



# Development of the Primary and Secondary Mortgage Market in Indonesia

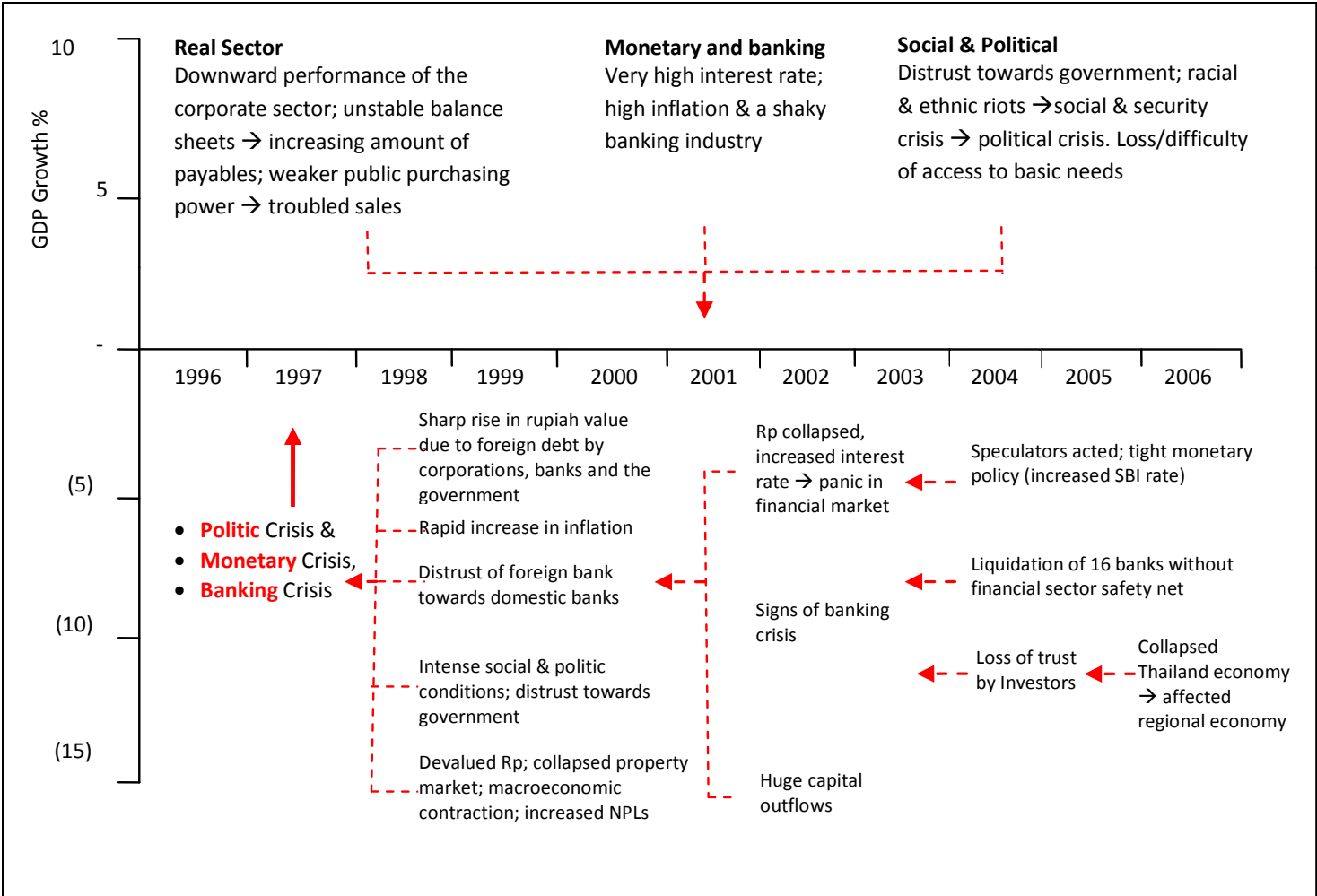
**By: Suhaedi**

**Biro Stabilitas Sistem Keuangan  
Bank Indonesia**

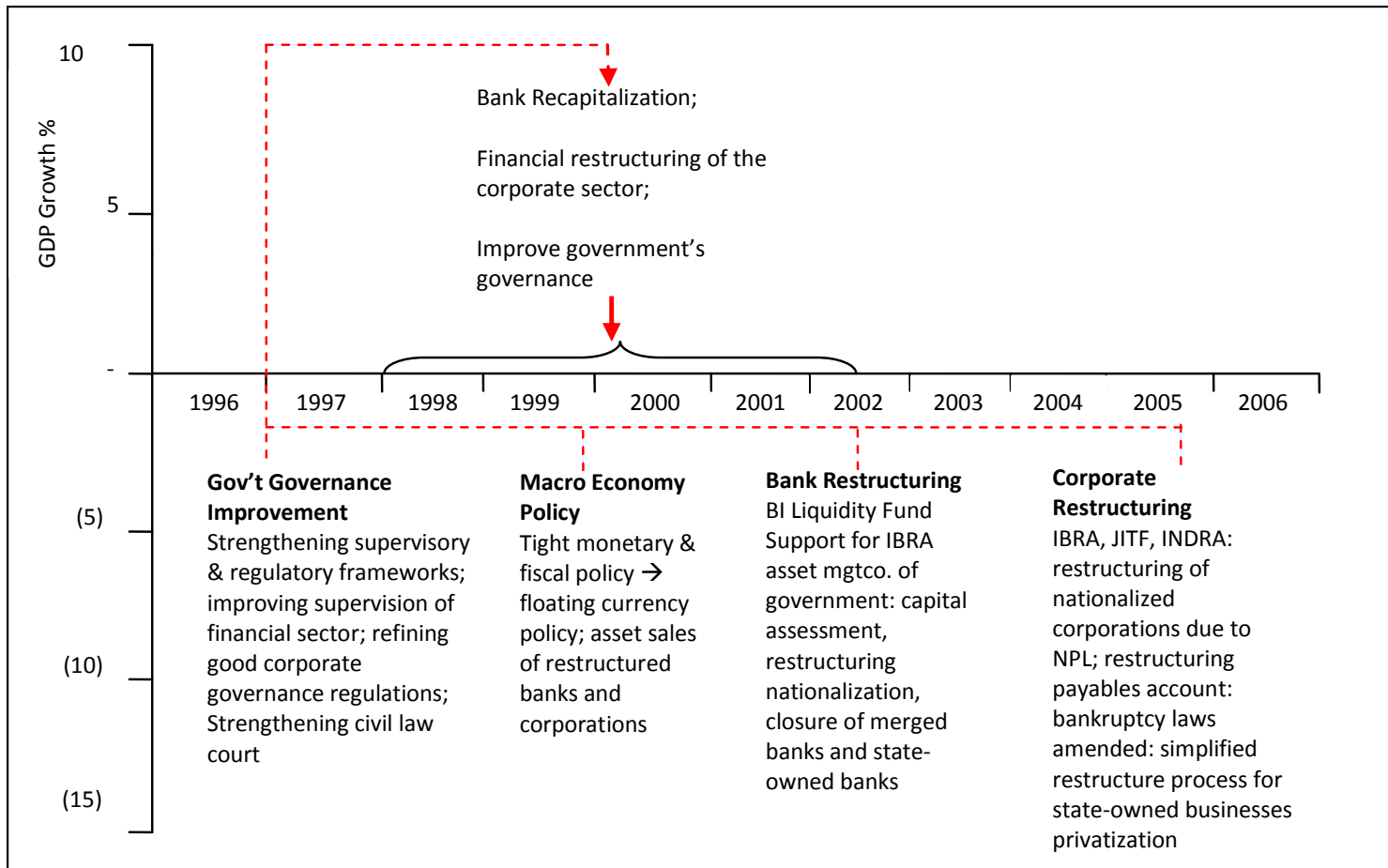
## Discussion

- **Chronology of The Crisis**
- **Financial System Stability**
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  - **Primary Mortgage Market: Demand and Supply**
- **Current Development and Issues in the Mortgage Market**
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# Causes: Chronology of the Crisis



