Land and Collateral Issues: The Asset Dimension of Housing Microfinance

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Abstract
In India, most poor rural families do not possess formal proof of land ownership. While formal land titles are not necessary in housing microfinance, land security is essential. Households are more likely to invest in their homes when they know they will not be evicted. This security is also important for financial institutions’ risk management. This paper specifically deals with the ways to address the challenges and obstacles that face low and moderate income families in accessing housing finance when land title cannot serve as a part of the collateral for a housing loan. It further discusses innovative and practical solutions which can facilitate extending housing credit to these rural families.

Introduction
Within the microfinance community, the asset dimension of housing finance, land, and collateral is among the least understood constraints in developing financially viable housing microfinance services. The nature of housing microfinance (relatively small loans with a short repayment period marketed to economically active poor people) effectively means that land and collateral strategies associated with mortgage financing do not provide a useful way forward. Conventional mortgage lenders typically will not issue a mortgage unless the property being financed is legally registered and can provide adequate collateral in case of default. But clients of housing microfinance institutions often are not able to produce a legally documented title deed for the land on which the property is build.

The asset dimension of housing microfinance, thus, contributes to an already challenging business environment both for institutions interested in expanding the range of services they provide to existing clientele as well as for institutions interested in providing an existing service to new clientele. The debated surrounding land issues and the effectiveness of land and property as adequate means of securing a loan is mostly foreign to the former, while only aspects of it will be familiar to institutions rooted in latter traditions.

Objective of the Study
The Research Paper aims at the following objectives
1. To analyse the problem of land rights in India
2. To understand the terminology warranted when it comes to a discussion of land tenure and land security.
3. To suggest practical solutions to address the problem of land rights

Research Methodology
This research paper is conceptual and analytical in nature based on field survey of condition of land rights in rural India. The data used for this research paper is primary and secondary in nature.

A. Primary Data
Though the study is regarding the condition of land records all over India, the scope of the empirical investigation (field study) is limited to two districts each of the backward regions of Maharashtra viz. ‘Marathwada’ and Vidarbha based on interviews with members of SHGs in villages. Beed and Osmanabad from Marathwada and Yavatmal and Wardha from Vidarbha were selected for the
survey. These districts are among the 100 most backward districts of India. Total sample size taken was 600 with 150 sample size from each district. Total 8 villages from Beed, 20 from Osmanabad, 28 from Wardha and 24 from Yavatmal districts were surveyed for the study with an average sample of 8 households per Village.

B. Secondary Data

Secondary data was collected from various books, internet and the publications of Reserve Bank of India (RBI), Indian Bank’s Association (IBA), Indian Institute of Banking & Finance (IIBF), National Housing Bank (NHB) and National Building Organisation (NBO). International publications, like those of International Union of Housing Finance (IUHF), The Joint Center for Housing Studies (Harvard University), World Bank Group and also from existing studies on land rights and Housing Microfinance.

Problem of land rights in India

There are four ways to demonstrate land rights in India. The first three ways can be used to access bank finance. First, one can gain land rights through a title deed which has the highest legal sanction. Second, one can attain a leasehold, which gives the holder rights to use property for a certain number of years. Third, one can receive a license to cooperative societies, upon which members register with the cooperative to demonstrate right to the property. The fourth is through stamp paper signifying sale of a property and has no legal validity. As noted earlier, access to formal sources of housing finance is limited by one's ability to show evidence of legal title and formal employment. Low-income households who inhabit informal settlements seldom have formal legal titles. Their rights to land exist through other forms of land security. Literature refers to these rights, which may be in the form of property tax receipts or through stamp paper signifying sale of property, as para-legal rights. Para-legal rights in urban areas can also take the form of government-granted security to slum dwellers which protect them against eviction. In rural areas, para-legal rights are typically embodied by pattas which are land rights to either ancestral or government-granted land. While ancestral pattas are accepted by banks and other financial institutions, pattas to government-granted land are not always acceptable. This is because, the latter specifies that the property may not be sold or transferred for a certain period of time. Clearly then, this form of land security would not be acceptable to a bank as collateral. Recognising these rights would incentivise rural households to invest in their dwelling because these rights provide them with land security.

