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Reversing forward

Reverse mortgage will be a boon to senior citizens who are rich in property but poor in cash and are not supported by their children

In the United States, reverse mortgage became popular after the Department of Housing and Urban Development (HUD) created one of the first reverse mortgages. The HUD's reverse mortgage is a Central Bank-insured private loan, and it's a safe plan that can give older citizens greater financial security. Many seniors use it to supplement pensions, meet unexpected medical expenses, make home improvements, and more.

A reverse mortgage is a spe- homeowner convert a portion of the equity in his or her home into cash. The equity built up over years of home mortgage payments can be paid to the owner. But unlike a traditional home equity loan or second mortgage, no repayment is required until the borrower(s) no longer use the home as their principal residence.

In order to become eligible for a reverse mortgage, the borrower has to be a homeowner, 60 years of age or older; own the low mortgage balance that can be paid off at the closing with proceeds from the reverse loan; and must live in the home. The home must be in reasonable condition, and must meet stipulated minimum property standards. In some cases, home repairs can be made after the closing of a reverse mortgage.

Non-recourse loan

A reverse mortgage is a 'non-recourse' loan. This means there is no personal liability to the borrower or his heirs. No matter what, the lender can only look to the property for repayment and if it is insured then the insurer would make up any shortage to the lender.

A reverse mortgage is a loan against your home that you do not have to pay back for as long as you live there. With a reverse mortgage, you can turn the value of your home into cash without having to move or to repay the loan each month. The cash you get from a reverse mortgage can be paid to you in several ways; all at once, in 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 don't have to pay anything back until you die, sell your home, or permanently move out of your home. To qualify for most loans, the lender checks your income to see how much you can afford to pay back each month. But with a reverse mortgage, you don't have to make monthly repayments. So you don't need a minimum amount of income to qualify for a reverse mortgage. You could have no income and still be able to get a reverse mortgage.

With most home loans, you could lose your home if you don't make your monthly payments. But with a reverse mortgage, there are no monthly re- payments to make, so you can't lose your home by not making them. Most reverse mortgages require no repayment for as long as you — or any co-owner(s) — live in the home.

Rising debt, falling equity

Reverse mortgages have a different purpose than forward mortgages do. With a forward mortgage, you use your income to repay debt, and this builds up equity in your home. But with a reverse mortgage, you are taking the equity out in cash. So with a reverse mortgage your debt increases; and your home equity decreases (unless your home's value is growing at a high rate).

'Debt' is the amount of money you owe a lender. It includes cash advances made to you or for your benefit, plus interest. 'Home equity' means the value of your home (what it would sell for) minus any debt against it. For example, if your home is worth Rs 20 lakh and you still owe Rs.14 lakh on your mortgage, your home

Reverse mortgage is a 'rising debt, falling equity' type of deal. But that is exactly what informed reverse mortgage borrowers want — to spend down their home equity while they live in their homes, without having to make monthly loan repayments.

Reverse mortgage systems would, perhaps be a boon to senior citizens who are property rich, but cash poor, and shall be another instrument for the banks to compete for. But there are issues, which need to be addressed. Will we reach a situation where banks would have a lien over a large amount of real estate? Would banks be able to make proper property evaluations? If the reverse mortgage is for about 10 to 15 years (like they have abroad), what percentage of the current market value of the property would dictate the mortgage value?

While these and other questions shall be answered in the coming years, one thing is sure — for our senior citizens and retired people, real estate market is getting interesting. ♦