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Review Paper- Reverse Mortgage in India

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Abstract –

In today's fast paced business environment, banks operating in retail space require a change resilient vertically integrated value chain for delivering the most competitive product and services. This need is redefining the boundaries of a bank's value chain creating greater thrust for the value add, right from the lowest end of the delivery channels. In the loans and advances product space, this requires an integration strategy right from sourcing, evaluating and servicing to collections, recoveries and written-off management. This project elaborate the delivery capability of bank, operating loan against property space which is faced with challenges of rapid changing products and business process and also to handle large transaction volume handling due to high business volumes.

This project focuses on the business challenges faced by one of the largest bank having 3000 concurrent users and with over 3 million customers worldwide. The bank needs to implement a business process with the needed level of automation and to build up services capabilities foe tapping a nationwide market for loans and advances business of secured and unsecured portfolio.

Keywords – Reverse Mortgage, Retirement Planning, India, Financial Independence.

I. INTRODUCTION-

If you're looking for a point in time at which the concept of loans came into being, you're in for a long search. Lending in any form is pretty much second nature and the practice probably extends way back into the mists of time. Now, that's not to say that there's no documentation about the history of loans. In fact, there are reams of historical documents dating back thousands of years that show the evolution of the loans industry Some of the earliest monetary loans have been documented in the Bible! Other cultures, including the Romans and ancient Greeks, have ample evidence of a thriving lending industry that dates back thousands of years.

But the oldest records go all the way back to Assyria and Babylonia where merchants of the time made grain loans to farmers and traders. The mechanisms in place were pretty sophisticated, even by modern standards, with lenders accepting both deposits and acting a little like a bureau de change.

Now if you're wondering who came up with the idea of paying interest on loans, you can lay the blame at the door of the Mesopotamians The main European economies didn't really catch on the power of lending until around the 13th century when the all-powerful churches realised the financial benefits of raising much needed revenue in the form of interest.

But how did loans evolve? Let's take a look.

Even though money lending is a very old practice, it didn't really evolve much until the Middle Ages. At this point in history a rapid change was seen in the ways money could be borrowed.

INDENTURED LOANS

Good old indentured loans; aka a way of ripping off the poor!

Used in Europe from the Middle Ages through the 1800's, the indentured loan was a mechanism that allowed the landed gentry and rich tradesmen to borrow money for the purchase of land or a house. In return for the necessary finances, the lender would be expected to work off their debt by working on the lender's estate.

When you think about it, indentured loans are a convenient way for both parties to get what they needed. But, some unscrupulous lenders over-inflated the debt or interest payments, resulting in the borrower effectively becoming a slave.

BANKING LOANS

Fortunately, there were lenders out there who recognized the value of repeat custom and were practicing an early form of sustainable lending at the same time as indentured loans were thriving. Early Italian pioneers were setting up stalls in local markets from which they would lend money. An interest rate was applied to the loan and the borrower was expected to pay back the outstanding monies at set intervals. Now you can see where modern banks get their ideas from. In fact, the word "bank" is derived from "banca"; the benches on which the moneylenders sat when trading. The only problem with this type of loan was the wild variation in interest rates which were set by each lender and not controlled by a central authority.

Point of interest: if a lender decided he wasn't making enough money he would smash his bench ("bankrupt") and look for another job. This phrase translates into "bankrupt", although the implications are somewhat different nowadays.

REVERSE MORTGAGE IN INDIA

The concept of reverse mortgage, although new in India, is very popular in countries like the United States. Recently, National Housing Bank (NHB), a subsidiary of the Reserve Bank of India (RBI), released draft norms of reverse mortgage (the final guidelines are awaited).

Following are some of the key features of the scheme from the draft norms.

1. Reverse Mortgage Loans (RMLs):

Reverse Mortgage Loans (RMLs) are to be extended by Primary Lending Institutions (PLIs) viz. Scheduled Banks and Housing Finance Companies (HFCs) registered with NHB. The PLIs reserve their discretion to offer Reverse Mortgage Loans. Prospective borrowers are advised to consult PLIs regarding the detailed terms of RML as may be applicable to them.

2. Eligible Borrowers:

• Should be Senior Citizen of India above 60 years of age.

• Married couples will be eligible as joint borrowers for financial assistance. In such a case, the age criteria for the couple would be at the discretion of the PLI, subject to at least one of them being above 60 years of age. PLIs may put in place suitable safeguards keeping into view the inherent longevity risk.

• Should be the owner of a self- acquired, self occupied residential property (house or flat) located in India, with clear title indicating the prospective borrower's ownership of the property.

