

**REVERSE MORTGAGE IN INDIAN BANKS – A STUDY****Sandhya Rani Dasari**

*MBA, Department of Commerce and Business Management, University College of Commerce and Business Management (UCCBM), Kakatiya University, Warangal – 506009, T.S, India.*

**Abstract**

*Reverse mortgage an agreement by which a home owner borrows against the equity in his home and receives regular tax free payments from the lender. Here equity is the value of the property over and above any mortgage or other liabilities relating to it. Thus, reverse mortgage is a contract between a homeowner and a financier which enables the homeowner to receive a stream of income, especially in retirement, from the future realizable value of the home. With the growth of the ageing population, old age security has become one of the prime concerns for the Indian government. All the measures are good for people who are into their working life and thus can save for their retirement now. But one of the segments which have been left is the one who are in their retirement phase and who may not have enough cash to sustain their life. They are called senior citizens. These people may not have enough income or saving in cash but may have assets which may not be providing income. To overcome this problem, some of the public sector banks and one private housing finance company have already come up with their products and the reverse mortgage market in India started growing. The objective of this paper is to provide an overview of the reverse mortgage market in Indian Banks and how it is relevant for Indian market today.*

**Keywords:** *Reverse Mortgage, Senior Citizens and Indian Banks.*



*Scholarly Research Journal's* is licensed Based on a work at [www.srjis.com](http://www.srjis.com)

**Introduction:**

With the growth of the ageing population, old age security has become one of the prime concerns for the Indian government. All the measures are good for people who are into their working life and thus can save for their retirement now. But one of the segments which have been left is the one who are in their retirement phase and who may not have enough cash to sustain their life. They are called senior citizens. Pension by Central and State Governments are not enough to sustain them. These people may not have enough income or saving in cash but may have assets which may not be providing income. To overcome this problem, The National Housing Bank, apex body on housing finance in India, came out with its guidelines on reverse mortgage in early 2007. Some of the public sector banks and one private housing

finance company have already come up with their products and the reverse mortgage market in India started growing.

### **Reverse Mortgage:**

Reverse mortgage can be defined as "an agreement by which a home owner borrows against the equity in his home and receives regular tax free payments from the lender." Here equity is the value of the property over and above any mortgage or other liabilities relating to it. Thus, reverse mortgage is a contract between a homeowner and a financier which enables the homeowner to receive a stream of income, especially in retirement, from the future realizable value of the home. A simple definition of reverse mortgage can be "A reverse mortgage is a loan available to seniors and is used to release the home equity in the property as one lump sum or multiple payments. The homeowner's obligation to repay the loan is deferred until the owner dies, the home is sold, or the owner leaves (e.g., into aged care)". The analysis of definition provides some basic features of reverse mortgage products. These are

- The loan is available only to senior citizens owning a home
- The loan can be in the form of Lump-sum or multiple payments like annuity etc
- Homeowner does not have obligation to repay the loan till the house is his prime residence
- The payback is done once the owner dies or leaves the house. This is done through selling the house and recovering the loan through its proceeds.

Thus, a home owner going for reverse mortgage may take his payment in the following form.

- A lump sum at the beginning (can be used for home improvement health expenses etc)
- Monthly payments till a fixed term
- Monthly payments as a life-long annuity
- Establishing a credit-line with or without accrual of interest on credit balance
- A combination of the above

The various considerations which needs to be taken while pricing a product of this nature are

1. **Age of the borrower**-If it is a joint borrowing then the age of the younger borrower is considered.
2. **Value of the property**- Then value of the property plays a major role in determining the price for an RM product
3. **Expected Interest Rate**- As the product resembles the normal annuity product in some sense, the current and expected interest also plays a major role in pricing the product

### **Significance of Reverse Mortgage Market for India:**

The society in India has under-gone huge changes in last 4-5 decades. Nuclear family has replaced the joint family system. The system of family supporting the older people has gone. As mentioned earlier the public pension system has not been able to provide an alternate support to old people. This condition leaves the older people in jeopardy. They face following issues

