SMEs. Thus, HOMI recommends that MOF take the led in the Credit Bureau initiative, and that an Inter-ministerial Task Force, or an expanded Working Groups, be established as soon as possible to carry the initiative forward. It is recommended that this Working Group Task Force have representatives from MOF, BI, BAPPENAS, PERBANES, Kimpraswil and the Ministry of Cooperatives.

5.3.1.1 Benefits of a Credit Bureau.

The Credit Bureau would greatly strengthen credit risk analysis in mortgage finance. It would assist in:

- strengthening underwriting;
- reducing credit risk and the incidence of non-performing loans;
- improving servicing and customer relations;
- providing information to support risk-based pricing; and
- enabling an expansion of lending to a much wider group of households.

Bank underwriting for mortgage credit should be significantly improved when the bank uses both its own information as obtained in the underwriting process and the additional information from the Credit Bureau. Banks will obtain measures of total debt, repayment behavior, and ultimately, a credit score based on international best practice in analyzing risk from the Credit Bureau.

The HOMI team recommends that the Credit Bureau focus be broadened to include all types of lending, including consumer finance and mortgage finance most especially. Credit scoring is not a plain vanilla, one size fits all endeavor. While some of the information collected by credit bureaus is common across the needs of most types of
lending, mortgage finance is especially dependent on the information because of its collateral-based, long-term characteristics. In particular, mortgage finance benefits especially from (1) information on debt that help determine that the downpayment is not being financed from other borrowing, and (2) an updating procedure that provides a historical record of debt behavior. Mortgage credit scoring is also particularly sensitive to the debt score – for example, the “FICO” score – in predicting default.\\(^{18}\)

5.3.1.2 Current Practice and Critical Issues.

**International Practice.** Credit bureaus are in operation worldwide, including the U.S., throughout Europe, and increasingly in Asia and Latin America. In Asia, credit bureaus are now operative in Hong Kong, Japan, Australia, New Zealand, Philippines, Taiwan, Philippines, and South Korea. Credit bureaus are in the process of being established in Thailand, Malaysia, India, and Shanghai. In Latin America, Brazil, Argentina, and Mexico rely on credit bureaus.

A fairly broad mix of public and private ownership and management options can be observed worldwide. In the U.S., U.K., Canada, Australia, New Zealand, Spain, Italy, Hong Kong, and South Korea, for example, credit bureaus are operated by private firms, such as Trans Union, Experian, Equifax, and Data Advantage.\\(^{19}\) In France and Shanghai, the central bank overseas the operation. In the credit bureau being developed in Malaysia, Bank Negara has outsourced the operations to a private partnership of companies from New Zealand and Malaysia. In India, the majority share of the bureau is owned by the State Bank of India and HUDCO, with minority shares from Trans Union and Dun & Bradstreet. Finally, in Thailand, the majority is owned by the Thai Bankers Association with a minority share held, again, by Trans Union and Dun & Bradstreet.

**Current Practice in Indonesia.** Indonesia already has the makings of a credit bureau in Bank Indonesia’s DIS (Debtor Information Service). BI provides information upon request from the banks. Based on the previous Banking Law, No.7/1992, article 40 concerning bank secrecy, information on both savings and loans was treated as confidential. Based on the new law, Law No.10/1998, article 1 point 28 states that bank secrecy covers only customers’ savings and no longer covers debt. Thus, BI now provides requested information on debt.
Limitations of BI's DIS. The DIS represents an extremely important service in Indonesia. From the perspective of a full service credit bureau, however, there are a number of serious limitations:

- the information provided by BI is limited to credit extended by the banks since BI supervision does not cover other financial institutions;
- information is reported to BI only on loans over Rp. 50 million;
- BI does not report back full information, but rather uses the “blacklist” approach - called the problem loan list;
- information is submitted only for those persons who hold a tax I.D. However, this is an incomplete approach, as those with only one employer do not have a tax ID, and there are other exceptions as well; and
- The response period is between 3 and 7 days. Application from the banks is done manually; response time is 5 days to two weeks.

Data Collected by Credit Bureaus. Credit bureaus generally collect the following types of information: total debt outstanding; history of payment behavior; number of years of a customer’s credit history; types of credit use; and recent requests for new credit. The types of additions and improvements to the DIS system which would be needed to support a Credit Bureau would include the following:

- information on all persons (not just those with a tax ID);
- information on all lenders: banks, finance companies, credit cards, department stores, leasing companies;
- information on small loans, certainly smaller than the present cut-off of Rp. 50 million;
- faster, computerized access; and
- frequent updating of the debt and repayment information.

Special Information Needs of Mortgage Finance. As noted above, because of its nature, mortgage lending can greatly benefit from the information supplied by a credit bureau.

- First, as is discussed at length in section 3.2, the LTV (loan-to-value ratio) is one of the most crucial parameters in the loan decision. The LTV is very highly correlated with future loan performance. Banks require that a household’s downpayment come from household assets- for example, from previous savings, sale of assets, and so on, but not on funds borrowed from other sources. Thus, the Credit Bureau assists in verifying that the
downpayment did not derive from new credit cards just opened or a consumer loan from another institution.

- Second, mortgage debt generally represents the largest and longest debt that most households will ever have. Thus, its repayment is sensitive to the size of the other debt obligations of the household – the so-called gross debt ratio. Banks are also interested in knowing the number of debts outstanding and the number of credit cards in use by the household.

- Third, again, as mortgage debt is generally longer-term than consumer finance or SME lending, the household’s repayment history becomes an especially important variable in underwriting.

**Institutional and Administrative Issues.** A number of institutional and administrative issues need to carefully addressed by Indonesia in the process of setting up a Credit Bureau.

- **Ownership.** As noted above, international practice offers a variety of ownership options: solely public, public/private, and solely private. Asia is dominated by the public/private and solely private options. Thus, GOI might consider a private company formed by the banks or a public/private entity. BI is no longer permitted to take an investment interest in new institutions. Preferably, the Credit Bureau would be primarily private, owned by Indonesia’s banks; as in other Asian countries, rating agencies or management companies might take an interest. Capital might also be sought from donors and/or the IFC.

- **Development and Management.** For operational efficiency in establishing a credit bureau, the use of the experienced private companies, already engaged in establishing credit bureaus in Asia and elsewhere would appear to be advisable. With regard to ongoing management, this could be carried out by a private company, or by Bureau staff hired for the purpose. A GOI institution could maintain policy and monitoring control over the Credit Bureau as desired.

- **The Identification Problem.** There are several important administrative hurdles to be overcome in Indonesia, especially regarding identification. Many Indonesians also use more than one name, more than one I.D. number, and/or more than one address. Thus, there is no certainty concerning the consumer’s identity and no uniformity in recording the individual’s name and address. Moreover, one person can obtain more than one identity
card. Not every person has a taxpayers number (Nomor Pokok Wajib Pajak-NPWP), as NPWP is only compulsory for multi-income earners. It would appear that date of birth plus name and address would have to be used.

- **The Future of DIS.** As noted, DIS forms a valuable basis for expansion into a comprehensive credit reporting system. The reporting discipline imposed on commercial banks by BI have resulted in a database of valuable, well-organized credit information; the basic integrity of the data is a direct result of the strong supervisory position of BI.\(^{20}\)

### 5.3.1.3 Changes in the Pipeline.

As noted above, the State Ministry of Cooperatives and SME, together with the ADB, is currently supporting the Credit Bureau initiative, primarily on behalf of the need in SME lending for improved and expanded information on debt performance. The government of Indonesia is concerned with the limited financial services mainly for the Usaha Kecil dan Menengah (Small and Medium Enterprises or UKM/ SME’s) and its progress in the future. If reliable credit information is available, banks lending to SMEs will be better able to undertake the necessary risk assessments. The Ministry for Cooperatives, it has the responsibility for supervising approximately 100,000 cooperatives throughout Indonesia, which generally offer loans ranging from Rp. 1 million to Rp. 5 million. This is well below the DIS cutoff of Rp. 50 million,\(^{21}\) which fails to capture the necessary information for smaller loans and for non-bank sources of credit.

Prior discussions to bring a credit bureau initiative to the immediate attention of both GOI policy makers had met with two major barriers: (1) reluctance to share debtor information on the part of some of the major banks, and (2) the considerable practical difficulties in identifying debtors and collecting the necessary information discussed above. Together, these issues halted the momentum to proceed.

Following Krismon, however, it is now more broadly recognized that excessive indebtedness, including that of conglomerates as well as individuals, helped fuel the credit crash; as a result, the GOI is now looking for ways to carry the Credit Bureau initiative rapidly forward. The numerous banks interviewed by the HOMI team, including the major mortgage lenders, all supported the Credit bureau initiative. And as mentioned, PERBANAS is active in supporting the effort.
There is no legal barrier to the establishment of a credit bureau in Indonesia. The legal bases supporting the establishment of a Credit Bureau includes Article 1, sub-article 1, point 28 and article 44 Law No 7/1992. Furthermore, sub-article 3 of the same article states that BI can operate the system itself or by a third party appointed by BI.

5.3.1.4 Recommendations.

A Credit Bureau is an important risk management tool supportive of overall financial sector development. The current GOI focus, by the Ministry of Cooperatives for the SMEs, is much too narrow. The Credit Bureau must have the support of a much larger group of public and private entities. For example, the Credit Bureau information is especially important for supporting risk analysis in both consumer finance, mortgage finance, and other lending as well as for SMEs. Finally, it must have the cooperation of a broad range of key banks and, ultimately, non-bank lenders; for this to occur, participants must have a very high level of confidence in the integrity and skills of the Credit Bureau’s management and the professional abilities of the staff. The banks prefer that the Credit Bureau should be primarily a private sector endeavor.

Our recommendations are as follows:

- The Credit Bureau initiative continues to be supported by the ADB. However, according to the ADB, there is not now a broad-based Task Force that is concentrating on the Credit Bureau initiative as such. Thus, HOMI recommends that an Inter-ministerial Task Force, or a Working Group, be established as soon as possible to carry a broad-based Credit Bureau initiative forward. A single Credit Bureau in Indonesia will be developed to provide the information needed by all interested lenders.

- The Credit Bureau will be raised by Bappenas at the Inter-Ministerial meeting now convened by Kimpraswil regularly (it is to meet every three months). It will be placed on the agenda in order to discuss the best approach to carrying the initiative forward and the most appropriate institutional home. In the opinion of HOMI, Bappenas or MOF is the logical champion for the Credit Bureau in order to structure is as be a nation-wide initiative serving banks and non-banks in a broad range of lending activities.

- The HOMI team recommends that Kimpraswil support and join a Task Force and work to broaden the scope of the Credit Bureau effort beyond SMEs to include numerous types of lending in the information service, including especially mortgage finance. PERBANAS is
now directly involved and will be a key player. It is also crucial that this Task Force have a representative from BI, as the DIS system can make important contributions to a credit bureau.

- The banks interviewed by the HOMI team were positive about the creation of the credit bureau. There is also a strong feeling that the Credit Bureau should be private. Capital could be sought from banks, donors, the IFC, and/or interested private sector rating or credit bureau management companies.

- The ADB study calls for a feasibility study to be undertaken as soon as possible. HOMII strongly supports this; continued funding should be sought from ADB. Assuming that the recommendations in the July 2001 ADB study are implemented, a feasibility study to address the administrative and structural issues noted above, should be carried out. The initial ADB study stressed that it would be far more cost-effective for Indonesia if a private sector firm, specializing in credit bureau development be engaged to conduct the feasibility study and the development of the Credit Bureau infrastructure.

- Thus, Following the completion of the Feasibility Study, HOMI recommends that private sector firms that specialize in credit bureau development in Asia and globally be invited to submit proposals with plans to assist development in Indonesia. As noted in the current ADB study, the development phase would be much less costly if experienced firms are involved. (Among other things, the identification and I.D. problems facing development of the Credit Bureau will be extremely challenging with regard to computer software able to uniquely distinguish households).

- The Task Force will determine the ownership of the Credit Bureau and the form of its operation and organize educational workshops and promotional campaigns.

- Finally, BI's information system was not planned to function as a credit bureau. The Law on Bank Indonesia No.23/1999 specifically article 32 sub-article 1, stating that BI arrange and develop an inter-bank information system, should be revised.
5.3.2 Some Tools for Increasing Efficiency and Risk Management: Automation and Credit Scoring

Overview. This section briefly discusses some tools for improving efficiency in the overall mortgage loan process, particularly with regard to underwriting. The topics noted here – automation, credit scoring, and risk-based pricing – represent a sampling of tools that might be introduced in bank training sessions in Indonesia. Based on information from HOMI's bank surveys and interviews, it is felt that there are a number of aspects of risk management that need improvement. This section briefly describes a few of the options and notes the steps in the process of automated mortgage credit scoring as it might be introduced in Indonesia.

The first step is to get development of the Credit Bureau underway, as discussed in section 3.1 above. Increased automation of the mortgage process should proceed in parallel for those banks planning on building large mortgage portfolios. Another step in the process is to develop a “debt behavior score” based on the Credit Bureau information. We have called it the “FICO” score in as noted in section 3.1, after the Fair Isaacs company that first developed it, and as it is known in the U.S. and increasingly worldwide.

Following this, banks could consolidate - in a computerized management system – both their internal data and Credit Bureau data to begin their own automated mortgage credit scoring model. Modeling techniques for undertaking these efforts are available from a number of private sector companies. What is required is to develop the requisite databases and match Indonesian data with these methodologies.

In sum, HOMI feels that bank training in a number of aspects of automation and underwriting would be helpful in improving efficiency and risk management. The exact selection of topics is, of course, up to the banks themselves. We recommend that training requests be coordinated through Perbanas.

5.3.2.1 Current Practice and Key Issues.

Current Practice in Indonesia. Some banks in Indonesia have computerized many aspects of the loan management process. A lesser number appear to have computerized mortgage finance, however, and the automation of the mortgage loan process is not well
advanced in Indonesia. Similarly, credit scoring, which is an approach to “summarizing” the numerous types of information that enters the loan decision process, is not widely used. Only two of the banks interviewed by HOMI indicated that they had developed credit scoring models. The process was not automated, however, which prevents the bank from developing more “predictive” models. Also, automation would achieve consistency in using credit scoring to evaluate different applicants, as well as making it far less time-consuming.

**International Practice.** Mortgage credit scoring is an important tool in analyzing and improving credit risk. Mortgage credit scoring enables a lender to use the full range of information summarized in the “Three Cs” model, which includes “collateral”, “credit reputation” and “capacity to repay” (again, see the introduction to section 3.0).

Credit scoring involves creating a database of information on the mortgage portfolio, and observing its behavior as it seasons. Many variables - describing the borrower, the loan type, the collateral, and the LTV - determine the risk of default. It is difficult to address the variables one-by-one in a consistent manner. The statistical credit scoring models “condense” the many types of information used in underwriting into one or more aggregate “scores”. The variables included in the scores are those – specific to Indonesia – which have the most impact on determining loan behavior. These scores are then used in the future to evaluate new loan applications. Model development requires automation, however. Ultimately, the entire process of underwriting and servicing should be automated with special IT systems.

Automated credit scoring is fully integrated into the U.S. system of mortgage credit. Its popularity and the wide extent of its use have, in part, been driven by the requirements of the U.S. secondary mortgage market. Fannie Mae and Freddie Mac both offer sophisticated systems of automated underwriting. Use of these systems greatly simplifies analysis of loan quality and thereby pricing decision and secondary market purchase of conforming loans. In addition, a private company, Fair Isaacs, works with all three credit bureaus in the U.S. to develop what is now a standard debt behavior tool in the U.S., known as a FICO score.

The process is now underway worldwide. As discussed in section 3.1, credit bureaus are now in place, or being developed throughout Asia and elsewhere. The development of FICO scores, credit scoring generally, is also underway internationally, especially in Europe.
and Latin America Germany, Brazil, Argentina, and Mexico, for example, have initiated
development of credit scoring. As more and more countries develop credit bureaus and
automate their mortgage lending systems, both “FICO” scores from the credit bureau and
bank mortgage credit scoring have now begun to spread in use.

The Benefits of Automation and Credit Scoring. The benefits of automation of the
mortgage loan process, and development of credit scoring, are many.

Automation can:
• enable the application process, underwriting, servicing, and record-keeping to be conducted
efficiently and effectively;
• aggressive servicing, in response to automated reports of delinquencies, is one of the key
tools in preventing default (important in Indonesia because foreclosure can be so costly;
see section 3.4);
• enhance prudent lending procedures and facilitate the inter-face with regulation and
supervision requirements.

Credit Scoring can:
• greatly speed-up the decision process of accepting or rejecting a loan application;
• combine the numerous variables known to be important in predicting loan performance
into one or two aggregate scores;
• pave the way for risk-based pricing – in other words, better terms and rates can be offered
to better customers and higher rates can be charged on loans with a higher risk profile;
• decrease the incidence of non-performing loans; and
• provide criteria for deciding how and when to follow-up delinquencies, thus saving time
and funds in servicing.

Thus, underwriting mortgage credit can be greatly improved if the bank is able to incorporate
the numerous variables known to be predictive of good payment history, delinquencies,
and default into a much lesser number of “scores”. Many types of information now go into
the loan approval/rejection process in Indonesia and worldwide. With this wealth of data,
it is often difficult weigh the different inputs to make decisions; automated underwriting
offers summary variables that can discriminate among good, fair, and poor credit risks. In
addition, credit scores have proved useful in developing servicing approaches to delinquent
loans; essentially, in order to save administrative efforts, follow-up begins first with those
more likely to become delinquent, as based on their credit score. Thirdly, computerization
of the underwriting, servicing, and loan performance processes will not only increase efficiency, but can feed valuable information back into the ongoing development of the credit scoring models and underwriting criteria. Note again that the models would be developed by Indonesian banks based on Indonesian conditions, but would draw on the statistical structure of state-of-the-art credit scoring models developed elsewhere.

In sum, this approach can enhance the “Investment Quality” of the loan portfolio. Especially in an automated system, it saves time, reduces servicing and default costs, and provides the basis for more safely expanding lending to a broader set of customers. In the long run, it assists in evaluating a portfolio in relation to its use in an SMF or SMM.

5.3.2.2 The Requirements of Credit Scoring.

The combined information flow and “modeling” efforts which define mortgage credit scoring can be summarized as follows. Referring to the “Three Cs” model as discussed in section 3.1, lenders would obtain measures of total debt and repayment behavior – so-called “credit reputation” from the Credit Bureau. In the longer-term, banks may also obtain an automated “credit score” (FICO) from the Credit Bureau. Then, from their own underwriting data, banks obtain borrower income, employment history, cash reserves, and so forth. With this information, lenders can compute the total (gross) debt burden and assess the “capacity to repay”.

Next, “collateral value” is a function of the loan-to-value ratio and the quality of the appraisal of the dwelling. (Note that HOMI feels that aspects of the appraisal process need improvement; please refer to sections 3.4 and 6.0) The source of the downpayment also indicates the extent to which the borrower has committed his own resources to the endeavor. Then, as the portfolio matures, and experience yields data on loan performance, a valuable analysis database can be constructed. Over time, the association of information on loan behavior and borrower and loan characteristics can be formalized in a statistical model, predictive of future loan behavior.

Variables Utilized in Mortgage Credit Scoring Models. Studies of loan performance in the U.S. have repeatedly shown that credit quality decreases as the LTV increases. One analysis in the U.S. has concluded that three key variables may provide up to 80% of the explanatory power in predicting default on mortgage loans: the LTV, the credit score (FICO score), and cash after closing.
Other variables found to be important in underwriting are the following, Timely and steady payment of rent and utilities;

- Payment-to-income ratio (mortgage loan payment relative to income)
- Gross debt ratio (total debt payment relative to income)
- Formally employed vs. self employed
- Type of mortgage (fixed rate, adjustable rate, terms of the adjustable rate)
- Source of downpayment

Many of these variables are already used in underwriting in Indonesia. The remainder would be derived from the Credit Bureau and application of credit scoring methodology to Indonesian data.

5.3.2.4 Recommendations.

(1) The first step is to begin development of a Credit Bureau as quickly as possible. Please refer to the detailed recommendations in section 3.1, which describes implementation of the next phase in Credit Bureau development.

(2) Simultaneously, HOMI recommends that the banks that plan to be heavily involved in mortgage lending, coordinate their training requests through Perbanas. Examples of topics suggested by HOMI include IT systems and automation, automated underwriting, servicing procedures, and credit scoring.

(3) Next, banks should develop their internal mortgage portfolio databases. Perbanas may also wish to develop an analysis database, on its own behalf and that of the smaller banks. Note that this step can take place whether or not the Credit Bureau is in place.

(4) When the Credit Bureau is in place, a Task Force should issue an RFP to invite a private sector firm to develop the debt scoring system - the “FICO” score - as discussed above. It is derived from Credit Bureau data; the process of its development, and the approach that might be used in Indonesia, can draw on extensive international experience.

5.3.3 Foreclosures

Overview. Foreclosure is, on average, both extremely costly and extremely time-consuming in Indonesia. Banks, or course, undertake concerted servicing efforts to enable
delinquent loans to again become current. If this fails, however, three quite distinct outcomes face the banks when the mortgage loan reaches the default stage.

(1) situations that banks can handle the on their own, generally within 3 to 6 months, with generally small loses (or none) of the outstanding principle;

(2) situations involving the debtor which require utilization of a debt collector and auction agency, in which case the process may take up to one year, and the bank generally experiences a moderate (or greater) level of loss with regard to the outstanding principle, delinquent interest, and so forth; and

(3) cases requiring court action, in which case the process can take up to two years overall, and the bank generally loses 20 to 60 percent of the outstanding principle and interest.

Most banks prefer to solve their more problematic loans using a debt collector rather then through legal procedures, which are the last resort because they are so costly. Although we do not have precise estimates, the interviewed banks suggest that the simplest solution holds in only 20 to 30 percent of cases, while about half of the remaining cases require the costly court-based solution.

Overall, it is generally felt that the existing mortgage law is sufficient to support a more rational foreclosure process. In addition, both the government auction agency, and the various private auction agencies, seem reasonably efficient in carrying out their duties. Furthermore, the government auction agency is scheduled to become a policy and monitoring body, which should assist the efficiency of the system. The main faults are said to lie in the fact that in cases of uncooperative debtors the case must go to court, and that court implementation, and the court’s role in the process are neither timely nor transparent.

The next puzzle is getting an idea of loss rates in the current mortgage portfolios. These data were presented in section 2.0. and as discussed there, it is not al at clear that these current NPL figures are representative of the ratios that would occur in a more “steady state” picture. The vast majority of bad loans were transferred to IBRA. Also, many of the portfolios represented in the NPL tables in section 2.0 are relatively recent, and have not had a chance to season. And, as noted, banks are currently lending in an extremely risk averse manner. Thus, in the next several years, a somewhat more seasoned, or long-term, picture of the delinquency and foreclosure rates is likely to emerge.

In sum, while the probability of entering into default may be reasonably low at the moment, it is likely to present a different picture as the portfolios mature. However, the probability of sustaining major losses, once a default occurs is extremely high.
The magnitude of these foreclosure problems have an enormous impacts on the efficiency, cost, and legal underpinnings of the mortgage finance systems. This is the case worldwide, no matter what the structure of the financial system, as heightened legal risk, and time-consuming procedures, threaten many aspects of the system. In Indonesia, the foreclosure problems have the following negative effects:

- Because the procedure is so costly, banks’ spreads are kept much higher than they need to be, exacerbating the affordability problem;

- The problems cast grave doubts on the viability of potential credit enhancement programs, such as the mortgage guarantee scheme briefly described in section 4.0 below and detailed in a separate HOMI Report.

- The problem is likely to severely inhibit banks’ efforts to lend downmarket. One of the main tools for doing so is allowing a higher LTV, which is likely to have an impact on defaults. Loans would be priced to cover the costs of this risk; however, the serious uncertainly surrounding the foreclosure process makes the pricing parameters quite problematic;

- Finally, such foreclosure problems will greatly compromise the development of any type of secondary market. Both the greater cost and the uncertainly are serious barriers.

**Foreclosure in Practice.** The following scenarios describe some of the complexities involved.

(1) *Simpler Cases.* In practice, the foreclosure process is greatly expedited if the debtor is cooperative and is willing to vacate the house without being forced to do so by the court. Again, although we do not have precise statistics, in 20 to 30 percent of cases, the debtor is cooperative, the land certificate and other paperwork are in order, and the bank conducts the entire process on its own, including resale. These cases can generally be expedited in about 3 months.

(2) *Debt Collection and Auction Required.* In other cases, actions by a debt collector and the government, or private, auction agency, must enter the process. In the early stages, when the loan is about 1 to 3 months in arrears, most banks undertake the collection themselves (by calling and visiting the debtor, send warning letters, and so forth). If this effort does not succeed, then the banks may engage a “debt collector” or a law firm to do the
foreclosure, and the property is auctioned. In either case, the fees may equal around 25% to 50% of the outstanding principle. Third parties are used for two reasons. Banks generally do not have staff experienced in dealing with the court or auction procedures (or with difficult customers). In addition, if the bank pays an “informal service charge”, no receipt is received, which poses problems for the bank’s accounting procedures.

(3) Cases Requiring Court Action. A major problem arises when the debtor (or a third party such as a renter who has signed a lease with the debtor) still occupies the house even after the auction process has been put in place. The mortgage loan (collateralized borrowing) involves a self-executing deed (parate executie) which can only be sold by the auction company (private or public) based on debtor approval. The auction company will not take the risk of being sued if there is an objection from the debtor. The auction winner then often encounters resistance by the previous owner to deliver the house unoccupied. In that case, the auction winner must request an evacuation order from the Court. In addition, the auction winner may face the possibility that the occupant will present a counter claim to cancel the auction or the evacuation order.

All in all, this case usually entails a lengthy and costly process. The bank faces not only delinquent interest and principal payments, but is “forced” into entering the real estate business via payments for maintenance, insurance, utilities, and so forth during the decision period. In addition, non-transparent processes on the part of the court result in additional costs. Where judicial foreclosure is required, the interviewed banks explained that the foreclosure process ranged from 6 months to 24 months and the cost averages between 20 and 60 percent of the mortgage loan outstanding.

Regulations on Foreclosure. The legal basis of the foreclosure process, described as follows, is generally adequate (unlike the case in some other emerging and transition nations).

- Based on article 224 RID¹, the creditor that holds the first lien on the registered mortgage has the right to execute the collateral as the holder of the mortgage rights, and reserves the right to sell the collateralized land at the public auction when the debtor defaults.

- Article 6 of Undang-undang Hak Tanggungan (UUHT/ Mortgage Law) No.4/1996 states that in case the debtor fails to fulfill the agreement, the mortgagee has the right to sell the property upon his own power of authority, by auction. Article 14 sub-article 2 of UUHT states that mortgage certificate includes irah-irah has the same execution power with
court decision. The execution auction of a mortgage as stated in article 20 sub-article 1 of UUHT, is based on article 6 and article 14 sub-article 2 of the same law.

- Article 200 RID\textsuperscript{27} sub article 1, states that confiscated property must be sold through auction. Further in sub article 12 stated that if the occupant of the property is unwilling to leave the property, the Head of District Court will issue an order to the auctioneer to force the occupant to leave the property, if necessary with the assistance of the police.

- Circular No.SE-23/PN/2000 dated 22 November 2000 of Badan Urusan Piutang dan Lelang Negara (BUPLN), concerning Guideline for Auction of a mortgage states that:
  \begin{itemize}
  \item In Conformance with article 6, auction of a mortgage can be requested by the creditor who is the first mortgagee, directly to Auction Office (Kantor Lelang Negara). No approval from the Court is required since the auction is an execution of an agreement. The applicant of the auction in this case is the mortgagee.
  \item Auction of a mortgage, as stated in article 14 UUHT, will be executed if the auction based on article 6 UUHT is not workable due to the insufficiency of the required criteria stated in article 6, to the objection of the debtor, or counter claim from the third party. The auction sale is an execution title and requires approval of the court. The applicant of the auction in this case is the district court.
  \end{itemize}

These laws protect both the lender and the tenant: protecting the lender as the holder of the mortgage and protect the debtor against the creditor. The protection of “uncooperative” debtors forces the foreclosure process into court proceedings.

**Auction Policy.** Based on BUPLN Circular No.23/PN/2000 dated 22 November 2000, the creditor may submit a request for an auction if, among other things, there is no objection by the debtors or resistance of a third party. In case there is an objection of the debtor or resistance of the third party, the creditor should submit request for \textit{parate executie} (execution) through the court. Only after receiving execution approval, should the application for auction be submitted. Request for auction of the creditor can be addressed straight to the Direktur Jendral Piutang dan Lelang Negara (DJPLN) or through a private auction office. However, the role of private auction offices is limited to pre-auction process.

Based on the regulations noted above, even if the creditor has a mortgage, but the house is still occupied by the debtor (or the debtor’s tenant), who refuses to leave the object (or if a third party poses a counter claim (verzet)), execution approval for vacating the property
must be requested from the court prior to requesting an auction because this case is considered “disputed” and must be decided by the court.

At present, auctions are conducted by both the Government Auction Agency and a number of private auction agencies. In order to facilitate the auction process, the Government Agency is being transformed into a policy-making and monitoring body. The policy of Government Auction Agency/ DJPLN in the future will be the following:

- Providing licenses for the operation of private auction officials;
- Regulating and supervising auction activity in Indonesia;
- Providing more opportunity for private auction agencies to take more active and professional roles;
- Preparing a draft Auction law to replace Vendu Reglement (Stb 189/1908); and
- Reducing the auction duties and abolishing uang miskin.

These are positive and appropriate steps.

**Recommendations.** Foreclosure is too often costly and slow. The probability of a mortgage loan entering the default stage varies considerably within the system; please refer to the NPL statistics in section 2.0. Also, since so many bad loans were placed with IBRA, it is difficult now to predict what the “steady state” default rate might be on new mortgage portfolios. **As noted above, while the probability of entering into default may be reasonably low, the probability of sustaining major losses, once a default occurs is extremely high.**

The existing mortgage law is sufficient enough to accommodate foreclosure process. In addition, the new role of the Government Auction Agency, as a policy making body, should help streamline the auction process. However, the mortgage law and the Dutch law of 1848 (RID Art. 200) can come into direct conflict in case where the debtor is not cooperative, in which the case court action is required. If the debtor (or legal occupant) refuses eviction, he cannot be evicted without a court order. In the ensuing legal proceedings, the chief of court has the power to decide the outcome.

It appears that several types of issues need to be addressed.

1. First, education of all parties involved. Customer education as to their rights and responsibilities in undertaking a mortgage loan might improve cooperation in the early stages. DJPLN should prepare socialization program covering key actors, procedures and regulations. The workshop convened on foreclosure suggested that Perbanas should follow
it up with a second workshop with the participation of Supreme Court, District Court, private auction companies, and bankers.

(2) Second, the 1848 Dutch law may ultimately need revision.

(3) Third, technical assistance is required to speed up the auction process. If the debtor is not cooperative, the auction should be optional, not compulsory.

(4) Fourth, delays and lack of transparency within the Court offices must be seen as responsible for many of the foreclosure problems. As a practical matter, automation and better IT systems should speed up the process, but more thorny court improvement issues fall within the purview of the Department of Justice.

5.3.4 Standardization

Overview. Standardization is a topic that has received particular attention over the past several decades. It may be narrowly defined as a uniform approach to the information collected during the mortgage loan process, particularly the credit application, appraisal report, and loan agreement. More broadly, it addresses both the definitions of key variables with enter into the three “Cs” (which were described in the introduction to section 3.0) and the rules which guide their implementation, especially for appraisal. In this light, standardization becomes closely linked to regulation and supervision of housing finance, which will be discussed below in section 6.0. Thus, the definition of income, the definition of gross debt ratio, and the definition and rules which guide appraisal, and thus determine “value” in the LTV, are all key aspects of standardization.

Standardization became of particular importance in the United States because of securitization. In order to perform due diligence on, and pool, vast quantities of mortgages to be packages into MBS, a “cookie cutter” approach to loan documentation and definitions became absolutely crucial. A significant amount of work has already been undertaken in Indonesia on standardization. An Annex to this report contains underwriting guidelines previously prepared by Erica Soeroto (prepared in Bahasa Indonesia). The original impetus for the effort was in preparation for a secondary mortgage market in Indonesia – that is, a conduit approach similar to Fannie Mae and Freddie Mac, which would securitize pools of mortgages for MBS. Section 7.0 of this report discusses our current approach to the secondary market, which is a liquidity facility, or SMF rather than a securitization approach (SMM) at present. Nevertheless, standardization has lost none of its importance in Indonesia for the following reasons:
• broadly defined, standardization is integral to addressing credit risk. The types of information collected during underwriting, the definitions of these variables, and the rules guiding determination of “value” still need to be addressed;
• standardization is also important in the development of an SMF, as it will greatly simplify due diligence by the SMF of portfolios backing the SMF loans to banks, as well as assisting in educating investors about SMF debt instruments;
• even in the absence of a centralized securitization conduit, individual banks may wish to undertake securitization, and, again, standardization will help investors understand debt instruments;
• in the very long-term, Indonesia may wish to develop a secondary mortgage market, in which case standardization becomes crucial.

Standardization in Indonesia: Progress to Date. Significant progress has been made on standardization issues, including the following:

• **Standardized Forms.** As noted, standardized forms have already been drafted and are presented in the Annex for review. The draft forms include an application form, appraisal report form, and credit agreement. These forms are based on current practice in Indonesia. Parts of the appraisal report was adopted from the US model combined with common practice in Indonesia. BI consent is needed for the loan agreement prior to its use.

  The underwriting guidelines (which are written in Bahasa) consist of:

  General Policy (definition, underwriting criteria, main job of the underwriter, goals, component to be analyzed, risk and parameter); Borrower Evaluation (ability and willingness to pay); Appraisal (appraiser selection, objective, method, appraisal report, LTV, problems); Verification (down payment, source of down payment, borrower income, employers, reference, resume, other obligations, continuity of income); Ratio Analysis (monthly payment, front end ratio, back end ratio); commitment letter; the role of quality control.

• **Standardization Workshop.** A workshop was organized in cooperation with Kimprawil and National Bankers Associations (Perbanas) in June 12, 2001 to collect input on the draft of standardized KPR application form, appraisal report form, and credit agreement.

• **Perbanas Task Force.** A task force coordinated by Perbanas has just begun developing a glossary for mortgage lending. The glossary will use the Indonesian terminology that is
in common use in the banking sector, capital market, and real estate law, and will use a U.S. glossary as a reference. The glossary is expected to contribute to uniform interpretation of the mortgage lending business

**Outstanding Issues.** Outstanding issues involve variable definition and appraisal practices.

- **Underwriting and Definition of Variables.** The credit application forms used by many Indonesian banks are reasonably uniform in its content. However, calculation of the payment-to-income ratio varies widely by bank according to the way income is defined. For example, some banks adjust income for various living expenses before calculating the ratio, while others do not. Similarly, the LTV is defined differently not only on the basis of the value calculation, but also based on treatment of closing and other costs. Thus, it is very difficult to compare LTVs and payment-to-income ratios across the banks because of very different approaches to defining these terms. Similarly, the “value” used in the LTV has no common definition. In some circumstances, a sales price quoted by the developer is utilized, without reference to appraised value.

- **Appraisal.** Appraisal appears to remain the most problematic area of underwriting practices. HOMI did not undertake a thorough analysis of appraisal procedures. However, some insights into the problems were formed through the bank surveys and bank and appraiser interviews.

  Agreement as to appraisal methodology is important. Elements of this include use of a bank versus independent appraiser, guidelines as to which of the three main appraisal methodologies is pertinent, whether one or two methodological approaches should be used in riskier loans, and procedures for resolution of major differences, should they occur among methodologies. In addition, guidelines are needed regarding use of banks’ own appraisers, which can be a risky approach to appraisal, rather than independent appraisers needs assessment. Also, some banks did not do an appraisal but relied instead on the developer’s asking price or the sales price.

**Recommendations.**

- Perbanas and the Task Force should continue to address the standardization issues, including definition of key variable such as the income measure used in payment-to-income ratios, and the value definition used in the LTV.
• A number of important appraisal issues need to be resolved through regulations established by BI for regulation and supervision, as discussed in section 6.0. This should be coordinated through discussions with Perbanas, as well as with appraisal and regulation and supervision experts.

• To avoid legal problems in the future, the Supreme Court should confirm, in the form of a Circular or Guidance, that the standard credit agreement, having been mortgaged, properly meet the criteria: for foreclosure in accordance with article 6 of Undang-Undang Hak Tanggungan (UUHT; that the auction request can be addressed straight to the Auction Office).

5.4 Downmarket Expansion Of Mortgage Lending

Overview. This report distinguishes three “markets” for housing finance in Indonesia, as was noted in section 1.0:

• traditional mortgage finance, provided largely by mainstream national banks, serving only higher income households, with loans over Rp. 50 million, and more typically ranging from Rp. 100- 500 million. This market is discussed in section 2.0;

• moderate income housing finance, which includes KPR/RSS lending and a very small amount of unsubsidized lending for housing conducted by regional development banks and a few other banks, providing mortgage loans of Rp.25 million or less. Downmarket lending to moderate income households is the topic of this section;

• microfinance for housing, a relatively new area of microfinance lending, providing small (less than Rp.5 or 10 million), short-term loans for lower and modest income households; a small proportion of BRI’s KUPEDES loans are now provided for housing, but the extent of housing-related loans by other microfinance institutions and other providers of small, short-term loans is not known. Microfinance lending is discussed in section 5.0.

While these definitions must remain somewhat arbitrary, there are sufficient differences to warrant separate policy approaches to each. The differences are seen in the affordability circumstances of the households, the type of housing required, the institutions most likely to serve these different markets, the appropriate loan products for each group of borrowers, and so forth.
In Indonesia, as in the majority of other emerging nations and some Western nations as well, only higher income households, served by traditional mortgage finance, currently have adequate access to credit. Other than the regional development banks, which together provide only a fraction of KPR lending, most other lenders are not participating in the moderate market. Some banks can be persuaded to go downmarket, however, with good incentives and proper tools, including, for example, mortgage default insurance, alternative mortgage products, risk-based pricing, and homeowner counseling.

Outline of the Discussion for Section 4.0. Section 4.1 provides a brief definition of moderate income housing finance. Section 4.2 discusses moderate income mortgage lending in Indonesia, including the results of HOMI’s Bank Survey II. The next two sections discuss some of the downmarket tools. Section 4.3 describes a credit enhancement tool – mortgage default insurance – which might be used in Indonesia as either a non-subsidized or subsidized tool for helping banks lend downmarket. Section 4.4 then briefly discusses alternative mortgage loan products and risk-based pricing. These tools are useful for the moderate income market and the higher income mortgage market as well, Section 4.5 provides an overview of the moderate income housing finance market in the U.S., including the so-called subprime market, where many of these tools come together to increase affordability for moderate income households. Finally, section 4.6 summarizes our recommendations.

5.4.1 International Experience in Moderate Income Housing Finance.

Moderate income housing finance stems from mainstream housing finance. However, whether LMI lending is carried out by mainstream banks or by community lenders and development finance institutions, it has a specific focus on bankable households who lack adequate access to formal sector housing loans. Moderate income lending for housing is defined by some or all of the following characteristics:

- It has a mission to focus on moderate income, bankable households, but is not intended to address the poor.
- It is based on formal sector housing finance systems and practices that have been specifically adapted to modest income households. Loans depend on mortgage collateral, adequate title, and so forth, but also on flexible underwriting, alternative loan products, etc.
• In some countries, it involves community-based partnerships that impact outreach, underwriting, and servicing;
• It is likely to have higher transaction costs than traditional mortgage credit. Extensive outreach, homeowner counseling, and aggressive servicing are common features;
• It may be combined with government subsidies, as a number of countries have demonstrated.

Examples of countries have made progress in addressing the distinct needs of the moderate income market include South Africa, Chile, the United States, India, and Malaysia. In South Africa, for example, new institutions have been put in place designed to provide credit enhancements, working capital, and technical assistance; they are gradually making inroads into the moderate income market. The hallmark of Chile’s approach is the “tripartite” system, combining a mortgage loan, household savings, and an upfront direct grant. Notably, Chile’s banks also fund themselves effectively from the capital market, and are thus able to address liquidity concerns.30

The lessons learned from international examples include the following:

• Moderate income lending is often provided by community banks, alternative lenders, and finance institutions with a mission of serving moderate income groups;
• Some mainstream banks will not go far downmarket even if incentives are offered. However, if there is competition, and various policy incentives and guarantees, other banks have gone downmarket and proven that it can be good business.
• Government policies and incentives are important in initiating and strengthening the downmarket programs. Involving a broader range of lenders, coordinating with community initiatives, developing credit enhancement policies, and revamping subsidy policies are all important;

5.4.2 Moderate Income Housing Finance in Indonesia.

Moderate income mortgage lending has been limited in Indonesia to KPR subsidized loans and unsubsidized moderate income mortgage lending, the latter being a very small proportion of total mortgage lending. We have attempted to provide an I estimate of moderate KPR and to better understand the role of the regional banks and certain other banks. Arbitrarily, we have defined moderate income KPR as all KPR/RSS loans and unsubsidized mortgage loans of moderate size.
KPR Lending by BTN. Table 4.2.1 provides an overview of BTN’s various KPR products:

Table 4.2.1 BTN Annual Originations of KPR Construction, and Other Housing Credits (Rp.000,000)

<table>
<thead>
<tr>
<th>Type of Credit</th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>KPR RS + RSS</td>
<td>1,355,560</td>
<td>890,596</td>
<td>512,377</td>
<td>1,351,631</td>
<td>364,523</td>
</tr>
<tr>
<td>KPR UMUM</td>
<td>480,738</td>
<td>165,369</td>
<td>30,714</td>
<td>69,813</td>
<td>342,470</td>
</tr>
<tr>
<td>Griya Multi</td>
<td>103,964</td>
<td>11,146</td>
<td>-</td>
<td>134,977</td>
<td>281,873</td>
</tr>
<tr>
<td>KPR Puko</td>
<td>12,731</td>
<td>4,547</td>
<td>573</td>
<td>1,318</td>
<td>4,982</td>
</tr>
<tr>
<td>Other (Land, Swa Griya, Griya Sambada)</td>
<td>8,954</td>
<td>1,430</td>
<td>150</td>
<td>284</td>
<td>6,829</td>
</tr>
<tr>
<td>Total Consumer Loans</td>
<td>1,007,866</td>
<td>1,093,480</td>
<td>643,814</td>
<td>1,567,803</td>
<td>1,010,624</td>
</tr>
<tr>
<td>Total Construction Loans</td>
<td>1,490,198</td>
<td>571,271</td>
<td>196,576</td>
<td>228,984</td>
<td>119,243</td>
</tr>
<tr>
<td>Grand Total</td>
<td>3,458,054</td>
<td>1,654,752</td>
<td>743,390</td>
<td>1,796,797</td>
<td>1,129,873</td>
</tr>
</tbody>
</table>

- BTN undertakes the major share of subsidized KPR lending;
- BTN makes KPR UMUM loans of moderate size. The average KPR UMUM loans originated in 2000 was Rp. 30 million; in 2001 (through July) the average was Rp. 25 million;
- BTN has other housing-related loan products, such as the home equity credit (Kredit Griya Multi). The average for loans originated in 2000 was Rp. 27 million.

Clearly, BTN has very substantial experience in lending modest sized loans, some of which are presumably to modest income households. It would be valuable to Indonesia to capture BTN’s moderate market experience of BTN and expand it on a commercial basis and/or combined with new subsidy policies. This recommendation is discussed below in section 4.5.

KPR in Regional Banks. Table 4.2.2 provides an overview of regional bank lending KPR lending, which represents a very small share of total KPR in Indonesia. Thus, for example regional banks provided 3.4 percent of subsidized KPR in 1999, and a somewhat greater amount of unsubsidized residential lending. As summarized in table 2.3 in section 2.0, the regional bank share of total real state lending was 5.4 percent in 1999, and has fallen to 2.3 percent in 2000.
Table 4.2.2 KPR & Construction Lending by Regional Banks  
(Rp. 000)

<table>
<thead>
<tr>
<th>KPR Lending</th>
<th>1999</th>
<th>2000</th>
<th>2001 (April)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of Lending</td>
<td>KPR RSS</td>
<td>KPR UMUM</td>
<td>Constr</td>
</tr>
<tr>
<td>Regional Bank Share (%)</td>
<td>3.4%</td>
<td>6.0%</td>
<td>6.25%</td>
</tr>
</tbody>
</table>

**HOMI Bank Survey II.** In order to have a better understanding of the types of banks that provide moderate loans for housing, and which banks might be inclined to do so in the future, HOMI conducted Bank Survey II, which was submitted to 12 banks, 6 state banks and 6 private banks. The state banks are all regional banks, while the private banks were selected from among those having applied to Kimpraswil to offer KPR/RSS loans.

Clearly, the regional banks offer KPR of modest size – in this sample ranging from Rp. 3.2 to 20 million. Some also offer small multi-purposes loans and general credit, which can usually be used for home improvement as desired. Five of the six state banks surveyed have already gone “downmarket” or say they intend to do so. Only one of the state banks did not wish to lend below Rp. 50 million.

There are also private downmarket lenders offering loans that moderate income households can afford. Thus, four of the private banks offered loans of Rp. 40 million or below. Two of the banks have already gone downmarket, offering loans as small as Rp. 5 million. Two more of the private banks said they intended to go down market. The banks noted the need for a guarantee program and long-term funds at a stable rate.
Table 4.2.3: Downmarket KPR Lending: Bank Survey II

<table>
<thead>
<tr>
<th>Bank</th>
<th>Minimum KPR Rp.000</th>
<th>Going Downmarket for KPR?</th>
<th>Factors Regarding Downmarket Decision</th>
<th>Other Small Loan Types</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>State Banks</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BPD Jabar (West Java)</td>
<td>5,630</td>
<td>Have done</td>
<td>NA</td>
<td></td>
</tr>
<tr>
<td>BPD Jateng (Central Java)</td>
<td>3,200</td>
<td>Have done</td>
<td>NA</td>
<td></td>
</tr>
<tr>
<td>BPD Jatim (East Java)</td>
<td>20,000</td>
<td>Yes</td>
<td>(No reason given)</td>
<td>Multi-purpose; 5 year loan</td>
</tr>
<tr>
<td>BPD Sumsel (South Sumatra)</td>
<td>5,200</td>
<td>Have done</td>
<td>NA</td>
<td>General Credit; 6 &amp; 10 years</td>
</tr>
<tr>
<td>Antar Daerah (Surabaya)</td>
<td>50,000</td>
<td>No</td>
<td>Too high risk; (no reason given)</td>
<td></td>
</tr>
<tr>
<td>Bank DKI (Jakarta)</td>
<td>9,000</td>
<td>Yes</td>
<td></td>
<td>GUSK7; 2 years</td>
</tr>
<tr>
<td><strong>Private Banks</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kesajahteraan</td>
<td>5,000</td>
<td>Have done</td>
<td>NA</td>
<td></td>
</tr>
<tr>
<td>Swansarindo International</td>
<td>5,000</td>
<td>Have done</td>
<td>Need guarantee program</td>
<td></td>
</tr>
<tr>
<td>Artha Cakra</td>
<td>50,000</td>
<td>No</td>
<td>Not targeted/need GOI subsidy</td>
<td></td>
</tr>
<tr>
<td>Bank Niaga</td>
<td>40,000</td>
<td>Yes</td>
<td>(no reason given)</td>
<td>KUR, Installment 3 – 15 years</td>
</tr>
<tr>
<td>Bank Bukopin</td>
<td>50,000</td>
<td>Yes</td>
<td>(no reason given)</td>
<td>KUR, 1-5yrs, KSG, 1-3 years</td>
</tr>
<tr>
<td>Bank Bumiputra</td>
<td>30,000</td>
<td>No</td>
<td>Need Long-term funds/stable rate</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bank Survey II

**HOMI Household Survey.** The HOMI Household Survey also offers evidence of lending in the lower and modest income areas that formed the survey’s sampling frame. Not only RSS loans were noted, but KPR UMUM loans on Kredit Griya Multi, and Kredit Swandana. Examples of the loan terms include:

**Pontianak:** BTN loans:
- KPR UMUM at 15 years, 19.5%, with an LTV of 70%;
- Kredit Griya Multi – 10 years. 20%, LTV 50%
- Kredit Swandana – according to deposit maturity; 1.5% above the deposit rate, LTV 80%.

**Tarakan:**
- Cooperative housing loan. The borrower must have land title; the minimum loan Rp. 6.4 million. The dwellings were located in a developers area; the loans were payroll deducted,
the was term 5-10 years, and interest 8.5% (this is subsidized, but the source was not indicated).

**Makassar.**
- There are KPR RSS/RS loans from BTN.
- There are also loans from a non-banking institution Wahana Peduli Pemukiman/WALKIM). The borrower must have IMB building status. The minimum credit is Rp. 1 to 2.5 million. WALKIM also provides house renovation credit for 1 to 2 years at 19%; installments are weekly or monthly; minimum monthly income is Rp. 500,000

**Kendari:** two banks active here: BTN and a regional bank, BPD.
- BPD finances only RS/RSS houses. The BPD requires a land certificate, a minimum house price of 20 million, minimum collateral of 6.21 million, and minimum income of Rp. 250,000 per month.
- BTN requires house price of Rp. 14 – 40 million, and a minimum LTV of 70%. Sixty percent of these BTN customers received a rehab loan, while 40% received a KPR. Minimum selling price of RSS was 14,400,000 and RS minimum was 33,000,000. Minimum income for non-government officials was Rp. 700,000 – 800,000 per month. The LTV requirement was 60%. Terms of BTN KPR were 20 years.
- BTN also had provided Kredit Griya Multi (rehab) for 10 years at 20%; Kredit Swa Griya for 15 years at 19.5%. Construction loans had been offered at 20%.
- FYI, BTN views its competition in Kendari to be BNI.

**Surabaya.** A different type of data was collected in Surabaya. The average size loans taken by residents of the surveyed areas was as follows:
- KIP Housing Area: Rp. 1.47 million
- Other Slum Areas: Rp. 2.49 million
- Renter Housing Areas: Rp 5.4 million
- RS/RSS Housing Areas: Rp. 18.9 million

**Conclusion.** In sum, the results are encouraging in some respects: there are banks already providing, or willing to consider, KPR of modest size. The bad news, however, is that this has been a very small proportion of KPR. Using the incentives and lending tools discussed below should become a high priority, one that is especially important as KPR RSS is phased out.
5.4.3 Mortgage Default Insurance

Mortgage default insurance (MDI) is a credit enhancement tool used to lower the downpayment requirements for bankable, moderate income households. It is one of the most powerful credit enhancement tools in use in the mortgage markets of the U.S., Canada, and increasingly Australia. MDI allows the borrower to purchase a home with a high LTV of 90 percent for example. From the discussion above in section 3.2, however, we know that the LTV is probably the single most important variable in predicting default – that is, high LTV loans are far more likely to default than low LTV loans, not least because the borrower has so much of his or her own resources invested if the downpayment is relatively large. Thus, from a risk standpoint, banks are correctly reluctant to offer high LTV loans. MDI benefits the bank by reducing the loss it might otherwise suffer in the case of default. There are many design options for realizing the balance between LTV assistance to the borrower and loss provision to the bank; HOMI has suggested, in essence, approaches that share the risk between the insuring agency and the bank, so that both have a stake in the outcome.

International Examples of Mortgage Default Insurance. Mortgage default insurance has long been a mainstay of the housing finance systems of Canada, where a government-sponsored system (CHMC) provides broad-based support to mortgage lending. In the United States, there is both a government-sponsored system (the FHA, Federal Housing Agency) and private mortgage insurance. In the United States, MDI is required for nearly all loans with LTV over 80 percent; this accounts for some 25 to 30 percent of the U.S. loans. Private mortgage insurance is now in place in Australia, and is spreading into Europe. Among emerging nations, South Africa has developed a system to support moderate income households, including via loans from alternative and community lenders.

Mortgage Default Insurance in Indonesia. MDI can play three important roles in Indonesia:

- As a guarantee to the banks, to assist them in lending downmarket. MDI would share the risk of providing higher LTV loans to moderate income households;
- As a credit enhancement, MDI would be important in helping assure potential investors in the debt instruments of an SMF, that the portfolio was of investment grade quality; and
- As a subsidy mechanism in those cases where the fees for MDI were fully or partially paid by GOI. MDI could also be easily combined with other subsidy mechanisms.
In Indonesia, the required LTV is most frequently between 60 and 70 percent. If households were able to offer only 10 percent of the house value as downpayment — that is, an LTV of 90 percent, this would greatly enhance the affordability of purchasing a home.

Note, however, that MDI is not a universal panacea for all households wishing to obtain a KPR loan. It is suitable only for a particular group of households. First, it would be offered only to moderate income households — there is no intention to assist those who can readily afford to provide an adequate downpayment. Second, it addresses the so-called “wealth” constraint: the difficulty that moderate income households have in saving a large downpayment. More specifically, it helps households who would have difficulty saving for a large downpayment in a short time period. With MDI, the household can thus obtain a housing loan more quickly. Third, the household must have adequate income to service the high LTV loan, so that this precludes lower income groups from this type of approach. The types of households who might benefited most, are, for example, groups, with adequate earning (and most likely good prospects of increasing real income), but who have not yet been able to save a large downpayment.

Finally, it should be noted that MDI, potentially, can take two forms and play two complementary roles: a subsidized version can assist moderate income housing obtain funding, and encourage the housing market to extend downmarket; a non-subsidized, borrower-paid version, a credit enhancement tool to help a somewhat higher income group obtain financing. In both cases, HOMI considers that MDI has important potential as a subsidy and/or a downmarket mechanism.

5.4.4 Alternative Mortgage Loan Products and Risk-Based Pricing

**Overview.** At present, mortgage lenders in Indonesia tend to offer a “standard loan package” — a discretionary, variable rate mortgage, an LTV of 60 to 70 percent, and the same, or similar, interest rate to all customers. This “plain vanilla” package relies on “average cost” pricing. In essence, this results in a bank’s best customers to subsidize the somewhat higher risk customers. Similarly, the discretionary mortgage product essentially places all the interest rate risk with the borrower.

This “standard package” may be suitable at present because the mortgage market is generally limited to a narrow band of customers: those with high income, a conventional formal income stream, and so forth. In the long run, however, this is neither an adequate “arsenal” of mortgage loan tools for enabling a bank to become highly competitive...
nor for expanding the customer base to those with somewhat different needs. And farther in the future, securitization can be made simpler with alternative loans products.

In sum, many more tools can be placed in the arsenal – for example, alternative loan products, risk-based pricing, variations in LTV and other loan features — to achieve the following benefits:

- better control and pricing of risk, for
- developing a more competitive product line;
- expanding the customer base by catering to a variety of needs, and/or
- for extending the banks’ reach downmarket

HOMI recommends that training in this “toolkit” be made available to lenders, most probably through the coordination efforts of Perbanas. These topics follow directly from the issues discussed in section 3.0: formation of the Credit Bureau, the development of credit scores (FICO) scores, automation of underwriting (and the entire loan process), and, ultimately, mortgage credit scoring. HOMI is not suggesting that Indonesian bankers eliminate the discretionary loan product, since this is what they are currently most familiar with. Rather, we suggest that mortgage bankers be provided more information on the various features of other loan products, why the features vary, why some products are better for some customers than others, and how different loan product features may be used to both control risk while satisfying borrower needs, and thus the principles for differential pricing.

**Mortgage Products in Indonesia.** Indonesia’s discretionary ARM product, essentially allows the banks to change the interest rate whenever they wish for an amount that they determine but is not known ahead of time by the customer, and that has no rules guiding the frequency of amount of interest rate change in any given period. The advantage to the banks is that the borrower, potentially, faces the entire burden of the credit rate risk. There are a number of disadvantages, however.

- because all the interest rate risk sits with the borrower, and no rules govern interest rate changes the borrower may experience “credit shock” in case of a steep rise in rates, and thereby default;
- lenders apparently tend not to change the rate frequently, which risks a bigger change when it does happen;
• if changes are infrequent, the borrower becomes accustomed to what has essentially become a fixed rate mortgage, and the shock of a rate change could be all the greater. 32

In addition, this “one size fits all” simply limits the bank’s ability to compete for a wider variety of customers and to price loans to fit customer profiles, and as befits the different level of risk that different customer groups represent – both high and low risk.

The toolkit summarized here includes alternative mortgage products, risk-based pricing, variations in LTV and numerous other features of the underwriting variables, as well as mortgage default insurance (see section 4.3), homeowner counseling (see section 4.5).

**Alternative Mortgage Loan Products.** There are numerous other types of loan products in use worldwide, most especially in the U.S. and U.K. We mention three of the generic types:

• Fixed rate loans, still the most common type of loan product in the U.S., but not necessarily recommended for Indonesia or other countries with a high risk of volatile interest rates;

• Indexed adjustable rate mortgages (ARMs), which are indexed variable rate loan products with fixed rules regarding maximum rate adjustments and rate adjustment periods;

• Balloon loans, which generally have a 5 or 10 term, but must be paid off or refinanced at the end of the term.

HOMI would suggest that Indonesian mortgage lenders look into several alternative mortgage products, including the indexed ARM products and the balloon mortgages. Ideally, these topics could be addressed in bank training sessions.33

The balloon is generally somewhat simpler than an ARM; it is also “affordable”, in that the payments are calculated as if the mortgage term were 30 years, even though the balloon term is generally 5, 7, or 10 years. However, with a balloon, the customer must either be planning to move, or be ready to refinance at the end of the balloon period; this will involve some settlement costs.

A wide variety of indexed ARMs is available. Just as examples, the most popular types in the U.S. include the so-called 1/1, 3/1, 5/1, and even 10/1. These denote ARMs which have a fixed rate for 1, 3, 5 or even 10 years, but thereafter adjust the rate according to the
index rules every year. The different features of various ARMS include the type of index, the rate adjustment cap, which limits the size of any one interest rate change, the frequency of the rate change, and the maximum rate change over the life of the loan. The advantages of indexed ARMs include a “competitive” compromise between the needs of the bank and the borrower, especially regarding sharing interest rate risk; and rules known to the borrower about interest rate changes, which help prevent credit shock. The disadvantages are their complexity - both for the banks and the customer. Banks would need to “model” which options seem best for their market. Because many variables are involved, designing and pricing ARMs can be complex, especially when the products are new to the market.

Indexed ARMs are also very useful as alternative loan products in the mainstream market. We have placed the discussion here in the section on downmarket lending, however, because we feel that discretionary variable rate loan products are less suitable for most moderate income households. If inflation rates were increase quickly, such households are far more likely to suffer “credit shock” than higher income households. This could increase the default rate, potentially seriously.

In order to utilize indexed ARMs in Indonesia, however, the issue of selecting an index must clearly be addressed, however. As in other emerging nations with potentially volatile interest rates, and without any obvious benchmark rates established in the capital market, this is not a simple problem. Four potential candidate rates are shown on Chart 2: JIBOR (Jakarta Interbank rate), SIBOR (Singapore Interbank rate), IRSOR (Interbank Swap rate), and the CPI (consumer price index). Data are presented from February 1999 to October 2001. SIBOR, for example, tends to follow the U.S. market, and has dropped steadily. The cost of funds in Indonesia, on the other hand, is better represented by the SBI rate, which has risen fairly steadily. The CPI has shown more volatility than most of the other candidate indices, but is generally lower than the SBI. Thus, the decision on construction of an index, perhaps a weighted combination of some of the rates noted here, will require expert study. We recommend that this be done as soon as possible.

**Risk-Based Pricing.** The mortgage lending industry in a number of developed countries has, in the last decade in particular, moved away from “average cost pricing” to risk-based pricing.34

To provide an example, the “tool kit” of risk-based pricing strategies might include the following.

Interest rates would be varied as a function of:
- the level of the LTV;
- the credit rating (FICO score);
- loan amount;
- type of mortgage loan product;
- incentive payments: funds paid to the customer following a fixed period of timely payments.

Again, these are appropriate topics for bank training sessions. Studies exist which have calibrated the interest rate differentials relevant to various customer, loan, or collateral features. Clearly, Indonesia would have to develop its own approach and develop its own interest rate variation based on experience here. Estimates made elsewhere can serve as a guide, however. Also, recent studies in the U.S. have documented the limits of innovations in mortgage loan products in assisting with affordable lending.

**Recommendations.**

HOMI recommends that training in alternative loan product and risk-based pricing “toolkit” be made available to lenders, ideally through the coordination efforts of Perbanas. As noted above, these topics follow directly from the issues discussed in section 3.0: formation.
of the Credit Bureau, the development of credit scores (FICO) scores, automation of underwriting (and the entire loan process), and mortgage default insurance (section 4.3). HOMI is not suggesting that Indonesian bankers eliminate the discretionary loan product, since this is what they are currently most familiar with. Rather, we suggest that mortgage bankers be provided more information on the various features of other loan products, why the features vary, why some products are better for some customers than others, and how different loan product features may be used to both control risk while satisfying borrower needs, and thus the principles for differential pricing.

5.4.5 Moderate Income Housing Finance in the U.S: A Tool Kit of Loan Products and Incentives for Lending Downmarket.

A number of different motivations and market forces have resulted in a very major increase in moderate income housing finance in the U.S. in the last two decades. These include:

- Community activists, who work largely through lenders with a mission to expand homeownership among modest income households. The lenders involved are often community development finance institutions;
- The advent of the CRA legislation in the United States, which essentially mandates that banks lend in all the neighborhoods in which they are active, including lower income neighborhoods. CRA followed on the heels of many years of arguments as to whether banks discriminated against entire low income and/or minority neighborhoods in mortgage lending. Arguably, CRA has resulted in increased moderate income mortgage lending;
- The realization by mainstream lenders that moderate income lending was in fact profitable, giving rise to a growing “subprime” market in the U.S. This market serves households that, for one reason or another, cannot meet the conventional underwriting rules. Instead of being refused mortgage credit, however, certain classes of “subprime” borrowers have been defined, and are able to obtain credit with both higher rates and credit enhancement features, such as mortgage insurance.

Table 4.5.1 summarizes how various lenders in the U.S. approach downmarket lending: essentially putting many of the downmarket tools and incentives together in a package: low downpayment, ARM loan products, mortgage default insurance, aggressive servicing, the FICO score from the Credit Bureau, and mandatory homeowner counseling.
In the “standard” lending approach, shown in the second column, a typical scenario is a loan with an LTV of 80 percent or less, with "conventional ratios for the payment-to-income calculation and debt to income ratio, requirements for borrower-only funds for the downpayment, no mandatory mortgage default insurance, and so forth. Also, closing costs are not included in the loan, so the closing LTV (CLTV) is the same as the LTV.

The last two columns, however, describe the new products being offered to enhance affordability. The third column represents one of the types of loans now being accepted in the secondary market by Fannie Mae and Freddie Mac. The last column shows a lender with an affordable loan product which will be kept in the lenders portfolio. For both, the loan terms are very lenient, especially with regard to the LTV and the source of the downpayment. However, for both, mortgage insurance is mandatory, homeowner counseling is mandatory, and servicing is undertaken aggressively when delinquencies first appear.

Table 4.5.1 Affordable Lending Tools in the United States: Alternative Mortgage Products, Mortgage Insurance, and Flexible Underwriting

<table>
<thead>
<tr>
<th>Affordable Lending Approach</th>
<th>Standard Mortgage Approach</th>
<th>Affordable Loans in the Secondary Market</th>
<th>Affordable Loans kept in Banks' Portfolios</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum LTV</td>
<td>80 %</td>
<td>97%</td>
<td>97%</td>
</tr>
<tr>
<td>Maximum CLTV</td>
<td>80 %</td>
<td>103%</td>
<td>103%</td>
</tr>
<tr>
<td>Downpayment</td>
<td>Must be borrower's funds</td>
<td>Minimum borrower funds</td>
<td>3% borrower funds, some gifts allowed</td>
</tr>
<tr>
<td>Subordinate Finance</td>
<td>No</td>
<td>Sometimes</td>
<td>Up to 103% LTV</td>
</tr>
<tr>
<td>Payment Income Ratio</td>
<td>25% - 28%</td>
<td>33%</td>
<td>33%</td>
</tr>
<tr>
<td>Debt Income Ratio</td>
<td>33%</td>
<td>38%</td>
<td>42%</td>
</tr>
<tr>
<td>Mortgage Insurance</td>
<td>No</td>
<td>Required if LTV &gt; 80%</td>
<td>None required</td>
</tr>
<tr>
<td>Cash Reserves</td>
<td>At least 2 months</td>
<td>Not required</td>
<td>Not required</td>
</tr>
<tr>
<td>Credit History</td>
<td>Credit score important</td>
<td>Credit score important</td>
<td>Minimum score required</td>
</tr>
<tr>
<td>Closing Costs</td>
<td>Borrower funds</td>
<td>Can come from gifts &amp; grants</td>
<td>Can come from gifts &amp; grants</td>
</tr>
<tr>
<td>Mandatory training</td>
<td>No</td>
<td>No</td>
<td>Yes for many lenders</td>
</tr>
<tr>
<td>Aggressive servicing</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Source: Merrill, Temkin, et.al., The Urban Institute, 2000

For all three loan types – standard and affordable alike, note that the FICO score, the statistic noted in section 3.2 which measures overall credit worthiness, is a very important aspect of the underwriting. For a conventional loan, a certain score must generally be achieved, and if it is not, some further provision – MDI, higher interest rate, and/or lower LTV - may be required. And, eligibility for the affordable loans will be denied if the FICO score falls beneath a certain threshold.
Note also that the interest rate is very likely to be fairly significantly higher for the “affordable” loan options. First, the lender must cover both transactions cost, especially in the case where counseling is mandatory, and the increased credit risk. The default rate on FHA loans is considerably higher than for standard loans not requiring MDI. In mid-2001, for example, the default rate on FHA-insured loans rose to about 10 percent, as compared with 3 percent on more conventional loans. Secondly, from the perspective of the borrower, he or she must be able to support monthly payments that include the fees for the mortgage insurance. Whether public ((FHA) or private (PMI), mortgage insurance is generally paid by the borrower.

In addition, a tool being used now on a much larger scale in the U.S. is homeowner counseling. Limited public sector initiatives began several decades ago, but with the advent of CRA and the much expanded affordable lending sector, numerous private, community group, and NGO programs have arisen to assist would-be homeowners who have had limited experience with either mortgages or perhaps even the banking sector. Recently, empirical studies have determined that counseling can, indeed, be effective in reducing mortgage delinquency.38 Notably, consumer education is also a major feature of microfinance for housing, which is discussed in section 5.0.

5.4.5 Conclusions and Recommendations

Conclusions.

Is the U.S. Affordable Lending Approach Appropriate for Indonesia Now? No. We do not advocate that Indonesia attempt to replicate the affordable loan products noted in table 4.5.1 at the present time. Especially with regard to liberalization of the rules for LTV and payment ratios, this would appear to be far too risky for the present environment in Indonesia. High LTV loans can only assist in a limited way in Indonesia until there is more experience with analyses of correlation of default and higher LTV.

However, there are features and underlying themes which are valuable to demonstrate flexibility, affordability, and risk management. The U. S. affordable lending market has grown substantially over the past decade, and the lessons learned can be modified to suit the different circumstances of other nations in a generic sense.39

It should also be noted that the affordable loan programs are sometimes connected to subsidy programs or charitable grants. For example, community housing programs and/
or NGOs may provide transactions assistance free of charge – for example, loan origination processing or more frequently the homeowner counseling. This is an approach that may be highly relevant to Indonesia.

**However, as KPR/RSS is phased out, moderate KPR UMUM lending will need to be greatly encouraged – not only for regional banks, but for a much wider variety of private banks and national state banks. Affordable lending tools and incentives will prove valuable.**

**Barriers in Indonesia to Extending Housing Finance Lending Downmarket.** There are a number of barriers to downmarket lending in Indonesia which is would be advisable to address. These include:

- Lack of experience with loan pricing based on risk and transactions costs
- Lack of Credit Bureau data on the quality of the would-be borrower
- Limited loan products (discretionary variable rate mortgages may not be suitable)
- Lack of credit enhancement tools, such as mortgage default insurance
- Risk averse behavior on the part of the banks post Krismon
- The constraining effect of KPR/RSS – this segment of the market has been “spoiled” by KPR/RSS subsidy system
- From the supply side – lack of continuity in affordable housing types, exacerbated by KPR/RSS system
- Uncertainty on future role of BTN (fear that GOI will provide it with implicit subsidy).

**Recommendations.**

Recommendations to encourage expansion of housing finance to moderate income households include a mix of policies: redesign of subsidy policies, government assistance in design of appropriate loan procedures, incentives for involvement of a variety of lenders, and subsidy policies designed for compatibility with both housing finance and downpayment contributions by households. Recommendations include:

- A definitive decision taken by GOI to **phase out the KPR/RSS subsidy.** Housing suitable for the needs to modest income households has been too limited by the KPR/RS/RSS approach to housing. The supply of moderately-priced housing should reflect a broader continuum of typologies, augmented by low cost technologies. An improved continuum in the supply of housing should emerge once developers realize that finance is not locked.
into the RSS/RS system. This supply stream will better match the effective demand of moderate and modest income households.

- **Mortgage Default Insurance.** GOI assessment of the feasibility of a credit enhancement via mortgage default insurance (MDI). As noted below, options for both a subsidized and unsubsidized version should be considered;

- Mainstream banks are not likely to lend downmarket until the KPR/RSS program is replaced with a market friendly subsidy approach and until the future of BTN is clarified and they can be assured of a level playing field in this segment of the market. Mainstream lenders willing to go downmarket also can be assisted in various ways, including via alternative loan products and credit enhancements.

- **Bank Training.** Cooperation with Perbanas in establishing a Subcommittee on Housing Finance. This subcommittee would, first and foremost, determine which of the topics introduced in sections 3.0 and 4.0 of this report would be most useful for management of their loans portfolios, improving underwriting, expanding moderate income housing finance, and so forth. Examples of specific bank training topics include mortgage insurance, ARMs and other alternative mortgage loan products, IT systems, credit scoring, and risk-based pricing

- **Downmarket Lenders.** Initiatives by GOI to seek broader participation by a broader group of lending institutions, including BPDs and smaller banks. Regional banks and a number of other state and private banks already provide KPR UMUM, although in very modest amounts, or, state that they are willing to go downmarket, (defined arbitrarily as loans of Rp. 25 million or less). These lenders should be encouraged. An assessment should be made of the financial condition of such lenders; sound lenders should provided with technical assistance regarding mortgage finance underwriting, servicing, loan products, and so forth;

- **The Future Role of BTN.** BTN, given its long experience in underwriting and administering the major share of the KPR/RSS interest rate subsidy, would seem to have a comparative advantage in lending downmarket to moderate income households. Under the scenario of phasing out the KPR/RSS subsidy by 2004, BTN might consider planning its commercial expansion into similar markets without this particular subsidy (and with or without another form of subsidy or credit enhancement such as mortgage default insurance). In contrast, however, BTN has tentative plans to expand into the upscale market and compete directly
with banks such as Danamon, BII Lippo, Mandiri, and NISP. A business prospectus prepared for BTN provides a number of scenarios about the demand for KPR, both “optimistic” and “moderate”. Under either scenario, however, BTN planned to capture a major share of the market for loans on Rp. 100 million and above. In both cases, about 70 percent of BTN’s KPR portfolio was to be dedicated to loans of Rp. an above, about half of which was for loans of over Rp. 200 million. The remaining 30 percent of the total was for loans between Rp. 50 and 100 million; there were no plans for loans of less than 50 million. In sum, this approach seems not to take advantage of the market familiarities and methodologies that BTN has developed to date.

5.5 Developing Microfinance For Housing

5.5.1 Overview.

Microfinance for housing – designed to serve modest and lower income households obtain credit for housing - is currently being discussed in numerous forums worldwide as a distinct and important new branch of housing finance. Microfinance for housing (MFH) combines elements of microfinance, consumer finance, and traditional mortgage finance in seeking to find loan products and underwriting methodologies that are appropriate to households of modest and lower income. Although these households cannot afford traditional formal sector housing solutions, incremental housing solutions and short- and medium term credits can provide a successful approach.

This section is concerned with the further development in Indonesia of commercially based microfinance for housing. MFH is one of three distinct “types” of housing finance discussed in this report, together with traditional mortgage finance, which was discussed in sections 2.0 and 3.0 above, and the downmarket extension of traditional mortgage finance for moderate income groups, as discussed in section 4.0.

The HOMI Project recommends that Indonesia promote and expand microfinance for housing, including further development of loan products and lending methodologies specifically designed for housing. This recommendation stems from the realities of the housing supply process:

- The vast majority of modest and lower income households construct their own dwellings;
• Many of these households could greatly benefit from housing credit to speed the construction process or improve existing dwellings.
• Indonesia will not be able to subsidize all of these households in the immediate future. Housing credit will enable them to assist themselves, but, in addition, could supplement subsidy funds if available.

BRI currently extends a limited number of Kupedes loans for housing, primarily for housing improvement and expansion of owner-occupied units to include rental housing. These loans, however, are generally not explicitly promoted nor underwritten for housing purposes. Thus, two steps should be taken:

1. MFH could be extended to a broader group of lenders including other microfinance institutions, credit unions, and cooperatives, bearing in mind the need to strengthen the commercial foundations of some of these institutions; and
2. Attention should be given to development of loan products and procedures more specifically aimed at housing.

Indonesia is well suited to an expansion of MFH. First, significant experience and expertise already exists in institutions such as BRI, which has established microfinance training programs for both Indonesian and foreign practitioners. Also, BRI already undertakes a limited amount of MFH and has some experience with its product development. In addition, Indonesia has other networks of institutions lending to modest and lower income households, such as LDKP, Bukopin and its Swamitra program, and CUCO, which coordinates the credit unions. What is needed is a significant expansion of MFH via these networks.

What would the increased emphasis on MFH hope to achieve? If micro credit is already being used for housing in BRI lending, for example, is there really any unmet effective demand for this type of credit? In other words, do we need to concentrate on MFH specifically as opposed to microfinance in general?

Our answer is “yes” for a number of reasons. Clearly, microfinance for housing is no panacea for the housing needs of low income households. The serious affordability gap will remain in place until real income has increased. Lack of liquidity will also remain a barrier: developing MFH, in and of itself, will not pull vast new resources into the housing sector. Nor can MFH be as effective as it could be if rigidities persist in land supply, land titling, unmet infrastructure needs, and so forth.
However, MFH can be a much more powerful tool than it is at present, especially if
the credits are specifically designed to meet low income housing needs. MFH is an
important stand-alone financial product for lower income households. Furthermore,
MFH may be especially effective if utilized in combination with other programs dealing
with land, infrastructure, and/or titling.

- The informal sector for housing, which is already felt to work well, could be even more
effective with improved access to credit;
- *MFH can speed up the home improvement and incremental building process, bringing
housing solutions to more households more quickly;*
- *MFH, when provided for rental units in owner-occupied dwellings, expands both housing
supply and income generation;*
- *MFH has important links to income generation activities, since many of these either are
located in the dwelling or the home is used for production or storage of micro-enterprise
goods;*
- *MFH, together with land title, can help make low income housing a productive asset for
use as collateral in other borrowing;*
- *MFH has somewhat different requirements than microenterprise finance, and the loan
products and procedures will be more effective if they reflect these needs. MFH loan
products may qualify households who previously had no access to such borrowing*

### 5.5.2 Defining Microfinance for Housing

Micro-enterprise lending for income generation is a well developed and increasingly
commercialized field in emerging nations worldwide. Micro lending for housing is a much
more recent and less widespread aspect of micro-finance, but one that is increasing. It
has appeared in several guises: (1) microenterprise loans which have been used, in fact,
for upgrading and expansion of dwellings, especially when the home is used for income-
generating activities; (2) as an explicit subset of micro-lending undertaken by a few micro
lenders, especially those dedicated to housing and community development; and (3) as
an offshoot of NGO activities in housing, especially NGOs which have developed “sister”
financial institutions, or other financial partnerships, to add housing finance to their shelter
projects.41

As noted, a number of studies are now being carried out to document MHF activities and
better understand what approaches are emerging as best practice in Latin America, Africa,
and Asia. While the definitional and policy debate continues, however, it is also clear that
a number of institutions, especially microfinance institutions and NGOs have already been providing MFH, especially during the last decade. For example, studies in the 1990s by BRI, SEWA Bank in India, and FIE in Bolivia all documented that some microenterprise credits were actually being used for housing-related purposes. Money is fungible, and SME credits were being channeled into housing. The main difference now is that, increasingly, micro loans are being offered specifically and explicitly for housing purposes. Previously, only a few low income lenders had developed loan products aimed at housing, such as BancoSol in Bolivia, SPARC in India, and CashBank in South Africa. Currently, BRI does not specifically distinguish its housing loans from the other KUPEDES products. However, awareness of MFH is increasing, which is important, because MFH loans may differ in particular ways from SME or other micro credits.

*Micro lending* for housing can be characterized as follows:

- It is guided, in part, by microenterprise lending experience, and in part by consumer finance;
- It often has a community-based focus, sometimes including group lending and group guarantees. It may be part of a multi-faceted urban development project, including land and infrastructure;
- Compared with traditional mortgage finance, The loans generally use non-mortgage collateral or are unsecured. MFH relies on alternative underwriting criteria, often including an emphasis on savings. Also in contrast with mortgage finance, it provides small, short-term loans, often with rollover or repeat features. It often involves counseling and personal outreach;
- The funding may be designed for incremental housing, rehabilitation, expansion, and/or core housing or infrastructure connections;
- It may be combined with government or charitable subsidies, often together with the household savings programs; and
- Land title issues are an important aspect of providing low income housing, and MFH lenders differ in their requirements for having formal title.

MFH is generally intended for a target group of “bankable” low-moderate income households, not for the very poor. Under some circumstances, it may extend to the poorest of the poor—such as squatters and pavement dwellers – but this may be in combination with other projects and funding by NGOs, community-based groups, donors, and/or governmental subsidy programs, including provision of land and/or infrastructure.
5.5.3 Indonesia’s Network of Microfinance Institutions

The microfinance sector in Indonesia has been analyzed in a number of recent reports, and recommendations for its improvement have been set forth. This report is not the appropriate forum for a lengthy discussion of microfinance. However, to a large extent, the health and future of MFH will rise and fall with the health of Indonesia’s microfinance sector overall. Thus, we briefly note several issues that will set the stage for advancing MFH.

An Extensive Microfinance Network. Table 5.1 presents an overview of the structure of microfinance institutions in Indonesia. The dominance of BRI is evident, as it has over three times as many accounts, and a slightly greater value of loans than the rest of the institutions combined. BRI is in fact the largest bank in Indonesia, and its fully commercial Kupedes loan program continues to be successful. Indonesia is fortunate in also having other microfinance networks, including some with apex institutions that would be able to assist in expanding their lending to include MFH. Examples include Bukopin’s Swamitra program, which includes coops, BPR, and microlenders, and CUCO, the umbrella institution for the credit unions.

Savings and Liquidity in the Microfinance System. Although BRI’s commercially successful micro lending program serves as a model worldwide, an argument can be made that the real success is found in its savings mobilization. Indeed, as of August 2001, there were nearly 27 million savings accounts. The BPR network is also an important outlet for small savers.

BRI’s success with savings suggests two issues that should be addressed. First, other MFIs could possibly achieve similar results with greater concentration on savings. This would enhance local intermediation, which could help in solving some of the liquidity problems facing other MFIs.
Second, many of BRI’s units are tremendously liquid. Overall, BRI had an LDR of only 0.37 in June 2000. Although BRI now shows a small expansion in lending, as shown in Table 5.2, the ratio was not much higher in August 2001, standing at 0.42. This is in marked contrast to the LDRs of 3.8 in 1984 and 2.69 in 1985. In addition, the performance of BRI’s portfolio has continued to improve. BRI’s loss rate was reasonably low even during Krismon, standing at about 5 to 6 percent. However, total arrears were only 2.27 percent in August 2001. The loss ratio has fallen from 1.48 percent to 0.67 percent over the same period. Thus, it would appear that tremendous leverage is available for BRI to adopt a less risk averse program. Note that the other microfinance institutions in Table 5.1 are much more highly leveraged.

**BRI’s Micro Housing Loans.** BRI decided to extend its Kupedes loan program into housing over a decade ago. The loans are not mortgage loans – that is, are not secured by the value of the property as collateral – but rather are underwritten in a similar fashion as the microenterprise loans, with regular Kupedes interest rates and terms. The loans are most often for home improvement, and less frequently for construction of housing on land already owned by the borrower (loans are not provided for land purchase). Loans are also provided for improvement of housing that will be rented out. Borrowers must be salaried or on fixed income to receive home improvement loans or for those just trying to enter the room rental business. Most of the loans are between $250 and $2500 (although they can go as high as $15,000).

---

<table>
<thead>
<tr>
<th>Microfinance Institution</th>
<th>Units Deposits</th>
<th>Loans</th>
<th>LDR</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td># Accounts (000)</td>
<td>Amount (Rs. Bil.)</td>
<td># Loans (000)</td>
</tr>
<tr>
<td>BRI (Bank Rakyat Indonesia)</td>
<td>3694</td>
<td>24,883</td>
<td>18,985</td>
</tr>
<tr>
<td>EPI (People’s Credit Banks)</td>
<td>2427</td>
<td>4837</td>
<td>2252</td>
</tr>
<tr>
<td>LDKP (Rural Credit Institutions)</td>
<td>1603</td>
<td>871</td>
<td>342</td>
</tr>
<tr>
<td>BKI (Village Credit Institutions)</td>
<td>4586</td>
<td>600</td>
<td>24</td>
</tr>
<tr>
<td>Pawnshops</td>
<td>645</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Cooperatives</td>
<td>1097</td>
<td>n.a.</td>
<td>166</td>
</tr>
<tr>
<td>Credit Unions</td>
<td>1105</td>
<td>252</td>
<td>117</td>
</tr>
<tr>
<td>TPSP (Savings &amp; Credit Groups)</td>
<td>1582</td>
<td>254</td>
<td>16</td>
</tr>
<tr>
<td>Microfinance Cooperatives</td>
<td>15,000</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>BMT (non-bank micro lenders)</td>
<td>879</td>
<td>175</td>
<td>46</td>
</tr>
</tbody>
</table>

Source: BI: Directorate of Rural Bank Supervision; Microfinance Institutions Study.
Table 5.2 BRI KUPEDES Loan Portfolio and Savings Accounts: Selected Years

<table>
<thead>
<tr>
<th>Year</th>
<th>KUPEDES Loans (Rp. Bil.)</th>
<th>12 Month Loss Ratio</th>
<th>Arrears</th>
<th>Total Savings (Rp. Bil.)</th>
<th>LDR</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>111</td>
<td>0.98%</td>
<td>5.4%</td>
<td>42</td>
<td>3.80</td>
</tr>
<tr>
<td>1995</td>
<td>229</td>
<td>1.84%</td>
<td>2.00%</td>
<td>66</td>
<td>2.63</td>
</tr>
<tr>
<td>1996</td>
<td>1648</td>
<td>3.40%</td>
<td>9.11%</td>
<td>3359</td>
<td>0.43</td>
</tr>
<tr>
<td>1997</td>
<td>4685</td>
<td>2.22%</td>
<td>4.73%</td>
<td>8836</td>
<td>0.53</td>
</tr>
<tr>
<td>1998</td>
<td>4697</td>
<td>1.94%</td>
<td>5.66%</td>
<td>16,146</td>
<td>0.29</td>
</tr>
<tr>
<td>1999</td>
<td>5956</td>
<td>1.72%</td>
<td>3.06%</td>
<td>17,061</td>
<td>0.35</td>
</tr>
<tr>
<td>2000</td>
<td>7627</td>
<td>1.11%</td>
<td>2.51%</td>
<td>19,115</td>
<td>0.41</td>
</tr>
<tr>
<td>August 2001</td>
<td>8854</td>
<td>0.63%</td>
<td>2.27%</td>
<td>21,078</td>
<td>0.42</td>
</tr>
</tbody>
</table>

Source: BRI

In 1994, the microfinance for housing loans were included in an analysis of a survey of BRI customers. The data indicated that a limited amount of KUPEDES loan funds were, in fact, being used for either school fees and housing-related purposes in addition to the conventional SME loans for investment and working capital. The housing loans were characterized as follows:

- they were concentrated among employed households, although those not formally employed actually had a somewhat better repayment record in the 1994 survey;
- they often functioned as income generation activities via construction of rental units in owner-occupied housing;
- if they were used for home improvement, they were underwritten based on the income stream from the household’s enterprise activities

MFH loans represent only a small portion of BRI’s portfolio. However, BRI has continued to discuss a larger future for the housing loans. BRI is just now analyzing a market evaluation and survey of future markets and possible new products carried out in 2001. An assessment of BRI’s customer profile and distribution of loan sizes will also be available from the new survey.

