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Liquidity Planning During Sunset Years: A Study of Reverse Mortgage Scheme in India

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ABSTRACT *The present study brings into light an emerging liquidity planning scheme during the post retirement years. The changing requirements and living standard of the masses have made the financial institutions in India to come out with a new loan product better known as 'Reverse Mortgage Loan' to plan the finances during the retirement years. The study spotlight the benefits as well as the operational guidelines issued by the regulator National Housing Bank over a period of time. A hypothetical case has also been taken to explain the working of the Reverse EMIs by the lender for a fixed period of time.*

When we think of the term ‘Financial Planning’, the first word that comes into our mind is ‘Companies’ or other institutions where the financial plans act as an important part during the board meets. But now a day, the term ‘Financial Planning’ has not been restricted only to the corporate world. The principles and the ideologies of the financial planning has been extended to the life of a common person as well, which in simpler terms denoted as ‘Personal Financial Planning’. If you have taken birth, then the planning part starts from that moment itself. The personal financial planning in a narrow sense means management of money related matters, but in a broader sense it comprises each and every aspect of the finance like planning about Insurance, Debt, Retirement, Investment, Estate and Taxes.

The topic which we are discussing is Liquidity planning during the sunset years or in other words planning about cash inflows during the retirement years of a person. Generally, a person spends around 35 years of his life in eking out his livelihood. During this time period, he saves money by investing in Provident fund, Insurance, annuity and non-annuity based pension plans, Mutual funds and through many other options available. The ultimate goal is to garner a good chunk of money to lead a tension free life after his retirement. On the other hand, what if a person has not invested and saved any sum of money throughout his wealth accumulation stage and now on the verge of making itself dependent on others after retirement. A situation where a person is out of the resources in the context of monetary terms, a passive option of Reverse mortgage loans comes into the picture to make both ends meet.

In the context of Indian retirement plans, there are two ways a person can build his wealth to support his post retiral years. The first way is through employer provided plans and the second way is by personally creating the plans. The employer created plans can further be classified on the basis of the Government sector and private sector. The plans are created keeping in view the age, risk taking capacity, and income level of the proposed subscriber. These plans act as a cushion for the subscriber during the retirement years. Lets take an example to comprehend the benefits of investment during the wealth accumulation years. Suppose, Ms Christie, age 30 years, presently spends around INR 37,500 per year as personal expenses and desires to retire at the age of 60 years. She wants to plan out her post retirement cash inflows by investing INR 671 every month for the coming 30 years in an equity fund, after considering her post retirement expenses. The expected rate of return and inflation is 12% p.a. and 5% p.a. respectively for throughout the accumulating years. After 30 years, she will be having INR 23,46,019 as a corpus at the time of retirement, which she can use for the rest of her life assuming as 80 years. At the time of retirement, she can withdraw the amount and invest in a Fixed deposit to live on the interest benefits.

The present study highlight the various features of the Reverse Mortgage scheme prevalent in India by taking a hypothetical case of Mr. Edwin Baretto. The study is necessary to be undertaken so as to bring into light a safer product, which is available in India from the past 7 to 8 years but still at an emerging stage and less popular. The annual reports of the National Housing Bank depicts the situation of the Reverse Mortgage loans in India from the year 2007. As on 30th June, 2011 the total loans sanctioned under the Reverse mortgage scheme were INR 1740 whereas the number fell down in the year 2013 to INR 1711 thereby indicating that the scheme will take a lot more time to get popularized among the senior citizens in the coming years.

REVERSE MORTGAGE SCHEME

Oh! I will be retired in December of this year and don’t have any financial plan for my future yet! Don’t think the idea of disturbing my sons at abroad as they are already not leading an easy life. Working after retirement is not an option for me. I really want to relax after my retirement with my wife, but then what about the earning source at home. Who will earn for both of us?! I wish I had bought a pension plan or systematically saved a good chunk of money to lead an effortless life after my retirement, but I think now I am too late for it!

If all these questions arise in your mind too at the age of your retirement, then we think that you are also not aware of the Reverse mortgage loans provided by the financial institutions but only if you have a self occupied permanent place of living. Eventhough a person has an annuity plan or a pension plan for his retirement years, but a situation can arise where additional cash inflows are required to meet out certain expenses. You can earn a regular income

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just by sitting at your permanent place through Reverse mortgage.

The reverse mortgage is a type of mortgage in which a homeowner can borrow money in installments or a lump sum from a financial institution by pledging his house, making the scheme opposite to the regular mortgage loans. In case of the regular mortgage loans, the borrower is supposed to return the principal amount along with the interest in a pre-fixed instalment period. On the contrary, in case of Reverse Mortgage loans, a financial institution (generally Banks and Housing finance companies) pays a certain sum of money to the owner of the property for a certain period of time at his request. A senior citizen receives a regular flow of income and continues to reside in the property till the end of his life. Sacks and Sacks (2012) examined three strategies that can be used to supplement the retirement income by using the Reverse mortgage scheme. A combination of active as well as passive strategies has been used by the authors to arrive at a conclusion that active strategies along with the reverse mortgage line increases the residual net worth of an individual. Similarly, Sass et al. (2014) highlighted the pros and cons of the reverse mortgage scheme that can really help in supplementing the retirement income.

WORKING OF THE SCHEME

Now the next question arises that how does a Reverse mortgage work? The working of the Reverse mortgage is very simple, but operationally took a longer period of time considering the involvement of an immovable property. When a home is pledged, the bank determines the monetary value of the house on the basis of the current property prices and other property related facts. After checking the market value of the property, the lender determines the reverse EMI amounts that shall be paid to the property owner, keeping in view the margin requirements, interest rates and frequency of the instalments. As the concept of the Reverse mortgage is based on the reverse EMIs, from the lender to the borrower for a pre-fixed period of time, the interest of the owner in the property reduces over a period of time. The amount shall be recovered from the legal heirs after the death of the borrower.

