**Housing Finance**: Majority of the new houses in urban Indonesia are built by contractors or and financed by the home owners by their personal savings. Only 200,000to 240,000 units are financed through Mortgage Finance per year out of a total requirement of 800,000 units/year: roughly 40-50 % of which receive a mortgage-linked subsidy. That means nearly one-fourth of the housing market is served by the formal mortgage finance industry. Many homeowners use short term loans from micro-lending institutions to fund housing construction, where no reliable data is available.(1zmr, p-7)

The top 30% of wage earners have no trouble in accessing a mortgage loan; it is the low-income segment which has issues in securing mortgage finance. About 40%, or more than 300,000 of the new households of the new households built annually, cannot qualify for loans because of low or uncertain income, high transaction costs, and credit risk perceived by the lenders. (1zmr,p-8)

Population: 217 mn (2004). 42% of people live in Urban areas. Population growth 1.49 % (1990-2000) ( 1zmr). Indonesia’s urban population increased rapidly from 17% of the country’s total population in 1971 to 48% in 2005. The proportion of the urban population is expected to increase to 68% by 2025. Besides natural population growth, urban-rural migration and the reclassification of urban areas are also factors. It is estimated that over the next 40 years, an average of 2.2 million people will move to urban areas each year. (2zmr, p- 11 )

Urban growth rate 3.5-3.75%, Household Size 3.9, No of Household 54.9 Mn

New Urban Household per year 800,000, which indicates demand for Urban Houisng 800,000/yr(1zmr, p-12)

**Inflation Rate** 9.06%, Interest Rate 14.17% (2005) GDP 6% at Rp 2.3 Mn Bn. Per Capita $ 1050 2004

**Min Wage Rate** Rp 711,843/Month The population living below the poverty line 24%. One out of four ( 1zmr, p-15)

Proportion of Labor Force in informal sector 74% (mostly in Agriculture and Trade), Formal 10% only. That means that for low income housing income assessment is a major issue.

**Banking** Out of total 131 banks, 70 are in private sector, 5 are State Owned, including the only housing bank, the Bank Tabungan Negara-BTN( a housing bank), and Bank Rajkat Indonesia-BRI ( a MFI), and 30 are Foreign Banks.( Central Bank of Indonesia, 2005).

The outstanding credit of 5 State owned banks ( Rp 242 Tr)s is nearly equal to that of 70 private banks Rp 276 Tn 2005

Banking Sector Net Interest Margin 5.75% 2005, NPLs 7%. NPLs of BTN mortgage portfolio increased from 3.2% to 5.3% in 2004 to 2005, mostly due to high NPLs on subsidized loans. Increase in NPLs is also caused by increase in Interest rates, since most of the Mortgage Loans are Adjustable Rate Mortgages.

Although the role of state banks in the provision of housing finance has changed considerably since the crisis, these banks still play a major role, especially for low-income households. In fact, the proportion of mortgages held by state banks in terms of value is roughly the same as privately owned banks. However, on average, the state banks grant much smaller average loans, so the actual number of loans facilitated by these banks is significantly greater than that facilitated by private banks. In particular, the government-owned Bank BTN has traditionally been a channel for the provision of housing subsidies, and remains so today.(2ZMR)

Banks continue to dominate the housing finance system. The funds for non-subsidized mortgages issued by private banks are derived mostly from deposits, which leads to insufficient liquidity and a potential problem arising from funding of long-terms loans from short-term deposits. The practice of adjusting interest rates according to the current level of cost to the lender reduces the interest rate risks borne by financial institutions and transfers the risk to borrowers (2ZMR, p-57)

In spite of some positive developments in the housing finance sector, the vast majority of Indonesian households do not qualify for housing finance. Rather, the majority of these households acquire housing through self-build, informal housing. The mortgage market still lags behind the overall economic development, although the value and volume of residential mortgage loans have been increasing quite fast, at a rate of between 20 to 40 percent per year from 2005 to 2010. Mortgages accounted for close to 9 percent of the total value of Indonesian banks’ portfolios in 2010. However, relative to the size of the economy, the sector remains small. The outstanding Mortgage Debt in 2010, represented a mere 2.3 percent of GDP. This is still lower than the pre-crisis level, when the figure stood at 3.1 percent. It is also much lower than the figure in comparable countries: for example, the proportion in the Philippines is more than twice as large. Moreover, government subsidized housing finance programs suffer significant problems with targeting. Although intended to facilitate the provision of low-cost housing, they do not seem to benefit households earning below the median income level. 2ZMR, p-53)