Subsidized Microcredit. Another important issue in the growth of commercially-based microfinance is the potential for “crowding out” by subsidized microcredit. There is an inherent conflict between development of commercially-based MFH institutions and programs that are supported by, and constantly in search of, subsidized funds lent at below-market rates through either financial or non-financial intermediaries. Particularly at
the present time in Indonesia, major crisis alleviation efforts are underway following Krismon. A subsidized credit approach to poverty alleviation is often at odds with the long-term strengthening of commercially based MFIs. Subsidized credit can pose a barrier to the strengthening of microfinance institutions, as numerous crisis alleviation programs in Indonesia can “crowd out” the efforts of improving commercially-based MFIs. It is estimated that there is now a very large amount of “program” credit outstanding, perhaps Rp. 5 trillion, which is nearly as much as the BRI credit outstanding (see table 5.1). The subsidized, cheap credit portions of this are likely to swamp commercially-based credit in some areas.

5.5.4 International Examples of Microfinance for Housing

As noted, MFH has recently been the topic of a number of workshops and research papers. MFH is becoming increasingly widespread in Latin America, based on early successes of institutions such as BancoSol in Bolivia. Table 5.3 provides a comparison of some of the characteristics of housing microfinance loans in representative micro lenders and low income housing lenders in Asia and Africa: SEWA Bank and SPARC in India, CARD in the Philippines, BRI, Grameen in Bangladesh, and People’s Dialogue, CashBank and African Bank in South Africa.

As discussed below, HOMI recommends more vigorous pursuit of MHF in Indonesia, including development of a variety of MFH loan products to suit various needs. Since the loans are not collateralized by a mortgage, the underwriting criteria are especially important, and display some common characteristics among the selected group of lenders. These are summarized in Table 5.4. Very briefly, some of the underwriting issues, potentially relevant to further development of MFH in Indonesia, include the following:
# TABLE 5.3: Housing Microfinance Loan Characteristics

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Individual Loan</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>no</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group-Based Loan</td>
<td>New const.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>no</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount of Loan</td>
<td>$20 - $200</td>
<td>$200 - $400</td>
<td></td>
<td></td>
<td>$250 - $2500</td>
<td>$265 - $850</td>
<td>$200 - $8000+</td>
<td>up to $2500 max</td>
</tr>
<tr>
<td></td>
<td>Same</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amt. Relative to microcenter price</td>
<td>Larger</td>
<td>N/A</td>
<td>Same</td>
<td>Same</td>
<td>Larger</td>
<td>N/A</td>
<td>N/A</td>
<td>Same</td>
</tr>
<tr>
<td>Term relative to microcenter price</td>
<td>Up to 5 yrs.</td>
<td>12 - 20 months</td>
<td>(3 - 36 months max)</td>
<td>Up to 10 years</td>
<td>15 years max</td>
<td>15 years max</td>
<td>30 months</td>
<td></td>
</tr>
<tr>
<td>Term Relative to microcenter price</td>
<td>Longer</td>
<td>N/A</td>
<td>Same</td>
<td>(same)</td>
<td>Longer</td>
<td>N/A</td>
<td>N/A</td>
<td>Same</td>
</tr>
<tr>
<td>Interest Rate</td>
<td>Market</td>
<td>Market</td>
<td>Market</td>
<td>Market</td>
<td>8% Heavy Subsidy</td>
<td>Heavy Subsidy</td>
<td>Market</td>
<td>Market</td>
</tr>
<tr>
<td>Rate Relative to microloans</td>
<td>Same</td>
<td>N/A</td>
<td>Same</td>
<td>(same)</td>
<td>Much lower</td>
<td>N/A</td>
<td>Risk-based pricing</td>
<td>Risk-based pricing</td>
</tr>
<tr>
<td>Rate Relative to market rate</td>
<td>Market rate</td>
<td>Market rate</td>
<td>Slightly higher</td>
<td>Slightly higher</td>
<td>Below market</td>
<td>Below market</td>
<td>Up to 600 points over prime</td>
<td>Up to 3 times prime</td>
</tr>
<tr>
<td>Fixed/Variable</td>
<td>Fixed</td>
<td>Fixed</td>
<td>Fixed</td>
<td>Fixed</td>
<td>Fixed</td>
<td>Variable</td>
<td>Fixed</td>
<td>Fixed</td>
</tr>
<tr>
<td>Incremental/repeat loans</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>New Construction</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>Expansion/Rehab</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
<td>no</td>
</tr>
</tbody>
</table>

• **Commercial Lending Rates.**

• **Risk Based Loan Pricing.** CashBank offers an example of very highly differentiated "loan product pricing". The bank has taken full advantage of the sophistication that exists in South Africa’s financial sector and the highly analytical approach to its own loan product development. The pricing is highly fine-tuned and geared to both transaction costs and credit risk. Pricing varies by the following features:
  - Type of collateral—mortgage, pension, or mixed;
  - Loan-to-value ratio;
  - Whether the application process is automatic or manual;
  - Whether collection is manual or conducted by electronic payment; and
  - Whether consumer education accompanies the loan

<table>
<thead>
<tr>
<th>Link</th>
<th>SBIA Bank</th>
<th>SABFIC</th>
<th>OPFD</th>
<th>ER</th>
<th>Germein Bank</th>
<th>Peoples Dialogue</th>
<th>Cash Bank</th>
<th>African Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mablog Savings</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
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<td>☐</td>
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<tr>
<td>SavingsCorp</td>
<td>☐</td>
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<td>☐</td>
<td>☐</td>
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</tr>
<tr>
<td>Reserve/Micro Loan</td>
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<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>NA</td>
<td>NA</td>
<td>☐</td>
<td>☐</td>
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<tr>
<td>Group Guarantee</td>
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<tr>
<td>Co-signors</td>
<td>☐</td>
<td>☐</td>
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<td>☐</td>
<td>☐</td>
<td>☐</td>
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<tr>
<td>Warranted Borrowers</td>
<td>☐</td>
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<td>☐</td>
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<tr>
<td>Risk based Lending</td>
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<tr>
<td>Legal Land Title Required</td>
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<td>Risk Nate Related</td>
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<tr>
<td>Property Deduction</td>
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<tr>
<td>Taxing Regime</td>
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<tr>
<td>Formal or Informal Employment</td>
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<td>☐</td>
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<td>☐</td>
</tr>
</tbody>
</table>

Source: Sally Merrill, "Implementing Housing Microfinance Program", for the IADB, October 2001.
• **Savings and Housing Credit.** Linking demonstrated savings behavior as a factor in underwriting lending can help with two problems: and assessment of credit worthiness, and as collateral – a form of self guarantee. Micro lenders learned long ago that the poor save. Savings groups are a crucial part of both microenterprise lending and microfinance for housing. First and foremost, low income housing lenders rely on demonstrated savings ability; this is a pervasive theme among nearly all of the lenders discussed here. Savings are a key aspect of underwriting — savings as proof of ability to pay — and savings deposits as alternative collateral. In may cases, the savings also supply a major portion of the funds used for lending, as discussed below. The savings requirement is ubiquitous across continents and lender types including, for example, SEWA Bank, SPARC, CARD, Casa Melhor in Brazil, Grameen Bank, People’s Dialogue, and UCDO in Thailand. One of the best known LMI housing programs is Chile’s so-called tripartite approach, in which savings is a required feature in order to access the government’s subsidy (and implicitly the loan which completes the three part funding). The terms for mandatory savings vary: SEWA Bank, for example, requires a minimum savings period of one year and CARD requires a minimum of 18 months. Most groups require regular payments, monthly, weekly, or daily, with minimum amounts established.

• **Previously Successful Microenterprise Loan.** This is a very frequently used form of underwriting for MFH by microfinance lenders.

• **Training Programs.** Training programs for would-be borrowers has emerged as one of the most ubiquitous characteristics of MFH. The training generally involved the rights and responsibilities of borrowers and lenders, as well as the savings requirements of the program in cases where this is mandatory.

• **Legal Land Title.** This is a difficult issue, dealt with differently in different countries. Some lenders require formal title. Other recognizing the difficulty of obtaining formal title, either do not require it, or will accept lesser forms of ownership proof, such as tax receipts. Still others have taken it upon themselves to assist poor borrowers to obtain title.

5.5.5 **Recommendations**

As discussed in the overview, microfinance for housing is not a panacea for the low income housing sector. However, the recent scrutiny that this topic has received worldwide suggests that it is a new tool with distinct benefits.
Microfinance for housing can:

- support incremental building
- support home improvements
- support additions for rental space

Thus, Indonesia could benefit from more focused and widespread development of MFH. *MFH can become a significant stand-alone tool for loans for home improvement, home expansion, including for development of rental rooms, and for new construction conducted on an incremental basis. In addition, when used together with other programs designed to address supply side constraints (land, infrastructure) and administrative constraints (land title, credit records of would-be borrowers, etc), and affordability constraints (direct voucher subsidies, for example) MFH can serve as one of the crucial inputs to low income housing development.*

Constraints posed by access to adequate funds will still need to be addressed. However, Indonesia’s network of low income lenders could ultimately provide important support via enhanced savings generation.

HOMI recommendations — to both promote MFH and to eliminate disincentives to the development of the microfinance sector on a financially sound basis — include the following:

- **Investigate a Capacity Building Role for BRI in Expanding an MFH Network.** We suggest that BRI would be ideally suited take a lead role in capacity building of the MFH sector, including further development of MFH loan products and underwriting policies. BRI could help promote MFH as an explicit component of microfinance. Most especially, BRI could expand its training programs to include MFH and assist in training other Indonesian MFI lenders in housing-related products. The networks of Bukopin, the Cooperatives, the BPD, the LKPD, and so forth, should be assessed under an expansion effort.

- **Develop more MFH Loan Products.** One key issue is whether to design and introduce loan products more specifically to support MFH. Some of the issues include:
  - Whether the housing loans be somewhat larger than the microenterprise loans?
  - Whether MFH loans could be somewhat longer term than the microenterprise loans?
  - Whether underwriting and collateral should be linked to prior savings programs, as an approach to self-insurance?
• **Further Focus on Private Sector Rental Housing.** As discussed in the HOMI report on the housing market, rental housing for low income households is cited as a priority. We are concerned here with private sector, low income rental accommodations in owner-occupied housing. BRI already lends to homeowners for the purpose of building additions to their dwelling to be used for rental. BRI could assist other MFIs to develop rental housing loan programs.

• **Strengthen Commercially-based MFIs.** Credit programs offered by the existing network of MFIs should be undertaken at commercially-based rates. In the interests of strengthening MFIs and commercially-based lending, encourage GOI and donor programs to limit subsidized credit. Subsidies can be provided through other means, in both supply and demand side programs. In sum, do not allow subsidized credit programs to “crowd out” strengthening of commercially-based microfinance institutions.

• **Better Integration of Microfinance “projects” into microfinance “systems” and “institutions”**. This recommendation calls for helping to upgrade clients of microfinance “projects” to be clients of microfinance “institutions”. Cobild is a case in point. Clearly, valuable lessons are being learned from the Cobild project concerning community-based endeavors, affordable building technologies, and so forth. But the credit aspects of the program are bringing the wrong message to those who wish to strengthen the institutional structure of MFIs and provide commercially-based credit. Integration of the Cobild process into the formal financial sector could include:
  a. Use civic groups only as “transaction” intermediary with formal sector lenders
  b. Use group loans in underwriting. If a household successfully completes this loan, then it could receive a “certificate” for a follow-on individual loan

• **Design Housing Programs Integrating MFH as a Component.** Finally, where appropriate, MFH should be integrated with broader programs for low income housing development, including land and infrastructure. This may also include a variety of subsidies to households, such as a direct transfer subsidy for assisting with downpayment.

• **Coordinate Findings with World Bank Pilot Project.** As described in section 1.0, and shown in the chart depicting the possible institutional structure of Indonesia’s mortgage finance sector, the World Bank Pilot Project on Microfinance is considering development of a liquidity guarantee fund to support housing microlenders. Efforts by Kimpraswil to expand housing lending downmarket should be coordinated with this pilot.
5.6 Regulation And Supervision

Overview. That real estate lending is risky worldwide, correlated with real estate bubbles, and continually implicated in banking sector problems and failures around the globe, has become clearer and clearer. The U.S., U.K, Latin America, Japan, and the ASEAN countries are all testimony to this fact.50

Given the often pivotal role of real estate finance in financial crises, there has been a broad-based movement worldwide to recognize the special risk elements inherent in long-term mortgage lending. Real estate crises have also shown that it is important to carefully monitor for the risk potential inherent in the sector; the crises have shown that once a crash has occurred, it is generally too late to do anything to repair the risk exposure. Thus, there is no more effective antidote that to attempt to foresee the potential for crises early on. For these reasons, a country’s regulatory agencies should adopt parameters and supervisory procedures which are explicitly responsive to risks inherent in mortgage finance. This also requires that mortgage portfolios be supervised and reported on separately from other types of lending. Consumer lending, for example, is short-term and has a different risk profile than long-term mortgage loans.

Indonesia is in the midst of important new development in regulation and supervision. As discussed below, a new supervisory institution, Integrated Financial Supervisory Institution (IFSI) would assume all supervisory functions, leaving BI with the regulatory function for banks. We would recommend that as part of these changes, that BI/IFSI review the supervisory structure for real estate financial – residential, commercial, and construction – is order to take specifically-tailored review of these portfolios as they again become substantial.

Issues in the Regulation and Supervision of Real Estate Finance. Currently, BI has generally adopted conservative regulatory parameters for real estate lending. This is to be commended, especially until banks have developed somewhat better risk management procedures.

However, during our discussions with BI and the banks, two issues deserve attention:

- First, we are recommending that, in the medium-term, the supervisory call reports be done separately for real estate finance.51 In contrast, however, BI has recently changed its reporting requirements such that mortgage loans (KPR) are no longer reported separately. The information on KPR can only be obtained by special request and does not seem to be available on a timely basis.
• Second, the banks do not seem to have either a uniform approach to appraisal, nor a sufficiently stringent approach to the rules and regulations which encourage independent and professional valuations. It appears that many banks use their own appraisers rather than independent appraisers. This needs assessment, as it can be a risky (and self-interested) approach to appraisal. Worse, some banks did not do an appraisal, but appeared to rely instead on the developer’s asking price or the sales price. Finally, it was not clear that two or more of the three standard appraisal methodologies were ever used on high risk/high value properties (residential or commercial), or that rules for resolving differences among the methodologies were in place. This issue is the subject of clear recommendations by international appraisal standard bodies.

• Third, HOMI has not done a separate study of the appraisal industry. It is recommended, however, that this be carried out. As has been discussed throughout this report, the LTV is one of the most important variables in mortgage lending. If the procedures which establish “value” are subject to ineffective procedures, risk management by the banks cannot be done adequately. Indonesia belongs to the Asian Association of Appraisers, where international principles are well known. Thus, it only remains to be determined whether the banks are complying.

The following principles are offered as additional suggestions to BI’s procedures.

(A) Real Estate (RE) lending should receive explicit attention.
   1. Detailed call reports that explicitly differentiate RE loans
      a. differentiate commercial and residential loans
   2. Quarterly Survey of Underwriting Trends
      a. watch banks beginning RE lending.
      b. watch banks having a rapid increase in RE lending

(B) Risk weights for commercial real estate loans
   1. 100 percent for commercial RE loans
   2. Residential loans are also weighted at 100 percent in Indonesia at present. BI might eventually consider a 50 percent risk weight for residential mortgage loans. The assessment would involve a number of factors. Most importantly, it will be necessary to wait until the current mortgage portfolios are more seasoned than at present. As discussed in section 2.0, many non-performing loans were transferred to IBRA, and it is not yet clear what the “steady state” NPL rates will be on current portfolios. In addition, the introduction of either
or both of the credit bureau and mortgage default insurance will have an impact on the risk profile of residential mortgage portfolio.

(C) LTV limits for different types of real estate loans
1. residential – range from 50% up
2. more detailed types of limits might be as follows:
   • 50% single family residential
   • 65% raw land
   • 75% land development
   • 80% commercial, multifamily, and non-residential
   • 85% 1-4 family residential
   • 85% property improvements

(D) Lending limits
1. loan-to-one-borrower limits set at 15%? 10%?
   In the U.S., these rules had been liberalized; under certain conditions it should be noted that the limit reached 25% and this was an aspect of the bank failures between 1985 and 1994.

(E) Stringent appraisal guidelines
   Again, we stress the importance of the value calculation. As discussed in section 3.0, the LTV plays a crucial role in the investment quality of mortgage loans, and as a key element of risk-based pricing. A major aspect of the Three Cs of mortgage underwriting – collateral value is of course fully dependent on the quality of appraisal. Briefly, some of the principles are:

1. final valuation by licensed appraisers rather than bank personnel
2. development of appraisal principles by BI
3. bank development of appraisal policies in response to BI guidelines
4. work with Appraisers Association to develop certification procedures
5. establishment of conservative rules for use of the three main methodologies (market comparable, income, and cost), rules for their application to specific residential and commercial properties, and procedures for resolution of differences in result when more that one method is to be applied.
Recent Development in Indonesia: New GOI Regulatory Initiative.

Regulation and Supervision. Up to now, financial services are supervised by BI, Directorate General of Financial Institutions, Ministry of Finance, and the Supervisory Board of the Capital Market (Badan Pengawas Pasar Modal-Bapepam) as well as other institutions supervising the management of community funds. BI supervises banking operations. Non-bank financial Institutions are supervised by Directorate General of Financial Institutions; security companies are supervised by Bapepam.

As part of the financial sector reform effort, GOI has prepared legislation to support integrated regulation and supervision of the overall financial sector through the Integrated Financial Supervisory Institution (IFSI; Lembaga Pengawas Jasa Keuangan). IFSI, which could be operational by 2002, would assume the regulatory and supervisory role for commercial banks now undertaken by BI. The institution will supervise banks and other financial service companies including insurance, pension funds, security institutions, venture capital, financial institutions and other financial institutions involved in community funds. It is independent in nature, non-governmental, and is liable for reporting to States Audit Board (Badan Pemeriksa Keuangan-BPK) and the Parliament (Dewan Perwakilan Rakyat-DPR). IFSI would work in coordination with BI.

Background of the establishment of IFSI.

- Article 34 of Law No.23/1999 concerning BI states that supervision on the financial service sector will be the task of an independent institution, established by law.
- Separating development function of financial services industry from other functions of the government and BI inline with the independence of BI’s functions.
- The other consideration is that the government has limited capacity to anticipate new innovations in financial services sector.
- Other considerations that have not been approved upon in the establishment of the institution are: Is the function of the institute limited to supervision or including managing and deciding policies, licensing etc.? Will the institute be a government, semi-government or private owned one.
- The benefit of having IFSI is the availability of a sound, accountable and competitive financial services industry and the development of an efficient market mechanism. Hence, the financial service products will be accessible to every part of the community.
Presently, the institutionalization of optimum supervision on financial institutions, especially the banking sector, is still under discussion. The issue is closely related with the function and task of Bank Indonesia as supervisor and regulator stated in the draft of Bank Indonesia revision Law presently under discussion in the Parliament. The plan for establishing a Financial Services Supervisory Institution will thus depend on the task and function of Bank Indonesia to be included in the revised Bank Indonesia Law. Various arguments on the issue are under discussion.53

Recommendations.

- If the government prefers to have multiple agencies such as Bank Indonesia and the Financial Services Supervisory Institution, there should be a clear roles and legal framework for both institutions.
- However the institutional structure is organized, most important issue raised here is that the real estate supervisory function should be specific to the real estate industry. A separate call report should be conducted for real estate loans once these begin to increase and become a significant proportion of the portfolios of certain banks.
- Indonesia already appears to have prudent regulatory parameters for most aspects of real estate lending. However, the rules and regulations for appraisal are either not followed or they need improvement and much stricter monitoring. The present circumstances would appear to introduce an unacceptable level of uncertainty into the system.

5.7 Developing a Secondary Market Institution in Indonesia

Overview. The secondary market initiative in Indonesia has been underway for nearly a decade.54 Although badly interrupted by Krismon, observers of the still depressed housing and mortgage markets are once again looking to an SMF (secondary market facility) or SMM (secondary mortgage market) to assist mortgage finance, noting the need for long-term funds and the importance of alleviating the maturity mismatch.

The major issues which are being addressed by capital market funding of mortgage portfolios include:

- Liquidity risk, which stems from the term mismatch of assets and liabilities;
- Interest rate risk, in cases where long-term fixed rate loans are funded with variable rate funds;
- The ability to mobilize large amounts of funds;
• The ability of a secondary market to provide incentives for improving the quality and standardization of mortgage loans and procedures in the primary market;

• Capital relief: on balance sheet funding via an SMF, which does not assist the CAR, versus off balance sheet funding via an SMM, which does; and

These criteria should be kept in mind as the options for Indonesia, and international examples of capital market access, are discussed below. Certainly there will be a need for increased funding as the housing finance sector recovers. However, the assumption that banks are not now lending for mortgages because there is no secondary market is a misleading and over-simplified description of the current situation. At the present time, lack of liquidity and term-mismatch are probably not the major issues preventing a renewed surge in mortgage lending. The barriers in Indonesia – the barriers to both a robust secondary market and a strong jump in mortgage lending — are more complex. As discussed in section 2.0, banks are now extremely risk averse; more complete recovery from Krismon and further strengthening of the primary market are both necessary. Nevertheless, it remains an appropriate goal for the medium term to develop efficient access to the capital market.

We recommend that Indonesia should continue with steps to develop a secondary market facility (SMF) rather than a secondary mortgage market institution (SMM).\textsuperscript{55} Both Cagamas in Malaysia and the Federal Home Loan Bank system (FHLB) in the U.S. can provide guidance for development of an SMF. We suggest that neither model should be followed in its entirety, however, as the recommendations must be tailored to the Indonesian context. Recommendations for an Indonesian SMF have been made in a number of earlier studies. We support most of these recommendations. We have updated them and provided a synopsis of the possible features of an Indonesian SMF below.\textsuperscript{56}

\textit{It is important to note that an SMF and an SMM stem from very different models of capital market access.}

• An SMF is a liquidity facility. Loans may be extended from an SMF to participating financial institutions backed by a mortgage portfolio (the FHLB model)\textsuperscript{57}. Or, loans may be purchased with full recourse (the Cagamas model). In both cases the SMF provides on-balance sheet funding, and thus does not impact CAR.\textsuperscript{58}

• An SMM, in contrast, is most frequently a “conduit” model. Conduits, such as Fannie Mae and Freddie Mac in the U.S., purchase loans and issue MBS (mortgage backed securities). This represents true off-balance sheet funding, and thus offers capital relief.
Both SMFs and SMMs address liquidity risk by helping lenders match the term of their assets and liabilities. In both environments, interest rate risk can also be addressed through the use of variable rate mortgage products. However – and this is important for Indonesia at the present time - the requirements for establishing an SMM are far more demanding than for an SMF. The differences revolve around the legal and administrative infrastructure, the standardization of loan products, and the uniformity of high investment quality of the mortgage portfolios. Investor sophistication is also a major issue, as mortgage-backed securities are complex instruments.

Thus, because many of these primary market and capital market constraints are not yet overcome in Indonesia, we believe that Indonesia should follow the SMF approach in order to be able to address the liquidity issue as soon as possible.

Summary of Recommendations. A more complete statement of our recommendations is provided below. However, a brief summary is as follows:

- **SMF.** Efforts should be re-initiated as soon as possible to develop an SMF, which is a liquidity facility. It is anticipated that an SMF could become operative in one to two years, in line with recovery of the mortgage sector. Both USAID and ADB has previously provided assistance to the secondary effort, and may be willing to do so in the future.

- **Reference to Cagamas and FHLB.** In designing an SMF, Indonesia will, of course, develop an institution, which responds to its particular goals and conditions. In developing an SMF model, we suggest that Indonesia examine the features of two of the most successful liquidity facilities worldwide - Cagamas and the Federal Home Loan Bank system in the U. S.

- **Detailed Feasibility Study of the SMF Structure and Regulations.** Based on the preliminary set of recommendations discussed below, a thorough assessment of the SMF proposal should be undertaken as soon as possible, including the ownership structure and any special provisions designed to facilitate the competitiveness of the SMF debt instruments in the capital market.

- **Capital Markets Feasibility Study.** A thorough assessment of the potential for investment in the debt obligations of the SMF has not yet been undertaken in Indonesia. This will be necessary as part of the development process.
• **Off Balance Sheet Funding in the Future.** A true secondary conduit, which has far more complex demands than an SMF, may follow only in the much longer-term. Efforts in developing the legal infrastructure for securitization have been underway since 1999.\(^{59}\) Note, however, that there are other alternatives to off-balance sheet funding, which would assist banks’ CAR position. This could be accomplished, for example, by introducing non-recourse purchase of mortgage loans by the SMF. This approach has been in planning by Cagamas for several years, but has not yet been implemented because of lack of demand for this type of funding by Malaysia’s banks.\(^{60}\)

5.7.1 **International Practice and Key Issues in Indonesia**

5.7.1.1 **Secondary Market Funding Worldwide.**

There is no single best funding system. And, if efficiency is used as the criteria, there is no single best way to access long-term funds from the capital market. A seminal article in 1992 compared the funding systems of five major Western countries:

- the U.S., where funding is dominated by the government-sponsored secondary mortgage markets, private conduits for MBS, and a major liquidity facility, the FHLB, although deposits still play an important role;
- the U.K., where funding stems from a variety of sources, including deposits, various general debt instruments (non-MBS) issued by the banks, but not specifically backed by mortgage portfolios, and, more recently, a slowly growing number of MBS issued by the banks;
- Germany, where the hallmark of secondary market funding is very specifically defined mortgage bonds (Pandbriefe), which are issued by a bank against a pool of mortgage collateral;
- France, where a number of deposit-based and capital market funding sources are utilized, including a liquidity facility, the Caisse de Refinancement Hypothecaire (CRH); and
- Denmark, where mortgages are almost entirely funded through issuance by the banks of callable mortgage bonds (the volume of these mortgage bonds, in fact, exceeds that of government bonds in Denmark).\(^{61}\)

The results indicated that in the ranking for the “efficiency” of the funding source, defined basically as the lowest spread over comparable, risk free, government paper, the U.K. won first place. However, the U.S, Germany, and Denmark were all very close seconds. France’s efficiency suffered, however, from an excess of non-market subsidies and government interference. This strongly suggests that it is something other than the...
exact form of capital market access which dictates achieving the level of efficiency that maximizes the affordability of mortgage lending rates. We suggest, rather, that the benefits begin with an effective primary market, in which risks have been reduced with effective legal, administrative, risk management, servicing, and information systems.

Table 7.1 is intended to demonstrate the “impressive panorama” of methodologies which exist to access long-term funds from the capital market. The table is by no means exhaustive in the list of countries, but does demonstrate the major approaches to capital market funding. The first major distinction is whether the capital market access is via individual banks or via a central facility.

Bank-based methodologies include the specialized approach to mortgage bonds prevalent in Germany and Austria and the mortgage bond approach used in Denmark. Both of these options represent on-balance sheet funding; the bonds are popular with investors because the strict rules associated with their issuance has proven their quality over the centuries! In contrast, private conduit MBS issuance offers off-balance sheet funding, but again, success is dictated by the extent of primary market efficiency, as well as investor education. Private conduit MBS is a relatively recent development in Europe and several emerging markets. In the U.S., numerous large banks and other financial institutions issue private MBS backed largely by mortgages which are not eligible for Fannie and Freddie funding, generally because of size (“jumbos”) and certain underwriting rules. Private conduit MBS are the rule, however, in the U.K. and Europe, where central facilities have not been established. Finally, issuance of bonds which are not specifically backed by mortgages, but rather are simply general debt obligations of the issuing bank, is a tried and true form of capital market access in developed countries and increasingly in emerging markets, including Indonesia.
Table 7.1 Models of Capital Market Access for Mortgage Funding: Examples from Around the World

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<tr>
<th>Bank Based Capital Market Access</th>
<th>Central Facility Based Capital Market Access</th>
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<tr>
<td>Mortgage Bonds: FRANDORIFTE</td>
<td>Liquidity Facility</td>
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<td>Other Mortgage-backed Bonds</td>
<td>Established Secondary Mortgage Markets</td>
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<td>General Bank Debt Issuance</td>
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<td>Private Conduit MBS</td>
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<td>Germany</td>
<td>US FHLB</td>
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<td>Denmark</td>
<td>U.S. Fannie Mae</td>
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<td>Sweden, other Scandinavian</td>
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<td></td>
<td>Argentina B. H.N.</td>
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<tr>
<td>Variants in Poland, Czech</td>
<td>Malaysia Cagamas</td>
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<td>Republic</td>
<td>Canada</td>
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<td>Chile</td>
<td>India? National Housing Bank</td>
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<td>Other European Countries</td>
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<td>France, Spain, other European</td>
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<td>South Africa</td>
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<td>Korea?</td>
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Central-based facilities include both SMF and SMM. The U.S. has major examples of both. In fact, the U.S is something of an anomaly because of the very major roles played by its centralized facilities. This has been described at length elsewhere, but in large part it is a historical development caused by the fragmentation of the U.S. banking system and rules which previously prevented an appropriate flow of capital across state lines. Australia’s MBS market has grown rapidly in the last decade and is now of increasing importance. In Canada, however, MBS have never played a major role. Finally, France has focused solely on the SMF approach, although this does not fund the major share of the country’s mortgages (deposits and general debt issuances are more important).

Bank versus Central? There are, of course, various advantages and disadvantages to bank versus central approaches to funding. This is generally true whether the modality is mortgage bonds or MBS. From Indonesia’s perspective, a central institution might be beneficial in at least two important ways: (1) investors may have confidence in a well-managed, commercially based institution, which has undertaken adequate due diligence in structuring its debt; and (2) smaller banks and/or banks with relatively small mortgage portfolios can take advantage of capital market access when perhaps they would otherwise not be able to access long-term funds on their own.
5.7.1.2 Secondary Markets in Emerging Nations: A Limited Success Story

The concept of a secondary mortgage market has, in the last decade, swept through the emerging and transition economies worldwide, particularly in Asia and Latin America. This popularity, fueled by a quest for increased liquidity and a source of long-term funds, often uses the U.S. secondary mortgage market institutions – Fannie Mae and Freddie Mac - as models. This model, however, is often quite inappropriate to emerging countries, especially in the short-term. Since HOMI recommends a liquidity facility instead of an SMM for Indonesia, however, several important points should be noted from the outset:

(1) First, as noted above, the U.S. secondary market system is somewhat of an anomaly worldwide, as no other country depends on securitization nearly as much as is the case in the U.S. Both its sheer size and its dominant impact on the procedures and functions of the primary market are unique.

(2) Although securitization is now growing in popularity in Australia and Europe, there are few successes as yet in emerging markets. As noted below, only Hong Kong has successfully established a true secondary market.

(3) Cagamas is the most successful of the SMF-type liquidity facilities in emerging markets. Other examples are limited. In the U.S., the Federal Home Loan Bank System is, in HOMI’s opinion, more relevant to Indonesia at the present time than an SMM.

There are, in fact, few secondary market success stories in merging markets, as the following examples indicate:

Successes:

• Cagamas is the most successful liquidity facility in an emerging market;
• The Hong Kong Mortgage Corporation is now established and active, and is the only true secondary market in an emerging economy;
• Trinidad & Tobago have a small SMF.

Efforts still underway or abandoned:

• Argentina, Korea, Israel, and India are examples of countries in the process of trying to develop secondary markets. Argentina’s National Mortgage Bank has issued mortgage-backed securities but there is no liquid market yet. The National Housing Bank in India has done a securitization, but it was a private placement, and again, the market is not yet liquid.
• South Africa has either delayed, or abandoned, its Gateway concept of a secondary market for funding moderate income mortgages. There is no secondary market in South Africa.
• Ghana has abandoned the secondary market concept;
• Brazil is developing individual bank securitizations, but has had not success with a secondary market as such;
• Mexico has initiated SMM efforts, has but not been in an economic position to develop a meaningful secondary market. Russia finds itself in a similar position;
• Secondary market facilities are under discussion in Jordan and Kazakhstan, but the efforts are preliminary.

5.7.2 The Current Indonesian Context for Development of an SMF

It is important to note that HOMI recommends development of an SMF only if it is understood in a broader context – both the need for further strengthening the primary market, and especially for improved risk management, IT, and automation - and a proper assessment of the Indonesian capital market.

• Lack of a secondary facility at the present time is, currently, not a major cause of the current depression in mortgage lending in Indonesia. That lies strictly at the feet of broader economic factors including slow growth in real income, the need for further recovery from Krismon by the banking sector, and weaknesses in the primary market which ultimately limit the investment quality of the banks’ mortgage portfolios;

• A secondary market is not a necessity for successful mortgage lending. There are numerous ways to access long-term funds, as discussed. Furthermore, worldwide, a large share of mortgage loans are still funded with deposits. For example, in Europe, 62% of mortgage finance is funded through deposits; much of the rest is financed with mortgage bonds, which are the obligations of individual banks.63 In the U.S., the GSEs fund a major share of new origination via securitization, but depositories, which keep the mortgages on their books, are still an important source of funding in the U.S.

• It should also be noted that the problems facing development of an SMF or SMM in Indonesia are shared by the vast majority of emerging markets. As noted, with the exception of Cagamas in Malaysia and the Hong Kong Mortgage Corporation, there are not, as yet, many successful examples of secondary market operations in emerging nations.

5.7.3 The Benefits of an SMF in Indonesia and Financial and Economic Barriers.

Benefits of an SMF. Indonesia should now undertake a thorough discussion of the goals for an SMF, the issues involved, and the potential difficulties of its development. What are
the financial and economic circumstances, which would point to success? What factors dictate beginning with an SMF rather than an SMM?

The potential benefits of an SMF will become increasingly important as Indonesia’s mortgage market recovers:

- an SMF will enhance liquidity for mortgage lending;
- an SMF will address the mismatch of bank assets and liabilities;
- as illustrated by Cagamas, an SMF can help the mortgage market achieve growth in a sound manner.
- Because the SMF model dictates that the primary lenders assume the lending risks, Indonesia’s banks will gain risk management skills from having this discipline;
- an SMF is highly flexible in several important ways: (1) it does not require full standardization of mortgage loans to get started and (2) the collateral backing a loan to an SMF member can also include non-mortgage assets (if the rules are written in this manner);
- an SMF avoids the complex legal structures needed for mortgage transfer under securitization;
- the SMF debt instruments offer the capital markets an important alternative to government paper. Cagamas, for example, is the largest non-government debt issuer in Malaysia. The FHLB system, taken as a whole, issues as much debt as Fannie Mae.

**Barriers to an SMF or an SMM.** As noted above, Indonesia is hardly alone in needing to address barriers to secondary markets. The two main barriers are improvement in the structure of the primary market and assessment of the financial and institutional climate for investment in SMF debt instruments. Primary market developments that will improve the quality of the mortgage portfolio have been discussed at length in previous sections of this report. These include, for example, foreclosure, standardization, and various aspects of risk management - computerized IT systems, credit scoring, and so forth. (Please refer to sections 3.0 through 6.0.)

A hypothetical example is presented in Table 7.2 below, which presents the typical interest rates and spreads now prevailing in U.S. mortgage lending for banks belonging to the FHLB. A comparable picture of an Indonesian SMF ded, with hypothetical assumptions about mark-ups drawn from the FHLB exais then provimple.

At present, interest rates are very low in the U.S. However, what concerns us here is not the level of rates, but the “spreads” – the relationships among them. The table notes the yield on Government paper, the return on a FHLB bond, the markup imposed by the FHLB
in lending to its member banks, and the spread, on average, between member banks' lending rates and the cost of funds borrowed from FHLB. In the U.S., to use a “typical” example, bank mortgage lending rates are, in total, about 300 – 350 basis points (bp) over the Treasury bill rate and about 250 to 300 bp over their cost of funds from the FHLB. The FHLB adds a mark-up of roughly 25 bp.

A hypothetical example is presented in Table 7.2 below, which presents the typical interest rates and spreads now prevailing in U.S. mortgage lending for banks belonging to the FHLB. A comparable picture of an Indonesian SMF is then provided, with hypothetical assumptions about mark-ups drawn from the FHLB example.

At present, interest rates are very low in the U.S. However, what concerns us here is not the level of rates, but the “spreads” – the relationships among them. The table notes the yield on Government paper, the return on a FHLB bond, the markup imposed by the FHLB in lending to its member banks, and the spread, on average, between member banks’ lending rates and the cost of funds borrowed from FHLB. In the U.S., to use a “typical” example, bank mortgage lending rates are, in total, about 300 – 350 basis points (bp) over the Treasury bill rate and about 250 to 300 bp over their cost of funds from the FHLB. The FHLB adds a mark-up of roughly 25 bp.

In addition, current macroeconomic conditions are a barrier to an SMF at present, and probably for the medium term. The dominance of Government paper in the bond market, and the high yield on this debt, have let to a situation in which long-term, mortgage-backed debt instruments will have a difficult time competing with Government debt instruments. In a sense, the public sector is “crowding out” private initiatives in bond issuance; mortgage-backed bonds will find it difficult to be cost competitive.

Second, the Indonesia bond market remains relatively thin and illiquid. The bond market was among the least developed in the region prior to Krismon, and it must now mature post-recovery. Banks can also buy recap bonds. Recap bonds make up 50 percent of the assets of the banking sector at present. Indonesian observers suggest that investors (banks, foreign banks, securities companies, and investment companies, etc.) are now demanding around 21 percent on non-SBI paper to cover risk factors. Given the markup needed by Indonesian lenders, this would result in very high lending rates indeed.

Assuming that spreads in Indonesia would be somewhat higher in the initial stages of an operation of an SMF, we have arbitrarily assumed a total spread of 3 - 5% at an initial stage this figure is the minimum rates used as a general rule of thumb in Indonesia. At present, given an SBI yield of 17.5 percent, this would require that banks lend for mortgages
at 18 – 21%. This is much higher than the present lending rate, since the cost of funds from deposits is much lower. Although this example is hypothetical, it is calculations of this type which must be undertaken to assess the types of cost-benefit trade-offs banks would need to make in the decision to borrow from an SMF or fund mortgage loans from deposits despite the term risk.

This problem is by no means unique to Indonesia. Worldwide, SMMs and SMFs in emerging markets face a bank liquidity situation, which often makes it difficult for secondary level funding to be cost competitive. Expert observers note that HKMC is currently struggling, as banks in Hong Kong are now over-liquid and engaged in a price war in mortgage lending. Some mortgage loans, initially at about 125bp (basis points) over prime, are reportedly at –250 bp, that is, under the prime rate. In this situation, banks have no incentive to sell HKMC their assets, and are lending out of their own funds. If liquidity lessens, securitization will again become more desirable.69
Table 7.2 Interest Rates and Spreads for SMFs: FHLB, Cagamas, and “Indonesian SMF”

<table>
<thead>
<tr>
<th>Spreads and Interest Rates</th>
<th>FHLB Spreads</th>
<th>FHLB Interest Rates</th>
<th>Cagamas Spreads</th>
<th>Cagamas Interest Rates</th>
<th>Hypothetical Indonesian SMF Spread</th>
<th>Indonesian Interest Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank mortgage lending rate</td>
<td>225 bp over FHLB loan</td>
<td>5.0 – 5.5%</td>
<td>290 – 335 bp over Cagamas loan</td>
<td>6.90% - 7.40% ELR* plus 60 to 100 bp</td>
<td>1 -5%</td>
<td>18% – 22%</td>
</tr>
<tr>
<td>SMF loan rate &amp; markup to borrowing bank</td>
<td>Mark-up = 25 – 50 bp</td>
<td>2.5% - 3.0%</td>
<td>**</td>
<td>3.75% - 4.00%</td>
<td>0 – 1%</td>
<td>10% – 19%</td>
</tr>
<tr>
<td>Yield on SMF debt instruments relative to Government paper</td>
<td>25 – 50 bp markup</td>
<td>2.25 – 2.5 %</td>
<td>10 – 30 bp mark-up</td>
<td>3.50% - 3.70% for 10-year Cagamas bonds</td>
<td>0.5 – 1%</td>
<td>19% –20%</td>
</tr>
<tr>
<td>Yield on Government Paper</td>
<td>n.a.</td>
<td>2.0 % (10 yr. Treasury note)</td>
<td>n.a.</td>
<td>3.40% yield on Govt. paper</td>
<td>n.a.</td>
<td>18.5% - 19%</td>
</tr>
<tr>
<td>Total markup</td>
<td>300–350 bp</td>
<td>3.0 – 3.5%</td>
<td>315–340 bp</td>
<td>3.15% - 3.40%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- The average base lending rate quoted by banks to their best customers (similar to concept of U.S. prime rate)
- ** the Cagamas mark-up to the banks was not calculated by Cagamas in this example.
- * Indicative based on the current market when SBI is at 17.5% and subject to change due to high volatility of the market conditions.

Cagamas is also currently facing a liquidity situation where banks have less incentive to borrow funds from Cagamas, although generally this has not been the case, and Cagamas loans have grown considerably. Finally, as another example, a liquidity fund established in Poland in the early 1990s, funded by USAID, the World Bank, and European donors, is now defunct, in part because the liquidity position of Polish banks was such that funding out of deposits was more cost-effective.

Cagamas has also provided us with an example of funding from deposits. Thus, according to the total margin shown in table 7.4, banks in Malaysia can achieve a greater spread under the current economic conditions via lending from deposits. As noted, the same phenomenon is occurring in Hong Kong.
### Table 7.4 Margins in Malaysia Based on Funding From Deposits

<table>
<thead>
<tr>
<th>Bank Mortgage Lending Rate</th>
<th>Spread</th>
<th>Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Mortgage Rate</td>
<td>60 – 100 bp over BLR (base lending rate)</td>
<td>6.30% - 7.40%</td>
</tr>
<tr>
<td>Base Lending Rate</td>
<td>250 – 300 bp over savings rate</td>
<td>6.30% - 6.40%</td>
</tr>
<tr>
<td>Savings Deposit</td>
<td>n.a.</td>
<td>3.20% - 4.00%</td>
</tr>
<tr>
<td>Total Margin</td>
<td>340 – 370 bp total</td>
<td>3.40% - 3.70%</td>
</tr>
</tbody>
</table>

**Why an SMF and not an SMM at present?** The main benefit of an SMM, as noted, is that it provides off-balance sheet funding, thereby assisting the banks’ CAR. In an SMF, we assume that the process begins with lending “with recourse”: that is, the risk stays with the lending bank.

In addition, we stress again that the requirements of an SMM are much more complex than for an SMF. For example, securitization requires stringent standardization of loan products. It also requires information from seasoned portfolios – prepayment and default rates - that Indonesia does not have at present. The legal issues involved in mortgage transfer and securitization, although they have been studied in Indonesia, have not yet been tested, and this may take some time. (Please note that the Annex to this chapter discusses the efforts underway to define and address securitization.) Indonesia uses discretionary variable rate loans; although these have been successfully securitized in Australia, this type of loan makes the process rather more complex.

Finally, another important drawback to an SMM in some emerging markets is a “moral hazard” argument: banks may try to sell their least attractive loans to the SMM. Leaving credit risk with the Indonesian banks is good discipline for improving practices. Thus, the weaknesses in the primary market cited above, and the difficulty of providing investors with a debt instrument that is cost competitive and well understood, makes establishing an SMM significantly more difficult than an SMF.
5.7.4 A Comparison of Liquidity Facilities: Cagamas, FHLB, and Recommendations for an SMF for Indonesia.

As noted above, Indonesia has been addressing the issue of a secondary market since 1993 through a series of donor-supported studies and GOI task forces. The studies recommended that Indonesia work to establish an SMF. Cagamas and the Federal Home Loan Bank system serving as models. We have adopted the basic framework of the previous recommendations for an SMF, which are summarized below in table 7.4. We have made changes only where new circumstances in Indonesia have altered the original assumptions; for example, BI is no longer permitted to take an ownership interest in institutions such as an SMF. We have also added recommendations that reflect the context in Indonesia. Most importantly, we do not recommend that an Indonesian SMF address low income lending via the SMF at present, as is done by Cagamas. In general, the structure should be as straightforward and market-based as possible.

In general, the recommendations for an Indonesian SMF have the following characteristics:

- the SMF is largely private sector in ownership and management;
- there are no GOI guarantees or back-up borrowing authority;
- GOU should consider incentives for investors to hold its bonds via special privileges similar to those offered to Cagamas and FHLB; and
- a generally conservative approach to the capital treatment for its bonds is adopted to help minimize risk in the system overall
Table 7.4 Comparisons of Secondary Mortgage Facilities and Proposed Indonesian SMF

<table>
<thead>
<tr>
<th>FEATURE</th>
<th>&quot;INDONESIAN SMF&quot;</th>
<th>CAGAMAS</th>
<th>FHLB</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. Organizational Characteristics and Loan Procedures</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Organization</td>
<td>Limited liability company</td>
<td>limited liability company</td>
<td>Government chartered</td>
</tr>
<tr>
<td>Ownership</td>
<td>majority private, government share</td>
<td>80% private, 20% central bank</td>
<td>100% private</td>
</tr>
<tr>
<td>Board of Directors</td>
<td>majority private</td>
<td>majority private</td>
<td></td>
</tr>
<tr>
<td>Capital Requirements</td>
<td>2.9% capital-to-assets</td>
<td>2.2% capital-to-assets</td>
<td>4.75% capital-to-assets</td>
</tr>
<tr>
<td>Asset Characteristics</td>
<td>Collateralized loans</td>
<td>Loans purchased from banks with recourse &amp; mandatory repurchase</td>
<td>Collateralized loans</td>
</tr>
<tr>
<td>Debt Characteristics</td>
<td>Short and medium term debt</td>
<td>Short and medium term debt (3–7 years)</td>
<td>Short and medium term (10 years)</td>
</tr>
<tr>
<td><strong>II. Recommendations on Special Treatment</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government Guarantee of Debt</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Back-up Borrowing Authority</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Favored Investment Status for Bonds</td>
<td>No</td>
<td>Yes (treated as Govt. security)</td>
<td>Yes (treated as Govt. security)</td>
</tr>
<tr>
<td>Special Tax Treatment of SMF Facility</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Special Tax Treatment of Debt</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Special Capital Treatment of Bonds</td>
<td>No (20% risk weight like interbank debt)</td>
<td>Yes (10% risk weight)</td>
<td>No (20% risk weight like interbank debt)</td>
</tr>
<tr>
<td>Special Advantages in Debt Issuance</td>
<td>Yes (exempt from prior SEC approval)</td>
<td>Yes (exempt from stamp duty &amp; SEC approval)</td>
<td>Yes (exempt from SEC approval)</td>
</tr>
<tr>
<td>Reserve Requirements for Loans</td>
<td>Exempt</td>
<td>Exempt</td>
<td>Exempt</td>
</tr>
<tr>
<td>Low Income Lending Features</td>
<td>Not recommended at this time</td>
<td>Yes (9%)...</td>
<td>No</td>
</tr>
</tbody>
</table>

Ownership and Government Guarantees. It is recommended that the SMF be largely private, as is Cagamas. FHLB is entirely private, having been bought out from its initial Government ownership by its member banks. BI is now restricted from participating in ownership. Since it is likely that banks will not have sufficient capital at present, participation of another GOI institution may be sought. In addition, as discussed below, ADB may assist with a contribution of seed capital; investment might also be sought from IFC. In emerging markets, it is often important that institutions such as the proposed SMF be
perceived as private, and not government owned or supported. Similarly, the SMF should have no GOI guarantee for its debt. This is also the case for Cagamas and FHLB.72

**SMF Lending.** Cagamas purchases mortgage loans from the banks with recourse and mandatory repurchase, that is, the risk stays with the bank, as noted. The FHLB extends collateralized loans, but the collateral can include assets other than mortgage loans (e.g., Treasury bills and other types of loans). This is a flexible approach that may be preferred for an Indonesian SMF; the loan is backed by the credit of the bank, rather than necessarily by a specific mortgage portfolio, although, in practice, the mortgage portfolio is usually the collateral for FHLB loans.

**Special Treatment for the SMF and for Investing in SMF Debt.** A variety of incentives for holding the debt of an SMF might be considered. These include tax treatment, capital requirements, reserve requirements, and debt issuance procedures. These are noted in the table. For example, the mortgage loans are exempt from reserve requirements for Cagamas and FHLB. There are other privileges noted in the table which are not recommended for an SMF in Indonesia. Cagamas bonds, for example, receive a 10 percent risk weight; we recommend the more conservative approach of 20 percent, as is the case with FHLB.

**Low Income Lending Initiatives.** In the last several decades, Malaysia has adopted a variety of measures to enhance the affordability of low income housing loans, including interest rate ceilings and the prohibition of refinancing loans with Cagamas that are over a certain moderate ceiling. These measures are felt to introduce inefficiencies into the system and unduly limit refinancing.73 We do not recommend that subsidy policies be part of the Indonesian SMF, which should be operated on a fully commercial basis.

**Cagamas Lending without Recourse.** Cagamas has been planning to take steps since 1999 toward being a true conduit via moving toward lending with no recourse or limited recourse. In this lending, the underwriting criteria would be more conservative than normal, as Cagamas would be assuming all or most of the risk. As discussed below, this should be considered for the Indonesian SMF only after there a very good track record for SMF lending and well established risk management procedures are in place.

**Other Efforts in the SMF Pipeline.**

**Donor Support for an SMF.** As noted, ADB, together with USAID, has supported a secondary market initiative beginning in 1993.74 The ADB set aside funding for continued assistance to the effort in 1998, but these funds have never been utilized, largely due to
the interruption caused by Krismon. The funds were to support both technical assistance and provide seed capital for the SMF. ADB had supported the concept of an SMF for Indonesia, and ADB continues to be willing to consider the SMF option. The main question now, however, is to determine when recovery of the economy, of restructured banks, and of mortgage lending at the banks has proceeded sufficiently robustly to again warrant consideration of SMF development.

5.7.5 Interim Steps for Indonesia

Kimpraswil has also asked the HOMI team if there are approaches to capital market funding which could be undertaken very quickly – that is, prior to an SMF being operational. Thus, rephrasing the question perhaps: in the absence of a centrally-based facility, is there a bank-based model which is immediately appropriate?

First, referring back to the models of capital market access in use worldwide, there are bank-based options which are in use in many countries. The one available to Indonesia at this moment is perhaps limited to the general bank debt issuance model. Indonesia banks already access the capital market for medium-term funds. Is there any advantage to doing so with a mortgage-backed bond of some type?

A structure can probably not be put in place quickly for a private conduit MBS. Similarly, Indonesia is not familiar with European mortgage-backed bonds, and there is no real advantage to creating this structure at this point. However, some other mortgage-backed debt instrument could conceivably be designed. HOMI has prepared one option for consideration, called a Real Estate Investment Fund Unit ((REIFU). This model, which is described in the Annex, is a type of GOI-guaranteed pass-through. Alternatively, once again, the simpler, general bank model can be addressed. In either case, however, nearly the same set of questions need to be answered:

- Which banks have a sufficient portfolio of sufficient quality to create mortgage-backed debt?
- Which banks are interested, at this time, in obtaining funds from the capital market?
- In general, investor concerns include credit quality, cash flow performance, and liquidity. Would investors be interested in mortgage-backed debt? If so, at what price?
- Would the cost of the funds require the bank to push up its mortgage lending rates – above those of its competitors (presumably funding themselves from deposits, general debt issuances, etc.)
• Would a mortgage-backed bond be more appealing to an investor than a bond simply backed by the full faith and credit of the bank?

• Would the Government wish – at this particular moment - to involve itself in a guarantee scheme? A guarantee which is essentially an implicit off-budget subsidy?

These questions need further evaluation before a decision can be taken. However, there is one approach that HOMI does not recommend: any structure that (1) “forces” investors to buy the debt, and (2) any below-market (i.e. below the SBI rate) interest rate approach. This will set back the development of the proper atmosphere and psychology for development of the SMF.

5.7.6 Recommendations for Secondary Market Development in the Medium- and Long-term.

5.7.6.1 Recommendations for the Medium-Term Strategy: Develop an SMF

• Indonesia should concentrate at present on development of an SMF, rather than an SMM. The Inter-Ministerial Committee should designate a Task Force for development of an SMF An institutional “champion” should be agreed upon as soon as possible. We suggest that the Task Force for development of an SMF should be headed by Bappenas as the institutional champion, with members including MOF, Kimpraswil, BI, and the Department of Justice.

• The Task Force should consider obtaining expert advice from at least two sources: Cagamas and the U.S. Federal Home Loan Bank system. As discussed above, the recommended Indonesian SMF has selected characteristics from each of these two systems, but does not replicate either in a direct manner. HOMI’s recommendations are that Indonesia’s SMF be as streamlined as possible and avoid non-market and/or special requirements, such as mandatory investments in low income housing and below-market interest rates, such as those in effect for Cagamas.77 A market-based approach to mortgage finance is especially important for Indonesia’s banks to shed the legacy of the KPR system and proceed to expand the market-based system.

• Nearly all the current mortgage portfolio is relatively new. The pre-Krismon portfolios can offer some information, but a large portion of this portfolio was taken over by IBRA. (In turn, some of this was sold at discount simply as an asset, or a stream of income.) Thus, for the most part, it is the new, post-Krismon portfolio that will become the basis of future
assets for use under an SMF. This portfolio must be further seasoned before its characteristics are fully clear to analysts. The Task Force should provide assistance for development of a database for analysis of the mortgage portfolio characteristics, perhaps centered in Perbanas.

- **Detailed Feasibility Study of the SMF Structure and Regulations.** Based on the preliminary set of recommendations discussed below, a thorough assessment of the SMF proposal should be undertaken as soon as possible, including the ownership structure and any special provisions designed to facilitate the competitiveness of the SMF debt instruments in the capital market.

- **Capital Market Assessment.** The capital market has suffered Krismon, leading to restructuring and recapitalization efforts, and is now dominated by GOI debt instruments. Even pre-Krismon, however, compared with some of its Asian neighbors, Indonesia’s bond market was noted as being thin and weak. A feasibility study should be undertaken for at least the following issues: (1) potential investors and the types of bonds they might invest in, (2) the comparative costs of raising funds for mortgage lending via an SMF as compared with other options open to the banks, (3) and the characteristics of the newly developing mortgage portfolio, including NPLs, will need to be undertaken to help ensure the success of an SMF.

5.7.6.2 Long-term Options: Development of SMF Lending without Recourse and Securitization Tools

- In the long-term, after successful operation of the SMF, the institution may wish to proceed as Cagamas has done, by examining the option for lending with little or no recourse.

- A Task Force should also continue to develop the legal and administrative infrastructure for securitization, as this can become a useful off-balance sheet tool for a variety of bank assets. Development of an SMM would require addressing a number of legal and regulatory issues, including the trust concept, bankruptcy remote, and mortgage registration in accordance with sales of securities.

- The steps already undertaken in this regard, and the outstanding issues are discussed in the Annex to section 5.7.
5.8 Recommendations

Consolidated Recommendations. This section consolidates the recommendations presented in the preceding sections. We have grouped them here according to the major issue the address in the overall process of strengthening the housing finance system: that is, credit risk, legal and administrative risk, expansion of the housing finance sector, and long-term funding and liquidity risk. Only the recommendations are noted in this summary, so please refer to each of the sections above to address the issues defining each topic. The recommendations are organized as follows:

1. Recommendations in Risk Management and Information Systems: Credit Risk, Legal Risk, and Administrative Risk
   a. Establishment of a Credit Bureau
   b. Automation and Risk Management: Credit Scoring
   c. Legal Risk: Improving Foreclosure
   d. Administrative Risk: Improving Standardization

2. Expanding the Housing Finance Sector
   a. Expanding the Lending Institutions
   b. Mortgage Default Insurance
   c. Alternative Mortgage Products and Other Tools in the Downmarket Expansion
   d. Eliminating the KPR/RSS Subsidy System

3. Developing Microfinance for Housing Finance in Indonesia

4. Long-term Funding for Mortgage Finance: Establishing a Secondary Mortgage Facility (SMF) in Indonesia

Schematic Overview of the Future Housing Finance System. Please also refer to Chart 1 in section 1.0, which is our schematic representation of the future Indonesian housing finance sector. It indicates first of all, that housing credit, in one form or another, is available to many more “bankable” households, including those of moderate and modest income. Many more lenders have been brought into active participation, not only mainstream banks, but regional bank, smaller banks, and many participants from Indonesia’s large network of microfinance lenders, rural banks, cooperatives, credit unions, and so forth. In the future, it is expected that credit enhancement policies (and other tools discussed in the report) will assist the expansion of the system. First, mortgage default insurance will
assist banks lend to moderate income households through a risk-sharing arrangement. Also under consideration, perhaps via a World Bank pilot project, is a guarantee fund for improving the liquidity in microfinance for housing. Finally, a goal long sought in Indonesia – access to long-term funding from the capital market - is to be obtained from a Secondary Mortgage Facility (SMF).

**Action Plan.** Finally, we have developed Our recommendations in this report are primarily concerned with long-term improvements to these efficiency and affordability barriers. Both the banking sector, assisted by Perbanas, and Government have important roles to play in undertaking reforms and improvement to housing finance. Given the nature of the recommended reforms, public/private partnerships are important. Clearly, donor technical assistance can also play a key role. Table 1.1 summarizes our action plan for improvement and expansion of housing finance. The specific recommendations and initiatives are discussed in detail throughout the remaining chapters of this report.

5.8.1 **Recommendations in Risk Management and Information Systems: Credit Risk, Legal Risk, and Administrative Risk**

5.8.1.1 **Establishment of a Credit Bureau**

- A Credit Bureau initiative has been begun by the Ministry of Cooperatives to assist the development of SMEs. The ADB has supported this effort. However, HOMI strongly recommends that the focus be broadened to the entire financial sector. An Inter-ministerial Task Force, or a Working Group, should be established as soon as possible to carry a broad-based Credit Bureau initiative forward. A single Credit Bureau in Indonesia will be developed to provide the information needed by all lenders for all relevant types of lending.

- The Credit Bureau issue will be raised by Bappenas at the Inter-Ministerial meeting now convened by Kimpraswil regularly (it is to meet every three months) in order to place it on the agenda and discuss the best approach to carrying the initiative forward and the most appropriate institutional home. In the opinion of HOMI, Bappenas (or MOF) is the logical champion for the Credit Bureau in order to structure is as be a nation-wide initiative serving banks and non-banks in a broad range of lending activities.

- The HOMI team recommends that Kimpraswil support and join a Task Force and work to broaden the scope of the Credit Bureau effort beyond SMEs to include numerous types of
lending in the information service, including especially mortgage finance. PERBANAS is now directly involved and must be a key player. It is also crucial that this Task Force have a representative from BI, as the DIS system can make important contributions to a credit bureau.

- The banks interviewed by the HOMI team were positive about the creation of the credit bureau. There is also a strong feeling that the Credit Bureau should be private. Capital could be sought from banks, donors, the IFC, and/or interested private sector rating or credit bureau management companies.

- The ADB study calls for a feasibility study to be undertaken as soon as possible. HOMII strongly supports this; continued funding should be sought from ADB. Assuming that the recommendations in the July 2001 ADB study are implemented, a feasibility study to address the administrative and structural issues noted above, should be carried out. The initial ADB study stressed that it would be far more cost-effective for Indonesia if a private sector firm, specializing in credit bureau development be engaged to conduct the feasibility study and the development of the Credit Bureau infrastructure.

- Thus, Following the completion of the Feasibility Study, HOMI recommends that private sector firms which specialize in credit bureau development in Asia and globally be invited to submit proposals with plans to assist development in Indonesia. As noted in the current ADB study, the development phase would be much less costly if experienced firms are involved. (Among other things, the identification and I.D. problems facing development of the Credit Bureau will be extremely challenging with regard to computer software able to uniquely distinguish households).

- The Task Force will determine the ownership of the Credit Bureau and the form of its operation and organize educational workshops and promotional campaigns.

- Finally, BI's information system was not planned to function as a credit bureau. The Law on Bank Indonesia No.23/1999 specifically article 32 sub-article 1, stating that BI arrange and develop an inter-bank information system, should be revised.

5.8.1.2 Automation and Risk Management: Credit Scoring

- The first step in improving the information systems in the sector is to begin development of a Credit Bureau as discussed above.
• Simultaneously, HOMI recommends that the banks that plan to be heavily involved in mortgage lending, plan to implement specialized IT systems for mortgage finance, if this has not already been done. In addition, some banks would benefit from training in risk management and automation issues. The banks could coordinate their training requests through Perbanas. Examples of topics suggested by HOMI include IT systems, underwriting and credit scoring, and automated underwriting and servicing procedures.

• Next, banks should develop internal mortgage portfolio databases. Perbanas may also wish to develop an analysis database, on its own behalf and that of the smaller banks. Note that this step can take place whether or not the Credit Bureau is in place.

• When the Credit Bureau is in place, a Task Force should issue an RFP to invite a private sector firm to develop the debt scoring system - the “FICO” score - as discussed above. It is derived from Credit Bureau data; the process of its development, and the approach that might be used in Indonesia, can draw on extensive international experience.

• In the long-run, banks will be in a position to introduce automated credit scoring, combining their own underwriting models with Credit Bureau data to provide a complete and overall comparative assessment of would-be borrowers.

5.8.1.3 Legal Risk: Improving Foreclosure

• Foreclosure is too often costly and slow. The probability of a mortgage loan entering the default stage now varies considerably within the system; please refer to the NPL statistics in section 2.0. However, since so many bad loans were placed with IBRA, it is difficult now to predict what the “steady state “ default rate might be on new mortgage portfolios. 

As noted, while the probability of entering into default may be reasonably low, the probability of sustaining major losses, once a default occurs is extremely high.

• The existing mortgage law is sufficient enough to accommodate foreclosure process. In addition, the new role of the Government Auction Agency, as a policy making body, should help streamline the auction process.

• However, the mortgage law and the Dutch law of 1848 (RID Art. 200) can come into direct conflict in case where the debtor is not cooperative, in which the case court action is
required. If the debtor (or legal occupant) refuses eviction, he cannot be evicted without a court order. In the ensuing legal proceedings, the chief of court has the power to decide the outcome.

It appears that several types of issues need to be addressed because of this conflict.

(1) First, education of all parties involved. Customer education as to their rights and responsibilities in undertaking a mortgage loan might improve cooperation in the early stages. DJPLN should prepare socialization program covering key actors, procedures and regulations. The workshop convened on foreclosure suggested that Perbanas should follow it up with a second workshop with the participation of Supreme Court, District Court, private auction companies, and bankers.

(2) Second, the 1848 Dutch law may ultimately need revision.

(3) Third, technical assistance is required to speed up the auction process. If the debtor is not cooperative, the auction should be optional, not compulsory.

(4) Fourth, delays and lack of transparency within the Court offices must be seen as responsible for many of the foreclosure problems. As a practical matter, automation and better IT systems should speed up the process, but more thorny court improvement issues fall within the purview of the Department of Justice.

5.8.1.4 Administrative Risk: Improving Standardization

- **Standardization efforts are already underway.** Draft documentation has been prepared and submitted to a Task Force, which is addressing a number of issues. Perbanas and the existing Task Force should continue to address the standardization issues, including definition of key variable such as the income measure used in payment-to-income ratios, and the value definition used in the LTV.

- More attention needs to be given, however, to the rules and regulations for appraisal procedures, which is one of the most crucial support services in housing finance. A number of important appraisal issues need to be resolved through regulations established by BI for regulation and supervision, as discussed in sections 3.4 and 6.0. This should be coordinated through discussions with Perbanas, as well as with appraisal and regulation and supervision experts.
• To avoid legal problems in the future, the Supreme Court should confirm, in the form of a Circular or Guidance, that the standard credit agreement, having been mortgaged, properly meet the criteria: for foreclosure in accordance with article 6 of Undang-Undang Hak Tanggungan (UUHT; that the auction request can be addressed straight to the Auction Office).

5.8.2 Expanding the Housing Finance Sector

Recommendations to encourage expansion of housing finance to moderate income households include a mix of policies: redesign of subsidy policies, government assistance in design of appropriate loan procedures, incentives for involvement of a variety of lenders, and subsidy policies designed for compatibility with both housing finance and downpayment contributions by households. Recommendations include:

5.8.2.1 Expanding the Lending Institutions

• **Downmarket Lenders.** HOMI recommends Initiatives by GOI to seek broader participation by a broader group of lending institutions, including BPDs and smaller banks. Regional banks and a number of other state and private banks already provide KPR UMUM, although in very modest amounts, or, state that they are willing to go downmarket, (defined arbitrarily as loans of Rp. 25 million or less). These lenders should be encouraged. An assessment should be made of the financial condition of such lenders; sound lenders should provided with technical assistance regarding mortgage finance underwriting, servicing, loan products, and so forth.

• **Bank training** would be a key part of these efforts. HOMI recommends centralizing and coordinating all bank training through Perbanas (see above for the recommendation that Perbanas form a Subcommittee on Housing Finance). State banks, including the regional banks discussed here, are currently represented by HIMBARA. Fortunately, HIMBARA will soon be merged with Perbanas.

5.8.2.2 Mortgage Default Insurance

• **Mortgage Default Insurance.** An assessment of the feasibility of a credit enhancement via mortgage default insurance (MDI) is the topic of a HOMI special report “Risk
Management and Mortgage Insurance”. MDI is developed as a key subsidy instrument in the HOMI report “Housing Subsidy Instruments for a Home-Owner Assistance Program”. MDI is mentioned in this report because it is a crucial aspect of the various incentives for banks to extend lending downmarket. It should be noted that MDI, potentially, can take two forms and play two complementary roles: a subsidized version can assist moderate income housing obtain funding, and encourage the housing market to extend downmarket; a non-subsidized, borrower-paid version, a credit enhancement tool to help a somewhat higher income group obtain financing. In either case, HOMI considers that MDI has important potential as a subsidy and/or a downmarket mechanism.

5.8.2.3 Alternative Mortgage Products and Other Tools in the Downmarket Expansion

- **A Tool Kit for Expanding Lending.** HOMI recommends that training in alternative loan product and risk-based pricing “toolkit” be made available to lenders, ideally through the coordination efforts of Perbanas. As noted above, these topics follow directly from the issues discussed in section 3.0: formation of the Credit Bureau, the development of credit scores (FICO) scores, automation of underwriting (and the entire loan process), and mortgage default insurance (section 4.3). HOMI is not suggesting that Indonesian bankers eliminate the discretionary loan product, since this is what they are currently most familiar with. Rather, we suggest that mortgage bankers be provided more information on the various features of other loan products, why the features vary, why some products are better for some customers than others, and how different loan product features may be used to both control risk while satisfying borrower needs, and thus the principles for differential pricing.

- **Bank Training.** Cooperation with Perbanas in establishing a Subcommittee on Housing Finance. This subcommittee would, first and foremost, determine which of the topics introduced in sections 3.0 and 4.0 of this report would be most useful for management of their loans portfolios, improving underwriting, expanding moderate income housing finance, and so forth. Examples of bank training topics include alternative mortgage products, as noted above, mortgage insurance, risk-based pricing and homeowner counseling. IT systems and credit scoring issues were already mentioned above.
5.8.2.4 Eliminating the KPR/RSS Subsidy System and Establishing a Role for BTN

- Mainstream banks and other lenders are not likely to lend downmarket until the KPR/RSS program is replaced with a market friendly subsidy approach and until the future of BTN is clarified and they can be assured of a level playing field in this segment of the market (see below). Mainstream lenders willing to go downmarket also can be assisted in various ways, including via alternative loan products and credit enhancements, such as mortgage default insurance.

- A definitive decision taken by GOI to **phase out the KPR/RSS subsidy**. Housing suitable for the needs to modest income households has been too limited by the KPR/RS/RSS approach to housing. The supply of moderately-priced housing should reflect a broader continuum of typologies, augmented by low cost technologies. An improved continuum in the supply of housing should emerge once developers realize that finance is not locked into the RSS/RS system. This supply stream will better match the effective demand of moderate and modest income households.

- **The Future Role of BTN.** BTN, given its long experience in underwriting and administering the major share of the KPR/RSS interest rate subsidy, would seem to have a comparative advantage in lending downmarket to moderate income households. Under the scenario of phasing out the KPR/RSS subsidy by 2004, BTN might consider planning its commercial expansion into similar markets without this particular subsidy (and with or without another form of subsidy or credit enhancement such as mortgage default insurance). In contrast, however, BTN has tentative plans to expand into the upscale market and compete directly with banks such as Danamon, BII Lippo, Mandiri, and NISP. BTN planned to capture a major share of the market for loans on Rp. 100 million and above; there were no plans for loans of less than 50 million. **In sum, this approach seems not to take advantage of the middle market comparative advantage and methodologies that BTN has developed to date.**

5.8.3 Developing Low Income Housing Finance in Indonesia

Indonesia could benefit from more focused and widespread development of MFH, microfinance for housing. MFH is not a panacea for the low income but it **can become a significant stand-alone tool for loans for home improvement, home expansion, including for development of rental rooms, and for new construction conducted on an incremental**
basis. In addition, when used together with other programs designed to address supply side constraints (land, infrastructure) and administrative constraints (land title, credit records of would-be borrowers, etc), and affordability constraints (direct voucher subsidies, for example) MFH can serve as one of the crucial inputs to low income housing development. Constraints posed by access to adequate funds will still need to be addressed. However, Indonesia’s network of low income lenders could ultimately provide important support via enhanced savings generation.

- **Investigate a Capacity Building Role for BRI in Expanding an MFH Network.** We suggest that BRI would be ideally suited take a lead role in capacity building of the MFH sector, including further development of MFH loan products and underwriting policies. BRI could help promote MFH as an explicit component of microfinance. Most especially, BRI could expand its training programs to include MFH and assist in training other Indonesian MFI lenders in housing-related products. The networks of Bukopin, the Cooperatives, the BPD, the LKPD, and so forth, should be assessed under an expansion effort.

- **Develop more MFH Loan Products.** One key issue is whether to design and introduce loan products more specifically to support MFH. Some of the issues include:
  - Whether the housing loans be somewhat larger than the microenterprise loans?
  - Whether MFH loans could be somewhat longer term than the microenterprise loans?
  - Whether underwriting and collateral should be linked to prior savings programs, as an approach to self-insurance?

- **Increased Focus on Private Sector Rental Housing.** As discussed in the HOMI report on the housing market, rental housing for low income households is cited as a priority. We are concerned here with private sector, low income rental accommodations in owner-occupied housing. BRI already lends to homeowners for the purpose of building additions to their dwelling to be used for rental. BRI could assist other MFIs to develop rental housing loan programs.

- **Strengthen Commercially-based MFIs.** Credit programs offered by the existing network of MFIs should be undertaken at commercially-based rates. In the interests of strengthening MFIs and commercially-based lending, encourage GOI and donor programs to limit subsidized credit. Subsidies can be provided through other means, in both supply and demand side programs. In sum, do not allow subsidized credit programs to “crowd out” strengthening of commercially-based microfinance institutions.
• **Better Integration of Microfinance “projects” into microfinance “systems” and “institutions”**. This recommendation calls for helping to upgrade clients of microfinance “projects” to be clients of microfinance “institutions”. Cobild is a case in point. Clearly, valuable lessons are being learned from the Cobild project concerning community-based endeavors, affordable building technologies, and so forth. But the credit aspects of the program are bringing the wrong message to those who wish to strengthen the institutional structure of MFIs and provide commercially-based credit. Integration of the Cobild process into the formal financial sector could include:

  a. Use civic groups only as “transaction” intermediary with formal sector lenders
  b. Use group loans in underwriting. If a household successfully completes this loan, then it could receive a “certificate” for a follow-on individual loan

• **Design Housing Programs Integrating MFH as a Component**. Finally, where appropriate, MFH should be integrated with broader programs for low income housing development, including land and infrastructure. This may also include a variety of subsidies to households, such as a direct transfer subsidy for assisting with downpayment.

• **Coordinate Findings with World Bank Pilot Project**. As described in section 1.0, and shown in the chart depicting the possible institutional structure of Indonesia’s mortgage finance sector, the World Bank Pilot Project on Microfinance is considering development of a liquidity guarantee fund to support housing microlenders. Efforts by Kimpraswil to expand housing lending downmarket should be coordinated with this pilot.

5.8.4 Long-term Funding for Mortgage Finance: Establishing a Secondary Mortgage Facility (SMF) in Indonesia

**Recommendations for Developing an SMF**

• Indonesia should concentrate at present on development of an SMF, rather than an SMM. The Inter-Ministerial Committee should designate a Task Force for development of an SMF. An institutional “champion” should be agreed upon as soon as possible. We suggest that the Task Force for development of an SMF should be headed by Bappenas as the institutional champion, with members including MOF, Kimpraswil, BI, and the Department of Justice.
• The Task Force should consider obtaining expert advice from at least two sources: **Cagamas and the U.S. Federal Home Loan Bank system.** As discussed above, the recommended Indonesian SMF has selected characteristics from each of these two systems, but does not replicate either in a direct manner. HOMI’s recommendations are that Indonesia’s SMF be as streamlined as possible and avoid non-market and/or special requirements, such as mandatory investments in low income housing and below-market interest rates, such as those in effect for Cagamas. A market-based approach to mortgage finance is especially important for Indonesia’s banks to shed the legacy of the KPR system and proceed to expand the market-based system.

• Nearly all the current mortgage portfolio is relatively new. The pre-Krismon portfolios can offer some information, but a large portion of this portfolio was taken over by IBRA. (In turn, some of this was sold at discount simply as an asset, or a steam of income.) Thus, for the most part, it is the new, post-Krismon portfolio that will become the basis of future assets for use under an SMF. This portfolio must be further seasoned before its characteristics are fully clear to analysts. The Task Force should provide assistance for development of a **database for analysis of the mortgage portfolio characteristics, perhaps centered in Perbanas.**

• **Detailed Feasibility Study of the SMF Structure and Regulations.** Based on the preliminary set of recommendations discussed below, a thorough assessment of the SMF proposal should be undertaken as soon as possible, including the ownership structure and any special provisions designed to facilitate the competitiveness of the SMF debt instruments in the capital market.

• **Capital Market Assessment.** The capital market has suffered Krismon, leading to restructuring and recapitalization efforts, and is now dominated by GOI debt instruments. Even pre-Krismon, however, compared with some of its Asian neighbors, Indonesia’s bond market was noted as being thin and weak. A feasibility study should be undertaken for at least the following issues: (1) potential investors and the types of bonds they might invest in, (2) the comparative costs of raising funds for mortgage lending via an SMF as compared with other options open to the banks, (3) and the characteristics of the newly developing mortgage portfolio, including NPLs, will need to be undertaken to help ensure the success of an SMF.
Long-term Options: Development of SMF Lending without Recourse and Securitization Tools

- In the long-term, after successful operation of the SMF, the institution may wish to proceed as Cagamas has done, by examining the option for lending with little or no recourse.

- A Task Force should also continue to develop the legal and administrative infrastructure for securitization, as this can become a useful off-balance sheet tool for a variety of bank assets. Development of an SMM would require addressing a number of legal and regulatory issues, including the trust concept, bankruptcy remote, and mortgage registration in accordance with sales of securities.

- The steps already undertaken in this regard, and the outstanding issues are discussed in the Annex to section 5.7.
ANNEX FOR SECTION 5.7

The Draft Securitization Law for Indonesia

**Legal Issues.** Before the crisis, securitization of asset secured by movable asset e.g. car loan and credit card, had been implemented through offshore trustee.

Mortgaging is customary; nevertheless, sale of receivables secured by a mortgage has never been implemented in Indonesia. Some of the legal issues are discussed by the securitization team under Department of Justice and Human Rights, such as:

- Content of article 613 *Kitab Undang-undang Hukum Perdata*, concerning cessie followed by delivery. Mostly lawyers agree that upon sales of receivables there must be an announcement to the debtor that the mortgage loan was sold.
- The approval from the debtor should be stated on the loan agreement between Lender and debtor.
- Problem of delivery related to the term “jual beli” (*sale-transfer of ownership*). Legally, *jual beli* is valid only after the delivery has taken place.
- In relation to bankruptcy, the law on bankruptcy states that the receivables owned by the creditors, prior to due date, will be included in *budel pailit* (*failliessement boedel*), if the creditor becomes bankrupt.
- Problems of taxation such as the needs for the incentive tax structure for securitization transaction.
- Problems of land related to the principle that the name of the land owner or the mortgage has to be registered and stated in the *buku tanah* (*land ownership register*) and *buku sertifikat* (*land title*).
- Investment limitation related Pension Funds Law and Insurance Law.
  Article 7 of the decree of the Minister of Finance No.481/KMK.017/1999 dated 7 October 1999.
- Mortgage law which stated that transfer of receivables secured by a mortgage will have the impact that the mortgage should also transferred. This relates to the principle of *droit de suite* of the mortgage. Transfer of mortgage has to be registered by the new creditor to the *Kantor Pertanahan* (article 16 sub-article 2).

**Draft of Securitization Law.** In 1999, Ministry of Justice and Human Rights organized a Team to design a draft of Securitization Law. This team consisted of practitioners, academicians, and bureaucrats.
Earlier in 1998, a small team consisting of practitioners who were previously heavily involved in preparing securitization processes for some banks before the crisis, voluntarily produced a draft of the Securitization Law which could be applied not only for mortgage lending but also for other receivables such as credit card, car loan, etc. It was then employed by the Ministry of Justice and Human Rights merged into the team organized in 1988 by the Ministry itself. The draft of Securitization Law was adopted into the product of the new team in 1999. The draft of this Law will be socialized to the major players at the end of 2001 and will be submitted to the Parliament in 2002.

The increase in national development that emphasizes on the economic sector needs a large volume of funds originating from a well-progressing market. For the benefit of the economic development, the required funds should be continuously available.

To give the market participant more confidence in doing their business, a set of regulations concerning securitization is needed. The preparation of RUU Sekuritisasi under the Ministry of Justice and Human Rights has been started since 1999 as mentioned above.

**Recommendation.**

As securitization is a new concept in Indonesia, the existing law has not anticipated any consequences related to its operation, especially in the Trust concept, bankruptcy remote, Land registration in line with the sale of securities etc. On the other hand, to adjust the existing law to the requirement of this concept is hardly possible.

Therefore, some way out which already covered under this law should be considered as a new innovation in the financial sector not as an exception or monopoly.

The biggest issue in this law are mortgage registration related to the sale of securities and taxes related to the mortgage transfer should be solved by related institutions in order to have the RUU legalized and implemented.
ANNEX FOR SECTION 5.7

REAL ESTATE INVESTMENT FUND UNIT ("REIFU")

Issuer : Bank
Guarantor : Government of Republic of Indonesia
Instrument : Guaranteed Pass-Through Real Estate Investment Fund Unit (REIFU)
Type of Issuance : Public and/or Private Placement
Interest Rate : Annual Adjustable Fixed rate with step down band structure. The band must determined on the issued date on the decreasing trend from year 1 to year 5.
Interest Payment : Pass-through interest payment to be in accordance to the underlying mortgage interest payment
Principal Payment : Pass-through principal payment to be in accordance to the underlying mortgage interest payment.
Tenor : 5 years
Enhancement features : (1) Step down Government Guaranteed on Principal and Interest Payments with accelerated payment if there is default. This Guarantee will be on the decreasing trend in accordance to the step up mechanism applied in the “investment” fund.
(2) Step-up mechanism on the “investment” fund over the life of the REIFU. This investment fund can only be invested in the SBI and/or Government Bond
(3) Final income tax applied on the REIFU (i.e. No withholding tax applied)

Protection on the Government Guarantee: Step down First Mortgage Lien on the underlying collateral to secure the mortgage financing should be given to the government in lieu of the Guarantee. The step down mechanism follows the Guarantee.

Accelerated payment of the principal and interest in the event of default by the bank in meeting its payment obligation (three) times in consecutive periods.
### Credit Bureau Initiative

Debtor information from all sources (for all debtor households) is crucial to effective underwriting of mortgage loans. If the DIS system is much too limited, as it covers only large loans from banks only. This is a key step in improving the investment quality of the mortgage portfolio.

**Recommendation:**
- ACB-funded Assistance for SMEs: Must be extended to assist all consumer lending. G7 Task Force now exists: Ministries of Cooperatives and Economic Coordination, MUF, PAPPENAS.
- Implications should be evaluated for Task Force recommendations, to represent the important needs of housing finance.

**Action Plan 2003-2004:**
- Begin implementation for Credit Bureau.

### Improved Risk Management, Including Computation and IT

These improvements are crucial to improving the investment quality of the banks' mortgage portfolio. Underwriting will be assisted via input from both the Credit Bureau, and improved bank systems. SMF dependent on improved risk management.

**Recommendation:**
- Bank Training coordinated through PEBARAS, eventually extended to Regional & other potential mortgage lenders (selected 9 PDs, BKKIs, LPOs).

**Action Plan 2003-2004:**
- Continue Bank Training through PEBARAS associations for PD, BKKIs, LPD.
- Develop manuals & procedures updated as risk management improves.

### Credit Scoring Models & Risk-based Pricing (end)

Alternative Loan Products

Offer borrower a range of products to reduce credit risk & share interest rate risk with the bank.

**Recommendation:**
- PERBANAS/MOF: Should follow up with new requirements based on improved underwriting information.

### Strengthen Mainstream Housing Finance

**Table 1: Strengthen & Expand Housing Finance**

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<td></td>
</tr>
<tr>
<td>Alternative Loan Products</td>
<td>Offer borrower a range of products to reduce credit risk &amp; share interest rate risk with the bank.</td>
<td>PERBANAS/MOF: Should follow up with new requirements based on improved underwriting information.</td>
</tr>
<tr>
<td>RECOMMENDATION</td>
<td>JUSTIFICATION</td>
<td>ACTION PLAN 2002</td>
</tr>
<tr>
<td>----------------</td>
<td>---------------</td>
<td>------------------</td>
</tr>
<tr>
<td>Expand Lending in Market to Moderate Income Groups</td>
<td>Improved access to credit for borrowers now denied. Sub-prime market operates on commercial principles; risk management, loan products, and risk-based pricing are geared to higher risk loans and borrowers.</td>
<td>Task Force of Kimpraswil, PER-BANAS, BRI, BPDs, BNI-KS, other lenders &amp; their associations as appropriate. Initiate a Feasibility Study and assess interest.</td>
</tr>
<tr>
<td>Assess New Loan Products and Risk-based Pricing for Sub-prime Market</td>
<td>Must follow from improved risk management procedures in mainstream market</td>
<td>Task Force Assessment and Product Development; Seek Concor Support</td>
</tr>
<tr>
<td>Assess Role of Mortgage Default Insurance Options (1) and/or (2) to encourage Downmarket Expansion</td>
<td>MDI is potentially an important credit enhancement tool to assist with downward expansion of mortgage lending.</td>
<td>See Recommendations on New Subsidies, GOI Initiative, Kimpraswil, MCF, BI, PER-BANAS Assess feasibility as Tool for Down market Expansion</td>
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**TABLE 2: EXPAND MODERATE & LOW INCOME HOUSING FINANCE**

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<thead>
<tr>
<th>RECOMMENDATION</th>
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<th>ACTION PLAN 2003-2004</th>
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<tbody>
<tr>
<td>Housing Microfinance Assessment of current lending which is used for housing related purposes. Assess extent to which lending is explicitly for housing or general consumer lending.</td>
<td>Low income lending for housing is one tool with which to assist moderate &amp; lower income groups. It is already done by some micro lenders. It is important to document this and assess ways to assess ways to increase the volume.</td>
<td>Kimpraswil should assemble a GOI Task Force, including major Micro Lenders. Assess current situation with regard to microlending for housing purposes. Introduction of micro-lending explicitly for housing purposes should be examined to see if that would evoke latent demand for this type of credit.</td>
<td>Bank Training for micro lenders, regional banks, specialty banks, coops, &amp; credit unions. Development of manuals, loan products, and lending procedures</td>
</tr>
<tr>
<td>Assess Loan products and procedures used in micro-lending. Assess suitability for housing and development of explicit tools for housing lending.</td>
<td>This lending is more similar to consumer that mortgage finance. In order to assist in specific, the most suitable loan products, terms, underwriting, and servicing procedures should be determined.</td>
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## ANNEX 1

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<thead>
<tr>
<th>STANDARDIZATION</th>
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<tr>
<td>II. KPR Application Form</td>
<td>I. Formulir Permohonan KPR</td>
</tr>
<tr>
<td>III. Evaluation Report</td>
<td>II. Laporan Penilaian</td>
</tr>
<tr>
<td>IIII. Credit Agreements</td>
<td>III. Akta Perjanjian Kredit</td>
</tr>
</tbody>
</table>
FORMULIR PERMOHONAN KREDIT

Dengan ini saya/kami mengajukan permohonan kredit sebesar Rp .................., untuk jangka waktu ........ tahun, dan akan digunakan untuk ................... dengan data dan keterangan sebagai berikut:

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21 Pendapat Penilai
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| 28  | Pendapat Penilai |

| 29  | Indikasi harga atas dasar reproduksi |
| 30  | Insikasi harga atas dasar perbandingan |

| 31  | Pendapat akhir penilai |

**Pernyataan:**
Kami tidak akan menarik keuntungan baik sekarang maupun di masa yang akan datang dari harta tetap yang ditaksir atau dari nilai yang diperoleh.
Kami tidak melakukan penelitian terhadap hutang kerugian atas harta tetap yang ditaksir tersebut dan jika dikemudian hari terdapat persoalan berkaitan dengan itu adalah diluar tanggung jawab kami.

