CASE STUDY: ANNEX G

INDONESIA - PT SARANA MULTI INFRASTRUKTUR (PT SMI)

Background and Establishment

Established in 2009, PT Sarana Multi Infrastruktur (PT SMI) aims to catalyse infrastructure development in Indonesia by providing funded and contingent financing products to projects that are largely originated in the public sector but financed by the private sector. As of the date of this Guidance Note, PT SMI has no subsidiaries but a 30 percent share in the PT Indonesia Infrastructure Finance (PT IIF), a private sector focused joint venture started in 2010.

The establishment of PT SMI came at a time when the Government of Indonesia was looking to significantly increase infrastructure investment, including from the private sector, after several years of low investment. For example, after the Asian financial crisis of 1997/98, infrastructure investment as a proportion of GDP fell from seven percent to just over two percent in 2001, and by 2006 had only reached slightly higher than three percent[1]. The Government of Indonesia aimed to increase infrastructure investment to five percent of GDP per year over the 2010 to 2014 period, or IDR 1,800 trillion (USD 128 billion), including IDR 365 trillion (USD 26 billion) from the private sector. However, an analysis of the financial sector in Indonesia by the World Bank[2] showed that the structure of bank liabilities in Indonesia, with more than 85 percent of deposits having maturities of less than one month, meant that providing long-term loans to infrastructure projects was not possible for banks. In addition, the asset bases of institutional investors were relatively small compared to overall financial assets, and such institutions were averse to lending to long-term illiquid assets, preferring investment in short-term instruments and government bonds.

Given these low levels of spending and the limited ability of the private sector to invest in infrastructure projects, the government initiated a range of legal, regulatory and institutional reforms aimed at catalysing investment in infrastructure. Prior to these reforms, the main government entity responsible for planning and supporting the development of infrastructure in the country was the National Development Planning Ministry (known as Bappenas). However, the government reforms expanded the role of the Ministry of Finance (MoF) in supporting infrastructure development, which included establishing PT SMI to act as a publicly owned centre of excellence for developing and financing infrastructure projects and assigning ownership of PT SMI to the MoF. In addition to establishing PT SMI, the government also set up a number of funds across government as arms-length institutions. This included the establishment of a revolving fund to support land acquisition within the Ministry of Public Works; a guarantee fund within the MoF; and a project development facility with the support of the Asian Development Bank (ADB) and the Government of the Netherlands within the Ministry of Public Works[3].

The Indonesia Infrastructure Guarantee Fund (IIGF) under the MoF is a 100 percent government-owned, independent state enterprise that was established in December 2009 under Government Regulation No. 35/2009[4]. It is the ‘single window’ for guarantees to infrastructure PPPs in Indonesia. To be eligible, such PPPs have to correspond to the definition given in Presidential Regulation No. 38 of 2015. The Indonesia Infrastructure Guarantee Fund is a fund, not an implementing agency, and it benefits from World Bank technical and financial support.

As reported in its Annual Report for 2017, the Indonesia Infrastructure Guarantee Fund had established a portfolio of 15 infrastructure PPP guarantees, with a total project value of IDR 178.9 trillion (USD 12.6 billion) and a guarantee exposure of IDR 35.6 trillion (USD 249 million).

1 World Bank (2009), Indonesia Infrastructure Financing Facility – Project Appraisal Document. In the decade or so after the crash, there was minimum infrastructure project finance activity in Indonesia.

2 See Footnote 112.

3 More recently, there is a Public Service Agency within the MoF, called Lembaga Manajemen Aset Negara (LMAN) or State Asset Management Agency, acting as a land-bank responsible for, among other things, procuring land for national strategic projects.

4 See http://www.iigf.co.id/en/, for annual reports and supporting documents.

As of 2017, PT SMI had made more than IDR 52 trillion (USD 370 million) in investment and financing commitments, and had supported 125 projects with commercial financing for private sector entities, municipal lending, advisory services, project development support, sustainable financing and sharia law financing[5].

PT IIF is substantially smaller. In 2017, it had made IDR 14.5 trillion (USD 103 million) in gross investment commitments, had assets of IDR 13.0 trillion (USD 921 million) and a debt to equity multiplier of 4.8[6]. Its main mandate is financing and investment of viable infrastructure projects in Indonesia. While there is some overlap with PT SMI, the two entities seek to be complementary; for example, for a PPP project where PT SMI will undertake project preparation and advise on the government side, PT IIF will take a lead arranging the financing or advisory services to the bidders in the transaction.

