Indonesia Infrastructure and Cities - 2017 Point of View

Private Investment Participation in Indonesian Infrastructure, A Long Journey

Indonesia's challenge is much greater than just optimizing existing infrastructure. But it is also cannot be simplified as just a question of investment. The provision of necessary infrastructure such as transit systems, toll roads, airport rail link, multimodal transport interchange, light rail, water treatment plants, information technology and communication backbones, is developed under a complex economic and political circumstances of being the 4th most populous country and 3rd largest democracy in the world. All of which require significant effort and a focused strategy in which both private investors and governments need to play significant roles.

Indonesia's challenge is much greater than just optimizing existing infrastructure. But it is also cannot be simplified as just a

The problem of underinvestment has been further exacerbated by existing infrastructure assets not being used or managed optimally. Infrastructure expenditure including budget allocation in public sector and private participation in Indonesia needs to increased if economic growth and poverty reduction targets are to be met. Several key issues need to be addressed including: improved public management; encourage private investment; reduce high cost economy; mobilize finance, and implement the needed bureaucratic and regulatory reforms.

The relevant infrastructure agenda in the Mid Term National Development Plan (RPJMN) are increasingly putting higher priority on delivery of priority infrastructure, and has been follow through by the issuance of Presidential Decree no 3/2016 on Accelerations of National Strategic Projects. Key area that are relevant include:

Growth centres and infrastructure development are considered the main building blocks of the proposed Indonesian economic development strategy, as such transport infrastructure improvements in roads, seaports, airports, water, energy, power and social needs are critical.

- The importance of implementation of PPPs in provision of priority infrastructure projects;
- Establish a more efficient infrastructure management systems and increase in the quality of infrastructure deliveries provided by both the government as well as private sectors.
- Make available financial support to meet infrastructure targets through alternative payment and funding mechanisms such as PPP schemes or innovative financing, such as availability payments.

Growth centres and infrastructure development are considered the main building blocks of the proposed Indonesian economic development strategy, as such transport infrastructure improvements in roads, seaports, airports, water, energy, power and social needs are critical. A key objective of the government is to enhance inter-island connectivity and upgrade port infrastructure. Integrated urban development planning is a priority, given the rapidly growing urban population at approximately 4.1% growth per annum.

With further major budget cuts for 2017 following one in 2016, the government has indicated the need to supplement public funds with possibly increasing borrowing from the Multilateral Development Banks including the newly formed Asian Infrastructure Investment Bank (AIIB).

Multidonor Trust Fund such as 'Sustainable Urbanization' is likely to become a common themed under which many partners can contribute or co-invest in essential urban management, and hopefully to develop a long-term national urban development strategy. Under a similar scheme, the Canadian Trust Fund in World Bank started a significant Technical Assistance support for the PPP Unit at Ministry of Finance.

Delivering infrastructure through inviting private participation would need a clear Government infrastructure plans, that set out globally accepted processes and documentation, coupled with effective dispute resolution processes.

The picture is not all grey. As HD Asia Advisory worked with various local governments, both city and provincial levels, we found that local governments are getting ready to take up the challenge. In the absence of national initiatives, working to expedite PPP project at sub-national and local level are starting to bear fruition. The Makassar PPP Investment Center, a joint initiative by HD Asia Advisory and Penida Capital, is the first in Indonesia, pending one local regulations to be issued soon, is starting to gain tractions in preparing projects. Bandung has decided to set up a PPP unit, and also pending few legislations will soon be able to prepare projects. Provinces such as West Java and South Sumatera is more than ready with potential projects.

Public Private Partnership

Public-Private Partnership (PPP) is one model government and private sectors can engage in provision of infrastructure, mostly in the form of long term concessions, asset regeneration and regulation. Concession owners involved in three levels, namely as project sponsors or equity partner, contractor and operation and maintenance. Any concessionaire will typically need to utilize their deep pools of capital and apply global best practice to deliver innovation and efficiency to these assets and in turn achieve its intended returns on investment and economic benefits for the project to sustain throughout its 'whole of life'.

Government success has been slow to come, but has had a limited positive impact to boost confidence.

The Presidential Decree no 38/2015 and the Head of State Procurement Agency Regulations (LKPP) no 19/2015, aimed at revising guidance on the use of PPP by broadening PPP investments to include social infrastructure (schools, health facilities etc.) and providing for the use of long-term availability payment arrangements for infrastructure assets.

