Reverse Mortgage: the new realty mantra

For many people born in the 1940s and '50s, a lifetime's savings have gone into building a home. True, the capital value of the home has appreciated, making them wealthy, but it has also locked up spending money in a non liquid asset. There is too little cash for the pleasures of life and dwindling interest rates have only accentuated the problem…

"These days the urban male in India typically lives up to the age of 82," says S Sridhar, chairman and managing director, National Housing Bank. Considering that the retirement age in India is 58, one typically lives 24 years after retirement. With rising inflation, it becomes difficult to fund these years by investing in traditional instruments. The answer can be found in the West, specifically in the US, where the concept of reverse mortgage is hugely popular among the newly retired. Essentially, a reverse mortgage is a loan against your home that you do not have to pay back for as long as you live in that house.

The concept

Reverse mortgage is a financial contract between a homeowner and a financier. This contract enables the homeowner to receive a stream of income, especially in retirement, from the future realizable value of the home. The principle of reverse mortgage can be applied to any asset, but its most utilitarian application is in the context of homes and retirement.

A "reverse" mortgage is a loan against your home that you do not have to pay back for as long as you live there. The cash you get from a reverse mortgage can be paid to you in several ways:

all at once, in a single lump sum of cash;
as a regular monthly cash advance;
as a "credit line" account that lets you decide when and how much of your available cash is paid to you; or
as a combination of these payment methods.

No matter how this loan is paid out to you, you typically do not have to pay anything back until you die, sell your home, or permanently move out of your home. To be eligible for most reverse mortgages, you must own your home and be 62 years of age or older.

The benefits

In the absence of provisions for social security in the country, a product like reverse mortgage has numerous benefits. You will not be financially dependent on anyone. The loan that you receive is not serviced during your lifetime.

While you unlock the value of your house, you continue to live in that property. Reverse mortgage enables fund inflows when income sources are generally restricted and tend to fall markedly as compared to your working life.

What if you outlive the loan tenure? Under the present recommendations of the NHB, you need to be 62 years of age and the tenure of the loan is fixed at 15 years. However, if you outlive the tenure of the loan, you will not be asked to move out of the house. Although payments made to you will stop after 15 years, the interest will keep accumulating till the accounts are finally settled. There is talk of adding insurance to reverse mortgage. So the premium for that will be deducted from the payment made to you. The corpus accumulated at the end of 15 years will be used to fund the years that you outlive the loan tenure.

Punjab National Bank has become the first national bank to launch its reverse mortgage scheme. Other banks are expected to soon enter the fray. Finance companies like Dewan Housing Finance have also launched a similar product. Given India's growing population of pensioners, it is an idea whose time has come.