# Policies Taken: Chronology of the Crisis

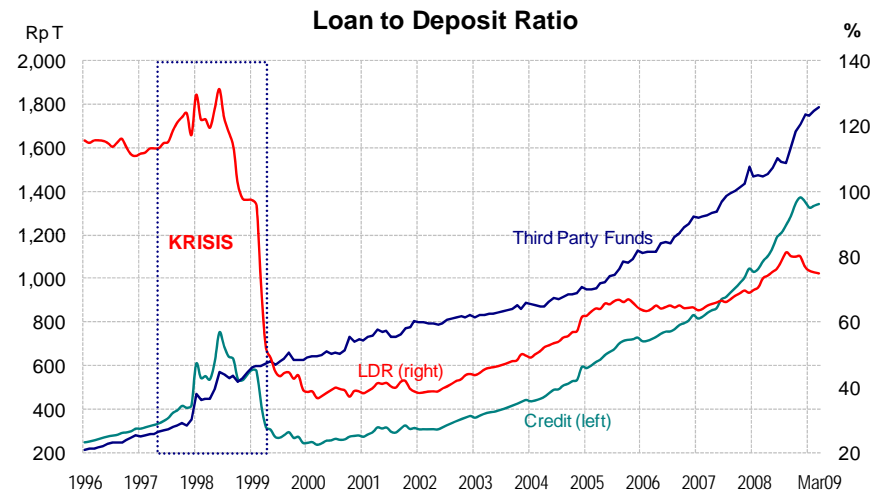


## Financial System Stability

- The resilience of the Indonesian financial sector during 2008, has been relatively maintained, despite the sharp increase in pressure to the financial system stability the global crisis has brought. This is indicated by the Financial Stability Index which surpassed the indicative maximum level of 2 in November and December 2008.
- In the banking sector, the pressure manifests itself in the form of increases in liquidity risk, particularly from August to September 2008. Liquidity pressures surface not only from the global crisis, but also from expansive growth of credit which was funded by banks' secondary reserves as opposed to being funded from increases in deposits. The banking sector also faced increases in exchange rate risk as the rupiah weakened.
- The most dominant industry of the financial sector, i.e. the banking industry, has been able to maintain relatively solid performance. At the end of December 2008, the banking industry's capital adequacy ratio (CAR) remained at a high 16,2% while asset quality was well maintained as indicated by low levels of NPL, i.e. 3,8% (gross) and 1,5% (net).

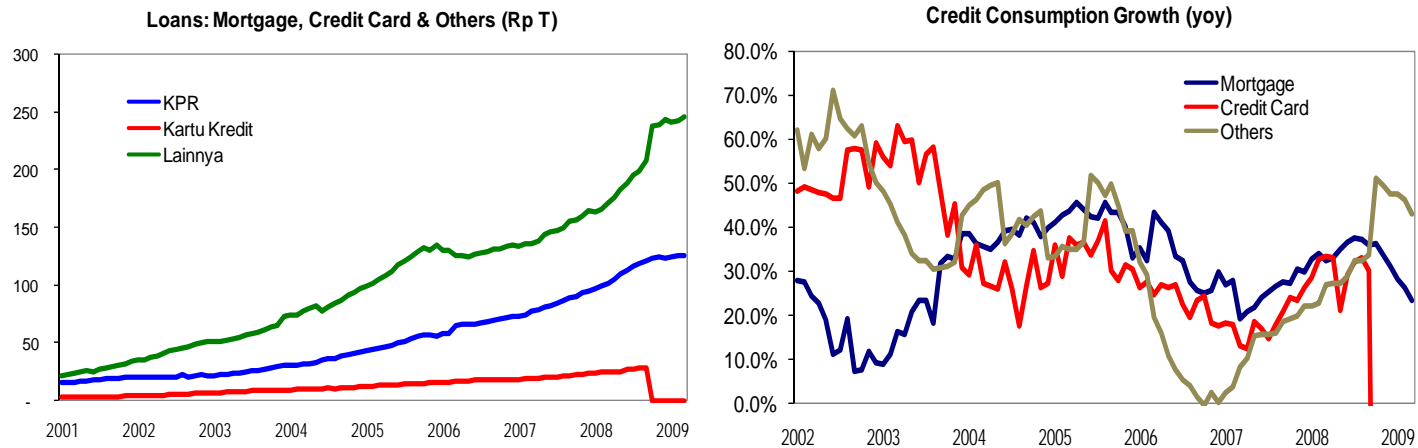
## Current Development: Banks Source of Financing

