

POTENTIAL OF REVERSE MORTGAGE LOAN AS A RETIREMENT PLANNING TOOL IN INDIA

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ABSTRACT

The main objective of this research paper is to study the feasibility of reverse mortgage loans as a retirement planning tool among Indian senior citizens and to find the major challenges against the acceptance of reverse mortgage loan. The paper includes SWOT, PESTEL and Five Force analysis by using secondary data. It also includes a detailed market survey conducted by using primary data collected from sample senior citizens. Developed countries are faced with severe budgetary constraints in sustaining their current universal and liberal Old Age Social and Income Security (OASIS) programmes. Developing countries are slated to face acute problems in meeting the OASIS needs of their projected population of the elderly. After the detailed research we found that retirement planning done by majority of retired people is not adequate to satisfy their current needs and majority of them are dependent on transfer from their children as their current source of income. So there lies huge growth potential for reverse mortgage loan in India.

Keywords: Longevity, Retirement planning, Home equity, Market potential, Reverse mortgage.

I. INTRODUCTION

Senior Citizens are a growing section of the Indian society and dependency in old age is increasing in the country. While on the one hand, there is significant increase in longevity and low mortality, on the other hand cost of good health care facilities is spiraling and there is little social security. Senior Citizens need a regular cash flow stream for supplementing pension/other income and addressing their financial needs. Also, secular increase in residential house prices has created considerable "home equity" wealth. Government of India introduced the Reverse Mortgage Scheme in its budget 2007-08. The National Housing Board has been given the task of drawing up the regulatory mechanism to enable the use of reverse mortgage in the country.

Reverse mortgage is a financial instrument that allows a homeowner to consume some of his housing equity by converting it into an income stream, yet maintain ownership and residence in the home. Reverse mortgages enable eligible homeowners to access the money they have built up as equity in their homes. Reverse mortgage is the opposite of a normal forward mortgage. In a forward mortgage loan, the borrower uses his house as collateral and receives a one-time lump sum payment, which he then utilizes to purchase the house. Subsequently, the borrower pays his regular mortgage installments, gradually reducing his outstanding loan amount and increasing his proportion of the equity of the house. Effectively, the borrower steadily buys his house back from the lender.

On the other hand, the reverse mortgage mechanism enables a borrower who owns a house without encumbrance to 'sell' his house to a lender and avail of a steady cash stream based on the valuation of his house. The unique aspect of this model is that the borrower continues to occupy the house until his demise, or until he sells the house to another party, or moves out of the house permanently. If any one of these exception conditions occurs, the borrower has to repay the loan amount availed from the lender. One of the positive features of reverse mortgage is that it is a non-recourse loan and therefore protects assets other than the house of the borrower from being used as collateral.

In India, most of the home owner's lifetime savings are used to buy or build a house, making reverse mortgage a welcome instrument that helps them convert some or all of their rising but locked home equity into a cash stream that can comfortably sustain them in their old age.

II. LITERATURE REVIEW

Looking at the popularity of reverse mortgage loans and its spread in number of developed and developing countries number of researchers have conducted research feasibility studies for reverse mortgage loans. This section covers review of literature from some of the important research papers, studies and articles as published by different authors.

R Rajagopalan (2006), in his paper explored the prospects for reverse mortgage products in India and concluded that, if designed properly and offered by an empathetic lender, RM might turn out to be the vanguard product to build up brand equity for the lender in this niche segment. Demographic projections indicate that this segment is the fastest. However, the actual size of the RM markets in India is nowhere near its estimated potential, for a variety of reasons

from the demand, supply and regulatory considerations. Any interested RM lender in the Indian market must proceed with caution.

Dr. V Chandrasekar (2007), in his research paper titled "Reverse Mortgage in India: Social Implications" found that, despite the potential for reverse mortgage, there are several issues that may slow its spread as a reliable and acceptable means of income generation. These issues include, complexity of reverse mortgage loan, fears of a debt burden, eviction and inability to leave a legacy behind by way of a bequest, lack of comprehensive database useful to construct the appropriate environment for reverse mortgage etc. He concluded that, key to the efficacy of reverse mortgages is the development of a strong financial and regulatory infrastructure that will minimize loopholes, prevent fraud, and make this product successful in serving the needs of the senior citizens in India.

Singhal Saket & Jain Amit (2008), in their research paper concluded that, As at present, India is poised for a strong economic growth, we should not miss any avenue to accelerate or support the growth momentum. Home equity/ Reverse Mortgage products are such products that have the potential of not only increasing the liquidity in the economy but also diversifying many risks. Besides insurance and pension products, actuaries with their long term horizon are in the position to play a leading role in designing products like reverse mortgage needing inputs both from actuarial and finance/investment domains.