- Outliving their retirement income
- Depending on their children to help pay expenses
- Getting sick and having no way to pay the expenses
- Not being able to guarantee an income for their spouse after they are gone
- Being able to live as long as they like in their own home

Looking at the current situation, the needs for a product which can help these people to solve some of these problems is always a welcome step. Reverse mortgage or equity release products tries to answer all these problems. Every Indian, irrespective of its income level tries to build a home for himself during his working life. Reverse mortgage will give him/her an opportunity to generate income from that very home. As the ownership remains with the borrower, he can transfer the home to his successors also if the later agrees to pay the loan amount. Such a product relieves the pressure on government also to provide old age security and thus government also needs to support such initiative. Many economies have been benefited from this arrangement and the market for such products has increase quite a lot in these markets.

### **Reverse mortgage, forward security:**

Reverse mortgage derives its awesome power from its ability to motivate people to build or buy their homes and, thereby, save for their retirement voluntarily. Reverse mortgage serves two significant purposes; it spurs economic activity and provides economic security. From such a perspective, it would be rational to assert that reverse mortgage and India are made for each other. Reverse mortgage is a financial contract between a homeowner and a financier. This contract enables the homeowner to receive a stream of income, especially in retirement, from the future realizable value of the home. The principle of reverse mortgage can be applied to any asset, but its most utilitarian application is in the context of homes and retirement.

The case for reverse mortgage has been made at the right time. Its relevance to India has been enhanced significantly by three proposals included in the recent Budget. The

proposals pertain to the tax treatment of savings up to Rs 1,00,000, continued deductibility of interest expenses on home loans and the legal framework for the issuance of mortgage-backed securities. Households will create more housing assets in the future. The incremental investment could be over Rs 29,000 crore each year. This estimate is based on the distribution of household incomes published by the Business Intelligence Unit (BIU). Reverse mortgages will accelerate the investment in housing assets. Therefore, the aggregate impact on investment in housing assets could be as high as Rs 1, 05,000 crore each year. There is bankable evidence from the BIU that housing explains 83.24 per cent of incomes. Trade explains the most: 85.95 per cent of incomes. If the contribution of housing to trade is reckoned with, housing is the foremost driver of the economy. Reverse mortgages will take the economy forward.

### **Funding old age:**

Old age impairs the capability of people to earn enough to pay for their needs. When needs pertinent to health care remain unfulfilled, further debilitation follows. To break this vicious cycle, governments of developed economies have funded many of the risks and costs of ageing of almost all their citizens. Social security is universal. Developed economies have shifted the burden of paying for pensions to those in employment. This has not been a problem as long as the developed economies and their workforces kept growing steadily. Moreover, people over 65 years of age have accounted for less than 3 per cent of the developed world's population throughout recorded time. But this has changed alarmingly as a result of higher standards of living, better access to health care and higher life expectancy. People above 65 years now constitute about 15 per cent of the developed economies. By contrast, social security is for the elite in the developing and least developed economies. Governments have focused their energies solely on funding the pensions of their employees. But as standards of living and life expectancy rise, old age will become financially riskier in the third world too.

### **Betting on the bankable**

India is a young country. The average age of its citizens is about 26. Moreover, its population is expected to grow at 1.6 per cent annually. The proportion of the working-age population will rise for a long time and remain at a high plateau for a longer time. Therefore, India's economy would continue to grow at over 6.5 per cent at least until 2040. The demand for housing, as a result, will remain high. The capital value of seasoned housing stock will rise at least as fast as incomes. Insurance companies would not have to dread any decline in

home values for the next 35 years. This also means that those who are 60 now will enjoy rising incomes or very certain incomes until they are 95.

