Economic Implication And Possible Structure
For Reverse Mortgage in Japan

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1 Definition of Reverse Mortgage in Its Broader Sense

Reverse Mortgage (hereinafter referred to as “RM”) in its broadest sense is defined as the financial structure that enables the elder persons to liquidate (or cash out) the financial value of their own and living houses in some ways other than the simple sale. Using it the elders obtain the money for the living expenses and/or other necessary expenditures, deferring the final disposition of such houses.

The legal structure of the RM can be classified into the two categories: collateralization type and title transfer type. The typical example of the former is the American reverse mortgage in its narrow sense, where the borrower borrows annuity like periodical installment mortgage on the residential house. The example for the latter is the French “rente viager”, where the elder persons contract with certain counterparty to transfer their houses on their death in exchange for the annuity for the period until such death from the date of the contract.

In addition to these typical RM, more and more needs have been recognized in Japan for the structure promoting the elder persons to move from their existing residence to the one for the senior life by utilizing the monetary value of the former in some manner. Though not strictly categorized as typical RM, this is called “the RM for the housing transition.”

2 RM in The Bubble Period

The history of the RM in this country dates back far more than one imagines. In the early stage, at the peak of the so-called bubble era (late 1980’s to 1992), the RM caught the eyes of the people as the type of a new mortgage offered by private financial institutions. This was used to “cash out” the equity value of the land inflated at the time without recognizing the capital gain for purpose of taxation.

Some regional governments also started the payment-in-kind type RM where the regional offices offer the lifelong medicare services in exchange for the payment of fees at the death which is collateralized by the house the resident lives.
These, however, became virtually dead on the collapse of the bubble far before reaching its maturity.

3 Aging Problem and RM

In late 1990’s the light was shed once again onto the RM as the aging problem of the Japanese society had become more and more serious.

Japan had been the youngest among the OECD nations until 1991 in terms of the aging ratio (the ratio of the senior citizen i.e. 65 years old or more in the entire population). It, however, has become the oldest country in the world in terms of the same ratio just within these ten years or so. This is owing to the constant extension of the average life after the WW II and dramatic decrease of the birth rate. There is no hint of speeding down of this phenomenon and Japan will run into the aged era that no other countries in the history have ever experienced.

Chart 1

Proportion of Age over 65

- As of year 2000, Japan becomes the most aged country.
- Just 10 years ago, Japan was the youngest country.
- Aging accelerates and Japan continues to be the top

(White Book on Aged Society)

It has become the imperative issue for Japanese to be financially secured in their senior
lives that lasts as long as 20 years after retirement age.

On the other hand, longstanding low interest environment and bearish stock market have aggravated the financial problem of the national pension system, which had already been hit by the change of the demographic structure. With this background, those who deal with pension problem started to focus upon the possible role of RM as an alternative pension. This constitutes the one of the context in which the government discusses the RM.

Chart 2

(Life Insurance Association of Japan)

This sort of discussion, however, could be taken by the nationals as the irresponsible request to eat up the residence to make up for the pension deficit. To avoid such criticism we need to make the sincere effort to position the RM as the proactive financial tool to activate the equity value of the residence in concert with the national housing policy for the elder persons.
4 The Need for Continuing Residence / Ownership

The housing required for the senior life is generally less expensive than that purchased during the days bringing up the children: first of all, just husband and wife may not occupy too much space; they do not have to seriously consider the commutation time; and the period of ownership is limited until death. If one could cash out this price difference, it could be used to enrich the senior life.

Japanese, however, tend to own and live in the same house even after the kids leave once they purchased it. This would comes from the following reasons:

4.1 Necessity for The Continuing Residence

4.1.1 Proactive Needs

For example, a good portion of elder persons tend to stick to the place where they have been accustomed to living with old neighborhoods. They may also feel guilty of abandoning the land where their ancestors have long lived.

Some may feel so much affection in the house they finally obtained after the painful effort that they never think of disposing it.

New type of family interdependence could be another reason.

For example, there arises the new phenomenon called “para-site single” where the kids who have come of age remain in the parent’s house. This could prohibit parents from starting their own senior life. Conversely some parents could not graduate from their kid-raising days. On the other hand, significant number of elder persons support their own parents, which also refrain themselves from commencing their own senior life by changing their housing environment.

4.1.2 Difficulty in Housing transition

From the different aspect, there are scarce facilities that can be called as “the housing where the elder husband and wife may live a comfortable and stable life until they see their last days.” If any they are generally very expensive. Even not expensive, one should be aware of the risk and possible future cost as such houses often are non-extraordinary ones with a perfunctory barrier-free items.

With these situation back in mind, the diet passed the Laws to Promote The Stable Housing for Elder Persons (Laws No. 26 dated April 6, 2001) and the government started the institutional support for the elderly housing. But we just stand on the starting line and
many still do not have the alternatives other than remaining their existing houses.

4.2 Needs for The Continuing Ownership

Another reason they hesitate to sell the existing house may come from the strong needs of ownership though not residence itself.

