

# Expanding the Formal Lower/Middle Income Housing Market in Indonesia

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Urbanization , Urban Housing and Housing Finance in Indonesia  
Lessons Learned and Critical Thoughts to Move Forward

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# Indonesia's Housing Policy at a Critical Junction

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## □ Ambitious Housing Agenda

- 2019 Slum free (currently 22% of urban hh in slums)
- 1M New Homes Program
- Comprehensive housing policy of 2015

## □ Scale of the urban housing problem large but not insurmountable

- ~1M new housing units needed annually for new household formation + urbanization
- Private sector: ~400,000 units/year (upper/ middle income)
- Government subsidized: ~95,000 – 150,000/year
- Self-built model predominant; but **density limitations** with increased urbanization (60% urban)
- Scaling up of multi-family housing in larger urban areas

# Economic/Financial Environment Positive

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- Economic growth well above population growth
- Decreasing poverty rate
- Modest inflation; Low indebtedness of population
- Stable and growing financial sector
- Major initiatives on infrastructure finance, infra PPPs, land acquisition, foreign investment in real estate

## But:

- Economy remains highly informal (60 to 70% of labor force)
- Fiscal constraints
  - ▣ Affects GoI Housing Budget: ~21 Tr IDR (~0.2% GDP/2016) insufficient to bridge housing gap with subsidies
- Need to bring private sector more fully into “affordable” urban housing market

# Current Private Sector Involvement

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- Vibrant private residential sector for the higher incomes, both lenders and developers
- Private participation in affordable segment limited to government assisted housing
  - BTN predominant lender
  - Apersi and REI developers more like contractors for subsidy program

**Question: how to expand private residential development down-market – subsidized and increasingly non-subsidized**

Gradual expansion in mid-market has enormous economic opportunities!

# Main Issues for Expansion of Private Market for “Affordable” Housing

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- Remaining inefficiencies in the housing finance system
- Lack of access to housing finance by large section of creditworthy lower/middle income households (e.g., informally employed)
- Growing stress between house-prices, location/land-cost and incomes/subsidies
- Growing stress with self-built model, density requirements, and need for mobility —trading of existing houses!!

# Paradox!!

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Achieving Greater Private Sector Involvement



