

WATER SECTOR FINANCING IN INDONESIA: THE POLICY ENVIRONMENT AND LEGAL FRAMEWORK



DECEMBER 2009

This publication was produced by Development Alternatives, Inc. for the United States Agency for International Development under Contract No. 497-M-00-05-00005-00

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Title:	Water Sector Financing in Indonesia: The Policy Environment and Legal Framework
Program, activity, or project number:	Environmental Services Program, DAI Project Number: 5300201.
Strategic objective number:	SO No. 2, Higher Quality Basic Human Services Utilized (BHS).
Sponsoring USAID office and contract number:	USAID/Indonesia, Contract number: 497-M-00-05-00005-00.
Contractor name:	DAI.
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Date of publication:	December 2009

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LIST OF ACRONYMS

ADB	Asian Development Bank
ASKRINDO	<i>Asuransi Kredit Indonesia</i>
DAU	<i>Dana Alokasi Umum</i>
DPRD	<i>Dewan Perwakilan Rakyat Daerah</i>
DWSRF	Drinking Water State Revolving Fund
ESP	Environmental Services Program
FN	Environmental Services Finance Component
GOI	Government of Indonesia
IDR	Indonesian Rupiah
IFI	International Finance Institution
IWF	Indonesia Water Fund
IWRF	Indonesia Water Revolving Fund
JBIC	Japanese Bank for International Reconstruction
KEPRES	<i>Keputusan Presiden Republik Indonesia</i>
MOF	Ministry of Finance of Indonesia
NGO	Non-Governmental Organization
PER	Public Expenditure Review
PMK	<i>Peraturan Menteri Keuangan</i>
PDAM	Perusahaan Daerah Air Minum
RDA	Regional Development Account
SOP	Standard Operating Procedures
SPV	Special Purpose Vehicle
USAID	United States Agency for International Development

I. EXECUTIVE SUMMARY

1. The scope of this paper is to explain the legal and regulatory framework governing water supply finance, to provide a summary of the current situation and the problems which are impeding progress towards extending the service coverage and Millennium Development Goals (MDG), and finally to describe the approach now being taken by the Ministry of Public Works (MPW) to improve PDAM performance and how donor support has assisted and can continue to support capacity-building in the industry. This executive summary provides a digest against each topic discussed in the main body of the text.

I.1. REGIONAL GOVERNMENT RESPONSIBILITY FOR WATER SUPPLY

2. Regional government is clearly identified in the regulatory framework as being responsible for water supply delivery, meaning that it is expected to oversee the quality of service and to fund it through existing arrangements (the PDAM, regional government public service units or the regional government public works department), if necessary from its own financial resources. It generally fails in this respect. However, minimum service standards on water supply have yet to be issued and all such standards will have to be promulgated and costed before the any financing gap can be identified and the means to fund it put in place.
3. In the meantime, heads of regional government – the owners of the PDAMs – are generally not sufficiently responsive to the need for full cost-recovery tariffs, although the situation is slowly improving. Many PDAMs are technically insolvent and the quality of service has deteriorated. There are also problems of governance and competent management at many PDAMs, which MPW is attempting to address through a capacity-building programme with donor assistance, including the USAID-funded ESP Project.

I.2. LENDING ARRANGEMENTS THROUGH THE MINISTRY OF FINANCE (MOF)

4. These facilities have been inoperative for more than 10 years due to a mass default by PDAM and regional government borrowers and a lack of action by MOF to resolve the problem, plus a false start. MOF has now issued the necessary regulations and decrees for the re-structuring of non-performing loans (NPL), with write-offs of arrears of interest and penalties. Restructuring of outstanding loan principal, a necessary pre-condition to obtaining future loans from MOF, is now underway. 85 PDAMs (nearly 50% of defaulters) are expected to have re-negotiated their loans by the end of 2009. However, the processing is time-consuming. Some PDAMs have indicated that MOF is more interested in accelerated payments rather than reviving a generally inefficient public service.

MOF states that its annual review process of adherence to agreed business plans will accommodate revisions to the agreed repayment schedule, if justified.

5. Defaulting regional governments have been less responsive to re-structuring their NPLs, although the related decree framework is more generous and requires less preparation than that for PDAMs.
6. In addition, the regulatory framework requires a two-year transitional period after restructuring agreements before write-offs become unconditional. This enforces financial discipline, but it does not necessarily mean that the quality of the service will be materially improved.
7. MOF and BAPPENAS have issued new regulations for regional borrowing. Although MOF on-lending directly to PDAMs is permitted by law, the implementing regulations close off this channel, by requiring their regional government owners to borrow for water supply and making separate financial arrangements with their PDAMs. MOF loans to regional governments are now supported by a mechanism whereby regional governments must agree to their central government financial transfers being intercepted in the event of loan default. All such loans must receive the approval of the regional government legislatures (DPRD) which are reluctant to borrow as a matter of principle and unwilling to put their intergovernmental fiscal transfers at risk of being intercepted, although this is standard practice in most countries. In addition, the procedures for applying for a loan through MOF are very cumbersome.
8. In effect, the MOF lending channel is expected to remain substantially inoperative for some considerable time.

1.3. GRANTING ARRANGEMENTS

9. Although water supply service is a regional government responsibility, central government may provide grants through the DAK channel for sectors which it considers to be a national priority. In 2009 DAK amounted to 2.4% of the APBN and has tended to increase by more than the rate of annual inflation. Approximately 5% of DAK funds are directed towards the water supply sector, especially village community-based systems. Donor funds may be used to supplement the DAK.
10. In 2009, MPW is managing a fund of Rp 300 billion which it directs for investment in raw water supply and treatment through the central government *tugas pembantuan* channel to PDAMs not meeting minimum service standards (as perceived by MPW – the standard for water supply has yet to be issued).
11. GOI has recently opened a new granting channel for regional governments, officially designated as *hibah*. *Hibah* is managed by the competent technical ministry, but is transferred to regional governments through the standard DIPA mechanism. Water supply is expected to receive Rp 3 trillion of *hibah* from the GOI own-resources APBN between 2010 and 2014. The *hibah* channel may also access donor funds, and already AUSAID expects to provide AUD 20 million

for water supply between 2010 and 2012. The water supply *hibah* will operate on a matching grant formula, with regional government (or its PDAM) providing up-front funds for the implementation of works approved by MPW (except for the household connections which will continue to be purchased by customers). MPW will verify installation and functionality of the works three months after installation and advise MOF to release the retroactive *hibah* co-financing.

12. The *hibah* programme seems to have been well defined. What is unknown is the extent of regional government's positive response, especially as the degree of dissemination to PDAMs and regional governments, particularly outside Java, does not appear to have been adequate so far, although this may be because MPW has not yet formally issued the required operating procedures. It is estimated that the amounting of financing committed to date by GOI will deliver between 1,000,000 and 1,250,000 connections.

1.4. COMMERCIAL BANK LENDING

13. Indonesian commercial banks have traditionally been reluctant to lend for capital investment, except to state-owned enterprises. Lending to PDAMs has been particularly limited, with banks generally considering them to be a poor commercial risk. Those very few loans which have been taken out by PDAMs have been made at high interest rates and with tenors far too short to accommodate long-run capital investment projects.
14. Mainly at the instance of the former Vice-President, MOF and MPW have negotiated an initiative with state banks to provide partial credit guarantees of 70% of loans to creditworthy PDAMs plus an interest subsidy of 500 basis points above Bank Indonesia lending rate. The initiative has been institutionalized in a presidential decree, and backed up by an MOF decree on operating procedures which will be issued shortly.
15. Twelve PDAMs have submitted loan proposals to MPW, with ESP having provided assistance in the preparation of these and AUSAID providing similar assistance to a further twenty.
16. The principal potential obstacle to the success of this initiative is the response of the heads of regional governments and the DPRD. Regional governments are required to provide a secondary guarantee of 40% of the loan amount (equivalent to 57.14% of the partial credit guarantee). MOF is the front-line guarantor of the entire 70%, but wishes to restrict its ultimate exposure to 30% of loan amount. The regional government has to support its secondary guarantee with an agreement to allow central government the right of intercept in the event of a default by the PDAM and the inability of the regional government to step in. This is something that DPRD have generally been unwilling to do.
17. Another issue is that participating banks will classify PDAMs as commercial borrowers, rather than corporate borrowers, because of the perceived credit risk. This, in effect, limits the loan tenor to ten years, including any grace period. Whilst this tenor is not suitable for water supply investment, it is the best offer available and creditworthy PDAMs are likely to accept these terms. Even if

successful, the initiative is expected to be available to a maximum of 40-45 creditworthy PDAMs.

1.5. OTHER POTENTIAL SOURCES OF FUNDS

18. MOF has recently established a wholly-owned infrastructure finance company, PT Sarana Multi Infrastruktur (PT SMI) which will provide construction finance. PT SMI is staffed with professional finance officers.
19. Within PT SMI is an entity which will lend long-term finance for private sector developed infrastructure. It is called the Indonesia Infrastructure Financing Facility (IIFF). The IIFF has a \$200 million capital joint venture, with 60% of the capital subscribed by donors, 30% by MOF and 10% unallocated. ADB and the IFC have each provided loans of \$100 million. Although primarily a supplier of fiancé to the private sector, it could lend to public-private partnerships (PPP) and creditworthy PDAMs. In the last case, it would be a competitor of Perpres 29/09 (Paragraphs 14-17 above). Its potential remains to be seen, as it has only recently received a business license and appointed a chief executive.
20. The Indonesia Clean Technology Fund is a sovereign wealth fund of \$250 million in which MOF has a 10% holding. It includes piped water supply as a candidate for investment. Its practice will be to take an equity position for a limited period (say 5-7 years) on appropriate return-on-investment terms and then require a take-out with replacement loan or bond financing, or substitution with equity capital. Its appeal will be limited to investment projects of significant size only.

1.6. BOND FINANCE

21. Efforts have been made in the last five years by both ESP and KfW to promote the issue of corporate bonds to creditworthy PDAMs. The initiatives by ESP involved, firstly, a revolving fund and, secondly and in parallel, a single corporate bond issue by a PDAM underwritten by a national investment house and with a USAID partial credit guarantee. Both initiatives raised initial enthusiasm. However, the first failed because of the lack of a “champion” and may also have been financially over-engineered, whilst the second was ultimately unsuccessful because of the risk-averse culture which is so pervasive in Indonesian central and regional governments. The KfW activity came to nothing simply because of central government failure or unwillingness to understand the methodology.
22. A further challenge to PDAM bonds is the desirability of a regional government guarantee, but this is prohibited by law. The issue could be overcome by the regional government issuing a municipal bond, for which legal and regulatory framework already exists, and making its own arrangements with the PDAM. However, bonds are now unlikely to succeed whilst the more competitive Perpres 29/09 remains valid.

1.7. MINISTRY OF PUBLIC WORKS POLICY

23. MPW has determined that the major obstacle to improved water supply service deliveries is the generally unsatisfactory standard of governance and management

skills at PDAMs. It has therefore embarked on a comprehensive capacity-building programme to improve management, financial, technical and operational competence and to enhance the perception of PDAM performance at regional government and DPRD level. It invites, donors, especially bilateral donors, to join the programme and to take measures to improve co-operation and communication at both central and regional level.

24. MPW will provide financial assistance to urban area PDAMs, except in cases where the service is to be extended to low-income groups consuming at subsidized tariff rates. Investment for raw water extraction, transmission and treatment will be provided for district IKK and community-based systems. MPW is opposed to loan finance to increase capacity for PDAMs which are not creditworthy and unable to manage their existing assets efficiently.

1.8. CONCLUSIONS

25. In May 2008, the then Vice-President, intervened in the process, convening a series of meetings with central government stakeholders in order to initiate policies which would produce an additional 10 million domestic connections and thus provide a further 50 million people with clean piped water by 2011. Three (3) specific initiatives were proposed to kick-start the process, namely:
 - a write-off of more than Rp 3 trillion of outstanding debt due MOF from PDAMs through forgiveness of all penalties, and interest and commitment fees;
 - a new grant system (*hibah*) channeling funds to regional governments, including funds for water supply investment
 - a programme whereby MOF would provide partial credit guarantees and interest rate subsidies to state banks making loans to creditworthy PDAMs:
26. The progress of these initiatives, including planned funding, suggests that it is unlikely that more than 2.5 million of the 10 million targeted connections will be installed. In addition to a need for a policy to resolve the problem of remote, uneconomic PDAMs and the increasing difficulties in finding new sources of raw water, subjects which are outside the scope of this paper, the main reasons for falling short of the target (and, consequently, MDG goals) are deemed to be:
 - the pace of re-structuring and restoration of PDAMs to financial health and creditworthiness;
 - the cumbersome nature of regulations for lending through the MOF channel;
 - the perception of domestic commercial banks that PDAMs are a poor credit risk;
 - the risk-averse culture which permeates all levels of government;
 - the widespread unresponsive attitude of regional government towards water supply and infrastructure investment generally.

27. Of the above five reasons, only the last two are considered to be wholly negative.
28. MPW's policy of capacity-building at PDAMs before encouraging investment to expand the service coverage will also defer attainment of either the former Vice-President's target or the MDG target for piped water coverage in urban and rural areas. On the other hand, it is the view of this paper that, seeking to provide a strong platform of sound management, good governance and creditworthiness in PDAMs, this policy may represent the most effective way of eventually getting there, even if not by 2015. It is therefore the conclusion of this paper that bilateral technical assistance in the water supply sector should be focused on these aspects.

2. REGIONAL GOVERNMENT RESPONSIBILITIES FOR PUBLIC SERVICE DELIVERIES

2.1. DECENTRALISATION LEGAL AND REGULATORY FRAMEWORK

29. In 1999, two radical decentralizing laws (UU) were passed, respectively, on regional government and the fiscal equilibrium between the central and regional governments¹. These were subsequently revised in 2004², and were followed by a series of implementing regulations (PP) and operationalising decrees (PM) issued by the Ministry of Finance (MOF) and the Ministry of Home Affairs (MOHA)³. Law 32/2004 reserves a number of functions to the sole responsibility of the central government, by implication leaving the balance, including public services deliveries, to regional governments⁴, “based on the principles of autonomy and assistance”⁵. This division of responsibilities between the various levels of government is formally defined in an implementing regulation (PP 38/07)⁶.
30. The fiscal equilibrium law provides financial measures to assist with the funding of governmental functions assigned to regional government under the regional government law, based on the principle that “money follows function”⁷, meaning that funding should be allocated to enable the regional governments to properly discharge their delegated governmental functions.
31. Law 32/04 requires annual reporting by regional government⁸ on their performance in carrying out their functions and responsibilities under regional autonomy, and the evaluation of this performance by central government (principally by MOHA)⁹. It also provides for various sanctions¹⁰ in the event that a regional government underachieves or fails in the implementation of these assigned duties. Reporting by regional government and evaluation by central government on the condition of infrastructure and other public services deliveries are included in these regulations.

