

**PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE**

Report No.: PIDA91525

Project Name	National Affordable Housing Program (P154948)
Region	EAST ASIA AND PACIFIC
Country	Indonesia
Lending Instrument	Investment Project Financing
Project ID	P154948
Borrower(s)	Ministry of Finance
Implementing Agency	Ministry of Public Works and Housing
Environmental Category	B-Partial Assessment
Date PID Prepared/Updated	01-Dec-2016
Date PID Approved/Disclosed	02-Dec-2016
Estimated Date of Appraisal Completion	
Estimated Date of Board Approval	30-Jan-2017
Appraisal Review Decision (from Decision Note)	

I. Project Context

Country Context

1. Indonesia is undergoing a major and rapid structural transformation into an urban, manufacturing and service-based economy. Indonesia's cities are growing faster than many of their Asian peers, with the urban population increasing at an average rate of 4.1 percent per year between 2000 and 2010 (compared to 3.8 percent in China, 3.1 percent in India and 2.8 percent in Thailand). In 2012, the urban population was over 52 percent of the total population, and by 2025, an estimated 68 percent of Indonesians will live in urban areas. Approximately 18 million of the 21 million jobs created between 2001 and 2011 were in urban areas, marking a major shift of the employment base toward cities.

2. However, a large infrastructure deficit, slow gains in labor productivity, rising inequality and a severe shortage of affordable housing threaten to limit the benefits of urbanization by stifling growth and poverty reduction. In urban areas, quality housing and access to basic services, such as water, sanitation, or transport connections, remain poor relative to Indonesia's wealth and level of income. In 2014, around 33 percent of the urban population did not have access to clean water supply facilities, while 40 percent did not have access to sanitation facilities. In addition, the large increases in urban population, combined with a dearth of affordable housing options for lower-income households has led to overcrowding and the growth of slums characterized by substandard housing, inadequate access to basic services, poor health and vulnerability to disaster risks. Approximately 22 percent of Indonesia's urban population (equating to a 29 million people) is

estimated to live in slums, which cover an estimated 38,000 hectares.

3. As more people move and work in urban areas, it will be critical to support inclusive and well-planned urbanization and increase the supply of adequate housing in well-served and connected neighborhoods in order to enhance living standards. As income rises and existing large metropolitan areas such as Jakarta and Surabaya become saturated, the demand for consumer durables, shopping space and housing will increase significantly in smaller cities. Empirical evidence shows that urbanization supports growth and poverty reduction in Indonesia only in the presence of adequate infrastructure, including safe and affordable housing.

4. The financial sector in Indonesia is still in the early phase. Banking dominates the growing Indonesian financial sector, controlling nearly 80 percent of its assets. Overall, assets of banks and non-bank financial institutions (NBFIs) have grown substantially since the global financial crisis, from IDR 2,942 trillion or 59.4 percent of GDP at the end of 2008, to IDR 7,459 trillion or 70.8 percent of GDP in early 2015. In August 2015, there were 118 commercial banks (including 4 SOE banks and 26 regional development banks) and roughly 1,644 rural banks in Indonesia. NBFIs consist of pension funds, insurance companies, mutual funds, and other financing institutions including venture capital, leasing companies, pawnshops, and microfinance institutions. Of these, insurance and financing companies are the two largest groups of NBFIs in terms of assets.

5. Only a small part of Indonesia's total population has access to banking services. Indonesia has a low rate of uptake of slightly under 20 percent, compared to Thailand at almost 78 percent and Vietnam at 21.4 percent. Only 21.9 percent of the poorest 40 percent of the Indonesian population has savings in a financial institution. Furthermore, over 40 percent of the population does not borrow, with only 13.1 percent having borrowed from a financial institution.

Sectoral and Institutional Context

6. There is a substantial demand for affordable housing in Indonesia as a function of both new annual demand creation and an unmet deficit. There are approximately 64.1 million housing units in Indonesia, of which around 20 percent are in poor condition and an estimated 820,000 to 1 million new units are needed each year to respond to annual housing demand from population growth, new household formation, and migration to urban areas. The private sector only produces approximately 400,000 units per year. Public sector programs, including incremental home improvement assistance, rental housing, and social housing programs, enable an additional 150,000 to 200,000 solutions. This leaves a gap of an estimated 220,000 to 370,000 households that must resort to informal solutions or overcrowding in existing units each year.

7. While estimates of the housing deficit vary widely (owing to conflicting definitions of the term), all official metrics indicate a substantial housing deficit. Based on 2015 National Household Survey data by BPS (Central Bureau of Statistics), MPWH estimates a housing backlog of 11.4 million units. However, this estimate is likely to be significantly overstated as it is based on home ownership information and fails to take into account renters or lessees whose lifestyle preference may not be to own housing. Using the alternative definition of overcrowding, the number of substandard units was estimated at 7.5 million in 2013. Lastly, a further quantification of substandard housing estimates that 45 percent of all units are substandard by some measure, i.e. overcrowding, constructed built of at least one poor quality material, or lack access to basic

services .