4.2.1 Positive Economic Reason

First of all if the owner elderly expect the possible raise of the house/land price in the future, they have a good reason to hold it for a while until they sell at the profit or have their descendants succeed to such house/land to decrease their future burden to buy the same at the higher price.

The traditional behavior of Japanese sticking to “My-Home” can be explained from this perspective as being economically reasonable. The existing 50’s – “Dan-kai (A Chunk)” (Japanese baby boomers) have typically been taking this strategy and they were generally right. Though the environment has changed, their success experience was so strong that they could hardly forget it and they tend wait until price comes back.

4.2.2 Negative Economic Reason

On the other hand, the following generation who acquired their own home in the bubble period have unanimously experienced the considerable prince fall. The house itself also will have substantially depreciated until they become 60’s.

In addition the used house price is significantly lower than its economic value even taking into account of the actual depreciation. This is usually attributed to the immaturity of the secondary house market. Possible reasons for this immaturity are as follows: the market has virtually accepted the shorter duration in spite of the governmental guidance or the theoretical period under the depreciation table; the banks are very cautious in lending on the used mortgage as it is very difficult to appraise the residual value just looking at the appearance; more in general, Japanese likes fresh things and may tend to devaluate used things.

Consequently the market value of the houses that this generation owns could be substantially lower than it book value. They have good reason to think that it is wiser to hold until real estate price gets back in the future.
5 The Possibility of Japanese RM

As seen above, we may expect sizable demand in the RM that enables us to cash out its equity value of the house while holding and/or living in it.

The last question is to clearly define the positive and pushing needs to do RM in addition to the potential demand. This will affect the product features, too.

5.1 Possibility of Line of Credit RM in Japan

5.1.1 Implication of the Public RM in US

As seen in Chart 4, 68% of the American RM takes the Line of Credit type, where the borrower sets the borrowing limit based upon the appraisal value of the collateral house at the outset and borrows against this credit line from time to time. This is not necessarily the same as the text book explanation of the RM introduced at the beginning hereof. The text book types are called Tenure and Term which share only 12% in total.
background of the higher share of Line of Credit type may explain the real usage of this financial product.

Chart 4  Share of Payment Plan in HECM

(May 2000, A Report of Congress on FHA’s Home Equity Conversion Mortgage Program)

**Hypothesis 1) Natural Preference to Line of Credit**

If circumstances allows, it is always best to cover the living expense in the elderly life by pension payment and the liquidation of financial assets. The sale of residence is apparently the last resort when the above monetary contracts and assets may not cover the necessary expenses. At the entrance of the elderly period, people tend to own the biggest amount of financial assets in their life. They do not yet worry about their health. Decrepit days are still far beyond. Namely the concern for the financial shortage is not yet realized. Under such circumstances, people prefer only to set the line of credit for the future emergency. In doing so they are able to limit the cost of finance not actually borrowing money right now. What they get is a big comfort in the future because it becomes more and more difficult as they age.

**Hypothesis 2) Motivation for Continuing Holding**

In 1990’s US generally saw a constant growth of the house price. Under such circumstance, one would try to defer the timing of disposition to maximize the capital gain.
5.1.2 Possibility in Japan

Younger senior generation in Japan are also comparatively affluent among the entire generations and they may see the RM as future emergency line rather than the alternative annuity for the immediate needs. They also have a strong preference to hold their houses for both positive and negative economic reasons as discussed above. Consequently it is likely that Japanese carries the strong needs in Line of Credit type RM.

Chart 5


Recently some economic leaders point out that the Japanese carry too much bank deposit with almost nil interest rate. Actually the share of deposit within the entire financial assets for elder persons (60 or more) exceeds 60%. Their absolute amount of asset is comparatively larger than the rest of generations and it occurs to us that the Japanese elders are requested to buy stocks to bet. We, however, have to be careful about such discussion since they talk about the shares of deposit only within the financial assets.

As shown in Chart 5, if we see the share of the financial assets in the entire assets for the same generation, it is merely around 30%. Likewise the share of deposit is 22%. One might have to take care of the university tuition for their kids and to share the cost of the marriage celebration in the early senior stage. In the later senior stage, one would have to be ready for the medicare expense. Considering the pension fund problem, 20% liquidity
ratio would probably be the right level for the balance sheet of the elderly.

Rather we need to focus upon the fact that the more than half of the entire assets is attributed to the residential land and houses in which the elders currently live. This portion of the assets is now “non-performing” in terms of the financial value. This could be one of the reasons that Japanese nationals do not feel themselves affluent in spite of the monstrous figures reported by the statisticians.

Chart 6

If we could release the cash value of only a half of this non-performing portion of the assets, it would easily exceeds the amount of entire bank deposit.