Prof. Sachin Napate (2012), concluded that, though the concept of reverse mortgage still in infancy stage in India, with the changing social milieu in India and the collapse of the joint family system, introduction of reverse mortgage products could be a worthwhile experiment. Instead of being dependent on their children for monetary support, this would be a good option for the elderly to continue with a graceful lifestyle.

V. Sivarama Krishnan (2009), in his study attempted to compare forward mortgage with reverse mortgage and found that, While the home equity conversion mortgage enjoys the advantages of government guaranteed performance, no-recourse funding, and of not requiring any qualifying credit or income standards, it also has high transaction costs. In researching data for this paper, the author encountered substantial difficulty in locating empirical studies on this topic and in obtaining accurate information from purveyors of reverse mortgages. Relating to the second issue, the authors contacted over 12 reverse mortgage vendors and none was willing to provide details without verification of an attained age of 65 and willingness to subject to a sales contact.

III. MOTIVATION FOR RESEARCH

Retirement planning is one of the most important aspects of the financial planning. In India with increased longevity of life and more preference for nuclear families there exists huge demand for retirement planning tools. Reverse mortgage loan is one of the retirement planning tools, where a homeowner pledges his home with an institution and receives a stream of tax free income based on future realizable value of home. As the concept is newly introduced in India, there is a questions that whether it will succeed or not. That inspired us to take up this study on feasibility of reverse mortgage loans as a retirement planning tool.

IV. RESEARCH OBJECTIVE

The main objective of this research paper is to study the feasibility of reverse mortgage loans as a retirement planning tool among Indian senior citizens and to find the major challenges against the acceptance of reverse mortgage loan

V. SAMPLING DESIGN

The market survey has been conducted by taking a random sample of 50 senior citizens (People above the age of 60 years) of Ahmadabad city.

VI. SWOT ANALYSIS OF REVERSE MORTGAGE LOAN

A. Strengths

- The senior citizens are entitled to regular cash flows at their choice like, monthly, quarterly, half yearly and annually.
- The loan is given without any income criteria at an age where normal loans are not available.
- No loan servicing or repayment required during the lifetime of borrower and spouse.
- If the borrower dies during the period, the spouse will continue to get the loan amount for 15 years.
- Tax treatment of a RML will be as loan, not income, so no tax will be payable on the regular cash flows.
- The borrower and their spouse can continue to stay in the house till both dies.

- Heirs of the borrower will be entitled to get the surplus of sale value of the property.
- Borrower/heir can get mortgage released by paying loan with interest without having to sell property at any time. Prepayment of loan is allowed.
- NHB to guarantee obligation of banks/housing finance companies to pay the committed loan amount as regular sums over a period of time.
- Reassessment of property value will be done periodically or at least once every 5 years.

B. Weaknesses

- This loan product has a maximum tenure of only 15 years. If the borrower outlives this period, the regular cash flows will stop.
- Basis of property valuation is not clear.
- Requirement of clear title to property in the name of the borrower to get the loan creates hurdle.
- Three days period to cancel loan is too less.
- Various fees to be added to borrower's liability, which can be quite substantial.

C. Opportunities

- Partial substitute for a social security scheme for senior citizens.
- Shift towards nuclear family structure is reducing social security during old age.
- Longevity is increasing with medical expenses and cost of living going up, increasing the need for additional income in old age.
- Most Indians have strong preference for own home. Therefore many eligible citizens may opt for the scheme.
- Quantum of loan can increase favorably for borrower on revaluation of property.

D. Threats

- Property valuations are ambiguous.
- There is a non-recourse guarantee, which means that loan plus interest should never exceed realizable value of property. In case of fall in property value or loan with interest exceeding assessed property value, banks may resort to strong-arm tactics to force the borrowers to move out, if they live too long after the loan period is over.

- Rate of interest is at the discretion of lender. Any increase in the rate, if floating, will increase the burden of the borrower.
- Lender has discretion to raise loan amount on revaluation. However, if it does not do so, borrower doesn't get loan according to proper value of property.
- Lender has right to foreclose loan by forcing sale of property if borrower doesn't pay for insurance, property taxes or maintain and repair house. Can lead to further harassment.
- This product seems very good in theory and can be of great help to senior citizens who can live in their own houses and yet avail of a loan against it. However, the norms need to be fine-tuned and made watertight so that these borrowers are not harassed or short-changed in their old age.

