CHAPTER I

Introduction

1.1. Reverse Mortgage (RM)

“Reverse Mortgage” means mortgage of capital asset by an eligible senior citizen against a loan obtained by him from an approved lending institution.

A reverse mortgage is a mortgage (a loan on house). It enables senior citizens (age ≥60 years), to avail stream of income from a lender against self-occupied, self-acquired house; while maintaining the ownership and staying in the same house. In simple words it is just “opposite” to that of traditional home loan where lender pays the monthly payments to the borrower. Reverse Mortgage Loans (RMLs) are also called as “Reverse EMI Loans”. The senior citizen borrower is not required to repay the loan, monthly repayments of principal or interest during their lifetime; while staying in the same house. On the borrower’s death or borrower leaving the house permanently, loan becomes due for repayment; along with accumulated interest, through sale of the property. The borrower(s) or legal heir(s) can repay the loan with accumulated interest and have the mortgage released without resorting to sale of the house.

In 2007, then Finance Minister P. Chidambaram introduced the novel scheme of Reverse Mortgage loan (RML) in India. RML is considered as an ideal solution for senior citizens to finance their retirement, who owns the house. RML is operational in many developed western countries and is quite popular among the senior citizens. It is proved to be good financial support for senior citizens in those countries. The Ministry of Finance vides notification no- SO 2310(E) dated 30th September 2008, has notified the “Reverse Mortgage Scheme 2008”. It provides the framework under which the lenders will operate the scheme. National Housing Bank (NHB) has prepared guidelines for the operation of RML schemes.
Reverse Mortgage is relatively new concept in India and is in the nascent stage. It can make up shortfall in pensions or incomes of senior citizens, required in years to come. It will help them to maintain the same standard of living. At the same time RML can become “golden walking stick” for senior citizens and will also reduce the possible financial burden on their families and the government.

1.2. Features of Reverse Mortgage Scheme

The draft guidelines of “Reverse Mortgage Loan (RML) in India” are prepared by National Housing Bank (NHB). The salient features of RML are as follows: ¹

1. Any house owner with minimum age of 60 years and above is eligible for a reverse mortgage loan.
2. Married couples will be joint borrowers for financial assistance. In such a case, the criteria for couples would be at the discretion of Primary Lending Institution (PLI). Most of the PLIs in India have a condition that at least one of them should be above 60 years of age and other should not be below 55 years of age.
3. The property to be mortgaged should be self-occupied, self-acquired residential property (house or flat) located in India, with clear title indicating ownership of prospective borrower(s).
4. The residential property should be free from any encumbrances.
5. Commercial property will not be eligible for RML.
6. The residual life of the property should be at least 20 years.
7. RMLs are provided by Primary Lending Institutions (PLIs) viz. Scheduled Banks and Housing Finance Companies (HFCs) registered with NHB.
8. The loan amount is dependent on the value of the house property as assessed by the lender, age of the borrower and the prevalent interest rate.
9. The maximum loan amount is up to 60% of the value of the residential property.
10. The maximum tenure of RML is 20 years.

¹[www.nhb.org.in](http://www.nhb.org.in)
11. The payment of RML should be decided mutually between PLI and borrower; should be decided in advance, as following:
   a. Periodic payments - monthly, quarterly, half yearly, and annual
   b. Lump sum payments in one or more tranches
   c. Committed line of credit
   d. Combination of the above three

12. The maximum monthly payments shall be capped at Rs. 50000 and maximum lump-sum payment shall be restricted to 50 percent of the total eligible amount of loan subject to a cap of Rs. 15 lakh. Lump-sum payments may be conditional and limited to medical exigencies.

13. Eligible end use of RML funds are as follows-
   a. Up gradation, renovation and extension of residential property
   b. Home improvement, maintenance and insurance of residential property.
   c. Medical, emergency expenditure for maintenance of family.
   d. For supplementing pension/other income.
   e. Meeting any other genuine need.

   Use of RML for speculative, trading and business purposes is not allowed.

14. Valuation of residential property is done at such frequency and intervals decided by the PLI in advance. As per regulation, valuation of the property should be done at least once in every 5 years.

15. The amount received through reverse mortgage is considered as loan and not income. It will not attract any tax liability, on the part of borrower. However, a borrower is liable to pay capital gains tax, only at the point of alienation of mortgaged property by the PLIs for the purpose of recovering loan.

16. Borrowers can stay in the same house even after completion of the tenure of reverse mortgage, till one of the borrowers is alive.

17. The borrowers or their heirs can repay the loan along with the accumulated interest at any time and have the mortgage released. The borrowers or the heirs also have an option of prepaying the loan at any time during the loan tenure or later without any prepayment levy.
18. On death of the borrowers or on the borrowers leaving the house property permanently, the loan is due for repayment along with the accumulated interest, through sale of the property.

19. The balance surplus (if any) remaining after settlement of the loan with accrued interest shall be passed on to the legal heirs or beneficiaries of the borrower.

20. All the RML products have clear ‘no negative equity’ or ‘non-recourse’ guarantee. The borrower will never owe more than the value of their property, provided the terms and conditions of the loan have been met.

