

INSTITUTE FOR LIBERTY AND DEMOCRACY

**POPULAR MORTGAGE: A FIRST STEP TOWARD LEGAL SECURITY
AND DEMOCRATIZING CREDIT**

Preliminary Version-Working Paper

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INTRODUCTION

The purpose of this report is to introduce and explain the workings of popular mortgage system created by the Institute for Liberty and Democracy (ILD), adopted by the Peruvian government under Legislative Decrees No. 495 and 496. Thus, the report is divided into three main sections, the first of which deals with potential relations between informal housing and access to credit, the second with the popular mortgage itself and the third, on a concluding note, with the system's advantages for Peruvian society in general.

However, as you will see for yourselves, the report not only introduces and explains the popular mortgage system but also clearly demonstrates the underlying principle of our research efforts, namely that informality is not an economic development model but merely a dramatic illustration of the chasm between Peruvian law and reality, requiring a new legal institutional framework which not only formalizes informal status but, at the same time, informalizes the formal sector, to promote equal access to business opportunities for all Peruvian citizens.

I. INFORMALITY, HOUSING AND ACCESS TO CREDIT

1. Based on its nine years of studies of the legal and economic reality of Peru, the Institute of Liberty and Democracy

was the first to establish the existence of a large segment of society engaged full or part-time in what are popularly known as "informal activities".

Informality is a concept developed by the ILD based on empirical observations of this phenomenon. It is not people who are informal, only status and their activities. Nor does informality correspond to any one specific static segment of society, but is rather a grey area paralleling the legal world where people take refuge when the cost of legality outweighs corresponding benefits. Only in rare instances does informality imply breaking all laws in general. In most cases only certain specific legal provisions are violated.

Informal activities also include those for which the government has created a special legal treatment under which a person may engage in informal activities, though not necessarily with the same legal status as those enjoying the full protection and benefits of the law. Thus, informal activities those which, though carried on in pursuit of legitimate objectives by means of lawful activities such as building a house, providing a service or operating a business, fail to meet requirements and discharge formalities established by corresponding government regulations and, thus, are considered "unlawful".

Efforts to measure these informal activities have revealed the amazing entrepreneurial energy of the poorest segments of Peruvian society which, for example, in aggregate terms, generated 39% of the gross domestic product for 1984 using 60% of the total number of man-hours worked during this period at the nationwide level. According to our estimates, by the year 2000, informal activities will account for 61.3% of GDP, despite average productivity equal to only one third of that of the formal sector. (1)

2. The roots of informality lie in the overwhelming, cumbersome regulations imposed by government on business activity, presenting an obstacle for anyone attempting to do business and particularly for the nation's poor, due to the country's inadequate legislative system under which ill-advised laws are enacted behind closed doors, ignoring the real interests of the people and, and thus, are totally divorced from reality.

The number of legal requirements imposed by government and the cost of meeting such requirements in terms of both time and money thwart private enterprise in two ways. First, is by discouraging investment in economically sound activities and, secondly, by causing a large percentage of new business activity

(1) Estimating the Magnitude of Informal Business Activity in the Peruvian Economy, ILD, December 1988.

to be carried out informally, in violation of the law, due to the impossibility of complying with requirements imposed by government regulations. The fact that, in order to evade government regulations, those engaged in informal activities find themselves forced to do things backwards or in a different way or to call them by names meaning exactly the opposite is an excellent illustration of the absurdity of business regulations. Take the case of street vendors ("ambulantes"), who are a far cry from itinerant, with fixed locations that have a value in many cases ranging from US\$500 and US\$750 per square meter, which is higher than the unit price of land in the city's most desirable residential and business districts, or "microbuses" carrying anywhere from 45 to 100 passengers, the same number of passengers as so-called "omnibuses" operated by the municipal urban transit company using Dodge, Scania-Gabriele and Mercedes Benz vehicles, which themselves are nothing if not "microbuses", or of the so-called "pueblos jovenes" ("young towns", the local expression for new-sites developments) which are neither towns nor new, many of which date back as far back as 1950, with several-year-old wide boulevards linking them to the heart of the city, despite which most of their residents have no legal title either to the plots of land they are occupying or to the buildings erected on such land.

3. One of the largest sectors of informal activity is the housing sector, offering a unique illustration of the chasm between government regulations and the Peruvian reality. Studies conducted by the ILD have found that, due to the controlled rental market and to distortions in the capital market, low-income groups are precluded from renting or purchasing formal housing or, in other words, from buying a plot of land, developing it for urban use according to corresponding municipal ordinances and ultimately building a dwelling to eventually live in, subject to the obtention of a municipal building permit.

In light of this fact, the legal alternative for these people is to apply for a grant of government-owned land, which is the case of most of the land on the outskirts of the nation's cities. However, as graphically illustrated in Figure No. 1, such land grants mean going through 207 administrative formalities with 48 different government agencies requiring a minimum of 43 months to complete. (2) Add to this another 40 months to obtain necessary land development and building permits, for a total wait in period of nearly seven years to find a place to live. In some case, total time adds up to 10 years.

