

# CHAPTER 27 *Indonesia, the Future*

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## Why Indonesia?

'Indonesia is the country of the future...and will always remain so.' French President Charles de Gaulle was actually speaking of another major emerging market, Brazil, more than 50 years ago but his sentiments could have applied just as much to Indonesia ever since. However, in recent years, that potential has been attracting increased attention from investors and their governments from elsewhere in Asia; the Government of Indonesia (GoI) is taking steps to address longstanding blockages to deal flow; and market players are again hopeful that more of that potential can be translated into actuality than has been in the past. Consider the following:

Firstly, Indonesia is big: at 235m, it is the world's fourth most populous country. This population's need for infrastructure is also big: for example, in the power sector, only 66 per cent of the population is connected to the grid compared to 99 per cent in neighbouring Malaysia and Thailand and 86 per cent in the Philippines. In the water sector, only 31 per cent of the population of urban areas has access to fresh water supply – and only 2 per cent to sewerage services. And in urban transport, Jakarta (and elsewhere) lags almost all south east Asian capital cities. The government cannot afford to build this infrastructure itself; local investors and lenders alone cannot meet the bill; and expertise is much needed across all disciplines.

Appropriately big numbers for foreign direct investment are being bandied about like never before:

- GoI is hoping that two thirds of the US\$157bn which it plans to be invested in infrastructure by 2014 will come from the private sector. In the power sector alone, over the next five years it is seeking US\$31bn for 22GW (gigawatt) of new generation, US\$7bn for 17,000km of transmission lines and US\$5bn for distribution networks.
- In January 2011, Japan and Indonesia signed an MoU to spend some US\$24bn across all infrastructure sectors in the so-called metropolitan priority area of greater Jakarta, i.e. Jakarta itself, Bogor, Depok, Tangerang and Bekasi collectively known as Jabodetabek; in all, Japan has committed some US\$53bn to investment in Indonesia over the next 15 years; Mitsubishi Corp alone is planning to invest US\$20bn by 2020.
- Also in January 2011, India and Indonesia signed 18 MOUs worth US\$15bn covering a wide range of sectors.

- And in April 2011, Chinese sovereign wealth fund CIC announced plans to enter the market, earmarking US\$4bn for loans to Indonesian infrastructure.

Secondly, there is reason today to be more optimistic about this potential than perhaps previously. Politically, Indonesia is increasingly stable. Susilo Bambang Yudhoyono was comfortably re-elected as president in 2009. He may not have been as bold in his reforms as some would have liked but remember that, in the aftermath of Suharto's ouster only 12 years ago, it was widely considered that Indonesia risked breaking apart as a country. Indonesia has the largest population of Muslims and moderate ones too so, post the terrorist attacks of 9/11, it has been paid increased attention by the West. It served as a member of the UN Security Council in 2006–08 and is the only south east Asian member of the G20. Economically, recent news has been good too: Indonesia is benefitting from the boom in coal and other commodities; and it largely missed the global financial crisis of 2008 if only because it is less connected to the outside world than some. Government finances are in comparatively good health with government debt at a manageable 29 per cent of GDP and an exchange rate that has strengthened modestly since 2008. In April 2011, Standard & Poor's duly followed other ratings agencies in raising its foreign long term sovereign rating to BB+ with positive outlook, only one notch off investment grade. The Indonesian Investment Coordinating Board (BKPM) has been promoting a wide range of prospects. New legislation, including Presidential Regulation (Perpres) 13/2010 which updated the framework for Public Private Partnerships (PPPs), and some implementing regulations have been enacted.

On the other hand, Indonesia has a long track record of over-promising and under-delivering in that the flow of deals actually consummated to date has been but a fraction of that potential. When it comes to making infrastructure happen, all the difficulties found elsewhere are to be found in Indonesia: opaque organization of the economy; weak legal/regulatory enabling environments; an inability of government to acquire and clear land at a sensible cost in a sensible time frame; decision making distorted by corruption; lack of properly prepared projects; and indecision over appropriate government support for both offtakers from projects and for projects themselves.

