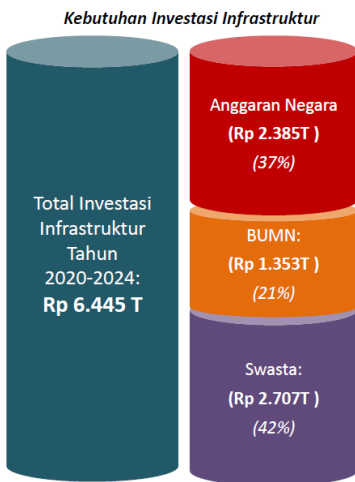




Municipal Public-Private Partnership (PPP) in Indonesia

Image: PT SMI Documentation

BACKGROUND OF MUNICIPAL PPP IN INDONESIA



Source: BAPPENAS, 2019

Public-Private Partnership (PPP) is one of the alternatives to the infrastructure financing plan, outside of the state/regional budget and non-state budget. PPP is expected to help fill in the infrastructure financing gap in Indonesia which requires approximately IDR 6,455 trillion or equivalent to USD 452 billion according to National Medium-Term Development Plan (known as RPJMN) of 2020-2024. Of IDR 6,455 trillion, only 37% or around IDR 2,385 trillion (equivalent to USD 167 billion) can be satisfied by State Budget, while the remaining 21% (around IDR 1,353 trillion or USD 95 billion) and 42% (around IDR 2,707 trillion or USD 189 billion) are expected to come from SOEs and the private sector, respectively.

PPP itself is not a new concept in Indonesia. It was first introduced during the New Order era under President Soeharto’s time and was utilized for infrastructure provision such as toll road and electricity.¹ Similarly, Municipal PPP was also introduced during the same period. One of the pioneers of Municipal PPP was the Jakarta Drinking Water Supply System where the Drinking Water

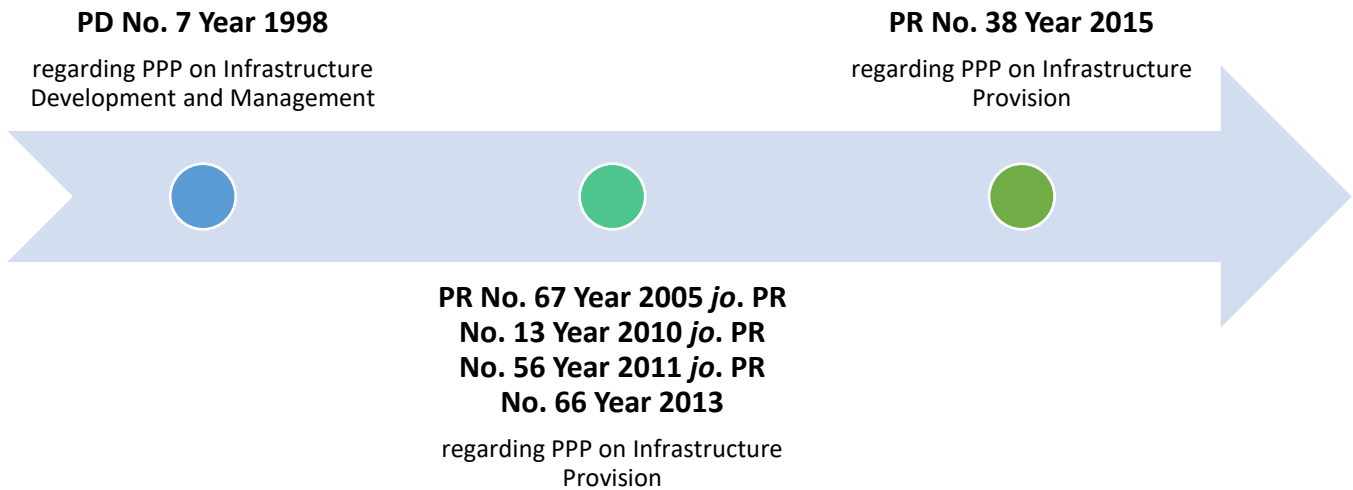
Company owned by the Provincial Government of Jakarta (PAM Jaya) signed a 25-year PPP agreement in June 1997 with two private consortiums, namely PT PAM Lyonnaise Jaya (Palyja) to manage the Drinking Water Supply System in the Western side of Jakarta and PT Thames PAM Jaya for the Eastern side of Jakarta.

Although PPP has been around in Indonesia for quite some time, PPP was only centrally regulated since 1998 through the Presidential Decree (PD) Number 7 of the Year of 1998 on PPP in Infrastructure Development and

¹ Noor (2016). “Mengenal Kerjasama Pemerintah dengan Badan Usaha (KPBU), Skema Public-Private Partnership (PPP) di Indonesia.” Available at: <https://www.djkn.kemenkeu.go.id/artikel/baca/11824/Mengenal-Kerjasama-Pemerintah-dengan-Badan-Usaha-KPBU-Skema-Public-Private-Partnership-PPP-di-Indonesia.html>. Accessed on 10 August 2021.



Management. Later, this Decree was revoked and replaced by Presidential Regulation (PR) Number 67 Year 2005 and its subsequent revisions and then substituted again with Presidential Regulation Number 38 Year 2015.