Moving forward, delivering infrastructure through inviting private participation would require GOI infrastructure to established clear plans, that set out globally accepted processes and documentation, coupled with effective dispute resolution processes. Strong government institutions are needed to coordinate all relevant government agencies as well as appropriate legal system. Based on innovative and cost efficient 'whole of life' solutions, government need to introduce an efficient exit resolution designed to facilitate re-organization of financially troubled projects.

The existence of three different agencies with similar tasks of promoting private engagement in priority projects, will require GOI to set out defined role between KPPIP, the PPP unit at MOF and the Directorate of PPP at Bappenas. While Committee for Acceleration of Priority Projects (KPPIP) under Presidential Regulation 75/2014 dated 17 July 2014, has an expanded role including de-bottlenecking regulations and project delivery at CAs level, bridge coordination with CAs at local government level, the PPP Unit under MOF is tasked with undergoing project preparation for government's guaranteed projects. Bappenas on the other hand, is tasked with project pipeline, to facilitate project preparation and the escalation of potential projects from sub-national to become GOI strategic list of potential projects.

As accelerated government spending has been majority driven by involvement of SOEs, we will see this continue to dominate the landscape in key sectors such as transport and power, with strategic maritime infrastructure projects in 45 different locations.

Between the Bappenas Blue Book published each year and the more than 225 strategic projects launched by GOI, as many as 30 are on the priority list. The government's effort will be required to give more directions as to the funding modes for all "ready for offer" projects, including foreign loans and grants, private/SOEs, PPP and/or a hybrid of those.

Government success in PPP has been slow to come, but has had a limited positive impact to boost confidence. Few "long-on-the-list" projects managed to reach financial close after prolonged process, including the Batang power plant, Umbulan water treatment plant and piping, and the Palapa Ring telecommunication project.

As accelerated government spending has been majority driven by involvement of SOEs, we will see this continue to dominate the landscape in key sectors such as transport and power, with strategic maritime infrastructure projects in 45 different locations assigned to PT. Pelabuhan Indonesia (Pelindo) I, II, III, & IV. The Kuala-Tanjung to Sei Mangkei rail road was assigned to PT. Kereta Api Indonesia. At the same time the Medan-Binjai toll road was assigned to PT. Hutama Karya (Persero) and the toll road connecting Tebing Tinggi-Kuala Tanjung-Sei Mangkei was assigned to PT. Jasa Marga (Persero) Tbk

At a first glance review, many of the projects offered lack of bankability due to lacking the sufficient user pay revenue. Moreover, projects are often not found in the existing city masterplan, permits are delayed, mediocre impact assessment document, and the inability of the CAs to procure the required land for the projects on time. In addition to these constraints, CAs are unable to develop bankable business cases due to a failure to develop a rigorous technical and financial analysis.

It is clear that progress has been slow due to lack of investable projects offered. At a first glance review, many of the projects offered lack of bankability since these projects lacking the sufficient user pay revenue.

Project development facility from the MOF to CAs will play a significant role in preparing priority projects. A good project preparation will eventually minimize the Viability Gap Fund required, better calculated risks, and consequently will be interesting for investors. High Demand Risks projects will benefit from the Availability Payments (AP) and multi-years budgeting.

A number of initiatives have been developed by GOI to invite the financial and institutional investors to invest jointly in infrastructure projects and assets. Feedback and input from a wide range of Indonesian stakeholders involving governmental leaders and industry leaders revealed a generic agreement that a well constituted approach focusing specifically on management of project preparation in Indonesia's infrastructure development is needed.

There are at least four immediate areas of improvement can be done.

Firstly, although it has been introduced through many studies and research, the Ministry of Finance are yet to fully supportive to providing a robust Performance Based Annuity Scheme (PBAS) or Availability Payments (AP) as possible PPP schemes. Quick wins may include the first few Availability Payments projects such as the Serang-Panimbang, Manado-Bitung toll roads. Also few social infrastructure such as hospitals.

Secondly, the structure of project development facilities and preparation must incorporate, the following key elements:

- Contribution of the project to the economy and to provide the basis of performance criteria for the project.
- Prefeasibility studies and due diligence process should be done to assess investment options and potential implementation and financing structures. It should preserve options for innovative project solutions from contractors and financiers.
- Market sounding and bid preparation process that are responsive to market conditions.
- An efficient and effective bid process of priority projects will need to continue to be enhanced – ensuring competition but providing incentives for inovation.

Third, we need to encourage more unsolicited bids. Private sectors come up with initiatives and potential projects, presented a Business Case and feasibility, set out required government risk portion and bid for the project. With a good and highly qualified CAs tender committee and processes, unsolicited bids can produce good quality projects.

