

# The Reverse Mortgage-a Response to Ageing Polish Society

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**Abstract.** The purpose of the article is to describe the current and planned solutions concerning the reverse mortgage in Poland. A reverse mortgage is a specific type of loan designed for elderly homeowners. This product enables a homeowner to access the wealth accumulated in the form of home and be able to continue to live in it. The available estimates and statistics published by national regulators and providers prove that the reverse mortgage market is developing very fast, especially in the USA. One of the main factors creating a demand for a reverse mortgage is ageing society. Considering the interests of ageing Polish society and institutions offering a mortgage pension based on a life-long structure as defined by the Civil Code, adequate regulations of this product in the Polish legal system become an urgent necessity.

**Keywords:** reverse mortgage, ageing society

## 1. Introduction

Preparing their offer of products banks try to meet market demands and above all have to take into consideration the changing needs of customers. Credits are some of the most popular banking products, among which mortgages stand for a considerable portion. Taking out a mortgage at the beginning of one's career is for the majority of our society the only way to satisfy their housing needs. Due to the observable demographic trend of ageing Polish society there has appeared a new need which can be fulfilled by a mortgage, namely the creation of a possibility of releasing the equity owned by old-age pensioners. The aim of the article is to present the reverse mortgage as a product which is to play both a social function in providing financial security to an ageing society as well as an economic one by widening the spectrum of banking offers.

## 2. The functioning of the reverse mortgage in the world

The idea behind the reverse mortgage is reaching a desired consumption level by households in possession of their dwellings. This product enables households to manage their debts and gain profits from their equities. According to the ECOFIN Report<sup>[1]</sup> payments to households resulting from a reverse mortgage are arranged in a similar way to that of a disability pension and a repayment is not required so long as a borrower uses his real estate as the main place of residence.

The reverse mortgage is a device used all over the world with a view to receiving additional funds over a long period of time. The best developed market is that of the USA, where the Federal Housing Authority (FHA) has worked out a special reverse mortgage program insured by the federal government called Home Equity Conversion Mortgage (HECM). As an accompaniment to this program, in 1994 there was a course book published with detailed information concerning the possibilities of applying for a reverse mortgage,<sup>[2]</sup> the procedures of offering it, maximum loan calculations, repayments linked with it and the monthly payments for the sake of borrowers.<sup>[3]</sup> The scale of popularity is illustrated by the HECM data in Figure 1.

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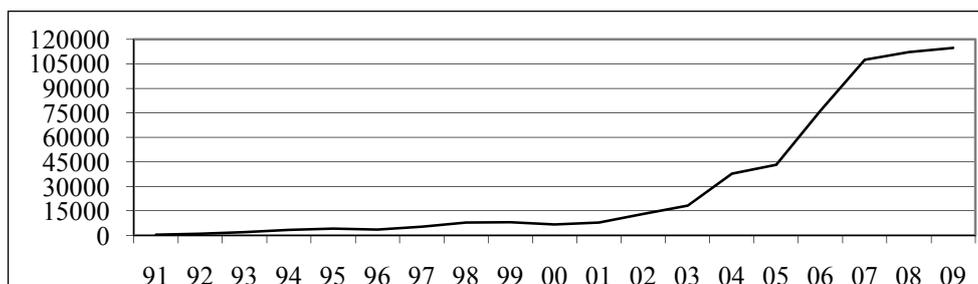


Fig. 1: The number of HECM mortgage loans offered in 1991 – 2009

In the USA the amount of loan that a person can receive within a reverse mortgage on their home is dependent on such factors as the current value and technical state of the dwelling, the interest rate on annual bonds as established by the Department of State, the borrower's age, the form of payment and the location of the dwelling. The exemplary monthly pension payments as dependent on the borrower's age; the value of a mortgage offered is shown in Table 1.<sup>[4]</sup>

Age	Maximum pension payment		
	50.000 \$	75.000 \$	100.000 \$
67	90 \$	158 \$	226 \$
75	154 \$	225 \$	355 \$
85	272 \$	433 \$	594 \$

Table 1: Exemplary monthly pension payments

The rule is that the older a borrower and the higher the value of the equity are, the higher a mortgage loan is. The monthly payment received is not income-taxable and is not included in the documents registering the borrower's monthly incomes.

Apart from the United States and Australia<sup>[5]</sup> a reverse mortgage is offered in 10 EU countries: the UK<sup>[6]</sup>, Germany, Malta, Italy, Sweden, the Netherlands, Romania, Spain, France and in Hungary. Studies on equity release schemes in the EU point out that the EU reverse mortgage markets are not statistically monitored but estimations assume that around 0.1% of the overall mortgage market consists of the reverse mortgage.<sup>[7]</sup> The second part of the ECOFIN Report shows that not in all the above countries it enjoys equal popularity,<sup>[8]</sup> first of all, because it requires quite a high degree of financial education among households and a precisely formulated law regulating particular issues related with this product.