21. The loan shall be liable for foreclosure due to occurrence of following events of default:
   a. Borrower has not stayed in the property for a continuous period of one year or not using the house as primary residence.
   b. Borrower fails to pay property taxes or fails to insure the house or maintain and repair the residential property.
   c. Borrower declares bankruptcy.
   d. If the mortgage property is donated or abandoned by the borrower.
   e. Due to perpetration of fraud or misrepresentation by borrower; like adding owner to the title of the house, making un-authorized structural changes or renting out part of the house etc.
   f. If the government under statutory provisions, seeks to acquiring the residential property for public use.
   g. If the government under statutory provisions, seeks to acquire or condemn the residential property, for health or safety reasons.

22. Senior citizens may not understand lengthy documentation and other processes. They may look it as tedious, complicated and difficult procedure. The PLIs will maintain high standards of conduct in dealing with the senior citizens and their families and treat them with due care.

23. The PLIs shall clearly disclose the terms & conditions and specify all the costs involved in the RMLs. They should also counsel prospective borrowers about possible impacts of movements in interest rates or fluctuations in the prices of residential properties.
1.3. Comparison between Forward and Reverse Mortgages

Reverse mortgages differs significantly from Forward mortgages in terms of purpose, category of borrowers, loan repayment and servicing. Table-1.1 below gives detailed comparison between forward and reverse mortgages.

Table-1.1: Comparison between Forward and Reverse mortgages

<table>
<thead>
<tr>
<th><strong>Forward Mortgage</strong></th>
<th><strong>Reverse Mortgage</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Purpose is to purchase a home.</td>
<td>Purpose is to generate an income.</td>
</tr>
<tr>
<td>Borrower population is general population.</td>
<td>Borrower population consists of senior citizens with equity in their houses.</td>
</tr>
<tr>
<td>Borrower needs income to qualify.</td>
<td>No income qualification is necessary.</td>
</tr>
<tr>
<td>Before closing, borrower has no equity in the home. At closing, borrower’s equity is very less.</td>
<td>A borrower has substantial equity in the house at closing.</td>
</tr>
<tr>
<td>During the loan term, borrower makes monthly loan payments and as a result loan balance reduces.</td>
<td>During the loan term, borrower receives monthly payments from the lender and as such loan balance increases.</td>
</tr>
<tr>
<td>At the end of the loan term, borrower’s liability is zero, as entire amount with accrued interest is repaid.</td>
<td>At the end of loan term, borrower’s liability is more.</td>
</tr>
<tr>
<td>Borrower’s equity increases over time – Loan balance decreases as payments are made to the lender – “Falling debt and rising equity” transactions.</td>
<td>Borrower’s equity decreases over time. The loan balance rises as loan advances are made to the borrower, interest is added to the outstanding loan balance, and no repayments are made. ”Rising debt, falling equity” transactions.</td>
</tr>
<tr>
<td>Borrowers have more incentive to make capital investments to maintain the house.</td>
<td>Borrowers have less incentive to make capital investments to maintain the house.</td>
</tr>
<tr>
<td>Borrower makes repayment of the loan.</td>
<td>No need to make repayment of the loan until death or move out or sale of the property.</td>
</tr>
</tbody>
</table>
1.4. **Reverse Mortgage Loan process**

Figure-1.1: RML Flow Chart

![Reverse Mortgage Loan Flow Chart](image)


The figure-1.1 explains the process of buying a reverse mortgage loan. A senior citizen who owns the house applies to a bank for RML, to receive better cash flow. The bank does valuation of the house for deciding the loan amount. The bank provides RML to the borrower up to 60 percent of the home valuation. Upon agreement between senior citizen and the bank the house property is mortgaged and loan amount is paid. Loan amount payment is made as combination of initial lump sum and monthly stream.

The monthly payout to the borrower stops after the period of 20 years. In case of annuity RML, the borrower receives monthly payout till death. The borrowers can stay in the house, till one of the borrowers is alive. After the death of the borrowers, the heirs can repay the loan along with accrued interest and get the house back or let the bank to take over the house. The banks will sale the house to recover its loan and interest amount. Any surplus amount after settlement of the loan will be paid to the heirs.
1.5. RML Working Example

Let’s assume a senior citizen with 60 years of age, has self-occupied and self-acquired house. He wishes to get a reverse mortgage loan with monthly income stream. After initial valuations, the bank can give loan for the amount of Rs. 50,00,000. Senior citizen wants monthly payout for 10 years, till the age of 70 years. Considering 6 percent rate of appreciation for residential property; valuation of the home at the end of the 10th year is Rs. 89,54,238.

This value is converted to monthly payout for 10 years using RML interest rate of 10 percent per annum and monthly payout comes to Rs. 43,712.

