Weighing the need for a reverse mortgage

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RETIREMENT savings have been put in the spotlight for some time now.

The percentage of the population aged 65 and above in Malaysia has hit 7.5% and is predicted to make up 14% of the population by 2044.

However, many seem ill-prepared for retirement. Reports note that 54% of Employees Provident Fund (EPF) contributors aged 54 have less than RM50,000 set aside for retirement. What's more, 70% of contributors who withdraw their funds at age 55 use up their savings in less than a decade after retiring.

The recent measure to allow members to dip into their already inadequate EPF savings may also exacerbate the risk of low savings at retirement. As of March 14, i-Sinar withdrawals of RM52.48bil had been approved for 5.94 million applicants.

Given the current scenario, there may be a need to look at other avenues to supplement the expenditure of retirees.

Over the past decade, many developed countries have used home equity release as a tool to help the elderly cope with the rising cost of living. Given that real estate makes up the largest single asset of any family, Cagamas Bhd president and chief executive officer Datuk Chung Chee Leong opines that monetising the equity portion of their home could be a way to help elderly people who do not have enough savings.

Additional income: People lining up to submit their i-Sinar application at an EPF branch. Inadequate EPF savings calls for a need to look at other avenues like reverse mortgages to supplement the expenditure of retirees.

"I think the first reaction for many old people is to keep the house for their children. But over the years, you find that products like these have become more popular because people now realise, if they don't have enough to spend, what can they do? One of the ways is to monetise the house because they can't go back to working," he says.

On that front, Cagamas is looking to launch its reverse mortgage scheme later this year to address income insecurity for seniors.

A reverse mortgage allows an elderly homeowner to take out a loan using his or her primary residence as a collateral. In return, they receive a steady stream of disbursement on a monthly basis while still being allowed to stay in the home.

The repayment of the loan, inclusive of interest, generally only occurs after the death of the homeowner, or when they move out or sell the house.

In this case, the next of kin may opt to repay the loan and take back the property or the property will be sold for recovery purposes.

If the house sells for more than the amount owed, the homeowner or heirs will receive the balance. But if the house sells for less than the amount owed, Chung says the losses will be borne by the guarantor – in this case, Cagamas.

For those in their advanced years who are asset-rich but have challenges with cash flow, this may be an additional lifeline that they can tap into.

But is a reverse mortgage really the way to go?

Notably, it is difficult to get an accurate projection when it comes to reverse mortgages. Property values will vary over the years and an individual's lifespan is unpredictable. This may lead to some lost opportunity to sell the property at a higher value or increases in cost from accumulated interest and fees if the homeowner lives longer.

Also, this would mean that the borrower will no longer be able to pass on the property as an inheritance to their heir – a tradition long-held in most Asian countries. If the next of kin intends to keep the property within the family, they will, instead, have to bear the debt from the loan.

The product itself may come across as complex and confusing for the elderly and there are, obviously, concerns that they may be taken advantage of. One can look up enough horror stories on reverse mortgages and the risk of foreclosures.

But Chung notes that its scheme has been designed to help safeguard retiree interest.

"The good thing about this is that it's a lifetime tenure. So if your property is worth RM2mil, for example, and Cagamas or the bank has already disbursed RM2mil over a period of time, they will still have to continue

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paying you the monthly amount of money as long as you live. If it's a couple, it will be valid until the other spouse passes away.

"There is also no repayment during their lifetime and there's a non-recourse, which is similar to the reverse mortgage scheme in South Korea and Hong Kong.

"So if we have disbursed a loan up to, say, RM2.2mil and the house is only worth RM1.9mil when we sell it, the guarantor will bear the shortfall of RM300,000.

"So actually, you don't have to worry.

"The guarantor will only take care of the losses.

"If there's a profit, they get nothing. It goes back to the next of kin or to the estate," he explains.

One of the key features of this product is that there must be adequate counseling given to the borrower to ensure that they understand the product and would only undertake the loan if they really need it.

If borrowers have other sources of income or adequate savings, a reverse mortgage is likely not for them.

Cagamas is currently in talks with a party that specialises in counseling to provide independent advice as part of the service.

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Chung emphasises that its reverse mortgage scheme is a developmental product to help the elderly rather than as a measure to drive the property market.

Where the EPF savings may only add up to a few hundred ringgit a month, this would be a supplement income for them.

Nonetheless, there are also concerns that the additional income may lead to a rise in unnecessary spending and mismanagement of finances, which does not bode well for household debt and may further push them into financial difficulties.

But Chung says the product is designed in such a way where the borrower only gets a certain stream of monthly income, which is calculated based on the projected value of the property divided over the expected lifespan of the borrower and spouse.

Hence, the amount paid out each month will not be very large, but still enough to enhance consumption to a certain level rather than encourage lavish spending.

There is a consideration for borrowers to take out a small lump sum of the loan for certain items like repaying a small outstanding home loan or for home refurbishment.

Understandably, there will probably be a greater traction for this product among older people who may not have children or are still single.

"But we do see that in Hong Kong and South Korea, it is gaining popularity even among those with children.

"If your children can't afford to help you in terms of subsistence, why not use the house to improve your standard of living?" says Chung.

He does not expect the take-up for reverse mortgage to be strong in the initial years.

Even for more mature Asian countries like South Korea and Hong Kong, it took about eight to 10 years before the product gained popularity.

For sure, a reverse mortgage is not for everyone and there are still finer details that will need to be ironed out along the way like regulatory requirements.

Nonetheless, for those who do need it, they'd be happy to know that such an option will be available to them soon.