8. Affordability remains a key constraint significantly improving housing outcomes for most Indonesians. Only the wealthiest 40 percent of households can comfortably afford to acquire housing in the formal commercial market based on an estimated IDR 250 million (USD 19,200) cost for a 36m² basic unit. Conversely, the 40 percent of households within the 3rd to 6th decile cannot afford an equivalent formal housing unit without subsidy enhancements. The bottom 20 percent of Indonesians cannot afford even a basic unit, without deep and expensive subsidies.

9. As a result, the vast majority of Indonesia's housing stock is self-built. Available data suggests that informal, self-built housing continues to produce the majority of housing in Indonesia, with a recent survey estimating that 71 percent of the housing stock in the country is self-built . Relying exclusively on self-built and incremental construction has severe limitations in relation to the systematic provision of services and infrastructure in a rapidly urbanizing context. Indonesia's housing production system is demonstrating severe signs of stress as evidenced by the growing housing deficit, poor urban service indicators and the proliferation of slums.

10. Increasing the availability of affordable mortgage lending to leverage the private lending sector is essential for providing formal housing at scale in an urbanizing context. However, the penetration of mortgage finance is limited given Indonesia's wealth and GDP. Mortgage lending accounted for only 2.8 percent of GDP in 2012, compared with 7.0 percent in India and 19.0 percent in Thailand . Mortgage lending is constrained by a complex range of factors. First, most Indonesians simply cannot afford a mortgage without subsidy enhancements and government mortgage subsidy programs have suffered from both inadequate funding and poor design. Second, over 60 percent of Indonesians are not part of the formal workforce and hence lack access to the financial system. Many of these households may be able to afford a mortgage, but lack credit histories and are considered non-bankable by the commercial banking sector. Unlike comparable countries such as India or Mexico, the mortgage lending sector in Indonesia has not yet adopted innovative underwriting and credit risk management solutions to reach lower-income and non-salaried earners for housing. Third, the banking sector lacks access to affordable, long-term funding from capital markets. Without the evolution of this secondary market, Indonesian banks will have limited ability to finance long-term mortgages from short-term deposits.

11. Nonetheless, the policy enabling environment for to develop the mortgage market is generally sound with important areas for improvement. Mortgage underwriting practices are generally positive. Bank Indonesia (BI) prudential regulations restrict LTV to 85 percent for first mortgages, 80 for second mortgages and 75 percent for third mortgages. BI recently relaxed the LTV (loan-to-value) ratio from 80 to 85 percent for first time home ownership and for those commercial banks with NPL of 5 percent or below. Additionally, debt service ratios are within international norms of 30 to 40 percent. Some key lenders such as BTN and BRI use residual income ratios that require a deeper understanding of the consumers' household cash flows, providing a good stepping stone for underwriting the non-documented informal income segment.

12. Property valuation standards are improving in Indonesia given the tightening supervisory oversight that MoF has over MAPPI (Indonesia Society of Appraisers) certified appraisers that require a strict certification process, continuing education and appraisal data reporting. While there

is no public central valuation database and the BI Home Price Index is available only for 16 cities, appraisers build their own internal database and rely on the MAPPI network for valuation.

13. Further, the credit rating industry is on the verge of expanding and is an important cornerstone in supporting the consumer credit lending growth. Pefindo Credit Bureau is the first private credit bureau that has received license in 2015 to operate in Indonesia and is prepared to extend the breadth of consumer data collected and the credit analytical services, beyond the BI debtor information system (Sistem Informasi Debitur/ SID) credit bureau offerings to date and in line with international best practices. Two more private credit bureaus are also in line to receive operating licenses. Experience in India has shown that the expansion of the credit bureau industry beyond the first credit bureau (i.e. CIBIL), has substantially improved both the quantity and quality of consumer data being collected and reported while extending consumer credit knowledge.

14. The performance of lenders in the consumer and specifically mortgage sector is generally strong. Non-performing loan (NPL) rates for all mortgages (inclusive of home equity loans) across all banks was 2.8 percent as of August 2016. For the LOI mortgage lenders, NPLs have remained low (i.e. BRI, ~2 percent for year end 2015; BTN 2.15 percent for subsidized mortgages and 2.91 percent for non-subsidized for H1 2016). Nonetheless, weaknesses in the system do exist. Even among the largest commercial banks, more robust analytical capacity is needed. BRI, for instance, does not capture adequate consumer data (e.g., fixed and non-fixed income) while BTN is currently engaged in an effort to strengthen its data analytical capacity. Beyond the five largest regional banks, mortgage infrastructure and capacity to quickly expand and grow is limited. PT. SMF is working to help build capacity while setting mortgage standards for the regional banks.

15. In addition to demand side constraints, complex supply-side constraints prevent the private sector from participating in low-cost housing development. Land availability bottlenecks, including complex land acquisition, permitting and servicing processes, and constraints on developer finance and the rising cost of construction, have limited formal housing development. This has kept annual production numbers low, particularly for low-margin affordable units. Failures in the provision of affordable housing have also contributed to the growth of slums. More than 50 percent of Indonesia's poor reside in slums characterized by substandard housing, inadequate access to basic services (e.g. water, sanitation and roads), poor public health conditions, vulnerability to disaster risks and, in larger cities, overcrowding. If no action is taken, the area in cities attributable to slums is expected to continue to increase, along with the number of households.

