PRIVATE BUILDING SECTOR IN DISARRAY IN INDONESIA AND THAILAND
ITS CONSEQUENCES FOR SOCIAL HOUSING
LESSONS TO BE LEARNED

THE WORLD WIDE TENDENCY TO DECREASE BUILDING HOUSING FOR LOW INCOME

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1. INTRODUCTION

Public-private-partnership or public-private-community participation is the slogan in development plans all over the world. Governments expect miracles from private sector involvement. In a few cases it works in other cases the private sector takes over the public sector role and attention for the low-income housing disappears.

In Indonesia and Thailand the disarray of the private sector causes serious problems for the
social housing program.

At the same time the public bodies created to provide housing for the low income are changing their profiles or even stop to exist. We witness the recent disappearance of National Housing corporations and Housing Banks. .

Programs designed for the low-income like Site and Services projects, Slum Improvement Projects, Roof –loan schemes etc have disappeared and are not replaced by other mechanism.

Only a few countries in this world have an updated housing policy with attention for low-income housing.

In the more then 30 years of working in this field of housing and urban development all over the world I witness in recent years a further decrease in interest and commitment from national governments and bilateral and international donors towards the shelter problem. Despite the initiatives from UNCHS Nairobi and the many conferences like HABITAT Istanbul in 1996 the situation for the poor to get access to land or housing is world wide worse than ever before. There are more street-sleepers more homeless and overcrowding in the already congested slums in Africa and in Asia and in Latin America then 10 years ago and the amount is growing world wide. Squatting in the inner city is out of the question. The low income are pushed out of the centers of the urban areas.

One of the pushing factors is the private sector. The fast increase in land-prices in the inner city makes it more and more difficult for the low income to maintain their position in the town. With world bank and bilateral donor finance upgraded slums in Jakarta and Bangkok were replaced by luxuries shopping centers and condominiums. Only the fringe of the multi-million cities offer a solution but is often too far from job opportunities. Legal or illegal migration seems an attractive alternative.

The urban problem is not anymore a local issue, it is a global problem. Globalization makes easy access to foreign capital possible. This has advantages for the public and particularly for the private sector but also carry large risks. Risks which led to the collapse of the private sector as I will explain in this paper. Risks which are to easily ignored when advising on privatization or public private partnership. The lessons from Indonesia and Thailand teach us that mistakes cannot only destroy the private construction sector but also have an impact on the economy as a whole. A capital destruction of billions of dollars hits the economy. In my opinion the building sector in Thailand and Indonesia triggered off the economic crisis. In this paper I will analyze the present trend in privatization and private sector approaches as well as the role of the public sector towards low-income housing. The cases are from Indonesia and Thailand.

2 Case Indonesia

In Indonesia the public sector played an important but gradually diminishing role in urban housing provision. After a chaotic urban development in the fifties and sixties the Ministry of Public Works started large scale kampong improvement projects (KIP) and all over the country. Integrated urban Infrastructure Development Projects (IUIDP) co-financed by many bilateral and multilateral donors gave the GoI a leading role in urban development in the 70ties and 80ties. The National Housing Corporation "Perum Perumnas" provided low-income housing be it on a too small scale for this large country. The majority of the houses however were constructed by the people themselves often on land not belonging to them. While in the urban informal settlements (Kampongs) the infrastructure was improved and people improved their houses the land issue was not solved.

Till 1998, Indonesia has experienced high rates of sustained economic expansion and unprecedented social change. At the same time, urban growth exhibited a fundamental shift towards a more industrialized, urbanized and autonomous character. Extensive urban area expansion precipitated complex processes of spatial transformation.

In the 90ties the private sector developed from small developers to large Real Estate developers listed at the "Bursa Effek" the Jakarta Stock Exchange.