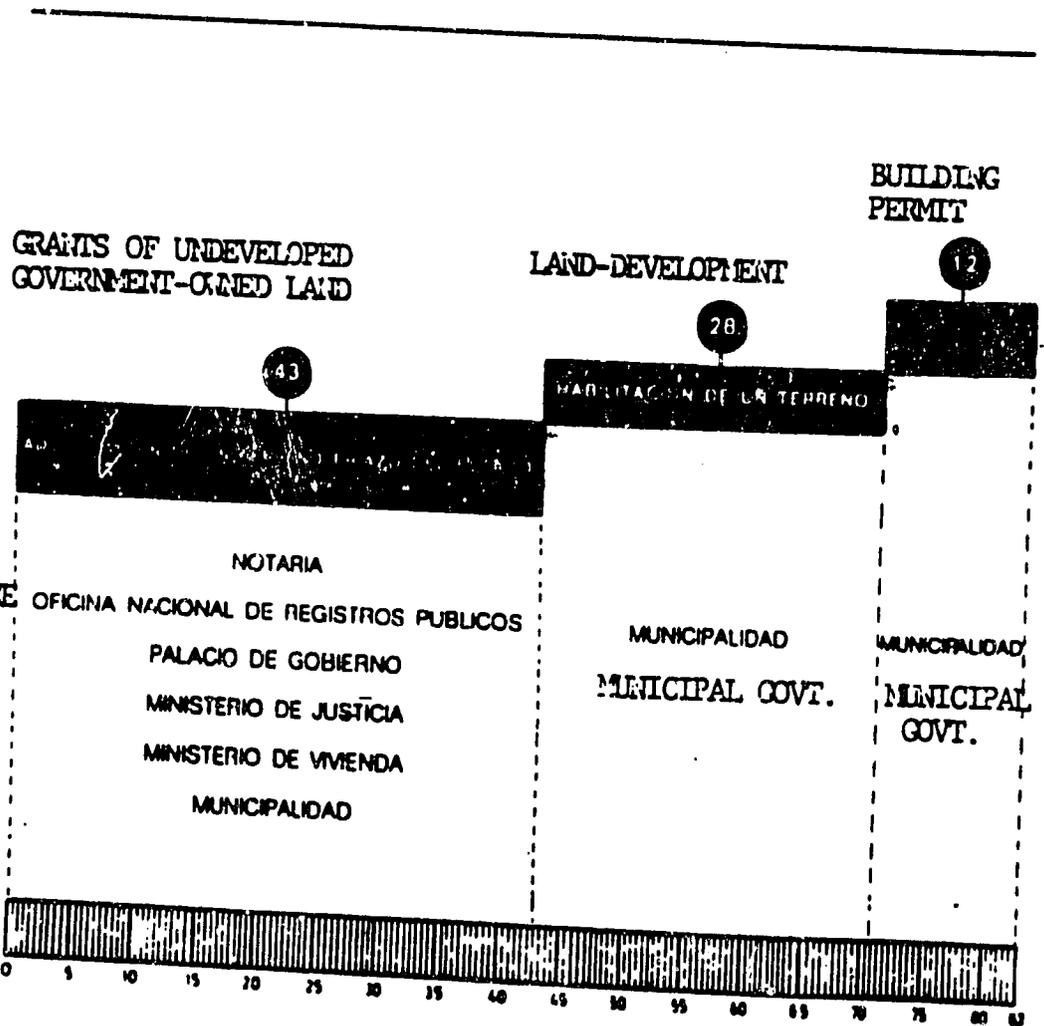
(2) The number of administrative formalities has recently been cut back to 116, involving 27 government agencies. However, the length of the land grant process has only been cut from 43 to 37 months.

GRAFICO N2 1

Figure No 1

**Trámites de acceso
a la vivienda formal**

**FORMALITIES FOR ACCESS
TO FORMAL HOUSING**



NOTARIA
 OFICINA NACIONAL DE REGISTROS PUBLICOS
 PALACIO DE GOBIERNO
 MINISTERIO DE JUSTICIA
 MINISTERIO DE VIVIENDA
 MUNICIPALIDAD

MUNICIPALIDAD
 MUNICIPAL GOVT.

MUNICIPALIDAD
 MUNICIPAL GOVT.

SECRETARY PUBLIC
 NATIONAL PUBLIC RECORDS OFFICE
 CITY HALL
 MINISTRY OF JUSTICE
 MINISTRY OF HOUSING
 MUNICIPAL GOVT.

● tiempo promedio de duración del trámite en meses Average length of formalities in months

■ Trámite Type of Formality

This is why, despite also being quite costly, the invasion and occupation of government and privately-owned land has come to represent the most effective alternative in providing shelter for the poor. The fact that, according to government statistics, there were 282 illegal occupations and only 3 official grants of government-owned land in Lima in 1985 and that seven out of each ten buildings constructed are informal dwellings is significant and clearly illustrates the inoperability of housing regulations.

A. ECONOMIC IMPORTANCE OF INFORMAL HOUSING

4. The ILD has continually maintained that poverty refers not only to the fact that the poor have no property of their own and the low productivity of their resources but also to the hurdles they face in attempting to defend and derive maximum benefit from any property they do own. Not only do they find it difficult to purchase property, but they are also unable to register it in a simple and rapid manner, to use it as collateral in applying for loans, to sell it without the buyer having doubts in regard to its title, to rent it without fear that the tenant will take adverse possession, to prevent its use by third parties or to simply use it without any type of interference, resulting in the erosion of much of its value, despite the proven fact that free exercise of these inherent property rights is vital to economic growth.

One of the major differences between developing nations and industrialized countries lies in the operability of government regulations and procedures and the effectiveness of the legal system in safeguarding the exercise of property rights. Governments of developing nations place significant restrictions on the exercise of these rights by banning or curtailing them or by failing to offer protection from third-party interference, including government interference. In many cases this is caused by the country's preservation of ill-advised, harmful regulations and flawed, improperly regulated or anticipated legal systems.

5. A government which does not recognize the possessor or property as its rightful owner, considers the possession of such property illegal or refuses to recognize the transfer of such property to another party produces two negative effects jeopardizing the well being of its citizenry and the nation's overall economic development. In the first place, owners fear that, at any moment, the government or another party may strip them of their property rights without their being able to legally challenge the expropriation or confiscation of their property or, even if such legal remedies are available, that the system will not operate effectively. Under these circumstances, owners are hesitant to invest in expanding or improving their property or to expand the business in which it is being used. Thus, their

inability to freely exercise their rights undermines the value of their property, unnecessarily aggravating their poverty. The country also loses, in terms of its inability to take advantage of the beneficial effects produced by the business which might have been carried on by the property owner. In the specific case of the legislation of squatter housing by granting occupants legal title to their dwellings, dealing with comparable socioeconomic groups, these benefits translate into an average level of investment in such housing nine times greater than its original value over a period of ten years. (3)

The second negative effect is a permanently stagnant market for such property. Nobody wants to buy property when its transfer is not recognized as legally valid. The result is that those who value the property the most or who can make the best use of it are dissuaded from buying it. Thus, the potential seller loses as a result of his inability to obtain a higher profit from the sale of his property than what he could earn by holding onto it. The buyer also loses by having to look for another less suitable business or property and, ultimately, the nation loses as well, in terms of lower levels of business activity and slower growth.

(3) See Annex.No. 1.

Thus, for these reasons and in view of the importance of property rights, government must fulfill two related functions. First, it must recognize such rights at low cost and, secondly, it must protect such rights through legal institutions whose operating procedures do not present overwhelming obstacles to those who use them. When government fails to meet these objectives, large number of businesses are shut down and those which continue to operate become informal operators with no official status or protection and, hence, less profitable and becoming inefficient.

