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STATEMENT OF THE PROBLEM
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MAPPING OF MUNICIPAL LOAN CAPACITY IN INDONESIA

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ABSTRACT
Region's dependence on central government is very high, the contribution of the balancing funds from 2010 to 2015 is consistently in the range of 60%. Thus the role of the region issuing municipal bonds is required. This paper examines loan potential area focused on the regional financial capacity and accountability using DSCR (Debt Service Coverage Ratio), Capability of LGR and BPK's opinion. Quantitative approach with descriptive statistical method is used to map the potential supply from region as issuer and local community as potential investors. Potential demand is quantified using ratio of deposits to the population of the local area. The results of this research indicate there seven provinces with greatest potential supply namely DKI Jakarta, Sumatera Utara, Jawa Barat, Jawa Tengah, Jawa Timur, Sulawesi Selatan, and Nusa Tenggara Barat. While the potential demand comes from DKI Jakarta, Sumatera Utara, Bali, Papua and Kalimantan Timur. These results prove that only two provinces that were ready to issue municipal bonds both demand and supply, they are DKI Jakarta and Sumatera Utara.

KEYWORDS
municipal bonds, region's potency, supply demand.

1. INTRODUCTION
Based on National Medium Term Development Term (NMTDT) 2015-2019, needs of infrastructure investment in Indonesia is USD 424,54 billion while potency of National Expenditure and Revenue Estimation (NERE) is still limited to USD 130 billion. It has gap funding in the amount of USD 294,57 billion which must be provided by the government through a loan (Nazara 2016). Fiscal policy to have a direct loan from developed countries is decreased and turned by issuing sovereign bonds with retail model. It influences the developments of retail conventional bonds and sukuk which had oversubscribed demand when they were being issued. In spite of increasing local investment culture, it also could decrease capital outflow.

Funding gap problem also calls for local governments' contribution, especially investing in strategic infrastructure in their country. But the capability of Local Expenditure and Revenue Estimation (LERE) has remained deficit for the past 5 years. While balancing funds policy from central government is continuing to decrease every year, on contrary locally-generated revenue (LGR) contribution to LERE is continue to increase (Kemendagri 2015). This potency must be optimized by the local government as a player and central government as regulator and supervisor to support municipal investment based on bonds.

TABLE 1: POSTURE OF LERE 2011 -2015

	LERE 2011	LERE 2012	LERE 2013	LERE 2014	LERE 2015
LGR Composition	13 %	20 %	20,65 %	22,67 %	24,11 %
Balancing funds	68 %	66 %	63,43 %	60,45 %	55,93 %
Another Income	19 %	14 %	16,02 %	16,88 %	19,95 %
Total Income	Rp. 522.33	Rp. 577.08	Rp. 682.34	Rp. 796.87	Rp. 937.00
Total outcome	Rp. 521.74	Rp. 617.54	Rp. 736.56	Rp. 855.27	Rp. 1.012.86
Surplus/ deficit	Rp. 0.59	Rp. – 40,46	Rp. -54,22	Rp. -58,40	Rp. -75,86

*in trillion rupiah

Source: www.keuda.kemendagri.go.id

Supporting the previous condition, in Government Regulation number 30 year 2011 about municipal loans has opened a chance for the local government to propose municipal loan through public offering in the capital market. The technical rule also has been ruled in Ministry of Finance Regulation (MFR) no 180 year 2015. It is assured a chance for the local government to issue municipal bonds independently to support local investment than depended on balancing funds from the central.

Municipal bonds known as Munis isn't new capital market instrument. The first official muni bond in the U.S. was issued in 1812 by New York City and sought to raise funds for the purpose of building a canal (neighborly 2015), it success then followed by Korea, Germany and India. Historically, Indonesia has issued Munis before the independent day. In early decade 1900-s many big cities in Indonesia has issued it such as Bandung, Batavia, Buitenzorg, and in the year 1921 Surabaya issued municipal bonds with tenor 40 years and interest rate 7,5% (Indriani 2013).

