

The Mystery of Credit

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The introduction of land titling programs to the informal land market seemed to offer a magic solution to the problem of poverty in third world countries. Various governments breathed a sigh of relief, as the struggle to reduce poverty would no longer require the complex and stressful income redistribution measures that always cause conflicts between social groups and classes. According to this magic formula, all that was required was for informal urban dwellers (about 50 percent of the population in the major cities) to formally register their properties and thus gain access to title deeds, so they could obtain mortgage loans from private banks. Their titles and newfound access to loans would enable them to increase their real estate capital, improve their homes and develop small businesses (de Soto 1986; 2001).

To put this hypothesis to the test, and at the request of Perú's National Institute of Statistics and Data Processing (Instituto Nacional de Estadísticas e Informática—INEI), I conducted a study of the official real estate registration policy under which more than one million title deeds were conferred in Perú between 1996 and 2000. This policy was implemented by the Commission for the Official Registration of Informal Property (COFOPRI) and the Real Estate Registry of Urban Settlements (RPU). As stated in Perú's Law Decree 803 of March 1996, the purpose of this policy was to establish a formal relationship between the distribution of land titles, access to formal credit mechanisms and better standards of living. Based on information provided by National Household Surveys (ENAHO) for 1998 and 1999, conducted by INEI, my study analyzed data on housing that either was acquired through invasions or other illegal means and did not have property titles or had obtained titles from COFOPRI through the regulariza-



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Homeowners in both informal and regularized housing use their own resources or funding assistance from family and friends more often than bank loans to finance building improvements.

tion process. The data base consisted of 913,335 units in 1998 and 1,033,480 in 1999, out of a total of 3,572,091 urban housing units for both years. The financing obtained for housing expansion and other domestic expenses was used as an indicator to determine the access to credit, whereas the structure of the dwelling and the supply of basic services were used to determine standards of living.

Those who advocate the regularization of property in Perú argue that property titles should be granted on a large scale by recognizing informal occupation (that is, legalizing land ownership), awarding registered land title deeds, and thus establishing the links needed to gain access to formal credit mechanisms. Official registration is the legal procedure whereby actual rights to a property result in legal ownership. A particular characteristic of this procedure is the firm resolve to establish connections between the legalization of land and property and the access to mortgages through the private banks. As described by the Path to Property Association, an organization dedicated to promoting these policies

worldwide, the basic philosophy behind the formal registration process is that prosperity in countries with market economies is largely achieved because those societies have adequate property systems that enable their markets to operate through exchangeable ownership rights in a wide-ranging market.

To grant landowners indisputable proof of ownership and protect them from fraud and uncertainty ownership rights must be standardized, and universally accessible exchange instruments must be registered in a central government system by legal norms and regulation. Consequently, through the official registration of property, the “energy” of the informal sector can be channeled toward organized and prosperous market economies. From this perspective, informality is merely the inability of governments to make their laws coincide with the real circumstances under which people work and live. Nevertheless, this viewpoint fails to reduce a complex phenomenon to its legal dimension and neglects its economic aspects.

Land Titling Policy and Outcomes

To speed up the distribution of land titles and to avoid troublesome formalities, COFOPRI took over this responsibility from the municipalities. The World Bank supported this policy, granting COFOPRI a US\$38 million loan in December 1998. Between 1996 and 2000, 1,134,000 duly registered land title deeds were awarded: 645,165 of them in Lima, 112,631 in Arequipa and 74,180 in Trujillo (the first, second and third largest cities in Perú, respectively). In terms of the distribution and registration of land titles, the success of the formal registration policy is undeniable. However, the fact that municipalities were removed from the process is questionable, since their legal role in the urban system was undermined.

A close connection between the official registration of property and the standard of living was observed in Lima after the policy was implemented. Between 1998 and 1999, regularized (formerly illegal or informal) housing in the capital city showed improved construction of walls, floors and roofing; however, the nonregularized housing units also had improved construction of walls and floors. In the rest of the country, informal housing in urban areas predominates over regularized housing.

While regularized housing units outside Lima increased from 17,929 to 48,869 between 1998 and 1999, the number of units still without property titles increased from 371,005 to 392,436, indicating the persistence of invasion mechanisms. The gaps between different types of improvements on regularized and informal houses outside Lima increased between 1998 and 1999 for most categories (see Table 1).

Looking at the relationship between official land titles and access to credit, the study found that of the 70,725 houses in Lima awarded land title deeds by COFOPRI in 1998, about 23,965 (34 percent) of those homeowners gained access to varied types of financing, such as loans from banks, lending agencies or family members, to improve or renovate their homes. In 1999, the owners of about 23,804 (18.3 percent) out of a total of 129,588 titled houses

obtained such financing. Although there is no official information on how many homeowners applied for credit and were denied, this result proves that officially registered households that gain access to loans are a minority and, in fact, the number has decreased. This situation is explained by complex factors including the economic recession, the default rate of 10 percent on private bank loans, fear of giving loans to lower-income sectors, and fear among these residents of mortgaging their houses and land.

Similarly, the number of bank loans to already titled landowners in Lima decreased from 12,750 in 1998 to 8,993 in 1999. In contrast, the use of own resources to finance housing improvements rose from 12,282 in 1998 to 14,811 in 1999. Not only is a larger majority spending their own funds on housing, but they are facing more difficulties in gaining access to credit institutions, despite the formal registration of their properties. A study by COFOPRI-DESCO (Riofrío 2001) identified several characteristics of those who are willing to take mortgages:

- Stable nuclear families;
- Both husband and wife are wage-earners;
- Entrepreneurial mentality and willingness to take risks;
- Have self-owned businesses (microbusinesses, taxis, etc.); and
- Have information on the use of the Urban Land Registry.