PPP Regulations Journey in Indonesia
Source: Indonesia Audit Board Legal Database²

The latest was PR No. 38 Year 2015, intended to enhance the PPP concept from the previous regulations, such as by adjusting the PPP concept to follow the latest global dynamics including with the addition of eligible infrastructure sectors such as social infrastructure ranging from hospital to state prison.

According to the latest PR mentioned above, PPP is defined as:

- (i) **Cooperation between the Government and Business Entity**
- (ii) **on Infrastructure Provision³**
- (iii) **for the best interest of the Public**
- (iv) in accordance with the **pre-determined specifications** (by the Minister / Head of Institution / Head of Region / State-owned Enterprise (SOE) / Regional-owned Enterprise (ROE))
- (v) partially or fully uses the resources from the **Business Entity**
- (vi) while considering **risks allocation among Parties.**
- (vii) **Return on investment** can be sourced from:
 - Payment from the user in the form of tariffs;
 - Availability Payment (AP); and/or
 - Other forms that do not conflict with the legislation.

Aside from PR 38/2015, Municipal PPP is also governed by the Law Number 23 Year 2014 regarding Municipalities/ Sub-national Government, Government Regulation (PR) Number 28 Year 2018 regarding Municipal Cooperation, and Minister of Home Affairs’ (MOHA) Regulation Number 19 Year 2016 regarding Municipal Asset Management Guidelines, which states that a Municipal can cooperate with third party(ies) in the context of administering Government Affairs that are under the authority of the Municipality to improve the welfare of its citizen and

² <https://peraturan.bpk.go.id/Home/Details/42594/perpres-no-67-tahun-2005>.

³ The scope of “Infrastructure Provision” according to PR 38/2015 includes: (i) build/construction; (ii) improvement/expansion; (iii) management; and/or (iv) maintenance of infrastructure.



accelerate the delivery of public services in the form of rent, borrow-use, utilization cooperation, build-operate-transfer (BOT), or cooperation in infrastructure provision. Additionally, there is also MOHA Regulation Number 96 Year 2016 on AP in the Framework of PPP in Infrastructure Provision in the Municipalities.

According to PPP Guide from APMG, PPP has the characteristics of long-term contract between public and the private party, where the private party bears significant risk and management responsibility throughout the life of the contract and its remuneration is linked significantly to performance and/or the demand of use.⁴ These characteristics is what makes PPP stand out when it comes to overcoming regional development problems which usually use a conventional procurement method.

PPP could provide a less volatile option in the infrastructure provision. If we look at the conventional procurement method, there are several risks that need to be considered, among others, Municipalities must bear full (100%) risks or the so-called non-sharing risk, the potential for budget absorption constraint, as well as the risk of consistently maintaining the quality of infrastructure which also has the probability of failing to meet the public's expectation. On top of that, we have seen a handful of Municipal infrastructure projects that experienced governance issues while using the conventional method and they usually end up in court.⁵ On the other hand, PPP has the potential to improve both the quality and quantity of projects through the sharing of project risks between the Municipalities and the private entity(ies), so that it creates an incentive for the project to be on budget, on service, and on time.⁶

Unfortunately, in spite of the existence of PPP in the past 24 years and with Indonesia implementing a Regional Autonomy and Fiscal Decentralization since 2001, it is still not being utilized optimally to support the regional development. Regional development, collectively very vital in supporting the national development, is still largely financed by the state and regional budget due to the lack of financing innovation for regional development.

In this paper, SMI Insight will explore the challenges of using Municipal PPP, provide some Municipal PPP case studies whose preparation is helped by PT SMI (to put things into perspective), and provide recommendations for the policymakers to promote Municipal PPP as an alternative to financing infrastructure development at the sub-national level.

CHALLENGES IN MUNICIPAL PPP IMPLEMENTATION IN INDONESIA

Based on our analysis, there are several main challenges when it comes to using Municipal PPP scheme:

1. Limitation of the Municipal's fiscal capacity in infrastructure financing

Ideally, regional autonomy and fiscal decentralization policy would encourage the Municipalities to be more independent in managing their finances. The balance funds which are transferred to the Municipalities were aimed at reducing the fiscal gap between the Central Government and the Municipalities or among Municipalities. The Central Government transferred the balance funds in the form of TKDD (Transfer ke Daerah dan Dana Desa or Transfers to Regions and Village Funds) so that the Municipalities can carry out their authority and programs. Nevertheless, according to the assessment by the Indonesia Audit Board in 2020 using the fiscal independence index and the ratio of Municipal income and retribution, most of the Municipalities (443 out of 503 Municipalities or 88.07%) fall into the "not yet independent" category. Meanwhile, 50 Municipalities (9.94%) fall into the

⁴ APMG PPP Guide.

⁵ Afandi, T. (2017). Press Release "KPBU Atas Masalah Pembangunan Daerah dan Mempercepat Pembangunan Infrastruktur." Available at: https://www.bappenas.go.id/files/7115/1131/6981/Siaran_Pers_-_KPBU_Atasi_Masalah_Pembangunan_Daerah_dan_Mempercepat_Pembangunan_Infrastruktur.pdf, accessed on 15 August 2021.

