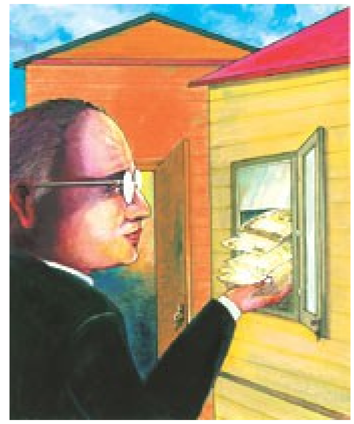
MONEY

Is Reverse Mortgage Worth It? This new instrument promises to provide much-needed retirement income for senior citizens. But the payback is not enough. By Nitya Varadarajan



There's nothing better than an increased retirement income. The money can come in handy for daily use or for regular medical needs. As inflation keeps making healthy retirement living more expensive, extra income options make retirement living much easier. But if you have been thinking of only reverse mortgage, then you may have to re-think your retirement strategy again.

It's being recently introduced in the country, and housing finance company Dewan Housing Finance is currently pilot-testing the product. Other banks are also drawing up plans to introduce the product.

A reverse mortgage, putting it simply and as the name suggests, means you pledge your house to a financier and get an additional income on it. The lending institution extends you a monthly periodic sum, which you can use for running expenses or other emergencies.

The New IPO Code
Coming of Networking Age
News Round-up

On the face of it, reverse mortgage might seem to be an income much like an annuity-but in reality it's a loan extended to the retirees. Unlike an ordinary loan, however, you don't get an upfront lump sum. If you are willing to forfeit your house, there is no further cash outgo to the lender, just your property gets pledged. You get the loan (the lender calls it annuity) in monthly installments after the interest and financing charges are deducted up-front. And at the end of the loan period, or after the lifetime of the homeowner, heirs must pay back the loan amount to whatever extent it was disbursed if they want to redeem the house.

The Reverse Mantra

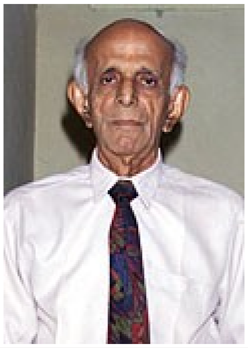
Should you use reverse mortgage? For now, reverse mortgage should be used as a last resort, because the installments (as pegged currently) are not enough-compared to other options in the market today. Besides, it's not likely to augment your income substantially. Says Shivakumar Mani, Dewan Housing Finance's General Manager Marketing, the first to introduce such a product: "We only recommend this product as a means to supplement existing income-it may not suffice as a pure income stream."

A lender takes over the mortgage of the property and after a valuation check-taking into account location, accessibility and condition of the building-assigns a value to the property. On the basis of this valuation, the retiree's monthly cash flow from a reverse mortgage is determined. A

Reverse Mortgage: How it Works

» After age 60, anyone who has acquired a property can mortgage it and get a monthly annuity for a period of 15 years
» He along with his spouse can continue to live in the property until death
» After this, the lender who has the title to the property can give it to the heirs if they choose to redeem it-or sell it and give the profit to the heirs
» The rate of interest levied is higher than market rates, while the property could be evaluated closer to guideline values than prevailing market rates
» All interest and finance charges are capitalised in the loan amount
» Annuities vary between 30 and 50 per cent of the loan amount or property value, and also depend on the age of the home owner

dilapidated house, for instance, will get a low valuation even if it is located in prime land. The valuation check will be done regularly every three years. "We will do an inspection every three years and revalue the property," says Mani.



"One should be able to maintain his house. A true reverse mortgage should give annuity for one's lifetime"
R. Ramakrishnan
Retired Chief Actuary/Life Insurance Corporation

If the property value has gone up, the occupant can get a better cash flow, but if it goes down, the annuity is lowered.

But if you aren't able to maintain your house adequately, then perhaps a retirement income through a reverse mortgage is not for you. Says R. Ramakrishnan, retired Chief Actuary of LIC: "A person should take a call on whether he can maintain his property adequately, pay the taxes and still have enough to spare as a viable income stream. Otherwise, he should explore other options of renting out the property and move to smaller, cheaper premises."

With a compound interest of 12 per cent that is built into the loan, the monthly annuity gets sizeably shrunk. If you are older, depending on the life expectancy table, you are eligible for a higher monthly cash flow. But there is no letting go of the interest and finance charges, which could work out to nearly two-thirds of the actual loan, depending on the lender.