• The residential property should be free from any encumbrances.

• The residual life of the property should be at least 20 years

• The prospective borrowers should use that residential property as permanent primary residence. For the purpose of determining that the residential property is the permanent primary residence of the borrower, the PLis may rely on documentary evidence, other sources supplemented by physical inspections.

II. INDIAN MARKET POTENTIAL –

India-specific Characteristics of Relevance to RM

• There are no universal old age social security related benefits. Only about 10% of the active working population is covered by formal schemes. This would substantially enlarge the potential target market for RM: 'house-rich, cash-poor'.

• A much lower proportion of urban households, and by implication, less scope for RM.

• A much larger proportion of elders co-living with their family members of subsequent generations and hence less scope for RM

• A possibly stronger bequeath motive, reducing the scope for RM.

• A possibly higher real rate of appreciation of real estate and housing prices, making RM more attractive to the lender.

• Widespread under valuation of real estate properties to accommodate transactions involving unaccounted money and evasion of taxes on property and real estate transactions.”.

• Complexity, variety and location specific variations in types of home ownership.

a. Benami holdings/ 'Irrevocable power of attorney'

b. Leasehold/ freehold

c. Land use conversion regulations

d. Floor space regulations

e. Rent/ tenancy controls

f. Disposal of ancestral property

• Absence of competitive suppliers for immediate life annuity products. This, in turn, is a consequence of,

a. Lack of data on old age mortality rates

b. Lack of long-term treasury securities for managing interest rate risks of annuity providers

• The fledgling nature of the secondary markets for mortgage and securitization of mortgage loans

• India specific legal and taxation issues

a. License/ Permission required under insurance/ banking regulation for offering RM

b. Income tax treatment for RM lender and borrower

c. Capital gains on property

d. Reporting and provisioning by the lender as per banking/ insurance regulation

e. Seniority of RM claims vis-à-vis other secured lenders

f. Status of RM loan in case of insolvency.

OLD AGE POPULATION

Though the Indian population is still comparatively "young', India is also 'ageing'. Some demographic projections for India indicate that

• The number of elderly (>60 yrs) will increase to 113 million by 2016, 179 million by 2026, and 218 million by 2030. Their share in the total population is projected to be 8.9 % by 2016 and 13.3% by 2026. The dependency ratio is projected to rise from 15% as of now to about 40% in the next four decades

• The percentage of >60 in the population of Tamil Nadu and Kerala will reach about 15% by 2020 itself!

• Life expectancy at age 60, which is around 17 yrs now, will increase to around 20 by 2020.

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III. HOW REVERSE MORTGAGE WORKS -

Mr. Patil has retired after what can be called a very fulfilling career with a leading engineering company. His only daughter is married and well settled in Bangalore. He owns a large house in Thane - worth about Rs 80 lakh (Rs 8 million), but he has limited savings (including PPF and EPF) of Rs 10 lakh (Rs 1 million) to generate any major income.

He is not expecting any pension either. His worry now is to pay for his modest monthly expenses of Rs 20,000. His financial assets can at best generate Rs 10,000 per month for him and the income thus generated will not keep pace with inflation - meaning that after five years, when he will require Rs 30,000 per month, while his financial assets will still generate only Rs 10,000 per month.

The only option he had earlier been to rent his house and move to a smaller house himself or to sell his house altogether and invest the proceeds to eam a higher monthly income. Either way, in his old age, he will be forced to look around for accommodation and keep on worrying about the ising rents -- not a very happy prospect. This is where reverse mortgage can be of great value.

Budget 2007 amongst other things gave a green signal to the launch of Reverse Mortgage - a widely used instrument in the developed world by the elderly to derive cash flows from their owned house. The popularity of the instrument lies in that it converts an illiquid asset - the house into liquid cash flows for the owner, typically a senior citizen. A more attractive feature is that senior citizens can continue to live in that house even after drawing cash-flows from it.

Here is how it works. Reverse mortgage as its name indicates operates in a manner opposite to that of the typical mortgage such as a home loan. In a typical mortgage, we borrow money in lump-sum right at the beginning and then pay it back over a period of time. In our payback – the EMI a portion goes towards paying the interest and the remaining goes towards paying back principal.

All along, we pledge the asset namely the home we have bought with the loan to the bank. This asset is the security against which the bank is lending to us. In reverse mortgage, we pledge a property we already own (with no existing loan outstanding against it). The bank in turn gives us a series of cash-flows for a fixed tenure. These can be thought of as reverse EMIs.