We need to encourage more unsolicited bids, especially the social infrastructures. Private sectors come up with initiatives and potential projects, presented a Business Case and feasibility, set out required government risk portion and bid for the project. With a good and highly qualified CAs tender committee and processes, unsolicited bids can produce good quality projects.

Last but not least, it is recommended for GOI to set up a PPP Preparation Unit (Badan Penyiapan KPBU) based on Presidential Decree no 38/2015 and the subsequent Regulation of The Indonesian Procurement Agency Perka LKPP no 19/2015, which specific task is to procure consultants and advisors, conduct Business Case and Feasibility Studies, run pre-qualification, tender to financial close of projects.

Additionally, a study by Melbourne University team for the Indonesian Infrastructure Development Initiative (IndI) has suggested the need of focus on infrastructure delivery. Also the need of a multi-stakeholder peak body to be the bridge between government and the private sector, so that potential projects can progress and private sector can receive guidance on achieving appropriate project assurance.

The Wake of Indonesian Cities

Against the backdrop of rising concern about the fate of our cities, urbanization has become one of today's most talked about and politicized issues in cabinets and boardrooms across the world. The future of our planet is debated as if it centered exclusively on the issue of a rapidly urbanizing world, the primacies of great metropolitans and conurbations, and the race to create more liveable spaces.
The UN has been very clear in its position that urbanization has significantly contributed to economic growth, while fostering development and improving welfare in many locations. But at the same time, urbanization also contributed to the challenges including multi-dimensional poverty, environmental degradation and low disaster preparedness.

Urbanization has become one of today's most talked about and politicized issues in cabinets and boardrooms across the world. The future of our planet is debated as if it centered exclusively on the issue of a rapidly urbanizing world, the primacies of great metropolitans and conurbations, and the race to create more liveable spaces.

Over the past three decades, cities in the Asia Pacific Region have experienced unprecedented rapid economic growth and development. The 21 APEC economies account for approximately 42% percent of the world's population, 57% of the world's total GDP and 44% of global trade. In 2014, APEC GDP was estimated at $41 trillion, based on purchasing power parity. APEC member economies include half the world's mega cities, 22 (55%) of the world's cities with populations of 5-10 million, 185 (41%) of the cities with populations of 1-5 million, and 284 (48%) of the cities with populations of 0.5-1 million. These percentages are expected to increase only slightly over the next three decades, as population growth and urbanization rates rise. Such rapid development in cities in the region has come at an environmental cost, with growing exposure to risks.

Over the next 35 years to 2050, an APEC report projected an unprecedented increase will occur in the urban population of the APEC economies. Currently, 1.8 billion people or around 60% of the region's population live in urban areas; this is expected to reach 77% by 2050. By 2050, the urban population of APEC member economies is expected to increase to 2.4 billion, or by 33%. Some economies are more than 80% urbanized and many others are urbanizing rapidly. 14 of the world's 37 megacities are located in APEC Member Economies, including Indonesia.

Indonesia has now ratified the New Urban Agenda, a twenty year program to define the narratives and future of sustainable urban development, planning and human settlements decided at Habitat III in Quito in October 2016. But quite alrmingly, it is yet to be clear how Indonesia is going to seize this opportunity to make a valuable contribution to the agenda. The introduction of what may only be described as a rather rudimentary National Report issued by Indonesia earlier this year is a cause for major improvement. It is barely an elaboration of significant principle differences faced by bureaucrats, contrasted against the setting of an ideal development planning practice in Indonesia.

Indonesia has now ratified the New Urban Agenda, a twenty year program to define the narratives and future of sustainable urban development, planning and human settlements decided at Habitat III in Quito in October 2016.

In reality Indonesia's relatively stable macro economic fundamentals are still heavily overshadowed by disparities between regions. The vast geographic area is by its very nature a constraint impeding uniform growth and distribution of resulting prosperity. At the same time, GOI has set a utopian target of 100-0-100, or 100% access to sanitation, zero slums and 100% potable water connection by 2019! This target was launched at the eleventh hour of the Yudhoyono administration and has since been adopted by President Jokowi's cabinet in the RPJMN.

By setting such an ambitious target, GOI must find suitable policies to address the gaps. As of today, the government claims that water connections stands at 67%, with 60% accessibility to sanitations and 12% slums. Altough it sounds like a great result, but the real problem is how those outcomes are distributed geographically across cities and regions.

The Indonesian National Report for Habitat 3 fails to reflect the necessary focus on the overwhelming disparities between regions, nor does it give fair consideration to the fact that strategic and supposedly fast-growth areas are not developing rapidly enough. Vision is clearly absent in urban development programs in Indonesia.