Indonesia has some difficulties all of its own: any country spread across more than 17,500 islands is going to struggle when building national power grids or road networks. Indonesia also has the full suite of national disasters to cope with: the Indian Ocean tsunami of 2004 killed 170,000; and 'Lusi', the mud volcano at Sidoarjo in East Java, has been spewing out a million cubic feet per day for the past five years and could carry on doing so for the next 30 years.

Lastly, in a country where the public sector remains active in many industries, Indonesia is interesting to project financiers because it has been prepared to experiment with different techniques for implementing government support for projects.

If the government can take some difficult decisions in consultation with counterparties and implement policies which it has been mulling for some time, it will be able to realize a higher fraction of that potential leading to a significantly greater deal flow across all industry sectors for the benefit of foreign and domestic investors, lenders and users alike.



**Figure 27.1** Indonesia

## Sector Review

### CONVENTIONAL POWER GENERATION

Historically, independent power producers (IPPs) have been the most active sector for project finance. The electricity industry is regulated by the Ministry of Energy and Mineral Resources (MEMR). Total installed power generation capacity is about 31GW. Of this, 27GW is owned by PT Perusahaan Listrik Negara (PLN) which, as a Persero, is a limited liability company wholly owned by the Ministry of State Owned Enterprises (MSOE); a further 4GW is owned by some 21 IPPs. In aggregate, this represents only 109MW (megawatt) of capacity per million of population, lower than Vietnam, Thailand or the Philippines; much of this capacity is concentrated in the main Java-Madura-Bali (Jamali) grid with much less elsewhere; as mentioned, the electrification rate is only 66 per cent so no less than 80 million people have no access to the grid; yet demand is forecast to grow at 7–9 per cent p.a.

IPPs were first contemplated in the 1985 Electricity Law. These featured a conventional long term take-or-pay power purchase agreement (PPA) which passed through to PLN substantially all demand, fuel price and currency risk. However, PLN's ability to pass these risks through to its customers is severely curtailed by the fact that it charges widely different tariffs to different categories of user and these tariffs are set for it by the DPR (Parliament), often at less than cost. For example, current prices are in the order of 11–12 US cents per kWh for industrial and commercial users but only 6 US cents for retail customers. This and operational inefficiencies have resulted in PLN making sustained losses and being dependent on the Ministry of Finance (MOF) for a significant subsidy, currently some US\$5.5bn per annum.

On the other hand, selling electricity at below cost constitutes providing 'a function of public benefit' and, if the government requires a State Owned Enterprise (SOE) such as

PLN to perform this Public Service Obligation (PSO), Law 19/2003 requires it to compensate the SOE. Crucially, the amount of subsidy is not the difference between the tariff imposed on PLN for each category of customer and the tariff it would otherwise have sold at; it is instead the difference (when negative) between the tariff and the total cost of supply for that tariff category plus a margin, set subsequently at 5 per cent in 2009. This has the effect of passing all major risk through to the government. PLN's accounts may look uncreditworthy when viewed on a standalone basis but, as a result of the PSO support, its counterparty credit risk is effectively the same as MOF's so long as i) the monthly reimbursement mechanism from MOF to PLN functions as intended (it has since 2006); ii) ironically, the government does not set PLN's tariffs above cost in each tariff category, at which point the PSO would fall away; iii) the law does not change. Fundamentally, one needs to ask, would the government walk away from its power industry?