- After the crises, credit has been mainly financed by third party funds



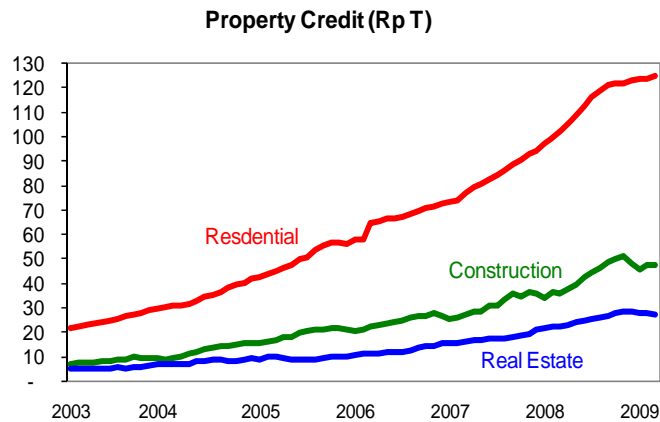
- Nominal credit increased around Rp 307,96 T (29%) to Rp 1,354 triliun by Dec'08 (yoy). As of March'09, nominal credit decreased to reach Rp 1,342 triliun mostly due to the financial global turmoil.
- Credit is still mostly financed using third party funds. By March'09, third party funds have reached around Rp 1,786 triliun.

## Current Development: Consumption Credit - Residential Mortgage

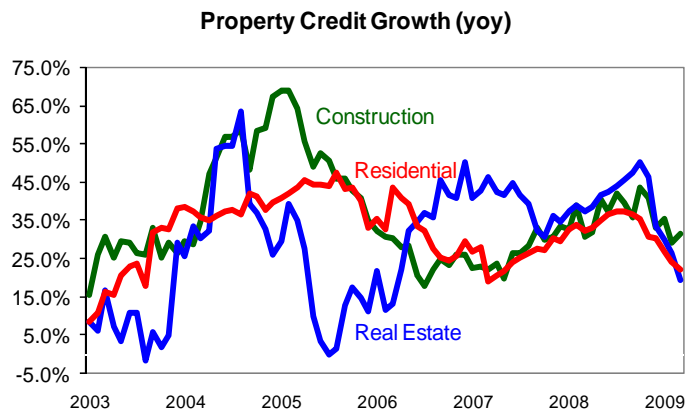


- **By Dec'08, residential mortgage grew around 30,25% (yoy) reaching Rp 28,520 T.** Credit classified as others (incl. multipurpose credit, credit vehicles) remain to be the biggest portion of consumption credit at 58,5% (30% growth - yoy) whilst credit cards account for 8,1% (28,4% growth - yoy).
- **Residential Mortgage accounts for 33,4% of the total consumption credit outstanding.**

## Current Development: Property Credit



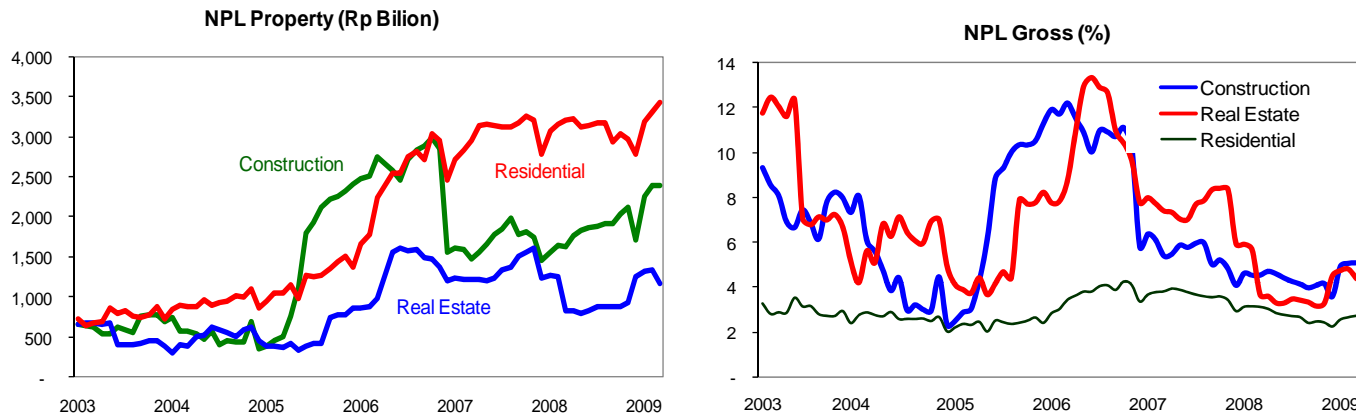
- **Property credit has grown quite significant but facing a declining trend since the end of year.** Property credit (residential, construction and real estate) has grown around 31,15% (Dec'07-Des'08), over-reaching the growth of the total banking sector's credit (29,5%).