Analysis of municipal finance is needed before issuing bonds to decrease default risk as it happened in Detroit (Hacket et al 2013). The capability of municipal finance may be measured from LGR performance which remains positive in previous years. Moreover, accountability of Local Government Financial Report (LGFR) may show the readiness of local government's human resource to becoming emitter in the capital market. In another side, the capability of local society also must be measured as expectant investors to hold municipal bonds. With participation from local society, it will increase local investment culture and build a sense of belonging to maintain local infrastructure development.

Opportunity to issue Munis has also opened the same chance for sukuk issued by region. It is Islamic municipal bonds with its law base may be benchmarked through conventional municipal bonds with an addition in UU number 19 year 2008 about SBSN (Sovereign Islamic Bonds). Its potency may be supported by the majority population of Moslem in Indonesia and sharia economic lifestyle that continue to increase during new millennium. Moreover, academic research on Islamic municipal bonds has been discussed since 2009 (Walidi 2009). It may be considered as potency alternative instruments to issue bonds.
Based on problems and condition mentioned above, the purpose of this paper is to analyze the potency of regional finance using quantitative method base on domestic regulation which has been legalized and the capability of local society to invest in municipal bonds which are issued by their local government.

2. MUNICIPAL BONDS
Paragraph 1 Government Regulation number 54 year 2005 mentioned that municipal bonds defined as all transactions which make region receive money or benefit as equal as money from others which cause it to be burdened an obligation to payback, it isn't included short term credit as it happens in trading. Variable to be calculated is LGR, profit sharing and natural resources, and do so resource from General Allocation Fund (GAF). Municipal total income estimation then compared with fixed expenditure. If fixed expenditure as much as or more than total income, a region isn't considered deserve to propose loan. Loan resources from domestic may come from central government, the financial institutions (bank or non-bank), and local society. Municipal loan risk is unscheduled payment of return. Deciding time period of loan depends on kind of project which is funded. Based on purpose and time period, municipal bonds is divided into 2 section:
1. Short term loan is used to help cash flow liquidity and early capital for long term investment.
2. Long term is used to finance infrastructure development which has the revenue stream to payback, also has benefit for public service.

One of the main factor to be concerned is loan capacity and its purpose. The ideal goal is to buy asset or long term investment and suppose not to cover the deficit. Then the exact model of Municipal bonds is revenue. However, if the loan is planned to be invested, it may consider the characters of investment whereas it is cost recovery or not. If it is cost recovery, total amount and loan capacity is not a big deal, yet if it isn't cost recovery, it must be calculated the limit of loan which decided by central government and region, in order not become burden of regional finance.
To avoid the mentioned risk, it is needed to review some theorems to estimate municipal loan capacity through LGR performance analysis. Beside it, there are two measurements which are usually used they are debt service ratio and debt coverage ratio.
1. Debt Service Ratio (DSR) is limit of municipal capability that used by local government to control a total of secured loan to be considered.
2. Debt Coverage Ratio (DCR) is a comparative number between municipal funding to be saved with the annual total return of loan payment.

In paragraph 10 verse 2 Ministry of Finance Regulation (MFR) number 180 year 2015 mentioned that regional properness to issue bonds is calculated by debt service coverage ratio at least 2,5 and total of cumulative loan (previous loan plus issued bonds) is not more than 75% of general income from the previous LERE.

3. REVIEW OF LITERATURE
Research written by Muslim Sarip under tittle Prospect of Municipal bonds development through sukuk issued by county/ city's government in Jawa Barat. Thesis took sample data from 2007 to 2008 as resource analysis to measure municipal bonds prospect base on the market mechanism. Supply side is analyzed by LGR performance, debt service coverage ratio, and maximal loan (base on formulae mentioned in PP number 54 year 2005). The demand side is analyzed by Moslem population, the amount of liquid fund and prosperous family. The result is county and city that proper to issue sukuk are Bandung city, Bandung county, Bogor county, Bekasi county, Bekasi city, Sukabumi county, Cirebon county and Garut county.
Walidi in his thesis The Map of demand and supply of Islamic municipal bonds, the sample used were data from 2005-2006. Supply side is analyzed by LGR performance, debt service coverage ratio, and limit of maximum loan then they were mapped by index and quadrant. While demand side is analyzed by moslem population, prosperous family, and the amount of liquid fund. The result there were 7 regions with high potency to propose loan they are DKI Jakarta, Jawa Barat, Jawa Tengah, Jawa Timur, DI Yogyakarta, Sumatera Barat and Jambi.
Gunawan in his thesis, Factors influence the readiness of regional government of DI Yogyakarta to issue bonds. His result found they were 5 factors that may explain this issue they are project readiness, the capacity of human resource, managerial principle, mechanism, administration and capacity of municipal finance. Based on qualitative descriptive analysis showed that generally the proposed project has social and service character or non-profit which provided by the government.