Mandate

PT SMI is mandated to act as a catalyst in fostering long-term infrastructure financing in Indonesia. The mandate focuses on two main objectives, specifically (i) optimising the social and economic benefits of infrastructure for communities; and (ii) supporting the achievement of the Sustainable Development Goals, including supporting climate change mitigation efforts. The PT SMI mandate has been expanded to include elements of local government finance.

PT IIF had a similar mandate to act as a catalyst but is more specialised, and is seeking to network opportunities within private sector sponsor networks, as well to develop domestic risk and credit expertise based only on commercial infrastructure projects. It also seeks to promote capital market development.

Institutional Structure

PT SMI was established as a non-bank financial institution that is 100 percent owned by the Government of Indonesia. Specifically, it is a limited liability company (SOE) that comes directly under the jurisdiction of the MoF. The purpose of PT SMI is to act specifically in the interest of the government in pursuing its objectives with regards to infrastructure development. PT IIF is a private non-bank financial institution and also regulated by the MoF.

5 PT SMI, Annual Report. (2017).

6 PT IIF, Annual Report. (2017).

Its shareholding is: PT SMI 30 percent; IFC 19.99 percent; ADB 19.99 percent; and DEG 15.12 percent; plus Sumitomo Mitsui Banking Corporation with 14.9 percent. PT IIF has some 85 permanent staff compared to PT SMI's 260.

Governance Structure

As the principal shareholder, the MoF holds the highest authority in the PT SMI and is central to making formal decisions regarding government investment in it. The nominee of the MoF participates in the company's General Shareholders' Meeting, which involves activities such as agreeing annual budgets and business plans, approving long-term plans and disbursements of loans to the company.

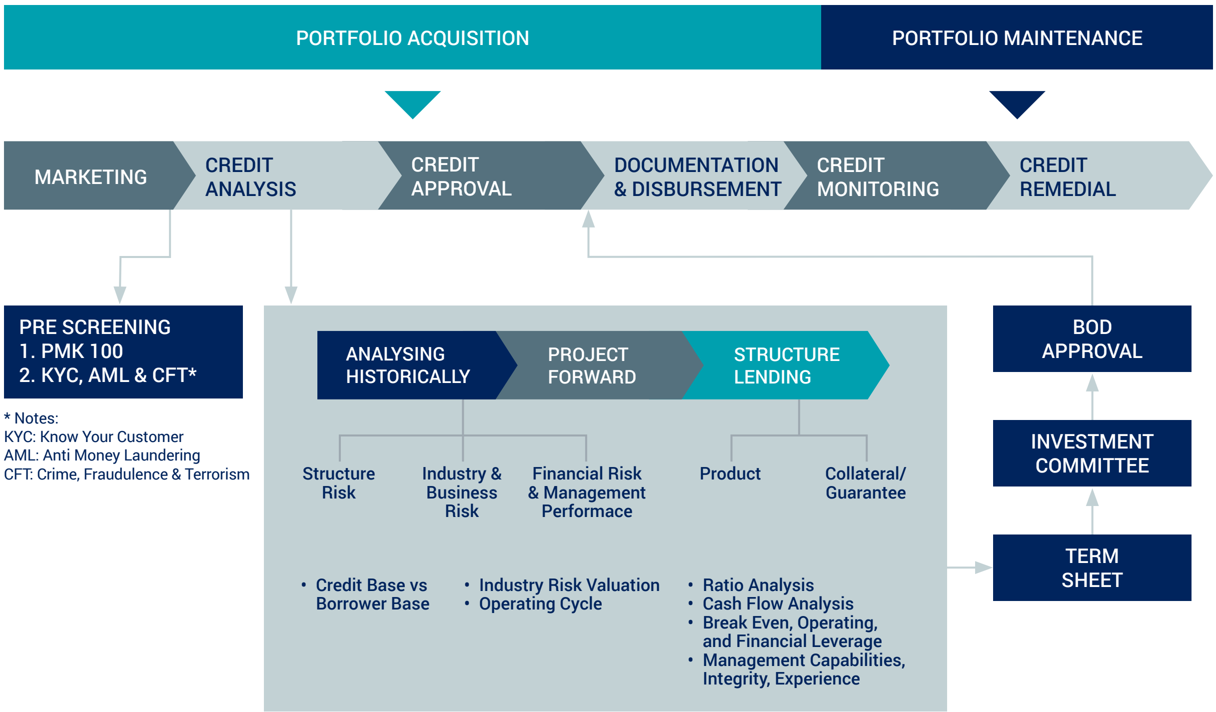
The overall governance of PT SMI is undertaken by a Board of Commissioners which comprises individuals from several key ministries, including the MoF, as well as independent commissioners, all of whom are appointed by the Minister of Finance. The role of the Board of Commissioners is to supervise and advise the Board of Directors on strategic issues and ensure that shareholders' interests (i.e. the interests of the Government of Indonesia) are protected. Along with the Board of Directors, the Board of Commissioners also ensures that the long-run sustainability of PT SMI is maintained.

