The Real Estate Law Review

Editor

David Waterfield

Law Business Research

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The Real Estate Law Review

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EDITOR'S PREFACE

In an age that has seen ownership of real estate become increasingly international, it is more necessary than ever to appreciate the basic framework of real estate law in different jurisdictions. This book aims to give readers a general feel and overview of some of the key substantive and practical considerations in the major markets around the world.

Each contributor to *The Real Estate Law Review* is a distinguished legal practitioner in his or her own jurisdiction, and this review represents an immediate and accessible summary of the most important and relevant issues across the many countries covered.

The Real Estate Law Review seeks to identify distinctions in practice between the different jurisdictions by focusing on key developments that highlight particular local issues – we believe that this will help practitioners to develop their understanding of practice beyond their own borders. As both domestic and international clients become ever more sophisticated in this regard, real estate practitioners need to be familiar with the issues in the markets that are most relevant to the interests of their clients. Overseas investors have for some time been key influences in most jurisdictions and it is therefore vital that practitioners are able to advise on a particular transaction in the light of an understanding of the investor's own home forum.

In addition to bringing together topical cross-border real estate issues and practical information on real estate practice around the world, *The Real Estate Law Review* also seeks to offer an overview of activity levels in each jurisdiction and, therefore, the global real estate investment market. The impact of events such as the collapse of the US sub-prime residential mortgage market and the Eurozone crisis has demonstrated how complex and inter-related investment markets have become. It is no longer possible to ignore globalisation and view real estate markets in isolation. The financial and economic turmoil of the past few years will continue to affect the international real estate investment market; the scarcity of debt finance seems likely to continue for the foreseeable future and investors with funds will increasingly look to a global real estate market for value and safety.

I wish to express my deep and sincere thanks to all my distinguished colleagues who have contributed to this first edition of *The Real Estate Law Review*. I would also like to thank Gideon Roberton and his publishing team for their tireless work in coordinating the contributions from the various countries around the world.

David Waterfield
Slaughter and May
London
February 2012

Chapter 14

INDONESIA

Dyah Soewito and Denny Rahmansyah[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The existing Agrarian Law provides for two categories of land title comprising a total of nine rights.

The first broad category of land title encompasses five primary titles derived directly from the state:

a the right of ownership ('*hak milik*');
b the right to cultivate;
c the right to build ('HGB');
d the right to use ('*hak pakai*'); and
e the right to manage ('*hak pengelolaan*').

The primary title is registered in the land office's records and is recorded on the land title certificate. Every region has its own land office, each of which is a subordinate of the National Land Office.

The second broad category of land titles encompasses secondary titles, which are titles granted by holders of primary titles on the basis of private agreements, which consist of:

a the right to lease;
b the right of share cropping;
c the right of land pledge; and
d the right of lodging.

1 Dyah Soewito and Denny Rahmansyah are partners at Soewito Suhardiman Eddymurthy Kardono (SSEK).

A secondary title is obtained by an investor based on an agreement whereby a primary title holder grants a legal interest or secondary title to another party. The secondary title is not registered in the local land office's records and is not recorded on the land title certificate.

An Indonesian individual is entitled to all primary titles as mentioned above; however, in order to conduct business in Indonesia, investors (local or foreign) need to establish a limited liability company. Such company in Indonesia (whether a locally owned company or a foreign joint venture capital investment ('PMA') company is entitled to an HGB or *hak pakai* title. *Hak milik* is also relevant to a PMA company since, when purchasing land, with assistance from the seller the PMA company can relinquish and convert such *hak milik* title into an HGB so that the PMA company can own such land.

An individual foreigner is entitled to a *hak pakai* title as long as he or she is a resident of Indonesia. Some investors will also agree to allow the seller to keep his or her underlying *hak milik* or *hak pengelolaan* title. In this case, the investor only obtains a HGB title (if the investor is a company, which includes the PMA company) or a *hak pakai* title (for an individual foreigner) 'over' the seller's pre-existing *hak milik* or *hak pengelolaan* title. The seller remains the owner of the *hak milik* or *hak pengelolaan* and the investor would need to pay the seller another 'purchase price' in order to renew the HGB title in 30 years' time. Alternatively, such renewal can be agreed and prepaid in advance.

ii System of registration

The system of registration in Indonesia includes measuring, mapping and recording the land dimensions, registering the land title (which includes a public announcement) and, finally, the issuance of the land certificate under the applicant's name. The advantages of registration include that the applicant is entitled to the title he or she acquires without any interference from other parties. The legal effect of recordation in a land registration book and land certificate varies depending on when the certificate was issued.

