



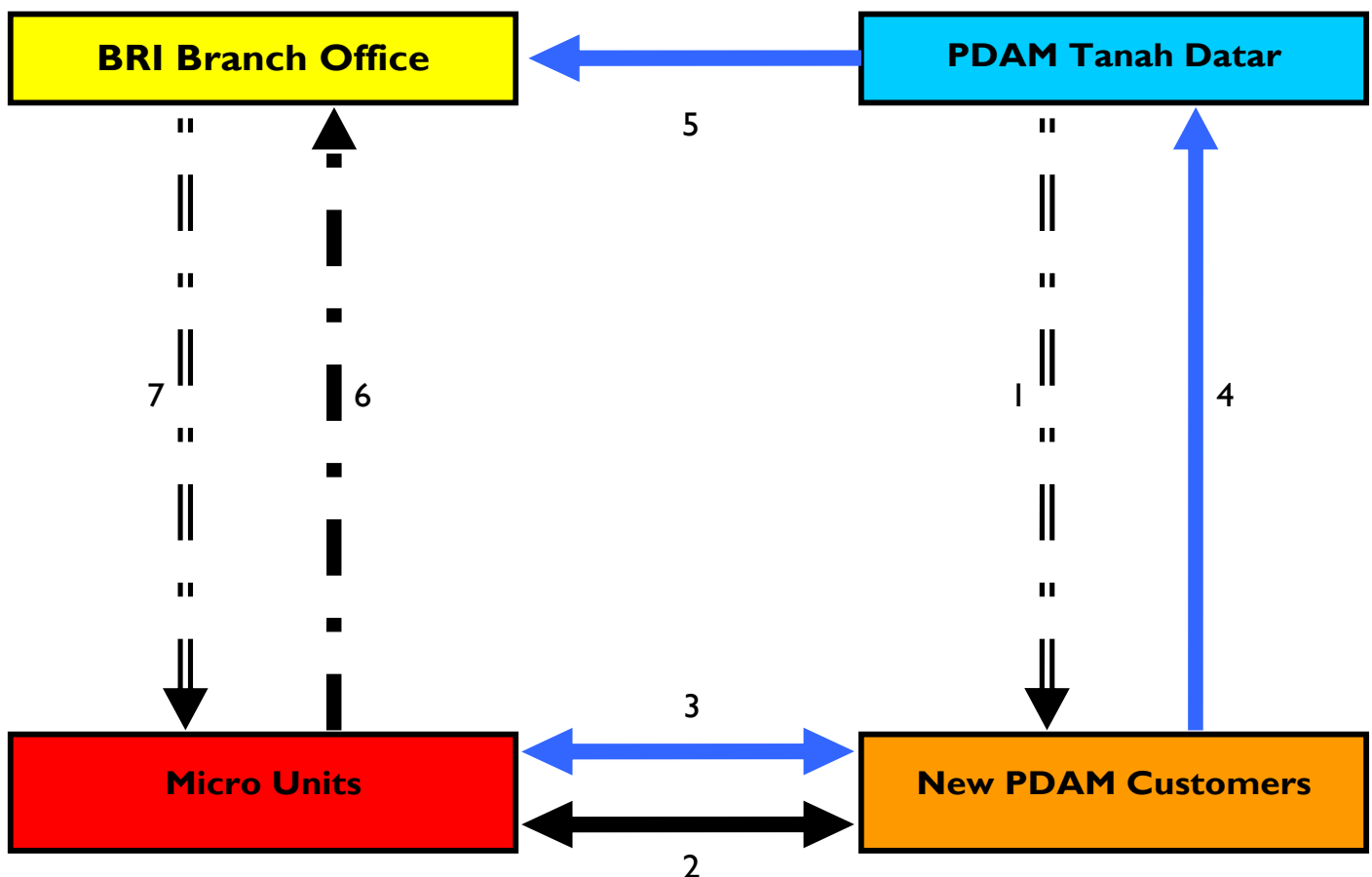
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MICRO-CREDIT FINANCE OF WATER CONNECTIONS TO NEW PDAM CUSTOMERS

ASSESSMENT STUDY

COOPERATION BETWEEN PDAM TANAH DATAR
AND BANK RAKYAT INDONESIA



FEBRUARY, 2006

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Illustration credit: ESP Jakarta.

Image caption: *Kupedes* loan approval and loan disbursement process. *Kupedes* (*Kredit Umum Pedesaan* or General Rural Credits) in 1984. *Kupedes* credit is granted to individual end-borrowers (micro-entrepreneurs and low income consumers) based on thorough evaluation of each end-borrower's repayment capacity. In collaboration with Bank Rakyat Indonesia, ESP is working to provide micro-credit through investment loan methods such as *Kupedes* to new PDAM customers for financing of water connections to the water company's supply lines.

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I. INTRODUCTION

I.1. BACKGROUND

The Environmental Services Program (ESP) is a development program funded by the United States Agency for International Development (USAID). ESP works for the Government of Indonesia (GOI) and regional stakeholders to promote better health through improved and expanded access to clean water and sanitation services.

Sustainable micro finance is used by several developing countries to finance water connections from municipal water supply companies to low-income households. Provision of micro credit to finance water connections to low-income families is widely used in countries like India, Pakistan, South Africa and Honduras.

Microfinance is commonly defined as the provision of financial services to low-income groups. Sustainable microfinance comprises both savings and credit. Saving instruments are important for low-income households to manage their liquidity, improve their creditworthiness and to accumulate resources for special expenditures. Savings is also important for microfinance institutions for sustaining and expanding their outreach.