This calculation is done by using PMT formula of MS-excel. Calculation is done as follows:

rate =10%/12, nper=12*10, pv=0, fv= -89,54,238 and type=0

=PMT(10%/12,120,0,-8954238,0)

Table-1.2: RML and Home Equity Calculation

<table>
<thead>
<tr>
<th>Year</th>
<th>Age</th>
<th>Monthly Loan Advance</th>
<th>Total Loan at Year End</th>
<th>Projected Cash Value</th>
<th>Balance Cash Value (Home Equity)</th>
<th>Loan to Value Ratio (LTV) (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>61</td>
<td>43712</td>
<td>549269</td>
<td>5300000</td>
<td>4750731</td>
<td>10</td>
</tr>
<tr>
<td>2</td>
<td>62</td>
<td>43712</td>
<td>1156055</td>
<td>5618000</td>
<td>4461945</td>
<td>21</td>
</tr>
<tr>
<td>3</td>
<td>63</td>
<td>43712</td>
<td>1826378</td>
<td>5955080</td>
<td>4128702</td>
<td>31</td>
</tr>
<tr>
<td>4</td>
<td>64</td>
<td>43712</td>
<td>2566893</td>
<td>6312385</td>
<td>3745492</td>
<td>41</td>
</tr>
<tr>
<td>5</td>
<td>65</td>
<td>43712</td>
<td>3384950</td>
<td>6691128</td>
<td>3306178</td>
<td>51</td>
</tr>
<tr>
<td>6</td>
<td>66</td>
<td>43712</td>
<td>4288668</td>
<td>7092596</td>
<td>2803928</td>
<td>60</td>
</tr>
<tr>
<td>7</td>
<td>67</td>
<td>43712</td>
<td>5287017</td>
<td>7518151</td>
<td>2231135</td>
<td>70</td>
</tr>
<tr>
<td>8</td>
<td>68</td>
<td>43712</td>
<td>6389906</td>
<td>7969240</td>
<td>1579334</td>
<td>80</td>
</tr>
<tr>
<td>9</td>
<td>69</td>
<td>43712</td>
<td>7608282</td>
<td>8447395</td>
<td>839113</td>
<td>90</td>
</tr>
<tr>
<td>10</td>
<td>70</td>
<td>43712</td>
<td>8954238</td>
<td>8954238</td>
<td>0</td>
<td>100</td>
</tr>
</tbody>
</table>
The graph-1.1 explains one of the important features of RML- “Rising Debt and Falling Equity”, with the help of calculations done in RML working example. It can be observed that initially home equity is high, total loan is less and thus LTV is less. The loan amount is paid every month for the period of 10 years i.e. till the age of 70 years of the borrower. At the end of the loan term, home equity is zero and LTV is 100 percent.

Graph-1.1: RML and Home Equity
1.6. Variants of Reverse Mortgages

Many variants of Reverse Mortgages are available, in different parts of the world. The product has evolved over the period of time considering needs of the senior citizens/borrower.

Following are some of the most popular RML variants:

1. **Term:**
   Borrower is eligible to receive monthly payments for a pre-decided time period. The loan is repaid with interest at the end of the set term, unless he moves out of the house or dies during the term.

2. **Split Term:**
   Borrower receives monthly payments for a pre-decided term. The payments will be stopped at the end of the set term. The loan has to be repaid only when the home owner dies or moves out of the home. This is in contrast to the term reverse mortgage where loan repayment needs to be done at the end of the loan term.

3. **Tenure:**
   In this variant of reverse mortgage loan, borrower receives the monthly payments as long as he lives in the house. Loan has to be repaid on death of borrower or when he moves out of the house.

4. **Line of Credit:**
   Line of credit reverse mortgage offers the borrowers access to a source of loan amount, as per their requirement. They can use the loan amount whenever and however they choose. This is similar to a credit card limit being sanctioned by the bank, based on repaying capacity. The principal limit is approved based on the borrower’s home value, age, origination fee, rate of interest, and percentage of shared appreciation the lender is entitled to. The entire line of credit may be advanced at the time of loan closing.
5. **Hybrid Term/Tenure:**

Hybrid term/tenure reverse mortgage offers the combined benefits of term, tenure, and line of credit plan. It allows the borrower to set aside part of the principal limit at the time of origination to establish a line of credit. The borrower receives the rest of the principal limit in the form of equal monthly payments as long as the term does not expire or the borrower lives in the house. The borrower receives monthly payments as well as lump sum amount set aside as per the need.

6. **Lifetime:**

This is in contrast to the term and tenure variants. Borrower receives monthly payments as long as he is alive even if he is not staying in the mortgaged house. The contingency to repay occurs on the death of the borrower. This is mainly an annuity based product which enables regular income to be provided to the borrower for life.

7. **Shared Appreciation Mortgage:**

Borrower agrees with the lender that they can have a share in the capital appreciation value of the mortgaged property, when it is sold. Here the rate of interest may be very less or nothing.

8. **Roll Up:**

This is a lifetime reverse mortgage offered in United Kingdom, with an added feature of lending additional cash advance to the borrower, in return for higher interest rate on loan.

9. **Fixed Payment Loans:**

In this variant, borrower receives a lump sum at the beginning of the loan period. Instead of being charged interest on the loan, borrower agrees that when the house will be sold he will pay the lender a higher amount of money than the amount borrowed. Thus the amount of repayment to the lender is decided at the beginning of the loan period.
1.7. **Reverse Mortgage Loan enabled Annuity (RMLeA)**

Till now, RML is launched by 23 Banks and 2 Housing Finance Companies (HFCs) in India. It remained non-starter and there are very few takers for the product, due to perceived drawbacks. These drawbacks are as follows-

1. **Limited payout tenure**: Maximum payout tenure to the borrower in RML is 20 years. This exposes the borrowers to the risk of living to long. There is a risk to the borrowers that they may outlive the payout period. They may not have adequate money to survive; after payout period of 20 years.

