HOUSING FINANCE MECHANISMS
in Indonesia

UN-HABITAT

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FOREWORD

At the dawn of this new urban era, UN-HABITAT research shows that by 2030, two-thirds of humanity will be living in towns and cities. We thus live at a time of unprecedented, rapid, irreversible urbanisation. The cities growing fastest are those of the developing world.

And the fastest growing neighbourhoods are the slums. Indeed, the global number of slum dwellers is now at or close to the 1 billion mark. Excessive levels of urbanization in relation to the economic growth have resulted in high levels of urban poverty and rapid expansion of unplanned urban settlements and slums, which are characterized by a lack of basic infrastructure and services, overcrowding and substandard housing conditions.

Yet housing and the services that should be provided with it are one of the most basic human needs. It is enshrined in various international instruments, including the *Habitat Agenda*. And reducing the number of slum dwellers around the world is a cornerstone of the *Millennium Development Goals* set to fight poverty around the world. So if we fail to achieve the Goals in towns and cities, we will simply fail to achieve them at all.

It was with this crisis in mind that the United Nations General Assembly decided in its resolution of 26 February 2002 to transform United Nations Commission on Human Settlements into a fully pledged programme. The General Assembly in its resolution called on UN-HABITAT to take "urgent steps to ensure a better mobilization of financial resources at all levels, to enhance the implementation of the *Habitat Agenda*, particularly in developing countries." It also stressed "the commitments of member states to promote broad access to appropriate housing financing, increasing the supply of affordable housing and creating an enabling environment for sustainable development that will attract investment".

The *Habitat Agenda* recognizes that housing finance systems do not always respond adequately to the different needs of large segments of the population, particularly the vulnerable and disadvantaged groups living in poverty and low income people. It calls UN-HABITAT to assist member states to improve the effectiveness, efficiency and accessibility of the existing housing finance systems and to create and devise innovative housing finance mechanisms and instruments and to promote equal and affordable access to housing finance for all people.

In our quest to reach as many people as possible, a cornerstone of our agency's new Medium-term Strategic and Institutional Plan is partnerships. We have no choice but to catalyze new partnerships between government and the private sector. This is the only way to finance housing and infrastructure at the required scale – the scale needed to stabilize the rate of slum formation, and subsequently reduce and ultimately reverse the number of people living in life-threatening slum conditions.

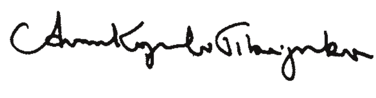
It is clear that in the coming 20 years, conventional sources of funds will simply be unavailable for investment at the scale required to meet the projected demand for housing and urban infrastructure. Many countries around the world continue to face deficits in public budgets and weak financial sectors. Local governments have started to seek finance in national and global markets, but this is only in its initial phase.

New mortgage providers have emerged, including commercial financial institutions and mortgage companies. But only middle and upper income households have access to such finance, while the poor are generally excluded. Although social housing is becoming less important in Europe and in countries with economies in transition, the need to provide shelter that is affordable to low income households still exists, including in developing countries.

This is why the exchange of information and knowledge on human settlements finance systems is so important. It is why it receives increased recognition in facilitating the development of human settlements finance systems and in turning knowledge into action for developing practical human settlements finance methods and systems for these pressing problems.

Our *Human Settlements Finance Systems* series documents the state, evolution and trends of human settlements finance in member states, and examines the factors and forces which drive the development of human settlements finance systems and the roles of different institutions and actors in shaping the systems and trends, and reviews human settlements finance systems. It presents an interesting review of policies, instruments, processes and practices. It examines the strengths and weakness of these systems and practices, their relations to the housing sector and the broad economic and social sectors, and lessons learned from practices.

Indeed, the country review studies we present are a valuable resource for member States because it is a body of work that also shows how human settlements finance systems and models can be applied to local use and thus provide a wider range of options for human settlements finance. The series also serves as guidebooks for policy makers, practitioners and researchers who have to grapple daily with human settlements finance systems, policies and strategies.