The microfinance sector in Indonesia is made up of a high variety of institutions, programs and services governed by a detailed legal, regulatory and supervisory framework. Microfinance services are provided by formal microfinance institutions; i.e. commercial banks and village banks (BPR), which are regulated and supervised by Bank Indonesia. Most informal, non-bank micro finance institutions are organized as cooperatives. They are partly funded with state budget allocations administered by the State Ministry of Cooperatives and SME Development.

Water is a basic need for all human beings. Access to potable water supplied by water companies has assisted large numbers of low-income micro-entrepreneurs to increase their employment and income generating activities.

Micro credit programs for financing of water connections are implemented successfully by micro finance institutions, when the programs are market based and follow simple loan administration procedures related to appraisal, approval, disbursement and repayments of micro credit.

Municipal water companies benefit from increased numbers of new customers through additional sales revenues combined with reduction in non revenue water (NWR). Water companies in Indonesia have so far shown little interest in assisting potential low-income customers get access to micro credit for financing of water connections. Only one municipal water supply company has so far entered into a cooperation agreement with a commercial bank for financing of water connections. This commercial bank offers micro credit for a wide range of purposes to its clients.

ESP assigned a consultant to prepare this report on the cooperation between the municipal water supply company of Tanah Datar district in West Sumatra (PDAM Tanah Datar), and the commercial bank, PT. Bank Rakyat Indonesia (Persero) Tbk (BRI). The two parties have

entered into a Cooperation Agreement aimed at providing micro-credit to new PDAM (Indonesia Water Supply Company) customers for financing of water connections to the water company's supply lines.

PDAM Tanah Datar assists BRI Batusangkar Branch office select new, creditworthy customers. It calculates water connection costs for each new customer. The cost estimates serve as micro loan ceilings for new customers, when they apply for Kupedes credit from BRI. The water company issues a recommendation letter to BRI on each new customer.

Bank BRI through its micro units (unit desa/unit kota), evaluates each new PDAM (Indonesia Water Supply Company) customer.

PDAM Tanah Datar started its micro credit cooperation with BRI on May 1, 2003. The company has so far assisted around 2,000 new customers to be granted micro credit from BRI's micro units in Tanah Datar district.

1.2. PDAM TANAH DATAR

The municipal water supply company PDAM Tanah Datar has around 13,000 customers. Nine percent of all customers are enterprises and small institutions. A small number of low income households (4 % of all customers) have access to subsidized, drinking water.

PDAM Tanah Datar delivers water to approx 67 % of the district's population. There has been a sharp increase in new customers after May 2003. The water supply company plans to increase its number of new customers by 2-3,000 by the end of 2008. Access to micro credit from BRI greatly assists many households and small enterprises to finance their water connection expenditures and become new PDAM customers.

The water company's accounting system is incomplete. The consultant could not access the PDAM's audited financial reports. It has so far not been possible to provide correct information on the water supply company's financial status. The financial and technical performance indicators in this report are taken from a benchmarking report prepared by ESP and from interviews with PDAM' Director.

PDAM Tanah Datar's total asset base has a nominal value of approximately Rp 13 Bn. (\$1.3 million). Current assets amount to Rp 2 Bn. (\$200,000). The procurement value of PDAM's fixed assets is around Rp 11 Bn. (\$1.1 mill.). The water company has a current outstanding debt of Rp 2 Bn. rupiah. PDAM Tanah Datar has accumulated a nonperforming long term debt balance of Rp. 3.15 Bn. (\$315,000). This overdue debt will be restructured in 2006 based on a debt restructuring agreement prepared by the PDAM and approved by the creditor; e.g. the Ministry of Finance, RI (MOF).

Annual turnover is around Rp 4 Bn. (\$400,000). The company's operating cost not including depreciation of fixed assets amounts to Rp 3.9 Bn. Personnel costs cover 41 % and energy costs 2.3 % of total operating cost. PDAM Tanah Datar has around 100 full time employees.

PDAM Tanah Datar implemented in June 2001 a graded water tariff with a price range from Rp 250 to Rp 3,000 per m3 water based on customer groups income level. The average sales price was Rp 1,586 and the average production cost of one cubic meter

tapped water was Rp 1,412 in 2004. The company reported 36 % in non revenue water in 2004

ESP's benchmarking report states that the company improved its operational performance in 2003 and 2004. The main reason for improved operational performance comes from a significant increase in the number of new customers. This has led to increased water production and sales incomes accompanied by a sharp reduction in the average production cost of potable water. BRI's financial support to new customers is a major factor that assisted PDAM Tanah Datar to improve its operational performance.

The water supply company has problems in repaying its current and long term debt despite the above-mentioned improvement of its operational performance. It is expected that the company would be able repay its debt on time, after the loan restructuring agreement with MOF has been signed and made effective.

1.3. BANK RAKYAT INDONESIA (BRI)

BRI is one of the oldest and biggest commercial banks in Indonesia. The Government owns 59% of BRI's share capital. The remaining 41 % were sold to the public in 2003.

The Bank has the largest office network of all Indonesian banks with the following logistical structure as at the end of 2004: (i) 1 Jakarta based Head office; (ii) 13 regional offices; (iii) 324 fully-fledged branch offices in almost every municipality; (iv) 162 sub-branches; (v) 4,061 micro units; and (vi) 148 village service points.

