Reverse Mortgages in India: New Dimensions in Emerging Horizon

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INTRODUCTION

The senior citizen segment of the Indian population is presently underserved in terms of financial assistance from banks and financial institutions as per their extant conventional retail loan programmes. Further, the absence of social security measures in India render senior citizens helpless in their old age in case if they do not have adequate savings for leading a comfortable life. Reverse mortgage is seen as a partial substitute to address the financial needs of house owning senior citizens.

OBJECTIVE OF THIS PAPER

The main objectives of this paper are:

- To discuss the concept of Reverse Mortgages.
- Highlight cross country experiences regarding the product features.
- Market Potential in India.
- Present the status of reverse mortgages in the Indian context.
- Reverse Mortgage Loan enabled Annuity.
- Discuss major limitations in Indian context and opportunities for the way ahead.

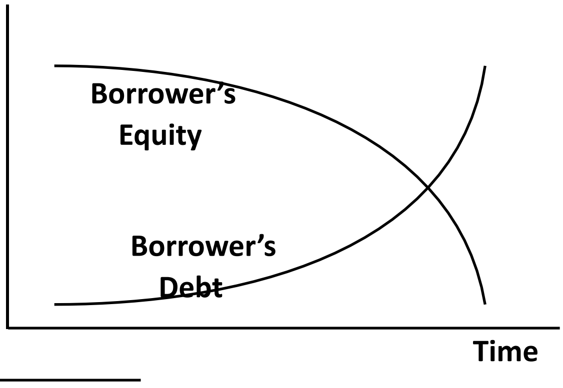
REVERSE MORTGAGES: THE CONCEPT

Conceptually, reverse mortgage is a financial product that seeks to monetize the residential property as an asset and specifically render liquidity to the owner's equity in the property. The product generically involves the senior citizen borrower(s) mortgaging their residential property to a lender, who then makes periodic and/or lump sum payments to the borrower(s) during the latter's lifetime. The senior citizen borrower(s) are not required to service the loan during their lifetime and ,therefore, do not make monthly repayments of principal and interest to the lender. On the borrower's death or on the borrower leaving the house property, the loan is repaid along with accumulated interest, through sale of the house property. The borrower(s) and/or their heir(s) can also repay or prepay the loan with accumulated interest and have the mortgage released without resorting to sale of the property. In the process, the lender will have limited recourse in respect of only the mortgaged residential property.

RISING DEBT AND FALLING EQUITY

A reverse mortgage is just the opposite of a conventional mortgage. While a conventional mortgage loan helps a

Figure 1



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borrower in retaining his home equity and hence in increasing the home value, reverse mortgage loans envisage no such monthly payments and so, the debts go on increasing. The reverse mortgage is so named because the payment stream is “reversed.” Instead of the borrower making monthly payments to a lender (as in a conventional mortgage loan), a lender makes payments to the borrower. In reverse mortgages, there are no monthly payments by borrower to lender and so, the debt of a borrower goes on increasing and the home equity, therefore, reduces to an extremely low value unless the property value keeps increasing. As such, reverse mortgages are known by their nature of "*rising debt and falling equity*".

METHODOLOGY

The basic features of the product in United States of America (USA), Canada, United Kingdom (UK) and Australia was studied based on secondary data collected from the National Housing Bank (NHB), Housing and Urban Development Department (HUD) USA, National Reverse Mortgage Lenders Association (NRMLA), USA, www.uklifetimemortgage.co.uk, www.seniorsfinance.com.au and www.chip.ca.

