

DRAFT  
SMTolbert:jn  
July 30, 1971

To: Mr. J. Burke Knapp (through Mr. Fontein)  
From: Stokes M. Tolbert  
Subject: INDONESIA - Bali Tourism Project

The report by a consulting firm (SCETO) on the tourism potential of Bali proposes a master plan for tourism development over a 15-year period, involving 9,500 hotel rooms and costing in excess of \$250 million. On the basis of the consultants' report, the Tourism Projects Department has now developed, for discussion with the Government, a first stage project to be completed by 1975 involving about 2,000 hotel rooms with a total cost - including hotel construction - of about \$55 million, about one-half of which would be foreign exchange. This project is described in the attached statement. Preliminary calculations indicate that the rate of return on such a project would be about 16 per cent (assuming a 20-year life for hotels and related infrastructure). Use of shadow prices to value realistically the local labor input would add about 4 per cent to the rate of return.

A project preparation mission will discuss the consultants' report with the Government and the Resident Mission in August and determine further the structure of the project. A subject likely to be raised by the Government is whether IDA funds could be utilized by the proposed "Bali Development Corporation" not only for infrastructure development but also for on-lending to hotel investors, as recommended in the consultants' report and also in the Projects' Department's first stage proposals. We would like to obtain your concurrence that the project preparation mission inform the Government that such use of a portion of the proposed Credit would be a

possibility, in principle, subject to the findings of an appraisal mission and further consideration within the Bank. We envisage that IDA might provide perhaps a third of the \$35 million capital needed for hotel construction, and that the funds would be on-lent at maturities of up to 15-20 years. We assume that private investors should provide at least a third of the capital needed in the form of equity, and that the remainder could be raised from other sources, domestic and international, including IFC, which is willing in principle to provide equity and/or medium term loans.

The following considerations underlie this proposal:

- a) Hotel investors throughout the world are experiencing difficulty in obtaining long term finance at suitable interest rates; and Indonesia's investment climate, though dramatically improved in recent years, makes obtaining of long-term mortgage finance from abroad even more difficult;
- b) The likely rate of return to hotel investors in the Bali project may not be adequate to attract investors to the project site unless long-term finance on reasonable <sup>or concessional?</sup> terms is readily available. On the other hand, the economic rate of return of the project as a whole (16-20%) is satisfactory and reflects the return of substantial benefits to Indonesia and the Balinese economy. Similarly, net foreign exchange earnings from the first stage project at full development are estimated to amount to about \$16 million per year (about \$300 million over the 20-year life of the project, from the initial investment of about \$55 million).

Remainder invest at all?

*But at what rate?*

The provision of long-term finance should therefore be a powerful inducement to investors and good insurance that full development would actually be reached. Hotel projects in many countries today are finding it difficult to meet payments on their mortgages because the terms are too stiff. IFC has experienced this problem in its own financing of hotels at its normal 8-12 years, 9-9½ per cent rate of interest. We believe that a mixture of investors' equity, plus equity and medium-term loans from IFC and other sources, plus some IDA long-term finance could be made into a financially attractive package.

*too stiff*

*no or duration?*

*at what rate?*

The specific terms and conditions of such financing will have to be formulated by the Appraisal Mission. We cannot be sure, for example, that foreign private investors - as distinguished from captive borrowers in Indonesia - would be willing to accept the Government's standard terms of 12 per cent interest, denominated in Rupiahs but with a clause providing for maintenance of value in foreign exchange. If the investor accepts the foreign exchange risk he is likely to insist on a lower rate of interest, and his alternative might be to turn to other sources of finance with a shorter repayment period, which we are trying to avoid.

*for whom? what?*

Two aspects will have to be kept in mind as this project is further developed:

- a) The optimum institutional arrangements for such finance have yet to be determined. At present it is envisaged that the Bali Development Corporation would serve as the channel, lending directly to hotel investors; on the other hand BAPINDO, which should be functioning by that time, could possibly serve as the channel for such lending; or the job might be split between them.

*What is this?*

*What?*

*Why?*

b) The Appraisal Mission will have to obtain the best estimates possible of the amounts and timing of relending to hotel investors so as to enable us to avoid tying up IDA funds unnecessarily; at present, it is envisaged that the funds for hotel construction would be fully disbursed by 1975.

*of lent when?*

To be cleared with & cc: Mr. Simmons  
Mr. Parmar  
Mr. Mathew