Prior to the 1997 Government Regulation on Land Registration, any land certificate issued constituted presumptive evidence that the registered holder of the certificate is the owner of the land covered thereby. This means that it was possible to set aside the certificate and title if another person claimed rights to the land and could successfully challenge the rights of the certificate holder. This may have occurred if, for example, in the course of the land relinquishment process, the notary or land deed official[2] failed to adequately ensure that all persons with customary law rights were included in the relinquishment. This created legal uncertainty in the certification process, and as a result the Government of Indonesia ('the GOI') adopted the Regulation mentioned above, under which the presumptive evidence of a certificate issued after 8 October 1997 becomes conclusive on the fifth anniversary of the date of the certificate.

2 Under Indonesian law, any actions related to land must be processed by a land deed official ('PPAT'). Most notaries are PPAT officials but PPAT officials need not be notaries. In rural areas, PPAT officials are often local government officials, such as the district head or the head of the land office (BPN), who has jurisdiction in the district in which the property is situated.

Failure to register means that there is no legal certainty as to land ownership. As mentioned above, the registration of the land by issuing the land certificate constitutes presumptive evidence of land ownership.

iii Choice of law

In Indonesia, the law applicable to a transaction involving real estate is the law of the state where the property is located. With respect to the creation and enforcement of security interests related to land, the choice of law where the land is located would most likely be deemed mandatory. In all cases, the debtor must follow the corporate requirements contained in its articles of association to duly authorise and sign the security agreement.

II OVERVIEW OF REAL ESTATE ACTIVITY

In the real estate sector, a current trend in Indonesia is for people, including foreigners, to purchase condominiums or apartments. With the growing emergence of foreign investment in Indonesia, many foreign investors need buildings or land for their homes or companies. Foreigners in Indonesia have rightful concerns regarding land use and ownership rights for business purposes.

As mentioned earlier, the Agrarian Law governs the rights over ownership of land in Indonesia, and this law covers land rights that apply to Indonesian citizens and foreigners. The specific land title for foreigners is the *hak pakai* title. After the enactment of the Agrarian Law in 1960, there were several developments in the real estate sector in this regard; for example, in the late 1990s, a new government regulation was enacted allowing foreigners to purchase apartments and office space in Indonesia if the underlying land is a *hak pakai* title. The Government Regulation on Housing Ownership by Foreigners Domiciled in Indonesia issued in 1996 states that foreigners who reside in Indonesia can purchase a home, apartment or condominium as long as it is not a part of a government-subsidised housing development; however, there are restrictions. Foreigners can only hold land with a *hak pakai* title, and a *hak pakai* title may only be granted for a maximum of 25 years and can be extended for a further maximum of 20 years. In certain special cases (i.e., religious organisations etc.) such title may be granted for an indefinite period as long as the land is utilised for certain specified purposes. While the GOI has hinted repeatedly that it will relax all restrictions on foreign ownership of land and property, we do not anticipate such regulatory changes in the near future.

Town houses represent another residential option that is increasingly popular in Indonesia. In recent years, properties have been developed with view towards low maintenance housing that still retains a 'feel' of a home. Town houses may also provide advantages to companies that need to house numerous foreign employees, as these are often favoured by many foreign employees that transfer to Indonesia, particularly those with families. Similar to town houses in other countries, those in Indonesia share a common building or roof, and the grounds and recreation or sports facilities are taken care of by a property management firm.

Another factor that may affect the market in 2012 is the law surrounding land acquisition in Indonesia. Often cited as holding back much needed infrastructure projects in Indonesia, the lack of clear rules on acquiring land for public use and the provision of

fair compensation for land owners have stopped or delayed many infrastructure projects and their accompanying negotiations. This issue has been addressed in the form of a new law on Land Procurement for Public Interest that the House of Representatives ('the DPR') passed in December 2011. The law is intended to overhaul the stifling procedures for obtaining ownership of land that is required for public purposes by streamlining the process and drastically reducing the time taken to acquire it. This law should also provide more legal certainty compared to the previous regulation stipulating similar matters. Under the new law, there is a dispute settlement mechanism that provides legal protection for rightful landowners to receive fair compensation, which is no longer limited solely to money. Landowners can be compensated through land swaps, resettlement, stock ownership or any other forms agreed by both parties (please see Section VIII, *infra*).