Tanggal Pemeriksaan
Tanda Tangan Penilai
Nomor Sertifikat Penilai
Tanda Tangan Pemeriksa
Lampiran: Denah & Foto obyek yang dinilai
PERJANJIAN KREDIT PEMILIKAN RUMAH ¹)

Nomor:

- Pada hari ini,
- Berhadapan dengan saya, .........................Sarjana Hukum, Notaris di .................
dengan dihadiri oleh saksi-saksi yang nama-namanya akan disebutkan pada bagian akhir
akta ini:
1. - menurut keterangan dalam hal ini bertindak berdasarkan Surat Kuasa tertanggal
........................., bermeterai cukup dan dilekatkan pada minuta akta ini selaku kuasa
dari direksi perseroan terbatas yang akan disebut dan karenanya sah bertindak untuk dan
atas nama perseroan (untuk selanjutnya bersama dengan pihak yang menggantikan
kedudukannya/penerus haknya (successor) disebut (BANK).
2. ........................., ........................., bertempat tinggal di .........................,
Jalan ......................... ;
- yang untuk melakukan findakan hukum dalam perjanjlan ini telah mendapat persetujuan
dari suami/isterinya ²) yarig turut menandatangani Perjanjian Kredit ini [sebagaimana
ternyata dari surat persetujuan di bawah tangan tertanggal .........................,
bermeterai cukup dan dijahitkan pada minuta akta ini], ³) untuk selanjutnya disebut
(PEMINJAM).

- Para penghadap telah saling setuju untuk dan dengan ini membuat serta menetapkan
Peqanjian Kredit dengan syarat-syarat dan ketentuan-ketentuan sebagai berikut:

Pasal 1

DEFINISI-DEFINISI

Perkataan-perkataan yang dimulal dengan huruf besar mempunyai arti sebagaimana disebut di
bawah ini:

Akta Jual Beli : aktu jual beli mengenai Tanah dan Bangunan dalam bentuk
akta PPAT.

Akta Pemberian Hak Tanggungan : aktu pemberian hak tanggungan atas Tanah (APHT) dan
Bangunan dalam bentuk akta PPAT dengan syarat-syarat yang tercakup dalam bentuk Lampiran I pada akta ini

Angsuran : pembayaran-pembayaran kembali Hutang secara berkala,
berturut-turut tiap bulan takwim selambat-lambatnya
tanggal 5 untuk angsuran bulan yang telah lewat, terhitung
mulai Tanggal Angsuran Pertama hingga Tanggal Angsuran
Terakhir terdiri dari jumlah angsuran masing-masing dan jumlah angsuran terakhir berjumlah sisa Hutang sebagaimanana dirinci dalam sub (III) Lampiran II pada akta ini.

**Asuransi**

: asuransi atas Bangunan dan asuransi jiwa atas diri PEMINJAM dirinci dalam Lampiran III.

**Bangunan**

: bangunan dan turutannya, yang didirikan di atas Tanah berdasarkan IMB yang berlaku dan disebut dalam Lampiran IV.

**Hutang**

: jumlah pokok yang terhutang oleh PEMNJAM pada BANK sewaktu-waktu yang semula berjumlah disebut dalam sub (I) Lampiran II, ditambah bunga yang belum dibayar, provisi, premi asuransi dibayar dimuka dan segala biaya ongkos dan biaya lain yang wajib dibayar PEMNJAM dan jumlah besarnya ditentukan oleh BANK berdasarkan catatan-catatan BANK yang mengikat PEMINJAM

**Izin Mendirikan Bangunan (IMB)**

: izin mendirikan bangunan mengenai bangunan dan turutannya yang dapat didirikan diatas Tanah.

**Penjual**


**Perjanjian Kredit**

: perjanjian kredit ini sebagaimana diubah, diperbaharui atau diperpanjang di kemudian hari

**Perjanjian Pengikatan Tanah Jual Beli (PPJB)**

: perjanjian pengikatan jual beli mengenai Tanah dan Bangunan antara Penjual dan PEMINJAM pada pokoknya dalam bentuk terlampir sebagai Lampiran V.

**Pokok Hutang**

: jumlah yang disebut dalam sub (I) Lampiran II pada Perjanjian Kredit ini.

**Sertipikat HT**

: sertipikat bukti pembebanan hak tanggungan atas Tanah dan Bangunan untuk manfaat BANK berdasarkan APHT pada intinya dalam bentuk Lampiran I pada Perjanjian Kredit ini

**Tanah**

: tanah terdaftar dalam sertipikat Hak sebagaimana disebut dalam Lampiran IV, bebas dari hak tanggungan apapun (kecuali untuk manfaat BANK).

**Tingkat Bunga**

: tingkat bunga yang ditentukan BANK dari waktu ke waktu sesuai ketentuan dalam Pasal 4 dibawah.
Pasal 2
FASILITAS KREDRT
-BANK setuju untuk memberikan fasilitas kredit kepada PEMINJAM berdasarkan ketentuan-ketentuan dalam Pedjanjian Kredit Ini sampai setinggi-tingginya sebesar jumlah yang disebut dalam sub (I) Lampiran II untuk selanjutnya disebut (Pokok Hutang) untuk tujuan tersebut dalam Pasal 3 dibawah, dengan syarat-syarat dan ketentuan-ketentuan dalam Perjanjian Kredit ini dan Lampiran-lampirannya.

Pasal 3
PENGGUNAAN KREDIT
-Pokok Hutang sebagaimana tersebut dalam sub (I) Lampiran II diberikan BANK kepada PEMINJAM semata-mata untuk membiayai pembelian Tanah dan Bangunan.
-Bilamana BANK tidak menerima permintaan penarikan kredit dalam bentuk Lampiran VI selambat-lambatnya pada tanggal yang disebut dalam sub (V) Lampiran II sebagai tanggal akhir penarikan pertama atau tanggal lebih akhir yang disetujui BANK, maka Pedjanjian Kredit ini menjadi batal.

Pasal 4
DENDA DAN BUNGA
4.1. Atas jumlah Pokok Hutang yang terhutang oleh PEMINJAM kepada BANK, PEMINJAM wajib membayar bunga kepada BANK dengan tingkat Bunga tertunggak (sejauh diperkenankan Undang-Undang) atas Pokok Hutang dan bunga belum dibayar yang dientukan dalam ayat 4.2 dibawah ini yang wajib dibayar tiap-tiap bulan takwin, berturut-turut selambat-lambatnya tanggal 5 dalam bulan berikutnya, untuk masa terhitung mulai tanggal penarikan Pokok Hutang atau bagian dari padanya hingga pembayaran lunas Pokok Hutang. Bunga diperhitungkan berdasarkan jumlah yang belaku dari hari ke hari.

4.2. PEMINJAM setuju bahwa Tingkat Bunga yang wajib dibayar PEMINJAM ditentukan BANK sesuai dengan kondisi dan keadaan pasar dan yang umum diberlakukan BANK. PEMINJAM setuju patuh kepada Tingkat Bunga untuk Pokok Hutang yang setiap waktu ditentukan BANK sesuai keadaan pasar dan yang umum diberlakukan BANK untuk perjanjian hutang sejenis. Perubahan Tingkat Bunga yang diberlakukan BANK dari waktu ke waktu diumumkan BANK pada papan pengumuman di kantor-kantor BANK. Karena ketentuan perubahan tingkat bunga melekat pada tagihan BANK, maka hak untuk menyesuaikan tingkat bunga sesuai keadaan pasar dinyatakan dengan ini berlaku pula untuk mereka yang memberi dan mendapat hak atas tagihan-tagihan BANK terhadap PEMINJAM dan menggantikan kedudukan BANK terhadap PEMINJAM
4.3. Untuk tiap-tiap hari keterlambatan pembayaran Angsuran pokok atau bunga, PEMINJAM setuju wajib membayar bunga denda diperhitungkan atas dasar ...% (………………... persen) diatas Tingkat Bunga yang berlaku, atas jumlah tertunggak pembayarannya terhitung mulai tanggal jumlah bersangkutan wajib dibayar hingga tanggal pembayarannya lunas.

4.4. Bilamana PEMINJAM tidak dapat menerima peningkatan Tingkat Bunga yang sewaktu-waktu ditentukan BANK, PEMINJAM dapat melunasi seluruh jumlah Hutang sebelum waktunya dengan berkewajiban (i) pemberitahuan 1 (satu ) bulan dimuka pada BANK; (ii) Hutang dibayar lunas seluruhnya, pelunasan sebagian Hutang tidak diperkenankan; (iii) pembayaran biaya administrasi (penalty) pada BANK sebesar 1 % (satu persen) dari jumlah Pokok Hutang yang tersisa; dan (iv) untuk masa setelah efektif berlakunya Tingkat Bunga baru dan tanggal pembayaran lunas, PEMINJAM wajib membayar bunga atas Tingkat Bunga yang diberlakukan BANK

Pasal 5
PENARIKAN UANG

5.1. Penyerahan jumlah Pokok Hutang berdasarkan Perjanjian Kredit ini pada prinsipnya diserahkan langsung pada Penjual Tanah dan Bangunan sesuai schedule pembayaran dalam PPJB atau Akta Jual Beli kecuali bilamana BANK atas pertimbangannya sendiri setuju menyerahkan hasil penarikan kredit langsung pada PEMINJAM. PEMINJAM menguasakan BANK untuk menyerahkan penarikan kredit ini pada Penjual dan PEMINJAM setuju bahwva cara penyerahan demkian berlaku sebagai penarikan jumlah Pokok Hutang (atau bagian dari padanya) oleh PEMINJAM sendiri berdasarkan Perjanjian Kredit ini.


5.3. Sebagai prasyarat penarikan uang berdasarkan Perjanjian Kredit ini, PEMINJAM wajib memenuhi syarat-syarat tersebut dibawah ini kecuali diantaranya yang atas pertimbangan BANK sendiri dapat dikesampingkan oleh BANK.5)
(a). Tanah sudah bersertifikat dan terdaftar atas nama Penjual;

(b). Peminjam telah menyerahkan pada BANK sebelum atau bersamaan dengan penyerahan Pokok Hutang (sebagian atau seluruhnya):
   (i) PPJB [atau Akta Jual Beli] yang telah diandatangani oleh Penjual dan Peminjam.
   (ii) Ijin Mendirikan Bangunan (IMB) Induk [atau asli dari IMB yang telah dipecah].
   (iii) Surat Kuasa Membebankan Hak Tanggungan (ASKMHT) atau [Akta Pembebanan Hak Tanggungan mengenai Tanah dan Bangunan] yang telah ditandatangani oleh Peminjam dan BANK dalam bentuk dan dengan isi yang dapat diterima BANK.
   (iv) asli polis asuransi jiwa atas diri Peminjam dan asli polis asuransi kebakaran atas Bangunan yang dikeluarkan oleh perusahaan asuransi dan dalam jumlah tanggungan yang dapat diterima BANK, dan didalam polis mana BANK ditunjuk sebagai pihak yang berhak menerima hasil asuransi.

(c). PEMNJAM dan BANK telah menandatangani perjanjian jaminan penyerahan hak milik dalam fidusia atas tagihan-tagihan asuransi jiwa atas diri Peminjam asuransi kebakaran atas Bangunan dan atas tagihan gaji Peminjam untuk bagian yang diperkenankan Undang-Undang terhadap majikannya dan perjanjian fidusia itu telah didaftarkan di Kantor Pendaftaran Fidusia.

(d). BANK telah menerima Surat Konfirmasi Cessie Tagihan dari majikan PEMNJAM dan Pernyataan Perusahaan Asuransi dalam bentuk Lampiran VII dan Lampiran VIII.

(e). PEMNJAM dan BANK telah menandatangani akta Pengakuan Hutang Murni dalam bentuk akta notaris untuk memberi manfaat pelaksanaan segera tanpa mengajukan gugatan perdata kepada Pengadilan Negeri sebagaimana diatur dalam Pasal 224 RID dan Pasal 258 Rbg (bilamana diminta), atau atas pertimbangan BANK, sebagai bukti tanda terima atas jumlah Pokok Hutang yang diterima, PEIANJAM telah memberikan tanda terima uang bermeterai cukup, dalam bentuk dan isi yang disetujui oleh BANK, yang merupakan bagian yang tidak terpisahkan dari Perjanjian Kredit atas permintaan BANK.

(f) PEMNJAM telah memberi kuasa dan petunjuk pada PPAT/Notaris bersangkutan [atau pada Penjual] untuk menyerahkan langsung pada BANK atas asli sertifikat HGB/ Hak Milik dan asli Sertifikat Hak Tanggungan mengenai Tanah dan Bangunan serta Sertifikat Fidusia (bila ada) setelah selesai diproses.
(g) PEMINJAM telah membuka rekening pada BANK sesuai ketentuan dalam pasal 7.1 dibawah.

(h) Tidak terjadi salah satu kejadian kelalaian sebagaimana tersebut dalam pasal 12 dibawah. Hal-hal yang dijamin PEMINJAM dalam pasal 10 dibawah tetap benar dan PEMINJAM telah memenuhi kewajiban-kewajibannya sesuai pengikatan-pengikatannya dalam pasal 9 dibawah.


5.5 BANK akan mengirim konfirmasi secara tertulis pada Penjual dengan copy pada PEMINJAM mengenai jumlah Pokok Hutang atau (sesuai keadaan) bagian dari padanya yang ditransfer oleh BANK pada Penjual.


Pasal 6
PEMBAYARAN KEMBALI

6.1. Pembayaran Hutang dilakukan secara berangsur pada tanggal-tanggal Angsuran, tiap-tiap bulan dibayar untuk bulan yang telah lampau berikut bunga yang terhutang selambat-lambatnya tanggal 5 tiap bulan oleh PEMINJAM kepada BANK wajib diakukan oleh PEMINJAM secara bulanan tidak melewati tanggal 5 setiap bulan kalender, pada tanggal dan dengan banyaknya Angsuran yang dirinci dalam sub (III) Lampiran II pada Perjanjian Kredit ini yang merupakan bagian integral dan tidak terpisah dari Perjanjian Kredit ini.
6.2. Jumlah Pokok Hutang berikut bunga, provisi denda dan biaya-biaya lainnya yang terhutang oleh PEMINJAM kepada BANK berdasarkan Perjanjian Kredit ini wajib dilunasi seluruhnya oleh PEMINJAM kepada BANK (dan/atau pihak lain kepada siapa BANK telah menjual tagihannya terhadap PEMINJAM, selambat-lambatnya pada tanggal pelunasan (angsuran terakhir) yang disebut dalam Lampiran II pada Perjanjian Kredit ini.

6.3. Setiap jumlah yang wajib dibayar PEMINJAM pada BANK (dan/atau pihak lain kepada siapa BANK telah menjual tagihannya terhadap PEMINJAM) akan dibayar penuh dan tepat pada waktunya, bebas dari dan tanpa dikurangi dengan jumlah-jumlah apapun berupa pajak (bilamana dikenakan) atau piutang-piutang PEMINJAM (bila ada) terhadap BANK. Untuk itu PEMINJAM mengesampingkan haknya untuk melakukan perjumpaan hutang berdasarkan pasal 1425 dan 1426 Kitab Undang-Undang Hukum Perdata. PEMINJAM sebaliknya setuju bahwa BANK berhak melaksanakan kompensasi hutang terhadap PEMINJAM dari jumlah-jumlah yang terhutang oleh PEMINJAM kepada BANK setiap saat dan untuk itu mengesampingkan kewajiban BANK berdasarkan perjanjian-perjanjian yang berlaku terhadap deposito atau rekening PEMINJAM pada BANK.

Pasal 7

KUASA MENDEBET REKENING

7.1. PEMINJAM mengikat diri untuk pada hari penandatanganan Perjanjian Kredit ini membuka rekening pada BANK (bilamana PEMINJAM belum mempunyai rekening pada BANK), didalam rekening mana oleh BANK akan dicatat semua penerimaan uang, jumlah-jumlah yang terhutang dan pembayaran-pembayaran yang diakukan oleh PEMINJAM berdasarkan Perjanjian Kredit termasuk jumlah uang yang ditarik berdasarkan Perjanjian Kredit ini dan dibayarkan pada Penjual, jumlah-jumlah bunga dan lain-lain jumlah uang yang harus dibayar oleh PEMINJAM pada BANK berdasarkan Perjanjian Kredit ini.

7.2. PEMINJAM wajib menyediakan dalam rekeningnya tepat pada waktu uang yang wajib dibayar oleh PEMINJAM pada BANK dari waktu ke waktu sesuai jadwal pembayaran kembali yang disetujui dalam pasal 6.

7.3. PEMINJAM dengan ini memberi kuasa khusus dan wewenang penuh pada BANK untuk setiap waktu dan dari waktu ke waktu yang ditetapkan oleh BANK sesuai Perjanjian Kredit untuk mendebet dan membebani rekening PEMINJAM pada BANK, baik rekening/account giro/rekening tabungan dan/atau rekening/ account lain apapun dengan jumlah-jumlah yang dari waktu ke waktu terhutang dan wajib dibayar oleh PEMINJAM pada BANK yang besarnya
setiap kali akan ditetapkan oleh BANK (berdasarkan buku-buku dan catatan BANK) sesuai 
Perjanjian Kredit ini dan untuk menggunakan jumlah uang yang didebetkan tersebut untuk 
membayar jumlah uang yang pada saatnya terhutang dan wajib dibayar oleh PEMINJAM 
kepada BANK berdasarkan Perjanjian Kredit, perjanjia-perjanjian jaminan, baik untuk jumlah 
Pokok Hutang, bunga atau lain-lain jumlah uang yang wajib dibayar oleh PEMINJAM kepada 
BANK. Wewenang dan kuasa yang diberikan oleh PEMINJAM ini tetap berlaku pula, tanpa 
batas untuk kepentingan para pihak yang membeli tagihan-tagihan BANK terhadap 
PEMINJAM. BANK (dan/atau pihak lain kepada siapa BANK telah menjual tagihannya 
berdasarkan tagihan ini dengan ini juga diberikan kuasa mutlak oleh PEMINJAM untuk melakukan tagihan 
berdasarkan perjanjian kredit ini dengan ini juga diberikan kuasa mutlak oleh PEMINJAM untuk melakukan tagihan 
terhadap bank-bank lain yang membuka rekening apapun atas nama PEMINJAM dan dengan 
inimemberi wewenang dan kuasa pada (i) bank-bank lain untuk membayar hutang-hutang 
PEMINJAM berdasarkan perjanjian kredit; (ii) BANK (dan/atau pihak lain kepada siapa BANK 
telah menjual tagihannya terhadap PEMINJAM) untuk memberitahu pemberian wewenang 
itu pada bank-bank lain.

Pasal 8

PERNYATAAN-PERNYATAAN PEMINJAM

PEMINJAM bersama ini menyatakan dan menjamin mengenai:

(a) PEMINJAM mempunyai wewenang bertindak dalam hukum dan tidak akan dicabut 
kewenangan bertindak dalam hukum:

   - PEMINJAM (bila menikah dan tidak membuat Perjanjian Kawin) 10): telah mendapat 
     persetujuan dari suami/isteri PEMINJAM yaitu dengan suami/istri turut menandatangani 
     Perjanjian Kredit ini atau berdasarkan surat persetujuan yang dilampirkan pada Perjanjiaann 
     Kredit ini (persetujuan mana merupakan bagian yang tidak terpisahkan dari Perjanjian 
     Kredit ini).

(b). PEMINJAM telah menyerahkan kepada BANK:

   - Dalam hal pasangan kawin tidak turut menandatangani Perjanjian Kredit asli persetujuan 
     suami isteri bermeterai cukup serta copy akta nikah, keduanya dilegalisir notaris terlampir 
     sebagai Lampiran IX pada Perjanjian Kredit ini.

(c). PEMINJAM menjamin bahwa ia telah menyetor kepada Penjual, uang muka pembelian 
Tanah dan Bangunan sebesar ...... % dari harga pembelian Tanah dan Bangunan 
sebagaimana ternyata dalam tagihannya terhadap PEMINJAM, akta Pengakuan Hutang 
Murni dalam bentuk akta notaril;

   (7) membayar segala pajak terhutang termasuk pajak-pajak atas Tanah dan Bangunan 
   dan semua kewajiban-kewajiban pembayaran lain tepat pada waktunya; dan
(8) memperbaharui asuransi dan membayar segera premi-premi asuransi.

(II). PEMINJAM tanpa persetujuan tertulis dari BANK terlebih dahulu tidak akan:

1. menjual Tanah dan Bangunan;
2. menyewakan Tanah dan Bangunan atau secara lain memberi hak pada pihak lain untuk menempati Tanah dan Bangunan atau bilamana Tanah dan Bangunan dengan ijin BANK telah disewakan, merubah syarat-syaratnya;
3. membebani Tanah dan Bangunan dengan Hak Tanggungan berperingkat kedua dan seterusnya untuk kepentingan pihak lain; dan
4. mengikat diri sebagai penanggung/penjamin terhadap pihak lain;

Pasal 10
JAMINAN KREDIT

10.1. Untuk menjamin lebih jauh pembayaran kembali dengan tertib dan secara sebagaimana mestinya setiap Hutang (sebagaimana dirinci dalam pasal 6.2. di atas) yang terhutang dan wajib dibayar oleh PEMINJAM kepada BANK baik yang saat ini ada maupun yang timbul di kemudian hari baik berdasarkan Perjanjian Kredit ini maupun perjanjian-perjanjian jaminan terkait, PEMINJAM dengan ini:

(i) setuju memberikan hak tanggungan terdaftar atas Tanah dan Bangunan.
Untuk itu PEMINJAM setuju dan wajib tanpa mengurangi kewajiban PEMINJAM untuk menanda-tangani Akta Pembebasan Hak Tanggungan setiap saat dikenakan di kemudian hari dan diwajibkan oleh BANK [atau memberikan pada BANK Surat Kuasa Membebankan Hak Tanggungan (SKMHT) dalam bentuk yang ditetapkan BANK dalam hal Tanah belum dikeluarkan];

(ii) PEMINJAM dengan ini memindahkan dan mencedeer pada BANK sebagai jaminan hutangnya dalam suatu Akta Jaminan Fidusia tersendiri yang akan dibuat oleh para pihak atas:
(a) semua tagihan, hak, wewenang dan klaim uang ganti rugi asuransi yang timbul berdasarkan polis asuransi kerugian dan asuransi jiwa yang sekarang telah ada dan dikemudian hari akan dimiliki/ dipunyai dan diperoleh PEMINJAM terhadap perusahaan asuransi siapapun, mengenai kejadian apapun mengenai;
   (i) Bangunan dan turutanya milik/kepunyaan PEMINJAM yang terletak di setempat dikenal sebagai Jalan.................................................. yang didirikan di atas bidang tanah yang dibeli PEMINJAM dari Penjual;
(ii) diri PEMINJAM terhadap bahaya/risiko kecelakaan, kematian dan bahaya/risiko lain yang dapat ditentukan oleh BANK;
(b) segala tagihan-tagihan terhadap Pemerintah Pusat maupun Daerah yang timbul bilamana hak PEMINJAM atas Tanah suatu saat diputuskan/diakhiri sebelum batas waktunya berakhir,
(c) sebagian dari gaji PEMINJAM pada tiap-tiap bulan yang besarnya ....... bagian dari gaji bulanan PEMINJAM atau sebesar Rp................. ; dan
(d) tagihan uang pesangon, uang jasa dan imbalan kerugian terhadap perusahaan dimana PEMINJAM bekerja, bilamana PEMINJAM berhenti bekerja dan memperoleh manfaat atas Dana Pensiun.

10.2. BANK (dan/atau pihak lain kepada siapa BANK telah menjual tagihannya terhadap PEMINJAM) berhak dan berwenang setiap saat menjalankan hak dan wewenangnya atas jaminan yang disebut pada ketentuan-ketentuan di atas (dalam hal terjadi sesuatu kelalaian tersebut dalam Pasal 12).

Pasal 11
ASURANSI

11.1 PEMINJAM berkewajiban untuk menutup dan mempertahankan selama masa Perjanjian Kredit:
(i) asuransi jiwa atas diri PEMINJAM; dan
(ii) asuransi kerugian atas Bangunan terhadap bahaya-bahaya kebakaran, pencurian dan malapetaka lain yang dianggap perlu oleh BANK;

untuk suatu jumlah pertanggungan yang dipandang cukup oleh dan dengan syarat-syarat yang dianggap baik oleh BANK pada perusahaan asuransi yang ditunjuk oleh BANK, dengan ketentuan surat polis asuransi-asuransi yang bersangkutan memuat Banker’s Clause guna kepentingan BANK (dan/atau pihak lain kepada siapa BANK telah menjual tagihannya terhadap PEMINJAM) dengan kewajiban menyerahkan asli polis tersebut dan asli kwitansi premi kepada BANK untuk disimpan oleh BANK.

PEMINJAM wajib membayar premi tepat pada waktunya. Polis wajib diperpanjang sebelum masa berakhirnya dan PEMINJAM wajib menyerahkan bukti perpanjangannya pada BANK.

- Bilamana PEMINJAM lalai menutup asuransi, BANK berhak dan dikuasakan dengan ini untuk menutup asuransi-asuransi itu atas beban PEMINJAM.

11.2 Dalam hal terjadi kejadian Kelalain dan/atau kejadian yang menimbulkan kewajiban pembayaran pada perusahaan asuransi, uang asuransi menjadi hak BANK (dan/atau pihak
lain kepada siapa BANK telah menjual tagihannya terhadap PEMINJAM) (hal mana untuk asuransi kebakaran sesuai ketentuan pasal 297 Kitab Undang-Undang Hukum Dagang) dan BANK (dan/atau pihak lain kepada siapa BANK telah menjual tagihannya terhadap PEMINJAM) berhak dan dengan ini diberi kuasa untuk menerima seluruh atau sebagian uang asuransi itu guna pembayaran Hutang PEMINJAM satu dan lain dengan ketentuan, bahwa jika jumlah uang ganti rugi asuransi tidak mencukupi untuk membayar jumlah Hutang PEMINJAM, maka PEMINJAM berkewajiban untuk membayar sisanya, sedangkan jika jumlah uang ganti rugi asuransi melebihi jumlah Hutang PEMINJAM maka BANK (dan/atau pihak lain kepada siapa BANK telah menjual tagihannya terhadap PEMINJAM) berkewajiban untuk mengembalikan sisanya kepada PEMINJAM.

Pasal 12

KELALAIAN

Menyimpang dari apa yang ditentukan dalam Pasal 6.1. dan 6.2. di atas, BANK berhak untuk menuntut/menagih pembayaran seluruh Hutang sebagaimana didefinisi dalam Pasal 1 yang terhutang oleh PEMINJAM kepada BANK dengan seketika dan sekaligus dan PEMINJAM wajib membayar lunas Hutang tanpa diperlukan somasi/teguran, sehingga dengan surat juru sita atau surat lainnya yang sejenis untuk itu tidak diperlukan lagi, bilamana terjadi salah satu hal atau peristiwa dibawah ini:

(a). bilamana suatu Angsuran atau bunga atau lain-lain jumlah uang yang terhutang, tidak dibayar lunas pada waktunya dan dengan cara sebagaimana ditentukan dalam Perjanjian Kredit, dalam hal mana lewatnya waktu saja telah memberi bukti yang cukup dan sah bahwa PEMINJAM telah melalaikan kewajibannya;

(b). bilamana PEMINJAM lalai memenuhi atau melanggar salah satu ketentuan-ketentuan lainnya dari pada kewajiban pembayarannya dalam Perjanjian Kredit dan/atau yang termaktub dalam perjanjian-perjanjian jaminan apapun yang dibuat berkenaan dengan Perjanjian Kredit yang dianggap material oleh BANK.

(c). bilamana suatu pernyataan, keterangan atau dokumen yang diberikan sehubungan dengan Perjanjian Kredit dan/atau perjanjian-perjanjian jaminan ternyata tidak benar, atau diketahui kemudian bahwa sesuatu hal yang oleh BANK dianggap penting dalam mengambi keputusan memberikan kredit ini tidak diungkapkan oleh PEMINJAM;

(d). apabila menurut pertimbangan BANK keadaan keuangan, bonafiditas dan solvabilitas PEMINJAM mundur sedemikian rupa sehingga PEMINJAM mungkin tidak dapat membayar hutangnya lagi;

(e). bilamana PEMINJAM dan/atau pihak lain mengajukan permohonan agar PEMINJAM dinyatakan pailit kepada Pengadilan atau PEMINJAM mengadakan permohonan penundaan
pembayaran hutang-hutang (Surseance van Betaling) atau bilamana karena sebab apapun PEMINJAM tidak berhak lagi mengurus dan menguasai kekayaannya;

(f). bilamana PEMINJAM meninggal dunia atau dinyatakan berada dibawah pengampuan (Onder Curatele Gesteld);

(g). bilamana teijadi suatu bahaya terhadap Bangunan yang diasuransikan dan mewajibkan perusahaan asuransi membayar kerugiannya;

(h). bilamana kekayaan PEMINJAM seluruhnya atau sebagian disita oleh Pengadilan atau Kantor Pajak;

(i) bilamana PEMINJAM telah lalai membayar hutang yang jatuh waktu atau melanggar atau tidak memenuhi sesuatu ketentuan dalam suatu perjanjian dengan pihak lain dan pelanggaran tersebut mengakibatkan atau memberikan hak kepada pihak lain untuk menagih kembali uang terhutang dengan seketalika dan sekaligus sebelum tanggal jatuh waktu pembayaran yang telah ditentukan atau bilamana karena pelanggaran dari perjanjian yang dijamin PEMINJAM, PEMINJAM wajib membayar hutang dijamin;

(j) bilamana hak PEMINJAM atas Tanah berakhir karena sebab apapun termasuk bilamana hak atas Tanah diakhiri sebelum waktunya;

(k). bilamana Hak Tanggungan Pertama atas Tanah dan Bangunan terdaftar atas nama BANK (dan/atau pihak lain kepada siapa BANK telah menjual tagihannya terhadap PEMINJAM) atau Jaminan Fidusia atas asuransi kerugian dari Bangunan atas asuransi jiwa PEMINJAM dan atas sebagian gaji PEMINJAM berakhir karena sebab apapun atau tidak dapat dilaksanakan karena sebab apapun.

(l). suatu kejadian kelaialan atau suatu kejadian yang dengan lewatnya waktu atau pemberitahuan atau kedua-duanya akan menjadi kejadian kelalaian sebagaimana dimaksud dalam Pasal 12 diatas.

Pasal 13

CESSIE/SUBROGASI/NOVASI KREDITUR

13.1. Dalam ranqka usaha PEMINJAM untuk mendapatkan pembayaran untuk kredit perumahan ini PEMINJAM setuju bahwa dapat digantikan kedudukannya oleh pihak lain dengan menjual tagihan-tagihan BANK terhadap Debitur dan/atau subrogasi dan/atau novasi kreditur dari Perjanjian Kredit ini.

13.2. Bilamana Bank digantikan kedudukannya oleh pihak lain dengan menjual tagihan (cessie), maka PEMINJAM melepaskan haknya berdasarkan pasal 613 ayat 2 Kitab Undang-undang Hukum Perdata untuk diberitahu oleh juru sita dan dengan pemberitahuan khusus pada PEMINJAM mengenai adanya cessie.
PEMINJAM setuju BANK melakukan pemberitahuan terjadinya cessie, dengan pengumuman cessie umum mengenai portfolio yang memuat perjanjian kredit ini di kantor-kantor Pusat BANK dan kantor-kantor cabang BANK atau dengan cara lain yang ditentukan oleh BANK.

13.3. PEMINJAM menegaskan mengetahui dan setuju bahwa pihak yang menggantikan BANK memperoleh dan dapat manfaat dari segala hak dan hak jaminan yang melekat pada tagihan tanpa kecuali termasuk tanpa pembatasan Hak Tanggungan, jaminan fidusia barang bergerak berwujud dan tidak berwujud termasuk atas uang asuransi kebakaran dan/atau uang asuransi jiwa serta atas sebagian dari gaji PEMINJAM, hak untuk menyimpan atau menunjuk pihak lain menyimpan segala dokumentasi Hutang dan Jaminan, hak sebagai kreditur berdasarkan Pengakuan Hutang sebagaimana disebut dalam Pasal 5.2., hak pembuktian dalam Pasal 5.5., hak menagih bunga, denda, meningkatkan bunga sesuai ketentuan dalam Pasal 4 di atas, hak untuk minta BANK agar mendebet rekening PEMINJAM untuk pembayaran Angsuran sesuai Pasal 7.3. di atas, hak untuk mengambil dana dari lain bank dengan siapa PEMINJAM membuka rekening, hak atas pelepasan hak kompensasi oleh PEMINJAM seperti diatur dalam Pasal 6.3. di atas serta hak untuk menyatakan kealpaan PEMINJAM sesuai pasal 12 di atas

13.4. PEMINJAM memberi kuasa dan persetujuan sepenuhnya kepada BANK (dengan hak substitusi) untuk:
   (i). melakukan segala tindakan perlu dan berguna (bilamana perlu) untuk mengalihkan Perjanjian Kredit berikut semua hak dan kewajiban yang timbul dari padanya serta untuk menjual/menjaminkan tagihan BANK terhadap PEMINJAM yang timbul berdasarkan akta ini kepada Pihak lain dan/atau mengadakan subrogasi dan/atau novasi kreditur;
   (ii). menyatakan dan memberitahu pada pihak berkepentingan bahwa PEMINJAM mengakui dan menerima cessie atas tagihan BANK terhadap PEMINJAM yang timbul berdasarkan Perjanjian Kredit ini oleh pembeli tagihan;
   (iii). mengungkap data-data keuangan dan lain-lain mengenai PEMINJAM pada calon Pembeli bilamana pembeli tagihan hendak menjual lagi tagihan terhadap PEMINJAM,
   (iv). menyerahkan segala dokumentasi mengenai tagihan pada pembeli atau pihak yang ditunjuk pembeli;
   (v). memecah tagihan-tagihan BANK terhadap PEMINJAM sedemikian hingga timbul tagihan dari multi-kreditur secara tanggung renteng dalam rangka sekuritisasi tagihan-tagihan,
demi kepentingan pembeli untuk memperoleh pembiayaan, asal saja tidak menyebabkan beban tambah untuk PEMINJAM;

pada umumnya Bank dan pembeli tagihan dikuasakan untuk melakukan segala tindakan tanpa kecuali untuk mencapai tujuan tersebut di atas serta menentukan syarat-syarat mengenai tagihannya terhadap PEMINJAM yang dianggapnya perlu dalam mengadakan sekuritisasi tagihan-tagihan BANK.

Pasal 14
KETENTUAN PENUTUP

14.1. Semua dan setiap kuasa yang diberikan oleh PEMINJAM kepada BANK (dan/atau pihak lain kepada siapa BANK telah menjual tagihannya terhadap PEMINJAM) berdasarkan Perjanjian Kredit merupakan bagian yang terpenting dan tidak dapat dipisahkan dari Perjanjian Kredit, yang tanpa adanya kuasa-kuasa itu Perjanjian Kredit tidak akan dibuat dan dengan demikian maka kuasa-kuasa tersebut tidak dapat ditarik kembali dan juga tidak akan berakhir karena sebab-sebab apapun juga, termasuk tetapi tidak terbatas pada sebab-sebab yang termaktub dalam pasal 1813,1814 dan 1816 Kitab Undang-Undang Hukum Perdata Indonesia, selama masih ada kewajiban PEMINJAM yang terhutang terhadap BANK (dan/atau pihak lain kepada siapa BANK telah menjual tagihannya terhadap PEMINJAM) dan setiap kuasa tersebut diberikan dengan hak substitusi atau hak untuk mengalihkan kuasa.

14.2. Perjanjian Kredit berlaku dan mengikat terhadap PEMINJAM dan BANK dan/atau pihak lain kepada siapa BANK telah menjual tagihannya terhadap PEMINJAM dan tidak dapat diubah, diperbaharui kecuali (ditentukan lain dalam Perjanjian Kredit ini) dengan suatu perjanjian perubahan atau pembaharuan yang ditandatangani oleh para pihak dalam Perjanjian Kredit ini.

14.3. PEMINJAM tidak dapat mengalihkan segala hak dan kewajibannya berdasarkan Perjanjian Kredit kepada pihak lain tanpa persetujuan tertulis terlebih dahulu dari BANK (dan/atau pihak lain kepada siapa BANK telah menjual tagihannya terhadap PEMINJAM).

14.4. Apabila karena satu dan lain hal biaya-biaya yang timbul sehubungan dengan Perjanjian Kredit dibayarkan lebih dahulu oleh BANK, maka PEMINJAM mengakui biaya-biaya tersebut sebagai hutangnya dan wajib melunasinya kepada BANK kecuali diatur lain dalam Perjanjian Kredit.
14.5. Mengenai Perjanjian Kredit, PEMINJAM dengan ini melepaskan ketentuan pasal 1266 Kitab Undang-Undang Hukum Perdata Indonesia.

Pasal 15

BIAYA-BIAYA

Semua biaya dan ongkos yang timbul untuk menyiapkan, menanda-tangani serta untuk melaksanakan Perjanjian Kredit ini termasuk tanpa pembatasan biaya hukum, biaya notaris, biaya perkara dan biaya pengacara yang ditunajuk untuk melakukan penagihan terhadap PEMINJAM, dipikul dan dibayar oleh PEMINJAM. Biaya yang timbul sebelum penarikan Pokok Hutang akan dipotong dari dana-dana yang ditarik oleh PEMINJAM.

Pasal 16

DOMISILI

- Mengenai Perjanjian Kredit ini dan segala akibatnya PEMINJAM memilih tempat kedudukan hukum yang tetap dan seumumnya di Kantor Kepaniteraan Pengadilan Negeri ……………………… di ………………….. namun dengan tidak mengurangi hak dan wewenang BANK (dan/atau pihak lain yang memperoleh hak tagihan BANK terhadap PEMINJAM) untuk memohon pelaksanaan (eksekusi) atau mengajukan tuntutan/gugatan hukum terhadap PEMINJAM berdasarkan Perjanjian Kredit dimuka pengadilan lain yang berwenang dalam wilayah Republik Indonesia.

- Para penghadap saya, Notaris kenal.

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1 See the discussion in World Development Report, 2001.
2 See, for example, Hongyi Li, Lyn Squire, and Heng-fu Zou, 1997; David Dollar and Aart Kraay, 2000.
3 See the report by BI “Credit Crunch in the Aftermath of the Crisis”. This issue is discussed in section 2.0.
4 See the HOMI Report “Effective Demand for Low Cost Housing” for complete information on income and affordability.
5 See the HOMI Report “Housing Subsidy Instruments for Homeowner Assistance”.
7 See World Bank, October 2000.
8 Even pre-Krismon, Indonesia has one of the weaker and thinnest bond markets in the East Asia region.
See Mahoney and Zorn, who initially developed the convenient Three Cs concept.

See Bruce Bargon.

A FICO score derives its name from the analyses carried out by the Fair Isaacs company. FICO scores are widely used in the U.S., increasingly in other developed systems, and are now being introduced in emerging markets.

As examples, Trans Union is operating in Thailand, South Korea, the U.S., and Spain. Data Advantage operates in Australia. Experian and Equifax operate in the U.S., U.K., Europe, Canada, and Latin America.

See Bargon, op. cit.

As reported in Bargon, op. cit., an analysis of small business credit was conducted by BI, which provided statistics on cooperative credits (Credit KUK) in June 2000. Of a total of Rp. 40,144 billion in loans, nearly 70 percent were less than Rp. 25 million, and another 7.4 percent from 25 to 50 million. Thus, none would have come under the DIS.

This assessment is based on discussions by Sally Merrill with Mr. Michael Ryan at ADB (24/10.01).

Fannie Mae’s Desktop Underwriter is available on a Fannie Mae website designed for its member banks. The URL for the website is www.efannie.com.

Also, Erica Soeroto has printed copies.

Mortgage default is a topic that has been addressed at length in the U.S. by practitioners, the secondary mortgage market institutions, and academics. Review articles which provide a background of the literature include: Stephen Ross, Mortgage Lending, Sample Selection, and Default, Real Estate Economics, V28, 2000; Robert Quercia and Michael Stegman, “Residential Mortgage Default: A Review of the Literature”, Journal of Housing Research, Volume 3, Issue 2.

See, for example, Pallia, “The Potential of Scoring in International Mortgage Lending”.

See Douglas Whiteley, “...”.

Note: RIB is Reglement Indonesia yang Dibaharui, a Law adopted from Dutch Law.

The standardization effort has been organized and let by Erica Soeroto. The credit agreement was prepared by Mrs. K. Santosos.

Please note that a full report on mortgage insurance has been prepared under the HOMI Project, and that it is one of the key new subsidy policies being proposed. See “Mortgage Insurance Feasibility Analysis” and “Housing Subsidy Instruments for Home-Owner Assistance Program”.

See Sally Merrill, Ken Temkin, and Claudio Pardo, all in the March 2001 issue of Housing Finance International for a discussion of the U.S., South Africa, and Chile.

As noted, please refer to the HOMI Special Report “Mortgage Insurance Feasibility Analysis”.

The commentary on alternative mortgage loan products is based, in part, on conversations with, and articles by, Professor Jack Guttentag, who has consulted in Indonesia and is familiar with the lending characteristics. The “Mortgage Professor’s Web Site”, developed by Prof. Guttentag, can be accessed at www.mtgprofessor.com.

Software programs exist in the U.S. to model a wide variety of loan products.

There are numerous articles by both practitioners and academics on alternative loan products, risk-based pricing, the default probabilities of different products and terms. We have listed a few in the bibliography. See for example, the monthly publication by Freddie Mac, “secondary Mortgage Markets.; Mahoney and Zorn, 1996, Kling, 1997, Straka, 2000, Quercia and Stegman.

Note the BRI already uses this incentive payment strategy.


See Hirad and Zorn, “A Little Knowledge is a Good thing: Empirical Evidence of the Effectiveness of Pre-Purchase Counseling, and Alan Mallach, “Home Ownership Education and Counseling”.

See for example, Nothaft and Surette, 2000, “The Industrial Structure of Affordable Mortgage Lending”.

Housing microfinance is now being supported and studied by donors, including USAID, IADB, and the World Bank, by research groups and NGOs in both merging markets and Western nations.

See Merrill, and ..........Harvard, “Housing Microfinance Initiatives”, the Center for Urban Development Studies”, where an explicit differentiation is made in the origins of micro lending for housing between shelter advocacy groups and microenterprise lenders.

See Ferguson and Haider (2000) for a discussion of funding the incremental building process.

See GTZ op. cit.; Richard Patten, get reference for Marguerite Robinson.

GTZ, page 57 BRI chapter

The data are either for 1999 or 2000, depending on the group.

In fact, Richard Patten suggests that BRI’s large corporate loans may be, in effect, be subsidized by BRI’s small savers. See Richard H. Patten, “The East Asia Crisis and Micro Finance: The Case of Bank Rakyat Indonesia through June 1999”, Jakarta, July 1999.

The detrimental impact of the KPR/RSS program in this regard, has already been noted by the HOMI team in a number of reports.

GTZ, page 37.

The IADB is in the process of publishing a book documenting MFH worldwide, including MFH in selected Asian and African countries. See Sally Merrill, “......”, forthcoming.

For a thorough discussion of this issue, see Bertrand Renaud, 1997 and 1998.

See William Handorf, “The Regulation and Supervision of Housing Finance”.

See Michael Lea et. al., “The Risks of Commercial Lending”. Commercial lending, is
indeed, generally more risky than residential.

A Workshop was held in May 2001 on the potential role of IFSI, and worldwide examples of the supervisory function. Ernst and Young and FISEK conducted the Workshop.

Various GOI Task Forces, as well as a series of donor-sponsored studies have support this effort. See Michael Lee and et al

The main difference between an SMF and SMM is that an SMM provides off-balance sheet funding, which assists bank CAR, whereas, in an SMF, at least in the initial stages, the loans remain on the balance sheet. However, as discussed below, the requirements for development of an SMM are far more complex and inflexible.

For A summary article describing these efforts, see Michael Lea, Alex Pollock, and Jay Rosengard, in HFI, September 1997.

In fact, the FHLB accepts a wider variety of assets as collateral.

This is also true of the Cagamas model. Because the loans are “purchased” with full recourse, it does not enable lenders to benefit from capital relief through off-balance sheet treatment. See Loic Chiquier, 1999.

This effort in summarized in the Annex to this section.

See the memorandum “Purchase Without Recourse Basis” Cagamas Berhad, November 210, 2001, provided to Sally Merrill by the CEO of Cagamas, Mr. Kokolarupan.

See Michael Lee, Alex Pollock, and Jay Rosengard, in Housing Finance International, September 1997. Several changes and additions have been made to accord with changes in Indonesian laws or other concerns.

It is difficult to avoid an “implicit” guarantee, however. A perception that FHLB, for example, is “too big to fail” gives rise to an implicit guarantee.

This model was developed by HOMI consultant Soebowo Musa. It will need to be evaluated along with other bank model options.

HKMC has started another line of business, which is doing well. Mortgage insurance. Banks submitted their portfolios to HKMC, which then allocated the portfolios to the insurance companies. In this structure, HKMC took only a small administrative fee. Now HKMC is taking on 20% of the risk, and the other 80% is born by the insurance companies. Thus, the HKMC fee is now higher, and this is a profitable line of business, and also helps maintain their links with the banks.

The FHLB example is based on discussions with experts in the capital markets division of several Federal Home Loan Banks.

The hypothetical Indonesian SMF assumptions have been developed by HOMI consultant Pak Soebowo Musa.

HKMC has started another line of business, which is doing well. Mortgage insurance. Banks submitted their portfolios to HKMC, which then allocated the portfolios to the insurance companies. In this structure, HKMC took only a small administrative fee. Now HKMC is taking on 20% of the risk, and the other 80% is born by the insurance companies. Thus, the HKMC fee is now higher, and this is a profitable line of business, and also helps maintain their links with the banks.

See R. Thillainathan, Lea and Chiquier, and Chiquier for a thorough analysis of the Malaysian market and the role of Cagamas.

This table is adapted from data in Michael Lea, Alex Pollock, and Jay Rosengard in Housing Finance International, September 1997. Several changes and additions have been made to accord with changes in Indonesian laws or other concerns.

It is difficult to avoid an “implicit” guarantee, however. A perception that FHLB, for example, is “too big to fail” gives rise to an implicit guarantee.

This model was developed by HOMI consultant Soebowo Musa. It will need to be evaluated along with other bank model options.

See Michael Lea, 98

Cagamas was incorporated in 1986, following discussions among the Central Bank, Malaysian financial institutions, and a consultant from a U.S. financial institution. Cagamas commenced operations in 1987. It should also be noted that the development of HKMC was a lengthy process that absorbed the time and energy of a considerable number of experts and staff. Similarly, a U.S. consultant with many years experience in Fannie Mae served as a senior staff member for HKMC for over two years.

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# CHAPTER 6

STRENGTHENING THE EFFICIENCY OF THE LAND AND HOUSING MARKET

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CHAPTER 6

STRENGTHENING THE EFFICIENCY
OF THE LAND AND HOUSING MARKET

6.1 Introduction

6.1.1 The Goals of this Report

This report focuses on the regulatory issues and supply constraints in the land and housing markets that we believe to be most important, and most amenable to change in the short or medium term. The report addresses:

- Improvements in land titling and registration;
- Policies for stimulating land supply in order to reduce land prices;
- Policies for improving the management of location permits, and for the encouragement of good practice in local land offices;
- The important role of rental housing, particularly the issue of whether publicly-assisted rental housing should be promoted; and
- The effectiveness of income mix policies in the housing market.

This report is one of a series of HOMI Project Reports. Its focus on supply constraints is intended to complement the focus of other HOMI reports addressing the demand for housing, the housing finance sector, new subsidy policies for housing, and new institutional arrangements, both for addressing decentralization and for delivery of local subsidies. In addition, companion reports on Kasiba/Lisiba and development of low cost building technology in Indonesia augment the issues addressed here.

The major policy questions and supply-side issues the report seeks to address are the following:

- What are the major supply and regulatory constraints impacting the efficiency of the housing and land markets in Indonesia?
- What types of regulatory improvements and/or changes in implementation could be expected to have a meaningful impact on land titling, registration, and permitting?
- How can an increased supply of land be encouraged?
- How can low income rental housing be encouraged?
- What is the role of income mix policies in the housing market?
- Complementary policy issues addressed in the companion reports include?
- To what extent is implementation of Kasiba/Lisiba feasible and useful, especially for developing low cost housing?
- What building technologies can provide more affordable housing?
The Context for Analyzing Land and Housing. The context of our discussion of land and housing is dominated by a number of features of the urban landscape. Some are familiar and hardly unique to Indonesia – for example, relentless urbanization, rigidities in land supply, lack of housing affordability for a major proportion of the population, shortfalls in sanitation and convenient access to water supply, and so forth.

However, it must be stressed that two major new features of the Indonesian landscape are dominating the context and will do so for some time: (1) a slow and painful recovery from Krismon, especially for the construction and housing finance sectors, and (2) Indonesia’s ground-breaking push toward decentralization. The major contextual issues are summarized as follows:

- In the aftermath of Krismon, Indonesia continues to face major declines in housing production, construction finance, and residential mortgage finance. The shortfalls are especially severe when placed in context, as both construction and residential housing credit have fallen in real terms relative to GDP. Specifically:
  - The share of GDP generated by the construction sector fell from 8.2 percent of GDP in 1997 to 5.8 percent of GDP in 1999\textsuperscript{1}. This decline of nearly 30 percent far exceeds the fall in real GDP of 12.7 percent during this period;
  - The same “real” decline is seen in housing finance. Total KPR (unsubsidized and subsidized) fell from 2.83 percent of GDP in 1996 to 0.9 percent in 2000. More importantly, unsubsidized KPR, a better representation of the interplay of bank behavior and household demand, fell from
  - Construction finance is has come to a virtual standstill. Between 1996 and 2000, construction finance fell from Rp. 2639 million in 1996 to Rp. 196 in 2000, a fall from 0.5 percent of GDP to .015 percent of GDP. This has not only bankrupted numerous developers and contractors, but is likely to leave an unknown backlog of unmet demand\textsuperscript{2};
  - The banking sector is gripped by a severe “credit crunch” and extremely risk averse behavior. Total credit outstanding has fallen from 55 percent of GDP in 1996 to 20.8 percent in 2000. Nevertheless, the falls in residential, and especially construction credit, were relatively worse\textsuperscript{3}.

- Decentralization will have a major impact on the institutional delivery of housing and land policies. A major concern from the perspective of this report is the capacity of local governments to assume major responsibilities for land administration, including

\textsuperscript{1} See Michael Lindfield. The comparisons are made in constant 1993 Rupiah.
\textsuperscript{2} See the HOMI report “Improvements in the Housing Finance Sector”.
\textsuperscript{3} Again, see the HOMI Report on housing finance cited above, and also the BI report “Credit Crunch in Indonesia in the Aftermath of the Crisis”, 2001
land use planning and review of location permits. The ability to implement Kasiba/Lisiba is also called into question.⁴

- Continued urbanization, stemming from both urban growth and rural-to-urban migration will continue to define the dimensions of Indonesia’s housing needs. In fact, the strain in Jakarta has reached the point of Jakarta officials calling for closing access by outsiders to the city. Other large cities have voiced similar calls.

6.1.2 Strengths and Weaknesses in the Housing and Land Markets

An International Perspective on the Land, Housing, and Housing Finance Markets in Indonesia. In 1998, a comparative analysis on the functioning of the urban land market in some 50 countries was developed by an international housing and land economist, based on years of developing appropriate comparative indicators. He argued that policies influencing the supply of land and housing are critically important for the broader economy.⁵ His analysis listed right and wrong ways of approaching each of the seven broad policy areas involved in enabling housing markets to work (developing property rights; developing mortgage finance; rationalizing subsidies; providing infrastructure; regulating land and housing development; organizing the building industry; and developing a policy and institutional framework). Mayo constructed a crude index to measure the degree to which each of the 50 countries had successful enabling mechanisms in place. Indonesia was somewhere in the middle of the list, scoring a total of 43 points out of a maximum of 100 for its policies and practices in 1990.⁶ Indonesia scored relatively well for its policies on residential infrastructure, and property rights; and was above average for organization of the construction industry. It scored poorly, however, on the indices for housing finance, and for the regulation of land and housing development.

Although the data used in this international comparison are now a decade out of date, we find that the conclusions are remain both relevant and valid.

Strengths. Indeed, Indonesia’s residential infrastructure policies, especially through the KIP programs, have become worldwide models. Similarly, formal sector the construction industry, is large, privately owned, and highly competitive. Industry groups such as REI and APERSI support the goals of their members. Informal sector construction, which produces roughly eighty percent of the housing stock, continues to be noted as one of the more effective worldwide.⁷ Importantly, Indonesia is planning on undertaking a perhaps far-reaching reform of the Basic Agrarian Law, following on the heels of recent simplifications and improvements in land administration. Finally, the banking sector, although it has been badly damaged by Krismon, is now consolidated, re-capitalized, and reorganized. The sector is competitive and the Government is newly

⁴ See the HOMI reports on Kasiba/Lisiba.
⁶ This compared with scores of 44 for Malaysia, 46 for Singapore, 90 for the United States, and 95 for Australia.
resolved to supervise it prudently. Thus, although housing finance, as noted below, is far too limited in its reach, at least the sector has a restructured and competitive platform on which to grow.

**Weaknesses.** In too many instances, however, it is the regulations and/or implementation policies of the laws, as well as the complexity of the regulations, which have failed. Regulations are too often ignored, side-stepped, or rendered inefficient by outdated forms and lack of computerization. And unfortunately, the less the degree of transparency, the greater the opportunities for KKN. Also, as we have discussed in the HOMI Report on housing finance, the housing finance sector is far smaller than it should be and far too limited to very high income households. Both the housing and housing finance markets have been unduly constrained by the KPR-RSS/RS interest rate subsidy system. A “barrier” to downward expansion of housing finance was created.

In summary, we list below the strengths and weakness of the housing and land markets. We have also listed the strengths and weakness in the housing finance sector. Although these are the subject of the HOMI Report on housing finance, and note addressed in this report, the strength of housing credit is integral to our comments on the housing market. Our recommendations in this report follow from the areas we find lacking.

- **Major strengths of the Indonesian housing, land, and housing finance markets:**
  - **Housing:**
    - Although it has been badly shaken by Krismon, the private sector construction industry remains competitive, and is still the most efficient vehicle for housing construction. Support groups for a wide range of housing production via REI and APERSI;
    - Effective informal sector housing production skills and capacity;
    - Major progress in residential infrastructure in low income areas which supports and complements informal housing production;
  - **Land:**
    - A mandate from the National Assembly in October 2001 to reform the Basic Agrarian Law, many aspects of which have long been studied and discussed;
    - This mandate follows on the heels of the major Land Administration Project (LAP), whose very extensive analyses have yielded a detailed body of recommendations;

---

8 The HOMI project has reviewed the LAP-C work and included in this report those of its numerous recommendations germane to the topics we cover here.
- One of the more important results of the LAP is an increase since 1994 of 1.25 million in the number of households holding registered title;
- Recent simplifications in land regulation, administration, and increased computerization, all carried out by BPN;

- **Housing Finance**

- A highly competitive, commercially oriented banking sector, jockeying for position in providing housing finance (competition inevitably increases efficiency);
- An important network of regional lenders and microfinance institutions, which could potentially be increasingly important in extending housing finance to moderate and modest income households;

- **Major weaknesses in the housing, land, and housing finance markets:**

- **Housing**

- The KPR/RSS system has placed an artificial “floor” in the market, causing a far too rigid and expensive definition of low cost housing and low cost building technology;
- As far as we can determine, the 6/3/1 rule is neither enforced nor monitored in the vast majority of cases. If social and income mix are to be sought in housing, national and local governments will need to be more proactive; a flexible interpretation is permitted under the law, and more realistic solutions should be sought;
- Housing can be, and should be, constructed entirely by the private sector;
- There has been insufficient emphasis on rental housing, especially in light of the density considerations caused by the urban inflow. Worldwide, however, publicly-sponsored rental housing has suffered from poor management and insufficient maintenance policies, so the Indonesia is forewarned to follow lessons learned;

- **Land**

- Land supply is constrained in a number of important ways: much of it is not “legally” available, as it is locked into location permits, held by IBRA while that agency continues with its restructuring and asset disposition task;
- Location permits must be more effectively monitored, and lapsed permits, or those for which no activity is proceeding, should be reviewed with an aim to release land onto the market;
- Although many reforms have already been undertaken — in practice — it appears that titling and permitting are still more time-consuming, costly, and uncertain than would be expected by the regulations (which thereby implicates KKN).
Housing Finance

The gap in the availability of housing finance to a large group of “bankable” households is far larger than it needs to be. Lending has barely extended to those who need loans of less than Rp. 50 or 100 million;

There are many, many households who can benefit from loans of less than Rp. 25 million, or less than Rp. 10 million. New loan products, new approaches to underwriting, shorter terms, and credit enhancements should be developed to expand the availability of credit;

The risks inherent in the current conduct of housing finance are excessive, which results in higher loan prices as well as inhibiting growth of the sector. Both credit risk and legal risk stem variously from lack of automation, lack of information such as from a Credit Bureau, ineffective foreclosure policies, and other factors;

Finally, as the banks, and thus mortgage lending, recover from Krismon, access to long-term funds will become increasingly important.

In conclusion, taken together, these problems increase costs, increase delays, deny access, etc. and thereby increase cost, reduce affordability. Most crucially, if the supply of serviced and titled land is plagued with rigidities, it is much less responsive than it should be. Thus, renewed housing demand will simply result in prices that are higher than would be the case if the barriers were reduced.

6.2. The Land and Housing Markets In Indonesia

6.2.1 Overview of the Housing Market

Indonesia’s housing sector remains characterized by two key characteristics: it is a nation of homeowner households and the overwhelming majority of households produce their own housing. In addition, however, fairly significant differences exist between urban and rural areas. Tables 2.1 through 2.4 provide a brief statistical overview of Indonesia’s housing market: the tenure status in urban and rural areas, the method of housing development, the quality of the drinking water, access to drinking water, and the method of solid waste management. The data are drawn from the BPS 1998 special survey for housing. Especially important for the issues discussed in this report are the following:

- the very much greater importance of rental housing in urban areas;
- also, the much higher proportion in urban areas of developer-built housing and housing purchased on the secondary market – both of which generally require a mortgage loan and therefore adequate title;
- the generally adequate quality of drinking water in both urban and rural areas; and
- the more difficult access to drinking water in rural areas and the ongoing difficulties in solid waste management, in both urban and rural areas. Both of these facts support the importance of KIP/infrastructure programs, as well as housing support per se.
Table 2.1 Households by Tenure Status, 1998

<table>
<thead>
<tr>
<th>Urban/Rural</th>
<th>Own</th>
<th>Rent/Lease</th>
<th>Official</th>
<th>Other</th>
<th>Total %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban</td>
<td>71.0%</td>
<td>22.9%</td>
<td>3.9%</td>
<td>2.7%</td>
<td>100%</td>
</tr>
<tr>
<td>Rural</td>
<td>91.2%</td>
<td>5.2%</td>
<td>1.6%</td>
<td>2.0%</td>
<td>100%</td>
</tr>
<tr>
<td>National</td>
<td>63.7%</td>
<td>11.8%</td>
<td>2.3%</td>
<td>2.3%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: BPS, National Social Economic Survey, 1998, the Housing Module

*This category includes rent, rent free, lease, and lease (real meaning).

Table 2.2 Households by Method of Ownership, 1998

<table>
<thead>
<tr>
<th>Urban/Rural</th>
<th>Developer</th>
<th>Self build</th>
<th>Purchase from Individual</th>
<th>Purchase Second Hand House</th>
<th>Other</th>
<th>Total %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban</td>
<td>5.8%</td>
<td>73.3%</td>
<td>1.9%</td>
<td>7.7%</td>
<td>11.3%</td>
<td>100%</td>
</tr>
<tr>
<td>Rural</td>
<td>6.9%</td>
<td>83.9%</td>
<td>0.7%</td>
<td>3.4%</td>
<td>11.5%</td>
<td>100%</td>
</tr>
<tr>
<td>Total</td>
<td>2.4%</td>
<td>80.2%</td>
<td>1.1%</td>
<td>4.8%</td>
<td>11.4%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: BPS, National Social Economic Survey, 1998, the Housing Module

Table 2.3 Quality and Access to Drinking Water

<table>
<thead>
<tr>
<th>Urban/Rural</th>
<th>Quality of Drinking Water (percent)</th>
<th>Distance to Water Source (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Good</td>
<td>Bad</td>
</tr>
<tr>
<td>Urban</td>
<td>93%</td>
<td>7%</td>
</tr>
<tr>
<td>Rural</td>
<td>88%</td>
<td>12%</td>
</tr>
<tr>
<td>National</td>
<td>90%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: BPS, National Social Economic Survey, 1998, the Housing Module

Table 2.4 Solid Waste Management

<table>
<thead>
<tr>
<th>Urban/Rural</th>
<th>Carried Away</th>
<th>Dumped</th>
<th>Composted</th>
<th>Burned</th>
<th>Thrown Away/Other*</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban</td>
<td>46%</td>
<td>8%</td>
<td>2%</td>
<td>32%</td>
<td>12%</td>
<td>100%</td>
</tr>
<tr>
<td>Rural</td>
<td>1%</td>
<td>15%</td>
<td>6%</td>
<td>48%</td>
<td>30%</td>
<td>100%</td>
</tr>
<tr>
<td>National</td>
<td>18%</td>
<td>12%</td>
<td>5%</td>
<td>42%</td>
<td>23%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: BPS, National Social Economic Survey, 1998, the Housing Module

*Thrown into river, thrown anywhere, other.

Recent Developments in the Housing Market. As discussed in the introduction, an active and competitive developer/contractor industry is a key strength of Indonesia's housing...
market. Statistics describing total production of housing by the private sector — formal or informal — are not available. Total housing production of housing by Perumnas, however, is provided in Table 2.5. Table 2.6 disaggregates total Perumnas sales between 1995 and 2000 by type of housing: RSS, two size categories of RS housing, and flats. Note that RSS housing has dominated Perumnas sales, while flats have accounted for only 2.6 percent of sales over the last 5 years.

Table 2.5: Housing Sales by Perumnas: 1995 – 2000

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>27,195</td>
<td>35,230</td>
<td>47,680</td>
<td>15,823</td>
<td>12,404</td>
<td>8,998</td>
<td>147,330</td>
</tr>
<tr>
<td>%</td>
<td>18.5%</td>
<td>23.9%</td>
<td>32.4%</td>
<td>10.7%</td>
<td>8.4%</td>
<td>6.1%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Perum Perumnas, Division of Data and Information

Table 2.6: Perumnas Housing Sales by Type of Housing: 1995 – 2000

<table>
<thead>
<tr>
<th>Type</th>
<th>RSS</th>
<th>RS&lt; 27</th>
<th>RS&gt; 27</th>
<th>FLAT</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>83,655</td>
<td>26,777</td>
<td>32,948</td>
<td>3,950</td>
<td>147,330</td>
</tr>
<tr>
<td>%</td>
<td>56.8%</td>
<td>18.2%</td>
<td>22.4%</td>
<td>2.6%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Perum Perumnas, Division of Data and Information

Based on the Perumnas data, as well as discussions with REI, real estate personnel, and others, it is clear that Krismon has severely depressed formal sector development for private developers and Perumnas alike:

- Sales of housing by Perumnas in 2000 had sunk to barely one-fifth their level in 1997;
- Demand for new housing in the formal sector has diminished because of lower real incomes, uncertainty about future incomes, and more cautious real estate lending by banks (and, of course, the recent cessation of subsidized loans by BTN);
- Demand for new housing has not completely dried up, but its characteristics have changed (e.g. demand for formal housing in greater Jakarta has moved closer in towards the city center). According to REI and APERSI representatives, the near-term demand for most new housing can be accommodated on land already owned by developers that have survived the crisis.

There are also some encouraging signs in the housing sector, however:

- Private developers have started to build RS and RSS housing within the last decade—both APERSI and REI members. Presumably, this is in response to demand (not directives), albeit led by the availability of subsidized loans. This shows that Indonesian developers are no less capable of responding to opportunities than developers in Bangkok or anywhere else in the world;¹
- Previous observers have suggested that there are high barriers to entry for new developers. The existence of APERSI seems to disprove this.

¹ Bangkok developers found they could make a profit from low cost condominiums, affordable down to the 30th or 40th percentile of the urban population.
Findings from the HOMI City Survey. The national BPS statistics are nicely complemented by the housing data obtained in HOMI’s survey of 10 cities in Indonesia, as shown in tables 2.7 and 2.8. The sampling strategy was designed to survey roughly 200 households in modest and lower income neighborhoods in each of these cities; the survey neighborhoods include Kampungs, rental areas, RSS/developer areas, community housing developments, and other slum areas. Table 2.7 describes the population, housing stock, and recent growth in the sampled cities overall. The average land and building areas, however, represent only the surveyed households. Table 2.8 provides an overview of the tenure status in the sampled neighborhoods and the method of housing production.

Table 2.7 Housing Market Characteristics from the HOMI City Survey

<table>
<thead>
<tr>
<th>City</th>
<th>Population</th>
<th># houses</th>
<th># new houses</th>
<th>Recent growth</th>
<th>Land m²</th>
<th>Building m²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aceh Tengg</td>
<td>21,468</td>
<td>41823</td>
<td>0</td>
<td>0</td>
<td>124</td>
<td>48</td>
</tr>
<tr>
<td>Denpasar</td>
<td>387477</td>
<td>80397</td>
<td>2030</td>
<td>2.5%</td>
<td>170</td>
<td>75</td>
</tr>
<tr>
<td>Kendari</td>
<td>160965</td>
<td>30,460</td>
<td>1738</td>
<td>5.7%</td>
<td>140</td>
<td>57</td>
</tr>
<tr>
<td>Makassar</td>
<td>1180336</td>
<td>193342</td>
<td>5616</td>
<td>7.9%</td>
<td>140</td>
<td>102</td>
</tr>
<tr>
<td>Mataram</td>
<td>304552</td>
<td>57405</td>
<td>208</td>
<td>0.3%</td>
<td>134</td>
<td>48</td>
</tr>
<tr>
<td>Medan</td>
<td>1703885</td>
<td>308,289</td>
<td>3134</td>
<td>1.0%</td>
<td>120</td>
<td>67</td>
</tr>
<tr>
<td>Palembang</td>
<td>1194440</td>
<td>199,999</td>
<td>3274</td>
<td>1.6%</td>
<td>95</td>
<td>51</td>
</tr>
<tr>
<td>Pontianak</td>
<td>404567</td>
<td>82049</td>
<td>7950</td>
<td>9.7%</td>
<td>109</td>
<td>56</td>
</tr>
<tr>
<td>Surabaya</td>
<td>2397765</td>
<td>469575</td>
<td>6193</td>
<td>1.32%</td>
<td>144</td>
<td>76</td>
</tr>
<tr>
<td>Taranan</td>
<td>78,929</td>
<td>14957</td>
<td>489</td>
<td>3.3%</td>
<td>155</td>
<td>94</td>
</tr>
<tr>
<td>Total</td>
<td>8034384</td>
<td>1,478,276</td>
<td>30641</td>
<td>n.a</td>
<td>n.a</td>
<td>n.a</td>
</tr>
</tbody>
</table>

The contrasts among the cities are quite striking:

- the rates of growth for “recent” housing construction vary widely among cities, from cities experiencing little or no growth to rather substantial increases in Pontianak and Kendari;
- the proportions of owners and renters vary widely across the surveyed neighborhoods, from a high of over 90 percent owners in Mataram, to a low of 42.7 percent in Kendari.
- in six of the cities, rental housing is far more important than the national average (22.9 percent) would suggest;
- correspondingly, the importance of self-built, developer built, and inherited housing varies greatly. In the surveyed neighborhoods in Kendari and Palembang, developer-built housing is highly important, as well as in Pontianak, Surabaya, Denpasar, and Makassar. The developer housing is predominately RS and RSS housing;
- employer housing exists in only 5 of the 10 cities, and does not account for a large share of the stock; and
- the average size of the areas for both land and buildings shows wide variation in the sampled areas.
Additional survey data are available on housing quality, housing satisfaction, neighborhood type, infrastructure, and so forth. The findings on housing and infrastructure quality by and large parallel those of the BPS national sample survey: electricity is generally available, but quality and access to drinking water and solid waste disposal remain problems. Finally, as discussed in the following section, the HOMI Survey findings with regard to land title characteristics vary considerably by city.

6.2.2 Overview of the Urban Land Market

Indonesia’s urban land market is uncharacteristic of any standard paradigm. Indeed, the land market has been functioning reasonably well in some ways, despite the presence of what should be serious obstacles. By objective measures, such as the freedom of individuals to purchase and own land; or outcomes, such as the proportion of homeless families, Indonesia would doubtless do well in international comparisons. By other measures, however, such as the relative cost of residential land, Indonesia does not measure up to international standards.

The diagnosis is as follows. There is an adequate legal framework to protect land rights (albeit inconsistent, and outdated in many respects); land use planning is benign, if irrelevant; competition exists in the land market; and illegal occupation of land has, generally, been well tolerated (witness the Kampung Improvement Program). In contrast, the regulatory regime is massively complex, giving rise to very high costs of compliance. For its size, the bureaucracy is also under-funded, resulting both in inefficiencies (e.g. due to a low level of computerization) and to excessive rent seeking. As a result, many people are simply unable to afford to comply with the regulations; others have chosen not to. Land prices—and therefore housing prices—are much higher than they need be.

We note that a number of reforms have been made in recent years, particularly by way of simplifying regulations. Other, perhaps more far-reaching, changes are in train with the anticipated reform of the Basic Agrarian Law, as mandated by the National Assembly at its October 2001 session. The Land Administration Project, funded by the World Bank and AusAID for BPN and BAPPENAS, succeeded in providing registered title to about 1.25 million parcels of land between its inception in 1994 and 2000. The technical assistance...
components were designed to enhance BPN implementation capacity, and to analyze and make recommendations concerning land administration in Indonesia. There are plans to extend this project, which will give further opportunities for reform of land administration laws, regulations and practices. We welcome these initiatives.

**Land Title.** Again, we rely on both BPS statistics and the HOMI Survey to assess the current status of land titles. Table 2.9, from the 1998 BPS Housing Module, indicates that fully 86.6% of all owners have Hak Milik title to the land (this is the interpretation of “property right” in the BPS data). A high proportion of both urban and rural households hold Hak Milik title, although rural households have a somewhat higher proportion: 88 percent. This estimate is higher than has generally been assumed by some analysts, however.

<table>
<thead>
<tr>
<th>Urban/Rural</th>
<th>Property Right</th>
<th>Right to Build</th>
<th>Right to Use</th>
<th>Other &amp; Unknown</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban</td>
<td>83.4%</td>
<td>7.0%</td>
<td>3.9%</td>
<td>5.8%</td>
<td>100%</td>
</tr>
<tr>
<td>Rural</td>
<td>86.1%</td>
<td>1.2%</td>
<td>4.7%</td>
<td>6.0%</td>
<td>100%</td>
</tr>
<tr>
<td>Total</td>
<td>86.6%</td>
<td>3.1%</td>
<td>4.4%</td>
<td>5.9%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: BPS, National Social Economic Survey, 1998, the Housing Module

It also appears to be higher than the estimates form the HOMI City Survey would suggest. Clearly, we cannot compare these sets of statistics in any direct way, because the city survey data are unweighted samples of modest and low income neighborhoods.

Nevertheless, the interview data presented in Table 2.10 suggest a number of interesting variations in the information on land title:

- First, the proportion having any title at all varies dramatically from city to city, reaching a high of 90 percent in Denpasar, and a low of 15.4 percent in Mataram. In general, roughly 30 to 40 percent of the homeowner households in the surveyed neighborhoods have some type of land title. This seems to be at odds with the BPS data indicated that 83 percent of urban (homeowner) households have formal (hak milik) land title.

**Table 2.10 Land Title Distribution in HOMI Survey Cities: Percent Distribution of Homeowner Households Who Have Land Title, by type of Title**

Of those having “any” type of title, a fairly high proportion do, in fact, have hak milik title. Lesser proportions have HGB, girik, or HP title.

In some cities, however, hak milik title is less frequent – Kendari, Makassar, Mataram, Surabaya, and Tarakan. Correspondingly, the incidence of girik, HP, and merely having a receipt is much higher. This may have serious implications for the ability of the homeowners to obtain title.

The Informal Sector Land Development Process. 11 There are three principal processes of informal land development: the occasional sale of single plots for individual development by owners of large parcels; the large scale purchase and informal subdivision of building sites by entrepreneurs; and the development of larger holdings into informal rental housing estates. The process of informal subdivision has, historically, been the more important, especially for the middle-income groups; it remains important throughout most of urban Indonesia.

There are a large number of informal subdividers operating in Indonesia’s large and medium-sized towns, although, to our knowledge, the scale has never been documented. Land is bought from land owners on an installment basis, often through intermediaries; site plans are drawn up; intermediaries find prospective purchasers, who are typically expected to pay for the plot over a period of three years. Construction by the individual purchasers can commence once payment for the land has been made in full. The subdividers reserve land for rights of way and public facilities, and this land is ultimately handed over to local governments.

Individual lot purchasers typically obtain Hak Girik, a legal but unregistered title to the land evidenced by tax receipts. Hoffman comments as follows: “If the subdivider purchased a

<table>
<thead>
<tr>
<th></th>
<th>% Hak Milik</th>
<th>% HGB</th>
<th>% Girik and HP</th>
<th>Receipt</th>
<th>Yes/any land title</th>
<th>No title</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aceh Tengg</td>
<td>75.2%</td>
<td>5.3%</td>
<td>9.8%</td>
<td>9.8%</td>
<td>80.1%</td>
<td>19.95%</td>
</tr>
<tr>
<td>Denpasar</td>
<td>81.4%</td>
<td>15.7%</td>
<td>2.8%</td>
<td>0%</td>
<td>90.0%</td>
<td>10.0%</td>
</tr>
<tr>
<td>Kendari</td>
<td>37%</td>
<td>2.9%</td>
<td>2.9%</td>
<td>57.0%</td>
<td>34.5%</td>
<td>65.5%</td>
</tr>
<tr>
<td>Makassar</td>
<td>50.0%</td>
<td>11.4%</td>
<td>22.8%</td>
<td>15.3%</td>
<td>38.6%</td>
<td>61.4%</td>
</tr>
<tr>
<td>Mataram</td>
<td>44.4%</td>
<td>7.4%</td>
<td>29.6%</td>
<td>18.3%</td>
<td>15.4%</td>
<td>84.6%</td>
</tr>
<tr>
<td>Medan</td>
<td>62.2%</td>
<td>5.5%</td>
<td>12.3%</td>
<td>0%</td>
<td>62.3%</td>
<td>37.6%</td>
</tr>
<tr>
<td>Palembang</td>
<td>74.3%</td>
<td>17.1%</td>
<td>0%</td>
<td>8.6%</td>
<td>22.3%</td>
<td>77.7%</td>
</tr>
<tr>
<td>Pontianak</td>
<td>79%</td>
<td>7.9%</td>
<td>2.6%</td>
<td>19.5%</td>
<td>29.5%</td>
<td>70.5%</td>
</tr>
<tr>
<td>Surabaya</td>
<td>50%</td>
<td>3.8%</td>
<td>42.3%</td>
<td>3.8%</td>
<td>62.4%</td>
<td>37.8%</td>
</tr>
<tr>
<td>Tarakan</td>
<td>35.6%</td>
<td>4.3%</td>
<td>59.8%</td>
<td>0.7%</td>
<td>81.0%</td>
<td>19.0%</td>
</tr>
</tbody>
</table>

site with clear traditional title, this will be passed on to the individual lot buyer who can, if he
wants to incur the cost, register the land. Such unregistered but wholly legal land rights
are held by approximately 24 percent of all urban homeowners. … [The title] conveys, in
theory, the same ownership rights as a registered title (hak milik), but most formal sector
lenders will not accept it as collateral. In addition, if the owner’s property is acquired for
development, he may not receive as much for his land as a similar parcel with registered
title.” It is usually possible to convert hak girik to hak milik, but this is a costly and time-
consuming process that many householders decline to follow.

The bureaucracy in Indonesia is unusually tolerant of informal subdivisions: at worst, turning
a blind eye to them; more often, acting to provide basic infrastructure and social services
as their resources permit. One reason may be charitable pragmatism and humanity. It is
ture, too, that the subdividers often make contact with government offices prior to purchase
and throughout the development period, to ensure that the proposed development is
consistent with official plans. Some subdividers may also hedge their bets by ensuring
that some local officials gain a financial stake in the project’s success.

The other principal route for informal land development is in the construction of low-income
rental units. Sometimes this is undertaken by a landowner in direct response to perceived
demand. In other cases, a commercial entrepreneur will purchase land for the construction
of rental units. It has been reported to us that this type of land conversion is becoming
increasingly common in the Jakarta area.

**The Formal Sector Land Development Process.** The formal market for land is dominated
by developers, and has been described in a number of reports. In brief, the process is as
follows: Every developer, public and private, needs to obtain a Location Permit (Izin Lokasi)
from the bupati or walikota (or DKI Jakarta) at the outset of the development process.\footnote{\textsuperscript{12} Prior to 1999, the Location Permit was issued by BPN. Since 1999, BPN merely has a reviewing and facilitat}
extension of infrastructure and so on. Second, and more crucial from the developer’s standpoint, it gives him permission to begin acquiring land for his project.\textsuperscript{13,14} Permits can carry conditions for development, such as a requirement to follow the 1-3-6 rule (which requires a developer to build 6 units of “simple” housing for every 3 units of “moderate” housing and 1 unit of “luxury” housing that is constructed).

With a Location Permit, the developer will be able to negotiate the purchase price of the land with the landowners. When compensation has been paid, the landowners release their land rights to the state. The developer then applies to the state for a grant of the land rights; the right is granted, registered, and the developer receives a Master Right to Build (\textit{hak guna banggunan}). At the same time, the developer will have received approval for the site plan from the Bappeda. The land is surveyed, and the master title is then split into individual plot titles. The developer registers individual plot rights. The titles are then sold to the buyers (or the mortgage lender) when the house is sold.\textsuperscript{15}

**Recent Developments.** There have been a number of developments in recent years that have affected the workings of the formal land market. These include:

- As a result of the financial crisis, \textit{Krismon}, many banks had their assets taken over by the Bank Restructuring Agency, IBRA (BPPN). IBRA has refused to disclose the extent or nature of its land holdings, except by saying that they are “large”. Informal calculations suggest that its property assets are valued at Rp.160 trillion (say, $16 billion at late-2001 prices). IBRA has also refused to discuss with us its policy of divestiture.
- There has been consolidation of huge land banks, by private and public sector agencies, consisting of land around many urban centers that is considered relatively ripe for development.
- Some improvements to the permitting system have been introduced by BPN (including clarifications about Location Permits). These changes are believed to have made little significant difference to the overall speed and cost of the permitting process. If it became widely known that Location Permits do not give any powers of monopoly to the developer holding the permits, it could have the effect of severely reducing the ability of developers to undertake large new developments on the scale of—say—Lippo Karawaci or Bumi Serpong Damai.
- Local governments have been empowered to undertake land management. They will eventually take over many powers presently exercised by local BPN offices. BPN has issued a decree that effectively maintains the status quo for the next two years. It is not clear whether the shift of power to local governments will improve matters ov

\textsuperscript{13} The Urban Institute, op.cit, page 128
\textsuperscript{14} Observers note, however, that Location Permits are often given to developers without much regard for an overall spatial strategy.
eral, or perhaps make things even worse (more opportunities for corruption; duplication of authority between local governments and BPN; poor levels of competence of local officials with little training and experience).

- Facilitators of land sales for informal housing are said to be becoming increasingly expensive and/or deceitful. Land purchase by low income households is thus becoming more difficult.
- Land affordable by low income households is necessarily getting further away from the center of urban areas. It is widely believed that average commuting times and costs are increasing to an unaffordable extent. This conjecture, however, is not obviously true, since much employment, too, is moving away from city centers.

**Outstanding Problems.** Despite these changes, the constraints on the efficient workings of the land market have not greatly changed in the last decade. The major problems include:

- High costs of development due to complex titling and permitting procedures, translate into higher land prices and therefore higher housing prices. Added development costs arise from official fees, bribes and time (land holding costs). These costs must be reflected in higher *prices* than would apply in an efficient market. One recent estimate (1998) is that these procedures added Rp.20,000/m² of built area—say, an extra Rp.1,000,000 for a 50m² house (1998 prices).
- Large land banks by a few monopsonists restrict the supply of land onto the market, thus holding up the price.
- This practice is reinforced by Location Permitting practice, which enables developers to gain development rights over large areas of land at low cost, but to refrain from purchasing and developing the land until they judge the time to be ripe; and the fact that Location Permit rules (e.g. time limits) are not enforced.
6.3 LEGISLATIVE AND REGULATORY ISSUES IN LAND TITLING AND REGISTRATION

6.3.1 Land Title Issues

Granting Land Title. The entire process of granting a location permit, submitting the land rights application, granting of land title, registration, and registration receipt is time-consuming. The land rights application is submitted to the land office in the Kab/Kotamadya, granting of land title is done by a BPN office, either regional, provincial, or national, and registration and issuance of the registration certificate is done at the land office in the Kab/Katamadya.

The following recommendations are made in order to simplify the process:

- Granting of land title be executed by Land Office in Kab/Region if the location is within the area of Level II Local Government (kab/kotamadya);
- If the location is within several Level II Local Governments, granting of land title is issued by the Governor upon the local governments’ recommendations; and
- The national BPN office should become largely a policy-making body, setting up the guidelines and policy implementation strategies. Granting of title is delegated to Level II Local Government with the exception of land located within several local governments.

Issues for Residential Mortgage Delivery. There are a number of issues arising from the body of Indonesian land law that make residential mortgages unduly risky, time consuming and, therefore, expensive. The same issues, therefore, strongly impede the possibility of developing mortgage insurance or a secondary mortgage market. The main issues are as follows:16

- Titles are uncertain. There may be several reasons for this. Genuine latent claims can lie dormant, and be raised unpredictably. Registration is not routine. Title deeds may be fraudulent; more than one title may have been issued for the same parcel of land; a previous owner may believe that the land was not fairly purchased (especially in the case of land development projects); land may be co-owned without the knowledge of the bank; there may be malicious, fabricated, claims to alternative ownership. LAP reports that “a significant number of subsequent competing claims are made. Of these, it is impossible to predict how many are sustainable or sustained (systematic analysis of court outcomes is not available).”17
- The court system is unpredictable in its decisions. Litigation is time consuming and expensive.
- For newly developed land, the process of transferring ownership title (Hak Milik) to individuals can be very time consuming.

16 We do not address a group of issues summarized by the Jakarta Post of September 16, 1992 as follows: “Efforts to hasten [land titling] procedures are hampered by the complexity of each step required by these agencies, public ignorance of the agencies’ fees, the belief among the public and officials that under-the-table payments make the difference, and the inability of the government to control the agencies…”.
17LAP is the World Bank and AusAID-funded Land Administration Program, undertaken by Arcadis Euroconsult and PT. Pusat Pengembangan Agribisnis for BAPPENAS and BPN, completed in 2000.
We believe that most of the issues will be addressed under the proposed World Bank-funded Land Management and Policy Development Program, and recommendations for reform could be included within the revised Basic Agrarian Law. We hope, in particular, that these forums will address issues of fraud and forgery, and the development of clear priority rules which establish firm and unequivocal rankings of interests in cases of competing claims, issues which hinder development of a primary mortgage market.

**Issue of Hak Milik on Subdivided Land.** When an individual buys a housing unit from a developer, he will need to obtain title of ownership (Hak Milik, or an individual Hak Guna Bangunan), if only to be able to obtain a mortgage. However, developed land is customarily sold with no formal title (the land still being under a master Right to Build, HGB). The master HGB must then be divided into individual HGBs, for each plot of land; and—in some cases—for these individual HGBs then to be converted to Hak Milik, before a mortgage can be issued.

Banks can issue mortgages based on the security of individual HGBs. However, the length of mortgage loan obviously cannot exceed the validity of the HGB. There are cases in which extended mortgages have been refused simply because the HGB is of a shorter duration (say, 18 years).

It is reported that the process of obtaining the individual title can take several years. Overall, the process of fully titling a project was estimated to be 32½ months in the late 1980s. We have no reason to suppose that this delay is greatly different at the present time.

The issue, then, is how a title certificate appropriate for mortgage delivery can be issued to a purchaser at the time of purchase of the lot.

The issues appear to be as follows:

- Why does the process take so long from acquisition to conversion of title to individual HGBs? Could the time taken be shortened?
- Would it be possible to move directly from a master HGB to individual Hak Milik?

Since 1999, the Location Permit has been granted by local governments, on condition that prior approval has been given in principle by a coordinating meeting of all concerned technical departments. The time to obtain this prior approval can be excessive, and we would accordingly recommend that members of the coordinating committee should be limited to representatives of the land office, the spatial planning office and the agency issuing building permits. We further recommend that the power of the local government should not be limited by the area of the land in question, but should be unlimited so long as the land is wholly within the area of that government.

**Solutions in Practice.** A practice that has been followed in the past (and, reportedly, is still followed in some places) is for the developer to register land, on purchase, in the name of the prospective buyer or other named individuals such as company shareholders.
Although this practice is clearly contrary to the spirit of the law, we are not aware that it has been abused. We therefore suggest that no action be taken to prohibit it.

In addition, HM could be obtained by applying the title directly under the name of the prospective buyer or other individuals such as shareholders, directors, etc. However, in several areas this method may not be applied because based on the development permit, all land should at first be registered under the name of the entity who holds the permit.

A Long-term Solution Requiring Major Legal Changes. LAP has proposed that “all individual certificates arising from the original HGB issued to the developer following land acquisition under a Development Permit should automatically be Hak Milik (unless the purchaser is not entitled to acquire Hak Milik). The proposal would ensure that the subdivided HGB, which would initially be granted to the developer, would automatically become a Hak Milik upon its transfer to an Indonesian citizen.”

This procedure cannot be followed without major legal changes, simply because a developer is a legal entity prohibited from holding Hak Milik. One way of addressing the problem would be for housing developers to be given the right to hold Hak Milik title to land. In particular, we recommend that the right of Hak Milik be given in conjunction with the granting of the Location Permit and on the conditions specified in the Location Permit. Thus, if the Location Permit specifies that development of the site must commence within three years—for example—the right of Hak Milik would be surrendered if development had not started within the prescribed time.

This would obviate the need for many of the intermediate steps involved in the granting of HGB, its subdivision and subsequent conversion to Hak Milik on sale to individuals. It is estimated that the time taken to acquire and title plots of land would be reduced by 25 to 33 percent, and that it would reduce the cost of land titling by around 40 percent.19 The cost of housing would thereby be reduced proportionately, and the efficiency of the housing market correspondingly enhanced.

We believe that this proposal is consistent with the principles and the regulations of the Basic Agrarian Law, Undang Undang Pokok Agraria (UUPA). This Law does not prohibit corporations from holding Hak Milik title: it explicitly permits specified types of corporation to hold Hak Milik. (Article 21, para. 2 of UUPA permits the Minister to legislate a regulation, such as PP No.38/1963, specifying permitted corporations). UUPA states that corporations that “further the social and economic interests of the community” are permitted to hold Hak Milik. Since the development of housing is now a priority of the community, it would be consistent with the spirit of the original legislation for the Minister of Home Affairs to declare housing developers to be permitted to hold Hak Milik in place of HGB rights.

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6.3.2 Land Registration Issues.

A land registration system serves to record land titles and interests for public record. It serves as a basis for land trading and credit security. “It allows owners and prospective owners not only to identify what they are buying and who the owner is, but also to close out third parties’ claims, to get clear titles, and to inform the public, including the state, of their interests and entitlement.” In Indonesia, the registration system does not guarantee the title, but merely provides evidence of it.

Progress in registering titles has been accelerated since the issue of Government Regulation No 24 of 1997. This allows both registration at the request of individuals, as well as systematic registration by BPN, with a defined adjudication process to deal with disputes. LAP explains that “the regulation requires registration of every land parcel and apartment as well as every transfer, encumbrance, and nullification concerning a right in a parcel or an apartment.” The Land Administration Project has succeeded in registering about 1.2 million additional parcels in its first five years.

In sum, we note a number of land registration issues and their proposed solutions, but emphasize that, relatively, land titling remains the most important matter.

We believe there are no data on the degree of effective registration of plots in urban areas. In Jakarta, however, up to 40 percent of land is not certificated. Unregistered land is found both in slum areas and in upper-middle income residential areas. Perhaps one third of the land in South Jakarta is formerly-Adat land (under Customary law), with ownership evidenced simply by receipts for the Land and Building Tax (PBB).

Issues holding back the registration process have been listed as including the following: “mistrust of central government, the political nature of some of BPN activities, the use of registration as a taxation stream, the wish of right holders/owners to stay outside the complex framework of some 2000 regulations affecting land, the lack of any improvement in the quality of the title, the comparatively high cost and complexity of the registration process, and the formality of conveyancing of registered titles and its cost compared with conveyancing of unregistered titles.” As a result, the process is either lengthy, or it is necessary to pay additional informal fees, or both.

The main registration issues that affect residential land are as follows:

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20 LAP, op.cit.
21 This regulation states, “Although the administration of land registration under Government Regulation No 10 of 1961 has been going on for over 35 years now, it has not achieved satisfactory results. Of about 55 million land parcels which qualify for registration, only 16.3 million have actually been registered”.
22 Regulation No. 24 of 1997 and LAP, op. cit.
The rights of many landholders are not registered. Although this applies more to rural than to urban landholders, the problem is more widespread among the urban poor. Without registered title, banks are unwilling to provide mortgages. Many people are reluctant to register their titles because the system is difficult to understand and relatively expensive to use.

Indonesia’s registration system does not guarantee titles, which, therefore, remain uncertain even on the registry. The risk of disputed title must therefore still be borne by mortgage bankers.

The registration system is still relatively inefficient, by keeping different titles in separate registers; it therefore fosters uncertainty.

Possible medium-term solutions include the following:

- Revision of the government regulation concerning land registration, PP 24/1997, to achieve the following:
  - Simplification of standardized forms of title evidence, such as certificates of title and certificates of Hak Tanggunan (mortgage);
  - The registration receipt should be on one page;
  - Simplification of standardized forms of Deed of Mortgage, and Sales Purchase Deed;
  - If the APHT is registered or the Mortgage Certificate is simplified into one sheet, there is no necessity to give the registration receipt for the mortgage (LAP-C);
  - Enforcing the requirement that registration be undertaken within seven days, with the imposition of penalties if necessary;
  - Improving the services of the PPAT (the Land Deed Official) as the assistant of the local land office, and enforcing sanctions if they do not perform their duties in accordance with the terms of their appointment.

In the longer run, the system should provide positive incentives for individuals to register, perhaps with lower fees for registration, improved transparency and holding officials liable for wrong actions.

The issue of unregistered land being unsuitable security for bank loans should also be addressed. LAP recommends that “a transparent system for raising credit on security of unregistered parcels owned by small householders and farmers should be created, based on use of a standard form and formal notification of arrangements to village functionaries appropriate to the implementation of the Autonomy Law. The standard transaction should incorporate non negotiable terms of loans, rights for the parties principally to balance disclosure of financial terms, exercise of the security right and proof of title, payment of the capital direct to the mortgagor while allowing freedom of contract in other areas. The arrangement should be balanced to ensure that owners are not removed from their land for small debts.”

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23 For instance, the PPAT should comply with the requirement of submitting the Sales Purchase Deed or Deed of Mortgage to the Land Office within seven working days of the signing of the deed. The PPAT should work closely with the local land office in order to speed up the process of registration.
**Other Specific Recommendations from LAP.** Other relevant specific recommendations to strengthen mortgages and other forms of security interests, made in the final reports of the Land Administration Project, include the following.

1 For instance, the PPAT should comply with the requirement of submitting the Sales Purchase Deed or Deed of Mortgage to the Land Office within seven working days of the signing of the deed. The PPAT should work closely with the local land office in order to speed up the process of registration.

- Integrate certification processes for ownership and mortgage titles so that the mortgage interest appears on the land title.
- Provide normal remedies available to secured first creditors in market-based systems, especially the right to possession on default; allow creditors to recover possession and sell without court intervention with opportunity for debtor to seek court monitoring if standards are not observed. *Comment:* This could be done by revision of Law No. 4 of 1996 regarding Hak Tanggungan (the Mortgage Law), but experts recommend that this would be contrary to the spirit of Indonesian legal philosophy.
- Reverse the principle of horizontal separation to make buildings become part of the land and property of its owner. *Comment:* The original principle is derived from Customary (Adat) Law and is, therefore, difficult to reverse.

An annex to this section lists further recommendations made by LAP to improve security of tenure on community land, land occupied informally, and conveyancing.
6.4 THE LAND MARKET AND LAND SUPPLY

6.4.1 Overview of the Costs of Regulation

There are many ways in which inappropriate regulation of land development can impose costs, on society, on developers and on individuals; for example:

- There can be huge costs incurred by developers as a result of months of delay getting through the bureaucratic maze to obtain development, planning and building permits: costs that are realized in terms of manpower, and in the cost of capital tied up waiting for the permits to be granted.
- There are proportionately even greater time costs incurred by poor households in trying to obtain similar permissions so they can comply with the law.
- Excessive time taken to get permits can dampen the ability of the private sector to respond to changes in market conditions, so lessening the beneficial impact of market forces.
- The bureaucracy is structured so as to connive at hidden charges: by its complexity, dense administrative requirements encourage officials to expect additional payments to get the done more efficaciously.
- Restrictive regulations can severely limit the availability of land for new development, and, thereby, contribute to raising its price.
- Not least are the social, environmental and economic costs imposed on the poor for being unable to comply with the regulations, hence being obliged to live outside the law, and unable to take advantage of government subsidies and other benefits.5

Most of these costs—the indirect costs of land regulation—are generally passed straight on to the consumer, if not borne directly, as significantly higher land prices. They are eventually translated into higher prices for housing, as well as for all locally-produced consumer goods and services.

The principle of regulation has generally been well-intentioned, often having been designed to counteract the effects of the market on the poorer and weaker members of society. But it has not really worked that way. Market mechanisms and personal incentives have generally proved more powerful in pricing and therefore shaping human settlements than all the benign ordinances and controls put together.

In the 1990s, Indonesia benefited from a number of reviews of the workings of its land market. They were generally unanimous in finding that the major distortions in the market arose from the expense and difficulty of obtaining documented title, and the expense and difficulty of obtaining the requisite development permits. They were less unanimous in their conclusions over the need to revise the land laws. Diamond, for example, found that

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“many of the problems … arise not from the general principles of land ownership expressed in the basic land law, but in the specifics of how official bodies recognize and regulate the system”. The Land Administration Project (LAP) produced a multi-volume report with perhaps 150 sets of recommendations, mainly for changing the law.

In this section, we examine the more prominent of these costs, and suggest ways in which they can be reduced. We note, below, that the processes for approving development permits were estimated to have added about one third to the cost of land in around 1990. Some processes have been improved since then, but we estimate that the “additional” costs have not been reduced significantly. The recommendations that we make in the following pages would not reduce the costs to zero, but they might serve to lower the cost of land by, say, 10 percent, a not-insignificant amount.

We recognize that there have been a number of other reports, before this one, that have made similar points. We are also well aware both that there have been some major improvements in the practice of land regulation in Indonesia in recent years, but that there remain several reasons for land costs being higher than they need be. Clearly, those constraints that have not yet been addressed are much more difficult to deal with than those that have already been moderated. However, we also believe that the present time—with the focus of this study being on affordable housing—is as good as any to make a fresh start in trying to reduce the costs of land regulation.

6.4.2 The Supply of Land for Housing

The balance between demand and supply largely determines the price of land, like any other commodity. If land with particular characteristics—say, its suitability for housing development—is in short supply, then its price will rise. Conversely, if the supply of that type of land is increased, the price will fall. If the price of land for new housing falls, so the price of new housing will fall.

Some people claim that there is plenty of land for new housing available in or near most major urban areas of Indonesia, by virtue of an examination of the extent of land in non-urban uses. This is true only in a trivial sense. Additional requirements for housing land are (a) that it is developable for housing—i.e. that it complies with conventional planning requirements (most importantly, that trunk infrastructure is available) and (b) that it be legally available—i.e. either in the ownership of an active developer (a public or private corporation, some other legal entity, or an individual) or available for sale to such a developer.

Although there are no data on land availability, it is clear that most of the developable land around DKI Jakarta and, maybe, around other major cities, too, is not legally available. Because it does not, therefore, form part of the supply of land for new housing, it may be expected that—all other things being equal—the price of land is significantly higher than

26 Bob Sudjana Tantra has developed these figures.
might otherwise be the case. We doubt if it would be even theoretically possible to estimate the likely changes in the price of land if the supply were to be increased; but we are willing to hazard a guess that the changes outlined below might cause the price of housing land around Jabotabek to fall by a not insignificant amount over the next five years.

If the price of land typically represents 43 percent of the cost of a low-cost house, 38 percent of a mid-cost house and 29 percent of a high-cost house, then we might expect that the price of low cost housing could be reduced by around 15 percent—say, by Rp. 3 million: from Rp. 20 million to Rp. 17 million, if we assume that the price of land had fallen by one-third over the five year period, for example.

The supply of land for housing is severely constrained because land is being held “out of development” by a variety of agencies, for a variety of reasons. We note that the practice of holding land out of development is contrary to the Constitution and the Basic Agrarian Law (BAL). Article 7 of the BAL states that land ownership and possession is forbidden in excess of public interests. According to the BAL, “abandoned land” reverts to the state. Article 27 defines “abandonment” as “deliberately not using the land in line with its condition or the nature and purpose of the right”. Compensation is not payable, unless annulment is explicitly done in the public interest.

Holders of idle land include the following:

- IBRA (BPPN): collateral and non-core assets divisions
- Large developers (e.g. members of REI): land banks, including land held under location permits
- Small developers (e.g. members of APERSI), as part of a land bank
- Some local governments
- Perum Perumnas
- Central government may also be a large holder of idle or vacant land (e.g. by the military)
- A few large manufacturing enterprises and industrial estate managers have access to land that could appropriately be used for residential purposes (cf. Mattel’s dormitories).

In addition, there are significant numbers of small plots of land, scattered throughout Indonesia’s cities and towns, that are undeveloped, but presumably serviced with secondary infrastructure, and ripe for development. There are no data on the extent of this vacant land, but observation suggests that, in total, it is relatively substantial, and above any international average for larger towns. Nor is there information on the ownership of this land, but it would appear to be predominantly in the ownership of individuals or families. If put on the market, it would certainly make a substantial contribution to improving the urban land supply.

Of the categories of idle land listed above, by far the most important for the housing sector are those parcels of housing land being held by IBRA, and in land banks of large developers. We do not have information on the extent of holdings by Perumnas, or by central government agencies, but expect these also to be potentially significant.
We deal with the release of land held under Location Permits in Section 4.4, below. We recommend there that unused location permits should be revoked. Other issues of land supply are addressed as follows.

**Land Held by IBRA (BPPN).** We would expect that the housing land held by IBRA will be sold to large developers over the course of the coming months, possibly at fire-sale prices, and that this land will then be legally indistinguishable from other land owned by developers. We assume that IBRA’s residential land is predominantly in HGB title, thus legally owned by corporations, but liable to revert to the State if the title is not converted within the specified period of time.

Other proposals have been made for disposal of IBRA’s land assets, including transfer to a state authority as the core of a new land bank, implicitly to help provide land for the under-served, or to secure funding for a liquidity facility. We do not support these suggestions. Experience from around the world suggests that public agencies are very rarely capable of managing land banks in the public interest. The prime example of mistaken land banking is in the socialist economies of Eastern Europe. There, most land was taken into public ownership: land was so badly misallocated over the decades 1950 to 1990 as to distort normal land use patterns and density gradients, leaving the cities inefficient and extremely expensive both to service and to live in (e.g. high transport costs because of excessive home-to-work distances). In other countries, land banking has done little more than increase opportunities for corruption without improving land use distribution.

We believe that it is in Indonesia’s best interests if the procedures already developed for the disposal of IBRA’s assets are pursued in the case of its land holdings, as much as for their other classes of asset. That is, they should be sold by open and transparent auction, without restriction on the type of bidder, and within the time frames agreed within government and with the international community. Insofar as it may be possible to disaggregate some of the holdings into smaller parcels, this would be preferable, since allowing smaller builders and developers access to developable land (and thereby also helping to maximize IBRA’s revenues). At the same time, however, the transfer of existing, time-expired, Location Permits to new purchasers as part of a land package would not be consistent with the land policies recommended in this report, nor with the principles of decentralized authority. We recognize that automatic revocation of existing Location Permits would probably diminish the value of the land. Nevertheless, we recommend that when land is auctioned, prospective purchasers be advised by BPN that existing Location Permits will not automatically be transferred.

**Public Sector Holdings.** We have not been able to find any data on the extent of land holdings by public sector bodies, including Perum Perumnas, DKI Jakarta and other local governments, the military and, perhaps, BPN. There is, however, anecdotal and partial evidence that these holdings, in total, are large and contribute significantly to the under-
supply of developable land for residential use. A range of policies should help to release some of this land onto the market, as follows:

- Insofar as lands in these holdings have Location Permits, we believe that these Permits should be reviewed and, if appropriate, revoked in the same way as for private developers. Detailed recommendations are made in Section 4.4.

- Certainly, Government agencies must hold sufficient land to meet their medium-term needs. Equally, we believe that there may be justification for local governments or other agencies to buy land to meet public needs. We do not, however, believe that it is necessary or appropriate for public agencies to engage in land speculation, nor to hold lands over and above their medium-term needs. We would therefore urge these agencies, through the good offices of the Inter-Ministerial Committee (BKP4N), to review their land needs, and subsequently to auction any land surplus to these needs. It would be appropriate for a sub-committee or task force working under BKP4N to develop methodologies and provide assistance as required.

- We also believe that local land offices should inventory unused land, including land held by the public sector, with a view to coordinating detailed proposals for new residential development. Further recommendations on this subject follow.

**Private Land Banks.** Large developers may be expected to hold or to have acquired very large areas of land suitable for residential development by, say, the end of 2003. Some of this land will be held as HGB land; most of the rest, under location permits. All other things being equal, it would be logical for the developers first to aim to develop the land they own, before starting to buy the residual land under location permits.

It may be seen to be in the immediate interests of the developers to restrict the supply of land suitable for new housing, simply to keep prices relatively high and thus to improve their profits, especially after a relatively lean few years. However, as already noted, we recommend that it would be both in the public interest and in the longer-term interest of the developers, if governments took a lead in increasing the supply of land with a view to driving prices down. It is obvious that this would be in the public interest, not least so that low cost housing may become affordable to a much greater proportion of the population. Lower land costs would also, of course, provide a significant boost to the national economy by lowering costs of new production. We believe that this would also be in the medium-term interests of private developers, by virtue of expanding their market and thus increasing opportunities.

We recommend that actions be taken to increase the supply of land and thus expand the housing market, as follows:
• Review and revoke unused Location Permits (Section 4.4, below);
• Charge PBB at a high rate on idle land, to encourage corporations and individuals with small holdings to release or develop it;
• Local governments to take the lead in reviewing land availability, especially for new lower-income housing, with a view to assembling and promoting development packages;
• Pro-active provision of infrastructure.

The Land and Building Tax (PBB). One potentially important way of encouraging individuals, corporations or other institutions to utilize developable land is to impose a high rate of taxation on idle land. By increasing holding costs, this would then provide an incentive for landowners, whether corporations or individuals, to release or develop the land (respectively, to avoid paying the tax, or to generate additional revenues). The vehicle for applying this tax is already in place: the PBB (Pajak Bumi dan Bangunan) or Land and Building Tax of 1985 (Law No. 12/85).

There are a number of international examples of the application of an “excess” tax on vacant land, where the purpose is to stimulate its release onto the market. Examples include the Philippines, Japan and parts of the U.S.

PBB is presently a centrally administered tax on the assessed value of land and buildings. The World Bank points out that “it is not aimed at addressing land-use related policy issues (for example, promotion of more efficient land use), but at improving domestic resource mobilization through increased tax revenue.” At present, 81% is distributed to the local governments in which the tax is collected (the residual amount is for central government, and to meet the administrative costs of collection). PBB forms a major part of local governments’ own-source revenues, or a projected 5 percent of total revenues.

The current tax rate is now 0.5% per annum of the “assessed value”, less an automatic exemption floor; the assessed value is usually 20% of the calculated market value (except for the most valuable properties, which have a 40% assessment ratio); but the calculated market value is said to be well below any sales value. DKI Jakarta is reported to have achieved a collection rate of 85%. Although the tax collection rates are generally reasonably good, it is reported that the tax base (the maps of taxable land and buildings) is grossly incomplete in some jurisdictions.

There is a long-standing debate about decentralizing this tax. There is a debate in principles about the degree to which this should or should not be a central government function; and it is reported that a number of local governments would prefer NOT to have the responsibility for setting tax rates, since they—rather than central government—could then be held responsible by their electorate for imposing unpopular taxes. The amendment of relevant legislation—notably Laws 25/1999 and 34/2000—is now being discussed by DG Pajak (the Directorate General of Taxes in the Ministry of Finance), with a view to redrafting legislation next year, to allow decentralization of certain tax responsibilities. This would be an excellent opportunity for Kimprawisil to propose an amendment that allows the tax rate

to be varied according to the use of land or building, or that allows vacant land to be taxed at a differential rate.

Although we believe that the power of varying tax rates should be delegated to local governments, it could still be used by central government until such a time as PBB is fully decentralized.

Further study would be needed to recommend an appropriate tax rate for vacant land, but it would likely be two- or three-times the standard rate. A subsequent regulation would probably also be needed to define “vacant land” more precisely. We believe that the services of consultant firms already contracted to help the Ministry of Finance could be utilized to address these issues.

**Land Re-packaging by Local Governments.** It is now the responsibility of local governments to ensure that sufficient serviced land is available to meet residential needs. Since the market is working imperfectly, especially to serve the needs of poorer households, it will often be necessary for local governments to intervene pro-actively to ensure that conditions are sufficient for developers to be able to construct appropriate housing. This may involve, simply, the provision of infrastructure—see below. It is as likely, however, to involve the assembly of packages of land and incentives so as positively to attract developers of lower-income housing.

We see two main reasons in justification of the need for intervention in this field: firstly, developers’ predilection for providing the more profitable high-income housing and their corresponding reluctance to build for low-income groups; and, secondly, the sterilization of much of the appropriate land by public and private land banking practices noted above.

Opportunities for intervention may arise from (a) the freeing of land previously held under Location Permits, and (b) release of land previously held in public land banks, perhaps in combination with (c) sales of land motivated by an increased PBB. We envisage that local governments would not be in a position provide any financial incentives. Incentives could, instead, consist of pre-approved Location Permits and the offer of other fast-track approvals, the facilitation and coordination of infrastructure provision, and perhaps the development of employment zones or of central service areas. In return, developers would undertake to construct housing appropriate for lower-income households. In effect, the development would be of a mini-Kasiba without, however, necessarily resorting to the Kasiba legislation.

We recognize at least three major obstacles to implementing such a scenario: the initial need for working capital; the shortage of expertise necessary to manage such deals; and the increased opportunities for KKN.

Some initial capital may be needed if the revocation of Location Permits requires the repurchase of land or, conceivably, even for the strategic purchase of land on the market. It
might not be needed if the deal is done with developers already holding land in the development area. We believe that it would be appropriate to use transfers from a National Housing Fund for this purpose, or borrowing from the Regional Development Account or a successor Municipal Development Fund, or by the issue of bonds.

Few local governments would have the capacity to put together deals of this nature (whether the housing section, the land office or the Bappeda). Although the National Housing Fund itself, or even regional housing boards (BP4D), might be able to provide technical assistance in the long run, we envisage that it will often be necessary to acquire outside, impartial, expertise to assist local governments to plan negotiate and, perhaps, implement land packaging in this form. We believe that foreign donors would be receptive to financing advisory services of this nature, perhaps through one of the associations of local governments. Oversight by a donor agency might also help to lessen the extent of KKN.

Infrastructure. A precondition for the development of land for housing is the availability of on-site infrastructure. Since the examination of infrastructure is outside the scope of the HOMI Project, we have not examined the issue in depth. There are established procedures for planning, financing and implementing trunk infrastructure services, although we note that provision often follows need, rather than leading it; and that there are currently severe funding shortfalls. We also note that it is standard practice for formal sector developers to be required to provide on-site infrastructure. However, although there are problems of coordinating public and private provision for formal development, the more pressing issue is one of servicing informal housing areas. Although theory says that it is more economical to provide infrastructure before an area is developed, the efficiency of the KIP system as it has been developed in Indonesia is such that there is probably little practical difference. Since KIP and its successor programs are clearly targeted at lower-income households, we believe it is appropriate for local governments to use the proposed National Housing Fund resources to complement other KIP funding sources.

6.4.3 Key Issues in Permitting and the Impact on Land Supply

Introduction. In Jakarta, the total regulatory cost of formal development has been estimated to be about one third of the total project cost:

- Interest carrying cost over the 2.7 years it takes to get development approvals: 9.3% of project costs; plus
- Informal and formal fees: 6.8% of project costs; plus
- The cost of restricting the supply of land, including the location permit process: 18% of project costs.

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28 Hoffman recommends that Location Permits include an assurance that infrastructure agencies can and will provide services in the required timeframe; and that “developers and local governments [should] execute an agreement [as part of the Location Permit process] outlining responsibilities and scheduling for infrastructure completion, maintenance and turnover by the developer, and the local government’s agreement to accept the handover, and subsequent responsibility, by a specified date.” Michael Hoffman and Sunario Basuki, Recommendations for Improving the Location Permit Process, Urban Institute and Hasfarm Dian Konsultan, for BPN and the World Bank, Jakarta, December 1989.
As noted in an earlier section of this report, the consequences of this are destructively extensive. One result is that considerable profits can be made from understanding how officialdom works. Indonesia is not unique. In the United Kingdom, for instance, one observer wrote that “the major part of the profits from a development is likely to accrue to a developer when permission for the development is obtained, rather than from the construction and sale of houses, offices or shops. If most of the profits can be made in this way, then for many developers gaining planning permission will become a relatively more profitable activity than building or selling offices, shops or factories.”¹¹ In India, observers say that “the main business of developers is to get the permission; construction is secondary”.¹² We suggest that a similar situation applies in Indonesia.

The cost estimates quoted above were made about a decade ago. In recent years, BPN has taken heed of many of the concerns expressed about the inefficiency of the permitting process and the lack of involvement of local representatives in decision making, and has issued a number of regulations to simplify and streamline the process.¹³ Nevertheless, there is anecdotal evidence that, although certain aspects of the process may be improved, others may have worsened. In total, the cost of the permitting system is in the same order of magnitude as it was a decade ago. We see four, related, issues concerning permits for residential land:

1) Although development permits are issued for a certain period of time, these restrictions are neither monitored nor enforced. As a result, land is effectively held out of development, and the land is thereby blighted.

2) Location permits used to be seen to confer an exclusive right to the developers to whom they were issued, thus effectively prohibiting their sale to third parties. Although this reduced the price of the land to the developers, the restriction was seen as neither efficient nor just. Although this restriction has been revoked, this change is apparently not widely known.

3) The permitting process is not well understood, either by developers or, in many instances, by land officials. As a result, both sides err on the side of caution by following old, known, procedures rather than the new, more cost-effective procedures (revocation of Izin Prinsip).

4) Although regulations have been issued regarding the maximum time to be taken by officials in completing certain processes, these regulations are often not observed. The time and the cost of obtaining permits therefore continue to be much higher than is officially allowed.

We examine these in turn.

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³⁰ Quoted in Michael Lee, op.cit.
³¹ op.cit.
(1) Land Blighted by Location Permits. Two characteristics of the Location Permit are important. Firstly, grant of a Permit has been seen as conferring exclusive rights of acquisition on the developer holding the permit, but without requiring him to acquire the land. The system makes it difficult for land owners to sell their land to a third party; reduces incentives to put land to the most economic use; and is potentially environmentally-damaging, since environmental issues generally take second place to pecuniary considerations.

Secondly, Location Permits are normally valid only for a limited period of time—one to three years, depending on the area of land involved. A permit could be renewed for one additional year if the developer could justify its extension (such as by demonstrating good faith in acquiring at least 50 percent of the land designated in the Permit). However, the Izin Lokasi legislation states that if all of the land has not been acquired within the specified period, the permit should be legally revoked for implementation of the regional plan, or to be released to other entities.

However, developers often fail to develop, or even to purchase the land. Land is held for speculation and land banking. Monopolistic situation are created, especially when large amounts of land are awarded under single Location Permits. This increases the scarcity of land suitable for development, inflates land prices and reduces competition. Under such circumstances, a Location Permit generally may—and should—be revoked.

In practice, however, very few location permits have ever been revoked.33 Their implementation is not systematically monitored, either by BPN or by local governments. (Local land offices, which issue the Location Permits, monitor acquisition of the land, but not its development.) There is thus no easy procedure for enforcement of their provisions.

As a result, there are huge areas of land throughout Indonesia blighted by Location Permits: suitable for residential development, but which are not being developed nor available for development by any entity other than the principal developer. Figures quoted by LAP show that—in the late 1990s—there was still a huge amount of land held out of the development process, facilitated by the location permit system.

The most recent statistics available to us date from 1998. According to BPN, there were then almost 9 million hectares of undeveloped land under Location Permits throughout Indonesia. Permits for residential development had been issued for 173,000 hectares of land in the five years 1993-98, enough to support growth of around 35 million people. A recent report cited by LAP stated that:

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33 In 1997, the State Minister of Public Housing urged the Botabek administrations to revoke development permits given to property developers who had not used the land. The Minister said that permits had been issued for over 92,000 hectares of land in the Botabek area, but barely 14,000 hectares had been used effectively.
“With efficient development, over 100 square kilometers is needed each year to cater for the demands of urban development across the country, but in fact 300 square kilometers has been converted each year to urban uses recently, much of it prime irrigation land.”

In Botabek and West Java, Location Permits had been issued covering 149,000 hectares. Of this, only 38 percent had been acquired, and 14 percent developed. The converse of this is that 86 percent of land with Location Permits had not been developed, and was thus not available for urban use. In Botabek alone, Location Permits were issued for residential development in the five years up to July 1998 covering some 72,000 hectares of land. This would be sufficient to house more than 8.5 million people.³⁴

There is, in fact, a process for revoking Location Permits. PP No. 36/98 sets up a process for examining neglected land, liaising with the developer and determining future plans for the site. The legislation makes provision for the land to revert to becoming state land (at the original acquisition price by the developer) if the developer undertakes no development within 3 years. We strongly recommend that local governments be advised to utilize these powers.

PP 36/98 provides local governments with the opportunity to encourage developers holding land under Location Permits, in excess of their immediate needs, to donate the surplus amounts to government for use for public projects in exchange for renewal of the residual Permits. This procedure could be used to acquire land for a Kasiba-like development, or in place of requirements for providing low cost housing under the 1-3-6 rule.

All other Location Permits for land not required for development in the near term (or where minimal amounts of land have been purchased) should be revoked if not used. The purpose of this is not simply to penalize non-performing developers, but to tend to reverse all the ill effects of unused Location Permits: not least, low supply hence high price of raw land; and the sterilizing effect on existing, small landowners wishing to sell their property.

We recommend that all local governments should set up a simple system for monitoring compliance with residential Location Permits. A central body would be needed to assist them in establishing and maintaining the system.

(2) Revocation of the Exclusivity of Location Permits. A second, related, issue relating to the Location Permits is the understanding that they give an exclusive right of purchase to the holder of the Permit. The Permit thus froze development on the land being held for eventual development. The process allowed developers to control large tracts of land while only gradually purchasing them. It both legally allowed developers to stretch out the development process over extraordinary lengths of time, and made it economically feasible to do so. Landowners are led to believe that they cannot sell to anyone but the developer holding the Location Permit; they can, indeed, be led to believe that they no longer hold rights in the land.

³⁴ Assuming 60% coverage and 200 persons per hectare.
This issue attracted the attention of a number of observers, with the result that BPN issued a clarifying regulation in 1999 (Circular No. 2/1999). This re-stated certain parameters, including the maximum amount of residential land holdings permitted to development companies, and the length of time for which a permit is valid. It also stated that the grant of a Location Permit does not convey an exclusive right to the holder of the permit; it merely permits the holder to negotiate acquisition with the affected landowners. This means that a landowner may choose not to sell, in which case the land is—in theory—available for other developers. Nothing in the legislation prevents the sale of land to third parties.

The overall impact, however, is nevertheless to blight the land for as long as the Permit is in force. Nevertheless, this adverse impact could be lessened if the knowledge of Circular No. 2/1999 were more widespread on the part of affected landowners.

We therefore recommend that local land offices should ensure that all affected landowners understand the implications of the issue of a Location Permit covering their land.

(3) Permit in Principle. The Basic Agrarian Law and its subsequent regulations stated that every company (and individual) requiring land for development must apply firstly for a Permit in Principle (Izin Prinsip) from the local government, before applying for a Location Permit. This requirement was criticized as duplicative and bureaucratically unnecessary. In Inpres No.23/1998, BPN revoked the need for the prior grant of Iizin Prinsip.

This change in the law is, however, not yet in practice throughout Indonesia. We recommend that local land offices should clarify its status.

(4) Complexity of the Process. In the early 1990s, the location permit was reported to take about 6 months to obtain (in a range from 1 to 12 months). However, because of the difficulties in assembling land, it typically took 10 to 25 years to assemble enough land for a residential development of 100 to 2,000 hectares. The processes were changed and simplified in 1993: the new process was intended to take 12 days. LAP reports, however, that the process took on average around 2 months but up to one year in West Java.

The location permit was only the first stage in the process of approving developments. The Urban Institute researchers of 1990 reported that average processing times for development approval and titling averaged 32 months in the late 1980s—Section 3.1 comments on the time taken to obtain Master Title, and to split this into individual titles. Formal and informal costs perhaps averaging Rp. 12.5 million/hectare (including fees for titling). Another developer suggested to LAP that total administrative costs add up to Rp. 20,000 per square meter to the final built development. LAP speculates that faster times mean higher costs.
There are two issues: firstly, that the complexity of the processes encourages rent seeking by officials in the form of informal fees; and secondly, that the process takes much longer than is mandated.

The basic solution would be:

- to reduce the number of steps needed for approval of the Location Permit (establish a fast-track model for approving permits);
- re-calculate a more realistic maximum period for the issuance of a new Permit;
- consolidate all fee payments within an acceptable formula;
- make these regulations transparent, by publishing them widely; and
- establish an appeals procedure.

In the context of increasing local autonomy, local governments can and should determine how to reduce and simplify the approval process. This would be done by issuance of a Regional Government Regulation (PERDA/Mayor’s Decree). It would be appropriate for the Ministry of Home Affairs (Dalam Negeri) to assist local governments in this respect.

These issues have been addressed to an extent by the land office in Jakarta Barat, which might serve as model elsewhere.

**Implementation.** All of the above recommendations involve BPN and the improvement of procedures in local land offices. The monitoring of developers’ compliance with the conditions of Location Permits may also be an interest of the Bappeda. However, insofar as they all have a strong bearing on the price and availability of land for housing, Kimpraswil has a legitimate interest in pressing for their resolution.

The resolution of all the topics discussed in this section is consistent with the Terms of Reference for the proposed World Bank-funded Land Management and Policy Development Program. The success of this program should be regarded as a very high priority for the success of a national housing policy. We recommend that it should be given full support by all relevant agencies and donors.

6.4.4 **The Implications of Decentralizing Land Administration**

In this section, we focus on the implications of the Government’s decision to decentralize certain responsibilities for land administration, in view of the several recommendations we have made elsewhere in this report that more effective land delivery can best be implemented by local—rather than central—actions.

**The Background to Decentralization.** A slow move to decentralization was in process in Indonesia since the 1970s, with the establishment of local offices of a number of formerly-central government administrations. The process accelerated somewhat in the 1980s, with a shift to increase the fiscal authority of local governments. However, it
was not until the political changes of the late 1990s and the popular demand for greater
government accountability—reformasi—that there was a real movement for
decentralization. The Habibie government bowed to popular demand, making a momentous
decision to prepare legislation to decentralize much responsibility to local governments,
thus freeing public administration from central bureaucratic control, and making it more
responsive and accountable to local communities.

The Law on Regional Autonomy, No. 22/1999, together with Government Regulation No.
25/2000, developed much of the hitherto-central authority to kota and kabupaten
governments.35 The general rule was that powers not specifically retained by central
government would automatically become the responsibility of local governments—the
principle of residuality. The law prohibited most central government agencies from keeping
on their offices within local jurisdictions. KEPPRES 95/2000 effectively abolished BPN’s
administrative authority over local land offices.

**The Relationship of BPN to Local Land Offices.** Although observers feel that the law
would have benefited from greater clarity, the law was sufficiently clear that the administration
of land policy was to fall under the mandate of local governments. BPN would thus lose
much power it held over local land agencies, although the precise nature of its residual
powers, and—more important—of its relationship with the local government land offices,
remained to be defined.

BPN paid a good deal of attention to the development of a new structure in order to comply
with the decentralization law. One possible interpretation of its future role is as follows:

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35 Law 34/2000 gave local governments to power to impose local taxes. Regulation 25/2000 clarifies the
authority of central government: in general, to be a policy-making body, not responsible for day-to-day
Text Box 4.1

Possible Role of Central Government (BPN Pusat) in Relation to Land

- Budgeting and financial administration
- Processing Izin Lokasi requests for large tracts of land
- Development of policy
- Power to make policy and national standards
- Determine conditions for the granting of land rights
- Determine conditions for land reform
- Develop and disseminate benchmarks, performance indicators
- Set standards in land administration
- Guidance to local government on fixing land service fees
- Monitor performance of service delivery units at local level
- Provide training, incentives and consultative processes to foster cooperation and compliance at the local level
- Develop non-prescriptive guidelines
- Monitor and review regulations
- Review organizational structures in order to comply with decentralization
- Coordination of donor-funded programs
- Technical support of lower level units.

Source: Institutional and Operational Changes to Land Office under Decentralization, Steve McFadzean and Topohartono, Indonesian Land Administration Project, February 2001; and Decentralizing Indonesia's Land Administration System, Thomas Rieger and other, COMO Consulting for World Bank, Jakarta and BPN, June 2001

Text Box 4.2

The Main Functions of the Local Land Office

- Map and register land
- Register transactions with land
- Maintain records of land ownership
- Land use planning; develop a master plan, monitor compliance, process Location Permits, etc
- Manage transactions with some State land, including compulsory acquisition
- Resolve land disputes
- Land tenure control
- Provide a land information service
- Provide community education on land-related matters

Source: McFadzean and Topohartono, op.cit.
BPN at central level will only retain a technical relationship with local land offices. Responsibilities retained by central government are: “(i) The stipulation of requirements for the granting of land titles (ii) The stipulation of requirements for land administration reform (iii) The stipulation of standards for land administration (iv) The stipulation of guidelines for land service charges (v) The stipulation of the national cadastral basic framework.”

Little responsibility for land administration was to be given to provincial governments. This structure would imply a substantial shift of responsibilities to local government offices. The kabupaten and kotamadya land offices would be expected to take on the functions noted in Text Box 4.2.

Note, however, that the Land Administration Project believes that land use planning, land use allocation and monitoring should be the responsibility of the BAPPEDA, not of the local land office.

New local responsibilities are a combination of responsibilities presently held by provincial and district land offices (themselves being units of the central BPN), and existing local government land offices. Among other concerns raised with the proposed new re-alignment were that there may not be sufficient capacity at local level to assume these responsibilities in the short term, that there may be insufficient local finance to manage the above responsibilities, that local legislative bodies may not have the experience to be able to manage the new agency. There were also a number of issues relating to legal questions and personnel management (for example, the need to transfer staff from BPN to local administrations).

Implementation Issues. The new structures were intended to take effect from January 2001. Presumably resulting from concerns similar to those listed above, however, BPN determined that a full transfer of responsibilities should be delayed by no more than two years. In mid-2001, it issued a decree to that effect (Presidential Decrees No. 10/2001 and 62/2001). The implications of these decrees created some confusion in land offices throughout the country. The extent and speed of future decentralization of land administration was unclear to many observers.

Options presented by one technical assistance team focused on the following three alternatives:

a) to proceed with decentralization of the land administration system on the lines mandated by Law 22/1999 and Government Regulation No. 25/2000, and try to put the remaining pieces of legislation into effect as soon as possible; or

b) to postpone decentralization and first promulgate the necessary legislation within the next two years; or

c) to decentralize a limited number of well run local land offices as pilot projects, putting the legislation in place, in order to complete the decentralization process within two years.36

That team unambiguously recommended Option (c).

Technical assistance was previously initiated under the Indonesian Land Administration Project to develop alternative models for the transformation to a decentralized system, including undertaking pilot projects at Tangerang and Malang, each using different models. The pilot program was terminated in March 2001. Other than by setting up a unified office with—presumably—more accountable procedures, the project also reviewed and streamlined certain procedures with regard to land recording and registration processes.

The COMO Consulting Project also studied a number of local land offices, and found many examples of good practice in the field. This team conducted a review of the Kantor Pertanahan at Semerang, similar in nature to the Tangerang exercise carried out under LAP, although examples of Good Practice at the two offices differ in several respects. The COMO report makes specific and detailed recommendations for change—including relationships between BPN Pusat and the Dinas Pertanahan, and for legislative and regulatory change—most of which are beyond the scope of the present study. The one set of recommendations, however, that we feel qualified to comment upon, and which we fully support is as follows:

*It is appropriate to involve donors in providing assistance which aims to develop and disseminate examples of good practice in local land offices, for example in projects that:

- “provide examples to be emulated not just by upgrading hardware, providing training or streamlining structures, but by setting examples for a systematic process of change;
- strengthening horizontal exchange on Good Practice, e.g. via workshops, and the establishment of a network, including a web site, that facilitates horizontal exchange among the Kantor Pertanahan Kabupaten/Kota;
- strengthening the service delivery capacity of BPN Pusat for supporting the regions.”*

We also support the recommendation by the COMO team to introduce a Quality Management system (which, they say, should go beyond ISO), throughout the local land offices. This would be preceded by introduction of the system in two of the more advanced offices, perhaps in Tangerang and Semerang. It is likely that this work should be supported by external donor agencies.

It is also likely that considerable capacity building for staff of local offices, under the new, decentralized, environment will be also necessary over coming years. This, indeed, is to be a focus of the proposed world Bank-funded Land Management and Policy Development Program (LMPDP). Among other outputs, this project would be expected to draft a program of capacity building for decentralized land administration services. The success of LMPDP, and of any successor program of capacity building, is critical to the success of many of the recommendations on land made in this, HOMI report. We recommend that it should be given full support by all relevant agencies and donors.
Appropriate topics for capacity building suggested by the Land Administration Project (Cycle 10) include those listed in Text Box 4.3 below.

Text Box 4.3

Training Needs for Decentralized Land Management

- Use of local skills for routine operations, including camat and kepala desa, RT and RW, 'desa surveyors' and local planners.
- Management of dispute resolution
- Assessment of land administration priorities
- Develop public-private partnerships to extend capacity to undertake land administration
- Increase accessibility to land information
- Introduce progressive land taxation

Source: Institutional Framework Reforms for Land Administration

6.5 THE SUPPLY OF LOW INCOME HOUSING

This section focuses on a variety of housing supply issues for low and moderate income households, with particular emphasis on rental housing, both public and private:

- What types of housing should be available in the market for lower and moderate income households?
- Who should build low income rental housing in Indonesia?
- Should low income rental housing receive greater emphasis – both public and private?

6.5.1 Housing Types and Housing Construction by the Private and Public Sectors

Publicly-assisted Owner Housing. In the formal sector, low income housing development has been dominated by RSS housing. However, it is HOMI's conviction that the tremendous emphasis on RSS/RS housing has drawn an "artificial boundary" between formal and informal; more flexible and affordable supply options are available.

We do not have precise statistics on the development of low income (RS/RSS) housing by the private sector. Units supplied by Perumnas were noted in section 2 – roughly 147,000 units have been sold between 1995 and 2000, of which over 97 percent were RSS and RS units (as opposed to flats). However, statistics from BTN indicate that cumulatively through 1998, BTN financed 1,551,900 units, of which 25 percent (400,000) were constructed by Perumnas and 1,551,900 were constructed by the private sector.
Rental Housing. Rental housing, both private and public, is already important in Indonesia. Recall from section 2.0 that nearly 23 percent of urban households were renters of one type of another in 1998. HOMI feels strongly that rental housing will continue to be vital to housing market. Indonesia already has good examples of government-assisted rental housing, employer rental housing, and private room rental, formal and informal. Our recommendations stress providing incentives for rental housing:

- It can provide affordable housing for lower income households;
- It is consistent with the increased density requirements of large high-land cost urban centers;
- It therefore responds to the increasing urbanization of Indonesia;
- Land affordable by low income households is necessarily getting further away from the center of urban areas. It is widely believed that average commuting times and costs are increasing to an unaffordable extent. This conjecture, however, is not obviously true, since much employment, too, is moving away from city centers;
- The tenure of new informal housing is already increasingly rental, rather than ownership, at least around Jakarta;
- Finally, recent international empirical research is again emphasizing the importance of rental housing to labor mobility and growth in GDP.

Employer Rental Housing. Employer-sponsored housing can play an important supplementary role in some circumstances. As noted in section 2.0, in one half of the cities surveyed by HOMI, employer housing played a role in the housing market, ranging from about 1 percent to 4.5 percent of the housing for lower income households. Local governments should be able to seek advice on incentive packages for sponsorship of employer housing. Tax issues – e.g. double taxation of employer housing benefits – should be examined and resolved.19

Private Sector Low Income Rental Housing. Private sector provision of rental housing for low income households, including room rentals in owner-occupied dwellings, should be encouraged. The sector can be assisted with more streamlined legal approaches to codifying tenant/landlord rights and responsibilities and providing mechanisms for timely adjudication of grievances, preferably in special housing tribunals outside the regular court system.

This brief synopsis of housing supply options gives rise to a number of suggestions and conclusions:

- A definitive decision should be taken by GOI to phase out the KPR/RSS subsidy. Housing suitable for the needs to modest income households has been too limited by the KPR/RS/RSS approach to housing. The supply of moderately-priced housing should reflect a broader continuum of typologies, augmented by low cost technologies.
- HOMI suggests a much less rigid emphasis on RSS/RS technologies and much more attention to alternative low income technologies. An improved continuum in the supply of
housing should emerge once developers realize that finance is not locked into the RSS/RS system. This supply stream will better match the effective demand of moderate and modest income households. Examples of these technologies are discussed in a companion HOMI report.

- A useful approach to thinking about the gaps in housing condition, and how various government policies might lessen the gap, is to shift from “need” per se to the concept of effective demand. “Effective” demand might be described as the housing people can actually afford using their own resources, which may or may not be augmented with various Government subsidies. However, improved policies for delivering land title, infrastructure, and housing finance at all levels of society will considerably enhance “effective” demand.

- Low and moderate income housing can be, and should be, built by the private sector. As noted, this is partially already the case. APERSI members, for example, are well versed in RSS production, and should be quickly able to adjust to other demand and technological realities. An assessment of the future role of Perumnas is not in HOMI’s scope of work. However, as noted in section 7.0, recommendations, we note very important roles for Perumnas under decentralization that rely on its planning and technical experience, rather than have Perumnas continue as a builder and manager of public housing, rental or owned.

- BRI currently provides microfinance loans for homeowners to add rooms for rental. This could be an important means of expanding the low income rental sector. As discussed in the HOMI Report “Improvements in the Housing Finance Sector”, microfinance for housing should be the focus of major efforts to extend various types of housing credit to moderate income, bankable households (See the HOMI report on the Housing Finance Sector).

### 6.5.2 Government-Assisted Rental Housing Programs

Most of the rental housing in Indonesia has been supplied by the private sector, in the formal and informal markets. However, a relatively small part of the market has been provided by the public sector. As noted in section 2.0, about 2.6 percent of Perumnas’ sales between 1995 and 2000 consisted of flats. (3950 units) This section briefly discusses the need for a continued involvement of the public sector in building, maintaining and managing rental housing.

However, we will also sound an important warning: It is generally not possible to provide successful low income rental housing without (1) strong management procedures and (2) a financial model that recognizes the need for assistance with long-term capital repair costs, and possibly even current operating costs. Country after country, including the U.S. most notably, has wasted tremendous amounts of long-term capital through the collapse of government-assisted low cost rental housing.

**The Existing Situation.** Data are available from Perumnas on its construction of rental housing in Indonesia’s major cities. Table 5.1 illustrates rental units built and being planned by Perumnas as of 2000. Jakarta, which has emphasized public housing, is apparently not typical of larger cities: over one-half of the rental units constructed by
Perumnas are in fact in Jakarta. There, public rental housing has been provided by two agencies: DKI Jakarta itself as well as Perum Perumnas.

The rationale for the provision of rental housing by these two agencies is straightforward: to meet a perceived gap in the housing market continuum, especially for lower income households. As noted in section 2.0, the private sector provides a large volume of informal, rental housing, as well as a much smaller volume of high-income rental units. The market for middle-income rental is being filled to some extent by individuals renting RS and RSS units bought speculatively from Perum Perumnas with the aid of KPR subsidized loans from BTN. Again, we do not have data on the magnitude of this market, but evidence from Parung Panjang suggests that housing units that are insufficiently attractive to their purchasers are little more attractive to renters. We speculate that middle income households wishing to rent are drawn into the informal market, often in peri-urban areas.

### Table 5.1 Rental Housing Constructed and Planned by Perumnas

<table>
<thead>
<tr>
<th>City</th>
<th>Rental Units Built</th>
<th>Units Being Constructed</th>
<th>Units Planned</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jakarta</td>
<td>7471</td>
<td>268</td>
<td>4360</td>
</tr>
<tr>
<td>Tangerang</td>
<td>192</td>
<td>192</td>
<td>-</td>
</tr>
<tr>
<td>Bandung</td>
<td>1086</td>
<td>-</td>
<td>600</td>
</tr>
<tr>
<td>Cirebon</td>
<td>-</td>
<td>96</td>
<td>-</td>
</tr>
<tr>
<td>Semarang</td>
<td>232</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Surabaya</td>
<td>1232</td>
<td>-</td>
<td>240</td>
</tr>
<tr>
<td>Palembang</td>
<td>3500</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Medan</td>
<td>628</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Batam</td>
<td>334</td>
<td>-</td>
<td>768</td>
</tr>
<tr>
<td>Samarinda</td>
<td>-</td>
<td>96</td>
<td>-</td>
</tr>
<tr>
<td>TOTAL</td>
<td>14,595</td>
<td>672</td>
<td>6768</td>
</tr>
</tbody>
</table>

DKI Jakarta and Perumnas therefore see the need for properly serviced rental housing to be provided for lower income households in locations relatively close to their employment. It is a rule of the Jakarta city council that all employers with more than 500 workers should provide housing for their workers; but this rule is widely ignored. The number of public rental units provided is not large, and the agencies presumably would acknowledge that they have been able to do more than satisfy a small proportion of the need. DKI Jakarta has told us that all of their new housing will be in the form of rental units, and they have plans for the construction of around 3,000 rental units in the next five years or so.

### Problems in Public Rental Housing

The units are generally provided in 4- or 6-storey walk-up blocks, with units typically of 31 m², but sometimes as little as 18 m². Observation suggests that maintenance of some of the blocks is generally rather poor. Rental charges are set by a formula based on the cost of construction, for example to recover 50 percent of the construction cost over a period of 20 years. Whether by chance or judgment, rental charges for new units approximate to about 25 percent of the minimum wage. Rent recovery and the ability to evict for non-payment of rent is a major problem in at least some of the public housing blocks.
It is clear that a number of issues should be resolved if local governments are expecting to continue to provide rental housing. The priority issues are as follows:

- **Rental Cost Model and Subsidy Calculation.** The full extent of the subsidy has not been calculated. In particular, the value of land is excluded from cost estimates; costs of interest and project management are excluded. The costs of management and maintenance, which are recognized as wholly subsidized, are not known. Unit rental charges are (often) not regularly inflated in concert, for example, with the cost of living or minimum wage rates. The cost to the city’s budgets of rental housing programs is, therefore, not known. Local governments do not have sufficient cost information to decide on the financial feasibility of a rental housing policy or program.

- **Rent Levels.** Rental prices should be set in full knowledge of costs, but—if subsidy is considered appropriate—based on a calculation of affordability by target groups, and with knowledge of market rental levels.

- **Management.** Unit management and maintenance are substandard. Practices need to be changed for tenants to be adequately served.

- **The Problem of Target Creep.** It is policy that these units be subsidized for lower income households (although the full extent of the subsidy has not been calculated—see above). Nevertheless, many tenants have chosen to re-let their allocated units at a higher rent (but still, presumably, below cost). Officials recognize that the benefits of the rental subsidy are largely being captured by middle-income households, and that the target households benefit only to the extent of the difference between rent paid and rental income. Thus, some programs are not well targeted; benefits are captured by higher-income households.

**Is Public Rental Housing Justified?** The cost structures for public rental housing that we have seen suggest that a considerable subsidy would be needed to undertake a rental housing program for lower income households. We do not have sufficient information to estimate the magnitude of subsidy necessary; these data are not readily available in Indonesia. *We note, however, that public rental schemes generally require moderate to heavy budgetary subventions in most countries: Indonesia would not be at all unusual in this respect.* In this case, there should be a good social or economic justification for providing subsidized housing for what can only be a minority of the population.

Such justifications could include the following: (a) that the provision of public rental housing would stimulate the private sector to improve standards; (b) that equivalent housing (of similar standard and in equivalent locations) is not provided by the private sector, and that it is unlikely in the future; (c) that certain categories of tenants are, from the perspective of local government, more deserving of housing subsidy than the rest of the general population.

It is not certain whether any of these conditions apply generally in most Indonesian cities. Although conditions in private low income rental units may sometimes be substandard, we believe that these conditions may be able to be improved more cost-effectively by means
of KIP-like schemes than by public sector competition. Justifications for housing public sector housing may include, however:

(1) housing public sector workers near their work, where otherwise they would not be able to afford appropriate accommodation;
(2) providing low income accommodations in relatively central areas, where land prices would otherwise be prohibitive;
(3) promoting social integration in urban areas (see the discussion of mixed income housing in section 6.0); and
(4) responding to density concerns in large cities in housing types which the private sector has not provided of its own accord.

Recommendations. We believe that local governments will not often be able to justify high recurrent expenditures on the provision of low-income rental housing, especially where the private sector is active in providing similar housing. Nevertheless, there will be some instances where local circumstances will place a high priority on new public rental schemes.

We recommend that:

• Local governments should be assisted to make an informed judgment about the costs and benefits of providing rental housing, including an analysis of the cost and management implications, and an analysis of the need for such housing;

• If they choose to proceed with a new rental housing scheme, they should be assisted in the process of designing a scheme, in aspects including costing, pricing and accounting techniques, the selection and retention of tenants, and rental management options (in-house and contracted out).

• Assistance to local governments should include the provision of manuals and one-on-one technical assistance. We believe that the Associations of Local Governments are best positioned to provide this type of assistance although they, too, will need initial help in establishing and training the staff of such a unit. Kimpraswil should offer to facilitate the start-up.
6.6 AFFORDABLE HOUSING: THE 1-3-6 RULE

6.6.1. The 1-3-6 Rule in Indonesia

The regulation that we describe as the “1-3-6 rule” was introduced as a central government initiative in around 1974, and was reformulated in 1992 (the Decree of 16 November 1992). It essentially requires (private) developers to build units of middle and low standard housing in proportion to the volume of high standard housing in the ratio 6 units of “simple” housing and 3 units of mid-standard housing, to every 1 unit of “luxury” housing constructed. This requirement is customarily included as a condition of the Location Permit. The regulation defines the housing types by plot size. “Simple housing” is defined as housing occupying plots of 54 to 200 m²; “middle housing”, on plots of 200 to 600 m²; and “luxury housing”, on plots of 600 to 2,000 m². The guideline applies only to developments with at least 100 “luxury houses”, and allows “simple” houses to be constructed in a separate location under some circumstances.

The 1-3-6 regulation continues in force today. Local governments are expected to impose this as a condition of development on Location Permits for all large new residential projects. We understand that the principal justification for the regulation is that low-income housing is usually unprofitable to private developers, given high land costs around major urban areas, and that, in the absence of this rule therefore, low-income housing would not be built. The rule was intended to provide a product (low cost housing) that would otherwise not be available from either the public or private sectors. It is also intended for use as a social tool, to encourage social integration by providing a mix of housing types within a single development location, as distinct from developments segregated by income. The rule was reportedly re-stated in the 1990s in order to assuage popular concern about developer greed.

Note that the regulation defines housing by plot area not, for example, by cost or sales price, nor even by the built-up area of the house itself. Even less does it define housing by the expected income of its occupants. In addition, the regulation refers to “simple” housing, not to “low cost” housing. It is, thus, possible, for developers to build relatively large and expensive houses on plots defined as “simple housing”, and still to meet minimum legal requirements. In Bumi Serpong Damai, for example, we find that the cheapest house currently advertised sells for Rp.83 million (say, $8,500). This is not a “low income house” according to our standards, since it is affordable only to about the top 10 percent of the income distribution in urban areas!

The guidelines permit developers to build “simple housing” in locations that are physically separate from the “luxury housing”. We understand that developers have sometimes claimed to build “simple housing” in different towns, and thus satisfy the formal requirements of the Location Permits. If this claim is true, it would do nothing to satisfy the housing needs of the locality that issued the Location Permit. Neither we, nor any established authority, have the ability to check the veracity of such statements. They may or may not
be correct. We must point out, however, that a regulation that cannot be monitored, nor compliance verified, cannot be enforced.

Because of the shortcomings of the regulation—in particular, that it cannot be monitored and enforced—it appears to be observed only rarely, and then more by casuistry than by actual construction of low cost housing. A developer told us that “the rule is dead”.

Nevertheless, it seems likely that the situation today is not greatly different to that prevailing a few years ago, when REI members as a whole (but not individually) reportedly did develop housing in the approximate ratio 1:3:6. This was achieved in response to market demand, rather than as a response to the government regulation. We suspect—but do not have data to prove—that an even higher proportion of low cost housing may have been developed by the private formal sector in recent years.

If this is the case, it would presumably be the consequence of developers responding to opportunities, including KPR incentives (the high end of the market having submerged for the moment), not because the 1-3-6 rule has been effective. Some private developers, notably members of APERSI, have certainly undertaken projects solely containing low-cost housing.

In the private new town of Lippo Karawaci, the 1-3-6 rule was waived. In Drijorejo Kasiba, so it is reported by LAP, the rule is enforced over the whole settlement, but not for individual developers. The latter “clearly use Perumnas as a development catalyst. ...Private developers can afford to pay more for land as there is no real requirement for them to build low-cost housing under the 1:3:6 ratio so all their housing has high profit margins which can easily absorb higher land prices.”

It appears that traditional concepts of mixed residential development have largely given way to more foreign notions of separate enclaves for the rich and poor.

**Enforcement Issues.** The regulation is formulated sufficiently vaguely that it is easy to circumvent. Its implementation appears not to be monitored by central government, nor by local governments, with a few possible exceptions including DKI Jakarta. We should expect that a rule that is neither monitored nor enforced is a rule that is rarely observed.

Monitoring has clearly been difficult, since neither developers nor local planning authorities are required or encouraged to collect and publish data either on the number or proportion of low cost houses actually constructed, or on compliance with Location Permits. Correspondingly, Kimpraswil and its predecessors, as well as BPN and local governments, have had no means of monitoring or enforcing compliance.

We do not believe that it would be practicable to require developers to monitor their own compliance with the rule (in the spirit of self-regulation), since it is in their own interests to obfuscate the statistics. Nor would it be practicable for Kimpraswil or any other centralized
body to perform the task of monitoring, since to do so would require a reporting capacity that is not consistent with current thrust of decentralization.

Correspondingly, devolvement of power and responsibility over local housing to local governments now means that they have both the authority and potential interest in enforcing their own planning conditions. If the planning conditions (for example, the 1-3-6 rule) had been worded sufficiently clearly, it would not be difficult for staff of the Housing Dinas to check whether they had been observed. We understand that developers are presently permitted to build low cost houses in a location different to the one for which a Location Permit may have been issued, although it is improbable that many developers would actually respect such a condition. It is clearly difficult, or impossible, to enforce if the two locations are in different planning jurisdictions. If the 1-3-6 rule is to be retained, we recommend that developers be required to observe the regulation within the planning jurisdiction that issued the permit.

In cases of non-compliance with conditions for a Location Permit, there would be a number of options for enforcement. These would range from the relatively simple (automatically refusing future permission to the same developer; notifying the Local Government Associations of the failure of that developer to meet his legal obligations), to the more sophisticated (such as imposing an automatic fine, to a level that could have been defined within the planning consent; taking the developer to court).

### 6.6.2 Can 1-3-6 be Made to Work?

Other than the problems, noted above, of implementing the existing regulation, there are some problems in principle with requiring private developers to provide “affordable” (low cost) housing, particularly in mixed developments.

We note that in many other countries, Asian and Western, the market tends to favor single-class housing developments. Developers know well that the effective demand for—and therefore the selling price of—low-density housing is likely to be higher in a one-class neighborhood than in a mixed estate. All other things being equal, developers are therefore likely to avoid mixed developments, as they provide a lower rate of return.

We also note that it is difficult for public sector planners to second-guess developers, by estimating the supposed “excess profit” they could make from a development, and requiring them to use this profit to cross-subsidize low income housing. Experience has shown that developers are masters of circumventing regulations, and of calling the planners’ bluff.

That developers do not want to build low cost housing, and that it is difficult to require them to do so, are not, however, sufficient reasons to abandon the principles of 1-3-6. In general, we support the concept, embodied in the 1-3-6 rule, that private developers should be...
encouraged to provide lower income housing, not least because this is a policy of the Government, consistent with the Constitution.

The consequences of segregated housing include the following:
(a) lower income households are generally required to look further afield for new housing and, thus, to pay dearly for journeys to work;
(b) class divisions are emphasized rather than mitigated through planning; and
(c) individual employers may find it more difficult to attract domestic staff, for whom flexible working demands a close relationship between home and workplace.

For these reasons, we also support the concept that housing should not always be provided in segregated enclaves.

International Experience.

- **U.K. Experience.** In the United Kingdom, for example, public sector planners have largely abandoned policies that require a developer to provide “affordable housing” on specific sites, instead mostly relying on a combination of market forces and financial incentives for housing associations to provide lower cost housing. It is generally only in high-profile sites, where planners are capable of negotiating an agreement with developers, that there are requirements to include a proportion of affordable housing in addition to the more profitable land uses.

- **U.S. Experience.** In the U.S., by contrast, numerous types of low income housing strategies are employed by both local and, indirectly through subsidies, by national government. Furthermore, the mixed income debate is alive and well!! The policy quest, which has gone on for decades, seeks to address issues of (1) methodologies for successful income mix; (2) gentrification and the re-entry of the upper and middle classes into central city areas long abandoned for the suburbs, with the consequent displacement of the current low income tenants; (3) NIMBY concerns (not-in-my-backyard), (4) the deregulated, private sector/asset management, and scattered-site future outlined for U.S., public housing.

For example, any locality that gets a federal subsidy, for example for public housing, has to abide by certain rules, such as the provision of a proportion of affordable housing. Most often local governments are setting the rules, and national subsidy policies are not involved. Local governments use an arsenal of zoning permits, land purchase, local subsidies, and required cooperation with local community groups, especially CDCs (Community Development Corporations) to encourage, plan, and monitor mixed income development. One fairly clear message is that a very wide range of intended incomes has not worked very well. Rather, the development are apparently more successful if a narrower range is planned for, one which allows the design and technology difference between “low” and “moderate”, or between “moderate” and “high” to be nearly invisible. Thus, less value is “lost” as compared with a homogeneous benchmark.
A recent review article of U.S. mixed income housing policies provides some lessons learned from this long – and sometimes “failed” experience – in promoting income mix.20

- Mixed income housing works best when it emphasizes the basics of real estate development and management.

- Where the goal of mixed income housing is upward mobility of the low-income residents, more the income-mixing and good management are required.

- Mixed income housing will work only where there are sufficient units aimed at the higher income population to create a critical mass.

- Mixed income housing works best when the income mix is not emphasized, and there are “no” differences in the nature and quality of the units being offered.

- Successful income integration in a neighborhood setting is more difficult than in a housing project context.

- Mixed income rental housing may be more difficult to manage when there is a dichotomy between the subsidized and market-rate renters, rather than a gradual climb represented by middle income tiers.

**Alternative Approaches to the Provision of Mixed, Affordable Housing.**

Several approaches to providing mixed housing could be adopted, as follows. Whichever approach is utilized, however, it is clear that responsibility for implementation must be taken by local governments, and that they must accept the responsibility for monitoring and enforcing compliance.

One approach would be to do nothing beyond maintaining the 1-3-6 rule unchanged, simply permitting local governments to utilize it as they see fit. This would be a no-cost approach, and would allow certain governments to try to enforce the regulation if they felt capable of doing so. There would be the twin risks, though, either (a) that the regulation would be so widely ignored by developers, as at present, that it would have no greater impact than at present; and/or (b) that more ambitious governments would try to enforce the rule to the extent of forcing developers out of business in their areas of jurisdiction.

We note, in passing, that there appears to be no particular reasons why the proportions should be 1, 3 and 6. *The ratios are arbitrary, and the lot sizes are not correlated with housing prices. The regulation should therefore be more flexibly defined. Local governments could adopt other proportions if sound analysis shows these to be more appropriate.*
An alternative approach would be for local governments to interpret the existing 1-3-6 regulation more flexibly. We understand that this is possible and, indeed, has been practiced by DKI Jakarta and a few other authorities. Thus, developers could be required to make a formal contribution, of either finance or land, to a public authority in lieu of building low cost housing on site. In Lippo Karawaci, for example, the local government collected a financial contribution towards the low cost housing required under the 1-3-6 ruling, although it is unclear whether that absolved the developer from having to provide unprofitable housing. Low-cost housing is said not to have been welcomed by the developer as low-income residents “often dispose of their rubbish anywhere and generally ‘lower the tone of the neighborhood’.”

Some observers suggest that Perumnas could be the beneficiary of financial contributions in lieu of providing low-cost housing. This proposal is, however, contrary to the spirit of decentralization (local contributions to a central fund). We believe the time is past when central organizations should be expected to manage funds on behalf of local governments.

As an alternative to providing financing for Perumnas, we suggest that consideration be given to the possibility of local governments soliciting developer contributions to their own, newly-created, housing funds. One difficulty here is in determining an appropriate level of contribution, without completely deterring developers from working in specific jurisdictions. Additionally, such a mechanism would give the opportunity for considerable financial leakage (KKN). For these reasons, we are skeptical whether it could be made to work, although we do not rule it out as impossible. In any case, we would prefer to see contributions made in land specifically designated for affordable housing, rather than cash, which can “disappear”.

One alternative is to encourage the local sale of ‘certificates of completion’, a device which would permit developers to claim virtual compliance with the regulation. Thus, for example, a developer specializing in low cost housing could sell a certain number of certificates of completion of low cost housing to another developer; in possession of the certificates, the latter would then be able to obtain a permit for high cost housing. This mechanism would facilitate a transfer of funds—a tax—from developers of high cost housing to developers of low cost housing. The market, not bureaucrats, would efficiently determine the price of transfer. By lowering the cost of new low cost housing within a locality, the effective demand for it would thereby be increased.

An approach that is increasingly used in the UK and other western countries is for planning permissions to be made conditional upon additional, sometimes unrelated, works being undertaken by the developer for the public good. For example, a developer wishing to construct a commercial building in an area where it might otherwise have been unacceptable, could be required to build low cost housing in exchange for permission to build the commercial building. LAP points out that ‘the concept of planning gain may seem attractive to local authorities with limited funds for public facilities. However, there is ‘a very fine line between extracting concessions from developments which are marginally
acceptable and the sale of permissions for any development. So this is a dangerous tool in the hands of an irresponsible or inexperienced authority.

Certain alternative means are available to obtain both an increased supply of low-income housing and, simultaneously, a preferred housing mix. One of these is by the implementation of large-scale developments, initiated by the public sector, but with substantive private involvement. Through such mechanisms, the public sector has the possibility of cross-subsidizing low-cost housing by high-cost housing, as well as ensuring the provision of an appropriate housing mix. This form of development essentially describes a Kasiba. This is further discussed in our separate report on the subject where we support the principle of Kasibas, but, because of doubts about their feasibility, we make recommendations for strengthening their implementation.

More pertinently, employment location policy can play a large part in determining the demand for low-cost housing in certain localities. Experience in Indonesia and elsewhere has shown that housing supply tends to follow demand, which follows employment. It may, for example, be a goal that housing for low-income employees should normally be available within-say 2 km of each center of employment, so reducing transport costs and time for these employees (and increasing production efficiency). Simple geometry dictates that much more land is available for low-income housing if employment is dispersed than if it is concentrated. It follows that a housing policy favoring low-income households should also incorporate a policy for dispersed employments.  

We would also point out the importance for complementary transport planning in determining the location of new housing developments. Expressed simply, an absolute determinant of a good location for housing is its relationship to employment opportunities. High-income households have a wider choice of transport mode and route than do poor households, simply because the latter have much lower disposable incomes. It is therefore of critical importance to poor households that they should be able to travel to work at reasonable cost and time. If they cannot do this on foot or by bicycle, relatively short road or rail links must be assured. The existing development by Perum Perumnas at Parung Panjang—see the Kasiba report—provides the ultimate demonstration of the futility of providing low-income housing on a site that has poor transport connections with existing centers of employment (and, conversely, the imprudence of providing insufficient local employment on a site that has poor external connections).

Recommendations.

Should the 3-6 Rule be Eliminated? If efficiency were the sole criterion by which...
regulations should be judged, we would recommend that the 1/3/6 rule be abolished. It is not effectively monitored (except perhaps in Jakarta). It is all too frequently ignored. This type of inadequate administration cannot help but to lead to inefficiencies (and perhaps more opportunities for KKN). Furthermore, from the strictly analytical point of view, cross subsidization policies of this type are usually viewed as inefficient.

However, Indonesia, like many countries in the world, has sought with the 1/3/6 regulation to promote income mix policies in housing. As discussed, this is a goal with many potential ramifications:

- improved social integration;
- housing for employees of homes and businesses in districts where land is expensive;
- location policies which coordinate both housing and industrial development, which thus helps ameliorate the costly and time-consuming transportation difficulties of lower income households from the urban fringe.

Thus, we presume that (1) the original goals intended for the 1/3/6 regulation are still valid; (2) therefore then the regulation should not be abolished because of ineffective enforcement; (3) that new life should be breathed into both the basket of methodologies used to carry out 1/3/6; (4) that presuming that local governments are to be charged in the near future with implementing and monitoring the rule, that they receive assistance in understanding some of the options in applying 1/3/6 to their land use plans; and (5) that mechanisms are put in place to monitor compliance.

We see a clear need for Kimpraswil to give a lead to local governments in the encouragement of low cost, and mixed, housing. Provision of incentives and deterrents to encourage developers to provide mixed, affordable, housing is not a straightforward matter. It has been proved to be easy both to fail absolutely in the attempt and, as a result, to gain no affordable housing from a putative deal.

We therefore recommend that Kimpraswil set up a working group to determine how best it can provide appropriate advice to local governments. Among other things, this working group would:

- Determine whether the same priority should be given to the provision of low cost housing, and to the provision of a housing mix, and whether the same tools could or should be used for both goals;
- Determine the degree to which the existing 1-3-6 regulation can be interpreted in different ways, or whether R needs to be modified;
- Re-draft the 1-3-6 regulation if necessary;
- Explore the practical and cultural implications of encouraging mixed, and low income, housing through use of the tools summarized above;
- Finally, issue a circular advising local governments on alternative methods of enhancing the supply of formal low cost housing, and follow up with briefing conferences, etc.; and
- Set up a unit capable of providing technical assistance.
6.7 CONCLUSIONS AND RECOMMENDATIONS

This section summarizes our recommendations on the key issues impacting efficiency and affordability in the land and housing market. These include:

- Land Titling and Registration
- Facilitating Increased Land Supply and Improving the Permitting Process
- Mixed Income Housing and the 1/3/6 Rule
- The Provision of Rental Housing

Institutional Roles in Housing Market Assistance

6.7.1 Increased Efficiency in Land Titling and Registration

Land Titling. Although progress has been made in a number of areas, land titling issues remain a key stumbling block, presenting problems in efficiency, timeliness and the access to full title, especially for low income households. Our recommendations include the following.

- There are a number of issues relating to land title that make residential mortgages unduly risky, time-consuming and, therefore, expensive. Most of these issues require a sustained approach to reforming the legal structure on the part of BPN. The issues can and should be addressed in the first instance by the proposed Land Management and Policy Development Program, to be supported by the World Bank.

- One major issue of land titling is the time taken for a purchaser of housing from a developer to be issued with a mortgageable title (Hak Milik or HGB). We recommend that (a) BPN takes no action to prevent developers from initially splitting the title to the benefit of fictitious individuals; and (b) the Minister of Home Affairs be asked to declare housing developers as “permitted corporations” under the Basic Agrarian Law, and thus able to hold Hak Milik in place of HGB rights.

- Converting Hak Girik to Hak Milik is currently costly, especially for lower-income households. For this reason, many households choose not to make the conversion, which unduly limits their access to formal sector housing finance, as many lenders will not accept HG title as collateral. A recent pilot program has shown that it is possible to reduce the costs of converting HG to HM, and these findings should be implemented more broadly.

- In order to improve timeliness, granting of land title should be executed by Land Office in Kab/Region if the location is within the area of Level 11 Local Government (kab/kotamadya). If the location is within several Level 11 Local Governments, granting of land title should be issued by the Governor upon the local governments’ recommendations. Central BPN sets up the guidelines and policy. Every granting of title are delegated to Level 11 Local Government with the exception of land located within several local governments.

Registration. Recent improvements have been made in registration procedures. Although there is still work to be done, HOMI concludes that improvement in titling and permitting issues are now relatively more important in increasing efficiency and land supply. Nevertheless, several recommendations are made to improve registration:

Land registration can be made more effective by revising PP 24/1997 to achieve the following: (a) simplification of standardized forms of title evidence; (b) simplification of...
standardized forms of Deed of Mortgage, and Sales Purchase Deed; (c) enforcing the requirement that registration be undertaken within seven days; and (d) improving the services of the PPAT to comply with existing requirements. We recommend that BPN, together with the Ministry of Home Affairs (Dalam Negeri) where relevant, should report on the feasibility of these reforms.

There is a need for consistency in rules on the issuing date of Land Certificate. The form of registration receipt should be in 1 (one) sheet. The form of Deed of Sale and Purchase of Land and APHT should be simplified. If the APHT is registered or the Mortgage Certificate is simplified into just 1 sheet, there is no necessity in giving registration receipt for mortgage. Computerization of Mortgage (HT) Land Certificate and Land Rights should be increased. PPAT’s function as the assistant of land application process by giving sanction should be improved.

Unregistered land is not acceptable security for bank loans, e.g. for house improvements. The Land Administration Project has recommended a number of detailed ways in which householders would be able to raise credit on unregistered parcels; and we support those recommendations.

6.7.2 Increased Efficiency in Land Supply

Facilitating Release of Land to the Market. The land supply is more constrained than need be, especially for low income housing. Most of the land that could be developed for housing around Jakarta and, maybe, around other major cities, is not legally available. Because it does not form part of the supply of land for new housing, it may be expected that all other things being equal the price of land is significantly higher than might otherwise be the case, and helps to keep house price high. Holding land out of development is also contrary to the spirit of Indonesian law. We therefore make some recommendations for stimulating the supply of land. These include:

· The procedures already developed for the disposal of IBRA’s assets should be followed for its land holdings, as for other classes of asset. That is, they should be sold by open and transparent auction, without restriction on the “of bidder, and within the time frames agreed within government and with the international community. Insofar as it may be possible to disaggregate some of the holdings into smaller parcels, this would be preferred. However, existing Location Permits should not automatically be transferred to new purchasers.

* Perum Perumnas, DKI Jakarta and other local governments, the military and, perhaps, BPN should review their land needs, and subsequently auction any land surplus to these needs. It would be appropriate for a sub-committee or task force working under BKP4N to develop methodologies and provide assistance as required.

· The law should be changed so that the Land and Building Tax (PBB) can be charged at differential rates on idle and productive land; it should be levied at a high rate on idle land, to encourage corporations and individuals with small holdings to release or develop it.

· Local governments should take the lead in reviewing land availability, especially for new lower-income housing, with a view to assembling and promoting development packages. It will be necessary to acquire outside, impartial, expertise to assist local governments to plan negotiate and, perhaps, implement land packaging in this form. Foreign donors would be receptive to financing advisory services of this nature, perhaps through one of the associations of local governments.

Technical Assistance For Policy Development For Enabling The Housing Market To Work In Indonesia
Land Supply and Permitting Issues

Permitting. HOMI concludes that inefficiencies in monitoring and enforcing location permits have a negative impact on increasing the supply of land available for development. More streamlined permitting procedures are also available, especially under decentralization, as local governments can increasingly utilize ‘permit’ by exception procedures.

- The time taken to obtain Location Permits can be reduced by limiting the number of members of the coordinating review committee.

- Although Location Permits are issued for a certain period of time, these restrictions are neither monitored nor enforced. As a result, land is effectively held out of development, and the land is thereby blighted. We recommend that the provisions of PP 36/1998 be invoked to encourage developers holding land under Location Permits, in excess of their immediate needs, to donate the surplus amounts to government for use for public projects in exchange for renewal of the residual Permits. All other Location Permits for land not required for development in the near term should be revoked if not used. All local governments should set up a simple system for monitoring compliance with residential Location Permits. A central body would be needed to assist them in establishing and maintaining the system.

Location permits used to be seen to confer an exclusive right to the developers to whom they were issued, thus effectively prohibiting their sale to third parties. Although this reduced the price of the land to the developers, the restriction was seen as neither efficient nor just. Although this restriction has been revoked, this change is apparently not widely known. We therefore recommend that local land offices should ensure that all affected landowners understand the implications of the issue of a Location Permit covering their land.

The permitting process is not well understood, either by developers or, in many instances, by land officials. As a result, both sides err on the side of caution by following old, known, procedures rather than the new, more cost-effective procedures. We recommend that local land offices should clarify the status Inpres No. 23/1998, which revokes the need to obtain an Izin Prinsip.

Although regulations have been issued regarding the maximum time to be taken by officials in completing certain processes, these regulations are often not observed. The time and the cost of obtaining permits therefore continue to be much higher than is officially allowed. We recommend disseminating the lessons learned from the land office in Jakarta Barat, with the Ministry of Home Affairs taking a lead in assisting local governments to draft decrees simplifying approval processes.

Permitting by Exception. The granting of the Location Permit is actually not needed if the Regional/Local Spatial Plan(s) are clear and detailed.

The resolution of many of these topics will be addressed by the World Bank-funded Land Management and Policy Development Program. The success of this program should be regarded as a very high priority for the success of a national housing policy. We recommend that it should be given full support by all relevant agencies and donors.
6.7.3 Mixed Income Housing and the 11316 Rule

*If efficiency were the sole criterion by which regulations should be judged, we would recommend that the 113/6 rule be abolished. It is not effectively monitored (except perhaps in Jakarta). It is all too frequently ignored. This type of inadequate administration cannot help but to lead to inefficiencies (and perhaps more opportunities for KKN).*

Furthermore, from the strictly analytical point of view, cross-subsidization policies of this type are usually viewed as inefficient. Market forces generally operate against income mix, in part because of the land price gradient, and in part because of the preferences of higher and middle income groups for homogeneous neighborhoods.

Nevertheless, many countries still search for answers to the income mix dilemma. If this rule is to be maintained, then it should be both flexibly defined and monitored for compliance. Our recommendations are as follows:

The 1-3-6 rule is formulated sufficiently vaguely that it is easy to circumvent. Its implementation is rarely monitored by any government body, central or local. A rule that is neither monitored nor enforced is a rule that is ignored. Several alternative approaches to providing mixed housing could be adopted. Responsibility for implementation must be taken by local governments, and that they must accept the responsibility for monitoring and enforcing compliance.

- Furthermore there appears to be no particular reasons why the proportions should be 1, 3 and 6. *The ratios are arbitrary, and the lot sizes are not correlated with housing prices. The regulation should therefore be more flexibly defined.* Local governments should adopt other proportions if sound analysis shows these to be more appropriate. The U.S., after careful study, has found that success in mixed income developments is more likely the lesser the range of disparity in income and housing quality: this suggests mixed neighborhoods with moderate and lower income groups.

- An alternative approach would be for local governments to interpret the existing 1-3-6 regulation more flexibly. We understand that this is possible and, indeed, has been practiced by DKI Jakarta, Lippo Karawaci, and a few other authorities. Thus, developers could be required to make a formal contribution, of either finance or land, to a public authority in lieu of building low cost housing on site.

- Another alternative is to encourage the local sale of ‘certificates of completion’, a device which would permit developers to claim virtual compliance with the regulation. Thus, for example, a developer specializing in low cost housing could sell a certain number of certificates of completion of low cost housing to another developer, in possession of the certificates, the latter would then be able to obtain a permit for high cost housing.

6.7.4 The Role of Rental Housing

HOMI considers that rental housing can become an increasing important aspect of the urban housing supply. This includes private rental accommodation for lower income households, public rental housing, and, to a lesser extent, employer-sponsored rental housing.
Public Rental Housing. Although public rental housing can play a vital role in low income housing, especially in very large urban areas, effective management of low income public rental housing has been fraught with difficulties worldwide. Thus, we believe that it is difficult to justify that all local government should become providers of subsidized rental housing. Thus:

Local governments should be assisted to make an informed judgment about the costs and benefits of providing rental housing, including an analysis of the cost and management implications, and an analysis of the need for such housing.

If local governments choose to proceed with a new rental housing scheme, they should be assisted in the process of designing a scheme. In aspects including costing, pricing and accounting techniques, the selection and retention of tenants, and rental management options (in-house and contracted out).

Employer Rental Housing. Employer-sponsored housing can play an important supplementary role in some circumstances.

Local governments should be able to seek advice on incentive packages for sponsorship of employer housing. Tax issues - e.g. double taxation of employer housing benefits should be examined and resolved.

Private Sector Rental Housing. Private sector provision of rental housing for low income households, including room rentals in owner-occupied dwellings, should be encouraged.

The sector can be assisted with more streamlined legal approaches to codifying tenant/landlord rights and responsibilities and providing mechanisms for timely adjudication of grievances, preferably in special housing tribunals outside the regular court system.