**Outreach**: Based on the current status of the housing finance sector, the biggest challenge relates to the expansion of access to housing finance. This expansion would involve bringing down the size of mortgages the private sector is willing to issue in order to free up government resources for low-income households and developing mechanisms through which those employed in the informal sector could become eligible for credit. Major financial institutions serve the salaried population only (tax returns are required even to benefit from subsidized loans), despite the fact that a majority of the population is active in the informal sector of the economy. Some institutions outside the mainstream financial system serve these segments, but their supply of housing loans is limited. Regional banks, which are well positioned to reach out to lower income households in their communities, did develop mortgage portfolios, but the volumes involved do not come close to those facilitated by commercial banks nor is this volume growing as fast. A mortgage business line has been developed by some credit cooperatives, although problems have been reported in the extension of low-income housing loans in this sector. (2ZMR, p-65)

Indonesia is well banked, despite a very difficult geography. Bank Mandiri, having nearly one-fourth of market share has 800 branches, and branches have internet connectivity. BTN, has a fairly extensive branch network in Urban areas, with 45 branches and 35 sub-branches (1zmr,p-21).

**NBFIs**: There are 237 FCs in Indonesia, most of which are engaged in consumer finance, but not much in housing finance at 0.5%.

**Microfinanc**e: MFIs provide a large number of small consumer loans, some of which are used for the upgrading of housing but not necessarily designed or recorded as housing finance.

MF loans are provided by Banks, Cooperatives and Credit Unions, Non-Bank Credit Unions and Pawn Shops. The BRI has an important role, and next are Non-Bank Credit Institutions like BKD, LDKP, BMT. However MF has not been focused on Housing. There ar a few special savings and credit products tailored to facilitate home improvements, home expansion, including development of rental rooms. and new construction on incremental basis. There are two main HMF programs: i) Govt led projects funded by international agencies, and ii) BRI’s special KUPEDES Product. The KUPEDES Product is not conventional mortgages, but the loans are secured by the Cash F lows.

There are a large number of non-bank credit institutions owned and controlled by

provincial, district or village government (over 4,000 in number), savings and credit

cooperatives and credit unions (over 2,000) and government pawn-shops (over 700

institutions). They play an important role in providing short-term credit, including for

home-improvement/expansion. Jointly with the large branch network of Bank Rakyat

Indonesia (BRI/People’s Bank of Indonesia), the micro-finance state-owned bank,

these institutions make access to financial services widely available in Indonesia.

The informal financial sector is known as microfinance sector.

The MFIs and BRI units serve more than 8.2 million clients, i.e. about 20% of the

Indonesian households. Their coverage of rural households is even significantly

larger (see Table 8). (4ZMR)

People in income bracket of less than Rp 100,000 are served by Moneylenders, Family and friends, while BRI clients are in income bracket of Rp 300,000 (2001 study).

**Cooperative**s: There are about 50,000 savings and credit cooperatives and Credit Unions, rural credit institutions and Govt owned Pawn shops.

**Secondary Mortgage Company (SMF)** was established as a State entity in 2005, with a capital of Rp 1 Tn. However, most funding of Bank’s credit is done through deposits and savings, and Banks have a mismatch of tenor on their books. Several banks, including BTN have issued Corporates Bonds, which is costly as compared to funding mortgages through deposits. Securitization through True Sale is rather expensive due to application of VAT at 15-20% (Double Taxation).

So far, the acceleration of securitization process

of mortgage asset has not been optimal yet. PT. SMF has begun the securitization

process and selling of stock collective investment contract guaranteed by asset

share fund of PT SMF, with nominal 100 billion rupiahs at the Indonesia Stock

Market (BEI).

**The Liquidity Facility**

In October 2010, the Ministry of People’s Housing developed and introduced a new housing finance funding program. This program is known as the Housing Finance Liquidity Facility (FLPP) and is being implemented by a new government entity, the Public Service Body for Housing Finance (*BLU Pembiayaan Perumahan*). The system is a shift from the previous one, in which housing subsidies were issued to households through interest rate buy downs or down payment assistance.

The FLPP is effectively a fund created to finance subsidized mortgages, with the goal of increasing liquidity in lending for “low-cost” housing. Funds are made available to banks at 4.5 percent for 15 years, and banks combine these funds with their own to issue 15 year fixed-rate loans at interest rates ranging from 8.15 percent to 9.8 percent, depending on the size of the loan and whether it is for a house or apartment. This gap in the interest rates enables banks to earn a market interest rate on the money they contribute.