As regards day-to-day management, the company is run by a Board of Directors, which includes a President Director (or CEO) and individuals responsible for PT SMI's different areas of the business, including Finance & Investment, Project Development & Advisory, Operation & Finance and Risk Management. The Board of Directors is also appointed by the Minister of Finance, suggesting some degree of political involvement in determining leadership positions.

As regards approvals for financing of projects, PT SMI follows general principles with regard to appraisal and risk management, and the specific process that is followed for determining these is outlined below. This shows that the initial credit analysis is undertaken by the internal team, before being presented to the Investment/Financing Committee, which will provide preliminary approval before final approval is given to the Board of Directors (whose members also form part of the Investment/Financing Committee).

PT IIF is governed with the same two-tier structure; at least three of the Commissioners are independents, four from joint-venture partners, and two from PT SMI/the MoF.

Figure G.1 – PT SMI approval process for financing transactions



Source: PT SMI (2009)

With regards to its investment criteria, PT SMI is guided by Ministry of Finance Regulation Number 100/PMK.02/2009, which stipulates that the company can support the following activities: (i) direct infrastructure lending; (ii) refinancing; (iii) subordinated loans; (iv) credit enhancement (including guarantees); (v) equity investment; (vi) swap market transactions; (vii) advisory services; and (viii) provision of subsidiary facilities in connection with supporting infrastructure financing on approval of the Minister of Finance.
As regards sectors, those which PT SMI is able to support include: (i) transport (roads, rail, ports and other maritime infrastructure and airports); (ii) water and wastewater; (iii) energy (including electricity, oil and gas); (iv) telecoms; and (v) other sectors on a specific basis, with approval from the Minister of Finance.

Capital Structure and Sources of Finance

As of 2017, PT SMI's capital structure consisted of equity and debt from a range of financiers, as detailed below.

EQUITY

Total equity in the company amounted to more than IDR 34 trillion (USD 240 million), which has all been provided by the Government of Indonesia as the sole shareholder. The Annual Accounts list this as paid-in, with an additional IDR 2 trillion (USD 140 million) received in 2017. At end 2017, total assets were listed IDR 55.4 trillion (USD 394 million) and liabilities at IDR 21.1 trillion (USD 150 million).

DEBT

Debt in PT SMI totalled more than IDR 20 trillion (USD 150 million), and has been provided from the following sources:

- **Loans from private sector banks and other financial institutions**, which amounted to IDR 3.7 trillion (USD 250 million). Lenders included UOB Indonesia, the Bank of Tokyo Mitsubishi, Bank Mandiri and AFD.
- **Loans from the Government of Indonesia.** These represent credits provided by the ADB and the World Bank, which have provided loans to the government on a sovereign basis to on-lend through PT SMI to its joint venture PT IIF. The total amount of outstanding loans was IDR 2.6 trillion (USD 180 million). Significant additional loans from ADB and World Bank were scheduled for 2018.

- **Bonds:** PT SMI has been active in issuing bonds in the Indonesian capital market, and as of 2017, had net outstanding debt securities of more than IDR 14 trillion (USD 100 million) – for further details see below.

Total debt and other non-equity liabilities amounted to IDR 21 trillion (USD 140 million), suggesting a debt:equity ratio of 38:62, which is relatively low by comparison to other institutions and is likely to reflect PT SMI being a relatively new institution.