Of course it does not mean that elder persons have to sell their houses. Rather if we could assure them that they may “withdraw” the money against their residence any time of the future emergency, they could seriously think about releasing their liquid assets currently held for emergency and future cash shortage and using it right now for the more proactive purposes. If this hypothesis is right, the Line of Credit RM could offer a substantial positive effect on the Japanese financial market.
5.1.3 Example Product Structure

US type of RM would basically satisfy this need. Japanese individuals, however, are not necessarily accustomed to the idea of “commitment fee” even more than the American. We may have to think about deferring the payment of commitment fee until they actually borrow (i.e. the fee will be consolidated with the loan balance upon withdrawal), or asking them to pay the fee up front while they have money.

Also the amount of credit line will generally be more conservative than could have been in the 90’s of US since the sentiment in the real estate market here is still very bearish.

To solve this problem, it could be realistic to take the increasing line of credit structure: i.e. just like annuity the credit line starts from a small amount and constantly increases as time goes. If the needs of the borrower lie in the emergency and the future cash shortage, this structure will offer the adequate comfort to the possible borrowers. Also the lender can limit the absolute amount of exposure, which would ease the risk of the RM.

The lender entity has to be creditworthy enough to play the role of an emergency wallet for a long time. We, therefore, may think about certain public entity to take this role.

5.2 Senior Housing and the RM for Housing transition

5.2.1 Bifurcated Structure of Housing Circulation

The housing required for the child raising period is not necessarily equal to the one required in the senior age.

Chart 7

Because of the various reasons discussed above Japanese generally keep staying in the same house after they become senior age. We gradually become to think, however, that we would be better off changing the housing style as life stage goes forward.
In order to make this happen, it is essential to promote the smooth transition from the housing for the earlier ages to the one for the senior ages. For this purpose we need to establish the bifurcated circulation of the houses: one for the houses for early life stage and another for the one for the senior life.

Chart 8  Bifurcated Structure of Housing Circulation

Here we would have to promote the building activities of senior housing with the proper guidance taking care of the different and various needs of senior residents.

5.2.2  The RM for Housing Transition

As the senior housing is prepared, the next question is how to get money for it to move from the current house. Story becomes very simple if we could easily sell our house in the used market. It is, however, not easy as discussed above. There arise the strong needs of certain structure either to acquire or rent the early stage houses based upon their theoretical market value rather than the actual one so that the seller elders could get the finance for the senior housing. This type of structure is generally called the RM for
Housing Transition.

5.2.3 Involvement of The Public Sector

It is not necessarily easy for a private institution to offer such “bridging” service. It may be worthwhile considering to have a public entity to take the role in the transition period.

5.2.4 Securitization Structure

The bridging entity will become to hold a substantial number of housing assets after starting its business. The imperative requisite for the structure is to offer certain ways to dispose or reinvest such residential assets.

I would like to suggest the following structure as one of the possible ideas to deal with this issue.

1. A senior person who wish to make use of the RM for Housing Transition (hereinafter “User”) assigns for entrustment his/her house to the public institution (or private trust company, hereinafter “House Repository”). In return the User receives the trust certificate representing the beneficial interest in the “entire” assets of the House Repository (note: not in the specific house he/she assigns) (hereinafter “House Certificate”). The House Certificate will be priced based on the average value of the entire portfolio of the House Repository. The House Repository will publicize this theoretical value periodically.

2. The House Certificate will be listed in the stock exchange. It is expected to behave like ETF(Exchange Traded Funds). Alternatively the House Repository may take the open end structure, whereby it buys and sells the House Certificate at the price they announce.

3. User borrows money pledging the House Certificate. For the banks it is always difficult to appraise the individual house and land for a collateral. House Certificate eliminates the needs of this individual appraisal and the banks only have to take the price risk of the entire portfolio of the House Repository. If the portfolio becomes adequately large the diversification will minimize the risk of price fluctuation. It also benefit User as he/she does not have to negotiate about the result of the house appraisal.

4. House Repository reinvest the houses so entrusted for rent. The major portion of the portfolio constitutes the houses of around 20 years since establishment. Though the actual market value is almost nil except for land as discussed above, the economic usability still remains at almost full level. In reality this segment is the very one that
Japanese house rental market lacks and would offer a variety of rental options for the younger generations. This will help the rental market of this country functioning properly, which is one of the core political goal in these days.

Chart 9

5. User keeps the first right to refusal in renting the very house he/she assigns. User also have the right to purchase back such house at the market value provided that House Repository still keeps it. This right of repurchase will be inherited only when the User rent and reside in the house.

6. User may sell the House Certificate in the market and use the proceeds to move to the senior housing.

7. The holder of the House Certificate will receive the periodic distribution of rental income and the capital gain realized as the House Repository disposes its assets.
The holder also may exchange its House Certificate with a specific asset at its market value.

Through the structure like this, the User will exchange its own house with the trust certificate of the giant real estate trust specialized in the residential houses and lots and may use this certificate for the finance of the new house in the senior life. This will help the elder persons to get into the second housing circulation graduating from the first one. The rental opportunities that House Repository creates will enhance the first circulation of housing within the younger generation.