CHAPTER 1

INTRODUCTION

1.1. Background

To have a comprehensive understanding regarding the new rent-to-own contract that has appeared recently in Indonesian jurisdiction, we must understand not only the history of the rent-to-own contracts, but also the trends of real estate throughout the years. To completely understand about this system, we must understand the bigger picture from the rent-to-own system, namely, security interest and its ineffectiveness during modern times.

Security interests are stipulated differently depending on which jurisdiction the property, or the right of an object, is bound by. The definitions are divided dependent on the type of jurisdiction that countries adopt.

Within Common Law countries, such as the United States of America, can trace its roots mainly toward past cases. This is because Common Law regime had always been influenced and dependent on past cases, which integrated itself into legislation. The belief within this regime is that Common Law systems tend to interpret the laws (from previous rulings) and create the law. Although United States of America had diverted to a hybrid system of

statues and judge rulings, it does not change that United States of America's foundation on laws is from Europe.[1]

Hence, it is essential for the Author to mention that the history of common law security interest in Europe. Ever since from the Roman system of security interest (which will be explained within the following part), practically the entirety of Europe had adopted the system. It was not until Johannes Voet, a Dutch lawyer, enabled the system into legislative means through his *Commentarius ad Pandectas*. Within his work, he had characterized common law as "a labyrinth of creditors, where lawyers creep around on winding and torturous tracks."[2] Dubbed as a great example of Roman law through *usus modernus*, he explains that the dangers of security interests were descripted through his elimination of consequences of non-possessory security interests.

Following his writing, Europe gradually adopted more writings about security interests. Within European countries, there was developing writing in regards to "special" and "general" security interests. Those that were placed within special security interests, which are security interests with specified assets that are accepted, that would abolish general security interests, which are

[1] Keinan, Y. (2000). The Evolution of Secured Transactions. Available at: https://documents1.worldbank.org/curated/es/564371468780338375/310436360_20050276035800/additional/wdr27827.pdf

[2] Voet, J., & Wilson, R. (1897). *Commentarius ad Pandectas*. London: J.C. Juta & Co.

Geneva 1757, Lib. 20, tit. 4, no 17.

security interests within anything. For example, there would be special security interest on property, but there would only be general security interest on a vehicle, if defined that way within a jurisdiction.

Another example of European development within Common Law Jurisdiction is found within English law, where there is division between possessory goods and non-possessory goods. There was even further suggestion that the two common law security interests to be considered as a roman hypotheca. This was explicitly rejected in the court of *Ryall vs. Rolle* (1749), where judge Burnet J had commented within this decision that: "An hypotheca gave only a lien and no property with a right to be satisfied on failure of the condition and a mortgage with us is an immediate conveyance with a power to redeem and gives a legal property." He attempts to further explain his stance by adding in a quote from *Corpus Iuris*, that states: "If your parents have sold land on condition that it be restored if either they themselves or their heirs have at some time or within a certain period offered to repay the price and the heir of the purchaser is not inclined to keep his part of that agreement, whereas you are prepared to satisfy him, a (personal) action on the basis of that agreement will be given to you." According to the Judge, this is how English mortgaging differs from Roman hypotheca, justifying the court's rejection. Simplifying the argument of Burnet J, he explains that within a Roman hypotheca, it only incurs a lien toward the debtor, using *immovable* property as a collateral upon failure

to payment (no claim to title otherwise). However, within a mortgage, it incurs debt that is tied upon physical, real property itself, binding the property to the creditor unless the mortgage had been paid.

It must be noted that there was not much common law development other than through court cases internationally. Presently, there are no unified statute for security interests in Common Law countries such as England, Australia, and New Zealand. However, there is one prominent legislation on security interests within common law, which is the Unified Commercial Code (UCC) Article 9, originating from the US.

UCC had first come to State law in 1951, which was prepared by the Uniform Law Commission (ULC). From the establishment of the ULC, uniform laws were created, such including the Uniform Negotiable Instruments Law, Uniform Sales Act, Uniform Warehouse Receipts Act, Uniform Bills of Lading Act, and many more, establishing the ULC even further within American legislative structure. After long, American Law Institute and ULC had partnered to create all component commercial laws into a single code, which gave rise to the first UCC. As it was under good consideration by the States of America, it soon was adopted by all 50 States.