As a full service commercial bank, BRI extends a full range of banking services to its customers. The Bank's credit portfolio which amounted to Rp 62 trillion (\$6.2 billion) at the end of 2004 was extended to the following groups of borrowers: (i) micro enterprises 30.77 %; (ii) small enterprises 28.01 %; (iii) consumers 23.06 %; (iv) medium-sized enterprises 4.59 %; and (v) corporate clients 13.56 %. The large amount of outstanding micro and small enterprise credit in BRI has given the Bank more than 50 % national market share of such credit.

BRI is internationally known for its very profitable micro-savings and micro-credit programs, which are operated and administered by the Bank's micro units (unit desa & unit kota).

1.3.1. KUPEDES CREDIT

BRI started a micro credit program known as Kupedes (*Kredit Umum Pedesaan* or General Rural Credits) in 1984. Kupedes credit is granted to individual end-borrowers (micro-entrepreneurs and low income consumers) based on thorough evaluation of each end-borrower's repayment capacity. Each end-borrower must identify one activity as the borrowing activity and show that the activity and/or the borrower are capable of repaying the loan. Kupedes can be extended as working capital credit or investment credit to "productive" end-borrowers.

Kupedes credit has an upper loan ceiling of Rp 50 million (\$5,000). However, most of the borrowers (82 %) have been granted loans of less than Rp 20 million (\$2,000) by BRI micro units. The average Kupedes loan size is around Rp 9 million (\$900).

There is a special Small Credit Kupedes program for borrowers who request credit with a maximal ceiling of Rp 3,000,000 (\$300) for a period of up to 12 months.

1.3.2. KUPEDES CREDIT TERMS AND CONDITIONS:

- 1) Kupedes loans are made to support any ongoing creditworthy productive activity in a wide range of family income-earning activities.
- 2) Working capital credit has a maximal maturity of 24 months; the maximal investment loan maturity is 36 months.
- 3) Payments of monthly interest cost and principal installments are agreed upon by the borrower and BRI before loan disbursements is started. The fixed monthly loan repayment costs are entered into a separate loan repayment table.
- 4) Loan interest rate is calculated from the loan ceiling at the end of each month (flat interest rate). The monthly, nominal interest rate is in the range from 2 to 2.5 percent.
- 5) BRI provides an interest discount of 0.5 % to end-borrowers, who repay their interest and principal loan installments on time.
- 6) BRI requires collateral for all Kupedes loans, except for Small Credit Kupedes. The borrowers' land and house are usually pledged as collateral. Pledges of savings accounts and payroll deductions are also commonly used as collateral.

BRI designed standardized loan application forms for Kupedes credit. Credit officers from the Bank's micro units interview and assist borrowers to fill in the application form. Credit officers visit the borrowers' enterprise and home to review the offered collateral. Kupedes loan with a ceiling of Rp 15 million (\$1,500) are approved by the micro unit manager. Loans in the range from Rp 15 to 50 million are approved in the branch office by the Micro business manager or by the Branch manager.

Micro unit staff is in frequent contact with borrowers of Kupedes credit. Borrowers of loans in the range from Rp 25 to 50 million are visited every month by micro unit credit officers.

Kupedes loans must comply with Bank Indonesia's regulation on loan classification, loan loss reserves and risk management. BRI's total outstanding Kupedes credit balance stood at Rp 19.2 trillion (\$1,92 billion) at the end of 2004 and Rp 14.5 trillion (\$1.45) at the end of 2003.

1.3.3. SIMPEDES/SIMASKOT SAVING SCHEMES

BRI's micro units operate two micro savings programs the first is known as Simpedes; the second is called Simaskot. Micro units offer in addition time deposit and current accounts to their clients. The total savings and deposit balance managed by the micro units amounted to Rp 32.9 trillion (\$3.29 billion) at the end of 2004. *BRI micro units with more than 31 million clients* all over Indonesia, offer market rates to its customers' savings and deposit accounts.

There is a large potential for rural savings, when small depositors' financial service needs are fully provided for by microfinance institutions. A main benefit from keeping savings in a micro unit is linked to the fact such savings provide easier access to micro credit for micro unit customers.

BRI has developed flexible regulations for its micro unit savings schemes. Depositors are free to withdraw part or all their savings at any time. The Bank's outstanding micro saving balance grew rapidly especially during 2004. Rural and peri-urban customers feel that their savings are managed in a professional and safe manner by BRI. The Bank with the Government as the main owners would not allow depositors to lose their savings should there be a financial crisis like the one of 1997/1998.

BRI micro units, located conveniently in almost all sub-districts of Indonesia, provide professional micro finance services to an impressive number of individual customers. The customers decide how to save and borrow from the micro units at competitive interest rates and terms.

Micro unit interest structure is reviewed on a monthly basis by the Unit System Management in cooperation with the Bank's Asset and Liability Committee. Rates are adjusted based on review of money market interest rates and the Units liquidity needs.

The average interest rate on third party funds managed by micro units is kept low partly due to the high administration cost of the huge number of accounts, each with a small balance. BRI's branch offices conduct semi annual lotteries with a total award equal to around 0.8 % of the total Simpedes/Simaskot balance managed by all micro units supervised by a single branch office. Prizes are paid in kind, ranging from automobiles, motorbikes, television sets, washing machines, radios and clocks. These lotteries have together with Kupedes made Simpedes and Simaskot very popular in all districts of Indonesia.

