Support for housing loans amid sluggish growth

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Indonesian loan growth has slowed down as demand has softened amid sluggish domestic economic growth triggered by a prolonged recovery process from the global economic downturn. In line with this, the growth of housing loans including home, apartment, and shop house ownership has also experienced a downward trend, particularly since the government applied strict loan to value (LTV) regulations in 2012 and 2013, including a restriction on the mortgage indent for second and third houses. Following the LTV regulations, which were intended to suppress housing loans that grew rapidly in 2012, growth fell to 7.0% year-on-year (YoY) in FY2015 from 22.4% YoY in FY2012.

To boost housing loan growth again, Bank Indonesia (BI), through BI Regulation No.17/10/PBI/2015 relaxed the LTV rules in June 2015, but the impact has not been significant enough. With persistent sluggish economic growth and a property sales slump, growth rose to 7.6% YoY in 1H2016 from 3.0% YoY in 1H2015. In June 2016, the government announced a new policy to ease the LTV rule further by lowering the required down payment, including for second and third house ownerships. Under the new regulation, the government also allowed the mortgage indent for second houses, where loans can be disbursed in stages based on the percentage of completion. To further boost loan growth, BI also increased to 80% from 78% the minimum requirement for bank's loan to funding ratio (LFR) related to the statutory reserve requirement, while the maximum remains at 92%.

Table 1: Loan to Value (LTV) Policy

Property type	Initial LTV	First relaxation (2015)	Second relaxation (2016)
Landed house & apartment > 70 sqm			
1st mortgage	70%	80%	85%
2nd mortgage	60%	70%	80%
3rd mortgage	50%	60%	75%
Landed house 22-70 sqm			
1st mortgage	n.a	n.a	n.a
2nd mortgage	70%	80%	85%
3rd mortgage	60%	70%	80%
Apartment 22-70 sqm			
1st mortgage	80%	90%	90%
2nd mortgage	70%	80%	85%
3rd mortgage	60%	70%	80%
Shop house			
1st mortgage	n.a	n.a	n.a
2nd mortgage	70%	80%	85%
3rd mortgage	60%	70%	80%

Source: Bank Indonesia

We are of the view that the relaxed LTV rules through BI regulation no. 18/16/PBI/2016, which came into effect on August 29, 2016, will support continued housing loan growth in the near term, particularly in the middle class primary home market, which bodes well for the country's young demographic profile and expanding middle class segment. However, the relaxation will not likely immediately impact housing loans significantly, given the slowing economy and more cautious consumer spending. We expect the impact to be felt in the medium to long term, as the real demand for houses remains high and government support in the form of regulations and subsidies for the housing program, including encouragement for banks to lower mortgage rates, will assist the development of the housing market. Moreover, around 78% of home purchases are still done using mortgage schemes.

Backed by strong demand for housing, with a backlog estimated at 11.4 million units, the Indonesian mortgage market has good potential for growth in line with support from the government. This support can be seen from the increase in government liquidity funding budget to IDR9.2 trillion in 2016 (as part of the One Million Houses program), up from IDR5.1 trillion in 2015. There also should be IDR2 trillion of interest subsidies, translating into available funding for over 240,000 housing units. To stimulate demand for low-end housing, the government has provided down-payment subsidies worth IDR1.2 trillion. In addition, the regulator has lowered risk-weighted assets for both subsidized and non-subsidized mortgages, which helps to reduce pressure on the banks' capital adequacy ratio.

The government's encouragement for banks to reduce their lending rates to a single digit after capping the time deposit rate for BUKU III & IV category banks, gradually lowering the BI benchmark rate to 6.5% as of 1H2016 from 7.5% in FY2015, and replacing the benchmark rate from the BI rate based on long-term bonds to the short tenor seven-day reverse repo rate, will also help to boost housing loans as with the lower cost of funds resulted from the policies, the banks would have more rooms to lower their housing loans rates.

The government also founded PT Sarana Multigriya Finansial (rated $_{id}$AA+/stable) in 2005, a government-owned institution with the special mission to increase home ownership through the development of a secondary mortgage market by providing financing to mortgage lenders, such as banks and finance companies, with the mortgage loans as underlying collateral. From FY2005 to 1H2016, it disbursed loans of IDR18.8 trillion to more than 271,000 debtors through banks and finance companies, and facilitated mortgage securitization of IDR5.6 trillion.

Another key catalyst to a more favorable climate for the sector is the expected increase in government disbursement for infrastructure spending in 2H2016 and FY2017. We project economic growth to gradually rise to above 5% in 2017, from 4.8% during FY2015, creating a multiplier effect in the economy, and in turn, improving purchasing power and domestic consumption over the medium term. This will eventually improve related industries, including the property sector and housing loans.

Rules and regulations issued either by the government, or by BI as the central bank, show a positive signal of support from the government related to the development of the housing loan industry. The government's recent easing on foreign ownership of properties could broaden the customer base for premium homes and apartments and help to boost growth in the sector, although not significantly as foreigners are still not entitled to the right of ownership certificate, which may restrict them selling the properties.