Before the crash the real estate industry was confident to the point of arrogance. They controlled around 60% of all commercial property assets and 40% of residential assets. They were a major player in national economic development. Through their capitalization on the Stock Exchange, fed by domestic and international investors, real estate developers formerly enjoyed ready access to development finance. However, this situation has been turned on its head since the economic crisis hit. On the 9th January 1998, 260 out of 282 companies listed on the Jakarta Stock Exchange (including all 23 property companies) were technically bankrupt (at that days exchange rate)[1].

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[1] "Only 22 Listed Companies Remain Healthy: Analyst", Jakarta Post, 9th January 1998.

Since then development projects have been cancelled, projects in progress have been suspended and new completions have been mothballed. Millions of manual workers in the building trades are still seeking employment. The combined foreign debt of the real estate industry stands in the billions of US$.

What are the consequences?

- The production of housing units by the private sector has come to a virtual standstill. While there is over-supply in the middle and upper brackets[2], low income housing completions in required locations have been consistently below targets and acute shortages are in prospect[3].
- The halt in construction will particularly affect low income groups employed as casual labour in the industry. Hundreds of thousands of workers will become unemployed to join the millions newly unemployed.
- Together with the large real estate developers, many small material producers, suppliers, contractors, architects and consultants became are bankrupt as well. The knock-on effects will increase the numbers of jobless.
- The specialist expertise which has been built during the past ten years in construction sector will be dispersed. Knowledge and experience will be lost. It will take many years to restore these levels of capability.
- Private Sector Participation (PSP) and Public Private Partnership (PPP), two central tenets of urban development policy and responsible for 70% of urban infrastructure expenditure in Relelita VII, will effectively cease to exist for the next few years.
- Unemployment will encourage a drift from peri-urban to urban areas and lead to increased squatting and overcrowding in the main urban kampung areas[4].
- Many housing and commercial buildings will remain unfinished. Unfinished and empty or unlet property deteriorates rapidly in tropical climates. Asset destruction and loss of invested capital and will hit small investors hard. There will be few buyers in the market and prices will be very low.

2.1 What Caused the Crash in the Property and Land Markets?[5]

The collapse of the real estate market was caused by a number of different factors which have not yet been fully assessed and linked to each other. The prevailing view is that the

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[2] As much of the current stock was bought for ill advised speculation, low occupancy rates are common in many schemes.

[3] Perhaps 50% of speculative housing units and commercial floor-space is poorly located. In the case of low income housing, the land cost equation and limited enforcement of the 1:3:6 formula has restricted access to housing. (*for each upper band house and/or 3 middle band houses, developers are obliged to build 6 modest, low cost houses. However, often this regulation is loosely interpreted with the low cost housing relegated to cheap in an unfavourable locations or simply postponed indefinitely*)

[4] “Kampung” in this context refers to high density ‘urban villages’, often with restricted vehicular access. Indonesia’s Kampung Improvement Program (KIP) is world renowned as an example of enlightened and cost-effective slum upgrading.

[5] Cor Dijkgraaf and Euan Ross ,1998. *The Collapse of the Real Estate sector in Indonesia*. LUSK Review.University of Southern California L.A.

currency crisis and stock market collapse affecting most of South East Asia precipitated the real estate crash. However, while these factors are clearly linked, the root of the problem probably lies in the practices of inflated asset pricing, high profit margins and short term debt cycles which, while common to all businesses in the region, were perhaps taken to new levels of recklessness by the real estate industry.

That at least some elements of the current real estate crisis can be directly attributed to obvious and predicted problems, is particularly gauling. A heady mix of optimistic sales projections to meet the demands of a speculative bubble, high risk financing supported by excessive margins, poor strategic planning (in relation to transportation and the juxtaposition of land uses and economic activities), inefficient land use management, ill researched marketing and, finally, ill judged phasing and programming, precipitated a crash, sooner or later[6].

