

# Individual Mortgagees as A Solution for Real Estate Developers

Benny Djaja

Faculty of Law, Universitas Tarumanagara, Citra Garden 2 Blok L3 No.12, West Jakarta, Indonesia  
bennyd@fh.untar.ac.id

## ABSTRACT

Not every people has the same willingness to make a full cash payment for a real estate purchase. Their financial capability to pay in cash and more aside, some people might decide that their reserved cash would better be allocated elsewhere to cover other needs, such as business financing or other investments. They would opt to fund their real estate purchase with bank loans, which is notoriously time-consuming and lengthy in process as well as demanding relatively high interest rates in return. However, banks are not the only available source of loans to consider. Individuals are alternative lenders with untapped potentials remained to be explored in fueling credit activities. Unfortunately, it remains that many are still apprehensive about granting loans for the fear of failure on the part of the debtors to make full repayment or return of their funds. Meanwhile, the Law of the Republic of Indonesia Number 4 Year 1996 concerning Mortgage over Land and Related Articles (hereinafter referred to as the "Mortgage Law") provides that not only banks are entitled to grant credit. Individuals, albeit uncommon, could also do the same and be the solution to credit funding, receiving mortgage as the collateral to secure the full payment of debts.

**Keywords:** Security laws, mortgage, debts and receivables, real estate, mortgage certificate

## 1. INTRODUCTION

Real estate is one of human's basic subsistence i.e., the need for a place to live and to call home. Therefore, real estate is an essential need for everyone, making it one of the most lucrative business with unfading potentials for as long as human civilization shall exist. In a community setting, human beings engage in various social activities to thrive as well as in economic activities to acquire goods and/or services to fulfill their needs and achieve prosperity. People make decisions to purchase real estate primarily in order to fulfill their basic needs, which will consequently affect their social activities. In addition, real estate could also be purchased for investment purpose since its ownership could generate a stream of profits for the owner, an action which falls well within the scope of economic activities.

Along with the ongoing development of era and human civilization, money could be deployed to work itself to pull in "its friends" i.e., more and more money, by way of investment. According to Comprehensive Indonesian Dictionary (*Kamus Besar Bahasa Indonesia*), investment is the money or capital injected to fund a company or project with the intention to gain profits. [1] It is safe to assume that every people would want to make effort to carry out investment activities. From the economic theory perspective, looking at the assets concerned, investment could be classified into 2 (two) types i.e., financial asset and real asset. Financial asset is considered intangible investment, taking the form of documents or bonds, meanwhile real asset is a tangible form of investment, such as vehicles and real estate. [2] Therefore, there avails a

host of means to accumulate wealth through investment, among others a real estate investment.

Wherever we set foot on the planet, real estate investment is not about to cease existing, driving both legal entity and individual property developers alike to keep real estate construction works alive. Various commercials for prospective and under-construction real estate products decorate many streets as well as shopping centers in Indonesia. As historical record goes, real estate value had barely plummet due to the ever-narrowing space and limited land plots available for purchase. [3] This resulted from the fact that most land have been developed into various real estate products, and even those land plots with huge potentials to be converted into residential areas have fallen into the ownership of property developers. Therefore, it is not surprising that real estate investment is often intended to generate relatively high return of profits, considering the constant increase of real estate value resulting from the additions of newly established families and migrations. Profits associated to real estate investment are generated in variations, among others by running business activities on the real estate, awaiting an increase of certain real estate value for resale, or renting certain real estate unit to other parties.

Real estate includes land and all ownership or entitlements and everything that is formed or attached on it either through natural process or human involvement. Meanwhile, real property is related to the interests, profits, and entitlements pertained to the physical ownership of certain real estate.

There are 4 (four) terminologies commonly used in the subject of real estate, as follows:

- *Real*, which means tangible or land;
- *Realty*, which could be associated with land matters;
- *Realtor or realist*, is the person carrying out land sale and purchase activities in a wide sense; and
- *Estate*, which could be closely interpreted as an article of inheritance. Technically, the dictionary defines *estate* as the degree of interest on land.

The body of real estate law is highly intertwined with the Law of the Republic of Indonesia Number 5 Year 1960 concerning Basic Agrarian Law (hereinafter referred to as “BAL”), Law of the Republic of Indonesia Number 5 Year 1967 concerning Basic Provisions on Forestry, Law of the Republic of Indonesia Number 11 Year 1967 concerning Basic Provisions on Mining, Law of the Republic of Indonesia Number 6 Year 1967 concerning Basic Provisions on Farming and Animal Well-Being, Law of the Republic of Indonesia Number 16 Year 1964 concerning Profit Sharing for Fisheries, and Law of the Republic of Indonesia Number 28 Year 2002 concerning Building Construction.