Looking at the figures in survey sample, only 7% of the rural households possessed clear titles, rest were all only in possession of Panchayat documents or tax receipts as these lands were either passed on from generations or were on encroached land.
This paper specifically deals with the ways to address the challenges and obstacles that face low and moderate income families in accessing housing finance when land title cannot serve as a part of the collateral for a housing loan.

**Tenure and Land Security**

A clarification on terminology is warranted when it comes to a discussion of land tenure and land security. Freehold title secures ultimate control over the land to its owner. It permits the owner to improve, sell, or use it as collateral or mortgage. It may be transferred or bequeathed by the owner. Conventional lenders and bank favour individual free hold title. Land security, on the other hand, is a de facto arrangement allowing an individual or a group of individuals to use land and residential property in a manner that precludes losing that land or property for a foreseeable period. In the context of microfinance, land security can be considered as the right to use property, assurance that the user will not be forced to vacate the property, and evidence that usual and customary local practices support this assurance. Tenure can be effected in a variety of ways, depending on the constitutional and
legal frameworks, social norms and cultural values and, to some extent, individual preferences. A household has secure tenure when it is protected from involuntary removal from the land or residence, except in exceptional circumstances, and then only by means of a known and agreed upon legal procedure, which must itself be objective, equally applicable, contestable and independent (UNCHS 1996, 4).

Housing Microfinance – Bridging the Gap

As housing microfinance is concerned, in spite of these obstacles posed by the lack of title, the existence of a full title has not always been necessary for housing microfinance, as some MFIs have already proven. Most MFIs in India retain legal title from their clients only as a psychological deterrent, without any intention of repossessing the house in the event of default. There are two reasons for this. Firstly, the process of foreclosure is often time-consuming and burdensome for MFIs. Secondly, MFIs may find it morally problematic to possess a poor person’s home or land.

In practice, the large majority of the poor produce their own housing. It is an incremental process that draws on their own resources: interfamily reciprocity and nonconventional financing with the help of semiskilled labor from the informal building market. This process can take from ten to twenty years to complete. Typically, the household has a plot passed obtains a plot, either through invasion of public or private land, or purchase in the informal land market where a provisional shelter is built. Once a degree of security is obtained and eviction is deemed unlikely, incremental investment takes place. Financial services enable the poor to leverage their initiative, accelerating the process of building their assets.

Housing and land are key assets for the poor, accounting for 60-70 percent of the total assets owned by low-income families. In addition to its function as a place of shelter, housing is an important productive resource, providing socioeconomic stability as well as a source of assets creation and savings (Moser 1998). It is estimated that between 30 to 60 percent of housing microfinance clients are engaged in some type of home-based microenterprise (Center for Urban Development Studies 2000, USAID 2000). Microfinance has developed mechanisms to enhance credit to low-income families in the absence of clear land title through flexible underwriting and alternative collateral. Microfinance institutions bridge the gap between conventional lending, and microhousing finance has emerged as a powerful tool since it has found cost-effective ways to judge credit-worthiness and to enforce repayment on uncollateralized loans (Ferguson 1999, Baumann 2000, McLeod 2000, Erb 2000). From the borrower or household standpoint, investment will take place if there is reasonable assurance of security.

Loan Size and Type of Guarantee

There is a close link between loan size and the type and quality of collateralization. The main factors in determining the choice of collateral are the transaction costs involved in verifying ownership of assets and valuating them; the ease of enforcement and fore-closure procedures; and likely sale price.