At the end of 15 years-which is currently the maximum tenure fixed by National Housing Bank (NHB)-the occupant ceases to get any further money-but he can continue to occupy the house till he dies. "In my opinion, this scheme is not true reverse mortgaging-it is just an ordinary mortgage with the loan being paid back in installments. A true reverse mortgage should give annuity for one's lifetime," says Ramakrishnan.

"We only recommend this product (reverse mortgage of property) as a means to supplement existing income"
Shivkumar Mani
GM Marketing/ Dewan Housing Finance

If any annuity is given over and above the value of the property because of an extended lifespan, this amount has to be made good during the final sale of the house. One has to pay back the financier with interest and usually that is by selling the house. Once the dues are paid, the remaining realised profits are paid to the heirs. Likewise, if the heirs are willing to redeem the property, they should pay up the full value of the amount actually disbursed (which could be more or less than the initial property loan that was defined).

In yet another scenario, after the occupant has drawn a substantial portion of the loan, there could be a sudden 'market fall' in value of the property-resulting in what is known as 'negative' equity. This means that the occupant may not get the pension till the end of term -since he has already taken more than his dues. It's important to understand how interest and finance charges are calculated, and how much should actually be paid if a property has to be redeemed or if a loan is to be foreclosed voluntarily. Therefore, scrutinise the contract agreement to know the fine print better.

Many banks are planning to get into the business, but for the immediate short term the choice of lenders is rather limited.

But not Enough

For now bankers are willing to give loans up to 90 per cent of the value of the property. On a property worth Rs 10 lakh, the eligible loan is Rs 9 lakh. On this, a 60-year-old having a property worth Rs 10 lakh (loan value of Rs 9 lakh) gets an annuity of Rs 1,683 for 15 years. This works out to Rs 3,02,940 over the tenure. The balance is the compounded interest and finance charges that he has to pay to the bank, which is deducted upfront in the loan amount. Senior citizens of age 75 get Rs 2,176.62 per month, higher than a 60-year-old. The outflows are based on mortality tables. So the higher the age, the higher the mortality rate so the higher your cash inflows.

For and Against

Advantage

» Provides additional source of income, which could be valuable
» If a senior citizen is childless or has children settled overseas who are not interested in the property, he can monetise this asset
» Continues to live in the house in his lifetime

Disadvantages

» The annuity received may be low compared to other market instruments, so is the flexibility to move to other schemes once the market matures
» The contract document has to be finely screened to check for adverse implications at a later date. For example, the value of the property going down. The product has to be completely understood
» There's little left to bequeath to the family
» Property has to be properly maintained or it could be devalued
» The annuity runs out after 15 years-it is not there for life
» Taxation issues not clear

Mortgage Options

What the future holds

A variety of new realty-based instruments are likely to make their entry

Home reversion/sale and lease back: The homeowner sells his house outright but retains the right to live in it for normal/reduced rent. The sale proceeds may be paid in lump sum or as an annuity

Interest only mortgage: for those who need an immediate lump sum but have limited loan servicing capacity. Only interest payments are made while principal is due upon maturity or death or permanent move or sale

Shared appreciation mortgage: loans are priced at below market interest rate and are repaid on death or moving or sale. The lender in turn gets a pre-agreed share in any appreciation in property value over the accumulated value of the loan

Mortgage annuity variant: In some schemes the annuity continues even if the borrower moves out permanently

Reverse mortgage allows seniors to live in their own property. Therefore, it can be used only for a temporary income setback. Even in the short-term the effects of compounding could see the retiree pay a higher amount back to the financier. The alternative of selling the property could be equally tedious. That involves facing an increase in rentals every year, extending lease deals, moving from one place to another, which is a hassle for senior citizens.

But for those who hardly have any source of income, except the house as an asset, reverse mortgage can be useful. Senior citizens must not bank on it entirely because the longer one relies on this, the more the mortgaging company gets. As newer variants of reverse mortgage will come into the market, things could change. Later perhaps seniors can part mortgage their houses, and raise temporary short-term loans. But, as always, before one takes the reverse mortgage, one has to ask how much he gets on hand after finance and interest charges are deducted.

The New IPO Code

Equity offerings are not a one-way street to riches. With the markets turning wobblier, investors need to exercise abundant caution.

Mahesh Nayak

It was never easy making a quick buck in an IPO (initial public offer). Last fortnight, SEBI tightened the IPO norms for realty companies on land banks and their valuations. Additionally, SEBI also made it mandatory for companies to grade their IPOs from rating agencies. All this is to ensure that the IPO business gets more transparent, and perhaps more profitable.