The integrity of the national economy has been shaken by these on-going events. Liquidity problems in the banking sector have been compounded by an incestuous relationship with the real estate system[7]. A substantial part of the banking system is characterized by over extension and a large number of bad loans connected to the real estate sector[8]. In many instances, it appears that loans have been arranged without proper ‘due diligence’ research on economic feasibility. The following factors played a key role in the collapse:

2.1.1 Ego Tripping and Commercial Cannibalism

Many real estate firms have focused on independent business development goals, concentrating on turnover and expansion without reference to market developments. With everyone chasing the same market segments in parallel not everyone could win. In this case everyone lost. Developers secured land in proximity to toll roads and major highways balancing land cost against journey times. They constructed housing estates, industrial complexes, apartment buildings, offices and shopping centres at breakneck speed with little reference to the real overall market[9]. Shopping centres grew up cheek by jowl and the supply of office space and apartments oscillated from over supply to gross oversupply. Everyone strove to build bigger, higher, more extravagant developments.

2.1.2 The Sky is the Limit

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[6] See discussion on the consequences of excessive mark-ups in “Indonesia and the IMF Pill”, Steven Susanto, The Fifth Column, Far East Economic Review, December 11th 1997.

[7] With banks and real estate development companies often owned by the same holding company, the government limits direct lending to 20% of portfolio to spread risk and protect investors. However, this regulation is honoured only in the breach; hence, ‘incestuous’ lending.

[8] See discussion on the role of over-valued assets in “What Happened to Asia” Paul Krugman, http://webt.mit.edu/krugman/www/

[9] See Metropolitan Medan Urban Development Project, Planning Strategy Review 1995. Huszar Brammah and Associates Limited and GKW Consult. Peter Gardiner and Euan Ross carried out urban dynamics modelling work. As an offshoot, the consultants modelled the impact of a major new town development project on housing demand in existing locations and showed how the dynamics of the market are controlled by more or less absolute levels of demand. Despite interest in the work, proposals to analyse the sustainability of the real estate industry in Jabotabek and Metropolitan Surabaya in 1996 unfortunately came to nothing.

Over the last 10 years Indonesia moved with impressive enthusiasm from a highly regulated government controlled financial sector to a laisez faire, free for all. The number of private banks soared from a handful to hundreds in a matter of a few years. Indonesia's increasingly open markets attracted the interest of foreign fund managers and investors. Real estate firms were expanding rapidly throughout South East Asia and capitalising that success on the regional stock markets. With some of the highest returns, property companies were a natural focus for investment[10].

However, this is 'fast in, fast out' money, as local, debt financed and publicly listed entrepreneurs have recently discovered[11]. If, at any time, the assessed risk outweighs assessed benefits, the finance immediately disappears to be re-invested elsewhere. More then 50% of the shares of the 23 listed real estate development companies were foreign owned before the crash. Counting on a continuous growth, real estate firms had continued their foreign borrowing and ambitious foreign investors continued to buy risky shares even after instability became apparent in Thailand in June 1997[12]. This happened with unseemly haste when it transpired that Indonesia's economy was not exactly problem free.

Economic planning using compounded high growth rate projections and sustained exponentially increasing prosperity, as practized by most investors in South East Asia was always dangerous. The simple logic of growth share and relative productivity in a fairly free world market suggests that very high rates of economic expansion cannot be sustained indefinitely in any situation. There are always factors which eventually tip the balance of comparative advantage. Economic growth has always followed cycles. For the most part, the developed world progresses through a series of relatively mild, usually out of phase booms and slumps. Against all logic, the majority of economists believed that the situation in the South East Asia region was somehow different. A slump was inevitable. It was only a matter of when and how deep[13].