⁶ Kendaro, A.G. (2019). "Kebijakan Umum Kerjasama Pemerintah dengan Badan Usaha." Available at: <https://bappeda.semarangkota.go.id/packages/upload/materi/5tKXiB82ax.pdf>, accessed on 15 August 2021.

category of “towards being independent.” Only 10 Municipalities (1.99%) entered the “independent” status. The study also found that the gap in fiscal independence between Municipalities nationally was very high.⁷

The unbalanced level of Fiscal Independence of each Municipal shows that most Municipalities in Indonesia are still dependent on the Central Government to supply funds for the Regional Budget, compared to the contribution of their own revenues to finance their development. The main contributors for this problem can be caused by: (i) the sub-optimum efforts of Municipalities in carrying out their autonomous role; (ii) limited capacity in developing their regional potential or not having conducted an in-depth analysis to explore the potential sources of regional income; and (iii) although there are potential sources of income for Municipalities, these are beyond the authority of the Municipalities.⁸

However, while due to this factor both the Central and Municipal Government feel the need to invite other party(ies) to be financially involved through the PPP, there are some challenges in the PPP’s implementation linked to the types of investment return. To implement PPP, there are two types of investment return depending on the project characters, namely AP and User Charge.

- **Availability Payment (AP)** - according to MOHA Regulation 96/2016, AP can be sourced from: (a) Regional Budget; (b) Municipal Loan/Grant; and/or (c) other sources in accordance with the provisions of laws and regulations. As stated previously, most Municipalities in Indonesia still rely their Regional Budget on TKDD. On one hand, TKDD cannot be fully used for AP because it has been pre-allocated for operational expenditure or for other pre-determined programs/activities. On the other hand, Municipalities have limited fiscal independence, especially in generating sufficient local revenues to pay for AP. As for other sources, such as Municipal loan/grant/or other eligible sources, they have not been elaborated further in the MOHA Regulation or its derivative regulation(s). As a result, there is a deviation between the expected project scope with the project scope that the Municipalities could afford based on their fiscal capacity.
- **User Charge** – Municipalities limited fiscal capacity can also impact the projects which adopt user charge as its source of return on investment. This is because in user charge-based projects, Municipality intervention is often times needed in the form of fiscal support (to cover part of the project scope) to keep the projects viable and maintain the users’ ability to pay for the infrastructure services. If the Municipality fails to provide fiscal support due to limited fiscal capacity, there is a possibility for the project to be cancelled midway or even before it even started.

2. Sub-optimum synergy among existing sources of financing to finance regional infrastructure development

Aside from Municipal PPP, there are other alternative sources of financing that could be accessed by the Municipalities, such as, among others (a) Municipal Loan, from either (i) PT SMI; (ii) Regional Development Bank (BPD); or (iii) Municipal Bond, or even (b) other Loans, such as Green Financing or Islamic Social Financing. The differences between these three types of financing are summarized in the table below:

Criteria	Municipal Loan			PPP	Others
	SMI	BPD	Municipal Bond/Sukuk		
Source of Financing	1) Central Government 2) Commercial	1) Municipality 2) Commercial 3) Public	Public	Commercial	1) Equity 2) Managed Funds 3) Commercial

⁷ Badan Pemeriksa Keuangan (2021). “Laporan Hasil Reviu atas Kemandirian Fiskal Pemerintah Daerah Tahun 2020.” Available at: https://www.bpk.go.id/assets/files/lkpp/2020/lkpp_2020_1624341245.pdf, accessed on 13 September 2021.

⁸ Christianingrum, R. dan Prasetyo, A. (2020). “Mendorong Kemandirian Fiskal Daerah Melalui Pembiayaan Kreatif,” Available at: <https://berkas.dpr.go.id/puskaianggaran/analisis-apbn/public-file/analisis-apbn-public-57.pdf>, accessed on 15 August 2021.



Criteria	Municipal Loan			PPP	Others
	SMI	BPD	Municipal Bond/Sukuk		
	3) Donor (e.g. RIDF WB ⁹)				4) Other legit forms financing
Risk Profile	Guarantee by the Central Government	No guarantee by the Central Government	No guarantee by the Central Government ¹⁰	Depending on the risks allocation, there is option to obtain Central Government Guarantee	Low risk
Tenor	3-8 years (on average 5 years following the term of office of the Region Head)	< 10 years	10-15 years	Long-term (10-30 years)	Based on agreement
Interest rate	On average $\pm 7.54\%$ ¹¹ (Depending on the yield of Government Securities with a tenor equivalent to +75 bps)	On average $\pm 8.3\%$ + risk premium ¹² (Based on BPD's Corporate Credit Basic Interest Rate (SBDK) as of August 2021)	On average $\pm 10\%$ (Municipalities with AA rating) (Depending on Municipalities rating, Government Securities rate, and global economy condition)	On average $\pm 10.5\%$ (Based on project references prepared by PT SMI which has reached financial close within 2016-2020 period)	Lower than conventional loan
Financing Potential	Moderate financing potential because it is not limited by Maximum Limit for Financing (MLF) by OJK. However, the Municipality must meet the debt service coverage ratio (DSCR) > 2.5	Low financing potential because it is limited by MLF by OJK	Vast financing potential because it is not limited by MLF by OJK	Vast financing potential, depending on risks allocation between the Municipalities and the private entity	Vast financing potential, but restricted to projects that meet the institution's criteria
Process complexity	Moderate	Moderate	High	High	Very High

Comparison between Municipal Loan, PPP, and other source of financing

Source: Processed ^{8, 10, 11, 12, 13, 14}

⁹ RIDF-WB: Regional Infrastructure Development Fund – World Bank.