Understanding that United States of America has a clear guideline found in the UCC that presented as a good example within the international community, the Author finds it important to discuss the United States of

America in relation to security interests. Accordingly, it is such a success that transitional countries, along with developing countries, all had adopted the UCC 9, an Article within UUC discussing security interests, despite it not being in regard to real property. Hence, becomes a prime example and an international standard that countries may be inspired by, such as Indonesia.

Civil jurisdictions' security interests also had started within Europe, as Common Law jurisdictions had. However, Johannes Voet's writing within the *Commentarius ad Pandectas* had not become the primary source of security interests, but rather from the Justinian code.

As new business methods grew from the Roman society, along with the fiducia system failing, Roman law came to discuss two types of security interests in writing, *pignus* and hypotheca. What had differed these concepts to fiducia is that there is commitment from the debtor to pay off to the creditor (pledge-debtor) within security interest rather than a fiducia where there is commitment from the creditor to transfer title for debtor to represent (pledge-creditor).[3] In doing this, the obligator is focused on the debtor and not the creditor, thus creating a more effective system.

[3] Zwalve, W.J. (2004). *A Labyrinth of Creditors*. Available at: view (universiteitleiden.nl)

However, there were issues within the Roman security rights. *Pignus* is the pledge from the creditor for the use of the, which was not able to accommodate moveable in particular to non-possessory security interests. There was no restrictions and any legal dichotomy between movable and immovable objects within security interests. Moreover, all types of security interests could leave objects of security by the debtor, as there was no publicity in these objects. Additionally, there was no rank of importance within security interests, creating uncertainty amongst creditors. Critics soon decided to rewrite the laws of security interests.

This is the turning point of security interests. The writings of Johannes Voet were revolutionary, inspiring other European countries. Along with the introduction of general and special security interests, Holland and some Civil Law jurisdictions adopted that all hypotheca, be it general or special, were to be *maxim mobilia non habent sequelam* (movables cannot be traced into the hands of third parties). The development of security interests does not stop here. Especially because of colonialism, civil law codes were distributed from colonizers such as France and Germany and adopted by countries such as Malaysia, Indonesia, and other third world countries. Conclusively from the turning point, Europe in particular, developed and enforced clearly and systematic laws on security interests.

However, it is important to note that despite the focus of modern security interests to be mentioned upon UCC 9, the law does not apply to most Civil Law jurisdictions for various reasons. These will be explained further within this research. However, because of this, Civil Law jurisdictions only can rely on their international obligations to enforce security interests, or they implement laws themselves due to the importance of it within their jurisdictions.

Gearing especially on an Indonesian jurisdiction perspective, security interests in this regard are essential to the applicable system of real estate, namely the hypotheca and fiducia. Historically this has been a fact since Dutch colonization. However, within Indonesian legislation, the exclusive option of hypotheca had been inaccessible, calling for the need to do fiducia. These are the following reasons:[4]

a. Moving goods as collateral for debt;

b. The Land rights could not have been mortgaged;

c. Debt collateral objects that are special;

[4] Fluita, A. (2021). TINJAUAN SEJARAH LEMBAGA FIDUSIA DI INDONESIA. *Jurnal Repertorium, Volume IV(1).* Available at: https://media.neliti.com/media/publications/213254-none.pdf

d. The development of the legal institution of ownership the new one;

e. Movable goods, objects of debt guarantee cannot be submitted;

Due to these factors accumulatively, the Fiducia system was implemented and was in high demand with hypotheca from small enterprises that needed credit facilities for their business. As the credit system, incurring security rights, developed further, the government had finally decided to regulate each type of security right in their respective laws.

The laws that the government released on regards to security rights were enveloped within real estate. In particular, hypotheca had become a general security interest that separated itself from real property. In replacement of hypotheca, the government had enforced mortgaging from the existence of Law Number 4 of 1996. Therefore, as of Law Number 4 of 1996, there is only two existing real property security rights existing in Indonesia, which are fiducia and mortgaging.

Unfortunately, as real estate becomes more developed, entrepreneurs and potential homeowners have evolved towards new interest from owning property and selling their right-to-own. This is majorly due to formalities

demanded by the security right systems,[5] time consumption,[6] efforts and processing fee.[7] Especially due to inflation and demand of real estate within the city, ideal property has become expensive for first-time owners.