Requires More Government Involvement

Not Less

Just Different

and by More Parties

# 1. It all Starts with Finance!

## No Finance, No Developer/Investor Participation

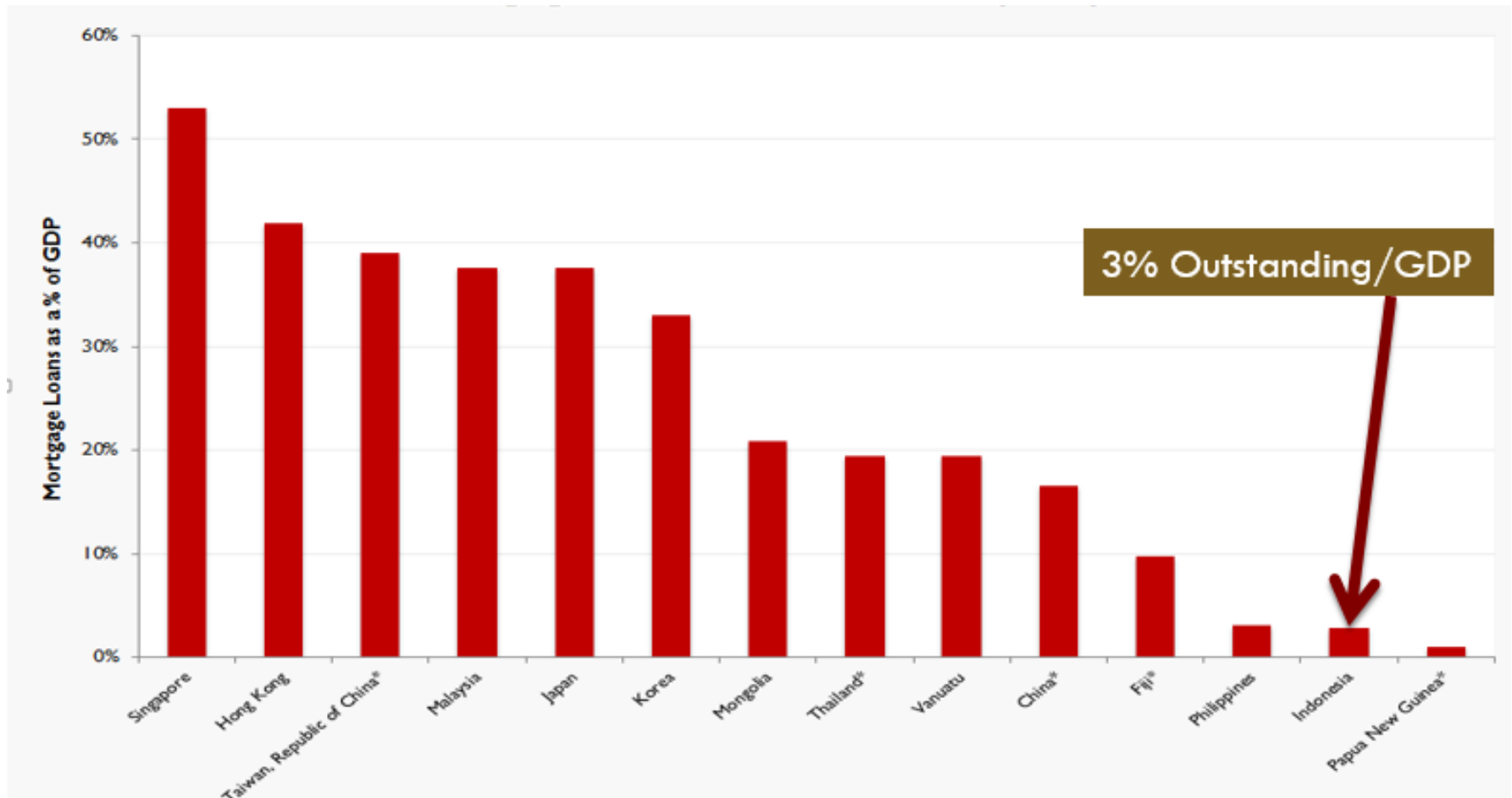
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- Current size/reach of housing finance system is small
- Down-market penetration limited to few lenders
- **Reasons Well Researched:**
  - ▣ **Limited capital market access;** few tools for interest rate & liquidity risk management, limited access to well-priced funding
  - ▣ **High perceived credit risk** - particularly for informally employed; limited credit information & credit insurance
  - ▣ High regulatory costs (Basel III)
  - ▣ **Subsidies linked to finance not-market compatible**
    - Risky & admin cumbersome for lenders
    - Uncertain subsidy flow & frequent changes
  - ▣ Resulting in BTN being ~only lender in subsidized & affordable segment for end-user and developer finance

# Indonesian Mortgage Market Is Extremely Small Relative to Other East Asian Markets

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## Mortgage Loans Outstanding as % of GDP 2014/15