2. COOPERATION BETWEEN PDAM TANAH DATAR AND BANK RAKYAT INDONESIA, BATUSANGKAR

2.1. IMPACTS ON NEW PDAM CUSTOMERS

Cooperation between PDAM and BRI Batusangkar branch office provide benefits to three participating parties. New PDAM customers are granted Kupedes credit, while PDAM and BRI increase their business volume and incomes from a growing customer base.

Around 2,000 new PDAM customers have been granted Kupedes investment loans from BRI's micro units to finance water connections installed by PDAM employees in Tanah Datar. Kupedes loans covered by the Cooperation Agreement have an upper ceiling of Rp 2.5 million (\$250) and a maximum tenor of 24 months. Most of the new customers, who have been extended Kupedes credit, live in or near Batusangkar town; the administrative center of Tanah Datar district.

PDAM water supply network cover around 40 % of the district's land area. A large share of the un-served land area is used for farming. The remaining land, which is mountainous, is sparsely populated.

PDAM Tanah Datar produces potable water of very high quality. The raw water comes from high altitude natural springs and rivers located in various regions of Tanah Datar District.

The average Kupedes loan size to new PDAM customers is Rp 800,000 (\$80). End-borrowers are obliged to open individual saving accounts in the micro units that approved their loan application. BRI has not yet reported any customers with overdue Kupedes loan repayments.

Every new water connection borrower must deposit an agreed part of the Kupedes loan in a compulsory savings account. The deposit covers three monthly loan repayments. PDAM calculates the compulsory deposit and requested deposits are transferred from the borrowers' loan accounts to their saving accounts, where the savings are kept during the loan repayment period.

The remaining loan amount balance is transferred to PDAM's current account in BRI's branch office, partly to serve as loan repayment guarantee and partly to cover PDAM's installation cost. Transfer of payment to PDAM is executed after completion of each water connection installation, when the new customer has tested the equipment and PDAM's water supply performance.

Monthly Kupedes loan repayments are fixed; i.e. of the same size during the whole repayment period.

New clients without previous customer relations with micro finance institutions are given an opportunity to obtain credit without collateral. This is very important for low income borrowers, who can prove their creditworthiness and gain access to additional Kupedes credit, when their water connection loans are fully repaid.

New customers are given access to saving accounts that enable them to develop long-term customer relations with BRI's micro units and BRI branch office. Borrowers can pay monthly loan repayments and water bills in cash or through internal transfers from their saving accounts. Many new customers; i.e. owners of small businesses have a potential to make frequent deposits of sales incomes to their saving accounts in the micro unit and develop business relations with BRI's micro units.

Year round supply of high quality, reasonable drinking water from PDAM Tanah Datar is the other major benefit enjoyed by the new PDAM customers, who are extended Kupedes credit to finance their water connections.

2.2. IMPACTS ON PDAM TANAH DATAR

The water supply company has increased its customer base by around 10 percent annually since it started its financial cooperation with BRI. The company increased its total water sales incomes by around 40 % from 2002 to 2005. This has led to a sharp decrease in the average water production cost, which declined from Rp 2,500 per m³ in 2002 to a present level of Rp 1,450 per m³ in 2005.

The new customers enabled PDAM Tanah Datar to reduce its non revenue water (NRW) production ratio from 56.5 % at the end 2002 to 36 % at the end of 2004. Relative water losses remained at the same level of around 22 % during the last three years.

Increased sales incomes led to an increase in PDAM's profit margin. The water supply company has improved its debt service capacity. The company would be able to fully repay its debt, when the loan restructuring agreement with MOF is signed. MOF is willing to write off a portion of calculated and charged loan interest penalties. Write-off of overdue interest cost will reduce the outstanding loan balance to a feasible level.

BRI has opened several accounts for PDAM Tanah Datar. One current account is credited with the company's water connection income earned from connecting new customers financed with Kupedes loans. Another PDAM current account at BRI's branch office is used by customers who pay their monthly water bills in cash or through bank transfers. This account is used by PDAM, its suppliers and customers for payment transfers of operating incomes and expenditures.

The water company has opened current accounts in the regional development bank of West Sumatra (Bank Nagari, Batusangkar branch) in addition to the company's accounts in BRI, Batusangkar. Each of the two banks manages around 50 % of PDAM's total annual transactions with suppliers and customers.

PDAM Tanah Datar keeps a daily, average current account balance of Rp 2-300 million (\$60,000) in BRI. These are deposits realized from increasing water sales incomes and profit earned from installation of new water connections. Financial cooperation between BRI and PDAM Tanah Datar could in future to be extended to finance PDAM's needs for additional banking services; i.e. working capital credit and financing of medium-term incremental capital investments.

The water company has agreed to fully repay defaulting PDAM customers Kupedes loans. PDAM issues warnings to customers with overdue loan repayments. The company threatens to cut water supply to customers with overdue loan repayments. Customers with more than three months overdue loan repayments are not supplied by the company. According to the Cooperation Agreement, PDAM Tanah Datar shall fully repay each non-performing loan classified as "substandard" or "doubtful" to BRI, when the company has ended its customer relations with problem clients.

The company shall cover payments of non-performing loans from its above-mentioned current account in BRI Batusangkar branch. There have been no incidences of non-performing Kupedes loans from May 2003 until the end of November 2005.