Moreover, even if homebuyers could decide that buying a house worth it, the opportunity cost to own the house would possibly hinder the extensive development of real estate that is already being focused by the Jokowi administration, the One Million Houses project (**OMH**). It is a fact that of 2019, 419,858 units (from a total of 1.25 million) had costed 709.1 million dollars, which is expected from the government to get from financing assistance, including subsidized loan programs.[8] Considering this fact, in the scenario that the government does not get the financial assistance, then the demand from potential owners would continue to be on the increase while the housing development would be disrupted. This could result to a housing shortage from

[5] Chapter 3 of Law Number 42 of 1999 on Fudiciary; Chapter 4 of Law Number 4 of 1996 on Security Rights

[6] *ibid*

[7] *ibid*

[8] Policies to Address Indonesian Housing Shortage Boost Real Estate Sector. (2021). Retrieved 24 November 2021, available at: https://oxfordbusinessgroup.com/analysis/no-place-home-schemes-address-housing-shortfall-encourage-residential-construction-and-spur-overall

an annual demand increase of almost 50%,[9] causing major issues in the development of real estate within Indonesia.

In avoiding this possibility, entrepreneurs and the government alike must have an alternative than having to merely commit to mortgaging or fiducia, as the system cannot be depended upon for house settlements. The solution, which has become a modern solution to housing, is rental property.

To understand rent, the Author must explain the historical intention for the rental property system. Rent had started from Ancient Egypt; however, it was not recognized for civilians, but rather slavery. The emperor would consider a place to live for his/her subjects as a reward to the slaves, or merely those who were not wealthy enough to own personal property. Even within the Roman times, where it was more civilized, there were a discriminative target to plebians as the in the past, the wealthy only became wealthier. Even after thousands of years after the Roman peak, "rentals" were still relevant. Landlords would leave the city to forests and uninhabited land to have the same plebians live upon their land in exchange for fairer rates in fealty and royalty, in a ruling system called feudalism. Feudalism is the ruling of a landlord amongst people who exchange their royalty or fealty for the landlord's protection. Hence, for thousands of years, rentals were meant for those who

[9] *ibid*

could not own their own property due to discrimination or status of an individual, as shelter always had costed more than their own lives.

However, human rights gradually implemented itself into general society. The gap between classes closed until the point that the clear line between rich and poor began to blur, where it was hard to distinguish the classes. As of the 1500s, a healthy middle class had emerged from England economy, where the general population had started earning moderate and reasonable income to afford property. However, despite the inherent balance of income amongst people within modern society in the 1500s, rentals were yet to be fair business.

In particular, Indonesia had started its colonization periods. VOC, the first invader, had treated Indonesians as equals by doing business with them, however in theory and practice Indonesians were considered within the slave system. This applies to the other invaders as well. A particular system is must be acknowledged from this period is from when England colonized Indonesia from 1811 to 1816, which is the Land Rent System (**LRS**). The LRS is a system made from the Thomas Stamford Raffles, who had believed that the government is the only legal owner of land. In that sense, then everyone else is leasing the land. Within this system, Indonesians must pay rates up to 50 percent depending on their class and land status.[10] However, clearly, this system

[10] Makfi, Samsudar. (2019). Masa Penjajahan Kolonial. Singkawang: Maraga Borneo Tarigas

had failed as the rent was too expensive and England was inconsistent in enforcing this towards every village, especially as Indonesia continuously resisted against the unfair system. Regardless, it poses as a bad example of rent.

Due to this system, and various unfair practices of leasing, Indonesia begun to take actions against the practice. In 1941, Netherlands had established protection for renting called *huubescherningsbesluit*, later converting to *Huurwet*, which Indonesia used for 20 years; until the first legislation on renting had been published within Law Number 5 of 1960. Following the definition within Indonesian legislation, which follows global standards, rents are now private and dependent on the parties of a rental contract.

Conclusively, rentals are property that are resided by individuals that own a property under the right-to-lease title.[11] The outstanding difference between security rights and rental property is the title of ownership, where a security right allows the debtor to have a right-to-own to a secured property; while a rent involves a landlord and the residents of the property, which are using the right-to-lease. However, they both include a lender, where there is a contractual relationship amongst the parties, and installments, where they must pay on a timely basis.

