

# How a reverse mortgage can help a retiree

By [Dr Azian Madun](#) - January 13, 2022 @ 12:01am

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Reverse mortgage is a financial instrument aimed at retirees who do not have a source of income but own a completely paid-up home. - BLOOMBERG PIC

Reverse mortgage is a financial market innovation introduced in the early 1960s in the United States. But its growth has been slow.

Not many countries, including Malaysia, have this type of product due in part to the risk associated with it, as well as its complexity.

Consumers may feel short-changed because they receive less money, while banks may believe they need to mark up the price as they are taking a greater risk, making it difficult to find the point of equilibrium.

Reverse mortgage is a financial instrument aimed at retirees who do not have a source of income but own a completely paid-up home.

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Many retirees do not have income since they are unable to work or not physically well enough to do so.

They also cannot borrow money using regular methods because they are no longer employed.

This is where a reverse mortgage comes in. Traditional mortgages require borrowers to service the loan until it is fully repaid. Reverse mortgages do not require this.

Instead, the bank pays the borrower and when the borrower dies or moves out, the house is sold. The proceeds of the sale will be used to repay the bank.


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Any balance will be returned to the deceased's estate or given back to the borrower. However, if the proceeds are insufficient, the bank must bear the loss.

This is when banks must properly identify and estimate the risk of each borrower.

Designing a reverse mortgage to be syariah-compliant would be similar to designing other Islamic banking products such as a car or home loan, which would contain contracts like sale, rent and buy-back.

The customer (borrower) may, for example, sell his home to the bank for \$X, which will be paid to the customer in monthly instalments.

The bank will rent it back to the customer for \$Y because the customer plans to stay in it. As a result, the customer will receive  $$(X-Y)$  per month. At the conclusion of the contract, the customer will buy the house back for  $$(X + Y + Z)$ .

However, due to the significant uncertainty in terms of tenure, namely the life expectancy of the customer, reverse mortgage products can be problematic in terms of syariahcompliance.

In terms of operation, although retirees who have fully paid off a loan can sell the house and move to a less-expensive location, they still need to buy a house in the new location, which means they have less money to spend.

So selling the house and moving elsewhere is only financially feasible if there is a significant difference in house prices between the current and new locations, as they can use the balance to fund retirement living expenses.

If the price difference is small, selling the current home and moving out is not a good idea. This is where this product comes in.

The retirees benefit financially because they do not have to deal with the hassle of finding a new place to live or moving out.

They can continue to live in the same house without worrying about money. They also don't have to worry about paying the bank on a monthly basis.

From the standpoint of human relationships, this product works well when borrowers have no heirs to worry about or when their heirs are uninterested in the house.

However, if the children are aware that their parents are taking out a reverse mortgage, they may be less interested in caring for them, knowing the home will be taken over by the bank when their parents pass away.

This may be of concern to retirees, particularly here, where government support for social work with the elderly is limited. As a result, society places importance on family values when it comes to caring for the elderly, which influences reverse mortgage take-up rates.

Even in the US, the adoption rate of this product in 2019 was 35 per cent lower than the previous year.

Due to an increase in scams, the authorities tightened regulations surrounding this product in 2017, making it difficult for borrowers to sign up for it.

Despite being considered a niche product, reverse mortgage products have the potential to serve their purpose well if the jurisdictions surrounding them are properly addressed, particularly with regard to the



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surrounding them are properly addressed, particularly with regard to the rights of heirs to the deceased's estate.

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