With regards to its bond issuances, the company aims to issue IDR 30 trillion (USD 213 million) as part of its program to attract institutional and other private sector local currency finance to the country's infrastructure sector. PT SMI has issued bonds in the following tranches:

- **First issuance:** In 2014, the company successfully raised IDR 1 trillion (USD 67 million) in two tranches, (i) a three-year IDR 100 billion (USD 6.7 million) tranche with a coupon of 9.6 percent; and (ii) a five-year IDR 900 billion (USD 61 million) tranche with a coupon of 10 percent.

Following this, the company issued significantly larger bonds in the capital market in 2016 and 2017. This was undertaken in two phases, as follows:

- **Phase I:** In 2016, the company issued IDR 5 trillion (USD 340 million), which comprised (i) IDR 2.3 trillion (USD 160 million) of three-year bonds with a coupon of 7.85 percent; (ii) IDR 1.3 trillion (USD 88 million) of five-year bonds with a coupon of 8.2 percent; (iii) IDR 700 billion (USD 74 million) of 10-year bonds with a coupon of 8.65 percent; and (iv) IDR 674 billion (USD 45 million) of 15-year bonds with a coupon of 8.9 percent.
- **Phase II:** In 2017, the company issued an additional IDR 7 trillion (USD 470 million) of bonds, which comprised (i) a one-year IDR 1.2 trillion (USD 81 million) tranche with a coupon of 6.15 percent; (ii) a three-year IDR 4.5 trillion (USD 300 million) tranche with a coupon of 7.4 percent; and (iii) a five-year IDR 1.35 trillion (USD 91 million) tranche with a coupon of 7.6 percent.

While the maturities of these bonds are relatively short, with only a small proportion being greater than 10 years, this does suggest that the government is making good progress on achieving its objectives of attracting local institutional investment into the market and developing infrastructure as an asset class.

As part of its issuances, PT SMI has been able to achieve relatively high national credit ratings of AAA from both PEFINDO and Fitch, which has enabled it to attract institutional finance on relatively favourable terms, given that is has only been around 100bps above government bond issuances (in the case of three-year bonds). Such ratings are driven by the support provided by the Government of Indonesia, plus the relatively low level of gearing of the company at present relative to equity injections. As a non-bank financial institution, PT SMI is limited in the level of gearing it can operate and, in its 2017 Annual Report, there is reference to transition to the Indonesian Development Financing Institution (Lembaga Pembiayaan Pembangunan Indonesia, LPPI), which may signal an aspiration to higher gearing.

In addition to these conventional issuances, in 2018, PT SMI also issued an IDR 1 trillion (USD 67 million) sukuk bond, as well as green bonds in Indonesia (further details of this are provided in the subsection below). It also has a sharia law finance division.

PT IIF has total assets of IDR 13.0 trillion (USD 921 million) and equity of IDR 2.2 trillion (USD141 million), reported as all paid-in. It is also rated AAA by Fitch. Currently, its main product is senior debt and it does not yet take many equity or other higher risk positions, although it aspires to do so as its capacity and expertise increases.

Financing Activities

PT SMI is an example of an institution with a sole focus on infrastructure. As regards products, the organisation provides a number of services based around three core business pillars: (i) Financing and Investment; (ii) Advisory Services; and (iii) Project Development.

PT SMI's Financing and Investment service line is its main area of business, which includes the provision of senior debt and equity financing. In addition to this, PT SMI can also provide relatively boutique services such as sharia-law financing, 'sustainable financing' and cash deficiency support. In 2017, PT SMI earned more than IDR 2.4 trillion (USD 160 million) from its lending activities, and IDR 677 billion (USD 45 million) from its investment activities, either PT SMI itself or PT IIF. This has increased from IDR 586 billion (USD 40 million) and IDR 141 billion (USD 9.6 million) respectively, demonstrating the huge growth in business activities in recent years. These revenues dwarf its earnings from its Advisory Services (IDR 6 billion, or USD 0.4 million) and project development (IDR 21 billion, or USD 1.4 million).

National priority PPP projects may be assigned to the PT SMI for project development and transactions support – to date, a total of 12 such projects have been closed.

As with other infrastructure financing organisations, senior debt accounts for the majority of financing provided by PT SMI, comprising more than 70 percent in 2017[7, 8]. Regarding sectors, electricity and road infrastructure accounted for more than 60 percent of total outstanding financing. In addition to supporting private sector and PPP projects, PT SMI also supported 18 projects for local government, with commitments totalling IDR 2.6 trillion (USD 184 million), primarily for toll road and bridge projects. As noted above, 12 PPP projects have been closed by PT SMI.

The majority of PT SMI's equity portfolio is provided to its joint venture PT IIF, and a significant proportion of these resources were lent to the government by the World Bank and ADB, with PT SMI essentially acting as an umbrella investment vehicle. While the mandate is similar, PT IIF deals only with commercial projects and, predominantly, financing activities, although it also offers some fee-based services such as public sector and private sector advisory services. While PT SMI is positioned as advisor and project developer/transaction adviser to government, PT IIF is more commercial and private sector facing, and seeks additionality through crowding-in DFI and other international sources by lead arrangements or other convening characteristics. Both see capital market development as a strategic objective, and both see their roles being increasingly clarified by business and market maturity.

As of 2017, PT SMI's interest in PT IIF was valued at IDR 600 billion (USD 42 million), which is significantly greater than its other equity investments. These include a five percent and a 10.67 percent share in two toll road projects.

A particularly interesting product that has been provided by PT SMI is through cash deficiency support. This support is similar to a bridge financing loan, in that funds are provided to cover payments to other lenders before projects begin to make revenues. Examples of where this form of support has been used include a number of toll road projects, although PT SMI is looking to significantly expand this product into other sectors. It is not clear the degree of concession involved but some is likely to exist and justified in accelerating market closure.

Further details of PT SMI's Sustainable Financing, Advisory Services and Project Development business lines are provided below.

Green Finance

As mentioned previously, in 2018, PT SMI issued IDR 1 trillion (USD 70 million) worth of green bonds, which was the first of its kind in Indonesia and the first issuance as part of an IDR 3 trillion (USD 210 million) program to raise finance for green infrastructure projects. In particular, the proceeds from these bonds will be ring-fenced to finance projects in: (i) renewable energy; (ii) energy efficiency; (iii) sustainable pollution management and prevention; (iv) sustainable natural resources and land use management; (v) clean transportation; and (vi) sustainable water and sewerage management. As part of these issuances, PT SMI received technical support from the World Bank and the Center for International Climate Research-Oslo, with funding support provided by the Swiss State Secretariat for Economic Affairs and by Global Affairs Canada.

In addition to issuing green bonds, in 2017, PT SMI established its Sustainable Financing division, which focuses on providing financing, grants and technical assistance support to projects with a focus on climate change mitigation, improving environmental quality and supporting low carbon development. This includes projects in wind, solar, biomass and energy efficiency, as well as the fund management services PT SMI provides in the geothermal sector, in particular the recently established Geothermal Infrastructure Financing Fund. This fund aims to provide resources for exploratory drilling and data collection on key sites so that projects can be developed faster and with less risk downstream.

The Sustainable Financing division has received concessional and grant funds from a number of international partners, including the Green Climate Fund, GIZ from Germany, AFD, UNDP, the World Bank's Clean Technology Fund and the Global Environment Facility (GEF), while the proceeds from its green bonds will also be used to on-lend to projects.

7 The original eight sectors have recently been expanded to include tourism.

8 Working capital makes up 13 percent and subordinated loans 11 percent; promoter financing, sharia and bridging loans were small.

While financing of renewable energy projects has formed a core part of PT SMI's business activities, it intends to provide greater support to project sponsors with quasi-equity products, given that, according to PT SMI, one of the major challenges facing the sector is the lack of suitable sponsors developing projects. In 2017, PT SMI sharply increased the value of equity investments, particularly in project sponsors and early stage preparation. PT SMI also tried to innovate with early shareholder loans and flexible, redeemable grant support or loans.

Sharia law activities included syndication via the Sharia bank network, raising IDR 4.3 trillion (USD 297 million) for the national power company; about a quarter of this was attributed to PT SMI.

Project Preparation and Technical Assistance Activities

ADVISORY SERVICES

PT SMI's Advisory Services arm includes its provision of financial and investment advisory and providing financial arrangement services. This includes acting as a syndicator for infrastructure transactions, as well as advising regional governments and other SOEs on financing aspects of infrastructure activities. The company has also provided advisory support to local private sector banks that traditionally have had less capacity to appraise infrastructure transactions. In 2017, projects that received advisory support included power plants being developed by the state-owned mining company, and the Kuala Tanjung Port. Going forward, the Advisory Services division aims to focus its services on strategically important projects, particularly in transport, utilities and water sector.

