DOI:10.26524/jms.2012.36

Reverse mortgage – a tool of protract the economic independence of senior citizen

DR.V.MANICKAVASAGAM[1] AND DR.S.SAHUL HAMEED[2]
[1]Professor and Head, Department of Corporate Secretaryship, Alagappa University, Karaikudi-3
[2]Asst.Professor in Corporate Secretaryship, Bharathidasan Govt.College for Women, Pondicherry-3

Introduction

India, the seventh largest country in size, continues to occupy the second largest populated country after China. The aged population in India (i.e. over 60 years) that stood at 84.7 million (7.5 per cent) in 2005 is expected to rise to 141 million (10.2 per cent) by 2020 and thereafter reach 194 million (13 per cent) in 2030. Even though income levels are going up and poverty declining, it can be reasonably expected that a significant number among the aged population would be in the low income category. The aged population requires additional attention both from the society and from the Government. More funds need to be allocated for pension, health and other social benefits of the aged people, while declining savings of the aged population could pose a threat in meeting such additional expenditure.

It is recognised that senior citizens need a regular cash flow for supplementing their pension/other income. For most senior citizens, the house is often the largest component of their wealth and the secular increase in residential house prices has created considerable ‗home equity' wealth.

Reverse Mortgage Loans

A mortgage is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability

Reverse mortgage is a financial product that allows the senior citizen to unlock the value of their most valuable asset, their home, by mortgaging it to a credit intermediary, thereby, enjoying the use of an assured cash flow during their lifetime while continuing to live in the house for as long as they wish . It is called Reverse-Annuity Mortgage or Home Equity Conversion Mortgage (HECM) The reverse mortgage loan (RML) was introduced in the Indian financial market, by the announcement in the Union Budget for 2007-08.

‗The union Budget 2007-2008 announced that the National Housing Bank would shortly introduce a - novel product for senior citizens, *viz*., a ‗reverse mortgage' under which a senior citizen who is the owner of a house can avail of a monthly stream of income against the mortgage of his/her house, while remaining the owner and occupying the house throughout his/her lifetime, without repayment or servicing of the loan. It assured that regulations would be put in place to allow the creation of mortgage guarantee companies whereby the mortgage can be guaranteed through a three way contract among the borrower, the lender and the guarantor, thereby allowing greater comfort to the lending banks and housing finance companies.

Reverse mortgage provides an opportunity to house owners to avail of a monthly stream of income against the mortgage of his/her house, while remaining the owner and occupying the house throughout his/her lifetime, without repayment or servicing of the loan. Realising the potential benefits, the Union Budget 2007-08 announced the introduction of 'reverse mortgage' by NHB. NHB issued the final operational guidelines for reverse mortgage loans (RMLs) on May 31, 2007. Many banks have already introduced RMLs. For tax purposes it have been clarified that reverse mortgage would not amount to ―transfer‖, and stream of revenue received by the senior citizen would not be income‖.

According to demographic projections, reverse mortgage loan products could be a hit among the metros and also in areas like Kerala, Tamil Nadu, Goa and Chandigarh in India[i] With hardly any old age social security schemes and financial helplines, reverse mortgages have a potential market. Loans are available in the form of reverse mortgage without any income criteria at an age where normal loans are not available. Reverse mortgage for senior citizens is a social assurance post-retirement.

Genesis of RML

Reverse Mortgage in India still at an infancy stage. The reverse mortgage came into existence in the UK during the crash of 1929. Having evolved genetically from the developed countries and mainly the USA, reverse mortgage is a scheme formulated to benefit the senior citizens the most. Although applicable for the younger people also, 'reverse mortgage loan products for senior citizens' is the basic that every bank of financial institution follows.

RML History started in 1980s in USA as ―reverse mortgage‖ known as Home Equity Conversion Mortgage; Providers were Banks and specialist reverse mortgage finance companies; In UK, it is known as ―Equity Release or Home Income Plans‖ mainly provided by Insurance Companies; In Canada, both banks and insurance companies are involved.

In order to provide proper Social Security, Regular flow Income, residential house RML Scheme was introduced for Senior Citizens to face Old Age Dependency which Increases the Longevity and Low Mortality Rising Cost of Good Health Care

Reverse mortgage as a product is fairly new to India. Dewan Housing Finance was the first institution in the country to come up with its reverse mortgage product-Saksham. Since then, most leading lending institutions have come up with their own reverse mortgage products.Some of these are State Bank of India, Punjab National Bank, Bank of Baroda, Central Bank of India, Union Bank of India, LlC Housing Finance, Indian Bank, Andhra Bank, Corporation Bank and Canara Bank.

HOW IT WORKS

In the case of home loan, every EMI payment towards the loan increases the equity in the house and once payoff the loan in full, the equity in the house is 100 per cent. It is vice versa in case of in reverse mortgage, when the home is pledged under reverse mortgage with a lending institution, the equity in the own house decreases with every disbursal that the lending institution makes to the borrower.

