

Foreign ownership implications on Indonesia's real estate

RYZ Property Consulting Internal View

Further relaxation

Foreign ownership in real estate in Indonesia has been regulated under the Law Number 5/1960 about Basic Regulations on Agrarian Principles and the Government Regulation Number 103/2015 about Ownership of Houses or Residences by Foreigners Domiciled in Indonesia. The laws are very restrictive to foreign ownership, especially for individuals. Under the law, a foreign individual can only possess the right to use (HP – *hak pakai*) for residential real estate. The original intention is to prevent perpetual land ownership and control by a foreign individual that can also be inherited to their descendants. This spirit was honored and shape every modern rules and regulation about foreign real estate ownership in Indonesia.

There is, however, a way for foreigners to own real estate in Indonesia through a foreign investment company (PMA – *penanaman modal asing*). Foreign investment companies can own any real estate assets, including commercial real estate. But, as the law itself has stated clearly, any company incorporated in Indonesia can only obtain the right to construct and own buildings on the land (HGB – *hak guna bangunan*) as the highest possible title. Right to construct and own buildings on the land have a definite life for up to 80 years after a series of extension and renewal. Fortunately, the existing regulations work just fine for any foreigners doing business in Indonesia using a foreign investment company. For businesses, it is not a necessity to control the real estate asset in perpetuity.

However, this situation soon to be changed. The government is eager to relax the law further, which will allow individual foreigners to obtain the right of ownership over condominium (HMSRS – *hak milik satuan rumah susun*) instead of the existing right to use. The new regulation is due very soon and has included in the new law draft about *Cipta Kerja*. Since the right of ownership over condominium offers more secure tenure and legality status to its holder, the government was hoping to stimulate the real estate industry in Indonesia in the aftermath of the COVID-19 pandemic. Furthermore, banks accept the right of ownership over condominium as collateral for a mortgage.

Knowing the limits

In the past, the government has been stringent with individual foreign ownership in real estate. The most recent ministerial regulation enacted in 2016 about foreign ownership was regarded as a futile attempt to stimulate the real estate industry in Indonesia. For example, aside from the obligatory right to use, foreigners are only allowed to purchase a property if they hold a residency permit in Indonesia and only for properties with a specific value and size. On top of that, the property must be transferred or sold to an eligible party within a year after they depart Indonesia, making a long-term investment option is not feasible.

Despite that, the government seems confident to repeat the same approach in the new *Cipta Kerja* law. The only notable difference is the changes of the allowed ownership title from the right to use to the right of



Restaditya Harris
Partner
restaditya@ryzconsulting.com

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ownership over condominium. Knowing the other pre-requisites are still in place, will this new regulation be able to achieve its objective and create a meaningful impact as designed?

Looking at the numbers

Surprisingly, only a few information available regarding the number of individual foreigners who eligible to purchase a property under the prevailing laws. A national survey by Bank Indonesia in 2009 may provide a rough indication of the proportion of the length of stay of individual foreigners who work in Indonesia, which may imply their likelihood to purchase a property. According to the survey, approximately 84% of their respondent have stayed for more than a year in Indonesia. That survey also discovered that most of the foreign workers reside in Java Island, with nearly 80% of them is in Jakarta.

Compiled from various sources, the number of foreign workers in Indonesia has reached nearly 96,000 people in mid-2019. Therefore, as an example, the number of foreign workers in Jakarta who might purchase a property is about 64,000 people. How significant is the impact?

Marketbeat report by Cushman & Wakefield in Q1 2020 shows the total condominium supply in the Greater Jakarta area by the end of 2019 stood at 300,675 units with the overall vacancy rate of 50%. So, nearly 150,000 condominium units are vacant by the end of 2019, and that situation will be most likely getting worse in 2020. Hypothetically, if all foreign workers in Jakarta decided to buy those condominium units, will the real estate market thrive and bloom again? The answer is rather complicated and depends on whose perspective.

Potential predatory situation

First, remember that all those existing foreign workers must already have a roof over their heads. What will happen is probably a predatory situation where tenants will move out from the condominium rental market to the ownership market, effectively negating each other's floor take-up on the market. Therefore, relying on the existing foreign workers' demand only will not improve the low occupancy situation in the condominium market. Undoubtedly, this must aggravate every new condominium development business case in the future.

Secondly, knowing the prevalent supply and demand mismatch, as well as the low rental yield in the Indonesian real estate market, foreign workers will be most likely to choose to rent over buying a condominium. Amplified by the troublesome pre-requisites to own a property, renting will be the most viable option for foreigners in the meantime.