GoI Efforts to Enhance Access to Affordable Housing

16. Indonesia has developed a broad set of policies and institutions to support affordable housing but these have not yet been effective in improving housing outcomes at the scale necessary. These measures include: (i) a series of neighborhood community driven development programs such as the National Program for Community Empowerment (Program Nasional Pemberdayaan Masyarakat, PNPM) - Urban; (ii) highly to fully subsidized public rental housing programs (e.g. Rusunawa); (iii) Home Improvement Assistance (Bantuan Stimulan Perumahan Swadaya, BSPS) - an up-front assistance for incremental home improvement; (iv) housing microfinance (KPRS/ KPRS Micro Bersubsidi) started in 2006 through a MPWH Ministerial Regulation No.05/Permen/ M/2005, which aims to provide mortgage for fixed and non-fixed low-income people by either subsidizing individual for housing improvement, mortgage interest rate buy down through KPRS Bersubsidi, or subsidy for development or housing improvement using KPRS Micro Subsidy; (v) a

subsidized Mortgage Liquidity Facility (Fasilitas Likuiditas Pembiayaan Perumahan, FLPP) which aims to enhance mortgage affordability for middle-income households by subsidizing interest rates for fixed-rate mortgages; and (vi) an interest rate buy-down subsidy for mortgages, Skema Selisih Angsuran (SSA) introduced in 2015 and Subsidi Selisih Bunga (SSB) introduced in 2016.

17. In addition, several state-owned enterprises, including the National Housing Development Corporation (Perusahaan Umum Pembangunan Perumahan Nasional (Perum Perumnas), the Secondary Mortgage Facility (Sarana Multigriya Finansial or PT. SMF), state insurance companies (Jaminan Kredit Indonesia, Jamkrindo) and public mortgage guarantee providers (Asuransi Kredit Indonesia, Askkrindo), have been developed in order to play an active role in improving supply of and access to affordable housing through direct housing development, secondary mortgage market development and the extension of mortgage insurance, respectively. Finally, some local governments have pioneered programs that have achieved localized results (e.g., a housing microfinance scheme in Palembang and a rental housing program administered by DKI Jakarta). However, these local initiatives often lack sustainable funding sources and the political support to scale up.

18. In spite of these initiatives, government spending on housing has historically been too low to have a significant impact. For example, in 2013 the government committed 0.4 percent of the total central government budget to spending on housing. This represented 0.06 percent of GDP, significantly less than housing budgets of regional peers (e.g. Thailand at 2.15 percent and Philippines at 0.3 percent of GDP respectively).

19. Additionally, GoI spending on housing has been regressive (disproportionately funding programs targeted to middle or upper-middle class households. First, from 2011 until 2014, 43.3 percent of Ministry of Housing budget was allocated to the FLPP Program (which caters to households with basic individual income of up to IDR 4.0 million (USD 318) per month, equating to household gross income of ~IDR 10.0 million or ~USD 796). The remaining budget was divided among other programs, including the BSPS incremental home improvement assistance program (IDR 6.3 trillion or USD 501 million, 19.3 percent of budget), Rusunawa or the rental housing program (IDR 4.9 trillion or USD 390 million, 15.3 percent of annual budget), and neighborhood upgrading and titling programs, all of which target lower income households. In 2015 and 2016, FLPP is accounted for 43.0 and 42.0 percent respectively of the total MPWH budget for housing. This represents an excessive allocation to a program that benefits only salaried households earning up to three times the national median income. See Figure 2 for more detail on public spending on housing. Second, the absolute value of subsidy to households across programs is significantly higher for programs that target relatively higher income households, i.e. higher income households accessing FLPP can potentially benefit from an effective government subsidy of IDR 126.0 million (USD 9,300), 43 percent of the maximum mortgage of IDR 300.0 million (USD 22,000) supported under the program. In contrast, the value of the BSPS incremental housing improvement assistance targeting lower income beneficiaries is only IDR 10.0 million to IDR 30.0 million. Lastly, within individual programs, subsidies are not scaled progressively to income, thus enabling households that qualify for and can afford a higher value property to capture a greater absolute value of subsidy.

20. In 2015, the GoI made reducing the housing backlog an explicit policy priority in the National Medium Term Development Plan (RPJMN) and launched an ambitious initiative called Satu Juta Rumah (One Million Homes). The specific policies developed in response to the RPJMN and Satu Juta Rumah include: (i) a mandatory savings-for-housing scheme (similar to a provident

fund or social security policies such as BPJS) called Tabungan Perumahan Rakyat (TAPERA), which was passed into law in February 2016; (ii) a new mortgage interest subsidy (Subsidi Selisih Bunga or SSB), and (iii) IDR 4.0 million subsidy (Bantuan Uang Muka or BUM) to help allay the cost of the down payment for households accessing both FLPP and SSB.

21. In order to achieve Satu Juta Rumah targets, GoI housing finance spending more than doubled from 2015 to 2016, increasing from ~IDR 6.0 trillion (~USD 450 million) to ~IDR 9.2 trillion (~USD 690 million). Subsidized housing credit helped originate approximately 90,000 new loans in 2015 using both FLPP and SSB but this level still fell far short of targets and needs and it is unlikely that the increase in spending is in itself sufficient to increase production as GoI policymakers now contend that housing subsidy policy is underachieving because of design issues in the available mechanisms and not because of insufficient spending.