1 UU 22/99 on Regional Government and UU25/99 on the Fiscal Equilibrium

2 UU 32/04 and UU 33/04 respectively. All subsequent references to regional government and fiscal equilibrium legislation are made in the context of the 2004 laws. It is understood that these laws are also being reviewed with the objective of promulgating revised legislation in 2010-11

3 Ministry of Finance decrees are called *peraturan menteri keuangan* (PMK) and Ministry of Home Affairs decrees are called *peraturan menteri dalam negeri* (PMDN)

4 Provincial (*provinsi*), city (*kota*) and regency (*kabupaten*)

5 Section 10 of UU 32/2004 on Regional Government

6 PP 38/07 on the Division of Functions between Central, Provincial, City and Regency Governments

7 Elucidation to Law 33/2004 on Fiscal Equilibrium

8 Implemented by PP 03/07 concerning Reporting on Regional Government Performance of its Functions

9 Implemented by PP 06/08 concerning a Guideline for Evaluating Regional Government Performance of its Functions

10 Implemented by PP 78/07 on the Establishment, Disestablishment and Merger of Regional Governments

32. Standards on public service deliveries are required by an implementing regulation¹¹ derived from Law 32/04. These stipulate qualitative and quantitative benchmarks for each service and are issued by the line ministry responsible. The standards on water supply have yet to be promulgated by the Ministry of Public Works (MPW).
33. However, these standards will be of little practical use until they all have been issued and properly costed in order to test regional government financial capability to fund public service deliveries to the required levels; and, if that capability does not exist, how to fund the gap.

2.2. RESPONSIBILITIES FOR PIPED WATER SUPPLY SERVICES

34. Piped water supply services are generally, but not exclusively, the responsibility of a regional government-owned enterprise (generically, a BUMD) known specifically as a PDAM, wholly-owned by its regional government owner but established as a separate legal entity¹².
35. The Government is currently in the process of developing a new legislative framework on BUMD to replace Law 05/1962. A new law¹³ was drafted nearly three years ago and has appeared regularly on the agenda of the national legislature (DPR) since then, but it has yet to be debated. The draft law divides BUMD into two types of entity: the first is called a *Perumda*, a BUMD fully under regional government control, with an equity rather than a share capital base. *Perumda* are more socially oriented in the way their service tariffs are constructed. The second type is called a *Perseroda*, a BUMD which may be owned fully by its regional government or co-owned with other entities, with a share capital, and be more commercially oriented.
36. Many PDAMs are heavily indebted to MOF¹⁴ with non-performing loans (NPL), an issue which is only now in the process of being resolved after several years of inactivity. This and the search for suitable investment vehicles to provide capacity building to PDAM management and operations, rehabilitate their run-down assets and extend their service coverage are the main subjects of this paper. Other unresolved problems, such as the persistent problems of regional government insistence on low tariffs without providing compensation in the form a public service obligation (PSO), and large losses in the form of non-revenue water, etc, have been discussed many times and it is not intended to repeat the exercise here.
37. In 2005, a regulation¹⁵ was issued to permit the establishment of public service units (*badan layanan umum* – BLU) at all levels of government. Unlike BUMN and BUMD, BLUs function as part of the government apparatus and not as separate legal entities, and are funded off the national (APBN) or regional (APBD) budget, as the case may be. They are essentially operated as non-profit

¹¹ PP 65/05 on Minimum Service Standards

¹² By UU 05./62 on Regional Government Enterprises

¹³ Draft Law on BUMD, November 2006 version.

¹⁴ Ref Section III hereof

¹⁵ PP 23/05 on Public Service Units

organizations although they are not prohibited by regulation from making a profit.

38. Most of BLUs established through PP 23/05 are state hospitals and universities and under the umbrella of the Ministries of Health and Education respectively. However, at least seven (7) water supply systems (including one former PDAM) are run by regional government BLUs, operating with their own budgets and separate from regional government public works departments (*dinas PU*). It is not intended that BLUs should replace PDAMs, although there is no legal impediment to their doing so; it is more likely that they will operate small, remote, water supply systems which it is not expedient or cost-effective for PDAMs to manage.

3. THE NON-PERFORMING LOANS ISSUE

3.1. BACKGROUND TO NON-PERFORMING LOANS

39. The issue of non-performing loans (NPLs) by MOF to both PDAMs and regional governments has a long history. NPLs first became noticeable in the mid-1990s and the problem was severely exacerbated by the economic crisis of the late 1990s. Its consequences have persisted well towards the end of this decade. At the end of 2007, the status of the MOF-PDAM loan portfolio, administered by the Regional Development Account (RDA) Sub-Directorate of Directorate DP3¹⁶ within the Treasury¹⁷, was reported¹⁸ to be as follows:

MOF-PDAM Loan Portfolio Status, 31 December 2007 ¹⁹

Item	Amount Rp Trillion	Amount USD Million ²⁰
Principal Borrowed	4.50	450
Principal Repaid	1.07	107
Arrears	4.39	439
Balance Outstanding	6.36	636

40. The balance outstanding from regional government borrowers at that same time was Rp 1.12 trillion (USD 112 million equivalent)²¹. 189 PDAMs and 124 regional governments had arrears on outstanding loans. The results for FY 2008 (not made available at the time of this report) are expected to show a further deterioration due to loan restructuring arrangements being put in place only in late 2008. Significant arrearages are limited to major secondary city regional government loans, but are spread broadly across the entire PDAM spectrum
41. The sources of the borrowings were primarily multilateral donor sovereign loans for multi-sector infrastructure development²² at regional government level. Proceeds from these loans were on-lent through the Regional Development Account (RDA) of DP3 to regional governments and their PDAMs for cost

¹⁶ DP3 – the Directorate of On-Lending Management

¹⁷ It is understood that the RDA may shortly be transferred from Directorate General of Treasury to the Directorate General of Fiscal Equilibrium (DJPK)

¹⁸ The software of the financial management information system used to administer DP3 operations is defective and the output is not accurate. An UNCTAD system, presently used to manage GOI's sovereign debt position, is in the process of being installed in DP3 but will not be operational until 2011. The State Audit Agency (BPK) has refused to accept the DP3 accounts for many years and the on-lending operations are still not included in the annual national budget report.

¹⁹ Source: DP3 Regional Development Account Loan Portfolio Status Report, 31 December 2007

²⁰ At an exchange rate of USD 1.00 = Rp 10,000

²¹ Ibidem

²² Known as IUIDP – Integrated Urban Infrastructure Development Project

recovery sector projects; a second lending channel for infrastructure financing was own-source GOI funds (*rupiah murni*) - also lent by the RDA for cost recovery sector projects. Whilst there was a process for issuing loans and SLAs, there was no regulatory framework which required due diligence for appraising *rupiah murni* loan submissions

42. The causes of PDAM NPLs are summarized in Appendix I. The impact of these causes on PDAM finances, together with a persistent attitude of many regional government legislatures (DPRD) (PP 16/05²³ and PP 23/06²⁴ notwithstanding) that PDAMs' function is largely social and that its tariffs should reflect this, have had a devastating impact on the quality and extent of their services which continues to this day. Most PDAMs have been technically insolvent for many years. On the other hand, since the implementation of decentralization in 1999, regional governments have generally been financially capable of paying down their own debt to MOF. Nevertheless, many have not done so for motives other than financial; these being mainly political, as well as the snowball effect as a result of MOF having remained largely passive in the face of this mass default.
43. In fairness, this lack of response on the part of MOF may have been due in part to the absence for several years of an appropriate legislative and regulatory framework through which loan restructuring (i.e. write-offs of state credits) could be implemented, although this would not have prevented MOF providing a lead on loan rescheduling. At any rate, MOF lending for investment in urban infrastructure, including water supply, through the RDA ground to a virtual halt. In the meantime, rescheduling in the case of many NPLs ceased to be a viable option as arrears increased to the point where only drastic loan restructuring, especially in the case of PDAMs, could resolve the problem. For several years, activity on RDA loans in DP3 seemed to be limited to calculating arrears and penalties thereon, as very few loans were being serviced by regional governments and their PDAMs, and even fewer new loans were being issued – none at all in the case of PDAMs.
44. The law on the fiscal equilibrium and an implementing regulation (PP) on regional government borrowing²⁵ provide an avenue for MOF to intercept central government transfers to regional government in the event of loan arrears²⁶ but, until 2008²⁷, MOF seemed reluctant to issue an operational mechanism in the form a decree (PMK) in order to exercise this right. In any case, it is understood that the Ministry of Justice had provided a ruling that the intercept could not be applied in the case of arrears on loans from central government to regional governments signed prior to the decentralizing legislation of 1999.

²³ PP 16/05 (MPW) on Establishing Systems for Drinking Water Distribution. It provides, inter alia, for full cost-recovery tariffs to be implemented

²⁴ PP 23/06 on Arrangements for Setting PDAM Drinking Water Tariffs, prescribing a methodology for calculating full cost-recovery tariffs

²⁵ PP 107/00 (MOF) on Regional Government Borrowing, subsequently revised as PP 54/05 (MOF).

²⁶ Section 64.2 of UU 33/04 and Section 41.1 of PP 54/05

²⁷ See Paragraphs 77-79 on PMK 129/08 concerning the intercept mechanism for loan arrears to GOI

3.2. LACK OF RECOURSE FOR MOF ON PDAM NPLS AND DIFFICULTIES IN BANKRUPTCY FILING

45. In any case, MOF cannot use the intercept to recover arrears from regional governments on PDAM loans, even though PDAMs are 100% owned by their regional government, because PDAMs are established as separate entities by the law on regional government-owned enterprises. This law makes no provision for bankruptcy proceedings against such enterprises. Furthermore, the Bankruptcy Law²⁸ omits any reference to either regional governments or their BUMD, probably because their essential public service delivery function cannot be suddenly terminated as a result of a successful bankruptcy petition.
46. The draft BUMD law states²⁹ that both *Perumda* and *Perseroda* may be filed for bankruptcy in accordance with prevailing laws and regulations. There are potential obstacles, however, in that only their directors can submit a petition for bankruptcy upon approval of its owners, not their lenders. Therefore, in the case of a *Perumda*, directors can only submit petition for bankruptcy upon approval from the Head of Regional Government and DPRD; whilst In the case of a *Perseroda*, directors can only submit for bankruptcy upon approval from the Head of a Regional Government and the regional parliament (DRPD) and to be further ratified by a General Meeting of Shareholders (RUPS)³⁰.

3.3. INITIAL REGULATORY ATTEMPTS TO RESCHEDULE/RESTRUCTURE NON-PERFORMING LOANS

47. The road to a formal restructuring process with debt forgiveness was not opened until the beginning of 2004 by passage of the State Treasury Law, which includes a provision for the write-off of state credits and levels of responsibility for write-off amounts in the case of a single debtor³¹. This paved the way for the issue of an implementing regulation³², which stipulated settlement by means of one of three processes which are, in order of central government preference, (i) rescheduling, (ii) changing the terms and conditions of the loan agreement and (iii) write-offs³³. Write-offs may be effected in two stages (firstly, conditionally and, secondly and finally, unconditionally) if it is determined that the borrower still does not have the capability of repaying its debt³⁴. The unconditional status is granted two years after approval of the conditional write-off subject to satisfactory performance, and is intended to instill management and financial discipline in the defaulting borrower. This two-stage process appears to be a

²⁸ UU 37/04 on Bankruptcy/Insolvency

²⁹ Sections 73.1 and 73.2 of the draft BUMD law

³⁰ Sections 43.2 and 43.3 respectively of the draft BUMD law

³¹ Section 37 of UU 01/04 on the State Treasury

³² PP 14/05 on Procedures for State/Regional Credit Write-Offs

³³ Section 3 of PP 14/05

³⁴ Sections 2 and 13 of PP 14/05.

throw-back to a much earlier law on state credit³⁵ which is still on the statute book, UU 01/04 notwithstanding.

48. Later in 2005, DP3 produced a decree³⁶ for the settlement of state credits to PDAMs. PDAMs were accorded priority because: (i) their arrears position was far more serious than that of regional government defaulting borrowers, (ii) water supply infrastructure was in a physically poor condition and the ability of GOI to attain its related international commitments against the Millennium Development Goals (MDG) in terms of service coverage for piped water supply was diminishing rapidly, and therefore (iii) it was necessary to re-establish the creditworthiness of PDAMs in order to get new investment in water supply moving. These last two objectives are still very far from being accomplished.

3.4. FAILURE OF PMK 107/05 TO RESCHEDULE/RESTRUCTURE PDAM NPL

49. However, although PMK 107/05 proposed a write-off of up to 100% on penalties and 40% of interest arrears, the decree was restrictive in terms of conditions set for eligibility to enter the state credit settlement process of restructuring PDAM debts. Furthermore, it required the submission by eligible PDAMs of a very complicated financial recovery action plan (FRAP) which necessitated the production by DP3 of a separate MOF Treasury decree³⁷ in the form of a guideline to enable PDAMs to prepare the FRAP. This guideline was not issued until October 2006. It suffers from being required to follow the prescriptions of PMK 107/05, and it is generally acknowledged, with hindsight, that it would have been better to have revised the PMK immediately in order to make it less prescriptive, restrictive and onerous and thus facilitate PDAM compliance.
50. Over the 12 months following the issue of PMK 107/05, the outstanding debts of 12 PDAMs, comprising 16 loans and including arrears, were fully paid off, not by PDAMs but by their regional government owners, in return for a discount on loan principal as provided for in the PMK. In addition, a further 7 PDAMs (or, more likely their regional government owners) had paid off individual loans, but still had other loans outstanding; some of these still contained arrears. After 12 months following the issue of Per DJPb 53/06, 40 PDAMs were at various stages of the restructuring process. However, not one PDAM had completed a rescheduling or restructuring pre-qualification exercise up to the stage of presenting new agreements for obtaining the required approval of the Minister of Finance, and the rigidities of PMK 107/05 and the consequent difficulties of PDAMs to comply with PerDJPb 53/06 had by then been generally recognized.
51. Events leading to a revision of PMK 107/05, the revised decree and progress in NPL re-structuring, are discussed in the next chapter.

³⁵ UU 49/60 on the Committee for Matters Relating to State Credits

³⁶ PMK 107/05 on the Settlement of State Credits Arising from Overseas Subsidiary Loans, the Investment Fund Account and the Regional Development Account.