Last, hotel development and the tourism industry in Indonesia – specifically in Bali as the most popular area for tourists in Indonesia – has been affected by new issues that may affect the market in 2012. The Balinese governor issued a Letter on 27 December, 2010 establishing a moratorium on new hotel development in three popular tourist areas in Bali: the Denpasar Municipality, the Badung Regency and the Gianyar Regency. This Letter was effective as of 5 January 2011 and will apply indefinitely until further assessment by the governor. As a result, the regional capital investment coordinating board ('the BKPMD') in Bali has subsequently decided not to issue any recommendations to the central capital investment coordinating board ('the BKPM') for new hotel developments in these areas. Consequently, without the recommendation from the regional BKPMD, the BKPM has now temporarily ceased issuing capital investment registration and the capital investment principal licences for both foreign and domestic capital investment companies intending to develop new hotels. Following its issuance, the governor also ordered the mayors and regents across Denpasar, Badung and Gianyar to comply with the Letter by not issuing any technical licences for new hotel developments in these areas. While some believe that the moratorium will unnecessarily slow economic growth in the three affected areas, others have supported the moratorium, noting the need to re-focus investment and development of related infrastructure projects for the tourism sector in other areas in Bali.

III DEVELOPMENTS IN REAL ESTATE PRACTICE

While the Agrarian Law regulated land, the increased demand for housing, particularly in cities, has led to new housing laws and regulations. Multi-storey structures, including condominiums, are governed by a new, additional regulatory regime.

Indonesia has recently enacted a new Condominium Law.[3] Under this law, a condominium is defined as a building divided into parts, functionally structured in horizontal and vertical directions and constituting units, each of which can be owned and used separately, including as residences, complete with common parts, common items and common land.

3 Law No. 20 of 2011.

Policy direction for condominiums in Indonesia can be found within the Condominium Law, which encompasses three essential concepts:

a the concept of urban development, aiming to use the land efficiently and optimally and also to create a densely populated residence;

b the concept of legal development, providing new real property rights consisting of individual ownership of a condominium but with incorporated rights over shared properties and shared land. This concept is furthered by creating a Tenant Association, which by its articles of association and by-laws, is allowed to act for external and internal matters in favour of the apartment or condominium title holders. The Tenant Association is also responsible for creating an orderly and peaceful environment within the building; and

c the concept of economic development, by providing the ability for a developer to request a credit or loan facility from the banks or other financial institutions by way of a mortgage or charge upon the land and building that is still under construction as the security of the credit or loan.

According to the policy direction mentioned above, the purposes of condominium development are as follows:

a fulfilling the needs for proper housing in a healthy environment;

b building appropriate, harmonious and well-balanced residences;

c rejuvenating slum areas;

d optimising the use of urban land resources; and

e encouraging densely populated areas.

The principles described above should form the guidelines for condominium developers. The general elucidation of the Condominium Law emphasises that the development of condominiums is intended primarily for residences, particularly for low-income communities. Nevertheless, the law envisions that the development of condominiums should create a complete and mixed-use community, which is why there should be other multi-storey buildings for other purposes than only residential; therefore, mixed-use real estate development is regulated in the Condominium Law.

Another development in the real estate sector is the requirement for private developers to provide low-income housing or apartments, anticipating the increasing demand for housing across Indonesia; this is a part of a much broader low-to-medium-income apartment and housing initiative on behalf of the GOI.

Under this Law, the developer must allocate 20 per cent of the total of the commercial apartment area to be developed for the low-income community. The allocated low-income area does not have to be at the same location as the commercial apartment, but it has to be in the same regency or city. Failure to fulfil this obligation will result in criminal sanctions, or a penalty or fine. This law also prohibits any leasing or assigning of the ownership of the low income housing or apartment, with relevant fines and penalties. Further, pursuant to this law, the GOI must also provide appropriate housing or apartments for the low-income community, although the law does not go into further detail.

Another development would be the rapidly increasing construction of town houses (discussed in Section II, *supra*). There are numerous reasons why people, including

foreigners, choose to live in a town house, which include easier means of addressing security concerns than in public housing complexes.