Table 1: Reverse Mortgage and Conventional Mortgage: Salient Differences

	Conventional Mortgage	Reverse Mortgage
Purpose of loan	To purchase/upgrade a house.	To encash residential asset for consumption
Eligible Borrowers	Creditworthy borrowers .	Senior Citizens with clear title to a house where they reside permanently .
Income Requirement	Loan quantum will depend upon the income level & regularity.	No income required .
At time of Loan Origination	Borrower has no equity in house.	Borrower has substantial equity .
During the loan tenure, the Borrower…	▪ Repays the lender; ▪ Loan balance goes down; ▪ Borrower’s Equity grows .	▪ Receives payments from the lender; ▪ Loan balance rises; ▪ Equity declines
At end of loan, the Borrower…	▪ Borrower owes nothing to lender; ▪ Borrower has substantial equity	▪ Borrower owes substantial amount to lender; ▪ Borrower has much less, little, or no equity
Repayment	Monthly (during loan period)	▪ Sale Proceeds of House Property used to Settle the loan dues, on borrower’s demise or giving up home ▪ Bullet repayment of principal and accumulated interest ▪ Borrower/Heirs have option to prepay or settle loan.

REVERSE MORTGAGE PRODUCT: CROSS COUNTRY EXPERIENCES

The reverse mortgage product is quite popular in USA and UK, and has been gradually gaining acceptance in Australia and Canada. Such a mortgage loan product had been introduced in India only in May 2007.

MARKET POTENTIAL IN INDIA

The population of persons over 60 years of age is 77 million (as per Census of India, 2001), which comprises of nearly 8% of the total population. This figure is projected to increase to 11% by 2021.

In order to test the concept and make a rough estimate of the market for such a product, a study was first conducted in the year 2006 by NHB, India's apex housing finance institution, to test the concept. The study revealed a distinct market for the product albeit limited to certain niches in the senior citizens market.

The survey revealed significant appreciation for the product concept and the following features :

☸ Target market being Senior Citizens.

☸Periodic payments to the borrowers.
☸Repayment of dues only after death or moving out of house.
☸No repayment by borrowercum-house owner during the loan period.

It was concluded that while the senior citizens who live with or are strongly supported by their children/wards may not be strongly in favour of the product, however, those who are childless or have their children staying away and not able/ willing to support their parents and who have inadequate regular earnings to maintain a good standard of life are a potential target segment for the product.