There are various forms of reverse mortgage available in the developed countries. The specific format National Housing Board (the facilitator for housing finance in India) is promoting is one in which the tenure is 15 years and the owner of the house and his/her spouse continue to live in the house till their death -- which can occur later than the tenure of the reverse mortgage.

IV. OBJECTIVE OF STUDY –

To study the effect of artificial intelligence in recruitment process

V. RESEARCH METHODOLOGY –

Research methodology in a way is a written game plan for conducting research. Research methodology has many dimensions. It includes not only the research methods but also considers the logic behind the methods used in the context of the study and complains why only a particular method of technique has been used. The basic task of research is to generate accurate information for use in decision making. Research can be defined as the systematic and objective process of gathering, recording and analyzing data for aid in making business decisions.

As the project involves analyzing of financial structure, the research is exploratory in nature, covering financial parameters and come of the important ratios to carry out research.

DATA COLLECTION METHOD:

The data will be collected using both by primary data collection methods as well as secondary sources.

(i) **PRIMARY DATA-** Most of the information will be gathered through primary sources. The methods that will be used to collect primary data are books, research, newspapers, wave sites etc.

(ii) **SECONDARY DATA** - Interviews, questioners, fill ups, different nationalized banks borrowers, financial consultants etc. Secondary data of this project on Reverse Mortgage will be collected from -

• Interviews from different categories of target group.
• Questionnaires will be arranged to get the data.
• Fill ups
• Different nationalized banks
• Borrowers
• Financial consultants

VI. WHY REVERSE MORTGAGE HAS FAILED TO TAKE OFF IN INDIA -

Reverse mortgage has proven to be a very effective tool to supplement one's income in old age, particularly in Western countries like the United States. However, despite being introduced 7-8 years back in India, it has failed to take off the way industry experts had hoped.

But before finding out the reasons, we need to take a look at what reverse mortgage is all about.

Reverse mortgage, in fact, is a special type of loan against a home that allows the borrower to convert a portion of the equity in the property into cash. In simple words, reverse mortgage is a scheme where any individual (senior citizen) who has a self-occupied house and is looking for regular income can mortgage it to a financial institution. In return, the institution pays the person a fixed periodic (monthly, quarterly, annual) installment or a lump-sum amount at a defined rate of interest.

"The payout is generally for a fixed term of 15-20 years, after which the borrower or legal heirs (on death can release the house by either repaying the loan or the company settles the amount by selling the house. Any excess in the process is paid to borrower or legal heirs as the case may be," says Jitendra P.S. Solanki, a SEBI-registered investment adviser and founder of JS Financial Advisors.

With a traditional second mortgage, or a home equity line of credit, one must show sufficient income versus debt ratio to qualify for such a loan, and needs to make monthly payments towards the mortgage. However, reverse mortgage pays the borrower, and is available regardless of current income or assets.

"The amount that can be borrowed depends on the borrower's age, the current interest rate, other loan fees, and the appraised value of the property. One does not have to make payments, because the loan is not due for paying off as long as the house is one's principal residence. However, like all homeowners, the borrower is still required to pay applicable real estate taxes and other conventional payments like utilities," says a Jones Lang LaSalle (JLL) India report.

Thus, as it is clear, unlike the other lines of credit, reverse mortgage doesn't require income or credit history of the borrower as repayment is based on the value of the house owned by the borrower. Also, "in reverse mortgage, the borrower doesn't have to pay principal or interest payments during the loan tenure (15-20 years). More importantly, the amount received from the lender with property as collateral is not taxable, as the same is considered as loan and not income with ownership fixed with the owner," informs Chintan Patel, director-real estate practice, Emst & Young.

However, despite having so many advantages and global acceptability, reverse mortgage has not managed to captivate the Indian market because of multiple reasons.

Anuj Puri, chairman & country head, JLL India, says, "In the first place, it is a predominant tendency for Indians to treat owned property as an important family asset. This asset is usually intended to be inherited by the next generation, and would be liquidated only as a last resource.

Also, the elderly tend to hold a place of importance in Indian culture. Property-owning senior citizens are generally assured of care and support in their golden years."

VII. CONCLUSION –

Reverse mortgage in simple terms is a rather unconventional retirement tool. The term loan contract provides for foreclosure under such conditions, this seems to be impractical and sure to result in litigation and bad publicity for the lender. Experience to date may not be a reliable guide to the future as most of the experimental schemes are in their infancy. Losses due to moral hazard may take many years to develop. Competitive pressures for achieving volumes in future may increase this risk.

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