IV FOREIGN INVESTMENT

The Agrarian Law provides that foreigners can only acquire the *hak pakai* title for land if they reside in Indonesia. If foreign investors wish to engage in business in Indonesia, they must each establish a PMA company. As stated at the outset, a PMA company is able to acquire a HGB or a *hak pakai* title, while foreign individuals can only possess the *hak pakai* title. As mentioned in Section I, *supra*, the HGB or *hak pakai* title may also be placed 'over' the seller's pre-existing *hak milik* or *hak pengelolaan* titles. Under the applicable regulation, individual foreigners are allowed to own residential property under the *hak pakai* title. Specifically, foreigners who provide benefits to national development, reside permanently or temporarily in Indonesia and have proper immigration documents can purchase the following:

a vacant land with a *hak pakai* title;
b apartments with a *hak pakai* as its underlying title;
c non-subsidised houses with *hak pakai* titles; and
d any of the foregoing with the lease right as evidenced by lease documents entered into with the landowner.

Issue arises if a foreign investor acquires traditional or customary land (known as *adat* land). In Indonesia (particularly in rural areas), large areas of land exist that usually are held through a traditional joint community ownership structure and that have not been registered and certificated with the relevant land office under the Agrarian Law. The rights to these areas are still governed by *adat* or customary law. *Adat* rules vary significantly from one area to another within Indonesia. Possession of uncertificated land is most often evidenced by a letter (either a *surat girik* or *surat petuk pajak bumi*) issued by the head of the relevant sub-district or village to the 'landowner' evidencing the payment of local land taxes. *Girik* (also known as Letter C) is not evidence of land title ownership (the tax authority[4] stopped using *girik* in 1994); these days, PBB receipts constitute the only evidence of payment of property tax.

In terms of purchasing the land, when 'uncertificated land' is transferred, the buyer must apply for a registered title pursuant to the Agrarian Law and obtain a formal certificate of title. To obtain a land certificate, *adat*-based proprietary rights must be relinquished by the original owner to the state by signing a right relinquishment deed in favour of the buyer. With this deed, the buyer can then apply to the state for one of the primary titles to the land.

Another issue affecting the ownership of property by investors (whether local or foreign) is the presence of public areas or amenities. For example, if there is a river, a public cemetery, or a public road within the land area, there may be special rules governing the right of use by other individuals. Likewise, if the intended land is located

4 The Land and Building Tax ('PBB') office.

in a protected forest area, construction upon such land can usually not be carried out without proper licences or permission from the relevant government institutions and community surrounding such areas.

The last relevant legal issue would be the exercise of eminent domain powers and land acquisition. The applicable regulation provides that eminent domain powers may be used for construction undertaken and eventually owned by the GOI in the public interest in various areas, including in areas where the land is owned by private investors.

It should also be noted that there are also foreign investment incentives for investment projects in the real estate sector approved by the BKPM. These include incentives for investment in remote areas of Indonesia and may consist of accelerated depreciation, special tax treatment, and exemption or reduction of import duties.

V STRUCTURING THE REAL ESTATE INVESTMENT

Acquiring an existing PMA company or forming a new PMA company is a common way for a foreign investor to conduct business activity and is the common structure by which to invest in Indonesia. There are advantages and disadvantages of the PMA company that need to be considered by foreign investors to determine whether a PMA company is the optimal corporate structure to fulfil their international business objectives.

i Advantages of PMA companies

A PMA company can be partially or fully foreign-owned and controlled by the shareholders of such PMA company.

A company in Indonesia, including a PMA company must have (1) at least two shareholders, (2) a board of directors ('BOD') and (3) a board of commissioners ('BOC'). The BOD needs at least one director to manage day-to-day operation of the company, and the BOC also needs at least one commissioner as a supervisory organ of the company to supervise the director of the company. A foreigner may occupy a position on the BOD and the BOC of a PMA company.

The PMA company structure permits investors access to a network of double-taxation treaties with countries that have a double-taxation treaty with Indonesia such as Singapore, the United States, the United Kingdom, Australia, etc.