Figure 2 : Graph Showing Potential For Reverse Mortgage In India

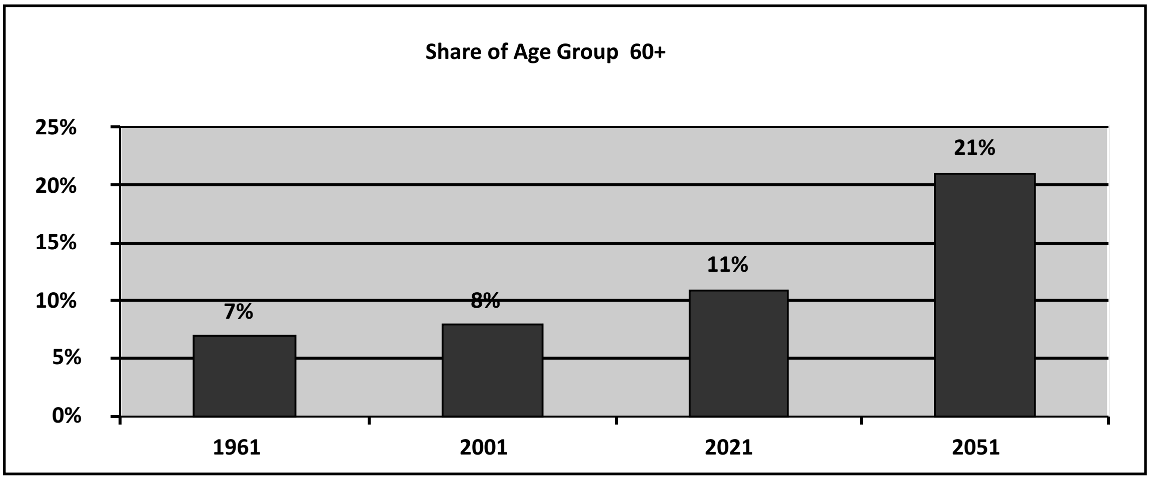


Table 2: Reverse Mortgage : Cross Country Experiences

	USA	Canada	Australia	UK
Maximum Amount of Loan	US$ 362,790	Cd $ 500,000	Aus $ 5,00,000	600,00 Pounds
Minimum Borrower Age	62 years	62 years	60 years	55 years
Maximum Loan as Proportion to Value of Property	40%	40%	50%	50%
Maximum Loan Term (for receipt of loan payments)	Residual Life-time	Residual Life-time	Residual Life-time	Residual Life-time
Interest Margin (over conventional mortgage)	2% to 3%	1% to 2%	1% to 2%	1% to 2%
Security	Mortgage of Residential Property	Mortgage of Residential Property	Mortgage of Residential Property	Mortgage of Residential Property
Source of Funds	Government, Private Sources	Government	Government, Private Sources	Government, Private Sources
Tax Benefits	Tax Exempt (For Periodic Payments)	Tax Exempt (For Periodic Payments)	Tax Exempt (For Periodic Payments)	Tax Exempt (For Periodic Payments)
Prepayment Penalty	Not levied	No levy if prepaid within first 3 years.	No levy if prepaid within first 3 years.	Not levied

THE REVERSE MORTGAGE PRODUCT IN INDIA: STATUS UPDATE

Reverse mortgage loan (RML) product was first introduced for the senior citizens in India during the year 2007. This product is now being implemented by 23 Scheduled Commercial Banks and two Housing Finance Companies (HFCs) having benefitted over 6000 senior citizens throughout the country so far. A novel Reverse Mortgage product variant is now in place for Senior Citizens in India. It will now be possible for the seniors to receive monthly cash flows as long as they live, something which was not so available till now. This new product is the financial sector's response to the need for providing a stream of payments to senior citizens throughout their life time.

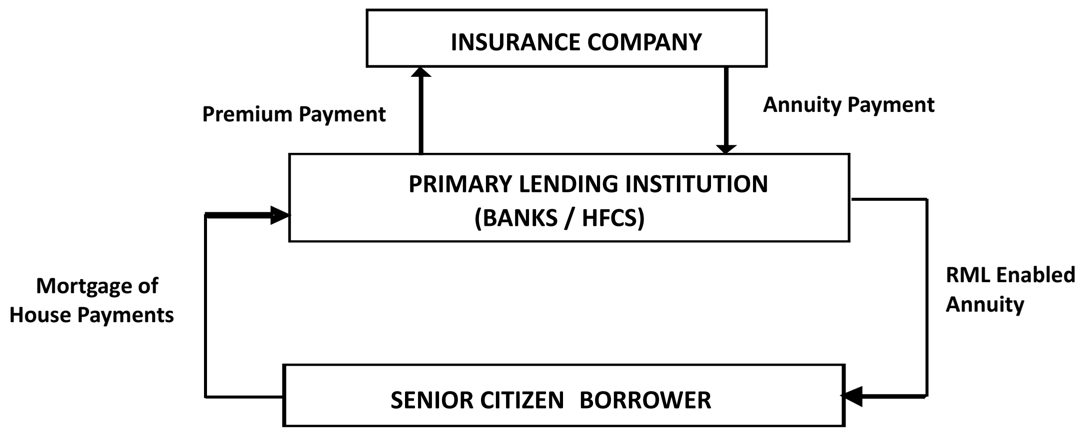
The loan tenure in the initial product variant was limited upto a maximum period of 20 years only. The new product overcomes this limitation and offers assured payments to senior citizens throughout their life time. This is made possible by a revised business model which involves direct integration of life insurance sector with the banking sector and housing finance market wherein, banks and HFCs can source life-time annuity from life insurance companies, for the first time in the country. This collaborative alliance between commercial banks and life insurance companies facilitates greater specialization, risk diversification and efficiencies in funding. While the banks and HFCs address the property mortgage related risks, the insurers address the longevity and survival related risks. As a result, it is the senior citizen who will benefit through assured life-time payments and higher monthly payments as compared to the earlier reverse mortgage loan.