PEFINDO is of the view that the supporting regulations along with the stronger demand for housing, given our expectation of an improved economy and lower mortgage rate, may result in the increased penetration of housing loans in the medium term. Indonesia still has a very low mortgage loan penetration rate, as reflected by its mortgage loan percentage to total gross domestic products of approximately 2.8%, well below neighboring countries such as Malaysia at around 56% and Singapore at around 57%. Property sales could grow higher if, in the future, the government decides to issue other regulations, such as lower tax imposed on property products and the implementation of longer loan tenors. Housing loans' contribution to the total banking industry was relatively small at around 9% in FY2012-1H2016, however, we expect their recovery could positively affect other sectors such as construction and services, and may assist in supporting national loan growth.

Table 2: Housing Loans Contribution, FY2012-1H2016

	FY2012	FY2013	FY2014	FY2015	1H2016
Total bank loans (in IDR bn)	2,707,862	3,292,874	3,674,308	4,057,904	4,168,308
Housing loans to total loans (%)	8.9%	9.3%	9.3%	9.0%	9.1%

Housing loans includes home, apartment and shop house ownership
Source: Indonesia Banking Statistics

Housing loans concentration to a few banks

Though more than 100 banks operate in Indonesia, housing loans are concentrated on only a few players - largely big banks with long experience in housing loans, robust infrastructure and a strong funding mix. As the state-owned mortgage bank, PT Bank Tabungan Negara Tbk (Persero) (rated $_{id}$AA+/stable) remains the largest lender, with a 34.2% share of total housing loans in the industry as of FY2015. Other banks that have made a significant contribution are PT Bank Central Asia Tbk (16.2%), PT Bank Negara Indonesia (Persero) Tbk (9.5%), PT Bank Mandiri (Persero) Tbk ($_{id}$AAA/stable, 8.4%), and PT Bank CIMB Niaga Tbk ($_{id}$AAA/stable, 6.4%).

Table 3: Top 5 Housing Loans by Bank (in IDR trillion), FY2012-1H2016

	FY2012	FY2013	FY2014	FY2015	1H2016
BBTN housing loans	70	87	103	125	136
BBCA housing loans	42	53	55	59	62
BBNI housing loans	25	32	33	35	36
BMRI housing loans	23	30	30	31	32
BNGA housing loans	21	22	22	23	23

Source: PEFINDO
Note: BBTN: PT Bank Tabungan Negara (Persero) Tbk, BBCA: PT Bank Central Asia Tbk, BBNI: PT Bank Negara Indonesia (Persero) Tbk, BMRI: PT Bank Mandiri (Persero) Tbk, BNGA: PT Bank CIMB Niaga Tbk

PT Bank Tabungan Negara Tbk (Persero) (BBTN) is the market leader in the mortgage segment, particularly for the subsidized Kredit Pemilikan Rumah (KPR). It is the dominant player in the subsidized mortgage market, controlling a 97% market share. For its parent, the Indonesian government, the Bank has an important function to provide housing loans to the low and middle income segments, in line with the government's One Million Houses program, where BBTN acts as the mortgage financing provider. PT Bank Central Asia Tbk (BBCA) targets the secondary home market in addition to its main focus on the primary home market under the middle-to-high segments to achieve its loan growth target. PT Bank Negara Indonesia (Persero) Tbk's (BBNI) mortgage loan portfolio is dominated by first-time homebuyers. In the near to medium term, PEFINDO projects that these banks will continue dominating house lending given their experience and expertise in the segment.

Challenges in managing asset quality

Given the higher LTV under the new regulations, we are of the view that there is a potential higher risk of non-payment. To manage the performance of asset quality, banks need to apply a more conservative approach in extending loans. This should include stricter risk management, more selective loan underwriting assessment, and more intensive loan monitoring. Moreover, BI regulates that banks with non-performing loan (NPL) ratios above 5% are not eligible for the relaxed LTV regulation.

The banks' attempts to safeguard their asset quality will also be challenged by the slower loan growth and debtors' weakening repayment capabilities amid the economic slowdown, as reflected by the NPL ratio for housing loans, which rose to 2.7% in 1H2016 from 2.1% as of FY2013. As such, we are of the view that the banks have difficulties in maintaining their asset quality at the current level, and we project NPL ratios to slightly increase in the medium term.

The increased credit risk, however, will be partially mitigated by the collateral profile of housing loans, which we view as better than other types of loans, such as unsecured loans. The banks can expect future recovery of the written-off loans when the collateral has been disposed of, although they should also consider the lengthy process and uncertainty in collateral execution, which may hinder loan loss recovery.

Although increasing, the housing loan NPL ratio of 2.1%-2.7% as of FY2014-1H2016 was still well below the industry's NPL of 2.4%-3.1%, reflecting a better asset quality profile compared to the overall industry, affected by the previous stricter LTV regulations, which required high down payments.