When loans are kept small, short term, and frequent the question of security for the loan becomes less important (McAuslan 1985, 46). Thus, much of the microlending for housing is based on the same underwriting criterion, client history, solid credit record, and small loan amounts. Lending is then based more on character and willingness to pay than on collateral.
The instruments that housing microfinance currently uses include:

- Land title and building
- Lien on assets
- Obligatory savings
- Assignment of future income (wages)
- Personal guarantee (cosigners)
- Joint liability and group guarantee (SHG/JLG - character based lending)
- Other financial assets (for example, life insurance policy)

Microfinance commonly relies on collateral substitutes to cover the shortfall in solid collateral. The best known examples for collateral substitutes are peer pressure and co-signer arrangements. What distinguishes these is that they are extra legal or social means that are not enforceable in a court.

**Para-legal Mortgage**

While many rural villagers own their homes, which they likely built themselves, they rarely own the property on which they live. Typically, in rural India, villagers are granted land from the government or live on land passed down to them from their ancestors. These land rights exist through means other than a title deed. Bruce Ferguson calls these land rights ‘para-legal title’ which he believes should be recognized by housing MFIs when disbursing a loan. This legitimizes the rights of villagers whose lack of legal title would otherwise prohibit them from obtaining a loan from formal financial institutions.

Although para-legal title serves as a reasonable proxy, it cannot be recognized on a mass scale. Lack of title prevents lenders from addressing the housing shortage issue in rural areas. A National Housing Bank (NHB) report in 2000 noted the complexity of the issue: The primary lending institutions have expressed that they are unable to lend more in the rural areas mainly because of absence of clear title to the land on which the house is to be constructed and non-acceptability of agricultural land as collateral security for housing. The respective State Governments will have to play a facilitating role so that the lending institutions can lend with comfort to the people in these areas.

The matter of title in India is further complicated by the fact that no central registry exists to provide definitive information concerning ownership. People often take advantage of the poor and sell land that they themselves do not own. Therefore, it is a matter of policy to ensure that those who own land de facto or through para-legal title are recognized as those with property rights.

Land title is regarded as a legal recognition of an asset, and thus can be leveraged as collateral when borrowing. Lack of title further begs the question as to what, then, can be recognized as collateral against a housing loan. In the case of many organizations that provide microfinance, hard collateral is not a necessary prerequisite for lending. In India, the Self Help Group (SHG) model predominates, which utilizes group guarantees, exercising peer pressure and character assessment to mitigate risk of non-repayment.

A study by Madeline Klinkhamer (2000) shows that the lack of paper title should not preclude microlending for housing purposes, particularly for shorter term, smaller loans. In fact, the onerous process of foreclosure is prohibitive for MFIs to enforce even in the presence of clear titles. Additionally, the very idea of collecting on a poor family’s land or home in the case of non-payment is a morally difficult task. Given both the burden and the moral impediment of foreclosure, efforts to formalize policy surrounding a regulatory framework for land title must be addressed before MFIs can focus on land title as collateral. Meanwhile, shorter, smaller...
loans can avail existing microfinance ‘modalities,’ such as group liability structures and alternate forms of collateral to guarantee the loan.

**Conclusion**

Access to land and property rights is a complex issue worldwide. The problem for those without land will remain a major challenge. The legal and administrative barriers for those with land who lack title are also daunting. In some states progress has been made in tackling the property formalization issue. Lessons are being learned, and the technological advances in property and registry reform are dramatically lowering costs, which should accelerate the titling processes. This should in turn enhance efforts to increase the flow of housing finance to low- and moderate-income groups.

This is an area where governments, both state and central, can play a significant role in ameliorating the housing environment that surrounds the poor. The industry acknowledges the difficulty of formal financial institutions to increase the extent of financial intermediary unless the land title conditions among the poor are improved. For example, the National Housing Bank, in its 2000 report, has commiserated with banks on the difficulty of lending to individuals without clear title, recommending that the state governments must get involved in order to assist the lending process in the absence of full land titles. In this context, Ferguson and Haider (2000) point out that in order to enable financial institutions to better serve low income clients, governments may direct some of the funds available for subsidies towards the regularisation of land title.

However, increasing flows of housing finance will not only depend upon land titling efforts, but also on simplification of the formal rules to create and enforce guarantees and create a greater transparency in registrars, thus, reducing the overall transaction costs.
References