Indonesia was hit hard by the Asian crisis in 1997/98. President Suharto was ousted after 32 years of rule amidst widespread unrest, GDP contracted 13 per cent and the rupiah collapsed from 2,500 to the US\$ to as low as 18,000. Neither PLN nor MOF could afford to pay a seven-fold increase in the price of its power! PLN cancelled some proposed IPPs and purchased or renegotiated the terms of others. It paid operational IPPs only according to the pre-crisis exchange rate, i.e., a partial payment default. Several years of 'contract rationalization' and litigation later, projects such as Paiton Energy and Jawa Power went ahead with slightly longer debt tenors and reduced, but still positive, equity returns; much-needed assets got built; and these are now generating to international levels of availability and efficiency – for their sponsors and lenders alike, not a bad outcome for a catastrophic downside sensitivity!

PLN's obligations to these IPPs were supported by comfort letters issued by MOF. In subsequent arbitral proceedings, however, a key sentence in these comfort letters was held to be a binding obligation on MOF to ensure that PLN could meet its obligations as they fell due.

Little progress was made during the post-Suharto Reformasi era in 1998–2004. Indeed, no new IPP of size was signed for the next 12 years. A new Electricity Law in 2002 was ruled unconstitutional by the Constitutional Court two years later. Perpres 67/2005 set a framework for Public Private Partnerships (PPPs) generally but it was unclear whether or not this applied to IPPs (This is what Perpres 13/2010 updated). Supposed model projects such as Pasaruan fell by the wayside, for want of gas supply in Pasaruan's case.

In 2006, MOF signed a Memorandum of Mutual Understanding (MOMU) with the historically most active of the export credit agencies (ECAs), namely JBIC, intending to issue for each Japanese-sponsored project a letter acknowledging the support which MOF gave PLN for fulfilling its Public Service Obligations. However, only one acknowledgement letter was issued under the JBIC MOMU (in March 2010 for the 815MW coal fired Paiton expansion (Paiton 3)) and no other ECA or multilateral signed a comparable MOMU. In the same month, Marubeni et al. signed the financing for the 660 MW coal fired Cirebon project but they had been appointed preferred bidder before the JBIC MOMU was signed.

A third model for government support of IPPs is now underway in the form of the long-awaited Central Jawa IPP. Seven bidders have been shortlisted for this 2,000 MW coal fired plant which is estimated to cost some US\$3 billion. The bidders include two Chinese-led consortia (China Shenhua and CNTI-Guangdong Yudean) who are bidding for the first time to take IPP risk rather than MOF-guaranteed PLN EPC risk (see below). The World Bank's IFC has been advising PLN since 2006. It is intended that PLN's obligations

under the 25 year PPA will be supported by the newly established and still evolving Indonesian Infrastructure Guarantee Facility (IIGF), more of which later.

In 2006, with the IPP programme progressing only slowly, the President issued Perpres 71/2006 to launch the Fast Track Programme, under which MOF would guarantee PLN's obligations under engineer, procure and construct (EPC) contracts for 10,000MW of capacity. Ten projects totalling 7,460MW would be built on Java and 23 much smaller projects totalling 2,513MW on other islands. All would burn low sulphur coal which PLN would source domestically, the intention being as much to tilt PLN's fuel mix away from a reliance on oil as to increase aggregate capacity. PLN would then operate the plants. The contractors were foreign/domestic joint ventures with all but one foreigner being Chinese. Offshore funding (principally from the Chinese state via China Exim, Bank of China and Sinosure) was raised alongside a domestic tranche on a project-by-project basis. Counterparty payment risk was not at a project level, though, but at the PLN corporate level guaranteed by MOF. MOF contingent liabilities had been brought under control in the aftermath of the Asian crisis and, conceptually, throwing guarantees at the problem was not unreasonable. As at December 2010, finance had been raised and construction was underway on 9,521MW of capacity. Some hiccups can be expected if completion is late or over budget as the EPC contracts were signed subject to a condition subsequent that financing be put in place within a year which did not happen. Further, the mines were required to undertake significant expansion then transport the volumes of coal required if the new plants were to be fuelled. Even in the event that there is some delay and a further contribution to costs is negotiated, though, PLN would be getting additional capacity more cheaply than it would have from western or Japanese suppliers.