22. Because of its high economic cost and regressive design, relying on FLPP to meet Satu Juta Rumah targets would be prohibitively expensive and inequitable. The subsidy also does a poor job of leveraging needed private resources (from both banks and households) to contribute towards the cost of housing. Nearly all FLPP financing comes from GoI and the program's non-market rate cash flows mean that the loans cannot be refinanced, further constraining market expansion and pricing needed capital out of the sector. Lastly, the use of an interest rate subsidy caps the net interest margin for lenders and makes the product somewhat unappealing, in spite of its highly concessional funding. While twenty-three lenders have signed MOUs ratifying their participation in the FLPP Program, one bank (the state-owned housing bank, BTN) holds a dominant 98 percent market share.

23. Moreover, FLPP benefits salaried borrowers nearly exclusively, excluding the approximately 59 percent of the Indonesian population earning non-fixed incomes. As an interest rate subsidy product at 5 percent fixed rate, the newly introduced SSB subsidy product performs no better than FLPP in terms of expanding the mortgage market and its unfunded future liabilities combined with an uncertain disbursement schedule and interest rate volatility risk have so far discouraged lender participation in the scheme. Only BTN has accessed the SSB subsidy did so only after budget funds for FLPP were exhausted in 2015. Lastly, both FLPP and SSB finance new developer built units exclusively, leaving out other forms of home ownership such as the purchase of existing properties and owner driven construction. As 71 percent of Indonesia's housing stock is self-built, this represents a massive gap in the market. Home extension/improvement financing to improve the quality of existing housing stock and address overcrowding is also excluded.

24. Lastly, both FLPP and SSB finance new developer built units exclusively, leaving out other forms of home ownership such as the purchase of existing properties and owner driven construction. As 71 percent of Indonesia's housing stock is self-built, this represents a massive gap in the market. Home extension/improvement financing to improve the quality of existing housing stock and address overcrowding is also excluded.

25. In light of the limitations with existing subsidy instruments, GoI has proposed moving to a more equitable and efficient housing finance subsidy system to meet housing targets under the Satu Juta Rumah Program in the current RPJMN period. This Program will assist with this transition by supporting a new mortgage-linked down payment assistance for affordable housing finance. The down payment assistance program will maintain affordability (i.e. monthly household installment

payments) at levels equivalent to FLPP and SSB, while significantly decreasing the per unit net present value of public assistance and the per unit required government budget allocation.

26. Nonetheless, housing needs and demand are diverse throughout Indonesia and require different policy responses. Lower incomes, a cultural preference to avoid long term indebtedness, and formal supply constraints mean that the housing deficit cannot be eliminated through housing finance alone. For instance, an estimated 2.5 million households are considered substandard along enough dimensions that they are officially classified as uninhabitable (Rumah Tidak Layak Huni) and require upgrading, in-situ redevelopment, or relocation. To respond to these needs, The National Affordable Housing Program will also increase the number of households reached by BSPS and help inflect that program towards urban areas so that it is better able to respond to the pressures of migration and new household formation in Indonesia's cities. As a home improvement assistance targeted towards lower income households, BSPS is the GoI's best targeted and most cost effective housing assistance and aligns with the self-build construction methods and ethos (Swadaya) that have historically constituted the bulk of Indonesia's housing production.

27. The World Bank Group has a history of providing advisory support to GoI on housing policy. In 2002, the Bank-supported Policy Development for Enabling the Housing Market to Work in Indonesia (HOMI) technical assistance project significantly advanced the understanding of GoI policy-makers on housing policy and laid the foundation for the introduction of down payment and buy-down subsidy programs. More recently, the 2012 Bank report on Expanding Access, Improving Efficiency in the Housing Sector advanced and updated the understanding of housing sector challenges in a rapidly urbanizing and decentralizing Indonesia, with a particular focus on land market failures. Additionally, in 2014, the Bank-supported advisory engagement on slums and informal settlements (SAPOLA) delivered a final analytical report and policy recommendations for addressing the growth in slums. The SAPOLA work served as the basis for the proposed National Slum Upgrading Program and included important analytical insights into issues related to informal urban land.

28. Most recently, since 2014, the World Bank has supported GoI through the Programmatic ASA on Land, Housing and Urban Settlements. The first phase of the PASA culminated in the delivery of the Indonesia: A Roadmap for Housing Policy Reform, which provided a thorough review of formal housing demand, affordability and backlog estimations, as well as an overview of housing policy, land administration, housing finance and housing supply issues in Indonesia. The report outlined a detailed roadmap for policy reform and investment, which served as a key input to GoI's Medium Term Development Plan (RPJMN 2015-2019). The recommendations of the Roadmap document have strongly influenced the design and content of this proposed National Affordable Housing Program. Support for the preparation of the Roadmap and the upstream development of this Program has been generously received from the multi-donor FIRST Initiative and the Government of Australia, Department of Foreign Affairs and Trade (DFAT).