Anna Tibaijuka,
Under-Secretary-General of the
United Nations,
Executive Director, UN-HABITAT.

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Executive Summary

The majority of new houses in urban Indonesia are built by contractors or financed by homeowners from their savings. Only about 200,000 to 240,000 units are financed through mortgage finance per year[1] out of a total requirement of 800,000 units: roughly half to 40 percent of which receive a mortgage-linked subsidy. Many homeowners use short-term loans to finance the construction of their homes from one of the many micro-lending institutions, but no data is available of the actual size of this type of lending and no special housing micro-finance product actually exists.

The construction of homes is close to the national requirement for new housing. Housing prices are not showing signs of an overheated market and house-price–to-income ratios (3 to 3.6) and to the overall CPI, appear modest.

The predominance of residential housing development has caused severe limitations, however, on the provision of services and infrastructure and as cities expand rapidly the quality of housing is declining. Indonesia's housing stock is showing major signs of stress in both areas.

This report focuses on two frontiers and examines ways of extending access to housing finance to households below the 60th percentile of the income distribution: 1) By improving efficiency and by providing progressive subsidies to households at the margin who can, with a subsidy, access a mortgage loan and either build a new house or renovate an existing one. 2) Formalize and strengthen micro-financing for housing to assist households who have land or who were given a serviced plot (with or without a core facility) by government to built their own house.

The report examines the constraints in the housing market beginning with a brief overview of the formal financial sector and the cooperative and micro-finance institutions of Indonesia. It shows how the current period of macro-economic volatility is having a negative impact on the expansion of the mortgage sector - just when this sector had made substantial improvements in the aftermath of the 1997/98 economic crisis. Nominal interest rates have increased since the end of 2004 because of rising inflation and, as a consequence, the number of non-performing loans has increased. Moreover, long-term investors have moved part of the deposits held in the banking system to short-term deposits, creating concerns about gaps in asset-liabilities. As a result, there has been a flattening out in mortgage lending in the past few years. The study concludes with a summary of the major constraints in the system and makes recommendations for the improvement of financing for the low-income sector, as summarized below:

[1] It comprised only 7.8 percent of all credit outstanding and was 1.83 percent of the total value of GDP in 2004.

A. There are serious gaps in accessing housing finance for two groups:

1. Lack of access to mortgages for credit-worthy households whom the market is not yet serving. The top 30 percent earners have no trouble accessing a mortgage loan. It is the low income sector that has problems in entering the mortgage market because of high transaction costs and the credit risks to the lenders. The current subsidy programs may extend access to mortgage loans to the 40th percentile of the income distribution (the subsidy program can cover approximately 12.5 percent of demand for new homes with its current scale), but this leaves a large gap of creditworthy households not yet deemed mortgageable. Lack of finance for affordable housing in the resale market inhibits upward mobility in the formal housing market. Some lenders may fill that gap, but may require some support (see suggestions under B).

Recommended actions:

i) The Ministry of Housing and MOF/BI explore ways to tie savings with subsidized loans so as to establish lender confidence and increase owner equity particularly for *borrowers who have no fixed*

iii) Focus consumer education programs and consumer support systems on this group specifically.

iv) Allow part of the subsidy programs to be used for existing housing.

2. Lack of a special short-term, non-mortgage-based housing finance product for those households who do not qualify for or who do not desire a mortgage. Irrespective of the exact number of households with access to a regular mortgage loan, with or without a subsidy, about 40 percent, or more than 300,000 of the total of new households built annually, cannot qualify for loans because of low or uncertain income or poor collateral. Several banks and possibly some finance companies and micro-lending institutions could target this market. A new subsidy program is being developed that seeks to stimulate the expansion of this sector through the provision of guarantees for part of the loan. But there is, as yet, reluctance by insurance companies to buy into the scheme.

Recommended actions:

i) Provide training in housing micro-finance and give technical support to cooperatives and other such lenders who are technically weak.