



# **REFORMS IN LAND**

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# CONTEXT OF THE PAPER

- Shleifer, and Vishny (1997, 1998): importance of equity and creditor rights in financial systems
- Credit markets develop where creditors rights are better protected; (See Stiglitz (2001) and Hart (2000) for a review)
- *“K Y`-functioning insolvency laws reduce financial distress for corporate sector; ....Improve resource allocation, efficiency .....equity... stability of the financial system”* (Claessens and Klapper, 2002)
- Thrust area of IFC/World Bank, model laws by UNCITRAL/EBRD



# COLLATERAL

- Credit markets are imperfect due to information asymmetry ; Lenders require costly information (Jaffee and Russell, 1976; Stiglitz and Weiss, 1981).
- Larr, 1994 defines collateral as "an asset that upon liquidation is adequate to cover most or all of the lender's risk exposure including principal, accrued interest and collection costs"
- Agency costs and monitoring costs of the lenders are reduced in the presence of collateral (Rajan and Winton 1995)



# COLLATERAL – ECONOMIC IMPACT

- Two functions of Collateral
  - Signalling function– higher the amount and quality of collateral, higher the firm signals its unwillingness to default (Tybout, 1983, 1984; Bester, 1987)
  - Enforcement function: Collateral covers for exogenous shocks by reducing the lenders loss given default (Barro, 1976, Benjamin, 1978).



# COLLATERALISATION

- Binswanger et al (1986) define collateral on 3 characteristics
  - appropriability: ability to dispose the asset quickly and with no loss in value in case of default. The liquidation of the collateral has to be easy, low-risk, and with low impact costs
  - ability to de-risk of collateral specific risks
  - appropriate returns to the borrower during the tenure of the loan
- All this at low marginal costs of collateralisation



# LAND AS PREFERRED COLLATERAL

- Land preferred by lenders also
  - No depreciation
  - Fixed asset/immovable
  - Insured against third party exogenous shocks (de-risked)
  - Therefore, 'appropriable'
- Costs of collateralisation of land impacts
  - Credit rationing (to give credit or not to, how much to give)
  - Interest rates
  - Loss-given default



# BORROWER'S SIDE OF THE STORY

- In India, ~65% property ownership across urban/rural
- Wealth in property forms the bulk of wealth for individuals; for corporates
- Hence, immovable property forms a large proportion of the property collateralised
- Ability to utilise land to raise credit important in agrarian societies- leads to higher welfare (Feder and Feeny, 1991)



# INSOLVENCY, CREDITORS' RIGHTS AND LAND

- Ease of Collateralising Land depends on
  - borrowers' ability to pledge land for collateral,
  - the lenders ability to accept land as collateral,
  - institutional structures that determine the marginal costs of collateralisation of land at two times
    - **Time of loan origination**
    - **Time of repossession**





# INSOLVENCY, CREDITORS' RIGHTS AND LAND

- Issues with land as collateral
  - Ex-ante : High costs of collateralisation and low appropriability lead to credit rationing; inefficient credit markets; financial exclusion
  - Ex-post : higher loss-given default, individual bank failures and systemic financial distress, social welfare losses.
- Process for collateralisation of land cumbersome
  - Legal report (title information report)
  - Valuers reports
    - Mortgaged documents
    - Physical verification of site



# CHECKLIST FOR COLLATERALISATION 1

## ○ **Ownership and Title**

- Does the land belong to the borrower? Is there a document trail that establishes the owners' right to alienate the property, which includes registration deeds, deeds of gift or succession?

## ○ **Parcel Identification**

- Is the land properly identifiable in classified records? Are these borne out in other documentation such as registration/sale deeds, mutation certificates, etc.

## ○ **Liens**

- Has the land been already pledged with other lenders? Are there other contractual obligations (long term lease, tenancy agreements) that may reduce the ability of the lender to possess and sell the property in case of default? This may include unpaid dues to government, building societies, etc.