- **Residential mortgage grew around 30,3% (yoy – Des'08).** The declining trend of property credit growth is mainly due to the global turmoil. Residential mortgage grew significantly by October (43,8% ytd).

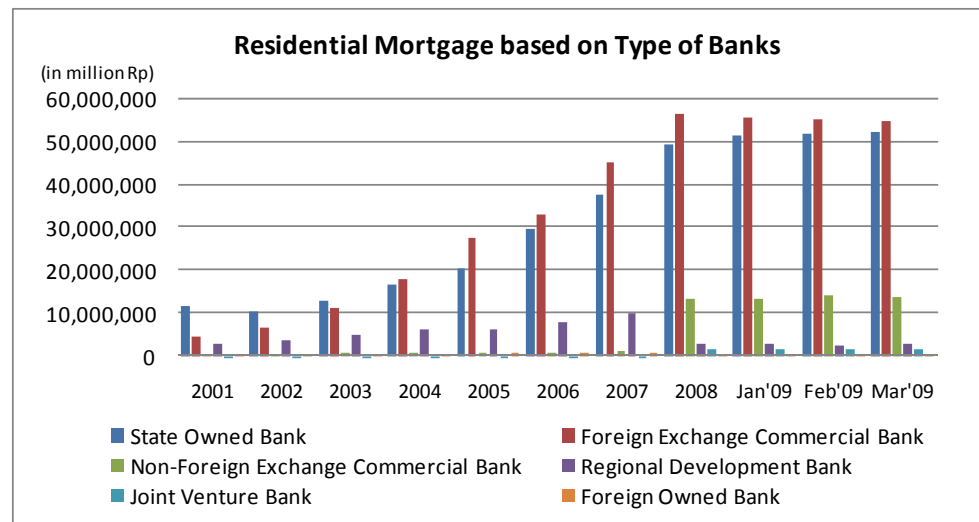


## Current Development: Non-Performing Property Credit



- NPL of property credit (*construction, real estate, residential*) by Dec'08 decreased Rp 0,27 T to around Rp 5,75 T that is mainly due to a decrease in the NPL of residential mortgage and construction, each around Rp 194,7 miliar and Rp 411,5 miliar. **By March'09 (ytd), NPL of residential mortgage increased quite significantly around 23,4% reaching Rp 3,428 T.**
- By Dec'08, gross NPL ratio for all components of property credit decreased from 3,63% to 2,89% (yoy). A decrease in the gross NPL ratio is most apparent in the Real Estate. Gross NPL ratio of residential mortgages decreased around 0,69% to 2,26%. **Gross NPL ratio of residential mortgages have shown a declining trend since the start of year 2008. However, during the first semester of 2009, the gross NPL ratio of residential mortgages have started to pick up (2,75% from 2,26%). The gross NPL of property credit also increased from 2,89% to 3,52%.**

## Current Development: Mortgage Loans by the Banking Sector



- By March'09, Foreign Exchange Commercial Banks tend to dominate lending in the residential mortgage market by about 43,44% or Rp 54,54 T whilst State Owned Banks mortgage lending account for Rp 52,11 T or 41,51% of the total residential mortgages outstanding.
- Mortgage lending is currently dominated by 10 banks which accounts for 83,16% of the total residential mortgage market. Four banks namely BTN, Mandiri, Niaga dan BCA account for 56,23% of the total mortgage outstanding. 95% of mortgage lending to middle and low income level is served by BTN.