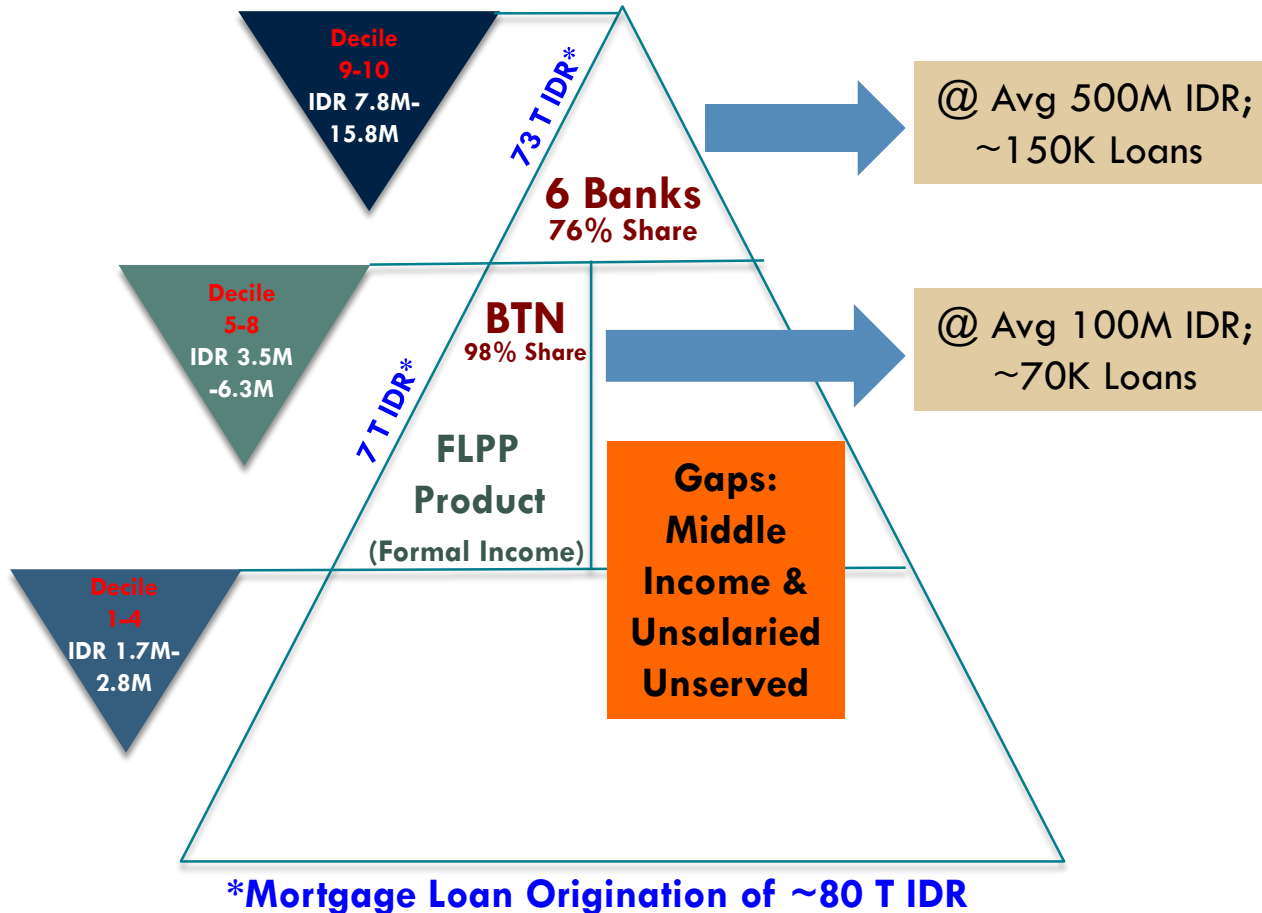
Source: Hofinet.org, 2014/15



# Main Banks Focus Mortgage Lending on Top 20% of Income Distribution- Only BTN in Broad Middle Income Segment

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\*Sources: BI Residential Property for Primary Houses, MPWH data and World Bank Assumptions – Average for 2014 and 2015



**No Housing Finance Available for Unsalaries, Middle Income and Below**

# Government Action to Incentivize Growth of Low-Middle Income Mortgage Market

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- Enhance status of SMF and its bonds in the market
  - ▣ Requires actions by BOI, OJK, MWHS
- Facilitate regulatory environment for mortgage lending without destabilizing system
  - ▣ BI and OJK recently eased LTV and capital requirements
- Improve credit guarantee scheme; credit bureau
- Shift to market-friendly subsidy program that has staying power and includes existing houses (mobility)
- Educate lenders to loan to non-fixed income customers
- Expand customer information/education
- Develop National Housing Information System

# Chile: Example of Early Reformer

## Many Adjustments over the Years

- 1978 fundamental reform in provident fund mortgage system
- Expand commercial mortgage market/capital markets
- Simple vouchers for ownership--worked only for bankable

### 1990-2000s Segmented Market approach:

- **Finance-based programs for Middle Income** - support to lenders to deal with transaction costs, credit and/or funding risks – voucher subsidy for households; includes existing houses
- **Community-based programs for Low Income** – after many false starts - variety of location incl. high density infill, avoiding concentration of poor- NGO intermediation- innovative designs
- **Rental programs /vouchers, but small**