¹⁰ Bappenas (2014). "Ringkasan Tinjauan Regulasi dan Kelembagaan Penerbitan Obligasi Daerah dalam Pembangunan Infrastruktur Daerah." Available at: <https://www.bappenas.go.id/files/pendanaan/kajian/kajian-2014-pendanaan-obligasi-daerah.pdf>. Accessed on 27 September 2021

¹¹ Based on PT SMI's calculation

¹² OJK (2021). "Suku Bunga Dasar Kredit." Available at: <https://www.ojk.go.id/id/kanal/perbankan/pages/suku-bunga-dasar.aspx>. Accessed on 28 September 2021.

¹³ Sofi, I. (2020). "Pilihan Pembiayaan Infrastruktur Daerah Makin Luas", Available at: <https://www.kemenkeu.go.id/publikasi/artikel-dan-opini/pilihan-pembiayaan-infrastruktur-daerah-makin-luas/>, accessed on 23 August 2021.

¹⁴ Harmanta (2020). "Strategi Kebijakan Pembangunan Infrastruktur Transportasi Yang Mendukung Kelancaran Distribusi Arus Barang dan Jasa dalam Kegiatan Ekonomi Jawa Timur." Available at: <https://ro-ekonomi.jatimprov.go.id/storage/file-tambahan/skk0gReGGeMJ3y6U1ikvr27bpoTx2Pc28d1dnDZM.pdf>, accessed on 23 August 2021.



If we look at the existing sources of financing available for Municipalities as stated in the table, each source has its own requirements and criteria. **Choosing the correct source of financing is key** in ensuring sustainability in developing regional infrastructure. This can be supported through the issuance of Government policy (in the form of regulation, guidelines, assistance, or other forms) that can help the Municipalities to synergize the existing sources of financing with the characteristics of regional infrastructure projects while considering the Municipalities' fiscal capacity, or a policy that can guide Municipalities to diversify or combine more than one source of financing to fund their regional infrastructure projects.

3. Uneven understanding of creative financing schemes and the impact of bureaucratic complexity

The uneven level of understanding of creative financing schemes among Municipalities has a major impact on the optimal utilization of each of the aforementioned schemes. This applies not only to PPP, but also to other creative financing such as the issuance of Municipal bonds/sukuk. One of the reasons behind the low interest of creative financing in Indonesia is because Municipal Head and other relevant stakeholders must have a comprehensive understanding of creative financing, which may require some time to fully comprehend.^{15,16}

Furthermore, there is a misconception which equates PPP as a project that will be fully financed by the private sector, hence require no fiscal support from the Central Government nor the Municipality.¹⁷ In reality, PPP process necessitates clear risks allocation among the public and the private sector, including financial risks. Due to this misconception, when the feasibility study finds that the project would require fiscal support from the government to make the project more viable and attractive to potential investors (market), the Municipality becomes reluctant to continue the project. This misconception has hindered Municipalities in Indonesia to explore innovative and sustainable PPP projects, where the private sector can add value to the infrastructure asset/services to fulfil the public needs in the long run, which can only be optimally realized if there is a fiscal support from the Government (both Central and Municipal).

By the same token, we cannot deny that bureaucracy complexities also add another layer of impediments to Municipal PPP implementation.^{18,19,20} Therefore, good institutional coordination is needed in order to accelerate the PPP transaction and preparation process. In implementing Municipal PPP, there are strategic steps that must be synchronized, namely the stages and timeframes between the decision-making process or approval in the regions with the stages and timeframe of the PPP project.

¹⁵ Mahardika, L.A. (2020). "Penyebab Belum Ada Pemerintah Daerah yang Menerbitkan Obligasi." Available at: <https://market.bisnis.com/read/20200115/92/1190473/ini-penyebab-belum-ada-pemerintah-daerah-yang-terbitkan-obligasi>, accessed on 16 August 2021.

¹⁶ CNN Indonesia (2019). "Bi Sebut Pemanfaatan KPBU Infrastruktur Daerah Belum Optimal." Available at: <https://www.cnnindonesia.com/ekonomi/20191107133955-92-446341/bi-sebut-pemanfaatan-kpbu-infrastruktur-daerah-tak-optimal>, accessed on 16 August 2021.