6. The housing sector is one of the best illustrations of informality in Peru, where oppressive laws have curtailed property rights to informal housing by 50%, hindering owners of such dwellings from selling, mortgaging, renting and investing in their properties, depriving them of protection under the law and creating a situation where owners are forced to rely on their own resources to protect their dwellings from government or other outside interference.

Moreover, those owners who have legalized their dwellings or who plan to complete necessary legalization formalities are finding it extremely costly to reap the benefits of government protection. The public registry is the mechanism through which home owners with legal title to their dwellings prove their legal

right to sell, mortgage, rent or improve their property. However, while this system works, it is too costly and ineffective, as discussed later in the report. Thus, those with legally recognized property rights are finding the cost of government protection of such rights increasingly high.

Once again, the property owner, the buyer, the potential tenant and the country all lose in such a situation. One type of loss is important enough to warrant special attention. Without legal protection or recognition, a dwelling may not be sold or rented, nor mortgaged for that matter, thereby precluding all possibility of converting the capital invested in such property into a generator of new resources. It is through such mortgage loans that significant number of small businesses are established in industrialized countries while, in Peru, this avenue of promoting small and medium-scale enterprises is nonexistent.

(4) Nor can such dwellings be used as evidence of creditworthiness, thereby restricting access to all types of lines of credit from more credit cards to those with much higher credit limits.

(4) The importance of an efficiently operating capital market to development is widely recognized. See, for example, Lawrence J. Lau, Ed., Models of Development, San Francisco, 1988, ICS Press, Rondo Cameron, ed., Banking and Economic Development, (New York: Oxford University Press, 1972) and Ronald I. McKinnon, Money and Capital in Economic Development, Washington, D.C.: Banking Institution, 1973.

This not only hurts the nation's overall economic growth but, even more so, that of lower-income groups who generally have most of their savings invested in their homes. Thus, the goal of the ILD is to correct these government operation flaws and to avoid discrimination against such groups.

B. INFORMAL HOUSING IN PERU

7. Sector studies and research reveal there are currently 1,014 informal settlements (5) in Lima with 514,028 improved lots covering a third of the city, occupying approximately 14,500 hectares. This means that 50.6% of all existing housing in the Lima metropolitan area was built informally, in violation of government regulations, without satisfying current legal requirements, sheltering a staggering 53.6% of the city's population. (6)

(5) Informal settlements include all settlements known in Peru as barrios, slums, similar areas, low-income developments, resettlement areas, shelters, new-sites developments, marginal settlements, public housing projects, housing associations and cooperatives.

(6) The number of dwellings and residents in informal settlements was estimated as of March of 1988 on surveys of data from the records of individual settlements, which figures were subsequently projected to March of 1989 using official intercensal coefficients (1961/1981), revealing the fact that, as mentioned in the body of the report, 50.6% of the city's dwellings are located in informal settlements sheltering 53.6% of the total population.

Over the past forty years, informal settlers in Lima have built dwellings with replacement value plus land value equal to US\$10,953 million, (7), or an average of \$20,000 per unit, placing the nationwide aggregate replacement value of informal housing at US\$20,272 million. This is approximately US\$2 billion higher than the country's total foreign debt. Bear in mind that the number of informally-built dwellings is 47 times the number of housing units built by the government for this same population group over the same period and that government investments in low-income housing over the past quarter century (8) represent a mere 2.4% of investments by informal settlers.

8. However, only 24.9% of the occupants of informal housing in the city of Lima have title to the land and only 3.7% have title to the dwelling per se. (9) In other words, of a total of 514,028 housing units existing as of March of 1988, 127,992 occupants have duly recorded land titles, while only 19,019 have title to both the land and the dwelling. Thus, a total of 495,009 dwellings are legally nonexistent.

(7) See Annex No. 2.

(8) De Soto, Hernando, *El Otro Sendero* (The Other Path).

(9) The March 1988 surveys referred to in Footnote (6) also produced the figure of 24.9% referring to the percentage of occupants of dwellings in informal settlements with title to the land.

The absence of legal title to land and housing means the occupant has absolutely no security and no legal status, precluding any possibility of using its inherent value as potential capital to generate additional income. Moreover, as indicated above, obtaining legal title to a dwelling, vesting it with legal status and security, can increase its market value significantly, which means not only getting a better price in the event of its sale, but also that the sale can be financed by a lending institution on better terms for the home owner.

C. INFORMALITY AND ACCESS TO CREDIT

9. Persons engaged in informal activities are considered "high-risk borrowers" by formal lending institutions for two basic reasons: first, because they are unable to prove their creditworthiness since such activities cannot be considered by formal institutions (subjective credit requirements) and, secondly, because they can offer no real security without title to their homes which, built in informal settlements, are nonexistent for all legal purposes and effects (objective credit requirements). Moreover, since nearly all such informal settlers are potential small borrowers, their evaluation as potential borrowers is extremely costly to banking establishments, resulting in their displacement by large borrowers.

Under these circumstances, informal settlers in need of credit are left with only two options: to resort to informal moneylenders to borrow relatively small sums of money repayable in two or three months at interest rates well above the official government rate or to apply for loans from other financial (mutual funds and cooperatives) and nonfinancial institutions serving the microenterprise sector such as IDESI, Accion Comunitaria del Peru (ACP) and Care Peru, whose economic impact is negligible, as illustrated in the following paragraph.

10. Credit obtained by informal settlers through the above-mentioned channels is inadequate to promote their development. Thus, for example, the value of loans granted to these borrowers in 1986 by the aforementioned nonfinancial institutions represented a mere 0.2% of the value of lending channeled to the private sector through the formal financial system (10). While, as previously mentioned in Paragraph 1,

(10) The following comparison of informal and government activity is based on ILD calculations for 1986.

	SHARE OF GDP	MAN-HOURS USED	PERCENTAGE OF *EAP USED	SHARE OF FORMAL CREDIT
Informal Sector	34.6%	61.2%	48%	0.2%
Government	13.6%	6.9%	10.4%	37.2%

*Economic Active Population

informal activities generated 39% of GDP for 1984 using 60% of the total number of man-hours worked. (11)

II. POPULAR MORTGAGE: A FIRST STEP TOWARD LEGAL SECURITY AND DEMOCRATIZING CREDIT

11. Considering that credit is one of the most important factors in promoting business development, the ILD has created a system which overcomes present obstacles barring those engaged in informal activities from gaining access to credit.