Many Indonesian cities and towns are still struggling, where water is in crisis, open latrines a common view and slum areas are still dominating to varying degrees. It is consistent the world across, with the WHO reporting that in 2015 only 68% of the world's population had access to improved sanitation facilities, and 2.4 billion people still did not have basic sanitation facilities such as toilets or latrines. Access to drinking water being defined as a source that is less than 1 kilometer away from its place of use and possible to reliably obtain at least 20 litres per member of a household per day. Water needs to be safe, with microbial, chemical and physical characteristics that meet WHO guidelines or national standards on drinking water quality.

Indonesia Must Take the Stand

The Indonesian National Report for Habitat 3 fails to reflect the necessary focus on the overwhelming disparities between regions, nor does it give fair consideration to the fact that strategic and supposedly fast-growth areas are not developing rapidly enough. Vision is clearly absent in urban development programs in Indonesia.

Development is dictated for the most part and indeed often measured by the sprawl of cities creating conurbation and physical interconnection thus producing a mega-urban system. Examples include the Greater Jakarta Megapolitans with a population of 28 million, Mebidangro System (Medan-Binjai-Deli Serdang) with 5 million in North Sumatera, Metropolitan Bandung with 7.7 million, Surabaya Gerbang Kertasusila with almost 10 million, and Maminasata area in Makassar of almost 4.5 million.

Central and local governments need to implement a "business not usual" approach, including focus on overwhelming common inter-region issues such as water resources, regional waste management, flood control and disaster management.

There is an absence of strong national system-of-cities plan, which has resulted in a lack of coordination and imbalanced growth of metropolitans, big, medium and small cities. A sharp decline in quality of life in urban areas due to "unproductive" urbanization will become more dominant if sub-national governments are lacking the political will to ensure consistency in the implementation of Master Plans.

One of the most immediate concerns is the ongoing massive land conversion from productive agricultural land to non-agriculture, and from productive land to residential. There are disparities between areas within small regions and intra-island, such as between East and West Coastal Areas of Sumatera, North and Southern Coastal areas of Java, and remote border areas with neighbouring countries.

Central and local governments need to implement a "business not usual" approach, including focus on overwhelming common inter-region issues such as water resources, regional waste management, flood control and disaster management. In addition bureaucrats must stop engaging in counter productive activities which contribute toward a high cost economy, as well as delivering much needed regulatory reforms to accelerate infrastructure development.

Indonesian cities need to identify innovative strategies to increase stakeholder engagement and boost investment. Several cities and regions have started to do so as evidenced by initiatives championed by Makassar, Bandung, West Java and South Sumatera governments to accelerate private participation in the development of key infrastructure such as roads, public utilities and mass transportation, transit-oriented-development, and water supply systems.

Indonesian cities need scaling up private sector involvement in urban infrastructure provision, particularly through Public Private Partnerships (PPPs) and private sector engagement in infrastructure financing. Financial intermediaries and project developers are also increasingly seeking funding for housing and housing finance related projects. However, the regulatory framework for private sector involvement in urban infrastructure projects is often lacking.

APEC, ABAC and regional organizations have reported that regionally, the number and capacity of development finance institutions has expanded, adding sub-sovereign finance, local currency finance, an enlarged range of credit enhancement mechanisms, and new types of lending instruments. The private sector has also multiplied the number of funds and financial products available for financing infrastructure.

INSIGHTS

- A well-designed approaches are important and critical to success in understanding the multiple levels of challenges associated with infrastructure projects in Indonesia.
- There are lack of clarity in frameworks and processes within GOI, which demonstrate the various level of capacity of a government agency's approach to planning and attracting investors.
- Both local and national governments in Indonesia need to build a strong project preparation capability, which in turn will results in robust planning in making projects attractive to the private sector.
- Improved transparency, governance and engagement are key to improving infrastructure outcomes; improvements in these areas will help narrow the gap between political and economic imperatives.
- As Indonesian cities are growing at unprecendented level, land use planning needs to be more inclusive, more conscious of the need to respond to climate imperatives, better related to finance for implementation, and better enforced. Project development needs to support the formulation of projects which comprehensively further the objectives of the plans.