³⁷ PerDJ MOF Treasury 53/06

4. CURRENT INITIATIVES FOR AND PROGRESS TO DATE IN RESTRUCTURING PDAM AND REGIONAL GOVERNMENT NPLS

52. PDAM and regional government NPL restructuring was included as one of the objectives in the agreed policy matrix of the World Bank's IDPL³⁸ I and II loans to GOI. In late 2007, the Bank suggested to MOF: (i) a loosening of the entry restrictions to the PDAM NPL rescheduling and restructuring process, thus making it accessible to all defaulting PDAMs and, significantly, (ii) the forgiveness of all penalties and up to 50% of interest arrears. This suggestion was accepted and DP3 commenced work on revising PMK 107/05.
53. In May 2008, the Government, in the person of the then Vice-President, intervened in the process, convening a series of meetings with PERPAMSI³⁹ and the Ministries of Finance, Home Affairs and BAPPENAS in order to initiate policies which would produce an additional 10 million domestic connections and thus provide a further 50 million people with clean piped water by 2011. Three (3) specific initiatives were proposed to kick-start the process, namely:
- a write-off of more than Rp 3 trillion of outstanding debt due MOF from PDAMs through forgiveness of all penalties, and interest and commitment fees, i.e. leaving PDAMs to pay principal arrears and principal outstanding in their loans;
 - a new grant system (*hibah*) channeling funds to regional governments, including funds for water supply investment to be on-granted to PDAMs through their regional government owners in the form of regional government equity⁴⁰.
 - a programme whereby MOF would provide partial credit guarantees and interest rate subsidies to state banks making loans to creditworthy PDAMs⁴¹;

4.1. NEW PMK ON PDAM NPL RESTRUCTURING

54. The PDAM re-structuring initiative was codified in PMK 120/08⁴². The PMK was widely disseminated by DP3 at official workshops to PDAM management,

³⁸ Infrastructure Development Programme Loan. Tranches of the loan are released upon accomplishment by GOI of agreed targets (including policy reform) to facilitate infrastructure service deliveries. These are known as "triggers".

³⁹ The Indonesian Water Users Association

⁴⁰ See Section VI, Paragraphs 85-95

⁴¹ See Section VIII, Paragraphs 105-112

regional government officials and representatives from regional government legislatures (DPRD). Salient features of the decree are:

- Arrears are categorized as those of principal and non-principal (interest, service charges and penalties). Arrears of principal will not be written off, either in whole or in part, but will be re-capitalised and rescheduled.
- Non-principal arrears will be completely written off for those PDAMs classified as sick or unhealthy by the State Development Audit Agency (BPKP)⁴³ in their annual performance audit reports. For those PDAM classified as healthy, arrears will be treated by a combination of write-off and debt swap to new investment in the PDAM. The debt can be funded by PDAM, by Pemda, or by a combination from both parties.
- Since the existence of loan arrears excludes, by any normal accounting standards, the classification of a “healthy” condition, it seems likely that all PDAMs entering the loan restructuring programme will now be classified as being “sick” or “unhealthy”, thus allowing all their non-principal arrears to be written off and thereby achieving the Vice-President’s target of Rp 3.1 trillion of write-offs (i.e. there will be no re-scheduling, only re-structuring).
- The decree allows entry to the loan restructuring programme to all PDAMs⁴⁴, provided certain pre-conditions are met⁴⁵, namely:
 - A cost recovery tariff – higher than the basic tariff (*tarif biaya dasar*) - must be already in place⁴⁶
 - A declaration that PDAM management has been subjected to a fit and proper test (as defined in Annex I to the decree) by the head of regional government
 - Submission of a 5-year business plan, approved by the head of regional government (as defined in Annex II). The business plan format seems much more flexible than that required by the previous decree in that they allow PDAMs to set their own targets instead of prescribing one target for all PDAMs to achieve. The plan is less onerous to prepare, although most PDAMs entering the process have still needed external help.
- A further requirement⁴⁷ is a letter from the head of the regional government owner, co-signed by the head of DPRD, pledging financial support to PDAMs if the latter is unable to meet its revised loan payments. Such a letter would seem to have only moral force, since the regulatory framework⁴⁸ prohibits regional government from giving guarantees to third parties.

⁴² PMK 120/08 on the Settlement of State Credits to PDAMs, replacing PMK 107/05.

⁴³ Unlike PMK 107/05, independent auditors other than BPKP are excluded

⁴⁴ PMK 107/05 made access to the re-scheduling/re-structuring plan conditional upon historical performance of debt service on MOF loans

⁴⁵ Section 8 of PMK 120/08

⁴⁶ Tarif biaya dasar is defined in PMDN 23/06 (Guideline and Procedures for Setting Water Tariffs by PDAMs).. PMDN 23/06 is referenced in the General Provisions (Section 10) of PMK 120/08

⁴⁷ Section 11e) of PMK 120/08

⁴⁸ Section 55 of UU 33/04 and PP 54/05 on Regional Government Borrowing, Section 4.1

- GOI will compensate, in an unspecified way but presumably via grants, those PDAMs and regional governments which responded positively to the previous decree⁴⁹, thus receiving less favourable treatment than that which PMK 120/08 now provides. Grants have already been budgeted in the FY 2009 APBN, to be channeled through MPW. Grant arrangements will be extended and, after 2009, will be controlled by and channeled through MOF on the advice of MPW⁵⁰. PDAMs which do not enter the loan restructuring programme are unlikely to be recipients of such grants
55. PMK 120/08 retains the two-step process of write-offs (conditional and unconditional) of Pp 14/05⁵¹. It should be noted that the Companies Law of 2007⁵² prohibits conversion of loan write-offs into equity, thus implying that the write-offs would be treated as non-operating income and therefore taxable. Since the tax is payable in one year, this would defeat the whole purpose of restructuring. MOF has discussed this matter with the State Audit Agency and the Indonesian Accounting Standards Board, whereby the Treasury would make an internal transfer to Directorate-General of Taxation to satisfy the liability. No change to the Companies Law will be required to accommodate this arrangement, but the transfers would have to be reported in the national budget. Such funds will not be needed before 2011⁵³.

4.2. PDAM NPL RESTRUCTURING EXPERIENCE TO DATE

56. By the end of October 2009, the status of PDAM loan restructuring was as follows:

Status of PDAM Loan Restructuring – October 2009⁵⁴

Restructuring Status⁵⁵	No of PDAMs
Approved by the Policy Committee (<i>Komite Kebijakan</i>) and awaiting signature of the Minister of Finance	15
In negotiation with the Technical Committee (<i>Komite Teknis</i>)	41
Under review by the Working Group (<i>Kelompok Kerja</i>)	24
Rejected for not meeting pre-conditions of PMK 120/08 (Full cost-recovery tariff)	8
Total	88

⁴⁹ Section 22 of PMK 120/08

⁵⁰ PMK 168/08 on Regional Grants and PMK 169/08 on Procedures for Channeling Grants to Regional Governments. See Section VI, Paragraphs 85-95

⁵¹ See Footnote #18

⁵² UU 40/07 on Company Law

⁵³ Or, to be more precise, 2 years after the Minister of Finance signs the first PDAM loan-re-structuring agreement (ref Paragraph 47).

⁵⁴ Source: Regional Development Account, Directorate of On-lending, Ministry of Finance A detailed list is provided at Appendix II.

⁵⁵ PDAM business plans and other required documents are examined first by a Working Committee, which decides whether these are compliant with PMK 120/08. Those which are acceptable are passed on to a detailed examination by a Technical Committee. The Technical Committee's decisions are relayed for approval by a Policy Committee before the re-structuring agreements are sent to the Minister of Finance for signature.

57. None of the 15 re-structured loan agreements sent to the Minister of Finance have yet been signed, although DP3 does not regard this as a problem. In any case, many PDAMs have already begun to service their re-structured loans in accordance with the agreements reached with the Policy Committee⁵⁶.
58. DP3 has a loan re-structuring target of 80 PDAMs by the end of 2009. Although PMK 120/09 refers to the preparation of 5-year business plans over the period 2008-2012 only, the programme will be extended as necessary without requiring any formal amendment to the decree. DP3 accepts that PDAMs have problems preparing even simplified business plans; in any case, the workload on the GOI committees in reviewing submissions is substantial and time-consuming.
59. ESP⁵⁷ issued a questionnaire⁵⁸ to 20 PDAMs in order to obtain information for this paper. It included a series of questions on PDAM experiences with the restructuring process, of which one asked whether they found that the Technical Committee was more interested in early payback of re-structured loans as opposed to settling repayment arrangements which would allow PDAM. Out of 6 PDAMs which had already entered into detailed negotiations with the Technical Committee, 5 indicated that the Committee was more inclined to early repayment and some of these had shortened the payback period in order to satisfy the Committee. At least one PDAM considered that it would be difficult to meet the repayment schedule finally agreed upon.
60. During discussions at MOF, DP3 accepted that it had pressed for accelerated repayments, but stated that it would be prepared to re-negotiate the payback periods, if necessary, at the annual business plan reviews stipulated in the PMK.

4.3. PMK ON RESTRUCTURING OF REGIONAL GOVERNMENT NPL

61. Since the channeling of future MOF loans for water supply will no longer be directly to the PDAMs, but through their regional government owners, it is appropriate to review the parallel decree⁵⁹ on restructuring regional government NPLs, bearing in mind also that loans for water supply through the regional government cannot in any case be made if either the PDAM or its regional government owner has an outstanding NPL.⁶⁰
62. Whilst the purpose of PMK 120/08 is to restore PDAMs to a state of financial health and creditworthiness, PMK 153/08 seeks to remove a political embarrassment to GOI Government by offering a partial write-off of regional government NPL arrears and attempting to kick-start urban investment through

⁵⁷ The Environmental Services Project funded by USAID. ESP has provided assistance to several PDAMs in the preparation of their business plans

⁵⁸ See Appendix III

⁵⁹ PMK 153/08 on the Settlement of State Credits to Regional Governments

⁶⁰ This provision is not contained in any regulation (PP) or decree (PMK). It is based on an internal memorandum from the Director-General of MOF Treasury.

the authorization of the use of the balance of the write-off as a debt swap to investment. In reality, MOF is offering a grant by proxy in the form of state credits whose value has been heavily eroded through years of standstill on debt resolution.

63. As in the case of PMK 120/08, the decree separates arrears into those of principal (including accumulated or capitalized interest) and non-principal (interest, service charges and penalties). Arrears of principal will not be written off, either in whole or in part, but will be re-capitalised and rescheduled.
64. Non-principal arrears are treated in a two-stage process:
 - Up to Rp 5 billion of arrears (principal and non-principal) is used as a benchmark to derive a write-off of an amount of non-principal arrears determined in accordance with the following formula:

$$\frac{\text{Non-Principal Arrears}}{\text{Total Arrears}} \times \text{Rp 5 billion}$$

- The remaining non-principal arrears plus the balance from the first-stage calculation above will be converted into a debt swap to investment

The debt swap is to be applied to urban infrastructure sectors such as education (schools), health (clinic), rural roads, irrigation, bridges and water supply.

4.4. REGIONAL GOVERNMENT NPL RESTRUCTURING PROGRESS TO DATE

65. DP3 and the RDA initially focused entirely on PDAM restructuring to date. Far fewer regional governments have NPLs and those with substantial arrears are limited to the major secondary cities. Provided these regional governments are willing to engage, the process should not be difficult since the procedures are far simpler than those for PDAM restructuring; for example, a business plan is not required. Moreover, it is understood that the draft decree was discussed in some detail with mayors and DPRD heads of secondary cities with substantial arrears, and it may be reasonably assumed that some degree of convergence was reached on the content.
66. Nevertheless, DP3 admits that results to date have been most disappointing, with only 26 regional governments⁶¹ having so far made complete submissions and having entered the negotiating process, especially as DP3 has a loan re-structuring target of 100 regional governments by the end of 2009. Reasons for the unsatisfactory response are stated to be:
 - The regional elections in April 2009 admitted many new members to the DPRD who have only now been made aware of NPLs. These members are enquiring about the nature of arrears and the uses of NPL funds.

⁶¹ Appendix IV

- The application of an intercept⁶² by MOF on intergovernmental fiscal transfers in the event that re-structured loans again fall into default makes regional government heads and DPRD's reluctant to prepare submissions.

67. Unlike PMK 120/08, PMK 153/08 has a validity period of one year from date of signature (22 October, 2008) by the Minister of Finance. In an attempt to encourage more submissions before the deadline, DP3 staff were sent to the field socialize the decree further with defaulting regional governments. This has resulted in an additional 16 regional governments submitting applications, but in the form of letters of intent only and without the supporting documentation. However, this step has allowed them to enter the process before the expiry of PMK 153/08. DP3 staff did not commit themselves on the possibility of renewing the decree in the near term, although such a step would not be surprising.

4.5. CONCLUSION

68. Given the lengthy history of PDAM and regional government NPLs, any prediction of an early completion of this issue would be a triumph of optimism over experience. Notwithstanding the inputs of MPW and bilateral donors such as USAID through ESP and AUSAID through the INTII⁶³ project, it is expected that the restructuring of PDAM non-performing loans will drag on for several years. It is therefore unlikely that restructuring alone will solve PDAMs' problems as an underperforming service provider.
69. A satisfactory conclusion to regional government NPLs is more problematic, given the unwillingness of DPRD's to put intergovernmental fiscal transfers at the risk of the intercept. Substantial delays in resolving this issue will only delay further rehabilitation and incremental investment in water supply systems, as well as regional government infrastructure service deliveries general, given the barrier to MOF lending and granting imposed on regional governments (as well as PDAMs) with NPLs through PP 54/05, PMK 168/08 and other instruments. It may be that MOF will have to introduce more severe measures to ensure loan restructuring and repayment, although GOI has traditionally been reluctant to apply overtly disciplinary measures against regional governments.

⁶² See Paragraphs 77-79 on PMK 129/08 on the intercept

⁶³ Indonesia Infrastructure Initiative

5. THE PRESENT GOVERNMENT LEGAL AND REGULATORY FRAMEWORK CONCERNING WATER SUPPLY FINANCING THROUGH MOF

5.1. STATE FINANCE AND STATE TREASURY LAWS RE LENDING/ON-LENDING FOR WATER SUPPLY INVESTMENT

70. MOF has generally blamed the multilateral donors and MPW for both PDAM and regional government NPLs. This is somewhat specious: whilst it is partly true in the case of Subsidiary Loan Agreements (SLA), where MOF has performed the roles of bookkeeper and debt collector for loans put together by MPW and the multilateral donors, it is fair to say that MOF was also culpable in issuing loans from GOI own-source (*rupiah murni*) funds without reference to MPW on their technical merit and without checking the validity of demand and financial projections.
71. At any event, following the mass default on infrastructure loans, MOF was determined in the future to strengthen its control over regulations governing the issuing of state loans to regional government and their enterprises. In this regard, it is interesting to note the provisions of the laws on State Finance and Treasury concerning loans to regional governments and their enterprises⁶⁴.
72. These state that loans funded by GOI own sources can be made to regional governments, but there is no mention of loans being made to regional government enterprises (e.g. PDAMs)⁶⁵. In effect, this codifies a previously issued MOF decree⁶⁶ which sets out procedures for regional government loan submission and approval but removes their enterprises from eligibility for GOI own-source loans. The inference is that creditworthy regional governments would have to borrow from MOF for water supply investment and then make their own financial arrangements with their PDAMs, e.g. on-lending and on-granting through equity injections
73. On the other hand, these two laws also stipulate that funds from sovereign external loans (i.e. sub-loans) can be made to both regional governments and their enterprises⁶⁷. However, MOF subsequently issued PP54/05 on regional

⁶⁴ Section 50 of UU 33/04 and Section 3.1 of PP 54/05,, on Regional Government Borrowing, forbid SNG to borrow directly from external sources

⁶⁵ Section 22.2 of UU 17/03 on the State Finances, and Section 33.1 of UU 01/04 on the State Treasury.