# CHECKLIST FOR COLLATERALISATION 2

## ○ **Legality of Usage**

- Do the constructions/settlements that are on the land adhere to local laws? Have laws regarding conversion of land and permitted land use been followed? If the land has a situated building that is put to a certain use, is the use allowed as per master plan documents, and are planning permissions valid? Have development control regulations been followed in these cases?

## ○ **Valuation**

- Is the risk-adjusted value of land sufficient enough to cover the loan in case of distress?? What is the value of different assets within the parcel (land and buildings and interiors)? How is risk adjustment provided for?

## ○ **Recovery**

- If there is default, can the land be sold to recover dues owed easily? (Recovery after default)



# ISSUES WITH LAND

- **NO SINGLE VIEW**
  - Land rights scattered; no title guarantee by state
  - Titles are presumptive, not conclusive; no Torrens' titles
  - Land registers and cadastre information unavailable.
  - Boundaries and ownership details conflict across different departments: fragmented jurisdictions, coverage, and operational domains (revenue dept, rural land dept, survey and settlement departments) maintaining different levels /details of data
  - Land registries with incomplete records, manual record-keeping
  - Lack of administrative and judicial enforcement capacity
  - 70% or more lands in certain administrative jurisdictions are legally impaired.



# ISSUES WITH LAND

- Many suggested reforms (FSLRC)
  - Full computerization and integration of land records
  - Full cadastral mapping of land
  - Settlement of land disputes.
  - Compulsory registration of all transactions.
  - Elimination of restrictions on land markets
  - Remote and easy access to registration procedures and to land records.
  - Standardization of forms and computerization of land offices.
  - Reduction of stamp duty.



# RECOVERY

- SARFAESI has proved quite effective
  - Anecdotal evidence
    - Black money in land, high value transactions are difficult to complete
    - Agricultural land not under SARFAESI
- Recovery timelines are not followed – borrowers in some cases play off SARFAESI vs. DRT.
  - Frivolous applications
- Role of the DM – responsibility /authority mismatch



# REASONS FOR LOW RECOVERY – DRT

## Challenges in implementing DRT/DRAT

Legal	Administrative
<p>In a number of cases, DRT grants time to borrower/applicant to make payment and subject to payment, bank's SARFAESI action is stayed and matter lingers on for a long period.</p>	<p>Though section 17 (5) provides that an application under section 17 shall be disposed of within 60 days of date of application (extendable up to 4 months) the said time frame is not being strictly followed in practice. There is long delay in passing orders by the DRTs</p>
<p>As per the RDDBFI Act, though the cases are to be disposed of within six months, in some cases, the next date itself is given after six months to one year.</p>	<p>When an appeal is filed before DRAT against the order of DRT, though there is provision for stipulation of deposit of 75% of the amount of debt due as a pre-condition for admission of appeal, most DRATs are exercising their discretion and do not insist for deposit of any amount despite the specific pleas made by the bank in this regard.</p>
	<p>In many DRTs, even frivolous applications filed by the parties are entertained despite the fact that the very subject matter does not fall under their jurisdiction. When an application is filed before the DRT, if they do not have jurisdiction on the subject matter, on the first day itself, the Presiding Officer is expected to dismiss the petition for want of jurisdiction so that no time is wasted on those frivolous applications being filed by the parties only to delay the bank's recovery process.</p>

Source: Talk delivered by Shri R. Gandhi, Deputy Governor on Dec 29, 2014 at the "Workshop for Judges of DRATs and Presiding Officers of DRTs"

# REASONS FOR LOW RECOVERY – SARFAESI

<b>Challenges in implementing SARFAESI</b>		
<b>Legal</b>	<b>Administrative</b>	<b>Land Market Driven</b>
<p>There is wide divergence in the time taken for various DMs to process the possession notice and to cause the creditor to take possession. Numerous cases of delays at the District Magistrate's office have been recorded. This seems to be the weakest link in the entire process</p>	<p>Collusion between various administrative agencies (DC, police officers, bank staff, etc.) with the defendant, delays the possession procedure.</p>	<p>Agricultural land is not eligible under SARFAESI. However, numerous cases have been filed where the defendant claims land to be agricultural in nature. However, the courts have taken a view that if agricultural activity is not currently on, then the said land may be eligible for acquisition under SARFAESI (e.g. Bijender Kr Gupta vs. Corporation Bank of India, 2013). Such frivolous cases lead to undue delay</p>
		<p>Dependency on Valuers adds a subjective tone with very high chances for collusion. When we compared the selling price against the reserve price of property under SARFAESI for one of the PSBs, we observe that selling prices are too close to reserve prices</p>





