International Development Association

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IDA/R78-117

From: The President

November 10, 1978

INDONESIA

Credit 479-IND - Proposed Amendment of Project Description for the Bali Tourism Project*

1. This memorandum seeks your approval for an amendment to the Development Credit Agreement dated June 14, 1974 (Credit 479-IND - Bali Tourism Project) to permit expected savings of about $3 million from the credit of $16 million to be used to finance Government's equity participation and/or a long-term loan for the construction of a hotel at Nusa Dua in Bali. The use of savings for such facilities at Nusa Dua would help achieve the basic objective of the Bali Tourism Project, which is to foster properly planned tourism development on the island.

Project Scope and Status

2. The Bali Tourism Project was appraised in 1973 and the credit was made in FY74. The project provides infrastructure to promote tourism development in Bali, including a 310 ha tourism estate at Nusa Dua (capable of accommodating hotels with about 2,500 rooms), facilities for hotel training, an access road from the airport, road improvements outside Nusa Dua to serve both tourism and other transportation demands, and technical assistance for implementing the project and the master plan for tourism in Bali.

3. Despite a one-year delay in project implementation, mainly at its inception, construction of the infrastructure for the tourism estate is progressing satisfactorily and the work is due to be completed by late 1979. The hotel training school has been completed and is in operation. The amenity core and service area for the hotels are in the design stage and work is scheduled for completion by late 1979. Construction of the Nusa Dua access road and other road improvements has commenced and is due for completion in December 1980. A 50-room practice hotel adjacent to the training school, not included in the project and financed by the Bali Tourism Development Corporation (BTDC), the project entity, is under construction and scheduled to be completed by late 1979. Electricity is available at the site and provision of telecommunications facilities is under way.

*Questions on this document may be referred to Mr. C.R. DeSilva, extension 72555.

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4. At appraisal, total project cost was estimated at $36 million, including $18.1 million in foreign exchange, of which the credit was to cover $16 million. Provision for physical and price contingencies totaled about 30% of project cost. It now appears, with about 80% of contracts for construction of the infrastructure placed and substantial physical progress already made, that the completed project will cost about $32 million, including $15 million in foreign exchange. As a consequence, it is estimated that $3 million will be left in the credit account at the time of project completion. These savings are mainly the result of lower than anticipated cost escalation and physical contingencies, of a decision by PERUMTEL, the state-owned telecommunications enterprise, not to request reimbursement of the construction cost of its telecommunications facilities included in the project and of a reduction in the scope of the road improvement works since some of the work has already been executed using local road maintenance funds.

Hotel Investment Problems

5. At the time the project was appraised in 1973, market prospects for tourism were good, and several hotel investors had expressed their interest. It was concluded that once the infrastructure was provided at Nusa Dua the private hotel investment would be forthcoming. This prediction was further reinforced by the Government's decision at that time, which was incorporated in the Credit Agreement, to limit hotel development in Bali outside the project at Nusa Dua to 1,600 hotel rooms of international standard. Accordingly, it was decided that it was not necessary to include seed capital for hotel development in the project.

6. However, with the slowdown in tourist traffic growth following the energy crisis in 1973, and a sizeable increase in the number of small hotels (not meeting the criteria of international standard) since 1973, average occupancies in hotels of international standard in Bali declined from 85% in 1973 to 52% in 1974 and 50% in 1975. During this period, the government was implementing a restrictive air access policy favoring the national airline, which required an extra stopover in Jakarta for many foreign flights; this policy operated as a disincentive to tour operators and to potential airline investors in hotels in Bali.

7. Since 1975, market prospects have improved markedly. Tourist traffic to Bali increased by 31% in 1976 and by a further 8% in 1977 to 286,000 visitors, in line with appraisal estimates, due mainly to the introduction of new charter flights, and more frequent scheduled services mainly by the national airlines. Average room occupancies of the five international standard hotels rose from 50% in 1975 to 64% in 1977. With the continued growth of international tourism in the Pacific area, prospective tourist traffic to Bali is rapidly returning to the previously predicted growth pattern. On the conservative assumption that tourist traffic to Bali will grow at 8% p.a., at least 400 additional hotel rooms of international standard

will be needed in Bali by 1980, and more each year thereafter. The 1,600-room limit is now fully taken up by existing hotels with approximately 1,400 rooms plus two hotel extensions, amounting to 200 rooms, under way. Since construction of a hotel in Bali requires a minimum of two years, it will be difficult to keep up with demand even if construction at Nusa Dua is initiated promptly.

8. Despite the encouraging trends, however, an understandable reluctance of hotel investors to commit themselves to "pioneering" the construction of a first hotel in a new resort continues. Scarcity of hotel construction credit on reasonable terms in Indonesia, high tariffs on imported hotel equipment, cumbersome customs clearance procedures and continuing air access problems reinforce this reluctance.