In effect, after extensive studies and analyses of the legal and economic realities of Peru, the ILD has created a popular mortgages system as part of its efforts to gradually establish new legal institutions to help provide access to business opportunities for all Peruvian citizens. Under the ILD system, occupants of dwellings built in informal settlements can enjoy the inherent benefits of property ownership, including the right to use, possess (control), dispose of (sell, donate, mortgage) and recover (repossess from third parties) their property and, at the same time, use cumulative investments in the construction of

(11) See Annex No. 3.

their dwellings as security for the obtention of loans through the formal financial system.

12. The system has three basic components: the Land Register for Young Towns and Popular Housing Developments (land register), popular mortgage itself and credit insurance.

(a) The land register (also known as the possession register for reasons to be explained below) designed by the ILD allows informal settlers to rapidly and definitively register their dwellings for legal recognition of their rights. This registration formality enables the settlers to exercise corresponding property rights, permitting them to sell or use their property as security for a loan transaction.

(b) Popular mortgages, which are recorded in the land register, allow for the use of possessory rights and property rights to any dwellings erected on such land as loan security while, at the same time, creating a rapid, simplified foreclosure procedure, making them highly attractive as loan collateral.

(c) The credit insurance program uses insurance companies as financial intermediaries, which issue guarantees to banks on behalf of borrowers, assuring the banks of immediate loan recovery in the event of default by a given borrower.

These three companies are mutually complementary, forming a bridge between the banks and domestic savings, on one hand and informal income-producing activities on the other hand, supported by the land register, popular mortgages and credit insurance, as graphically depicted in Figure No. 2 below.

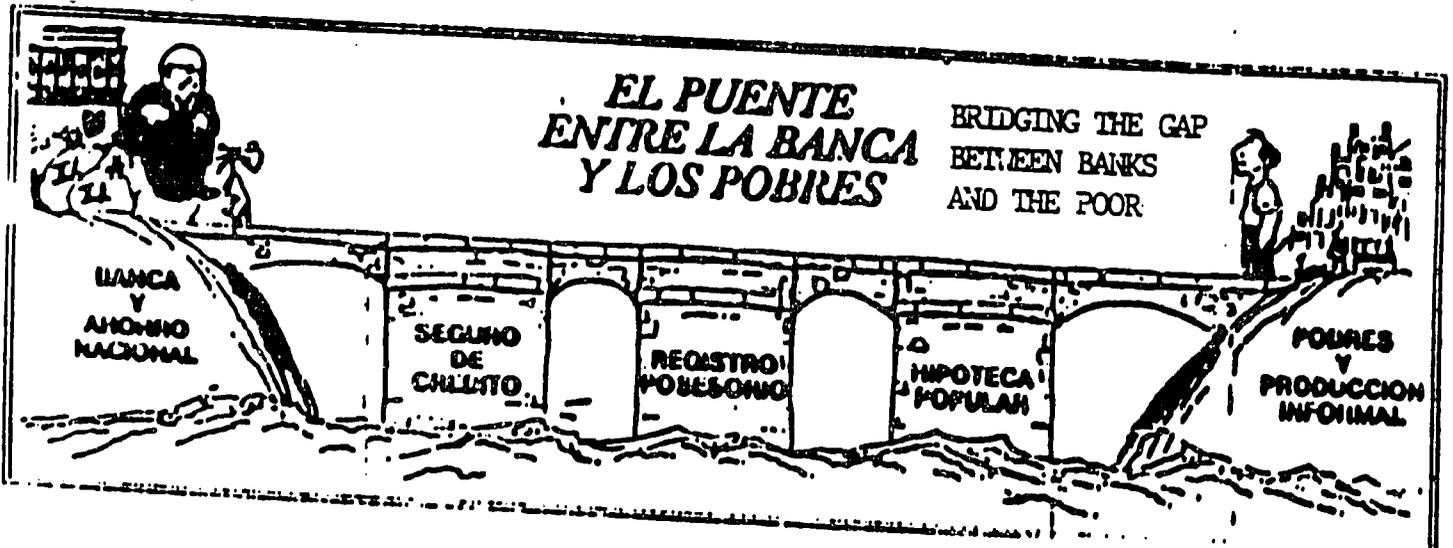
A. COMPONENT 1: THE LAND REGISTER

13. At present, the only existing government registry of real property rights is the real estate register which, as its name implies, is used exclusively to record titles to real estate and legal acts affecting real estate ownership, such as sales, leases, mortgages and legal attachments. Mere possession can not be recorded in the real estate register as it is expressly prohibited by law.

The real estate register is a centralized, cumbersome system employing obsolete registration procedures designed specifically for individual entries, not mass entries as required for the registration of informal settlements. As a result, after one hundred years in existence, its records show less than half of all formal housing in the Lima metropolitan area. Moreover, to make matters worse, nor are rights to even duly recorded properties totally secure since corresponding data is not

GRAFICO NO 2

Figure No 2



BANKS AND
DOMESTIC
SAVINGS

CREDIT
INSURANCE

LAND
REGISTER

POPULAR
MORTGAGES

THE POOR
AND INFORMAL
ACTIVITIES

processed correctly, as illustrated below, doubling the time required to obtain a mortgage-backed loan.

Furthermore, the present register was designed according to the conventional home ownership process, namely the purchase and servicing of a plot of land, followed by the construction and occupancy of a dwelling, with corresponding entries in the real estate register made in the same order and record of the land title serving as basis for all subsequent entries.

However, this sequence of entries in the traditional register is inapplicable to informal housing, where the home ownership process is exactly the opposite in an attempt to evade government regulations, as explained above. In other words, the first step is to take possession of the land through informal occupancy or squatting. The next step is to build a dwelling and develop the land through the approval and registration of a survey and final site development plan. The last step is the acquisition of property ownership through the subsequent legalization of title to the land and to the dwelling erected on such land in accordance with regulations for the legalization of Youngtown. As you can see, the obtention of legal title is the last rather than the first step in this process. Thus, throughout the almost 10-year interval elapsing between the initial occupancy of the land and the obtention of legal title to the

corresponding dwelling, 30% of which are imperfect, the dwelling has no legal status whatsoever, resulting in the erosion in its potential capital value.

14. Considering the totally unrealistic nature of the traditional real estate register, in an effort to eliminate the incongruities of informal status, the ILD designed a new Land Register for young towns and Popular Housing Developments whose major innovation is its provision for the registration of property rights to dwellings built in informal settlements for the first time in the history of Peruvian legislation, once the government has recognized the existence and permanency of such settlement, granting corresponding title holders the same rights as those enjoyed by owners of formal dwellings. Thus, once the government has decided to grant possession, residents of informal settlements can obtain rapid, definitive legal recognition of their rights to their dwellings, which may then be disposed of or mortgaged to third parties, dispensing with the 207 administrative formalities with 48 government agencies requiring nearly seven years to complete. (12)

(12) See Footnote (2) on these 207 formalities.