But will it? And will investors be able to still profit from IPOs? Going by past listing data, there's hardly room for optimism. Of the 63 companies that tapped the markets over the last year, more than half (35) are trading below their offer price, showing that most investors still holding the shares have lost money (see The Profitability Snapshot).

"Institutional subscription level is an indicator, but not necessarily always accurate"
S. Ramesh
COO/Kotak Mahindra Capital

"Companies aggressively price their stocks. Now that the market is falling, many of these newcomers are hit hard"
Gurunath Mudlapur
Managing Director/Atherstone Institute of Research

One big reason for most IPOs failing to hit it off with investors has been: aggressive pricing. Analysts contend that many IPOs had high priced tags that did not justify their underlying fundamentals. Even better known companies like Cairn India, which is in the business of oil production, saw its IPO floundering. The issue, priced at Rs 160, is currently trading at Rs 137.

In bull markets, valuations of stocks of peer companies and the broad market escalate, which prompts new companies to ask for a higher price for their shares. Says Gurunath Mudlapur, Managing Director, Atherstone

Institute of Research: "Companies aggressively price their stocks in a bull market. Now that the market is falling, many of these newcomers are hit hard."

The Way Forward

Gone are the days when an investor could blindly follow all the IPOs that hit the market. Though the compulsory grading of IPOs should aid investors to evaluate an IPO, the final investment call has to be made by the investors themselves. IPO grading is just an indicator of the fundamentals of the company, and does not give a view on the price call (see We do not Analyse the Investment Viability of an IPO).

Merchant bankers could tend to price IPOs higher and, therefore, investors must take a cautious approach. Says Prithivi Haldea, Managing Director, Prime Database: "Investors must first assess the company's fundamentals closely, and then take a view on investing in its IPO."

Market volatility, on the other hand, could see more IPOs hitting the rough on listing. Therefore, investors must tighten their own filtering process for new IPOs. Says Ajeet Verma, Head (Investment Banking), ask Raymond James: "Now, very few stocks are likely to give upside immediately on listing. But one has to study the stock and its prospects in detail."

Six Questions To Ask Before You Take The Ipo Plunge

Are the promoters known and genuine? Check out past records, promises and performances, and criminal proceedings against them

What is the reason for the IPO? Is the promoter cashing out, or is the business in growth stage and needs to expand?

Is the sector growing? The company should operate in an industry that's growing at a decent clip or has the potential to grow

Where does the company stand? Do a comparison check with its industry peers. Take an in-depth look at the financials, balance sheets, profit and loss, industry growth, products and compare with the big and strong players in the segment

How is it valued? Valuations should be fair and profit visibility should be near-term. It should not account for profits that are two-to-three years down the line. Ideally, it should be valued lower than similar-sized companies

Is the business scalable? The company's business should have the ability to grow in size over time, both organically and inorganically

INTERVIEW: **R. Ravi Mohan, Managing Director &**
"We Do Not Analyse the Investment Viability of an IPO

What are the parameters to grade an IPO?

IPO grading is based on five parameters-business prospect of a company and the industry in which it's operating, financial & accounting risk, including credit risk, corporate governance, management capabilities (can it survive in a competitive environment), and project prospects. Grading will be assigned on a five-point scale-grade 5 indicates strong fundamentals while grade 1 means very poor.

How can investors benefit?

Assessment of an IPO is done on three parameters. First, evaluate whether the company is good or bad fundamentally. Second is its valuation, and third is whether to pick the stock or not through the primary market. Credit rating agency will evaluate the first, and indicate if the company is good or bad. We do not analyse the investment viability of an IPO. However, based on our report about the company, investors can evaluate the valuation and investment angles.

Do you plan to grade the IPO on valuation parameters as well?

We may do it in the future. Currently, we don't have the expertise to evaluate the company on its valuations. We have an equity team that comes out with company report, but it wouldn't be fair on our part to evaluate the company on its financials as valuation parameters will differ between analysts.

The Cues

An important parameter is to evaluate an IPO with its similar-sized peers within the sector and, more importantly, assess the appetite for the stock in the market. "Benchmark the IPO price of the issue with the listed peers. Invest only if it's priced reasonably and the promoters have a good track record," says Ravi Sardana, Senior Vice President, ICICI Securities. "Be extremely selective in IPO-picking."