2.1.3 Low Interest Rates Abroad

With domestic interest rates driven up through inflated differentials managed by Bank Indonesia to cover the costs of historic and endemic bad debts, many Indonesian based businesses borrowed overseas in $US at 9% or 10%. Most of this borrowing was invested in domestic business opportunities, but some was simply banked in Rupiah to earn

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[10] When money markets were based in the nation state, economic boom / bust cycles were usually, but not always, out of phase to some extent, thus ameliorating their global impact. Today, however, most of the world's free capital in moving within a single system. This brings advantages in that 'system efficiency', in terms of matching finance to activities in a free market, is higher. However, it also opens the prospect for increasingly rapid economic cycles on the world scale. Thus, the recent crisis started in Bangkok and spread as far as Wall Street. This effectively killed the bull market of the late 1990s.

[11] Morningstar Inc. In Chicago reports that, of 13 US mutual funds with Indonesian stockholdings ranging from 2.8% to 10% of their assets at the end of June 1997, 11 had cut that to zero by September 30, 1997. Source: David Wessel, Darren McDermott and Greg Ip in The Wall Street Journal December 30th, 1997. "Indonesian Currency's Plunge was Fed by Local Borrowing".

[12]"Why did Asia Crash?" The Economist, January 10th , 1998.

[13] Krugman, 1997, writing in the Economist.

interest. Very few Indonesian businesses were adequately insured against currency risks[14].

2.1.4 Unrealistic Expectations Concerning Short term Loans

The average maturity for the private sector external debt in Indonesia is about 1.5 years[15]. When considered against the economic life of land and property assets in the real estate business, such short term borrowing can only indicate grossly inflated profit margins and rapaciously short return periods, even in the context of the notoriously short investment cycles norms of South East Asia.

2.1.5. Speculation

Short borrowing cycles and high mark ups in relation to real value added drove land prices through the roof[16]. Land price inflation and speculation involving the big developers, intermediaries and small scale operators has been rampant[17]. This had incurred serious repercussions for low income housing and low value added land uses such as parks and open space which have virtually been squeezed out of the main cities[18].

Another kind of speculation has been evident in the 'single family dwelling' housing market. Middle income small scale speculators bought second and third houses in the new towns and condominiums, purely for speculation purposes; these units are seldom rented due to unrealistic rental expectations[19]. All this speculation is, of course predicated on continuing growth and self reinforcing inflation of property values. With the collapse

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[14] David Wessel, Darren McDermott and Greg Ip, 1997.

[15] "Is a Stronger Rupiah Already Around the Corner?", C.J. de Koning in the Jakarta Post, January 13th, 1998.

[16] In Java high residential land prices have exerted tremendous knock on pressure on both residential and industrial land, to the point where (at onset of the current crisis in June 1997) land costs were generally considered excessive by South East Asian development standards. Currently (January 1997) land prices are still being held up 'with no visible means of support' although many real estate developers are advertising 50 to 40% discounts up-front. However, there are few buyers, and there is virtually no market in the absence of affordable mortgages, so a 'wait and see' attitude has been adopted. However, come March, if loans begin to default as anticipated and bankruptcies result, the resultant 'fire sale' will send land and property prices tumbling.

[17] Krugman, 1998, sets out this simple but graphic example. Let us assume that: "*the rent of a plot of land has a 2/3 probability of being US$25 and a 1/3 probability of being US$100. A risk neutral investor would pay US$50 for the plot, i.e. (2/3 times 25 and 1/3 times 100) for the rights to that land. But now suppose there are financial intermediaries able to borrow at the world interest rate because they are perceived as being guaranteed by the government. The result is obvious; the intermediaries will be willing to bid 100 on the land. So all the land will end up held by intermediaries and the price of land will be double what it would be in a undistorted market*". On a smaller scale the same thing is happening on the housing market. This bubble only persists as long as the government guarantee is maintained (a perceived guarantee that the sector will not be allowed to default and that the investor, in this case a financial intermediary, will be able to walk away from a loosing situation). But when that stops, the bubble will burst. This is the much discussed 'moral hazard' issue.