15. The three main guidelines serving as basis for the design of the new register were simplification, deregulation and decentralization.

(a) Simplification refers to the greater transparency in the daily relations between the land register and those using its services. Thus, in this sense, simplification means creating institutional devices facilitating and reducing the cost of these relations, avoiding overlapping and eliminating impractical formalities and requirements to lower unnecessarily high charges to the public.

Thus, compared with the traditional registration system, the new land register has been simplified as follows.

Notarized certificates replaced by standard printed forms:
To record rights to real estate, the present register requires notarized certificates or documents drawn up in the presence of a notary public and witnesses attesting to the existence of a formal contract and confirming the capacity and intent of the parties to such contract. These notarized certificates are long, formal, complicated statements drawn up based on other documents known as memorandums, consisting of the application addressed to the notary public containing the text of the contract and requiring signature by an attorney for presentation to the notary

public. The preparation and recording of notarized certificates can take anywhere from 30 to 60 days under the best of circumstances and cost approximately US\$50.00.

The new land register replaces these notarized certificates by easily obtained standard printed forms that will contain the contract and establishes the property rights over the housing units. These will be completed with basic information on the parties concerned, the property in question and the transaction pertaining to such property, with only the signatures of the contracting parties requiring certification by a notary public or an attorney.

Building certificates replaced by standard forms and photographs: The traditional register of buildings constructed on real estate holdings requires presentation of a building certificate drawn up in the presence of a notary public based on a memorandum containing a detailed description of the type of structure, the building materials, the different rooms and room dimensions, signed by an attorney as well as by a civil engineer or architect. This memorandum describing the building must be accompanied by a municipal building permit, an inspection certificate attesting to the fact that the building was constructed as authorized by the building permit, a municipal numbering certificate and a receipt from the Peruvian Social

Security Institute as evidence that the builder has paid all corresponding social security contributions for workers employed on the construction site. A building certificate takes approximately four months to prepare at a cost somewhere in excess of US\$100 depending on the particular building.

The sole requirement for the recording of buildings in the new land register is the submission of a standard printed form with basic information on the building in question, provided by an engineer or architect who will act as a private inspector accompanied by a photograph.

No proof of payment of property taxes required: To record a transaction in the traditional real estate register, the property owner must supply proof of payment of all outstanding taxes on the property in question through the presentation of corresponding receipts.

The new register requires no proof of tax payments whatsoever, first, because there's no reason for the recording of a title to real estate to be subject to the payment of property taxes and, secondly, because it is not the role of a real estate register to verify such payments.

In conclusion, unlike the present register in which everything the applicant says must be proven by documents, certificates and receipts from appropriate authorities, the new land register assumes the applicant is telling the truth (presumption of good faith), confirming the veracity of the information supplied through periodic sampling by private individuals selected specifically for such purpose.

(b) Deregulation is the transfer of decisionmaking power over certain matters currently in the hands of the real estate register to the individuals using such register. The new land register has been deregulated as follows:

Recognition of settlers' associations: Under the current system, associations of residents of informal settlements have no legally recognized powers in regard to real estate rights although, in practice, they do have certain de facto powers, though limited by their lack of legal standing.

The system established by the new land register creates an appropriate legal framework to delegate powers to settlers' associations or officials in young towns based on their own extralegal rules and regulations, empowering them to issue statements and certificates of occupancy recognizing such and

such a party as the title holder for a particular property to the exclusion of other parties.

Government bureaucrats replaced by private inspectors:

Under the current registration system, inspections of property holdings in informal settlements are performed by government officials of the municipality in which the settlement is located.

Under the new system, inspections for purposes of verifying information supplied by occupants of informal dwellings are performed by private individuals appointed specifically for such purpose, such as engineers and architects, eliminating the need for administrative proceedings before municipal government agencies.

Separation of title registration and site development:

According to the current registration system, in order to subdivide and grant title to individual plots of land in a popular housing development, the site development plan must be approved by the municipal government, executed and inspected by municipal government officials. Only after this is accomplished can its subdivision into individual plots be recorded in the real estate register for the granting of legal title to corresponding owners.

The new register specifically disassociates the titling of individual plots and dwellings from administrative formalities with municipal government authorities in regard to site development. The land register will record subdivisions and titles to urban plots of land without applicants being required to present corresponding site development plans.

User participation in register management: Under the traditional system, users play absolutely no role whatsoever in register management, supervision and organization.

User representatives are not only actively involved in the management and supervision of the new land register per se, but have direct oversight of corresponding administrative formalities and requirements to prevent their becoming overly cumbersome and complicated.

(c) Decentralization refers to the delegation of true decisionmaking powers to local registration offices, placing them in closer contact both with the local reality and with existing problems in need of solutions.

Until the creation of the new land register, the traditional real estate register has its decisionmaking powers concentrated at its Lima headquarters, with any registration formality liable

to be referred to its top decisionmaking authorities, making it unduly long, cumbersome and complicated. The new system decentralizes registration powers through the creation of autonomous regional registers (or departmental until the regional system is officially introduced), in turn further decentralized through the creation of district offices as needed. In this matter, the entire registration process is carried out from beginning to end within the area in which the property is located.

Applying the principles of simplification, deregulation and decentralization as described above, residents of informal settlements are given the opportunity of registering and obtaining legal title to their dwellings and reaping the benefits derived from their investments of capital and labor. Only through the simultaneous application of all three principles can we ensure that the new land register will operate smoothly and efficiently, streamlining administrative formalities, involving users in the system per se and delegating decisionmaking powers to the local office for the area in which corresponding property is located. Deviation from any of these principles will mean only partial modernization of the real estate registration system. We estimate that, within five years time, we will have registered 60% of all property holding in informal settlements, with 95% coverage in ten-years time. (13)

Even if such properties are not duly registered, the mere creation of the register enhances their value simply by offering the possibility of rapidly obtaining possessor rights to the land and title to the corresponding dwelling erected on such land.

