

The Challenges of Indonesia's Municipal Bond Issuance in 2014

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Municipal bonds has been widely discussed in recent years as an alternative financing for the development of Local and Regional Governments (LRGs) in Indonesia. Many LRGs in Indonesia are starting to understand and start to explore the concept and the importance of Municipal Bonds in development for the regional government. To realize municipal bond issuance in Indonesia, Ministry of Finance, supported by the World Bank and the Asian Development Bank (ADB), is conducting many workshops or seminars about the importance of the municipal bond for regional development in Indonesia. Regardless of full support from Ministry of Finance and all institution donors, PEFINDO still has not seen any signs of LRG planning to issue Municipal Bond in the Market Capital in 2014. West Java Province, as the only province so far that is expected to be the first LRG to issue municipal bond, will likely do so in 2015. Although all stakeholders are expecting municipal bond to in the capital market soon, PEFINDO till sees some issues that could hinder the issuance of municipal bonds in the coming years if it is not settle immediately by all interested parties.

A major issue that must be resolved this coming year is related to the regulation ruling the Local Government Financial Report which will issue bonds must be audited by the Public Accountant listed in the *Otoritas Jasa Keuangan (OJK)* as Financial Services Authority. This could become an issue because according to the Law No. 15 Year 2006 regarding State Audit Agency that the task of the State Audit Agency (BPK) is auditing the management and the financial accountability of the Central Government, Local Governments, other State Agencies , Service Units, enterprises or other entities managing state finance. So in accordance to the stipulated laws, All local financial statements must be audited by BPK. Meanwhile the FSA provision requires that the entities aiming to raise fund from capital market including local governments must be audited by Public Accountant . This issue must soon be resolved by the BPK , the Ministry of Finance and the FSA to get a common ground so that the issuance of municipal bonds will run smoothly.

Another issue that should be a concern in 2014 is related to the selection of construction projects that will be financed municipal bonds. The LRGs have to really understand the needs of development and the types of projects that will be developed in the region. The projects need also supported by a good feasibility study to ensure that the project financed by municipal bond is not only a project required by the community but also project generating revenue for the local government as required by regulations. The project in the long term is expected to provide solutions to the problems that exist at the moment such as adequate transportation, markets, hospitals, airports, water supply and waste management or disposal. Moreover, in the long term, local government should be able to ensure that this project will be beneficial to improve the community's economy and can become another source revenue so that revenue from the project can be used to pay interest and principal of muni bond as well. The feasibility study process is also a concern, it is very common that the Local Government spends a lot of money to prepare the feasibility study for a project. The quality of the feasibility study, however, often shows not a good study. In the process of issuance of municipal bonds, FSA requires that the projects to be financed by Municipal Bonds must be appraised by appraisers listed in the FSA as well. This will become a burden for local government because it will have to spend double to prepare a feasibility study. Local Government needs to re-do the feasibility study if the previous feasibility study was completed by consultants who are not registered in the FSA. This issue also must be solved immediately by the FSA, the Ministry of Finance and the appraisers.

In addition to the technical factors mentioned above, unfavorable economic conditions will also be a limiting factor for local governments to issue municipal bond. With central bank rate (BI Rate) of 7.5 %, is quite challenging for local governments to get coupons with low interest rate. Not only will local governments be cautious to issue municipal bond, corporations will do the same as well. General election which will be held in 2014 will also become concern for local governments or corporation to enter capital market. They expectedly will wait and see the result of the election.

To encourage local governments in utilizing Municipal Bonds as an alternative financing for regional

development, the Ministry of Finance, the OJK, capital market participants and State Audit Agency (BPK) should sit together to solve the above problems and remains actively educate local government to provide better and more details information about the benefits and the risks that need to be comprehended by the local government prior to the issuance of Municipal Bond. There should be a breakthrough that could reduce barriers in regulation so that the process of the issuance of municipal bonds can be soon realized.

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