ADB

Board of Directors

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R93-19
26 September 2019

Proposed Loan
Leveraging Private Infrastructure Investment Project (Indonesia)

1. The Report and Recommendation of the President (RRP: INO 50297-001) on the proposed loan to Indonesia for the Leveraging Private Infrastructure Investment Project is circulated herewith.

2. This Report and Recommendation should be read with (i) *Country Partnership Strategy: Indonesia, 2016–2019: Towards a Higher, More Inclusive and Sustainable Growth Path*, which was circulated to the Board on 23 August 2016 (DOC.Sec.M23-16); and (ii) *Country Operations Business Plan: Indonesia, 2020–2022,* which was circulated to the Board on 18 September 2019 (DOC.IN.281-19).

3. In the absence of any request for discussion and in the absence of a sufficient number of abstentions or oppositions (which should be communicated to The Secretary by the close of business on 18 October 2019), the recommendation in paragraph 44 of the paper will be deemed to have been approved, to be so recorded in the minutes of a subsequent Board meeting. Any notified abstentions or oppositions will also be recorded in the minutes.

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ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 50297-001
September 2019

Proposed Loan
Republic of Indonesia: Leveraging Private Infrastructure Investment Project

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Asian Development Bank

CURRENCY EQUIVALENTS
(as of 15 August 2019)

Currency unit	–	rupiah (Rp)
Rp1.00	=	$0.000070
$1.00	=	Rp14,293

ABBREVIATIONS

ADB	–	Asian Development Bank
BAPPENAS	–	Badan Perencanaan Pembangunan Nasional (Ministry of National Development Planning)
ESMS	–	environmental and social management system
ESSF	–	environmental and social safeguard framework
GDP	–	gross domestic product
IIF	–	PT Indonesia Infrastructure Finance
MOF	–	Ministry of Finance
OJK	–	Otoritas Jasa Keuangan (Financial Services Authority)
SDG	–	Sustainable Development Goal
SEMS	–	social and environmental management systems
SMI	–	PT Sarana Multi Infrastruktur (Persero)

NOTE

In this report, "$" refers to United States dollars.

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PROJECT AT A GLANCE

1. Basic Data — **Project Number:** 50297-001

Project Name	Leveraging Private Infrastructure Investment Project	**Department/Division**	SERD/IRM
Country	Indonesia	**Executing Agency**	PT Sarana Multi Infrastruktur (Persero)
Borrower	Republic of Indonesia		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=50297-001-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=50297-001-PortAtaGlance		

2. Sector

Sector	Subsector(s)	ADB Financing ($ million)
✓ **Finance**	Infrastructure finance and investment funds	100.00
	Total	**100.00**

3. Operational Priorities

✓ Strengthening governance and institutional capacity

Climate Change Information

Climate Change impact on the Project: Low

Sustainable Development Goals

SDG 9.1

Gender Equity and Mainstreaming

No gender elements (NGE) ✓

Poverty Targeting

4. Risk Categorization: Low

5. Safeguard Categorization — **Environment:** FI **Involuntary Resettlement:** FI **Indigenous Peoples:** FI

6. Financing

Modality and Sources	Amount ($ million)
ADB	**100.00**
Sovereign Credit line (Regular Loan): Ordinary capital resources	100.00
Cofinancing	**0.00**
None	0.00
Counterpart	**0.00**
None	0.00
Total	**100.00**

Currency of ADB Financing: US Dollar

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the Republic of Indonesia for the Leveraging Private Infrastructure Investment Project.

2. The project involves a sovereign financial intermediary loan of $100 million to Indonesia, which will be relent to PT Sarana Multi Infrastruktur (Persero) (SMI), then on-lent to PT Indonesia Infrastructure Finance (IIF) for mobilizing private sector investment in infrastructure development. The project will help close the infrastructure financing gap, raise the quality and standards of infrastructure projects, and alleviate competing demands on fiscal resources.

II. THE PROJECT

A. Rationale

3. **Stable economic growth.** Prudent macroeconomic management enabled Indonesia to weather the global financial crisis in 2008 as well as the sharp global commodities downturn in 2015, while achieving an annual average economic growth rate of 5% over the last decade. Indonesia has achieved measurable improvements in reducing poverty. National poverty incidence fell from 11% of the total population in 2014 to 9.4% in 2019. However, about 20.8% of the total population (56 million people) are clustered marginally above the national poverty line. With the country's output already close to its potential, any further increase in economic growth will require structural economic transformation.