Abbreviations

ADB	Asian Development Bank
ABAC	Asia Pacific Economic Countries Business Advisory Council
AIIB	Asian Infrastructure Investment Bank
AP	Availability Payments
APEC	Asia Pacific Economic Countries
AP	Availability Payments
BAPPENAS	National Planning and Development Agency
CA	Contracting Agency
GDP	Gross Domestic Product
Gerbang Kertasusila	Gersik Bangkalam Mojokerto Surabaya Sidoardjo Lamongan
GOI	Government of Indonesia
IFC	International Finance Corporation
IIGF	PT Indonesia Infrastructure Guarantee Fund
IndII	Indonesia Infrastructure Initiative
KPPIP	Committee for Acceleration of Priority Projects
LKPP	State Procurement Agency Regulations
Maminasata	Makassar Maros Sugguminasa Takalar
Mebidangro	Medan-Binjai-Deli Serdang
MOF	Ministry of Finance
PBAS	Performance Based Annuity Scheme (PBAS)
PIP	Pusat Investasi Pemerintah
PPP	Public Private Partnership
RPJMN	Mid Term National Development Plan
PT SMI	PT Sarana Multi Infrastruktur
NGO	Non Government Organization
OECD	Organization for Economic Cooperation and Development
SOE	State Owned Enterprise
VGF	Viability Gap Funding
WB	World Bank
WHO	World Health Organization

References

Djonoputro, B. The Jakarta Post. Project Preparation Key to Lure Private Investment http://www.thejakartapost.com/academia/2016/06/30/project-preparation-key-to-lure-private-investment.html

Djonoputro, B. The Jakarta Post. Redefining Indonesia Urban Agenda, Get real! http://www.thejakartapost.com/academia/2016/07/26/redefining-indonesias-urban-agenda-get-real.html

Djonoputro, B, Kompas.com, Maukah Swasta Bangun Infrastruktur, http://properti.kompas.com/read/2016/09/05/210000621/maukah.swasta.bangun.infrastruktur.

Djonoputro, B, Kompas.com, http://properti.kompas.com/read/2016/07/10/112017021/kesiapan.proyek.tentukan.percepatan.pembangunan.infrastruktur

Djonoputro, B, Kompas.com, Indonesia Gamang Libatkan Swasta Bangun Infrastrastruktur, http://properti.kompas.com/read/2016/06/20/105646921/indonesia.gamang.libatkan.swasta.bangun.infrastruktur

Djonoputro, B. Kompas.com. Agenda Baru Perkotaan Indonesia http://properti.kompas.com/read/2016/05/11/075009521/Agenda.Baru.Perkotaan.Indonesia.

Djonoputro, B. Kompas.com. Jokowi kembalilah Membangun Sesuai Rencana Tata Ruang http://properti.kompas.com/read/2016/04/01/162543521/Jokowi.Kembalilah.Membangun.Sesuai.Rencana.Tata.Ruang.

Djonoputro, B. Kompas.com. Teknologi Disruptive Untuk Kota http://properti.kompas.com/read/2016/03/28/163417721/Teknologi.Disruptive.Untuk.Kota

ADB. 2006. *Special Evaluation Study on Urban Sector Strategy and Operations*. Manila.

UN-HABITAT. 2010. *State of the World's Cities 2010/2011: Bridging the Urban Divide.* Kenya

ADB. 2010. Managing Asian Cities. Manila.

Dubel, Hans-Joachim. 2008. *Does Housing finance Promote Economic and Social Development in Emerging Markets?.* (Short version study for International Finance Corporation). Berlin. IFC.

Bray, D., Coulthart, A. and Reddel, P. 2014. Assessment of the Effectiveness of Project Preparation Facilities in Asia. See: http://www.g20australia.org/sites/default/files/g20_resources/library/assessment-effectiveness-ppfs-in-asia-15092014.pdf

V. Lall, Somik. 2013. Planning, connecting, and financing cities - now : priorities for city leaders. Washington DC : World Bank Group. http://documents.worldbank.org/curated/en/2013/01/17197253/planning-connecting-financing-cities-now-priorities-city-leaders

---

HD Asia Advisory Report Methodology note: In developing this analysis, HDAA used data drawn from government, multinational organizations and various publicly available and media sources. The view incorporates all available information at that time.

HD AsiaAdvisory
Infrastructure and Cities Practice

HD Asia Advisory Infrastructure and Cities Practice is part of PT HD Asia Advisory, a Strategic Advisory firm based in Jakarta focuses on market entry, investment, policy advocacy and in-market representations for investors. The firm also has interests in investments focused on infrastructure such as toll roads, power, water, ports and city development sectors, as well as a regional based Urban Design Consulting firm operating in Indonesia, Malaysia and Brunei. Its clients include an assorted list of many investors, Fortune 500 corporations, foreign governments, as well as Indonesian central and local government agencies.

Contact: Bernardus Djonoputro, Managing Partner,
bernardus.djonoputro@hdaadvisory.com