Sectoral and institutional Context

6. There is a substantial demand for affordable housing in Indonesia a function of both new annual demand creation and an unmet deficit. There are approximately 64.1 million housing units in Indonesia, of which around 20 percent are in poor condition and an estimated 820,000 to 1 million new units are needed each year to respond to annual housing demand from population

growth, new household formation, and migration to urban areas. The private sector only produces approximately 400,000 units per year. Public sector programs, including incremental home improvement assistance, rental housing, and social housing programs, enable an additional 150,000 to 200,000 solutions. This leaves a gap of an estimated 220,000 to 370,000 households that must resort to informal solutions or overcrowding in existing units each year.

7. While estimates of the housing deficit vary widely (owing to conflicting definitions of the term), all official metrics indicate a substantial housing deficit. Based on 2015 National Household Survey data by BPS (Central Bureau of Statistics), MPWH estimates a housing backlog of 11.4 million units. However, this estimate is likely to be significantly overstated as it is based on home ownership information and fails to take into account renters or lessees whose lifestyle preference may not be to own housing. Using the alternative definition of overcrowding, the number of substandard units was estimated at 7.5 million in 2013. Lastly, a further quantification of substandard housing estimates that 45 percent of all units are substandard by some measure, i.e. overcrowding, constructed built of at least one poor quality material, or lack access to basic services.

8. Affordability remains a key constraint significantly improving housing outcomes for most Indonesians. Only the wealthiest 40 percent of households can comfortably afford to acquire housing in the formal commercial market based on an estimated IDR 250 million (USD 19,200) cost for a 36m² basic unit. Conversely, the 40 percent of households within the 3rd to 6th decile cannot afford an equivalent formal housing unit without subsidy enhancements. The bottom 20 percent of Indonesians cannot afford even a basic unit, without deep and expensive subsidies.

9. As a result, the vast majority of Indonesia's housing stock is self-built. Available data suggests that informal, self-built housing continues to produce the majority of housing in Indonesia, with a recent survey estimating that 71 percent of the housing stock in the country is self-built. Relying exclusively on self-built and incremental construction has severe limitations in relation to the systematic provision of services and infrastructure in a rapidly urbanizing context. Indonesia's housing production system is demonstrating severe signs of stress as evidenced by the growing housing deficit, poor urban service indicators and the proliferation of slums.

10. Increasing the availability of affordable mortgage lending to leverage the private lending sector is essential for providing formal housing at scale in an urbanizing context. However, the penetration of mortgage finance is limited given Indonesia's wealth and GDP. Mortgage lending accounted for only 2.8 percent of GDP in 2012, compared with 7.0 percent in India and 19.0 percent in Thailand. Mortgage lending is constrained by a complex range of factors. First, most Indonesians simply cannot afford a mortgage without subsidy enhancements and government mortgage subsidy programs have suffered from both inadequate funding and poor design. Second, over 60 percent of Indonesians are not part of the formal workforce and hence lack access to the financial system. Many of these households may be able to afford a mortgage, but lack credit histories and are considered non-bankable by the commercial banking sector. Unlike comparable countries such as India or Mexico, the mortgage lending sector in Indonesia has not yet adopted innovative underwriting and credit risk management solutions to reach lower-income and non-salaried earners for housing. Third, the banking sector lacks access to affordable, long-term funding from capital markets. Without the evolution of this secondary market, Indonesian banks will have limited ability to finance long-term mortgages from short-term deposits.

11. Nonetheless, the policy enabling environment for to develop the mortgage market is generally sound with important areas for improvement. Mortgage underwriting practices are generally positive. Bank Indonesia (BI) prudential regulations restrict LTV to 85 percent for first mortgages, 80 for second mortgages and 75 percent for third mortgages. BI recently relaxed the LTV (loan-to-value) ratio from 80 to 85 percent for first time home ownership and for those commercial banks with NPL of 5 percent or below. Additionally, debt service ratios are within international norms of 30 to 40 percent. Some key lenders such as BTN and BRI use residual income ratios that require a deeper understanding of the consumers' household cash flows, providing a good stepping stone for underwriting the non-documented informal income segment.

12. Property valuation standards are improving in Indonesia given the tightening supervisory oversight that MoF has over MAPPI (Indonesia Society of Appraisers) certified appraisers that require a strict certification process, continuing education and appraisal data reporting. While there is no public central valuation database and the BI Home Price Index is available only for 16 cities, appraisers build their own internal database and rely on the MAPPI network for valuation.

13. Further, the credit rating industry is on the verge of expanding and is an important cornerstone in supporting the consumer credit lending growth. Pefindo Credit Bureau is the first private credit bureau that has received license in 2015 to operate in Indonesia and is prepared to extend the breadth of consumer data collected and the credit analytical services, beyond the BI debtor information system (Sistem Informasi Debitur/ SID) credit bureau offerings to date and in line with international best practices. Two more private credit bureaus are also in line to receive operating licenses. Experience in India has shown that the expansion of the credit bureau industry beyond the first credit bureau (i.e. CIBIL), has substantially improved both the quantity and quality of consumer data being collected and reported while extending consumer credit knowledge.