As a result, the rental condominium landlords might not be having any happy ending as opposed to those who wish to liquidate their condominium assets. But it might not be a happy ending too for them as they need to sell it at a bargain to attract potential buyers. The fact is, these days are the best time for renters, but not so much for buyers despite the COVID-19 pandemic. There is a massive and collective reluctance among landlords to lower their selling price, at least on the surface.



Restaditya Harris
Partner
restaditya@ryzconsulting.com

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Driving up demand where it least needed

Another implication from foreign ownership in residential real estate is the rising demand. Although by means of number it is relatively low compared to the demand generated by local residents, it is still a demand. In the case of Jakarta and perhaps other urban areas in Indonesia, additional demand is not welcome when the existing demand is there, and the number is astronomical.

Quoted from the Bureau of Central Statistics (BPS – *Badan Pusat Statistik*), the demand for housing in Indonesia, as represented by housing backlog number, is estimated at no less than 11 million units. In Jakarta alone, there are at least 1.3 million housing units on demand. Inevitably, rising demand from foreign ownership scheme will lead to a price hike across all real estate sub-sectors regardless of the effort to contain the impact in a specific sub-sector, like the condominium.

Competing for scarce common resource: land

The original setting of the previous and new regulation is to allow individual foreigners to purchase condominium units only, with the hope of minimizing competition with local residents. However, in the end, that competition will lead to one scarce common resource: land.

Despite the number of individual foreigners who will purchase a condominium unit is only a fraction of the local population, such a situation can significantly impact the real estate market in general. One big potential problem lies if the future new condominium development is driven and led by speculative behavior. Such behavior is extremely harmful to the real estate industry and economy in general. Speculative actions will drive real estate prices even further, right when housing unaffordability becomes one of the primary issues worldwide today, especially when considering that the purchasing power of foreigners is often much stronger than the local residents. And last but not least, speculative development tends to lead to speculative investment from the buyer's side and cause a bubble to the real estate market. Often, the owner of those properties is the one who suffers and takes the loss when the music stops.

Meanwhile, the government seems powerless in controlling the supply side of the real estate market. Apart from the pro and cons, the government should step in and take tighter measures to regulate the real estate supply-side and prevent such speculative development. For example, perhaps it is time to scrutinize every real estate development planning application to ensure they have conducted proper market research and feasibility study before granting any permits, just like the typical infrastructure projects.

Reflecting from other countries

The impact of foreign investment on real estate prices is evident. The study by Nguyen (2011), Gholipour (2012), Gauder *et al.* (2014), Gholipour *et al.* (2014), Wokker & Swieringa (2016), Brooks *et al.* (2017), and



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Partner
restaditya@ryzconsulting.com

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Guest & Rohde (2017) demonstrated that foreign investment does contribute to real estate price increase. However, it varies between cities and countries used in the study.

Currently, about 109 countries allow full ownership for individual foreigners, while the other 17 only allow partial ownership, and the remaining 71 prohibited individuals foreigners to own property in their market. Restriction on foreign ownership is more prevalent in Asia rather than in America and Europe. However, there is an emerging protectionism trend among countries that already allowed individual foreigner ownership in their real estate market.

There is a growing concern about the impact on rising real estate prices, which makes local residents hard to buy or rent a property in places like London, New York, San Francisco, Sydney, and Melbourne. Additionally, a significant amount of foreign ownership will make a real estate market is more susceptible to external shocks. It is critical to ask whether Indonesia is ready or not to open its door, even just slightly wider, to foreign ownership? Knowing even the most advanced real estate market out there is considering readjusting their policies on foreign ownership.

Ways forward

At one point in the real estate industry journey of a country, allowing foreign ownership is almost a necessity. Even for Indonesia, foreign ownership is already happening through the foreign investment company. The new *Cipta Kerja* law only slightly improves the existing regulation and fair chances that it will have no impact on the foreign ownership real estate demand but, it may lead to speculative behavior from the supply side. However, if Indonesia has finally decided to welcome and open the market to allow full foreign ownership in its real estate market, there are a lot of things that need to prepare. Every real estate's stakeholder must be ready and establish all the necessary policies, regulations, governing authorities, market infrastructures, and capable human resources.

Addressing the current supply and demand mismatch by improving real estate market data transparency and providing education to stakeholders is the most important thing that both government and private sectors must do for the real estate industry in Indonesia. The government must also reevaluate the medium to a long-term policy and strategy for the real estate industry in the country. Improving the quality of housing backlog data by aligning the backlog definition from the Bureau of Central Statistics and the Ministry of Public Works and Public Housing could be the first step. Afterward, providing an integrated land registry system and forming a super regulatory body to control the supply side of real estate are a few actions that the government can also consider.

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Restaditya Harris
Partner
restaditya@ryzconsulting.com

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