Terra Economics and Analytics Lab
Whitepaper 11
November, 2021

Whitepaper 11- Evolution and Current Status of Reverse Mortgages in India

A reverse mortgage is a loan which allows senior citizens (people aged above 60 years) to avail of periodic payments from the mortgage-lender while remaining the owner of their properties. Borrowers are not required to service reverse mortgages during their lifetimes. The central government introduced the Reverse Mortgage Scheme in the Union Budget (2007-08) to enable senior citizens to earn additional income for the repair, maintenance or upgrading of their houses or meeting other personal expenses. While the borrower has the option to repay the reverse mortgage including the principal and interest in his lifetime, the repayment typically occurs when the lender sells off the mortgaged property upon the death of the borrower. Alternatively, the heirs of the borrower repay it after the borrower's death and retain ownership of the property. Currently, in India, some nationalised banks such as State Bank of India, Punjab National Bank and Bank of Baroda, and some private players including HDFC, Kotak Mahindra and Bajaj Finserv offer reverse mortgages.[1]

Salient features

The central government appointed the National Housing Bank (NHB) as the chief regulator of the Reverse Mortgage Loan Scheme. In this capacity, the NHB may refinance lenders for the disbursement of reverse mortgages.[2] The key features of the guidelines[3] prepared by the NHB to govern reverse mortgages are:-

- **Eligibility of borrowers:-** Only borrowers aged 60 years and above may avail of reverse mortgages. Married couples may also borrow these, subject to the condition that at least one of them is more than 60 years of age and the other is not below 55 years of age.

[1] Mint (2015)- Why Reverse Mortgage is Unpopular
[2] National Housing Bank- A guide to Reverse Mortgage for Senior Citizens
[3] National Housing Bank (2007)- Reverse Mortgage Loan- Operational Guidelines

- **Eligibility of lenders:-** Only primary lending institutions i.e. Scheduled Commercial Banks, Housing Finance Companies and any other institutions which may be notified by the government are allowed to extend reverse mortgages.
- **Payment method:-** Borrowers may opt for periodic payments, the amount and frequency of which may be decided jointly by them with the lender. However, the NHB capped the periodic payment amount at INR 50,000 per month. Alternatively, they may opt for a Committed Line of Credit, with an availability period agreed upon mutually, to be drawn by the borrower. Lastly, they have the option of availing of periodic lump sum payments the amount of which may not exceed 50% of the loan amount or INR 15 lakh for that period, whichever is lower.
- **Permissible use of funds:-** Borrowers are allowed to use the funds received from the lender for carrying out repairs and renovations of their property, or repaying other mortgages or meeting medical expenses or any other personal expenses. They may not, however, use these for speculative purposes.
- **Valuation of property:-** Lenders may appoint in-house consultants to determine the value of the property, which may be revised after at least every five years.
- **Mortgage value:-** Most lenders typically cap the mortgage amount at INR 1 crore. The average ticket size of reverse mortgages lent by the State Bank of India in 2015 was INR 28 lakh.
- **Loan to Value Ratio:-** The LTV varies between 40% and 60% depending on the age of the buyer. Lower the age of the borrower, lower is the LTV.
- **Tenure of mortgage:-** Lenders may not extend the reverse mortgages for a tenure of more than 20 years. Borrowers who outlive the tenure are not required to service it in their lifetimes. However, interest will continue accruing till its repayment.
- **Interest rate:-** Interest rates are typically fixed in the region of 10 to 12 percent. Lenders offer both fixed and floating lending rates.
- **Processing fee:-** Processing charges are in the range of 0.25%-0.50% of the loan amount with a minimum and maximum cap.
- **No registration with registrar:-** Borrowers need not register with the Sub Registrar's Office (SRO) while borrowing a reversible mortgage. They are however required to to pay the processing fee at the SRO.
- **Cancellation:-** Borrowers may cancel the reverse mortgage within three days of entering into the transaction with the lender by repaying the full amount of the loan. The borrower is not liable to pay any interest in such a case.
- **No negative equity guarantee:-** The borrower will never owe more than the net realizable value or market value of their property at the time of repayment.
- **Taxability:-** The funds extended by the lender to the borrower are not counted as personal income and thus not taxable under income tax.