2. **Loan to Value (LTV) Ratio is Low**: There is maximum LTV ratio of 60 percent in reverse mortgages. It is very low considering higher equity in houses and rate of appreciation of residential property. It makes RML a low income generating option compared to the value of the asset.

3. **Uncertainty of payouts**: Payouts offered by RMLs may change as per the property revaluation and changes in rate of interest. This makes RML payouts vulnerable to frequent changes and may become uncertain. This will have negative impact on the finances of senior citizens who have secured a reverse mortgage loan.

NHB has introduced new variant of reverse mortgage in December 2009- **RML enabled Annuity (RMLeA)**. This new product addresses the above drawbacks and more beneficial to the senior citizens. LTV ratio can go up to 75 percent of the property valuation, which in turn provides higher loan amount to the borrowers. RMLeA provides **assured life-time payments (annuity)** to senior citizens against mortgage of their residential property; overcomes the drawbacks of limited payout tenure and uncertainty of payouts.
Table-1.3: RMLeA LTV ratio

<table>
<thead>
<tr>
<th>Age of the Borrower (Years)</th>
<th>Maximum Loan to Value Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Between 60 and 70</td>
<td>60%</td>
</tr>
<tr>
<td>Between 70 and 80</td>
<td>70%</td>
</tr>
<tr>
<td>80 and above</td>
<td>75%</td>
</tr>
</tbody>
</table>

Source: www.nhb.org.in

1.7.1. Structure of RMLeA

RMLeA is a tri party agreement between lender (Bank or HFC), Life Insurance Company and borrower. Borrower approaches to a primary lending institution (PLI) for RMLeA. PLI does the valuation of the property and upon customer’s agreement transfers the loan amount to the life insurance company. The life insurance company considers loan amount as premium for the purpose of purchasing annuity for the borrower. Borrower receives life annuity from the life insurance company through PLI.

Figure-1.2: Structure of RMLeA
There are two options in RMLeA-

1. **Life annuity without return of purchase price**-

   In this option, on the death of borrower legal heirs will have to repay loan out of own contribution or PLI will take over the house.

2. **Life annuity with return of purchase price**-

   In this option, legal heirs of the borrower receives purchase price (loan amount) after the death of borrower. They can use this amount to repay loan along with accrued interest and get the property back.

Annuity amount in life annuity in without return of purchase price is higher than the second option. Borrowers can choose any of the option at the time of taking the RML.

**1.7.2. RMLeA Working Example**

RMLeA provides more cash in the hands of senior citizens compared to traditional RML. This advantage is illustrated in following example.

**Table-1.4: RMLeA Working Example**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Net Monthly RMLeA for Life time (Rs./per month)</th>
<th>RML (2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>Property Value (Rs.)</td>
<td>LTV</td>
</tr>
<tr>
<td>60</td>
<td>50000000</td>
<td>60%</td>
</tr>
<tr>
<td>65</td>
<td>50000000</td>
<td>60%</td>
</tr>
<tr>
<td>70</td>
<td>50000000</td>
<td>60%</td>
</tr>
<tr>
<td>75</td>
<td>50000000</td>
<td>70%</td>
</tr>
<tr>
<td>80</td>
<td>50000000</td>
<td>75%</td>
</tr>
</tbody>
</table>

Option-1: Life Annuity without return of purchase price
Option-2: Life Annuity with return of purchase price
As per recent announcement made by the government, annuity payments under RMLeA are now exempted for income tax. This announcement has made RMLeA more attractive option than earlier.

Central Bank of India is offering RMLeA (Cent Swabhiman Plus) product along with private insurer- SUD Life Insurance Company. It has already acquired 25 percent of the market share. Recently, Union Bank of India has also launched its RMLeA product- Union Reverse Mortgage.

The product launched in 2009 has shown lackluster performance with only Rs. 30 crore sanctioned, as of 31 March 2011. RMLeA was considered as big step towards RML penetration, in Indian market.

1.8. **Major Reverse Mortgage Products in India**

So far, 23 banks and 2 HFCs have launched RML products. Following are few of the major products launched:

1. **Saksham:**
   Dewan Housing Finance Limited (DHFL) is the first company in India, to launch reverse mortgage product. This product was initially restricted to Mumbai and Thane area initially.

2. **PNB Baghban:**
   Punjab National Bank is the first public sector bank to launch RML product. The qualifying amount depends on the realizable value of the residential property, after maintaining margin of 20 percent.

---

3. **Baroda Ashray:**

Bank of Baroda launched RML product named- Baroda Ashray, in line with the guidelines provided by NHB. Maximum loan amount including interest is restricted to Rs. one Crore only, subject to margin of 20 percent on present market value of the property.

4. **Cent Swabhiman Plus:**

Central Bank of India is the first bank to launch RMLeA, in India. Bank has collaborated with Star Union Dai Ichi Life Insurance Company for the purpose of providing life annuity, to the senior citizens. Cent Swabhiman plus has already acquired 25 percent of the market share. Central Bank has also launched traditional RM product i.e. Cent Swabhiman.