VII. PESTEL ANALYSIS OF REVERSE MORTGAGE LOAN

PESTEL Analysis is a simple, useful and widely used tool that helps you understand the "big picture" of Political, Economic, and Socio-Cultural and Technological environment. As such, business leaders use it worldwide to build their vision of the future.

A. Political

- As a concept is new in India it may experience significant changes with the change in governments in power.
- 40% FDI limit is allowed in the sector, so many foreign player are attracted in the sector like Citi bank, standard chartered bank etc
- Housing sector as a whole contribute 5 percent of our total GDP which make this sector more important So government direct interference is always there.
- The frequent changes in guidelines of National Housing Bank (NHB) and Reserve Bank Of India (RBI) also affect the reverse mortgage sector in India
- Regulation of secularization and mortgage on the security is quite stringently curb the growth of the sector. And current bearcats make thing little difficult for various procedure

B. Economic

- The business of reverse mortgage is on growth stage in the country. The strong presence of financial market in the country and various financial institution provide the money for the sector

- Still a large part of Indian people are not making adequate retirement planning. They often face the problem of insufficient income after retirement.
- The cost of living is increasing with the passage of time because of inflation rate.
- Demand of the new homes has increased tremendously during last year which shows that more number of people would have their own home after retirement.

C. Socio-Cultural

- As per Indian psyche, it is comfortable to think that the younger son will take care of their parents during their old age. But today's younger generation prefer independent life and nuclear family. They are drifting away from the traditional joint family set up when there is no physical or financial supports from elders. So there is a need for retirement planning.
- One typical feature of senior citizen in India is that they spend most of their work life earning in buying a residential property for themselves. This residential property accounts for significant proportion of their total assets value. As any immovable property is less liquid it fails to help on liquidity front. In above circumstances a reverse mortgage loan is a welcome addition to the retirement planning tool.

D. Technological

- The development and advancement in the medical technology have increased the average life span of people. Retirement planning acquires added significance because of the fact that though longevity has increased the number of working years have not.
- Online payment, e-banking and other facility make things better for consumer of industry. Most of players offer on-line application of home loan and e-payment facility. Stronger IT-Infrastructure makes private bank like HDFC and ICICI different from other players. and lead to greater brand name and customer satisfaction
- E-surveillance and on-line processing make strong access system for inquiry for sector. And strong data base make less error in the inquiring and fast processing for loan

E. Legal Issues

- The necessary regulations have to be put in place. This would require new laws apart from amending some of the existing ones such as the NHB Act, RBI Act, etc.
- Besides, there is a tax angle to all this. Should this amount received from the bank be treated as income (and hence taxable) or a loan (therefore, no tax)?
- Further, as the experience in US shows, mortgage insurance would become important. This would protect the bank in case there is a shortfall in the sale proceeds vis-à-vis the loan amount. Otherwise, it is the lender, which bears the loss. The borrower is not asked to pay the difference, if any. Nor can he be forcibly evicted.

VIII. MICHAEL PORTER'S FIVE-FORCE ANALYSIS

A. Customer's Bargaining Power

- Buyer power is high because as the concept is new in India. Until recently (2 years back) this phenomenon was absent entirely. Bank and housing finance companies want to promote it at any cost.
- Availability of other retirement planning tool is also adding to the bargaining power of buyers.
- Companies are wooing the customers on the basis of various frills added to their offerings. Differentiation is the only way to attract the customers and make them feel good. Aspects like brand and quality have come up. In all now customer has some value in the market or great value.

B. Supplier's Bargaining Power

- For the industry like housing finance identifying the supplier is very tricky and difficult. The lenders to the HFCs in the form of bonds and other instruments can be termed as one of the suppliers of funds. For banking HFC it is the retail saving account deposit and all other term deposit is the source of funds. NHB can form a major part of this funding because of their refinance schemes available only to the HFCs.
- The other factor that can be considered is services obtained by HFCs from industries like construction, information technology and marketing support in terms of direct marketing channels.
- Let's take each one in detail and try to assess the ability and power to influence the industry.