2.3. IMPACTS ON BRI BATUSANGKAR

Tanah Datar has a total population of around 170,000 persons; i.e. around 30,000 households. BRI micro units have extended water connection credit to around 2,000 new customers since May 2003. There is a potential to grant another two, three thousand new water connection loans to PDAM customers during the coming three years.

BRI's branch manager and the Bank's micro unit manager in Batusangkar consider the Bank's cooperation with PDAM Tanah Datar to be profitable and beneficial to BRI in this area. Lending to new customers is based on commercial principles and BRI's internal Kupedes credit regulation.

New customers have their Kupedes loans appraised and administered by micro unit staff. Customers are accompanied by PDAM staff that hand over recommendation letters and summaries of the customers' water connection cost statements to be financed with Kupedes loans to micro unit staff. Water connection loans extended to new customers based on the Cooperation Agreement, range from Rp 200,000 (\$20) to Rp 2,500,000 (\$250).

Micro unit staff interview the new borrowers and inspect buildings where new water connections are going to be installed. A Kupedes loan information sheet (Appendix 2) is filled in by a micro unit staff in the final interview with the new borrower after micro unit staff have completed appraisal of the borrower's earnings and repayment capacity. The decision to extend or refuse credit is taken by the micro unit manager, who countersigns the loan information sheet after it is signed by the micro unit credit appraiser and the end-borrower.

Borrowers are not requested to provide collateral to secure their water connection credit. Kupedes loans covered by the Cooperation Agreement between PDAM and BRI are below Rp 3,000,000 (\$300); the low-end ceiling for Kupedes loans which must be secured with collateral.

MICRO-CREDIT FINANCE OF WATER CONNECTIONS TO NEW PDAM CUSTOMERS

BRI Batusangkar supported by PDAM deposits and the new PDAM customers “frozen” savings, are exposed to a very small credit risk on Kupedes credit extended to new PDAM customers. The outstanding Kupedes loan balance for financing water connections to new PDAM customers exceeded Rp 600 million (\$60,000) at the end of 2005.

Micro credit staff are in frequent contact with the new borrowers to promote the unit’s payment transaction and savings products. Many new borrowers request the micro units to transfer monthly loan repayments from their saving accounts in the micro units. The borrowers are issued written debit advice slips and cash receipts, when they have repaid their monthly interest and loan installments to BRI micro units.

The water company channels 50% its cash flow through Bank BRI’s branch office in Batusangkar. Around 20% of the average outstanding Kupedes loan amounts is kept in the borrowers’ savings account at the micro units. PDAM Tanah Datar deposit a considerable amount of its water connection incomes financed from Kupedes credit in a separate current account in BRI Batusangkar. PDAM customers together with the PDAM finance indirectly around 50% of the outstanding Kupedes loan balance from their deposit and saving accounts in BRI Tanah Datar.

The Cooperation Agreement has greatly assisted BRI micro units increase their number of creditworthy borrowers. Many new clients keep surplus savings in the units. They use their saving accounts to pay water and electricity bills. It is estimated that BRI’s branch and micro units in Tanah Datar district have increased their third party funds by around 10 percent as a direct result of the Cooperation Agreement with PDAM Tanah Datar. Both BRI and PDAM managers interviewed by the consultant expressed keen interest to continue their cooperation in assisting new PDAM clients access to tapped water financed with Kupedes credit.

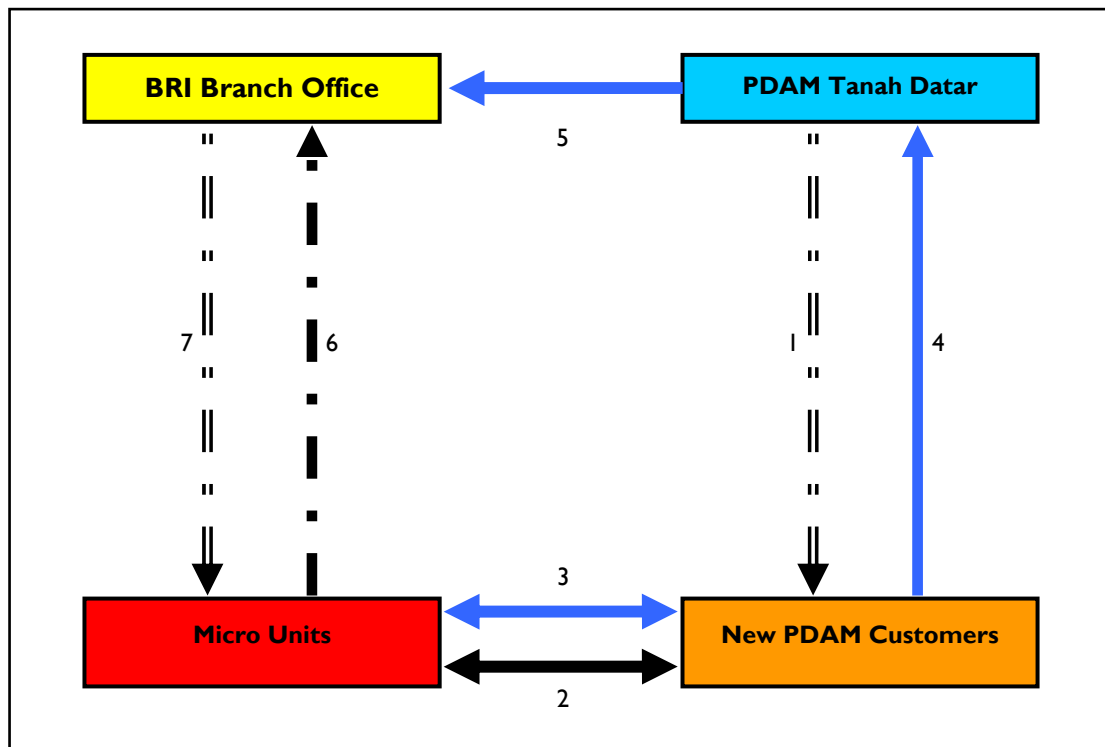




Figure 1 KUPEDES loan approval and loan disbursement process

Each number in the above figure covers individual activities as follows:

- 1: PDAM staff identify, interview and prepare water connection cost calculations to new, potential customers.
2.  New PDAM customers submit Kupedes loan application requests.
BRI micro uni, Batusangkar, approves or refuses Kupedes loan application requests.
3.  Kupedes loans are disbursed to the new borrowers saving accounts.
New borrowers repay monthly loan installments.
4. A portion of all Kupedes loan proceeds are transferred to PDAM.
5. PDAM deposits Kupedes loan proceeds to its current account in BRI branch
6. BRI micro units submit copies of monthly reports and copies of new approved loan information sheets to BRI Batusangkar branch office.
7. BRI Batusangkar branch (micro unit supervisors) monitor Kupedes loan administration, loan disbursements to new customers and actual loan repayments in the micro unit.

Kupedes loan extended to new PDAM customers under the Cooperation Agreement between BRI Batusangkar Branch Office and PDAM Tanah Datar must comply with the following terms and conditions:

- 1) Each new PDAM customer must be creditworthy;
- 2) PDAM Tanah Datar shall prepare correct water connection cost installation statements to each new customer;
- 3) Water connection loans are in the range from Rp 200,000 to Rp 2,500,000;
- 4) Maximum investment loan repayment period is two (2) years;
- 5) The loan interest rate is 2 % per month, flat rate;
- 6) End-borrowers who repay their loan interest cost and installments on time are given an interest rate discount of 0.5 %; i.e. 25 % of total paid in interest costs are refunded to the end-borrower by BRI at the end of each six months.
- 7) BRI micro units shall issue receipts to end-borrowers covering payments of monthly interest and loan installment charges.
- 8) PDAM Tanah Datar guarantees the loan repayments of all non-performing loans financed from its current account balance in BRI Batusangkar Branch.

3. COOPERATION BETWEEN BRI AND PDAMS IN OTHER DISTRICTS

3.1. MICRO UNITS IN BRI'S ORGANIZATION

BRI's micro units are administered at BRI Head office by the Bank's Micro & Retail Business Unit. A separate Micro Business Division which is part of this Business Unit is responsible for issuing micro unit regulations and operating guidelines. This Division is organized in three Departments: (i) Product and Marketing Management Department; (ii) Operation Management and Reporting Department; and (iii) Information System Development Department.

Head office staff develop guidelines and regulations for micro unit lending, savings and payment services. Separate regulations issued by the Head office cover supervision and monitoring of the micro unit activities and staff. BRI has in addition developed and continuously improved its micro unit computer programs and information systems. On line computer systems are gradually implemented by new micro units each month.

BRI micro units are assigned to and report to BRI branch offices. Branch office staff supervise, monitor and assist micro units carry out payment transactions and cash management. Many micro units hold cash reserves, which are managed by BRI branches. Micro units earn interest on their cash reserves in accordance with internal BRI regulations.

BRI branches administer a wide range of banking services provided by the Bank's back office divisions at BRI Head office. Such services include personnel administration, liquidity management, internal audit, compliance with good corporate governance and BI's prudential banking regulations. BRI has assigned micro unit supervisors to its branches. One micro unit supervisor administers up to four micro units. The number of micro units per branch office range from 3 to 35 with an average of 10 micro units per branch office.

Micro units have a high degree of autonomy to approve loans and mobilize savings. Small loans are approved by the micro unit manager. Loans with ceilings above Rp 20 million are made by the Micro unit manager or by the branch manager both working at the BRI branch office.

Micro units employ the following staff categories: (i) a micro unit manager; (ii) one or more credit officers; (iii) tellers; and (iv) fund mobilizers (deskmen). A credit officer administers around 500 individual Kupedes loans. Fund mobilizers promote Simpedes and Simaskot to existing and new clients. Tellers carry out payment transactions. Allocation of working time on lending and fund mobilization is determined by the Unit manager based on targets set in the annual business plan, branch office staff instructions and BRI regulations.

3.2. EXTENDING PDAM COOPERATION TO OTHER BRI BRANCHES

Cooperation between PDAM Tanah Datar and BRI branch and micro units has so far been very positive. BRI with its 323 branches and 4,049 micro units is favorably placed to develop similar cooperation agreements with PDAMs in other regions of Indonesia. BRI micro units have a national micro credit market share of more than 50 %. The Bank's national market share of micro savings is above 75 %.

There are few alternative micro finance institutions to BRI micro units on some of the big islands; like Sumatra, Sulawesi and Borneo.

A separate group of micro finance institutions known as Bank Perkreditan Rakyat (BPR) are well established on Java and Bali. BPRs are owned by private investors and companies. They are supervised by Bank Indonesia. Their technical standard and financial capacity are less developed compared to BRI micro units.

