
REVERSE MORTGAGE

Introduction:

Senior Citizens are an increasing component of the Indian society and dependency in old age is increasing in the country. While on the one hand, there are persons who start savings at the age of 20- or 30- something and make a comfortable nest egg by the time they retire, there are others who realize on the eve of their retirement that their retirement funds are just a pittance. Their options are tragically limited - sell house and live off that money in a smaller house, or give house to the child and live with him/her.

Most people are unwilling to consider the first option, as a house is an asset that is acquired for generations to enjoy. And living with children is not something most modern-day retirees want to do, as it means compromising on their independence. So what can the elderly in India do to fund their retirement years?

The answer can be found in the West, specifically in the US, where the concept of reverse mortgage is hugely popular among the newly retired. Essentially, a reverse mortgage is a loan against your home that you do not have to pay back for as long as you live in that house.

The reverse mortgage facility allows senior citizens to unlock the value of their most valuable asset, their home, by mortgaging it and enjoying the use of the money in their lifetime while continuing to live in it until their deaths. The senior citizens in India will definitely find reverse mortgage a solution for their financial needs after retirement and help them in regaining their feeling of independence.

The Concept:

In your working life, when you buy a house on loan, with every equated monthly installment that you pay, your equity in the house increases. When you pay up your entire loan, your equity in your house is 100 per cent. In reverse mortgage, you do the opposite.

The concept of reverse mortgage seeks to enable house-owning senior citizens to meet their expenses without selling their house.

Reverse mortgage is so named because the payment stream is reversed, that is instead of the borrower making monthly payments to the lender (as in a conventional mortgage), a lender makes payments to the borrower.

Under the Reverse Mortgage, citizens aged 60 years and above will be able to pledge their house and derive an income -- monthly or a lump sum -- for 15 years while living in it. If you go for the lump sum amount, you can deposit it in a bank, withdraw from your account according to your requirements and keep earning interest on the balance.

What is Reverse Mortgage?

A Reverse mortgage (or Lifetime mortgage) is a loan available to seniors, and is used to release the home equity (interest) in the house 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). A reverse mortgage is analogous to an annuity where the principal and interest are paid with homeowner's equity.

In terms of financial jargon the definition of 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.

Difference b/n Reverse Mortgage & Conventional Mortgage:

Conventional Mortgage	Reverse Mortgage
All persons are eligible.	Only Individuals, who are above 60 years of age are eligible.
Any immovable property can be offered as security for obtaining mortgage loan.	Only Residential House Property in which the borrower <i>permanently</i> resides can be offered as security. The lender shall have no recourse to any other property of the borrower except his permanent residence.
Borrower begins with a large loan and lower equity in his house.	Borrower has a very high equity in his house and a <i>non-recourse</i> loan secured by the home property.
The Borrower makes monthly amortised payments to the lender.	The Borrower makes no payments to the lender during his life time. Instead, the lender makes payment, either in lump sum or in installments, to the borrower. All Interest is added to the lien on the property.
As the regular mortgage payments are made the outstanding loan decreases and the house equity increases.	The loan amount increases with time and the home equity decreases with time.
The tenor of the mortgage will be mutually agreed.	The tenor of the mortgage shall be 15 years (maximum) or the remaining life of the borrower(s), whichever is lower.
The entire loan is repaid in full at the end of the tenor of the loan and the property is released by the lender.	The loan shall be realized on the death of the borrower(s) by any of the following modes: ▪ sale of the residential house property by the lender; or ▪ Repayment of the loan amount along with interest by the legal heirs of the borrower(s).

How does it work?

Suppose the value of your house is assessed at Rs 40 lakhs and you are 65 years of age. Under the present recommendations, you will be eligible to get a loan for 15 years that is till you turn 80 years of age.

Supposing you are eligible to unlock 60 per cent of the value of the house, then you can receive Rs 24 lakhs through reverse mortgage. And supposing you are eligible to receive Rs 8,000 every month, you will receive Rs 96,000 every year for the next 15 years, assuming that changes in the value of the property do not affect the payments to you.

At the end of 15 years you would have received a total of Rs 14.40 lakhs. The interest component (compounded annually) on this amount, will be Rs 21.38 lakhs.

So the total amount that you owe to the bank will be Rs 35.78 lakhs. However, if you die at end of the loan tenure, then the bank will sell the property to realise what you owe them, that is Rs 35.78 lakhs, the balance will be passed on to your heirs. However, if your heirs want to keep the property, they can settle the amount that you owe to the bank and keep the property.