Homeowners in reverse mortgages will be protected against inflation. When capital value adjusts to inflation, incomes too can be adjusted upwards. Goods and services will remain affordable to retirees. Reverse mortgage is made for India. It is a bankable scheme that takes away the sting from defined-contribution pension plans. Defined-contribution schemes impose two risks on savers. They may earn insufficient returns. Retirees may live unexpectedly long. At the same time, reverse mortgage is a good bet. It retains the principal flavour of a defined-benefit scheme. It provides a guaranteed base income.

**Present status of reverse mortgage in India:**

The market for reverse mortgage could be around Rs. 5,000 crores in India at present. In case of a mortgage loan the borrower gets a lump sum amount and earns by investing the same in business etc. and repays the same in monthly installments or as per the agreed terms. In reverse mortgage the borrower receives the money in monthly installments and the dues are recovered from the sale proceeds of the property after the death of last surviving spouse. It can also be repaid by the heirs who are interested in retaining the property. Reverse mortgages are aptly so called because instead of paying the monthly loan installments, the borrower actually receives money from the lender in monthly installments.

All over the world, one of the chief concerns of the elderly is that they will outlive their savings. Seniors in India are no exception. A lack of sufficient income can affect their retired life substantially, unless their children take on the responsibility of supporting them, fully or partly. Although old values still prevail in India and children do support the parents in many instances, this is fast changing in a system where nuclear families are becoming the order of the day. Improved health care and better nutrition have been primarily responsible for increased life expectancy. Today, those who cross the age of 60 are expected to live till 75 and will increase to around 80 by 2020.

According to the 1991 census reports, India has an estimated 314 million workers, of which a mere 11 % are covered by the formal pension system. For the majority, personal savings are their only source of retirement income. Though the Indian population is still comparatively 'young', India is also 'ageing'. Some demographic projections for India indicate that the number of elderly (>60 yrs) will increase to 113 million by 2016, 179 million by 2026, and 218 million by 2030.

Their share in the total population is projected to be 8.9 % by 2016 and 13.3% by 2026. The dependency ratio is projected to rise from 15% as of now to about 40% in the next four decades. In Tamil Nadu and Kerala >60 yrs old will reach about 15% of the total population of their states by 2020 itself against 2046 for India. Most retirees, especially from the middle class in India are unlikely to have big savings, they are often called "asset-rich, but income-poor" at retirement, meaning that they are by no means penniless, but that their wealth is tied up in their homes and they do not have enough liquidity to meet their daily needs. Reverse mortgage is a way to borrow against one's house to create a regular stream of income while continuing to live in that house.

**Reverse mortgage scheme to the rescue of senior citizens:**

For elderly people, the houses they live in are often their only or main source of wealth. CNBC-TV18 reports on National Housing Bank's plan, which enables senior citizens to live it up without losing their roof. For the elderly, a house is a prized possession, a tangible expression of accumulated savings that have appreciated over time. But because it is also a home, the value of a house is just so much money in a mattress. If their pension or liquid savings are not big enough, they cannot live it up. Such people can be said to typically face a cash flow problem. For them, National Housing Bank has come up with a reverse mortgage option, which allows them to pledge the house and get a dollop of money, monthly or in one go.

"One can opt for lump sum payment; he can have it monthly or on a committed line of credit and would be able to use it whenever needed. And when he dies or permanently leaves the house, the house will be sold by the bank to draw the value of loan and interest. The excess will be returned to the heir of the senior citizen" says S Sridhar, CMD, National Housing Bank. The facility will be made available by banks to people aged 62 years and above. National Housing Bank will do the re-financing. The loan will be for up to 15 years. The value unlocked will be a function of borrower's age and value of the house. The interest will be based on the prevailing rate. National Housing Bank is currently sorting out issues with CBDT that the finance received by senior citizens is treated as a loan and not income. The bank is also trying to build in a mechanism where the loan amount could flow beyond 15 years.