Investors can also look at the level of interest and participation of the institutional investors. "Institutional subscription level is an indicator, but not necessarily always accurate," says S. Ramesh, coo, Kotak Mahindra Capital, adding, "This could be one of the many criteria that an investor could use." Institutional investors are equipped with better analytical tools and may have greater experience with similar industries or companies. Also, pay attention to the size of the issue, since it ensures a larger float and better liquidity.

Not all issues give similar returns. Some provide high returns in the near-term, whereas others may provide similar returns over a relatively long period. If you are looking for IPO profits, then prudence is your buzzword.

Coming of Networking Age

Many different technologies are vying for your home connectivity. Here are a few basic things to get you started.

By T.V. Mahalingam

Like most other smart choices in life, choosing your internet service provider (ISP) too hinges on one factor-knowing exactly what you want. With more than half a dozen well-established ISPs offering net connectivity right at your doorstep, across different technical platforms, choosing the right ISP can be a mind-bending proposition. Today, players like Tata Indicom, Sify, BSNL, Hathway, Net4India offer internet connectivity across price slabs and technology platforms such as cable, DSL and leased line.

With the launch of IPTV, which is likely to challenge established cable and DTH players with its 'triple play' offerings of internet, television and telephone service over a single connection, the marketplace is likely to get more complex or simple-depending on the way you see it.

To make sense of this plethora of options, a good starting point is to define what exactly you want from the internet and how you plan to use the internet. Ask yourself the following questions. One, how many hours do you plan to use the net every day? Would you be using the net just to check e-mail or do you plan to download music, games or other software? If you plan to download music/software regularly, try and make a guesstimate of the regularity and size of downloads. When are you most likely to use the internet-during the day time or the night?

Visit Websites

Once you answer these questions, visit websites of the service providers you are evaluating and look at the offers they have. Most established players today offer schemes that fit various categories of consumers. Today, ISPs have taken a leaf out of the telecom service providers and have introduced 'prepaid' internet connections. Says Naresh Ajwani, Executive VP, Sify: "The telecom revolution really took off with the launch of prepaid cards. With the introduction of prepaid internet, the cost-conscious Indian consumer is likely to get control over the way he uses the internet." Today, most operators such as Sify and Tata Indicom offer prepaid internet schemes, in addition to the postpaid one. Understanding your usage of the internet might help you in choosing the right scheme.

ISP Basics
Technologies that connect you to the information superhighway.

Cable: Allows your computer to connect to the internet through the same cable that carries your TV signal. Customer usually will have to rent or purchase a cable modem.

DSL: Works by splitting copper lines into two frequency ranges. The frequencies above 4 kHz are reserved for data while frequencies below 4 kHz are reserved for voice. Therefore, with DSL it's possible to use the same line for phone calls and data access simultaneously. Examples of such service providers: Tata Indicom Broadband, MTNL and BSNL.

Integrated Services Digital Network (ISDN): An ISDN line is a type of digital phone line that can transmit data many times faster than a conventional modem and phone line. Data/Voice and Video can be transmitted by combining the channels allocated for faster transmission. A relatively costly technology and used in industries. ISDN services are provided by BSNL and MTNL, among others.

Satellite connections: Reliable technology, but speed is an issue compared to a leased line. Deployed in remote locations.

How to Choose an ISP

Know what you want: Think clearly about why you want to use the internet. Is it just for e-mail? How much are you likely to download each month? When are you likely to use the net? How many hours are you likely to use the net every day? Once you define your usage on these parameters, then you can choose an ISP's offer accordingly

Subscription plan: Providers may offer a flat monthly fee for unlimited access, a metered hourly fee, or both. The fee that is most reasonable for customer depends on how much time you plan to spend online. If customers are online for more than five hours per month, a flat monthly fee makes an economical choice. Otherwise, you'll be paying for service you don't need

Installation cost: Certain providers charge a fee for setting up new accounts or installing hardware like routers on a client's site. Providers may also charge "hidden" costs (like maintenance fees) and premium rates for access at certain times. Ask for a clear break-up of all fees before signing on

Contracts: You may be offered a yearly or multi-year contract for service in exchange for a discount rate. However, if you cancel your account before the contract is up, the provider might charge you a penalty. Also, make sure that your service provider is stable and reliable before committing to a long-term agreement, particularly if you are required to pay upfront

Availability: The ability to establish a connection during peak hours has become an important issue as more people go online. Check with peers and users of a particular ISP about downtime issues