[18] See, for example, the analysis of the Surabaya 2005 City Plan revision by Euan Ross in the Surabaya Integrated Transportation Network Project, Dorsch Consult and others for Government of Indonesia, 1995.

[19] Where this worked, investors would put down a deposit for 3 or 4 units at a fixed price 'off the plans' sell at a higher price (*sometimes through the developer's agent*) on demand for final payment on completion and end up with one or two free units.

of the market these conditions no longer exist. In most instances these disasters still have to take place at the time of writing, but they can be predicted with total accuracy. This will result in a ‘melt-down’ in the housing market.

2.1.6 Urban Planning and Management

Rapid urban growth, in line with the dispersed paradigm described earlier, requires appropriate transportation and strategic utility infrastructure. It also requires integrated planning of service catchments, an understanding of journey to work demands and a systematic consideration of environmental and sustainability criteria.

2.2. What is the policy of the new Government in Indonesia.

A new ministry for Human settlements and Rural Development has been formed in Indonesia. One of the new activities is a start with the formulation of the new Housing Policy. This policy is focussed on community participation. This is understandable after the collapse of the private sector and the role the private sector played with the previous government. Yet the role of the private sector for a large part of the market is essential. It is too early to comment on the draft of the new housing policy. One thing is very clear the new government is very much concerned about housing for the low income and is in this an exception to the

3. Case Thailand

In Thailand the public sector never played an important role in urban housing provision. Earlier then in Indonesia the private sector started to control the housing and office market in the eighties. A second wave came in early 1992 after a series of Government measures and the enforcement of the first Bangkok Master Plan. Land prices went up and the real estate development became booming. The mistakes made in Bangkok are the same as mentioned above from 2.1.1 till 2.1.6. The speculation was on a larger scale then in Indonesia. Condominium units were seen as a convenient vehicle for investment and speculation. This created an artificial market and drove up the prices. Condominium units like housing projects in the new towns in Indonesia were sold out in a few hours. Large amount of units were sold but unoccupied (up to 35 % in certain projects)[20]. In Muang Thong Tani a ghost new town of 640 ha more than 50 % of the 26,000 existing units remain unsold and many sold remain unoccupied.

Speculation, infrastructure deficiencies and conspicuous planning disasters have been recognized as important contributors to the economic crash in Thailand. On average, each Bangkok resident spends almost 3 hours each day in the city’s traffic jams. The resulting economic inefficiencies and loss of ‘quality of life’ has meant that foreign companies

[20] Source Agency for Real Estate Affairs quoted in the Bangkok post 9 July 1997

have been hesitant to invest in Thailand for some years now, causing the economic slow-down which preceded the current crash.

4. Lessons learned

Very little attention has been given to the collapse of the real estate sector in Indonesia and Thailand. While in more places of the world similar collapses can be forecasted. .

The following lessons are important to note:

1. The public sector should remain in control of the housing and urban development and should have a system of sanctions if regulations and plans are ignored. This is particularly true for the low-income housing. If National Housing Corporations disappear or change into real estate agencies the public sector should interfear.

2. There is a clear need for a spatial planning and housing policy in which it will be defined who will take care of which target group.If the pprivate sector alone is in command the lowest groups will be ignored.

3. Ego tripping and canibalism in the building sector should be avoided. This leads to capital destruction

4. The private and public sector should realize that easy access to foreign capital is attractive but has also certain dangers. Short term loans should be avoided.

5. Large scale speculation will lead to an artificial market and is one of the factors that can lead to a collapse of the sector.

6. The public and private sector should jointly plan new projects.

7. A collapse of the construction sector can lead to thousands of unemployed and further backlog in the housing production. No developing country can permit a complete standstill of the construction sector. The construction sector contributes for about 15% to the GNP.

8. The lack of reliable information on the situation in the public and the private sector (which is in Indonesia and Thailand at the core of the financial crisis) made an analysis of the situation even more difficult. Both the public and the private sector should have a good documentation of production and market and an early warning system.