Real estates are generally classified into 4 (four) types, as follows:

1. Real estates for commercial purposes e.g., office (buildings), hotel and resorts, shopping centers, and shophouses;
2. Residential e.g., residential estates and apartment buildings;
3. Real estates for industrial activities e.g., industrial estates, standard factory buildings, and warehouses;
4. Public facilities e.g., schools and universities, hospitals, religious places, and recreational spaces.

Real estate products are hugely defined by the following characteristics:

- *Immobility* (immovable);
- *Heterogeneity* (having no certain standard/unique);
- *Durability* (long-lasting, suitable option for long-term investment);
- *Divisibility* (could be divided into smaller units);
- *Legal complexity* (subject to the various legal provisions in force where the real estate is located);
- *Flexibility* (multi purposive with regards to its utilization, as well as subject to the supply and demand market mechanism).

Meanwhile, real estate products also possess certain added values, as follows:

#### *a. Stable appreciation of land value*

While the number of human beings multiplies at all times, the total amount of land remains ever so constant. Unsurprisingly, trend shows that the demand for land constantly increases while the amount of land plots available for purchase is increasingly limited, creating an

overall condition of land scarcity. This classical theory simply explains how land valuation keeps an upward trend from time to time, hence the consequent appreciation of land value.

#### *b. Added value generated from development project(s) done upon it*

A plot of land could be developed into ready-to-build vacant land plots (*kaveling*) on which houses or shophouses could be built. A building or residential area will gain increasing added value worth of investment where it is located in a strategic area (with easy access to the city centre, shopping centres, hospitals, bus stops, stations, etc.), supported with complete facilities, serious account has been taken into the aesthetical design of the architectures, and is in well-maintained condition. A real estate investor will generate profits from rent due to land and real estate scarcity which has been and will be a constant issue alongside the economic growth of a country.

#### *c. Gains obtained from activities conducted on its premise*

A real estate could be utilized in many ways, used as a business site, or otherwise put up for rent, all of which will generate for the owner a stream of income. At the same time of acquiring benefits from those, the real estate itself will incur value appreciation.

#### *d. A good, well-reputed form of collateral*

Security backed with real estate investment is quite unlike financial investment which is better known for its uncertain prospect and unstable value. Real properties are the most stable form of collateral due to their constant and even increasing value generally inherent in real estate ownership. In several countries, banking institutions are sometimes even optimistic enough to lend 80% of the real estate value as loan with the real estate itself as collateral. Therefore, it is quite conclusive that real estate is generally a good form of collateral.

#### *e. Source of pride for the owner/consumer*

Compared to other types of investment, the pride stemming from the ownership of real estate is relatively higher. Even in the past times, landlords were commonly associated with wealth. So for real estate owners, high value return real estates are sources of pride, especially when said estates are located in prime and promising (usually exclusive) locations.

Not every people has the same willingness to make a full cash payment for a real estate purchase. Their financial capability to pay in cash and more aside, some people might decide that their reserved cash would better be allocated elsewhere to cover other needs, such as business financing or other investments. They would opt to fund their real estate purchase with bank loans, which is notoriously time-consuming and lengthy in process as well as demanding relatively high interest rates in return. However, banks are not the only available source of loans to consider. Individuals are alternative lenders with untapped potentials remained to be explored in fueling credit activities. Unfortunately, it remains that many are still apprehensive about granting loans for the fear of failure on the part of the debtors to make full repayment or return of their funds. Meanwhile, the Mortgage Law provides that not only banks are entitled to grant credit.

Individuals, albeit uncommon, could also do the same and be the solution to credit funding, receiving mortgage as the collateral to secure the full payment of debts.