### 3. The reverse mortgage in Polish reality

#### 3.1. Current solutions

The existing laws do not regulate directly the issue of the reverse mortgage. The Long-Term Development Strategy for the Housing Sector for the years 2005–2025 points out that there should be the possibility of a safe conversion of a lifetime equity in the form of a house or flat into a permanent and safe source of income in old age through the introduction of a legal framework for a reverse mortgage offered by financial institutions on commercial conditions as well as based on the new regulations which would allow communes to apply the technique of an old-age pension guaranteed by a mortgage.<sup>[9]</sup>

It is true that the current laws do not forbid this type of loans, nevertheless, there are numerous limitations, which result in the fact that no Polish bank has decided to include a reverse mortgage among its offers yet. At present there are institutions offering a mortgage pension based on a life-long structure as regulated by the law of the Civil Code of 23 April, 1964. These are DOM (HOME), which was the first institution of this type in Poland, and the Centralny Fundusz Hipoteczny (Central Mortgage Fund). Exemplary monthly pension payments are shown in Table 2.<sup>[10]</sup>

Age	Real estate value			
	400.000		1.000.000	
	Woman	Man	Woman	Man
65 lat	529	677	1322	1692
75 lat	868	1066	2170	2665
85 lat	1645	1848	4119	4621

Table 2: Estimated monthly reverse mortgage pension payments in Mortgage Fund DOM

In the estimations of pension payments there is a clearly visible trend of the growing monthly contributions according to the growing age and the value of the real estate. Due to the longer life span of women their monthly pension is lower. The calculations show that the sum of payments amounts to about 30%-40% of the value of the real estate. Its level is connected with the fact that it is a commercial product whose purpose is to generate profits for the institution offering it.

Work on regulating the issue of the reverse mortgage in the Polish legal system is continuing. Working out adequate guidelines is necessary because of the need to establish the rights and duties of the parties as well as to create effective methods of supervision of this type of loans with a specification of a category of creditors entitled to offer them. The free market mechanism may turn out not to be sufficient, at least in the initial phase of the introduction of the product constructed in this way.

### 3.2. The influence of demographic trends on the Polish banking sector

The popularity of mortgages has found its direct reflection in the structure of nonfinancial home equities owned by households. Drawing upon the data of the National Censuses of the Population and Homes of 1988 and 2002 we find out that the percentage of homes possessed by physical persons in the overall number of dwellings increased by 28%. The number of homes owned by physical persons plays an important role in the structure of the reverse mortgage. Besides the basic purpose which is fulfilled by mortgages, namely meeting housing needs, there appear new ones such as investment objectives, the protection of capital against inflation, and financial security. The last element is particularly essential against the background of ageing society, which is observed by demographers. It is exemplified by anticipated changes both in the size and structure of the Polish population as included in the demographic forecast for the period till 2030, compiled by the GUS (Central Bureau of Statistics). The research and analyses conducted by demographers<sup>[11]</sup> concerning ageing society comprise such indicators as fertility and longevity. The results in Table 3.

Indicator	2015	2020	2035
Fertility	1,42	1,45	1,45
Longevity:			
- men	72,3	73,4	77,1
- women	80,2	80,8	82,9

Table 3: Fertility and longevity forecast

The lengthening average life span with the parallel low rate of fertility and minimal foreign migration balance<sup>[12]</sup> will certainly cause negative changes in the population's age structure, virtually over the whole projected period. These are the basic indicators of ageing society. The results of the forecast signal the advanced extent of this process. The changes in age groups prepared by GUS are shown in Figure 2.

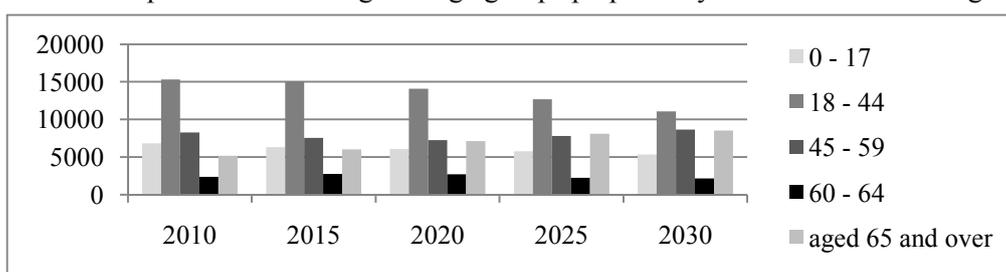


Fig. 2: Age forecast of Polish society

One of the measures illustrating the efficiency of the social security system is the average old-age dependency ratio presented by OECD.<sup>[13]</sup> Its size as broken down by every five years is presented in Figure 3.