24x7 customer support: If you call with a question concerning your account at an odd hour, will your call be taken? Will your e-mail

queries be answered? The major providers usually have excellent customer support, but smaller outfits may offer little or no support services. Also, be alert to premiums charged for support calls
Source: Hathway Cable and industry

Tata Indicom broadband, for example, offers three broad schemes-time-based plans (where you can download as much as you want but within a time limit that you choose), volume-based plans (where you can spend as much time as you want on the net, but your maximum data download capability depends on the plan you choose), and unlimited plans. If you are a netizen who loves to chat endlessly with friends and check e-mail compulsively once in every half-an-hour, you should ideally opt for a volume-based plan. On the other hand, if you are a heavy downloader of Mozart's symphonies or byte-guzzling online games from the net, a time-based plan makes more sense. And if your home doubles up as your office, and you like to be on the internet for most of the day, an unlimited plan makes sense.

Most companies, including Sify and Hathway, offer variations of these plans. For example, Hathway offers a 'Day & Night Flexiplan' called 'Blast' with a download limit of upto 1 GB during the day while night surfing is free. The plan comes at a price point of Rs 500 per month. Similarly, if you are in Mumbai, a 150 hour, 64 Kbps (kilobits per second) pack with a validity of six months from Sify can cost Rs 1,445. Surfing is 50 per cent free in the nights and completely free on Sundays. It's a decent pick for a home user who is an occasional downloader and regular browser.

Understand Your Net Usage

The moral of the story, therefore, is this-before choosing a plan, understand your internet usage and go through the ISP's website to understand various plans. Pricing can also vary from city to city so ensure that you check on the portal for the costs in your town.

Another aspect that one should be careful about before zeroing in on an ISP is the quality of service of the ISP and hidden costs. "Some providers charge a fee for setting up new accounts. Providers may also charge hidden fees and premium rates for access at certain times. Ask for a breakdown of all fees charged before sign on," says Rajeev Pareek, General Manager, Hathway. It's also a good idea to check with friends and other subscribers about the quality of service of a particular ISP before signing up. Some ISPs such as Sify and Tata Indicom offer value-added services from maths tuitions for school kids to mock entrance exams online.

NEWS ROUND-UP

The Year Of Growth
MF corpuses notched above average growth rates, and returns weren't far behind.

By Mahesh Nayak

The last financial year was boom time for the mutual funds industry. Assets under management (AUM) increased by a massive 52 per cent for the first 11 months of FY 2006-07 taking the total AUMs to Rs 3.53 lakh crore from Rs 2.31 lakh crore as on March 2006. Barring Gilt funds, there has been a higher double-digit growth in AUMs across mutual funds.

AUMs of liquid funds doubled to Rs 1.22 lakh crore from Rs 61,500 crore in March 2006. Despite the cautious overtones and the volatile equity market, AUMs of growth funds rose by 22 per cent to Rs 1.13 lakh crore from Rs 92,867 crore. And since tax planning has seen the launch of some new funds last year, ELSS schemes continue to woo investors-AUMs of ELSS increased 40 per cent to Rs 9,251 crore.

Meanwhile, the hardwork paid off for the private sector mutual funds, with Prudential ICICI AMC and Reliance Capital AMC displacing the public sector mutual fund-UTI Fund House-from its #1 position. Big fund houses such as Prudential ICICI AMC and Reliance Capital AMC consolidated their hold over the industry as they witnessed a jump of 84 per cent and 71 per cent in corpuses last year, respectively. But UTI Fund House holds its forte at the #3 position, having also seen a rise of 31 per cent in its AMC (see The Biggies Grew Bigger).

New entrant Lotus India AMC garnered total management assets of Rs 1,239 crore, mainly through its liquid fund. And there are more players waiting in the wings. Foreign fund management major JP Morgan, along with AIG and Dawnay Day, received the SEBI nod to start mutual fund business, while UBS bought over Standard Chartered Mutual Fund. As on February 2007, the mutual fund managed AUM worth Rs 13,000 crore that mainly came from its debt schemes. Increased participation from players also saw more sophisticated products like derivative & hedge funds and Gold ETF hitting the market. Investors, although, are eagerly awaiting the real estate mutual fund.

But along with the growth in corpuses, fund performance, too, has not lagged too far behind. Many funds have managed to outperform their benchmark indices. Among the best performing fund was a sector fund-SBI Magnum Infotech Fund, which gained 44 per cent in its NAV. For now, the going has been good. All eyes are now on the next financial year.