4. RESEARCH METHODOLOGY
Mapping potency of loan capacity sees municipal finance capability to issue bonds as supply and capability of local finance society to invest as demand. Index from both variables are mapped by quadrant. Index methodology is used to see sample's position among others, while quadrant method is used to see sample strategic position based on two variables that have been quantified before.
This research is used secondary data. Secondary data is taken from report and publication from the related institutions such as Financial Service Authority (FSA), Ministry of Finance, Central Bureau of Statistic (CBS), National Development Planning Agency and others related literature. Data is analyzed using panel that is a combination between time series and cross section. Data series are annual reports from 2012-2014 and cross section between regions consist of 33 provinces minus North Kalimantan, because this province has just been launched in 2013.

5. RESEARCH STAGES
5.1. ANALYSIS OF MUNICIPAL FINANCE CAPACITY
a. Define the value of LGR performance
1. Calculate elasticity of LGR performance to gross domestic product (GDP)
2. Calculate share LGR to LERE income
3. Calculate growth for outstanding to previous LGR

b. Define the value of Debt Service Coverage Ratio based on MFR 180/MFR.07/2015.

$$DSCR = \frac{(LGR + GAF + (SF - SFR)) - CSE}{(OC + OI + OE)} \geq 2{,}5$$

Definitions:
LGR : Locally-general revenue
SF : Shared Fund
GAF : General allocation fund
SFR : Shared Fund for Reforestation
CSE : Civil servant expenditure
OC : Outstanding credit
OI : Outstanding interest
OE : Others expenditure.

c. Maximum cumulative of the principle amount of municipal bonds is less than 75% of general income for the previous LERE. With formulae below:
GR = TMI – (SAF + EF + AL + AIS)

Definitions:
GR : Genera Revenue
TMI : Total Municipal Revenue
SAF : Special allocation fund
EF : Emergency fund
AL : another outstanding loan
AIS : others income with a special purpose.

d. Define regional accountability index. Accountability value is defined for scoring to BPK's opinion on Local Government Financial Report from 2012-2014. The score is made based on BPK's grade opinion consecutively from 1 up to 5.

e. Define the value of Local financial capacity index using Bayes method. Weight is defined from an expert who has the decision to judge the properness of local finance. Marimin (2004) explained that Bayes method is technical analysis to decide the best decision among available alternative. Weight in Bayes method based on trust level, faith, experience along with decision background. Bayes equation that used to calculate each alternative's value simply as mentioned below.

$$Total\ Value_i = \sum_{j=1}^{m} Value_{ij}(criteria_j)$$

Definitions:
Total value $_i$ = final total value from alternative to $_i$
Value $_{ij}$ = alternative value
Criteria $_j$ = importance level (weight) criteria to $_j$
i = 1,2,3,…n : n = total alternative
j = 1,2,3,…m : m = total criteria

5.2. ANALYSIS OF LOCAL INVESTMENT CAPACITY

Local investor potency is mapped by calculating capability real investment per capita. That is total deposit in region x is divided by total population.

$$Rm = \frac{\bar{X}\,d}{\bar{X}\,p} x100\%$$

Definitions:
Rm : Capability of real investment per capita
$\bar{X}\,d$: Total banking deposit year n
$\bar{X}\,p$: Total Region population year n

The used data is limited to annual bank deposit from 2012 to 2014 taken from each province that published by Financial Service Authority, except Kalimantan Utara. The limit due to deposit is because this saving type is purely for investment purpose and its customer is assumed as the customers who have leeway funds and good financial literacy.

5.3. MAPPING OF MUNICIPAL LOAN CAPACITY

Municipal financial capacity is mapped by quadrant. Regional properness to issue bonds is assumed as supply, while the capability of local society to invest is assumed as demand. Combination from both results are entered into graphic and mapped into four quadrants.