The consultant discussed the Cooperation Agreement between BRI Batusangkar and PDAM Tanah Datar with of BRI Micro Business Division, Assistant Director, Bp. Sutarjo and the Sectional Head of the Bank's Retail Business Division, Bp. Rusli.

The two Divisions at the BRI Head office have no responsibilities or rights to decide on selection of BRI branch and micro unit clients. The Head office is not in a position to instruct regional branches enter into similar Cooperation Agreements with PDAMs in other districts.

Decisions to develop and approve Cooperation Agreements between BRI and PDAMs in the municipalities are delegated to individual BRI branch managers and PDAM managers and owners. ESP could play an important role in promoting cooperation between BRI and properly managed PDAMs in other districts. Promotion of cooperation aimed at financing new customers water connection with Kupedes credit should be based on regulations, cooperation principles and the actual work procedures, which have been developed by BRI Batusangkar and PDAM Tanah Datar.

Micro Business Division staff at BRI Head office are willing to support and promote cooperation between BRI branches and PDAMs in other areas. The Head office could prepare promotion materials and issue special regulations if required. The Bank is willing to cooperate with ESP on regional and Head office level. ESP could assist BRI select financially viable PDAM and start to promote BRI's micro credit program and a Standardized Cooperation Agreement to PDAMs in other regions of Indonesia.

BRI and PDAMs could extend their scope of cooperation beyond financing of water connections to new PDAM customers. Extended financial cooperation between BRI branches and PDAMs is highly feasible. Such cooperation should be developed gradually, and it should aim at providing medium term loans for financing of incremental PDAM investments; i.e. Extension and maintenance of water supply networks, replacement of old machinery and equipment etc. PDAMs should compile feasibility studies and BRI would appraise each incremental capital investment project before loans are extended to PDAMs.

APPENDICES

APPENDIX I COOPERATION AGREEMENT

APPENDIX 2 FORM K-3

APPENDIX I

COOPERATION AGREEMENT
BETWEEN
THE MUNICIPAL WATER SUPPLY COMPANY OF TANAH DATAR
AND
PT. BANK RAKYAT INDONESIA (PERSERO) Tbk
BATUSANGKAR BRANCH OFFICE
REGARDING
KUPEDES CREDIT FOR FINANCING OF WATER CONNECTION
EXPENSES AND OTHER PDAM SERVICES TO NEW PDAM CUSTOMERS
IN TANAH DATAR DISTRICT

On this day, Thursday the first of May 2003 (01-05-2003), in BRI's Batusangkar branch office, Jl. S. Parman No. 45 Batusangkar, this Agreement was signed by us:

1. Ir. Gusril Bahari Managing Director of PDAM Tanah Datar with its principle office in Jl. Ahmad Yani No. 41 is authorized to sign this agreement on behalf of PDAM Batusangkar hereinafter referred to as the **FIRST PARTY**

2. Putu Gde Ekajaya S, SE Branch Manager of PT. Bank Rakyat Indonesia (Persero) Tbk
MM Batusangkar Branch with its office in Jl. S Parman No. 45,
Batusangkar hereinafter referred to as the **SECOND PARTY**

The two parties have agreed to enter into a cooperation agreement on provision of KUPEDES credit for financing of water connections and other services provided by PDAM Batusangkar to new customers in accordance with agreed upon regulations, as stated in the following paragraphs:

PARAGRAPH I

FIRST PARTY tasks and responsibilities:

- a. In order to increase community welfare in Tanah Datar District, the First Party would issue recommendations to new customers of PDAM Tanah Datar, who apply for KUPEDES credit for financing of water connections to PDAM Tanah Datar's water supply network.
- b. Give recommendations and information regarding new PDAM customers' creditworthiness and capacity to be granted Kupedes credit by the Second Party based on BRI's prevailing credit regulations.
- c. Prepare and issue cost estimates for water connections to new PDAM customers as basis for being granting Kupedes credit by the Second Party.
- d. Issue warnings to customers with overdue Kupedes repayments of more than three months stating that PDAM shall disconnect water supply to the defaulting borrowers.

- e. Guarantee repayments of substandard Kupedes loans; i.e loans with more than three months repayment default after water supply has been disconnected. Overdue loan repayments paid by PDAM Tanah Datar is guaranteed and paid from the company's current account with the Second Party.
- f. Open a current account with the Second Party; deposit water connection incomes paid by new PDA customers financed with Kupedes credit into the current account.

PARAGRAPH 2

SECOND PARTY tasks and responsibilities:

- a. Extend Kupedes credit in accordance with BRI's prevailing Kupedes credit terms and conditions to new PDAM customers for financing of water connection costs.
- b. Eligible Kupedes credit extended by BRI to new PDAM customers are based on actual PDAM water connection costs on the following terms and conditions:
 - (i) loan ceiling is in the range from Rp 200,000 to Rp 2,500,000;
 - (ii) maximum loan repayment period is two (2) years;
 - (iii) loan interest rate is two percent per month calculated from maximum loan amount (flat rate);
 - (iv) to end-borrowers who repay their interest cost and loan installments on time, an interest rate reduction of 0.5 % or 25 % of total interest costs are refunded to the end-borrowers by BRI at the end of each six months period.
- c. Receive payments of interest costs and loan installments from each individual new PDAM customer, and issue receipts to end-borrowers that cover their total payments of interest and loan installments.
- d. Provide incentives to PDAM customers that repay their credit on time based on prevailing Cooperation Agreement regulations.
- e. Provide payment transaction services to PDAM through the current account used by PDAM to deposit incomes earned from new PDAM customers, who have financed water connections with Kupedes credit. BRI charges an administration fee and deducts income tax from PDAM's current account in accordance with prevailing BRI regulations.
- f. The Second Party has a responsibility to receive payments of water bills from PDAM customers, who have been granted Kupedes credit without any charges until the loan is fully repaid.