Encouraged by the comparative success of Fast Track 1, Perpres 4/2010 launched a second 10,000MW of capacity to benefit from MOF guarantees. 21 projects totalling 5GW have been listed for PLN to build at a cost of perhaps US\$5bn; and 72 projects, also totalling about 5GW, are listed for development as IPPs at a cost of perhaps US\$11bn. This time around, the emphasis was to be on (more expensive) renewables rather than coal fired plant. A MOF guarantee of PLN obligations represented a fourth model for government support of IPPs.

Industrial users have built some 13GW of captive generation in Indonesia. Various additions are planned.

Historically, PLN has had a monopoly over transmission and distribution. The 2009 Electricity Act, which has attracted some controversy, and its implementing regulations which are still underway, contemplate a relaxation of this and various other privileges. PLN has used export credits from time to time to finance the purchase of transmission equipment and has various plans for domestic and cross border interconnectors.

## RENEWABLES

In Indonesia, renewable has to date primarily meant geothermal. Being on the Rim of Fire, potential capacity is huge at 28GW (40 per cent of the world's) although less than 2GW has actually been built.

As elsewhere, the size and shape of the resource of a geothermal field needs to be first determined, a risk more familiar to the oil and gas sector than to power utilities. The tariff usually needs to be a feed – in one, i.e. subsidized, but who pays for this, how much do they pay and for how long?

In Indonesia, sponsors have been expected to negotiate a deal with the owner of the resource, usually the state-owned oil and gas company Pertamina, before negotiating a tariff with PLN. This is because Geothermal Law 27/2003 addresses the production of steam whereas generation of electricity therefrom is governed by the 2009 Electricity Law. There has been the perennial issue of PLN's creditworthiness. And implementation of the carbon credit scheme pursuant to the Kyoto Protocol's Clean Development Mechanism has been slow.

In the private sector, Chevron operates the 377MW Salak and 260MW Darajat plants, both on Java (plus two smaller ones); and Star Energy operates the 227MW Wayang Windu plant, also on Java (In 2010, Wayang Windu raised US\$350m via a five year project bond, a rare event in Indonesia). Sponsors Itochu, Kyushu Electric, Medco International and Ormat have shortlisted banks for the US\$1.25bn/18 year debt facility for a 330MW geothermal plant at Sarulla in North Sumatra. Government support comes from a pre-Asian crisis comfort letter. Otherwise, though, progress was hampered by, inter alia, no feed-in tariff. However, MEMR has recently announced that PLN would pay a headline price of 9.7 US cents/KWh (kilowatt hour). It remains to be seen whether this will be enough to kick-start some 30 waiting projects.

Indonesia has some 3GW of installed hydro-electric capacity but has not built large dams the way that Malaysia, for example, has. Challenges include acquiring then clearing the land as well as building the required transmission lines.

Being close to the equator, Indonesia may not be especially suitable for other renewable technologies such as wind or tide; nor can it afford them yet.

## NATURAL RESOURCES

As elsewhere, natural resources projects benefit from revenues being denominated in hard currency; sponsors/offtakers having deep pockets; locations being stand alone, often remote, i.e., more able to be controlled by sponsors; and capital expenditure requirements which are both large and which need a significant proportion sourced from offshore, making them attractive to ECAs. Significantly, there is not the need for government support that there is in other sectors. Resource projects also bring heightened environmental and social responsibilities, of course, under the 2009 Environment Law and other legislation.

Key legislation for oil and gas is Law 22/2001. BPMIGAS regulates upstream activities and BPH MIGAS downstream ones.

In terms of oil, Indonesia produced about 950,000 bbl/day in 2009, down 32 per cent from 2000 levels. It became a net importer in 2004 and withdrew from OPEC in 2008. Pertamina is no longer a monopoly but it is still a major player, operating all nine of the country's refineries, for example. Oil products are still sold to domestic consumers at subsidized prices. Private sector opportunities are more at the corporate level: Chevron operates the two largest oil fields, Minas and Duri whilst ExxonMobil is developing the new Cepu block. Going forwards, there may be discrete opportunities for pipelines, storage or even coal-to-liquids.