In a typical mortgage, the money borrowed in lump-sum right at the beginning of the purchase or construction of the house. The repayment of borrowed money towards the home loan with interest will be made over a period of time by Equated Monthly Installments (EMIs).

In reverse mortgage, the owners of the home pledge their home with bank in which no outstanding loan against it. The bank in turn gives a lump sum or a series of cash-flows for a fixed tenure. These can be considered as reverse EMIs. Simply put, any senior citizen, opting for reverse mortgage will get annuity (the reverse EMI) from the bank for 15 years. After that, the annuity payments stop. However, they can continue to live in the house. The maximum tenure is 15 years or The owner of the house and his/her spouse can continue to live in the house till their death – which can occur later than the tenure of the reverse mortgage

TABLE

Age of an Senior Citizen Borrower	65 years
Value of House Property Assessed:	Rs 40 Lacs
Eligible of Period of loan	15Years -180 months
Eligible Amount of Loan --*40% of Market Value Reverse Mortgage Loan:*	Rs. 16 Lacs
Mode of payment :	Rs. 8,000 every month
Rate of Interest: (Fixed or Floating)	10 % pa
Total Principal amount received in 15 years	Rs. 14.40 Lacs
Gross Interest on Rs. 14.40 Lacs – compounded annually	Rs. 21.38 Lacs
Total amount due to Bank:	Rs. 35.78 Lacs

Note- Reverse mortgage is a fixed interest discounted product in reverse. It does not take into account the changes in interest rates as yet.

From the above it is clear that the total amount due at the end of 15th year is 35.78 Lacs and it is assumed that No effect of changes in value of property during pendency of the loan (15 years)

If RML borrower dies at the end of 15 years, bank sells house property, realises the dues and releases the balance, if any, to legal heirs If Legal Heirs want to retain the property, entire dues of Rs. 35.78 Lacs may be paid to the bank and complete legal formalities. When the market value of the mortgaged property is taken as 50 lac. at the end of the loan period. The banker will realize it and the balance may be given to the legal hairs or to the borrower.

REVERSE MORTGAGE LOAN - ESSENTIALS

The scheme of reverse mortgage has been introduced recently for the benefit of senior citizens owning a house but having inadequate income to meet their needs. Some important features of reverse mortgage are:

- A homeowner who is above 60 years of age is eligible for reverse mortgage loan. It allows him to turn the equity in his home into one lump sum or periodic payments mutually agreed by the borrower and the banker.
- The property should be clear from encumbrances and should have clear title of the borrower.
- No Repayment is required as long as the borrower lives, Borrower should pay all taxes relating to the house and maintain the property as his primary residence.
- The amount of loan is based on several factors: borrower‗s age, value of the property, current interest rates and the specific plan chosen. Generally speaking, the higher the age, higher the value of the home, the more money is available.
- The valuation of the residential property is done at periodic intervals and it shall be clearly specified to the borrowers upfront. The banks shall have the option to revise the periodic / lump sum amount at such frequency or intervals based on revaluation of property.
- Married couples will be eligible as joint borrowers for financial assistance. In such a case, the age criteria for the couple would be at the discretion of the lending institution, subject to at least one of them being above 60 years of age.
- The loan shall become due and payable only when the last surviving borrower dies or would like to sell the home, or permanently moves out.
- On death of the home owner, the legal heirs have the choice of keeping or selling the house. If they decide to sell the house, the proceeds of the sale would be used to repay the mortgage, with the remainder going to the heirs.

- As per the scheme formulated by National Housing Bank (NHB), the maximum period of the loan period is 15 years. The residual life of the property should be at least 20 years. Where the borrower lives longer than 15 years, periodic payments will not be made by lender. However, the borrower can continue to occupy.
- From time to time, the value of the property is re-visited by both parties. If the valuation has increased, the applicants are given the option of increasing the quantum of the loan, and should they do so, are given the incremental amount in lump-sum
- From FY 2008-09, the lump sum amount or periodic payments received on reverse mortgage loan will not attract income tax or capital gains tax.

RMLs provide an opportunity to house owners to avail of a monthly stream of income against the mortgage of their house, while remaining the owner and occupying the house throughout their lifetimes, without repayment or servicing of the loan. Realising the potential benefits, the Union Budget for 2007-08 announced the proposed introduction of RMLs in India by the NHB. The NHB issued the final operational guidelines for RMLs on May 31, 2007.

Various public and private sector banks are currently offering RML in Indian markets. Typically, banks in India charge interest on the RML in the range of 10-12 per cent per annum. The loan (including the interest cost) to value ratio varies from 60-90 per cent and the maximum tenure of the loan ranges from 15-20 years. Thus, in the Indian context, if the borrower outlives the loan tenure, he can continue to stay in the house but he will no longer be eligible for any payments from the lender. Internationally, however, the period of such payments is not for a specified number of years, but for the remaining life time of the owner of the property (and his/her spouse), and therefore, reverse mortgage effectively is a life annuity in other countries.

The Benefits of a Reverse Mortgage include:

Since, the bulk of the savings for the average Indian are typically locked away in a house or other property at the time of retirement, and in case of requirement it cannot be encashed except by selling the home or moving out. This is where reverse mortgage comes as an answer.