⁶⁶ KMK 347.a/00 on State Credits to Regional Governments

⁶⁷ Section 23.1 of UU 17/03 on State Finances and Section 38.1 of UU 01/04 on the State Treasury

government borrowing which omits all reference to borrowing by regional government enterprises, thus aligning itself in this respect with the previously issued KMK 347.a. In summary, whereas the law permits on-lending directly to PDAMs, MOF regulations and decrees circumvents this by not providing implementing and operationalising procedures to allow this form of on-lending to be effected. Therefore, as in the case of MOF *rupiah murni* loans, regional government must borrow the sovereign external loan proceeds through the SLA mechanism⁶⁸ and then make their own arrangements with their PDAMs.

5.2. PROCEDURES FOR OBTAINING SOVEREIGN LOAN FINANCE FOR REGIONAL GOVERNMENT INVESTMENT

74. As the national planning agency, BAPPENAS co-ordinates all activities related to the acquisition of external loans for infrastructure financing and their subsequent on-lending/ on-granting, as appropriate. In 2006, BAPPENAS issued a new and comprehensive implementing⁶⁹ and operationalising⁷⁰ framework in this regard. This contains eight steps, six of which concern the intra-government (sub-national and national) application and evaluation process, and the remaining two relate to the negotiations with external lenders and the conclusion of on-lending/on-granting agreements with approved regional government borrowers⁷¹.
75. Steps 1-4 involve submission of an application, with a project feasibility study⁷², by the regional government to the competent technical ministry for evaluation, its forwarding to BAPPENAS if approved, and its inclusion in the book of prioritized projects⁷³. A list of projects proposed to be financed in the next year is forwarded to MOF which checks the total proposed borrowing fits in with overall borrowing limits as prescribed in the Law on the State Finances⁷⁴.
76. Steps 5 and 6 concern confirmation by regional governments and approval by BAPPENAS of completion of all implementation arrangements ("readiness criteria") so that on-lending and on-granting agreements can be concluded and

⁶⁸ The variable interest rate charged on SLAs when on-lending is denominated in rupiah is 6-month LIBOR plus 5.02% to cover GOI's foreign exchange risk (ref PMK 83/05 on Additional Interest on SLA to Regional Governments). At September 2009 LIBOR, the rate would be about 6.75%. Previously the interest rate was fixed for many years at 11.5%. The interest rate on GOI own-source *rupiah murni* loans is believed to be still fixed at 11.5% per annum (ref KMK 347.a/00, Section 17.5)

⁶⁹ PP 02/2006 on Arrangements for Acquiring External Loans and /or Grants and their Channeling

⁷⁰ PerMen PPN 05/06 on Procedures for for the Planning, and Submission of Proposals and the Appraisal of Projects and Activities to be Financed from Foreign Loans and/or Grants

⁷¹ No parallel procedure to PP 02/06 for domestic loans is yet in place

⁷² The feasibility study must include calculations to show that (a) the proposed loan, together with any existing borrowings, will not exceed 75% of regional government discretionary revenues in the previous year and (b) the debt service coverage ratio (DSCR) will not exceed 2.5 in any year of the loan tenor, as well as a declaration that current maturities of any existing regional government debt is regular (Ref: Section 54 of UU 33/04, Section 12 of PP 54/05 and Section 2.2 of PMK 53/06).

⁷³ These books are rolling lists of projects. The list for projects to be financed from external loan proceeds is kept in the so-called "Blue Book", and the annual list in the "Green Book"

⁷⁴ Clarification (*penjelasan*) to Section 17.3 of UU 17/03. Total outstanding borrowings of national and regional government should not exceed 60% of GDP in any given year and the cumulative deficit should 3% of GDP.

proceeds disbursed immediately upon signature and effectiveness of the sovereign loan agreement and conclusion of on-lending procedures and negotiations (Steps 7 and 8)⁷⁵. These steps are intended to avoid further occurrences of substantial accumulations of commitment fees charged by external lenders on un-disbursed loan funds, caused by lengthy delays in concluding implementation arrangements, as happened frequently in the case of external loans taken out by GOI in the 80s and 90s.

5.3. INTERCEPT OF CENTRAL GOVERNMENT TRANSFERS FOR REGIONAL GOVERNMENT DEFAULT ON MOF LOANS

77. The final piece in the legislative/ regulatory framework on MOF lending to regional government is a decree⁷⁶ permitting MOF to intercept central government transfers in the event of loan default, including water supply investment loans made with regional governments and passed on to their PDAMs. This intercept cannot be applied to NPLs made before the initial decentralizing legislation of 1999, but can be to those made thereafter. However, very few loans have been made since 1999, and none which involve water supply investment.
78. PMK 129/08 was one of the last regulations to be issued from UU 33/04, thus indicating the extreme sensitivity that MOF placed upon its drafting. The prime concern of MOF was to ensure that the intercept could be applied without interfering with the day-to-day functions and services of regional governments. To this end, the decree sets maximum limits in the form of percentages of annual transfers of the DAU and/or DBH⁷⁷ which can be intercepted. These are based on the fiscal capacities, as determined and periodically revised in MOF decrees⁷⁸. In the event these ceilings are insufficient to recover all arrears, the balance is carried over and subject to intercept in the following fiscal year Prior to issuing the decree, DJPK tested these ceilings for the FY 2007 DAU⁷⁹/DBH⁸⁰ allocations against regional government arrears and then the sum of regional government/PDAM arrears at 31 December 2007 (i.e. before the issue of PMK 120/08 and PMK 153/08). All except two regional governments showed capacities to repay their regional government arrears and all except twelve for both categories of arrears within one year. Nearly all these exceptions were major secondary cities.

⁷⁵ These procedures are elaborated upon in detail in PMK 53/06 on Procedures for On-Lending External Loans to Regional Governments. PMK 207/08 on Procedures for Transferring External Loans/Grants to Regional Governments describes channeling arrangements for on-lending/on-granting.

⁷⁶ PMK 129/08 on Procedures for Implementing an Intercept of the General Allocation Fund (DAU) and/or Shared Revenues (DBH) in connection with a Regional Government Loan from Central Government.

⁷⁷ Section 5.1 of PMK 129/08

⁷⁸ The last such being PMK 224/08 on the Regional Government Fiscal Capacity Map

⁷⁹ DAU- *dana alokasi umum* – the general allocation fund

⁸⁰ DBH – *dana bagi hasil* – shared revenues from royalties through natural resource exploitation

79. The intercept will be made pro-rata against each transfer. In general, DAU transfers will be the primary object for the intercept, since the transfers are made in 12 equal monthly installments per year. However, the fiscal capacity indices of some regional governments are so high that they do not qualify for a DAU allocation, and in such cases the DBH will be the object of the intercept.

5.4. CONCLUSION

80. The recent history of MOF lending and on-lending for water supply, as shown below, makes for bleak reading.

History of PDAM Loan Issuance by MOF

Type	<1987	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
RDA	10	10	19	11	19	12	29	31	25	6	24	25
SLA	35	5	5	1	7	21	8	7	13	14	21	36
Total	45	15	24	12	26	33	37	38	38	20	45	61

Type	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
RDA	1	0	0	0	0	0	0	0	0	0	0	0
SLA	29	8	4	4	0	0	0	0	0	0	0	1
Total	30	8	4	4	0	0	0	0	0	0	0	1

81. Although the submission and approval procedures for loans from MOF are time-consuming and complicated, the most severe obstacles are posed by regional government heads and their DPRD in that:
- They show little enthusiasm for borrowing from any source for investment in infrastructure, but prefer inefficient “pay-as-you-go” capital rationing methods;
 - In particular, they consider that PDAMs should be able to borrow against their own balance sheets, even though they are unwilling to approve full cost-recovery tariffs and alternative financing sources are either not available or not appropriate for water supply investment;
 - They reject the threat of the MOF intercept against their central government transfers in the event of default, although this mechanism is standard practice in other countries.
82. These attitudes make it especially difficult to put together an external loan package of appropriate administrative efficiency for water supply investment. Both the ADB and World Bank have abandoned projects for the above reasons after 2-3 years of expensive loan preparation efforts. The latest initiative by the World Bank, begun in 2006, has succeeded in attracting only three (3) regional governments⁸¹ who are willing to borrow on behalf of their PDAMs and have agreed to their central government transfers being intercepted in the event of

⁸¹ It is understood that only one of these regional governments (Kota Bogor) has already signed an SLA with the Ministry of Finance.

default. Consequently, the prospect of MOF resuming its role as a direct major source of infrastructure finance, including water supply finance, seems remote.

6. THE LEGAL AND REGULATORY FRAMEWORK FOR GRANTING AND ON-GRANTING TO THE WATER SUPPLY SECTOR

6.1. LEGAL BASIS

83. Central government regulations for grants to regional government from GOI own –source funds and on-granting from external loan and/or grant proceeds, including granting and on-granting for water supply, are derived from Law 17/03 on the State Finances, Law 01/04 on the State Treasury, Law 32/04 on Regional Government and Law 33/04 on the Fiscal Balance.
84. There are currently three principal grant mechanisms in place, as described below. In all cases, the grants are made to nominated levels of regional government which then passes on the grants to PDAMs or spends the funds on PDAM's behalf.

6.2. GRANT (*HIBAH*)

85. Grants to regional governments in the form of *hibah*⁸² are regulated by PP 57/05⁸³. Grants may be from GOI own-sources or from external donor proceeds. In the latter case, the approval process is governed by PP 02/06 and is the same as for external donor loans⁸⁴. PP 57/05 is not very specific, but has now been supplemented by a very detailed operationalising decree⁸⁵.
86. Criteria for the utilization of grants by regional governments depend upon the original source of funds, i.e:
 - GOI own-source grant funds may be used for: (a) improvements to functions, basic services and regional government apparatus, (b) administrative activities relating to national/regional government relations and (c) complying with policies which place an additional burden on the regional government budget (APBD);

⁸² *Hibah* is a specific category of grant in the GOI budgetary and accounting system as well as the generic word for grant in the Indonesian language

⁸³ PP 57/05 on Regional Grants

⁸⁴ Ref Paragraphs 74-76

⁸⁵ PMK 168/08 on Regional Grants (replacing PMK 52/06), plus a channeling decree PMK 169/08 on Procedures for Distributing Grants to Regional Governments

- On-granting of external donor loan proceeds may be used for: (a) attainment of regional government service targets and national government development priorities and (b) prioritized activities of regional governments with low fiscal capacities⁸⁶.
- On-granting of external donor grant proceeds may be used for (a) improvements to functions, basic services and regional government apparatus, (b) natural resource preservation, and environmental and cultural enhancement, (c) research and technology activities, and (d) humanitarian purposes.

87. All grants through PMK 168/08 are authorized through grant agreements between MOF and the head of the beneficiary regional government. There are different forms of agreement depending on whether the grant is internally or externally sourced. All such grants are budgeted and channeled through MOF's standard DIPA mechanism⁸⁷. Reports on grant usage must be prepared by each responsible regional government work unit⁸⁸ and submitted to MOF through the head of regional government.
88. The scope of the grants, as indicated above, is very wide and can range, say, from funding the supply of primary school text books to construction of water supply facilities. Consequently, the evaluation process varies considerably. Each technical ministry issues its own guidelines in this regard.
89. In terms of the water supply sector, the *hibah* is the second step in the Government's programme to provide an additional 10 million piped water household connections by the end of 2011⁸⁹, which is now stretched to the end of 2014 under a 5-year Potable Water Grant Programme. It should be noted that the programme is intended to provide water supply infrastructure which will deliver 10 million incremental connections. However, it is not intended that the grant funding will be used to supply free connections, which household customers will be expected to continue to purchase themselves, although the *hibah* funds could be accessed for meter replacement.
90. The programme is based on central government grants channeled through the *hibah* mechanism against matching funds from regional governments which are required to sign grant agreements, including an undertaking to place their contributions on their regional budgets (APBD), and grant channeling agreements with MOF. The grants are geared to incentives which deliver higher value grants against a rising number of connections, i.e:-

1-2,000 connections – Rp 2 million per connection,
2,001-4,000 connections – Rp 3 million per connection,

⁸⁶ Fiscal capacity is calculated by MOF for each region, based on which fiscal capacity indices are derived (high, medium and low) and the level of grant is thus determined. The operationalising document is known as a fiscal capacity map which is periodically revised by MOF decree. The latest version is PMK 224/08 on the Regional Government Fiscal Capacity Map

⁸⁷ As provided for in PP 21/04 on the Formulation of State Ministries/Institutions Work Plans and Budgets

⁸⁸ Satuan kerja (satker)

⁸⁹ Ref Paragraph 53

> 4,000 connections – Rp 4 million per connection,
The total amount of grant per regional government is capped at Rp 20-25 billion⁹⁰.

91. Technical proposals must be evaluated by MPW. As a pre-condition, the matching funds of the regional government and the related investments must be delivered up-front. A technical audit will be conducted by MPW to verify installation, number and proper functioning of household connections three months after installation in order to obtain release of grant funds from MOF to the regional government. MPW is in the process of finalizing its own detailed procedures grants to the water supply sector. It is understood that PDAMs (and their regional government owners) with NPLs that have not been restructured with MOF will not be eligible for *hibah* grants, although this is not specifically stated in PMK 168/08.
92. GOI plans to spend Rp 7 trillion on *hibah* from its own resources in FY 2010. MPW expects to approve investments of Rp 3 trillion for water supply over the period 2010-2014. Based on the matching grant formula given in Paragraph 89, this will yield a theoretical total of between 750,000 and 1,500,000 additional connections.
93. Additional assistance is expected from donors. For example, AUSAID plans to provide a grant of AUD 20,000,000 over two years from its IndII⁹¹ Project which would be channeled through the *hibah* mechanism. Based again on the matching grant formula above, this would yield between 45,000 and 90,000 incremental household connections.
94. The *hibah* programme and its operating procedures have been developed over the past year in great detail and with considerable care by the central government stakeholders⁹². However, committed funding will at best yield slightly in excess of one million new domestic connections, well short of the 10,000,000 connections required by the three GOI initiatives.
95. An element critical to the success of the *hibah* programme will be the willingness of regional governments to respond to the matching grant formula. In this connection, the ESP questionnaire (Appendix III) asked 20 PDAMs about their awareness and understanding of PMK 168/08 and their reactions to it. Only eight PDAMs had knowledge about the contents of the decree and their response, unsurprisingly, was very positive. The other twelve without knowledge included all PDAMs outside Java which were contacted. It is doubtful whether their regional government owners and the DPRD are any more aware. This indicates a need for significant additional socialization by MPW, although the delay in doing so may be due to the fact its *hibah* operating procedures have not yet been formally released.