A PMA company is given certain fiscal 'facilities' intended for investment in Indonesia. Among these facilities are exemptions from and reductions on imported capital equipment, and suspension of value added tax and sales tax on goods. Further, under the Foreign Investment Law, PMA companies are also granted the right to transfer (repatriate) their invested capital in their original currencies and at the prevailing exchange rates. The repatriation guarantee facility is provided by the GOI to attract foreign companies to invest in Indonesia, as long as the investment is approved by the BKPM and recorded as an approved investment. At present, such foreign exchange assurances are of theoretical interest only, since there are no foreign exchange controls in Indonesia. The foreign exchange guarantee is a guarantee that if foreign exchange controls are adopted, the foreign investor will have access to the foreign exchange made available by the GOI on a *pari passu* basis with all other foreign investors similarly situated. Foreign exchange controls have never been adopted since the enactment of the

Foreign Investment Law, and it is not possible to predict precisely how the GOI would implement the foreign exchange guarantee in such event.

ii Disadvantages of PMA companies

The establishment of a PMA company can be hampered by foreign investment restrictions and is subject to the Negative Investment List ('the DNI'). The GOI issued the latest DNI in Presidential Regulation No. 36 of 2010 ('PR36'). PR36 lists areas in which investment by both Indonesians and foreigners is prohibited or restricted. In addition to PR36, the laws and regulations governing the conduct of certain lines of business need to be reviewed to determine whether that line of business is open to foreign investment and, if so, whether a PMA company established to conduct that line of business may be wholly foreign owned or only partially foreign-owned. PR36 also lists those lines of business that are closed to foreign investment or in which foreign ownership is restricted. If a particular line of business is not listed in PR36, then it is open to 100 per cent foreign investment. For example, if the PMA company wants to engage in the real estate sector, and considering that there is no reference to the real estate business in PR36, such business is understood to be open for 100 per cent foreign investment. For certain strategic industries, a PMA company may be formed with foreign equity of up to 95 per cent.

If the PMA company is 100 per cent foreign-owned, then the foreign shareholder must divest at least 5 per cent of the firm to an Indonesian entity 15 years after the PMA company starts commercial production.

PMA companies are legal entities (i.e., limited liability companies) and their articles of association ('AOA') must be approved by the Ministry of Law and Human Rights ('the MOLHR') and registered with the Minitry of Trade ('the MOT'). It is a lengthy process to establish a PMA company in Indonesia, starting from the registration of the PMA company with the BKPM until the AOA of the PMA company are approved by the MOLHR and then registered with the MOT. For example, although the BKPM implementing regulation provides that the investment registration for the establishment of a PMA company will be issued by the BKPM a day after the application is deemed complete by the BKPM, in practice, it takes up to five days to obtain the same.

iii New PMA company versus acquiring an existing PMA company

Establishing a new PMA company and acquiring the existing PMA company have their own advantages and disadvantages.

Control by the foreign investor is established as soon as a new PMA company is set up and the management can be suited to the investor's preferences. However, establishment of a new PMA company requires permits, setting up a physical presence (office) and hiring employees, which is time-consuming compared with acquiring an existing PMA company. Setting up a new PMA company would also require completing an administrative process with certain government institutions or agencies related to the technical licences of such PMA company.

In the case of existing PMA companies, brand recognition in the market may already be established if the PMA company is widely known to be of good standing;

neither is there a need for an establishment process regarding licences, offices and employees.

Before acquiring the existing PMA company, however, an investor should conduct legal due diligence on such existing PMA company's documents to investigate the soundness of the company, specifically with regard to the outstanding taxes and financial obligations and whether the PMA company has any disputes with other parties. Due diligence may incur legal costs and require more time before the foreign investor can proceed with the next steps.

Similarly to establishing a new PMA company, acquiring a existing PMA company also requires time; certain administrative procedures must be followed, such as the notification or registration to certain government institutions or agencies on the acquisition of an existing PMA company.

VI REAL ESTATE OWNERSHIP

i Planning

Before commencing the land acquisition process, a purchaser must first research the permissible use of the targeted land and obtain a location permit. This can only be obtained if the intended use of the land conforms to the regional government's spatial layout plan. The Spatial Layout Law provides that any person intending to utilise land must obtain a space utilisation permit. The Spatial Layout Law defines a space utilisation permit as a permit required for specified activities, but the law is silent as to the specific form of such permit. A spatial layout plan describes the land utilisation and construction patterns permissible within a certain area, which consists of a master plan and a detailed plan. In the process of investigating a possible location for the project, a company should contact the related government offices to obtain official information on the land, which will be followed by an application to the local government for a location permit. A location permit (1) is granted to a company to acquire land needed for capital investment, (2) forms the transfer of title of land to a company, and (3) is a permit to develop the land for a company's needs following the land purchase. The location permit also serves as the relinquishment permit.