# REASONS FOR LOW RECOVERY – SARFAESI

Challenges in implementing SARFAESI	
Administrative	Land Market Driven
Occasionally, stay orders issued by the State High Court have been recorded. This is in spite of the Supreme Court's directive to not interfere in matters pertaining to SARFAESI Act.	<p>Quite often, Tenants have been set up and inducted by the Borrowers after the creation of the mortgage by creating/antedating documents, with a view to defraud the Banks and impede the taking of possession. These Tenants would resist efforts of the Bank to take possession of the property by contending that they cannot be dispossessed except by following due process of law i.e. after a civil suit/eviction petition has been filed in a regular Civil Court/House Rent Control Court and a decree/order of eviction has been passed. Such litigation would take a long time and consequently delay the process of recovery. In the Harsh Govardhan Sondagar v. International Assets Reconstruction Company Ltd case, the Supreme court has ruled that banks can vacate:</p> <ol style="list-style-type: none"> <li>1. Those Tenants whose leases/tenancies have expired or stood determined;</li> <li>2. Those Tenants whose leases/tenancies are contrary to Section 65A of the Transfer of Property Act, 1882 (the "TP Act") or contrary to the terms of the mortgage or created after the issuance of notice of default and demand by the Bank under Section 13(2) of the SARFAESI Act.</li> </ol>



# IMPACT ON LENDER

- Collateral does not work as good signalling mechanism
  - Dependence on other information to reduce asymmetry
- The Loan-to-value ratio that may be provided against collateral reduces, leading to under-leveraging of assets.
- Marginal costs of collateralisation increase.
  - Marginal costs of collateralisation involve not only the financial costs of evaluating collateral, but also the processing time spent on providing credit and on recovery
- Systemic dead weight losses are increased due to loss of credit-supply.



# SUGGESTIONS

- Lenders need a transparent, efficient means of obtaining security that would reduce their transaction costs and guarantee them recovery of their debts in case of default.
- Strategic, requiring a complete systemic overhaul – out of reach of lenders, government's domain
- Opportunistic and process oriented reforms
  - This is our focus



# SUGGESTIONS - STRATEGIC

- Better land titling systems
  - Implement modernised cadastre system and use it to bring all new urban and existing urban areas, rural zones, and informal settlements into the ambit of the law.
- Strengthening the court system and developing alternative dispute resolution techniques
- Efficient registration system with unrestricted access (registration process on average takes 62 days, and costs on average 7.7 per cent of the property value – highest amongst all BRICS)
- Credit information registry sharing made public;



# SUGGESTIONS - OPPORTUNISTIC

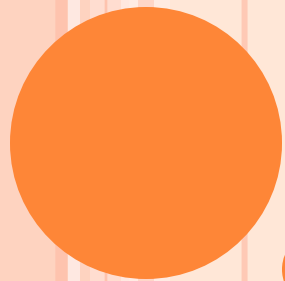
- Use Valuers data smartly
  - Create a system whereby all transactions through all lenders are geo-plotted and aggregate valuation information is shared.
  - All locations geo-referenced. All documentary evidence available in digitised formats for parcel under question
  - Potential price changes captured; GIS map hot areas, perform analytics on credit exposures by administrative jurisdiction/location
  - Similar to Uniform Mortgage Data Program in the US



# SUGGESTIONS - OPPORTUNISTIC

- Document dictionary
  - Different states have different documentary requirements
  - Common minimum documentary library used across all lenders
  - Assists in providing better valuation reports
- Link CERSAI to documentary evidence available (similar to KYC for lands);
  - rate cleanliness of land within the banking system and use this information to make credit rationing decisions





**THANK YOU**

**Questions**