## 2. PROCESS OF MORTGAGE SUBMISSION

Mortgage is the collateral deployed to secure the full payment of the debts granted to fund certain land purchase, which prior to the enactment of the BAL was known as hypothec. Article 1 of the Mortgage Law provides that:

*Mortgage over land and its related articles, which hereinafter referred to as Mortgage, is the collateral rights encumbered upon certain rights over land as referred to in the Law Number 5 Year 1960 concerning Basic Agrarian Law, including or excluding other articles attached to the land, to secure the full payment of certain debts, which consequently endows a superior order of settlement priority to certain creditor(s) over the others.*

Article 8 point (1) of the Mortgage Law stipulates that:

*A Mortgagor is an individual or legal entity possessing a legitimate authority to carry out legal actions with regards to certain mortgaged object.*

While Article 9 of the Mortgage Law stipulates that:

*A Mortgagee is an individual or legal entity acting as the party entitled to receivables.*

Mortgage could be encumbered upon the Right of Ownership, Building Rights on Land, Cultivating Rights, Right of Ownership over Apartment Unit, as well as the Right of Use over State-Owned Land and/or over Right of Ownership.

An agreement on mortgage submission is by nature an accessoio of a principal agreement i.e., the agreement which give rise to a legal relationship involving the debts for which the repayment is guaranteed. Such agreement could be drawn in an informal deed or, depending on the legal provision regulating the subject matter contained in said agreement, required to be drawn as an authentic deed. Where the debts and receivables relationship stemmed from a Loan Agreement or Credit Agreement, such agreement could be made abroad and the relevant parties could either be a foreign individual or a legal entity insofar as the credit obtained is utilized for development purposes within the jurisdiction of the Unitary State of the Republic of Indonesia. [4]

This aligns with the provision contained in Article 3 of the Mortgage Law, as follows:

(1) *The debt which full payment is secured with mortgage, which could be an existing debt or a debt which value has been promised in advance, or otherwise the amount claimed at the time the petition for mortgage execution is filed, could be determined based on the Loan Agreement or another agreement giving rise to a relationship involving debts and receivables.*

(2) *Mortgage can be submitted to secure the repayment of debts resulting from one or more*

*legal relations, or for one or more debts resulting from several legal relations.*

Therefore, a single mortgaged object (collateral) could be encumbered with more than one mortgages in order to secure the full payment of one debt. Where the mortgaged object is encumbered with one or more mortgages, the order of settlement priority of each mortgages shall be determined according to their registration dates at the Land Office. The respective orders of more than one mortgages which are registered on the same date are determined based on the date of the Mortgage Submission Deeds. Article 7 of the Mortgage Law stipulates that:

*A mortgage follows its object in whose hands said object is possessed.*

Where certain receivable is transferred to another creditor, the mortgage securing its payment will follow suit and shift by law to the new creditor. Such transfer of mortgage does not necessitate a PPAT deed; a deed stipulating the transfer of the secured receivable shall suffice. Such transfer of mortgage shall be recorded in the Mortgaged Land Register and on the Mortgage Certificate, as well as on the Certificate of Land Rights Entitlement submitted as collateral. This particular characteristic of mortgage is called *droit de suite*.

The process of mortgage submission is carried out through 2 (two) stages, as follows:

### 1. Mortgage submission stage

This is carried out through a Mortgage Submission Deed made by a Land Deed Official (hereinafter referred to as "PPAT"), which is preceded by a security backed Credit Agreement. Mortgage submission is preceded by the promise to submit mortgage as a collateral to secure the full payment of certain debts (without which no loans could have possibly been granted), as contained in and is an inseparable part of the Loan Agreement or other agreement that give rise to such debts in the first place.

PPAT is a public official endowed with the authority to draw the deeds detailing the transfer of rights over land and other deeds drawn to place encumbrance upon certain rights over land, which form of deeds and the manner in which the procedure is carried out are stipulated by the prevailing laws and regulations, as the evidence to certain legal actions carried out over a land plot located within their appointed official region. With due regards to their authority, the deeds produced by a PPAT are therefore considered authentic deeds.

As stipulated in Article 11 point (1) of the Mortgage Law:

*The Mortgage Submission Deed shall specify:*

*a. The name and identity of the Mortgagee and the Mortgagor;*

*b. The respective domiciles of the parties as referred to in (a); where either of the parties is domiciled outside Indonesia, a chosen domicile located in Indonesia shall be specified, otherwise the PPAT office where the Mortgage Submission Deed is drawn will be considered as the domicile of choice;*

*c. Clear and explicit determination of the secured debt(s) as referred to in Articles 3 and 10 point (1);*

- d. amount of secured debt;*
- e. Detailed specifications of the mortgaged object submitted.*

Where the abovementioned details are not specified in the Mortgage Submission Deed, said Deed could be considered void by law for the lack of certain subject matter required for an agreement in Article 1320 of the Indonesian Civil Code. These provisions are intended to fulfill the principle of specialty underlying mortgage submission i.e., concerning the subject, object, and the secured debts.