⁹⁰ Director General Cipta Karya, Ministry of Public Works circular, dated 19 August 2009

⁹¹ Indonesia Infrastructure Initiative

⁹² Ministries of Finance and Public Works, BAPPENAS

6.3. SPECIAL ALLOCATION FUND (DANA ALOKASI KHUSUS - DAK)

96. The Special Allocation Fund is part of the regional fiscal balance and is regulated by PP 55/05⁹³. It is a non-discretionary (for the beneficiary regional governments) physical investment grant for sectors nominated annually by GOI technical ministries as technical priorities for investment; the DAK may not be used for project administration, project preparation, research or training. The DAK has increased rapidly over the decade and was Rp 24.2 trillion in 2009, equivalent to 2.4% of the APBN.
97. Allocations for each regional government are determined by MOF based on financial capacity which is calculated on the basis of APBD discretionary revenue (PAD⁹⁴ + DAU⁹⁵ + DBH⁹⁶) minus expenditure on regional government staff.

Since the selection of DAK recipients is within the discretion of MOF, it may not be funded from external loans and grants but only from *rupiah murni*. Regional governments must provide matching funds of a minimum of 10% of the DAK. Otherwise channeling arrangements and reporting activities are much the same as they are for *hibah*.

98. Approximately 30% of the 2009 DAK was allocated to infrastructure, of which 16.6% to water supply and, to far lesser extent, sanitation. Therefore, DAK for water supply was about 5% of total DAK. The distribution is broadly based in terms of recipients, but is largely directed at community-based rural systems. The actual amounts of DAK allocated on the APBN for water supply for the past four years⁹⁷ have been as follows:

DAK Funding for Water Supply (2006-2009)

Year	Amount
2006	Rp 0.6 billion
2007	Rp 1.1 trillion
2008	Rp 1.4 trillion
2009	Rp 1.4 trillion

⁹³ PP 55/05 on the Fiscal Balance. The DAK is specifically dealt with in Sections 47-62.

⁹⁴ *Pajak asli daerah* – regional government own-source funds

⁹⁵ *Dana alokasi umum* – the general allocation fund transferred in monthly tranches by central government to regional governments for their discretionary use – mainly for paying recurrent costs such as salaries to staff and DPRD plus related apparatus expenditure.

⁹⁶ *Dana bagi hasil* – royalty payments from natural resources (e.g. oil and gas, forestry) plus the land and building tax receipts which centrally administered. Transfers are made quarterly and their application is the same as for the DAU.

⁹⁷ Source: Ministry of Finance. In 2008 and 2009, the DAK amounts include for sanitation, as well as for water supply

6.4. DECONCENTRATION (*DANA DEKONSENTRASI*) AND CO-MANAGED RESPONSIBILITY GRANTS (*TUGAS PEMBANTUAN*)

99. These grants are for tasks which are the responsibility of the central government to carry out but which are assigned to the regions for implementation, together with appropriate funding. The regulating mechanism is PP 07/08⁹⁸. *Dana dekonsentrasi* are for non-physical activities and are channeled to the provincial government for spending on behalf of the designated beneficiary; *tugas pembantuan* grants are for non-physical activities and can be channeled to the beneficiary level of regional government (province, kabupaten, kota).
100. MPW administers both types of activity on its budget. It is not entirely clear why this is so, since piped water supply is clearly designated by regulation as a regional government responsibility⁹⁹. At any rate, MPW received Rp 270 billion in 2008 and Rp 300 billion¹⁰⁰ in 2009 as *tugas pembantuan* for physical investment in water supply, predominantly raw water abstraction, transmission mains and treatment plant, as new water sources become ever more distant from their distribution areas, and hence more costly. . Again, for reasons not entirely clear, these funds are sent to the provincial government, rather than the PDAM's kota/kabupaten owner, which spends the funds on the PDAM's behalf. It is possible that grants are made because the PDAM is not capable of delivering appropriate service standards, although minimum service standards for piped water supply have not yet been formally established.
101. The rationale for MPW administering *dana dekonsentrasi* is more understandable since central government has always been responsible for training and capacity building activities.

⁹⁸ PP 07/08 on De-concentrated Funds and Co-Managed Responsibilities

⁹⁹ PP 38/07 on the Distribution of Responsibilities between Central, Provincial and Regional (Kota Kabupaten) Governments

¹⁰⁰ Source: Directorate General Cipta Karya, Ministry of Public Works

7. COMMERCIAL BANK LENDING TO PDAMS

102. The domestic banking sector has traditionally not been very responsive about lending for capital investment, with lending by state-owned bank to state-owned enterprises being an exception. Experience of lending to PDAMs is very limited, although there is some evidence of lending to construction companies which then make their own on-lending arrangements with PDAMs. These arrangements are usually on very short loan tenors and at high interest rates, so water supply investment is usually targeted at high-income catchment areas. Another source of investment is through residential housing estate developers who provide water distribution infrastructure within their developments and hand over the assets to the PDAM which then operates and maintains them; however, PDAM has to deliver treated water to the estates
103. The limited bank lending to PDAMs is usually characterized by creditworthiness of the PDAM itself, supported by a good relationship between the lending bank and the PDAM's regional government owner. Even so, lending tenors are generally not appropriately matched to the long-run investment/depreciation lives of the fixed assets and interest rates are high, particularly in an industry whose social obligations are valued locally as being higher than cost recovery considerations. These limitations obviously have a knock-on effect in limiting the scale of investment, with low-income populations usually being the disadvantaged community groups. Debt to equity ratios are normally in the order of 70:30, but the equity ratio is sometimes higher. Periodic meetings with state-owned banks throughout the duration of the ESP activity have consistently confirmed that there is little appetite for lending to PDAMs. They are generally seen as not being supported by their regional government owners and lacking in capable management – in short, not an appropriate credit risk.
104. Three examples are given below of domestic bank loans to PDAMs. In general, recent loans terms are improving but are still not appropriate to the needs of the industry. It is the writer's conclusion that tariff affordability is linked more closely to loan tenor than the interest rate.

Examples of Commercial Bank Loans to PDAMs

Borrower: PDAM Kota Malang
 Lender: Bank BNI
 Amount: Rp 26.8 billion
 Tenor: 7 years 9 months (including 1 year and 9 months period)
 Interest Rate: 15.5%

Borrower: PDAM Kota Malang
 Lender: Bank BNI
 Amount: Rp 17.6 billion
 Tenor: 10 years (including 1 year's grace period)
 Interest Rate: 14%

Borrower: PDAM Kota Bogor
 Lender: West Java Regional Development Bank
 Amount: Rp 25 billion
 Tenor: 10 years (including 1 year's grace period)
 Interest Rate: 11%

7.1. PERPRES 29/09

105. This presidential decree¹⁰¹ represents the third plank in the Government's plan to deliver 10 million new household connections, in addition to the PDAM/regional government re-structuring programme¹⁰² and the Drinking Water Grant Programme¹⁰³.
106. Essentially, the Perpres provides a partial credit guarantee of 70% of any bank loan to a PDAM plus an interest subsidy of 500 basis points above the prevailing Bank of Indonesia SBI rate (currently 7.5%, thus indicating a full interest rate of 12.5%). Borrowers must have no NPLs or be in an advanced state of re-structuring with MOF, have a cost-recovery tariff in place and be in a healthy condition according to the latest audit report. All investment proposals must receive a favourable technical evaluation report from MPW.
107. Although MOF is the up-front guarantor to the lending banks in the event of a default by the PDAM borrower, the Ministry, through the PerPres, will, in turn, require a supporting guarantee of 40% of the loan amount (equivalent to 57.14% of the partial credit guarantee) from the PDAM's regional government owner, together with the approval by the DPRD. This guarantee will be backed up with an agreement, co-signed by the DPRD, allowing MOF to intercept discretionary central government transfers.
108. The PerPres will be operationalised by an MOF decree. Banks BRI, Mandiri and DKI plus the Association of Regional Development Banks have assisted in the drafting. At the time of writing, the final version of the draft PMK was stated to be in the Legal Department of MOF, after which it will go to the Minister for signature. An important element in the draft PMK is an expression of MOF's willingness to extend the partial credit guarantee and the interest rate subsidy over a loan tenor of 20 years, indicating MOF's understanding of the importance of the loan tenor.
109. Nevertheless, MOF will not attempt to influence the lending policy of participating banks. It is understood that negotiations between MOF and the banks over the draft PMK were limited to technical lending issues only. In fact, when ESP consultants visited Banks Mandiri and BRI to ascertain the extent of their collaboration, both stated that they would only offer a maximum loan tenor of 10 years, including any grace period. Mandiri would consider loans on a 70:30

¹⁰¹ Perpres 29/02 on the Provision of Guarantee and Interest Subsidy by the Central Government for the Acceleration of Potable Water provision

¹⁰² Ref Paragraphs 53

¹⁰³ Ibidem

debt to equity ratio and BRI 65:35. The wariness with which banks treat PDAMs is a credit risk is exemplified by the fact that PDAMs have been classified as commercial rather corporate borrowers, with lending terms and conditions being structured accordingly.

- I 10. Furthermore, whilst the PerPres requires to borrowers to put all revenues in an account with the lending bank, with the bank having powers to draw loan principal and interest payments when due, Mandiri proposes an escrow account and paying the balance after deductions into a PDAM operating account. Mandiri is also concerned about the availability of collateral against the 30% of the loan amount for which it is liable. The only suitable collateral is land owned by PDAM, but this might run into insolvency issues¹⁰⁴.
- I 11. Twelve PDAMs have so far registered with MPW to take part in this initiative. Their investment requirements and financing plans are given in Appendix V. In addition, AUSAID INTI is assisting more than 20 PDAMs (Appendix VI) who wish to participate with budget preparation and financial management capacity building. It is understood that technical advice is not being provided.
- I 12. The ESP questionnaire (Appendix III) asked 20 PDAMs about their knowledge of PerPres 29/09 and their intentions to submit investment proposals. Twelve had digested the PerPres and seven of these were in various stages of preparing submissions. One PDAM had partial knowledge, presumably meaning that the management had heard about the PerPres but had not read it, and seven PDAMs knew nothing about it. This indicates a requirement for socialization of the decree, which the participating banks stated would take place following the issue of the PMK on the operating procedures for the PerPres. It is worth noting that none of the PDAMs outside Java which were contacted by ESP had comprehensive understanding about the initiative.

7.2. CONCLUSION

- I 13. Whilst this is an important step forward by the Government to widen access to potable water, there is only a limited number of PDAMs (possibly 40-50 maximum) which can demonstrate the necessary degree of creditworthiness in order to be able to participate under the terms and conditions likely to be levied by participating banks. Even these will face problems in meeting the required pre-qualifications, such as:-
 - reluctance of regional government owners and their DPRD to provide their share of the GOI 70% partial credit guarantee and to authorize an intercept of their intergovernmental fiscal transfers in the event of default;
 - PDAM ability to raise the required amount of equity capital. a difficulty which might be mitigated by use of the *hibah*.
 - The availability of suitable collateral for the lending banks in the event of default of the exposed 30% of the loan.

¹⁰⁴ Ref Paragraphs 45-46

8. OTHER POTENTIAL FUNDING SOURCES FOR WATER SUPPLY INVESTMENT

8.1. PT SARANA MULTI INFRASTRUKTUR (PT SMI)

114. PT SMI is a state company owned by the Ministry of Finance and established¹⁰⁵ in February 2009 with the following objectives¹⁰⁶:

- Become an agent of GOI in promoting infrastructure development
- Provider of alternative sources of financing
- Address the lack of long-term debt for infrastructure
- Work with government, private investors, banks, bilateral/multilateral agencies, regulators to create appropriate financing mechanisms
- Increase PT SMI's capacity and effectiveness through partnerships

115. PT has a GOI equity capital of Rp 600 billion, plus an operating budget of Rp 400 billion provided on the FY 2009 APBN. It is staffed with experienced professionals, recruited mainly from domestic banks and investment houses.

116. It will function essentially as a revolving fund provider of construction finance in the form of a series of medium-term notes progressively issued on the basis of satisfactory implementation performance. These are already being provided to state-owned enterprise construction companies (Persero). Since PT SMI may not commit more than 20% of its capital to any single project, it will form syndicates with other domestic providers of finance. It will be well placed to do this because of the connections of its staff.

117. At the end of the construction period, the construction finance will be taken out by a long-term debt instrument (loan, corporate bond or municipal bond). Since the major problem with water supply finance is the lack of access of PDAMs to long-term funds, PT SMI is unlikely play a significant role in this regard unless in conjunction with the IIFF (see below); on the other hand, its services could be of assistance to private investors in the sector who are able to provide appropriate guarantees.

8.2. INFRASTRUCTURE INVESTMENT FINANCING FACILITY (IIFF)

118. The IIFF will be a separate department within PT SMI. It is a joint venture with a \$200 million equity allocated as follows:

¹⁰⁵ By PP 75/08 (replacing PP 66/07) on Equity Investment by the Republic of Indonesia for the Establishment of a State-Owned Enterprise in the Infrastructure Sector

¹⁰⁶ As quoted in PT SMI literature

- Asian Development Bank – 20%
- International Finance Corporation – 20%
- DEG (Deutsche Equity Gruppe) – 20%
- PT SMI - 30%
- Unallocated – 10%

The IIFF also has loan facilities of \$200 million: \$100 million from each of the World Bank and the Asian Development Bank.

- I 19. Its scope is the provision long-term finance, principally to the private sector, for infrastructure investment, with toll roads, telecommunications and power generation seen as primary objectives at national level, and water supply at the regional level. Loans to public sector infrastructure operators are not officially foreseen, but it is understood that the IIFF would lend to PDAMs if a bankable project were to be presented. However, it is not seen as a significant source of long-term finance to PDAMs, especially if Perpres 29/02 is successful. It may be of assistance to the private sector investors in water supply, especially those wishing to mitigate their foreign exchange risk by financing the debt portion of their investment in rupiah rather than in foreign currency.
- I 20. The IIFF has just received its business license¹⁰⁷ and it has recently appointed a chief executive officer. However, it has yet to engage the rest of its executive management team. Its operating procedures have recently been completed by an ADB-funded consultant.

8.3. GOVERNMENT INVESTMENT UNIT

- I 21. The Government Investment Unit (Pusat Investasi Pemerintah – PIP) is a sovereign wealth fund¹⁰⁸, managed by the Ministry of Finance, whose purpose is investment in a variety of asset categories in order to generate economic growth.
- I 22. The PIP's major investment to date is a 10% stake in the USD 250 million Indonesia Clean Technology Fund (ICTF). Ant Global Partners Pte Ltd¹⁰⁹ will raise the balance of the fund's capital over the next three years for investment in the Fund's three key areas of food production, renewable energy and water supply.
- I 23. The ICTF's interest in water supply is likely to be as medium-long term (5-8 years) equity stakeholder with a private sector investor, subject to a take-out at the end of the agreed period with replacement loan or bond financing or substitute equity capital. In this respect, it could enter into a long-term financing package in conjunction with the IIFF. As regards the public sector, only substantial investments from large creditworthy PDAMs would be likely to stimulate the ICTF's appetite.