16. The main features of the new registration system as compared with the traditional register are outlined below:

(a) Manual records replaced by a computerized system:

Under the traditional system, all information is manually entered in two separate media, a system of books or "tomes" and a special card file typed by hand, requiring title searches to be performed manually with an unduly high margin of error in the accuracy of the resulting data. On the other hand, the new land register is fully computerized, with special property registration programs automatically comparing new data with prior information, accurately supplying the name of the title holder, a description of the property and a list of current liens and encumbrances.

(b) Only vital information is recorded: Under the current system, real estate transactions are recorded in the most minute detail, encumbering the register with the innumerable,

(13) See Annex No. 4.

complicated details supplied by corresponding notarized certificates.

In the new system, only that information which is strictly necessary is entered in the register, such as a general description of the property, the names of the contracting parties and the main terms and conditions of the corresponding transaction, with the data recorded on a special computerized registration form.

(c) Curtailement of the discretionary powers exercised by the registrar: Under the traditional system, registration requires the presentation of notarized certificates, as well as other documents such as receipts for tax payments, municipal building permits and inspection certificates. In practice, the registrar is in effect a judge, with such broad discretionary powers that six out of every ten titles presented for registration are rejected for some formal defect or another. (14)

By requiring only strictly necessary data for registration purposes, the new land register curtails the discretionary powers of the registrar who, in this case, is confined to simply transcribing the data supplied by specially designed forms.

(14) See Annex No. 5.

(d) Geographic location of property holdings: The traditional register places undue emphasis on the dimensions and individual identification of real estate holdings while, at the same time, failing to define their specific geographic location to pinpoint their position on a city map. Thus, the only way of locating a property in the traditional register is through the name of the corresponding property holder.

Giving less importance to their exact dimensions, the new register pinpoints properties by means of a number corresponding to a clearly demarcated space on the city map, such that records on any given property can be located either by the name of the property holder or by the address of the property per se.

17. The new land register not only modernizes the obsolete, complicated procedures of the traditional real estate register as described in the preceding paragraphs, but revolutionizes the entire registration system by taking into account the extralegal standards and regulations established by informal settlements, the present-day reality and the extralegal institutions operating in the informal housing sector. Thus, the new mortgage popular mortgage system embodies the following:

(a) Bricks as the original land title: The accuracy of recorded data on the boundaries and linear measurements of real estate holdings is verified by the registration of possessory rights to land and title to the structure erected on such land as a tangible fact, since the ILD has found that residents of informal settlements will erect a dwelling on their assigned plot of land only if they have at least some form of collective possessory security. In other words, they will build homes only if they are absolutely certain they will not be evicted. This legal security comes with municipal government approval of the corresponding survey, definitively allocating the land to the informal occupants and thereby recognizing its existence and location, in turn triggering home construction by informal settlers with permanent building materials in previously assigned plots of land, agreeing among themselves as to the boundaries of their respective plots based on the dwellings which are built side by side without leaving any space between them. In other words, the bricks used in the building process not only fix the limits of the dwelling unit per se, but also constitute the original title to such dwellings as the basis for their official registration.

Thus, in registering these dwellings we are also constituting accurate records of the boundaries and linear movements of the land held by each informal settler.

Moreover, while the new system is designed to record possessory rights to individual plots of land based on the dwellings erected on such land, it also allows for the registration of unimproved lots. However, this case requires prior approval by the municipal government not only of the survey of the informal settlement, but of its layout and site development plan as well, since only at this point are unimproved lots given definite, clearly defined dimensions.

(b) The occupant of a plot of land is the presumed owner of the building constructed thereon: As established in the preceding paragraphs and in view of the ILD finding to the effect that informal settlers will build with permanent building materials only on their duly assigned plots of land and only after the survey is approved by the municipal authorities, the new registration system provides that anyone in possession of a plot of land, even without formal title to such land, is the presumed owner of the buildings constructed thereon, applying to realty the same presumption contained in the current Civil Code in regard to personal property under which any one in possession of personal property is presumed to be the owner of such property by the mere fact of its possession, unless proven otherwise. Thus, extending this to realty in informal settlements, unless proven otherwise, the occupant of the land is also presumed to be

the owner of the building erected on such land. This has bridged the gap between the law and the reality existing in the urban areas of the country in which more than 50% of houses have been built on a plot of land where its occupancy have a possessory right and not a property right.

(c) Easing requirements for evidence of title and property boundaries: Present requirements and prescribed documentary evidence of titles to be recorded in the land register and corresponding information on the physical location and boundaries of property holdings have been totally overhauled to take into account the daily lifestyle of residents in informal settlements.

The types of evidence required to verify land tenure rights have been based on the customs and extralegal standards and regulations studied by the ILD and are, therefore, both realistic and easily obtainable by users of the new land register. Examples include certificates of occupancy from the municipal government or other competent authority and, where such certificates are unobtainable, other equally effective documents such as written statements from neighbors or local residents' associations verifying tenure, receipts for payments for basic services such as water, electricity, street paving, local residency and loan agreements with building and loan associations.

New forms of evidence of property boundaries have been developed to facilitate the registration of parcels of land in informal settlements and of the buildings erected on such land. The new registration system places greater emphasis on the description and location of the dwelling unit than on the exact dimensions of the land holding since, as indicated above, it is the structure erected on the land which defines its title.

Thus, a single act confers legal status on both the land and the building, which, in most cases, represents as much as 80% of the total property value. With the new system, recognition of corresponding dwellings has been replaced by a standard form supplying basic data on the building in question, accompanied by photographs of the property holding visually depicting the dwelling and boundaries with adjacent properties.

18. By creating a simplified land development procedure, the new land register also allows for the legalization of popular housing developments known in Peru as housing development associations, housing associations and housing cooperatives which, despite owning the land and having invested large sums of money in housing construction, cannot handle the enormous outlays of both time and money required for the completion of necessary land development formalities and the subsequent subdivision and

registration of individual plots of land. Bear in mind that, according to the ILD definition of informality, these popular house developments, with their special legal status and treatment, are considered informal in the same manner as illegal or squatter settlements.

In order for these settlements to subdivide and officially register the individual plots of land comprising the housing development, the current system requires prior municipal approval of a professionally-prepared site development and subdivisional plan, plan implementation and subsequent inspection and approval of corresponding work by the municipal authorities. The new registration system requires only that the site development plan be submitted to the municipal government, whereby it is automatically considered approved after thirty days provided no objections are raised in the interim. Once the plan is approved, the site may be subdivided into individual plots for registration and allocation to cooperative or association members who, in turn, may use their properties as collateral for loan transactions.