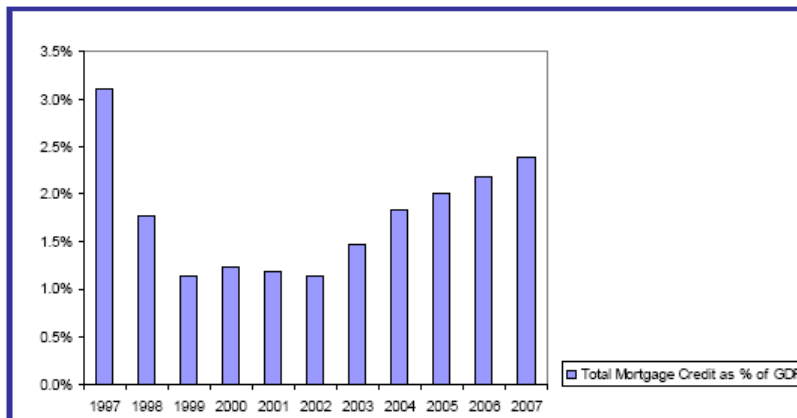
## Characteristics of the Current Mortgage Market

- **Expanding Mortgage Market.** Mortgage loan outstanding are around 2,4% of GDP. Mexico (19%), Thailand (15%), China (10%), Hongkong (44%). There is still potential expansion in the primary mortgage market --> The IFC survey on housing in Indonesia confirms that within the next 3 years, there will be around 199,000 households who will buy a house in the seven big cities in Indonesia where around 49% of them will need mortgage financing.
- Mortgage maturity profile is around 15 years with an average duration of 8 years and a loan to value ratio of 70%-90%.
- State lenders tend to dominate the sector until 1998 with major implicit subsidies in the system. However, private sector has recently overtaken state sector.
- Mortgage interest rates are mostly fixed for the first couple of years then floating. Fixed rate mortgage loan with certain conditions also applies to syaria mortgage loan.
- Banks still play a major role in the development of the primary mortgage market.
  - Mismatch problem since banks rely on short term funds to finance long term mortgage loans. To circumvent the problem, there is a need to develop the secondary mortgage market.

## Current Development in the Primary Mortgage Market: Supply and Demand

### → Growing House Demand

Population of 234,693,997 and real income growth (10%) in 2007. According to the Ministry of Housing, the average demand for housing until 2020 would reach around 1.2 million units.



### → Housing Supply

According to the Housing Development Strategic Plan 2005-2009:

1. Lower the housing supply gap from 5,8 million units in 2004 to 4,8 million units in 2009 and to meet new (first) housing needs at an average of 800 thousand units per year.
2. Lower the number of slum houses from 13 million units in 2004 to 5,8 million units in 2009
3. Lower slum areas from 54,000 ha in 2004 to 27,000 ha in 2009.

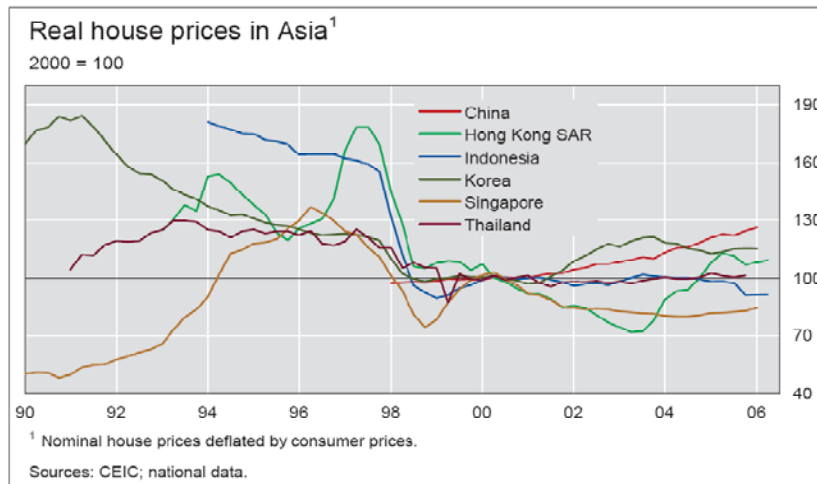
## Current Development in the Primary Mortgage Market

→ **Improved Legal Environment.**

Property registration >85%, Foreclosure process shortened.

→ **Stable House Price Environment.**

Formal real house prices have remained stable since the crisis. Fairly elastic housing supply through **informal sector** (Marja, 2008). However, housing needs served through the formal sector accounts for only 15% of the total housing needs whereby the rest is self-fulfilled.