¹⁰⁷ It requires a separate license to that for PT SMI

¹⁰⁸ Established and regulated by PP 01/08 on the Government Investment Unit

¹⁰⁹ Ant Global Partners Pte Ltd is the Singapore branch of Ant Capital partners which manages about \$ 1.5 billion in assets, with Bank Mitsubishi of Japan a major stakeholder.

9. BOND FINANCE

9.1. PDAM CORPORATE BONDS

124. There have been two donor initiatives to introduce corporate bond financing for water supply. Both have failed. The first, through the USAID-sponsored Environmental Services Programme (ESP), is described in considerable detail in an earlier ESP paper I 10, of which a summary is provided below.

9.2. ESP INITIATIVE

125. The ESP initiative was based on an initial review in 2005 which concluded that lending for water supply through the RDA was unlikely to resume any time soon because of the NPL issue¹¹¹, as well as the resistance of Regional government to borrow either for themselves or for their PDAMs due to risk of their central government transfers being intercepted in the event of default¹¹². The review also confirmed that lending directly to PDAMs through the domestic banking sector was difficult and that, even where possible, loan tenors and interest rates were most unsuitable for long-run investment programmes¹¹³. It was therefore decided that a more promising route might be through the issue of corporate bonds by creditworthy PDAMs through the domestic capital market, since bond issues carry longer loan tenors than long-term loans (particularly so if blended with up-front finance) and their interest rates are both lower and fixed. A particular advantage of this medium was the absence of need to comply with GOI regulations, except those of the MOF Capital Markets Supervisory Agency (BAPEPAM).
126. A two-pronged approach was taken. The first was a broad strategic concept of a fund, with underwriting and project financing arranged by a major investment house in the domestic securities market. The proposed financing was to be sourced from the Japan Bank for International Reconstruction, with the proceeds being on-lent to the investment house which is a state-owned enterprise (SOE). It was recognized that the high initial costs of bond arrangements would not be attractive to most PDAMs because of the relatively small size of their investment packages. This would be overcome by establishing the fund as a Special Purpose Vehicle (SPV) whereby bonds would be pooled for several PDAM, participants whose collective investments would carry sufficient bulk to make a bond issue feasible.

¹¹⁰ Alternative Financing for Water Utilities in Indonesia – a Review of Lessons and Challenges (ESP, August 2008)

¹¹¹ Ref Sections III and IV

¹¹² Ref Paragraphs 77-79

¹¹³ See also Paragraphs 102-104

127. The second approach was to assist a creditworthy PDAM with a proposed bankable project of significant investment value which would warrant the issue of a single straight corporate bond through the same investment house. The bond issue would be made more attractive to investors through the attachment of a partial credit guarantee.
128. Although these activities were initially welcomed at both GOI level, in terms of the fund, and the participating PDAM, they both failed for the following principal reasons:
- The “champion” of the fund concept, a senior official in MOF, changed position, and no-one else was willing to take up the initiative. Thus, important implementation issues, such as the JBIC loan and on-lending procedures, and the preparation of amending regulations to remove double taxation elements of the SPV arrangements, were not delegated to the operational levels of MOF.
 - The “champion” of the straight PAM corporate bond issue, the managing director of the target PDAM, retired at a crucial time. The successor was not strong enough to overcome the resistance of the PDAM supervisory board (*badan pengawas*), which was opposed to any form of long-term financing in case the loan went wrong and the supervisory board was saddled with the blame.
 - The head (*bupati*) of the regional government, the senior regional government civil servant (*sekda*) and head of the regional government legislature (DPRD) were usually inaccessible, no doubt influenced by the PDAM’s supervisory board.
 - Regional governments are forbidden to provide any form of guarantee for loans to their enterprises¹¹⁴. This constitutes a significant obstacle to obtaining partial credit guarantees and, ultimately, bond investor confidence.

9.3. KFW INITIATIVE

129. The objective of this assignment was to assess the feasibility of establishing a financing facility in a state-owned financing institution to promote investment in municipal infrastructure services, in particular municipal water supply, by improving access to long-term loan financing to creditworthy Regional government or their PDAMs, private enterprises and public-private partnerships (PPPs) involved in the provision of municipal water services. The assignment was divided into two stages – design and implementation.
130. Having rapidly ascertained the continuing lack of enthusiasm in the state-owned banks for long-term financing, the focus was again turned to the possibility of bond issuance, with the same state-owned investment house¹¹⁵ involved in the ESP initiative as the facility manager. The facility was designed around the issue of

¹¹⁴ See Footnote 48

¹¹⁵ PT Danareksa

straight corporate bonds to individual PDAMs, supported by partial credit guarantees. The facility would also be shielded by a KfW loan to be utilised in the event that the bond issue was not fully subscribed or if the facility decided take a certain bond allocation into its own inventory.

131. The design stage was approved by the Executing Agency and other GOI stakeholders, including BAPPENAS which agreed to place the assignment on the Blue Book. At this point, as in the case of the ESP initiative, senior officials in both MPW and BAPPENAS changed positions. Their incoming successors understood the concept imperfectly and MOF senior officials were not fully briefed by their staff. The major objection of GOI was that no mention of readiness criteria was made in the design stage, contrary to PP 02/06¹¹⁶. However, the readiness criteria in PP 02/06 are clearly aimed at capital goods projects. PP 02/06 stipulates that activities can also consist of “funds as inputs to generate outputs in the form of goods/services¹¹⁷”, for which no readiness criteria are prescribed. The proposed facility appeared to fall into this second category, and the necessary readiness criteria, different from those for a project, were to be drafted during the implementation stage.
132. There were other objections from GOI, all of which could probably have been solved if there had been a positive will to discuss the issues and search for an acceptable solution. There was not. The GOI stakeholders did not understand the activity for a variety of reasons and, consequently, in typical risk-aversion mode, did not wish it to proceed. The implementation stage of the assignment was therefore quietly shelved by KfW.

9.4. MUNICIPAL BONDS

133. PP 54/2005 authorizes sub-national governments to issue municipal project revenue bonds on the domestic capital market. Their issuance is regulated by MoF decree 147/2006¹¹⁸ within the context of regional borrowing requiring MoF approval, and by a series of decrees from BAPEPAM¹¹⁹ in terms of due diligence and issuance requirements. A sub-national government will be able to issue a bond for investment in water supply and make its own financial arrangements with its PDAM for utilisation of the funds in much the same way as it could under PP 53/2006¹²⁰, except that the threat of the DAU intercept is absent (Box 4.2). The Decentralised Service Facility (DSF) at the World Bank and MOF are presently helping DKI Jakarta and Kota Bandung to prepare for the first issuances of municipal bonds in Indonesia. However, neither of the proposed bonds contains a water supply component.

¹¹⁶ Section 14.1 of PP 02/06 on Arrangements for Acquiring External Loans and /or Grants and their Channeling

¹¹⁷ Section 1.28 of PP 02/06

¹¹⁸ PMK 147/06 on Municipal Bonds

¹¹⁹ BAPEPAM Decrees 63/07- - 69/07

¹²⁰ See Footnote 72

9.5. CONCLUSIONS

134. There was some appetite originally for straight corporate bonds among creditworthy PDAMs, largely because of the absence of alternative financing mechanisms. The issue of PerPres 29/09¹²¹, with its lower interest rates, may have changed that perception. However, these will be difficult to place bonds without at least: (a) changing the law to allow regional government owners to issue a guarantee on behalf of their PDAMs (b) the availability of partial credit guarantees and (c) financial back-up support for investment houses if the mechanism is going to be widely offered. In the last case, some form of vision at very senior level in MOF and BAPPENAS is needed to sustain momentum against unnecessary passive resistance from Echelon II levels. This is considered unlikely, at least in the medium-term and these corporate bonds will probably, if at all, attract only large creditworthy, i.e. perhaps ten to twelve in all. Pooled bonds for smaller investments is unlikely to be a viable option for a long time and, with hindsight, the SPV concept initiated by ESP was a financial engineering step too far.
135. Municipal bonds with a water supply component intrinsically offer a more realistic option, even though the guarantee offered under PMK 147/06 is limited to the assets purchased by the bonds proceeds. Investors will be attracted by the overall revenue streams of Regional government, even if these streams cannot be pledged. In addition, it allow for investments in water supply which would otherwise not be feasible for a bond issue, when water supply is packaged with other infrastructure projects. However, with very few exceptions, this would require a sea change in attitude from regional government heads and their DPR representatives. In addition, because of the initial on-costs, the municipal bond would be a suitably economic vehicle for financing investments for only a very few large PDAMs.

¹²¹ See Paragraphs 105-112

10. MINISTRY OF PUBLIC WORKS

CURRENT APPROACH TO WATER SUPPLY FINANCE AND THE FUTURE DIRECTION OF TECHNICAL ASSISTANCE PROVIDED BY BILATERAL DONORS

136. Whilst multilateral donors are willing to make sovereign loans for water supply, the financial condition of many PDAMs (including their NPLs) and the reluctance of their regional government owners to borrow on their behalf make it very difficult to provide for new investment to expand service coverage. The present MOF/BAPPENAS regulations on applications and pre-conditions regional borrowing are also very stringent and time –consuming, although given the past history of NPLs and the continued unwillingness of regional governments to provide guarantees for MOF loans, this is understandable. Other potentially feasible financing mechanisms on the domestic market are also difficult to implement because of the general perception that PDAMs are an unsatisfactory credit risk. In addition, MOF is unwilling in principle to accept large sovereign loans for on-granting to the water supply sector for what it considers should be a full cost recovery sector or otherwise to be sustainable through the provision of a public service obligation by the regional government owner.
137. Faced with these limitations, MPW has embarked on a broadly-based, comprehensive programme of capacity building to improve PDAM management and governance. This capacity- building programme includes:
- Business planning
 - Budget preparation and control
 - Routine financial management, with special attention to improving the efficiency of accounts receivable and inventory control
 - Tariff pricing
 - Technical management, especially in areas such as non-revenue water reduction and power consumption
 - Asset management, including capacity sizing and maintenance
 - Marketing and complaints handling
138. MPW will also focus on public policy activities, through socialization of the PDAM capacity-building programme with the heads of regional governments and their DPRD in order to promote understanding and commitment of the need to instill a corporate culture in PDAMs through the maintenance of a full cost-recovery tariff and surveillance by DPRD of progress by PDAM in reaching

objectives. PDAMs should covenant with the heads of regional government to achieve targets in return for full cost-recovery targets being awarded.

139. Since most PDAMs are not creditworthy, this programme is vital to enable them to access credit markets. It is already a condition of admission to the PDAM NPL re-structuring programme that the incoming PDAM managing director should have passed a “fit and proper” administered by the head of the regional government¹²².
140. MPW would like the focus of future technical assistance from bilateral donors to be on capacity-building. The USAID ESP and AUSAID IndII activities have already demonstrated the value of such support in assisting PDAMs to prepare their business plans for re-structuring and applications for entrance to the PerPres 29/09 programme. MPW emphasizes the need for greater communication and co-ordination between donors and stakeholders, including facilitation of relationships between PDAM and the regional government. This will require a presence in the provinces, together with a good understanding of both the culture and the language.
141. MPW’s capacity-building programme is supported by its grant-financed investment activities in water supply (called *stimulan* by MPW) which are based on urbanization criteria and general principles, as follows:
 - Urban water supply: these are usually single supply systems. MPW expects urban PDAMs to be capable of financing investments (debt and equity) off their own balance sheets through full cost-recovery tariffs. Grants should only be provided to support investments which will facilitate increased access to piped water supply for low-income groups paying subsidized tariffs.
 - Semi-urban water supply: these are *kabupaten* PDAMs with one or two single supply systems (known as BNA –basic needs assessment – systems) in the urban areas, although usually only the *kabupaten* capital (*ibu kota*). In addition, small-sized urban areas (district centres known as *kecamatan*) with populations up to 25,000 are served by IKK¹²³ systems with capacities ranging between 2 and 20 litres per second (but usually between 5 to 10 lps). MPW may finance raw water infrastructure (intakes and transmission mains) and water treatment plants, but not distribution networks (to be financed by the PDAM or the regional government) or connections (to be financed by the customer). If the operation of IKKs places a financial burden on the PDAM to the detriment of its ability to manage its BNA systems, MPW recommends that the regional government takes over the system(s) through a BLU¹²⁴ and makes appropriate provisions on the APBD. The extent to which regional government follows these recommendations is not known.

¹²² Annex I to PMK 120/08

¹²³ Ibukota kecamatan

¹²⁴ See Paragraphs 37-38

In other cases, MPW is building IKK systems and handing them over for management of operations to the regional government's public works department (*Dinas PU*), an agency distinct from a BLU. The whole policy of *kabupaten* water supply systems, especially those in the remote, sparsely populated regencies outside Java requires review with a focus of turning these PDAMs into financially self-sustaining units. This would involve rationalization of IKK management and operation and, indeed, the regionalization of PDAMs themselves.

- Rural water supply: these are village community-based systems, through investments made by regional governments with funds flowing through the DAK mechanism. In addition to Ministry of Health systems, MPW is financing systems which will eventually provide water to 4,000 villages (*desa*) distributed among 110 *kabupaten* in 15 provinces through the PAMSIMAS¹²⁵ programme.

142. In principle, MPW considers that donor loan finance for water supply should be aimed at increasing the service coverage through additional capacity only for PDAMs which can demonstrate proper asset management. This implies that PDAMs should efficiently utilize their existing capacity through comprehensive non-revenue water reduction (physical and non-physical) activities.

¹²⁵ *Proyek air minum sistem masyarakat* – community drinking water systems project, co-financed by the World Bank

II. PROGRESS IN INDONESIA TOWARDS ACHIEVING MILLENNIUM DEVELOPMENT GOALS FOR WATER SUPPLY

143. Progress towards achieving the MDG target of halving by 2015 the proportion of people without sustainable access to safe drinking water has been severely compromised by the problems discussed in the previous sections, even though there are other problems outside the financial and institutional sectors which also constrain advancement towards the desired levels of coverage, as shown in the table below¹²⁶:

Target 10 of MDGs for Indonesia
Halve by 2015 the Proportion of People without Sustainable Access to Safe Drinking Water

Indicator	1990	Present	Target	Remarks	Status
% with safe access	38.2%	52.1%	67.0%	Increasing	Likely to achieve
Piped water coverage - urban		30.8%	67.7%	Decreasing	Needs improvement
Piped water coverage - rural		9.0%	52.8%	Progressing slowly	Needs improvement
Protected water source – urban		87.6%	76.1%		Already achieved
Protected water source – rural		52.1%	65.8%	Progressing	Likely to achieve

¹²⁶ Source: Let's Speak out for MDGs: Achieving the Millennium Development Goals in Indonesia (2007/08): BAPPENAS/UNDP

APPENDIX

APPENDIX I: REASONS FOR NON-PERFORMING LOANS AT THE RDA

The RDA makes loans from GOI own-source funds and from proceeds of sovereign loans. The first are known as RPD loans and were initiated by regional government and regional government enterprise borrowers through feasibility studies presented to MOF; the second are sub-loan agreements (SLAs) and were usually generated as part of the integrated urban infrastructure development projects (IUIDP) co-financed by multilateral donors and GOI. These projects were prepared by consultants and approved by the Ministry of Public Works (MPW) and the multilateral donors. MOF had no role in the SLA process, except as administrator.