TABLE 1: DEFINITION OF QUADRANTS

Quadrant 1	An ideal condition. Local authority has good financial capability to issue bonds, followed by ability of local society to invest in its bonds
Quadrant 2	Minus for the ideal condition. Local authority has bad financial capability to issue bonds but followed by good ability of local society to invest
Quadrant 3	Minus for the ideal condition. Local authority has good financial capability to issue bonds but followed by inability of local society to invest in its bonds
Quadrant 4	Not ideal condition. Local authority has bad financial capability to issue bonds followed by inability of local society to invest in its bonds

6. RESULT & DISCUSSION

6.1. MUNICIPAL FINANCE CAPACITY

6.1.1. LGR PERFORMANCE

1. Elasticity

Result for elasticity analysis of LGR to GDP from 2012-2014 show that there are no any regions in Indonesia which have elasticity value more than 1 (≤ 1), moreover there are three regions which have minus value (Riau, Jambi and Kalimantan Timur) with total average 0,14. This result shows that every change GDP doesn't have sensitivity to change LGR value. It may be caused by impropriate tax revenue as the main resource of LGR. In the year 2014, elasticity result >1 has achieved by Jawa Barat (1,01) Kalimantan Selatan (1,35) and Bali (1,49).

2. Growth

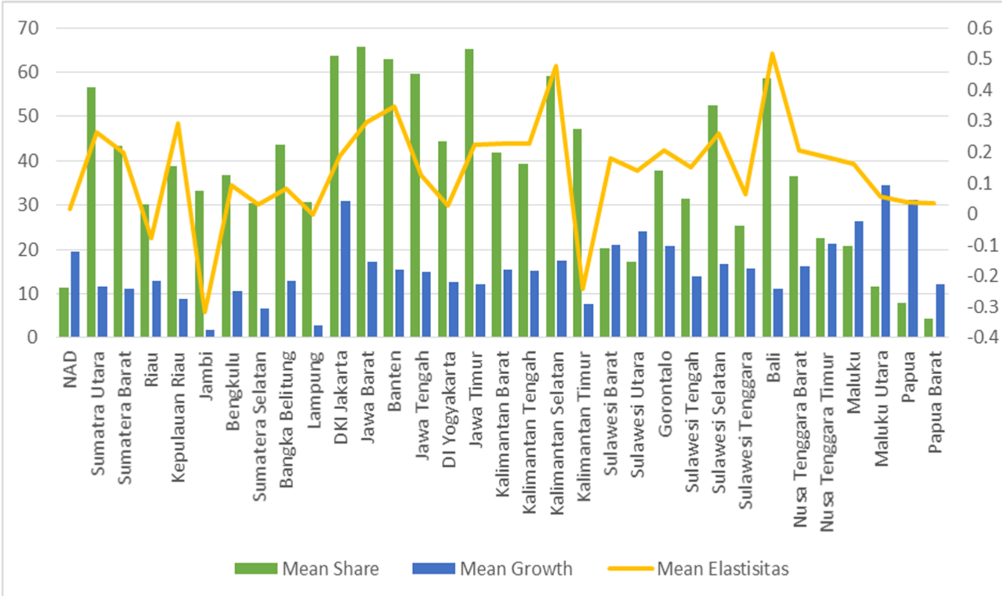
Calculation on realization data LERE from the year 2012 to 2014 shows that national growth average is 15.85%. The result shows that LGR contribution average to LERE is keep growing, and there are no any regions which have minus. Moreover, the biggest growth is performed by provinces located on East side Indonesia which their growth more than 25%. They are Papua (31,19%), Maluku Utara (34,43%) and Maluku (26,26%). The calculation shows that there is a positive correlation between elasticity and growth, that provinces which have the less elasticity so do their growth they are Jambi (1,74%) and Lampung (2,74%).

3. Share

Generally, all provinces in Indonesia don't have the capability to finance their own needs. It is showed by calculation of share national average of LGR to LERE 37.9%. There are only 4 provinces which their LGR more than 60% they are DKI Jakarta (63,79%), Jawa Barat (65,6%), Banten (62.96%), and Jawa Timur (65,26%). Increasing of LGR's contribution in those provinces because of industrial sector development, both real and financial. Many factories and central government facility were built in those provinces become an excellent resource for the tax to increase LGR. Unfortunately, in other provinces mainly in east and middle have only depended on limited natural resources.

