INTEREST RATES AND THEIR IMPACT ON HOUSING LOANS

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Housing finance has become a booming sector in India and is expected to grow at phenomenal growth rates in the coming years despite the global meltdown. The HFIs have brought changes to their strategies as there is a shift from buyers market to sellers market. Liberal tax rates by the Government, low and competitive interest rates have made housing finance really competitive. But in the present scenario, a shifting trend is being observed in respect of the interest rate charged on housing loans.

There are two kinds of interest rates for housing finance - Fixed rate and Floating rate. In the former, the interest rates are generally fixed during the entire term of the loan, whereas, in the latter the interest rates are dependent on the market situation and are greatly affected with the ups and downs of the housing market. The housing loan products offered by HFIs are either on a fixed rate of interest or floating rate of interest or a hybrid of both depending upon the tenure and type of housing loan products.

Interest rates of different HFIs have been changing very quickly during the last two years period. Changes are so quick even after the 15 days to one month interest is changing. But, at present it varies from 8.4 per cent 11.2 per cent in different schemes. Almost there is difference of 0.5 to 1 per cent in the various HFIs. Interest rates are going down day by day due to severe competition in the market and there is interest war in the market if one housing finance agency lowering down interest rate, other company announces in the next day. After entry of commercial banks in the housing finance sector, competition is in the war foot ground and every financial institution is enter in to the housing finance sector because of potential market in the housing sector and changes in the rules and regulations of RBI towards Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). This is the positive indication for the housing industry and borrowers' point of view.

The rise in interest rates, again, depends on the tenure of the loan and the amount borrowed. The current rise in interest rate on home loans is a reflection of the market realities. The spiraling inflation rate is one factor that is forcing the lending institutions to charge more on housing loans. Besides, RBIs step to increase the Cash Reserve Ratio for controlling inflationary trends of the market has also dominated negatively towards the interest rates.

The higher cost of housing loans has subsequently raised the property prices in an unprecedented manner. The situation of property prices was further worsened by higher costs of land, materials and labour charges. In view of the global meltdown and high inflation, it is expected that the interest rates on housing loans would further zoom in the coming years. Despite the rising interest rate, home loans grew by about

20 per cent during 2008-09. The loans from banks and housing finance companies grew at the rate of 14-15 per cent and 24 per cent respectively[2]. It is expected that the housing loan segment would keep the pace with the trend in the coming years also.

REVERSE MORTGAGE LOAN (RML)

Senior Citizens in their twilight years need a reasonable level of regular income to sustain their essential needs. The need for an alternate source of retirement income will become increasingly crucial. Senior citizens need a regular cash flow stream for supplementing pension/other income. For most senior citizens, the house is often the largest component of their wealth and the secular increase in residential house prices has created considerable "home equity" wealth. Reverse mortgage is a financial product that allows them to unlock the value of their most valuable asset, their home, by mortgaging it to a credit intermediary and thereby, enjoying the use of an assured cash flow during their lifetime, while continuing to live in it as long as they wish. Reverse Mortgage Loan (RML) seeks to enable house owning Senior Citizens to meet their financial needs without selling their property. The reverse mortgage is so named because the payment stream is "reversed" i.e. instead of the borrower making monthly payments to a lender (as in a conventional mortgage), a lender makes payments to the borrower.

The Genesis

Internationally, RML is a well entrenched concept, countries like USA, UK, Canada, Australia and New Zealand have an active market for the product. The genesis of reverse mortgage can be traced back to the developed countries where, due to higher standards of living, better access to health care and higher life expectancy, people above 65 years of age constitute a significant part of the population. The rising cost of pensions and health care for the old led the insurance companies to introduce the reverse mortgage in the US, UK and Australia.

The Product features

Conceptually, Reverse Mortgage seeks to monetise the house as an asset and specifically, the owner's equity in the house. The scheme involves the senior citizen borrower(s) mortgaging his/her house property to a lender, who then grants a loan and makes periodic payments (including an upfront lump sum payment, if desired) to the borrower(s) during the latter's lifetime. The amount of loan depends largely on market value of residential property, as assessed by the lender, age of borrower(s), and prevalent interest rate and would be a percentage of the assessed value of the property. Often the loan is structured as an annuity. Generally speaking, the older a borrower, the larger would be the percentage of the house's value that can be borrowed, on account of mortality rates. The senior citizen borrower is not required to service the loan during his lifetime and therefore does not need to make monthly repayments of principal and interest to the lender. Consequent upon the borrower's death or his leaving the house property permanently, the loan, along with accumulated interest, is recovered by the lender through sale of the house property. The borrower(s)/or their heir(s) have the option to repay or prepay the loan along with accumulated interest, and thus, have the mortgage released without the lender having to resort to sale of the property.