REVERSE MORTGAGE LOAN ENABLED ANNUITY: A NEW DIMENSION

The new market oriented alternative product variant in India has been termed ***'Reverse Mortgage Loan enabled Annuity (RMLeA)',*** as the life-time payments to the senior citizens are annuities enabled by reverse mortgage loan. The National Housing Bank (NHB) in association with Star Union Dai-ichi Life Insurance Company Ltd., (SUD Life) and Central Bank of India (CBI), conceived this model value chain to ensure life-time annuity payments and other benefits to the senior citizens. In addition to assured life-time payments, the senior citizens can expect to receive increased quantum of annuity as compared with the earlier product variant. Further, the senior citizen may prepay the loan any time during the currency of loan. In such a case, seniors will not only be absolved of the mortgage over the property but also will continue to receive the annuity payments as long as they live. The spouse can also be made a joint borrower with option to receive life time payments. In such a case, the annuity payments will continue to flow to the spouse even after the death of the primary borrower.On entering into a reverse mortgage loan contract, the borrowers will have to mortgage their house property to the Bank. The Bank will charge a rate of interest that will accrue during the tenure of the loan, but will not have to be repaid by the borrower as long as they live in the property, occupying it as their primary residence. It is also possible to ensure safety for the spouse by making him or her as the co-borrower. In such a case, the loan need not be repaid as long as the surviving borrower lives.

The loan becomes due and payable only on death of the last surviving borrower. In such an event, the Bank shall bring the property to sale and use the sale proceeds to settle the principal and accrued interest. On full settlement of the loan dues, the remaining balance is remitted to the heirs. However, if the heirs do not want the property to be sold, they will have the first offer to settle the loan dues.

Figure 3



NO NEGATIVE EQUITY GUARANTEE

A unique feature of the product is that borrower(s) will be liable to bank or HFC only to the extent of value of the mortgaged house property. In the event of value of house property falling lesser than the loan dues viz. principal and accrued interest, the bank can only recover the loan by adjusting the proceeds received by way of sale of the house property after the demise of the last surviving borrower. This is known as the 'no negative equity' guarantee. Further, the banks and HFCs cannot look to any other assets including bank accounts, Fixed Deposits, Shares, Debentures, etc. for recovery of the loan, except the moneys returned by the life insurance company on demise of the last surviving borrower, as per contracted terms for partial settlement of the loan dues.

LENDERS' PERSPECTIVES

Since the borrower's outstanding debt increases with time, the residual life risk and the property price adverse fluctuation risks are the two main risks for the lenders. In the initial version of the scheme that was introduced in 2007, both these risks were assumed by the banks and HFCs. As such, the disbursement tenure was restricted to a maximum period of twenty years. This was a significant limitation, considering the fact that the payments to the senior would cease after a period of twenty years, particularly at a time when he or she may need it the most. With the revised product model ushering the services of the life insurers, it has been possible to separate and transfer the survival risks to these specialist institutions. As such, the banks and HFCs are left with the mortgage and property price adverse fluctuation risks common to their domain. As a measure to cover the property price adverse fluctuation risk, it has been envisaged to build an optional credit enhancement in the form of a 'reverse mortgage redemption reserve' in such a manner that a portion of the loan is set aside and held by the bank or HFC which can be used only at the time of redemption of the loan. In the new RMLeA product, the borrowers are to interface directly with the bank and HFCs and not with the insurers. For such services, the banks and HFCs may charge servicing fees not exceeding 1.5% p.a of the principal amount outstanding. This will ensure fee based income for the banks and HFCs, a feature that the old product variant lacked. NHB has formulated Operational Guidelines for the new product which can be seen at www.nhb.org.in . The Insurance Regulatory and Development Authority (IRDA) has approved the annuity plan for introducing the product in India. Presently, the reverse mortgage loan enabled annuity is being offered, for the first time, only by the Central Bank of India and the Star Union Dai-ichi Life Insurance Company Ltd. It is expected that this product will be in the show case of other banks and life insurers in due course.