Who are eligible to extend Reverse Mortgage Loan Facility?

Reverse Mortgage Loans (abbreviated as RMLs) are to be extended by Primary Lending Institutions (PLIs) viz. Scheduled Banks and Housing Finance Companies (HFCs) registered with National Housing Bank (NHB) or any other class of institutions as may be notified by Government of India.

Who is eligible for a reverse mortgage?

- Should be Senior Citizen of India above 60 years of age.
- 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 PLI, subject to at least one of them being above 60 years of age and the other not below 55 years of age.
- Should be the owner of a self- acquired, self occupied residential property (house or flat) located in India, with clear title indicating the prospective borrower's ownership of the property.
- The residential property should be free from any encumbrances.
- The residual life of the property should be at least 20 years.

- The prospective borrowers should use that residential property as **permanent primary residence**. Permanent primary residence refers to the self acquired, self occupied residential property where a person spends majority of his time.
- The PLIs would ensure that the equity of the borrower in the residential property (Equity to Value Ratio - EVR) does not at any time during the tenor of the loan fall below 10%
- The PLIs will need to re-value the property mortgaged to them at intervals that may be fixed by the PLI depending upon the location of the property, its physical state etc. Such revaluation may be done at least once every five years; the quantum of loan may undergo revisions based on such re-valuation of property at the discretion of the lender.
- If the valuation has increased, the applicants are given the option of increasing the quantum of the loan and should they do so, they are given the incremental amount in lump-sum. If they have opted for the monthly payment scheme, this amount is appropriately increased.

What are the guidelines and restrictions regarding RML disbursements?

- The payment of RML can be made by any or a combination of the following:
 - Periodic payments (monthly, quarterly, half-yearly, annual) to be decided mutually between the PLI and the borrower upfront; or
 - Lump-sum payments in one or more tranches; or
 - Committed Line of Credit, with an availability period agreed upon mutually, to be drawn down by the borrower.
- The maximum monthly payments shall be capped at Rs. 50,000/- or such other amount as may be notified by the Government of India.
- Lump-sum payments may be conditional and limited to medical exigencies.
- The maximum *lump-sum payment* shall be restricted to 50% of the total eligible amount of loan subject to a cap of Rs. 15 lakh or such other amount as may be notified by the Government of India, to be used for medical treatment for self, spouse and dependants, if any. The balance loan amount would be eligible for periodic payments.
- The PLI will pay all loan proceeds directly to the borrower, except in cases pertaining to retirement of existing debt, payments to contractor(s) for the repairs of borrower's property, or payment of property taxes or hazard insurance premiums from the borrower's account set aside for the purpose.

What are the Eligible End uses of the funds?

- The loan amount can be used for the following purposes:
 - Up gradation, renovation and extension of residential property.
 - For uses associated with home improvement, maintenance/insurance of residential property
 - Medical, emergency expenditure for maintenance of family
 - For supplementing pension/other income
 - Repayment of an existing loan taken for the residential property to be mortgaged
 - Meeting any other genuine need
- Use of RML for speculative, trading and business purposes shall not be permitted

What is the maximum period for which the RML facility can be availed ?

The maximum loan disbursement tenure should not exceed 15 years.

What if you outlive the loan tenure?

If you outlive the tenure of the loan, you will not be asked to move out of the house. Although payments made to you will stop after the loan tenure, the interest will keep accumulating till the accounts are finally settled.

There is talk of adding insurance to reverse mortgage. So the premium for that will be deducted from the payment made to you. The corpus accumulated at the end of the loan tenure will be used to fund the years that you outlive the loan tenure.

There are also suggestions that a certain portion from the payments be parked in bank fixed deposits to fund the years that you outlive the loan. The accounts will be settled by the HFC only after your death or if you vacate the property.

What security should be provided for availing RML facility?

- The RML shall be secured by way of mortgage of residential property, in a suitable form, in favour of PLI.
- Commercial property will not be eligible for RML.

How will the house be valued by the bank/ housing finance company?

- The residential property should comply with the local residential land-use and building bye laws stipulated by local authorities, with duly approved lay-out and building plans.

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- The PLI shall determine the Market Value of the residential property through their external approved valuer(s). In-house professional valuers may also be used subject to adequate disclosure of the methodology.

What are the other covenants subject to which the RML facility will be extended?

