REVERSE MORTGAGE

We are all aware of the mortgage for the housing loan that we avail of when we buy a house. Reverse mortgage, as the name suggests, is just the opposite. National Housing Bank (NHB) has taken steps to introduce this product in India, though it is quite common in the US. This scheme would provide greater financial security for the elderly, especially those who either prefer or are forced to live independently. This may prove to be a useful scheme in India, where more than 90% of the population does not enjoy any old-age benefits like pension or social security. There are various forms of reverse mortgage available in the developed countries. In UK it is popularly known as "life time mortgage". In US it is available only to 62 and older people). This type of loans have become very popular in advanced countries as it converts an illiquid asset – the house -- into liquid cash flows for the owner, typically a senior citizen. The best part of this loan is that the borrower senior citizens continue to live in that house even after drawing monthly payments. In such loans, the bank bears the risk that the outstanding may exceed the market value of property.

The amount of money available to the senior citizen is determined by number of factors which varies from country to country. Some of the factors which determine such a loan are:-

- The value of the property;
- The condition of the property - whether it will require some major repairs etc.
- Whether there are any existing liens on the house.
- The current interest rate applicable to such loans;
- The age of the house owner who wishes to take loan;
- Whether the payment is taken as line of credit, lump sum, or monthly payments.
- Line of credit will maximize the money available, while lump sum provides the cash immediately, but the interest amount will be high. Monthly payments are set up as a "Tenure" payment. The senior citizen will receive them for the rest of his / her life no matter how long the couple lives.

What is Mortgage?

Mortgage is a transaction where a mortgagor takes a loan from a mortgagee, against an immovable property as security. Land or land with building / house is the security that we generally reckon as immovable properties, while considering a mortgage transaction.

What is a Reverse Mortgage?

It is a novel loan product under which a senior citizen who is the owner of a house can avail of a lump sum amount or a monthly stream of income against the mortgage of his house, while remaining the owner and occupying the house throughout his life time, without repayment or servicing of the loan. The home owner's obligation to repay the loan is deferred until the owner dies, the home is sold, or the owner leaves the house.

Why it is called as "Reverse"?

In a reverse mortgage, the home owner makes no payments and all interest is added to the lien on the property. If the owner receives monthly payments, then the debt on the property increases each month. Reverse mortgages work much like traditional mortgages, but in reverse. Instead of the borrower making a payment to the lender each month, the RM lender pays the borrower. In a typical mortgage, the equity of the borrower in the mortgaged property increases over a period of time. While in a RM, the equity of the borrower in the mortgaged property normally decreases over a period of time. Reverse Mortgage loans are also called "rising debt, falling equity" loans. As the amount you owe (your debt) grows larger, your equity (that is, your home's value minus any debt against it) generally gets smaller.

What are the advantages of a reverse mortgage?

There are many. Here are a few of the most significant:

- Remain independent - a reverse mortgage allows you to remain in your home and retain home ownership.
- No monthly mortgage payments - you need not pay back the reverse mortgage loan nor make any monthly mortgage payments until you permanently move out of the home.
- Tax-free money - because the money you receive from a reverse mortgage is not considered income, it is tax free. (Pending clarification)
- Freedom and flexibility - the money you get from a reverse mortgage is yours to use in any way you choose.

Who is eligible for a RM loan?

You will have to be a Senior Citizen of India above 60 years of age who have retired from active work life. Married couples will be eligible as joint borrowers for financial assistance. One should be the owner of a self- acquired, self occupied residential property (house or flat) located in India. Residential property should be an approved construction, free from any encumbrances and the residual life of the property should be at least 20 years.

How is the appraised value of property calculated?

The PLI shall determine the Market Value of the residential property through their internal or external approved values. PLIs are advised not to reckon expected future increase in property value in determining the amount of RML.

How is the value of loan amount calculated?

The amount of loan will depend on market value of residential property, as assessed by the PLI, age of borrower(s) and prevalent interest rate. As per the NHB guidelines it may vary between 40% (for those at 60 years) to 60% (for those at 75 years) of the Assessed Value of Property. The PLI may consider ensuring that the equity of the borrower in the residential property or Equity to Value Ratio (EVR) does not at any time during the tenor of the loan fall below 10%. The PLIs will need to revalue 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 and the quantum of loan may undergo revisions based on such revaluation of property at the discretion of the lender.

What are the allowed end uses of RML?

The loan amount can be used for renovation, extension, maintenance/insurance of residential property, medical/emergency expenditure for maintenance of family, supplementing pension/other income, repayment of an existing loan taken for the residential property to be mortgaged and also for meeting any other genuine need of the borrower. But use of RML for speculative, trading and business purposes is not permitted.

What about the settlement of RML?

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 of the home for care, to an institution or to relatives. Settlement of loan along with accumulated interest is to be met by the proceeds received out of Sale of Residential Property. However, the borrower(s) or his/her/their estate shall be provided with the first right to settle the loan along with accumulated interest, without sale of property. Two months time may be provided when RML repayment is triggered, for house to be sold. The balance surplus (if any) remaining after settlement of the loan with accrued interest shall be passed on to the borrower or to his estate. The borrower will have the option to prepay the loan at any time during the loan tenor. There will not be any prepayment levy/penalty/charge for such prepayments.

What are the other major clauses of the RML covenant?

The PLIs shall ensure that all reverse mortgage loan products carry a clear and transparent ‘no negative equity’ or ‘non-recourse’ guarantee. That is, the Borrower will never owe more than the net realizable value of their property, provided the terms and conditions of the loan have been met. In addition, the PLI may also consider 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 favor of the PLI. The PLI will also ensure that the borrower has insured the property against fire, earthquake, and other calamities and pay all taxes, electricity charges, water charges and statutory payments.

Can PLIs foreclose the loan?

The loan shall be liable for foreclosure if the borrower fails to meet the terms and conditions of the RML covenant. Instances such as the borrower declaring himself bankrupt, the borrower effect changes in the residential property that affect the security of the loan and the government seeks to acquire the residential property for public use are sufficient reasons for the PLI to trigger foreclosure.

What are the tax implications of RML?

Bank customers want to know whether the monthly RML payments are taxable. Technically they should not be, as the payments are in the nature of a loan, but banks want the IT department to explicitly clarify this point. Another aspect is, whether the interest accrued on this reverse mortgage loan can be treated at par with that of accrued interest in case of a normal housing loan. At present, such interest accrued up to the tune of Rs. 1.5 lakh per year can be deducted from the taxable income. Bankers themselves want clarification on another point. The interest accrued on the monthly payments is booked as income, but banks want to pay tax on it only when they recover the money by selling the house after the borrower dies!

ISSUES:

Lack of awareness, high interest rates and a “mental block” among senior citizens who prefer that their houses are passed on to their children are some of the reasons for the lackluster response.

Under the reverse mortgage scheme, the loan can be given only on self-acquired property. Most property in the country is ancestral and governed by inheritance laws. This could cause legal hurdles for banks to possess the property after the demise of the borrower. Another reason for the scheme not gaining wide acceptance is that the monthly payments are low due to the prevailing high interest rate scenario. You need a very low interest regime for reverse mortgage to succeed. The biggest problem for the scheme in India is from the discounting factor. In order to fix monthly payments, the bank takes into consideration the current value of the house, adds the appreciation and discounts the interest rate. As the interest rates are high, when you do the compounding, the property value becomes half in just six years.

Conclusion

Reverse mortgage is a new product and there are bound to be some teething issues – operational and legal - which need to be sorted out. Not withstanding all these issues, which seem quite challenging, the reverse mortgage is a product, which offers an option to the old people to continue to live with dignity.