Of the 12,750 households officially registered and regularized in Lima in 1998 that also received bank loans for renovations and improvements, 52.6 percent obtained their loans from the *Banco de Materiales* and 47.4 percent from the National Construction Company (ENACE). In 1999,

8,993 officially registered and regularized households received loans for renovations and improvements, 4.43 percent from the *Banco de Materiales* and 15.57 percent from the ENACE. Since these are both public entities that grant subsidized loans (at the same annual interest rate of 7 percent), there is no connection between the official registration of property through regularization programs and access to loans from private banks.

With respect to seeking financing for other kinds of household expenses, only 11,323 (8.7 percent) out of a total of 129,588 households registered in Lima in 1999 resorted to any kind of financial assistance. Since no public entity provides loans for these expenses, most households receive money from friends and relatives (47 percent) or other sources such as lending agencies (25 percent). Only 28 percent of these 11,323 registered households gained access to loans from private banks for household needs.

In other urban areas, the situation of officially registered households is different from Lima's experience. In 1998, the use of the households' own funds for housing improvements predominated over bank loans (78.7 percent compared with 21.2 percent), whereas in 1999 bank loans predominated over own funds (51.3 percent compared with 42.9 percent). In 1998, all of the loans were public loans granted by *Banco de Materiales*, and 93 percent were from that source in 1999. With respect to loans for other household expenses, 6,163 (13 percent) of the total of 47,302 households officially registered during 1999 received some financing. Of this small group, 45 percent received financial assistance from lending agencies and other sources, 34 percent from friends and

TABLE 1 Improvements in Regularized and Informal Housing Outside Lima, 1998–1999 (%)

	1998		Gap	1999		Gap
	Regularized	Informal		Regularized	Informal	
Improved walls	67.0	41.5	25.5	78.5	44.0	34.5
Improved floors	75.6	48.0	27.6	80.0	54.0	26.0
Improved roofing	61.0	21.0	40.0	78.0	23.0	55.0

relatives, and 21 percent from their employers or work centers. None of them obtained funds from private banks.

Conclusions

The study yielded the following conclusions with regard to the relationship between official registration of titles and access to credit:

- In general, and despite the increase in the number of properties regularized between 1998 and 1999, access to loans decreased during that period, coinciding with the economic recession and related problems affecting private banks.
- The use of personal resources predominates over bank loans as a source of funds for the expansion of both regularized and informal housing. Loans for other household expenses are obtained mainly from relatives and friends, followed by private banks and informal lending systems. Lower-income families primarily use their own funds or those of social networks for improvements to both regularized and informal housing; resources from formal public or private institutions are secondary.
- Surprisingly, informal households gain more access to loans from private banks than do regularized households. For example, in 1999, 100 percent of loans for improvements to housing units regularized by COFOPRI in Lima were public loans, thus none received private loans, whereas 28 percent of nonregularized housing units did obtain private loans. This suggests that the eligibility criteria used by private banks is based on job stability and fixed monthly income, rather than on land tenancy. The information obtained from ENAHO shows that in 1998, 25 percent of families living in informal dwellings earned about US\$747.50 per month. This is the equivalent of “6 to 7 minimum monthly wages,” a frequently used measure for salaries for lower-income sectors in Latin American countries. In contrast, only 12 percent of families living in officially registered properties regularized by COFOPRI earned



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Commercially developed housing in a gated community (in the foreground) competes for land on the urban periphery with an informal self-produced settlement (in the background).

a comparable salary. This paradoxical situation, whereby title holders do not have access to private banks, while those without titles have higher incomes and better access to loans, may be explained by the fact that COFOPRI, seeking to grant a large number of titles quickly and to create political impact, concentrated its efforts in newer, fragmented neighborhoods where it was easier to identify the landowners. In contrast, COFOPRI tended to ignore older and more close-knit neighborhoods where it was harder to identify the owners due to the presence of multiple generations living under the same roof.

- In the case of both regularized and informal properties, the main sources of loans were public entities that grant subsidized loans (i.e., *Banco de Materiales*).

Thus, there is no direct relationship between the number of title deeds handed over to informal dwellers and their subsequent access to loans from private banks. This conclusion was confirmed when the transition government that succeeded former President Fujimori (1990-2000) revealed in 2001 that only 12,388 mortgages had been recorded in the RPU throughout the country, which is equivalent to only 5 percent of potential beneficiaries. Although registration facilities may be

useful, they are certainly not sufficient to increase access to credit. Effective policies require an in-depth study of a number of different factors, including:

- The policies on which private bank loans are based. Discriminatory policies (redlining, etc.) are prevalent in Latin America, as in the U.S.
- The popular credit culture, particularly as regards poor people's fear of losing their property (which is virtually their only asset), as well as the lack of understanding of concepts of property titles, credit and even banks. It's important to study the patterns of cultural inertia that are put to the test by this type of policies and consider the opportunities for education that could facilitate these processes.
- The reluctance of people to register their properties and use the registries.

The intention of this article, and the research behind it, is not to minimize the importance of policies aimed at facilitating access to credit by the poor by means of regularization programs. On the contrary, such policies are important and should be stimulated, although we would not suggest urban poverty can be resolved exclusively through this means. For the system to improve, it is essential to have a better understanding of the credit system and the popular credit culture, as well as