4. **Inadequate quality infrastructure a critical constraint to inclusive growth.** Indonesia's infrastructure and infrastructure services are inadequate to support a modern, competitive middle-income economy and provide basic services to its people.[1] Poor infrastructure constrains connectivity in Indonesia's archipelagic geography. Indonesia's roads, ports, and airports are heavily congested. Logistics costs are high by middle-income country standards, affecting trade and investment. Inadequate infrastructure is a drag on Indonesia's competitiveness. In the 2018 Global Competitiveness Index, Indonesia ranked 45th out of 140 countries, but ranked 75th on the quality of roads and 87th on utility infrastructure.[2] Estimates indicate that a 1% of gross domestic product (GDP) equivalent of permanent increase in infrastructure investment in Indonesia would lead to a 2% increase in GDP in the medium and longer term.[3]

5. **Infrastructure development a key government priority.** The government has undertaken important institutional and regulatory reforms to facilitate infrastructure development. In 2010, with the support of ADB and the World Bank, the government established IIF, SMI, and PT Penjaminan Infrastruktur Indonesia (Persero), who have emerged as major players in the infrastructure landscape of Indonesia by providing debt financing, equity, guarantee as well as advisory services.[4] In 2014, the government established the Committee for Acceleration of Priority Infrastructure Delivery to address coordination problems leading to delays in rolling out

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[1] H. Hill, M.E. Khan, and J. Zhuang. 2012. *Diagnosing the Indonesian Economy – Toward Inclusive and Green Growth*. Manila: ADB; ADB. 2010. *Indonesia: Critical Development Constraint.* Manila.

[2] World Economic Forum. 2018. The Global Competitiveness Report 2018. http://reports.weforum.org/global-competitiveness-report-2018/.

[3] International Monetary Fund. 2018. *Article IV Staff Report*. Washington, DC.

[4] PT Sarana Multi Infrastruktur (Persero) is a state-owned enterprise that provides infrastructure project finance, advisory services and project development support. PT Penjaminan Infrastruktur Indonesia (Persero) is a state-owned enterprise that provides government guarantees for infrastructure projects.

infrastructure projects. In 2017, the government established the Non-Government Budget Investment Financing Initiative at the Ministry of National Development Planning (BAPPENAS) to promote private and other non-budget investment in selected projects.[5] The government plans to spend $450 billion in infrastructure development under the medium-term development plan, 2020-2024.[6]

6. **Leveraging private investment essential for closing the financing gap.** While continued improvements in public revenue and expenditure management will help create fiscal space for infrastructure and other priority development spending, increasing private sector participation will be essential for delivering the infrastructure development plan while reducing the fiscal burden. In 2017, the annual infrastructure expenditure of about $30 billion was dwarfed by annual investment needs of more than $70 billion before adjusting for climate change.[7] Moreover, private sector investments have the potential to enhance the quality of infrastructure through improved efficiency as well as knowledge and technology transfer.

7. **Limited sources of long-term finance and project facilitation services.** [8] With assets of about 117% of GDP, of which 74% are concentrated in the banking sector, Indonesia's financial sector is small compared to the Association of Southeast Asian Nations comparators such as the Philippines (193%), Viet Nam (215%), Thailand (359%) and Malaysia (385%). Project financing and more innovative structured products remain nascent. Legal lending limits applicable to single borrowers and borrower groups, and Basel III norms and asset-liability mismatch issues limit the scope of commercial banks' financing of infrastructure. With equity and local currency bond markets valued at approximately 51% and 19% respectively of GDP, Indonesia's capital market struggles to provide the long-term debt and equity financing needed to support government's ambitious infrastructure agenda. Unlike banks, institutional investors such as life insurance companies and pension funds are well suited to channel capital into infrastructure projects, because of the match between the long-term liabilities of such investors and the long-term nature of infrastructure investments. However, the institutional investor base is still relatively small in Indonesia, accounting for around 13% of GDP, and such investors tend to take a conservative and short-term approach to investments. Moreover, outside of liquid asset classes such as public equity and government bonds, participation of international institutional investors is limited due to the lack of a market for currency and interest rate hedging instruments.

8. **IIF can catalyze private sector participation.** IIF was established by the Government of Indonesia and development partners including ADB to provide financing solutions and instruments that are otherwise unavailable in the market.[9] In April 2019, PT Pemeringkat Efek Indonesia (PEFINDO), a national credit rating agency, maintained its national long-term rating of IIF's bonds at AAA with a stable outlook based on IIF's strategic importance, public sector and supranational ownership structure, and tight monitoring by the Ministry of Finance (MOF).[10] IIF bonds are mostly held by institutional investors (e.g., pension funds, mutual funds, and insurance), which help channel long-term funds to infrastructure projects. IIF has an expanding

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[5] These include 19 toll roads, 4 airports, 10 power projects, and one tourism project with a total value of $25.8 million. PINA (Center for Private Investment). http://pina.bappenas.go.id/.

[6] Government of Indonesia. 2019. *Medium-term Development Plan (RPJMN), 2020-2024: Technocratic draft*. Jakarta.

[7] ADB. 2017. *Meeting Asia's Infrastructure Needs.* Manila.

[8] ADB. 2019. *Report and Recommendation of the President to the Board of Directors: Financial Market Development and Inclusion Program (Subprogram 3)*. Manila.

[9] IIF has a total equity capital of Rp2,225.1 billion, which is owned by PT SMI (30.00%), International Finance Corporation and ADB (19.99% each), Deutsche Investitions- und Entwicklungsgesellschaft mbH (15.12%), and Sumitomo Banking Corporation (14.90%).