→ **GDP growth allows for credit Expansion.**

Improved Regulation, Safety Net Lowers Risk

## Current Issues in the Primary Mortgage Market

### → Relatively High Transaction Costs.

Net Interest Margins of around 7-8% are high due to risk and high transaction costs incurred by banks. Average total transaction costs are 12,5% in Indonesia.

Real estate taxes and transaction costs in Asia					
As a percentage of property value					
	Property tax <sup>1</sup>	Stamp duty and legal costs	Deeds and transfer tax	Sales tax or business tax	Other
China	0.96	0.13	3	5	0.05–0.35 <sup>2</sup>
Hong Kong SAR	0.7	1.25–5.75			
Indonesia	0.1–0.2	1–2	1	10	
Korea	1	0.23–0.83	4		0.6 <sup>3</sup>
Singapore	0.2	1–3			
Thailand	0.6	0.50 <sup>4</sup>	2	3	1.05 <sup>5</sup>

<sup>1</sup> In Hong Kong SAR, Singapore and Thailand, the property tax is calculated based on the annual value (rents), which is assumed to be 5% of the property value. <sup>2</sup> City maintenance and construction tax. <sup>3</sup> Including 0.2% rural development tax and 0.4% education tax. <sup>4</sup> The stamp duty is waived if the special business tax (3%) is paid. <sup>5</sup> Including 1% withholding tax and 0.05% income tax.

Sources: World Bank; Jones Lang LaSalle (2006a); authors calculations. Table 2

### → High Taxation on Transfer of Property

### → Mortgage Subsidy Scheme:

- Various housing subsidy schemes still lacks acknowledgement by customers.
- Most banks are still reluctant to participate the mortgage subsidy program due to the time consuming and complicated reimbursement process.

### → Need for the establishment of a mortgage insurance facility to allow for a lower risk weighted asset value of subsidized mortgages used to derive the capital adequacy ratio (as in the case of micro credit lending).

## Development and Risks of the Secondary Mortgage Market: Collective Investment Contract – Asset Backed Securities

### Definition of the Collective Investment Contract – Asset Backed Securities

- Collective Investment Contract is recognized to be a contract between the investment manager and the custodian bank that is binding upon them and the ABS holder through the concept of accession. The investment instrument derived from the collective investment contract is in the form of unit of participation (as in mutual funds). Asset Backed Securities is the participation unit of the collective investment contract with an underlying portfolio that consists of mortgage pools.

\*The first CIC-EBA was introduced on the 29<sup>th</sup> of January 2009 through the launch of Danareksa SMF I – KPR BTN with an underlying asset of mortgage pool receivables selected from PT. Bank Tabungan Negara at a value of Rp 111 bilion. In 2008, PT. Bank Tabungan Negara have sold Rp 500 bilion worth of mortgages to PT. SMF to be securitised as CIC-EBA.

### Risks associated with the CIC-ABS

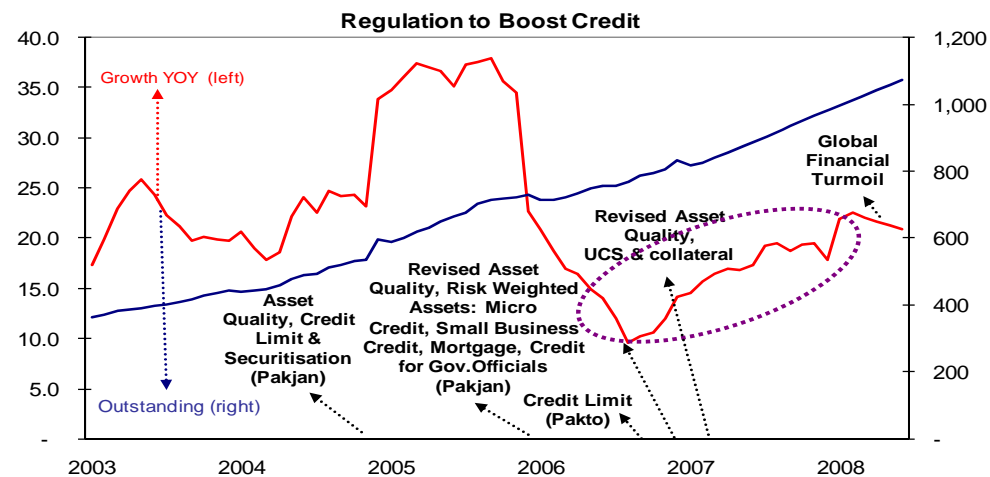
- Risks characteristics associated with the CIC-ABS scheme are quite similar to risks inherent in mutual fund instruments. Having mortgages as the underlying asset of the CIC-ABS subjects this instrument to interest rate risks.
- Banks acting as a selling agent of mutual funds (incl. CIC-ABS) are subject to reputational risks.
  - CIC-ABS that is perceived as a mutual fund instrument with mortgage as the underlying asset may also cause the bank as the original creditor to be subjected to reputational risk.