REGULATORY CONDITIONS

A. Eligible Borrowers:

The person should be a senior citizen above the age of 60 years. In case of couples, at least one of them should be above 60 years of age and the other partner not below 55 years, coupled by the maximum tenure of the loan as 20 years. A borrower should be the owner of the self occupied property located in India. The institution is required to ensure that the borrower's equity in the house at any time should not fall below 10 percent. A re-valuation provision of the property has also been inserted by the regulator.

B. Payments

The payments can be done by the lender monthly, quarterly, half-yearly, annually and even in lump sum subject to certain conditions. A cap of INR 50,000 has been imposed on the monthly payments, whereas the maximum lump-sum payment that can be taken by the borrower shall be 50% of the total eligible amount of loan with an overall cap of Rs.15 lakh or amount as may be notified by the Government of India. The lump sum amount can be taken for medicinal purposes for self, spouse and dependants, if any. The periodic loan amount can also be used for the upgradation, renovation, maintenance and extension of residential property.

C. Settlement

The loan recovery stage arises on the death of the last surviving borrower and the recovery is done out of the sale proceeds of the house property. The legal heirs of the borrowers are given an option to settle the loan amount along with the interest part before selling the property. The amount which is received by the borrower through a reverse mortgage is considered as to be loan not as income. So, it doesn't attract any Income tax under Section 10 (43) of the Income-tax Act, 1961, but a borrower is required to pay the capital gains tax at the time of disposal of the property to recover the loan.

Apart from the Reverse mortgage loans, now a days, we have the option of RMLeA that is Reverse mortgage loan-enabled annuity. Functioning of both the Reverse mortgage and RMLeA is almost the same. Now you must be thinking that if the functioning is almost same, then how they are different from each other? Yes, there functioning is same but up to a particular level. Under Reverse mortgage, a loan amount is paid for a tenure of 20 years while RMLeA pays the loan amount for the lifetime along with the difference of a tie up with an Insurance company. In the present study, we are restricting ourself to the Reverse mortgage loans only.

HYPOTHETICAL CASE

Let us take an example for better understanding of the Reverse mortgage loans, working and how it is calculated? Mr. Edwin Baretto, having no child, has spent around 35 years of his life working in a telecom sector. At the time of his retirement, he was having a total of INR 10,00,000 from the Gratuity benefits, Provident fund and other savings. Mr. Edwin purchased an immediate annuity plan from an Insurance company but the monthly payments determined by the company are very low less than INR 10,000 a month. To live a tension free life along with his wife and to make both ends meet, Edwin decides to take a loan under the reverse mortgage scheme.

Exhibit-1

Value of a house 80lakh	**Age of borrower** 60 years	**Rate of interest** 13%
Loan to value **Ratio** 90%	**Tenure of loan** 20 years	**Payment frequency** Monthly
Amount of loan 72 lakh	**Total instalments** 240	**Monthly payment** Rs.6353

The house in which both Mr. and Mrs. Baretto has been residing for the past many years, is located at one of the costliest areas in Mumbai. Let us assume that the value of the property comes out to be 80lakh and considering a loan to value ratio to be 90 percent, the amount of loan that a borrower can take comes out to be 72lakh. The prevailing fixed rate of interest is 13% p.a. and tenure of the loan is for 20 years. Payments are received every month, that means the number of installments comes out to be 20years*12months=240installments.

A simple formula for calculating reverse mortgage loan amount is: (as available at the National Housing Bank web-

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site)

$$EMI = \frac{Loan\ to\ value\ ratio * Value\ of\ Property * (Interest\ rate/frequency)}{[1 + (Interest\ rate/frequency)]^{\wedge}n - 1}$$

Where n is the number of instalments and frequency is the number of times the amount is paid within a year. After putting values in their respective places monthly payment comes out to be INR 6353. With this additional and supplementary amount of INR 6353, Mr. Edwin can live a tension free life after retirement. The amount of repayment at the time of recovery shall be equivalent to INR 72,00,000. This is the main feature of the scheme that the recovery amount shall not be more than the value of the property.

CONCLUDING REMARKS

The Reverse mortgage scheme is a retirement planning tool in the hands of a senior citizen, which is helpful in creating a new source of cash flow for medical purposes as well as other genuine purposes. Under the Reverse mortgage scheme, the lender stops the payouts after the tenure of 20 years, but the borrower can continue to live in the house till death without getting more amount. The legal heirs comes into the picture at the time of disposal of property. If the heirs can repay the amount of the loan, then the disposal is not required.

But on the other side, if the Reverse mortgage scheme is providing regular payouts and that too without working for anything, still the scheme is not that prominent in India! What is the reason behind it?! A reason for this could be that a house is the only main asset that a person has and that too earned after decades of hard work. In a country like India, savings throughout the life of a person acts an important part and that too in the form of a house property. There is an emotional attachment of the residers with the house. New generation might not have a concern for their parents, but we know that every parent just live and earn for the sake of their children. Moreover, after retirement, a person wants to live a debt free life without any obligations thereon. Apart from these consumer driven factors, there are certain reasons which are attached with the distributors (financial institutions) who are not making efforts in a much more caliberated manner to sell these loan products. Thus, we can say that this scheme is still in progressive stage and may achieve popularity with the passage of time. This scheme is not on the top of anyone's mind, but, may have created a space for being last option!

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