**Mortgage Credit**: Outstanding Mortgage Credit 2005 Rp 50 Tn., (1997 Rp 20 Tn) MD: GDP is around 2% and Mortgage Credit is about 8% of Total banking credit. Banks dominate the Mortgage market. 2005 Figures reveal that Private Banks held 50% of the Mortgage Credit, while State owned banks including BTN control 38%, whereas BTN holds 25 % of the entire mortgage market. Before the financial crisis , BTN controlled nearly 80% of the mortgage accounts, but had suffered heavy losses in the crisis. However, under the cleaning and restructuring process, a sizeable portfolio was sold to the private banks. ( 1zmr,p-30)

On financing point of view, property credit grows as much as 29.7% annually in

the last five years (2002-2006). Property credit’s growth is higher than total credit

growth on conventional banks reaching 20.7% annually. The raise of property credit

is due to the policy that most banks put priority to deliver the credit to consumer

credit segment particularly Home Mortgage. Within the past five years, home

mortgage has been the main core for banks in expanding their credit; ratio of

property credit to total credit increases from 9.6% in 2002 to 14.7% in 2006.

Bank penetration in housing finance is still focusing on upper middle class

community with fixed income, with home mortgage value ranges from IDR 100-500

millions. This specific class covers 60% of housing business capitalization in

Indonesia.(4ZMR)

Housing Finance Assistance Programs

The implementation of housing policies is conducted by two main programs,

namely Housing Development Program and Housing Community Empowerment

Program, which aimed to improve housing quality in particular targeted at the poor,

low-income, and middle-income households:

a. Housing Development Program, which focuses on (i) improving housing

regulations, (ii) the provision of housing infrastructure and amenities for the poor,

(iii) development of healthy housing (low-rise and high-rise), (iv) exchanging

experiences and (v) best practices on housing development.

b. Housing Community Empowerment Program, which focuses on (i) developing

housing finance system, (ii) improving the quality of slums, traditional villages,

fishermen villages and resettlement areas, (iii) facilitating and stimulating

community-based housing development, (iv) facilitating and stimulating the postdisaster

rehabilitation of human settlements, (v) simplifying the procedures, (vi)

improving secure tenure, (vii) enhancing local housing institutions such as microfinance

institutions/cooperatives, (viii) strengthening stake-holder’s forum and

(ix) supporting social housing development.

**Mortgage Products**: There are three basic types of mortgage products in Indonesia. Loans that are issued under the subsidy program are provided as fixed-rate loans. This is also true of Sharia products, which represent a small but growing share of the market. By contrast, non-subsidized loans are generally adjustable-rate mortgages (ARM). Interest rate adjustment on the ARMs is not capped and is at the discretion of the lender, although most banks use movements in Bank Indonesia Certificates (SBI) as guidance. Adjustments of rates have been significant in the past and can impact the level of non-performing loans to a high degree.

Mortgage loans are extended for maturities of up to 20 years, but often actually run for far shorter periods as it is a common practice for borrowers to prepay. Because of funding constraints, interest rates are generally adjustable according to the lenders’ cost of funds, which can translate into a credit risk in stressed financial market conditions. Loans with an initial period at a fixed rate also exist, but at a higher rate. According to a recent survey (NORC, 2008), a large majority of households would prefer fixed rate loans.

**Loan Terms**: Tenor 8, 10, 15 years. LTV average 75-80%. Range is 50-90%, depending upon perceived risk.

The average maturity of housing loans is 15 years, although certain banks, can

lend for up to 20 years.

Most banks, including BTN, demand a fixed monthly installment with floating

interest rates.

Most banks set a Rp300 million limit for mortgage financing, but certain upscale

banks are willing to lend up to Rp1 billion. Generally, the monthly installment

payment should not exceed 30–35 percent of the borrower’s monthly income.