¹⁷ Indopremier (2017). "Ketidakpahaman Skema KPBU, Hambat Proyek Infrastruktur Di Daerah," Available at: https://www.indopremier.com/ipotnews/newsDetail.php?idl=Ketidakpahaman_Skema_KPBU_Hambat_Proyek_Infrastruktur_Di_Daerah_&news_id=78021&group_news=IPOTNEWS&news_date=&taging_subtype=INFRASTRUCTURE&name=&search=y_general&q=proyek%20infrastuktur_&halaman=1, accessed on 25 August 2021.

¹⁸ Koran Sindo (2015). "Pentingnya Ekonomi Daerah bagi Nasional," Available at: <https://nasional.sindonews.com/berita/1038834/149/pentingnya-ekonomi-daerah-bagi-nasional/>, accessed on 25 August 2021.

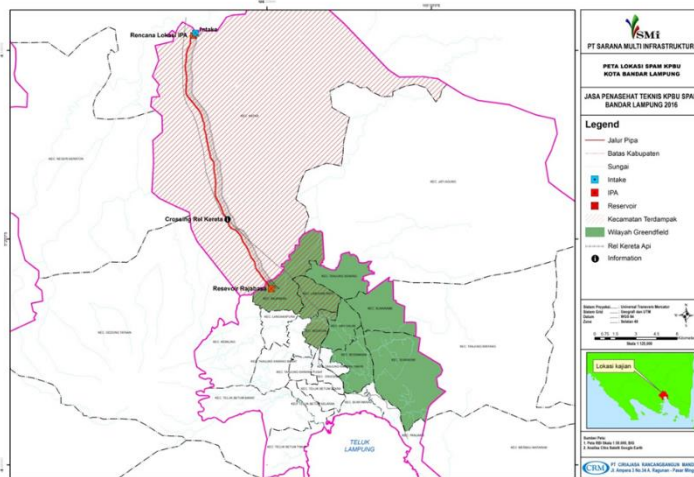
¹⁹ Radies Kusprihanto Purbo, Christine Smith & Robert J. Bianchi (2020) Local government and public-private partnerships: experiencing multilevel governance issues in Indonesian water supply provision, International Journal of Water Resources Development, 36:1, 27-49, DOI: [10.1080/07900627.2019.1625754](https://doi.org/10.1080/07900627.2019.1625754)

²⁰ Talomau, M. (2018). "Faktor-Faktor Kesiapan Implementasi Skema Kerja Sama Pemerintah Swasta Untuk Penyediaan Infrastruktur di Indonesia." Available at: https://simantu.pu.go.id/personal/img-post/superman/post/20181130132505_F_KMS_JURNAL_20180726085525.pdf, accessed on 9 September 2021.

Although the level of implementation for Municipal PPP is not yet high, there are several Municipalities that have implemented it and are expected to set an example for other Municipalities. The following are two case studies of Municipal PPP that received project development facility from PT SMI:

1. CASE STUDY: DRINKING WATER SUPPLY SYSTEM IN BANDAR LAMPUNG CITY

Background



Location of Bandar Lampung City Drinking Water Supply System

Source: FBC, 2017

Bandar Lampung City has undergone a rapid development as evidenced from the housing growth to the establishment of a Central Business District (CBD) in the City. This rapid development needs to be balanced with an increased adequate utility, including having a drinking water supply system. On this basis, the Bandar Lampung City Government, decided to pursue a PPP on the drinking water supply system of Bandar Lampung City. This is based on the Final Business Case (FBC) which stated that pursuing PPP could potentially give 10.2% savings (Value for Money / VfM) to the City, or equal to Rp136 billion (equivalent to USD 9.6 million) savings compared to using conventional procurement method.

This project takes raw water from the Way Sekampung River, around 500 meters from the planned location of the Water Treatment Plant (WTP) in Relung Helok village, Natar District, South Lampung Regency and will bring drinking water to a reservoir in Rajabasa District, or around 22 km away from the WTP. The water will be distributed using pump and gravity systems. This project will serve eight sub-districts in Bandar Lampung City, namely (1) Rajabasa District; (2) Labuhan Ratu District; (3) Way Halim District; (4) Kedaton District; (5) Tanjung Senang District; (6) Sukarame District; (7) Sukabumi District; and (8) Kedamaian District.

Project Structure

The Rp750 billion-worth project (approximately USD 52.7 million) is conducted using a solicited method through open tender. 12 participants, both local and foreign, participated in the prequalification process held from March to December 1997. Of the 12 participants, a consortium of PT Bangun Cipta Kontraktor – Bangun Tjipta Sarana (BCK-BTS) was selected. The consortium then formed a Special Purpose Vehicle (SPV) named PT Adhya Tirta Lampung. The Government Contracting Agency (GCA), PDAM Way Rilau, which is the Drinking Water Company of Bandar Lampung City, signed a PPP contract with PT Adhya Tirta Lampung as the Executing Entity (EE) on 14 February 2018. The contract will be done using a Build-Operate-Transfer (BOT) scheme for 27 years, 2 years construction period and 25 years operational period. At the end of the contract, the asset will be returned to the GCA.