PROJECT DEVELOPMENT

PT SMI's project development line refers to services it provides more upstream in the project development cycle, including PPP pipeline development, feasibility studies, support for municipal financing projects, as well as government technical assistance and capacity building related to infrastructure development. Examples of activities it has supported include initial preparation activities for PPP projects, such as the West Semarang PPP project in 2017 where it had taken the project to the transaction stage. As part of its support for project development, PT SMI has also established a project development facility (PDF) which it can use to obtain resources to support these activities.

Performance Monitoring

PT SMI tracks a number of financial metrics as part of its corporate risk management activities to ensure financial sustainability. This includes monitoring return on investments and overall equity, as well as productivity measures. With regards to the former, it is noteworthy that PT SMI has been making returns on investment of around three percent on average over the past five years, which is low for an organisation operating commercially. However, given that the organisation is meant to be playing a catalytic role, it could be argued that this is a reasonable return.

In addition, PT SMI also tracks the extent to which it has support infrastructure outputs across the different sectors. More widely, the company also tracks how its activities impact economic output, including gross value-added, its impact on household income and its impact on employment, all of which feed into its annual reporting process.

In 2017 the return on assets was 2.29 percent and 4.77 percent on equity. Non-performing loans were 1.9 percent in the same year.

Key Lessons Learned

Despite it being a relatively new organisation, PT SMI has provided extensive support to infrastructure projects across Indonesia, offering a range of traditional and more innovative forms of support. This has been a direct implementation of government policy, reflecting national and also regional/local government priorities; these are increasingly clustered in networks or corridors. The move to add local government financing and tourism underlines this. The result is a more systematic and programmatic approach. Both PT SMI and PT IIF offer advisory services; the former more upstream and the latter more downstream. Capacity and knowledge building is a feature, particularly of PT SMI.

A major aim has been to accelerate the financial close of projects, with PT SMI seen as a central and systematic enabler or catalyst; this relies on strong public working relationships both with the MoF and other line Ministries. This direct MoF sponsorship appears to have been a major positive factor, as has been the willingness to address long-term capital and credit markets issues through market-based incremental regulatory and policy mechanisms.

There appears to be the start of a general movement away from a senior debt-only model to one which offers other flexible products and robust project preparation to de-risk transactions and build longer, higher quality pipelines.

Particularly noteworthy activities include its ability to offer local currency financing to infrastructure projects on relatively long tenors, which was previously lacking following the Asian Financial Crisis. Lack of local currency financing has been a key issue across a range of emerging markets, yet PT SMI has been able to utilise the support from the Government of Indonesia to attract local sources of institutional capital to finance its operations. At the same time, the tenors of such bond issuances have been relatively short to date, but are now moving to 10/12 years, while raising interest from institutional investors. In the long-term, PT SMI will likely need to raise capital with longer tenors in order to reduce its reliance on central government equity support to finance its operations.

PT SMI is also an interesting example of how infrastructure banks can play a role that goes beyond financing transactions, as it has played an important role in project development activities both upstream and further downstream – although the extent to which it is able to offer such support is likely to be a function of it being fully government-owned, in that such activities may not be possible for institutions that have significantly higher levels of private sector equity or debt in their capital structure.

PT SMI also provides an interesting example of how green financing can form part of a NIB portfolio, and it will be interesting to see the implications of the recent capital-raising activities on PT SMI's deal flow for green and sustainable infrastructure projects.

PT IIF capitalisation is relatively low compared to the average ticket size of national infrastructure projects, and it is clear that impact of the Asian Financial Crisis in 1997/98 still constrains the appetite for project finance risks and modalities. Nevertheless, the drivers of limited fiscal space and heavy public debt continue to drive the need to leverage diverse funding sources and to crowd-in the private sector. The lessons of capital market development in both traditional and non-traditional bonds seem positive and tenors have extended, plus commercial bank and other institutional interest has increased, as demonstrated by the PT SMI-sponsored infrastructure stock index.

The need for innovation and flexibility in both project packaging and product design is evident; an example is the cash deficiency support bridging product and the move to developer equity and early stage loans. The questions on the overall value added of PT SMI and PT IIF need more evidence and analysis; this includes the different roles of PT IIF and PT SMI going forward and the degree of overlap that might result.