Table 3 : Initial Reverse Mortgage As Compared With The New Product

	RML (2007)	RML enabled Annuity (2009)
Eligibility Criteria	• Senior Citizens 60+ yrs and Spouse 55+ yrs • Own Residential Property	Same.
Security	Mortgage of House Property.	Same.
Nature of Payment	• Periodic payments • Lump sum; • Line of Credit; • Combination of above.	Same.
Periodic Payment Tenure	Maximum 20 years.	Throughout Life time. Option for Spouse to continue to receive life time annuity.
Loan Repayment	Not during Borrower's Lifetime	Same.
Recourse	Borrower Liability not to exceed Property Value.	Same.
Loan Settlement	• Through Sale of House Repayment by Heirs .	Same.
Prepayment of Loan	• Allowed. Mortgage Released and • Loan payment Stops.	Allowed. Mortgage Released, and Annuity payment Continues.

RML ENABLED ANNUITY: SALIENT PRODUCT FEATURES

The product presently offers two options:

❁**Option-1: RMLeA (without Return Of Purchase Price):** Life-time Annuity payment till demise of borrower. In case spouse is made a co-borrower, the Annuity can be procured separately in their respective individual names on a proportionate basis that they may decide.

❁**Option-2: RMLeA (with Return Of Purchase Price):** Life-time annuity payment till demise of borrower. After demise of the borrower, purchase price (initial net premium amount) will be returned. In case of Joint borrowers under this option, the Annuity shall first be sourced in the name of the primary borrower. On death of the primary borrower, bank or HFC shall use the returned purchase price to re-purchase Annuity in the name of the second borrower at annuity rates applicable for his/her age at time of re-purchase, so that the flow of Annuity continues.

The salient features of the product are given hereunder.

Table 4 : RML Enabled Annuity

RML enabled ANNUITY			
S.No.	**Features**	**Option 1**	**Option 2**
1	Lending Institution	Scheduled Commercial Banks and Housing Finance Companies	Scheduled Commercial Banks and Housing Finance Companies
2	Annuity Institution	Life Insurance Company	Life Insurance Company
3	Eligible Borrowers	Senior Citizens above 60 years and spouse provided that he/she is above 55 years	Senior Citizens above 60 years and spouse provided that he/she is above 55 years
4	Borrower Interface	Lending Institution	Lending Institution
5	Security	Mortgage of House Property in favour of Lending Institution	Mortgage of House Property in favour of Lending Institution
6	Benefits on Survival	RML enabled Life Time Annuity	RML enabled Life Time Annuity
7	Annuity Benefits on Death of Borrower/s	No	Return of Purchase Price *
8	Joint Borrowers	Joint borrowers can obtain separate Life time Annuities	On death of primary borrower, co - borrower becomes automatically eligible for receiving Annuity
9	Prepayment o f Loan	Annuity will continue to flow till borrower's demise	Annuity will continue to flow till borrower's demise
10	Servicing Fees	Maximum 1.50% p.a. (of Loan outstanding)	Maximum 1.00% p.a. (of Loan outstanding)
11	Whether taxable	Yes. In hands of R ML enabled Annuity recipients	Yes. In hands of RML enabled Annuity recipients

* to be used towards partial settlement of Loan dues of borrower/s

** detailed Operational Guidelines can be seen at www.nhb.org.in

A comparative statement on the indicative periodic payments that can be expected is given in Table 4.While the above amounts are only indicative and the actuals could vary depending upon the age of the borrower, property value and other factors, it may be observed that the RML enabled Annuity payments can be over 150% of the amounts applicable under the earlier product. Further, there is a great scope for extensions in the product features such as incremental life time annuity payments, periodic payments of annuity premia, etc. leading to an array of features suited to various sub classes amongst the senior citizens.

Table 5 : Indicative Payment Periods

	Particulars		Net Monthly RMLeA* For Life time		RML (2007)
Age	Property Value	Loan to Value Ratio	Option-1	Option-2	upto 20 yrs
60	₹ 50,00,000	60%	₹ 17,295 p.m	₹ 10,955 p.m	₹ 4214 p.m
65	₹ 50,00,000	60%	₹ 19.935 p.m	₹ 11,335 p.m	₹ 4214 p.m
70	₹ 50,00,000	60%	₹ 24080 p.m	₹ 12095 p.m	₹ 4214 p.m
75	₹ 50,00,000	70%	₹ 35,830 p.m	₹ 16,555 p.m	₹ 4916 p.m
80	₹ 50,00,000	75%	₹ 51,597 p.m	₹ 24,941 p.m	₹ 5267 p.m