In terms of gas, Indonesia has some 112 tcf (trillion cubic feet) of proven reserves, the tenth largest in the world. Pertamina and a number of foreign operators dominate the market. Majority state-owned PT Perusahaan Gas Negara (PGN) operates a network of pipelines. Three LNG (liquefied natural gas) liquefaction projects are in operation. The

most recent, Tangguh in West Papua, is led by BP and raised US\$3.5bn of debt in 2006/07. Interestingly, the sponsors tried initially for recourse on one tranche to be limited to the project but eventually they went for the cheaper funding and less intrusiveness of all tranches having recourse to the sponsors on a several basis. Next up is Donggi Senoro in Central Sulawesi. Sponsored by Mitsubishi Corp, Korea Gas Corp, Pertamina and Medco International and with the debt led as usual by JBIC, it will cost US\$2.8bn and produce 2 mtpa of LNG and 47,000 barrels of condensate a year. Future opportunities include coal bed methane (CBM): Indonesia is estimated to have three times as much CBM as it has conventional natural gas.

In the mining sector, Indonesia is the world's second largest exporter of coal, principally thermal coal for the booming power industries of China, India and elsewhere; as well as copper, gold, tin and nickel. A new Law on Mineral and Coal Mining 4/2009 replaced the well-established contracts of work with three categories of mining licence. Reaction has been mixed, however, and some implementing regulations are still awaited. Mining activities will always need to address environmental considerations, of course: GoI has recently draughted rules for a two-year ban on permits for forest clearing after signing a US\$1bn climate aid deal with Norway aimed at avoiding greenhouse gas emissions from deforestation. These rules will impact eight mining projects worth at least US\$14bn, though. Again, investing and lending opportunities are more corporate than project in nature. Just two current examples are:

- Posco of Korea and state-owned Krakatau Steel are progressing a US\$2.7bn integrated steel mill project with an annual production capacity of 6 mtpa.
- Aneka Tambang (Antam) and Showa Denko of Japan are in documentation for the US\$400m Tayan alumina mining project.

## TRANSPORT

Indonesia has one of the lowest road densities in south east Asia, whether measured in terms of length per 100 people or per square km, whether paved or all roads. There are only 693km of toll roads, 72 per cent of which are operated by Jasa Marga which is 70 per cent owned by GoI.

Road projects in Indonesia bring two significant issues. Firstly, they have been hobbled by GoI's inability to exercise its powers of eminent domain and forcibly purchase the required land at a reasonable price in a reasonable time frame then clear it of legal and illegal occupants. Instead, land on the route chosen has been purchased by connected parties ahead of the announcement; prices have escalated subsequently; delays have been extensive; the government has been unable to clear the land of legal or illegal occupiers; contracts have been awarded to parties with no wherewithal to perform; and contracts have been let subject to raising finance within, typically, 12 months – when this did not occur, the contracts should have lapsed but this has often been difficult to enforce for political reasons.

A Land Procurement Bill has been making its way through the DPR for some time. Implementing regulations then need to follow. Fundamentally, the compulsory acquisition process needs to be put onto a much more rigorous basis so this legislation needs to be both robust and implemented robustly – neither will be easy or quick. GoI is also planning a Land Revolving Fund to take some of the price escalation risk (see below).