5. **Union Reverse Mortgage:**

Union reverse mortgage provides RML up to 90 percent in metro, 80 percent in urban and 70 percent in other areas; of the market value of residential property. Maximum loan amount offered is Rs. one crore. It provides the highest LTV ratio among all products available till date, in India. Recently, Union Bank has also launched RMLeA product.

6. **SBI Reverse Mortgage:**

The largest public sector bank has joined the club by launching RML product. It offers joint loan with loan amount equal to 90 percent of the value of the property. Loan amount would include interest till maturity. It offers minimum loan value of Rs. 3 lac as well, which is not offered by any lender as of now.

LIC Housing Finance, Allahabad Bank, Indian Bank and some of the private sector banks have started offering Reverse Mortgage products.
Table-1.5: Comparison of RML Products

<table>
<thead>
<tr>
<th>Lender</th>
<th>Dewan Housing Finance Limited</th>
<th>Punjab National Bank</th>
<th>State Bank of India</th>
<th>Central Bank of India</th>
<th>Union Bank of India</th>
<th>Bank of Baroda</th>
</tr>
</thead>
<tbody>
<tr>
<td>RML Product</td>
<td>Saksham</td>
<td>PNB Baghban</td>
<td>SBI RM</td>
<td>Cent Swabhiman Plus</td>
<td>Union Reverse Mortgage</td>
<td>Baroda Ashray</td>
</tr>
<tr>
<td>Annual Interest Rate (Reset Period)</td>
<td>12% (linked to PLR)</td>
<td>10.5% p.a. (5 years)</td>
<td>10.75% p.a. (5 years)</td>
<td>Base Rate +1.5%</td>
<td>12.75% p.a. (5 years)</td>
<td>Base Rate +1.75%</td>
</tr>
<tr>
<td>Processing Fee</td>
<td>NA</td>
<td>½ month's loan installment maximum Rs. 15000</td>
<td>0.5% of Loan amount</td>
<td>1% of loan amount</td>
<td>0.5% maximum Rs. 10 Lacs</td>
<td>NA</td>
</tr>
<tr>
<td>Tenure</td>
<td>10-20 years</td>
<td>10-20 years</td>
<td>Max 15 years</td>
<td>Life Annuity</td>
<td>Max 20 years</td>
<td>15 Years extendable for life based on valuation.</td>
</tr>
</tbody>
</table>

1.9. Role of National Housing Bank (NHB) in RML

National Housing Bank (NHB) is the 100 percent subsidiary of Reserve Bank of India and apex housing finance institution. NHB has an important role to develop Indian housing finance system by promoting a sound, healthy, viable and cost effective housing finance. NHB has to play a lead role in starting of Mortgage Backed Securitization (MBS) and development of secondary mortgage market, in the country. NHB acts as both policy maker and regulator for housing finance in India. NHB has now an additional role of regulator for RML business.

In 2008, NHB has provided operational guidelines for the Reverse Mortgage Scheme. NHB regulates RML and refines all PLIs to the extent of RML disbursed by them. It also has to play an important role in promoting and developing RML business.
NHB has launched ‘Reverse Mortgage’ counseling centers for senior citizens in metros like Mumbai, New Delhi, Bengaluru, Chennai, Kolkata, Hyderabad, Ahmedabad, and Bhopal. NHB is also organizing various awareness events for senior citizens, in different cities along with NGO like Helpage India. NHB is also a resource for complete information about the reverse mortgage. Its website is source of information for all the stake holders.

NHB has also played active role in launching reverse mortgage enabled annuity (RMLeA) schemes by banks like- Central Bank of India, Bank of Baroda, and Union Bank of India.

NHB is doing a lot to develop RML in India, but there is need to do much more. NHB should increase activities to increase awareness among senior citizens. Activities should also aim at crossing the boundaries of metros and reach to all geographical areas. Product development is another area which needs strong and immediate focus. Reverse mortgages in India, needs strong regulatory framework as the borrowers involved are senior citizens. Any adverse impact of reverse mortgages will have far reaching consequences in their lives. NHB has to be a strong regulator like SEBI and IRDA, so as to protect interests of the customers and create conducive environment for the growth of reverse mortgages growth in India.
1.10. RML in Developed Countries

Reverse mortgage products are popular among senior citizens in developed countries. Higher percentages of senior citizens are opting for RML to finance their retirement. Robust process to facilitate senior citizens along with better products is increasing RML penetration in these countries.

1.10.1. RML in USA

USA has identified issues of ageing population and issues related to elderly much before other developed countries. Reverse Mortgage loans were launched in USA in the year 1988. Senior citizens with age 62 years are eligible for RML, in USA. There are mainly three products in RML product suite as below-

1. Home Equity Conversion Mortgage (HECM):

HECMs are available since 1989, and accounts for 90 percent of the reverse mortgages business in USA, making them the most popular. HECMs are insured by the Federal Housing Administration (FHA), a part of US department of Housing and Urban Development (HUD). Lenders gets protection through FHA equal to the amount lent. HECMs’ are most popular because of following two factors:

   I. The actual loan payouts are usually higher.

   II. The government provides mortgage insurance.

HECM limits vary by the county and ranges from $2, 00,160 to $3, 62,790. They are 50 percent higher ($5, 44,185) in Hawaii, Alaska, and the Virgin Islands. Mortgage insurance plays significantly different role in reverse mortgage. It guarantees that you will receive your payments, even if your lender goes out of business. The insurance also guarantees that you will never owe more than the value of your home, when the HECM are due for repayment.