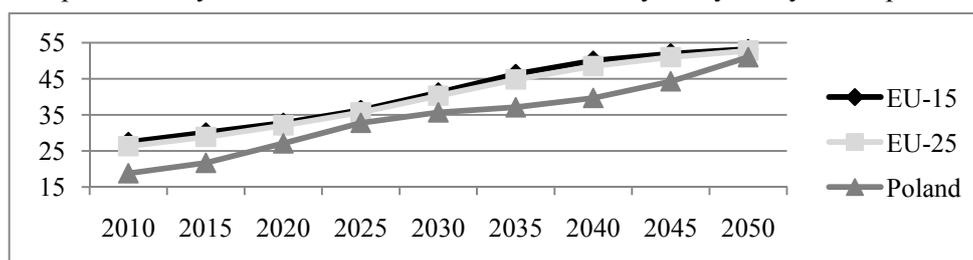


Figure 3: Average old-age dependency ratio (per 100 persons in working age)

From the perspective of social security systems the average old-age dependency ratio for Poland remains at lower levels than that in EU countries. Its dynamic upward trend is a negative phenomenon. Hence, in the next few years the main challenge in the area of social insurance systems will be the state of the pension system. In ageing society households will be forced to manage their home equity in such a way as to cover the costs of the lengthening retirement period. In this context households may be interested in providing security for their financial situation.

Demographic changes exert a significant impact on public spending in EU countries. Forecasts for the period 2000-2050 prepared by the European Commission estimate that in the EU-15 public spending on pensions will increase by 2.3 percentage points of the GDP between 2004 and 2050. In the EU-10 new member states public pension expenditure is projected to rise by 1.3 p.p. by 2050, with an overall increase of 0.3 p.p. in the GDP between 2004 and 2050.<sup>[14]</sup>

According to the paper by A. Blundell-Wignall, Hu Yu-Wei, J. Yermo<sup>[15]</sup> every government, on the other hand, will be interested in the products offered by the financial market which may improve the efficiency of the public pension system. The resistance of a pension system to demographic changes is dependent on the structure of the social benefit system. The classic contributory system (PAYG, pay-as-you-go) is not sufficient in an ageing society. In consequence, the basic way of counteracting the effects of the process of ageing society is adequate reform of the social security system. The very reform might not turn out to be satisfactory and therefore the government aims at starting cooperation with institutions of the financial market with the intention of fulfilling state guarantees and improving the efficiency of the public pension system. The joint action will rely on the products created especially for this purpose.

#### **4. Recommended solutions concerning the reverse mortgage**

In 2010 a bill of the reverse mortgage was prepared.<sup>[16]</sup> It envisages the reception of additional funds by people over age 60, with a title to real estate, hereditary tenure or a cooperative ownership title to a flat.

Through a reverse mortgage deal a crediting institution pledges to pay a borrower over a certain period of time a sum of money specified in the deal or offers a loan in the form of a lump sum of money. The funds received by a borrower can be allocated to any purpose. The payment requirement of the reverse mortgage is on principle postponed by 6 months from the day of the distribution of the testator's estate, however, no later than 12 months after the day of the succession opening (the borrower's death day) and is executed in the way specified in the bill.

The borrower will remain till his death the owner /co-owner /hereditary tenure user of real estate or have a cooperative ownership title to a flat, and will be allowed to inhabit his home till his death so long as he does not breach certain terms and conditions specified in the law. The basis for establishing the amount of a reverse mortgage is the market value of the home by a property expert, and in order to limit the risks taken by a mortgagee institution the bill recommends entering a mortgage on behalf of the mortgagee in position one of the real estate register.

The reverse mortgage should be taxed similarly to other mortgage deals. The payment of the main portion of the loan is exempt from taxation, whereas the interest on the loan is taxed according to the rules specified in the corporate tax law. The matter that is extremely important in view of the social character of the reverse mortgage and its target, i.e. the old age group, is the need to provide customers full and reliable information. For this reason a minister appropriate for financial institutions has been obliged by ordinance to work out a uniform information sheet.

Despite the announcement the proposed solutions have not been put into operation and are still under preparation by the Ministry of Finance. Further specifications in the regulations of the law of succession are definitely an obvious and urgent expectation. Certain controversy is raised by the sums of loans as calculated by banks. On the part of banks there is an observable fear of the slowing down of the upward trend of flat prices and on the part of society – reluctance from potential inheritors.

#### **5. Recommended solutions concerning the reverse mortgage**

It is essential that a speedy regulation of the issue of the reverse mortgage should be made in the Polish legal system due to the inevitable phenomenon of ageing society and, connected with it, the risks of the

inefficiency of the public pension system. It results in increasing mistrust of state insurance systems. Thanks to the new financial service elderly homeowners will receive an instrument supporting their incomes in old age with funds resulting from the release of their home equity. It will allow them to reduce their dependence on financial help from their family members or state aid in return for the costs of interest and other charges imposed by crediting institutions, providing this type of service.

The passing of the reverse mortgage bill will make it possible for banks to broaden their range of product offers and gain additional profits. However, it will also force banks to cover the costs of adjusting their infrastructures to the new financial service. In the light of the fact that the bill of the reverse mortgage has not passed in Poland as yet, it is hard to predict what effects the introduction of this product will bring. Considering the individual character of a reverse mortgage deal, which is affected by such factors as the value of real estate, a borrower's age as well as market circumstances and anticipations of their changes in the future, it is not possible to estimate now the probable number of loans offered, their value or their impact on banks' financial results.

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