From three analyses above, it can be measured LGR performance index based on elasticity, growth, and share. Map of LGR performance is showed by the graphic given on the next page:

FIGURE 1: LGR PERFORMANCE FOR 33 PROVINCES OF INDONESIA

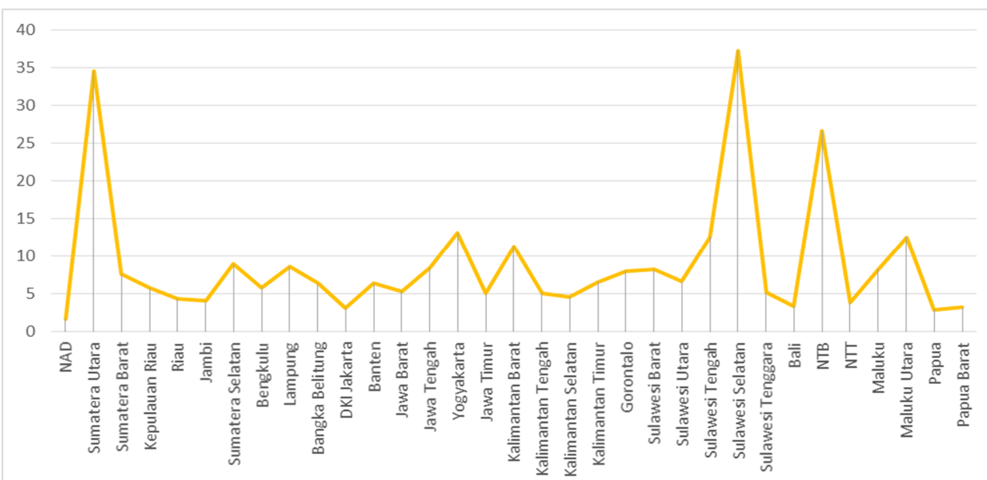


This graphic shows a significant different between each province in all three analysis ie elasticity, share and growth. Therefore, to know current position for a sample to the population using index method. The best five of LGR performance is DKI Jakarta, Banten, Kalimantan Selatan, Bali and Jawa Barat. Based on the index value, 33 provinces in Indonesia are divided into 3 zones they are 7 provinces in zone 1 with high performance, 18 provinces in zone 2 with medium performance, and 8 provinces in zone 3 with low performance. The best value for elasticity is achieved by Bali, for growth is achieved by Maluku and for share is achieved by Jawa Barat.

6.1.2. DEBT SERVICE COVERAGE RATIO

DSCR analysis is used to measure capital adequate ratio to debt load. Calculated based on interest expenditure and financing expenditure average. The limit number is 2,5. If there are any regions which have more, it is considered as a proper region to propose loan. The result shows that only NAD which its ratio less than limit number ie 1,65. The rest regions have value more than 2,5. The big four result are achieved by Sulawesi Selatan (37,3), Sumatera Utara (34,6), Nusa Tenggara Barat (26,6) and Yogyakarta (13,1). Whereas the rich provinces like DKI Jakarta (3,1), Jawa Barat (5,31), Jawa Timur (4,97) and Kalimantan Timur (6,54) have small value due to civil servant expenditure, interest cost, and others outstanding loan.

