

Reverse Mortgage: Conceptual Frame Work And Few Issues

*Prof Ramakant Kulkarni

INTRODUCTION:

The word "Reverse" to a common man finds association to automobile (Such as taking the car back). This word has its share in modern one-day cricket like reverse swing in bowling and reverse sweep in batting. In banking this word is associated with RBI financing to bank like reverse repo. In stock market parlance it is associated to reverse split. Such association of this word can be further taken and found in other areas as well.

One new area where this word now finds its mention and the practice in the days to come is the MORTGAGE. The Finance Minister in his recent budget has introduced Reverse Mortgage. This concept is new to the "Aam Adami" in India though for experts it is not.

This concept is widely practiced for years in countries like UK and USA hence in world of Finance it is a settled concept.

Aging society is one of the most representative demographic characteristics. An average life expectancy has greatly increased and living conditions for the elderly also has continuously been improved. The number of elderly population has been greatly increased and this trend will be continued in the next decades. The welfare and housing problems of the elderly people will be great social issues in the near future. Pension is not enough to cover the living costs. Therefore, the elderly people have suffered the shortage of their living costs and it will be gradually deteriorated.

THEORY OF A REVERSE MORTGAGE SYSTEM

A reverse mortgage system is one of the most representative income conversion programs for the elderly homeowners. It allows an elderly homeowner to convert some of the housing equity into cash or monthly income for the living costs without moving out or changing ownership types. For several reasons, a reverse mortgage for the elderly is more appealing alternative solution than that of selling the house and moving out. An elderly household that sells a home and moves would have to reduce the level of housing consumption or change the composition of the housing services bundles such as a familiar environment and the neighborhood.

The main advantage of a reverse mortgage over other means of tapping housing equity is in its repayment schedule. It does not require the repayment on loan until a household dies or moves.

TYPES OF A REVERSE MORTGAGE SYSTEM

The concept of a reverse mortgage system is available in three basic forms and their combinations:

1. Tenure
2. Term
3. Line of Credit.

A tenure reverse mortgage provides the homeowners with monthly payment for the second half of household life cycle, as long as the homeowner retains the house as the primary residence. After the homeowner

* Associate Professor, Global Business School, Hubli

moves or dies, the house is sold and the loan is repaid. The amount that the borrower can receive in monthly installments during the lifetime of household depends on several factors such as his or her ages and life expectancy, the value appreciation of housing, and the interest rate.

A term reverse mortgage, in contrast, provides the borrower with the monthly payment for a fixed contract period, usually less than ten years. At the end of the term, the loan should be repaid.

A line of credit mortgage allows the borrower to make draws at any time up to some maximum pre-specified amount. The loan becomes due only if the borrower dies, moves, or sell the house.

WORKING OF THE SCHEME.

The reverse mortgage product will be introduced through National Housing Bank. The scheme would be based on the UK scheme model, will be available to the senior citizen of age 62 years and above who owns the house. The loan will be given on the house up to a fixed sum, which will be worked out as a percentage of market value of the house. The loan will be given on mortgage. The senior citizen can opt for receiving the amount on monthly basis in the form of annuity spread over a period of 15 years. The loan opted as a lump sum will be available for such emergency purposes as medical treatment, marriage in the family, education of the children, but not for investment purposes. The revaluation of the housing property is expected to be provided based on which the loan amount / annuity could be revalued.

The spouse will be joint borrower and would continue to enjoy the peaceful living even after the death of the owner besides continuing to get the monthly payment (if so opted).

If the borrower survives the term of 15 years the monthly payments would be stopped but would be allowed to live in the house till death. The loan would become payable when the last surviving owner dies.

The settlement of loan with the accumulated interest will be from the sale proceeds of the house. The heirs can keep the property by paying the loan with interest. The provision for the fore closure/ early settlement of the loan before 15 years can be utilized.

THE BENEFITS

No repayment of the loan during the lifetime of the last surviving owner. The recovery will be from the sale proceeds of the house.

The owner and his/ her spouse can continue to occupy the house during their lifetime.

The provision of revaluation of the house after 5 years enables the owner to get higher amount.

No eviction after the completion of 15 years of mortgage period even if the owner and his/ her spouses survive beyond this period. (Interest will have to borne or the installments will be stopped depending on the scheme chosen).

In the event of early death (before completion of 15 years) of the owner and the spouse the amount recovery is limited to the loan or the installments given.

The surplus, remaining after the sale of the house & adjustment of the loan and interest would be given to the heirs.

The heirs can retain the property by settling the loan and interest.

SOME ISSUES

For the Middle class Indian owning the house is the life time dream hence the emotional attachment developed over the years to the house would be very pose hard decision making dilemma.

Further making provision for the next generation and the thought of the house being not available would pose hard decision making dilemma.

The temptation of over spending on marriages would leave very little with the owner and might defeat the purpose of stable post-retired life.

The dependent children would oppose the idea of taking to this scheme by their parents.

The legal hurdles prevalent in case of the property being not self-acquired need the remedy.

CONCLUSION

The scheme is well intentioned and deserves a try. The change of mind set by the user is the key for the success of the scheme. The increasing life expectancy and the resultant social issues will receive a well-timed scope for the solution.

Note: The above article is in form of personal Opinion/Commentary about what author has felt about REVERSE MORTGAGE concept.

Reference: Union Budget 2006-2007