Secondly, roads bring traffic risk, of course. Countries such as Australia have recently demonstrated how difficult it is to forecast traffic numbers. If these cannot be forecast with some degree of confidence, then it is surely more sensible/cheaper in the long run for the government to retain this risk. It can do so via viability gap funding, i.e. contributing enough to upfront costs such that project revenues divided by the now reduced upfront costs represent a reasonable return for the project, as has been done in India. Alternatively – and quite possibly more cheaply – the government can undertake to the project to top up revenues in the event that they fall below a pre-agreed level (minimum revenue guarantees). Revenue collars allow for the government, in return, to share in the upside benefit too. Such structures have been implemented in South Korea. The government can also share downside and upside risk by paying shadow tolls to the road operator, i.e. payments which may be more or less than the tolls which the operator charges actual users of the road and which it then hands over to the government.

Some of these ideas are being mulled over by GoI. In the meantime, the Ministry of Public Works is preparing to put up for tender five toll road projects totalling US\$2bn as public private partnership (PPP) schemes although it is not yet clear what risk profiles are contemplated.

Rail projects in Indonesia face similar issues. Heavy rail is dominated by state-owned Kereta Api and likely to remain so. However, two exceptions are currently being promoted by GoI. Both offer challenging risk profiles and both will require considerable GoI support, recent announcements notwithstanding:

- The US\$2.2bn Puruk Cahu-Bangkuang railway in central Kalimantan is intended to link a number of coal mines in the interior to the coast, 185km away. The mines will only commit to expansion if they are confident that the rail line will go ahead and the builders of the rail line will only go ahead if they are confident that the mines will be expanded. Such significant mutual performance risk can be addressed only by the central government standing in the middle. This is possible, though: take the example of the MRT lines being proposed by the Thai government for Bangkok where it will let separate EPC and operations and maintenance (O&M) contracts such that (sensibly) it is the government which takes the risk of ground conditions and traffic volumes.
- The US\$1.1bn Sukarno Hatta airport rail link is intended to connect Jakarta's main airport to downtown Manggarai. Three bidders have been shortlisted. However, rail links to airports worldwide compete with other modes of transport, principally taxis, so tend to make money only if subsidized directly by government or via the development of associated real estate; and connections for onward travel are crucial, often involving considerably more capital expenditure, so these need to be sorted out at the Manggarai end.

Urban rail, whether heavy, light or mono (a politically connected unsolicited bid in Jakarta did not proceed) faces issues of cost, land acquisition and coordination with other modes of transport. Jakarta has some heavy rail operated by Kereta Api but, in comparison to cities such as Bangkok or Manila, has no mass rapid transit, light rail or subway. Instead, Jakarta has introduced several Bus Rapid Transit routes, i.e. lanes on main roads dedicated to buses. These need to be connected to covered footpaths so that passengers can complete their journeys in a modicum of comfort; and squeezing the



other traffic into, say, two lanes instead of three, leads to significant congestion for them; but BRT schemes are, at least, more affordable.

There has been little, if any, private sector involvement in ports (Hutchison has a stake in Tanjung Priok in Jakarta) or airports to date but GoI is exploring how best to introduce PPPs.

## WATER

Back in 1998, France's Ondeo/Palyja and the UK's Thames Water won fresh water distribution franchises in Jakarta. However, both have struggled, Thames sold out in 2006 and no further franchises have been let.

Several new prospects are being examined. For example, AusAid has been leading renewed attempts to finance the Umbulan Springs fresh water pipe from the foothills of Mount Bromo to the conurbation of greater Surabaya. This typifies the issues which need to be addressed in so many water projects: uncreditworthy PDAMs (municipality-owned water distribution companies) (some progress has been made in this respect), the PDAMs' need to build out their distribution networks so as to take delivery from the pipe; how to clean up their water from other sources before it is mixed with the clean water from Umbulan Springs; uncertainty over ownership rights; and, in particular, a political reluctance to increase tariffs to consumers so as to cover full cost.

When the political will is there, wonders can be achieved in the water sector: between 1993 and 2006, the publicly owned Phnom Penh Water Supply Authority in Cambodia cut non-revenue water from 72 per cent to 6 per cent (developed market levels); increased its coverage area from 25 per cent to 90 per cent of the city and collection rates from 48 per cent to 99 per cent; and transformed itself from needing a heavy subsidy to covering full cost.