Based on the contract, the EE is responsible to process the raw water from Way Sekampung River to the WTP in Rulung Helok village, which is around 500 m from the intake location, and distribute the water through 22-km drinking water transmission pipe to the reservoir in Rajabasa Sub-District, and sell the drinkable water in bulk size (with a capacity of 750 litre per second) that has fulfilled the health requirements to the GCA, PDAM Way Rilau, as the user. Meanwhile the GCA is responsible to pay for the bulk water to the EE with a take-or-pay



principle²¹, connecting water to the public with a target customer of ±60,000 house connections in the project service area (8 sub-districts), conducting operation and maintenance of the water distribution system, and collecting tariffs from the customers.

In addition, this project also received support from the Central Government in the form of a Viability Gap Fund (VGF) of Rp258 billion or USD 18 million and support from the Bandar Lampung City Government in the form of providing fiscal support for part of the distribution network construction, land provision, granting the necessary permits for the project, as well as providing fiscal support for PDAM reserve funds in the payment of bulk water tariffs to EE.

The project reached financial close with the financing total of around Rp550 billion or USD 39 million from PT Indonesia Infrastructure Finance (IIF) and Bank BNI. The construction started in August 2018 and began operationalisation in August 2020.

2. CASE STUDY: MEDAN CITY TRANSPORTATION

Background

This project was pursued based on a study conducted by the Institute for Transportation and Development Policy (ITDP) Indonesia in 2016 which showed that public transportation use in Medan City accounted for 6% of total mobility of its residents. Medan residents' mobility was dominated by motorcycles (59%) and private cars (27%). These figures were expected to grow bigger in a few years ahead. On the other hand, the growth of the use of private vehicles was not compensated with the increase in road length by the Medan City Government according to data from "Medan in Figures" (2016). Medan City Government expected that this will create a gridlock phenomenon in some of Medan roads in 2022, where the ratio of vehicles volume over road capacity reached more than 1. The situation could affect the overall economic growth of Medan City. As a result, Medan City Government initiated Mass Public Transportation System in the modes of Bus Rapid Transit (BRT) and Light Rail Transit (LRT) in several road corridors in Medan City. PPP was chosen for this project because it was based on the calculation of the VfM analysis in the FBC which showed that it was feasible to use the PPP scheme with savings value of IDR 2.336 trillion or 17.28% of the total project value using a conventional procurement scenario.

Project Structure

This project – which was estimated at around Rp13,374 billion or USD 939 million based on the FBC in 2017 – was aimed at initiating an LRT system on a 17.4 km elevated corridor, with 11 stations and 1 depot, and 18.3 km BRT system with 31 stations and 2 terminals. The project was expected to use a BOT scheme with a contract period of 24-34 years, including 2 years of BRT system construction and 4 years of LRT system construction.

The EE was expected to handle the financing, design, construction of the BRT infrastructure, procurement of BRT facilities and LRT rolling stock, operations and maintenance risks (including the operation of the facilities built by the Central Government) on an annual and periodic basis (per five years).

In order to make the project feasible and bankable, the FBC stated that the project would need the support from the Central and Medan City Government, as well as guarantee-support from the Infrastructure Guarantee Company. Medan City Government as the GCA was expected to take care of the tariff and non-tariff collection, provide availability payment to the EE, ticket subsidy (if needed), land to build the infrastructure of the project, and provide relevant permits. The FBC also stated that the Central Government should be responsible for the

²¹ *Take or Pay* is a clause within a contract where one of the parties has the obligation to receive goods or services, or if not, will have the consequence to pay. In this case, if the EE fails to supply water to the GCA according to the volume and quality agreed in the PPP contract, the EE will be given penalty and time to fix their performance.



development and construction of the LRT infrastructure (including structure, station, and depot), as well as providing the trackwork, telecommunication system, and electricity for the LRT system.

The EE would get their return on investment from the availability payment provided by the Medan City Government. Meanwhile, the Medan City Government shall have the right to collect the farebox and non-farebox revenue, including retail and advertisement revenue.

Unfortunately, the project was halted during the preparation stage (not continued to transaction stage) due to the lack of support from the Government, which would need to be regulated in the form of policies and regulations due to the very large investment costs of the project.

RECOMMENDATION TO ENCOURAGE MUNICIPAL PPP IN INDONESIA

In order to encourage the utilization of Municipal PPP in Indonesia, the following are the lessons learned that can be drawn from the previous explanation, which can be considered by the Central and Municipal Governments:

1) **The need of having policies that allow or encourage Municipalities to be capable of optimizing creative financing²²**

One of the reasons of the non-optimal utilization of creative financing at the Municipal level is the high level of dependence on the state budget. The government has even planned to increase TKDD by roughly 4% in the next year's budget.²³ Although understandable during the pandemic, measures to increase Municipalities' independence still needs to be implemented, however gradually.