The NPL issue was caused by specific problems in the RPD and SLA process, and by problems common to both. These are summarized below.

RPD NPL Issues

- Inadequate project justification provided by prospective borrowers, e.g. lack of real demand surveys, optimistic revenue projections, poor technical design, inappropriate site locations (especially markets and terminals), incorrect financial analysis methodology.
- Lack of resources within DP3 to evaluate loan submissions properly and a failure to consult technical ministries as a matter of course.
- The only control mechanism in DP3 for approving or not approving RPD loans was compliance debt service of borrowers on prior loans. Many borrowers returned for additional loans before the grace periods on previous loans had expired.
- Absence of covenants in loan agreements linking disbursements to technical and financial targets.
- Lack of monitoring during project implementation and operation by DP3 due to lack of human resources and budget allowances.

SLA NPL Issues

- Development of supply-driven, as opposed to demand-driven, projects was a common cause of poor performance. Projections were frequently far too optimistic. The result was oversized projects and, especially in the case of PDAMs, funded at unsustainable levels by SLAs.
- Ambitious IUIDP projects which attempted to cover too many local governments and were therefore inadequately prepared and appraised.

- The practice of follow-up IUIDPs in major secondary cities at 5-year intervals did not allow performance in earlier IUIDPs to be properly evaluated, and the lessons to be learnt were rarely digested. Additional SLAs were concluded without proper evaluation of whether borrowers were capable of servicing their existing debt. It is noted that major defaults with major secondary city Pemda and PDAMs caused by this practice still (December 2008) constitute obstacles to NPL resolution
- Some SLA from proceeds of bilateral loans to GOI were tied. Some projects were oversized and overpriced.

Common NPL Issues

- Financial irregularities and lack of transparency in contracting out of the works by borrowers.
- Bunching of loans led to convergence of maturities and an unsustainable debt service.
- Required tariff increases were not been implemented by Pemda or DPRD in a timely manner for political reasons. PDAMs in particular suffered badly. This practice was encouraged by MOHA which during the economic crisis in 1998 issued a guideline recommending a freeze on all service delivery tariffs
- Loan agreements did not specify MOF as the preferred creditor and were unenforceable except through the Civil Code. Some borrowers took out loans with no intention of repaying.
- Unsuitable loan typologies. Grace periods were too freely granted and for too long in the case of many projects (e.g. markets and terminals). Lack of experience in local government and PDAM with debt and cash flow management led to failure to plan for debt service.
- The passive approach of MoF towards defaulting borrowers encouraged borrowers to default.
- The transformation of many water utilities from BPAM to PDAM status in 1993 was premature. This has meant that financially weak kabupaten PDAMs with inexperienced managements lost their eligibility for full grant funding and have had to borrow for their expansion programmes.

APPENDIX II: PDAM STATUS OF NPL RESTRUCTURING – OCTOBER 2009

**APPENDIX IIA
APPROVED BY POLICY COMMITTEE**

No	PDAM
1	Kabupaten Ciamis
2	Kota Banjarmasin
3	Kabupaten Sleman
4	Kota Palopo
5	Kabupaten Wonosobo
6	Kabupaten Cilacap
7	Kabupaten Madiun
8	Kabupaten Badung
9	Kota Palangkarya
10	Kota Ternate
11	Kabupaten Mojokerto
12	Kota Samarinda
13	Kabupaten Intan Banjar
14	Kabupaten Jombang
15	Kabupaten Jayapura

**APPENDIX IIB
UNDER NEGOTIATION WITH TECHNICAL COMMITTEE**

No	PDAM
1	Kabupaten Kuningan
2	Kota Padang
3	Kabupaten Magetan
4	Kabupaten Bojonegoro
5	Kabupaten Purwakarta
6	Kabupaten Blora
7	Kabupaten Garut
8	Kota Bandung
9	Kota Sibolga
10	Kabupaten Purbalingga
11	Kota Bandar Lampung
12	Kota Palembang
13	Kota Solok
14	Kabupaten Pasaman
15	Kabupaten Tanah Datar
16	Kabupaten Karawang
17	Kabupaten Muna
18	Kabupaten Tabanan
19	Kabupaten Jemrana
20	Kota Padang Panjang
21	Kota Denpasar
22	Kabupaten Gowa

23	Kota Surakarta
24	Kota Pontianak
25	Kabupaten Subang
26	Kabupaten Kupang
27	Kabupaten Blitar
28	Kabupaten Karang Asam
29	Kabupaten Klungkung
30	Kabupaten Gianyar
31	Kota Pematang Siantar
32	Kabupaten Tulung Agung
33	Kabupaten Indramayu
34	Kabupaten Sukabumi
35	Kabupaten Tangerang
36	Kabupaten Sragen
37	Kota Tebing Tinggi
38	Kabupaten Grobogan
39	Kota Pekalongan
40	Kabupaten Pamekasan
41	Kabupaten Bone

APPENDIX IIC UNDER REVIEW WITH WORKING GROUP

No	PDAM
1	Kabupaten Mamuju
2	Kabupaten Manokwari
3	Kota Sawah Lunto
4	Kabupaten Kolaka
5	Kabupaten Tana Toraja
6	Kabupaten Cirebon
7	Kota Padang Pariaman
8	Kabupaten Lampung Selatan
9	Kabupaten Donggala
10	Kabupaten Malang
11	Kota Bandar Lampung
12	Kabupaten Enrekang
13	Kabupaten Lumajang
14	Kota Lubuk Linggau
15	Kota Sukabumi
16	Kabupaten Bangkalan
17	Kabupaten Sumbawa
18	Kota Semarang
19	Kota Jambi
20	Kota Gorontalo
21	Kota Bolaang Mongodow
22	Kabupaten Bekasi
23	Kota Makassar
24	Kota Bitung

APPENDIX IID
REJECTED BECAUSE NOT COMPLIANT WITH PMK 129/08
(TARIFF BELOW FULL COST RECOVERY)

No	PDAM
1	Kabupaten Kepulauan Sangihe
2	Kabupaten Polewali Mandar
3	Kabupaten Lamongan
4	Kabupaten Buol Toli-Toli
5	Kabupaten Ogan Komering Ulu
6	Kabupaten Ponorogo
7	Kabupaten Ngawi
8	Kabupaten Agam

APPENDIX III: QUESTIONNAIRE ADMINISTERED TO PDAMS INCLUDING RESPONSE FROM PDAM KOTA MALANG

PDAM KOTA MALANG **Kuesioner untuk PDAM**

A. Data Dasar/ Background

A1. ESP:

#	Parameter	Responses	Comment
1.	Current Financial Condition	Good	Except for current ratio, less than 1 (0.92)
2.	Operating Ratio	0.73	
3.	Current Average Tariff	Rp4,134	May 2009 water bills
4.	Percentage of last Tariff Increase (with date)	47%	No increase in customer charge
5.	Current NRW	35.06%	For year 2008
6.	Historical NRW (3 yrs ago)	41.54%, 36.4%, 40.24%	Respectively for 2007, 2006, 2005
7.	Functional Bulk Water Meter	Yes / No	Yes / No
8.	% Meter Functionality	99.88%	Based on reports of the meter readers from Jan-Jun 2009
9.	Service Continuity	24 hours	In more than 95% of service area
10.	Service Coverage	63.04%	2008
11.	Staff to Connection Ratio	1:179 or 5.58:1000	2008
12.	Debt Service Coverage Ratio (from most recent audit yr)	5.91	
13.	Net Profit/Loss (from most recent audit yr)	Rp 13,172,521,496	After Cadangan Dana Tujuan

A2. PDAM:

1. What is your greatest challenge in delivering clean water to your community?
Apakah tantangan terbesar yang dihadapi PDAM dalam memberikan pelayanan air bersih kepada masyarakat?

Answer:

The establishment of isolated zone as required to achieve various strategical targets related to quantity, quality, continuity, water loss control and effective and efficient water distribution will require relatively big budget and definitely is not a simple work. *Pembentukan zona yang terisolasi sebagai prasyarat untuk mencapai berbagai sasaran strategis berkaitan dengan kuantitas, kualitas, kontinuitas, pengendalian kehilangan air dan pendistribusian air secara efektif dan efisien. Program ini memerlukan dana yang relatif besar dan pekerjaan yang tidak sederhana.*

2. What is the greatest source of complaints received from the community?
Apakah yang menjadi sumber keluhan terbanyak dari pelanggan?

Answer: -

3. Regarding tariff increases, does the Kepala Daerah (and DPRD) generally approve the increases you request, or ask for lower/higher percentage? How long did the process of -approval take?

Mengenai kenaikan tariff, apakah Kepala Daerah (dan DPRD) biasanya menyetujui besaran kenaikan yang diusulkan, ataukah meminta persentase yang lebih rendah/tinggi? Berapa lama waktu yang diperlukan untuk proses tersebut?

Answer:

The Mayor approves the proposed tariff adjustment based on the inputs from the Dewan Pengawas. Dewan Pengawas discusses the proposed tariff increase with the PDAM. As long as the requirements and mechanism stipulated in the Permendagri No 23 yr 2006 are fulfilled, including the affordability of the tariff to customers, the proposed increase will be approved. The process (from proposal to approval), in general, takes 3 months. DPRD usually asks for explanation for the PDAM regarding the proposed tariff increase.

Walikota menyetujui usulan kenaikan tarif setelah memperhatikan pertimbangan dari Dewan Pengawas. Dewan pengawas melakukan pembahasan terhadap usulan kenaikan tarif yang diajukan oleh PDAM. Sepanjang persyaratan dan mekanisme yang ditentukan dalam permendagri no 23 tahun 2006 dipenuhi termasuk keterjangkauan tarif yang disampaikan dalam usulan maka usulan kenaikan tarif dapat disetujui. Proses usulan sampai persetujuan biasanya memakan waktu 3 bulan. DPRD biasanya meminta penjelasan dari PDAM terkait rencana kenaikan tarif tersebut.

4. Does the Kepala Daerah refer tariff increases to the DPRD?

Apakah Kepala Daerah meminta persetujuan/pendapat DPRD atas rencana kenaikan tariff?

Answer:

The tariff increase is with the authority of the Mayor. DPRD's approval is not mandatory.

Kenaikan tarif adalah wewenang Walikota dan tidak harus melalui persetujuan DPRD.

B. Loan Restructuring (Restrukturisasi Pinjaman)

Not applicable to PDAM Kota Malang

B1. ESP:

1. Has the PDAM applied for loan restructuring?
Apakah PDAM telah mengajukan usulan untuk restrukturisasi pinjaman?
2. What stage has the PDAM reached in the restructuring process?
Dalam proses restrukturisasi pinjaman, berada pada tahap apakah PDAM saat ini?
3. Did the PDAM prepare its business plan internally, or have outside assistance?
Apakah PDAM menyusun Business Plannya sendiri (in house) ataukah mendapatkan bantuan dari pihak luar?
4. Does the PDAM have an up-to-date Corporate Plan? Was it used as a reference to prepare the Business Plan?
Apakah PDAM memiliki dokumen Corporate Plan terkini? Apakah digunakan sebagai acuan untuk menyusun Business Plan?

5. How many years of loan repayment was originally proposed in the PDAM's business plan? *Berapa tahun jangka waktu rescheduling utang yang diusulkan oleh PDAM dalam Business Plan?*
6. How many years of loan repayment was finally agreed upon with DP3 Treasury? Do you find this final agreement realistic? *Berapa lamakah jangka waktu pembayaran pinjaman yang disetujui oleh Perbendaharaan DP3? Apakah menurut anda ini realistis?*
7. If the PDAM agreed to reduce the number of years of repayment from its original proposal, from where in the business plan were the funds taken? *Apabila PDAM setuju untuk mengurangi jangka waktu pinjaman dari pinjaman, dari manakah uang yang akan digunakan untuk membayar cicilan utang tersebut?*
8. If funds have been taken from incremental investment or replacement investment, what will the impact be in terms of service coverage and quality? *Apabila dana untuk membayar cicilan secara lebih cepat diambilkan dari dana untuk investasi atau penggantian aktiva, apakah pengaruhnya terhadap cakupan dan kualitas pelayanan?*
9. Did the PDAM budget for paying dividends to Pemda in the business plan? If so, is there any agreement with Pemda for their reinvestment in the PDAM? *Apakah PDAM menganggarkan pembayaran deviden ke Pemda di dalam Business Plan? Apabila iya, apakah ada kesepakatan dengan PDAM untuk mereinvestasikan kembali ke PDAM?*

B2. PDAM:

1. What have you found difficult in preparing the business plan in accordance with PMK 120/08? *Apakah kesulitan yang Sdr temui/hadapi dalam menyusun Business Plan sesuai dengan PMK 120/08?*
2. Did you have the full support of Pemda and DPRD in approving your business plan? If not, what were the problems? For example, audit delays. *Apakah Sdr mendapatkan dukungan penuh dari Pemda dan DPRD dalam pemberian persetujuan business plan? Apabila tidak, apakah penyebabnya?*
3. Do you think you will be able to reach your 20% NRW target? If not, what do you think the consequences will be? *Apakah menurut Sdr target NRW 20% bias dicapai? Apabila tidak apakah kemungkinan konsekuensinya?*
4. What was your experience with Komite Teknis? Do you think they were sympathetic to your investment/rehabilitation needs or more interested in accelerated loan repayments? *Bagaimana pengalaman Sdr dengan Komite Teknis? Apakah menurut Sdr mereka memahami kebutuhan investasi/rehabilitas perusahaan Sdr atau mereka lebih tertarik dengan percepatan pembayaran pinjaman?*
5. Do you think you will have any problems in meeting loan repayments under the restructuring plan? *Apakah Sdr merasa akan ada masalah dalam memenuhi kewajiban pembayaran pinjaman sesuai dengan rencana restrukturisasi?*

6. What improvements to PMK 120/07 do you suggest to facilitate the restructuring process, including any measures to simplify the business plan preparation and the negotiation process? *Apakah perbaikan yang perlu dilakukan thd PMK 120 yang Sdr sarankan untuk mempermudah proses restrukturisasi, termasuk ukuran-ukuran untuk menyederhanakan penyusunan business plan dan proses negosiasi?*

C. Investment Finance (Pendanaan Investasi)

C1. ESP:

1. What has been the PDAM's source of investment finance in the last 5 years (PDAM, Pemda, bank loan, GOI grant, housing developer, construction finance)? *Apakah sumber pendanaan investasi PDAM selama 5 tahun terakhir ini (PDAM, Pemda, pinjaman bank, hibah Pemerintah, developer atau pinjaman konstruksi)?*

Answer:

The source of investment finance for the last 5-year has been from PDAM internal cash, Pemda's equity, commercial loan, Government Grant, developer and private contractor (pre-financing)

Sumber pendanaan investasi 5 tahun terakhir berasal dari dana internal PDAM, penyertaan pemda, pinjaman bank komersial, hibah pemerintah, pengembang dan pihak swasta pelaksana pekerjaan.