---

2. **Fannie Mae Home Keeper:**

Fannie Mae is the name of the reverse mortgage lender in USA. Fannie Mae insured loan offers maximum of $4,17,000; but also 50 percent higher ($5,44,185) in Hawaii, Alaska, and the Virgin Islands. Fannie Mae is actually a private company, but not government. However, because of their size and the amount of regulation over them, their guarantee is virtually the same as the government. It is often used to buy a home. The loan value in Fannie Mae is large, but differences in calculation offers lower loan to value compared to HECM. It is often used when home value is high and HECM loan amount provided is low due to lower limits.

Home Keeper loans come with two options:

**a. Home Keeper** - In this variant borrowers stay in their current home. Home Keepers are used to get higher loan value which is not possible in HECM, due to lower loan limits and home value is very high. Home Keeper has higher loan limit (2006) of $4,17,000 (vs. $3,62,790 for HECM loans for most areas).4

**b. Home Keeper for Home Purchase** - This variant is used to buy a house by the senior citizen. The home keeper for Home Purchase allows you to move to another home, pull out a chunk of cash, and have no payments on the new home. This is useful for those senior citizens who wish to sell old house and buy new one. This product is combination of purchasing a new house and reverse mortgage loan, bundled in one product. It enables senior citizens to shift house near to children or convenient location. Most of the senior citizens use this for unlocking the home equity in their old home. This product is more popular among senior citizens as they get higher amount of money in their hands.

---

3. **Financial Freedom Cash Account:**

Financial Freedom Senior Funding Corporation is a lending group that has introduced a number of “jumbo” or high value loans focused on homes with higher lending limits than HECM and Fannie Mae Home Keeper reverse mortgages. These loans may work well for unusual properties and situations that are not covered by HECM or Fannie Mae.

Minimum value of financial freedom cash account loans is $75,000 while there is no maximum limit. It is more suitable for homes which worth at least $5,000,000.

1.10.2. **RML Application Process in USA**

A Reverse Mortgage needs lot of serious thoughts and as the borrowers involved are senior citizens. Concept of reverse mortgages itself is complex and process of taking a loan is also tedious. It involves lots of documentation and high cost. Senior citizens may avoid RMLs due to these factors.

RML regulators in USA, has rolled out robust processes to ensure right decision, right product and security to the senior citizens. There are mainly four steps in RML closing process. Every senior citizen has to undergo mandatory counseling session prior to making an application for reverse mortgage loan. The counseling sessions are conducted by registered counselors. All the counselors are registered and approved by HUD, AARP or Fannie Mae. They issue a certificate that a senior citizen has attended counseling session. Application process follows a counseling session where a registered originator guides senior citizen on application, appraisal and closing.

All the three intermediaries i.e. counselor, originator, and appraiser are registered. This process ensures that a borrower is guided in his decision making, gets a life-long solution, and is not misguided in the process of taking RML.
1.10.3. Growth of RML in USA

Table 1.6 reveals growth rate in the use of HECMs since 1990. There is robust growth in volume, from year 1990 to year 2007, fuelled by increase in house prices. This trend is showing reversal from year 2008 in the wake of financial crisis and lower rate of appreciation in house prices.6


Table-1.6: HECM Loans

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Number of HECM Loans</th>
<th>Percent Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>157</td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>389</td>
<td>148%</td>
</tr>
<tr>
<td>1992</td>
<td>1019</td>
<td>162%</td>
</tr>
<tr>
<td>1993</td>
<td>1964</td>
<td>93%</td>
</tr>
<tr>
<td>1994</td>
<td>3365</td>
<td>71%</td>
</tr>
<tr>
<td>1995</td>
<td>4165</td>
<td>24%</td>
</tr>
<tr>
<td>1996</td>
<td>3596</td>
<td>-14%</td>
</tr>
<tr>
<td>1997</td>
<td>5208</td>
<td>45%</td>
</tr>
<tr>
<td>1998</td>
<td>7896</td>
<td>52%</td>
</tr>
<tr>
<td>1999</td>
<td>7982</td>
<td>1%</td>
</tr>
<tr>
<td>2000</td>
<td>6640&lt;sup&gt;a&lt;/sup&gt;</td>
<td>-17%</td>
</tr>
<tr>
<td>2001</td>
<td>7781</td>
<td>17%</td>
</tr>
<tr>
<td>2002</td>
<td>13049</td>
<td>68%</td>
</tr>
<tr>
<td>2003</td>
<td>18097&lt;sup&gt;b&lt;/sup&gt;</td>
<td>39%</td>
</tr>
<tr>
<td>2004</td>
<td>37829</td>
<td>109%</td>
</tr>
<tr>
<td>2005</td>
<td>43131</td>
<td>14%</td>
</tr>
<tr>
<td>2006</td>
<td>76351</td>
<td>77%</td>
</tr>
<tr>
<td>2007</td>
<td>107558</td>
<td>41%</td>
</tr>
<tr>
<td>2008</td>
<td>112154</td>
<td>4%</td>
</tr>
<tr>
<td>2009</td>
<td>114692</td>
<td>2%</td>
</tr>
<tr>
<td>2010</td>
<td>79106</td>
<td>-31%</td>
</tr>
<tr>
<td>2011</td>
<td>73131</td>
<td>-8%</td>
</tr>
<tr>
<td>2012</td>
<td>54822</td>
<td>-25%</td>
</tr>
<tr>
<td>2013</td>
<td>60091</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: Data from HUD. Year-to-year percentage change calculated by CRS.