## TELECOMS

Majority state-owned Telkom Indonesia is the incumbent fixed line provider. Fixed line teledensity, mostly fixed-wireless, remains low in Indonesia at about 15 per cent. On the other hand, the mobile subscriber base passed 150 million in 2010, a penetration rate of 65 per cent, and continues to grow at some 20 per cent p.a. 3G technology, mostly from Telkom-owned Telkomsel, accounted for perhaps 7 per cent of this.

Investing and lending opportunities are mainly at the corporate level with mobile carriers. With these growth rates, they have made money. They face the usual risks of changing technology and stiff competition but there is political risk too. In 2007, the Commission for the Supervision of Business Competition (KPPU) forced STT Telemedia to sell its stake in Indosat, alleging that because it and Singapore Telecom, which held a stake in another carrier Telkomsel, were both partly owned by the Singapore sovereign wealth fund Temasek, then they must be colluding to drive up prices to consumers. The ruling overlooked the fact that the Singaporeans controlled neither carrier, that GoI had approved STT buying into Indosat, that GoI itself also owned indirect stakes in both carriers and that there was plenty of competition from other operators.

## SOCIAL INFRASTRUCTURE

In due course, hospitals, schools, prisons and other municipal infrastructure could be financed on the basis that facilities are made available to the government which then operates them. Indonesia can learn lessons from elsewhere as to how best to finance this risk profile and there are plenty of bilateral and multilateral partners eager to assist with advice and/or funding.

## Government Support

GoI experimentation with different levels of support for government-owned offtakers from projects has, to date, been almost exclusively concerned with PLN. Different counterparties have taken very different views of PLN risk:

- As explained above, all PLN activities benefit from MOF support via the PSO mechanism.
- Historically, this PSO support has been sufficient for the ratings agencies to rate PLN the same as the sovereign. The capital markets essentially view PLN as sovereign risk but with an extra 105–115 b.p. of yield in that PLN has issued domestic and offshore bonds for maturities out to 30 years with no further MOF support.
- This PSO support alone has also been sufficient for smaller scale IPPs with domestic players which are not considered here.
- In terms of PLN's obligations to larger IPPs, JBIC took a supportive stance via its MOMU but others did not follow. Now, all nationalities bidding on Central Jawa are doing so under the IIGF-led regime.
- At the same time, PLN had the option of developing plants on an EPC basis under the first Fast Track programme but these required MOF guarantees of PLN's obligations.
- Now Indonesian IPPs are being offered to the market on three different bases: the IIGF-led regime (on Central Jawa with more expected to follow); MOF guarantees (on Fast Track 2); and PSO only (on everything else).
- In doing so, PLN and MOF need to address two conceptual issues:
- Which method of support should be offered for which IPP? Who makes this decision?
- How should PLN decide whether to proceed with a project as an IPP or on an EPC basis?

## INDONESIAN INFRASTRUCTURE GUARANTEE FACILITY (IIGF)

Perpres 13/2010 not only updated Perpres 67/2005 but also established SMI (see below) and set up PT Penjaminan Infrastruktur Indonesia (PT PII) also known as the Indonesian Infrastructure Guarantee Facility (IIGF). The fund will provide guarantees in support of performance and payment obligations by state owned counterparties to PPPs. The fund was initially seeded with Rp1tr (US\$115m) from MOF with a further Rp1tr per annum intended out to 2014. The World Bank is contributing a US\$500m facility. The proposed structure has been shown to counterparties for the first time on the Central Jawa IPP which is currently being bid (see above) so details are variously yet to be made public, yet to be sorted out or yet to be agreed by counterparties.

For Central Jawa, it is currently proposed that the first loss of Rp300bn (US\$35m) caused by PLN default under its PPA with the project proponent shall be borne by IIGF – so sponsors benefit as well as lenders. Losses in excess of this would be met by MOF and from the World Bank facility with the IIGF acting as a ‘single window’ for all three.