Among the three largest housing loan players, only BBCA maintained NPL of housing loans under 1% due to its prudent risk management policy and strong loan underwriting policies. Other major players such as BBTN and BBNI have higher NPL figures. The outlooks for these companies are stable and, therefore, we do not expect any rating changes as a result of the new regulations, as they are being more selective in their loan disbursement and we expect them to benefit from the Indonesian Financial Supervisory Authority's (OJK) stimulus, where banks obtain leniency to restructure loans.

Table 4: Housing loan NPLs of BBTN, BBCA, and BBNI

	FY2012	FY2013	FY2014	FY2015	1H2016
BBTN housing loan NPL	3.9%	3.8%	3.4%	2.8%	2.9%
BBCA housing loan NPL	0.6%	0.5%	0.4%	0.4%	0.6%
BBNI housing loan NPL	2.0%	1.4%	1.8%	2.7%	3.0%
Housing loan industry NPL	2.0%	2.1%	2.1%	2.3%	2.7%
Banking industry NPL	1.9%	1.8%	2.4%	2.5%	3.1%

Source: Indonesia Banking Statistics and PEFINDO

Impact of lower interest rate environment

Other conditions that affected housing loan growth were tight liquidity and high cost of funds amid the higher interest rate environment (under BI rate of 7.5%-7.75%), as reflected by the high 92.1% loan to deposit ratio (LDR) of the banking industry in FY2015 and around 89% in FY2014 and FY2013, up from 83.6% in FY2012. To boost liquidity and spur credit growth, the BI rate was cut in the first six months of 2016 to 6.5% in 1H2016 from 7.5% in FY2015. As a result, the LDR eased to 91.2% in 1H2016, from 92.1% in FY2015. We are of the view that in the near to medium term, banks will benefit from the lower interest rate environment, as it will result in a lower cost of funds, giving them more room to reduce mortgage lending rates while still being able to achieve margin targets.

Table 5: BI Rate, NIM and LDR of Banking Industry

	FY2012	**FY2013**	**FY2014**	**FY2015**	**1H2016**
BI Rate [%]	5.75	7.50	7.75	7.50	6.50
NIM [%]	5.5	4.9	4.2	5.4	5.6
LDR [%]	83.6	89.7	89.4	92.1	91.2

Source: Indonesia Banking Statistics

The top three housing lenders started to lower their mortgage lending rates following the BI rate cut. In 1H2016, BBTN's prime mortgage lending rate was 10.5%, down from 11.5% in FY2015 and FY2014. For BBCA, it was 10.25% in 1H2016 and FY2015, down from 10.5% in FY2014, and for BBNI it was 10.5% in 1H2016, down from 11% in FY2015 and 11.1% in FY2014. Housing loans are considered to have a lower risk profile due to their strong collateral base, resulting in competitive pricing. Lower mortgage lending rates are expected to attract demand from more cautious consumer spenders, particularly customers with weaker purchasing power amid the slowing economy.

Table 6: Average Lending Rate of Commercial Banks to Third-Party Non-Banks (IDR loans)

Lending rate (%)	FY2012	FY2013	FY2014	FY2015	1H2016
House ownership	10.5	10.4	11.2	11.3	11.1
Apartment ownership	8.8	9.5	10.8	11.6	11.7
Shop house ownership	9.9	10.0	11.0	11.3	11.2
Working capital	11.5	12.1	12.8	12.5	11.8
Investments	11.3	11.8	12.4	12.1	11.5
Consumption	13.6	13.1	13.6	13.9	13.8

Source: Indonesia Banking Statistics

As the net interest margin (NIM) may be narrowed in the medium term due to the lower lending rate, banks will have to strive to improve efficiency to achieve their targeted profitability. They also can increase their fee-based income from housing loan products such as administration fees, and commissions from notary, appraisals, insurance companies, and developers.

To strengthen their funding base and mitigate a maturity mismatch from their long-term housing loans and short-term deposits, the banks' sources of funding usually come from bond issuances and borrowing from other banks or financial institutions. As an alternative, they also can conduct asset sales or securitization. With securitization, banks, as the originator, can convert their long-term loans into cash to finance future business activities. Developing a more conducive environment to support the growth of securitization of mortgage loans is still an ongoing challenge. There are not many parties that are familiar with mortgage securitization, as there was only one bank as a consistent originator between 2009-2015– BBTN. Banks are either reluctant to part with their good quality mortgage assets, fearing it would have an impact on their overall asset quality, or have not familiarized themselves with the securitization process, which is relatively new in Indonesia. Moreover, securitization in the short term may reduce the loan and asset size of banks, putting pressure on their market position in the industry. In addition, smaller banks (sharia and regional development banks) do not have large mortgage portfolios to securitize in the first place. We are of the view that in the medium term, most banks will continue to rely on borrowing and bonds issuance as their main funding sources, but we expect securitization to increase, particularly for large banks, as it provides for more diversified funding sources.