a. HECMs could not be made for part of FY2000 (July to early October 2000) because FHA insurance authority had been exhausted temporarily.

b. HUD ran out of insurance authority and could not insure HECMs during the last two weeks of September 2003.
1.10.4. RML in UK

The market for Reverse Mortgages or Equity Release (as it is known in the UK), has been growing very fast. UK has witnessed 10 folds growth within a span of last 5 years. Senior citizens with minimum age of 62 years are eligible for RML in UK. There are around 40 players in the market. Major Player includes Abbey, Norwich Union, Prudential, and Standard Life Bank.\(^7\)

1.10.5. RML in Australia

There are two types of Home Reversion Schemes (HRS) in Australia.

1. Sale and Lease Model
2. Sale and Mortgage Model

HRS is available to the senior citizens with minimum age of 60 years and lives in certain areas in Sydney or Melbourne. A home Reversion scheme is different from reverse mortgages in most of the countries and is a loan. A proportion of home equity is sold for future value of home and borrowers receive lump sum which reflects ‘discounted’ value. This value is calculated on the basis of borrower’s age, rate of interest, rate of appreciation and life expectancy.\(^8\)

----


1.11. Risks in Reverse Mortgage Loans

Any financial product involves some risk and reverse mortgage is no exceptions to it. These risks must be managed in prudent way and should not harm progress of RML in its initial phase. In Indian scenario, following are risks in reverse mortgages, for both-lenders and borrowers.

1.11.1. Risks for Borrowers:

1. **Difficult to understand:**

   Many individuals could not understand RML, as it is complex and confusing. Senior citizens entering into reverse mortgages don’t fully understand the terms and conditions associated with the loan. It has been cautioned that some lenders may take advantage of this to grow the business. It may have adverse impact on senior citizen borrowers.

2. **Expensive:**

   Reverse mortgages can cost more to enter into, as compared with other types of loans which often costs less. Apart from processing fee, which is 0.5 percent to 1 percent for most of the lenders, borrowers will also have to pay for property insurance premium. This adds up to the initial cost of borrowing a RML.

3. **Compounding interest:**

   No monthly re payments are made by borrower on reverse mortgages. The interest that accrues is treated as loan advance. Each month, interest is not only calculated on the principal amount received by the borrower, but also on the interest of previously assessed loan. The longer a senior citizen has reverse mortgage, it is more likely that all of the home equity will be depleted, due to compounding interest, when the loan becomes due.
4. **RML for short term:**

RML can be very expensive, if it is taken for short term by senior citizens. It is imperative that senior citizen should take RML considering long term future only. This risk is also there if RML is taken too late that is in very old age.

5. **Valuation and interest risk:**

RML payouts are subject to change, depending upon interest rates and valuation of property. Valuation of property is done frequently, at least once in 5 years. RML payouts will be reduced in case of increase in rate of interest or value of the property goes down.

6. **Inheritance Issues:**

In India, residential property is always inherited to the next generation and has emotional value. Senior citizens opting for RML may face various social issues like children not looking after parents who have taken RML. It could also be seen as burden on next generation.

11.2. **Risks for Lenders**

1. **Longevity Risk:**

   This is a major risk to a lender if the borrower lives longer than expected. The lender has to provide the payment upfront either as lump sum or installments. But the lender will receive the loan amount along with accrued interest only when the borrower dies or moves out of the residence. As the life expectancy in India is increasing, the risk of late recovery of RML is a big risk for lenders.

2. **Crossover Risk:**

   Risk of loan value exceeding the house value is called as crossover risk. This is a function of occupancy risk, mobility risk, mortality risk, interest rate risk, and home appreciation risk. The lender can claim back loan only from the property on which the loan has been granted. Lender does not have recourse to any other
assets of the borrower, to recover entire amount of loan. If the sale proceeds of the home are not sufficient to cover loan along with accrued interest, the lender cannot claim the balance from legal heirs of the borrower. This will result into losses for the lender.

3. **Interest Rate Risk:**

The payments to the borrower in case of RML are fixed, either for a given term or lifetime. But the cash flows to the lender are dependent on current rate of interest and is dependent on the market conditions. Thus the lender runs the risk that the interest rates may move in the opposite direction of that the lender anticipated which will result in lower recovery and loss to the lender.

4. **Early Repayment Risk:**

Borrower has an option to repay the loan along with accrued interest, at any point of time. This leads to a risk of early repayment and this repayment is done by borrower when it is more beneficial for him. This early repayment, in most of the cases, does not coincide with the interests of the lender.