- **Liability for foreclosure:-** The lender may foreclose the borrower's property in the event that:-
    - He has not stayed in the mortgaged property for a continuous period of 1 year
    - He fails to pay property tax on it or fails to maintain it
    - He declares bankruptcy
    - He donates or abandons the mortgaged property
    - His actions after mortgaging the property affect the security of the property for the lender. For instance, if he rents it out or adds a new owner to the property
    - He misrepresents his personal information or information relating to the property at the time of executing the reverse mortgage transaction
    - The government seeks to acquire it for public use
    - The government condemns it for health or safety reasons

Advantages of obtaining reverse mortgages

According to Reserve Bank of India (RBI) estimates, 77 percent of the household wealth in the country is channelled into real estate.[4] Thus, for many borrowers in India, who are 'asset-rich, but cash poor', reverse mortgages are a means to earn a steady income by monetizing their residential properties.[5] The no negative equity guarantee offered by lenders under the NHB mandate also ensures that borrowers do not end up paying more than the market value of the property when they or their heirs repay the mortgage. Furthermore, as long as borrowers continue to reside in their mortgaged property while adhering to the conditions of the loan, they do not have to worry about lenders foreclosing their properties. The added benefit of the periodic funds obtained by the borrower being non-taxable, make reverse mortgages an attractive option for senior citizens looking to generate income from their real estate. The provision allowing spouses of deceased borrowers to retain the rights of the property also ensures security for both the borrower and his spouse. Lastly, although the equity of the borrower reduces as the mortgage interest accumulates, he continues to remain the owner of the property, retaining the option of repaying the mortgage or having his heirs service the loan.

From the perspective of the lender, selling off the property upon the demise of the borrower and his spouse would typically fetch a higher value of the property, sometimes amounting to even double the value at which it was mortgaged.[6] Additionally, since the prevailing interest rates charged on reverse mortgages are higher than those charged on regular mortgages, the lender ends up gaining a higher return on the mortgaged property.

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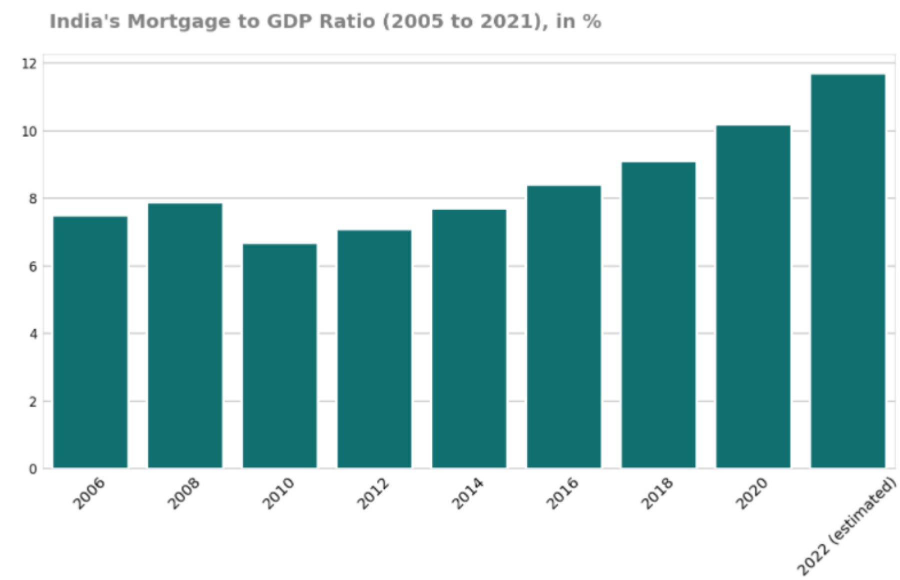
[4] Report of the Household Finance Committee (2017)- Indian Household Finance
[5] Times of India (2020)- Are you asset-rich but cash-poor?
[6] Divya Paul (2007)- Reverse Mortgage