The Location Permit Regulation exempts companies from obtaining a location permit in certain circumstances, such as where the land needed to implement its business activity does not exceed 25 hectares in the case of an agribusiness company or 10,000 square metres for a non-agribusiness company. An individual person does not need a location permit to purchase land but the development of the land purchased must be consistent with the regional government's spatial layout plan for such land.

Change of use of the land area will result in the amendment of a spatial layout plan. The Spatial Layout Law provides that a spatial layout plan for a regency or municipality must be stipulated by a regional regulation, issued by the relevant regent or mayor. This regional spatial layout plan for the regency or municipality must be used as the basis for the issuance of permits to develop the relevant area.

For amending the spatial layout plan, the Spatial Layout Law states that the relevant minister (the Coordinating Minister for Economy Affairs) must coordinate the land spatial layout plan, including control of any amendments, of any area that has a

large and important impact. This law further provides that a large-scale amendment or conversion of a spatial layout plan, such as a change of use from a forest area to a mining area or from a mining area to an industrial, trade or tourism area, requires an assessment and evaluation of the amendment, which is coordinated by the Minister. The amendment of the spatial layout plan is effective only after the relevant regional regulation regarding the spatial layout plan is amended.

Further, the Spatial Layout Law provides that any amendments may only be done after consultation with the DPR. Such stipulation is the basis for the review of the spatial layout plan of the relevant province, regency or municipality.

There are a number of sanctions that the GOI may apply if a location permit is not obtained or is improperly obtained, or if the land is used in a manner inconsistent with the spatial layout plan. The sanctions range from warnings to a requirement that the offender cease activities, that the location be closed, that other permits be cancelled, that constructed buildings be destroyed and that administrative fines be imposed. In addition, if a location permit is issued, it may be withdrawn under certain circumstances. If a location permit is inconsistent with the spatial layout plan or the area is not accordance with the regency's or municipality's spatial layout plan, it may be cancelled by the relevant head of region. Furthermore, a location permit that was improperly obtained may be deemed void by law. Finally, a company that does not obtain a location permit may also be subject to criminal sanctions in the form of imprisonment and criminal fines, if such company uses the land in a manner that does not comply with the spatial layout plan.

ii Environment

Contaminated land is understood to mean land that has been contaminated with dangerous waste that is known, under Indonesian law, as hazardous and toxic materials waste (*bahan berbahaya dan beracun* or 'B3'). Under the applicable regulation, the management of the company or business activities are required to restore and rehabilitate land contaminated by B3.

During the rehabilitation process, contaminated land must be isolated and cannot be used. A sign is required to be placed on the land to inform the public that the land is contaminated and heavy equipment must be used to lift the contaminated land to be placed in containers in accordance to the specific characteristics of the B3 waste. The land should later be backfilled with processed land.

This regulation also provides that the producer of B3 waste is responsible to clean the contaminated land due to B3 waste. Failure to do so will cause the relevant institution to clean the contamination at the producer's cost.

iii Tax

The following are the legal costs, transfer tax and duty payable on the acquisition of real estate:

a land and building acquisition duty ('BPHTB') in the amount of 5 per cent is paid by the purchaser, computed based on the transaction value or the tax object sale ('NJOP') value, whichever is higher;

b income tax ('PPH') in the amount of 5 per cent paid by the seller, also computed based on the transaction value or the NJOP value, whichever is higher;

c Value added tax ('VAT') of up to 10 per cent, paid by the purchaser, the calculation and imposition of which will vary (and certain transactions may be exempted from VAT) depending on the condition and location of the land being transferred, the identify of the seller (whether or not a taxable entrepreneur) and whether VAT was imposed on a prior transfer of the land;

d PBB is payable annually following assessment by the tax office;

e stamp duty in the amount of 6,000 rupiah is levied;

f a PPAT fee for handling the land title transfer, which is negotiable; and

g contribution expense to the state, which depends on the size of the land.

iv Finance and security

The most common form of security over real estate is a security right (*hak tanggungan*). Under the Security Rights Law,[5] security rights are defined as rights of security encumbered over the rights on land as intended in the Agrarian Law, with or without anything erected upon such land, for the payment of certain debts that provide a preference position to certain creditors against other creditors.