B. COMPONENT 2: POPULAR MORTGAGE

19. The second element in the system known as the "popular mortgage", through which common people are able to use the value

of occupied land and that of the dwellings erected on such land as security for the obtention of formal credit.

Prior to the ILD proposal resulting in the enactment of Legislative Decree No. 469, under the rules of Peruvian civil law, only a real property owners could mortgage such property to a third party. Thus, a mere occupant could not mortgage land in his possession, despite the establishment of the new property registration system under which his possessory rights to such land and, if applicable, his title to the building erected on such land were duly recorded in the land register. Moreover, despite land possessions regulations for young towns requiring municipal authorities to grant legal title to informal dwellings, in practice, free exercise of the rights inherent in property ownership was sharply curtailed in that title holders could neither sell, rent nor mortgage their homes.

With this in mind, in an effort to derive economic benefit from large cumulative capital investments in informal housing, the ILD proposed creating a new type of mortgage for realty in informal settlements based on mere tenure rights which, duly recorded in the Land Register and Popular Housing Developments, grant corresponding title holders the inherent rights of property ownership, including the rights of use, enjoyment, disposal and recovery, creating a title free from any and all restrictions

and, for the first time in Peruvian history, making it possible to place a mortgage on a piece of real estate without formal title to such property.

20. The basic features of this new-style "popular" mortgage are as follows:

(a) The mortgage is based on possessory rights: Unlike the conventional mortgage referred to in the Civil Code requiring that the grantor have title to the property in question in order to establish a mortgage right thereon, popular mortgages are established on realty located in informal settlements based on mere possessory rights recorded in the land register. Note that, as previously indicated in discussing the land register, by presuming the occupant of a plot of land to be the owner of the building erected on such land, legally, the mortgage is placed on the tenure right to possess the land and the title to the dwelling, if there is a dwelling, both of which rights are linked for purposes of the mortgage, which considers the property an indivisible whole.

Bear in mind that, while the right of the landholder is referred to as a "possessory" right, he enjoys all inherent property rights, namely the right of use, enjoyment, disposal and

recovery, in effect making him the owner and not simply the possessor.

Moreover, presuming the holder of a plot of land to be the owner of the building erected on such land extends to realty the presumption established by the Civil Code to the effect that, unless proven otherwise, any one in possession of personal property is the owner of such property.

However, unlike the presumption of personal property ownership which may be challenged by the true property owner, proving the possessor does not in fact have such right, the presumption of ownership of informal dwellings may not be contested by previous land owners, whether private citizens or the government per se, inasmuch as, once such rights are duly recorded in the land register they become final. Thus, as soon as the title is duly recorded in the land register, the property may be mortgaged under the terms of a popular mortgage as security for formal credit.

Lastly, the new land register allows informal dwellings to be recorded upon approval of the site survey, before municipal government formalities for the conferral of title have been completed, in effect recognizing the title holder of record as the property owner. Thus, municipal government titling

formalities run parallel to this process until their conclusion, without affecting or modifying the finality of the right previously conferred by the registration system.

(b) The mortgage is constituted on the basis of a standard registration form: The process of establishing a mortgage has been simplified dramatically by eliminating the need for a mortgage deed drawn up in the presence of a notary public. Popular mortgages are created on the basis of a standard registration form completed by the borrower and the lender and duly recorded in the land register, officially constituting the debt secured by the mortgage and the value of the mortgage placed on the property.

(c) Simplified judicial foreclosures: A new abbreviated judicial foreclosure procedure has been created to make popular mortgages an effective, rapidly enforceable security device. Prior to the enactment of Legislative Decree No. 495, foreclosures were subject to a long, tedious collection process, attaching the auctioning off the mortgaged property. This slow-moving judicial procedure, taking anywhere from three to four years, discouraged the granting of mortgage-backed loans, in which delinquent borrowers reaped the benefits of inflation and negative interest rates payable on such loans. The new procedure provides for immediate foreclosure in the event of default and

can be halted only through the presentation on documentary evidence of payment of the debt. Moreover, this type of foreclosure has been limited to an original and single appellate jurisdiction, eliminating the need for intervention by the Supreme Court, which only delayed the conclusion of these proceedings. Furthermore, in an effort to speed up the foreclosure process and protect corresponding lenders from harmful inflationary effects, discouraging them from continuing to go on lending, loan maturities have been shortened and public auctions of mortgaged property have been simplified to prevent borrowers from obstructing the process.

(d) Extrajudicial foreclosures: The final and most important innovation as regards foreclosures which makes some popular mortgage attractive to creditors is the design of a new extrajudicial foreclosure system. Obviously, even with the most streamlined judicial foreclosure proceeding, the slow-moving cumbersome nature of the Peruvian system of due process makes this legal remedy a highly unattractive prospect. Hence, the new extrajudicial foreclosure system establishes that, in constituting a mortgage on realty, the parties mutually agree to designate a third party such as a bank, notary public, magistrate or any other individual or corporate entity to sell the mortgaged property in the event the borrower should default on the

principal obligation to enable the creditor to recover the outstanding loan amount from the proceeds from its sale.

The third party charged with selling the mortgaged property in the event of default is appointed by means of a power of attorney drawn up in the form of a private instrument with signatures certified by a notary public, to be recorded in the land register together with the corresponding mortgage. In the event of nonpayment of the duly incurred debt, the creditor notifies the third-party agent who, in turn, promptly proceeds to sell the property within a maximum of thirty days.

C. COMPONENT 3: CREDIT INSURANCE

21. Nowadays, in granting loans, financial institutions require not only objective security devices such as mortgages, collateral or bonds, but the satisfaction of other subjective requirements such as verifiable formal sources of income.

It is virtually impossible for most Peruvians to satisfy these requirements, not for lack of income, but because such income does not come from formal sources and, hence, is nonexistent for all legal purposes and effects. This is particularly serious considering that 61.72% of the country's total population engages in informal activities, preventing

informal business owners from qualifying as "good credit risks" despite the wealth generated by their income-producing activities.

22. To bridge the gap created by these subjective requirements for access to formal credit, the ILD has recommended the use of insurance companies in a new mechanism whereby such companies play an active role in expanding access to credit based on a new type of insurance known as credit insurance.