Advantages and disadvantages

Some of the major benefits of RML are that it enables the Asset-Rich and Cash-Poor senior citizens who own a house but have inadequate income, to meet their routine needs and unexpected lump sum expenditure needs such as renovation/repairs to house, hospitalisation, etc. The borrower owns and occupies the home till his demise or change of residence. Even after his/ her demise, the spouse can continue to stay until demise. Also, if the spouse is a co-borrower, he/she will continue to receive payment up to the contracted term of the loan[3].

One of the disadvantages of a reverse mortgage is the issue of origination fees and other closing costs for the product, which at times can be relatively higher. Nevertheless, these fees are deducted from the amount of loan sanctioned and do not involve an out-of-pocket expense for the borrower but may reduce the amount receivable by the borrower. Also, during the tenor of the RML, the borrower remains responsible for the major expenses related with keeping a house: property taxes, utility payments, insurance, maintenance and upkeep of the house in good condition.

The Indian Perspective to RML

Various public and private sector banks are currently offering RML in Indian markets. Typically, the banks in India at present charge interest on the RML in the range of 9-11 percent per annum, and offer a monthly instalment of Rs. 8000 to Rs. 10000 to a borrower for a loan of Rs. 10 lakh with tenure of 10 years, for a property valued at about Rs.13 lakh. The amount of instalment decreases to around Rs. 2000 as the tenor of the loan increases to 15 years. The Loan (including the interest cost) to value ratio varies from 60 to 90 percent and the maximum tenor of the loan ranges from 15 to 20 years. Thus, in the Indian context, if the borrower outlives the loan tenor, he can continue to stay in the house but he will no longer be eligible for any payments from the lender. Internationally, however, the period of such payments is not for a specified number of years, but for the remaining life time of the owner (and his/her spouse) of the property, and therefore, reverse mortgage effectively is a life annuity in other countries.

RML's take-off in India

In India, Reverse Mortgage has witnessed a slow start owing to several reasons. Lack of product awareness and Indian society's norms seem to work against the scheme. A possible motivation for avoiding the reverse mortgage market is a strong motive to bequeath. India still has a strong joint family culture, with the younger generation supporting the elderly, which to an extent, obviates the need for the elderly to opt for such schemes, unlike in the Western Countries, where social mores usually dictate that the old people live on their own. Nonetheless, given the large population of our country, there could, potentially, be significant demand for the product in India.

Another reason for avoiding the RML market altogether may be a desire to move from the current home. For an elderly citizen planning to move (to a smaller house or a cheaper house elsewhere) in the near future, a reverse mortgage would seem to be a very bad idea, since the transactions cost alone would take a huge bite out of the housing equity.

Another major limitation of the RML scheme is the fixed loan term of 20 years i.e. a borrower shall receive payment for a maximum of 20 years. However, he/she shall continue to stay in the mortgaged residential property. Their monthly stream of income will stop after completion of the loan tenure leaving them abandoned particularly when they would need it the most. Further, in India, borrowing, till some time ago, was generally, not considered a very desirable option, more so for the people in older age bracket. However, with the gradual changes in the social fabric, this product could see greater acceptance.

Another reason for the slow take-off of the scheme in India is that the monthly payments are relatively low due to the prevailing high interest rate scenario and higher margins. Besides, the norms pertaining to property valuation, maintenance and repossession need to be well-established. It is reported that the enactment of the Maintenance and Welfare of Parents and Senior Citizens Act, in December 2014, which has made it mandatory for children and relatives to take care of parents in their old age, could also have some implications for the growth of this product. Maintenance Tribunals, soon to be set up under the law, can ask the heirs of a senior citizen to pay up to Rs 10,000 a month for their maintenance. This Maintenance Law could thus obviate the need for the senior citizens to resort to the reverse mortgaging facility.