PARAGRAPH 3

PDAM customers can repay their outstanding Kupedes loan balance before the end of the agreed upon loan repayment period and receive an interest cost reduction based on prevailing BRI regulations.

PARAGRAPH 4

Debitors who enjoy Kupedes credit for financing of PDAM water connections, have a responsibility to open Savings accounts with the Second Party and deposit an amount that will be used as a loan repayment reserve should there occur overdue loans or delays in payments of interest and loan instalments. The size of each saving, reserve amount is decided by the First Party.

PARAGRAPH 5

Matters not regulated in this Cooperation Agreement or additions considered necessary by the two Parties shall be further regulated in an Appendix based on mutual agreements between the two parties.

PARAGRAPH 6

- a. Should disputes occur between the Parties or the two Parties are unable to fulfil their obligations related to implementation of this Cooperation Agreement such disputes would be settled amicably in meetings between the two Parties.
- b. Any dispute or differences which cannot be settled amicably shall be settled by Batusangkar District Court based on written requests submitted by the Parties.

PARAGRAPH 7

This Cooperation Agreement is binding for holders of the Position Director PDAM Tanah Datar and Branch Manager, BRI Batusangkar. Tasks and responsibilities included in this Cooperation Agreement shall be transferred from incumbent position holders to new PDAM and BRI employees, when new employees are appointed to replace the incumbent position holders.

PARAGRAPH 8

This Cooperation Agreement is issued jointly by the two Parties without any undue pressure from any other Party. The Agreement is issued in two signed copies legalized with duty stamps. The first copy is for to the First Party and the second copy for the Second Party.

PARAGRAPH 9

This Cooperation Agreement is valid from the date it is signed by the two Parties.

FIRST PARTY
PT. BANK RAKYAT INDONESIA
(PERSERO) Tbk
BATUSANGKAR BRANCH OFFICE
BRANCH OFFICE MANAGER

Putu Gde Ekajaya S, SE. MM

WITNESSED AND AGREED UPON
MAJOR OF TANAH DATAR DISTRICT
TANAH DATAR

Masriadi Martunus

SECOND PARTY
PERUSAHAAN DAERAH AIR MINUM
TANAH DATAR DISTRICT

DIRECTOR

Ir. Gusril Bahar

APPENDIX 2

FORM K-3
 Appendix SE
 No.:S. 27-DIR/MKR/10/03 10-03-2003

BANK RAKYAT INDONESIA	BRI UNIT :
	KANCA :

INFORMATION ON KUPEDES LOAN APPLICATIONS WITH CEILING RP: 3,000,000.

APPLICATION DATE :	NO. PANGKAL/NIN :
APPLICATION NUMBER :	

I. CLIENT & ENTERPRISE IDENTITY

1.	APPLICANT'S NAME	:
2.	WIFE/HUSBAND'S NAME AND POSITION	:
3.	APPLICANT'S STATUS: OLD / NEW	: REPUTATION: GOOD/NOT GOOD
4.	IDENTITY CARD NO.	:
5.	HOME ADDRESS	:
6.	ENTERPRISE TYPE / EMPLOYMENT POSITION	:
7.	ENTERPRISE AGE	:
8.	ENTERPRISE ADDRESS/LOCATION	:
9.	TIME SINCE LOCATED AT THIS ADDRESS	:
10.	LOAN PURPOSE	:
11.	REQUESTED LOAN TOTAL AND TENOR	:
12.	TYPE AND TOTAL MICRO UNIT SAVINGS	: Rp. / Months

BORROWER SIGNATURE	DESKMAN SIGNATURE	AGREED TO
DATE:	DATE:	APPROVE/REFUSE
		MICRO UNIT MANAGER
		SIGNATURE
		DATE:

II. FINANCIAL ASPECTS (to be filled in/analyzed by Credit Analyst)

1.	<u>MONTHLY AVERAGE:</u>		
	- GROSS INCOMES		Rp
	- OPERATING ENTERPRISE EXPENDITURES	Rp	
	- HOUSEHOLD EXPENDITURE	Rp	
	- OTHER EXPENDITURES	Rp	Rp (-)
2.	NET MONTHLY INCOMES		Rp
3.	MONTHLY REPAYMENT CAPACITY (RPC*)		Rp

* MAXIMUM 75 % OF NET MONTHLY INCOME

III. LIST OF COLLATERAL

	TYPE OF COLLATERAL	VALUE	BORROWER SIGNATURE
1.		RP.	
2.		RP.	
3.		RP.	

IV. AGREED UPON LOAN CONDITIONS

1.	TOTAL LOAN	RP. ()
2.	REPAYMENT PERIOD	REPAYMENTS PER
3.	TYPE OF PRINCIPAL REPAYMENTS	LOAN INSTALLMENT RP.
4.	OTHER CONDITIONS	LOAN INTEREST RP.

MICRO-CREDIT FINANCE OF WATER CONNECTIONS TO NEW PDAM CUSTOMERS

CREDIT OFFICER SIGNATURE	SIGNATURE OF LOAN APPROVER
DATE:	DATE: