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Reverse Mortgage Loan Option- A Liquidity Management Tool for Senior Citizens amidst Changing Demographics of India

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Abstract: *This article intends to study a Reverse Mortgage Loan Scheme (RML), a relatively new financial planning tool introduced by Government of India in 2007-08 for senior citizens to provide them an additional source of income by unlocking the value in home equity. The paper presents the operational guidelines of RML scheme and proposes to study the need of this product against the backdrop of changing social and demographic structure.*

Keywords: *senior citizen, reverse Mortgage Loan (RML), home equity, demographics of India, social structure*

I. World Economic Order And Demographics

The economic think tanks believe that the United States, China and India would be the three major economies in the world leading to a transformation from unipolar world to tri-polar world by 2050. There is a very high probability that in terms of global power, the world will become bipolar by 2025 and tri polar by 2050 estimate by Arvind Virmani (Director, Indian Council for Research on International Economic Relations). In a recent working paper he concludes "that the current unipolar world will be transformed into a bipolar world during the first quarter of this century, and into a tri-polar one (China, USA, India) during the second quarter of the century." Europe will fade away.[3]

Kathleen and Powell find that a 10% increase in the fraction of the population ages 60+ decreases the growth rate of GDP per capita by 5.5%. Two-thirds of the reduction is due to slower growth in the labor productivity of workers across the age distribution, while one-third arises from slower labor force growth. Our results imply annual GDP growth will slow by 1.2 percentage points this decade and 0.6 percentage points next decade due to population aging. [2]

II. India's Growth Trajectory And Demographics

The IMF forecasts India's GDP to grow at 7.5% over the next two years. This indicates the speeding economic development of India which currently is a USD 2 trillion economy. The developmental economics states that country's development is a combined outcome of labour force and its productivity.

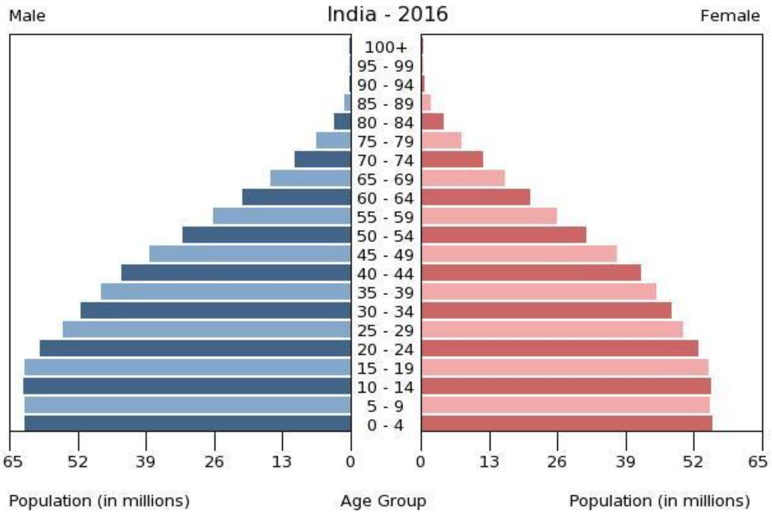
While many Asian countries are aging (Japan most notably), approximately half of India's 1.2 billion people are under the age of 26, and by 2020, it is forecast to be the youngest country in the world, with a median age of 29. [8]

Demographic Profile of India 2016
Population 1,266,883,598 (July 2016 est.)
Age-structure 2016 estimate

Age group	Proportion
0-14 years	27.71%
15-24 years	17.99%
25-54 years	40.91%
55-64 years	7.3%
65 years and over	6.09%

Source: Indexmundi.com by Central Intelligence Agency of the United States

The details from population pyramid supports the view that the by 2020, India would be the youngest country which can encase the demographic dividend to bolster its income and would join the league of superpowers.



Source: The World Factbook, CIA

A closer look at the above pyramid reveals an interesting details about the future trends in demographics. It indicates that in another10 years or more, the Indian population stratum which belongs to 45 year and above age group will be nearing their sixties. With the retirement days nearing, there would be a need for financial planning for generating liquidity to support their day to day needs as well as contingencies.

III. Growing Proportion of Aging Population in The Near Future

In India, the annual growth rate of elderly population is 3%, which is more than the 1.9% growth rate of the population as a whole. According to Census figures, the percentage of older people in the India's population was 5.3% in 1961, and is estimated to touch 9.9% in 2021.

IV. Changing Social Structure

There is a transformation leading to nuclear family set up from traditional joint family system. Nuclear family is becoming a common practice out of changing nature of society and need for migration for economic reasons. There is also a trend of migration from rural to urban areas, leaving many older people without familial support in rural areas. This demands reassessment of their financial needs by senior citizens.

The senior citizens are confronted with various issues such as-

- Rising medical expenses not aligned with increase in income,
- Inability to support their spouses with guaranteed source of cash flow after their death
- Frustration out of undesired financial dependence on their children

V. Present Social Security System And Gaps Therein

In 1995, the Government adopted the National Social Assistance Programme (NSAP), which is includes three components: National Old Age Pension Scheme (NOAPS), the National Family Benefit Scheme (NFBS), and the National Maternity Benefit Scheme (NMBS). Out of these, NOAPS specifically targets older people in poverty. In November 2007, the Government renamed it as the Indira Gandhi National Old Age Pension Scheme (IGNOAPS).

Post-Retirement Benefits for Employees of Central Government include the schemes like Central Government Employees Group Insurance Scheme, General Provident Fund and Incentives. Additionally National Pension System (NPS) is a voluntary, defined contribution retirement savings scheme. Under the NPS, individual savings are pooled into a pension fund which are invested by PFRDA regulated professional fund managers as per the approved investment guidelines in to the diversified portfolios comprising of government bonds, bills, corporate debentures and shares. These contributions would grow and accumulate over the years, depending on the returns earned on the investment made. There are few models of the scheme: All Citizen, Government Sector, Corporate and NPS Swavlamban .The Government announced the introduction of universal social security schemes in the Insurance and Pension sectors for all Indians, specially the poor and the under-privileged, in the Budget for the year 2015-16. Rashtriya Swasthya Bima Yojana or RSBY started rolling from 1st April 2008. RSBY has been launched by Ministry of Labour and Employment, Government of India to provide health insurance coverage for Below Poverty Line (BPL) families. Jan Arogya Bima Policy-the Scheme is primarily meant for the larger segment of the population who cannot afford the high cost of medical treatment. The policy is available to individuals and family members.[5]

These are some of the initiatives taken by Government relating to old age security. The fact is that benefits provided by the Central and State Governments are not enough for maintenance of standard of living on account of eroding of purchasing power. Besides, it covers only a certain sections of the society. A large section of population belonging to middle class remains uncovered.

The current social security set up highlights the need of additional source of cash flow to the elderly people both stratums belonging to BPL section as well as a growing population of middle class. They may not have enough money accumulated in their pension funds but few of them may have productive assets which could provide regular inflow of income. This obviates the need for closer look at the policy of Reverse Mortgage Loan which was introduced in Union Budget 2007-08.

VI. Concept of Reverse Mortgage Loan

Reverse Mortgage Loan (RML) enables a Senior Citizen i.e. above the age of 60 years to avail of periodical payments from a lender against the mortgage of his/her house while remaining the owner and occupying the house.

Features of the RML Scheme

- The Senior Citizen borrower is not required to service the loan during his/her lifetime and therefore does not make monthly repayments of principal and interest to the lender.
- RMLs are extended by Primary Lending Institutions (PLIs) viz. Scheduled Banks and Housing Finance Companies (HFCs) registered with NHB.
- The loan amount is dependent on the value of house property as assessed by the lender, age of the borrower(s) and prevalent interest rate.
- The loan can be provided through monthly/quarterly/half-yearly/annual disbursements or a lump-sum or as a committed line of credit or as a combination of the three.
- The maximum period of the loan is 20 years.
- The borrower(s) will continue to use the residential property as his/her/their primary residence till he/she/they is/are alive, or permanently move out of the property, or cease to use the property as permanent primary residence.
- On the borrower's death or on the borrower leaving the house property permanently, the loan is repaid along with accumulated interest, through sale of the house property.
- The borrower(s)/heir(s) can also repay the loan with accumulated interest and have the mortgage released without resorting to sale of the property.**Error! Reference source not found.**

VII. Difference Between Reverse Mortgage And Conventional Home Loan

Traditional Mortgage Loans

In a conventional mortgage a home buyer pays some percentage of the home value as a down payment, and then pays off the loan amount for the home over a period of time. Traditional mortgages can be designed as fixed rate or floating rate. Once the loan is paid off the home buyer owns the home.

Reverse Mortgages

In reverse mortgages, the homeowner already owns the home. A financial institution agrees to pay cash to the homeowner for the value locked up in their home. When the homeowner dies or moves, the loan is to be repaid by the borrower or their remaining family members. The bank can sell off the home and recover the accumulated loan amount. The legal heirs of the deceased borrower can get back home after paying the outstanding amount to the financial institution. During a reverse mortgage the homeowner still owns the home, but the maintenance and insurance cost to be borne by the borrower. Even if the homeowner survives longer than expected or value of the home depreciates, the borrower under RML can never owe more than the value of his house.

VIII. Benefits Of A Reverse Mortgage

It aims at partially meeting the financial needs of senior citizens without selling the property and enables recurring funds inflows to the senior citizens during their life time. After the death of the senior citizen, the surviving spouse can continue to occupy the property till his/her demise

IX. Need For Reverse Mortgage As An Alternative Financial Tool

It would be an accessible option to augment the cash flows they would require to support their liquidity needs. With the increased life expectancy, there would be need for assured income on regular basis.

A large proportion of income locked in Home equity-With the constantly evolving banking system and range of loan products available in the market, it has become easy to buy a home in the beginning of your career as against earlier practice of having an owned house property in the later years of career out of accumulated savings or staying in ancestral property. These senior citizens have substantial part of their earning locked up in the home equity. Besides, the homes they have invested in are based on the expectations of requirements of their children and their families. But as they grow older, their sources of income starts drying up at faster pace. On the other side, their expenses of maintaining the same life style and good health starts inflating too.

This brings us to the root of the problem of liquidity crunch, funds locked in real estate, specially the self-occupied house property. This being indivisible asset, could not be liquidated partially.

X. Conclusion

The byproduct of the RML would be that family disputes related to the property matters and the pressure from the family members over the elderly people would by and large likely to wane.

As a retirement planning tool, Reverse Mortgage is an attractive option to enhance a senior citizen's income in his post retirement days. With the changing demographic profile and evolving social se up, it could make good the shortfall in one's pension or post retirement cash flows to lead a quality life ahead.

XI. Scope For Further Research

The paper focuses on the changing demographics and need for alternative revenue sources for elderly people. It highlights the gap in the current social security system. Hence it suggests the reverse mortgage loan as an option for retirement planning. Though it western world it is has been practiced since lone, in India it is at a very nascent stage. Going ahead the scope of RML in Indian context can be explored further. Additionally, performance review of the present policy implementation will provide insights for the various stakeholders.

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