**Programs efficient enough to be used as economic stimulus**



## 2. What about Housing Supply?

### Will it Increase Simply b/c Access to Finance Increases?

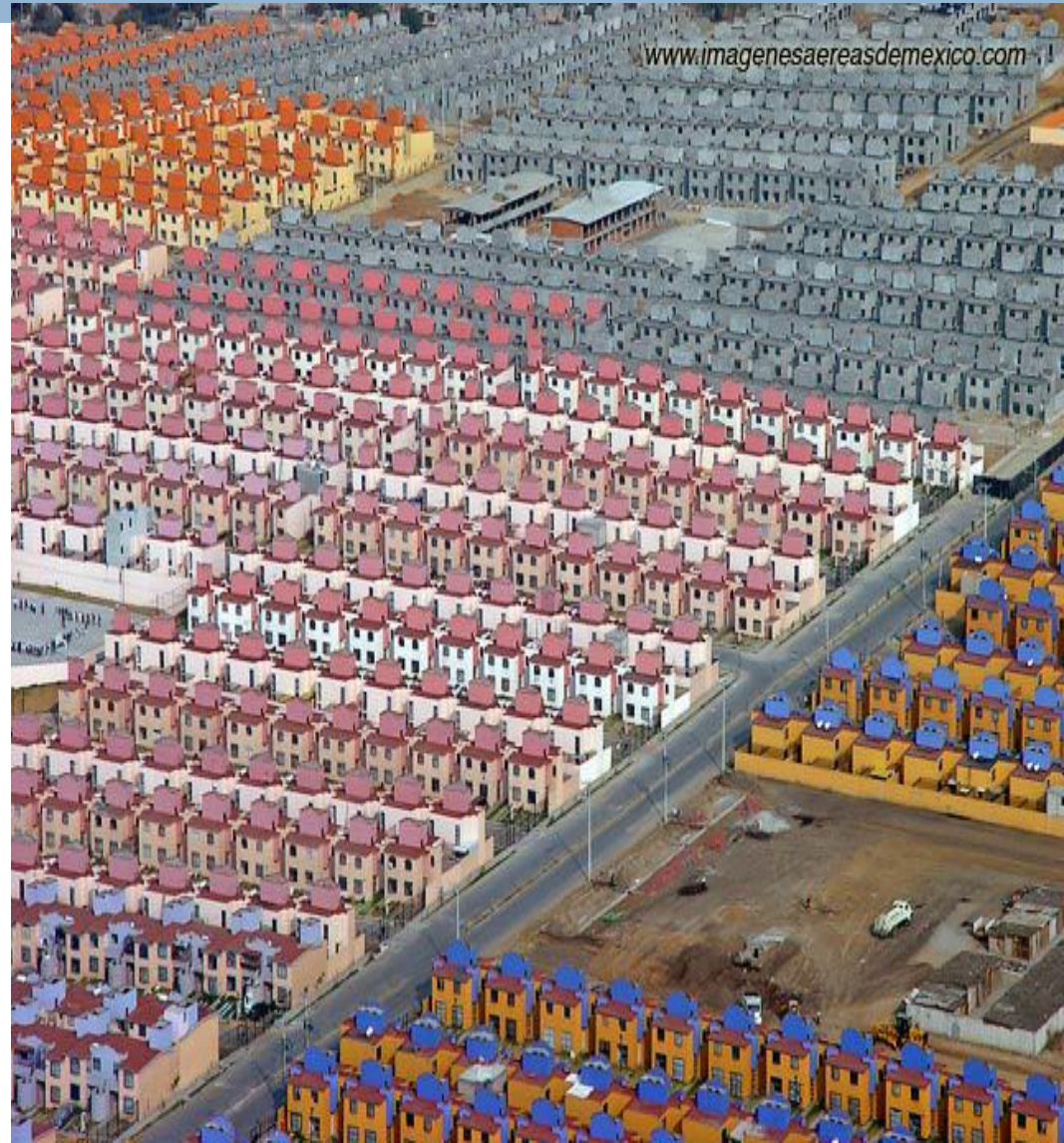
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- Mexico and US Examples show that a single focus on increased access to finance is insufficient
  - “Affordable” housing markets requires oversight /support to:
    - ▣ Developers and Investors (rental)
    - ▣ Local Governments
    - ▣ And related actors in supply chain
      - Appraisers
      - Notaries
      - Land Offices
- } not discussed here



# Mexico: Focus on Credit Based Formal Ownership for Very Low-Income HH (1.5MW)

- Housing provident funds control supply-chain; subsidized loans + upfront subsidies / guarantees reach very low income hh-1.5 MW
  - Unit costs/type set by provident funds/
  - Private developers/ land cost compromised location
  - Massive vacancies
  - Developers under stress
  - Excludes informally employed
- ➔ **Housing deficit continues to grow**

