



Whitepaper 12- Challenges in Using Land As Collateral in India

Land is regarded as an ideal collateral for loan transactions from the perspectives of both the lender and the borrower. It is efficient for the lender because land is an immobile asset, ensuring that the costs of monitoring would remain low. Secondly, because the value of land typically appreciates over time, the borrower is less likely to default on its repayment, mitigating the risk associated with lending against land.¹ Finally, the lender can easily recover the losses associated with the loan default by simply selling the land.

From the perspective of the borrower, the interest rates of all loans against property including land are lower than the interest rates on other personal loans, making borrowing a loan against property an attractive option.²

Despite the widely accepted benefits of using land as collateral, and more than 65 percent urban and rural Indians owning land,³ its use as security is not as common as certain other assets such as bullion and ornaments.

Low penetration of loans against property

Several studies indicate that most households, whether rural or urban, rely on unsecured loans from non-institutional lenders, and even in case of unsecured loans, land is not the most commonly used collateral.⁴ Borrowers of both secured and unsecured loans use personal security, bullion and ornaments as collateral rather than immovable properties.

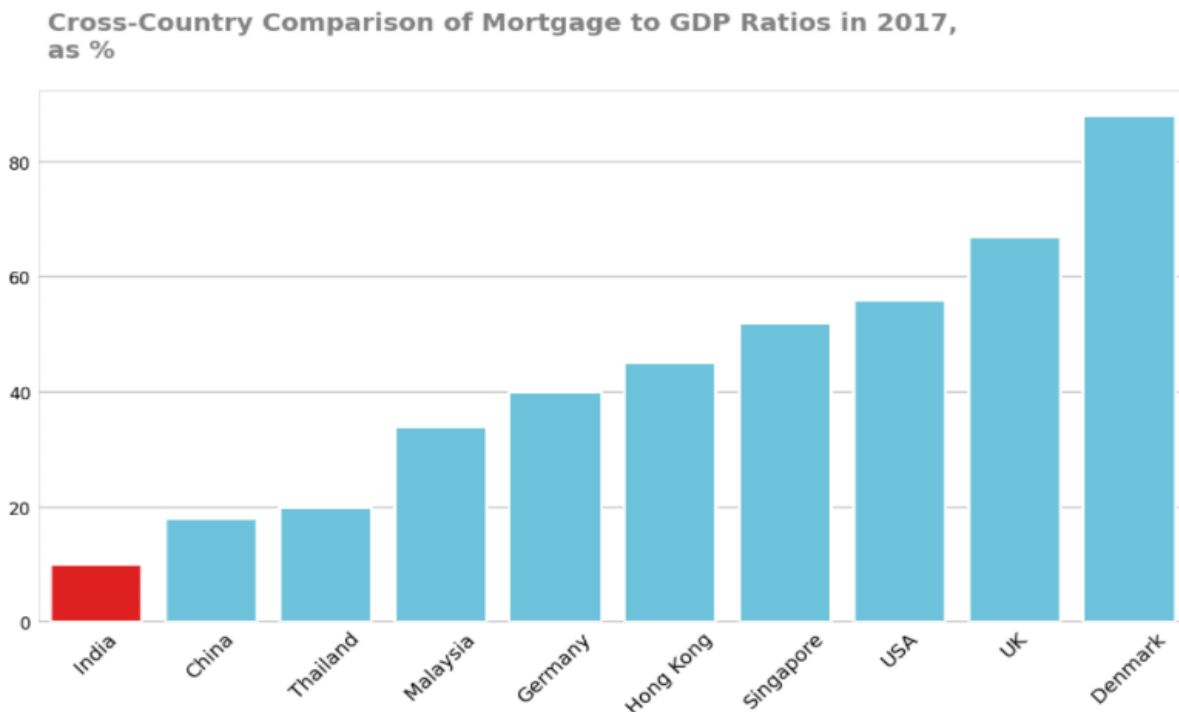
¹ [Indira Gandhi Institute of Development Research, Mumbai \(2019\)- Land as collateral in India](#)

² [NDTV \(2021\)- Should You Choose A Loan Against Property? Consider These Factors Before Making A Decision](#)

³ [Indian Institute of Management \(Bengaluru\) \(2016\)- Distortions in Land Markets and Their Implications for Credit Generation in India](#)

⁴ [National Sample Survey Organisation \(NSSO\) \(2013\)- 70th Round National Sample Survey](#)

Thus, India's formal mortgage penetration is lower compared to other large economies.