One such measure is by enacting and using government policies. The Draft Law on Financial Relations between the Central Government and Municipalities ("HKPD Bill") is one of the policies that can be utilized to increase the fiscal independence of Municipalities.²⁴ This bill encourages fiscal independence of Municipalities through policies in the following forms:

- **The need to link the Special Allocation Fund (DAK) from the Central Government with the service performance of the Municipality.** In this draft bill, Municipalities with good performance will receive financial assistance from the Central Government in the form of block grants (assistance without ties or certain conditions), while Municipalities that are still lagging behind, the DAK will be given in the form of a mixture of block grants and specific grants (conditional assistance from the Central Government). It is hoped that linking the Municipalities' performance with DAK will encourage the Municipalities to be more innovative and creative in accelerating regional development because only by having good performance, the Municipality would have greater freedom in allocating funds in accordance with the plans targeted by the Municipality concerned.
- **Simplification**, including simplification of procedures in financing complex Municipal loans (debt) by combining local parliament DPRD approval with Regional Budget discussions, as well as simplification of simpler types of Municipal taxation.
- **Strengthening local taxing power, especially for Regency and City Governments.** This local taxing power is expected to increase Municipal fiscal independence without increasing the burden on taxpayers, because tax revenues will be recorded as local revenues, as well as providing certainty on tax revenues and providing flexibility in spending these revenues at each level of government, compared to the previous profit-sharing scheme.

²² Komisi XI DPR RI (2021). "Laporan Singkat Rapat Dengar Pendapat ke-1 RUU HKPD." Available at: <https://www.dpr.go.id/dokakd/dokumen/K11-RJ-20210721-112717-3975.pdf>. Accessed on 13 September 2021.

²³ Santoso, Y.I. (2021). "Dana Transfer ke Daerah Meningkatkan, ini Pesan Sri Mulyani ke Pemda." Available at: <https://newssetup.kontan.co.id/news/dana-transfer-ke-daerah-meningkat-ini-pesan-sri-mulyani-ke-pemda-1>. Accessed on 11 August 2021.

²⁴ HKPD Bill is one of the prioritized national legislations under the Indonesian Parliament. So far, it has conducted four hearing session.



- **The Regional Budget is prioritized for the welfare of the citizen.** Currently, there is inefficiency in the use of Regional Budget because the majority of the budget expenditures are expenses related to Municipal employees. The Bill therefore will set the highest limit for Municipal personnel expenditures and a minimum limit for regional infrastructure spending. The aim is to optimize the use of Municipal expenditures and focus on public services.
- **Improving the quality of regional financial management** through (i) the development of an integrated financial management information system (IFMIS) which will enable the consolidation of financial information and its presentation in real-time basis, alignment of fiscal policies and Municipal development with the central government, as well as the implementation of an adequate monitoring and evaluation system, (ii) development of Municipalities' human resources on financial management through mandatory certification, and (iii) implementation of the supervision of Regional Budget management through capacity development of the Municipal Internal Supervisory Apparatus (APIP).

The provisions stated above are expected to encourage Municipalities to not only increase innovation in regional development financing, but also be capable of improving service quality through a better financial management system, both in terms of facilities (through IFMIS) and human resources. However, when this Insight is written, the HKPD Bill has not clarified the link between the Bill with strategies of creative financing, such as PPP and Municipal Bond/Sukuk. This was also reiterated by one of the experts in the Fourth Hearing Session which stated that the HKPD Bill has not included creative financing strategy, especially innovative financing based on cooperation with third party(ies).²⁵

One of the recommendations that can be included in the HKPD Bill includes creative financing, particularly on simplifying requirements and procedures to accelerate PPP process, as well as synergy among available regional infrastructure financing which allows Municipalities to diversify or combine more than one type of financing to fund their regional infrastructure.

2) Increasing the competence of the apparatus of Municipal Governments as well as local parliament members/staffs on PPP scheme which plays a strategic role.

The unequal understanding of Municipal apparatus and stakeholders regarding the PPP scheme is also one of the biggest challenges in implementing Municipal PPP projects. For this reason, it is necessary to increase the understanding that is accommodated through training programs and mandatory PPP certification not only for local officials, but also for relevant local parliament members/staff to build a common understanding of the PPP scheme. The understanding among stakeholders is expected to facilitate the negotiation and decision-making process during the PPP process. Regarding training programs and mandatory certification (which can also be linked to the implementation of HKPD Bill), it can be prioritized for Municipalities that are already or are moving towards fiscal independence and/or are currently conducting the PPP process. Those Municipalities are considered ready and have a moderate to high-risk acceptance to undertake PPP project that has a high complexity. This mandatory certification program is expected to speed up the Municipal PPP implementation in the future.

3) The importance of having a strong leadership (champion) in implementing PPP project to showcase the commitment of the Municipality

One of the most important elements in implementing a PPP project is having the commitment of the Municipality as the owner of the project. According to a literature study conducted by Talomau (2018), this commitment aspect includes understanding of PPP policies, availability of regulation and law apparatus regarding PPP program,

²⁵ Komisi XI DPR RI (2021). "Laporan Singkat Rapat Dengar Pendapat ke-4 RUU HKPD." Available at: <https://www.dpr.go.id/dokakd/dokumen/K11-RJ-20210721-113231-4776.pdf>. Accessed on 14 September 2021.



commitment on the sustainability of the policies, commitment on budget provision and PPP implementation, and commitment for financial transparency.¹⁹ This commitment would need to be showcased through a strong leadership (champion) in the Municipality, which is vital in coordinating the many processes of PPP, including negotiation and consensus-building process.²⁶

The importance of having a champion can be seen through the case study of Drinking Water Supply System of Bandar Lampung. The Head of PDAM Way Rilau as the GCA has a very solid leadership. He has a vision on how the project should run as evidenced in his willingness to take important decisions needed in the project implementation. In addition, the Mayor of Bandar Lampung also demonstrated his leadership by being directly involved in determining the project location and pushing the land acquisition process for the benefit of the project.