9. In consultation with Bank staff the Government has identified a number of actions to address the issue:

(a) use of funds saved on project implementation for Government participation in the financing of a hotel. This measure is the subject of this memorandum;

(b) identification of domestic long-term credit sources to assist in the financing of hotels. Such long-term credit facilities are particularly inadequate in Indonesia. However, the Government is canvassing insurance companies to determine their willingness to provide long-term credit for hotel construction;

(c) relaxation of presently prohibitive customs duties on several items required for hotel operations and simplification of customs clearance procedures. The Minister of Tourism has requested BTDC to make specific proposals for lowering customs duties which will be presented to the Ministry of Finance for consideration. Closer contact between tourism and customs authorities in Bali has been established to achieve simplification of procedures;

(d) further liberalization of air policy with regard to access of foreign carriers to Bali. The Government has authorized two foreign airlines to fly to Bali (Quantas and Thai International) and has indicated it will consider requests from other foreign airlines;

(e) commissioning of a tourism market and hotel investment study for Nusa Dua. Such a study by consultants (Howarth & Howarth) in the first half of 1978 concluded that tourist traffic to Bali was likely to increase at a rate of 10% p.a. in the next few years which would justify the opening of at least a 450-room hotel in 1981 and a 300-room hotel in 1982 at Nusa Dua;

(f) hiring of investment promotion experts. The BTDC has already retained one investment promotion expert specialized in the US and Far East markets; it is searching for another to cover Europe and the Middle East;

(g) allowing one or two smaller hotels of 100-150 rooms to be built at Nusa Dua in addition to the project hotels of 250 or more rooms, with a view toward attracting "small" (Indonesian) investors. The Association supports this proposal from the Government;

(h) granting special promotional benefits to the first hotel investors at Nusa Dua. Such benefits were already granted in 1973/74 to promote construction of some of the existing hotels in Bali. The Government has indicated its willingness to grant special promotional benefits for initial hotel investments if they prove necessary during negotiations with hotel investors.

10. Notwithstanding the constraints on hotel investments in Nusa Dua, a number of groups of investors are exploring the possibility of coming into the tourism estate. The Association, therefore, could play an important role as a catalyst in providing funds to finance the government's contribution to the construction of a first hotel at the project site. In fact, it is precisely because of the difficulties encountered with the "first hotel" in Bali's project that the Bank has included funds in later tourism infrastructure projects for a first or pilot hotel. This was done in Senegal (Loan No. 1412-T-SE/1413-SE), and in Mexico (Loan No. 1420-ME). The Bank has also helped to overcome the lack of hotel credit on reasonable terms by financing a line of credit for hotel development in the Ivory Coast (Loan No. 1124-IVC), in Mexico (Loan No. 1524-ME), and in Morocco (Loans No. 848-MOR and 1279-MOR/ 1077-MOR).

11. Although implementation of the infrastructure facilities at Nusa Dua is progressing well, the economic viability of the project is being jeopardized by the lack of firm hotel investments. The economic rate of return of the project is dependent upon revenues to be generated by hotels. The appraisal report assumed a build-up of hotel rooms beginning with 800 in 1978 coinciding with the completion of infrastructure facilities, increasing to 2,500 rooms by 1983. Project infrastructure is now expected to be ready by end 1979. A recalculation of the project's rate of return, using the same infrastructure costs and total revenues as assumed during appraisal and 40% higher cost of superstructure gives an economic rate of return of the project of 15.0% (as compared to the appraisal estimate of 18.7%). A two-year delay in hotel construction would reduce the economic rate of return to 13.5% and a four-year delay to 12.3%.

12. The Borrower requests a change in the description of the original project which would permit the use of the projected unexpended $3 million to finance a Government investment for hotel construction. It is therefore proposed to amend the Credit Agreement so as to provide for hotel construction at Nusa Dua to be financed in part from the proceeds of the Credit, and to postpone the date by which the Credit is expected to be closed to June 30, 1982.

Revised Project

13. The cost of a 300-room hotel at Nusa Dua is estimated at about $14 million, of which the foreign exchange component would be about $9 million. Savings in project implementation amounting to about $4 million (about $3 million from the credit and $1 million from the originally anticipated Government contribution) are expected to cover about 30% of total cost for such a hotel. The balance would be raised either domestically or from abroad. In this connection, IFC is prepared in principle to consider assistance in the financing of a hotel at Nusa Dua. Immediate IDA assistance for hotel investment at Nusa Dua would stimulate private investor interest in pioneering hotel construction there, reduce the time that the completed infrastructure would be unutilized, help the Government to generate revenues from the capital investment already made at the project site and create circumstances in which the economic viability of the project would be protected.

Recommendation

14. In the absence of objections (which should be notified to the Vice President and Secretary or Deputy Secretary, by the close of business on November 22, 1978), I propose to amend the Credit Agreement for Credit No. 479-IND to reflect the changes proposed in this memorandum.

Robert S. McNamara
President