**Payment to Income ratio** is 35%. Transaction Costs are high, effecting low-income borrowers.

**Transaction Costs** for Mortgage Finance in Indonesia is relatively very high (Rp 2.5-3.0), due to title verification and transfer, insurance, and Fees involved. In some cases it makes 2-3 times the monthly income of the low-income borrower. This over and above the down payment of around 20% he needs to arrange. Other than a subsidized house, it becomes too high and un-affordable for the poor. (1zmr,p-35)

Given that lenders charge high up-front origination fees and require flat insurance premiums (life and property), the cost of housing loans is high for consumers. Closing costs, for example, range from 3.5 percent to 5 percent of the property value.(2zmr)

Only BTN serves the low cost housing market, while all other lenders serve the market of Rp 100 Mn housing cost, while majority households can only **afford** housing below Rp 50 mn.)1zmr)

**Mortgage Regulations**: Mortgage Law (Udang Udang Hak Tanggungan-UUHT-4/1996)

**Regulator**: Banks including BTN are regulated by Central Bank- Bank Indonesia, with no specific regulations for HFCs. (1zmr,p-37). There are no fiscal concessions to mortgage lending. Tax on financial services and VAT (10-15%) are applicable as per norm and that makes secondary market more expensive and prohibitive.

**Titles**: Titles are relatively better in urban households, but needs improvement. **National Land Agency** (BPN) trains the local registers.

**Appraisal**: Self-regulated by some leading professional Appraisal organizations. They have certifies Appraisers.

**Consumer Credit Information System**: There is no Credit Information system, nor a Credit Bureau.

**Foreclosure**: Mortgage Law addresses the issue quite effectively. However the Eviction remains an issue, since it needs a court order, which is time consuming and involves cumbersome procedures. However the court route facilitates the eviction.

Foreclosure Mechanism

Based on article 6 Law no 4 of 1996 that the creditors as the holder of the

mortgage rights can reserve the right to sell the collateralized land at public auction

when the debtor default. This right takes precedence over other creditor’s rights.

**Large Scale Developer Finance:** There is a shortage of Construction Finance, less than 1% of the formal value of the construction by the developer’s. One reason for slow growth in this is that most of the Construction Finance went bad in the crisis, and even after that, the market sees more defaults in that. The Developers fund their projects through owner equity. The Govt is encouraging large scale developer built housing.. In2005, Developers supplied a total of 193,000 units, out of which 82,500 houses, nearly 40% were in Low-Income segment financed by BTN. Land at affordable cost remained one major constraint for the developers to enter into lower and middle income housing market. The Govt has to come forward to provide Serviced Land at affordable price to the developers for enhancing low-cost housing.

**Housing Supply by Developers**: The number of housing units produced by developers has grown in proportion to the increase in Indonesia’s urban population, which roughly doubled in the period from 1990 to 2010. In 1988, approximately 100,000 housing units were produced by formal developers. In 2005, the number of housing units produced by such developers had increased to almost 200,000. In 2009 and 2010, roughly half of the sales of formal houses were for “small houses”, which are defined as houses occupying no more than 21 square meters on a 60 square meter lot (Bank Indonesia 2010). It is also important to note that developer-built housing is located predominantly in the larger urban areas, where incomes are on average higher.

The dominant form of housing production in Indonesia remains self-build incremental housing which, according to the 2007 housing module of SUSENAS, was responsible for more than 70 percent of houses produced in the period from 2002 to 2007 (2zmr, p-68)

**Housing Stock and backlog**: The estimated housing stock is around 54 Mn units, out of which 24 Mn is Urban Housing Stock. There is an estimated backlog of 6 Mn units. The Govt plans to build One million units per year to cover up the backlog by 2020.

Homeownership is extremely high even in urban areas at 70 %, whereas it 90% in rural areas. A vast majority of homeowners have valid legal titles deeds to the land after the massive campaign of Land Agency (BPN), and owners have either Freehold Titles or BPN Certificates. Property Rights to Land are primarily Freehold (Milik), Urban 91% and Rural 96%. The remaining are Rights to Build given by the Developers. (1zmr,p-41)

According to BPS Housing and Land Survey-2004, close to 80% of urban housing is single storey non-attached and only 1% is multifamily. Unit sizes are 50% with covered area of 50-100 SqM, and 34% with 29-49 SqM. While 58% of homeowners built their own houses, 11% buy from the secondary market, and 8% buy their hoses from the developers. Nearly 2/3rg owners buy from their own resources, while 28% used mortgage finance.(1zmr, p-42).

To get an indication of price of housing, while BTN portfolio has 21 M2-36**M**2 in price range of Rp 35 Mn - %7 Mn, the Private Banks operate in the higher price range at 36 M2-45 M2 at price range of Rp 100-120 Mn.

**Income and Affordability**: Indonesia needs nearly 800,000 housing units per year in Urban areas only to meet the demand due to population growth and urbanization. The need will be more to cover up for the backlog, say more than One million units per year. Since a family has more than one wage earner, Household Income rather than individual income.

Housing in Indonesia has been referred to as ‘relatively affordable’, based on an estimate of the price of a new house and the median household income (Hoek-Smit, 2008). However, since 2000, this seems to be changing. A simple measure of affordability – the share of household expenditure allocated to housing – showed an almost one quarter increase in the period from 2001 to 2007, from about 18 percent in 2001 to 22 percent in 2007. (3ZMR, p-27)

**Cost Affordability**: Based on 2004 estimates, for a Median Income of Rp 1.2-1.5 Mn, , Median Price of Rp 50 Mn in formal/urban housing of size 36 M2, , and Price-to-Income ratio of 3-3.5, seems affordable. This is the range BTN is operating. The issue is that market based supply in this range is very limited, and developers have to be supported to enter in this price range. (1zmr,p-46).

Low Income Housing Finance: The commercial banks are generally not interested in low-income housing finance, for various reasons including high intermediation cost, high transaction cost, higher risk etc. They are more inclined to a larger section of creditworthy middle income households. The lower income segment either depend upon informal sources or personal savings, and to some extent to subsidized housing fiancé programs through institutions like BTN.

Bank Tabungan Negara (BTN) : BTN’s mandate is to provide housing loans to low, lower middle and middle income segments. It is the main user and administrator of Govt’s mortgage subsidy program. Founded in 1897 as a Savings bank, BTN was converted to a specialized housing finance institution in 1974, primarily as a delivery arm for Govt’s subsidized housing finance program. The subsidies were primarily (75%0 going to Civil Servants, and even middle income segment could use it by understating income. The tenors were 20 years, and interest rates highly subsidized. The preferred to be delinquent since Foreclosure were difficult, and people used the money either for consumption or in Bank Savings yielding higher interest income. Its funding sources remained Govt funding and World Bank loans. Its market share of urban housing market, needing nearly 800,000 units per year in urban Indonesia has been very small. NPL’s are more in subsidized mortgages ( at 6% 2005) than non-subsidized mortgages ( at 3% 2004). (1zmr, p-51).

Subsidy Programs: The GOI KPR Subsidy Program enables BTN to lent at fixed, below market inters rate to qualifying homeowners. All subsidized lending was associated with specific housing developments, implemented by developers, who also captured some of those subsidies. The program has since been slashed due to financial constraints, more so after the financial crisis in 1997.and is only available to the remaining portfolio in the books. Now the mortgage linked subsidy program has two options: an Upfront Subsidy Program , and Buy Down of Inters Payments, a kind of an interest rate swap methodoloigy.

**Low Income Housing Policies**:

The lowest income group, which includes the poor community, indeed does not

have capability to buy a house. Therefore, the policy is to support them in economic

empowerment so that their capacity, in term of purchasing power, will be improved.

The policy on rental low cost flat is formulated for group that has only capability to

rent based on their income.

In order to provide affordable shelter for each group, government supports are

also given in supply side, such as for permits, infrastructure, taxes, and land

availability. All supports hopefully could make the shelter price be affordable to low

income community.

Latest policy released is for low-income community who would like to live in

vertical housings, or known as low-cost apartments, especially in urban areas. This

policy is to solve the problem of urban land availability and to promote people living

close to their workplace.

Low-income community is divided into four (4) groups based on income up to

2.500.000 rupiahs per month. For vertical housings in urban areas, the income is up

to 4.500.000 rupiahs per month (considered as middle-income community). A

support from government is subsidy in demand side to increase purchasing power of

the groups, and tax incentive in supply side to shape an affordable price. (4ZMR)

**Credit Bureau**:

Development of Credit Bureau is one way to improve the market efficiency. This

bureau will provide information of middle and low-income community who would like

to apply for home mortgage. By getting information from this bureau, the lender will

have advanced information to appraise his ability to pay and therefore, the mortgage

default could be eliminated.

1ZMR: Housing Finance Mechanisms in Indonesia, UN-HABITAT, Nairobi, 2008

2ZMR: Housing Indonesia: Expanding Access, Improving Efficiency, World Bank 2012

3ZMR: Hoek-Smit, M.C. 2008. Housing Finance Mechanisms in Indonesia. United Nations Human Settlements Program. UN-Habitat, Nairobi.