**A model case for reverse mortgage:**

While the rich face no such difficulty and the problem for the poor is entirely of a different dimension, for the middle-class, this is a cause for worry, particularly as they near

retirement. A lack of sufficient income can affect their retired life substantially, unless their children take on the responsibility of supporting them, fully or partly.

Let us consider a hypothetical example of a retired couple living in their own flat (valued at Rs 10 lakh) but not receiving any pension income. Further, let us assume that their requirement towards living expenses is, on an average, Rs 10,000 a month. A 9 per cent return on investment (the rate guaranteed by the Government under the Senior Citizens Saving Scheme) means they should have investments and personal savings exceeding Rs 13 lakh to achieve this monthly return. Considering the host of other important factors, such as inflation and capital expenditures, the investment requirements would only go much higher. Most retirees are unlikely to have such big savings. This situation is not unique to the Indian middle-class, who are often called "asset-rich, but income-poor" at retirement, meaning that they are by no means penniless, but that their wealth is tied up in their homes. For a number of years, policy-makers and retirement specialists in many countries have been analysing various options to generate retirement income from private houses. Reverse mortgage is one such option, which is gaining popularity in the United States and a few other developed nations, but is almost unheard of in India.

Reverse mortgage is a way to borrow against one's house to create a regular stream of income while continuing to live in that house. The difference between a reverse mortgage and a conventional loan, where the house is offered as a collateral security, is that one would still have to make monthly repayments towards a loan. With a reverse mortgage, all that is required is to pay property tax and insurance and maintain the house so that the value is retained. No repayment is required till the owner continues to live in the house and the full amount becomes due only on the death of the last surviving spouse, or when the house is sold, whichever is earlier. Reverse mortgages are so called because instead of paying the monthly housing loan installments, the borrower actually receives money from the lender. How does this work? The amount available is based on several factors, such as the applicant's age, appraised value of the house, projected rate of house price appreciation and the current interest rates. In addition there are other costs involved, which can go up to 5 per cent of the value of the house.

Generally speaking, the higher the age of the retiree, the higher the value of the house, and the more the money is available. Studies in different countries have indicated that based on benchmark scenarios, reverse mortgages are likely to achieve about 50 per cent income replacement ratios. In the earlier example, this would mean that using this option the retiree

can generate approximately Rs 5,000 a month. Taking another approach, if the assessed value of the flat in the above example, eligible for reverse mortgage loan is Rs 8 lakh (assuming 80 per cent of market value), and a monthly payout option is selected, this would yield approximately Rs 5,752 per month starting age 61 (see Table). This is based on the immediate annuity rates, in the absence of reverse mortgage tables.

Age	Monthly Pension (in Rs)	
	For Rs. 1,00,000/-	For Rs. 8,00,000/-
50	587	4696
55	638	5104
61	719	5752
65	794	6352

This amount is paid every month till life. On the death of the last surviving spouse, the loan amount (principal and interest) needs to be repaid to the lender. The bank/financial institution can sell the house; take what is owed and pay the excess, if any, to the heirs. In the rare case when the value of the property does drop below the amount owed on the reverse mortgage, the lender must absorb the loss. The heirs, however, have the option to pay off the bank directly and keep the house themselves. In the above example, (assuming payments are made for 15 years), amount to be repaid would be approximately Rs 17.38 lakh — Rs 10.35 lakh towards principal and Rs 7.03 lakh towards interest thereon (assuming an interest rate of 9 per cent).

Considering the present trend in real estate appreciation, it would not be unrealistic to presume that property values will double in 15 years, even in non-metropolitan locations. If this trend continues, it is very likely that even after repaying the mortgage amount there would be still be something left for the heirs. It would be a profitable proposition for the lenders too since they would be able to get their expected return on capital invested. Why is there no such product in the Indian market? In many ways, reverse mortgage is an unconventional retirement tool. Even in countries where it has been around for quite a while, acceptance has been very cautious.