- Lenders to the HFCs in terms of Bond & other instruments holders: These investors hold very low amount of power in influencing the players as they subscribe to what these players offer, but factors like increasing competition between the HFCs & Banking firms has led to sharp fall in the interest rates in Home loan segment, that in turn squeeze the option of issuing high rate bonds, so low attractiveness for investors. The other factor is of increased investor's awareness about various investment instruments.
- Saving and Term Deposits with Bank: they really don't have any bargaining power as such, in most of the cases the interest on such deposits are fixed and the investor can't do anything about it.
- NHB Refinance: NHB hold some power in influencing the industry through its refinance activity, where in NHB is deciding factor about the rate at which it will refinance the existing loans, but government's commitment towards servicing the industry to fulfill its social objectives reduce its impact.

C. Threat Of Substitutes

- Reverse mortgage loan have the threat of following substitutes
 - Pension fund
 - Private pension plan
 - Government sponsored pension plan scheme
 - Work after retirement
 - Other retirement planning tool
- Almost all substitute are well established in the Indian market and Cost of switching to substitute is very high
- Still people exist the huge tendency to give the home to the children.
- The other factor which reduces the threat of substitute is the Indian social requirement where owning a house is a sense of pride rather than living in a rented house. And there is no sign of any change in that perception at all.
- Overall threat of a substitute is moderate high in the industry with initial stage of market fuelling the industry towards one of the economic accelerator.

D. Threat Of New Entrants

- The industry doesn't pose much threat from new entrants; as far as the entry requirement is concerned it is not a problem factor for somebody to enter in the market but the market forces like very stiff competition and very high

level of market penetration by the current players has left no place or very low place for any new participant to come in.

- The threat of new players can also be faced from the various players which are living in the dormant phase and are not so active in the market for example almost all the banks have their set up for housing loans but only some bank provide RML. Still only few housing company provide reverse mortgage loan.
- The only big matter of concern is aggressive nature of multinational banks such as Citibank etc which has recently joined the industry and there are still various international banks which are evaluating the option of entering the Indian market And foreign bank having expertise in the RML and they might pose a very big threat to the industry as they have access to low cost funds and they deep pockets to continue to hold in the market for longer run.
- So in all the industry is pretty secured from the new entrant threat and again the market growth will give a lot of time to all players to settle down as demand is high the players can very well move in the market.

E. Competition In The Industry

- Rivalry among the player is medium. The number of player is very few in reverse mortgage sector. Only few banks and housing finance company provide RML.
- Demand for the reverse mortgage loan is very less.
- As a high chance of entry of new player in the market the rivalry may increase in future.
- Foreign banks with their low cost funds have the given market a whole new dimension, where in players are providing loans to customers at sub PLR levels. And the interest rates are at their minimum level and there is expectation of its going up.

IX. RESEARCH FINDINGS AND ANALYSIS

This section includes findings and analysis of research study. (Kindly refer Table -1)

The data from table 1 shows that for the majority of senior citizens the major source of income during post retirement period is transfer from children and pension and other retirement planning incomes. As majority of senior citizens are dependent on transfer from their children as source of income it shows

inadequate retirement planning investment and potential for reverse mortgage loan. (Kindly refer Table -2)

Table 2 highlights that 68% of the sampled respondents made the retirement planning investment while remaining 32% didn't made any investment for retirement planning. Further the data shows that out of 34 respondents who made retirement, 23 respondents (68%) are not satisfied by their current level of income. It proves that due to inadequate retirement planning investments, income generated during the post-retirement period is not sufficient to meet the need of senior citizens, creating demand for the additional income during the same period. Product like reverse mortgage can perform this job of crating additional source of income for senior citizens during post retirement period. (Refer Table-3)

It can be observed from the data in table 3 that, one of the main reasons for not making retirement planning investment is insufficient income during the pre-retirement period. In India as people spend a large part of their income in purchasing the home, they fail to make required investment for retirement planning. This type of situation again creates demand for the additional income during post retirement period, which can be generated through reverse mortgage loan. (Please refer Table -4)

The data in table 4 highlights that, Senior citizens saving schemes and post office monthly schemes are the most preferred tool of retirement planning tool among the sampled senior citizens. The main reason for the preference of these tools is the lower level of risk involved in it. Mutual fund and private pension plans are the second most preferred retirement planning tool. Penetration of reverse mortgage loan is very low. No of the sampled senior citizens have taken reverse mortgage loan. (Kindly refer Table -5)

The data in table shows that awareness level about reverse mortgage loan is very low. This is mainly because concept is new in India. Again those who are aware about the reverse mortgage loan possess much generalized knowledge about it. Most of them don't know about nitty-gritty of loan and other operational issues. (Kindly refer Table -6)