- The borrower(s) will continue to use the residential property as his/her/their primary residence till he/she/they is/are alive, or permanently move out of the property, or cease to use the property as permanent primary residence.
- Non Recourse Guarantee: The PLIs shall ensure that all RML products carry a clear & transparent 'no negative equity' or 'non recourse guarantee'. That is, the Borrower(s) will never owe more than the net realizable value of their property, provided the terms and conditions of the loan have been met.
- The PLI may consider, at its discretion, obtaining a Registered Will from the borrower stating, inter-alia, that he/she has availed of RML from the PLI on security by way of mortgage of the residential property in favour of the PLI, meaning thereby that in the event of death of the borrower (and co-borrower, if any), the mortgagee is entitled to enforce the mortgage and recover the loan from the sale proceeds. The surplus, if any, has to be returned to the heirs of the deceased borrower(s).
- The PLIs may consider, at its discretion, taking an undertaking from the prospective borrower that the "Registered Will" given to the PLI is the last "Will", prepared by him/her at the time of availing of RML facility as per which the property will vest in his/her spouse/beneficiary name after his/her demise. The borrower will also undertake not to make any other 'Will' during the currency of the loan which shall have any adverse impact on the rights created by the borrower in the PLI's favour in respect of the mortgaged property.
- The PLI will ensure that the borrower(s) has insured the property against fire, earthquake, and other calamities.
- The PLI will ensure that borrower(s) pay all taxes, electricity charges, water charges and statutory payments.
- The PLIs will ensure that borrower(s) are maintaining the residential property in good and saleable condition.
- The PLI may reserve the option to pay for insurance premium, taxes or repairs by reducing the homeowner loan advances and using the difference to meet the obligations/expenditures.

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- The PLI reserves the right to inspect the residential property/premises or arrange to have the residential property/premises inspected by its representatives any time before the loan is repaid and borrower(s) shall render his/her/their cooperation in respect of such inspections.

Whether the borrower has the right to rescind the RML facility after the loan transaction is finalized?

- As a customer-friendly gesture and in keeping with international best practices, after the documents have been executed and loan transaction finalized, Senior Citizen borrowers may be given up to **three** business days to cancel the transaction, the "right of rescission".
- If the loan amount has been disbursed, the entire loan amount will need to be repaid by the Senior Citizen borrower within this three day period. Interest for the period may be waived at the discretion of the PLI.

Is the borrower eligible for a reverse mortgage loan if his house is already mortgaged with another institution?

If the property is already mortgaged with another institution, then the bank/ housing finance company that is offering the reverse mortgage may consider allowing you to use part of the amount to prepay/repay the existing housing loan. But the loan amount will be paid directly to the institution to the extent of the loan outstanding with it with a view to release the mortgage

Can the borrower 'will' his mortgaged property?

The loan agreement may include a provision that the borrower shall not make any testamentary disposition of the property to be mortgaged and even if it does so, it would be subject to the mortgage created in favour of the lending institution. In such a case, the borrower shall make a testamentary disposition of the mortgaged property in favour of any of his/her relatives, subject to the discharge of the mortgage debt by such legatee and a statement that the heirs shall not be entitled to challenge the validity of the mortgage as also the right of the mortgagee to enforce the mortgage in the event of death of the borrower unless the legal representative is willing to undertake the responsibility for discharging in full the amount of loan and accrued interest thereof.

What happens if the bank finds the mortgaged property risky after five years and stops further disbursements?

This does not usually happen, but in the rare event of the bank stopping disbursements after a certain period of time, for whatever reason, the borrower need not pay back the amount he has received so far. The bank will recover that money after the borrower and his/her spouse have expired by selling the property. Till then, interest will be charged on the amount paid to the borrower.

What are the Taxation Implications?

Mortgage of property for obtaining a loan under the Reverse Mortgage Scheme is 'transfer' [inclusive definition u/s 2(47)] within the meaning of the Income Tax Act thereby giving rise to capital gains u/s 45. However, **in the context of Reverse mortgage, the intention of mortgage is to secure a stream of cash flows against the mortgage of residential property and not to alienate the property.** Therefore, finance Act 2008 has inserted clause (xvi) in section 47 from the Assessment year 2008-09 which provides that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government shall not be regarded as transfer and therefore shall not attract capital gain tax.