14. The performance of lenders in the consumer and specifically mortgage sector is generally strong. Non-performing loan (NPL) rates for all mortgages (inclusive of home equity loans) across all banks was 2.8 percent as of August 2016. For the LOI mortgage lenders, NPLs have remained low (i.e. BRI, ~2 percent for year end 2015; BTN 2.15 percent for subsidized mortgages and 2.91 percent for non-subsidized for H1 2016). Nonetheless, weaknesses in the system do exist. Even among the largest commercial banks, more robust analytical capacity is needed. BRI, for instance, does not capture adequate consumer data (e.g., fixed and non-fixed income) while BTN is currently engaged in an effort to strengthen its data analytical capacity. Beyond the five largest regional banks, mortgage infrastructure and capacity to quickly expand and grow is limited. PT. SMF is working to help build capacity while setting mortgage standards for the regional banks.

15. In addition to demand side constraints, complex supply-side constraints prevent the private sector from participating in low-cost housing development. Land availability bottlenecks, including complex land acquisition, permitting and servicing processes, and constraints on developer finance and the rising cost of construction, have limited formal housing development. This has kept annual production numbers low, particularly for low-margin affordable units. Failures in the provision of affordable housing have also contributed to the growth of slums. More than 50 percent of Indonesia's poor reside in slums characterized by substandard housing, inadequate access to basic services (e.g. water, sanitation and roads), poor public health conditions, vulnerability to

disaster risks and, in larger cities, overcrowding. If no action is taken, the area in cities attributable to slums is expected to continue to increase, along with the number of households.

16. Indonesia has developed a broad set of policies and institutions to support affordable housing but these have not yet been effective in improving housing outcomes at the scale necessary. These measures include: (i) a series of neighborhood community driven development programs such as the National Program for Community Empowerment (Program Nasional Pemberdayaan Masyarakat, PNPM) - Urban; (ii) highly to fully subsidized public rental housing programs (e.g. Rusunawa); (iii) Home Improvement Assistance (Bantuan Stimulan Perumahan Swadaya, BSPS) ➤(an up-front assistance for incremental home improvement; (iv) housing microfinance (KPRS/ KPRS Micro Bersubsidi) started in 2006 through a MPWH Ministerial Regulation No.05/Permen/ M/2005, which aims to provide mortgage for fixed and non-fixed low-income people by either subsidizing individual for housing improvement, mortgage interest rate buy down through KPRS Bersubsidi, or subsidy for development or housing improvement using KPRS Micro Subsidy; (v) a subsidized Mortgage Liquidity Facility (Fasilitas Likuiditas Pembiayaan Perumahan, FLPP) which aims to enhance mortgage affordability for middle-income households by subsidizing interest rates for fixed-rate mortgages; and (vi) an interest rate buy-down subsidy for mortgages, Skema Selisih Angsuran (SSA) introduced in 2015 and Subsidi Selisih Bunga (SSB) introduced in 2016.

17. In addition, several state-owned enterprises, including the National Housing Development Corporation (Perusahaan Umum Pembangunan Perumahan Nasional ➤(Perum Perumnas), the Secondary Mortgage Facility (Sarana Multigriya Finansial or PT. SMF), state insurance companies (Jaminan Kredit Indonesia, Jamkrindo) and public mortgage guarantee providers (Asuransi Kredit Indonesia, Askrindo), have been developed in order to play an active role in improving supply of and access to affordable housing through direct housing development, secondary mortgage market development and the extension of mortgage insurance, respectively. Finally, some local governments have pioneered programs that have achieved localized results (e.g., a housing microfinance scheme in Palembang and a rental housing program administered by DKI Jakarta). However, these local initiatives often lack sustainable funding sources and the political support to scale up.

18. In spite of these initiatives, government spending on housing has historically been too low to have a significant impact. For example, in 2013 the government committed 0.4 percent of the total central government budget to spending on housing. This represented 0.06 percent of GDP, significantly less than housing budgets of regional peers (e.g. Thailand at 2.15 percent and Philippines at 0.3 percent of GDP respectively).

19. Additionally, GoI spending on housing has been regressive ➤(disproportionately funding programs targeted to middle or upper-middle class households. First, from 2011 until 2014, 43.3 percent of Ministry of Housing budget was allocated to the FLPP Program (which caters to households with basic individual income of up to IDR 4.0 million (USD 318) per month, equating to household gross income of ~IDR 10.0 million or ~USD 796). The remaining budget was divided among other programs, including the BSPS incremental home improvement assistance program (IDR 6.3 trillion or USD 501 million, 19.3 percent of budget), Rusunawa or the rental housing program (IDR 4.9 trillion or USD 390 million, 15.3 percent of annual budget), and neighborhood upgrading and titling programs, all of which target lower income households. In 2015 and 2016, FLPP is accounted for 43.0 and 42.0 percent respectively of the total MPWH budget for housing.

This represents an excessive allocation to a program that benefits only salaried households earning more than the national median income. See. Second, the absolute value of subsidy to households across programs is significantly higher for programs that target relatively higher income households, i.e. higher income households accessing FLPP can potentially benefit from an effective government subsidy of IDR 126.0 million (USD 9,300), 43 percent of the maximum mortgage of IDR 300.0 million (USD 22,000) supported under the program. In contrast, the value of the BSPS incremental housing improvement assistance targeting lower income beneficiaries is only IDR 10.0 million to IDR 30.0 million. Lastly, within individual programs, subsidies are not scaled progressively to income, thus enabling households that qualify for and can afford a higher value property to capture a greater absolute value of subsidy.