## Regulatory Measures to Support Mortgage Market Development

Securitization is governed by regulation from both the **capital market authority body (Bapepem-LK)** as well as **Bank Indonesia**.

**Circular Letter No. 8/3/DPNP** regarding the change in the calculation of risk weighted assets for micro credit, housing credit (mortgage) and credit for officials/pension.  
→ Boost mortgage lending activity by banks (primary mortgage market).

**Bank Indonesia Regulation no. 7/4/PBI/2005** and **Circular Letter No. 7/51/DPNP** regarding prudential principle of securitization activity by commercial banks.  
→ Allow for the development of the secondary mortgage market





## Other Measures Taken to Develop the Mortgage Market

- Ensure supporting regulation and coordination between BI and other regulatory bodies and government institutions → memorandum of understanding between the Ministry of Housing, Bank Indonesia and Ministry of Finance regarding the establishment of a Task Force to coordinate and foster developments in housing finance.
- The main duties of such Task Force are as follow:
  1. To ensure coordination and to do research on the adequacy of regulation/legislation which relates to housing finance.
  2. Review developments in housing finance schemes.
  3. Enhance coordination by ensuring proper sharing of information needed to support housing finance (Debtor Information System).
- BI maintains close coordination with PT. Sarana Multigriya Financial (Secondary Mortgage Facility) → To endorse investor education program and ensure prudential lending practices by banks.
- BI continues to develop the debtor information system to be able to accommodate securitization activities by banks as well as to provide a more detailed information on mortgage loans.

## Resilience of the Banking Industry

- Overall, the banking performance up to Mar'09 remains positive, with a CAR of around 17,4%.
  - Market Risk and Liquidity Risk are well managed. However, potential liquidity pressure is still prominent due to the majority (83,1%) of liquid instruments being held by big banks (total asset > Rp15 T).
  - Potential increase in credit risk. During Mar'09, nominal NPL increased Rp 2,8 T, whilst provision for bad debts decreased to Rp 1,3 T. As a result, NPL *gross ratio* and *net* increased from 4,3% and 1,6% to 4,5% and 1,9%.
  - Credit (yoy) growth remains low (24,3%) despite an increase in Mar'09 (mtm) around Rp7,9 T (0,6%). By Mar'09, credit experienced a negative growth of Rp 11,6 T (-0,9%) whilst, credit growth until 28 Apr'09 also remained negative around Rp 41,7 T (-3,2%).
  - The low credit growth in 2009 (until April) was followed by an increase in SBI around Rp 41,6 T (25%). There is an indication that banks tend to increase their funds in SBI with longer duration. This somewhat indicates towards a prolonged credit crunch.
- Nevertheless, the *stress test* result have shown that in general, banks are still resilient to various risk pressures. With such resilience, continuous enforcement in the banking industry needs to be made to allow significant contribution to economic growth.

## Concluding Remarks

- Before the crisis, mortgage credit had contributed significantly to GDP. After a significant fall that was later experienced during crisis, mortgage financing is still gradually recovering.
- Mortgage credits are mainly financed by banks → mismatch problem
- Development of the secondary mortgage market is still in its initial phase. Proper legal infrastructure governing securitization still needs to be put in place.
- To foster the development of the primary and secondary mortgage market, continuing efforts are made to ensure close coordination between regulatory bodies and the government whilst at the same time safeguarding financial system stability by ensuring that prudential practices in mortgage lending and securitization activities are well maintained.
- Potential pressure that is shown by the increasing signs of a credit crunch in the banking industry may affect the development of the primary mortgage market and in turn may also disrupt the performance of the real sector, both at corporate and household levels.
  - Need to continuously improve and increase surveillance quality to support an early warning mechanism.

Thank You