2. Describe the PDAM's investment plans for the next five years in terms of scope of work and cost. What are the proposed sources of funds (PDAM, Pemda, normal commercial loan, Perpres 29/09, MOF, GOI grant, housing developer, construction finance)? *Jelaskan rencana investasi PDAM untuk 5 tahun kedepan dalam hal cakupan pekerjaan dan biayanya. Apakah sumber dana yang diusulkan (PDAM, Pemda, pinjaman bank biasa, Perpres 29/09, Depkeu, hibah Pemerintah, developer atau pinjaman konstruksi)?*

Answer:

PDAM will invest on reservoir, transmission and distribution pipe network, zoning, pumps replacement and information system development amounting to approximately Rp100 billion.

Dalam 5 tahun mendatang PDAM Kota Malang akan melakukan investasi terutama berupa reservoir, jaringan pipa transmisi dan distribusi, pembentukan zona, penggantian pompa, dan teknologi informasi dengan nilai kurang lebih Rp 100 milyar.

3. Has the PDAM prepared a feasibility study for these investments? Were the studies prepared internally or externally? *Apakah PDAM telah menyusun studi kelayakan untuk investasi tersebut? Apakah studi kelayakan disusun sendiri atau oleh pihak lain?*

Answer:

The investment is prepared based on ideal technical consideration. The FS' have been prepared for some part of the investment plan. The investment plan will be included in the Corporate Plan 2010-2014 of which now is in preparation process by PDAM, assisted by a consultant.

Investasi ini berdasarkan pertimbangan teknis yang ideal dan sebagian belum dikaji feasibility studinya. Ini dituangkan dalam corporate plan 2010 – 2014 yang saat ini dalam penyusunan oleh internal PDAM dengan bantuan konsultan

4. Were the feasibility studies approved by the kepala daerah/DPRD?

Apakah studi kelayakan tersebut disetujui oleh Kepala Daerah/DPRD?

Answer:

Some of the investment (approximately Rp31 billion) to be co-financed by BNI and PDAM has been approved by the Mayor.

Sebagian usulan investasi (kurang lebih senilai Rp 31 milyar) yang rencananya akan dibiayai oleh BNI dan self financing PDAM telah disetujui oleh Walikota

C2. PDAM:

1. What is your biggest challenge in terms financing a new project/investment?

Apakah tantangan tersebut yang Sdr hadapi dalam hal pendanaan proyek atau investasi baru?

Answer:

PDAM's investment is usually quite big and have long return. Actually the most suitable financing source is Pemda's equity, but the available amount is relatively small. While using the commercial loan will require PDAM to provide a certain percentage of the investment needs which usually too much for the PDAM financial condition.

Investasi besar PDAM umumnya memiliki masa pengembalian yang lama. Sumber dana yang paling tepat sebenarnya adalah penyertaan pemda, namun sumber pendanaan tersebut nilainya relatif kecil. Sementara apabila menggunakan pinjaman maka harus ada self financing yang seringkali memberatkan kondisi kas perusahaan.

2. What is your understanding is of PerPres 29/09.

Bagaimanakah pemahaman Sdr terhadap Perpres 29/09?

Answer:

The advantages could be:

- Relatively low interest will be a big favor for PDAM
- The creditor will feel more secured with government providing insurance
- Pemda's role will only be encouraging PDAM to improve its performance to be able to pay the debt service on schedule supported by a set of policy including for water tariff.

However, until now the implementation of the Perpres is not yet clear, especially at the bank's side. Bank will need to prepare a specific guidelines for it.

The preparation of umbrella agreement involving DPRD in the process will not be easy either since the mechanism might have impact to the APBD. However, PDAM could assure Pemda/DPRD that the scheme will eventually not affect the APBD, in other words, PDAM will pay for the arrears at the end if it fails to pay on time.

Bila diterapkan ada beberapa manfaat yang bisa diambil :

- PDAM akan sangat terbantu karena beban tingkat bunga yang relatif rendah
- Bank kreditur lebih yakin uangnya akan kembali karena ada jaminan pemerintah
- Pemda tinggal mendorong PDAM memiliki kinerja baik sehingga dapat mengembalikan angsuran tepat waktu dengan berbagai perangkat kebijakan termasuk tarif air.

Namun rencana implementasi Perpres tersebut masih belum jelas terutama mengenai kesiapan bank. Dibutuhkan penerbitan aturan tersendiri di bank yang bersangkutan yang sampai saat ini belum ada. Umbrella agreement yang melibatkan DPRD mungkin memerlukan proses yang

tidak mudah karena mekanisme ini bisa (mungkin juga tidak) memiliki dampak terhadap APBD. Namun hal ini bisa diyakinkan dengan penjaminan oleh PDAM bahwa skema ini tidak akan mempengaruhi APBD. Atau dengan kata lain PDAM akan tetap membayar tunggakan yang tidak tepat waktu (gagal bayar).

3. Have you considered applying for loan funds under Perpres 29/09? If so, when do you think you will present your application for funding under Perpres 29/09?
Apakah Sdr sudah mempertimbangkan untuk mengajukan pinjaman di bawah Perpres 29/09? Apabila iya, kapan Sdr akan mengajukan permohonan untuk mendapatkan pinjaman tersebut?

Answer:

We are expecting to be able to have that loan under Perpres 29/09. While the bank is working on the mechanism, PDAM will start preparing any requirements to apply for the loan.

Kami berharap bisa memperoleh pinjaman dengan skema sesuai Perpres 29/09. Sambil bank dapat menerapkan Perpres tersebut, PDAM menyiapkan berbagai kebutuhan yang diperlukan untuk pengajuan pinjaman dengan skema tersebut.

4. Have you discussed the possibility of Perpres 29-0/ funding with the kepala daerah/DPRD? What was the result? If not yet discussed, do you anticipate support?
Apakah Sdr telah membicarakan kemungkinan memanfaatkan pinjaman Perpres 29/09 dengan Kepala Daerah/DPRD? Bagaimanakah hasilnya? Apabila belum dibicarakan, menurut Sdr, apakah mereka akan memberikan dukungan?

Answer:

It's been conveyed to the Mayor and he responded positively to such initiative.

Sudah disampaikan kepada Walikota secara lisan dan Walikota menyambut baik adanya terobosan semacam ini.

5. If there have been problems with the kepala daerah/DPRD, or if you anticipate problems, what are/will they be?
Apabila ada masalah dengan Kepala Daerah/DPRD, atau Sdr sudah mengantisipasi akan ada masalah, apakah kira-kira masalah tersebut?

Answer:

There should be a meeting with all relevant parties (PDAM, Pemda officials, MPW, MoF, Bank and DPRD)

Mungkin diperlukan pertemuan yang melibatkan pihak pihak yang terkait dengan pelaksanaan Perpres tersebut (PDAM, pejabat Pemkot, PU, Depkeu, Bank dan DPRD)

6. Do you agree with Perpres 29/09? What difficulties do you see in it? What improvements would you like to see?
Apakah Sdr setuju dengan Perpres 29/09? Apakah kesulitan/kelemahan yang Sdr lihat dalam Perpres ini? Apakah perbaikan yang Sdr harapkan?

Answer:

No answer

7. Assuming any loans under Perpres 29/09 will require an equity contribution – possibly as much as 30% of the investment costs, what will be your source of funds (PDAM cash flow, Pemda, hibah)?

Dengan anggapan pinjaman melalui Perpres 29/09 akan mensyaratkan kontribusi modal – mungkin sebesar 30% dari biaya investasi, apakah sumber dana yang Sdr gunakan (kas PDAM, Pemda, hibah)?

Answer:

The self financing for investment (say 30%) will be provided by PDAM internal cash and PDAM Equity.

Self financing yang diperlukan untuk investasi (misalnya 30%) akan didanai dari internal PDAM dan Penyertaan Pemda.

8. Please describe your understanding of PMK 168/08? Will it work? Will it change your policy towards investment financing? What problems do you foresee?
Tolong jelaska pemahaman Sdr tentang PMK 168/08. Apakah menurut Sdr bias dilaksanakan? Apakah hal ini akan mempengaruhi kebijakan Sdr dalam hal pembiayaan investasi? Apakah permasalahan yang Sdr lihat?

Answer:

This is another source of fund for PDAM suitable for investment that actually is not feasible for PDAM but very important for the community. The grant could be in cash, goods or services, from either from GOL or foreign country.

The foreseen problems would probably be that the implementation does not match with the technical specification as required by PDAM, since PDAM's role will only be a member of a monitoring team to take notes and make reports. At the end PDAM itself will have to fix the problem .

PMK No. 168/PMK.07/2008 tentang Hibah Daerah merupakan sumber pendanaan lain bagi PDAM yang tepat untuk investasi yang menurut perhitungan kelayakan PDAM tidak feasibel namun sangat dibutuhkan oleh masyarakat. Hibah dapat berupa uang, barang maupun jasa, dapat berasal dari pemerintah atau pihak lain dalam negeri maupun luar negeri.

Masalah yang mungkin muncul adalah pelaksanaan mungkin ada yang tidak sesuai dengan spesifikasi teknis yang dibutuhkan PDAM. Karena PDAM hanya sebagai bagian dari pengawas hanya bisa mencatat dan melaporkan. Di kemudain hari pekerjaan pekerjaan yang tidak sesuai tersebut diperbaiki sendiri oleh PDAM.

9. Will you be applying for hibah? When? For what? How much? What percentage of your FY2010 investment needs will this be?
Apakah Sdr akan mengajukan permohonan hibah? Untuk apakah? Kira-kira berapa persen dari kebutuhan investasi 2010 Sdr?

Answer:

PDAM Kota Malang is interested to get the grant to finance the pipe network extension. In principal, more alternative financing source is better.

PDAM Kota Malang berminat mendapatkan hibah untuk penegmbangan jaringan pipa. Pada prinsipnya semakin banyak semakin baik.

10. When implementing a new investment project, do you have your own procurement procedures or do you follow Keppres 80/03? Any particular problems? Any difficulties with auditor (BPKP)?
Pada waktu pelaksanaan investasi, apakah untuk proses pengadaan Sdr mempunyai pedoman sendiri atau mengikuti Keppres 80/03? Apakah ada masalah tertentu? Apakah ada kesulitan dengan auditor (BPKP)?

Answer:

We have President Director Regulation for the procurement of goods and services in PDAM Kota Malang, referring to Keppres 80 Year 2003. Up to now BPKP doesn't have problem with it. BPKP will consider it fine as long as the procedure and administrative requirements are complete and accountable. It is indeed necessary to differentiate treatment to purchase through Pemda's equity/APBD to purchase by PDAM internal cash. In general the regulation is similar with Keppres 80/2003, the difference is in the price/value and the selection methods.

Ada Peraturan Direktur Utama yang mengatur pengadaan barang dan jasa di PDAM Kota Malang yang mengacu pada Kepres 80 tahun 2003. Dalam pelaksanaannya BPKP tidak memperlakukan hal tersebut sepanjang administrasinya bisa dipenuhi dengan lengkap dan dapat dipertanggungjawabkan. Memang perlu ada perbedaan perlakuan dalam pengadaan yang didanai dari penyertaan pemda dan pengadaan yang didanai dari internal perusahaan. Secara umum sebetulnya peraturan Direktur Utama tersebut sama dengan Keppres 80 tahun 2003, perbedaannya hanya pada nilai pengadaan dan metode pemilihannya.

APPENDIX IV: REGIONAL GOVERNMENTS NPL RE-STRUCTURING STATUS – OCTOBER 2009

APPENDIX IVA UNDER NEGOTIATION WITH TECHNICAL COMMITTEE

No	REGIONAL GOVERNMENT
1	Kabupaten Karawang
2	Kota Langsa
3	Kabupaten Bangka
4	Kota Tanjung Balai
5	Kota Padang Panjang
6	Kabupaten Tana Karo
7	Kabupaten Langkat
8	Kabupaten Pinrang
9	Kota Bitung
10	Kabupaten Aceh Tenggara
11	Kabupaten Pangkalan Kepulauan
12	Kabupaten Gowa
13	Kota Palu
14	Kabupaten Lampung Utara
15	Kota Padang
16	Kota Makassar
17	Kabupaten Purwakarta
18	Kabupaten Kepulauan Sangihe

APPENDIX IVB UNDER REVIEW WITH WORKING GROUP

No	REGIONAL GOVERNMENT
1	Kabupaten Ciamis
2	Kota Pematang Siantar
3	Kota Pandang Pariaman
4	Kabupaten Minahasa
5	Kabupaten Maros
6	Kota Banjarmasin
7	Kabupaten Indagiri Hulu
8	Kabupaten Bengkalis

APPENDIX V

PDAMS APPLYING FOR PERPRES 29/09 FINANCE

No	PDAM
1	Kota Tangerang
2	Kabupaten Bogor
3	Kabupaten Ciamis
4	Kabupaten Bekasi
5	Kabupaten Bandung
6	Kabupaten Serang
7	Kota Malang
8	Kabupaten Gresik
9	Kabupaten Pematang
10	Kota Semarang
11	Kota Pontianak
12	Kota Medan

APPENDIX VI

PDAMS BEING ASSIATED BY AUSAID INTI PROJECT TO QUALIFY FOR PERPRES 29/09 FINANCE

No	PDAM
1	Kabupaten Lahat
2	Kabupaten Banyuwangi
3	Kota Tasikmalaya
4	Kabupaten Asahan
5	Kabupaten Pekalongan
6	Kabupaten Lombok Timur
7	Kabupaten Cilacap
8	Kabupaten Pamekasan
9	Kabupaten Gowa
10	Kabupaten Indramayu
11	Kota Kediri
12	Kabupaten Bojonegoro
13	Kabupaten Karawang
14	Kota Samarinda
15	Kabupaten Jombang
16	Kota Kediri
17	Kota Kendari
18	Kabupaten Blitar
19	Kabupaten Probolinggo
20	Kabupaten Kuningan
21	Kabupaten Tulung Agung
22	Kota Denpasar
23	Kabupaten Wonosobo

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