Under the new credit insurance mechanism, insurance companies evaluate credit applicants from the standpoint of both income (regardless of its source) and objective security devices and assume the risk of default by borrowers vis-a-vis corresponding lending institutions. These services are rendered in return for the payment of a premium equal to 4% of the full amount of the loan and the creation of a mortgage in favor of the insurance company, in an arrangement which is extremely advantageous for informal borrowers accustomed to paying three to six times the interest rate charged by the formal financial system. Thus, the responsibility for evaluating loan applicants is transferred from the lender to the insurance company, streamlining the lending process and enhancing its appeal since repayment is fully guaranteed. The credit risk is assumed by the insurance company through the insurance coverage offered by the

company in return for the collection of premiums from large numbers of policy holders.

ANNEX 1

Based on a sampling of human settlements with differing legal status, we have shown that the average value of houses with property title is 9 times higher than the value of houses without a title.

This figure was obtained from a sample survey of human settlements with varying degrees of legal recognition. The sample included 38 settlements, each represented by 20 individual plots. Our first step was to compare the average value of dwellings in settlements at both ends of the scale, namely those whose occupants had legal title to their dwellings versus squatter settlements, obtaining the following average building values per square meter for both types of legal status:

Average Value, per square meter
(in 1984 soles)

Squatter	Titled
68.05	333.17
(6 observ.)	(12 observ.)

This gave us a ratio of 4.9 to 1 between the average value of a legally secure dwelling compared with a dwelling with no legal security whatsoever.

We then eliminated from the sample certain observations likely to produce an upward or downward bias in average values, giving us the following figures:

Average Value, per square meter
(in 1984 soles)

Squatter	Titled
33.53	313.05
(3 observ.)	(7 observ.)

This, in turn, gave us a ratio of 9.3 to 1 (or 9.1) between the building value of legally secure dwellings and that of dwelling units with absolutely no legal protection. We simultaneously followed an alternate approach using econometric methods to isolate the effects of income and age variables, producing extremely similar results.

ANNEX 2

The value of dwellings in informal settlements was based on the number of such dwellings as estimated by the ILD in March of 1988 at 498,089 units based on interviews with top community leaders. This figure was then projected to March of 1989 using the intercensal housing growth rate for the period from 1961 to 1981, giving us a total of 514,028 dwellings in informal settlements. We also assumed the same distribution of dwellings by stage of construction produced by field surveys conducted in 1986.

The next step was to calculate average building prices per square meter by type of dwelling unit using the 1986 official schedule of building values for coastal areas published by the Ministry of Housing, computing average unit building costs per square meter for each type of dwelling at list prices, for new-sites developments, housing associations, cooperatives and low-income housing developments.

To ensure that the resulting figure reflected real building costs, we calculated the ratio between resale prices for advertised home sales and the list price published by the Housing Ministry for the same type of dwelling, obtaining a relationship of 2.08 between replacement values and list prices.

We then multiplied the list prices per square meter for each type of dwelling by 2.08, giving us the building value at replacement prices.

We calculated land replacement values by adjusting the list price per square meter established by the Appraisal Department of 1986 for each land category by a factor representing the ratio between market and list prices, in turn calculated based on advertisements of land for sale in low-income settlements appearing in the daily paper El Comercio.

After calculating the land replacement value for 1986, we determined the share of land in total building value to be 5% in the case of new-sites developments and 15% for housing associations, cooperatives and low-income housing developments, using these two percentages to calculate the replacement value for 1989, arriving at an aggregate figure of US\$10,953 million.

ANNEX 3

The value of loans from these nonfinancial institutions (IDESI, Accion Comunitaria del Peru, Care Peru) was US\$9 million at the official exchange rate. However, seeking a somewhat less distorted dollar value, we decided to use a parity rate developed by Apoyo, S.A., bringing the value of lending by the aforesaid institutions down to US\$6 million.

National financial system data is based on government statistics Central Reserve Bank (BCR). At the parity rate, national financial system lending to the private sector would be US\$2,736 million, in which case loans by nonfinancial institutions would represent 0.2% of the total value of lending by the national financial system.

Lending by the Banking System in 1986
(in millions)

	<u>Total</u> (Intis)	(US\$)	Percent %
- Private Sector	48,409	2,290	62.8
- Public Sector	28,668	1,356	37.2
TOTAL	77,077	3,646	100.0

Lending by the Financial System in 1986
(in millions)

	Total (Intis)	(US\$)	Percent %
- Private Sector	57,842	2,736	63.1
- Public Sector	33,790	1,598	36.9
TOTAL	91,632	4,334	100.0

Source: BCR, Annual Report for 1987.

Loans to Microenterprises from Private Nonfinancial Institutions

- Accion Comunitaria del Peru	(at 8/30/86)	US\$3,510,174
- FOGASI	(at 2/28/87)	528,936
- CARE	(at 2/28/87)	646,412
- IDESI	(at 12/31/86)	1,372,942
- FOFISI	(at 12/16/86)	<u>10,420</u>
		US\$6,068,884

ANNEX 4

Our first step was to define the statistical population of the land register as consisting of 498,089 realty holdings in new-sites and low-income developments throughout the Lima metropolitan area as of March of 1988 (Period 0.) We then subtracted 29,486 dwellings for which we figured no surveys were available and, thus, would be difficult to record in the register. The next step was a projection of potentially recordable properties for the first five years of operation of the land register based on the intercensal growth rate of housing in the Lima metropolitan area for the period from 1972 to 1981.

The number of registrations in the first year of operation of the land register was estimated at 12,000 for each of the three district offices in Lima, for a total of 36,000 property registrations. Growth rates for property registrations in the following four years were estimated at 50%, 30%, 15% and 10% respectively, for a cumulative total of approximately 313,590 registrations by year five.

These growth rates for property registrations were calculated based on the operating experience of the National Public Records Office and the Mining Registry Office and on the computerized organizational structure and infrastructure of the popular mortgage project. The reason for the steady slowdown in

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property registrations is that occupants of existing housing units in informal settlements are expected to press for their official registration in the early stages of operation of the land register.

ANNEX 5

The following summary of title registration statistics for land register headquarters of the province of Lima is based on the 1987 Statistical Yearbook published by the National Public Records Office:

Titles Presented for Registration	90,923
Titles Resubmitted	60,945
Titles Examined	39,330
Titles Contested	26,327
Titles Cleared	21,518
Titles Recorded	58,962

One indication of the obstacles confronted by persons applying for legal title to their dwellings is the ratio between the number of titles presented for registration and the number of titles resubmitted, according to which roughly six out of every ten titles presented have to be resubmitted to the Public Records Office.

However, this indicator should be viewed with a grain of caution since any given title may be resubmitted more than once as a result of multiple examinations or challenges in the course of processing.