The granting of a security right must be preceded by a promise to grant a security right for the settlement of a certain debt that is incorporated in and forms an inseparable part of the loan agreement or any other agreement creating such debt.

The granting of a security right is performed by drawing up a deed for the granting of a security right ('APHT') by a PPAT, in the presence of the grantor of the security right or its proxy. Such proxy will be given by a power of attorney to place a security right encumbrance ('SKMHT'). An SKMHT shall be drawn up by notarial deed or by PPAT's deed. The applicable law places the following restrictions on an SKMHT: a right on land that has already been registered must be followed by the drawing up of the APHT no later than one month after it is given, and a right on land that has not yet been registered must be followed by the drawing up of the APHT no later than three months after it is given.

At least seven working days after the signing of the APHT, the PPAT should send the APHT concerned to the local land office and have it registered it in the Land Book for Security Rights by describing the right on the land (which is the object of the security right). The local land office will then record such security right on the certificate of title to the land concerned.

The date of the security right as entered in the Land Book of Security Rights will be the seventh day after receipt of the complete documents required for the registration. The security right is created when such right is registered in the Land Book of Security Rights; as evidence, the local land office will issue a certificate of security right.

Another form of security is the land pledge. This is a way for the landowner to receive money without having to sell his or her land. The landowner may borrow money from another party and in return allows such party to use or occupy the land. The landowner receives the land back when the loan has been repaid; however, this pledge arrangement is not common and rarely conducted at the present time.

5 Law No. 4 of 1996.

VII LEASES OF BUSINESS PREMISES

Indonesian laws and regulations do not stipulate any maximum term for either a lease of land nor a commercial building lease in Indonesia; the parties are free to decide the number of years that the lease agreement will be effective. The parties to a lease must, however, take into account the duration of the lessor's relevant title over the land, except for *hak milik* titles, which are of unlimited duration. For example, if the right over the land to be leased is HGB, the term of the lease should take into account the term of the HGB. An original HGB term is 30 years, which may be extended for 20 years and then be renewed again for up to 30 years. The term of the lease must be consistent with the term of the underlying title, such that if the parties agree to a lease term of 50 years for land with HGB title, such lease term must be made subject to an agreed obligation of the lessor to obtain the necessary extension of his underlying title.

As for land with *hak milik* title, since there is no restriction on duration, the land can be leased indefinitely, with no maximum term. There is a possible exception to this rule, however: while there are no restrictions on the length of leaseholds in Indonesia, it is possible that the state could take the view that a leasehold longer than the original term plus a renewal of the underlying title, or as long, in the case of *hak milik* title, that it is equivalent to outright ownership, is against public policy on the grounds that the lease is an attempt to circumvent the restrictions on foreign ownership of property. For example, in the case of a *hak milik* title, if the lease period were 100 years with an option to renew for an additional period of 100 years, the GOI could conclude that a 200-year lease is the same, in economic terms, as a *hak milik* title. In the case of a HGB title, if the lease were for 50 years with an option to renew for 50 years, the leasehold might be regarded as equivalent economically to the HGB title itself, which foreigners are not permitted to own. While this is theoretically possible, there appear to be no instances of this argument having been upheld.

Under Indonesian law, the lessee is protected should the lessor wish to sell or transfer the land to another party while the lease is still effective. Article 1576 of the Civil Code provides that leases, as a matter of law, survive the sale of property unless the lease agreement specifically states otherwise.

VIII OUTLOOK AND CONCLUSIONS

Indonesia's housing market remains surprisingly weak, despite strong economic growth and high levels of investment.

The relatively poor performance of residential real estate prices in Indonesia has been something of a puzzle. There is tremendous pent-up housing demand considering that Indonesia's population, at approximately 240 million, is the world's fourth-largest. Rapid urbanisation has led to increased urban density, especially in big cities such as Jakarta. High inflation, however, with its subsequent effect on economic growth, and wages that have not kept pace with inflation, increase the level of uncertainty over the economy; this tends to discourage people from borrowing to finance house or apartment purchases.