Reverse mortgage loan requires the ownership of home to be in one's own name or in the name of spouse. The data in table 6 shows that, 74% of the sampled senior citizens have their home in their own name or in the name of spouse. So

as far as the requirement of home ownership is concerned it will not create any hurdle for reverse mortgage loans in India. (Please refer Table-7)

The data in table 7 shows that 68% of the sampled senior citizens have rated the concept of reverse mortgage loan as very good or good. This means that prospective customers of this product holds positive attitude about it, which may lead to huge level of acceptance for this product. So there is high probability of concept of reverse mortgage loan being accepted by retired senior citizens in India. (Kindly refer Table – 8)

The data in table 8 shows that 32% of the sampled retired people want to take reverse mortgage loan. It has also been observed that, majority those who want take reverse mortgage loan are receiving help from their children and are not satisfied with their current income. Out of 16 people who want to take reverse mortgage loan, 11 (69%) have made retirement planning, but because of inadequate retirement planning investment they are not satisfied with their current level income and are dependent on transfer from children as their current source of income. It shows that majority of the prospective customers are those who didn't make adequate retirement planning investment and are dependent on their children as their current source of income. (Please refer Table-9)

Looking at the data in table 9 it can be said that, limited annuity period of 15 years is one of the main reasons creating hurdle for reverse mortgage loan in India. In India reverse mortgage loan has maximum tenure of only 15 years, if borrower outlives this period, the regular cash flow stops. Apart from this, the desire to give home in bequest is the second most important factor acting as a hurdle for reverse mortgage loan.

X. CONCLUSION

With the changing social milieu in India and the collapse of the joint family system, introduction of reverse mortgage products can be a worthwhile experiment. Instead of being dependent on their children for monetary support, this would be a good option for the elderly to continue with a graceful lifestyle.

After the detailed research analysis it is concluded that retirement planning done by majority of retired people is not adequate to satisfy their current needs and majority of them are dependent on transfer from their children as their current source of income. So there exist huge growth potential for reverse

mortgage loan, to feel up this income gap of retired people during their post retirement period. But on other hand the level of awareness about reverse mortgage loan is very low. The current market penetration of reverse mortgage loan is also very low with senior citizens saving schemes and post office monthly deposit schemes being the most preferred retirement planning tool. However the future prospects for reverse mortgage loan seems very good because majority of respondents considers the concept as a very good and have shown readiness to take reverse mortgage loan in future. When it comes to operational issues, the limited annuity period, desire to bequest home and high interest rate are some of the major factors creating hurdle for reverse mortgage loan

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TABLES:

Table 1 Current Source of Income

Particulars	No. of responses	Percentage
Fully Satisfied	14	28
Partial Satisfied	11	22
Not Satisfied	25	50

(Source: Market Survey)

Table 2 Retirement planning and level of satisfaction by current income

Particulars	Fully satisfied		Not satisfied or partially satisfied	
	No.	%	No.	%
Made retirement planning	11	32	23	68
Not made retirement planning	3	19	13	81

(Source: Market Survey)

Table 3 Reasons for not making Retirement planning investment

Particulars	No. of responses	Percentage
Insufficient pre-retirement income	12	75
Expectation of receiving support from children	2	12.5
Other reasons	2	12.5

(Source: Market Survey)

Table 4 Preferred tools for retirement planning investment

Particulars	No. of respondents	Percentage
Post office monthly income scheme	14	26
Senior citizens saving scheme	15	28
Mutual fund (MIP)	10	19
Private pension plan	9	17
Annuity scheme	5	10
Reverse mortgage Loan (RML)	0	0

(Source: Market Survey)

Table 5 Preferred tools for retirement planning investment

Particulars	No. of responses	Percentage
Know	13	26
Don't Know	37	74

(Source: Market Survey)

Table 6 Home Ownership

Particulars	No. of responses	Percentage
In my own name	20	40
In name of spouse	17	34
In name of children	13	26

(Source: Market Survey)

Table 7 Ratings for the concept

Particulars	No. of respondents	Percentage
Very good	24	48
Good	10	20
Average	6	12
Not good	10	20

(Source: Market Survey)

Table 8 Readiness to go for reverse mortgage loan

Particulars	No. of respondents	Percentage
Will take	16	32
Will not take	10	20
Can't say	24	48

(Source: Market Survey)

Table 9 Reasons for not taking reverse mortgage loan

Particular	No. of responses	Percentage
Not having own home	2	8
Want give home in bequest	4	17
Had already pledge the home	2	8
Enough retirement planning done	3	13
RML is risky	2	8
High interest rate	4	16
Limited period of annuity	7	30

(Source: Market Survey)

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