In India, the housing finance market is booming and, therefore, financial institutions do not see the need to launch innovative products. Also there are other issues such as pricing which can be extremely complex as it involves a number of uncertainties, such as future value of houses, life expectancy, and interest rate risks. On the borrower's side the biggest challenge would be balancing the need for supplementing retirement income and the desire and wish to bequeath homes to children. Compounded with the natural reluctance of many



seniors, who have worked a lifetime to pay off a housing loan to go back into debt, irrespective of the merits of the scheme, the psychological acceptance of this concept in itself would, no doubt, be difficult. Nevertheless, there are a number of advantages that could act as incentives. Chief among them are:

- Reverse mortgage can supplement retirement income. Particularly when there is a shortage of monthly income, this equity reduction may be preferable to a reduction in the standard of living.
- Also with the burgeoning real estate market in India there is a good possibility of the value of the house appreciating more rapidly than the mortgage loan increasing. In such a scenario, there could be some equity left over for heirs.
- There is no upper age limit for getting the benefit of the reverse mortgage facility. On the contrary, the older one is, the easier it would be to get the loan.

From the retirees' perspective, this is a good option, particularly if they are comfortable during the initial years of retirement, and may wish to opt for this in their latter years, when their savings have dwindled or are inadequate to cater to their needs on account of increased cost of living due to inflation. For the lender, it is definitely more profitable to offer mortgages to older people due to reduced life expectancy.

- It is a non-recourse loan, which means the bank/financial institution can never come after any person or estate for repayment of the loan. The lender can only receive payment of the loan from the value of the home.
- At the macro level, implementation of reverse mortgage schemes could reduce the burden on the Government and employers who are paying pensions, whether in the public or in the private sector, and would thus be an indirect measure to bring in pension reforms.

With the changing social milieu in India and the collapse of the joint family system, introduction of reverse mortgage products could be a worthwhile experiment. Instead of being dependent on their children for monetary support this would be a good option for the elderly to continue with a graceful lifestyle.

### **Conclusion:**

As at present, India is poised for a strong economic growth, we should not miss any avenue to accelerate or support the growth momentum. Home equity/ Reverse Mortgage products are such products that have the potential of not only increasing the liquidity in the economy but also diversifying many risks. The case for reverse mortgage has been made at

the right time. Its relevance to India has been enhanced significantly by three proposals included in the recent Budget. The proposals pertain to the tax treatment of savings up to Rs 1,00,000 continued deductibility of interest expenses on home loans and the legal framework for the issuance of mortgage-backed securities. Households will create more housing assets in the future. The incremental investment could be over Rs 29,000 crore each year.

### **References**

- Ginnie Mae HECM MBS Are the Latest Reverse Mortgage Innovation- Asset Securitization Report* November 2007
- INRnews Correspondent* (2007), "National Housing Bank guidelines for reverse mortgage loans", *INRnews - Indian Real Estate & Property News, Mumbai, India, August 17, 2007.*
- Joseph Samson* (2007), "Reverse Mortgage in India: Your property pays you a regular income", *Rupee Times, News & Advice, [www.rupeetimes.com](http://www.rupeetimes.com)*
- Praveen Kumar* (2007), "Reverse Mortgage", *News Letter, Indian Bank Management Academy for Growth & Excellence, – Issue – 25, May 2007.*
- PricewaterhouseCoopers* (2008), "The Mortgage Industry & Emerging Markets", 2008 MBAA Servicing Conference, New Orleans, February 27, 2008.
- Singhal, Saket & Jain, Amit* (2008), "Reverse Mortgage- Growing Market in India" 10th Global Conference of Actuaries, Institute of Actuaries of India, PP – 187-193
- Subasri Sitaraman* (2005), "The case for reverse mortgage", *Business Line, Financial Daily from THE HINDU group of publications, Tuesday, Mar 15, 2005*