In addition, Article 11 point (2) of the Mortgage Law regulates the substance of promises a Mortgage Submission Deed could well accommodate (the promise authorizing the Mortgagee to appropriate the mortgaged object at the instant of the debtor's default of repayment, for example, is specifically prohibited and such action shall be considered void by law). These promises shall only apply cumulatively and shall not affect the legality of the deed. The parties are entitled to decide whether to specify what promises in the Mortgage Submission Deed, which shall then be registered at the Land Office for it to have a binding force towards any interested third parties.

In submitting a mortgage, the Mortgagor shall be present before the PPAT. Should the Mortgagor is unable to be present himself, he shall appoint another party as a proxy by means of an Authorization Letter to Encumber Mortgage drawn in the form of authentic deed made by either a notary official or a PPAT in the form of a notarial deed or PPAT deed respectively. It shall specify in details the mortgaged object, the amount of secured debts, the name and identity of the creditor, and the name and identity of the debtor where the debtor is not the Mortgagor.

Within 1 (one) month, the Authorization Letter to Encumber Mortgage made with regards to a registered right over certain land shall be proceeded by a Mortgage Submission Deed. As for an unregistered right over land, the Deed shall be drawn at the latest 3 (three) months following the date of the Authorization Letter to Encumber Mortgage. Beyond the abovementioned timeframes, the Authorization Letter to Encumber Mortgage shall be deemed void by law.

## 2. *The registration/perfection stage*

Registration shall be filed at the Land Office, which shall perfect the encumbered mortgage.

Article 13 of the Mortgage Law stipulates that:

- (1) Mortgage submission shall be registered at the Land Office.*
- (2) At the latest 7 (seven) working days following the date of Mortgage Submission Deed as referred to in Article 10 point (2), the PPAT shall submit the Mortgage Submission Deed along with the other required documents to the Land Office.*
- (3) The registration of mortgage submission as referred to in point (1) shall be carried out by the Land Office by placing annotations on both the Mortgaged Land Register and the Register*

*for Land Rights Entitlement as well as on the Land Rights Entitlement Certificate of the mortgaged object concerned.*

The certainty of mortgage registration time is of great importance in favor of the creditor's interest. One significant principle underlying mortgage is the principle of publicity. This means that the registration of mortgage submission at the Land Office as a public institution which keep records of public information is an absolute requirement to the perfection of mortgage and consequently its binding force towards a relevant third party. At the stage of mortgage submission to the creditor, a mortgage is yet to be perfected. Its perfection is only later concluded at the time of its registration in the Land Register at the Land Office.

For the purpose of evidence to the existence of a mortgage encumbered upon certain right over land, the Land Office shall issue a Mortgage Certificate in accordance with the prevailing laws and regulations. This Certificate opens with the sentence "*DEMI KEADILAN BERDASARKAN KETUHANAN YANG MAHA ESA*" (in favor of justice based on the belief in the One and Only God). This implies that mortgage possesses an executorial force equal to that of a court decision with a binding legal force. A Mortgage Certificate is also applicable as a substitute to the older version i.e., grosse of hypotec deed, insofar as it concerns certain rights over land.

One of the strong characteristic of a mortgage is the simple and certain execution procedure it accommodates should the debtor is in default. Although the procedure surrounding execution has generally been regulated in the prevailing Civil Procedural Law, the Mortgage Law provided a specially instituted method known as "*parate executie*". Unless otherwise agreed, the Land Rights Entitlement Certificate on which annotation has been made concerning mortgage submission shall be returned to the concerned land title rightholder (which in most cases are the Mortgagor), while the Mortgage Certificate shall be submitted to the Mortgagee, at the same time protecting the respective interests of both the Mortgagor and the Mortgagee.

This way, although the ownership of certain mortgaged object has been transferred to another party, the creditor could still utilize his rights to implement execution should the debtor falls into default. Said rights is based on the promise issued at the offset of the legal relationship by the Mortgagor that should a default occurs, the Mortgagee would remain entitled to sell the mortgaged object through a public auction without any further consent of the Mortgagor and from the proceed retain as his repayment for the debts in a prioritized order against the other creditors. In alignment with another mortgage principle i.e., *droit de preference*, should the debtor falls into default, the first order Mortgagee shall be entitled to the first order of settlement priority to sell the mortgaged object. The entitlement granted to sell said collateral on the ground of the creditor's own authority is one manifestation of the prioritized order entitled to the Mortgagee or the first order Mortgagee where more than 1 (one) Mortgagees are concerned. Only the remaining

proceeds of the sale shall then be returned to the Mortgagor as the rightful owner.