*** Net of Service Fees**

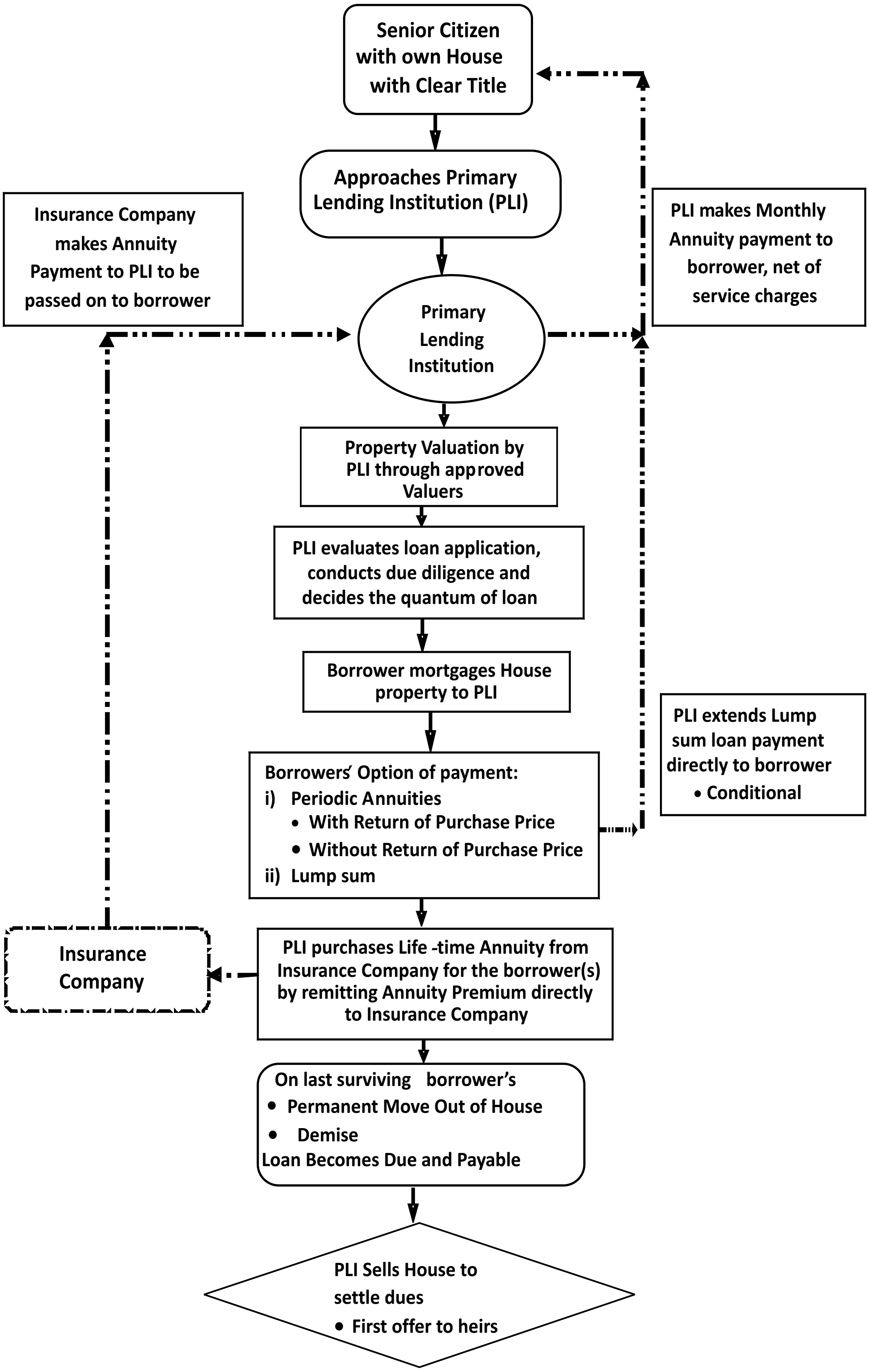
MAJOR LIMITATIONS IN THE INDIAN CONTEXT: TAXATION ISSUES

All payments under reverse mortgage loan are exempt from income tax under Section 10(43) of the Income-Tax Act, 1961. Presently, periodic annuity payments are subject to tax under Section 56 of the Income Tax Act and taxable in the hands of the annuity recipients. In the present context, the tax exemption limit for senior citizens is ₹ 240,000/- per annum. At the same time, in the present context, a senior citizen having taken a reverse mortgage loan can also claim the accrued payable to the bank or HFC, to off-set the annuity income. The issue regarding the status of reverse mortgage loan enabled annuity is presently unclear. This may be an aberration considering the fact that the life time annuity payments to the senior citizens are enabled and sourced by reverse mortgage loan. Further, general annuities are sourced by individuals or group of individuals with their income. On the contrary, annuities sourced by reverse mortgage loans are cash payments that are enabled by loans. Further, payments arising out of reverse mortgages are exempt from taxation. The matter is being taken up with the Central Government for a clarity on the issue to the senior citizens.

THE WAY AHEAD

While the product has gained acceptance in developed nations, it was introduced in India only during May 2007. In India, the senior citizen population is about 77 million, which constitutes nearly 8% of total population. This figure is projected to increase to 11% by 2021, which signifies the potential for the product. Already over ₹ 1400 crore have been sanctioned to nearly 6000 senior citizens since its introduction. In many other countries, the product has received significant support from the respective Governments for addressing the salient risks such as longevity, property price fluctuation, legal and interest rate risks. In India, the product has been introduced entirely in a market oriented manner and needs to have sustainable, strategic and innovative financial solutions for its increasing success. The product is merely two years old and is in the process of its evolution. Direct comparisons with the evolution of the product in any of the developed nations such as USA, Canada, UK or Australia may not be entirely appropriate because of the different composition of population and inherent cultures of such nations as compared to India. There being defined social security benefits for the citizens of these countries, the proportion of reverse mortgage loans is relatively low as compared with the overall population. While the reverse mortgage is growing in popularity in these countries, it is mainly