20. In 2015, the GoI made reducing the housing backlog an explicit policy priority in the National Medium Term Development Plan (RPJMN) and launched an ambitious initiative called Satu Juta Rumah (One Million Homes). The specific policies developed in response to the RPJMN and Satu Juta Rumah include: (i) a mandatory savings-for-housing scheme (similar to a provident fund or social security policies such as BPJS) called Tabungan Perumahan Rakyat (TAPERA), which was passed into law in February 2016; (ii) a new mortgage interest subsidy (Subsidi Selisih Bunga or SSB), and (iii) IDR 4.0 million subsidy (Bantuan Uang Muka or BUM) to help allay the cost of the down payment for households accessing both FLPP and SSB.

21. In order to achieve Satu Juta Rumah targets, GoI housing finance spending more than doubled from 2015 to 2016, increasing from ~IDR 6.0 trillion (~USD 456 million) to ~IDR 13.2 trillion (~USD 1.0 billion). Subsidized housing credit helped originate approximately 90,000 new loans in 2015 using both FLPP and SSB but this level still fell far short of targets and needs and it is unlikely that the increase in spending is in itself sufficient to increase production as GoI policymakers now contend that housing subsidy policy is underachieving because of design issues in the available mechanisms and not because of insufficient spending.

22. Because of its high economic cost and regressive design, relying on FLPP to meet Satu Juta Rumah targets would be prohibitively expensive and inequitable. The subsidy also does a poor job of leveraging needed private resources (from both banks and households) to contribute towards the cost of housing. Nearly all FLPP financing comes from GoI and the program's non-market rate cash flows mean that the loans cannot be refinanced, further constraining market expansion and pricing needed capital out of the sector. Lastly, the use of an interest rate subsidy caps the net interest margin for lenders and makes the product somewhat unappealing, in spite of its highly concessional funding. While twenty-three lenders have signed MOUs ratifying their participation in the FLPP Program, one bank (the state-owned housing bank, BTN) holds a dominant 98 percent market share.

23. Moreover, FLPP benefits salaried borrowers nearly exclusively, excluding the approximately 59 percent of the Indonesian population earning non-fixed incomes. As an interest rate subsidy product at 5 percent fixed rate, the newly introduced SSB subsidy product performs no better than FLPP in terms of expanding the mortgage market and its unfunded future liabilities combined with an uncertain disbursement schedule and interest rate volatility risk have so far discouraged lender participation in the scheme. Only BTN has accessed the SSB subsidy did so only after budget funds for FLPP were exhausted in 2015. Lastly, both FLPP and SSB finance new developer built units exclusively, leaving out other forms of home ownership such as the purchase

of existing properties and owner driven construction. As 71 percent of Indonesia's housing stock is self-built, this represents a massive gap in the market. Home extension/improvement financing to improve the quality of existing housing stock and address overcrowding is also excluded.

24. Lastly, both FLPP and SSB finance new developer built units exclusively, leaving out other forms of home ownership such as the purchase of existing properties and owner driven construction. As 71 percent of Indonesia's housing stock is self-built, this represents a massive gap in the market. Home extension/improvement financing to improve the quality of existing housing stock and address overcrowding is also excluded.

25. In light of the limitations with existing subsidy instruments, GoI has proposed moving to a more equitable and efficient housing finance subsidy system to meet housing targets under the Satu Juta Rumah Program in the current RPJMN period. This Program will assist with this transition by supporting a new mortgage-linked down payment assistance for affordable housing finance. The down payment assistance program will maintain affordability (i.e. monthly household installment payments) at levels equivalent to FLPP and SSB, while significantly decreasing the per unit net present value of public assistance and the per unit required government budget allocation.

26. Nonetheless, housing needs and demand are diverse throughout Indonesia and require different policy responses. Lower incomes, a cultural preference to avoid long term indebtedness, and formal supply constraints mean that the housing deficit cannot be eliminated through housing finance alone. For instance, an estimated 2.5 million households are considered substandard along enough dimensions that they are officially classified as uninhabitable (Rumah Tidak Layak Huni) and require upgrading, in-situ redevelopment, or relocation. To respond to these needs, The National Affordable Housing Program will also increase the number of households reached by BSPS and help inflect that program towards urban areas so that it is better able to respond to the pressures of migration and new household formation in Indonesia's cities. As a home improvement assistance targeted towards lower income households, BSPS is the GoI's best targeted and most cost effective housing assistance and aligns with the self-build construction methods and ethos (Swadaya) that have historically constituted the bulk of Indonesia's housing production.