Source: Reserve Bank of India (2019): Report of the Committee on the Development of Housing Finance Securitisation Market

Government of India's Committee on Household Finance (2017) suggested that, nationwide, mortgage loans account for only a small part, that is, 23 percent of the total liabilities.⁵

Rural versus urban borrowers of loans against land

The findings of the All India Debt and Investment Survey (AIDIS) (2013) revealed that urban borrowers borrow loans against property (LAPs) to a lesser extent compared to rural borrowers. Furthermore, the immovable properties the urban borrowers use as collateral tend to be built-up structures rather than land. **In contrast, borrowers from rural areas not only opt for LAPs to a greater extent, they typically use land as collateral.**

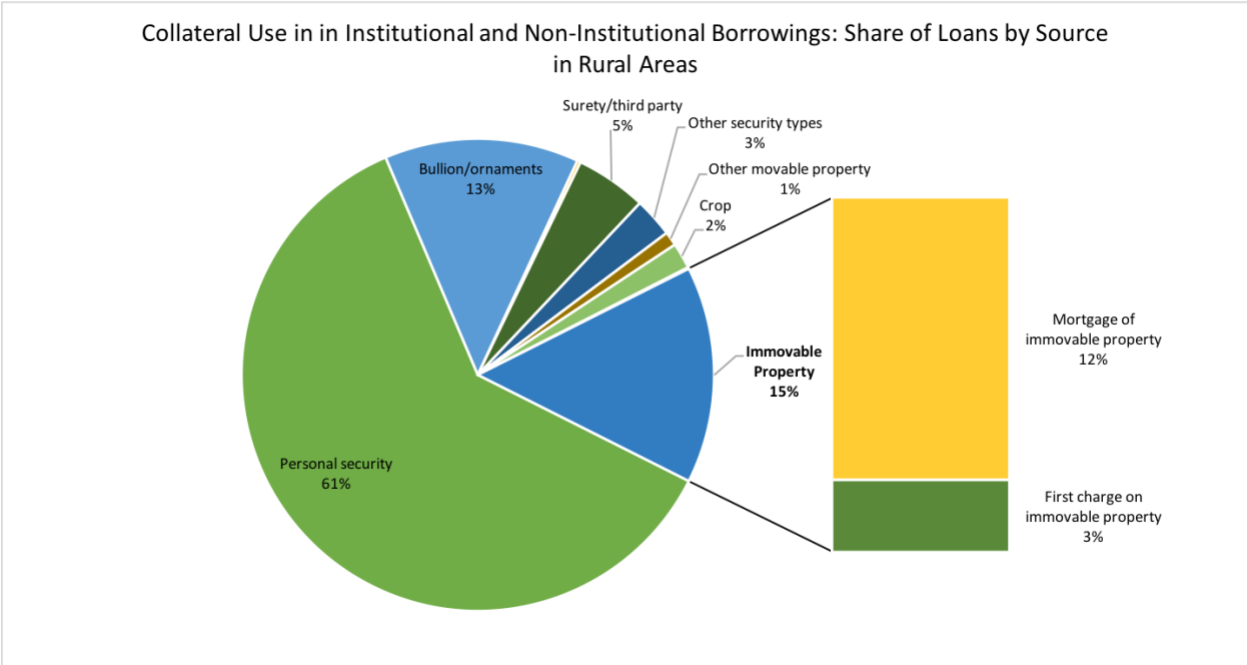
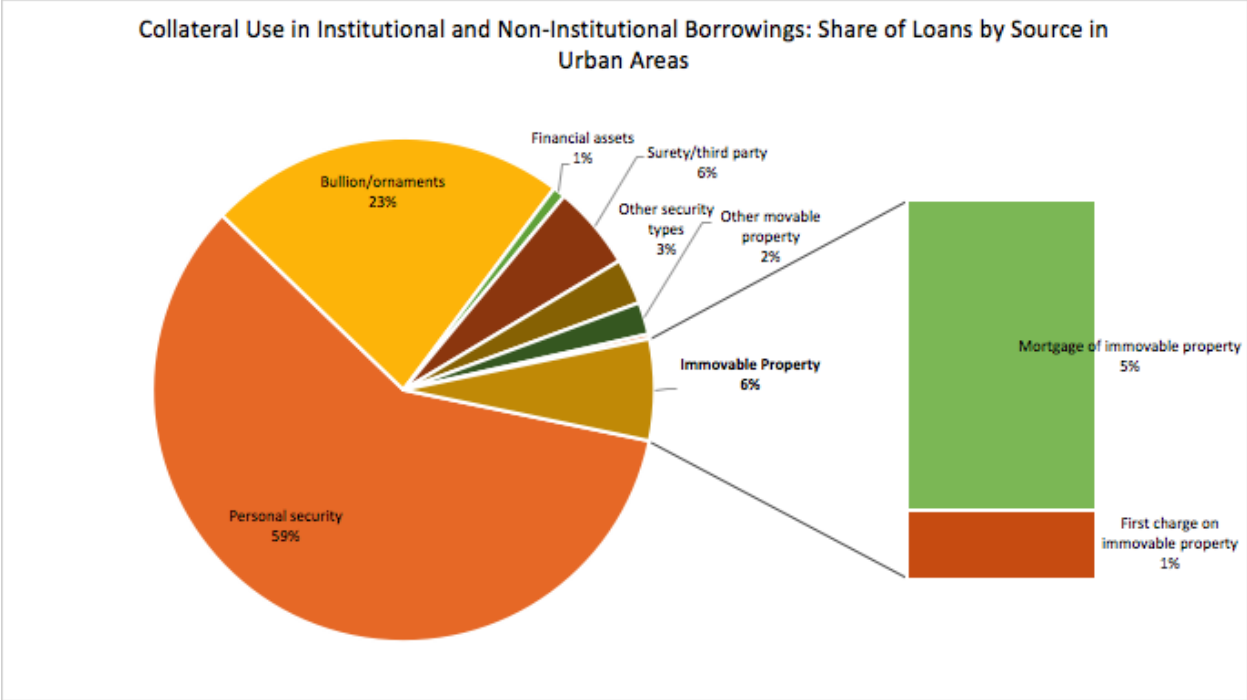
⁵ Indira Gandhi Institute of Development Research, Mumbai (2019)- Land as collateral in India

	Urban			Rural		
	Institutional sources	Non-institutional sources	Both	Institutional sources	Non-institutional sources	Both
Personal security	37.2	81.5	58.1	35.9	85.7	61.8
Bullion/ornaments	33.8	12	23.5	20.4	6.4	13.1
Financial assets	1.6	0	0.8	0.5	0	0.2
Surety/third party	8.3	2.4	5.5	7.2	2.6	4.8
Mortgage of immovable property	9.3	1.2	5.5	22.2	1.7	11.5
Other type of security	3.8	2	3	2.7	2.7	2.7
Other movable property	3.4	0.7	2.1	1.6	0.4	0.9
First charge on immovable property	2.1	0.2	1.2	5.8	0.3	3
Crop	0.6	0	0.3	3.3	0.3	1.7
Agricultural commodities	0	0	0	0	0	0.3

Source: Computed by authors of 'Land as collateral in India' report using AIDIS (2013) data⁶

Although the preference for loans against property (LAPs) including land is more pronounced among rural households, they still opt for personal security, bullion and ornaments as collateral, rather than going for LAPs. Land is the third most commonly used collateral after personal security and bullion among both, secured and unsecured loans.