due to the support provided by their Governments for encouraging these loans. For instance, the US Government not only guarantees the liabilities for the primary lending institutions to the senior citizen borrowers, thus assuming the longevity and property price adverse fluctuation risks, but also has enabled a secondary reverse mortgage market whereby the primary lenders can securitize the reverse mortgage loans once they are originated, so as to ensure immediate liquidity to the lenders. Besides, the conducive fiscal and tax milieu in these nations have significantly contributed to its success, while this product continues to evolve entirely as a market response to the needs of seniors in India. Considering the population of India, even a small proportion of house owning senior citizens is expected to be a potentially huge niche market for the product. With increasing nuclearization of the Indian family units, senior citizens who are childless or have their children staying away and not able/willing to support their parents and who have inadequate regular earnings to maintain a good standard of life are a potential target segment for the product. RMLeA opens a door for cash poor but house-asset rich senior citizens to monetize their equity in the

Figure 4: Reverse Mortgage Loan Enabled Annuity: The Process



residential property to meet their increased living expenses. It is expected that measures for enhancing the attractiveness of the product would evolve in due course, thereby not only expanding the market, but also the course of financial intermediation in the country. The reverse mortgage loan enabled annuity is a beginning in this direction.

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It suggests that investors should sell the stock when it meets their expected return. Another important finding of the study is that only 47% of the stocks outperformed the market index. Significant positive correlations were found among the stocks and market index. This suggests that all stocks are moving in tandem with the market. Based on this, investors are advised to design a portfolio in which an equilibrium is maintained among high and weak correlation stocks.

LIMITATIONS

As the study is confined to blue chip and most actively traded stocks, investors should be vigilant in relating these results to mid-cap and small-cap stocks. The study period may also have its impact on the results. Similar results may not be expected in some other time period.

FUTURE RESEARCH

In future, studies should concentrate on mid-cap and small-cap sectors. There is also a need to conduct the impact of systematic risk in stock performance and portfolio selection.

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