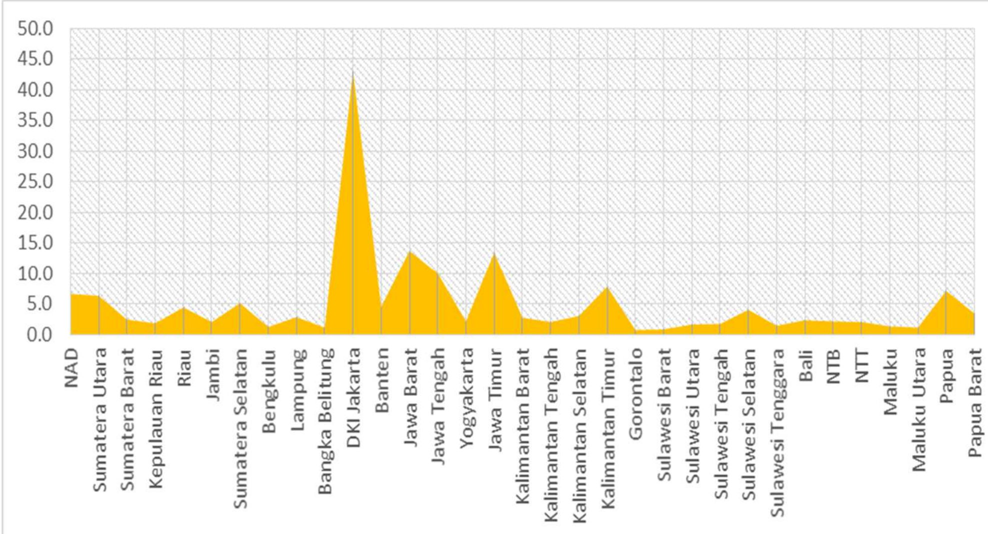
FIGURE 2: DEBT SERVICE COVERAGE RATIO



6.1.3. ANALYSIS OF MAXIMUM LOAN

The considered maximum loan is 75% from general income for the previous year. In this research, the aimed previous year is 2014. As ruled on MFR 180/MFR.07/2015 mentions that new total loan is no more than 75% of general income for the previous year. The result from this analysis shows 5 rich provinces have domination begin from DKI Jakarta (43 Trillion), Jawa Barat (13,6 Trillion), Jawa Timur (13,4 Trillion), Jawa Tengah (10 Trillion) and Kalimantan Timur (7,7 Trillion). While the lowest are achieved by Gorontalo (794 Billion) and Sulawesi Barat (820 Billion).