⁶ Indira Gandhi Institute of Development Research, Mumbai (2019)- Land as collateral in India



Source: Indira Gandhi Institute of Development Research (2019)- Land as collateral in India

An overwhelming majority of LAPs borrowed in rural areas are agricultural loans.⁷ In fact, more than 80% of agricultural loans are loans against land.⁸

⁷ Agricultural loans are loans availed by farmers to fund agricultural and allied activities.

⁸ The Committee on Household Finance (2017)

Challenges to using land as collateral

1. **Bulk of borrowers are small farmers for whom land constitutes greatest proportion of wealth-** A majority of rural borrowers are small and marginal farmers and are less likely to use land as collateral because their livelihood depends on their piece of land. In case of unsecured loans, they prefer to use diverse collateral such as bullion and ornaments while borrowing. Wealthier borrowers for whom land also constitutes the greatest share of their wealth use land as collateral. They are also more likely to borrow high value loans.⁹
2. **Non-enforcement of SARFAESI Act-** The Security and Reconstruction of Financial Assets and Enforcement of Security Interests Act ('the SARFAESI Act') which was enacted in 2002, empowered banks to initiate loan recovery in case of non-repayment of loan. However, it does not make provisions for repossession of agricultural land used by the defaulter as collateral. The lack of a legal recourse for lenders in case of default by borrowers who used agricultural land as collateral disincentivizes banks from lending against it.
3. **Poor documentation and maintenance of land records-** Land records in India are poorly documented. Thus, title documents may not reflect the true ownership of the land, paving way for third-party claims to it. The land may also have encumbrances which may not be documented on the land records. The lack of clearly documented land records often prevents lenders from lending against land.
4. **Difficulty in obtaining legible data on land-** State land registries can only be accessed from specified nodes within the state. Information on land related disputes and pending litigations is also accessible only locally. The lack of standardized land related data across jurisdictions can increase the costs of collateralization substantially for lending across state borders.¹⁰
5. **High symbolic value of land-** In rural areas, land has significant cultural value. Thus, borrowers are often reluctant to mortgage their land while borrowing loans and often use it only as the last resort.
6. **Tedious documentation process-** Since recording practices of land transactions vary across states, with each state mandating the documentation of different details,¹¹ lenders find it difficult to prescribe standard guidelines for lending against land.

⁹ Indira Gandhi Institute of Development Research, Mumbai (2019)- Land as collateral in India

¹⁰ Indian Institute of Management (Bengaluru) (2016)- Distortions in Land Markets and Their Implications for Credit Generation in India

¹¹ Terra Economics and Analytics Lab (2020)- SVAMITVA Scheme- Challenges and Recommendations

Cleaning and linking title records over the years can help lenders in undertaking due diligence of lands in an efficient manner, reducing the risk associated with lending against land.

Establishing transparent procedures to carry out the valuation of land can ensure that lenders are able to sell the land of the defaulter efficiently and immediately recover losses. Although standardized land titling and computerization of land records are important factors in ensuring greater usage of land as collateral, a study in Andhra Pradesh found that the prevalence of property as security on computerization of the records increased only in urban areas.¹² Thus, apart from efficient documentation practices, the presence of other factors like availability of formal credit, presence of robust financial markets, legal enforceability on recovery of security interest in land and a change in social and institutional perceptions around using land as security are important in unlocking the usage of land and property as collateral.¹³

¹² [World Bank Group \(2010\)- Going Digital : Credit Effects of Land Registry Computerization in India](#)

¹³ [Indira Gandhi Institute of Development Research, Mumbai \(2019\)- Land as collateral in India](#)