- Tax-free funds for as long as you live in your home
- No loan repayment for as long as you live in your home
- No income, medical or credit requirements
- Retain ownership of your home for life; this is guaranteed as long as you maintain your home, and pay insurance and real estate taxes
- Choose a cash flow plan tailored to your needs
- No restrictions on how you may use the funds
- A tax-advantaged way to pass on part of your estate today Funds from a reverse mortgage are tax-free; it‘s not an additional income.
- Even seniors with an outstanding first mortgage or some other debt on their home may qualify for a reverse mortgage. The proceeds of the reverse mortgage may be used to pay off such debts.

Tax benefits on reverse mortgage.

An arrangement in which a homeowner borrows against the equity in his/her home and receives regular monthly tax-free payments from the lender. Under income tax Act any amount received by an individual as a loan, either in lump-sum or in installment in a transaction of reverse mortgage referred in xvi of section 47 which is not regarded as transfer hence any gain arising from such transactions is also not taxable under the head capital gains. Reverse mortgage loan received either in lump sum or in installments is a capital receipt and shall be exempted U/S10(43)

Constrains and drawback of RML

Which 60-year-old couple would wish to put themselves in a position to have to redeem the principal plus interest amount when they are 75 or more, at which age they are unlikely to have the stamina to sell out and move to a new home, which would inevitably be their only option Inadequate clarity and inappropriate terms have led the reverse mortgage loan facility in India to have limited takers.

Recent reports seem to indicate that a very small percentage of senior citizens only seem to have taken advantage of the facility since its inception. This could be perhaps a better awareness had not been created about the product. Secondly, the Indian banking industry caps the available loan amount at Rs. 50 L, instead of providing for an equitable percentage of the property‘s value, and limits the loan period to a tenure of 15 years.

The product is still evolving and may take on new dimensions depending on how the banks wish to present its consumer appeal.The borrowers have to maintain the home in good condition and are responsible for repairs, insurance and property taxes, etc.

The Indians sentiments and value are lacuna to RML It is possible that most Indians will not sell the family home, and would prefer passing it on to the next generation, even if they have to live in relative penury during their waning years because of the small income. However, many Indian traditions and values have to be changed on RML by proper propaganda of the RML.

One of the conditions laid by the banks is that the home must be debt-free to qualify for a reverse mortgage. It is incorrect on the part of the needy borrower.

Recommendations

As The reverse mortgage an important financial option for senior homeowners, educating consumers and lenders about the varied applications of this type of loan and its importance

Due to the cumbersome and hidden procedure, the reverse mortgage has not reached the senior citizen with its original object that to offer social security. The banks should assure fair, ethical, and respectful practices in reverse mortgage. This creates confidence and hope to make use of reverse mortgages as a real scheme to the seniors.

Originally the reverse mortgage helps people to address their retirement needs. But the most common fear of the borrowers due to misconception is that in a reverse mortgage the bank gives some money and then takes the house. To Counterfeit this fear banks should create awareness among the seniors.

Conclusion

21 Demographic Trends In 2030, 9% of India‘s population, or nearly 130 million people, will be over 65 years of age. The population over 60 years of age will approach 200 million in that period By 2030, 237 million people, or 16% of China‘s population will be over 65 years of age The vast numbers of elderly adds a human dimension and imposes a significant responsibility on the part of those who are involved in managing retirement funds and systems How Asia addresses the challenge will largely determine how the world will cope with ageing Implications for India.

The product is still evolving and may take on new dimensions depending on how the banks wish to present its consumer appeal.

So while the reverse mortgage idea may not take off in India as it has in the West, where social and parent-child behaviour usually dictates that the old folk live off their very last penny before they die, there are sufficient demographic and psychographic data to indicate that in India there are takers in the millions who, for one reason or another, are likely candidates for the reverse mortgage idea.In any event, the proposal should be given the opportunity to fail for the right reasons. And that means it should be packaged and marketed in a way that makes sense to the likely customer.

Taking the usual mortgage loans in lieu of your home as a security will not be feasible in the age above 50 as the repayment of the loan is not feasible. The Banks and Financial Institutions also won't be of any help in case of no income source. This is where the house property proves as an asset and brings in reverse mortgage that allows you to be the home owner as long as you live. Home ownership is an area most Indians are sensitive about and reverse mortgage entitles you your house throughout your remaining life. The reverse mortgage pros and cons should be measured carefully before subscribing to it.

References

[1]. www.thehindubusinessline.com;
[2]. www.nhb.org.in;
[3]. www.domain-b.com;
[4]. www.google.com;
[5]. www.rediff.com
[6]. www.reverse.org;
[7]. www.investorwords.com
[8]. www.reversemortgage.org
[9]. www.apnaloan.com
[10]. www.iloveindia.com/real-estate/reverse-mortgage.html
[11]. www.financialexpress.com
[12]. www.tapmi.org/paper1/rr.rtf

*****

[i] Http://Www.Indiahousing.Com/Banks-In-India/