Surprisingly, all the building has taken place despite a relatively underdeveloped mortgage market. Even during the recent financial turmoil, Indonesian banks have

remained strong and adequately capitalised. Memories of the Asian crisis are still vivid, however, leading banks to be extremely cautious in extending housing loans to the real estate industry. While Indonesian banks continue to increase credit for smaller purchases, such as cars, long-term multi-decade mortgages for residential homes remain relatively undeveloped in Indonesia's credit environment.

Another possible reason for Indonesia's lacklustre residential prices has been the massive amount of real estate construction while the economy has grown. This massive rise in the number of apartment units has affected prices and some say this downward pressure is likely to continue.

While the aforementioned factors may pose risks to business activities in Indonesia, the country has made tremendous gains over recent years. It has made a relatively successful transition to democracy over the past decade and the 2004 election of President Susilo Bambang Yudhoyono has been followed by a revival of confidence and substantial economic reforms.

The country's leadership has been able to focus on the policy and return the country to a strong and steady economic growth during the past several years despite the economic downturn on the other side of the world. Under the current GOI, there have been a number of efforts to eradicate corruption in Indonesia, and public disclosure of corruption practices has increased.

Moreover, Indonesia has also made reforms in many sectors, including in the real estate sector. Several laws have been issued in order to provide clarity. An example of legislation in the real estate sector that has recently been passed by the DPR is the new Law on Land Procurement for Public Interest. The Law aims to accelerate the land procurement process for public-interest projects while also prioritising economically fair and democratic principles, thereby providing a process for landowners to receive fair and proper compensation. The Law also aims to improve the previous regulations on land procurement, which are outdated and no longer appropriate. Projects that qualify as in the 'public interest' are classified into 18 categories: national defence and security purposes, public roads, toll roads, tunnels, railways, train stations and train-operating facilities, water embankments, reservoirs, irrigation drinking-water channels, water-disposal channels and sanitation and other water resource management buildings, seaports and airports, oil, gas, and geothermal infrastructure, rubbish disposal and processing facilities, structuring of urban development or land consolidation, low-income residential properties, and government educational facilities. Land procurement for public projects is to be organised by the GOI and it will be conducted in accordance with various regional spatial layout plans, national and regional development plans, strategic plans, and any work plans by the relevant government institutions.

Although improvements in several sectors have been made by the GOI, the achievements have been modest and much more remains to be done.

Appendix 1

ABOUT THE AUTHORS

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Dyah Soewito is a founding partner of SSEK. She is a specialist in Indonesian oil and gas law, foreign investment law, maritime law, real estate, construction, and corporate and commercial law. She has been a guest speaker at a number of domestic and international conferences has lectured at various government agencies, including the Ministry of Forestry and the Ministry of Finance, and was involved in preparing the draft foreign investment law.

Ms Soewito has been recognised by *Asia Law & Practice* as one of the leading practitioners in Indonesia in mergers and acquisitions, property, and shipping, maritime and aviation, and is recognised by the *International Financial Law Review* as one of the leading Indonesian practitioners in mergers and acquisitions, property, and maritime and aviation law.

Ms Soewito is a member of the Association of Indonesian Legal Consultants and the Inter-Pacific Bar Association. She was a member of the board of advisers of the ELIPS project, Indonesia's commercial law reform project (1992 to 1996).

Ms Soewito is a graduate of the University of Indonesia Faculty of Law (1977) and in 1988 she was a visiting scholar at the Boalt Hall School of Law of the University of California at Berkeley.

DENNY RAHMANSYAH

Soewito Suhardiman Eddymurthy Kardono

Denny Rahmansyah is a partner of SSEK. He joined SSEK in 2001 and has been deeply involved ever since in various transactions related to mergers and acquisitions, debt restructuring, banking and finance companies, plantations, private power and infrastructure projects. He is also experienced with oil and gas law, mining law, real estate and property law (including hotels and villas), anti-corruption law, telecommunications law, forestry law, foreign investment and general commercial and corporate laws. He has

worked on major transactions involving cross-border mergers and acquisitions as well as debt restructurings.

Mr Rahmansyah was described by *Asialaw Profiles 2011* as an 'up-and-coming' lawyer for mergers and acquisitions.

Mr Rahmansyah obtained his bachelor of law degree majoring in private law from the Faculty of Law of the University of Indonesia in 2000 and received his master of laws degree (LLM) majoring in international economic and business law from the University of Groningen in 2009.

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