BRI currently provides micro finance loans for homeowners to add rooms for rental. This could be an important means of expanding the low income rental sector. As discussed in the HOMI Report ‘Improvements in the Housing Finance Sector, micro finance for housing should be the focus of major efforts to extend various types of housing credit to modest income households.

6.7.5 Institutional Roles in Housing Market Assistance

For a complete discussion of HOMI’s recommendations regarding institutional roles, please see the HOMI Report ‘Local Level Housing Assistance Programs and Institutional Arrangements’. In this section, we also briefly mention the important roles of Kimpraswil and Perumnas in a decentralized environment, especially as they impact the effectiveness of local governments in planning, establishing and monitoring land use, and assisting with housing and infrastructure supply decisions.

The Role of Kimpraswil under Decentralization.

The role of Kimpraswil, along with so many other Government institutions, will ultimately be changed in a dramatic fashion under decentralization. There is a great deal for Kimpraswil to accomplish, however first, to serve as a policy-making and technical assistance body to...
local governments, and secondly, to build a significant research, information service, and policy development capacity. Our recommendations include the followings:

Kimpraswil should set up an internal working group to determine how best R can provide appropriate advice to local governments as facilitators of land regulation and use planning, public rental housing, infrastructure, and related services.

Assistance to local governments on the provision of public rental housing should include the provision of manuals and one-on-one technical assistance. The Associations of Local Governments are best positioned to provide this type of assistance although they, too, will need initial help in establishing and training the staff of such a unit. Kimpraswil should offer to facilitate the start-up.

As discussed in the HOMI report ‘Implementation of Kasiba/Lisiba’, Kimpraswil has an important role in assisting selected local governments assess the feasibility of the Kasiba/Lisiba approach to infrastructure and low income housing development.

A useful approach to thinking about the gaps in housing condition, and how various government policies might lessen the gap, is to shift from ‘need’ per se to the concept of effective demand. ‘Effective’ demand might be described as the housing people can actually afford using their own resources, which are then augmented with various Government subsidies and/or with improved policies for delivering land title, infrastructure, and housing finance at all levels of society. Please refer to the HOMI Report ‘Housing Subsidy Instruments for Home-Owner Assistance Programs’.

We stress the importance both of pursuing a pro-active employment location policy, and of sound transport planning in facilitating appropriate housing policies.

Kimpraswil should create a Department of Policy Development and Research. This group would establish advanced IT systems, gathering all available housing data into a central facility, and quite possibly, developing its own housing survey capacity. The staff would undertake research into policy development issues as well as design studies which are then competitively bid to private research firms and universities. In the long-run, this group would be the central depository of national, regional, and local statistics necessary to evaluate local government housing and infrastructure policies under decentralization as well as the cost-effectiveness of alternative subsidy policies. From these efforts, new policy developments would be supported.

- Many of the recommendations in the sections above involve not only Kimpraswil, but also other key agencies, especially BPN, Perum Perumnas, and Bappenas. Thus, it is important that Kimpraswil continue with its lead role in activating the Inter-Ministerial Committee.

- It is appropriate to involve donors in providing assistance that aims to develop and disseminate examples of good practice in local land offices. The donor role will need central guidance and coordination from Kimpraswil.

The Role of Perum Perumnas.

- Housing can be, and should be, built by the private sector. RSS/RS draws an ‘artificial boundary’ between formal and informal; more flexible and affordable supply options are available.
• Perumnas’ long experience and particular expertise can best be utilized in several important ways, including development planning assistance for local governments and Kasiba/Lisiba development. Under decentralization, these are now more important than ever.

• As discussed in the HOMI Report cited above - ‘Local Level Housing Assistance Programs and Institutional Arrangements’ - Perumnas itself should be decentralized into Regional Offices, to bring its local experience in infrastructure to best use in the local government context.

• Although outside our Scope of Work, we emphasize the importance of infrastructure for land development for housing. It would be appropriate for local governments to use National Housing Fund resources, and Perumnas expertise in infrastructure planning, to complement other KIP funding sources to provide post-hoc infrastructure as necessary to areas of lower-income housing.
Annex: LAP recommendations for tenure on community and informally-occupied land

The following recommendations are abstracted from the Land Administration Project Final Report and Policy Matrix: Land Policy Reform Indonesia, September 2000.

Recognize Community Ownership
Allow communities to have rights in the basic tenure - ownership.

Allow communities to manage land and internal land affairs according to their traditional customs within the community boundary.

Allow communities to control conversion of land out of their ownership by local adat processes.

Allow communities to map and to register freehold ownership of their land, in name of selected persons as ‘representatives of the (named) community’ or other appropriate legal mechanism with a defined outside boundary for the global title.

Recognize and Accept Informal Land Delivery Systems
Recognize the methods used by local people (traditional and non-traditional) to deal with land.

Extend proofs of ownership to include local and informal evidence, for example village records (e.g. Buku C) and tax records.

Optimize use and creation of local records for recording changes through transactions, inheritance, marriage, birth, securitization, resolution of disputes and so on.

Incorporate local knowledge about land, land use and natural resource management into the formal system.

Use mapping, boundary identification and surveying tools appropriate to the value of the land and capacity of the administration.

Concentrate on creating an accurate public record to deliver security of tenure.

Recognize Leaseholds as Interests in Land
Ensure that leaseholds are land tenures.

Allow wrongly evicted tenants to recover land and damages for evictions.

Allow tenants to recover key money, payment for possession, deposits and accelerations of rent from lessors, up to a value.

Recognize Possession as Tenure

Deliver security of tenure by making land rights accessible through possession on state and private (not community) land’

- For whole parcels or areas which could be recognized as parcels defined by general boundaries (pending improvement) to eliminate ownership disputes and
- For parts of a parcel capable of being merged with an existing parcel to eliminate boundary disputes.
Establish Legal Remedies and Upgrade Informal Land Rights

Create precise remedies to allow an owner (including a possessor) to recover 1. Land and 2. Damages for interference with land.

Control eviction from private land and land occupied for housing and agricultural purposes unless preceded by due process, alternative land and/or compensation.

Allow all landowners and people using land informally for housing and agricultural purposes access to anti-eviction protection.

Develop laws to
· deal with the transitional implementation stage
· Balance claims based on possession and anti-eviction rights with legal titles and identify no go land upon which no right to use can be claimed.

Develop strategies to upgrade titles and boundary identification.
Assist upgrading of facilities in sub-standard urban housing and kampungs by identifying the land, preferably by survey of the outer boundary and registration or recording of the area in local records.

Simplify Evidence of Ownership
Allow tax receipts to be used especially when accompanied by possession (other than as lawful possessor in which case the proof goes to the landlord's or owners title).

Allow other forms of local of evidence, including local information.

Increase Capacity of Local Government to Administer Land Affairs
Legally empower local officials in villages, communities and government to undertake a range of land administration functions, especially in relation to land rights outside the registration system.
Design public window for land information to attract local users, redress lack of knowledge and literacy, empower the community, and implement transparency and accountability.

Conveyancing
· Clarify conveyancing, priority and evidence laws and create a modern regime of law for land contracts.

· Require writing for creation of an interest in land (outside adat communities) other than for residential leases less than 1 year.

· Reduce transaction formalities and allow simple (non-notarized or PPAT (land deed official) witnessed standard forms for transactions, inheritance and other common situations.
Clarify the private law applying to contracts relating to land (other than capacity to deal with land.

· Clearly state in the law that a forgery is void, that is not effective to create any interest in land and any registration of the forgery does not cure this defect.

· Introduce service function and complaints handling system for all land offices. Make records available to public and other agencies.

Provide land office liability for administrative error including issuance of two titles for the same parcel.
## CHAPTER 7

INSTRUMENTS FOR A HOUSING ASSISTANCE PROGRAM (HAP) A FOCUS ON HOME OWNERSHIP

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CHAPTER 7

INSTRUMENTS FOR A HOUSING ASSISTANCE PROGRAM (HAP)
A FOCUS ON HOME OWNERSHIP

7.1 Background

7.1.1 The Demise of the Old System; Reasons for Change

The KPR interest rate subsidy. The corner stone of the GOI housing policy was the KPR interest rate subsidy for loans for specific house-types. Under the system lenders received subsidized liquidity credit from Bank Indonesia for part of the loan amount and on-lent at fixed, below-market interest rates to qualifying households. The interest rates charged to borrowers and the proportion of liquidity credit to lenders varied per cost of unit.

The system remained unchanged for at least 20 years until the economic and financial crisis of 1997. However, the 1997 collapse was just the final straw for a system that had become untenable and had an increasingly negative impact on housing market and housing finance sector development. After the crisis, and as part of the IMF agreement, BI liquidity funding for KPR subsidies was ceased and MOF had to carry the subsidy on its RDI budget. It is supposed to be phased out by 2004.

Other housing assistance programs. Indonesia developed and implemented some of the world’s most successful low-and moderate income housing projects. For example KIP, IUDIP, PPMK and varied community-based housing projects are acknowledged as highly effective approaches in improving the living standards of local communities. They coordinated different inputs and ministries, incorporated community participation and local capacity building.

However, these projects depended on donor funding and died when the funding cycle stopped. When the project implementation units were closed, the accumulated knowledge, procedures and systems disappeared as well. No continued budget allocation was afforded to these projects, and no institutional continuity was provided. Current poverty alleviation programs could not build on the institutional tradition of these programs and have great difficulty building up sound local level and community-based systems for meaningful aid disbursement.
It is widely understood that these past ways to provide housing assistance have been detrimental to the healthy development of the housing sector and are inadequate in providing the country with the continuous housing support systems it requires.

7.1.2 Need for a New Approach to Housing Assistance

The housing demand analysis that was conducted as part of the HOMI project, showed the severe constraints in the housing and housing finance market. Approximately 750,000 new households have to be housed in urban area each year. The cheapest low-income house produced in the market place (approximately Rp.25 million) can only be afforded by households at the 50th percentile of the urban income distribution, because of high financing costs and perceived risks by lenders that housing values will be negatively impacted by neighborhood conditions. Without effective housing assistance systems, most of the housing requirements for the below median income groups (375,000 housing units per year) will be built in the illegal and non-compliant housing sectors. This will have an extremely negative effect on the quality of urban areas, already congested and struggling to provide basic services to their swelling populations. It will negatively affect the quality of life of all urban Indonesian households.

The HOMI project was asked to develop a comprehensive housing assistance program for Indonesia. This report details possible national level finance oriented housing subsidy approaches, while another HOMI report deals with local level ownership and rental programs. These complementary proposals for housing assistance programs will be integrated in a comprehensive report at a later date.

The analyses provided in this report are as yet incomplete since the critical inputs from the market and finance sector studies (Component C) and local level subsidy design (component D) were not yet available at the time of writing. During the preparation of the final comprehensive report, recommendations from all reports will be incorporated in the proposals for a complete housing assistance program.
7.2 The Dominant KPR Subsidy Scheme

7.2.1 Strengths of the KPR subsidy program

The KPR interest rate subsidy system was initiated in the early 1970s as a program of the state savings bank, BTN. It was one of many such initiatives around the world and reflected the general feeling that conventional banks would never make long-term mortgage loans for small houses and moderate income households. Like many other countries, Indonesia is currently reconsidering that position in the face of evidence that banks will lend to moderate income customers for smaller properties if risks can be assessed properly.

The old system was not without merits. We summarize the strengths of the KPR system briefly:

*Expanded private sector participation in low cost housing.* The subsidy program was designed to expand the role of the private finance and lending sector in low and moderate income housing, and it was successful in doing so. When the crisis hit the country, approximately 35 banks participated in the program and a much larger number of developers produced housing under the subsidy system. Contrary to what is often assumed, Perumnas, the state-owned developer, constructed subsidized houses for 25 percent of the total disbursed Rupia value (Appendix 1).

*Simplicity of the system to produce and allocate substantial numbers of low-income houses and Hak Milik titles.* The program developed approximately 100,000 units per year, less in the earlier years and up to 180,000 in the pre-crisis boom period. It produced Rp.9 trillion worth of houses since its inception. The system of production of subsidized units was simple for both the government, the developers and to a lesser degree for the lenders. Developers, public and private, would seek qualifying customers to whom they would pre-sell the houses. Developers assisted with subsidized mortgage applications for their customers. They received mortgage finance, which was granted to the borrower, directly from the bank and constructed proto-type houses at set prices. No further appraisals were often conducted and real values of the houses were not assessed (depending on
the banks involved). From the standpoint of the developer, this system was, of course, highly profitable since no construction credit was required.¹

The system posed risks to the lender, however. Moreover, lenders had to advance the funds for the mortgage loans and were often reimbursed for the government part of the funds as much as 6 months later. BTN administered the system on behalf of itself and the other appointed banks.

From the perspective of the borrower, the procedures to get a subsidized loan and house were equally simple. Indeed, once signed up and having paid the deposit, the house, including the right to the land title would be delivered, without any hassles to the beneficiary. Upon full payment of the loan, the beneficiary would be handed the Hak Millik title to the property.

Liquidity funding for a large part of the loans was provided by the system. Banks only had to mobilize a limited amount of their own funds for loan disbursement under the system, since one half to three-quarter of the loan amount was provided by BI's heavily subsidized liquidity credit. This may have been the strongest inducement for banks to participate.

### 7.2.2 The Weaknesses of the KPR System

The weaknesses of the program have been discussed and documented on many occasions, and will only be briefly summarized here:

*Unsustainable cost of the system.* Since the set house-prices of the lowest costs units did not go up with increasing land and construction cost, the quality of the RSS house went down, both in terms of construction quality and location/neighborhood quality. Indeed no RSS houses can be built in Jakarta and other major cities because of land costs.² At the same time the interest subsidy increased in order to reach a somewhat similar target group despite inflation. Sometimes developers would cross-subsidize the low-cost units, a system that is not sustainable and will lead to fewer low-cost units being produced.

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¹ Additional incentives were provided for developers to increase housing production, for example, through issuing preferential development rights (location permit). On the other hand, developers were required to build a mixture of house-types (6-3-1 rule). The 6-3-1 rule has, however, not been enforced on a regular basis.

² During the HOMI focus group discussions in four cities, many RS/RSS owners mentioned that they had to totally renovate the house before they could move in. They would have preferred to buy a plot and self-construct if they had been given the money.
With rising interest rates, the cost of the subsidy increased. The high cost of the housing subsidy system became painfully clear when the BI off-budget low-interest liquidity funding was eliminated. MOF has to calculate the present value of the interest-rate subsidy, budget for it and disburse the amount to the banks. MOF and Kimpraswil are trying various ways to limit the cost of the current “on-budget” subsidy system. However, without changes in the entire system of fixed house-types and costs that can be subsidized (set out in Government Decrees), and a lack of incentives to lenders, this is a near impossible task. A more fundamental overhaul of the current housing subsidy system is required.

**Inefficiency of the system.** The subsidy is inefficient in several ways:

- Compared to other finance-based instruments, the cost of the current subsidy is unnecessarily high. Even for a Rp.20 million house, with a modest interest rate subsidy (an interest rate of 14 percent compared to a market rates of 20 percent), the present value of the subsidy is approximately Rp.4 million over the life of the loan (15 years).

- Beneficiaries would have preferred to spend the subsidy on self-constructed houses in other locations if they had been given the opportunity to choose (HOMI focus group research).

- Beneficiaries do not appear to value the houses at their real cost and, even more importantly, the program is not designed to enhance the long-term value of the properties. Many are vacant (Perumnas information) and many units are worth less than the construction price from the outset, because poor neighborhood conditions and location have a negative impact on their value.

**Negative influence on market expansion and innovation.** The subsidy system was meant to increase the role of private lenders and developers in moderate-income housing. It did succeed in doing so, but only for the allocated number of subsidized housing solutions. No innovations were stimulated in the market place beyond the KPR subsidy program. In fact, expansion and innovation were hindered because competition with the subsidized loans and houses was impossible. The current real market place and financial sector need new tools that will stimulate an expansion of moderate income housing production.

This negative impact on market expansion was most pronounced in the financial sector. BTN, the state-owned housing bank handled the major share of all subsidies. There were other banks involved in the program (35 approved banks before the crisis, of which the former Bank Papan had the largest subsidized KPR portfolio), but BTN issued approximately 85 percent of the mortgage loans. As a State-owned bank, it had other operational advantages as well, which made it hard for the other banks to compete. And
as a bureaucratic institution it was impossible for BTN to bring innovations to the market place. As a consequence, the mortgage finance sector remained small and in limbo (Hoek-Smit, 1999).

The crisis has changed this situation considerably. The mortgage portfolios have been redistributed and BTN is no longer the largest mortgage lender. Rather than having an advantage as the only state-owned housing bank, BTN now suffers under this yoke. Under political pressure, it is forced to issue subsidized KPR, while RDI allocations from the Ministry of Finance (MOF) are uncertain. Given the uncertainty of the future subsidy regime, BTN is moving to the unsubsidized sector. It was, however, not provided with the appropriate consultant firm and technical assistance to make that transition successfully, nor was it able to drastically reorganize its operations itself to face the new competitive market place.

Negative impact on urban development. The entire subsidy system has an increasingly negative influence on urban development, since the incentive to developers is to build low-cost units on cheap land far away from infrastructure. Indeed, many owners of RS/RSS houses complained during the HOMI focus group discussions about the lack or poor quality of infrastructure (no permanent drainage or roads, far from public transportation, etcetera).

Inequitability of allocations. Since the program is mortgage finance based it can only serve households that qualify for mortgage loans. This means mostly fixed income earners and a disproportionate number of civil servants.

We have conducted an analysis of BTN’s subsidized and non-subsidized loan portfolio since 1996. It showed the following trends:

- While in 1998 the program served mostly income groups below Rp.500,000, by 2000 and 2001 the majority of allocations were to households with incomes above Rp.700,000. See Table 1 and 2 and Appendix 2.
- Government officials, SOE and army personnel have consistently received more than half of the subsidy allocations, a figure that has increased to two-thirds since 1997.
Table 1

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In an attempt to make the program more equitable Kimprasad recently eliminated allocations for the 36m² RS housing option, which had a maximum price of Rp.30 to 50 million depending on the region and was, of course, much preferred by developers.

The enormous challenge for government now is to design a new housing assistance program that will contain the strengths of the old system, but will avoid, its weaknesses, now and in the future.

7.3 Possible Goals For A Housing Assistance Program In Indonesia

7.3.1 Why Subsidize Housing?

In section 1.0 of this report and in the housing demand report we have already mentioned several important reasons why subsidies for housing are critical at the current time in Indonesia. The bottom-line is that, out of the 750,000 new housing units required per year to house newly formed urban households, the regulated housing market can be expected to deliver no more than one half. Household affordability and constraints in supply markets prevent the bottom half of the population from being served. If urban areas are to remain healthy and desirable places to live, government action is required. Access to water and sanitation, property rights, roads and transportation are already a main concern for low-income households in Indonesia. See Appendix 3.

Much can be done to extend access to formal housing by the housing market actors themselves, i.e., the banks and developers. Government, both central and local, can further improve the regulatory and policy environment. Proposals for change are made in the Housing Finance and Housing Market reports of the HOMI project. These measures can, however, not fill the gap in the market.

What are the constraints that need to be addressed by housing assistance programs to expand housing production for underserved households? We summarize some of the main demand and supply constraints:

1. **Housing finance is expensive** and is the most critical factor limiting housing affordability.
2. **Lenders’ requirements** further limit the number of households that qualify for a loan: savings requirements are high (30 percent down-payment), stable income is required (close to half of the urban population is self-employed or family worker), minimum limits to the value of the property are high (Rp.20 to Rp.25 million affordable
only by median income households), lending is restricted to houses with Hak Milik title and in stable neighborhoods.

3. **Lender constraints** add other limits to lending to moderate-income households: fees for small loans are low and access to funds is limited, foreclosure is risky and costly especially for low-cost properties (the outstanding loan amount is often not recovered because of high foreclosure costs and value losses of low-income properties).

4. **Unsecured lending for housing by credit unions and micro-finance lenders is costly** and only feasible for home-improvement.

5. **Micro-finance lenders are funding constrained** particularly for longer term and larger housing loans.

6. **Land and infrastructure markets for low-income housing do not work well.** Risks connected to uncertain housing values (titles and a mismatch between cost and value of houses) and neighborhood externalities (uncertain provision of services and infrastructure, social and security risks) cannot be priced for.

7. **Capacity at the local government level to address low and moderate housing problems is exceedingly limited**, nor are there many NGOs that could act as intermediaries to assist low-income communities with their housing problems.

Interestingly, housing costs per se appear reasonable in relation to incomes and markets for building materials and labor work well. It is therefore not advisable to focus a housing assistance program on lowering standards. It would help affordability little and would negatively impact urban environments.

Land markets require regulatory improvement to increase land being made available to the market. However, housing subsidies should not be applied to land purchase in order to avoid further distortions in the land market. Equally, low-income private rental housing markets appear to work well, although some regulatory reform would improve the leasing (longer term rentals) markets.

7.3.2 **Possible Goals for a Subsidy Program**

Based on the demand and supply analyses of the HOMI team we propose three main goals to subsidize housing in Indonesia.
1. **Crisis related and longer-term poverty concerns that can be addressed through housing programs.** Poverty can be expressed as a lack of access to adequate sanitation, safe water, access to roads, transport and electricity and other neighborhood services such as security. Residential infrastructure development is critical for poverty alleviation. However, people would not necessarily prioritize housing if given access to funds, as discussed in the demand study. Government has to guide funds into the residential infrastructure and housing sector to bring about a healthy living environment for all.

2. **Addressing new frontiers to improve the efficiency of and access to housing and housing finance markets.** There is currently no efficient private market for low and moderate income housing, particularly for home-ownership. Well-targeted incentives for lenders and households may expand the regulated housing market.

3. **Enhancing the efficient development and improvement of urban neighborhoods through broad-based housing assistance programs in view of continued urban expansion.** Government regulations alone are unable to stimulate sufficient volume of new construction of low and moderate-income housing. Efficient and regulated land and housing markets simply do not work at the lower-income end and government has to play a more direct role in overcoming these constraints. Similarly, improvement of existing areas does not happen unaided through private initiatives, and government’s role as a provider of incentives is critical. See Appendix for a national overview of housing and residential infrastructure conditions.

Well functioning housing markets will stimulate economic growth and housing assistance programs will contribute to this outcome. Moderate and low-income housing is mostly a local product that requires little import and is therefore well positioned to assist the macro-economy. However, while housing may play an important role in economic recovery, we do not propose to focus housing subsidies towards that goal directly. Massive government investment in housing construction to stimulate the economy will be too expensive and the outcomes in the current development climate too uncertain, even if funds were available. We rather propose a reform and incentive agenda for the housing market to play a larger role in economic growth.

The goals listed above are not mutually exclusive and programs can be designed to address several of these at the same time. We will provide suggestions on how they might be achieved in the short- and medium term through various HAP components. In

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1 The HOMI project worked with the University of Indonesia in conducting qualitative research on housing preferences of low-income households. Focus group discussions were held in four cities—Surabaya, Denpasar, Makassar and Kendari—with households from different neighborhoods—KIP, RSS/RS, CBHP, Unimproved Slums.
in this report we focus on incentive programs for market expansion. Another HOMI report deals with neighborhood improvement and development programs and incentives for rental housing production. But first we will briefly describe the considerations that we suggest should be the basis of the design of any HAP program.

### 7.4 Guiding Principles And Parameters For Subsidy Design

#### 7.4.1 Growing International Consensus on Housing Subsidy Design

Indonesia is not alone in struggling to reform its housing assistance programs. Many countries have embarked on dismantling their outdated and unsustainable housing subsidy systems and are finding ways to provide housing assistance that leverage private initiatives rather than replace them. There is a growing consensus on the principles of good housing subsidy design.

1. **Subsidies should be fiscally sustainable.** Government debt reached 100 percent of GDP after the bank recapitalization program was completed (up from 23 percent before the crisis). Debt service and the wage bill plus the much debated fuel subsidies (which benefits moderate and high income households and is larger than the entire development budget) comprise more than four-fifth of the government revenues (World Bank, February 2001). Government deficit of the state budget (APBN) is around 5 percent (MOF estimate). The pressure on the budget is therefore severe, putting development spending on the backburner. GOI does not have easy access to international capital markets, because of the high-risk premium for the county and is forced to finance the budget with domestic debt at high rates. These are severe conditions by any standards. Even the argument that the deficit is artificial in some respect, in view of the assets accumulated in IBRA, does not look convincing, given the long time-horizon required to dispose of IBRA assets.

The budget therefore poses an enormous challenge for new subsidy allocations, at least in the shorter term. It puts pressure on GOI to phase out inefficient subsidies and replace them with subsidies that are designed to leverage private, household and local government investment in housing, rather than replacing their investments. This is the core principle of our proposals for new housing assistance programs.

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4 The housing sector received continued support during the crisis, which was shown in a much higher housing output than neighboring countries of Thailand, Malaysia and the Phillipines in the early years of the crisis. Despite the subsidies, little improvement was shown in the sector. Most subsidies went to finance surplus supply that should not have been built in the first place, an indication of the weakness of the current system.
2. **Subsidies should be transparent.** Non-transparent housing subsidies, i.e., subsidies of which the full cost is not visible on the state budget, have bankrupted several countries. Indonesia only became aware of the full cost of the KPR interest rate subsidy when MOF had to place the subsidy on the RDI budget. Reform of the system would have happened much earlier if these figures would have been understood. HOMI proposes a fully transparent new housing subsidy approach, where even multi-year commitments are calculated on their present values for the fiscal year in which they are disbursed.

3. **The effects of the subsidy on the entire housing or financial market, and vice versa, need to be considered.** Only when the totality of market impacts can be traced, can we understand whether a program fulfills the criteria of efficiency (including its transaction costs), equity (whether and at what scale low-income households are served), compatibility with market improvements, and transparency of cost and allocations.

For example, a program may provide incentives to the private sector to increase lending for housing and move down-market, and to middle- and lower-income households to acquire housing finance. However, the success of such subsidies hinges on other housing market factors. When financial subsidies stimulate demand for housing but demand or supply of housing is not elastic (i.e., demand does not respond to the income/finance incentives provided, or supply will not be able to expand with increased demand in the targeted market), the effect of such subsidies will be dissipated or offset by a negative impact on the price of housing, at least in the targeted sector. It will also thereby make housing less affordable to those not receiving the subsidies. It is, therefore, important to consider the wider market context when introducing any kind of subsidy. It is believed that the KPR interest rate subsidy has a negative effect on market expansion and innovation, because these basic market factors have not been appreciated.

The market for construction and financing of housing in Indonesia is already well developed, but can be improved considerably to serve moderate-income households. It is, nevertheless, a strong base on which to build a housing assistance program. Subsidy programs should trigger and support innovations in the market place. However, current confidence in the housing market and the overall economy is low and demand is depressed, particularly for the lower end of the market. Any housing
stimulus program has to weigh the costs of overcoming fairly inelastic demand through income/finance approaches against other ways to improve the residential market, e.g., through provision of land, infrastructure and services. New programs should not displace the market. We suggest that a finance oriented demand-side approach is feasible for moderate-income households, but will not effective for low-income households because supply markets will not respond.

4. **Subsidy systems should build on the strength of existing institutions.** There are already several institutions that provide housing assistance and housing finance to lower-income households, e.g., regional banks, micro-lenders, credit unions, NGOs. New programs should build on and enhance the strength of these institutions. Housing assistance programs should incorporate carefully designed incentive systems for private and non-governmental partners in housing assistance programs in order to gain the benefits of their efficient performance of the needed services.

5. **One shoe does not fit all.** Subsidies to extend the formal market have to be distinguished from those that serve a section of the housing system where markets for housing and related services and infrastructure are “incomplete”, i.e., do not work efficiently yet.

- The first type of subsidies can serve those with a sufficient level and stability of income and financial prospects to access formal private sector finance and to sustain formal sector housing solutions. This group would be assisted primarily through private sector-led mechanisms, supported with explicit separate assistance or incentive packages.

- The second type of subsidies will serve those with low or unstable incomes, collateral problems and/or other cultural/educational characteristics that impede access to formal finance and housing, and who require additional support in acquiring land and services, before simple demand side approaches can be effective. For this group, NGO and government support will be required as an integral part of the assistance package. Financing for this group would be mostly non-mortgaged based.

Indonesia’s KPR interest rate subsidy, as the only continuous housing subsidy for decades, was focused towards the first group. KPR interest rate subsidies were forced onto the second group through the Triguna program, without an appreciation of the fact that the
formal mortgage instrument was not appropriate for the target group, nor could it address the fact that land and infrastructure markets do not work well at the low-income level.

7.4.2 Indonesia-Specific Guidelines for Subsidy Design

Decentralization. Housing assistance programs need to fit the ongoing decentralization of government. Housing programs will be mostly the responsibility of the local government. However, there is still an important role for central government to play, both at the national level and to induce local governments to develop and implement appropriate housing programs. We have identified specific housing assistance programs that address national level financial sector weaknesses and affordability issues that need to be funded nationally. Another set of programs offer incentives through DAK and foreign donor funds to local governments for local level programs. We have elaborated our proposals for funding and implementation of housing assistance programs in a separate HOMI report.

Policy principles. The policy design principles for Indonesia which we identified in the Housing Policy document and which were based on Laws 22, 1999, Law 25, 1999 and Law28, 1999 and Propenas, are pertinent in guiding the design of new housing assistance programs. It is relevant to summarize these here:

- **Partnership and participation.** Government is committed to have people participate democratically in the processes of housing policy decision-making. This principle calls on all housing partners to contribute their skills, labor, creativity, financial and other resources. Government’s role is to provide financial resources and the creation of institutions and support structures in a decentralized governance framework.

- **Fairness and equity.** The housing policy must promote fairness and equity among all Indonesians. Government programs will need to provide a wide range of support options and not discriminate in terms of location, income, gender, religion or creed.

- **Quality and affordability.** Housing must be built to an acceptable quality and at prices people can afford. Government will set basic quality standards particularly for housing assistance programs, including for residential and neighborhood quality, based on performance and future maintenance.

- **Innovation.** The housing policy should foster innovation, creativity and diversity, particularly in terms of the products provided and the environments that are created.

- **Transparency and accountability.** The housing policy should be implemented with transparency, particularly in terms of housing assistance programs and the flow of funds. It is vital that appropriate monitoring systems are implemented and
that responsible authorities and implementers are held accountable for performance against clear standards.

- **Sustainability and fiscal affordability.** The government has insufficient resources to meet the need of all underserved households in Indonesia. Sustained and substantial investment in housing from sources outside the government focus is essential. Thus a central focus of the housing policy is to create a normalized market that will attract maximum private investment.

The most significant principles underlying the proposed subsidy design are to reach the largest number of households with limited resources, based on the need for fiscal discipline. It is impossible to provide finance or subsidies for the vast majority of underserved households. Subsidies are designed to leverage household, financial sector and local government investment in housing.

### 7.4.3 Outline of a Comprehensive Subsidy Program for Indonesia

The housing demand analysis clearly showed the need for three types of housing assistance programs to address needs of varied households and varied supply constraints:

1. **Home-ownership assistance through the financial sector for those households who can, with assistance, use the regular housing market to obtain a house.** These programs should include three components:
   - A subsidy for households currently at the margin of the finance sector (the 55th to 40th percentile of the urban income distribution; Rp.900,000 to Rp.750,000 per month). Because of the various constraints face by this group of households several different subsidy instruments need to be designed.
   - A lender incentive system to induce participation
   - An implementation system that facilitates developer participation

2. **Home-ownership assistance through more comprehensive supply (services and infrastructure) support for households dependent on those parts of the housing market that do not function well.** Two types of programs are envisioned, block grants for neighborhood/ home improvement programs, and mixed new development programs. Income criteria need to be flexible since neighborhoods have mixed income profiles. It is estimated that the majority of beneficiary households would have incomes below the 50th percentile of the urban income distribution. Unaided land and housing markets do not yet work well at the low-income level, and, therefore, simple credit-related upfront subsidies would not work.
3. **Support to increase the availability of low-cost rental housing, preferably through the private household sector.** Rental housing construction, particularly for migrant laborers, is a high priority. While the provision of rental housing is mostly a local government and private sector function, national incentives to private employers may facilitate the development of selected rental housing in strategic locations.

We will analyze alternative approaches to the first set of programs in the remainder of this report. Local level neighborhood approaches and rental incentive are discussed in another HOMI report.

### 7.5 Subsidy Instruments To Improve Access To Housing Finance

#### 7.5.1 Alternative Housing Finance-based Subsidy Instruments to Address Different Household and Market Constraints

*Household constraints.* Households that are currently unable to obtain a housing loan, but could qualify with some finance-based subsidies, have different constraints:

- **Income constraint.** Incomes are too low to comply with the minimum property value requirements
- **Income instability.** Borrowers have an insecure income-stream and are therefore more likely to miss payments and fall in arrears. Both borrowers and lenders fear default, because of income instability.
- **Savings constraint.** First-time home-buyers find it difficult to save the 30 percent required down-payment, while paying rent.
- **Collateral constraint.** Potential home-buyers cannot comply with land or building regulations or land title requirements of the lending institution.

*Lender constraints.* Lenders will only make loans for moderate and low income housing if some of their constraints are addressed:

- **Credit risk** is perceived to be higher for low-income households. Given default, foreclosure risk is high. Also, the cost of foreclosure and risk that the outstanding loan amount will not be recovered through the sale of the house is high, because of value losses of low-income properties.
- **Limited access to funds.** Mobilizing long or medium term funds is hard in the current financial markets in Indonesia. Most banks depend on time deposits. Small, but long-term housing loans may not be a priority under these circumstances.

- **Administrative cost.** Fees for small loans are low as these are calculated as a percentage of the loan. At the same time, small loans often require more work to underwrite. Thus, lenders have a disincentive to make smaller loans.

**Alternative instruments.** There are several main types of subsidy instruments that can be used in combination with housing finance to address these constraints using the principles of transparency. Some can be applied to mortgage lending and others are more suited to non-secured housing finance.

**Instruments dealing with income constraints.**

- **Interest-rate subsidy.** The interest rate on subsidized loans is reduced in order to make monthly payments more affordable. Typically, the interest rate subsidy is provided on a fixed-rate loan and for the life of the loan. In order to make the subsidy transparent, the present value of the difference between market rate and subsided interest rate needs to be calculated and put in an escrow account.

- **Monthly payment buy-down subsidy.** Part of the initial total monthly payments or the interest-part of the monthly payments are paid for by a subsidy in order to make loans more affordable. Generally, the subsidy part of the payment is reduced each year and phased out over a period of 5 to 7 years. The subsidy is transparent, since the present value of the total subsidy is typically placed in an escrow account in the bank.

- **Up-front lumpsum subsidy towards the loan amount.** The loan amount is partly replaced with a subsidy in order to bring down the monthly payments. Since the full amount is paid out at loan closure, the subsidy is transparent and on the current FY budget.\(^5\)

**Instruments dealing with savings constraints.**

- **Up-front lumpsum subsidy towards the down-payment.** Part of the down-payment requirement is paid for by a subsidy in order to lower the savings requirements. Similarly, this up-front subsidy is completely transparent.

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\(^5\) There are other subsidy instruments dealing with income constraints, e.g. *soft-second loans.* A second interest free loan is provided to lower the repayable loan amount. The soft-second loan is to be repaid when the house is sold and its value is higher than the outstanding first loan. This instrument would not work in Indonesia for a variety of reasons (low resale activity, difficulty to request repayment of soft loans after a long period of time, instruments does not work well under fairly high inflation) and will not be further discussed for Indonesia.
- **Mortgage insurance subsidy.** The down-payment requirement is lowered by paying for the increased risk to the lender through a mortgage insurance. Mortgage insurance deals with the savings constraint and not with monthly payment constraints. The monthly payment on the loan is guided by the maximum allowable payment to income ratio applied by the lender. The rate of the insurance premium depends on the risks of default and the costs and risks of foreclosure. Mortgage insurance insures the lender for part of the costs and loan recovery in case of default and foreclosure on the loan. The amount of coverage can vary and can be for the top 30 or 40 percent of the loan and unpaid interest and legal costs in case the loan goes bad. For the mortgage insurance subsidy to be transparent and on budget, the premium payment could be calculated as a single payment, or, if a monthly premium payment is used, the present value of all future monthly premium payments needs to be calculated and escrowed (we prefer the single payment system for Indonesia).

- **A combination of mortgage insurance and upfront lumpsum subsidy towards the down-payment.** If part of the down-payment reduction is paid for by an upfront subsidy (e.g., 10 percent) and part can be brought down by mortgage insurance (e.g., 10 percent), the mortgage premium will be lower since the risk that the outstanding loan balance can not be recovered in case of foreclosure, is smaller. When risk premiums are high, as in Indonesia, this alternative may be worth pursuing as an interim measure until rates come down.

**Instruments dealing with income instability and collateral insecurity.**

- **A subsidized pledged-account against default.** In cases where both the borrower and the lender fear a default situation (the borrower because of the fear of losing the house and lender because of the costs of foreclosure or, for unsecured loans, the fear of losing the cash-flow or even the outstanding loan amount) a pledge account can be set up with a multiple of monthly payments on the loan. This account can be accessed in case of default, in order to guarantee the lender’s cash flow and not have defaults accumulate for borrowers with unstable incomes. It is often difficult for moderate and low income borrowers to make up missed payments and rescheduling of loans is expensive. This pledge account mechanism can be combined with a flexible payment arrangement, which allows borrowers to repay higher or lower amounts according to their income stream. Households should have an incentive not to rely on the pledge account. An arrangement whereby the household will receive the amount left in the account after several years in order to improve their house, may provide such incentive.
While in principle all of these subsidy instruments can be applied for mortgage-based and non-mortgage-based loans, in reality, mortgage insurance will be applicable only for mortgage-based loans in Indonesia. In other countries “mortgage” insurance is also used for the non-mortgage housing loans. The concept of mortgage insurance is new and should probably begin with regular collateral-based loans. The pledge-account is most suitable for non-secured housing loans.

**Lender incentives.** We have only looked at the borrower constraints addressed by these different instruments. How can lender constraints be addressed and what lender incentives are known to work?

### Table 3
MI and Upfront Down-Payment Subsidy Combined

<table>
<thead>
<tr>
<th></th>
<th>MI and Down Payment Subsidy</th>
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</thead>
<tbody>
<tr>
<td>Housing Price</td>
<td>Rp 20,000,000</td>
</tr>
<tr>
<td>% Down Payment from borrowers</td>
<td>10.0%</td>
</tr>
<tr>
<td>Down Payment from borrowers</td>
<td>Rp 2,000,000</td>
</tr>
<tr>
<td>Household Pledged Savings Account (6 Months)</td>
<td>Rp -</td>
</tr>
<tr>
<td>Down Payment Subsidy Rate</td>
<td>Rp 2,000,000</td>
</tr>
<tr>
<td>Loan Amount</td>
<td>Rp 15,000,000</td>
</tr>
<tr>
<td>Interest Rate</td>
<td>20.0%</td>
</tr>
<tr>
<td>Interest Rate Subsidy</td>
<td>0.0%</td>
</tr>
<tr>
<td>Mortgage Insurance Premium by borrower</td>
<td>7.38%</td>
</tr>
<tr>
<td>Mortgage Insurance Premium by subsidized</td>
<td>0.0%</td>
</tr>
<tr>
<td>Term (in year)</td>
<td>15</td>
</tr>
<tr>
<td>Monthly Payment</td>
<td>Rp (281,007)</td>
</tr>
<tr>
<td>Percentage Income spent on Housing</td>
<td>30%</td>
</tr>
<tr>
<td>Affordable Monthly Income</td>
<td>Rp 936,691</td>
</tr>
<tr>
<td>Total Value of Subsidy (zero discount)</td>
<td>Rp 3,180,800</td>
</tr>
<tr>
<td>PV of Subsidy 20%</td>
<td>Rp 3,180,800</td>
</tr>
<tr>
<td>PV of Subsidy 17%</td>
<td>Rp 3,180,800</td>
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</tbody>
</table>

While in principle all of these subsidy instruments can be applied for mortgage-based and non-mortgage-based loans, in reality, mortgage insurance will be applicable only for mortgage-based loans in Indonesia. In other countries “mortgage” insurance is also used for the non-mortgage housing loans. The concept of mortgage insurance is new and should probably begin with regular collateral-based loans. The pledge-account is most suitable for non-secured housing loans.

**Lender incentives.** We have only looked at the borrower constraints addressed by these different instruments. How can lender constraints be addressed and what lender incentives are known to work?
Reducing credit and collateral risk. Only the upfront loan subsidy, mortgage insurance and the pledge account subsidies are directly focused on the credit risk to which the lender is exposed in the uncertain housing market in Indonesia. They all increase the “buffer” between the outstanding loan amount and the value of the property, in order to improve the lender’s chances to recover the outstanding loan and cost in case of foreclosure. Interest rate and buy-down subsidies will also decrease the likelihood of default, since households would forfeit the subsidy if they default. Indeed, households do not want to prepay subsidized loans either for the same reason.

Additional safeguards may be built in to group- and neighborhood-based housing programs. CBOs or intermediary NGOs may establish a waiting list for houses in the neighborhood. The intermediary institution may facilitate the resale of houses that need to be sold because of non-payment, e.g., by keeping a waiting list and assisting in assessing the real value of houses. Foreclosure risk is indeed the biggest hurdle to overcome.

CBOs and NGOs can also play a critical role in consumer education and collection of loan payments. Recent large scale studies in the US, but also experiences in other countries like South Africa, show that consumer education may one of the most potent ways to decrease the incidence of default end foreclosure given default.

Improving mortgage portfolios to leverage funds. Mortgage insurance is by far the best instrument to improve the credit quality embedded in the mortgage loan. As we argue elsewhere in the paper, mortgage insurance can facilitate standardization of underwriting practices and can provide a higher quality investment product. It is an important first step on the way to long-term investment in the sector by pension funds and insurance companies, who seek long-term investment products. The government can further facilitate the connection and knowledge about the new directions in the housing sector by organizing high-level training across lenders, investors, NGOs, government staff and politicians. The government intends to stimulate a secondary facility through which lenders could access longer-term funds based on the collateral of their mortgage portfolio, or non-secured loans for housing.
• **Charging real cost for underwriting and servicing small loans.** Another incentive for lenders might address the fee for small loans. Lenders could be allowed to charge the same amount as the fee on the average size loan on their books for program loans and be paid for from the subsidy program. Servicing charges are a bit more complicated, since they are embedded in the interest rate charge. Community organizations or employers may assist with this task.

### 7.5.2 Comparing Different Housing Finance Subsidy Instruments

We mentioned the different borrower constraints addressed by these different subsidy instruments. There are important other dimensions that need to be analyzed before the best subsidy instruments can be selected for Indonesia’s market condition.

*Macro-economic risks.* The interest-rate and upfront buy-down instruments based on fixed interest-rate subsidies, are designed explicitly to offset the tilt problem (increasing current interest rates because of the expectations of future inflation). The buy-down is further based on the assumption of future increases of household incomes. It is designed to decrease the subsidy component over time, and will break down if household incomes do not keep pace with inflation. In comparison, the up-front grants are not affected by future macro-economic trends (only the related market-rate mortgage payments).

Mortgage insurance is vulnerable to down-turns in the real-estate cycle or other major events causing large scale defaults (e.g., massive lay-offs in one area, natural disasters), i.e., catastrophic risk. As Askrindo, the micro-enterprise credit insurer, has shown, there are ways to protect a mortgage insurance firm against such risks, at least partially (risk sharing with the financial institution, reinsuring with overseas companies that have a totally different risk profile, etcetera)

*Capital market requirements.* In the near future, Indonesia needs to find ways for the mortgage sector to mobilize medium and longer term funds from the capital markets or directly from long-term investors. What types of subsidized mortgages will provide the best investment risk to potential investors? Clearly, interest-rate subsidy mortgages are the least attractive since they have compromised market-pricing of the financial instrument itself. And, equally clear is the fact that a market-based instrument, enhanced with mortgage insurance is the best note for an investor. While an upfront down-payment
grant and mortgage insurance both may allow a lower loan to value ratio (i.e., of 90 percent) and have, therefore, the same effect for the borrower, the mortgage insurance has great additional advantages for the lender and, may be, even more so for the investor.

- The mortgage insurance underwriting process will have the effect of providing standardization in the market by the establishment of mortgage insurance underwriting guidelines, standardized documents and adopting practices that are more efficient.
- Mortgage insurance companies provide a second review of the underwriting decisions by financial institutions. Only after such a review can an insurance decision be taken.
- The mortgage insurer pays only the top percentage of the claim-for-loss submitted by the financial institution. It does not pay the full loss. This type of claim payment structure requires the bank to underwrite quality loans. In other words, the bank retains a moral risk.

There are other benefits as well to establish a mortgage insurance entity. The mortgage insurer will provide support for industry wide services and standardization of sound practices and processes for originating residential loans, i.e., establishment of a credit bureau, improved disposition of property ownership claims, specifically speeding up the current foreclosure process, clarification and automation of property titles. The combined measures will facilitate resource mobilization from the capital markets and long term investors. (See Whitely’s report in the HOMI series.)

**Beneficiary concerns.** The interest-rate subsidy, upfront loan grant and buy–down subsidies address the mismatch between household incomes and the required monthly payments on a market-rate mortgage. The upfront buy-down contribution made by the government is spread out over several years, normally in successively declining amounts. The borrower makes correspondingly larger contributions as his/her income increases with inflation. If it is necessary to add an additional subsidy in excess of correcting the forward-tilt problem created by inflation, the pace of increase in the borrower’s contribution can be slowed down. Conversely, the rate of increase in the borrower’s contribution can be faster, if it is expected that household incomes will increase at a faster rate than inflation, either because of economic growth or because of life-cycle changes (e.g., increasing participation of both spouses in the labor force). If a fixed upfront amount is provided for the buy-down, the financial institution can work out the best buy-down schedule with the household. Current interest-rate subsidies address monthly payment constraints,
but have a tendency to overcompensate after the initial years when household affordability has increased. Few households require a subsidy for 20 years (other problems with the interest-rate subsidy have been discussed elsewhere).

Mortgage insurance and upfront down-payment subsidies deal with savings constraints and not with income constraints. While mortgage insurance and default pledge accounts are focused on default or credit risk (see below).

**Default risk:** Because of its dependency on rising household incomes, the buy-down instrument carries a higher default risk in case incomes do not keep pace with inflation or with expected real income increases. This risk can be systemic, but also exists at the level of the individual mortgagor. In other words, overall incomes may be rising at anticipated levels, but individual households may stray from the norm and face payment problems. In order to provide for larger loan losses, this mortgage is likely to be priced slightly higher in the market than a regular mortgage. By comparison, in the up-front grant subsidy, which often carries low requirements for down-payment savings by the borrower, savings discipline for low-income borrowers may be negatively affected, increasing late-payment and default risk. Mortgage insurance equally eases the savings requirements and discipline, but compensates for it by insuring default. The default pledge account subsidy may create the impression that one can be lax in paying without repercussions. Incentives, such as the provision that the household may use the amount left over in the pledge account after several years, may prevent such an attitude.

**Transparency:** All these alternative subsidy instruments require an up-front subsidy payment by the public sector, either in the form of a grant to the borrower for part of the down-payment, or loan or by way of an escrow payment or mortgage insurance payment. This is in sharp contrast with the implicit and unbudgeted subsidy in the current interest-rate subsidy.

**Administrative and interest cost:** The up-front grants and mortgage insurance/pledge accounts are easiest to administer since they involve a one-time transaction. The upfront buy-down mortgage carries higher administrative costs because of its requirement for an escrow account and the more complicated monthly payment transaction. In addition, the cost of the subsidy is influenced by the type of arrangements for interest payments on the escrow account (e.g., whether government payments to the lender are made yearly or for the entire duration of the buy-down period). Interest-rate subsidies can be more
difficult for banks to incorporate in their overall financial management, depending on the arrangement made by government for interest-income compensation.

*Flexibility in mortgage design:* The mortgage insurance, up-front grant and the upfront buy-down instrument allow a greater flexibility in mortgage design to accommodate different loan amounts and household needs than the current interest-rate subsidy mechanism. This is important in a country like Indonesia with great regional differences in house-cost and income. Similarly, inflation or real income adjustments can be included in both up-front grant instruments in ways consistent with household affordability. Equally, mortgage insurance premiums will be set according to local and, indeed, individual lender’s risk profiles (e.g., Askrindo has a system of risk sharing with individual banks).

*Subsidy targeting:* All mortgage finance subsidy programs have to cope with the problem of (mis)targeting and unauthorized transfer of subsidies or subsidized loans to non-qualifying households. While verification of income of potential beneficiaries is difficult irrespective of the instrument used, the transfer of subsidies to middle-income households has proven to be a severe problem with the up-front grant system in other countries. A study of housing allowance systems in Latin American countries found that transfers of the grants to middle-income households or cashing out of vouchers by private developers is widespread (Ferguson et al., 1996; Rojas, 2001). Arrangements whereby the subsidy materializes over a longer period of time such as the up-front buy-down is a deterrent to middle-class take-over. Similarly, mortgage insurance and pledge accounts are tied to the loan and are therefore less vulnerable to misuse.

*Subsidy cost:* An understanding of the relative costs of these subsidies in relation to the conventional interest-rate subsidy is critical in relation to the fiscal sustainability and efficiency principles. We have calculated several comparative examples, based on specific interest-rate and real income trend assumptions. In an example that keeps the initial loan amount, term, down-payment requirement and market interest rate the same, we show the effects of different subsidy instruments on the size of the down-payment and monthly payment levels. We then compare these outcomes with the present value costs of the different subsidies. While we calculate the monthly household income that can be reached under different subsidy, equally important is the level of savings required. The two are often negatively related. In other words, scenarios that allow households to save less, increase the size of the loan, unless the loan or down-payment
### Table 4 Comparison of Different Mortgage Instruments

#### Subsidy Program Comparisons

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<td>Rp 20,000,000</td>
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<tr>
<td>% Down Payment from Borrowers</td>
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<tr>
<td>Household Pledged Savings Account (6 Mos)</td>
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<td>Rp 0.0%</td>
<td>Rp 0.0%</td>
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<td>Market Interest Rate</td>
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<td>20.0%</td>
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</tr>
<tr>
<td>Interest Rate Subsidy (after-age-rate, rate)</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
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</tr>
<tr>
<td>Mortgage Insurance Premium to borrower</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
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<tr>
<td>Mortgage Insurance Premium subsidized</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
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<tr>
<td>Term (in year)</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
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<tr>
<td>Percentage Income spent on housing</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
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<tr>
<td>Affordable Monthly Income</td>
<td>Rp 792,785</td>
<td>Rp 752,785</td>
<td>Rp 1,019,295</td>
<td>Rp 504,040</td>
<td>Rp 504,040</td>
<td>Rp 1,174,647</td>
<td>Rp 1,174,647</td>
<td>Rp 1,174,647</td>
<td>Rp 1,174,647</td>
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<tr>
<td>Total Value of Subsidy (zero discount)</td>
<td>Rp</td>
<td>Rp</td>
<td>Rp</td>
<td>Rp</td>
<td>Rp</td>
<td>Rp</td>
<td>Rp</td>
<td>Rp</td>
<td>Rp</td>
</tr>
<tr>
<td>PV of Subsidy 20%</td>
<td>Rp 17,444,473</td>
<td>Rp 2,000,000</td>
<td>Rp 1,314,000</td>
<td>Rp 2,676,690</td>
<td>Rp 1,630,672</td>
<td>Rp 1,630,672</td>
<td>Rp 1,630,672</td>
<td>Rp 1,630,672</td>
<td>Rp 1,630,672</td>
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<tr>
<td>PV of Subsidy 17%</td>
<td>Rp 4,278,564</td>
<td>Rp 4,278,564</td>
<td>Rp 4,278,564</td>
<td>Rp 4,278,564</td>
<td>Rp 4,278,564</td>
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<td>Rp 4,278,564</td>
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</table>

Technical Assistance For Policy Development For Enabling The Housing Market To Work In Indonesia
is decreased through a direct up-front subsidy. The interpretation of the different scenarios has to be done with care.

We start our calculations from a basic non-subsidized loan with the following conditions:

- **Value of the house:** Rp. 20 million
- **Loan term:** 20 years
- **Interest rate:** 20 percent
- **Down-payment:** 30 percent of value of the house

### Table 5 Summary of Subsidy Instrument Comparison

<table>
<thead>
<tr>
<th>Loan Instrument and Subsidy</th>
<th>Savings Required</th>
<th>Monthly Income Required</th>
<th>Subsidy Amount</th>
<th>Remarks</th>
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<tr>
<td>1. Unsubsidized loan</td>
<td>Rp.6 million</td>
<td>Rp.793,000</td>
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<tr>
<td>2. Current KPR interest rate subsidy</td>
<td>Rp.4 million</td>
<td>Rp.550,000</td>
<td>Rp.4.5 million</td>
<td>The down-payment is only 20%; higher credit risk is not carried in a higher rate</td>
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<tr>
<td>3. Lumpsum down-payment subsidy</td>
<td>Rp.4 million</td>
<td>Rp.793,000</td>
<td>Rp.2 million</td>
<td>Covers 20 percent of down-payment and 10 percent of top of the loan</td>
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<tr>
<td>4. Mortgage insurance for 30 percent of top of loan</td>
<td>Rp.2 million</td>
<td>Rp.1 million</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Mortgage insurance plus lumpsum down-payment</td>
<td>Rp.2 million</td>
<td>Rp.900,000</td>
<td>Rp.2,875,000</td>
<td>The subsidy covers 10% additional down-payment and mortgage insurance over smaller exposure</td>
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<tr>
<td>6. Pledge account guarantee</td>
<td>Rp.4 million</td>
<td>Rp.906,000</td>
<td>Rp.1.6 million</td>
<td>A 6 month pledge account was considered a sound time for default insurance</td>
</tr>
</tbody>
</table>

Morja Hoek-Smit, Subsidy Calculations

This brief summary shows that there are no free lunches; subsidy amounts reflect either the reduction in savings requirements or in the household income level that can be reached. It is evident, however, that the current interest rate subsidy is relatively expensive and carries more risk for the lender since the down-payment required is lower than for comparable loans and therefore the lender’s risk exposure. The Payment Buy-down subsidy was not included in the table, since it appears unlikely that it will be utilized in
7.5.3 Recommendations for the Establishment of New Housing Finance Subsidy Programs

Preferred Instrument(s). Given the relatively low subsidy cost, its focus on default risk and savings constraint, its transparency and administrative easiness, and the additional institutional advantages of mortgage insurance based instruments, it is our recommendation to focus on mortgage insurance as the most promising policy direction for Indonesia, in combination with upfront subsidies when necessary to reach targeted income groups. For non-mortgaged based lending, the pledge account subsidy is preferred, because it protects both the lender and the borrower from default trauma.

The special mortgage insurance study we conducted as part of component B, calculated the insurance premiums we used here. These are preliminary and may come down fairly quickly when risks in the housing finance sector decrease as a result of institutional reforms and measures by the private sector to improve NPLs. With gradually decreasing rates, mortgage insurance would become more cost-efficient, compared to other subsidies. Mortgage insurance also has the advantage that the subsidy part can be decreased gradually for income and risk-groups that no longer require a subsidy, but can and are willing to pay for mortgage insurance themselves to decrease the savings requirements. Equally, the pledge account can first be fully subsidized, but can increasingly be shared with borrowers own savings to move scarce resources to new households on the margin.

Institutional linkages within the housing sector. The main institutional advantage of mortgage insurance subsidies is that it is an important step to further professionalize the housing finance sector and make it an attractive focus for long-term investors. The pensionfunds and insurance companies and their regulators, who are looking for long-term investment instruments and mechanism, expressed an interest in making loans to mortgage lenders on the basis of sound mortgage portfolios that use insurance as credit enhancement (See Whitely paper in the HOMI series).

Institutional Home. Three types of institutions are required for such a new housing assistance program to operate well; a government agency to detail the principles, target groups and implementation mechanism and to regularly adjust program parameters, a
mortgage insurance agency to implement the program and financial institutions to package
the loan and subsidies. Since specialist knowledge is required about the housing finance
sector and not to subsidize what is no longer required, a special housing assistance
agency is proposed by HOMI supported by a housing fund and staffed by professionals
in the critical areas.

We further talked to various credit insurance agencies in the country. Indonesia is fortunate
to have a well-functioning credit insurance institution, focused on small-scale enterprise
credit, i.e., Askrindo. It is in the process of changing from a fully government owned to a
half privately-owned company (BI is divesting its share in Askrindo). It has received long-
term technical assistance from the largest insurer in the Netherlands and has developed
interesting risk-sharing programs with its client-lenders. Askrindo is prepared and well-
situated to explore the two types of housing credit insurance we discussed above.

There are many interested banks that want to move down-market and would welcome a
new subsidy program. Equally, there are strong but few, and weak but many micro
lenders who could be engaged in non-mortgage lending. Other parts of the HOMI study
propose strengthening of the banking sector, while a World Bank study is in the process
of developing a support system for micro-finance lenders. The focus is on the
establishment of a liquidity window for micro-lending.

In the final report, the complete Housing Assistance Program will be integrated. It will
include the three housing assistance programs we set out above.
## Appendix 1

### Perumnas Production of Houses

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of units constructed</th>
<th>Cumulative</th>
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<tbody>
<tr>
<td>1995</td>
<td>30,704</td>
<td>313,526</td>
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<tr>
<td>1996</td>
<td>38,330</td>
<td>351,856</td>
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<tr>
<td>1997</td>
<td>39,631</td>
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<td>386,863</td>
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<tr>
<td>1999</td>
<td>-</td>
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<table>
<thead>
<tr>
<th>Type of units constructed</th>
<th>Cumulative</th>
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<tbody>
<tr>
<td>RSS</td>
<td>205,040</td>
</tr>
<tr>
<td>RS</td>
<td>180,460</td>
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<td>Apartment</td>
<td>13,066</td>
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### BTN Financed Houses

<table>
<thead>
<tr>
<th>Cumulative # of units financed</th>
<th>1,551,900</th>
<th>25%</th>
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<tr>
<td>1.0 Perumnas</td>
<td>400,000</td>
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</tr>
<tr>
<td>2.0 Non-Perumnas</td>
<td>1,151,900</td>
<td>75%</td>
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</table>

Total value in Rp: 9,347,724 million

Source: Statistical Year Book of Indonesia, 1999
Appendix 2. KPR Subsidy Program

PT Bank Tabungan Negara
Percentage of Subsidized and Non Subsidized Mortgage Lending Per Income Group
1996 - 2001

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
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<th></th>
<th></th>
<th></th>
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<td>1</td>
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<td>39.4</td>
<td>7.4</td>
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<td>37.5</td>
<td>4.9</td>
<td>26.9</td>
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<tr>
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<td>Rp 500,000 - Rp 700,000</td>
<td>19.4</td>
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<td>25.3</td>
<td>5.8</td>
<td>19.4</td>
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<td>1.8</td>
<td>13.2</td>
<td>18.2</td>
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<td>5</td>
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<td>86.7</td>
<td>1.9</td>
<td>88.4</td>
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<td>100.0</td>
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PT Bank Tabungan Negara
Percentage of Subsidized and Non Subsidized Mortgage Lending Per Employment Category
1996 - 2001

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
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<td>1</td>
<td>Government Employee</td>
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<td>State Own Company</td>
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<td>8.7</td>
<td>17.2</td>
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<td>4</td>
<td>Private Sectors</td>
<td>29.9</td>
<td>47.9</td>
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<td>100.0</td>
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Note: S = subsidized
NS = non subsidized
## Technical Assistance for Policy Development for Enabling the Housing Market to Work in Indonesia

### Non-Subsidized Mortgage Lending Per Employment Category
1996 - 2001

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<tr>
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### Non-Subsidized Mortgage Lending Per Income Group
1996 - 2001

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**Technical Assistance For Policy Development For Enabling The Housing Market To Work In Indonesia**
Appendix 3
Selected Housing Indicators from Susenas Housing Module 1998

Tenure and Land - Rights

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<tr>
<th></th>
<th>Tenure</th>
<th>Urban</th>
<th>Rural</th>
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<tr>
<td>1</td>
<td>1.0 Own Property</td>
<td>70.96</td>
<td>81.13</td>
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<tr>
<td></td>
<td>2.0 Lease</td>
<td>10.46</td>
<td>0.76</td>
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<tr>
<td></td>
<td>3.0 Rent</td>
<td>7.62</td>
<td>1.34</td>
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<tr>
<td></td>
<td>4.0 Lease (real meaning)</td>
<td>0.54</td>
<td>0.06</td>
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<tr>
<td></td>
<td>5.0 Official House</td>
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<tr>
<td></td>
<td>6.0 Rent Free</td>
<td>4.25</td>
<td>3.00</td>
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<tr>
<td></td>
<td>7.0 Others</td>
<td>2.69</td>
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<tr>
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<th>How was Property acquired</th>
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<tr>
<td>2</td>
<td>0.0 Build on Account</td>
<td>73.27</td>
<td>63.48</td>
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<tr>
<td></td>
<td>9.0 Purchase from Developer</td>
<td>5.83</td>
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<td></td>
<td>10.0 First Hand Purchase from Individual</td>
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<td></td>
<td>11.0 Purchase 2nd Hand House</td>
<td>7.66</td>
<td>3.41</td>
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<td></td>
<td>12.0 Administrative Allocation</td>
<td>0.41</td>
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<td>13.0 Others</td>
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<td>57.56</td>
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<td>15.0 Legal Heir/Grant</td>
<td>35.30</td>
<td>52.83</td>
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<td>16.0 Rent</td>
<td>1.81</td>
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<td>17.0 Joint Owner</td>
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<td>19.0 Property Rights/hakmiik</td>
<td>83.36</td>
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<td>21.0 Right To Use/HakPakai</td>
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<td>22.0 Others</td>
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<td>23.0 Unknown</td>
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<td>1.91</td>
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Source: Housing Module, BPS, SUSenas 1998
### Housing Quality Indicators (%) 1997 and 1999

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<td>Floor Area, 10m² per person</td>
<td>20.5</td>
<td>25.9</td>
<td>27.7</td>
<td>23.5</td>
<td>28.3</td>
<td>24.5</td>
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<tr>
<td>Permanent Wall Material</td>
<td>91.7</td>
<td>92.3</td>
<td>74.8</td>
<td>76.5</td>
<td>81.1</td>
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<tr>
<td>Electricity</td>
<td>96.4</td>
<td>97.8</td>
<td>65.9</td>
<td>74.6</td>
<td>77.2</td>
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<td>Piped Drinking Water</td>
<td>39.9</td>
<td>36.4</td>
<td>7.0</td>
<td>7.0</td>
<td>19.2</td>
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<td>Safety of Drinking Water Source</td>
<td>57.5</td>
<td>72.3</td>
<td>45.3</td>
<td>33.1</td>
<td>40.7</td>
<td>49.5</td>
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<tr>
<td>Own Private Toilet with Septic Tank</td>
<td>48.3</td>
<td>51.4</td>
<td>13.8</td>
<td>16.8</td>
<td>26.1</td>
<td>30.4</td>
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**Source:** BPS, SUSENAS 1997, 1999

### Percentage of Household by the Shortest Distance to Public Facilities (in km), 1998

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<tr>
<th>Public Facility</th>
<th>Urban &lt;1</th>
<th>1 - 2</th>
<th>3+</th>
<th>Rural &lt;1</th>
<th>1 - 2</th>
<th>3+</th>
<th>Urban + Rural &lt;1</th>
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<th>3+</th>
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<tr>
<td>Public Transportation</td>
<td>78</td>
<td>20</td>
<td>2</td>
<td>54</td>
<td>23</td>
<td>18</td>
<td>62</td>
<td>25</td>
<td>12</td>
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<td>Shopping Center</td>
<td>32</td>
<td>47</td>
<td>22</td>
<td>8</td>
<td>24</td>
<td>69</td>
<td>17</td>
<td>32</td>
<td>51</td>
</tr>
<tr>
<td>Health facility</td>
<td>26</td>
<td>51</td>
<td>20</td>
<td>14</td>
<td>33</td>
<td>54</td>
<td>18</td>
<td>41</td>
<td>41</td>
</tr>
<tr>
<td>Police office</td>
<td>16</td>
<td>47</td>
<td>37</td>
<td>3</td>
<td>15</td>
<td>82</td>
<td>8</td>
<td>27</td>
<td>85</td>
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<tr>
<td>Fire fighting services</td>
<td>6</td>
<td>23</td>
<td>70</td>
<td>1</td>
<td>2</td>
<td>94</td>
<td>3</td>
<td>10</td>
<td>85</td>
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<tr>
<td>Junior High School</td>
<td>38</td>
<td>49</td>
<td>13</td>
<td>14</td>
<td>34</td>
<td>51</td>
<td>23</td>
<td>39</td>
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**Source:** BPS, Welfare indicators, 1999
Garbage Collection Methods, 1998

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<th>Ways Garbage Disposal</th>
<th>Urban</th>
<th>Rural</th>
<th>Urban + Rural</th>
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<tr>
<td>Collected by special workers</td>
<td>46</td>
<td>1</td>
<td>18</td>
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<tr>
<td>Buried</td>
<td>8</td>
<td>15</td>
<td>23</td>
</tr>
<tr>
<td>Utilized for compost Burnt</td>
<td>2</td>
<td>6</td>
<td>8</td>
</tr>
<tr>
<td>Thrown away to the river</td>
<td>32</td>
<td>48</td>
<td>80</td>
</tr>
<tr>
<td>Dumped in any place</td>
<td>6</td>
<td>8</td>
<td>14</td>
</tr>
<tr>
<td>Others</td>
<td>2</td>
<td>11</td>
<td>13</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>10</td>
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Source: BPS, Welfare Indicators, 1999

Percentage of Household by Drainage Facility, 1998

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<th>Condition of Drainage</th>
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<tr>
<td>Drainage Facility</td>
<td>90</td>
<td>56</td>
<td>65</td>
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<tr>
<td>- Completely not working</td>
<td>4</td>
<td>3</td>
<td>3</td>
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<tr>
<td>- Water drain slowly</td>
<td>14</td>
<td>8</td>
<td>22</td>
</tr>
<tr>
<td>- Water drain well</td>
<td>63</td>
<td>44</td>
<td>107</td>
</tr>
<tr>
<td>Drainage not available</td>
<td>20</td>
<td>44</td>
<td>64</td>
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Source: BPS, Welfare Indicators, 1999
Appendix 4: An illustration of a HAP: The case of Chili

A good way of illustrating the discussion on a Comprehensive Housing Assistance Program may be to review briefly the experience of Chile with respect to redesigning its housing schemes in the 1980s.

Chile is famous for being one of the first countries anywhere to attempt to put all of their housing subsidies into explicit lump-sum grants. One advantage of such an approach is that the burden on the budget is transparent. Moreover, the allocation of these subsidies was also made transparent, with an explicit rationing process.

In Chile, the housing sector is a traditional focus of redistributive or social welfare activities. By 1980 the government had already experienced the problems that accompany large scale direct provision of housing (corruption, very high cost, low quality, poor locations) and government sponsorship of a separate system of subsidized lending institutions (they went bankrupt from making long-term loans at fixed nominal interest rates).

One significant difference from Indonesia is that it is not considered acceptable for low-income households to build squatter settlements or outside of accepted building standards. Squatter settlements are dealt with strictly. This implies that the poor must acquire formal sector housing and formal sector infrastructure in urban areas. The end result seems to be that low-income households cope by doubling up. Another result is that subsidies to the low-income housing sector must be huge to provide some chance for maintaining these standards.

As of 1995, the grant program consisted of three tiers (plus a variety of smaller variants), as follows:6

Progressive Housing Program
(1) Incomes under US$ 85/month
(2) Grant of US$ 3,700 (94 percent) towards core house of 14 sq. meters on a serviced plot for US$ 3,950
(3) Minimum savings: US$ 250
(4) No Loan

---

6 All money figures are expressed in US dollar terms (as of 1995), to permit easy comparison.
Basic Housing Program
(1) Incomes between US$ 86 - 220/month
(2) Grant of US$ 3,950 (61 percent) towards finished new house of 42 sq. meters, costing US$ 6,450
(3) Minimum savings: US$ 310
(4) Loan: US$ 2,190 from the Ministry of Housing

Unified Subsidies Program
(1) Incomes between US$ 221 - 1680/month (segmented into 3 sub-groups)
(2) Grant of US$ 3,640 at lowest incomes, falling to US$ 1,960 at higher end. Maximum House Price for each group: US$ 14,000, US$ 28,000, US$ 42,000
(3) Minimum savings: US$ 1,400 rising to US$ 4,200
(4) Loan: about US$ 5,000 rising to US$ 35,840 from State Bank or private bank

The Basic Housing Program approximates that of all three tiers of low-cost housing in Indonesia, with incomes ranging up to Rp.900,000 a month. In Chile, the decision has been made that 42 s.m. is as small a complete house that the government wants to “force” on beneficiaries.

One aspect of the system that is immediately noticeable is its generosity. This reflects the fact that housing is the major social welfare and redistributive program in the country and extensive redistribution has traditionally been employed to achieve social peace. As a result, about 10 percent of the government’s budget is allocated to housing yearly.

Despite these large sums, the subsidies are strictly rationed. Only about 20 percent of those who are “eligible” for a subsidy, including meeting the savings requirement, are awarded a subsidy in a given year. The formula for establishing priority includes family size, income, current housing condition, and size and term of savings effort.

The important aspect of the Chilean system is that all explicit subsidies are being delivered via a lump-sum grant or down-payment assistance. Thus, there was no need under their HAP to provide for a trust fund or HAF to house funding for future subsidy commitments, such as for interest rate subsidies. However, if additional sorts of subsidies were to be set up, then a HAF could be created to fund all of the different subsidies.
The Chilean system is recognized as one of the first to emphasize transparency in budgeting and in allocation. However, it is not a perfect system, even in this regard, because, in practice, it utilizes hidden and unbudgeted loan subsidies. These arise in two ways.

The government intervenes to provide below market finance to all beneficiaries in the Basic scheme through the Housing Ministry. The result is a situation much worse than that with BTN. The default rate on the loans by the Housing Ministry is 70 percent. The Ministry has tried to use rescheduling, condonation of penalties, and private collection agencies, but refuses to pursue foreclosure and has no prospect for collection. There is a lesson here for the Co-bild experiment.

While these losses represent an additional “hidden” subsidy that should be recognized under the HAF/HAP philosophy, at least the funding for these loans was coming out of direct budget appropriations.

A more serious abrogation of the principle of a HAP is in the Unified Subsidies Program, because most of the loans in this middle-income range are made through a state-owned bank in order to take on the credit risk of making the loan portion, rather than see private lenders charge a risk and servicing premium for these loans. The default rate on these loans is not known exactly, but the information available suggests that about 20 percent of their borrowers were on average a year delinquent. The losses on these loans are borne by the bank, along with the uncompensated higher servicing costs, out of implicit subsidies embedded in other bank relationships with the government. It was commonly perceived, though, that the poor recoveries were as much due to the politicization of the situation (by having a government-controlled lender) as by any difficulties faced by the borrowers.7

There is another serious concern with the Chilean voucher system, relevant to the Indonesian context that goes beyond the strict financial issues. Because developers and government alike were searching for affordable land to build houses for the lower income groups, developments were often not integrated with urban infrastructure and social services. As a consequence, undesirable urban planning outcomes resulted from the subsidy program. A different implementation mechanism, (for example neighborhood based allocations) might have improved the system.

7 It has been suggested that one way to resolve this situation would be for the government to contract with private banks to make certain quantities of loans to this target group. To the extent that such loans, made at normal market rates, are unprofitable, the bank would be compensated by the government. But the compensation would be determined ex ante, through competitive bidding for the contract, and all risks and rewards would thereafter lie with the bank. In other words, banks would bid for subsidies to make such loans, and the lowest bids for subsidies would win the contract. The banks would then treat the loan like any other loan, and the current politicization of the loan recovery process would be minimized.
Chile was the first country to shift to a lump-sum grant type of housing assistance, but many have followed, especially in the 1990s. Costa Rica, Ecuador, and Suriname have similar programs of up-front grants, but with major differences in delivery mechanisms. Even Germany merged almost all of their homeowner subsidies into a lump-sum grant to first-time homeowners. Other European countries also moved towards explicit budget allocations for housing subsidies rather than indirect schemes that build up unbudgeted future commitments. Although the U.S. has not generally adopted up-front subsidies, it has also followed a philosophy similar to that of the Housing Assistance Fund discussed above, i.e., accounting for future budget commitments implied by programs that offer a stream of assistance over several years.

This approach can be improved further by having one pool of on-budget funding (the HAF) which supports a truly flexible HAP that allows for a variety of assistance approaches. Such an approach is very attractive for a complex situation of different housing policy objectives, such as in Indonesia.
# CHAPTER 8

LOCAL LEVEL HOUSING ASSISTANCE PROGRAMS AND INSTITUTIONAL ARRANGEMENTS

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CHAPTER 8
LOCAL LEVEL HOUSING ASSISTANCE PROGRAMS AND INSTITUTIONAL ARRANGEMENTS

8.1 Legal Framework For Decentralization Process

8.1.1 Introduction

As the following report is a part of the Special Reports produced by HOMI Project, it should be viewed as an integrated part with the other Special Reports.

This Special Report discusses Housing Assistance Program’s in Local Level and its Institutional Form. It is closely related with SR concerning “Indonesia’s Emerging Housing Policy”, SR on “Institutional Arrangements and Funding Mechanisms for HAP” and SR on “Instruments for a HAP”. There are also several aspects which are related to SR regarding the demand of cheap housing and its implication to housing subsidy, with SR concerning land and housing market efficiency in local level, and with SR about the development of financial insititutions on local/community level.

This Special Report consists of 5 (five) Chapters. Chapter One discusses the functions and roles of Housing Assistance Program within the decentralization of housing system with its relation to other assistance program, i.e. subsidy program on national level, increasing the market abilities program, and capacity building program. The legal aspects will also be addressed, mainly those related to legal framework on local level.

The consequences of the necessity of legal framework will be discussed in Chapter Two will be discussed in Chaional development proposal. This concept is the base in developing the concept of organizational framework of housing assistance program executor on local/community level (see Chapter 5).

In Chapter Three, the most important chapter, will be clarified three proposals of Housing Assistance Program for Local level, which are Community-Based Housing Upgrading Program (CBHUP), Mixed Income Housing Development Program (MHDP) and Rental Housing Development Program (RHDP). These three programs should be integratedly implemented with other national subsidy/assistance programs within a coordinated working pattern of central-local government.
Chapter Four would explain about the need of a sustainable capacity building program in developing a Housing Development system in local level. Gradually, the program will increase local’s independence in addressing housing issues to the point where assistance from central government is no longer needed. This condition would be achieved if several requirements are accomplished, i.e. mechanism of housing market is efficient, and development of Housing Finance Sector is satisfactory.

Chapter Five is the first phase in implementing Special Assistance Program for Local Level. In accordance with its character as incentive of local’s initiative, thus the assistance is firstly implementated in certain areas, which fulfill the requirements, as Pilot Projects. The following phase, is developing replication pattern (scale-up) from the experiences gained from the pilots for several local typology. The assistance program ends when the local housing development system is functioning sustainably.

8.1.2 Housing Conditions In Local Level

8.1.2.1 Varied Local Conditions

Local housing conditions are very heterogenous, which are set in by several different factors such as urbanization level, industrialization intensity, the size of the city, economic ability, and local’s traditional/cultural character. All the above mentioned factors and several others set off the housing issues to emerge differentially;

Within the areas with high level of urbanization, it is certain that slum housing would emerge mainly as a result of the immigrants’ low level of economic abilities. Thus the density of the settlement would increase, as often exceed the environment’s supporting capacity, and effecting the housing development issue as a continuous and actual agenda. Based on the data available, the growth of urban population could reach 3.4 – 4% per annum which indicate there are 735,000 new households per year that needs housing. The housing issue within the area with a high level of industrialization intensity has different character. The slums is generally developed within the urban periphery surrounding the industrial area in the form of rental housing/rooms, where most of the unmarried workers live in collectively rented houses/rooms without any facilities. The main housing issue within this area is how to deliver affordable rental housing with better qualities for the workers.

The size of the city could also determine the character of emerging housing issues. In moderate size cities, the immigrants could usually built very modest housing in urban
periphery where land is still affordable. On the contrary, it is incredibly difficult to implement in big cities due to time factor and transportation cost, thus many of immigrants become the inhabitants of illegal housing.

In addition, the local level’s tradition is very important in identifying the character of housing issue. In urban areas with relatively homogenous cultural tradition, housing issues are probably more dominated with physical problems. As within urban areas that culturally more heterogenous, non physical problems such as conflicts between ethnic/religious communities could occur, therefore the community-based problem solving become more difficult to implement.

The examples mentioned above have given the overview of the heterogenous local’s housing issues. The diversity would increase depend on the local government’s attitude in dealing with housing issues, varied from doesn’t care, ambivalent, to very concern.

8.1.2.2 General Character of Local Housing Issue

Based on the heterogenous housing issues mentioned above, it could be concluded that whichever housing assistance programs should be designed with high level of flexibility in allowing the local adapting the implementation according to its conditions. The design should also take consideration of several issues concerning general character of local housing issue, on the following.

The first general issue is the attitude problem of local government towards housing condition resulted from the government officials’ misconceptions. From around 400 local governments throughout Indonesia, there are only small numbers who have concerns on housing where only about 20 of which, have specially allocated fund for the housing sector. Most of those concerned local governments implement the housing program partially, i.e. slum upgrading program, kampung improvement program, etc. which are mostly funded by the central government. Many of these local governments do not realize how closely related the urban and housing development are, and the importance of the integration in a city’s spatial development plan. In addition, local government generally does not integratedly improve the ability of local housing sector.

The second local housing issue is that the local ability in providing and utilizing housing resources coordinatedly and efficiently is still very low. The housing (70-80%) are mainly self-built by the people in a non-comply way, regardless of facilities from the government and without any coordination between housing actors. This housing development pattern
has a centralistic function in fulfilling the people’s needs. The results of this non-systemic pattern are the squandering of housing resources and uneven distribution pattern. (For example; a small number of housing actors dominate an abundance of land resources due to unhealthy competition which then resulted in the unaffordability for most of urban inhabitants. On the other hand, the majority of the people who do not have access to banking fund should borrow from the creditor with high rate of interest.)

The third general issue is the low level of abilities of the local housing actors’, whether public/government sector, private sector, NGO or communities, both in technical and managerial abilities. Regardless of the housing actors’ abilities in coordinating and synergizing the resources, most of which do not have the adequate requirements in performing their profession, due to the lack of reliable training system in housing field. Many of the skills are acquired informally through self-learning system and not systematic. As there are no working pattern agreed on, thus on daily practices each actors improvise and choose the ad-hoc way in solving problems, done by the contractors or the do-it-yourself builder, private developers or non-profit NGO, bankers and materials shop owners as the creditor of housing development, even by the permit-issuing official and decision-maker in government institution. In several big cities the conditions are slightly better, but it is achieved with high learning cost from the previous failures.

As a whole the conclusion is that the three general issues mentioned above are originated from one main problem, which is the lack of people’s awareness on the importance of housing issues. Thus the fourth issue is the difficulties in improving awareness and how to change the misconception the local people’s have regarding housing issues. Other Special Reports have emphasized that the investment on housing sector in Indonesia belongs to one of the lowest among developing countries. It is also confirmed from the HOMI study survey, that saving for housing is not a high priority for the majority of the people (see survey result, especially the results from Focusgroup).

8.1.3 Developing Local Housing System

It is previously mentioned that most of housing issues could not be solved on national level but through a sturdy local housing development system. The questions are what kind of system should be developed in local level and how is the basic framework?

Each system is designed to achieved certain objectives and the basic framework of housing system should be defined from those objectives.
New Housing System should be based on the fact that **housing sector is one whole entity** so as the new system does not differentiate formal – informal, commercial – non-profit, subsidy – non-subsidy, well-to-do – poor, bankable – unbankable, even legal – illegal. Housing System should be effectively developed in delivering housing to all income groups. Therefore the housing delivery system should efficiently utilize and mobilize the limited housing resources.

The new Housing System should be developed in accordance to the concept of **empowering the housing actors** so as gradually they could improve local capacities in the housing field. The success of the new housing system will depend on the improved housing actors’ abilities in mobilizing, coordinating and creating synergy of varied housing resources found in the people, government and private sector, with special attention on funding and land aspects, the latter being a critical problem in urban areas with high density.

The developed Housing System should **have a sturdy institutional foundation** and should not be operated only by ad-hoc organization which could be changed anytime. For example the relation of housing development with urban development, procedures that would guarantee people’s participation and transparency should be first priority in developing local institutions.

On a more advanced phase, the developed Housing System should be integrated within the concept of urban/local economy development. An efficient housing economy could generate the development of urban economy, while on the other hand inefficiency creates high cost economy. If the new system could improve the efficiency of housing market, thus more households could then afford to acquire housing. In addition, an effective housing assistance program would increase the quality of urban settlement and motivate the people in saving and making investment in housing sector, so that the housing industries grow and become more efficient. On the next phase, the growth of housing industries would create new job opportunities, and so forth.

### 8.1.4 The Needs For Local Housing Assistance Program

In general, the HOMI Team proposes two kinds of housing assistance program, firstly is assistance program on national level and secondly is assistance program on local level.
The housing assistance program on local level could be divided into two major groups which are **capacity building program** and **special assistance program**. These divisions are not merely oriented to local needs but also have strategic values.

From the previous discussion (see 1.2 and 1.3) it has been clarified that the local government needs two kinds of assistance, firstly is assistance in dealing with housing issues (see 1.2) and secondly is assistance in improving local’s abilities in building a solid housing development system. As these two programs have different characters, it is advisable not to execute the implementation within one package of assistance.

Special assistance program concentrates on assisting the local level in dealing with housing issues. The approach is oriented towards actual problems found in the field. The diversity of problems in local level demand flexibility in the implementation of assistance program concept. The special program should also function as *pilot project* in testing the development concept and housing improvement program in certain areas which are more prepared. If these concepts are considered fit, then the same concepts could be replicated (scale-up) for other areas. Special program is temporary in nature and functions as an incentive to generate local in dealing housing issue in a more serious and systematic way. Local readiness is a crucial criteria in appointing which local is suitable to receive the special assistance program. Following the well-functioning local housing development system, then the special assistance could be ended. Special program has an objective to eliminate itself; thus when the whole of housing system has been well decentralized, the special program would ended.

In contrast, the capacity building program is oriented on changing the perception and improving housing actors’ abilities including human resources and housing related government institutions.

Included in the capacity building program is increasing the efficiency of local housing market ability in fulfilling the need of housing for majority of the people. The program does not directly involve in the development process or housing improvement but more to the initiative in developing the local housing system. The sustainability of these assistance programs should not depend on whether or not there is an assistance program.

Principally, the capacity building program will continue as the main task of national level government/institution, not merely of around 400 administrative regions. The type of assistance would be attuned to the needs of each local government. Where on the initial stage the capacity building program will cover most of housing development aspects,
thus on the final stage, it would be more concentrated on developing local housing economy, research activities as well as developing housing information system.

### 8.1.5 The Need For Alteration In Legal Framework

The local housing system should be positioned on a solid institutional framework, although the formulation of this institutional framework should not be based merely on Law 22/99 and 25/99, of which stated is existed on local level. On the other hand, the Housing Law No.4/92 which should be the ‘shelter’ of housing system legal framework is still centralistic in nature and could not be referenced for developing the legal framework of local housing system.

#### 8.1.5.1 Legal Framework on National Level

Another problem is that not all elements of housing system could be decentralized, partly because of authority issue (i.e. aspects of financial institution/bank, tax aspect, etc.) and if viewed from material point of view, it is better to handle the issue inter-regionally (such as research and development aspect). In creating a stable environment and increasing the efficiency of resources utilization, the following matters should be based on national regulations/law, i.e. rental and leasing system, land titling procedure, house quality standardization, housing environment and housing facilities.

The following aspects of housing development system are recommended as principal materials that need national arrangement:

(a) Major description on the position of housing and settlement sectors in relation with national and regional development program as well as strategic planning of other related sectors.

(b) Definition and clarification on several basic meaning of housing, such as housing, settlement, environment infrastructure, environment/housing facilities, public/social facilities, serviced land lot, land consolidation, etc.