FIGURE 3: TOTAL MAXIMUM LOAN OF 33 PROVINCES IN INDONESIA



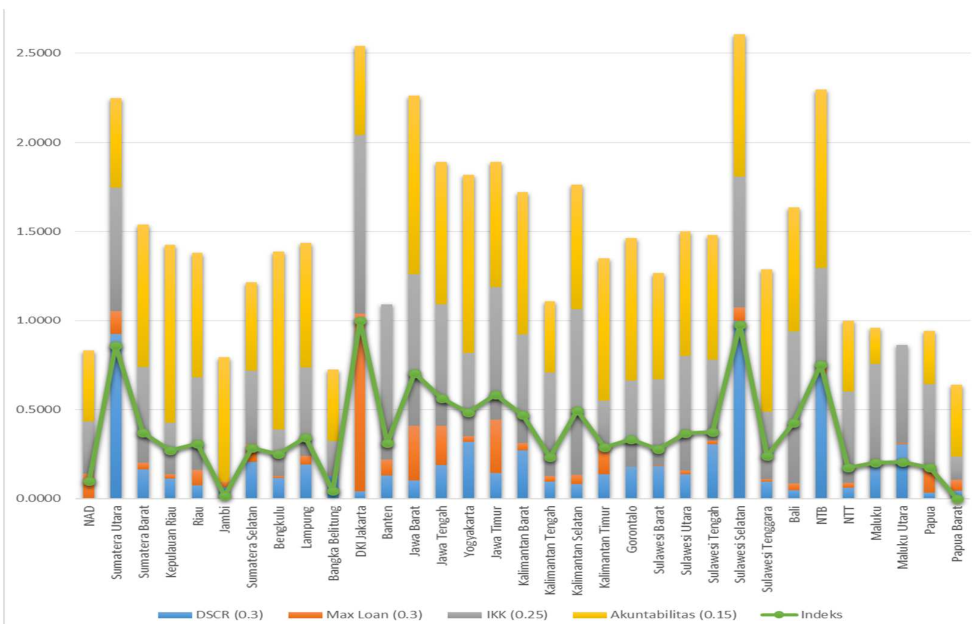
6.1.4. ACCOUNTABILITY ANALYSIS OF MUNICIPAL FINANCE

This analysis based on Government Regulation number 30 year 2011 which perfecting of government law number 54 year 2005 about needs of municipal finance accountability as a requirement to asses province properness to propose loan. Scoring result Municipal Financial Report refers to BPK's opinion from year 2012-2014 show only 5 provinces which consistently have WTP opinion (Proper without exception) during 3 previous years they are Kepuluan Riau, Bengkulu, Jawa Barat, Yogyakarta and Nusa Tenggara Barat. Meanwhile other provinces which have good LGR performance such as DKI Jakarta, Banten and Papua trapped in the ground zone. Only Jawa Barat which consistently in high zone. Banten and Maluku Utara got the lowest value due to 2 o 3 their financial report got TM opinion (No Opinion). It indicates that good LGR performance and financial concession don't have a positive relation to financial accountability.

6.1.5. CAPACITY ANALYSIS OF MUNICIPAL FINANCE

After calculating and getting the index from four previous analyses they are LGR performance, loan capacity, maximum loan, and municipal accountability. Index result from each analysis is calculated by Bayes Method. The weight value is made by an expert who works as fiscal analysis in Ministry of Finance which has a direct relation to influence for issuing municipal bonds. The weight value from expert show the LGR performance index (0,25), DSCR Index (0,3), Maximum Loan index (0,3) and municipal accountability index (0,15) with total weight is 1.

FIGURE 4 GRAPHIC MUNICIPAL BONDS CAPACITY

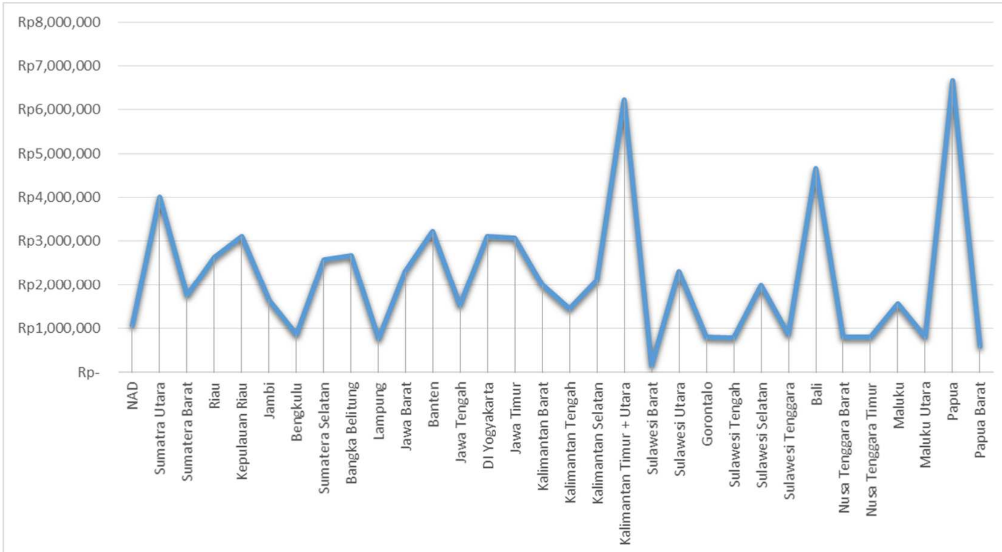


Index calculation result based on bayes weight show that 7 provinces has big value to issue bonds above 0,5 they are DKI Jakarta (1.0000), Sulawesi Selatan (0,9766), Sumatera Utara (0,8575), Nusa Tenggara Barat (0,7519), Jawa Barat (0,7046), Jawa Timur (0,5847) and Jawa Tengah (0,5628). It means those 7 provinces have the capability to become the role models for other provinces to issue bonds either in conventional bonds or sukuk.

6.2. LOCAL INVESTMENT CAPACITY

To see local capacity to invest use ratio banking deposit which is published to the population of local citizen. The used data is from 2012 to 2014. Data from sharia bank and civil financing bank are ignored due to incomplete available data. However, the issue doesn't influence much due to its percentage less than 10% of banking market share in Indonesia. Population data is taken from BPS for the year 2014. Because it is the last available data which is published by BPS. The previous data is census population data in 2010. The result may be seen in the graphic below.

