REVERSE MORTGAGE IN INDIA: CHARADE OR REALITY

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Can one have the cake and eat it too? Impossible says ancient wisdom. But with the advent of the concept of "Reverse Mortgage" the opinions have diametrically transformed from the classic view of "Mortgage".

Mortgage, traditionally considered a burden, hanging like the democles' sword on the young and old, has today completely transformed to become a big boon for the generation, described as the "asset rich – cash poor", in their sunset years. Senior Citizens are a burgeoning constituency of the Indian society and dependency in old age is increasing in our country. While on the one hand, there is significant increase in longevity, the cost of good health care facilities is simultaneously spiraling and there is little social security.

A regular cashflow stream has become a necessity for Senior Citizens for the purpose of supplementing their pension / other income and addressing their financial needs. Exponential increase in residential house prices has created considerable **"home equity"** wealth. For most Senior Citizens, a home is the largest component of their wealth. Thus, in Reverse Mortgage, the capital value of a home is converted into an annuity over the homeowner's lifetime.

"Reverse Mortgage" is an arrangement by way of which a home owner can borrow monies against the equity of his home and receive regular payments till his life time and / or until he permanently moves from the property by selling the same or otherwise.

Reverse Mortgage involves the Senior Citizen borrower(s) mortgaging his home to a lender, who then makes payment(s) to the borrower(s) during the latter's lifetime. The borrower(s) is not required to service the loan during his lifetime and therefore does not make monthly repayments of principal and / or interest to the lender. On the borrower's death or on the borrower(s) leaving the house permanently, the loan is repaid along with accumulated interest, through sale of the house. The borrower's heir(s) can also repay or prepay the loan with accumulated interest and have the mortgage released without resorting to sale of the house. However, in India the maximum tenure of the Reverse Mortgage Arrangement / Policy is likely to be introduced for 15 (Fifteen) years only.

Though, the Reverse Mortgage Loan is not required to be serviced during the borrower(s) lifetime or as the case may be, there are certain costs which may be required to be borne by the borrower(s) at the time of availing the loan. The borrower(s) is required to pay

(i) origination fee and closing costs, which may also be financed as part of the Reverse Mortgage Loan; and

(ii) premium for the mortgage insurance required to be taken by the borrower(s), insuring the Reverse Mortgage Loan.

The insurance is ultimately beneficial to the borrower(s) as incase the lender goes out of business, the Insurance Company shall ensure that the borrower(s) continues to have access to his loan funds and incase the loan amount surpasses the value of the home, the lender will recover its monies from such insurance. The borrower(s) shall in no case owe more than the value of his home.

The loan which the borrower(s) is eligible to receive is determined on the basis of

(i) the market value (built up equity) of the home as assessed by the lender; and

(ii) the age of the borrower(s); and

(iii) the interest rate at the time of origination.

The loan amount however, will be fixed on the basis of current value and not on possible future appreciation. The methodology adopted for ascertaining the quantum of loan including the detailed calculations, the rate of interest and assumptions (if any), are clearly disclosed to the borrower(s). In countries where Reverse Mortgage is already in existence, the quantum of loan that may be disbursed by the lender to the borrower(s) is calculated on the basis of the age of the borrower(s). Ex. The loan amount shall be equivalent to 45% of the value of home incase the age of the borrower(s) is between 60-70 and 50% if the age is between 71 – 75. As the concept is new in India, it may follow a similar criteria. In some other countries, the borrower(s) has three business days after signing papers in which to cancel the loan. Upon expiration of this period, the loan funds are disbursed. It is also proposed that a similar system may be followed in India granting the borrower(s) time to cancel or avail the loan before the monies are disbursed to him.

The valuation of the home may also be required to be re-valued at intervals that may be fixed by the lender depending upon the location of the home, the physical state of the home, etc. The quantum of loan may accordingly undergo revisions based on such re-valuation of property at the discretion of the lender.

The quantum of the loan approved by the lender may be received by the borrower(s) in one or a combination of the following manners:

- Up front lump-sum payment; or
- Lump –sum payments in one or more tranches; or
- Periodic payments (monthly, quarterly, annual) to be decided mutually between the lender and the borrower(s) upfront; or
- Committed Line of Credit, with an availability period agreed upon mutually, to be drawn down by the borrower(s); or
- A combination of any of the above arrangements.

Generally the nature of payments is decided in advance as part of the Reverse Mortgage Loan covenants. The lender at his discretion may consider providing for options to the borrower(s) to change.

The loan may be used by the borrower(s) for any purpose including upgradation, renovation and extension of residential property, 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. The only limit on how to use a Reverse Mortgage Loan is one's imagination.

Tax Treatment of Reverse Mortgage Loan

Though the receipts of the Reverse Mortgage Loan in various countries are tax free, the treatment of the same in India is still under consideration along with the concept itself. Although a handful of Financial Institutions have initiated the facility of Reverse Mortgage in India, the National Housing Bank is endeavouring towards crystallizing its concept and scheme. Reverse Mortgage was introduced for the first time by the Hon'ble Finance Minister while presenting Budget for 2007-08. The modalities in relation to taxability of the payments to be received under the Reverse Mortgage are yet to be considered and have to be worked upon. However, the thrust of the considerations and deliberations shall focus on imposing no burden of tax on the borrower(s) as the nature of the Reverse Mortgage Loan is on the lines of a welfare loan for the Senior Citizens.

A Reverse Mortgage is an excellent financial planning tool for older homeowners to supplement their retirement income, pay for healthcare costs, make home improvements, buy a second home, and/or establish an emergency fund, while staying in their home. The Reverse Mortgage Loan may be used anyway the borrower(s) wishes as it is his money and his house.

So modern wisdom rightfully says, one can have the cake and eat it too.