(c) Definition and clarification on roles and functions of government institutions, private/people involved in policy making, planning, development and maintenance, as well as research and development in the housing and settlement fields.

(d) In institutionalizing participation process, the following should be defined, roles and functions of many profession, institution and community groups involved in planning process, housing and settlement development and maintenance, as well as appoint which institution to facilitate the participation process.
(e) Identify varied housing and settlement development pattern, including those done solely by the people and NGOs/community organizations.

(f) Identify many land provision and utilization pattern, permit procedure, funding, institutions, etc.

8.1.5.2. Legal Framework on Local Level

The following aspects should be regulated within a solid local level legal framework as it is viewed from the development of decentralized housing system:

(a) Roles and functions of local government institution which involved in policy making, planning, development and maintenance in the field of housing and settlement.

(b) The position of housing and settlement development planning in relation with local development Properda and Renstra.

(c) Relation between housing and settlement development plan with the Local/City Spatial Development Plan

(d) Roles and functions of varied profession, community groups and private sector within participative housing development system, as well as the forum/insti tution which would facilitate it.

(e) Local capacity building plan within the development of local housing system

(f) Appointing organizations and financial institutions which would facilitate the mobilization, distribution and synergy of housing fund resources.

8.2 Institutional Development

8.2.1. Introduction

Every step in the development process brings with it constraints in connection with related institutions and also the legal framework. The housing delivery system does not rely on ad hoc procedures nor does it rely merely on the potency of the market. This is a very basic principle but also very generic characteristic of housing development in Indonesia. One main reason for the malfunctioning housing system in Indonesia is because of the institutional constraints which must be resolved. In this chapter we shall discuss the concerns related to institutional development which are relevant to a decentralized housing development system.
### 8.2.2. The Need For Development Of Housing Institutions In Indonesia

Aside from the back log of total housing units which must be produced, Indonesia has a "back log" in development of its housing delivery system. Up until now, the majority of households are organized on a "do it yourself" basis with very limited resources and on a very small scale. Only a small minority of households have access to organized formed sector housing through the market mechanism or through "organized groups of users". This situation brings with it some positive aspects, but also many negative concerns, such as the unjust distribution of resources, poor housing conditions for unskilled / low income households, undeveloped housing market, production quality below minimum standards, and many other concerns. Another aspect of the study being carried out by the HOMI team has already been classified, namely that resolving all the above problems must require a sound housing system, because the present system is highly underdeveloped and cannot solve these problems. This backwardness stems from problems that are more difficult, because housing problems in accordance with Law 22/1999 must be resolved in a decentralized manner. In reality, although responsibility for housing already rests with local government, very few local governments give the housing problem very high priority. There are still many local governments which have the perception that it is necessary to pay attention to the problem of slums give a bad image to the city. Ironically, people also perceive that the housing problem is a private affair. Generally, urban households perceive that slum upgrading is a matter between government and slum dwellers. The majority of the urban population does not realize that slums or housing problems in urban areas generally constitute an urban community matter that cannot be separated and given over piecemeal to government.

The above description forms a picture which up till now shows that housing institutions are still a new concern in Indonesia, not just for government but for the entire populace. What are the problems which institutional development is now facing?

### 8.2.3 New Way of Thinking

Although in accordance with Law 22/1999, housing concerns are already delegated to the regions, the reality is that local government cannot control or strongly direct work in housing preparation. Part of this strength rests with central government's non-housing policies, such as monetary and fiscal policies or the regulatory system which has a large impact on the housing sector.
At present, the government of Indonesia is trying to free itself from the sectoral system which is difficult to coordinate. In the housing sector, the Indonesian government is still searching for the proper form of organization for management. After it became a ministry on its own, the housing sector returned to become part of KIMPRASWIL. But changes in the form of organization did not in itself change the system of management, so long as the policy concepts concerning housing itself did not change. The institutional form and structure is an instrument for policy implementation which, effective or not, must be evaluated from the output which results. Because of this, institutional development proposals in the home study cannot be separated from basic policy and strategy proposals.

Basically housing is a complex, composite product. The peoples’ view is the housing is also a private matter reflected in previous policy. The HOMI Study proposes that the home be viewed as a commodity in the public dimension, hanging on public policy, influenced by public policy, and also producing a public identity. (This latter aspect is felt more easily at regional and local levels.) The HOMI Study proposes that the concept of future public policy should rest more on the lower income groups, because these groups until now have not been given the opportunity to gain access to resources they require for housing, such as land, infrastructure and finance. Thereafter, the HOMI Study wishes to propose that the problem of housing development cannot be discussed independently of local economic development, and therefore local government must pay maximum attention to “housing economics”.

8.2.3.1 Institutional Function of Housing Development

Therefore, at the national level, it is necessary to change the perception of housing.

- Government or special institutions are formed to facilitate the people in obtaining housing. The central government must influence the market mechanism so that housing resources, namely land, infrastructure, finance, etc. are allocated in an ideal and transparent way for all levels of households. Subsidies are only given as an incentive to those with low income who are truly in needs.

- Local government must fashion its effort as a housing delivery system in regions with capacity to mobilize the peoples’ skills to the maximum. Subsidies or assistance which is provided must be decided and channeled transparently through a process
which is participative, and is only given “on top” after there is maximum effort by the people.

With this perception, the institutions which must be developed are those which influence the market mechanism and not those which carry out quotas. Therefore, these institutions will not achieve static policy results, but rather policies which gradually bring assistance into line so as to support the market mechanism in serving the lower income groups.

8.2.3.2 Empowering NGOs

Because activities such as these are not usual for familiar government agencies, it is necessary for a new institution to carry out these autonomous functions. But any institution cannot perform well without a partner, supporter, competitor and supervisor. In a centralized system, government only has supporters and partners. Now it is necessary to have competitors and supervisors as well. But at present such institutions are not available. Therefore, the legal system must include elements of institutional development.

Certainly new institutions cannot directly operate well. Thus institutions which also serve the public interest are those institutions which must be given a proper place. Institutions which play a supervisory role are also proposed to be given facilities. Certainly this issue is not only finished in connection with housing, because it is also related to general policies.

Furthermore, the government needs to take up a new role as a facilitator instead of a provider. Thus the government should delegate some of its functions to an independent institution. The HOMI Study proposes to form a National Housing Agency, Regional Housing Agency and Local Housing Agency, non-governmental institutions which would execute the implementation of policies.

NHA is an operational executive organ. Its operation’s objectives are executing the Housing Agenda, which are implemented programs to achieve the objectives formulated in the policy concept. As the NHA could not operate on itself, in relation with mobilizing fund, coordinating financial resources from varied parties (sponsor, government, private sector and people), the National Housing Fund (NHF) needs to be established.

Furthermore, the government should acknowledge the existence of Regional Housing Forum and Local Housing Forum in establishing Regional Housing Agency and Local
Housing Agency. On national level, NHA along with NHF devise the Housing Agenda for national and local levels, following the inputs given by National Housing Forum and in accordance with the policy guidelines. In the process of formulating the housing agenda on local level, local representative should be involved to better accommodate the local’s needs.

There are no new institutions that could directly be operational. If the government is willing to delegate its functions and acknowledge the existence of non-governmental institutions, then the next step is to have faith and give them opportunities. As resolving housing problems requires a long time span, thus the policies concept should be consistent and lasting. The institutions are formed instruments to execute the pragmatic decisions, therefore the success of the institutions is depended on its ability in implementing the programs within the agenda.

8.2.3.3 The Needs for Institutional Development on Community Level

On local level, sometimes the establishment of institutions are redundant and many of the local level institutions are not performing well. Assessments are often wrong instead of right, due to the standard used. Although the matter is still contradictory, due to current needs, minimum requirements should be defined from the point of developing housing system.

The major question is: How is the institutional development on community level? Are current institutions (i.e. Kelurahan Council or People Representative Insititution) reliable in implementing policies on local level? Regarding the difference in characteristics and customs of each communities, there are no regular answers to those questions. Therefore, there should be an agreement between the community and other institutions on how to justify a decision or fund utilization, how to make decision participatively and transparently, etc. By way of speeding up the implementation, minimal standards and criterias for several institutions are determined, such as equality, democratic, transparent and responsible.

What do the communities really require? The opportunity to formulate its own system within its own determined target of time. Community system, especially in dealing with matters on leader transition and fund management, should be the major benchmark in assessing its capacities. These two capacities should then be tested within its interaction with other parties which have different interests.
There are at least 3 (three) different types of institutions needed. Firstly, a public institution which is integrated in the formal governmental system, with official task related to the process of housing delivery, whether relating to land, infrastructure, technical/standard plan, etc. Secondly, an institution within the internal community, involving those living and dwelling in the boundary of a settlement unit, relating to maintenance, security and improvement of the environment. Lastly, an institution related to fund management, savings, loans, etc. In general, these three institutions should be established on community level, so as the individuals of community members could organize themselves in a community-based housing delivery system.

8.2.4 Legal Framework For Coordinating, Integrating And Distributing Housing Resources

One of the toughest problems in implementing the project on local level is integrating various resources possessed by actors with different interests. Thus it is necessary to establish an operational coordination center on local level in order to execute the tasks mentioned above. In accordance with the institutional framework discussed in Special Report on “Instruments for Housing Assistance Program”, then on local level will be established a Local Housing Agency (LHA) or Regional Housing Agency (RHA). LHA should be directly established in the dense and relatively wide urban areas, i.e. metropolitan city, as for RHA established in extensive area but with limited cases. The Local Housing Agency (LHA) or Regional Housing Agency (RHA) have the following functions:

1. R/LHA identify communities and groups which are potential as groups of beneficiaries. Organization stability in dealing with leader or members turnover and the ability in managing assets should be the basic criteria.

2. R/LHA should stimulate the groups to develop themselves, but not merely with promises. Development should not be limited on housing itself. R/LHA should cooperate with other organization/institution in supporting the communities/groups taking the initiative steps. RHA/LHA prepare the first phase for Capacity Building in developing the required institution. Bank/Financial Institutions should be involved from the commencement, as for the proposal produced is in accordance to the sponsor’s requirements.
3. R/LHA assist the communities/groups in formulating their proposals, within the second phase of Capacity Building which aims in assisting them in formulating a housing development plan.

4. R/LHA and financial institutions/banks executing the selection process. The basic criteria is fund utilization for as many households as possible. The result of this selection process is submitted to NHA to be evaluated regionally.

5. For those who are not chosen but regarded appropriate in receiving assistance, then RHA/LHA would create second phase of Capacity Building program, to assist the communities/groups in improving their proposal and settling their weak spots.

Concerning the difference and constant-changing condition of the fund within the program, thus R/LHA should constantly evaluate. Based on this evaluation process, the NHA could make adjustments in maintaining the entire program's efficiency and effectivity.

8.3 Development of Special Programs at Local Level

8.3.1 The Basic Principles of Housing Assistance Programs at Local Level

8.3.1.1 The Basic Principles

At the outset of describing housing assistance programs at the local level, we need to begin by discussing basic principles which must be used in formulating such programs. These basic principles include the following:

- decentralization
- participation
- empowerment
- equity
- transparency
- efficiency / effectiveness
- sustainability

Many of these principles, often portrayed as key components of “good governance”, need to be incorporated into the design of housing assistance programs at the local level. These principles can be manifest at different levels of intensity in the different programs proposed below.
The first principle is that of decentralization. Laws No. 22/1999 and 25/1999 define housing as a function of local government. The requirements of decentralization will have a profound influence on the empowerment of communities and the provision of local housing resources. It will take time, however, for local governments to be fully democratized and for low-middle income populations to forge a collaborative relationship with local government to jointly address these housing problems. HOMI assumes that decentralization of administrative and fiscal responsibilities from central government, to regional and local governments is inevitable (although the pace may be unclear), and that accommodating this principle is a crucial element of the housing assistance program (HAP) at the local level.

Yet another key principle of housing assistance programs at the local level is that they be participative: i.e. that people’s participation in facilitating the planning, implementation and monitoring of development activities is seen as a critical element for a successful strategy. Closely related to participation is the principle of empowerment which gives residents at the local level the power to realize their aspirations and control their destiny. This process enables local communities and residents to achieve synergy based on resources available to them.

A closely related principle is that of equity, in that government policy should encourage all groups of households to have equal access to land, infrastructure and other urban facilities and services. This ideal situation cannot be completely achieved, but government needs to intervene on behalf of lower income and other disadvantaged groups to improve access to better housing and environments. If these assistance programs only result in supporting the privileged few while others are not supported for reasons that are not clear, it means that such programs are a failure.

Another important principle is that of transparency. As the belief of local residents in themselves increases, they will eventually be able to put pressure on local government and on other housing-related stakeholders to be more open and equitable. As local government policies and programs become more transparent, local residents will have more belief in their government and a cooperative spirit can be developed.

The principle efficiency in local level housing assistance programs is also essential. Efficiency in the design of these programs implies that the process and products are cost-effective, that resources are well utilized and coordinated, and that a variety of
heterogeneous local conditions can be accommodated. These programs must reflect the needs of a range of beneficiaries under varying conditions. This method will increase the effectiveness of assistance because the beneficiaries appreciate what they are receiving. Assistance cannot be provided to those who don’t need it.

Finally, the principle of sustainability is a critical factor in formulating housing assistance programs at the local level. If all the principles mentioned above – decentralization, participation, empowerment, equity, transparency and efficiency – are adhered to the maximum extent, sustainability of these programs will be significantly enhanced. However, such programs will not be successful overnight, but must be carried out in steps. These steps must be supported by sustained capacity building and institutional development which is well designed and systematically backed by central and local governments. Through Capacity building program (will be addressed in greater detail in Chapter 4) the local or urban community (included the local government) should be enable to develop the new decentralized housing development system at local level. Throuh the implementation of HAP at local level the new decentralized system should be gradually improved and established as a sustainable system.

8.3.1.2 Introduction to Three Housing Assistance Programs

In the context of housing assistance programs, the HOMI team proposes that the following three types of programs be carried out at the local level:

1. Community-based housing upgrading for existing low-middle income built-up areas;
2. Mixed-income development for new residential areas;
3. Rental housing development in particular situations.

These three programs proposed by the HOMI Project to meet the needs of various low-middle income households have very different characteristics. Overall they can serve the majority of Indonesia’s urban population.

In the first program, namely “community-based housing upgrading”, the target groups are those who live in kampungs dominated by informal housing. The population consists of mixed groups from low and middle income classes. Most of these people are “self-employed” or work in the informal sector, but some also work in the formal sector. This program does not establish at the outset which group must be given priority, because the ultimate goal is to improve the condition of housing and environment overall, both physically, legally and economically.
The second program, namely “mixed-income development”, is focused more on those residents who need new housing in developing areas. This program must begin with the process of empowering those groups interested in participating in the program, including groups under CBHP, housing cooperatives, work based community groups such as university or hospital employees, or persons from the same professional community such as tradesmen, government officials and others.

The third program is directed at those households who cannot yet purchase or build housing because their incomes are too low or because they do not yet require a house themselves, so they rent a house or room. This program is primarily aimed at industrial workers who up to now live close to industrial areas under conditions which are very poor. Besides improving the quality of rental housing required by industrial workers, the program also aims to push factory/business owners to develop homes/rooms for rent for their employees.

Unlike previous efforts, these three programs are not a monopoly of government, but in principle can be carried out by a variety of organizations. With or without government involvement, the management system must be transparent and accountable. All of the programs are designed to have a high level of peoples’ participation in order to avoid the perception that they are simply limited to government subsidies or grants.

Foremost among these three programs, namely rental housing development, is the perception that rental housing is developed with substantial government subsidy. However, in many cases, government is not capable of meeting necessary operation and maintenance expenses. Therefore, in the case of rental housing, government’s role must be limited to that of facilitator and stimulator to encourage rental housing to be developed by other parties.

As to the question of who will develop rental housing in particular and housing generally for low-middle income households, the answer is that it can be any number of organization. We can begin with community groups on the basis of geography – or other communities based on similar work, or socio-religious organizations. Other possibilities include workers from the same non-profit organization such as hospitals, universities, educational foundations or cooperatives.
Certainly these organizations cannot all become housing developers overnight. Therefore, for an initial period of 5 – 10 years, the central government should carry out training and encourage local governments to implement pilot projects which can function as “living laboratories” for those institutions wishing to become developers, in particular non-profit developers.

8.3.2 Program I: Community-Based Housing Upgrading Program

8.3.2.1 General Description
The Community-Based Housing Upgrading Program (CBHUD) is a program designed to empower community residents with the goal to improve the quality of housing and residential environments, in particular the kampungs by means Direct Community Grants (or BLK). The priority use of BLK funds must be in accordance with local needs as determined through community groups, neighborhood organizations and other institutions involved in a participative implementation process.

8.3.2.2 Program Goals
CBHUD has the following goals:

- To assist local governments in formulating innovative programs for housing and residential development on the basis of community empowerment and participation.
- Within the framework of the decentralization process, the system of housing and residential development is delegated to local governments. One goal is to upgrade the general capacity of local government in dealing with problems of low-income settlements by means of developing an improvement program for housing and residential development through motivating, facilitating and upgrading people’s capability, both collectivity and individually, for improving their housing and environmental conditions.

8.3.2.3 Program Targets
CBHUD has the following targets:

- To assist community residents living together in particular kampungs under below-standard conditions to collectively improve their housing and residential environment.
- To assist community residents in improving their skills for mobilizing both their own resources as well as resources of the public and private sectors which can be used for planning and implementing upgrading programs.
- To assist local households to improve their capability for upgrading their homes.
To assist residents in improving their skills in developing a good and efficient system for managing their community.

8.3.2.4 Scope of Program

The scope of CBHUP is divided into the following categories:

- Included in the first category is improvement in physical conditions, such as improvement in residential and social infrastructure related to immediate environment, and improvement and upgrading of housing.
- The second category includes improvement in productive economic activities, such as small and medium scale businesses and citizen’s cooperatives, coordination of marketing, and improvement in management skills, etc.
- The third category includes institutional development, such as the structure of local environmental management bodies, community fora, community support institutions, foundations and cooperatives.
- The fourth and final category includes legal – administrative support, such as improvement in status of land, processing of development controls as well as controls over business, cooperatives, etc.

8.3.2.5 Establishing Program Locations

Step One
Each Local Government or other organization/institution working together with Local Government, by fulfilling certain requirements for receiving assistance, will submit a proposal to the “Regional Housing Agency” (see chapter on Institutional Development), concerning those locations within its jurisdiction which are feasible for receiving assistance. The Local Government must also show that it is prepared to carry out the program (see chapter on Capacity Building at the local level).

Step Two
When the proposal from the Local Government is approved, the Regional/Local Housing Agency (R/LHA) will appoint a Development Consultant to assist community groups in the proposed location to formulate a plan for use of the assistance in the form of a proposal. This proposal should include both technical and cost proposals, organizational structure for implementation and other important requirements. After completion, the proposal should be submitted as a “project proposal” to the R/LHA.

Step Three
The R/LHA will form a “selection team” and based on the evaluation system already agreed to beforehand, the selection team will divide the results of the evaluation into four categories:

- Category a involves those project proposals which can be implemented immediately because all requirements have been fulfilled;
- Category b are those proposals which in principle can be implemented with minor improvements or changes;
- Category c involves proposals which in principle are good, but which require substantial improvements or
changes, so that their implementation must be postponed until all requirements are fulfilled; and finally *category d* involves those proposals which are in principle rejected.

**Step Four**
The R/LHA then carries out the process of evaluation concerning program implementation, thereafter carries out program modification and develops recommendations for Capacity Building concerning the following issues:

a. Recommendations concerning successful pilot projects as “best practices” and necessary considerations for program replication on a larger scale (scaling up the program).

b. Recommendations for institutional development an capacity building for regions (local governments) with a variety of needs.

**8.3.2.6 Beneficiaries**

Persons who benefit from CBHUD can be divided into three groups:

*The first group* involves the entire population residing in the area which will be upgraded and is organized as a “Community Forum”. Membership in the forum consists of those local residents who are appointed as community representatives and group representatives. The forum determines priorities through democratic and transparent means for the use of assistance both for grant subsidies and revolving funds, in accordance with evaluation results and proposals from the various groups.

*The second group* are those who live or work within the residential area, and who have a special role, function or importance. Included in this group are home owners, small and medium scale business people, cooperative/aris an sub-groups, sub-groups with the same skills or work, owners of rental housing, and others. Each sub-group or individual household will submit their specific proposal for use of the assistance, in accordance with their needs, together with the requirement that their proposal will have a positive impact on development and improve the quality of their settlement.

*The third group* involves the people’s organizations which are concerned with improving the quality of housing and settlements, and which have proposals for the use of assistance to achieve their goals. This third group includes Non-Governmental Organizations (NGOs), social organizations, universities, cooperatives, etc.

**8.3.3 Program II: Mixed-Income Housing Development Program**

**8.3.3.1 General Description**
The Mixed-Income Housing Development Program (MHDP) has as its goal improving the capacity of Local Government to assist and facilitate low-middle income households to develop their housing by means of efficient and integrated implementation within new
residential areas. Assistance can be directly provided to household groups or to housing organizations formed specifically for this purpose, or indirectly through Local Government.

8.3.3.2 Program Goals

MHDP has the following goals:

- To assist local governments in improving their capacity to develop affordable new residential areas for needy household groups, especially for low-middle income groups.
- To assist actors involved in residential development at the local level, from private sector, public sector, NGOs or from other community-based organizations, to carry out development of residential areas efficiently and effectively, so that the needs of community groups desiring to own their own housing can be realized.

8.3.3.3 Program Targets

MHDP has the following targets:

- To facilitate and give assistance to low-middle income community groups desiring to develop their own housing to mobilize the necessary housing resources, including finances, land, infrastructure, house development and skills to organize and manage these resources.
- To assist local governments and related institutions to develop residential areas for low-middle income community groups through upgrading the capacity to facilitate the activities of these groups in the form of synergy between actors, so that productive housing is realized for an increasing share of the population.
- To facilitate a system of residential land preparation which is efficient and benefits most community groups in the region.

8.3.3.4 Scope of Program

The scope of MHDP can be described as follows: in principle this program takes the form of two types of incentives, namely direct assistance and supporting assistance. The focus of direct assistance is preparation of community groups and residential land, and the focus of supporting assistance is directed at implementation of residential development schemes.

The structure of this assistance is based on the assumption that the critical step in achieving results related to the internal capacity of local community organizations, combined with the capacity of local government to prepare reasonably priced “serviced land”, among other factors. If this critical step can be completed reasonably, subsequent steps - namely development of supporting facilities and house construction - will be more easily
carried out. Therefore, these final concerns of the assistance have a character which is more managerial and technical. Following is a more detailed description concerning the scope of assistance.

The first activity includes the category of “Group Preparation Assistance” which is work to identify community groups with potential to be supported by organizational, financial and legal aspects. The goal of this preparation stage is to formulate a housing development plan to be agreed by all group members. This plan includes a plan for collection of funds together with a savings program, and a plan for cooperation with other parties (NGOs, private sector, government institutions, etc). MHDP can provide a kind of insentif for those who joint the saving program.

The second step includes “Assistance to Prepare Serviced Land” which is affordable to low-middle community groups. This includes the category of assistance to form non-profit land development organizations at local government level. This organizations can take the form of housing foundation, cooperatives housing, housing development board, or other forms.

The third step involves assistance to land development implementation support in the form of technical, managerial and legal-administrative support given to non-profit land development organizations appointed to provide and prepare land.

The fourth step includes “Housing Development Assistance” which is given in the form of support for access to finance / loans, support for the techniques of planning and construction techniques, etc.

8.3.3.5 Establishing the Assistance

Step One
Based on the recommendation from the socialization program carried out within the framework of Capacity Building, the Regional / Local Housing Agency requests the development consultant who will provide “group preparation assistance” to those interested and have potential to receive assistance (see discussion of Capacity Building). The goal of this assistance is to improve the skills of these groups, enhance cooperation between these groups as well as with other actors in housing development, including cooperation between private sector and government agencies. Other assistance is for work plan formulation, including financing plans where they form an integrated part of these plans. For groups who meet certain requirements MHDP will give incentives for saving activities.
for housing. Funds which are collected from savings will be combined with other resources both from the groups themselves and from other parties, including those from the government.

**Step Two**
Simultaneously with "group preparation assistance", provision is made for "assistance to prepare serviced land" which will begin as a Housing Forum which functions as a communications vehicle between actors and is continued with the appointment or formation of a non-profit organization as the professional implementor of housing development. The form of this organization should be in accordance with the concept of land acquisition, whether for land purchase, land consolidation, Guided Land Development or other methods. This assistance is analyzed by formulating a housing land development plan which is agreed by all involved actors, beginning with users (namely supporting groups), landowners, related local government agencies, contractors, donors, etc. This housing land development plan will be submitted to the Regional / Local Housing Agency, and therefore should clarify all internal issues including activities or expenses which should receive assistance and those which will be self-supporting.

**Step Three**
After the evaluation process by RHA / LHA is completed with positive result, incentive funds for implementation of land development can be given. Thereafter, within the framework of "assistance to land development implementation support", RHA / LHA will support consultants to give assistance in technical, legal-administrative and managerial aspects. If the above proposal is not agreed to, RHA / LHA will ask the proposer to improve their proposal until their requirements are fulfilled. If the proposal cannot yet fulfill the principle requirements, RHA / LHA will formulate a recommended follow-up action program to those responsible for the Capacity Building program to provide assistance for improving the capability of housing actors. Depending on the situation in each local government, special assistance can be given for support to participating households, related government institutions, and other housing actors, in accordance with needs.

**Step Four**
When the process of land development has reached a certain stage and housing contraction is about to begin, financial support for housing development will be provided for those who wish it. Assistance is also necessary so that the process of housing development is carried out efficiently and in stages, and design and use of materials is carried out in
accordance with various households. Included in the package of this assistance is aid to the community from persons with skill in conducting environmental management well and efficiently.

8.3.3.6 Beneficiaries

Persons and organizations benefiting from this Program include groups from the low and middle income levels, and members from well organized groups. This priority is given because experience from similar programs shows that program results are highly dependent on group stability which is difficult to fulfill in newly established groups. Previous experience shows that low income peoples’ priority is not focused on home ownership. Generally the beneficiaries of MHDP can be divided into the following broad groups:

The first general type of group are those organized into a work-based group at a single location, such as business / factory, hospital, university or those organized into a group because their work or business is similar and in the same location. From these work-based groups stems groups with an interest in developing new housing in a manner integrated with MHDP. In the subsequent implementation, the main organization is still involved, for example as a facilitator or as guarantor for program participants.

The second type of group are those organized into associations on the basis of religion, employment or social organization, including traditional community group. As with the first type of group, the role of the main organization is still necessary.

The third type of group are social, business, cooperative or other peoples’ organizations who wish to develop housing for their members with a rental or rental-purchase system.

The fourth type of group are organizations who play a role as facilitators or mediators. As described above, these groups can submit proposals to RHA / LHA either together or individually in a coordinated manner, for obtaining necessary assistance. But program implementation cannot be carried out individually. One goal of MHDP is to build synergy between groups wishing to own their homes so that economics of scale can be achieved. Therefore, besides more efficient implementation of housing development, it is hoped that many problems such as the difficulty of obtaining land, networks with other housing actors (especially with related government agencies), technical problems in the field such as water supply or transportation, can be overcome much more cheaply and easily.
Therefore, one goal of MHDP is to support Non-Profit Developers and Development Consultants because it is hoped that they will become “facilitators” and “mediators” to achieve economies of scale. Relatedly, MHDP will allocate some funds to support mediator organizations, specifically those outside the Capacity Building program.

8.3.3.7 Components of Program Finance

Program finance consists of costs allocated for operations, or Operational Cost Program (BOP), and costs allocated for Group Investment Assistance (BIK).

1. The BOP component is all costs used for preparation, implementation support, monitoring and evaluation, together with all other supporting activities, both those carried out by implementation organizations (for example, RHA / LHA) or by other parties appointed to assist (such as Housing Forum, Auditor Program, Development Consultant, etc.)

2. The BIK component is assistance given directly to program beneficiaries or to third parties through beneficiaries, such as to land development organizations, housing contractors, etc. The BIL component is made up of grant and loan components.

3. A portion of BLK funds are used for “assistance in developing serviced land”. This assistance could be drawn down if certain requirements have been fulfilled, i.e. the ability to pay the installments, groups / organizations’ stability, certain percentage is self funding in the form of savings, the Housing Forum is established, etc, where the fund for land provision and basic infrastructure should be provided integratedly and in unison a certain period. A portion of BIK allocated for providing serviced land is in the form of grant fund, but other portion is in the form of loan fund. The composition of grant and loan funds are determined based on the proposals and competitions between the proposal submitted groups.

4. Other portion of BIK is specially used for housing development assistance. In this regard, the fund given in short term subsidized loan, which could be used by the beneficiaries as a down payment addition to reduce their monthly installments, if they intent to take up a credit. The same fund could also be used to start develop the house gradually. The management of revolving fund should be assigned so far as possible in corporation with an existing financial institution or a new established one.
8.3.4 Program III: Rental Housing Development Program (RDHP)

8.3.4.1 General Description
Rental Housing Development Program (RHDP) is aimed to increase the ability of local government in assisting and facilitating housing actors to develop rental housing for community groups who require housing, especially the low income groups and those who are unable to own a house.

Assistance could be given to groups of inhabitants or the inhabitant candidates or to individual investor, company, cooperation, or organization who would like to build or improve the condition of rental housing.

8.3.4.2 Program Goals
- Helping the local government in the extending its ability in planning and developing affordable rental housing for majority of the people who require them.
- Increasing the local government ability to facilitate housing actors who would like to develop rental housing.
- Motivating and assisting organization, worker, communities, company, cooperation or individual investor to build rental housing

8.3.4.3 Program Targets
- Helping local government in conducting arrangement and formulation of a conducive rental housing development system, as a base for other interested actors to increase investment in rental housing, by means of constructing affordable rental housing for those who require them, especially the low income groups.
- Facilitating and assisting rental housing investors in mobilizing housing resources needed, such as funding, land, housing infrastructure, buildings of rental housing and the ability to organize and manage those resources.
- Assisting housing actors, including local government in order to increase the ability in providing rental housing by forming synergy between actors, where local government, NGO or development consultant could function as mediator.
- Assisting rental housing owners or inhabitants who are not fulfilling certain minimum standard to improve the condition of the rental housing.

8.3.4.4 Scope of Program
The scope of program of rental housing development could be divided into four categories which are rental housing development for working community, rental housing development...
The development of rental housing for the working community is intended for factory or company workers on certain locations, where suitable housing is not available. Through the capacity building process and program socialization – workers / employees, factory-owned company, surrounding community and local government – are motivated to solve problems in workers housing integratedly. Assistance could be given directly to the worker groups or to a specially formed organization called Steering and implementing Committe, which is established by the beneficiary-groups to development of rental housing located in the area.

The development of rental housing by developers is aimed primarily for rental housing organization who in cooperation with land owners intend to develop rental housing for the low income groups. By forming a cooperation with the factory-owned company, labour organization, local government and the land owner, the development organization could formulate a rental housing development scheme. The assistance could be given to the development organization, directly to the organized tenant groups or to the company where the workers work, depend on the form of cooperation, rental requirements and contribution of each involved actors.

The improvement of rental housing quality has an objective to improve the condition of rental housing inhabited by low income groups and located in a strategic area. Based on cooperation between rental house owners, tenant groups or company which rent the houses and related local government institutions, an improvement program for the rental housing located within the area could be formulated. Assistance may possibly given in the form of subsidy to improve the house condition and physical facilities, or even in the form of direct loan to the owner, if certain requirements concerning funding utilization is fulfilled.

Development of construction and management system of rental housing is firstly aimed to all rental housing actors (organization/company/institution/individual), who intend to build and manage rental housing. Secondly, it is concerning the local government institutions/organization with the roles of facilitator, mediator, assistant
in the rental housing development, in relation with establishing a “rental housing coalition” as the motor of rental housing development.

8.3.4.5 Establishing the Assistance

- The initiative to build rental housing for the working community could originate from many parties, i.e. labour groups/organizations, company management, NGO, or one of the related local government institution. These initiators thus form a coordinating agency called “coalition of beneficiaries groups”.

- This coalition, assisted by the development consultant, thus formulate a rental housing development scheme intended for various worker groups which integrally united in the coalition.

- The scheme would then submitted to RHA/LHA to obtain assistance. In relation, it should be clearly describe the amount of resources available from coalition members and how much the assistance is expected in amount and the form of assistance utilization. Coalition should also verify that all key actors from the development scheme are willing and have the abilities in executing their obligations; who would provide the land, which institutions would fund the physical development, which organization to manage the rental housing, who will be the guarantor for loan-formed assistance, etc.

- The rental housing development coalition could take initiative in cooperating with land owner in strategic locations. Based on this agreement, the coalition could formulate a rental housing development scheme. For example, an agreement which stated that the company would like to rent and distribute it to its workers, the local government would assist by building infrastructure and labour/worker organization would manage the rental housing. There should also be an affirmation on how much the land owner would like to finance part of the building construction, and whether the shortage will be subsidized by the company and/or program assistance. This sort of agreement should have been confirmed beforehand, prior to the proposal submission to RHA/LHA.

- Analogous with rental housing development process, the coalition could also propose an improvement in quality of existing rental housing. The sort of scheme should also be based on a cooperation agreement which involved rental housing owner, tenant groups/workers, local government and possibly the company where the
tenants work. Based on all related parties agreement, thus a proposal is composed to request assistance from RHDP.

- Based on the valid evaluation system, selection committee from RHA/LHA form a grouping of submitted proposal as in the following order; (a) proposal that has fulfilled all the requirements and could be immediately implemented, (b) proposal which principally could be executed, but still necessitate minor adjustment before implementation, (c) a quite good proposal but the implementation should be postponed for some time as substantial adjustments or additions are needed, and (d) a proposal which is basically rejected as not fulfilling major requirements.

- During the preparation or implementation period, RHA/LHA carries out the assistance process through the appointed assistance consultant. Following the finishing of implementation, overall process will be audited by the appointed auditor.

- RHA/LHA executes the evaluation and program modification sistematically, as to produce a development model as ‘best practices’, which could be considered in creating a large scale replication program (scaled-up program).

8.3.4.6 Beneficiaries

Community groups which could benefit from RHDP are divided into several groups, as follows:

(a) working community groups which need rental housing or are living in flats with unappropriate condition,

(b) company/factory owner who would like its employees to live in a better housing, as it will positively resulted in their working performance.

(c) local government who would like a problem solution concerning slum housing in its region as well as

(d) rental housing owners/land owners who intend to build rental housing or improving the existing condition of rental housing which they own. The last group is

(e) the people, such as labour organization, social-society organization, who would like to improve the condition of its labour, housing environment and settlement in their region.

8.3.4.7 Components of Program Finance

Program Finance consists of two components, which are (1) Operational Cost Program (BOP), and (2) Development Investment Assistance (BIP).

1. **BOP component** is all costs used for preparation, implementation support, monitoring and evaluation, together with all other supporting activities, both those carried out by implementation organizations or by other parties appointed to assist.
2. **BIP component** is assistance fund given directly to groups of beneficiaries or through representative organization / party. This component consists of assistance in the form of Grants and Loans.

   a. **Grants** could be given to groups of community, organization, local government institution or company, in assisting the development of rental housing, i.e. land provision, construction of building or infrastructure. The amount of grants given is greatly depended on the problems occurring in the area and the contribution from beneficiary groups. All grants used in cooperation with a third party will be considered as an asset of beneficiary groups/organization.

   b. **Loans** are given to groups/organizations of beneficiaries or to individual as the aid of investment fund in rental housing development. The amount of loans is depended on the needs and the ability to pay. All loans are given within certain utilization requirements. The monitoring of fund utilization should involve all related actors in the development of rental housing.

8.3.5 **Organization Structure to Implement Special Assistance Program**

   (a) The organization structure of implementation is mainly divided into three levels; national level, regional/local level, and community/settlement unit level. At the national level, prior to ratification of new law (see Chapter 1), the political and legal - administrative responsibility of program implementation is temporarily lies within the ‘**Interministerial Steering Committee**’, which then form an Executive Agency called **National Housing Authority (NHA)**. This agency functions as the executor in handling strategic and principal matters regarding program implementation at the national level. In formulating its working agenda, NHA coordinates with National Housing Fund or NHF (see Chapter 2).

   (b) Regarding the region’s condition, **Regional Housing Authority or Local Housing Authority** will be established to deal with more operational matters and have functions as follows; socializing the program, providing training and assistance, selecting proposals, delivering fund, monitoring and evaluating program implementation, as well as developing ‘best practices’ into ‘living laboratory’. In executing the functions, RHA/LHA could establish a special task force or appoint a professional consultant / institution to execute it. The first task force will specifically deal with program support activities such as socializing, mobilizing, consultation, implementation control and program evaluation. As for the second taskforce is established in dealing with
proposals selection process and managing assistance fund in the form of grants or revolving fund (see diagram).

(c) Program Director and Implementation Committee will be established on project level, who will be responsible for program implementation on project level. Principal members of Implementation Committee are representatives from beneficiary groups and other representatives from other actors organizations, namely from Local Housing Forum as well as representatives from local government institution. The working area of Implementation Committee could be oriented on administrative boundary (kelurahan), or traditional/informal boundaries (as in the Community-Based Housing Upgrading Program), if not on boundary of functional program area (such in the Rental Housing Development Program). The Implementation Committee, which primarily is a coalition of beneficiary groups, functions as decision maker and director of program implementation on project level.

(d) On the operational implementation of project, the Director and Implementation Committee forms Operational Implementation Organization which functions as Project Management Unit (PMU). With regards on program type and local condition, PMU could be in the form of foundation, cooperation or professional private company. The Operational Implementation Organization could also be in the form of “Consortium o be in the form of “Consortium od, i.e. there is an involvement of private sector and local government as contributor/investor.

(e) In a more detailed Organization Structure of Project Executor, a management unit responsible in managing revolving fund should be specifically described. The majority of revolving fund is currently managed on community level in a similar way with the management of arisan +, as a fund which could be utilize in turns. Within medium and long term, the revolving fund should be referred to as initial capital in mobilizing resources of housing fund on local and community levels. The ability of revolving fund management unit should be improved firstly in collecting housing development fund through savings program within local community members, labour/worker organization, etc. and subsequently in collecting fund from other investors. In order to achieve this, the management unit should be integrated in city/ regional level network, not merely on community level. With regard to this criteria, it is necessary to jointly manage revolving fund with existing professional financial institution. Which institution should be appointed will very much depend on local condition. Thus fulfilling
two key requirements, firstly is the concern to local development and secondly the ability to manage micro credit.

Diagram: Organization Structure of Special Program Executor on Local Level

8.4 CAPACITY BUILDING

8.4.1 Capacity Building Basic Concept

In accordance with many efforts of accomplishing local autonomy on city and kabupaten levels, the central government (Department of Settlement and Regional Infrastructure) together with other related stakeholders have the intention of executing housing and settlement decentralization on local level. With local autonomy, the decentralization of housing and settlement becomes the task of local government instead of central government, as it was previously. Therefore the housing and settlement development system should be inserted into the new governance order in accordance to local autonomy concept.

Within the transitional era to the new government order, the capacity building and institutional development on local level should be well-prepared as those are the foundation of future housing and settlement development system. With the decentralized system, the capacity building program should be executed within all levels of government institutions.

The obstacles in most cities/locals are the lack of awareness in the importance of housing/settlement issues, which resulted in the lack of financial independence and human
resources. Other preparation steps are to strengthen and improve local government institutions to be more effective, along with the delegation of authority in decision making and increased local income. Currently reform actions are ongoing on local level with focus on increasing local income, and not on urban development, housing/settlement such as urban land management, infrastructure development or developing community financial institutions (i.e. credit system for community).

The strategy of capacity building in housing and settlement sectors are aimed gradually at local independence (city and kabupaten) in dealing housing and settlement issues sustainably. Therefore, participative processes from all related actors are required, as follows:

- Identification of local problems, potentials and needs;
- Analysis and plan of local level institutional system;
- Planning of local actors capacity building program;
- Gradual implementation by setting benchmarks which are integrated with housing and settlement projects.
- Monitoring, evaluation and adaptation

The capacity building program is also a comprehensive, sustainable empowerment, which enable the actors in developing its activity programs according to the potential, needs and context.

The condition of ability level, objectives of institutional development and capacity building in executing decentralized housing development system are the foundation of improving local ability, which are:

1. **Various Ability Levels of City/Kabupaten**
   Within the decentralized system, the development of housing program should be differentiated according to various ability levels of each local in adapting the program to suit its condition.

2. **Improving Institutional Ability in Decentralized System**
   Capacity building should be done to all institutions related within the decentralized housing development system.

3. **Housing Actors Capacity Building**
   Capacity building program should be performed to the actors’ roles and functions on all levels, from city/kabupaten level down to group/community as well as individual and corporation.
8.4.2 Various Ability Levels of City/Kabupaten

The perception of local government to housing development along with its ability levels in dealing with the issues of Policy, Management and Support System could be divided into 4 (four) levels:

a. **First Level**

   Local government on this level views the investment for housing as dispersion of limited resources. Housing and settlement issues are regarded to solve itself along with the economy and income growth. It is due to the perception that housing and settlement issues are individual/family issues.

   On Policy level, local government generally do not have housing development legal framework, and the issues of slum and squatter areas are not regarded as housing issues. There is also no policy dealing with allocation plan of funding resources intended for middle and low income housing development.

   On Management Level, including technical and financial issues, the local governments are not capable in managing many housing resources, there is no institution such as housing forum to coordinate related stakeholders within the resources management of local housing development and government has not developed the standards and implementation manual of housing development.

   On Support System, generally local governments do not have the ability in developing training program for housing development experts. Universities and Study and Research Centers that give out study products and research on housing development do not exist.

b. **Second Level**

   The local government begins to identity housing issues, problems in informal sector in general, but has not been able in dealing with the problems.

   On Policy level, there is no comprehensive housing legal framework in managing inter-sectoral policies related with housing development, and we could not competently translate the national policy to local level. The existing legal framework only regulates parts of housing issues, i.e. government-owned housing and slum area. The illegal squatter area is identified as housing issue but the local government does not have the ability to develop comprehensive concept to deal with the problems yet. The funding policy for housing development is existed although the development system does not effectively and efficiently work.

   On Management level, including technical and financial aspects, the local governments are beginning to be able to manage housing resources. The housing
forum to coordinate stakeholders in managing local housing resources is established although has not taken the form of institution, so that it is not effectively functioning. Information system in certain aspects are available though not comprehensive. The implementation manual and housing development standards are begin to be developed but the housing development plan is not integrated within the urban development system.

On Support System level, the training programs are in general developed, but a good coordinating system is not. Universities and Study and Research Centers are established but with limited products.

c. **Third Level**

The local government has identified housing issues, problems in informal sector and several solving efforts but without the systemic and replicated model. Several experiences are still individually encountered as there are no institutions appointed in evaluating and systematically improving the model.

On Policy level, the local government in general has a comprehensive housing legal framework and could subsequently translate the national legal framework. The problems are in the implementation of regulations as the institutions are not completely established and developing a comprehensive concept in dealing with slum and squatter area though these are already considered as housing and settlement issues. Funding policy for developing low income housing are available but the development system is still inefficient and ineffective.

On Management level, including technical and financial aspects, in general the local government is able in managing the housing resources. The housing forum as an institution is existed to effectively coordinate stakeholders within resources management of local housing development. Although most of the housing development information system are developed, i.e. land, credit, expertise, building technology, it still needs improvement as an integrated part of comprehensive housing development system. The implementation manual and housing development standards are developed using normative approach and not yet participative.

On Support System level, extensive training programs on housing development expertise are developed, i.e. community-based housing program, slum handling program, and developing new housing district. A fine coordinating system for stakeholders is developed. Universities and Study and Research Centers are established and give out study products and research reports that support local housing development though still voluntary and unsustainable in nature.
d. Fourth Level is a level where the local government is able in setting up a sustainable and reliable housing development system thus dealing with housing and settlement issues independently.

8.4.3 Improving Institutional Ability in Decentralized System

As Local abilities could be improved and executed on all levels, within the decentralized system, the functions of institutions at all levels should be prepared. On regional level, the improvement could be in the form of supporting varied institutions/organizations in improving its operational ability on local/community level, i.e. providing technical training and understanding of government order related to land management, infrastructure provision for housing and settlement, developing several funding sources, etc. The institution/organization also function as intermediary organization within central and local housing actors.

8.4.3.1. Comprehensive Approach in Improving Institutional Abilities

The process of setting housing development policy which is decentralized within a democratic government system should regard the interests of related institutions and actors on national, regional and local levels. The development of policy specifically for public with multi aspects input system would be very difficult to implement without involving potential related parties.

In accordance with policy making, the improvement of related institutions within housing development should be comprehensively executed on all levels: National, Regional, Local and Community. On each level there should be a coordination between Government, Civilians/People, and Private Sector.

A holistic approach is needed in forming housing development policy as most of housing resources are under the control of non-governmental parties and accepted by all related parties. The approach should also regard these related groups to be developed: Legal Framework, Institutional Framework, and Operational Framework.

On national level, the function of the central institution should be to receive inputs from many parties and formulate national housing and settlement agenda, integrate housing and settlement issues within national development agenda and carry out inter-sectoral coordination especially regarding administrative and substantive aspects in the implementation of national housing and settlement agenda. The institution’s role and position as Interministerial Housing Committee is discussed in separate report. The National Housing Agency (NHA) could be established as the executor. Within the civilians/people,
the coordination could be executed by Universities, Research Foundations, NGOs and on private sector, it is done by extending the role of developers associations, consultants associations, contractors associations, etc. The communication of all actors within NHA could be done through Hearing mechanism which is routinely scheduled. The program should also include fund development and development financial institution.

Coordination should also be developed on regional level. Regional institution should be supported in functioning as arranger of program implementation, monitor implementation of local housing agenda, etc. The coordination function is executed by Bappeda either on provincial or kabupaten levels in coordinating varied technical institutions that manage local resources. As executor agencies, the Regional Housing Forum (RHF) and Local Housing Forum (LHF) could be established. Within the civilians/people, the coordination could be executed by Universities, Research Foundations, local NGOs and on private sector, it is done by extending the role of local level developers associations, consultants associations, contractors associations, etc.

On community level, the local community forum should be developed, firstly based on district/kelurahan thus on RW and RT levels which are more oriented on implementation and its coordination, namely community groups (pokmas / kelompok masyarakat). Groups with certain expertise or interest could also be established and cooperating with community forum or pokmas in identifying local issues and management of housing development. Administrative ability of Kelurahan, RT, RW in managing housing development resources, i.e. land, permit, etc.

### 8.4.3.2 Improving Institutional Ability

The improvement should use a holistic approach in regulating roles within multi-level government as well as executed within handling levels of Policy, Management and Technical, and Support Level.

On **Policy Level**, local ability in formulating housing development policy should be improved, including the formulating process, target groups policy priority, program priority, area priority and people empowerment and participation.

In general, local governments are still unable to translate national legal framework and policy into effective local policy instruments.

Some standards for local government to use in improving housing development policy level are as follows:

- Ability to identify potential local context in dealing with housing development (i.e. Banjar in Bali)
- Ability in developing housing development policy based on people’s empowerment and participation.
- Ability to develop comprehensive policy in dealing with urban slums.
- Ability to identify affordability levels of obtaining housing on low and moderate income groups.
- Ability to develop policy for new housing district affordable for low and moderate income groups.
- Ability in identifying existing rental housing market located in urban areas, and develop the policy for low and moderate income groups.
- Ability to plan and allocate funding sources for housing development, especially for low and moderate income housing.
- Ability to integrate housing and settlement development system into spatial and economic urban development plan.

On Management, Technical and Financial Level, local improvement ability is within the management of local housing resources which includes: Land Resources, Infrastructure Resources, Fund Resources, Building and Construction Resources, Human Resources and Regulations.

(a) **Ability Improvement on housing resources management** on local level is aimed towards:
- Developing coordinating roles between related stakeholders in housing resources management
- Development of housing development and provision manuals and standards, i.e. land titling procedure, applicative Housing Regulation Standard, flexible Building Permit Regulation, etc.
- Manual of Preventing Illegal Land Inhabitation (squatter area)
- Implementation Manual of urban land development concept for housing, i.e. Land Consolidation, Guided Land Development
- Implementation Manual of housing development concept based on people’s empowerment and participation.
- Implementation Manual on urban slum handling concept
- Implementation Manual on new housing district development concept which affordable for low and moderate income groups
- Implementation Manual on rental housing system for low and moderate income groups.

(b) **Developing varied information system** on local level concerning:
- Land allocation for housing related to land utilization plan on local level
- Credit, from macro (BTN) to micro level (employers cooperation, etc.)
- Expertise, accredited expertise and training program in developing local housing
- Housing technology and materials
- Developing service system in local housing building permit
- Management of local housing fund sources to be manage transparently and efficiently

(c) On Support System Level:
- Developing capacity building program for several expertise on housing field through training within the following fields:
  - Housing Development Concept is based on people’s empowerment and participation
  - Concept of Handling Urban Slums
  - Development Concept of new housing district which is affordable for low and moderate income groups
  - Development Concept of rental housing for low and moderate income groups
- Developing coordinating system between related stakeholders
- Extending the abilities of Universities, Study and Research Centers in producing study and research reports on local housing development.
- Improving the ability of funding sources in mobilizing fund for local housing development

8.4.4 Housing Actors Capacity Building

The local actors abilities in housing development are still limited in provision and management of housing resources as well as the implementation of housing development programs.

The capacity building in housing resources management will be based on developing the provision and management manuals in building housing for the people. The capacity building on housing development implementation will be based on in-the-field coordination, monitoring and evaluation of existed obstacles and potentials.

Capacity building should also be done to the roles and functions of each related actors, intended in the form of programs which is developed from new roles of local institutions within decentralized system, as follows:

1. Capacity Building Program in Formulating Housing Development Policy
   Government on central or local level are still regarded lack of adequate ability in formulating comprehensive and integrated housing and settlement development policy. The programs to be developed on regional/provincial or city/kabupaten are technical assistance and training in formulating housing and settlement policy for
officials, including: Basic Policy of Housing; Policy on priorities of target groups, program, area; People’s Empowerment Policy; People’s Participation Policy. This program will be the initial step.

2. Developing coordination on national and local levels
   It is to coordinate institutions managing resources within housing and settlement development program which is integrated with other development sectors. The roles of Bappeda and Bappenas is optimized by operational institutions established under its control.

3. Development of information system in housing delivery system and identification of conditions and potential of local housing actors which consist of institutions, private sector and community groups.

4. Development of accreditation system of varied expertise in housing field.

5. Development of housing development manuals and standards, executed on regional/provincial level, such as:
   a. Applicative Housing Regulation Standard
   b. Manual on Illegal Land Inhabitation Prevention (squatting)
   c. Implementation Manual of concept of urban land development for housing, such as Land Consolidation, Guided Land Development
   d. Implementation Manual of housing development concept based on people’s empowerment and participation
   e. Implementation Manual of urban slum handling concept
   f. Implementation Manual of new housing district development concept which affordable for low and moderate income groups.
   g. Implementation Manual of rental housing system for low and moderate income groups

6. Training and technical assistance program in providing and managing housing development resources for local officials, private actors and community groups.

7. Technical assistance in implementation of pilot projects based on the concept and approaches of: Land Consolidation, Guided Land Development, CBHD, KIP, Kasiba, Lisiba, Land Information System, Land Bank System, Squatter Settlement Handling and etc. on selected areas.

8. Technical assistance in implementing, monitoring and evaluating local programs.

9. Capacity Building of Development Consultant (KP / Konsultan Pembangunan), the personnel who facilitate and relate varied stakeholders of Housing and Settlement development, originated from varied educational background. Basically, a KP should
have abilities in three dimensions: Academic Competency, Understanding and Ability to Coordinate varied fields, and Depth of Experience. KP still needs several additional knowledge to be able to perform in the field.

8.5 RECOMMENDATION FOR PILOT PROJECTS

8.5.1 Goals for Pilot Projects

The following goals are envisaged for pilot projects proposed to be carried out as special programs at the local level:

- To encourage innovation in developing new approaches to housing and human settlements programs at the local level.
- To motivate all actors in the housing field to take initiative to formulate pilot programs for new mixed income housing development, community-based upgrading and rental housing.
- To stimulate extension and replication of already successful housing assistance programs at the local level (e.g. PPMK, KIP comprehensive, etc.) into other regions and local governments.
- To demonstrate to all actors the process of organizing and implementing special programs at the local level as a “living laboratory”.

8.5.2 Criteria for Selection of Pilot Projects

Criteria for selection of priority pilot projects are described below. They are divided into those criteria which pertain to all three special programs described in Chapter 3 (General), and into those criteria which are specific to each special program.

8.5.2.1 General Criteria

The following criteria apply generally to selection of all pilot projects at the local level:

- Innovative proposed projects which demonstrate new techniques and/or organizational approaches should be given priority.
- Projects which build on experiences of already successful programs or “best practices”, whether located in Indonesia or abroad, should be prioritized, so that they can be transferred to / replicated.
- Project proposals which contain significant financial contributions from local residents should be given priority.
Projects proposed by community groups or other actors, which receive support from, and endorsement by, the local government leadership (e.g. Kepala Daerah and DPRD) should be prioritized.

Priority should also be given to project proposals which are highly flexible and competitive, and which can be implemented by a variety of organizations, including the private sector, NGOs and local government – or a combination of these.

Projects which show evidence of a high level of participation by all actors in their planning and implementation should be given priority.

8.5.2.2 Criteria Specific to Each Program

The criteria below pertain specifically to each program:

- **CBHUD**
  - Participatory upgrading projects which emphasize synergy between improvements to the physical environment and socio-economic development at the community level should be prioritized.
  - Upgrading projects which insert some new mixed income housing and/or rental housing into pockets of open space or slum development, as part of an overall plan for the community, should be given priority.

- **Mixed-Income Development Program**
  - Proposed schemes located in the path of projected heavy growth and expansion of built-up area in primary or secondary cities should be given priority in selection.
  - Projects which emphasize the mixed income or heterogeneous character of this program, through innovative physical design or financing (cross subsidy) mechanisms, should be prioritized.

- **Rental Housing**
  - Schemes which especially meet critical needs of blue collar employees including a high percentage of single person households, in growing industrial areas should receive priority.

The above mentioned criterias are not final, regarding the experiences undergone in the pilot projects, as other considerations can be identified, added on or substitute the previous one.
8.5.3 Strategy for Development of Pilot Projects

Implementation of pilot projects for the special programs has as one goal providing an incentive to encourage local governments to achieve breakthroughs in their housing program. Assistance to be provided must be linked to the capability and initiative in each local government. In other words, a primary purpose of the pilot projects – and part of the strategy for their development – are to encourage competition among the housing actors and to provide strong incentives for breakthrough in local level housing assistance programs. Those local governments or other initiative groups, which show capability to formulate innovative pilot project proposals will be rewarded with assistance. In developing these proposals, local governments should be encouraged to utilize locally available non-governmental resources, including the private sector, NGOs, universities, etc.

After pilot projects are implemented and evaluated, successful and replicable ones can be considered as “best practices”. In some of the cases involving best practices, local governments should establish and institutionalize these developments as “living laboratories”. These “living laboratories” can be organized to present opportunities to study specific, practical projects which have been relatively successful. The projects can be analyzed from all perspectives: technical, financial and organizational. Stakeholders from other regions and local governments can visit these sites, and the concepts can be replicated elsewhere.

This living laboratories provide the “incubation points” at which local level housing assistance programs are scaled up. In this effort, regions and local governments which are less capable are given the opportunity to visit successful pilot projects, study methods used, and replicate them in their own regions. Future housing assistance programs for local areas should support this process by providing technical assistance. This TA can assist local governments to understand the successful projects and to modify and adapt them to their own situation. Capacity building activities (described in Chapter 4 of this Report) are designed to help speed up the replication and scaling up process by developing and enhancing various capabilities in lagging regions and local governments.

The stages of pilot project would end, if a model and mechanism to scale-up, which are considered fitting to each program, have been discovered. The time of when a program could put an end to the pilot project stage and enter the replication stage (scale-up), will be determined based on several indicators, which do not have to be identical for all three programs.
However, the main indicators are generic in nature and are generally applicable, such as successful capacity building and institutional development program, the roles of communities and private sectors, funding mechanism, as well as research and development. If the indicators mentioned above have reached certain standards, then a “replication typology” should have been concluded. In other words, the replication model should be formulated from the experiences undergone by several pilot projects.

It is highly predicted that those three special programs – CBHUD, MHDP, and RHDP – would need different time to pass the pilot phase and become replicable. Regarding the varied conditions on each regions/cities, it is clearly possible that each program will need several replication typologies in order to accommodate the heterogenous conditions existed on the regions/cities.

The founding of replication typology does not necessarily indicate that the program development is finished on that stage. In the following table, the development stages of a program is described into three development stages: pilot project stage, replication stage (scale-up), and sustainability stage. This table presents what should be done or achieved on each stages concerning the improvement of indicators.
At the pilot project stage, the above chart presents several steps that should be carried out to begin developing a housing system on local level. It is also stated that many elements of the system should be carried out in an “ad-hoc” manner and could not be institutionalized just yet, i.e. the case of communities/people’s participation (see point 3 on the table). Upon this stage, an effort on finding the best model or procedure to develop the legal framework of community participation should be explored, thus the next stage – the replication stage – could be better carried out. At the sustainability stage, as is shown on the chart, “the community becomes a real, equal partner of the government and private sectors”, is a crucial requirement for achieving the target.
8.5.4 Institutional Structure to Implement Pilot Projects

Section 2 within this Special Report discusses the type of institutional framework and structure at national, regional, local and community levels required to implement a full-fledged Housing Assistance Program (HAP). These tentative institutional arrangements are summarized below as follows:

◆ At National level
  ▪ Inter-ministerial Housing Committee (I-MHC)
    Consists of Ministers of Finance, SRI, Home Affairs / National Land Agency and Bappenas. Main task is to define overall national housing policy.
  ▪ National Housing Agency (NHA)
    Executing agency for I-MHC to implement policy, allocate subsidy, rationalize institutional capacity and strengthen market.
  ▪ National Housing Fund (NHF)
    Manages all funds coming from different sources.
  ▪ National Housing Federation (NHFed)
    Federation of all Regional Housing Forums

◆ At Regional and Local levels
  ▪ Regional Housing Forum (RHF)
    Multi-stakeholders forum with representatives from NGOs, developers, universities and local government. Comprising more than one local governments (possibly provinces), the main purpose is to control housing policy implementation and operations of RHA.
  ▪ Regional Housing Agency (RHA)
    Executing agency appointed by RHF, it executes programs from NHA and allocates subsidy to local areas.
  ▪ Local Housing Forum (LHF) and Local Housing Agency (LHA)
    These organizations have functions similar to RHF and RHA, but LHF and LHA operate in a single kota or kabutapen (local government).

◆ At Community level
  ▪ Local Community Forum / Group (LCF/G)
    These are local community forums or groups which submit proposals to obtain assistance and implement projects.
    The process of selection and implementation of pilot projects should be “bottom-up” in nature; that is, proposed pilot projects should be initiated at the LCF/G level, with approval given at the regional level. When the full-fledged housing assistance program (HAP) is in place, this process could
be relatively straight-forward, with the RHA selecting the pilot project and allocating assistance funds.

However, a major institutional problem exists in selecting pilot projects prior to establishing the full-fledged HAP set-up. At present time, only the two extreme ends of the HAP institutional structure exists, namely the I-MHC at the top and, in some local areas, LCFs at the bottom.

To overcome this problem, it is suggested that ad-hoc Regional Housing Forums (RHFs) be established under guidance from I-MHC and DGHSD. These RHFs could be created in each of the large Java provinces, and in groups of provinces on other islands. The RHFs could have members from selected provinces and local government officials, in addition to knowledgeable professionals related to the housing field. These ad-hoc RHFs can assist the central government in selecting pilot projects and allocating assistance funds.

Several proposals will be discussed below, as how the institutions’ structure mentioned above could be broken down to implementation stages of supporting program on local level. Furthermore, an effort to formulate a more detailed concept on the subject of community participation on several stages of supporting program implementation should be undertaken.

Further details on pilot project organization structure are provided in Annex I to this Special Report.
ANNEX 1: DETAILS ON PILOT PROJECT ORGANIZATION STRUCTURE

DETAILS (I) CBHUP PILOT PROJECT ORGANIZATION STRUCTURE

1. **Regional/Local Housing Forum (R/LHA)**
   
   The proposals could be from varied parties, local government, community groups, Cooperation or intermediary NGO. Through capacity building program, the actors who would be involved in the program implementation are given training/assistance in preparing and formulating program proposals. (This program is a continuation of Capacity Building Program which aimed in building a comprehensive housing development system addressed in Chapter 4). Within the proposal, the roles and functions of each groups/institutions should be clarified as well as all the preparation stages executed. One of the capacity building program’s targets is establishing Local Housing Forum (see item 2). If the local government would like to be involved, it should prepare themselves; personally, institutionally/organizationally and financially. The form of partnership between local government with community groups and other stakeholders should also be clarified.

2. **Local Housing Forum**
   
   One strategic maneuver in building a decentralized housing system is establishing Housing Forum. Institutionally, it should have clear status and roles on local level, and could be a part of a more general Forum (City Forum) or independent. Local government should facilitate its activities, though organizationally and politically independent. Thus the Forum send representative to be members of Steering and Program Implementation Committee which is established by Groups of Beneficiaries on community level. Its functions are to guarantee transparency within the decision making process done by the committee and equal partnership with the government.

3. **Groups of Beneficiaries**
   
   Groups of Beneficiaries is a coalition of all groups or organizations which receive assistance. Each groups could formulate their own work plan/activity or ask assistance from Associate Consultant if needed. On the next level, those plans should be coordinated with other groups in a comprehensive program. The coalition could ask Associate Consultant for assistance in integrating these plans.

4. **Local Government**
   
   Government institution on Kelurahan level, the lurah and people’s representative institution (4.1), has the functions to coordinate CBHUP implementation with local government activities within the location, becomes a mediator between CBHUP and related government
agencies, i.e. Housing Agency (Dinas Perumahan), City Council (Dinas Tata Kota), General Affairs Agency (Dinas PU). If needed, local government would establish Project Implementation Unit (4.3) in the location to guarantee excellent partnership.

5. **Steering and Program Implementation Committee**

It is a committee which responsible on program implementation, functions as Executive Board of Member-Group and is responsible to them, as well as maintaining good partnership with all related and relevant local government institutions. The members are representative from groups of beneficiaries and Housing Forum. The committee could receive technical assistance from Development Consultant appointed by R/LHA. Based on the programs formulated by the committee, R/LHA would determine the form and size of investment assistance which would be given to groups of beneficiaries.

6. **Project Management Unit (PMU)**

The committee appoints a Project Management Unit (PMU) as operational executor which is controlled by / responsible to the committee. PMU could be in the form of an institution specifically established for that purpose, such as foundation or cooperation. Based on certain consideration, the operational task could be assigned to professional organization / private company. PMU should cooperate with other investment actors such as local government or individual/private investor. Within this implementation stage, the main task of R/LHA is performing the controlling and assistance in program implementation.

7. **CBHUP Sub-Program**

CBHUP sub-programs could be developed or added according to the needs of beneficiary groups and experiences of pilot project. Whether there should be any relations of these sub-programs with other local government projects would also be determined from local experiences and could not generally be determined. R/LHA should assist local government in executing program evaluation in its entirety, and project auditing by appointing independent and professional public auditor.
1. CEBHUD PILOT PROJECT ORGANIZATION STRUCTURE

- RHMLHA
  - Assistance in investment support
  - Assistance in control
  - Evaluation on auditing

- LOCAL HOUSING FORUM
- HOUSING FORUM
- LOCAL GOVERNMENT

- PROGRAM, STEERING, AND IMPLEMENTATION COMMITTEE

- GOVERNMENT INSTITUTIONS ON KEURAHAN LEVEL
- RELATED LOCAL GOVERNMENT AGENCIES

- PROJECT MANAGEMENT UNIT

- IMPROVING SOCIAL CONDITIONS
- UPGRADING OF PHYSICAL INFRASTRUCTURE
- HOUSING UPGRADEXING

- IMPLEMENTATION UNIT ON PROJECT LEVEL
- RELATED LOCAL GOVERNMENT PROJECTS
DETAILS (II) MHDP PILOT PROJECT ORGANIZATION STRUCTURE

1. Regional/Local Housing Forum (R/LHA)
   Identifies critical and protential areas for MHDP implementation. Main criteria is the vast necessity for new low/moderate housing development and the existence of potential community groups to participate in the program. Proposals could be from varied parties; groups of workers, labour/worker organization, company which owns the factory, social organizations, credit union, cooperation, intermediary NGO, local government. Through capacity building program, the future actors would be given training to formulate development plan proposal for a mix-income housing development project as it is required by R/LHA. The functions and roles of each groups/ institutions, preparation steps implemented, and form of partnership between local government, groups who would build houses with land owner or other investors, should be clarified in the proposal. On of the objectives is establishing Local Housing Forum (see item 3) as inter-actors coordinating institution.

2. Local Government
   The main role of local government in implementing MHDP is to facilitate program actors in delivering required resources such as land and infrastructure. Varied related local government institutions, Bappeda, Housing Agency, City Council, or General Affairs Agency should actively involve in facilitating preparation/planning process and program implementation. If needed, local government would establish Implementation Coordination Unit (2.1) in the development location to guarantee partnership between government and all groups of beneficiary and program implementation. Local government should give special attention in formulating policy and implementing land provision for low/moderate housing which would participate in MHDP. The location should already be adjusted in accordance with urban/city development plan.

3. Housing Forum
   Establishing Housing Forum is a strategic maneuver in building decentralized housing system. Institutionally, it should have clear status and roles on local level, could be a part of a more general forum, i.e. Urban Forum, or independent, and functions to ensure transparency within the process of decision making executed by the committee and equal partnership with government. Local government should facilitate this forum in performing its activities within medium period, but organizationally and politically independent. In relation with MHDP implementation program, the forum could establish a specific task committee or delegate a representative as member in the Steering and Program Implementation Committee which is established by Beneficiary Groups on community level. On locations
other than within urban areas, Housing Forum could be independent and established as representative from community groups and other housing actors (contractor, consultant, cooperation, etc.) without any relation to the existence of Urban/City Forum.

4. **Housing Actors outside Forum**

Community groups which plan to invest or develop housing could become a member of the Housing Forum. The latter of which could organize cooperation with groups outside the Forum, such as land owner, Housing Cooperation, and so forth. Each groups within or outside the Forum could formulate their own activity plans or ask for assistance from Associate Consultant. On the following step, these plans should be coordinated with other groups’ into one comprehensive program. In integrating these plans, they could ask Associate Consultant appointed by R/LHA for assistance.

5. **Steering and Program Implementation Committee**

The committee is responsible on MHDP implementation on that location, as members are representative of housing development actors and representative from Housing Forum. It functions as Executive Board and an executor organ of cooperation with all related parties/ institutions including relevant local government institutions and actors outside Housing Forum. The committee could also ask Development Consultant appointed by R/LHA for technical assistance. Based on the proposal formulated by the Steering Committee, R/LHA would determine the form and size of investment assistance that would be given to beneficiary groups.

6. **Project Management Consortium**

The committee would appoint a Project Management Unit (PMU) as the operational executor on the field which is controlled by/responsible to the committee. PMU could be in the form of an institution specifically established for that purpose, i.e. foundation or cooperation. Based on certain consideration the operational task could be delegated to professional organization/private company. As MHDP is a joint program of several investors, thus it is best to establish Project Management Consortium where technical implementation unit from local government or other investors are also joint. The main task of R/LHA on this level is to execute control and assistance in the consortium establishment process and implementation process on the field.

7. **MHDP Sub-Program**

Varied MHDP sub-programs could be developed and added according to the necessity of beneficiary groups and experiences on pilot project. Whether there should be any relations of these sub- programs with other local government projects would also be determined from local experiences and could not generally be determined. R/LHA should assist local government in evaluating the program, as well as performing project auditing by appointing independent and professional public auditor.
II. MHDP PILOT PROJECT ORGANIZATION STRUCTURE

- Assistance in investment support
- Assistance in control
- Evaluation on auditing

LOCAL GOVERNMENT

HOUSING FORUM

OTHER
STAKEHOLDERS
OUTSIDE THE
FORUM

MHDP PROGRAM STEERING and IMPLEMENTATION COMMITTEE

2.1 RELATED LOCAL GOVERNMENT INSTITUTIONAS

5.1 PROJECT MANAGEMENT UNIT

4.1 OTHER IMPLEMENTATION UNIT (INVESTOR)

LAND PROVISION

INFRASTRUCTURE DEVELOPMENT

HOUSING DEVELOPMENT

ENVIRONMENT FACILITIES
1. **Regional/Local Housing Forum (R/LHA)**
It identifies critical areas or potential community groups to be given assistance. Proposals could be from varied parties, worker groups/labour organization, company who owns factory, local government institution, community groups which need rental housing, Housing Cooperation or intermediary NGOs. Through capacity building program, the future actors would be given training to formulate development plan proposal. (This program is a continuation of Capacity Building Program which aimed in building a comprehensive housing development system addressed in Chapter 4). Within the proposal, the roles and functions of each groups/institutions should be clarified as well as all the preparation stages executed. One of the capacity building program’s targets is establishing Local Housing Forum (see item 3). If the local government would like to be involved, it should prepare themselves; personally, institutionally/organizationally and financially. The form of partnership between local government with worker/tenant community groups and other stakeholders should also be clarified.

2. **Local Government**
Government institution on project level, the lurah and people’s representative institution (4.1), has the functions to coordinate RHDP implementation with local government activities within the location, becomes a mediator between RHDP actors and related government agencies, i.e. Housing Agency (Dinas Perumahan), City Council (Dinas Tata Kota), General Affairs Agency (Dinas PU), which would be the member of Implementation Management Consortium. If needed, local government would establish Project Implementation Unit in the location to ensure excellent partnership.

3. **Local Housing Forum**
One strategic maneuver in building a decentralized housing system is establishing a Housing Forum. Institutionally, it should have clear status and roles on local level, and could be a part of a more general Forum (City Forum) or independent. Local government should facilitate its activities, though organizationally and politically independent. Thus the Forum would establish Special Task Committee to deal with rental housing issues. Its functions are to ensure transparency within the decision making process done by the committee and equal partnership with the government.
4. **Groups of Beneficiaries**

Groups of Beneficiaries is a coalition of all groups or organizations which receive benefit from rental housing improvement or development program. Each group could formulate their own work plan/activity or ask assistance from Associate Consultant if needed. On the next level, those plans should be coordinated with other groups in a comprehensive program. The coalition could ask Associate Consultant for assistance in integrating these plans.

5. **Steering and Implementation Program Committee**

The committee is responsible for MHDP implementation on that location, as members are representative from beneficiary groups and Housing Forum, as well as other key actors; related local government institutions, representative from investors/land owners. It functions as an Executive Board of its member groups and responsible to them, as well as maintaining cooperation with all relevant non-governmental and local government institutions. The committee could also ask Development Consultant appointed by R/LHA for technical assistance. Based on the proposal formulated by the Steering Committee, R/LHA would determine the form and size of investment assistance that would be given to beneficiary groups.

6. **Implementation Management Consortium as PMU**

The Steering Committee along with other key actors appoint a Project Management Unit (PMU) as operational executor on the field which is controlled by and fully responsible to the committee. PMU could be in the form of Implementation Management Consortium specifically established for that purpose, such as foundation or cooperation. Based on certain consideration the operational task could be delegated to professional organization/private company. The consortium should represent all stakeholders’ interests which are groups of beneficiaries, related local government institutions or individual/private investors. The main task of R/LHA on this level is to execute control and assistance in the implementation process on the field.

7. **RHDP Sub-Program**

Varied RHDP sub-programs could be developed and added according to the necessity of beneficiary groups and experiences on pilot project. Whether there should be any relations of these sub-programs with other local government projects would also be determined from local experiences and could not generally be determined. R/LHA should assist local government in evaluating the entire program, as well as performing project auditing by appointing independent and professional public auditor.
III. RHDP PILOT PROJECT ORGANIZATION STRUCTURE
<table>
<thead>
<tr>
<th>Monthly income in Rp., adjusted to 2001</th>
<th>10th%</th>
<th>20th%</th>
<th>30th%</th>
<th>40th%</th>
<th>50th%</th>
<th>60th%</th>
<th>70th%</th>
<th>80th%</th>
<th>90th%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>377,300</td>
<td>510,800</td>
<td>633,700</td>
<td>754,400</td>
<td>892,500</td>
<td>1,064,000</td>
<td>1,317,500</td>
<td>1,682,100</td>
<td>2,327,000</td>
</tr>
<tr>
<td>Borrowing capacity</td>
<td>15%</td>
<td>15%</td>
<td>20%</td>
<td>20%</td>
<td>25%</td>
<td>25%</td>
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Diagram:

- Solid line: Solid line
- Dotted line: Dotted line
- Double arrow: Double arrow
- Single arrow: Single arrow

Note: The diagram shows the relationship between housing assistance and policy development for enabling the housing market to work in Indonesia.
## CHAPTER 9

**RECOMMENDED INSTITUTIONAL ARRANGEMENT AND FUNDING MECHANISM PROGRAM**

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CHAPTER 9
RECOMMENDED INSTITUTIONAL ARRANGEMENT AND FUNDING MECHANISM PROGRAM

9.1. Introduction

Past housing subsidy programs, both KPR interest rate subsidies and local level and community-oriented subsidy programs like KIP, CBHP, IUIP programs, have all proven to be unsustainable, all-be-it for very different reasons. The KPR interest rate subsidies proved to be too expensive when their costs could not be hidden through soft loans by Bank Indonesia and MOF had to carry them on the national budget. The fact that real subsidy costs were not accounted for caused the system to continue unchecked and without fine-tuning the subsidy to changes in the market place and household demand. There were other problems as well as the negative impact on market innovations and expansion and poor integration with urban development patterns. These problems were never seriously assessed, since no one really “owned” the program.

Local level subsidies were much more affordable and served low-income household needs. None of these programs received long-term budget support. They were discontinued because they were tied to donor funding and when funds disappeared, no sustained institutional home was found, no matter how excellent the programs were or how well these served household needs. The idea was that new donor funds would be found to do similar projects. Indeed, donors complied and continued project funding, rather than building up sustainable programs. Consequently, no institutional memory was built up on any scale. The accumulated knowledge, procedures and systems disappeared as well. To this day, the number of well trained and experienced community level project facilitators within NGOs or government agencies is exceedingly small for a country the size of Indonesia. Decentralization of the housing function will make it even harder to build up needed capacity.

The disjointed management of the different housing assistance programs, and the difficult task to adjust the programs to changing market conditions and household needs, has led the HOMI team to propose to the Government of Indonesia (GOI) to consider creating a new, best practice system. It is a major task to create a well functioning replacement system that avoids the mistakes of the past, while achieving acceptable levels of production.
and improved levels of targeting. Below we outline, the role of a new Housing Assistance Agency and related funding mechanism.

9.2. The Role of A Housing Agency And Housing Fund

9.2.1 Why Set Up a New Housing Agency?

In another study of the HOMI project we have outlined a comprehensive set of housing assistance programs that would serve a broad range of households and institutions, both through national level finance mechanisms and through local level neighborhood block grants. Subsidies would be transparent, well-targeted, on-budget, administered in an efficient and effective manner, and tailored to meet the varied needs of lower-income households in differing circumstances. The new schemes will involve greater roles for private financial institutions and NGOs. They are designed to leverage household, community, financial sector and local government investment in housing development. This principle of incentive funding requires a close interaction with and knowledge of the financial and real sector.

We have also spelled out the need for continued central government involvement in the housing sector during the transition to decentralization. A focus on local level housing programs requires flexible and varied subsidy approaches, a combination of technical assistance, capacity building and investment support. Most of all these programs need to build up support institutions for housing.

Successful implementation of this new generation of housing assistance programs cannot be done in the scattered and stop-go fashion of the past. HOMI recommends that the GOI assess the feasibility of establishing a specialized housing assistance agency and a related fund to guide and implement approved subsidy and incentive programs. The assessment will need to weigh the cost of establishing a new agency against the greater efficiency of the use of limited housing resources and donor funds. The major objectives for the establishment of a new housing agency and a housing fund would be:

- **Creation of a stable environment for housing sector reform:**
  Reforming the housing sector requires long-term strategic objectives and implementation strategies. The importance of a stable policy environment is critical for that transition. A dedicated housing agency, less prone to short-term changes in
ministerial environments, and with specialized staff, can provide such stability. Similarly, funding for programs need to be stable and long-term in order to attract investors and local actors.

- **Improved coordination of programs and institutional development inputs:**
  A coordinated approach is required to gradually build up new institutions, regulations and capacities, and streamline different subsidy program inputs. Regional housing capacities and institutions vary and will require different programmatic and institutional inputs. Donor grants and loans, jointly with GOI funds, have to be guided to strengthen priority housing support institutions, (e.g., mortgage insurance, micro-finance, liquidity funds, human settlement NGOs), and priority program investments. While donors always desire autonomy for their own projects to some degree, they are willing to be directed to specific programs when these are well thought out and managed and guided by clearer principles. A dedicated housing agency coordinating all main housing programs will be better able to respond to these varied requirements.

- **Pooling of resources for housing programs:**
  Housing resources from the national budget will be scarce. A housing fund, linked to the housing assistance agency, will facilitate the pooling of other available resources in order to maximize outputs for the housing sector. For example resources from APBN (Central government budget, DAK funds), non-APBN government resources (local level loans, grants, and later on bonds), private and semi-private resources (e.g. the special housing fund of Jamsostek, Bbapertarum’s funds) and donor funding. In addition a NHA/HAF can strengthen the lobby for housing funds.

- **Need for program adaptation to “tease the market down” and respond to changing conditions:**

  The dynamic subsidy systems we propose will need continuous adaptation during this time of economic, fiscal and financial sector transition. The programs are designed to gradually increase the role of local governments, the private and NGO sectors. Incentives need, therefore, to be adjusted regularly to “tease the market down”, and get the priority inputs from local partners. The subsidy programs are based on the concept of incomplete markets. Subsidies should provide institutional and household assistance to intermediate the gap in current finance and other markets for housing.
Once the market is comfortable making loans to a selected segment of the market, subsidies and target groups should be adjusted to include other risky groups.

Similarly, incentives to local government and the NGO sector need to be adjusted regularly to extend their inputs. Also, the mix of programs will need adaptation in accordance with local level demand for lower-income housing. This process requires a dedicated housing agency with highly specialized professional staff, and sufficient freedom to make program adjustments.

When local governments are better able to implement housing programs on their own and housing market institutions are well established, this Housing Agency and housing fund could be phased out. A clear exit clause could be provided in its statutes.

9.2.2. Specific Tasks of a Housing Agency

The tasks of the Housing Agency would be to:

- Develop priority housing programs for national and local level implementation with inputs from Kimpraswil, local governments, private and NGO/CBO housing actors.
- Set up selection and qualification criteria for financial institutions interested in participating in the financial subsidy programs.
- Set up a disbursement and monitoring system for financial subsidies.
- In collaboration with the Board, adjust rates and program parameters (income and other household indicators, loan amounts).
- Solicit and assist in preparing proposals by local governments or NGOs for neighborhood-based program funding.
- Select proposals with the assistance of a regional unit, facilitate planning and implementing of projects, carry out quality control and monitor the results.
- Coordinate program technical assistance and investment inputs by international development agencies.
- Review the allocation of funds to different programs and adjust according to regional and program related demand.
- Adjust program parameters and propose alternative programs when economic and housing conditions change.
9.3.  Indonesian Experiences With Special Funds

There are a number of special funds in Indonesia. There are some similarities with the proposed NHA/NHF, mainly as administration of a pool of funds. However, each of them has its unique characteristics.

9.3.1 Special Funds with a Lending Function

Probably, the special fund that is still in function during the crisis is the SLA (Subsidiary Loan Agreement Fund). It is a national resource pool of loans from international institutions. The loans are made by central government and then extended as two staged loans to local governments. The major problem with the SLA Fund is low repayment from the local governments. In the past there is no intercept mechanism to collect the repayments directly from the central to local government transfer. The function of the proposed NHA/NHF is different from the SLA. The NHF is a pool of funds for subsidy (with a complementary allocative function in the NHA), while the SLA Fund is a pool of funds for two-stage loans. Primarily the NHF needs a good subsidy accountability, while the SLA Fund needs a good repayment rate.

A special fund which has more flexibility compared to the SLA Fund is the RDA (Regional Development Account) Fund. The RDA Fund is a revolving fund originated from international loans made available at national level for borrowing by local governments. The RDA Fund has specialized in small-scale projects in the range of USD .5 to 2 million. The main problem with the RDA Fund is also a low repayment rate. It should be noted again that the RDA Fund deals with tending, while the function of NHA/NHF is allocating subsidies.

Similar to the RDA Fund, there is a special fund known as the RDI (Rekening Dana Investasi, Special Account for Investment Fund) Fund. The different of the RDI Fund compared to the RDA Fund, is that the RDI funds come from government money, i.e., it is a domestic fund. The main problem with the RDI Fund is also a low repayment rate.

The SLA, RDA, and RDI Funds share the same feature, they have a lending function. They have the same problem, i.e. a low repayment rate. In addition to that problem, they face a limited management capacity, most probably because they are administered within a bureaucracy (of MOF) rather than by dedicated institutions staffed with specialized professionals.
9.3.2 Non-lending Special Funds

There is another special fund that does not have a lending function. That is the Reforestation Fund. Its function is to collect forest exploitation fees and allocate 40% of this amount annually to the provincial government where the forest is allocated and the rest to the central government. The use of the fund is limited to forestation purposes only. Compared to the NHAINHF, the allocation function of the Reforestation Fund is much simpler. The NHA/NHF allocates funds for a number of subsidy programs that may be adjusted dynamically.

Another special fund that is still in the stage of conception is the Road Fund. Its source of funds is vehicle taxation that will be pooled to finance road maintenance. The allocation of the fund will be much more complex than the allocation of the Reforestation Fund. The Road Fund should allocate funds for the maintenance of road segments through local governments to maintenance contractors. The allocation should consider, among others, assessments of the condition of road segments, the category of roads, the number of vehicle registered in localities, etc.

9.3.3 NHA/NHF Compared to other Special Funds

The SLA, RDA, and RDI face a problem of continuous inflow of capital, while the Reforestation Fund and the upcoming Road Fund do not. The proposed NHAINHF will face a similar problem of funding as the SLA, RDA, and RDI in relation to raising the fund. That problem must be solved, initially through making a case for government budget allocations, which explain the importance of housing funding to be continued and the new reorientation of programs that ensure the effectiveness, efficiency, and equity. It should, then, be followed by deliberations of the government and the parliament to reach agreements. The importance and rationale of subsidies for the housing sector has been mentioned in previous sections and other HOMI papers.

The SLA, RDA, RDI, the proposed Road Fund, and the proposed NHAFNHF face complex allocation issues. The NHA/NHF deal with primarily how to encourage housing markets to work. The other funds deal with public infrastructures primarily regarding how to develop and maintain them in a sustainable manner. AJI of the funds need institutions that should be handled professionally. For the housing sector, the new institutions proposed should
be able to mobilize the capacity of professionals who understand and promote housing markets.

9.4. Legal Issues

9.4.1 Set up of NHAINHF

There are some legal issues concerning the set up of NHAJHAF and their operations. First, we should explore alternatives to the structure of an NHA. The NHA might be in the form of a non-departmental agency similar to BKKBN (The Coordination Agency for Family Planning) or LAN (National Institute for State Administration), etc. It might be in the form of a working group supervised under Inter-ministerial committee such as TKPP (Coordinating Team for Urban Development). At the lowest it might be in the form of an extended Project Management Unit attached to a technical ministry.

Based on the backgrounds, contexts, and objectives of a new housing agency mentioned earlier, we consider the TKPP4ike unit as the most appropriate. Considering that this will be an institution under supervision of the inter-ministerial committee, one might propose that the establishment of the institution will be based on an inter-ministerial decree. However, it has been mentioned earlier that the ministerial institutions may change while a stable housing environment is needed. Therefore, a presidential decree is considered the most appropriate legal bases for the establishment of the NHA.