[11] Article 44 of Law Number 5 of 1960 on Agrarian Law

However, there is a solution in the scenario that the residents of a rental property would want to acquire the house in time, and that is the rent-to-own contract, where there is an option in a rental agreement/contract that buyers may choose to purchase the property at the end of the term. Moreover, following the increasing demand of individuals to own property for themselves, particularly within America and Indonesia, it is essential for individuals to have housing. Following the facts above that conclude the idea that security rights are exclusive to middle to high income individuals and that renting becomes a feasible solution towards low-income individuals to reside in property, Indonesia must find within the laws to accommodate more options to rent and have its individuals invest in options in rentals.

1.2. Formulation of Issues

In regard to the topic of this thesis, the Author will discuss the following formulation of issues:

a. How is the rent-to-own contract executed within the jurisdiction and legislation within the United States of America?

b. What are the challenges and benefits in adopting the rent-to-own contract within jurisdictions?

c. To what extent can the rent-to-own contract be legally enforced within the Republic of Indonesia?

1.3. Purpose

The Author's purpose of writing this thesis is to answer the formulation of issues stipulated above, namely:

a. To understand how the rent-to-own contract is executed within the jurisdiction and legislation within the United States of America and the Republic of Indonesia.

b. To conclude the challenges and benefits in adopting the rent-to-own contract within jurisdictions.

c. To find whether or not the rent-to-own contract can be legally enforced within the Republic of Indonesia.

1.4. Benefits

1.4.1. Theoretical Benefits

Theoretically, the Author hopes that this research will be able to give a conclusive analysis on the laws of real estate, based on the trends from American legal system on rent-to-own. From these facts, the Author hopes that this will give an insight on the possible legal voids that could potentially cause harm in the real estate legal system by the rent-to-own contract. All in all, the Author hopes that it could become a great study in the real estate law, in particular in terms of ownership and security, showing the urgencies to amend real estate law into a more secured and cleared system in Indonesia, with a basis from the American legal system.

1.4.2. Practical Benefits

Practically, the Author hopes that this research can provide an input for the Indonesian government in giving reforms to the real estate law, to make real estate more secured and trendier in accepting new options. The Author realizes that the real estate system, in particular to contracts and ownerships, are outdated, in which Indonesia must enforce more practicality in acceptance to real estate in Indonesia and their statuses.

In addition, the Author also hopes that this research can be useful for the general public, notary, and relevant players in real estate who directly influences the world of real estate in Indonesia. It is apparent that startups and other forms of real estate businesses are starting to be creative in selling property, and rent-to-own contract is definitely a new trend that will take its hold in Indonesia someday, as it did in America. This is because it could be the solution in resolving the lack of home ownership in Indonesia, considering that it is conducted in good faith. Lastly, it could become useful information to other businesses that are interested in rent-to-own in general, both America and Indonesia, to understand the risks that it proposes and the benefits entrepreneurs, sellers and buyers, can receive from it.

1.5. Systematics of Writing

This thesis is arranged into five main chapters that will ease the reader s to understand the discussion of this thesis:

a. Introduction

This chapter discusses the introduction, which is divided into five parts, which are the background, formulation of issues, purpose, benefit, and systematics of writing.

b. Literature Review

In the literature review chapter, the Author will divide this chapter into sub-chapters. First, the Author will determine all the relevant laws, policy, regulations, and case studies of real estate that exists in America. Second, the Author will describe the concept of rent -to-own through relevant institutions in America, along with the written thoughts and articles regarding the risks of rent-to-own. Then, the Author will provide relevant statutory from Indonesia regarding its leasing law, to which the Author will carefully limit the scope to the point where the rent-to-own contract is emphasized. Finally, the Author will attempt to create a hypothesis regarding whether or not the system being used in America, regarding the rent-to-own, could be implemented in Indonesia.

c. Research methods

This chapter will discuss in general about the types of research used in this thesis, and then the data analysis techniques from the type of research. Then the Author shall discuss them in regarding of collecting data for this thesis.

d. Discussion and Analysis

The fourth chapter will discuss the research problems along with its solution, following the result from the research methods. It will be divided in two sub-chapters, which are the analysis from the research methods regarding the legal systems in the determined countries and the discussion from the analysis, leading to a conclusion

e. Closing

In this last chapter, the Author will conclude with the relevant answers that has been discussed throughout the thesis (all four parts in this paper). After the conclusion, the Author will recommend and provide insight regarding the real estate law and the implementation of the rent-to-own contract in Indonesian jurisdiction, creating legal certainty and protection for the benefit of Indonesia.