The rationale for establishing a guarantor separate to MOF stemmed firstly from MOF payouts needing DPR approval, a process which is both slow and politically fraught. Secondly, IIGF could bring a quicker and more rigorous appraisal of projects at the financing stage than had earlier initiatives such as the Risk Management Unit (RMU) in MOF, the Inter- Ministerial Committee for the Acceleration Programme [of PPPs] (KKPPI) or the PPP Central Unit (P3CU) in Bappenas, the planning ministry.

Issues remain with the IIGF:

- How transparent/reliable/politically independent will the IIGF claims payment procedure be? It will certainly be untested.
- US\$35m would be exhausted in less than a week on Central Jawa. How automatic will be the mechanisms to access the MOF and World Bank funds? Will these be paid directly to the project proponent or to IIGF which must then agree to pass them onto the project proponent?
- What is a reasonable gearing ratio in terms of volume of guarantees to be issued versus funds available? After all, any ratio greater than 1.0 runs a theoretical risk of the fund running out of money; claims are likely to be correlated; and counterparties learned in the global financial crisis to be more cautious when assessing long tail probabilities such as these.
- No matter how conservative the gearing ratio, what happens in the event that the fund runs out of money?
- How can investments be structured so as to minimize the strain on IIGF/GoI finances? For example, *ceteris paribus*, it is better to pay out a claim over time than in one lump sum upfront.
- Ultimately, the story needs to be told to the ratings agencies and all counterparties that IIGF risk is essentially the same as MOF risk but with enhanced liquidity.
- Less significantly, which party will the IIGF charge for issuing its guarantee and how much will it charge?
- Once the IIGF-led regime has been sorted out on Central Jawa, GoI will apply it to not just further IPPs but GoI obligations in other sectors. The IIGF could again guarantee performance by state-owned counterparties; or it could provide support directly to projects, such as the minimum revenue guarantees and collars needed on roads.

## INDONESIAN INFRASTRUCTURE FINANCING FACILITY (IIFF)

Perpres 13/2010 also set up the government-owned PT Sarana Multi Infrastruktur (SMI) which, in turn, invested alongside the IFC, Germany's DEG and the Asian Development Bank in PT Infrastruktur Financing (Indonesian Infrastructure Financing Facility or IIFF). Initial debt and equity funds committed were Rp3tr (US\$345m). Modelled on India's IDFC, on the asset side IIFF will invest equity, mezzanine and senior debt across the full range of PPP sectors where appetite is not forthcoming from the private sector, i.e., longer maturities, no political risk cover, etc. On the liabilities side, it aims to develop the long term domestic currency market via issuance of bonds. It also intends to advise on

pathfinder transactions. However, like the private sector, the IIFF is waiting for properly prepared projects to be brought forwards ready for the financing phase to commence. It has also recently lost its senior staff.

In April 2011, GoI announced that it would be contributing US\$120m to a US\$485m pan-ASEAN infrastructure fund. Again, details are not yet available as to the fund's risk appetite, criteria for prioritization of opportunities or plans to expand its funding sources.

### LAND REVOLVING FUND (LRF)

The LRF is aimed specifically at the difficulties faced by road operators in purchasing the required land. It is intended that it will provide bridging finance to private sector operators whilst they negotiate the purchase of remaining lots of land. GoI has also floated the idea of land capping whereby it would bear the risk of the price of land exceeding, say, 10 per cent of an agreed price. GoI had allocated US\$150m by 2009 with more promised. However, both initiatives appear to address the symptom rather than the cause of the problem; and both could be prohibitively expensive.

### Conclusion

Indonesia has long had the potential for a significant flow of project finance deals across all sectors. There is more reason today than perhaps ever before to be optimistic about converting more of that potential to actuality. But much remains to be done.