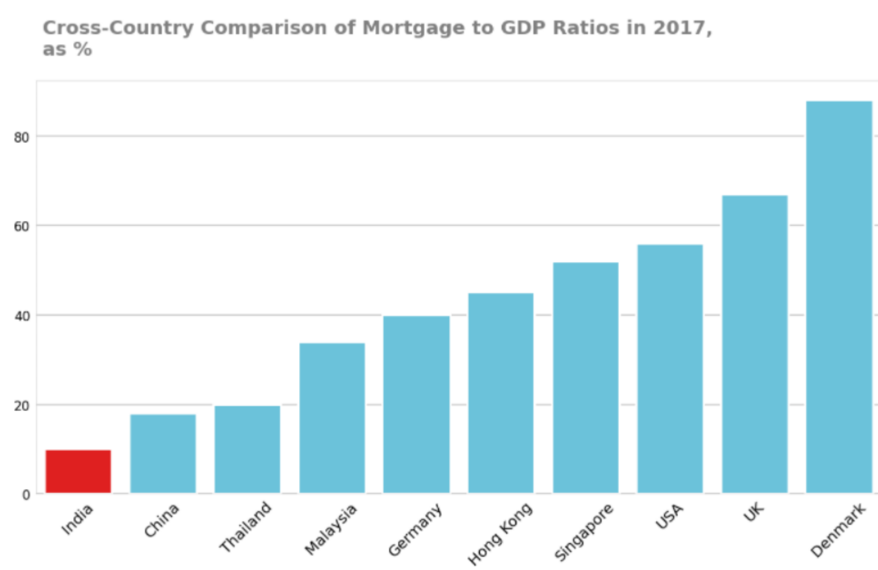
Challenges to introducing reverse mortgages in India

Although India's formal mortgage penetration is increasing, it continues to be low compared to other major economies.



Source: Reserve Bank of India (2019): Report of the Committee on the Development of Housing Finance Securitisation Market

**India's mortgage-to-GDP ratio has increased steadily over the last ten years.*



Source: Reserve Bank of India (2019): Report of the Committee on the Development of Housing Finance Securitisation Market

In addition to the fact that the prevalence of formal mortgages in India is low, reverse mortgages have also failed to take off in spite of the government launching the Reverse Mortgage Loan (RML) Scheme more than a decade ago.[7] Some of the reasons for the failure of the RML Scheme are:-

- Senior citizens are often reluctant to write away assets which can be inherited by the next generation. They often prefer to sell their bigger house and relocate to a smaller one, and use the proceeds from sale of the older house for their day-to-day expenses. They may also face some resistance from their heirs for signing away real estate.[8]
- The product has not received much publicity, giving rise to a lack of awareness of its benefits. For instance, there is an erroneous perception prevailing that borrowing a reverse mortgage amounts to pledging away one's property to the lender.
- The product was not initially successful because the periodic income sent by the lender to the borrower was thought to be too low.
- The risk of losing one's property in the event that the borrower or his heirs are unable to repay the mortgage serves as a deterrent to availing of this product.
- In a country wherein the average lifespan is 65 years, obtaining a reverse mortgage at the minimum age of 60 years is not an attractive option for many citizens.
- The total transaction costs, including the processing fee and interest, can amount to as much as 14% of the mortgage amount making it unaffordable for potential borrowers if they desire to move out of their property soon.
- From the perspective of the lender, if the market value of the borrower's property falls after his demise, the lender ends up bearing a loss.

India has one of the youngest populations globally, with an average age of 29 years. While reverse mortgages typically have a greater uptake in countries with aging populations and high home ownership rates, they can be leveraged as welfare-enhancing instruments in developing economies like India. In India, only 10 percent of senior citizens enjoy public pensions and with the waning of traditional financial support networks in a soon-to-be-aging society, reverse mortgages have the potential to prevent the financial exclusion of senior citizens.[9]

Reverse Mortgage Market in the World

It is mainly the advanced economies with a relatively high median age and an advanced financial market that have introduced reverse mortgages. These include the United States, Canada, Hong Kong, Australia, Canada, China and the United Kingdom.[10] However, the reverse