Second, similar to the discussion of the NHA, the form and legal bases of the HAF should be explored. However this might be similar, since the HAF is a complementary function of NHA. They should be established simultaneously under the same legal bases. The HAF will be also supervised by the same inter-ministerial committee.

The NHA/HAF operations must comply with various legal aspects of state and local planning and budgeting. They must comply, among others, with the State Guideline (GBHN) mandated by the People Assembly, Law of Autonomy, Law of Fiscal Decentralization, Law of the National Planning Framework (Propenas), Law of Annual Budget (APBN), and Local Planning Framework (Propeda), etc.
9.4.2. **NHA/HF Operations**

There are some critical issues regarding the NHA/HF operations. The fund that will be conveyed to intermediaries/target groups basically can be categorized as having two types of subsidies: explicit subsidies (such as KPR, up-front subsidy, mortgage insurance subsidy, etc.) and institutional subsidies (such as capacity building, housing infrastructure, etc.). The institutional subsidies are commonly understood as a part of the ministerial development budget or sector budget and are partly implicit. The explicit subsidies, however, may have a specific entry in the state budget. Some of the institutional subsidies should also be explicit budget allocations. The discussion and negotiation of the explicit subsidies will be harder when they are proposed by the government to the legislature, compared with the implicit subsidies. The importance of the explicit subsidies should be mentioned as complementary to the implicit subsidies, the expected impacts of each of them should be indicated.

Local government is probably the most important of local intermediaries. Local governments may receive for a housing assistance program. According the fiscal decentralization law, the assistance should be regarded as DAK, a central to local government transfer, tried to specific programs. From the state administration point of view, the local government should take the initiative of proposing a DAK application to the technical ministry. Moreover, the local government should, at least, contribute a matching fund of 10%. Under the current state and local administration system, however, the budget prepared by local government should comply with the Five Year Local Development Program Plan (Propeda) and the Five Year Local Government Strategic Plan. The problem is that at this time only a small number of local governments include housing as a priority sector in their plans. To be responsive to the housing assistance programs offered, most of the local governments should get their plans adjusted. This needs approval from the local legislature. In the long run, housing sector should be promoted by local stakeholders to be included as a priority sector. To stimulate the adjustments and stakeholders’ initiatives, a scheme of local capacity building should be introduced.

Housing assistance may also be accessed by other local intermediaries, such as NGOs or community groups, for example, to do slum upgrading. To ensure that their programs conform with the local development plan and or policies, they should get approval from the local government, before their applications are evaluated by NHA.
9.5. What Might A Complete Housing Agency And Housing Fund System Look Like?

At the center of the new system would be a National Housing Agency (NHA) that coordinates all housing assistance programs that would be funded through a Housing Assistance Fund (HAF).

9.5.1 A Menu of Programs

Clearly, under a NHA, different subsidy schemes can be developed to cater to different target groups and regions. In addition, priorities must be set, explicitly or implicitly, among different groups and within groups, and regions or local authorities. This arrangement allows for a greater coordination of different housing programs under the NHA, both for short-term economic stimulus objectives and for longer-term improvements in housing sector performance.

What would the subsidy channels look like? At a minimum, these channels can be similar to those that exist today, including loans at subsidized rates or explicit subsidies through BTN and other banks, slum upgrading and low-income housing subsidies. But mostly, new programs should be considered such as:

- a program to pay premiums for mortgage default insurance,
- upfront grants for down-payments, loan amount, or buying down the monthly payment in initial years,
- grants for small house improvements,
- a pre-purchase savings related subsidy in a pledge account, for default prevention, and
- subsidized infrastructure and services provision through local authorities or NGOs.

Also, institutional subsidies need to be considered such as subsidies to NGOs or other intermediary institutions, subsidies for capacity building. There are many questions about the design of each of these channels, some of which are explored in the two subsidy reports.
9.5.2 Allocation of Funds

A HF can be perceived as a pool of money, allocated through annual appropriations for housing programs by the government and international agency and donor funds. The HF administration would allocate those funds to various trust funds for different programs within the HF, specified by the government and approved by the Board and Interministerial Committee, but with substantial flexibility. All (or most) subsidizing activities of the government would be funded explicitly by the HF, thereby assuring that the subsidies are transparent. Even more importantly, the future flows of subsidies that are being committed currently, such as the present interest rate subsidies, should be accounted for and funds set aside to cover them.

With the HF at the center, the spokes of the HF wheel would channel funding to various programs in an explicit tradeoff between alternative modes of subsidy delivery. Within the NHA there would be different subsidy programs. If BTN makes loans at a below-market rate, the future subsidies to be paid would be calculated and that sum needed to finance them would be set aside in a trust fund. If a government sponsored mortgage insurance system would be initiated, the expected loss on loans would be budgeted for or actually paid to the mortgage insurance company in the form of a monthly premium or one-time payment.

If an alternative program is offered that provides a grant to a homebuyer to supplement their down payment, that would be paid out and no future liability would have to be budgeted for.

Similarly, if grant for infrastructure is provided per household/plot, that amount would be paid out to a Local Government or NGO without budgeting for further liabilities. If a serviced plot is provided and paid for through a grant plus a loan, the subsidy plus expected default cost on that loan would be assessed and budgeted for. Reserves could be set up or an amount paid to a private lender to cover the risk.

The advantage of this arrangement is the rational allocation of subsidies. Subsidies that pay out over 15 years are compared explicitly with those that pay out fully now. Those that involve no hidden risks or costs of collection are seen to be cheaper than those that do have hidden costs. This also encourages the redesign of subsidy schemes to avoid extra risks, costs and inefficiencies. By the same token, this approach does not allow for
running up future commitments of subsidies or mountains of bad debt without recognizing those costs today.

This would represent a critically important departure from past practices. It implies that the hidden subsidy on RSS/RS housing would now be on budget if the program were to continue. It would further imply that the amount of budget available for additional housing subsidies would be chosen each year by Congress (previous commitments would be fully funded already) and MOF (for donor funds). This gives fiscal policymakers more control, but also confronts them and the political process with the full future cost of subsidy commitments made today. Transparent and appropriate principles of funding future commitments are essential to a HAF.

Putting housing subsidies on-budget can also mean that there may not be enough funding for everyone who wants a subsidy to get it immediately. In other words, in addition to targeting subsidies through defining eligibility criteria, there will also need to be prioritization criteria saying who gets funded first if funding supply is less than demand. Prioritization will have two levels: local level project developers and individual households within projects.

Once the subsidies are on budget and fully funded, many new options for structuring and delivering the subsidies open up. For example, the current interest rate subsidy can be molded into new forms, such as mortgage insurance payments, down payment assistance or other modes of mitigating credit risk. It can even be applied to non-mortgage-based lending. (See the Alternative Subsidy Report).

Thus, a HAF is the key to more responsible and flexible subsidization in the housing sector.

The perceived disadvantage of a HF and related NHA is that individual ministries and state agencies will lose some of their autonomy in allocating funds. Agencies, finance institutions, local governments and NGOs would have to compete for funding under the HF. However, if staffed with housing industry professionals a HF/NHA has more flexibility to respond to rapidly changing conditions in the housing and housing finance system than the current divided ministerial allocation system. Much will depend on how the administrative unit of a HF is allowed to operate and whether it is led by housing market experts who can be trusted to make responsible and responsive decisions.
9.5.3 Who should control the Housing Assistance Programs and Fund?

The NHA controls the NHF substantively. NHA is controlled by the NHA board of directors that translates primarily the policies set up by inter-ministerial committee on housing into housing programs, but also takes into consideration the inputs from other stakeholders of housing development, into a set of programs. The NHA gives instructions to the NHF for housing program funding.

The Housing Fund is controlled administratively by a financial controller under the NHA Board. accounting controllers working under a board of directors of NHA / NHF (see diagram). The board of directors maintains a standard operation procedure (SOP). The main elements of the SOP are instructions given by the NHA and the internal management and operation system of the NHF.

In a broader sense the control over NHF/NHA is shared by the inter-ministerial committee, the source of fund agencies, and other stakeholders. Without inter-ministerial committee approval, NHF/NHA would not receive government funding, whether domestic origin or international. Without the willingness of the source of fund agencies to channel funds through the NHF/NHA, it would not be able to operate. The stakeholders may alter the proposed national program framework prepared by the NHA/NHF, simply by withdrawing their support for the housing programs.

In practice, therefore, the core control rests with the NHA board of directors. The effectiveness of the NHA/NHF operation depends on whether the NHA board of directors is able to effectively influence stakeholders of the merit of the programs on the basis of professional criteria. In short, it is professional management and good governance that controls the NHA/NHF.
# ADDITIONAL REPORT NO. 1
## THE DEVELOPMENT OF KASIBAS IN INDONESIA

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*Technical Assistance For Policy Development For Enabling The Housing Market To Work In Indonesia*
Kasiba—“Ready to Build Area”—is the acronym for a specific formula for large-scale housing and urban development projects in Indonesia, involving private-public partnerships. The legislation was passed in 1992, but the regulations came into force only in 1999. Only one Kasiba project is currently being implemented, as a pilot scheme, in Driyorejo (Surabaya). In addition, we know of one more planned Kasiba near Medan. However, several other projects, actual and proposed, provide us with some lessons for the development of future Kasibas. In addition to reviewing the principles and experience to date in Indonesia, this report also draws on the experience of British New Towns, which have many similarities to Kasibas.

We find that Kasiba legislation is notionally well suited to facilitate the mass provision of housing by private sector or other developers. This is because it has a management structure designed to oversee large scale projects; because the magnitude of the project allows a degree of cross-subsidization more easily than in small projects; and because we do not expect to witness large-scale housing projects initiated by the private sector in the immediate future.

In practice, however, implementation—of both “true-Kasibas” and “near-Kasibas”—has proved to be very difficult. Thus, there are important issues that must be addressed, before the future of Kasibas in Indonesia can be fully clarified:

• There may be only a limited number of areas that are suitable for Kasiba development, based on the extent to which developable land with the potential for land price increases in still available in the large urban areas;

• Strategies for land assembly, in concert with assessment of employment opportunities and transportation options, must be assessed; and

• The public/private partnership which can best guide Kasiba development must be structured to take advantage of Indonesia’s seasoned private developers and contractors and the experience of several Asian neighbors in new town development, as well as the goals established by the local government sponsors.

• Although it is not listed as one of the objectives of the Kasiba concept, risk sharing should also be considered as one hallmark of effective public/private partnerships.
We draw two major conclusions from these outstanding issues:

• Unless more concerted and determined actions are taken by local governments, especially with regard to land assembly, there are likely to be very few opportunities for the development of new Kasiba schemes in Indonesia in the near future; and

• Much more attention needs to be paid to planning the development of new Kasibas, including the preparation of feasibility studies, than has been the case in the recent past. A pilot Kasiba is proposed to address many of the planning and feasibility issues.²

In the final section, this report lists a number of actions that can and should be taken, by Kimpraswil and other agencies, if Kasibas are to become a reality in Indonesia, and if they are to have any significant impact on the supply of affordable housing.

In summary, they are as follows:

• An investigation should be started into the feasibility of establishing a pilot Kasiba.

• In order to access land for Kasibas, local governments, with technical assistance from a central body, should consider the revocation of Location Permits; and should be encouraged to use all the powers presently available to them to acquire land suitable for Kasiba development.

• Kimpraswil should ask local governments to consider setting aside the proceeds of the proceeds of PBB on idle land into a special low cost housing fund.

• Kimpraswil should determine ways of amending the Kasiba legislation in order to give powers of expropriation to a local government or to a Kasiba Management Board.

• Kimpraswil should request the donors to consider funding a project to train local governments, directly or through local government associations, in the principles and best practices of negotiation for land development for housing.

• Kimpraswil should issue a clarification—if necessary, by legislative amendment—that two local governments may jointly designate a Kasiba.

² Again, see the companion report cited above; a proposal for a pilot project is presented there.
It is not clear that any single public body in Indonesia possesses the capacity of developing a Kasiba, simply because of the range of skills needed is so extremely broad. Therefore:

- Representatives of all interested local governments, and of experienced (and properly remunerated) private sector representatives with no direct interest in the outcome, should always be included on Kasiba Management Boards.
- The feasibility study and design of at least the first Kasiba should be procured from an experienced consulting organization, supervised by and responsible to the Kasiba Management Board.
- Kimprawisil should approach representatives of donor countries—particularly of countries immediately neighboring Indonesia—to seek their financing of a Kasiba feasibility and design study, as well as the management of its implementation.

There is a need for a central unit to take the lead in actively promoting the Kasiba concept—a Kasiba Oversight Unit. Responsibilities would range from seeking legislative amendments, liaising with private sector interests, negotiating contracts for a Kasiba pilot project, seeking donor financing, to ultimately providing advice and assistance to local governments.

In addition, Perumnas, through its regional offices are well situated to providing capacity-building assistance to local governments and exercising quality control and monitoring of the building standards for housing built by the private sector.
2.0 THE KASIBA DEVELOPMENT PROCESS

2.1 The Goals of Kasiba / Lisiba

In essence, a Kasiba is a large-scale housing and urban development project, usually managed by a public sector entity, but involving private-public partnerships. Kasibas comprise several Lisibas, each Lisiba being intended for development for housing by a single developer, public, private or NGO. Although the size is not fixed and would vary according to local circumstances, a Kasiba might typically accommodate up to 100,000 people, together with supporting social, commercial and public facilities, and employment zones (around 1,000 hectares in total); and individual Lisibas might accommodate a few hundred housing units of, perhaps, 2,500 people in each.3

Literally, “KASIBA” is an abbreviation of Kawasan Siap Bangun, a Ready-to-Build Area. “LISIBA” is Lingkunan Siap Bangun, a Ready-to-Build Neighborhood. The concept of Kasiba was introduced in Law Number 4 of 1992, and the enabling regulations were approved in 1999. The law explains that Kasibas are intended to promote “proper, healthy, harmonious and orderly development of housing and settlements”, in accordance with the 1945 Constitution.

The literature on Kasibas lists a variety of objectives that Kasiba projects are intended to meet by bringing land under government control, including the following:

- to prevent sprawl by coordinating private real estate development, and controlling informal development, on the urban fringe;
  
  thus to formalize development, and to achieve well planned and well serviced urban development;

- to provide additional housing, especially for low income households;

- to advance objectives of the regional spatial plan by directing development to the most strategic but least environmentally sensitive locations;

- to mobilize a new source of funding for infrastructure development and leveraging of limited government funds; and

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3 The legislation refers to a minimum of 3,000 housing units and a maximum of 10,000 in a Kasiba; and between 1,000 and 3,000 units in each Lisiba. These ranges appear not to be followed in practice.
• to capture the increase in land values in order to recover the cost of neighborhood infrastructure and facilities, and to cross-subsidize housing for low-income households.4

It was expected that individual Kasibas should be designed to meet the above goals, and to attain specific additional, local, objectives, such as:

• to decentralize overcrowded urban areas;
• to stimulate economic growth; and/or
• to stabilize house prices.

In essence, a Kasiba is a new town, managed for the public good. It takes on the characteristics of a joint venture partnership, between the public and private sectors, for developing large tracts of land, predominantly for housing. The mobilization of private funds is implicitly part of the fourth objective of the Kasiba framework listed above (although other sources of public funds might also be included as “a new source of funding”, such as the proceeds of donor-supported grants or loans).

However, the characteristics of a good public-private partnership should be that risks are shared between the different parties. Risk-sharing is not listed as one of the objectives of the Kasiba concept and, consequently, it is not incorporated into the conceptual project design, as outlined in the following section.

The Kasiba concept is used only to refer to settlements initiated, designed and managed by the public sector. However, because private sector new towns share some of the same characteristics, some examples of these are discussed later in this paper.

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4 In this respect, Kasiba appears to be the conceptual successor of the Guided Land Development (GLD) program, proposed in the Jabotabek Metropolitan Development Plan of 1980. GLD was to be implemented on privately owned urban fringe land. GLD was to provide basic infrastructure, the costs of which would be recovered through betterment taxes levies). GLD attempted to guide and control private development, as well as improving its technical standards. The project was never implemented as planned.
2.2 The Kasiba Development Process

The processes to develop a Kasiba are spelled out in the law and regulations, and have been amplified by a number of other documents, especially a series of reports and manuals prepared for the then-Ministry of Housing and Human Settlements with the assistance of JICA experts. The processes are complex: the following summary, by simplifying the description, necessarily omits some detail. The legislation and guidelines are also sufficiently broad and flexible that there is usually more than one way of developing an implementation strategy.

- The local government takes the initiative in establishing a Kasiba. Typically, the BAPPEDA would be expected to lead the task force.

- The local government designates an appropriate part of the area of the regional plan as a Kasiba project area.

- A Kasiba Management Board is appointed by the local government, with the responsibility to plan, implement and manage development of the Kasiba. For the purposes of this report, we refer to this simply as the “Management Board”. Different forms of this Board are possible—see the discussion below.

- The Management Board has the responsibility of acquiring the land within the project area. The Board is not given any special powers of compulsory acquisition (eminent domain).

- The Management Board is also responsible for the construction of infrastructure, working in cooperation with local public enterprises and local governments. The general schema for infrastructure finance is assumed to be that, national infrastructure (such as trunk roads) is financed by central government; primary infrastructure (such as the water supply), is financed by local authorities; all infrastructure within Lisibas, is financed by the developers of the Lisibas. Normal principles of cost recovery apply.

- Each Kasiba is subdivided into Lisibas (housing areas) and other areas (e.g. roads, commercial centers, etc). All the Lisibas are to be either developed by the Management Board, or—in most instances—sold to private developers under competitive procurement procedures. (The guidelines state that the sales price of
Lisibas should not exceed their cost; this seems to imply a potential subsidy to developers, which is presumably not intended. It is, however, also stated that the Management Board may impose a license fee on the Lisiba developers, one presumes in addition to the sales price.)

- Private housing developers can build houses in Lisibas, or continue independent land development schemes elsewhere. However—with certain exceptions—the private sector is not to be permitted to sell undeveloped plots without houses.

The legislation states that the Management Board should be a BUMN (State Owned Enterprise), or a BUMD (Regional Public Enterprise), or another institution established by the government for this task—our emphasis. The Board should be a non-profit organization, although there is no restriction on private companies being represented on the Board. (If a private company is appointed to the Board, presumably there must be provisions to prevent conflict of interests.) Board responsibilities can thus be (a) delegated to an existing BUMN, such as Perumnas; or (b) given to a specially appointed new Board. There is no reason why a specially appointed Board should not comprise representatives of the private sector or local communities in addition to public sector representatives.

In either case, the responsibility for planning and implementation can be contracted to a private firm or firms. Doubtless, the Board would want to look to companies with considerable experience—preferably international experience—in managing new town developments before awarding such a contract. The legislation and manuals imply that the Management Board is to be decommissioned as soon as it has completed the sale of Lisibas and transfer of infrastructure to local administrations.
3.0 KASIBA PROJECTS IN PRACTICE

This section describes some actual, planned and proposed Kasibas in Indonesia, and draws some comparisons with similar projects elsewhere. To our knowledge, there is no master list of Kasibas. Although Kimpraswil has the overall responsibility for Kasiba legislation and, at least implicitly, has the authority to promote Kasiba development, there is no requirement that Kimpraswil actually be involved in project development. Similarly, Perumnas has an obvious interest in Kasiba promotion, but does not possess any overall list of Kasibas. We have a list of ten potential Kasiba schemes, drawn up several years ago, which is summarized in Table 3.1. We briefly discuss Driyorejo, Bumi Serpong, Tiga Raksa, Parung Panjang, and the private new town Lippo Karawaci.

### TABLE 3.1: STATUS OF PROPOSED KASIBAS AND SIMILAR DEVELOPMENTS

<table>
<thead>
<tr>
<th>Name</th>
<th>Planned Status</th>
<th>Area (approx.)</th>
<th>Management</th>
<th>Issue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Driyorejo (Surabaya)</td>
<td>Kasiba</td>
<td>1,200 ha</td>
<td>Management team established</td>
<td>High cost</td>
</tr>
<tr>
<td>Tulunggan</td>
<td>Kasiba</td>
<td>2,500 ha</td>
<td>Private</td>
<td>Not in regional plan</td>
</tr>
<tr>
<td>K. Sumatra</td>
<td>Kasiba</td>
<td>260 ha</td>
<td>Perum Perum</td>
<td>No decision in principle</td>
</tr>
<tr>
<td>Garoea (Jawa Barat)</td>
<td>Kasiba</td>
<td>200 ha</td>
<td>Not known</td>
<td>No finance identified</td>
</tr>
<tr>
<td>Mipangat (Minahasa)</td>
<td>Kasiba</td>
<td>300 ha</td>
<td>Not known</td>
<td>No finance identified</td>
</tr>
<tr>
<td>Lambang Bubuk (Padang)</td>
<td>Kasiba</td>
<td>200 ha</td>
<td>Not known</td>
<td>No finance identified</td>
</tr>
<tr>
<td>Bumi Serpong (Darmi)</td>
<td>Independent Kasiba</td>
<td>6,000 ha</td>
<td>Private</td>
<td>Poor transport lines</td>
</tr>
<tr>
<td>Bangunpung (Tiga Raksa)</td>
<td>Independent Kasiba</td>
<td>3,000 ha</td>
<td>Private</td>
<td>Uncertain demand</td>
</tr>
<tr>
<td>Bangunpung (Maja (Lebak))</td>
<td>Partnership</td>
<td>5,700 ha</td>
<td>Partnership</td>
<td>Potential only for low income</td>
</tr>
<tr>
<td>Kibang (Batu)</td>
<td>Partnership</td>
<td>1,100 ha</td>
<td>Not known</td>
<td>Lack of support</td>
</tr>
<tr>
<td>Parung Panjang (Bago)</td>
<td>Kasiba</td>
<td>300 ha</td>
<td>Not established</td>
<td>No finance identified</td>
</tr>
</tbody>
</table>

In addition to these ten—several of which are not Kasibas in the strict terms of the legislation—we know of one more planned Kasiba near Medan.

3.1 Case Study: Kasiba at Driyorejo, Surabaya

**Status.** Driyorejo was the first pilot Kasiba in Indonesia and was set up as a Repelita VI commitment. The site, which lies 20 km. to the south-west of Surabaya within the Surabaya

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*The field case study was undertaken by Bob Sudjana Tantra; this section is based on the field report and information from LAP Report 'Land Acquisition and Development Controls, Topic Cycle 2, Chapter 4-38. Again, also refer to the Companion report cited above, 'The Kasiba Pattern: Large-Scale Land Development for Housing and Settlement', Bob Sudjana Tantra*

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metropolitan area (SMA). It should be noted that this site is not a Kasiba in the strict sense of the original 1992 legislation. It started as a purely individual Perumnas initiative to acquire land for low-cost housing (they bought the original 203 ha. in 1990 for which they then acquired an Izin okasi). It was not originally envisaged as a major spatial initiative contributing to integrated development in the area. However, the site was later expanded in size from a low-cost housing core to become “Perumnas Plus” or a “quasi-Kasiba”. So neither the site layout, phasing of development nor the land acquisition problems of this site would necessarily be repeated in an actual Kasiba\(^6\), but Driyorejo was ultimately supposed to be developed according to the “Kasiba” pattern. Rp. 30 billion in equity capital from the KSO plus Rp.20 billion debt capital (in a medium-term note) have been expended. Due to Krismon and other problems, however, the project has been discontinued and land clearance was stopped in mid-1997. The unit head of Driyorejo (IR. Chavidz Ma’ruf, Dipl. SE) indicated that most of the necessary permits from the Regional Government and the Land certificates from BPN and their updated amendments have now been secured, however.

**Management Structure.** The development consortium that was established for this Kasiba was set up in 1994 by the Minister of Public Works and consists of Perumnas and 5 BUMN with Perumnas holding 60% of the equity.

**Design Characteristics, Construction to Date, and the Revised Plan.** The total area for the new town or Kasiba covers some 1200 hectares of which 203 ha. are for Perumnas housing (for approximately 4,000 families), 655 ha. are for town development by the consortium and the remaining 342 ha. that surround the area are for integration into the scheme. The latest RDTRK allocates 813 ha. for a variety of housing and other urban uses. The area has been split into several Lisiba with supporting infrastructure: these areas are either reserved for Perumnas, are reserved for public facilities or are intended for sale. It was expected that land would sell in these Lisiba for around Rp. 100,000/m 2.

Total development costs are expected to be Rp. 272 billion. Sales of Lisiba alone are expected to return Rp. 450 billion. A total of 475 ha. has already been acquired outside

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\(^6\) See the LAP Report, op. Cit.
the Perumnas area but 180 ha. scattered through the area are still required. Apparently, the original owners are holding out for higher compensation. Prices in the area originally started at less than Rp.5000/m² but have now risen to Rp.13,000/m². This is partly due to a better bargaining position for later sellers but mainly due to the higher rates paid by other developers with Izin Lokasi in surrounding locations. These developers located in the area following the establishment of the Kasiba and clearly use Perumnas as a development catalyst. Failure to acquire the remaining land as shown on the attached Figure will prevent further overall development. Outstanding parcels are too fragmented to allow major development to commence outside the Perumnas area.⁷

A total of 7683 housing units had been planned, of which 4767 are already constructed.

The additional facilities constructed by Pemda include a wet market shed and bus terminal, 6 Mosques/Prayer Rooms and 9 food vendor sheds (Pujasera), 1 Kindergarten and 2 primary school buildings. Transportation is available by mini buses (angkot) from the main road, for which 4 shelters have been erected. The provision of public utilities includes (PDAM) water supply, (PLN) Electricity and (TELKOM) Telephone. However, no business activities were observed during the field visit (November 2001).
The revised land allocation plan for 2004 is summarized in Table 3.2.

<table>
<thead>
<tr>
<th>No.</th>
<th>Type of Land Use</th>
<th>Size Ha.</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Housing</td>
<td>372.9</td>
<td>46.2</td>
</tr>
<tr>
<td>2.</td>
<td>Tradeservice</td>
<td>37.3</td>
<td>4.3</td>
</tr>
<tr>
<td>3.</td>
<td>Meetingpoint</td>
<td>55.5</td>
<td>6.9</td>
</tr>
<tr>
<td>4.</td>
<td>Pasun &amp; Field</td>
<td>70.6</td>
<td>8.6</td>
</tr>
<tr>
<td>5.</td>
<td>Gereja &amp; Golf Course</td>
<td>64.5</td>
<td>7.9</td>
</tr>
<tr>
<td>6.</td>
<td>Pasun &amp; Field</td>
<td>162.6</td>
<td>19.3</td>
</tr>
<tr>
<td>7.</td>
<td>Pemkotagen</td>
<td>21.2</td>
<td>2.6</td>
</tr>
</tbody>
</table>

Source: Research Officers DRIKRES.DIVPOM.1007  

**Future Financial Requirements.** The General Manager of Region VI – Perumnas (Ir. Bihar Tobing, Dipl. SE.) and the unit head of Driyorejo (Ir. Chavidz Ma’ruf, Dipl. SE.) explained the difficulties encountered during the land acquisition process, which were particularly aggravated by escalating prices, as noted above. In sum, financial constraints are preventing immediate resumption of constructing the access and ring roads and

⁷ LAP, op. Cit.
drainage systems within and outside the boundaries of this complex. Additional budget requests to complete the project total approximately Rp. 90 billion. In addition, nearly Rp. 6 billion is required for three Lisibas planned as extensions.8

Comment.
Driyorejo requires additional funding totaling nearly Rp.100 billion for continuation and completion. If funding for infrastructures from both the APBN and APBD is made available, should this project be given the preference? Or should a new Kasiba and/or Lisiba be developed elsewhere? This should determined based on a study of market demand. What will be the benefits, if the funding is acquired? What will be the cost benefit ratio? Although the new plans and estimated budget have been duly prepared and submitted, it may still be wise to prepare a pre-feasibility study in order to ascertain the project’s viability and reaffirm its financial feasibility as well as the expected ROI.9

Land consolidation has been problematic for several reasons. Price escalation and Krismon created a difficult environment for consolidation. Also, because the consortium can only acquire HGB while the owners enjoy Hak Milik, it is difficult for the developer to ascribe any potential increase in plot value until the final layout is complete.10

3.2 Case Studies of Other Large Scale Developments

In this section, we describe four Kasiba-like developments in Jakarta’s western corridor. The first, Parung Panjang, is a proposed Kasiba. The others—Bumi Serpong Damai, Lippo Karawaci and Tigaraksa—although not Kasibas, share many of their characteristics and are in the course of implementation. We have less information about the three latter settlements than about Parung Panjang, simply because the plans for the former—being a potential Kasiba—are better documented.

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8 Bob Sudjana, op. Cit.
9 Bob Sudjana, op. Cit.
10 LAP, op. Cit.
3.2.1 Parung Panjang

**Status.** Parung Panjang is a proposed Kasiba, 35 km southwest of Jakarta. It was intended by Cipta Karya to become Indonesia’s second Kasiba, after Driyorejo. Implementation has not yet started. Of the problems hindering implementation, the most severe would seem to be the lack of demand for housing caused by the bad transport links with the rest of Greater Jakarta. There is no immediate prospect of a resolution of this latter problem and, therefore, no immediate prospect of the Kasiba being implemented. Please also refer to the Annex to section 3.2, for a financial review of Parung Panjang by JICA.

Parung Panjang is located on the border of Kabupaten Bogor, adjacent to Tangerang. The land is currently predominantly agricultural, but there are several existing small settlements, of which the most important is the small town of Parung Panjang, with its rail station, shops, school and mosque, and other facilities. A proportion of the land intended for the Kasiba has been acquired by Perumnas.

Perumnas has already built a settlement in the vicinity of the Kasiba, although many of the houses, built to the RS and RSS models, are unoccupied because of the lack of local employment and the absence of adequate transport links. Most houses—although not all—have, nevertheless, been sold by Perumnas. These houses were presumably bought for investment, perhaps with the intention of redeveloping them although, since there is very little demand for accommodation in the area, the investment has not (yet) become profitable. Indeed, current rents are close to the level of maintenance costs, implying that the houses have a negligible net value, and reinforcing the conclusion that the time is not ripe to invest in the Kasiba. Perumnas has halted on-site construction.

**Management Structure.** The scheme is described as a public-private partnership, since much of the land was first purchased by Perumnas. The planners say that Perumnas “should play a leading role” in setting up the Kasiba, and a “leadership role” within the Kasiba management board. We understand that Perumnas still expects to play such a role if and when the Kasiba comes to implementation. No active steps have been taken to establish the Kasiba Management Board. We believe that the Kabupaten has not yet designated the area as a Kasiba.
Planned Characteristics. The town was planned to accommodate 130,000 people (in 31,000 households, occupying 1,000 hectares). The first phase, to be developed over a period of five years, would have 48,000 people housed within 8 Lisibas. The Lisibas are intended to for development by both Perumnas and by private developers. The town plans show the usual social and commercial facilities. Land is designated for industrial use, although employment issues are not discussed in the reports that we have seen. The importance of local employment appears to be downplayed in view of the relative vicinity of Parung Panjang to Jakarta. Implicitly, it would become a commuter town. (However, we suspect that an economic fare, by road or rail, to central Jakarta would militate against this as a residential location for low-income commuters. The present rail fare is an affordable Rp.9,000 per month!)

The site is close—as the crow flies—to the private new towns of Lippo Karawaci and Bumi Serpong Damai, both of which are still under course of development. Since both of these towns consist of predominantly higher cost housing, the planners of Parung Panjang concluded that there would be little demand for “luxury” housing in their Kasiba. They have therefore planned for development to be in the proportion 3 mid-cost units to 6 low-cost units (with no high-cost units). The consultants say that this would “demonstrate social solidarity”. House sizes are, however, expected to range from 21/54 to 150/350. (Contrary to the implications of the Parung Panjang planners, the latter house sizes are, in fact, appropriate for high-income households.)

Transport Links. Parung Panjang is sited on the route of the Jakarta-Serpong-Rangkasbitung railway, and on the Metropolitan Ring Road proposed to provide a link with Jakarta via Bumi Serpong Damai. Indeed, these two routes are vital for the future development of the area, for without them travel to Jakarta and elsewhere is at best lengthy and time-consuming. The existing roads are narrow and in poor condition, and are presently neither suitable for commuting out of Parung Panjang nor are they suitable to attract inward investment by new employers.

The railway towards Jakarta is presently a single-track line, which can carry only a very limited passenger service, currently 8 trains per day. (The present passenger service is said to be already overloaded, and incapable of expansion without major investment. There are plans, by the Department of Land Transportation, to upgrade the line to dual track. These plans, however, are currently on indefinite hold pending decisions to invest
in the whole rail network. Indeed, it appears that the decision to designate Parung Panjang as a Kasiba was predicated on the prior existence of a good rail link with Jakarta (and thus, by implication, of the town becoming a major commuter settlement). The planners describe it as a “rail oriented new town”.

The route of the toll road extension to Parung Panjang is planned, but we know of no current proposals to extend it beyond its present terminus in Serpong. Indeed, this is perhaps a question of chicken-and-egg: the road will not be built unless there is proven demand (presumably in the first instance, by a car-owning population), but the demand will not materialize until there are good transport links with Jakarta and with the main road network. A road link with the Jakarta-Merak highway is also foreseen but—as far as we know—not actively planned.

**Project Finance.** This is the only such development for which—to our knowledge—a financial appraisal has been prepared and made public. We have had access only to the summary version of the appraisal, and therefore do not have all of the supporting information.

The estimated cost of land purchase and infrastructure construction, excluding interest, was quoted as Rp.61 billion (the date of the report was January 2000, but we suspect that 1998 prices were used; the cost would thus be equivalent to about US$7.5 million)\(^{11}\),\(^{12}\). The cash flow estimate calculates a need for capital of Rp.36 billion (say, $4.5 million), including land already owned by Perumnas and valued at Rp.12 billion. The rest of the capital was assumed to come from local governments, including possible foreign loans. The report states, “with low-cost fund provided by government, the infrastructure cost can be recovered through Kasiba”.

The summary plan shows that the scheme would have a positive rate of financial return, varying from 6 to 7 percent, depending on the method of development proposed. *It appears to us*, however, that the financing assumptions are somewhat fragile. We do not want to seem to criticize the experts who prepared the financing plan—especially since we do not have full details of the assumptions and methodology—and have therefore confined our comments to an annex to this chapter. In summary, however, please note

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\(^{11}\) Taking $1 = Rp. 8,000 (average rate for 1998, quoted in *Laporan Bulanan*, Bank Indonesia). However, please note that exchange rates fluctuated very widely in 1998.

\(^{12}\) This works out at a bargain investment of $250 per household for all land and infrastructure.
that we are doubtful whether it would be appropriate for a government to undertake this particular development project unless it was willing to accept the risk of bearing a substantial degree of subsidization.

Comment. With the benefit of hindsight, we can say that the project was, at best, premature, having been planned before there was any certainty of the two essential transport links—road and rail—being completed. Without these links, the project would fail. Indeed, such is the present climate for large-scale infrastructure investments that partnership between the Kasiba Management Board and companies managing the toll road and the rail upgrade might be the only way to ensure that both the transport links and the town get built. Such a financial partnership would involve a degree of risk, and a management capacity, greater than would normally be appropriate for a Kasiba Management Board.

Because the scheme was premature, Perumnas has spent Rp.12 billion (maybe $1.5 million) on land acquisition, a capital investment on which it has received no return, and on which it is unlikely to make any return in the near future.

We can also surmise that Perumnas was able to acquire this land, presumably near agricultural values, because the land had not been acquired by a commercial developer and because it was perceived as having little short-term development value. It had little value (a) because the market believed the transport links were unlikely to be completed in the near future, and (b) because most of the demand for higher cost housing will have been satisfied by other development projects (Lippo Karawaci and Serpong). In short, there was an intrinsic flaw in the implementation plan: it was shown to be affordable only because land was implausibly cheap. Land was cheap because there would only be low demand for new housing. We are also skeptical about the financial plan: not least, that it assumes both foreign loans and low cost loans. We do not know whether these are likely to materialize, but it may be doubtful. However, if Perumnas’ investment to date can be written off, if the rail link to Jakarta is upgraded, if the toll road is extended, and if a major local employment center can be promoted, then there may be justification in proceeding with the Kasiba to meet social goals of housing Jabotabek’s poorer households.
3.2.2 Bumi Serpong Damai

Status. Bumi Serpong Damai was the first private new town to have been developed in Indonesia. It is about 15 kilometers south-west of Jakarta, a short distance from the Jakarta-Merak toll road. It serves as a practical demonstration that the private sector is capable of implementing a socially responsible project, although it does not meet several of the development criteria required of a Kasiba, such as a public management board and non-profit. Development of the town was, however, an integral part of the regional plan to reduce the pressure of the population growth on Jakarta. It also incorporated the concept of Lisibas. It is debatable whether the town is succeeding in including a substantial proportion of lower-income housing.

Management Structure. Development is implemented by a consortium of ten private real estate developers uniquely established for this project, known as PT Bumi Serpong Damai (PT BSD). The land development company understood its tasks to include the acquisition of land, designing the development plan, installing infrastructure, and subdividing the land for housing construction.

In 1984, the company was given the right to develop 5,750 hectares of land, including ten existing villages.

Design Characteristics. The town is designed for an ultimate population of 600,000 in 140,000 households. Construction was planned to be completed within 25 years (say, by the year 2015). Development had started by 1989, and by 1998 it had a population of 50,000. The promotional material for the city states that its objective is “not merely profit, but to establish a major national development project which would define the role of the private sector in working consistently with the government’s objective of transforming Indonesia into a developed nation.”

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14 Compare this with the size of DKI Jakarta, 64,000 hectares.
15 LAP says that “PT BSD endeavored to minimize the hardship imposed on the local population. Without any outside influence, such as from the World Bank or the Asian Development Bank, the company offered the affected persons [the existing population of the area] a fair deal”. 

*Technical Assistance For Policy Development For Enabling The Housing Market To Work In Indonesia*
We believe that the scheme is subject to the 1-3-6 regulation, but development of upper-middle income houses predominate. The city brochure talks only of “luxury … and middle income houses”. Published house prices, net of discount, range from Rp.83 million (36/72), up to Rp.800 million (243/375).\(^{16}\) The median house price may be in the order of Rp.500 million. The smaller units are planned in neighborhoods well segregated from richer areas. A small corner of the town has been reserved for RS and RSS housing, mainly occupied by public sector employees working in the town. The BSD company says that houses have been provided in the ratio 8:27:65, about 1-3-8 (large: medium: small), but without clarifying their definitions of each category. The planners intended “a high mixture of different neighborhoods that represent different quality standards and a variety of spatial concepts. This is very much in contrast to the normal uniformity of public sector low-cost housing schemes.”\(^{17}\)

The city planners have ambitions to create 300,000 jobs. Facilities already in place include the Indonesian Institute of Technology, the German Center for Industry and Trade, and several multinational factories. Other city facilities, existing or planned, include a commercial center, hospitals, numerous golf courses, and an internal monorail linking residential areas with the train station for central Jakarta.

The design brief foresaw that the town was to become a self-contained city within about eight years, maturing from a simple dormitory settlement. Much of the “critical mass” development foreseen for this, the “first phase”, has indeed materialized.

**Finance.** The town, including all infrastructure, was privately financed. We have no information on the details

**Comment.** The town is still little more than one-tenth complete (around half the population planned for this time). It nevertheless appears already to be functioning as an entity, even though visual evidence shows that a significant proportion of

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\(^{16}\) By convention, the figures in brackets indicate, respectively, the built-up area of the house, and the area of the plot.

\(^{17}\) Santoso, op.cit.
residents commute outside Serpong. One locational advantage of the town is its proximity to Jakarta, enhanced by the provision of well-serviced industrial sites in prominent positions. The planners have also taken care to attract leading providers of amenities, which serve to increase demand as well as to act as further promotional tools (a task made easier by the favorable location of Serpong in relation to Jakarta). There is a mix of house types and, therefore, income groups. We note, however, that the developer elected not to provide any significant quantities of low-income housing within the main town area, although the literature states otherwise. (The low cost houses available today are not affordable to the poorest 70 percent of the population.)

We also note that the town was planned for development over 25 years, but is now well behind schedule. This should not come as a great surprise, but nevertheless serves as a warning that developers of similar schemes with less favorable locations may find it takes even longer to reach a critical mass. In this case, the developer was helped by the acquisition of Location Permits, which allowed development in phases without the need for large upfront capital outlays. It may be that this situation will not pertain elsewhere in the future.

3.2.3 Lippo Karawaci

Lippo Karawaci is growing to be a major private new town, just south of the Jakarta-Merak toll road, and about 35 kilometers west of Jakarta. It is located partly within Kabupaten Tangerang and partly within Kotamadya Tangerang; the overlap has caused some planning problems (e.g. where the infrastructure plans of each administration are inconsistent). The town is designed to accommodate about 50,000 people. It was conceived in 1990; implementation started shortly afterwards.

Lippo Karawaci was exempted from the need to build low cost housing (the 1-3-6 regulation) by virtue of a financial contribution made by the Tk.I administration in 1992. We do not know the value of that contribution, nor whether low cost houses to that value have actually been built elsewhere. The town, however, has been designed as an upper-middle income development, complete with an out-of-town shopping and entertainment mall. It is presumably dependent to a considerable extent on car-borne commuters to Jakarta, since there is relatively
little white-collar employment in the vicinity. We may assume that marketing has suffered recently, both because of the economic slowdown and its corresponding uncertainties, and because of the heavy congestion at the Jakarta end of the toll road, which would add an unacceptable length of travel time for many potential residents.

The developer has tried to encourage local people to stay in the area. LAP reports, however, that “this generally does not work: locals often prefer to use the money to move elsewhere; they don’t actually work in the development area; and they are unwilling to wait for the money as a partner of the developer who will not pay them until the final product is sold. There is also a risk that the development may not go ahead and no sale will take place.”

Development is managed by a consortium of seven companies, under the lead umbrella of the Lippo Group. The urban management company, set up by the development consortium, continues to be responsible for management of all the city’s infrastructure and facilities, until such time as the local governments express a willingness to assume responsibility themselves.

3.2.4 Tigaraksa

Status. Tigaraksa, some 55 kilometers west of Jakarta, was chosen as the new municipal capital of Kabupaten Tangerang. The reasons for this choice include the following:

- “To develop the western part of Tangerang District, since hitherto development tended to concentrate on the east side, at Ciputat and Serpong; and
- “To support the border region of Merak, Serang and Tangerang.”

This selection is consistent with the regional plan for Jabotabek, which envisaged the creation of a major, self-contained settlement in the west intended to take the pressure off the central sector, and from eastern Tangerang. The regional plan states that “Tigaraksa City will grow in order to become a center of development, with functions as governmental, commercial, settlement and industrial center.”
**Management Structure.** PT Panca Wiratama Sakti, a private development company, manages development. This company has a memorandum of understanding with the Tangerang government, by which the government agreed to assist the developer to obtain the location permit, provided advisory planning services, and will receive 45 hectares of land for the government office center, including the construction of the Bupati’s office and the Local Parliament Building.

At one point in the implementation process, the establishment of a Tangerang Development Team or (Tim Persiapan Pembangunan Kota Tangerang) had been proposed, comprising representatives of local government, the developer, and “a professional mediator able to harmonize the interests of both of parties”. The team was to be responsible for:

- regional planning;
- evaluating local spatial planning;
- assuring community participation; and
- assisting in the budgetary planning process.

We do not have information whether this team was actually created.

**Design Characteristics.** Tigaraksa is planned to have a population of 100,600 in 56,505 housing units (sic), by the year 2009. The total city area is 3,000 hectares, and it is planned to accommodate the usual commercial and social facilities, three universities, a “tourism area”, as well as local government offices.

Development of Tigaraksa has been relatively slow: the location permit was issued in 1987; it was extended in 1992, with conditions (including the establishment of a land acquisition committee); and was formalized in 1995, with the issue of Government Regulation No. 14/1995, which recognized the move of the capital of Tangerang to Tigaraksa. Krismon stopped all development by PT Panca Wiratama Sakti in 1997, although some construction of government offices, financed from the local government budget, continued after that date. At that time, development was estimated to have been about 40 percent complete. Fears have been expressed that, as a result of the cessation of construction, the town will merely turn into a commuter settlement.
The relatively slow speed of development was attributed to a number of factors, including substantial difficulties with land acquisition (due to uncertainties concerning land use rights and land tenure); and to poor access to water supply.

**Comment.** Lessons learned from Tigaraksa include the following:

- New town developments that are driven by social goals or by political interest are always less robust (less flexible) than developments led by market demand. The former are much more subject to failure if any of the project preconditions is invalidated. There are examples of less-than-successful new capitals from Asia (e.g. Chandigarh, the capital of the Indian states of Punjab and Haryana), Africa (e.g. Abuja and Dodoma, the designated capital cities of Nigeria and Tanzania, respectively), Europe (e.g. Newtown in Wales), and elsewhere. There are, of course, examples of successful political new town projects (such as Washington, DC, Canberra or Ankara), but these all required a greater degree of national commitment and financial capital than is readily available today.

- Development of a new town is a complex undertaking. Delays should be expected, and built into the process.

- Unless an emphasis is placed on the attraction of employment from the outset, most of the new housing is destined to be occupied by commuters.

- The establishment of an entity such as the Tangerang Development Team is totally appropriate for a new development such as a Kasiba, and should be emulated elsewhere.
4.0 EVALUATION OF THE KASIBA PROJECTS

4.1 Criteria for Measuring Achievements

We have assessed the projects summarised in Section 3.1 and 3.2 in order to analyse the effectiveness of regulations and procedures regarding Kasiba projects, and to make concrete recommendations to enhance project implementation in future. The following section draws on the lessons learned from equivalent projects in the United Kingdom. We set out to base the following assessment on the conceptual goals listed in Section 2.1. The criteria we sought to use were as follows (although we did not have full information on all these characteristics):

- Was Kasiba legislation used? Was it necessary (or would it have been helpful)?
- What management structure was adopted? What entities were represented on the Management Board? Who staffed the implementation unit? Did this prove to be ideal?
- Were project objectives spelled out in advance of project implementation? How did they compare with stated Kasiba objectives?
- How does the development now outside the Kasiba area compare with the prior situation, in terms of “urban sprawl”?
- How were the Lisibas contracted out?
- What income (social) groups were intended to benefit from the project, and which ones did actually benefit?
- Have the social and commercial facilities, and other employment facilities, been constructed in a timely manner?
- How did the speed of implementation compare with the plan? What caused the differences?
- What sources of capital were used?
- Has cost recovery proceeded according to plan? Have land value increases been captured? Has there been cross-subsidy to lower income housing?
- Have other (public sector) project objectives been met?

4.2 The Assessment

We have undertaken a summary assessment of the projects described in sections 3.1 and 3.2 above, for which we have a certain amount of information: Driyorejo (data based on a field visit by Pak Bob Sudjana Tantra), Parung Panjang, Bumi Serpong Damai, Lippo Karawaci and Tigaraksa. So far as we have data, these projects are evaluated against Kasiba criteria in table 4.1 below.
<table>
<thead>
<tr>
<th>Kasiba legislation</th>
<th>Drivorejo</th>
<th>Parung Panjang</th>
<th>Bumi Serpong Damai</th>
<th>Lippo Karawaci</th>
<th>Tidar Saka</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Planned, but not yet utilised</td>
<td>No: “Independent Lisiba”</td>
<td>No</td>
<td>No: “Independent Lisiba”</td>
<td></td>
</tr>
<tr>
<td>Management structure</td>
<td>Development consortium, with 60% of equity held by Perumnas</td>
<td>Perumnas expected to manage HMD</td>
<td>Private developer</td>
<td>Private developer</td>
<td>Private developer in conjunction with local government</td>
</tr>
<tr>
<td>Project objectives</td>
<td>New housing</td>
<td>Relieve pressure in Jakarta</td>
<td>Profit</td>
<td>Profit; demonstrate the potential of public-private partnership</td>
<td>New capital of Tangerang; create new focal point relieve pressure from east</td>
</tr>
<tr>
<td>Housing units planned/completed</td>
<td>75634/767</td>
<td>0 / 31,000</td>
<td>13,000 / 140,000 Planned 50,000 pop.</td>
<td>About 40%</td>
<td></td>
</tr>
<tr>
<td>Development outside</td>
<td>Has attracted new development</td>
<td>Not yet affected</td>
<td>?</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Lisiba contract method</td>
<td>“Kasiba” like, led by Perumnas</td>
<td>Planned to be led by Perumnas</td>
<td>Single developer</td>
<td>Consortium under umbrella developer</td>
<td>Believed to be single developer</td>
</tr>
<tr>
<td>Income groups benefiting</td>
<td>Extensive RSS/RS housing</td>
<td>Planned: middle and lower incomes</td>
<td>Upper middle, little RS housing</td>
<td>Upper middle</td>
<td>?</td>
</tr>
<tr>
<td>Facilities</td>
<td>Some facilities but not an employment zone</td>
<td>N/A</td>
<td>Extensive; integrated employment zone</td>
<td>Extensive; integrated employment zone</td>
<td>Government offices being developed</td>
</tr>
<tr>
<td>Speed of implementation</td>
<td>Established 1994</td>
<td>Delayed indefinitely</td>
<td>10% completed within 10 years</td>
<td>Conceived in 1990, implementation still proceeding</td>
<td>Location permit issued in 1987</td>
</tr>
<tr>
<td>Source of capital</td>
<td>Perumnas and 5 BUMN</td>
<td>Not specified: “low cost, foreign” funds anticipated</td>
<td>Private</td>
<td>Private</td>
<td>Private, with some local government funds</td>
</tr>
<tr>
<td>Cross-subsidy</td>
<td>Some</td>
<td>Some cross-subsidy implied, but not clearly stated</td>
<td>Probably not</td>
<td>Probably not</td>
<td>?</td>
</tr>
<tr>
<td>Implementation issues</td>
<td>Failure to acquire land, transportation development required</td>
<td>Transport links absent; no demand for housing; uncertain financing</td>
<td>Land acquisition issues</td>
<td>Local government refuses to take over infrastructure</td>
<td>Land acquisition; water supply</td>
</tr>
</tbody>
</table>
Of the five projects evaluated, two are designed to be Kasibas, and two have formally been described as “Independent Lisibas”; the fifth probably falls into the latter category.

The description “Independent Lisiba” seems to mean no more than that it is a settlement that conforms to the regional plan, but is implemented by a single entity. Insofar as most of their funding is private, they may be said to have mobilised new sources of capital. In other respects, the “Independent Lisibas” do not conform to the stereotype of Kasibas, notably in that they have provided little additional housing for low income households; have not provided any cross-subsidy; and have had little recognisable impact on informal development on the urban fringe. It is doubtful whether they have “captured the increase in land values in order to recover the cost of neighborhood infrastructure and facilities”.

Despite the poverty of evidence, we can, nevertheless, draw a few conclusions. That is:

• The private sector has proved capable of building self-contained new towns, at least in Jabotabek. They have had more limited objectives than true Kasibas. Although we have not had access to the original plans of these projects, it seems extremely probable that their speed of implementation has been much slower than was anticipated and, therefore, that “even” the private sector had overestimated demand prior to Krismon. Like the rest of the world, they were of course totally unprepared for the consequences of the economic slowdown of the late 1990s.

• Nevertheless, despite the slow speed of implementation, the project developers may, in some cases, have been able to withstand a drop-off in revenues because they have “unfunded” land reserves held under Location Permits. The costs may have thus been borne by existing landowners at least as much as by the developers. Since the rights of Location Permits have recently been constrained, private developers may no longer be able to afford to undertake similar large-scale developments in the future.

• Given the amount of land still remaining undeveloped in the three privately funded towns we examined, we suspect that there is little scope for additional new town developments in the near future, at least in western Jabotabek. Given the relatively low demand for housing in private new towns experienced from the large, rich catchment area of Jabotabek, we may expect demand for equivalent new towns to serve other (smaller) cities in Indonesia to be even lower.

• Parung Panjang has experienced fatal problems because its market potential was not properly researched. The public sector needs private sector market analysis skills at the concept stage.
• The land assembly problems at Driyorejo should stand as lessons learned. In addition, a feasibility study should be done to see whether the substantial funds needed for infrastructure and transport are an appropriate investment.
• The development of large new settlements is complex, and fraught with unforeseeable difficulties. The financial and implementation plans must be sufficiently robust to be able to withstand major shocks.
• The interests of concerned local governments should be fully reconciled with the town plan before implementation starts.
• It is vital to obtain the agreement in principle of the majority of existing landowners before a commitment is made to proceed with implementation.

4.3 Comparison with International Experience: the New Town Experience in Britain

Introduction. The preceding analysis finds that Kasibas are intended to take on many of the characteristics that the great social designers of the twentieth century intended for their new towns. Although new towns have been built in many countries, in many eras, by both the state and by private entrepreneurs, it is only in the last century or so that they have been designed to meet a range of public welfare objectives. The character of the planned new towns has altered over the course of the twentieth century. For example, financial and economic considerations have become much more prominent in the last two decades. Nevertheless, we find that the principles of the Indonesian Kasibas have so many similarities with the objectives of the British New Towns that it is worth briefly tracing the history of the latter. Towards the end of this section, we draw some conclusions relevant to the Indonesian context.

The British Experience. The British New Town movement developed towards the end of the nineteenth century as a reaction against the overcrowding and misery of the large cities. Rural areas were then “sunk in misery”. The father of the movement was Ebenezer Howard who, in 1899, founded the Garden Cities Association, the forerunner of today’s Town and Country Planning Association. His main ideas were to attain towns that:
• facilitated the planned dispersal of people and jobs, creating new towns of sufficient size to provide “the level of culture needed by a balanced cross-section of society”;
• were sufficiently limited in size that all residents would have easy access to the countryside and planned open spaces (hence the term “Garden Cities”); the towns were thus expected to be built at high densities, providing a contrast to the then-common suburban sprawl
• were well-planned, with the full range of social, cultural and commercial amenities expected at that time;
• were divided into neighborhoods, so as to facilitate social integration;
• for which the whole site to be under quasi-public ownership, so securing planning gain for the community as a whole, as well as facilitating planning control.

Howard had as much interest in social processes as urban form: citizens of “his” new towns would own the land in perpetuity; the towns would be managed on the basis of local self-government; and people would build their own houses with capital to be provided by building societies. The social activist Bernard Shaw wrote of Howard, “he was one of those heroic characters who do big things whilst our prominent wordlings [e.g. politicians] are explaining why they are utopian and impossible”.

Two new towns were, in fact, built on these principles—Letchworth and Hatfield. But a lack of capital prevented their large-scale replication. It was not until the Second World War (1939-45) that the ideas were taken up with enthusiasm by politicians, seeing afresh the need to deconcentrate people, and their jobs, from London. The period of the war saw the commissioning of several seminal reports in Britain that eventually led to the establishment of the post-war welfare state. One was Abercrombie’s Greater London Plan of 1944, which recommended that three-quarters of a million people should actively be encouraged to move out of London—around 10 percent of the total population. Among the most radical measures was to be the creation of eight new towns, each to house around 60,000 people.

The Plan was no more than that. It was, however, followed, in 1946, by passage of the New Towns Act. This was, indeed, visionary for its time. Lord Reith said that the new towns were to be “an essay in civilization”. Leslie Lane, Director of Civic Trust, later described new towns as “the greatest conscious program of city building ever undertaken by any country in history”.

The Act authorized the building of new towns by specialist bodies. Although it sanctioned their construction and management by public corporations sponsored by local governments, or even by “authorized associations”, in the event they were all implemented through the agency of New Town Development Corporations—bodies appointed by central government, with no local representation. Top down planning triumphed.
Equally lost in the 1946 Act was Howard’s original principle that the community should benefit from increases in land value as a result of the creation of the new towns. The Development Corporations themselves were, implicitly, to reap the benefit, although neither the financing nor the economics of new town development were much openly debated in those still-early years.

The Development Corporations were vested with extraordinary powers, over-riding those of existing local and other government bodies, although they necessarily had to cooperate with certain local authorities, such as those responsible for infrastructure or the provision of social services, and were empowered to contribute to these capital costs. The Corporations were, for example, their own planning authorities; they could build houses, commercial facilities, and industrial premises. Most importantly, they were able to acquire land compulsorily at existing use value.

The building program got under way shortly after passage of the Act in 1946. The new towns themselves came in for a good deal of later criticism—their critics saw them as places without soul, urban areas designed by architects reporting to financiers. One of the towns regarded as more successful, Milton Keynes, celebrated a major anniversary in 1992. That year, The Times described the town as “a memorial to a tradition of social engineering that must be seen as dead and buried. However, hardly to be mourned… Residents…found themselves in single-class towns with poor services and a lack of communal continuity vital to a humane neighborhood…” A survey of new towns by researchers from the London School of Hygiene showed anxiety neuroses running at double the national figure; duodenal ulcers were two and a half times as common as nationally.

To offset the received opinion about the bleak character of the new towns, the original Act was subsequently amended to permit it to encompass the expansion of existing towns. This was seen to be more likely to produce a town socially and culturally more at ease with itself than a completely new product; it was also assumed to be more economical in terms of cost person housed, in the sense that much of the physical infrastructure for the expanded town was already in place, underutilized. The intention was to increase the size of existing towns by around 150,000 people; the outcome was typically an expansion by 100,000.

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18 A theoretical exercise found the cost per person was least when the size of the existing town was doubled.
19 One of the authors of this report worked for an Expanded Town under the New Towns Act—Peterborough, in the English Midlands.
As it turned out, a total of 28 new and expanded towns were built in Great Britain. Their total population was 2.3 million (with a population of 0.9 million at the time of Designation). The biggest independent new town (i.e. not an expanded town) is Basildon, with a population of 158,000; the smallest, Newtown in Wales, with 11,000 people. Typically, the time from designation to completion of 90 percent of planned development was some 20 years. In total, the 28 new towns occupied 0.45% of the country’s land area, and provided 7.5% of all new housing built between 1951 and 1992. New towns were initially built to accommodate overspill population from London and, later, other large cities; and later for other purposes, including the provision of housing and support facilities for major new industries, or even the construction of new administrative centers.

Political principles in Britain had sharply shifted away from the type of social engineering and large public expenditures represented by the new towns well before the Thatcher era of the 1980s. Many of the public facilities were privatized, often with negative consequences for their users. Local opposition to the establishment of new settlements increased sharply (“the NIMBY effect”). The last new town was designated in 1970; and the last Development Corporation was closed in 1992. A Commission for New Towns was formed to take over the assets and liabilities of the Development Corporations when their work was complete; certain of their assets, including housing, was turned over to local governments.

Comment. The following questions should be asked:

- ‘Were the British New Towns successful?’; and
- ‘What lessons have been learned?’

The answer to the first question is ambiguous: they obviously did succeed in providing new housing, in towns that—despite the press reports—were usually well liked by the majority of the new residents. The older generation of new towns, in particular, provided housing for people who could not otherwise hope to buy in the freehold market. In that a high proportion of their residents moved from large cities, it may be presumed that they succeeded in reducing pressures on congested neighborhoods. A major success was in creating a balance between residence and employment. The Development Corporations generally succeeded in attracting new employment, particularly in the form of large

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20 NIMBY = Not In My Back Yard
industrial enterprises: they provided attractive inducements for employers, including housing for key workers, planning permissions, development advice, and ready-made factory premises. However, few small enterprises were created, and the new towns have a much smaller proportion of self-employed people than the national average.

The new towns were also successful in creating green spaces and good recreational opportunities; and the standard of public housing has been high. But, with a few exceptions, they have remained a cultural wasteland because (a) their often did not include any physical cultural elements, (b) promotion of “culture”, such as painting or theater on the part of the resident population, was not actively encouraged, and (c) the various elements of the incoming population, initially from very mixed backgrounds, had few cultural traditions or legacies in common. The communal integration and social balance desired by the early planners have remained elusive. Although the migrants to the new towns did include a mix of income groups and classes—the ‘self contained and balanced communities’ sought by the social planners—over the course of time, the new towns have become very much one-class communities. As Frederic Osborn, one of the founding fathers of the new town movement said, “people gravitate towards others of like social class and interest”.

It is equally clear that the new towns did not meet two of the main goals enunciated by Howard. The first of these goals was to facilitate and benefit from public participation. The absence of participation of existing local communities was perhaps the major shortcoming of the new towns: many were established in the face of opposition from established local governments, with little or no consultation of local communities by the corporations appointed by central government. No wonder that opposition to their creation grew as time passed.

The second of Howard’s goals that was not realized was to plough the planning gains back into the community. In fact, it is by no means clear who did gain—most probably, central government. The financing of the new towns was opaque, at best. They were funded by 60-year annuity loans. The first generation of New Towns showed a financial surplus only because they benefited from low interest rates; later ones had a financial shortfall. By 1967, the financial results for all 21 new towns then designated showed an overall profit of only £671,000 ($1 million at today’s exchange rate). Letchworth—a new town established on Howard’s original principles, founded in 1903—is the only one to be owned by the community; it did not see its first financial surplus until 1973.
Lessons for Indonesia. What, then, are the lessons learned from this experience, particularly insofar as they relate to Indonesia?

The later new towns were a public-private partnership, although the public sector took on some entrepreneurial roles with little success, and vice versa. The aims of each party should clearly be recognized. It is the responsibility of the public sector to look after the public interest, but it is not a good property developer. The private sector should build the houses, commercial and industrial facilities, and not pretend that it has a social conscience.

The planning, design, development and management of the new towns was an extremely skill-intensive process. Many of the best brains in the country in planning, architecture, social welfare and financial management were engaged in the development of settlements that housed fewer than 10 percent of new households. Even with this deployment of skill, the results were, at best, mixed. The development of new towns is not easy, and should be undertaken only when public sector skills are assured. A general principle is that new development must be simple in both concept and operation; and that the management system be efficient. However, as Albert Einstein was reported to have said, "everything should be made as simple as possible; but no simpler".

One of the more important aspects of the success of the British new towns was their ability to attract employment, and to maintain a good balance between employment and residence. This could only have been achieved by the existence of a strong Development Corporation, with the will and ability to provide sufficient incentives to provide a magnet for new employers.

The Development Corporations also had other powers that are probably not shared by the Kasiba Management Boards. The most critical of these is the ability to acquire all of the land for the new town compulsorily and at existing market value (often agricultural value). This power, which was accepted by the general population of the country as just and reasonable, added immensely to the robustness of the projects, and to the ability of the Corporations to start implementation quickly. Another power not shared with Indonesian Kasiba Management Boards is their authority to construct housing and other facilities.

One of the main disadvantages of the Development Corporation model was their isolation from the private sector, and from local government. A successful model, on the contrary, would engage private enterprise and locally elected people in the development and
management of a new town. We believe that new towns must be seen to benefit local
governments, as well as others with an interest in the locality.

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Most of the British new towns were completed close to schedule. This could be done only with a firm financial commitment from central government. Even when land was acquired at agricultural use value, the British new towns did not "make a profit", and may not even have broken even financially. They must be accompanied by a sound financial plan, and firm capital commitments from the outset.
5.0 CONCLUSIONS AND RECOMMENDATIONS

Introduction. Kasiba projects are essentially new town developments, built to meet specified public welfare objectives. There is a variety of welfare objectives, each of which, independently, is well conceived. We support each of them. From the present perspective of HOMI and, we believe, of Kimprawsil, the most significant is the mass provision of low- and middle-income housing and associated facilities. We emphasize low and middle income housing, because we believe that the private sector is capable of providing high-income housing in and around Jabotabek, and can provide middle- and high-income housing around other large towns. We also emphasize mass provision, because we believe that smaller programs can be implemented without using the Kasiba legislation.

We have seen that “true-Kasiba” programs have been slow to get off the ground in Indonesia, or have been overcome with difficulties. There are, however, several other large projects with some Kasiba-like elements, from which we have been able to draw certain conclusions. We have also seen that other countries have attempted to develop new towns with a “balanced provision of housing” (i.e. including low income housing), from which we have drawn other conclusions.

In general, we believe that the need for low cost housing and, in some areas, for middle-income housing, is such that Indonesia is correct to look for mass means of provision, as distinct from relying simply on accretion. In particular, with the likelihood that Perumnas will terminate its own (small) housing programs, it will become even more important to facilitate the private provision of low-income housing.

The Kasiba legislation is notionally well suited to facilitate the mass provision of housing by private sector or other developers, although we believe that a similar result could be achieved in the absence of this legislation. However, implementation—of both “true-Kasibas” and “near-Kasibas”—has proved to be very difficult. We draw two immediate conclusions:

- Unless more radical action is taken by local governments, especially with regard to land acquisition and assembly, there are likely to be very few opportunities for the development of new Kasiba schemes in Indonesia in the near future; and
• **Much more attention needs to be paid to planning the development of new Kasibas, including the preparation of feasibility studies, than has been the case in the recent past.**

We elaborate on each of these primary conclusions in sections 5.1 and 5.2 below.

### 5.1 Opportunities for New Kasibas.

If we accept that a primary purpose of Kasibas is the provision of lower cost housing, it follows that their implementation must benefit from the ability of the public sector to acquire land at low cost. Ideally, there should also be the opportunity for cross-subsidy, from higher- to lower-cost housing, and from commercial and industrial development to housing.

LAP\(^{21}\) has summarized necessary conditions for the development of Kasibas. We have adopted and amended the conditions, as follows:

- there should be potential for significant land price increases (i.e. the area has not been subject to intensive anticipatory speculation);
- the area has short-term development potential (i.e. it is reasonably close to a growing urban area, with good transport links; and with the potential for attracting industry);
- the area is generally undeveloped (i.e. limited built development can be incorporated into a scheme);
- development of the area would conform with overall planning strategies, both regional and local (i.e. local governments have accepted the responsibility for servicing and managing urban development in the future); and
- existing land owners are generally amenable to development.

However, as discussed in Section 4 of the Housing Market Report\(^{22}\), most of the land “with short-term development potential”, at least around Jabotabek, has already been allocated to private developers. By this, we mean that developers own this land, or that they hold location permits for the land, or that the land is held by IBRA for likely sale to developers. We believe that Indonesia’s developers are as astute and well informed as developers in any country, and that they have used all of the opportunities that Indonesia’s laws, regulations and customs have allowed them in order to acquire developable land. Put another way, we believe there is little land still available with “short-term development potential”. We believe that there is even less land available that has not been “subject to intensive anticipatory speculation”. In short, we believe that there may now be very few areas left around Indonesia’s cities that are suitable for development as Kasibas—unless further action is taken.\(^{23}\)

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\(^{21}\)LAP is the World Bank and AusAID-funded Land Administration Program, undertaken by Arcadis Euroconsult and PT. Pusat Pengembangan Agribisnis for BAPPENAS and BPN, completed in 2000.

\(^{22}\)See the HOMI Project Report “Improvements of Housing and Land Market Efficiency”

\(^{23}\)LAP believed, in 2000, that “there may be potential for 4 or 5 Kasibas around Jabotabek, 2 in Surabaya plus one each in Bandung and a few other selected high growth areas. Perhaps a total of 10 Kasiba could be argued for Indonesia as a whole”.

**Technical Assistance For Policy Development For Enabling The Housing Market To Work In Indonesia**
Kasiba Pilot Project. We recommend that an investigation should be started into the feasibility of establishing a pilot Kasiba, as described in the companion HOMI report on Kasibas. 24 This investigation would be structured so as to fulfill several objectives, including proving the feasibility of the management and implementation measures already proposed. As importantly, however, is that it will help to determine the extent to which developable land with potential for land price increases is still available. This may help to verify or refute our thesis that very few opportunities for new Kasibas currently exist.

Land Assembly and Development. We also recommend two further sets of action that would help release land for Kasiba development.

(1) The first is a recommendation that we have also made in the HOMI Housing Market Report. We recommend that local governments, with technical assistance from a central body, should consider the revocation of Location Permits from private or public developers that have not used them and that cannot demonstrate their ability to use them in the immediate future. (Location Permits are valid for one year, with the possibility of a further one-year extension. If all of the land has not been acquired within two years, the permit should be legally revoked by the local Land Office without charge.) This, and parallel actions would help to free up land that is otherwise blighted. The Housing Market Report (Section 4) gives more detail on the justification for, and the practicalities of, this set of recommendations.

• If the same local authorities see the need and the opportunity for the development of a Kasiba locally, they should simultaneously designate the newly available land as a Kasiba area, and, if appropriate, negotiate with developers holding the Location Permits to assure integration of their land within a Kasiba.

(2) Secondly, we believe that local governments should be encouraged to use all the powers presently available to them to acquire land suitable for Kasiba development, subject to confirmation by a pre-feasibility study. Acquisition should preferably be compulsorily and at existing use values. This includes use of PP No. 36/98 that “sets up a process for examining neglected land, liaison with the developer and determining future plans for the site. The legislation makes provision for the land to revert to becoming state land (at the original acquisition price by the developer) if no action is taken by the developer after 3 years”25

24 See Bob Sudjana, op. Cit.
25 Source: LAP
It may also be appropriate to utilize Law No. 13/80, which introduces the concept of “Dawasja” (Daerah Pengawasan Jalan / Restricted Road Reserve). This is a 30-metre reserve (the “Restricted Reserve”) on either side of the mid-point of a road. The “Dawasja” can either be used for development or as access to development behind it. This gives the acquiring authority the ability to control the planning of the whole area of land accessed by the road.

We also believe that it would be consistent with the Basic Agrarian Law for the Kasiba Management Board to use powers of eminent domain (compulsory acquisition) of all land within the area designated for the Kasiba. Article 18 of that Law allows expropriation of land under the following conditions:

- The land to be used to fulfill public interest;
- Expropriation to be accompanied by suitable compensation;
- Expropriation to be based on a Presidential Decree.

(3) We recommend that Kimpraswil determine whether powers of expropriation can be used by a Kasiba Management Board including possible introduction of special powers to be given to local governments for the purpose (to obviate the need for a Presidential Decree on each occasion). Kimpraswil should then seek to amend the Kasiba legislation accordingly.

(4) We are well aware that there is a cost to most of the above recommendations, to be borne either in the first instance by the local government and later by the Kasiba Management Board. However, Kimpraswil should ask local governments to consider setting aside the proceeds of the proceeds of PBB on idle land (again, see the HOMI Housing Market Report, Section 4.2) into a special low cost housing fund. They should also be willing to negotiate with distressed developers to receive “free” land in return—for example—for a time extension on Location Permits for which they have a realistic likelihood of being able to develop housing in the near future.

Capacity Building. We are also aware that most local governments do not have the capacity to enter into the detailed and sensitive negotiations that are implied by the above recommendations and, therefore, that their staff would need special training in the requisite skills.

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We therefore recommend, in addition, that Kimpraswil should request the donors to consider funding a project to train local governments, directly or through local government associations, in the principles and best practices of negotiation for land development for housing. Associations, such as APPSI (provincial government), APKASI (city government) and APEKSI (kabupaten) are expected to play a major role in the broad dissemination of improved practices for local government and encouragement of their adoption and implementation.27

5.2 Kasiba Design and Management

Next, we address the issue that more attention needs to be paid to planning the development of new Kasibas, including the preparation of feasibility studies.

We have seen, in Indonesia and overseas, that there is an indefinite number of reasons for the failure of Kasibas or other new town projects. These range from the mundane (difficulties of land acquisition), to the practical (failure to undertake a thorough marketing survey; premature privatization), to the unthinkable (Krismon). Very few public sector organizations anywhere in the world are capable of planning, implementing and managing development the magnitude of a Kasiba. We are not confident that any single public body in Indonesia possesses the capacity of developing a Kasiba, simply because of the range of skills needed.

Of course, many professional Indonesians do possess the necessary skills to become members of the Kasiba design team. Many of them are, however, within the private sector and expect to receive private sector remuneration. There are, as well, overseas organizations which already have the experience of developing large new settlements on behalf of governments; Singapore and Malaysia are cases in point. We strongly recommend that their expertise be tapped in the development of specific Kasibas, for their expertise to be passed on to Indonesians.

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27 USAID is specifically mentioned in this context because it already has in place several programs of assistance to local government and to several of Indonesia's new associations of local governments, including those of provinces, kabupaten, and kota. USAID also expects to put in place a new project to develop a foundation to promote local government management efficiency. This project is designed to develop improved management practices for local governments and develop a network of linkages to other institutions and resources that can provide practical, meaningful advice and models to local governments.
Such individuals or organizations could be utilized in two ways, simultaneously. One is as members of each Kasiba Management Board, working alongside representatives of public bodies. The Kasiba legislation states that the Management Board should be a BUMN (State Owned Enterprise), or a BUMD (Regional Public Enterprise), or another institution established by the government for this task—our emphasis. The Board should be a non-profit organization; there is no restriction on private companies being represented on the Board.

Our further recommendations include the following:

1. **Representatives of all interested local governments, and of experienced (and properly remunerated) private sector representatives with no direct interest in the outcome, should always be included on Kasiba Management Boards.**

   We are concerned that the Kasiba Law and its regulations imply that a Kasiba will necessarily (our emphasis) be within the area of a single local government. We believe that there will be instances where a Kasiba could properly overlap the area of different administrations (Lippo Karawaci is an example of a new town development implemented in two administrative areas).

2. **We therefore recommend that Kimpraswil issues a clarification—if necessary, by legislative amendment—that two local governments may jointly designate a Kasiba, and thus would both be represented on the Management Board.**

3. **The responsibility for planning and implementation can be contracted to a private firm or firms. The feasibility study and design of at least the first Kasiba should be procured from an experienced consulting organization, supervised by and responsible to the Kasiba Management Board.**

   It is possible that, if well designed, the contract with a consulting firm could be structured so that the firm’s fees are met from the proceeds of development. Otherwise, we believe that it would be entirely appropriate for a donor to meet the costs of the firm, since the outcome will be in the public interest—trained Indonesian staff, capable of managing later Kasiba developments, as well as a major new settlement that helps meet local low income housing needs.
(4) We therefore recommend that Kimpraswil should approach representatives of donor countries—particularly of countries immediately neighboring Indonesia—to seek their financing of a Kasiba feasibility and design study, as well as the management of its implementation.28

Finally, we see the need for a single, central, unit to take the lead in actively promoting the Kasiba concept—a Kasiba Oversight Unit. As noted above, responsibilities would range from seeking legislative amendments, liaising with private sector interests, negotiating contracts for a Kasiba pilot project, seeking donor financing, to ultimately providing advice and assistance to local governments.

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28 Including, for example, Australia, Malaysia and Singapore.
Annex to Section 3.2
The Financial Appraisal of the Parung Panjang Kasiba Project

As stated in the above text, the following comments are based on our reading of the “JICA Report” of 1999. We have not had access to the full financial appraisal report.

The analysis purports to show that, under two principal alternative scenarios, the internal rate of return (IRR) on the project would be between 6 and 7 percent, with the IRR on Lisiba development for low cost housing varying from 4 to 8 percent, and on Lisiba development for moderate housing from 12 to 13 percent. The cash flow is projected to turn positive in Year 4, with a net cash surplus (over the first five years) of Rp.4.5 billion (August 1998 prices).

However, project financiers would need clarification on several points, as follows:

Firstly, although the capital cost of constructing the infrastructure includes an (unspecified) amount for physical contingencies, the published summary analysis includes no sensitivity analysis. It would, for example, only need revenues to be 7 percent below forecast, or for costs to be 8 percent higher, for the project to run a financial deficit. Such a level of sensitivity is normally unacceptable for a project of this magnitude.

Secondly, we are unsure whether the expenses of project management have been included in the calculation, but suspect that they have been omitted. If this is the case, the project costs will have been understated by a significant amount.

Third, the calculation assumes a “low cost” loan, the payments for which have not been factored into the calculation.

Fourth, the financial appraisal appears to assume that land will be acquired at present-day prices, i.e. in the absence of good rail or other transport connections with Greater Jakarta; but that land will be sold on the assumption that these transport connections will have been put in place. Although these may be realistic assumptions, we doubt whether it is equally realistic to assume that there will only be a two-year interval between buying at low prices and selling at high prices.

Fifth, a related point, the physical plan appears to assume that, at least in the immediate future, most residents of Parung Panjang will commute to work in Greater Jakarta. There is, without doubt, demand for commuter housing. However, experience from overseas—together with common sense—suggests that the costs of commuting will tend to reduce the effective demand for housing, in the sense that people will be willing (and able) to pay less for housing than if they were employed locally and had lower transport costs to meet from their household budgets. In short, we suspect that revenue from house sales may have been overestimated.

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28 Interim Report of The Study on Land Provision for Housing and Settlements Development through Kasiba and Land Consolidation in Jakarta Metropolitan Area, Yachiyo Engineering Co. Ltd and Pacific Consultants International, for the Indonesian State Ministry of Housing and Human Settlements, and others, July 1999. The same analysis is repeated in other reports in the same series.
# ADDITIONAL REPORT NO. 2

## THE KASIBA PATTERN:

A LARGE SCALE LAND DEVELOPMENT FOR HOUSING AND SETTLEMENT

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A Special Report

By C3 - Expert

(BOB) SUDJANA TANTRA

THE KASIBA PATTERN
A Large Scale Land Development
For Housing and Settlement

Jakarta
Dec - 2001
The Government Regulation of the Republic of Indonesia

PP 80/1999
[30 September 1999]
on
Area Ready to Build on and Independently located Site Ready to Build on

KASIBA
LISIBA Berdiri Sendiri (BS)

CHAPTER CONTENTS:

Chapter I : General Regulation (Art 1)
Chapter II : Objective (Art 2)
Chapter III : The Implementation of Management of KASIBA and LISIBA BS (Art 3 - 7)
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Chapter VI : Organizing Kasiba and Lisiba (Art 30 - 42)
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HIERARCHY OF ACTS & RULES
Relating to the
KASIBA & LISIBA BS

CONSTITUTION 1945
Article 33, Sub 3
Land being Part of the Earth,
Has a social function complementary to satisfying
Basic need for shelter

Article 28 H (1)
Everyone is entitled to own …… a
Home and enjoy a good and healthy environment

(BAL) UU PA
5/1960
Basic Agrarian Law

UU 4/1992
Housing and Settlement

UU 24/1992
Spatial Planning

UULH 23/1997
The Environment
Art 5 : Same right on good and healthy environment
Art 6 (1) : Responsible to preserve the sustainable function of the environment

UU 4/1982
Managing the Environment

PP 80/1999
[30-09-1999 ; LN 171 ; TLN 3892]
Land Area Ready to Build on and
Independently Located Area to Build on.

KASIBA
with Lisiba inside and
LISIBA BS
1.0. OVERVIEW AND INTRODUCTION

2.0. THE KASIBA / LISIBA DEVELOPMENT PROCESS

2.1. The intended Goal of Kasiba / Lisiba
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3.1. Kasiba / Lisiba near Surabaya : Case Study of Driyorejo
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5.1. Goals for Urban Development
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5.3. Recommendations / Regulatory Changes

6.0. CONCLUDING REMARKS
1.0. OVERVIEW AND INTRODUCTION

Pursuant to the Housing and Settlement Act UU 4/1992 (10-03-92), the Government Regulation PP 80/1999 (30-09-1999) was issued. But certain aspects and items supposedly to be regulated therein, have not been duly detailed. Hence the need has been felt by some to have the Ministerial Decrees prepared relating to (Juklak) Implementation Directives and (Juknis) Technical Specification Directives. The time lapse of nine years between the promulgation of the Act and the Rule and its scope of applicability, after issuance of the Regional autonomy Act UU 22/1999 (07-05-1999) are also being queried.

However notwithstanding the absence of the Ministerial Directives from DepKimPrasWil and other related Ministries, large scale land development, (while minimizing costs and achieving economies of scale) can still proceed in preparing planned subdivisions and providing serviced allotments of diverse measurements, for an equitably built environment (Consistent with the Joint Ministerial Decree on 1 : 3 : 6 rule of 1992).

Objections to this rule by certain developers, have been dealt with by the very opinion of PusLitBang – Perkim (as in Citation) and by an estimate using a financial model of Bp.Haedar, who still demonstrated an IRR of 13,13% even while obeying this equitable proportion rule. The elaborations which follow, will attempt to approach the real truth.

Critics have been aired that due to large scale land speculation, rather than due to the negative impact of the monetary crisis, culminating mid 1997, the provision of land allotments stagnated and followed by increase of Land prices and decrease of house construction.

Another reason of stagnancy, was the (BI) Central Bank Decree No. 30/46/KEP/DIR. which restricted Credits by Banks, for the financing of Land acquisition and development that is still valid until at present [should this be cancelled soonest ?].

2.0. THE KASIBA/LISIBA DEVELOPMENT PROCESS

2.1. The Intended Goal of Kasiba/Lisiba

In meeting the increasing demand for housing and settlement, development of large scale settlement area through the provision of land ready-to-build-on and serviced allotments, that are matching the Regional Spatial Planning (RTRW) of the Kabupaten (Regency) and the “Kota” (City) is primarily to inhibit land speculation and to improve efficiency in providing and utilizing land, infrastructure and environmental facilities as well as the public utilities.

[Art 2] Objective: The Management of Kasiba aim, is the provision of one or more Lisiba, installed with primary and secondary environmental infrastructure, as well as meeting the required service infrastructure, environmental facilities and public utilities for the development of Housing and Settlement, in accordance to the Regional Spatial Planning.

The Goal of Managing Lisiba as part of a Kasiba or as Lisiba BS, an independently located built environment, is the provision of serviced land allotments and houses
according to balanced settlement environment planned and affordable to all strata in Society. *(Refer to citation on the 1 : 3 : 6 rule)*.

2.2. A Summary of the intended process of Kasiba/Lisiba

Implementation development of the large scale settlement areas, which is to be comprehensively integrated and coordinated with the development program of the Region comprises of the preparation of “Kasiba”, land area ready to build on and “Lisiba - BS” an independently located environment ready to build on.

*Pola Kasiba – (6A) – depicts the Summary diagrammatically in next page*

2.3. Recommendations / Regulatory Changes :

- When preparing the usual Ministerial Decrees *Juklak* and *Juknis*, as stated in Art 4 (4) of Government Regulation (PP 80/99), further conditions on the operational procedure for the Management Council of Kasiba as mentioned in Art 4 (1), shall be elaborated.

- [Art 3 (1)] The Management of Kasiba shall be performed by the Government while the Management of the operations shall be entrusted to a Management Council (MC).

- [Art 3 (2)] This MC shall be a BUMN (SOE) and or another legal entity (i.e. Otorita) formed by the government with duty as MC and including BUMD (Regional Government Owned Enterprise).

- *In order to respond to the objections raised by some group in the private sector, that the MC shall be either BUMN or Otorita/BUMD, clarification has to be given that Art 3 shall be read in conjunction with Art 36 (2) which permits MC to establish Cooperation (JV) with (unspecified) corporate enterprises which are operating in the field of development of housing and settlement. Actually ownership of a corporate entity shall be considered as “colorless”. What critically matters, is the professional ethics and managerial skill, in addition to the organization’s qualification stated in Art 4 (3) a.*

- [Art 7 (7)] Also requires detailed conditions on the procedure for Operators of Lisiba as mentioned in Art 7 (4).

* For all the above and the following paragraphs, Decrees from the Minister of Dep. KimPrasWil and other Department, are still required.
Technical Assistance For Policy Development For Enabling The Housing Market To Work In Indonesia

PP80/99 - Pasal 3 (2): "Pengelolaan Kasiba dilakukan oleh Pemerintah dan diarsanakan oleh BUMN atau Badan Lain (BUMD)"

BADAN PENGELOLA [(SOE) Management Council]

[3000-10,000 House Units]
Kawasan Siap Bangun
(Land Area Ready to Build on)

In Compliance to
RTPL
As Stipulated
by the
Regional Head

PRIVATE INVESTORS AND
DEVELOPERS WELCOME

Reality Developed for the large scale Development of Housing & Settlement

PP80/99 - Pasal 9: "Pernah naus memperhatikan jumlah unit rumah seperti tercantum di atas.
(The regional government shall observe the number of house units, as shown above)"

PUBLIC FACILITIES
Fasam

LSIBA
1000 - 3000

LSIBA
1000 - 3000

LSIBA BS
(Independent LSIBA)
1000 - 2000
House Units

Terdiri atas
Kaveling
Tanah matiing
Serviced
Allotments

PUBLIC FACILITIES
Fasos

Provide with
Secondary Infrastructure

Provide with Primary Infrastructure

Social Facilities
Fasos

In Compliance to
RTPL
As Stipulated
by the
Regional Head

PRIVATE INVESTORS AND
DEVELOPERS WELCOME

Reality Developed for the large scale Development of Housing & Settlement

PP80/99 - Pasal 9: "Pernah naus memperhatikan jumlah unit rumah seperti tercantum di atas.
(The regional government shall observe the number of house units, as shown above)"
- [Art 10 (4)] Similarly a regulation on the criteria and technical specification for preparing the detailed spatial plan for the land area mentioned in Art 10 (2) a, will be arranged by the Minister responsible for Spatial Planning.