FIGURE 5: GRAPHIC REAL INVESTMENT PER CAPITA



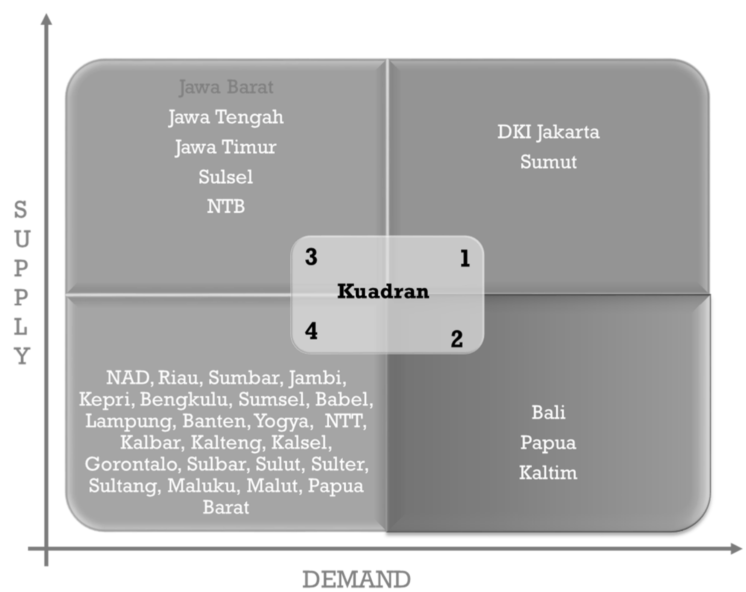
DKI Jakarta isn't included in the graphic above because it has very high value exceeded others 32 provinces. Real investment per capita for DKI reach out Rp. 80,261,597. It's caused due to central government cash flowed over there. So that, DKI Jakarta is ignored to keep the diversity of data. However, it directly assumed DKI Jakarta as the province which has demand potency to invest. The other provinces with demand potency are Papua (Rp 6.673.727), Kalimantan Timur (Rp 6.230.887), Bali (Rp. 4.663.776) and Sumatera Utara (Rp. 4.16.857).

6.3. FINDINGS

6.3.1. MAPPING OF MUNICIPAL LOAN CAPACITY

Based on supply and demand analysis, capacity map of municipal finance is showed by quadrant method to see equilibrium between demand and supply all regions to issue bonds and to buy it. The map may be seen on the figure below:

FIGURE 6: MAP OF FINANCIAL CAPACITY OF 33 PROVINCES IN INDONESIA



Quadrant table above shows only two provinces which categorized as the proper region to issue bonds both in supply and demand side they are DKI Jakarta and Sumatera Utara. Meanwhile Papua, Bali and Kalimantan Timur gathered in quadrant II that show the high local capability to invest in other word has high demand potency but haven't been followed by properness of local authority to issue bonds. On contrary, Jawa Barat, Jawa Tengah, Jawa Timur, Sulawesi Selatan and Nusa Tenggara Barat have readiness from their local authority to issue bonds but haven't been followed by the capability of local society to invest. The result from this analysis also shows that majority of provinces in Indonesia don't have properness yet both in supply and demand to propose loan through bonds. It is indicated by the domination of other 24 provinces in quadrant IV.

7. RECOMMENDATIONS

The result from this paper may become a reference to the central and local government to decide a suitable policy for each region based on their strategic position in the quadrant.

8. CONCLUSION

Mapping the potency of municipal capacity to issue bond show only 2 provinces which have properness in demand and supply, they are DKI Jakarta and Sumatera Utara. These provinces may become the role models to issue bonds with retail model. Meanwhile the provinces in quadrant II needs training for their local government about management of regional finance focused on their LGR performance and accountability. In view of Bali and Papua have many foreign citizens, it is needed a followed research to calculate capital inflow and a number of the account to check the validity of their real per capita revenue. Provinces in quadrant III which their local government has good properness to issue bonds may issue municipal bonds with Project Based Bonds Model.

The policy for other 24 regions in quadrant IV is increasing LGR and GDP based on local natural resources with decreasing loan and increasing GAF and DAK mainly for regions with high accountability value. Education and socialization are also needed to increase their LGR performance thorough elasticity. Because income per capita has a positive correlation to increasing LGR which it main source from tax.

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