5. **Moral Hazard Risk:**

This is a risk of borrower’s negligence or improper maintenance of the mortgaged property. This may also arise due to borrower not taking home insurance or not renewing home insurance in time or not paying property taxes. This may lead to depreciation of value of the property. This will be a loss to the lender as it will result in cross over risk.

6. **Litigations:**

This is a risk of litigations with legal heirs during loan repayment or in handling over the property to the lender. Thus lender is at risk of losing time in recovery of loan amount, due to litigations. This risk can also be considered as reputation risk for the lender and may impact future business.
7. **Condemnation or Sovereign Takeover of the property by Government Agency**

The asset available to the lender is the house and if there are changes like take-over of property by the government due to policy or developmental changes etc. This will lead to a loss to the lender as the house is acquired by the government agency at a very low price or no price.

1.12. **Potential segments for Reverse Mortgage**

1. **Middle class segment:** An average middle class person would have utilized all his savings to purchase a house so that later in his life he can fall back upon the property for his sustenance. Providing a start-up in living or financing education or performing marriage of the dependents is still the responsibility of some elderly population.

2. **Health care priority segment:** Old age persons may need to incur high costs for maintaining their health or medical treatments. Current income levels may not be sufficient to take lump sum costs. Besides, these people will not get any credit due to their age and lower income. Health insurance is not wide-spread and also getting cashless service facility is difficult. The only way out in this case is to have credit line available at the shortest call, in the form of RML.

3. **Small business segment:** There is a very low possibility of non-salaried segments of population to have personal pension schemes. These people who may be the owners of small businesses may not have any source of regular income after they retire from active business or after passing on the business to their next generation.

4. **People who can afford comfort spending:** A study conducted by Technical Committee on Population and Planning Commission shows that 52 percent of the elderly people in urban areas are living alone. A large section of this population
will be on the lookout for a relaxed life style. The may also be having bequeath their property, so they may intend to spend the equity in their house to meet the expenses in increased standard of living.

5. **A parent of Non-Resident Indian (NRIs):** This is a growing segment of old age parents living alone in India, while their children make a living abroad. Children may not be having plans of coming back and staying in India. In this situation, utilizing home equity to enhance their living comfort is better than handing over property issues to the children.

6. **Low current incomes relative to desired standard of living:** There are households whose current levels of income are insufficient to afford their desired standard of living. A potential Reverse Mortgage borrower would be one who had high pre-retirement income no substantial pension/post-retirement benefits.

7. **Long tenure at current home:** Reverse mortgage is attractive to a borrower especially when he has decided to stay in his current residence and plans to do so for a long term into the future. This is likely when he has already stayed in his current home for a relatively longer period- say a minimum of 10 years. Additional indicators for such a desire would be a person currently residing in home town.

8. **Lack of other supports:** Reverse mortgage can make substantial contribution to the standard of living for an individual who is living alone like widow or widower. Alternatively, the next generation may be living far away, either in India or abroad.

9. **Independence and quality of life:** A potential reverse mortgage borrower must be an elderly person who values his financial independence. He must be interested in maintaining his desired quality of life rather than curtailing consumption for lack of current cash income. This implies that he may be mentally prepared for borrowing in old age. Innovative financial products like reverse mortgage may be useful to these senior citizens.
1.13. Current Status of Reverse Mortgage in India

Reverse Mortgage, is an innovative financial product for needy senior citizens in India. RML acts as an important option which provides regular income stream as per their requirement. But as of now it has not taken off and there are very few takers for it. Reverse Mortgage is being launched in India by 23 banks and 2 HFCs from 2008, but only Rs 1800 crore is sanctioned and Rs. 800 crore is disbursed, as on 30 September 2013. According to conservative estimate, Reverse Mortgage market in India is valued at Rs. 20000 Crore.9

Many PLIs has cited “Psyche of the Indians” as a reason for low response to this innovative product. They feel that it is working against this product. Dewan Housing Finance Ltd., is one of the largest housing finance companies, has been able to sell only 4 to 5 reverse mortgage loans during the last two years. Few large financial institutions, including home finance lenders in the country, do not have reverse mortgage loan product in their portfolio.10

Reverse mortgage can take a front seat in India as there is intrinsic need for the product to generate regular stream of income. Changes in socio-economic scenario, demographics, uncertainties in the returns of investment options, rate of appreciation in property rates and major changes in the pension system; indicates that there is need for such product. Awareness level among potential borrowers must be increased along with new product development for further penetration of this product.

RML has also initiated changes in the financial and retirement planning for the individuals as well. Many financial planners have already started suggesting RML as part of retirement plan, for their clients. This will bring a sea change in the lives of individuals who are finding it difficult to manage their investment for the retirement planning. Financial planners should increasingly focus on RML while planning for their clients. They should also add up to their skills, as this product is new and complex.

9 Business Standard, October 21, 2013
Reverse mortgage loan is the need of the country as there is lack of formal social security system for senior citizens. Government intervention is also important in the growth of RML in India. RML can also be seen as a social security option for senior citizens who own homes. This product will be definitely take important position in the financial plans of many individuals and this will happen with time.