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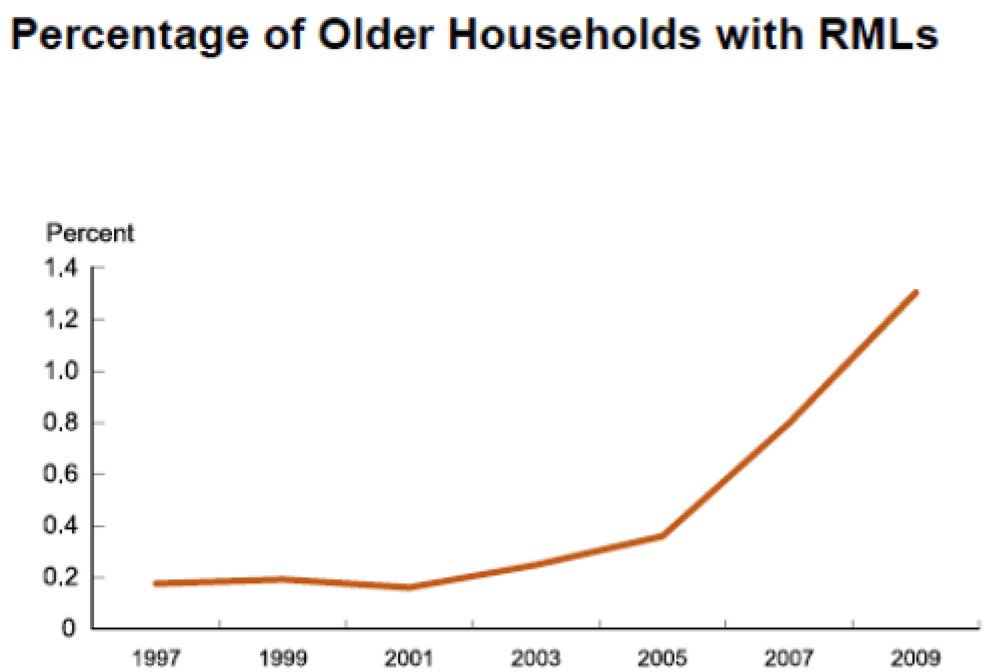
[7] The Hindu (2020)- Borrow, don't sell
[8] Mint (2015)- Why Reverse Mortgage is Unpopular
[9] World Bank Group (2020)- Reverse Mortgages, Financial Inclusion, and Economic Development
[10] Ong (2008)- Unlocking housing equity through reverse mortgages: The case of elderly homeowners in Australia

mortgage market size in these countries, like in India, is still small. In the United States for instance, which has the oldest reverse mortgage market, the percentage of seniors having a reverse mortgage stood at less than 1.5 percent in 2009 and increased to merely 2.2 percent in 2011.[11]



Source: World Bank Group (2020)- Reverse Mortgages, Financial Inclusion, and Economic Development

There are several common constraints which have led to the failure of reverse mortgage markets in these countries. Senior citizens often find it difficult to understand the product owing to its complexity. Reverse mortgages in the United States acquired a bad name after lenders foreclosed nearly 100,000 mortgaged properties whenever the borrowers missed a paperwork deadline or fell behind on taxes or insurance. News articles reported that some lenders targeted low-income black neighborhoods after the Great Recession in 2008 to sell the product to them while glossing over the risks associated with obtaining a reverse mortgage.[12] Apart from product complexity, bequest motives and high processing fees disincentivize seniors from obtaining reverse mortgages in all economies. In countries where moving to nursing homes is common, the possibility of leaving their mortgaged property early prevents seniors borrowing reverse mortgages.[13] In Europe, reverse mortgages are relatively common in the United Kingdom, but countries like France, Germany, Finland and Hungary have merely set up a legal framework for

[11] World Bank Group (2020)- Reverse Mortgages, Financial Inclusion, and Economic Development
[12] USA Today (2019)- Seniors were sold a risk-free retirement with reverse mortgages. Now they face foreclosure.
[13] World Bank Group (2020)- Reverse Mortgages, Financial Inclusion, and Economic Development

Ibid

their disbursement and sold very few products. Lower homeownership and lower home appreciation rates in these countries may account for the slow uptake of reverse mortgages.[14]

[14] Ibid