Following the mutual consent of both the Mortgagor and the Mortgagee, the sale of the Mortgaged object could be carried out informally (*penjualan di bawah tangan*) where such action will potentially render a higher sale price in favor of all parties' interest. This, however, could only be carried out after 1 (one) month has passed following the issuance of written notification of the Mortgagor and/or the Mortgagee to another interested parties as well as the announcement in at least 2 (two) locally distributed newspapers and/or local mass media stream, and insofar as no interested parties has henceforth filed for objection of said informal sale.

### 3. THE ANNULMENT OF MORTGAGE

Mortgage shall be considered annulled on the following grounds:

- a. The annulment of the underlying debts secured by mortgage as collateral. The petition for the writing-off of mortgage is filed by an interested party by enclosing the Mortgage Certificate having an annotation or a written statement issued by the creditor that the mortgage is annulled since the debts which repayment is secured by the mortgage has been fully paid.
- b. The renouncement by the Mortgagee of the rights of mortgage, signified by the issuance of a written statement concerning such renouncement by the Mortgagee to the Mortgagor.
- c. The clearance of the mortgaged object in accordance with the order of settlement priority determined by the Head of District Court in response to the mortgaged object buyer's petition for clearance of the rights over the purchased mortgaged land from all mortgages encumbered upon it. Alternatively, said buyer, either through public auction on the order of the Head of District Court or through voluntary sale and purchase, is entitled to request to the Mortgagee to clear the purchased mortgaged object of all remaining encumbrances which value exceeds the agreed purchase price. In this case, the Mortgagee shall issue a written statement setting out the renouncement of mortgage which amount exceeds the purchase price.
- d. The annulment of the rights over land on which a mortgage is encumbered, which does not result to the annulment of the secured debts.

Once the mortgage is considered annulled by the Land Office as shown on the Land Register, an annotation shall be added concerning the annulment of such right, while the Certificate is permanently recalled by the Land Office which issued it in the first place. Similar annotation, which is called the write-off of the mortgage encumbrance, or is better known as "roya", shall be carried out on both the Mortgaged Land Register and the Land Rights Entitlement Certificate which has previously been made a security. Said Land Rights Entitlement Certificate on which such annotation has been made shall then be returned to the original rightholder.

All rights and obligations endowed by the Mortgage Law for the Mortgagee shall apply for both legal entity and individual Mortgagees. This could provide an option for the property developer to encourage mortgage submission by real estate buyers, especially those with limited fund, to ensure the full payment of the purchased units. Buyers could now turn to more familiar individuals such as a close relative for loans by granting the rights pertained to a Mortgagee as endowed by the Mortgage Law.

### 4. CONCLUSION

The Mortgage Law has regulated to accommodate and protect individuals to grant credits secured with mortgage as collateral to ensure full payment of the debts. Therefore, individuals shall no longer be apprehensive in deciding to grant loans or credits for the fear of facing non-payment or no secured return of their funds. This way, no longer shall debtors depend on bank loans for credit source, insofar as individuals would willingly assume the role of creditors by utilizing mortgage as collateral to secure the repayment of the loans.

Mortgage submission is completed through 2 (two) stages i.e.:

1. Mortgage submission stage, signified at the time the Mortgage Submission Deed is made before a PPAT as preceded by a secured Loan Agreement; and
2. The registration stage at the Land Office, which signifies the perfection of the encumbrance of mortgage.

Where the debtor is in default, the Mortgagee is on a superior order of settlement priority against another creditors and shall therefore be entitled to sell the mortgaged object through a public auction without obtaining further consent of the Mortgagor and then to keep his rightful portion in the amount sufficient to cover the full repayment of the (remaining) debts from the resulting proceeds of sale. The remaining proceeds of the sale shall be returned as the rights of the Mortgagor.

Following the full repayment of the debts by the debtor, the mortgage could be annulled. The petition the writing-off of mortgage shall be submitted by an interested party to the Land Office, enclosing the Mortgage Certificate with an annotation or a written statement issued by the creditor showing that the mortgage shall be considered annulled since the debts which repayment is secured by the mortgage has been successfully paid in full amount.

The property developer could encourage mortgage submission to individuals as a strategic option to improve their real estate products sales.

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