[10] PEFINDO. 2019. PT Indonesia Infrastructure Finance. Press release. 10 April. http://www.pefindo.com/index.php/fileman/file?file=PressRelease/2019-04-10-IIFF.pdf

portfolio and plays a critical market development role for infrastructure financing by (i) providing longer tenors (8 years on average) than what is available in the market; (ii) extending nonrecourse and limited recourse financing that support the development of a new asset class for project finance instruments; and (iii) offering scarcely available products such as mezzanine and equity finance. IIF partners with other banks and financial institutions through a syndication approach as prescribed by its investment limits. As of 2018, IIF leveraged Rp137 trillion of infrastructure investment from the domestic market through loan syndication and bonds issuance. When IIF plays the role of lead bank in the lending syndicate given its project structuring expertise, its participation adds an element of comfort to cofinanciers. In cases where IIF is not the lead bank, it undertakes an independent due diligence of the underlying risk and lenders agree on a common term sheet. Where IIF provides mezzanine or equity investments, it takes the riskier leg of the financing equation, thereby catalyzing senior bank debt. The MOF has expanded IIF's investment mandate to include social infrastructure such as health and education. To support IIF's expansion in response to the growing infrastructure finance market, the government obtained $200 million in additional financing from the World Bank and requested a new $100 million financial intermediation loan from ADB.

9. **Previous ADB assistance.** Since 2006, ADB has continuously supported the development of the infrastructure finance market in Indonesia through policy-based loans, grants, and technical assistance. To help set up IIF, in 2009 ADB approved (i) a financial intermediation loan of $100 million to Indonesia, and (ii) an equity investment of up to $40 million (rupiah equivalent) in IIF's capital.[11] ADB holds 19.99% of equity and has a representation in IIF's board of commissioners.[12] The loan partially financed eight subprojects with an aggregate investment cost of $1.3 billion, implying a loan multiplier effect of 12.7 times. The ADB loan was rated *highly relevant* and *effective* in achieving outcomes, *efficient* both in terms of utilizing the inputs to achieve the desired outcome and in terms of supporting the establishment of efficient processes and arrangements in IIF, and *likely sustainable*.[13] The project was assessed as being overall *successful*.[14]

10. **Lessons.** The proposed project incorporates lessons from previous engagements with IIF, which include: (i) subproject eligibility criteria, focusing on long-term debt and excluding subprojects with adverse environmental or social impacts; (ii) complementary technical assistance to strengthen IIF and SMI capacity in areas such as safeguards and credit enhancement products; (iii) submission of financial statements following ADB requirements; and, (iv) adequate coordination mechanisms between MOF, BAPPENAS, IIF, SMI, and ADB to proactively discuss project issues. The project also draws on lessons from similar financial intermediary loans, e.g., the ADB loan to the India Infrastructure Finance Company.[15] The lessons have been included in the project design, which include quarterly progress monitoring,

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[11] ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Equity Investment to the Republic of Indonesia for the Indonesian Infrastructure Financing Facility Company Project*. Manila.

[12] The conflict of interest that ADB's status as a shareholder and lender could give rise to is deemed manageable. ADB does not lend directly to IIF, although ADB and IIF will be parties to the same project agreement. ADB or its nominee on the IIF's board of commissioners will comply with all applicable Indonesian law requirements in relation to conflict of interest. The current practice of ADB and its nominee in IIF is to abstain from decisions that include transactions involving ADB.

[13] ADB. 2017. *Completion Report: Indonesian Infrastructure Financing Facility Company Project.* Manila.

[14] ADB. 2017. *Validation Report: Indonesia Infrastructure Financing Facility Company Project.* Manila.

[15] ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to India for the Second India Infrastructure Project Financing Facility*. Manila (approved 17 November, $700 million). Lessons include strong partnership with stakeholders and providing capacity building support.

establishment of subproject eligibility criteria, submission of audited project financial statements in a timely and acceptable manner, and coordination with development partners.

11. **Modality**. Building on the experience of the previous ADB assistance (footnote 11), the financial intermediation loan modality is best suited for the project as it will ensure financing of infrastructure projects through market-based allocation mechanisms as well as help strengthen the capacity of participating financial intermediaries. IIF is a financially sound institution and meets ADB's policy requirements for financial intermediation loans.[16] As reported by the national credit rating agencies, IIF has a superior capacity to meet its long-term financial commitments relative to that of other Indonesian obligors.[17]

12. **Coordination with development partners.** ADB, jointly with bilateral and other multilateral development financing institutions, played a critical role in the establishment and operation of IIF as an innovative financing mechanism to support infrastructure development in Indonesia. ADB coordinates with IIF's other shareholders (SMI, International Finance Corporation, Deutsche Investitions- und Entwicklungsgesellschaft mbH, and Sumitomo Mitsui Banking Corporation) and the World Bank (as lender to IIF) to maximize complementarity and synergy in the respective support provided to IIF.