- The Minister of Home Affairs (previously Agraria) Head of BPN will arrange land consolidation in accordance to Art 13 and Art 22 as well as will determine the compensation value referred to in Art 24-25-26.

- [Art 52 (3)] The Minister of KimPrasWil will determine furtheron, the procedure for organizing and submitting the reports (by the regional head to the Minister) as stipulated in Art 52 (2).

- [Art 55 (2)] Counseling will be done by the following Ministers of KimPrasWil for items a and c and Minister of Home Affairs (Agraria/BPN) for items b and d.

- [Art 56 (1)] The completed infrastructure and environmental facilities which function to serve Kasiba, Lisiba or Lisiba-BS, shall be transferred to the Regional Government.

* Perhaps the zoning and percentage range of various reserve and built-up areas: greenbelt, CBD or Housing Areas and the respective densities, as illustrated in next page 7A, may be also added.

3.0. KASIBA / LISIBA PROJECTS IN INDONESIA

3.1. Kasiba / Lisiba near Surabaya: Case Study of Driyorejo

The development of a new metropolitan initiated in 1995 was considered a trial execution of the Housing & Settlement Act. UU 4/1992 and the then anticipated relevant Government Regulation PP 80/1999 on Kasiba and Lisiba (30-09-1999) However, the project brochure describes that it will contain a Lisiba and 67 Sub – Lisiba each of 25 – 50 Ha. Actually this latter subdivision is unknown and not mentioned in the respective Act/Rule?

The location is in South Gresik Regency (Kabupaten), 10 Km from Surabaya (The Capital of East Java Province) from which a connecting highway through Driyorejo is leading to the industrializing town of Mojokerto.

The original Area is 860 Ha to which 5 surrounding villages will be integrated, to form the new Metropolitan of DRIYOREJO measuring total 1.000 –1.200 Ha.

- The Master plan (as prepared by the Consultant Consortium: PT. BINA KARYA & PT. CIRIAJASA) correctly includes:

  Housing (Small – Medium – Large) – CBD: (shopping/trade centers, offices, educational centers), Social – Public – Sport and Health Facilities, Hotel, Shop Houses/Office Houses, Green belt & pond, as well as a Golf Course (seen only in the Maquette but not in the brochure?)
### The Alternatively Proposal Proportions, and Areas of Reverse and Built Environments

**Based on The Financial Model for urban Planning by Tubagus Haedar Ali**

<table>
<thead>
<tr>
<th>Kawasan Lindung (Reserved Spaces)</th>
<th>Max 5 Ha</th>
<th>5 Ha</th>
<th>5 Ha</th>
<th>Land / Area</th>
<th>Population 16,000 person</th>
<th>Density 101 Persons/Ha</th>
<th>Alotments 3256 units @ allotment size M²</th>
<th>Total Number of Houses 3912 units unit @ floor area M²</th>
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<tbody>
<tr>
<td>PERDESAAN</td>
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<tr>
<td>Residential Zoning Ha.</td>
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<td>23.46</td>
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<td>FASOS</td>
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<td>Simple</td>
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<td>21.32</td>
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</tbody>
</table>

The Recommended Specifications to be incorporated in the Sanks may ideally also follow, eventually after updating and improving certain sections / sketches, the following Public Works Ministerial Decrees:

- No. 50/KPTS/1996: Technical guideline for the Construction of simple low – rise houses
- No. 01/KPTS/1998: Technical guideline for the development of Ready to Build Alotments
- No. 54/PRT/1997: Technical Directives for the construction of very simple houses
- No. 60/PRT/1992: Technical specification for the construction of high rise buildings
The Developers undertaking this project, consist of Perum PERUMNAS and a consortium of the 5 well known SOEs in the engineering/construction field.

<table>
<thead>
<tr>
<th>Box 1:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LIS 18A – PERUMNAS</strong></td>
<td>203 Ha, Built</td>
</tr>
<tr>
<td><strong>1.1. Houses</strong></td>
<td></td>
</tr>
<tr>
<td>RS 21</td>
<td>1371 units</td>
</tr>
<tr>
<td>RS 36</td>
<td>786 units</td>
</tr>
<tr>
<td>RS 21</td>
<td>496 units</td>
</tr>
<tr>
<td>RS 36</td>
<td>1701 units</td>
</tr>
<tr>
<td>RS 45</td>
<td>381 units</td>
</tr>
<tr>
<td><strong>4716 units</strong></td>
<td><strong>53 units</strong></td>
</tr>
<tr>
<td><strong>1.2. Shop houses 4 units</strong></td>
<td></td>
</tr>
<tr>
<td>Serviced land allotments 5236 units</td>
<td></td>
</tr>
<tr>
<td>Social Facilities constructed 8 units</td>
<td></td>
</tr>
<tr>
<td>Prayer Centers (Mosques) 6 units</td>
<td></td>
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<tr>
<td>Market Place 1 unit</td>
<td></td>
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<tr>
<td>Kindergarten &amp; Primary school 1 unit</td>
<td></td>
</tr>
<tr>
<td>Food Centers (Pujasera) 3 units</td>
<td></td>
</tr>
<tr>
<td>Medical Clinic 1 unit</td>
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</tr>
</tbody>
</table>

Box 2:

According to the Information Memorandum obtained from the VSO – KASIBAD YCREDO,
the basic data highlights per 20-02-2001 are as follows:

**LAND:**

1. Izin Lakes | 200 Ha – Pemda TKI | 22-12-1996
   (Location permit) | 800 Ha – Pemda TKI | 10-03-1991
2. Land Clearance | Total Target 685.7 Ha
   Performed 74.2% 487 Ha – not yet done (25.8% 188.7 Ha
   integrate since Nov 1997, due to the Monetary Crisis)
3. Master Certificates | HS 352/33 Ha – Phase I
   HPUC 357.4 Ha – Phase II

**FINANCE:**

Equity Capital | Rp. 30 Billion from the 5 KSO Members
Medium Term Note | Rp. 20 Billion, which matured in September 1998,
may have been converted to GOI Equity?

KSO:

Institution: Formed on 12/12/1994 between Perum Perumnas and the
consortium of 5 SOEs: Wijaya, Wasita, Hulara, Adhi, and
Nindya Karya (s)
3.2. Other Examples:

3.2.1. [LIPPO] KARAWACI (West Java)

The land area of 3,000 Ha, is located in Tangerang. Accessible via the busy Tol Road: Jakarta – Merak.

The “Fasos & Fasum” comprise of a large Supermall, Siloam Gleneagles (Int’l) Hospital, School and University Pelita Harapan. The houses being built include Town Houses, low rise houses, detached luxurious houses.

3.2.2. BSD SERPONG

A block of 6,000 Ha of marginal land in the rolling hills of Serpong, 13.1 Km West of Jakarta, was earmarked for this development project since 16-01-1989. BSD is a landmark achievement. The master plan of this large modern city was designed by a consortium of Japanese Consultants, lead by PCI and revised by Doxiadis Associates at Athens; CBD was designed by John Portman & Associates, USA and BSD Sports Centre and Central Park by Aspinwall Clouston, Singapore.

BSD adheres to a set of principles based on the five key elements of self-contained city: Housing for quality living – Prestigious and Hi-tech Business and Industry – Social and Public Facilities from Birth to Autumn years - Infrastructure for the 21st century - Social and Environmental Awareness.

The city is due for completion in 2014 by which year; it is projected then to have 140,000 houses and a population of 600,000 people.

Since 1996, the CBD and Techno Park are being developed too. “BSD is a place for people to live, work, visit, shop, study and enjoy life in a comfortable, convenient, secure and inspiring environment” The Progress Report (4 pages) of BSD 1989 – 1999 is in the Appendices. (BSD – Bulletin)

3.2.3. ALAM SUTERA (Tangerang)

This well planned housing development area, directly located adjacent to BSD, is divided into clusters, with low-rise detached and two level houses of diverse attractive design.

Makro whole-sale supermarket is next door; while the mini market, Int’l School St. Laurensia, Sport center and recreational center, are located inside the complex. [www.alam-sutera.com]. Price per May 2001 are:

(Alope) Low-rise; 170/108; 4 Room; Rp. 307,080,000
(Clivia) two-level; 170/146; 5 Room; Rp. 385,200,000
3.2.4. PARUNG PANJANG (Bogor)

It is located 35 Km from Jakarta and although part of Bogor Regency (in West Java Province), it is closer to Tangerang Regency. This new town is planned to become a “Buffer City” to Jakarta. Its current population of 10 million, is projected to doubles in 2003. Perumnas has commenced building affordable houses for the middle to low income households. Location permit of Perumnas covers 600 Ha; but of which only 200 Ha has been cleared. Approx 3014 units low Cost Houses (RS/RSS) have been built. Other developers which have commenced building earlier include PT. Masa Kreasi 125 Ha; PT. Taman Mekar Sari 200 Ha. Ciputra Group Planned to develop 500 Ha. Access Road from the main road from Jakarta is not completely sealed. Many of the completed low cost houses though may have been sold, are vacant and several are badly vandalized. Many inhabitants are commuting to their work place in Jakarta, since local work opportunities are still scarce. The train frequency to Jakarta v, will be increased only as transportation demand rises.

<table>
<thead>
<tr>
<th>Box 3 :</th>
</tr>
</thead>
<tbody>
<tr>
<td>The low-cost houses built by Perumnas Region III in Parung Panjang ready for immediate occupation are as follows:</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>House Type</th>
<th>Construction of Houses</th>
<th>Sales of Houses</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sector I</td>
<td>Total (Sold Stock)</td>
</tr>
<tr>
<td>1. RS 21/60</td>
<td>369</td>
<td>332</td>
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<tr>
<td>2. RS 336/84</td>
<td>531</td>
<td>975</td>
</tr>
<tr>
<td>3. RI 21.04</td>
<td>-</td>
<td>1304</td>
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<tr>
<td>4. RI 21.90</td>
<td>-</td>
<td>427</td>
</tr>
<tr>
<td>5. RS 36/98</td>
<td>182</td>
<td>399</td>
</tr>
<tr>
<td>6. RS 45/120</td>
<td>4</td>
<td>-</td>
</tr>
<tr>
<td>7. RS 54/153</td>
<td>61</td>
<td>24</td>
</tr>
<tr>
<td>8. RS 70/187</td>
<td>-</td>
<td>2</td>
</tr>
<tr>
<td>9. RUKO 85/90</td>
<td>-</td>
<td>10</td>
</tr>
</tbody>
</table>

**Total:** 1143 | 3477 | 62 | 672 | 4312 | 360

3.2.4. MARTUBUNG (North Sumatra)

This large scale land development for housing is located North of Medan (the Capital City of North Sumatra) and it is well consistent with the RTRW of the Medan municipality. The land areas of Martubung I: 106 Ha, II: 130.05 Ha & III: 40.8 Ha. [=276.85 Ha.]

Strategically located along the Tol Road: Belawan Port – Medan – Tanjung Morawa and flanked by two: Industrial Estates (KIM 1000 + 1500 Ha). Construction of low-cost houses has been performed by Perumnas (Region I) on 70 Ha. Area.
3.3. Recommendations/Regulatory Changes

Most, if not all, of the large scale land developmental works, have commenced primarily based on the Act UU 4/1992 (10-03-1992) and long before the issuance of the relevant (Kasiba) regulation PP80/1999 (30-09-1999) Therefore, all conditions stipulated in the articles of this very Act, shall logically be followed.

(Art 19) 1 - The regional government determines one part or more of the settlement area according to the spatial plan (RTRWK and RTRW) which meets the conditions of the ready - to - build - on, environment.

2 - It shall minimally include the provision of:
   a. Detail spatial plan (RTRR) – [refer also to Art 19 (2) – UU 24/1992].
   b. Data on the sizes, boundaries and land ownership.
   c. Primary and secondary environmental infrastructures.

3 - Regional Development program and Sectoral Development plan regarding infrastructure, environmental facilities and public utilities are partly geared toward supporting the establishment of the ready - to - build - on area.

4 - The implementation of the above stipulations shall be regulated in a Government Regulation (PP).

(Art 23) Housing Development performed by corporate entities in the field of housing construction, shall only be constructed on the ready – to – build – on areas within an independent ready – to – build environment.

Non – compliance [to its Art 7 (1) – Art 24 – Art 26 (1) – Art 12 and Art 13] shall be considered a criminal offence subject to jail term and or fine up to Rp.100 million.

(Chapter III)
The criminal offence rules, necessarily have to be observed, are in Art 36 and Art 37 of UU 4/1992.

In preserving a sound environment, the Law of Spatial Plan UU 24/1992 shall also be observed.

(Art 19) The spatial plan consists of:

   a. RTRW – National;
   b. RTRW – Province;
   c. RTRW – Kabupaten / Kota Madya (KKM)

(Art 22) (1) Concerns:
   a. The objective of (c) RTRW – KKM which is to improve societal welfare and defense / security;
   b. Structural plan and utilization pattern of space in the Kabupaten / Kotamadya.
   c. General spatial plan of KKM
   d. Guidelines on control of the utilization of space in KKM

(2) Comprises of:
   a. The Management of Reserve spaces and Built Environment.
   b. The Management of village, city and special environments.
   c. System of development activities and settlement of villages and cities.
4.0. EVALUATION OF THE KASIBA PROJECTS

4.1. Criteria for Measuring Achievements

The criteria has naturally to be set out clearly beforehand, towards which the achievements at any phase shall be measured. Generally, measuring performance is not simple! Across the organization, several methods are known to be applicable such as: US-based Malcolm Baldrige criteria, European–Business Excellence Model, Safety Health Environmental assessment method, Quality Award Criteria.

The internationally known certificates of quality management system ISO 9001 : 2000 and ISO 14001 for urban environment, shall also be considered.

From the Socio–Economic legalistic point of view, measurement tools and techniques have to be adequately selected and deployed, in order to ascertain viability of the project and assess compliance during the physical implementation.

The Planning has naturally to comply not only with the prevailing legislation / regulations such as the articles of Act UU 4/1992 and Rule PP 80/1999 as well as the prospective Juklak and Juknis, but must also match the spatial plan Act UU 24/1992 and particularly, i.e. (RBWK) Partial Municipal area plan (City Plan) and Detail Spatial Plan of the Kabupaten (Regency) [RRTRW – K].

The Project proposal shall be in the form of a [Pre] – Feasibility Study, producing a stream of annual Revenues, resulting in a NPV $> 0$.

The investment appraisal (if IRR = i x 100) shall conform to the following formula:

$$NPV \geq 0 = \frac{CF_0}{(1+i)^0} + \frac{CF_1}{(1+i)^1} + \frac{CF_2}{(1+i)^2} + \frac{CF_3}{(1+i)^3} + \ldots$$

A (housing market) marketing survey shall always precede and be performed completely, in order to select the appropriate project size and site, as well as to ensure successful acquisition of both equity and debt capital and furtheron to facilitate the implementation of its social marketing.

4.2. Comparison with International Experience

Generally, sprawl shall be actually contained though not possible to inhibit, by effective urban planning which shall be matching the increasing urbanization phenomena, especially in metropolitans of many developing countries.

The immediate impact of urbanization to larger cities, is not merely population and density increases, but also continuing increased demand for land and shelter as well as public utilities.

The urban growth shall be planned, guided and controlled by the spatial plan, otherwise sprawl and abundant “RULIs” (Rumah Liar = Wild Housing) and “PKL” (Pedagang Kaki
Lima = Pedestrian walk vendors) as recently found abundantly in Batam, will indefinitely flourish.

Urban Renewal Authority (URA) usually manages the renewal plan of the commercial districts, zoning and related expansion activities. This authority normally invites private developers to tender while submitting appropriate design and allocates project sites to highest bidder with best architectural design.

Housing and Urban Development Corporation (HUDC) undertakes the physical implementation and or permits international private developers to tender, finance and construct, after paying prime land prices and development costs.

Another Housing Development Board and or National Housing Corporation, centrally controls the housing land acquisition and development, manage design as well as construction of the project with standardized low and high rise housing units, being executed by preselected, qualified international / domestic contractors.

During the agreed warranty period of say 5 – 10 years, after completion, all repair is to be performed by the estate management, usually kept by the builder, which will then turn it over to the principal / owner, upon its expiry.

4.3. Recommendations / Regulatory Changes

No Rule without sanction will be an effective regulation. Furthermore, non compliance without enforcement and penalties accorded to, is not quite logical. Therefore, if the Juklak and Juknis from Dep. KimPrasWil and other ministerial decrees from related departments are being formulated, sanctions against non-compliance and relevant penalties / fines shall be adequately fixed and seriously contemplated.

A newly reoriented Urban Development Corporation may be well supported by a National Housing Corporation. If an Urban Authority is established as a “Perjan” (Perusahaan Jawatan) with prime emphasis on public service rather than financial gain, the two corporations can be respectively taking the form of “Perum” (Perusahaan Umum) and “Persero” (Perusahaan Perseroan) with escalating interest in financial gain, though, without neglecting care for appropriate public services.

The scope of “Kasiba” (Kawasan Siap Bangun), the large scale land development for housing and settlement, implies design and construct of a new City, in some six larger provinces; While that of a “Lisisba-BS” (Lingkungan Siap Bangun – Berdiri Sendiri) the independently located environment ready to – build – on, implies design and construct of a new Town in much more numbers of thinly populated provinces.

Considering many of the newer cities and or towns are not necessarily complying to all the prevailing legislation and regulations, corrective and progressive actions shall be encouraged to be duly taken by all actors and authorities.
5.0. DESIGN OF A PILOT KASIBA

5.1. Goals for Urban Development

Both New Urban Planning and Urban Renewal Development shall always be directed towards improving the liveable built environment, in accordance to prevailing directives and standards for all people of varying income brackets.

The ultimate aim is an environmentally friendly housing complex not only provided with sewerage, drainage, infrastructure, public utilities, security, and sewage treatment plant, but also being conducive toward enhancing a harmonious community culture.

As the middle and upper income brackets are already well served by the private developers, the tasks of all the publicly oriented organizations (such as: URA, HUDC and NHC) shall be utmost concerned with serving the more disparaged people in the lower – middle and upper – lower income brackets.

Furtheron, those with irregular and low income people as well as the 48.4 million people now still below the poverty line, may eventually also await special attention and meaningful assistance, when the urban developmental efforts are successful.

5.2. Design Criteria

Determination up-front of the Design Criteria shall necessarily differentiate the regulatory standards (as to be stipulated in the Juklak) and the technical specifications (as to be compiled in the Juknis) to be complied to. This latter needs not so urgently to be compiled, because all standard specification in all engineering fields, such as for road construction, concrete structures (PBI – ASTM); M & E installation, etc. are abundantly available, though scattered, but well known to all engineering consultants and contractors.

However the Juknis shall incorporate updated standard, directives and technical specifications / guidelines which are described / sketched in the Various Public Works Ministerial Decrees as follows:

No. 20/KPTS/1986 No. 01/KPTS/1989
No. 54/ PRT /1991 No. 60/ PRT /1992

Supervision and quality control are important for due compliance! The proposed Juklak may determine the necessity of the “Amdal” study (Environmental Impact Study), Project feasibility, the assorted allocation of spaces for reserve and diverse Built environments, the maintenance procedure and estate management, in addition to due observance of all legislations / regulations.

Naturally, the sufficiency of IRR and ROI are important; however most relevant is the positive stream of annual income (NPV \( \geq 0 \)) of the project. Furtheron, compliance to the equitably built environment according to the 6 : 3 : 1 rule, shall be dictated, although variations of low and high rise building shall be simultaneously allowed.

Standardization of mayor building components shall be introduced and followed, in order to minimize wastages and production costs, while simplifying construction.
5.3. Recommendations / Regulatory Changes

The cost reductions to be sought, shall commence right from the land subdivision and development; continued with standardizing building components and adopting modular design; perform effective (mass) construction technique, project management and estate management.

This latter is very important in preserving the appearance and maintaining the state of repair and value of the housing estate. Therefore, the “Fasos – Fasum” to be transferred and handed over to the Regional Government [as stipulated in Art 56 (1) – PP80/99] shall be reviewed.

Ideally after eventual transfer of title, the Regional Government shall appoint the Management Council to continue managing and maintaining them [C3 – Expert’s Comment].

According to earlier design studies, the cost increases as the width of the land allotment increases; consequently, the most cost effective land & house unit, is the row house and duplex, where land and infrastructure uses are optimal.

Construction traditionally generates plenty of material wastages on site and requires much labor and time.

Prefabrication of certain building components will rationalize use of materials and shorten construction time, while improving quality. In order to explore new methods, collaboration with the PusLitBang of KimPrasWil in Bandung will be mandatory in exercising a pilot project.

6.0. CONCLUDING REMARKS

The large scale land development for housing and settlement will minimize development costs and become economical.

The value of the formulated strategy contained in PP 80/1999 can not be measured before it is implemented. Therefore a pilot project of Kasiba and or at least of an independent Lisiba-BS in the Jabotabek area, is highly recommended. Without dissemination, especially to the Bupati’s (Regents) and Walikota (Mayors) in the densely populated metropolitans with heavy urbanization trend, and successful implementation, that strategy is but a fantasy.

These promotional activities and eventual technical assistance, shall best be undertaken by a Kasiba project management unit at DitJen Perkim.

The management council’s performance is not so much a result of the Kasiba’s strategy, but of the MC’s capabilities to effectively carry out that strategy.

Successful strategy depends on having in place, the right organizational structure managed by a competent MC, due resource allocation, adequate construction and end financing programs, clear management information system and a conducive organizational culture.
The following matrix depicts the four probable alternative outcomes of the varying combination of the strategy formulation (horizontal axis) and strategy implementation (vertical axis) activities.

<table>
<thead>
<tr>
<th>Good Successful</th>
<th>Doubtful</th>
<th>Strategy Formulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Good Problem</td>
<td>Failure</td>
<td>Implementation</td>
</tr>
</tbody>
</table>

Can these funds be considered as State equity and managed by the Kasiba MC, being a SOE?

The private developers of the Lisiba shall be held responsible for the reimbursement of relevant infrastructure costs, to be incrementally completed by proportional annual installments in which compound interest is calculated based on the illustratively guiding formula.

If at initial year Yo, the price was Po Rp. 110, then installment payments made annually in subsequent years, shall be calculated at least with compound interest.

\[
Y_1 = P^1 = \text{Rp 110 x (1.16)}^1 = \text{Rp.110 x 1.160} = 127.60 \\
Y_2 = P^2 = \text{Rp 110 x (1,16)}^2 = \text{Rp.110 x 1,3456} = 148.02 \\
Y_3 = P^3 = \text{Rp 110 x (1,16)}^3 = \text{Rp.110 x 1,560} = 171.69 \\
Y_4 = P^4 = \text{Rp 110 x (1,16)}^4 = \text{Rp.110 x 1,809} = 199.06 \\
Y_5 = P^5 = \text{Rp 110 x (1,16)}^5 = \text{Rp.110 x 2.098} = 230.83
\]

The Kasiba Project shall include well built standardized modular housing of various designs, row and townhouses, low-rise and duplex, though still meeting the 6 : 3 : 1 Rule, but eventually also rental low-cost houses and walk-up apartments as well as the supporting environmental infrastructure, public facilities, CBD area, clinic, sewage treatment plant and refuse bin center, fire hydrants and extinguishers.

The MC may initially consider hiring a professional estate manager as trainer, prior to having the Kasiba managed directly by own in-house staff.
An appeal may be lodged to the Head of the Training Center for Construction Services [Puslatjakons] to also consider teaching courses on professional estate management and building maintenance services.

*Badan Pengembangan SDM – Pusat Pelatihan Jasa Konstruksi (Puslatjakons)*
Departemen KimPrasWil.
Jl. Sapta Taruna Raya – Kompleks PU – Ps. Jumat,
Jakarta 12310 – Tel. 7656512

It may be certainly advisable to also consider the very detailed study and recommendations concerning Kasiba / Lisiba, as performed earlier under the auspices of JICA.

The Recommended specifications to be incorporated in the *Juknis* may ideally also follow, eventually after updating and improving certain sections / sketches, - the following Public Works Ministerial Decrees:

- **No. 20/KPTS/1986**: Technical Guideline for the Construction of simple low – rise houses
- **No.01/KPTS/1989**: Technical Guidelines for the development of Ready – to – Build allotments
- **No.54/PRT/1991**: Technical Directives for the Construction of very simple houses
- **No.60/PRT/1992**: Technical Specification for the Construction of high rise buildings.

In finalizing the relevant ministerial decrees, especially the *Juklak*, Review of the criteria and directives in the RP4D and the stipulations in the Regional autonomy Acts UU 22, UU 25 and UU 28 all of 1999, may also be considered.

*The Pedoman Penyusunan Rencana Pembangunan dan Pengembangan Perumahan dan Permukiman di Daerah (RP4D), m e a n s : The guideline for preparing the construction and development of housing and settlement in the Regions.*

*Note : The tentative program and schedule of the proposed workshop on the promotion of Kasiba Pattern, are as attached sheets 18 A & 18 B, for proviso information and consideration.*
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Attachments

1. Interview List
2. Mortgage Insurance Example
3. Aging Analysis Graph
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   Variable Values
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INTRODUCTION

Mortgage Insurance is a credit enhancement product used by several countries to lower the down payment requirements for moderate and lower income borrowers. The credit guaranty benefits the lender (Banks) in that it will reduce their incurred loss in the event of borrower default. The purpose for studying the feasibility of using mortgage insurance in Indonesia is to provide an incentive for the Banks to make loans of less than 50,000,000 Rp to the moderate and lower income segments. Mortgage insurance can be used with other subsidies, such as payment buy downs to provide affordable housing while assuring the Bank that the loan is an acceptable risk. The objective of mortgage insurance is to support the goal of increasing access to housing finance and increase homeownership for lower income borrowers.

1.0 MORTGAGE INSURANCE

1.1 Product Description

Mortgage Insurance is a credit guaranty that is provided to a Financial Institution, which is in the business of making mortgage loans to individuals. The credit guaranty is payable if the specified loan becomes delinquent and goes through foreclosure. The Financial Institution must be able to provide clear and unencumbered title to the property prior to submitting their claim for loss.

The Claim for Loss is a percentage of the sum of the following items accrued up to the completion of foreclosure: outstanding principal, delinquent interest, property taxes, hazard insurance premiums, utilities, normal property maintenance (excludes renovations or major repairs) and up to 5% of the property value in legal and/or court costs. The Coverage Percentage (PG) is established at a level that may require the Financial Institution to incur a loss on an insured loan. Losses incurred by the Financial Institution will increase or decrease based upon the value of the collateral, the amount of time required to complete foreclosure, their servicing procedures and the quality of their insured loan originations. In particular, the quality of loans will be improved and a level of consistency will be achieved as a result of the Banks adherence to the Mortgage Insurers Master Policy and underwriting guidelines.

Financial Institutions (Lender / Insured) that are approved by the Mortgage Insurance Company (MIC) are issued a Master Policy (MP). The MP defines the terms and conditions of coverage governing all Commitments and Certificates (C/C) of Insurance that are issued by the MIC for the benefit of the Financial Institution.
A commitment / certificate of insurance coverage is issued based upon each loan meeting the MIC’s specified underwriting criteria / guidelines. This is determined by the MIC’s evaluation of the loan instrument, borrower(s) credit worthiness, borrower repayment capability, capacity and collateral value (property value).

1.2 Benefits
The major benefit of providing MI coverage to Financial Institutions in Indonesia would be to provide an incentive for the Financial Institutions to make high LTV ratio loans (up to 90%) to the moderate and lower income segments that may not have sufficient funds to provide a 30% down payment and that require loans for less than 50,000,000 Rp.

In the current environment the Banks do not make loans less than 50,000,000 Rp and avoid the lower income segments that are market candidates for lower cost housing. The primary reasons for the Banks’ avoidance appears to be an expectation of higher defaults and the cost of putting the loan on the books. Mortgage Insurance can help alleviate some of the Banks reluctance associated with the increased risk of making loans less than 50,000,000 Rp.

- The Mortgage Insurance Company will be in the first loss position on all loans submitted for a claim.
There are several secondary benefits to facilitating the utilization of mortgage insurance in Indonesia.

- The mortgage insurance underwriting process will have the effect of providing standardization in the market by the establishment of mortgage insurance underwriting guidelines, standardized documents and adopting practices that are more efficient. These issues are discussed in greater detail in parts of Component C.
- The MIC provides a second review of the Financial Institution’s underwriting decisions. The Financial Institution must underwrite and deem the loan an acceptable risk prior to submitting the loan to the MIC for its underwriting review and insurance decision.
- The MIC pays only the top percentage of the claim-for-loss submitted by the Bank. This type of claim payment structure, where only the top portion of the claim-for-loss is paid by the Mortgage Insurer, rather than payment for 100%, requires the Bank to underwrite quality loans. The Bank, due to the shared risk of loss on foreclosed property, retains a moral risk.

Other benefits of establishing a mortgage insurance entity in Indonesia are the Mortgage Insurance Entity’s support for industry wide services and standardization of the practices and processes for originating residential loans.

- The establishment of a Credit Bureau, which is a repository of a borrower’s credit history, would be a critical tool for providing efficiency in the underwriting processes and, therefore, faster turn around times by the Mortgage Insurance Entity.
- Improved disposition of property ownership claims, specifically speeding up the current foreclosure process, will be necessary in order to achieve “claim for loss costs” that will allow mortgage insurance to be a feasible option.
- Clarification and automation of property titles is needed to facilitate the transfer of ownership in the event of foreclosure and to maintain costs at an acceptable level.
- The establishment of a Mortgage Insurance type of program in Indonesia and the resulting emphasis on establishing standards for documentation, standards for underwriting, standards for the financing notes, standards for servicing and improved efficiency, will set the stage for resource mobilization from the Capital Markets and long term investors.

I will not go into any detail regarding the analysis or impediments to the above benefits as they are covered in detail in other sections of the Project Report.
2.0 INFORMATION RESOURCES

2.1 Loan Performance of Banks

Historical residential loan (KPR, KPR/RSS, KPR/RS) portfolio performance reports were obtained from several Banks, both on an individual basis as well from NPL data collected with the assistance of Perbanas. The data was analyzed in the context of the above methodology in an attempt to ascertain and develop an “aging frequency expectation” for delinquencies and foreclosures applicable for a representative Book Year. The available information to track foreclosures, and subsequently develop an approximated aging curve for Actual Losses, was virtually non-existent. As the market participants do not maintain data in this format. The delinquency data (NPL’s) that was available from the Banks’ reports was reported as aggregated totals at a specific point in time. The NPL numbers were not segregated by the respective origination Book Years that made it difficult to ascertain any aberrations relative to a specific origination year or discern the respective book year delinquency rates. The most useful data was obtained from the old Bank Papan reports, which did report originations by Book Years and also reported NPL data by severity in months. Although it was not possible to ascertain exactly when a loan completed foreclosure and became REO, it was assumed by the author that any NPL loans reported to be over 12 months delinquent resulted in a foreclosure and became REO.

2.2 Banks

Interviews were held with several Banks to validate our estimates on the severity of losses incurred as a result of foreclosure, and to get the Banks’ perception of their historical and future expectations of the delinquency and foreclosure rates. Additionally, the Banks were asked to explain what major impediments existed that inhibited them from making down market loans (KPR of less then 50,000,000 Rp).

Results:

Bank Lending Risk Issues:
- Banks avoid loans under 50,000,000 Rp due to the high origination cost and perceived increase in risk.
- Maximum KPR LTV offered is 70%.
- Loan Terms range from 3 to 10 years. 5 years for low incomes or small loans.

Bank Lending Practices:
- Several Banks have a practice of making employers loans to employers with whom the Bank has a relationship.
- Customers want a combined construction and end loan.
Developers are disbursed funds for construction prior to completion of the respective work.

Credit Reporting Issues:
- Credit scoring system exists at Bank Danamon.
- BI has a bad debt database.

Appraisal Issues:
- Regulator (BI) does not require an appraisal unless the loan is over 1 billion Rp.

Pre-payment Issues:
- First time homebuyers refinance after 3 to 5 years.

Court System issues:
- 80% of foreclosures go through the court system and it cost 2 to 5 million Rp.
- A court settlement results in a minimum loss of 40% of the principal.
- Court system does not penalize mortgage fraud perpetrators.
- Eviction process is difficult and takes 2 years or more.
- Completion of foreclosure can take up to 4 years.
- Legal and court costs can be 20% to 60% of the property value for a foreclosure.
- Debt collectors used by Banks charge a 40% fee for the bad debts collected.

REO Resale Issues:
- Salvage values in the current market are about 60% to 70% of the original value.
- Salvage values are dependent on the market areas.

Speculation Issues:
- Developers create speculation problems in some market areas.
- Developers create most of the market problems, overbuilding, speculating and tying up buildable land.

Mortgage Insurer Issues:
- Askrindo would be a preferred choice over establishing a costly new government agency.
- Preference for a government (public) mortgage insurance entity.
- Requirement that MI pays claims in 14 days of claim for loss submissions.

Possible Developer Program: developer could grant a loan. Then refer to the bank to set up an account for the borrower. The developer guaranties the loan and takes the property as collateral in default. The bank holds back about 10% of the developer’s funds for security.
2.3 Regulators - Ministry of Finance
We met with the Director of Insurance and the Director of Pension Funds to determine what regulations currently existed that would prohibit Pension Funds and Insurance Companies from investing in residential mortgage loans.

Investment Constraints:
- Current regulations would categorize KPR to be a non-admitted asset.
- Insurance Companies and Pension Funds are allowed to invest up to 20% of their assets in Real Estate (property, not loans).
- Insurance Companies can only make loans to their policyholders.
- Pension Funds are not allowed to make loans to borrowers.
- 70% of Pension Fund assets are invested in Bank notes of 1 year or less duration, due to the high yields and the Indonesian Government guarantees them.
- Both Directors indicated a willingness to revise the investment limit of 20% for low income housing if the investment scheme was prudent.

Mortgage Insurer:
- The Directors indicated that they thought Askrindo would be a good candidate to provide a mortgage insurance product.
- The Directors both felt that a private company mortgage insurance provider would be preferred over a government entity.

Education Issue:
- There was a strong emphasis on the need to educate the government and private sectors on mortgage insurance as well as other concepts and proposals regarding mortgage financing. The Directors expressed an interest in being involved.

2.4 Credit Insurance Company
Askrindo, an insurer that currently provides credit insurance coverage on small enterprise loans, was interviewed with respect to their interest in providing a mortgage insurance product. They were asked what their issues and concerns would be. We shared the Aging Spreadsheet Report with Askrindo.

Credit Insurance Experience:
- Askrindo’s current credit insurance product has both a stop loss* and shared risk features which are attractive for a mortgage insurance product. The “Stop Loss” is set such that when the Bank reaches a specified NPL rate no more claims are paid.

* A stop loss is a limit that, when reached, allows that insurer to stop paying losses under their agreement.
The Bank and Askrindo pay individual claims on a percentage basis as long as the Banks’ NPL remains below their Stop Loss percent.

Note: A Stop Loss is a limit that when reached allows the insurer to stop paying losses under their agreement.

- Low-income credit loans are pooled with other loans to borrowers in the same type of business. The peer groups are between 10 and 20 borrowers per pool. This type of peer group structure may be a good approach for involving CBO’s.
- Askrindo indicated that their prepayment rate on loans to business of less than 50,000,000 Rp was low. This is different from the experiences of most of the Bank’s.
- Their credit insurance product had a 4.9% NPL rate.
- Their credit insurance default rate was less than 2%.

Court System Issues:

- Askrindo has also a process of avoiding the court system to obtain their collateral in the event of default. This not only expedites the process but also keeps the legal and court costs at a more reasonable level. The procedure is possible because of the contract relationship between Askrindo and the Bank. A similar type of relationship is proposed for mortgage insurance, with the Master Policy as the contract between the Bank and the Mortgage Insurance Entity.

REO Disposition:

- Acquired collateral was sold at auction.

2.5 Pension Fund

Jamsostek was interviewed to ascertain their level of interest in investing in mortgage loans with mortgage insurance coverage. Their issues and concerns were discussed.

Investment Issues:

- Jamsostek would be a willing investor in mortgage insured loans subject to the following issues being addressed.
- Investment in the loans would need to be deemed a tax-free investment by their regulators.
- Jamsostek requires the approval of their regulator and the Board of Directors prior to extending a loan to another company.
- The investment would need to be secure and address both the prepayment and default risk.
- The investment must provide a competitive return and risk.
3.0 MORTGAGE INSURANCE PRICING

3.1 Methodology
An attempt was made to analyze the performance of several Banks loan portfolio(s) by Book Years in order to determine three factors that are needed to calculate the mortgage insurance premium rate and coverage applicable for the Indonesian lending market. We need several Book Year performance variables to price mortgage insurance.

- Persistency
- Frequency
- Severity

A Book Year is defined as a group of loans consisting of similar characteristics that were originated in the same time period. Generally a Book Year would be comprised of loans originated in a single calendar year (12 months).

3.2 Persistency (Run Off Rate)
In analyzing the Book Year data an attempt is made to determine the Persistency of the original loans. The persistency is defined as the number of outstanding loans remaining at a future point in time out of the total loans originated for the respective Book Year. The Book Year number (and Rp) of pre-payments, payoffs plus defaults by each quarter of the loans age when the action occurred will be used to determine the persistency rate for each Book Year. Analysis of several Book Years with similar characteristics will (should) provide a consistent pattern, after being adjusted for abnormalities in the market over the life of the analysis period. On the basis of this analysis the modeler can calculate the outstanding loans and the resulting Mortgage Insurance Premium revenues expected for the life of the Book Year.

3.3 Frequency
Once the respective Book Years are segregated, an attempt is made to determine the number (and Rp) of loans that are delinquent by their age, and of the age at which they initially went delinquent. Delinquent loans that become current are moved to a subset of current loans, “cured delinquencies”. Technically these loans are current however; experience in other countries lead me to suspect that at least 25% of the delinquent loans over the life of each Book Year will be repeat delinquencies. The same process is used to determine the age of the foreclosure, claim for loss.

The number (Rp) of delinquencies at each age is used to determine the establishment of loss reserves and provides a leading indicator for the losses to be incurred. The number (Rp) of foreclosures at each specific age is used to determine the actual losses.
3.4 Severity

The severity of the loss is determined by incorporating all of the costs incurred by the Financial Institution from the time of the initial delinquency through foreclosure, plus the outstanding principal balance on the loan. Typical costs and current costs where applicable for each Book Year with similar characteristics are averaged to determine the amount of loss that is expected. It is critical to make sure that the Book Year’s similar characteristics include:

- Size of the original loan amount
- Occupancy of the insured property, for example Owner Occupied
- Type of financing instrument*

* In Indonesia it appears that the type of title ownership would be important to assure that only owner occupied risks and not investor or speculative risks are being insured. Additionally, the current costs involved with the foreclosure processes and legal proceedings in order to obtain a clear and salable title are excessive when attempting to reasonably price a mortgage insurance product.
4.0 MI PRICING MODEL INPUTS:

4.1 Information for MI Pricing Model

The Mortgage Insurance Pricing is dependent upon adherence to the underwriting terms and conditions contained in Section 5.0. MI pricing is predicated on, (a) a review of the financial strengths and lending practices of the Bank, (b) underwriting individual loans in accordance with the mortgage insurer’s stated underwriting policy and underwriting guidelines. On this basis the model requires three types of information:

- Persistency – How long do loans remain current and outstanding?
- Frequency – How many and when do loans default?
- Severity – How much does a foreclosure and REO disposition cost?

Persistency (Runoff Rate) Factor

The weaknesses in the data did not allow for the determination of persistency (runoff) rates with a high degree of comfort. The discussions with the Banks did indicate that the payoff rate on KPR’s under 100,000,00 Rp was between 3 and 7 years. This rapid payoff rate was not present on the very high KPR’s.

Persistency Rate (Run Off Rate)

The author has utilized a runoff rate of 20% for the basis of the MI Pricing Model calculations. This is believed to be a conservative runoff rate, particularly for lower income families who would not be able to at one would not be able to payoff their loans as easily as the higher income borrowers.

Frequency of Default Resulting in Foreclosure Factor

The weaknesses in the data did not allow for a determination of an estimated frequency of default resulting in foreclosure by independent book years. The NPL data provided by the Banks and through Industry Surveys indicated a wide disparity between the Banks’ performance. For example the range was between 1.4% to over 18% based upon the Banks’ current aggregated loan portfolio performance.

Frequency of Foreclosure

The author has utilized a 12% foreclosure rate for the basis of the MI Pricing Model calculations. This rate is less than what appears to be the default rate during the economic crisis, but it is believed to be conservative (high) based upon the current market conditions and discussions with the Banks.
4.2 **Loss Severity Calculation**

Information relative to determining the expected severity of loss for an incident of foreclosure was more reliable due to the analysis that has been done by the HOMI Team regarding tax rates, foreclosure costs, court system costs and impediments, property market values and trends and the current resale market conditions. Meetings with the Bankers were useful in validating this information. This discussion also showed that there are significant differences in the processes utilized by the respective Banks to minimize the costs to obtain the collateral.

The following approximated costs were utilized in determining the amount of a claim for loss in the MI Pricing Model calculations.

- **KPR** – loan balance due at time of last payment
- **Delinquent Interest** – limited to 18 Months (most Banks indicated that this time period was between 18 and 48 months due to the additional costs and delays in the court system.
- **Legal Costs** – Limited to 5% of the KPR.

The Delinquent Interest and Legal Costs mentioned above were limited to 18 months and 5% respectively in order to provide a reasonable price for the mortgage insurance product. Significant improvements are necessary in the court system and the title research and registration systems in order to facilitate an efficient market. These topics are discussed in detail in other sections of the Project Report.

- **Property Taxes** – 20% of the Property and Land Value was used for the MI Pricing Model calculations. This percentage was obtained from the information developed by the HOMI Team.
- **Hazard Insurance** – Normal and customary costs for hazard insurance premiums, which are paid by the Bank while the property is in default, are included in order to protect the collateral.
- **Utilities and Normal Maintenance** – Normal and customary cost necessary to maintain the property are included. Specifically excluded are any appliance replacement, renovations or improvements to the property.
Mortgage Insurance Premium Rates
Indonesia MI Feasibility Pricing Model
Non-Refundable Single Premium MI Rates

<table>
<thead>
<tr>
<th></th>
<th>Subsidized MI Level 1</th>
<th>Subsidized MI Level 2</th>
<th>Unsubsidized MI</th>
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<tr>
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<tr>
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<tr>
<td>MI Coverage Percent</td>
<td>40%</td>
<td>30%</td>
<td>25%</td>
</tr>
<tr>
<td>MI Single Premium Rate</td>
<td>7.38%</td>
<td>5.43%</td>
<td>4.59%</td>
</tr>
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</table>

Details for the above Mortgage Insurance Prices are contained in Attachments 5 and 6.

Rating Notes Applicable to the MI Coverages
Terms of Coverage

- The LTV Ratio is based on the lesser of the appraised value or purchase price
- Financing Instrument (note) has caps on the maximum annual interest rate increase of 2.0%.
- Level 1 and 2 are for new construction only.

(The Level 1 and Level 2 Premium Rate could to be paid as a subsidy for qualifying low income households).

5.0 ACCEPTANCE OF THE MORTGAGE INSURANCE RISK

Loans are individually underwritten and insured under each respective Banks’ Master Policy at the rates determined by the MI Pricing Model in Section 4.0. The mortgage insurance prices quoted in the exhibit in Section 4.0 above, rely upon the compliance of individual insured loans with the underwriting guidelines contained in this Section.

5.1 Underwriting Risks

Pricing for Mortgage Guaranty Insurance is predicated on the Mortgage Insurance Entity having prescribed underwriting guidelines and policies in place to determine which individual KPR risks it will or will not accept under the Banks’ Master Policy.

The following is a brief synopsis of some of the critical underwriting criteria required to provide mortgage insurance based upon the MI Model Pricing.
• LTV Ratio: The loan amount must be divided by the lower of the purchase price or its appraised value. This is not the current practice for all Banks in Indonesia at this time. Many Banks do not obtain appraisals on property values of less than 50,000,000 Rp.

• Credit History: The borrowers credit history should exhibit a track record of willingness to repay their obligations in a timely manner.

• Mortgage Payment Ratios: 20% to 30%, lower for the lower income borrowers.

• Total Debt Ratios: Preferably 36% or less, but not more than 40%.

• Mortgage Financing: The note will need to have some caps on the annual or periodic interest rate increases. Preferably the caps on interest rate increases will be limited for annual increases and increases over the life of the loan (KPR).

• Owner Occupied Family Residence: The insured property cannot contain multiple or separate dwelling units.

5.2 Institutional Approval / Master Policy Issuance
The Mortgage Insurance Entity will need to develop policies for approval of Banks prior to the Issuance of a Master Policy. These policies will need to establish standards for approval that the Banks must meet in their application prior to the issuance of a Master Policy. The following is a brief list of the types of information that should be reviewed.

- Financial Strength
- Experience in KPR originations
- Regulatory Agency
- Most recent Regulatory Review Report
- Background check on the Principals

Quality Control
Another condition of the Banks’ approval and issuance of their Master Policy is the right to perform an audit, a quality control review, of the insured loans on the Banks’ premises.

Master Policy Termination
Performance of the Bank must be maintained at an acceptable level of performance on an ongoing basis. Performance standards need to be established by the Mortgage Insurer. These standards should provide for the termination of the Banks’ Master Policy if they fail to meet the standards and have not taken adequate actions to correct their performance.
Process Risks
Several current processes in Indonesia exist which present increased levels of cost and perhaps risk with respect to providing mortgage insurance. Some of these processes are being addressed such as:

- Developing a Credit Bureau
- Automation of Title and Registration (40 Offices to date)
- Standardized Loan Origination Documents
- Standardized Loan Origination Underwriting Guidelines

Other processes that need to be improved or developed to make mortgage insurance and the mortgage finance markets operate more efficiently are:

- Improving the case disposition of the court system
- Standard mortgage instruments notes.
- Property appraisal along with the purchase price need to be used to determine LTV Ratios, the lesser of the two must be used as the denominator.
- Standardized Servicing Guidelines

Unacceptable Risks

- **Mortgage Financing**
  The current financing instrument allows for unlimited interest rate increases, generally every 3 to 6 months, with no limit on the interest rate increase over the life of the loan.

- **Non-Owner Occupied Property**
  The borrower must be the owner / purchaser and occupant of the insured property. Non-owner occupied, rental or speculative ownership risks are beyond the scope of this study. These types of ownership forms represent a commercial risk and would be an excessive risk for mortgage insurance in the current environment and at the prices calculated by the MI Pricing Model.

6.0 **Recommendations:**

It is my recommendation that a Mortgage Insurance Entity be seriously entertained as one part of a solution to support the lower income housing initiatives and mortgage finance reforms. It is clear from the interviews with the Banks that an incentive in the form of a risk reduction is needed to encourage the Banks’ participation in making loans of less than 50,000,000 Rp.
This affirmative recommendation is predicated on several issues. Specifically, it is recommended that the mortgage insurance premium on the loans under 50,000,000 Rp be paid as a single premium subsidy to the Mortgage Insurer.

6.1. Business Approach

A (semi) Private not a Public (Government operated), Mortgage Insurance Company should be entertained to provide the mortgage insurance credit enhancement. The mortgage insurance coverage needs to create a risk reduction incentive to the Banks to induce them to make down market loans in support of the moderate and low-income housing initiatives.

At least one viable corporate candidate exists, Askrindo. Currently Askrindo is partially owned by the government. In addition, Askrindo has experience in the credit insurance business with small business loan guaranty program. Askrindo additionally has an understanding of the principals of shared risk and insurance disciplines required for a successful operation. A corporate entity with a profit motivation will take a more focused business approach and be less likely to be influenced by political interests.

As a viable alternative to the Mortgage Insurance Product proposed in this report, a Mortgage Insurance Product patterned after the current Askrindo Credit Insurance product may be developed as an initial step. The Banks already have experience with the Askrindo credit model and Askrindo has experienced successful performance.

6.2. Capital Adequacy

The Mortgage Insurance Entity will need to be capitalized. A risk to capital ratio of 25 to 1 is the standard in the US. A slightly higher risk to capital ratio may be warranted for the Indonesian Mortgage Insurer due to the volatile economic environment. Capital acquired from private investors would be preferable to a public capital infusion. This form of capitalization would help distance the insurer from political interests.

6.3. Reserve Adequacy

The mortgage insurance premium should be structured as a non-refundable single premium plan. This structure should provide adequate premium cash flows in the inception years in order for the Mortgage Insurer to build up its reserves prior to the commencement of the peak claim for loss payments on its initial book years of insured loans. The term of the single premium should be no more than 7 years.
6.4. Risk Considerations

The risk issues delineated in section 5.0 Above should be adopted, in their entirely.

6.5. Master Policy Terms

The current Court system and the respective Foreclosure Process needs to be facilitated through terms specified in the Mortgage Insurance Master Policy, which is a contract between two corporate entities, the Mortgage Insurer and the Banks. There is a question regarding the feasibility of the borrower assigning their rights to the collateral as a condition of the Mortgage insurance.

6.6. Process Improvements

Support for the rapid implementation of the Credit Bureau System and the Automated Title Registration System is critical for creating risk acceptance and foreclosure cost efficiencies for a Mortgage Insurer, as well as the other mortgage finance participants.
<table>
<thead>
<tr>
<th>Date</th>
<th>Organization</th>
<th>Role</th>
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<tbody>
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<td>Regulator and Supervisor of Banks</td>
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<tr>
<td>Thursday</td>
<td>Legal Department</td>
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<td>Regulator and Supervisor of Banks</td>
<td></td>
</tr>
<tr>
<td>30-Nov</td>
<td>Bank NISP</td>
<td>Lender</td>
</tr>
<tr>
<td>Friday</td>
<td>Mortgage Division</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bp. Pramukti Surjaudaja</td>
<td></td>
</tr>
<tr>
<td></td>
<td>President - CEO</td>
<td></td>
</tr>
<tr>
<td></td>
<td>I Puto Surya Negra</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Business Development Division Head</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Muliadi Hardja</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Assistant to the Board of Directors</td>
<td></td>
</tr>
<tr>
<td>30-Nov</td>
<td>Ministry of Finance</td>
<td>Regulator</td>
</tr>
<tr>
<td>Friday</td>
<td>Mr. Indomen Saragih</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Direktur Dana Pensiun</td>
<td>Regulator of Pension Funds - Government and Private</td>
</tr>
<tr>
<td>30-Nov</td>
<td>Ministry of Finance</td>
<td>Regulator - Insurance</td>
</tr>
<tr>
<td>Friday</td>
<td>Firdaus Jaelani MA</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Direktur Asuransi</td>
<td>Regulator of Insurance</td>
</tr>
<tr>
<td>4-Dec</td>
<td>Perbanas (MBA)</td>
<td>Banker’s Association</td>
</tr>
<tr>
<td>Tuesday</td>
<td>Banker’s Assn. / Trader Group</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bank Bumiputera</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Ibu Winny E. Hasan</td>
<td></td>
</tr>
<tr>
<td></td>
<td>President Director</td>
<td></td>
</tr>
<tr>
<td>4-Dec</td>
<td>Bank BNI</td>
<td>Lender</td>
</tr>
<tr>
<td>Tuesday</td>
<td>Mortgage Division</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bp. Saifudien Hassan</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Direktur</td>
<td></td>
</tr>
<tr>
<td>Date</td>
<td>Company</td>
<td>Role</td>
</tr>
<tr>
<td>--------</td>
<td>--------------------------</td>
<td>-------------------------------------------</td>
</tr>
<tr>
<td>4-Dec</td>
<td>Bank Danamon</td>
<td>Lender</td>
</tr>
<tr>
<td></td>
<td>Mortgage Division</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bp. Arman B. Arief</td>
<td>CEO</td>
</tr>
<tr>
<td>5-Dec</td>
<td>Askrindo</td>
<td>Credit Insurer for business</td>
</tr>
<tr>
<td></td>
<td>Credit Insurance Division</td>
<td>with Captive Restructure</td>
</tr>
<tr>
<td></td>
<td>Drs. Adrie Tasyam</td>
<td>Logical MI candidate</td>
</tr>
<tr>
<td></td>
<td>Managing Director</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Suharsono</td>
<td>Division Head of Credit Insurance</td>
</tr>
<tr>
<td>10-Dec</td>
<td>Jamsostek</td>
<td>Investor</td>
</tr>
<tr>
<td></td>
<td>Pension Fund</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Teguh Purwanto</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Analyst</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Yogi Dharmawanto</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Investment Division</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Dindin Gunari</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Division of Property and Long Term Investment</td>
<td></td>
</tr>
</tbody>
</table>
### Mortgage Insurance Example

<table>
<thead>
<tr>
<th></th>
<th>Without Mortgage Insurance</th>
<th>With Mortgage Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Value</strong></td>
<td>20,000,000</td>
<td>18,000,000</td>
</tr>
<tr>
<td><strong>LTV</strong></td>
<td>70%</td>
<td>80%</td>
</tr>
<tr>
<td><strong>Loan</strong></td>
<td>14,000,000</td>
<td>13,000,000</td>
</tr>
<tr>
<td><strong>M Guarantee</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Amount</strong></td>
<td>5,400,000</td>
<td></td>
</tr>
</tbody>
</table>

#### Benefit:
- Lower Down Payment needed for customer
- Higher Loan Amount for Lender

#### Negatives:
- Higher Loan Payment for Customer

#### MI Claim Example

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unpaid Balance</td>
<td>17,500,000</td>
</tr>
<tr>
<td>Delinquent Interest</td>
<td>318,000</td>
</tr>
<tr>
<td>Legal Cost to Obtain Title</td>
<td>10,000,000</td>
</tr>
<tr>
<td><strong>Claim Amount</strong></td>
<td>27,815,000</td>
</tr>
<tr>
<td>MI Guarantee %</td>
<td>30%</td>
</tr>
<tr>
<td>Claim Amount Paid</td>
<td>5,044,500</td>
</tr>
<tr>
<td>Property Disposal / Salvage</td>
<td>14,000,000</td>
</tr>
<tr>
<td>Bank Loss</td>
<td>5,470,500</td>
</tr>
</tbody>
</table>

#### Parameters:
- UPD: 175,000,000
- Interest Rate: 21.0% per year
- Value: 20,000,000
- Legal Cost to Obtain Title: 50% of value
- LTV/without MI: 70%
- LTV/with MI: 90%
- MI Coverage: 30%
- Property Disposal / Salvage: 14,000,000
Mortgage Insurance Book Year Aging Analysis Example
Persistancy, Delinquency and Foreclosure by Book Year

Assumptions:
- LTV’s Greater than 70%
- Loan (KPR) Less than 50,000,000 Rp
- One Family Units
- Owner Occupies Homes
- Financing is ARM with No caps, No Limits for adjustments
<table>
<thead>
<tr>
<th></th>
<th>Subsidized MI Level 1</th>
<th>Subsidized MI Level 2</th>
<th>Unsubsidized MI</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>KPR Maximum (Rp)</strong></td>
<td>34,999,999</td>
<td>49,999,999</td>
<td>300,000,000</td>
</tr>
<tr>
<td><strong>KPR Minimum (Rp)</strong></td>
<td>20,000,000</td>
<td>35,000,000</td>
<td>49,999,999</td>
</tr>
<tr>
<td><strong>LTV Ratio Maximum</strong></td>
<td>90%</td>
<td>90%</td>
<td>90%</td>
</tr>
<tr>
<td><strong>LTV Ratio Minimum</strong></td>
<td>71%</td>
<td>71%</td>
<td></td>
</tr>
<tr>
<td><strong>MI Coverage Percent</strong></td>
<td>40%</td>
<td>30%</td>
<td>25%</td>
</tr>
<tr>
<td><strong>MI Single Premium Rate</strong></td>
<td>7.38%</td>
<td>5.48%</td>
<td>4.59%</td>
</tr>
</tbody>
</table>

**Rating Notes Applicable to the MI Coverages Shown:**

**Ratee Applies to:**
- Single Family Detached Residence
- Owner Occupied Property
- Adjustable Rate Loan with Annual Caps of 2% or less

**Terms of Coverage:**
- LTV Ratio is based on the lesser of the appraised value of purchase price.
- Financing instrument (note) has caps on the maximum annual interest rate increase of 2.0%.
- Levels 1 and 2 are for new construction only.

**Premium Remittance:**
- The premium is due within 30 days after the loan has been closed.
- The term of coverage is for 7 years or until the loan has been repaid in full.
- The premium is non-refundable.

**Claim for Loss Coverage Restrictions:**
- Maximum amount of delinquent interest claimable is 18 months.
- Maximum amount of legal and court cost claimable is 5% of the original loan (KPR).

**The Level 1 and 2 Premium Rate is paid as a subsidy for qualifying low-income households.**

**Effective Date:** December 14, 2001
### Alternative Mortgage Insurance Product

Stop Loss Mortgage Insurance Example patterned after: "ASKRINDO" Type of Mortgage Insurance Program

<table>
<thead>
<tr>
<th>Stop Loss</th>
<th>Bank Risk</th>
<th>MIC Risk</th>
<th>Premium Rate (est)</th>
<th>Stop Loss</th>
<th>Bank Risk</th>
<th>MIC Risk</th>
<th>Premium Rate (est)</th>
</tr>
</thead>
<tbody>
<tr>
<td>NPL Share</td>
<td>Share</td>
<td>Share</td>
<td>7.75%</td>
<td>NPL Share</td>
<td>Share</td>
<td>Share</td>
<td>3.75%</td>
</tr>
<tr>
<td>10%</td>
<td>20%</td>
<td>80%</td>
<td></td>
<td>5%</td>
<td>20%</td>
<td>80%</td>
<td></td>
</tr>
<tr>
<td>10%</td>
<td>30%</td>
<td>70%</td>
<td>6.75%</td>
<td>5%</td>
<td>30%</td>
<td>70%</td>
<td>3.25%</td>
</tr>
<tr>
<td>10%</td>
<td>40%</td>
<td>60%</td>
<td>5.75%</td>
<td>5%</td>
<td>40%</td>
<td>60%</td>
<td>2.75%</td>
</tr>
<tr>
<td>10%</td>
<td>50%</td>
<td>50%</td>
<td>4.75%</td>
<td>5%</td>
<td>50%</td>
<td>50%</td>
<td>2.25%</td>
</tr>
<tr>
<td>10%</td>
<td>60%</td>
<td>40%</td>
<td>3.75%</td>
<td>5%</td>
<td>60%</td>
<td>40%</td>
<td>1.75%</td>
</tr>
<tr>
<td>10%</td>
<td>80%</td>
<td>20%</td>
<td>1.75%</td>
<td>5%</td>
<td>80%</td>
<td>20%</td>
<td>0.75%</td>
</tr>
</tbody>
</table>

### Rating Notes:

The Mortgage Insurer shares the Insured Banks losses in the Risk Share percentage and Stop Loss NPL agreed to by the parties. Agreements are reviewed and renewed on an annual basis.

Once the Banks's NPL rate is reached no more claims are paid by the Mortgage Insurer.
ADDITIONAL REPORT NO. 4
DESIGN AND CONSTRUCT LOW INCOME HOUSING

TABLE OF CONTENTS

1.0 Overview 1

2.0 Rural 2

3.0 Sub-Urban 3

4.0 Costs 5

5.0 Concluding Remarks 7

Appendices:

Table 1: Cost / Affordability Analyses
A Special Report
By C3 - Expert
(BOB) SUDJANA TANTRA

DESIGN & CONSTRUCT
Low Income Housing

Jakarta
Dec - 2001
OVERVIEW

A functional approach will be adopted while making the elaborations in this paper. The comments and opinions are based on exploratory comparative studies, bibliographic survey, observations made of the practices employed during the planning and physical implementation as well as post construction stages, field experiences both as senior management practitioner and strategic management consultant, in the building industry.

The following Figure 1 may simplify the subsequent discussions. Basically the first two interrelated progressive stages will be primilarly discussed, while the third stage, is merely shown to just indicate that whatever may have been choosen and performed earlier, will definitely impact cost and affect success of Estate Management.

The major activities under Design and Construct which are illustratively listed, are to be dictated by and to be in compliance with the Lowest Economical Cost Criteria ! Naturally, this Lowest Economical Cost Criteria to be met by all Contributors is geared toward ensuring that housing is really built at lowest economical cost while still meeting minimal standard, though not of low quality, especially for the low – income bracket Beneficiaries. How to overcome hindrances and achieve it, will be subsequently explored in this paper.

Who will be the targeted Beneficiaries within the low income brackets ? Where are they located : in (Sub) Urban or Rural areas ? What are the priorities to be given and to which strata among the wide ranging low – income brackets ? Can the selected range of individual low Monthly Income Brackets vary from Rp. One Hundred Thousand to the Provincial Minimum Wage and then by Rp. 100.000 increments onwards to Rp. One Million, per person?

How should the higher joint–monthly–income per household be considered and treated ?
RURAL

The following Table 01 indicates that the population under the poverty line in the villages are almost twice the number of that in the Cities.

(Table 01)

<table>
<thead>
<tr>
<th>Year 1996 - 1999*</th>
<th>Poverty Line Rp. Capital/Month</th>
<th>Total Population under the Poverty Line (Million)</th>
<th>Percentage of Population under the Poverty Line (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>City</td>
<td>Village</td>
<td>City</td>
</tr>
<tr>
<td>1996</td>
<td>42,032</td>
<td>31,366</td>
<td>9.6</td>
</tr>
<tr>
<td>1998**</td>
<td>96,959</td>
<td>72,780</td>
<td>17.6</td>
</tr>
<tr>
<td>1999***</td>
<td>92,409</td>
<td>74,272</td>
<td>15.7</td>
</tr>
</tbody>
</table>

Notes:
* Using definition of Susenas 1998
** Based on Susenas December 1998
*** Based on Susenas February (regular) 1998

Logically, the design and construct methods to be applied in the villages, concern mostly, if not only low-rise buildings, for which many indigenous architecture can be considered and local materials are found, that may be different than in sub-urban areas.

The modified technical specification for simple housing [refer Final Report July 2001] prepared by the R&D Centre (PusLitBang) of Dep. KimPrasWil in Bandung, does include many good simple low-rise house types/designs, which shall be well suited to meet most of the housing need in the villages.

However, preference should be best given to construct the permanent external walls, all at once completely, while leaving only the interior partitioning for later additions rather than allowing the (growing) core-unit [RIT & RITL] to be extended irregularly using odd materials lateron, that may create disharmonious elevations and environment in the respective cluster.

The three house types mentioned therein, [as shown in Appendices] are brickwork (core-unit), ½ brick work and timber single-storey houses.

Another type with raised floor on stilt (Rumah Panggung) as usually found in Kalimantan & Papua, may be probably added by using manufactured components.

This latter type [with M-Series sketches in Appendices] will double the land use and the floor area, whenever the groundlevel, initially left open, is also enclosed lateron. Also ideal for low or flood prone areas!
SUB URBAN

Other than the concentration of the targeted Beneficiaries and House types, Density of both the population and size of Allotments (particularly its width) as well as the density of buildings within a multi level Apartment environment and also the minimal space need [as PusLitBang Tables 02,03,04 below] shall be considered in minimizing costs too.

Road class and its respective width shall also be simple and eventually only bicycle/footpath with concrete interlocking pavers shall be initially constructed, in low – rise complexes. Building - Line set back shall also be reduced, in order to improve land use.

When low – rise houses could still be built in the rural areas/villages ; more multi – level residential flats have necessarily to be constructed in the (sub - ) urban areas, as land becomes scarcer and urbanization into major cities is increasingly becoming crucial.

[Table 02] Population Density ; Allotment size and Allotment numbers

<table>
<thead>
<tr>
<th>Person/Ha</th>
<th>Allotments Size SqM</th>
<th>Total Allotment Number/Ha</th>
</tr>
</thead>
<tbody>
<tr>
<td>444</td>
<td>54</td>
<td>111</td>
</tr>
<tr>
<td>332</td>
<td>72</td>
<td>83</td>
</tr>
<tr>
<td>200</td>
<td>120</td>
<td>50</td>
</tr>
<tr>
<td>160</td>
<td>150</td>
<td>40</td>
</tr>
<tr>
<td>120</td>
<td>200</td>
<td>30</td>
</tr>
</tbody>
</table>

[Table 03] Density of Buildings in Multilevel Apartment Environment

<table>
<thead>
<tr>
<th>KDB (%)</th>
<th>KLB</th>
<th>Floor level</th>
<th>Total People Per Ha</th>
</tr>
</thead>
<tbody>
<tr>
<td>34</td>
<td>1.105</td>
<td>3 ~ 4</td>
<td>1528</td>
</tr>
<tr>
<td>28</td>
<td>1.20</td>
<td>4 ~ 5</td>
<td>1667</td>
</tr>
<tr>
<td>25</td>
<td>1.25</td>
<td>5</td>
<td>1736</td>
</tr>
<tr>
<td>20.20</td>
<td>1.33</td>
<td>6 ~ 7</td>
<td>1847</td>
</tr>
<tr>
<td>17.50</td>
<td>1.375</td>
<td>7 ~ 8</td>
<td>1909</td>
</tr>
<tr>
<td>16</td>
<td>1.4</td>
<td>8 ~ 9</td>
<td>1944</td>
</tr>
<tr>
<td>15</td>
<td>1.42</td>
<td>9 ~ 10</td>
<td>1972</td>
</tr>
<tr>
<td>14</td>
<td>1.436</td>
<td>10 ~ 11</td>
<td>1955</td>
</tr>
<tr>
<td>13</td>
<td>1.45</td>
<td>11 ~ 12</td>
<td>2014</td>
</tr>
</tbody>
</table>

Selecting of the space allocation from the following Table 04 is also important in determining the lowest cost.
In attempting to economize and to rationalize through standardization and mass construction, would it not be wiser to select only, at least temporarily, the 27 SqM units? The space need of 9 and 18 SqM shall be sought by the singles and new couples in Rusuna (Multi Level Housing) and in Rusunawa (Rental MLH). Are the 5-level walk-up flats with open ground floor reserved for vendors (SMEs), to be selected? Probably, yes!

### Simplified Road Network

From the land/house price lists, is evidently clear that the price increases as the road becomes wider. Simplification of roads and eventually constructing initially only bicycle/footpath of 1.50 M wide of concrete interlocking paving block, with 0.25 M shoulder and 0.25 M earth drain on either side, may suffice for the time being. The width of the allotments shall be kept minimal and more row – houses and duplexes shall be increasingly built. Similarly, more attention shall be given to both Rusuna and Rusunawa.

### Simplified Road Network

From the land/house price lists, is evidently clear that the price increases as the road becomes wider. Simplification of roads and eventually constructing initially only bicycle/footpath of 1.50 M wide of concrete interlocking paving block, with 0.25 M shoulder and 0.25 M earth drain on either side, may suffice for the time being. The width of the allotments shall be kept minimal and more row – houses and duplexes shall be increasingly built. Similarly, more attention shall be given to both Rusuna and Rusunawa.

### Road Classification

<table>
<thead>
<tr>
<th>Road Classification</th>
<th>Minimum Building line conforming Pemda Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Two-Level</td>
</tr>
<tr>
<td>Secondary Local Road</td>
<td></td>
</tr>
<tr>
<td>1. Bicycle Track/ Pedestrian</td>
<td>2.00</td>
</tr>
<tr>
<td>2. Road</td>
<td>3.50</td>
</tr>
<tr>
<td>Secondary Road I</td>
<td>5.00</td>
</tr>
<tr>
<td>Secondary Collector Road</td>
<td>7.00</td>
</tr>
</tbody>
</table>

Source: Final Report of PusLitBeng - Bandung
Perhaps it becomes clearer now that the lowest economical cost criteria shall be applicable not only to the various activities listed earlier under design and construct, but constructing low cost houses shall simultaneously consider all other related cost components.

Table 1 – Jakarta in Appendix, indicates that there are at least five major cost components. The percentages of their subtotals are: Construction 39% - Land 32% - Permit 1% - Taxes 20% - Margin 12%. Another exercise made by Ir. Haedar with his Macro Financial Model for Urban Development (Table 6.1 [25 – 04 – 2000] though costs are rather outdated) resulted for a 100 Ha. Development, in the following reduced percentages: Construction 18.5% - Land 5.46% - Permit 0.1% - Taxes 22%.

Probably, the larger development scale, the more improved percentages may be forthcoming.

Hence, a large scale land development (Kawasan Siap Bangun - Kasiba) for Housing and Settlement will be further elaborated in another separate paper.

When the re-designing and newer methods of constructing will be deployed, more equitable percentages shall also undoubtedly be achievable.

[Table 06] SUMMARY OF COST COMPARISON (RUPIAH)
Between RS-21 generic, RS with local building material and Extendable Core – Unit (Prior to the proposed re-designing and revised method of constructing)
[Table 07] COMPARATIVE UNIT BUILDING COSTS Per SqM

<table>
<thead>
<tr>
<th>TYPES</th>
<th>R  S  21</th>
<th>R  S  21 - Local</th>
<th>RIT</th>
<th>RIT -½</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Generic</td>
<td>Material</td>
<td>19.2 SqM</td>
<td>19.2 SqM</td>
</tr>
<tr>
<td></td>
<td>21.6 qM</td>
<td>21.6 qM</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Totals (R p.)</strong></td>
<td>691.393</td>
<td>445.354</td>
<td>448.672</td>
<td>360.781</td>
</tr>
</tbody>
</table>

Comment:

From this comparative unit costs can be concluded that both RITs, although initial construction costs are much less, but as unit costs do not differ significantly at all, they can not be much more attractive!

Especially if the land price of 60 SqM has to be added equally to each of these 4 types.

**Multi – Level Apartment COSTS**

Dependent on the location and foundation types needed (for varying soil bearing capacity) the current construction costs of simple (multi) 5-level Apartments, many range from Rp. 1 to Rp. 1.5 million/SqM.

Generally, the re-inforced concrete structure and floor slabs are cast-in-situ, and removal of concrete formwork occurs after 28 days curing (as in accordance to spec of PBI).

However, when suitable concrete admixtures are introduced and earlier compressive strength gain is made possible, then stripping of formwork (either with waffle or flat slab support) will be faster and reduce construction time.

*Fast stripping flying formwork* (when tower crane is available) and simultaneous provision of formwork for two levels, will economize cost and also reduce construction time.

The walls, usually consisting of brickwall infill that is to be plastered, need to be replaced! Another newer construction method for mass production of consistent quality and quick erection, to be considered, is the *prefabrication* of both concrete wall and floor components. Partitioning may substitute internal walls.

Let us now compare the total building costs of low – rise and multi – level buildings plus the related land price.
If one twin Block 5-level Apartment, Consisting of 2 x (4 x 12) = 96 units, each of 21 SqM measure 2016 SqM ; then one Block only measures 1008 SqM. If the Staircase Hall and the Public Areas (incl. Balcony) measure respectively approx : (4 M wide x 4 levels) + (1.5 M wide x 4 levels x 36 m) = 16 SqM + 216 SqM = 232 SqM ; then the construction costs of (232 x 1.250.000/SqM) = Rp. 290.000.000 must be shared equally by the 48 Apts, plus 12 Business units on the ground floor, amounting each to Rp. 4.833.333/per unit. *). Excluding the cost of the common Land Areas.

CONCLUDING REMARKS

In Designing and Constructing low - income housing, all the activities involved in both the Planning and Implementing stages, shall be strictly guided by the lowest economical cost criteria. When doing so, the maintenance costs at the post - Construction phase, will be economical too. When the target Beneficiaries differ widely, it may be wise to stipulate the priorities to be given to the varying low – income brackets, which can be identified by Rp. 100.000 increments, as shown below in Table 09, and who are mostly found in both the rural and (sub) – urban areas.
According to Monthly Income Brackets; though disposable income of each bracket differs and is highly dependent on size of household and number/age of children.

**TENTATIVE TARGET BENEFICIARIES**

<table>
<thead>
<tr>
<th>Monthly Income</th>
<th>Per Capita</th>
<th>Per Household</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rp. 100,000</td>
<td>Rp. 1,100,000</td>
<td></td>
</tr>
<tr>
<td>Rp. 200,000</td>
<td>Rp. 1,400,000</td>
<td></td>
</tr>
<tr>
<td>Rp. 300,000</td>
<td>Rp. 1,700,000</td>
<td></td>
</tr>
<tr>
<td>Rp. 400,000</td>
<td>Rp. 2,000,000</td>
<td></td>
</tr>
<tr>
<td>Minimum Wage</td>
<td>Rp. 2,300,000</td>
<td></td>
</tr>
<tr>
<td>Rp. 600,000</td>
<td>Rp. 2,600,000</td>
<td></td>
</tr>
<tr>
<td>Rp. 700,000</td>
<td>Rp. 2,900,000</td>
<td></td>
</tr>
<tr>
<td>Rp. 800,000</td>
<td>Rp. 3,200,000</td>
<td></td>
</tr>
<tr>
<td>Rp. 900,000</td>
<td>Rp. 3,500,000</td>
<td></td>
</tr>
<tr>
<td>Rp. 1,000,000</td>
<td>Rp. 3,800,000</td>
<td></td>
</tr>
</tbody>
</table>

Do those under the poverty line with income (capita/month) of Rp. 92,409 in the city and Rp. 74,272 in the village, qualify for both subsidy and the governmental care?

For each category, certain house type and housing scheme may be adequately designed and constructed, while taking into consideration the simplified modification on the Technical Spec of Simple Houses, as proposed by the R & D Agency of Dep. KimPrasWil.

Furthermore, attention shall be given to the diverse prices/building costs prevailing in each Kabupaten [Regency] and Kota [Municipality] as depicted in the Journal of Building Construction & Interior material prices.

Similarly, raised – floor / two – level houses (Rumah Panggung) shall also be promoted, as it may be economical and also permits better land use as well as also suitable for low lying or flood prone areas.

Simple Multi – Level Housing Units, called Rusuna and Rusunawa, shall also be constructed, especially in crowded major cities of the four most densely populated provinces. The height shall be up to 12 levels only, served by elevator stopping at alternate floor level, and provided with open ground floor for (SMEs) vendors.
APPENDICES

LOW – RISE BUILDINGS
The Three Types Proposed
by PusLitBang – Bandung

RAISED FLOOR HOUSE TYPES
(Rumah Panggung)
Jointly developed overseas by the Author and his Co-Planner

COST / AFFORDABILITY ANALYSES
Table 1 – Jakarta

REFERENCES

Laporan Akhir: MODIFIKASI SPESIFIKASI TEKNIS RUMAH SEDERHANA
Pusat Penelitian dan Pengembangan Permukiman [R & D Agency]

CONSTRUCTION INDUSTRY
A Feasibility Study (1970) by
Bob Sudjana Tantra

JURNAL BAHAN BANGUNAN,
KONSTRUKSI DAN INTERIOR
### Technical Assistance For Policy Development For Enabling The Housing Market To Work In Indonesia

#### III. AFFORDABILITY DISCUSSION INPUT FOR COST/AFFORDABILITY ANALYSES

**TABLE 1: JAKARTA**

<table>
<thead>
<tr>
<th>HOUSE TYPE / COST COMPONENT</th>
<th>SIMPLE HOUSE</th>
<th>SIMPLE HOUSE COST-SAVING DESIGN</th>
<th>RS (136)</th>
<th>MIDDLE HOUSE</th>
<th>LUXURIOUS HOUSE</th>
</tr>
</thead>
<tbody>
<tr>
<td>M2 of House</td>
<td>21.5</td>
<td>21.5</td>
<td>36</td>
<td>72</td>
<td>144</td>
</tr>
<tr>
<td>Construction Cost/m2</td>
<td>300,000</td>
<td>290,000</td>
<td>400,000</td>
<td>500,000</td>
<td>600,000</td>
</tr>
<tr>
<td><strong>SUBTOTAL CONSTRUCTION COST</strong></td>
<td><strong>6,400,000</strong></td>
<td><strong>5,400,000</strong></td>
<td><strong>14,400,000</strong></td>
<td><strong>36,000,000</strong></td>
<td><strong>86,400,000</strong></td>
</tr>
<tr>
<td>M2 of land</td>
<td>60</td>
<td>54</td>
<td>72</td>
<td>180</td>
<td>240</td>
</tr>
<tr>
<td>Price of Raw Land/M2</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Urban Infrastructure</td>
<td>30,000</td>
<td>35,000</td>
<td>40,000</td>
<td>50,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Serviced/Land Cost/m2</td>
<td>1,800,000</td>
<td>200,000</td>
<td>300,000</td>
<td>400,000</td>
<td>500,000</td>
</tr>
<tr>
<td><strong>SUBTOTAL LAND</strong></td>
<td>1,830,000</td>
<td>285,054</td>
<td>340,072</td>
<td>460,180</td>
<td>580,240</td>
</tr>
<tr>
<td>PERMITS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Building Permit - IMB 6,000/m2</td>
<td>129,600</td>
<td>129,600</td>
<td>216,000</td>
<td>432,000</td>
<td>864,000</td>
</tr>
<tr>
<td>Other Permit Costs / Allow</td>
<td>100,000</td>
<td>100,000</td>
<td>150,000</td>
<td>250,000</td>
<td>600,000</td>
</tr>
<tr>
<td><strong>TOTAL PERMIT COSTS</strong></td>
<td>229,600</td>
<td>229,600</td>
<td>366,000</td>
<td>682,000</td>
<td>1,564,000</td>
</tr>
<tr>
<td>5% NPCP - Rp. 30 Million</td>
<td>0</td>
<td>0</td>
<td>316,300</td>
<td>3,394,100</td>
<td>8,382,000</td>
</tr>
<tr>
<td><strong>TAXES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value Added tax : 8% Land (PPN)</td>
<td>960,000</td>
<td>1,060,000</td>
<td>1,528,000</td>
<td>5,760,000</td>
<td>9,600,000</td>
</tr>
<tr>
<td>Value Added tax : 10% Building (PPN)</td>
<td>668,000</td>
<td>510,000</td>
<td>1,440,000</td>
<td>3,600,000</td>
<td>8,400,000</td>
</tr>
<tr>
<td>Land &amp; Building Tax (PBB) Approx p.a.</td>
<td>187,100</td>
<td>19,150</td>
<td>35,800</td>
<td>108,885</td>
<td>205,040</td>
</tr>
<tr>
<td>Income Tax (PPN 2% - 5%)</td>
<td>406,720</td>
<td>415,715</td>
<td>1,984,459</td>
<td>6,104,240</td>
<td>11,755,000</td>
</tr>
<tr>
<td>Other Tax (? Regional)</td>
<td>120,000</td>
<td>160,000</td>
<td>180,000</td>
<td>300,000</td>
<td>600,000</td>
</tr>
<tr>
<td><strong>TOTAL TAXES</strong></td>
<td>2,133,840</td>
<td>2,204,925</td>
<td>5,379,080</td>
<td>15,672,925</td>
<td>30,600,040</td>
</tr>
<tr>
<td><strong>TOTAL COSTS + PERMITS + TAXES Rp</strong></td>
<td><strong>4,213,100</strong></td>
<td><strong>7,654,455</strong></td>
<td><strong>20,145,059</strong></td>
<td><strong>62,564,925</strong></td>
<td><strong>118,564,460</strong></td>
</tr>
<tr>
<td>Mark-Up 15%</td>
<td>1,339,456</td>
<td>2,398,178,75</td>
<td>3,021,750</td>
<td>7,883,240</td>
<td>19,534,655</td>
</tr>
<tr>
<td>Promotion</td>
<td>1,339,456</td>
<td>2,398,178,75</td>
<td>3,021,750</td>
<td>7,883,240</td>
<td>19,534,655</td>
</tr>
<tr>
<td><strong>SALES COST</strong></td>
<td>1,339,456</td>
<td>2,398,178,75</td>
<td>3,021,750</td>
<td>7,883,240</td>
<td>19,534,655</td>
</tr>
<tr>
<td>BPHTB (developer 5% transfer tax upon sale)</td>
<td>433,152</td>
<td>797,726,25</td>
<td>1,007,256</td>
<td>2,627,746,25</td>
<td>849,162,60</td>
</tr>
<tr>
<td><strong>GROSS TOTAL</strong></td>
<td>14,506,300</td>
<td>15,984,104</td>
<td>40,630,172</td>
<td>105,560,030</td>
<td>237,688,300</td>
</tr>
</tbody>
</table>

**Note:** The Figures are subject to variations, dependent on many local factors

**Legend:** [Assumptions]

- IMB = SIKUGL 63/2000 Art 5: Rp. 6,000/m2 x Build Size
- Urban Infrastructure: Rp. 30,000 / Rp. 35,000 / Rp. 40,000 / Rp. 50,000 / Rp. 60,000 per M2

<table>
<thead>
<tr>
<th>Percentages of Gross Total</th>
<th>Construction 35%</th>
<th>Land 32%</th>
<th>Permit 1%</th>
<th>Taxes 20%</th>
<th>Margin 12%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ir. Hador</td>
<td>18.5%</td>
<td>6.4%</td>
<td>0.1%</td>
<td>22.0%</td>
<td>-</td>
</tr>
<tr>
<td>MACRO FINANCIAL MODEL FOR URBAN DEVELOPMENT</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table: (25/04/2000)
APPENDIX NO. 1

SUMMARY OF SCOPE OF SERVICES

Following is the summary scope of work for each component:

Component A: Advisory Service to Directorate General of Human Settlement Development

1. Assist daily activities, dealing with operational and strategic issue.
2. Provide sound policy analyses and judgments required by the DG.
3. Proactive in unraveling policy-related problems faced by DGHSD.
4. Assess the organizational and management capacity.
5. Assess and prepare the HRD programs and training needs.
6. Facilitate the required training programs and activities to competent staff.
7. Promote conducive working environments for good governance.
8. Plan and arrange for survey of the housing needs and market in 10 cities.
9. Organize, conduct 2 national workshops.

Component B: Design of Policy Instruments for the Housing Assistance Program

1. Review International experience and best practices in Housing Assistance Program for Indonesia
2. Assist in planning the Survey under Component A.
3. Examine the need for Housing Assistance Program to the Underserved in Indonesia:
   a. Inventory of available statistical evidence in housing market in Indonesia
   b. Review the nature and performance of the current social housing programs.
   c. Inventory evidence on perception and socio-economic capacities of the target groups and stakeholders.
4. Design Policy Instruments on HAP for:
   a. Direct First-Time Home Ownership Assistance
   b. Home Improvement
   c. Self-built Housing
5. Develop Legal and Financial Structure of a National Housing Fund.
6. Disseminate the Proposed Program and Instruments for HAP for the Under-served through a 1st Workshop.
7. Coordinate work with experts C and D and the Team leader A.
8. Technology transfer: incorporate training elements as required within activities.
Component C: Policy Instruments for Housing Market and Housing Finance System


2. Assist in planning the Survey under Component A.

3. Examine the Housing Market and Housing Finance System in Indonesia:
   a. Inventory of available evidence on market distortion due to Govt policies and HFS in Indonesia
   b. Review the nature and performance of the current HM and HF policies and programs


5. Discuss the proposed Program and Instruments for EHM and HFS through 1st and 2nd Workshops.

6. Coordinate work with experts B and D and the Team Leader A.

7. Technology transfer: incorporate training elements as required within activities.

Component D: Development of Policies for the Community Based Housing Program

1. Review International experience and best practices on CBP’s.

2. Assist in planning the Survey under Component A.

3. Examine the performance in existing Slum Upgrading Program and CBHP in Indonesia:
   a. Inventory of available evidence on the current practice of KIP / CBHP
   b. Review the performance of current KIP / CBHP
   c. Inventory evidence on perceptions and socio-economic capacities of the target groups and stakeholders.

4. Develop Delivery Systems to scale up CBHP:
   a. Examine legal framework
   b. Devise delivery system for different CBHPs.

5. Design Policy Instruments on CBHP and Coordinate with the HAP (Component B).

6. Coordinate work with experts B and C and the Team leader A.

7. Disseminate the Proposed Program and Instruments for CBHP through a 1st and 2nd Workshop.

8. Technology transfer: incorporate training elements as required within activities.