4) The importance of thorough due diligence

As can be seen in the Medan City Transportation Project, to determine the feasibility of the project, there is an advantage to conduct a more thorough due diligence, including conducting necessity assessment and identifying creative financing such as through other non-farebox revenues such as transit-oriented development, land-value capture (a policy to use increased land value resulting from investments, activities and government policies in the area), naming rights, etc. to make the project more financially viable.

Additionally, choosing the right transaction advisor plays a very strategic role to make the PPP project run well. A transaction advisor with good reputation as shown by its track record can help the GCA in preparing the PPP project more thoroughly from the planning to the transaction stage. The transaction advisor will also help in providing input based on global best practice, such as ensuring that the project complies with the Environmental, Social, and Governance (ESG) standards or integrating the appropriate sustainability aspects for a PPP project. Selecting a strategic transaction advisor does require a financing commitment from the Municipality, but it is an investment that supports the success of the PPP project particularly in safeguarding the output of the project, that is providing the best service to the public.

5) Active support from stakeholders

As shown in the Bandar Lampung's Drinking Water Supply System project, active support from stakeholders also plays a major part in the success of the PPP project. Not only it received support by the GCA, but also obtained support from the Central Government through project development facility (PDF) and VGF from the Ministry of Finance and support from the Ministry of Public Works and Housing to cover part of the distribution network construction. The local parliament also provided support by issuing a local regulation that allowed the project to kick start. Meanwhile, the Municipal government provided fiscal support to the GCA to build the distribution network and reserve funds for bulk water payments, as well as land acquisition support and granting the necessary permits for the project.

The same project also involved the public since the beginning through public consultation fora. This consultation process has generated strong support from the public which are key for ensuring the sustainability of the project.

²⁶ Yale Insight. "How do you build effective Public-Private Partnerships." Available at: <https://insights.som.yale.edu/insights/how-do-you-build-effective-public-private-partnerships>, accessed on 13 September 2021.



6) Land provision to be carried out in parallel with the PPP process²⁷

Based on the Ministry of Finance’s article, some of Municipal PPP projects are constrained due to the uncertainty of land availability which can ultimately reduce investor interest in submitting bids during the auction process. The Bandar Lampung PPP project is a great example because the land provision was fully assisted by the City Government prior to the tendering process, thereby increasing investor interest in participating in the pre-qualification process.

7) There is a clear risk allocation between the GCA and EE

One aspect that adds value to PPP is the risk allocation between the GCA and EE where risks are allocated to parties who are better at managing them or because they have the lowest costs to absorb these risks to incentivize the parties to be more innovative, especially in maintaining the quality of infrastructure and services. This is because risks allocation is associated with the long-term sustainability of the project. The implementation of the Bandar Lampung PPP project was considered a success because the two contracting parties shared similar interests, such as the financial aspects of the project, which subsequently translated into clear risks allocation between the GCA and EE. The EE must maintain the volume and quality of drinking water according to the agreed requirements to be able to receive payments from the GCA, while the GCA has the incentive to expand the coverage area as well as reduce leakage/non-revenue water (NRW). By creating efficiency to its operation and wider coverage, the GCA would be able to receive higher returns received from the customers.

To support Municipalities in realizing development in their regions, PT SMI, as the Ministry of Finance's Special Mission Vehicle (SMV) that plays a catalyst role in supporting the acceleration of infrastructure development in Indonesia, is committed to assisting Municipalities and Business Entities through our services. PT SMI provides services in the form of capacity building, assisting the development of PPP projects, advisory services for the preparation and transactions for Business Entity, as well as providing other sources of financing that can complement PPP schemes such as project financing and Municipal loans.



Disclaimer

All information presented were taken from multiple sources and considered as true by the time they were written to the knowledge of PT Sarana Multi Infrastruktur (Persero). PT Sarana Multi Infrastruktur (Persero) cannot be held responsible from any inaccuracy contained in the material.

PT SMI follows all internal and external guidelines and regulations that govern the evaluation process on determining the financing feasibility of an infrastructure project. Every decision to finance or not to finance a project is therefore based on a responsible and thorough due diligence process.

Any complaint in the process of financing irregularities can be submitted to:

Ms. Ramona Harimurti, Corporate Secretary PT SMI

Tel : +62 21 808 252 88

Fax : +62 21 808 252 58

Email : corporatesecretary@ptsmi.co.id

Public complaints on PT SMI service will be kept strictly confidential and handled by a special committee to ensure that complaints are addressed appropriately.

²⁷ Kementerian Keuangan RI. “Pelaksanaan Fasilitas KPBU.” Available at: <https://kpbu.kemenkeu.go.id/read/20-233/pjpk/pelaksanaan-kpbu/pelaksanaan-fasilitas>. Accessed on 14 September 2021.