13. **Alignment with ADB Strategy 2030 and country strategy.** ADB's sovereign financing will help address a key constraint posed by the lack of long-term funding sources and enable IIF to crowd-in private investments in infrastructure, while easing the fiscal burden. The project is consistent with ADB Strategy 2030 priorities on addressing remaining poverty and reducing inequality through the creation of quality infrastructure.[18] The project is aligned with ADB's country partnership strategy for Indonesia, 2016−2019 as well as the forthcoming country partnership strategy (2020−2024), which will focus on the acceleration of Indonesia's infrastructure development and promotion of private sector participation.[19] It complements ongoing ADB activities in support of Indonesia's efforts to strengthen preparation and implementation of infrastructure projects, and will link with both sovereign and nonsovereign infrastructure development operations in Indonesia.[20]

B. Project Description

14. The project is aligned with the following impact: availability of quality infrastructure increased. The project will have the following outcome: private investment in infrastructure catalyzed.[21]

15. **Output: Availability of long-term financing and facilitation services for infrastructure projects increased.** The project will allow IIF to provide long-term finance to the

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[16] IIF. 2019. *Financial Statement and Auditors Report as of 31 December 2018*. Jakarta.
[17] PEFINDO. 2018. *PT Indonesia infrastructure Finance Credit Profile*. Jakarta.
[18] ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific.* Manila.
[19] ADB. 2016. *Country Partnership Strategy: Indonesia, 2016−2019—Towards a Higher, More Inclusive and Sustainable Growth Path*. Manila.
[20] ADB. 2018. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan for Subprogram 3 to the Republic of Indonesia for Stepping Up Investments for Growth Acceleration Program.* Manila; ADB. 2018. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan for Subprogram 2 to the Republic of Indonesia for Financial Market Development and Inclusion Program.* Manila; and ADB. 2018. *Technical Assistance to the Republic of Indonesia for the Sustainable Infrastructure Assistance Program Phase II*. Manila.
[21] The design and monitoring framework is in Appendix 1.

infrastructure sector at tenors otherwise difficult to secure in the market. The ADB loan will be relent by the MOF to SMI and then onlent to IIF to finance infrastructure projects. IIF will lend to subprojects at commercial terms following IIF's operations manual and ADB's subproject and subborrower selection criteria. Lending to additional infrastructure projects would offer IIF a platform to expand its project facilitation services and products such as transaction advisory and credit enhancement.

C. Value Added by ADB

16. Building on the experience of the first ADB loan for IIF, the project will seek to add value by strengthening Indonesia's infrastructure finance market and boosting the capacity of two key institutional actors in the infrastructure financing landscape (SMI and IIF). ADB loan will help IIF expand its lending operations and its ability to offer longer tenors on its loans, which in turn will fill a critical market gap for infrastructure financing. An improvement from the previous ADB loan includes the establishment of clearer subproject selection criteria to enable expansion of quality infrastructure projects.[22] ADB technical assistance will support IIF with the planned expansion of credit enhancement products, undertaking financial and economic assessments of subprojects, and social and environment safeguards.[23] ADB's financial support for the proposed project and application of IIF's overall product lines and exposure limits are anticipated to generate the financial close of $1,536 million in terms of project costs. This means that every dollar of the ADB loan would leverage about $14.36 from the market.

D. Summary Cost Estimates and Financing Plan

17. The IIF has identified 12 potential infrastructure subprojects in the following sectors: transportation, water, energy, telecommunication, and health.[24] The indicative list of subprojects will be evaluated and screened based on IIF's operations manual and the project's subproject and subborrower selection criteria. The total investment for the subprojects is estimated at $1,536 million. ADB will finance $100 million of the estimated total investment. IIF is expected to mobilize $1,436 million from the domestic market through loan syndication and bond issuance.[25] Table 1 summarizes ADB's financing plan during the investment period.

Table 1: Summary Financing Plan

Source	**Amount** ($ million)	**Share of Total** (%)
Asian Development Bank		
Ordinary capital resources (regular loan)	100.0	100.0
Total	100.0	**100.0**

Sources: Asian Development Bank.

18. The government has requested a regular loan of $100 million from ADB's ordinary capital resources to help finance the project. The loan will have a 20-year term, including a grace period of 9.5 years; an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; a commitment charge of 0.15% per year and such

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22 Financial and Economic Analysis (accessible from the list of linked documents in Appendix 2).

23 ADB. 2018. *Technical Assistance to the Republic of Indonesia for the Sustainable Infrastructure Assistance Program Phase II*. Manila.

24 Based on project readiness documents submitted by SMI and IIF to BAPPENAS. The indicative list of subprojects is in Annex A of the Supplementary Document: PT Indonesia Infrastructure Finance (accessible from the list of linked documents in Appendix 2).

25 The World Bank approved $200 million in 2017. World Bank. 2017. *Indonesia Infrastructure Finance Facility Additional Finance*. Washington, DC.

other terms and conditions set forth in the draft loan and project agreements. The loan will be repaid in three installments (50% in 10 years, 40% in 15 years and 10% in 20 years). Based on the custom-tailored repayment method, the average maturity is 13 years, and no maturity premium is payable to ADB. The ADB loan may finance taxes and duties for subprojects. ADB loan proceeds will be relent in rupiah and US dollars by (i) MOF to SMI under a subsidiary loan agreement, and (ii) subsequently from SMI to IIF under a subordinated loan agreement. The MOF relending charges are as follows: (i) in US dollars, the rate per annum is the rate in the loan agreement for the project plus 0.34%, and (ii) in rupiah, the rate per annum is similar to the rate on 20-year government securities issued in the same year.

E. Implementation Arrangements

19. The implementation arrangements are summarized in Table 2 and described in detail in the project administration manual.[26]

Table 2: Implementation Arrangements

Aspects	Arrangements
Implementation period	January 2020–September 2023
Estimated completion date	30 September 2023
Estimated loan closing date	31 December 2023
Management	
(i) Oversight bodies	Ministry of Finance and Ministry of National Development Planning
(ii) Executing agency	PT Sarana Multi Infrastruktur (Persero)
(iii) Implementing agency	PT Indonesia Infrastructure Finance

Sources: PT Sarana Multi Infrastruktur (Persero); PT Indonesia Infrastructure Finance.

20. **Project management.** SMI will be the executing agency and IIF will be the implementing agency. BAPPENAS will carry out quarterly reviews of project implementation through the quarterly monitoring meeting mechanism, which is chaired by BAPPENAS in coordination with the MOF pursuant to Article 53-56 of BAPPENAS Regulation no. 4/2011 on planning, submission, assessment, monitoring, and evaluation mechanism of activities financed from foreign loans and grants.

21. **Subproject eligibility criteria.** The eligibility requirement for subprojects are as follows:[27]

(i) each qualified subproject is financially viable (i.e., financial rate of return is higher than the weighted average cost of capital);
(ii) each qualified subproject has environmental and social safeguard *category B* or *category C* under the environmental and social management system (ESMS); any qualified subproject with *category A* based on IIF's screening procedures for any of the safeguards will be excluded from financing;
(iii) for qualified subprojects with likely *category B* impact, (a) ESMS is used to screen and categorize the potential impact; (b) relevant safeguard plans are prepared and disclosed; and (c) the qualified enterprise commits to periodic monitoring and review of such qualified subprojects and takes corrective actions as necessary;[28] and,

[26] Project Administration Manual (accessible from the list of linked documents in Appendix 2).
[27] Qualified subproject refers to a subproject that satisfies the subproject eligibility criteria. IIF will ensure that subproject approval procedure detailed in the project administration manual (footnote 25) will be followed.
[28] Qualified enterprise refers to an enterprise that satisfies the subborrower eligibility criteria.

(iv) each qualified subproject is screened in accordance with IIF's operational guidelines and screening procedures for legal, financial, and integrity risks, among others.

22. **Subproject screening.** IIF has a robust and well-established subproject screening mechanism. Due diligence covers legal, financial (e.g., sponsor financial performance and debt service capacity), environmental, and social aspects, with special attention on risk assessment focusing on commercial, reputational, regulatory and legal, compliance, macroeconomic, political, insurance, and severity of audit-finding risks. Based on the feasibility and risk analyses, an assessment is conducted on whether any form of guarantee or collateral is needed to raise the subproject's bankability. Site visits are conducted to verify the preliminary data and information received from the potential borrower. IIF will ensure that subprojects follow the approval procedure detailed in the project administration manual (footnote 26).

23. **Subborrower eligibility criteria.** The eligibility requirement for subborrowers are as follows:

(i) an incorporated entity engaged in infrastructure development with demonstrated competence to undertake the qualified subproject;
(ii) a financially viable institution as demonstrated by, among others, its capacity to repay the subloan and, where applicable, an average debt coverage ratio higher than 1.1 times as determined in accordance with IIF's operations manual;
(iii) not a related party of IIF or its senior management unless it is in accordance with IIF's related party transaction policy; and
(iv) eligible under IIF's operational guidelines and screening procedures, including know your customer requirements.

24. **Maximum subloan size.** IIF can finance up to 40% of total project cost for direct lending for subprojects above Rp3 trillion, 50% for subprojects above Rp500 billion to Rp3 trillion, or 80% for subprojects below or equal to Rp500 billion. ADB will not stipulate any additional limitations on subloan size.

25. **Procurement.** All goods and works to be financed under the ADB loan will be procured in accordance with the ADB Procurement Guidelines (2015, as amended from time to time)[29] as applicable to a financial intermediary loan, and detailed arrangement agreed between the government and ADB. The ADB Procurement Guidelines relating to financial intermediary states that where the financing provides funds to an intermediary institution, such as this project, to be onlent to beneficiaries such as private sector enterprises, small and medium-sized enterprises, or autonomous commercial enterprises in the public sector for the partial financing of subprojects, the procurement is usually undertaken by the respective beneficiaries in accordance with established private sector or commercial practices that are acceptable to ADB. IIF will follow its operations manual and procurement manual (2011) on the procurement of goods, works, and services, which ADB assessed in September 2018 to be acceptable private sector practice. IIF will also cause the subborrower to ensure that goods, works, and services to be financed under the project be produced in and supplied from ADB member countries with due attention to eligibility requirements for all project contractors, suppliers, consultants, and other service providers.

[29] ADB. 2015. *Procurement Guidelines*. Manila. The concept paper of the proposed project was approved in February 2017.

26. **Disbursement.** IIF will be responsible for preparing disbursement projections, collecting supporting documents, preparing withdrawal applications, and submitting the withdrawal applications to ADB (through SMI) in accordance with ADB's *Loan Disbursement Handbook* (2017, as amended from time to time). Financial due diligence undertaken during project preparation determined that both SMI and IIF have significant financial management experience and capacity and will be able to ensure effective and appropriate project financial management, including to administer advance account and statement of expenditure procedures.

III. DUE DILIGENCE

A. Economic and Financial Viability

27. The ADB loan is expected to catalyze investment of $1,436 million to finance about 14 subprojects in sectors such as transportation, water, energy, telecommunication, health, and education. The 2009 ADB loan (footnote 11) financed eight subprojects with positive economic impact.[30] The subprojects contributed to the much-needed expansion of the telecommunication tower network throughout the archipelago. For example, one subproject enabled the borrower to acquire 3,500 operating telecommunication towers, making it Indonesia's third-biggest tower company. The power generation subprojects have contributed to raising the population's access to electricity through the construction of new gas pipelines and provision of additional gas-based electricity capacity.

B. Sustainability

28. The 2009 ADB financial intermediation loan of $100 million to Indonesia, which was relent to SMI and then onlent to IIF, was rated *likely sustainable* (footnotes 13 and 14). The project completion report highlighted that since its establishment, IIF has become a credible—though still small—player in the domestic infrastructure finance market because of its focus on project finance, robust risk management framework, expertise in social and environment safeguards management, and ability to provide long-term debt to infrastructure projects. More importantly, IIF has proven its ability to raise (i) medium- and long-term rupiah funding domestically, and (ii) medium-term funding from international lenders. IIF has also benefited from the capacity building support provided by its shareholders. For instance, the World Bank has been supporting IIF on safeguards. Furthermore, IIF has benefited from its shareholder structure in terms of organization structure, processes, and arrangements, as well as the quality of its operational policies.

29. IIF and SMI are regulated by the Ministry of Finance Regulation no.100/PMK.010/2009 on Infrastructure Financial Institutions, which also requires IIF to maintain a debt-to-equity ratio not exceeding 10 to 1. Indonesia's Financial Services Authority (OJK) supervision team monitors IIF's compliance with the MOF regulation. Under the project, IIF will maintain the following financial ratios during its financial year and for each financial quarter following the borrower's applicable laws and regulations and IIF's accounting practices: (i) capital adequacy ratio of 12%, which is calculated as a percentage of IIF's total capital to its total risk-weighted assets, each as defined in IIF's operations manual; (ii) total long-term debt to total equity ratio of 10:1; and (iii) current ratio of 1.0 where the current ratio is calculated as current assets of IIF divided by its current liabilities. Should IIF fail to maintain any of the financial ratios, IIF and ADB will agree on an action plan within 90 days from the date of submission to ADB of the earlier of (i) the annual audited financial

[30] Economic internal rates of return on private sector infrastructure investments are difficult to quantify because prevailing private sector practices on due diligence do not include estimates of economic returns of subprojects. Project pre-feasibility studies often include a cost−benefit analysis.

report, or (ii) the quarterly risk management report, which evidences the noncompliance, for IIF to implement measures to address its financial performance and maintain such ratios. Upon the date of agreement, IIF will start implementing the action plan and complete implementation within the timeline set out in the action plan.

30. In 2018, IIF's risk-weighted capital adequacy ratio was 35.1%, which is projected to be gradually reduced to 25.6% by 2023. The capital adequacy ratio of Indonesia's banking industry averaged 20% in the last five years. IIF's current ratio in 2018 was 1.27 times, which is projected to be 1.1 times by 2023. In 2018, long-term debt to total equity ratio stood at 3.15, which is expected to be 4.0 in 2023. In 2017 and 2018, IIF recorded a net loss of Rp81.62 billion and Rp42.95 billion, respectively, breaking with profitability trend of prior years. The loss in 2018 is due to early repayment fee for two loans and loss on interest rate hedge. The 2017 loss was partially attributable to unrealized loss stemming from change in fair value of equity investment. IIF projects to gain profit in 2019 on the back of growth in loan commitments and disbursements in 2018. The projection of return to profit is supported by the 2019 first quarter data in which IIF recorded profit.

C. Governance

31. **Financial management.** IIF complies with all prudential regulations and lender's financial covenants as disclosed in its annual audited financial statements, and has adequate credit and risk management policies, operating systems, and procedures to administer the proposed project.[31] IIF has adopted a two-tier decision-making oversight system with its board of directors and board of commissioners. IIF conducts operations in accordance with a comprehensive operations manual that was initially designed with support of the World Bank and ADB and then approved by IIF shareholders.[32] IIF is relatively conservative in its investment decisions and has a tight and strict lending policy that has been implemented since its inception, adopting international best practices from its shareholders' policies. IIF established a special asset management unit in 2016 to monitor and manage loans defined as problematic, including those not yet in default but have shown deteriorating quality. IIF manages liquidity risk mainly by monitoring position against limits, maintaining adequate reserve funds, and matching the maturity between financial assets and liabilities as far as practicable.

32. The pre-mitigation financial management risk is *low* mainly because (i) financial statements are prepared in accordance with the International Financial Reporting Standards and follow the OJK mandatory requirements as a public listed company in the Indonesia Stock Exchange; (ii) the internal audit functions are guided by an operating manual, which has adequate arrangements for a functional internal control; (iii) financial statements are audited regularly by an independent auditor registered with OJK; and (iv) structure, qualifications, and capacity are adequate. No significant integrity risks were identified in the integrity due diligence carried out on IIF.

33. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government, SMI, and IIF. The specific policy requirements and supplementary measures are described in the project administration manual (footnote 26).

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[31] Financial Management Assessment (accessible from the list of linked documents in Appendix 2).

[32] Like all Indonesian limited liability companies, IIF's board of commissioners represents the shareholders, and the board of directors is responsible for day-to-day operations.

D. Poverty, Social, and Gender

34. Infrastructure provides significant benefits for the poor, with a robust negative correlation between infrastructure availability and poverty in Indonesia. For example, when road quality in rural areas improves, household income is also seen to improve, and vice versa. Ensuring quality roads and public transport systems is important for women's access to jobs, markets, and other services. To meet global commitments in line with the Sustainable Development Goal (SDG) framework on universal access to affordable, reliable, and cleaner energy services (SDG 7) and quality infrastructure to support economic development and equitable access for all (SDG 9), investments need to be scaled up. The channels through which poor and vulnerable people will benefit from the project include improved access to social and economic services associated with infrastructure investment.

35. IIF will adopt the following gender-related design features: (i) assess internal mechanisms and capacities to promote greater visibility of gender and social inclusion considerations in the design of its subprojects; (ii) ensure that recipient subprojects will identify and maximize opportunities for women's participation in employment opportunities during construction, operation and maintenance of infrastructure, with potential adoption of evidence-based gender-related targets; (iii) promote adherence to national core labor standards and commitments to gender equality and women's empowerment stated in the government's legislation and regulations; and (iv) assess the social and gender impact of the project and the potential use of identified women-friendly technologies for greater social and gender-related elements. Potential subprojects to be financed by the ADB loan would promote women's empowerment through improved access to health services, telecommunication, electricity and transport networks. This would optimize the time women are able to spend engaging in productive activities.

E. Safeguards

36. The ADB loan will only finance *category B* and *category C* subprojects. IIF's operations manual, environmental and social safeguard framework (ESSF), and social and environmental management systems (SEMS), prepared with ADB, International Finance Corporation, and World Bank assistance, align with the policies and guidelines of these institutions. IIF's ESSF is guided by eight principles: (i) social and environmental assessment and management system; (ii) labor and working conditions; (iii) pollution prevention and abatement and climate change; (iv) community health, safety, and security; (v) land acquisition and involuntary resettlement; (vi) biodiversity conservation and natural resources management; (vii) indigenous people; and (viii) cultural property and heritage. Under the third principle, subprojects financed by IIF are required to address pollution prevention and management of impacts arising from subproject activities, ensure conformity with global good practices and standards, promote more sustainable use of resources, and ensure that climate change issues associated with subproject activities are assessed, mitigated, and monitored over the life of IIF's investment.

37. ADB's assessment of the IIF's ESSF, SEMS, and operations manual pointed to equivalence to ADB's Safeguard Policy Statement (2009), while noting minor differences in procedural and administration processes.[33] An ESMS for the proposed project has been prepared following ADB's Safeguard Policy Statement and IIF's SEMS and operations manual. The ESMS describes the safeguard principles, assessment on IIF's SEMS, operations manual and implementation practices, identification on the gaps, and mitigation measures to be implemented

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[33] Financial Intermediary: Environment and Social Management System Arrangement (accessible from the list of linked documents in Appendix 2).

for the subprojects. The ESMS also includes procedures for screening and categorizing subprojects and building capacity of IIF and its clients to manage safeguard monitoring and reporting.

38. IIF will screen and categorize subprojects for social and environmental safeguards using the ESMS. IIF will provide categorization of impacts and risk to allow ADB to assess each safeguard adequately. Subprojects triggering *category A* for environment, involuntary resettlement, or indigenous people safeguards will not be selected. Subprojects involving business activities included in the prohibited investment activities list in the ESMS will not qualify for ADB financing and applications involving such activities will be rejected. IIF will advise and provide guidance to their clients on the types of social and environmental management plans that need to be prepared, and consultation and disclosure requirements.

39. IIF can add value to the infrastructure financing market by raising standards based on international good practices. However, bridging the gap between international good practice on safeguards (as reflected in IIF policies) and the prevailing national practices will require continued efforts on dialogue with stakeholders and strengthening of capacity through the project implementation chain. To address these gaps and through support from its shareholders, IIF has taken measures including (i) substantially boosting the capacity of the social and environmental safeguard unit at IIF, (ii) training on social and environment safeguards to IIF staff and clients, and (iii) public disclosure of project summary and documents.[34] ADB will continue to coordinate with IIF's shareholders and lenders who are supporting IIF on strengthening safeguard capacity, including on environment and climate-related issues.

F. Summary of Risk Assessment and Risk Management Plan

40. There are no substantial risks. Moderate risks and mitigating measures are described in detail in the risk assessment and risk management plan.[35] IIF will employ its risk management plan to address project specific risks (para. 41). Furthermore, quarterly project progress review meetings, chaired by BAPPENAS (para. 20), will provide oversight and address risks to subproject implementation.