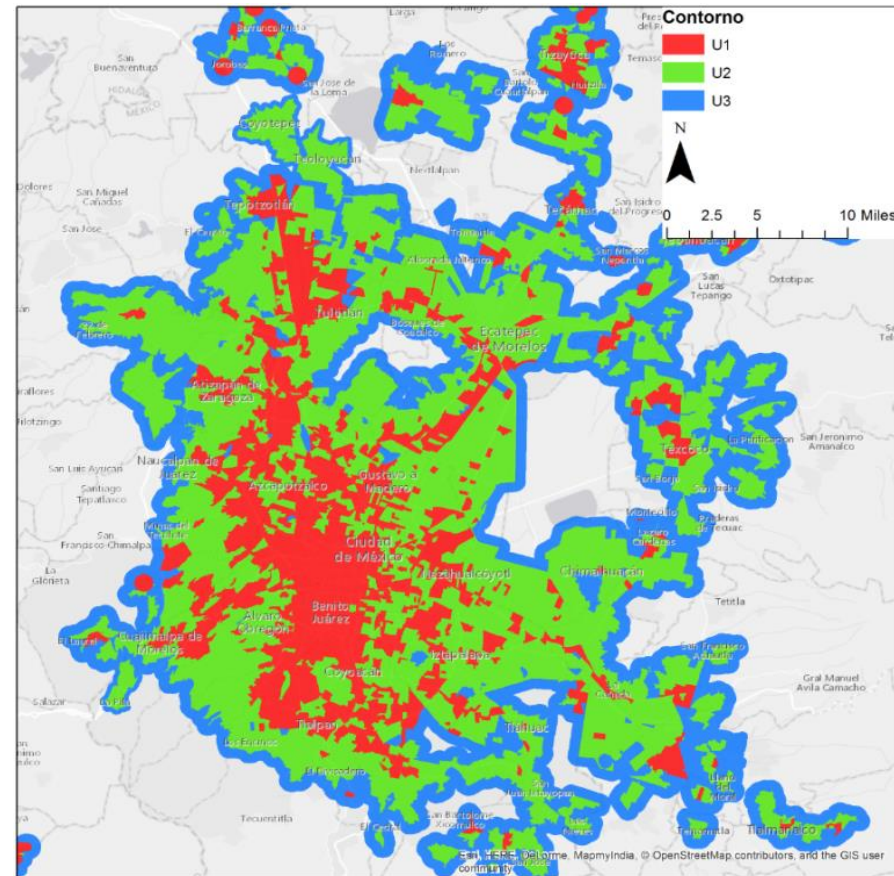


# Mexico: Major Shift in How to Work with Private Developers

- Shift in subsidy policy to include **locational variables** in subsidy amount -2013-subsidies vary by zone
- Expand **housing choices**, including rental

## Remaining Challenges:

- Inclusion of existing houses in subsidy program
- Active supply side support (regulations, permitting, PPPs) to developers
- Now PPP with rental investors



Source: Conavi; Mexico city

# Indonesian Developers: Constraints to Enter Affordable Market and Possible Incentives?

- 700 Developers in affordable housing (Apersi) and many more in regular market (REI)- Great capacity/interest
- Prelim Research Shows their Issues:
  - Need for efficient PPPs linked to land and infrastructure access
  - Weak Local Govt. planning process (**densities** and enforce 1-2-3 rule)
  - Access to land and bridge-finance;- regulatory issues (OJK)
  - Unpredictability of subsidy allocations; need pipeline of projects
  - Govt. bld. standards/prototypes; need for innovation in house types;
  - Better systems for transfer of properties
  - Lack of information on home-prices, housing markets
  - But most of all: **need capable efficient municipal procedures to assist with land assembly, land registration, project design/ approval/ packaging– one stop shop**



### 3. The Critical Role of Municipalities: Constraints?

Housing is local!!

Municipalities must want and facilitate low-middle income housing/Not necessarily the case:

- ▣ Is there capacity to plan for low-middle income housing?
- ▣ Is affordable housing low priority b/c of low return (low tax pmts and high servicing costs, small developer payments)?
  - Is improvement of tax-roll an incentive for munis at all?
- ▣ Can munis make adjustments to national subsidy program? Does it keep waiting lists for applicants? Does it pre-select people?
- ▣ What is munis' role in approving/inspecting self-construction?

More research is needed in this area



# The Critical Role of Municipalities: Possible Incentives?

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- Government has support program for Municipalities/  
World Bank plans similar type of support
- Are these effective to address munis' capacity to plan for affordable housing?
- Should Indonesia consider **incentive program for munis** to engage with the supply of affordable housing?
  - ▣ Option: a block grant program that allows flexible spending specifically for affordable housing and related services (US example)?
  - ▣ Grant munis a larger role as subsidy demand managers?

**More research is needed in this area**

# Conclusion and Way Forward

## Much capacity available in private lending and developer sectors

- Harnessing these resources for the expansion of the broad middle income housing market requires incentives for:
  - Lenders
  - Developers
  - Municipalities
- Needed reforms/incentives for finance sector well understood
- Research needed on incentives for developers and municipalities
- For all parties – Government, Financial Sector, and Developers-  
- a high priorities is **better information on the housing sector**
- This agenda is multi-year, multi partner
- Implementation may be facilitated by high-level committee

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