It is well known that the receipt of loan amount, either in lump sum or in installment, is in the nature of capital receipt and, therefore, cannot be taxed as 'Income'. However, with a view to provide certainty in the tax regime to the senior citizen, clause (43) is inserted in section 10 from Assessment year 2008-09 to provide that any amount received by an individual as a loan, either in lump sum or in installment, in a transaction of reverse mortgage will be exempt from income tax.

Consequent to these amendments, a borrower, under a reverse mortgage scheme, will be liable to income tax (in the nature of tax on capital gains) only at the point of alienation of the mortgaged property by the mortgagee for the purposes of recovering the loan.

How the RML will be settled?

- The loan shall become due and payable only when the last surviving borrower dies or would like to sell the home, or *permanently moves*¹ out of the home for aged care to an institution or to relatives.
- Settlement of the outstanding loan amount, along with accumulated interest, is to be met by the proceeds received out of Sale of Residential Property.

¹ "permanent move" may generally mean that neither the borrower nor any other co-borrower has lived in the house continuously for one year or do not intend to live continuously.

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- The borrower(s) or his/her/their heirs/estate shall be provided with the first right to settle the loan along with accumulated interest, without sale of property.
 - The balance surplus (if any) remaining after settlement of the loan with accrued interest shall be passed on to the legal heirs/estate/beneficiaries of the borrower.
 - In case the accumulated interest and loan amount is larger than the value of the mortgaged property, the mortgage loan is capped at the value of the home equity only and the lender is the party at loss.

Can a borrower Pre pay the loan during the tenor?

- In case the borrower has an additional income and accumulates amount to repay the loan, he has the option to prepay the loan at any time during the loan tenor and free his property in mid term and can also apply for re-reverse mortgage if required on the same property.
- There will not be any prepayment levy/penalty/charge for such prepayments.

Can the reverse mortgage be foreclosed? When does that happen?

- Foreclosure of a loan means terminating the contract of giving regular payouts to the borrower by the bank/housing finance institution before the tenure gets over. So, as per the NHB, the loan is liable for foreclosure on occurrence of following events of default:
 - If the borrower has not stayed in the property for a continuous period of one year.
 - If the borrower(s) fail(s) to pay property taxes or maintain and repair the residential property or fail(s) to keep the home insured, the PLI reserves the right to insist on repayment of loan by bringing the residential property to sale and utilizing the sale proceeds to meet the outstanding balance of principal and interest.
 - If borrower(s) declare himself/herself/themselves bankrupt.
 - If the residential property so mortgaged to the PLI is donated or abandoned by the borrower(s).
 - If the borrower(s) effect changes in the residential property that affect the security of the loan for the lender. For example: renting out part or all of the house; adding a new owner to the house's title; changing the house's zoning classification; or creating further encumbrance on the property either by way taking out new debt against the residential property or alienating the interest by way of a gift or will.
 - Due to perpetration of fraud or misrepresentation by the borrower(s).
 - If the government under statutory provisions, seeks to acquiring the residential property for public use.

- If the government condemns the residential property (for example, for health or safety reasons).

Pros & Cons of Reverse Mortgage Facility:

Taking the usual mortgage loans in lieu of your home as a security will not be feasible in the age above 60 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.

With hardly any old age social security schemes and financial help lines, 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. You will not be financially dependent on anyone. The loan that you receive is not serviced during your lifetime.

On the flip side, recent reports seem to indicate that very less people have taken advantage of the facility since its inception, and it is, therefore, likely to be considered a failure. This is unfortunate because the facility simply has not been adequately explained. It was also unattractively packaged.

Conclusion:

The initial ride of the idea is expected to be slow and bumpy. Unlike in the West, joint families are still prevalent in many parts of India, although their number has shrunk. 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.

The extent to which the potential of reverse mortgage gets realised in India will depend a lot on the guidelines that will govern it and how Indian society takes to it. But there is no doubt that it can lend dignity and peace of mind to elders by opening a financial lifeline for them.

In Reverse Mortgage, the period of repayments is '**the remaining life time of the owner (and his/her spouse) of the property.**' Thus by investing in a house through a housing loan and repaying the loan during his working life time, one will not only have a roof over his head throughout his life time, but also secure a joint life pension, that keeps in step with inflation, after retirement. Seen in this perspective, reverse mortgage would motivate people to build or buy their homes and, thereby, save for their retirement voluntarily. Hence reverse mortgage results in a double-whammy: it spurs economic activity and provides economic security.