41. IIF continuously monitors risks arising from its operations through its risk management department. Quarterly risk management reports cover the analysis of (i) the investment and treasury portfolios' development; (ii) credit risk (including social and environment risk); (iii) market risk; (iv) liquidity risk; (v) operational risk; (vi) business, reputation, and legal risks; (vii) macroeconomic, political, regulatory, and strategic risks; (viii) information technology risks; and (ix) the severity of audit findings, and insurance and compliance risks. These reports are submitted to the board of director's risk management committee and board of commissioner's risk oversight committee for consideration and guidance. If developments such as rating downgrade of sponsors or delay in implementation of safeguards action plan require proactive mitigation measures, IIF transfers them to the special asset management unit to administer such subprojects until they return to normal status.

IV. ASSURANCES

42. The government, SMI, and IIF have assured ADB that implementation of the project shall conform to all applicable ADB policies, including those concerning anticorruption measures,

[34] IIF. 2019. *Project Summary*. https://iif.co.id/en/social-environmental/project-summary/
[35] Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

safeguards, gender, procurement, consulting services, financial management, and disbursement as described in detail in the project administration manual and loan documents.

43. The government, SMI, and IIF have agreed with ADB on certain covenants for the project, which are set forth in the loan and project agreements.

V. RECOMMENDATION

44. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of $100,000,000 to the Republic of Indonesia for the Leveraging Private Infrastructure Investment Project, from ADB's ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 20 years, including a grace period of 9.5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan and project agreements presented to the Board.

Takehiko Nakao
President

20 September 2019

DESIGN AND MONITORING FRAMEWORK

Impact the Project is Aligned with
Availability of quality infrastructure increased (National Medium-Term Development Plan, 2020–2024) [a].

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcome Private investment in infrastructure catalyzed	By 2024 end: Infrastructure investments leveraged by IIF increased to Rp170 trillion (2018 baseline: Rp137 trillion)	IIF's annual, quarterly risk management and audit reports; IIF bond underwriters' report	Dilution of government commitment to acceleration of infrastructure delivery Economic or financial sector crisis adversely affecting investor and lender interest in infrastructure projects
Output Availability of long-term financing and facilitation services for infrastructure projects increased	By 2023 end: 1a. Average tenor of IIF's debt increased to 12 years (2018 baseline: 8 years) 1b. At least one social infrastructure subproject financed (2018 baseline: 0) 1c. IIF's income from transaction advisory services increased to Rp21 billion annually (2018 baseline: Rp12.4 billion) 1d. IIF operationalized at least two additional credit enhancement products (2018 baseline: 1)	1a-1d. IIF's annual, quarterly risk management reports	IIF's portfolio quality deteriorates leading to shortening of loan tenors Higher cost of IIF financing because of changes in regulatory requirements or tightened liquidity conditions Small project pipeline because of inadequate preparation or delayed bidding of infrastructure projects by government contracting agencies

Key Activities with Milestones
1. Availability of long-term financing and facilitation services for infrastructure projects increased 1.1 Finalize indicative project pipeline to be financed by ADB funds (Q1 2020). 1.2 Conclude subsidiary loan agreement between MOF and SMI, and subordinated loan agreement between SMI and IIF (Q1 2020). 1.3 Conduct risk assessment and financial and safeguards due diligence on projects to be financed by ADB loan (Q1 2020–Q2 2023). 1.4 IIF management obtains IIF board approval for projects eligible to be financed by ADB loan per IIF's operations manual (Q1 2020–Q2 2023). 1.5 Develop enhancements to corporate and business development and funding strategies to strengthen IIF capabilities and institutional setup, given the expansion of products and services (Q1 2020–Q2 2023). 1.6 Conduct monitoring of approved projects financed by ADB loan (Q1 2020–Q2 2023). 1.7 Disseminate knowledge on best practices in infrastructure finance, including on environment and social safeguards in infrastructure projects delivered by the private sector (Q1 2020–Q2 2023).
Inputs
Asian Development Bank: $100,000,000 (loan)
Assumptions for Partner Financing
Not Applicable

ADB = Asian Development Bank, IIF = PT Indonesia Infrastructure Finance, MOF = Ministry of Finance, Q = quarter, Rp = Indonesia rupiah, SMI = PT Sarana Multi Infrastruktur (Persero).
[a] Government of Indonesia. 2019. *National Medium-Term Development Plan, 2020-2024 (technocratic draft)*. Jakarta.
Contribution to the ADB Results Framework: No linkages to the transitional results framework
Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

http://www.adb.org/Documents/RRPs/?id=50297-001-3

1. Loan Agreement
2. Project Agreement
3. Sector Assessment (Summary): Infrastructure Financing
4. Project Administration Manual
5. Financial and Economic Analysis
6. Summary Poverty Reduction and Social Strategy
7. Risk Assessment and Risk Management Plan
8. Financial Intermediary: Environmental and Social Management System Arrangement

Supplementary Documents

9. Financial Management Assessment
10. PT Indonesia Infrastructure Finance