27. The World Bank Group has a history of providing advisory support to GoI on housing policy. In 2002, the Bank-supported Policy Development for Enabling the Housing Market to Work in Indonesia (HOMI) technical assistance project significantly advanced the understanding of GoI policy-makers on housing policy and laid the foundation for the introduction of down payment and buy-down subsidy programs. More recently, the 2012 Bank report on Expanding Access, Improving Efficiency in the Housing Sector advanced and updated the understanding of housing sector challenges in a rapidly urbanizing and decentralizing Indonesia, with a particular focus on land market failures. Additionally, in 2014, the Bank-supported advisory engagement on slums and informal settlements (SAPOLA) delivered a final analytical report and policy recommendations for addressing the growth in slums. The SAPOLA work served as the basis for the proposed National Slum Upgrading Program and included important analytical insights into issues related to informal urban land.

28. Most recently, since 2014, the World Bank has supported GoI through the Programmatic ASA on Land, Housing and Urban Settlements. The first phase of the PASA culminated in the

delivery of the Indonesia: A Roadmap for Housing Policy Reform, which provided a thorough review of formal housing demand, affordability and backlog estimations, as well as an overview of housing policy, land administration, housing finance and housing supply issues in Indonesia. The report outlined a detailed roadmap for policy reform and investment, which served as a key input to GoI's Medium Term Development Plan (RPJMN 2015-2019). The recommendations of the Roadmap document have strongly influenced the design and content of this proposed National Affordable Housing Program. Support for the preparation of the Roadmap and the upstream development of this Program has been generously received from the multi-donor FIRST Initiative and the Government of Australia, Department of Foreign Affairs and Trade (DFAT).

II. Proposed Development Objectives

The development objective of the Program is to improve access to affordable housing for lower income households

III. Project Description

Component Name

Component 1: Mortgage-Linked Down Payment Assistance (Bantuan Pembiayaan Perumahan Berbasis Tabungan/BP2BT)

Comments (optional)

30. Subcomponent 1.1: Mortgage-Linked Down Payment Assistance (BP2BT). The Program will support provision of mortgage-linked down payment assistance to lower income first time home-owners through Participating Lending Institutions for the purchase or construction of a residential property. Specifically, the mortgage-linked down payment assistance scheme (Bantuan Pembiayaan Perumahan Berbasis Tabungan (BP2BT) targets aspiring lower income first time home-owners by providing down payment assistance support to match beneficiary savings and a market rate mortgage from a participating lending institution for the purchase of: (i) a new or existing landed house ; (ii) a new or existing multi-story house/apartment; or (iii) a new or existing low-rise vertical house/apartment, and (...)

Component Name

Component 2: Home Improvement Assistance (Bantuan Stimulan Perumahan Swadaya/BSPS)

Comments (optional)

33. Component 2 will support the scaling up and improvement of the national Home Improvement Assistance Program (Bantuan Stimulan Perumahan Swadaya (BSPS) with the aim to support poor and lower income Indonesian households to attain safe and affordable housing through an incremental home improvement process. The specific household income segments targeted by the component are the bottom 40 percent of all households as measured by gross household income. MPWH has been implementing BSPS since 2006, having achieved considerable success in terms of reaching primarily rural households.

34. The component will support the expansion and strengthening of the BSPS with the aim of supporting 450,000 home improvement solutions reaching over 1.8 million beneficiaries. NAHP has introduced (...)

Component Name

Component 3: Technical Assistance for Strengthening Housing Policy Reform

Comments (optional)

38. The component will finance a technical assistance program to support policy reform,

improved governance and enhanced capacity in the housing sector. The component will support two subcomponents on demand-side and supply side technical assistance, summarized in greater detail below. Activities to be supported under this component were identified and, in most cases, benefit from analysis and policy advisory work conducted under both the Roadmap for Housing Policy Reform 2015 the ongoing Land, Housing and Settlements PASA.

39. Subcomponent 3.1: Expanding Access to Housing Finance. This subcomponent will support the provision of technical assistance to support policy and regulatory reform and improve governance to strengthen the primary and secondary mortgage markets and the enabling envi

IV. Financing (in USD Million)

Total Project Cost:	1207.00	Total Bank Financing:	450.00
Financing Gap:	0.00		
For Loans/Credits/Others			Amount
Borrower			757.00
International Bank for Reconstruction and Development			450.00
Total			1207.00

V. Implementation

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	x	
Natural Habitats OP/BP 4.04		x
Forests OP/BP 4.36		x
Pest Management OP 4.09		x
Physical Cultural Resources OP/BP 4.11		x
Indigenous Peoples OP/BP 4.10	x	
Involuntary Resettlement OP/BP 4.12	x	
Safety of Dams OP/BP 4.37		x
Projects on International Waterways OP/BP 7.50		x
Projects in Disputed Areas OP/BP 7.60		x

Comments (optional)

VII. Contact point

World Bank

Contact: Taimur Samad
 Title: Program Leader
 Tel: 5781+3037 /
 Email: tsamad@worldbank.org

Borrower/Client/Recipient

Name: Ministry of Finance
Contact: Robert Pakpahan
Title: Director General of Budget Financing and Risk Management
Tel: 62213500841
Email:

Implementing Agencies

Name: Ministry of Public Works and Housing
Contact: Maurin Sitorus
Title: Director General for Housing Finance
Tel: 62217245751
Email: maurin_sitorus@yahoo.com

VIII. For more information contact:

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: <http://www.worldbank.org/projects>