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Loan against property: What you need to know

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Recently, loan against property (LAP) has emerged as a popular form of long-term loans, especially among the self-employed. According to a recent report from CRISIL, this loan category is expected to grow 22% annually over the next four years. However, there are a few points borrowers should keep in mind.

Key features As opposed to personal loans, the interest rate on LAPs is lower since it is secured against the house. The interest rate ranges from 11.5-15% per annum and the tenure is from 1-9 years, which can be extended up to 15 ɛars, compared to only five years in the case of a personal loan. Also, you can receive the loan amount lumpsum or as an overdraft facility.

Before sanctioning the loan, all financial institutions will check your income, debt-servicing obligations and your credit score. "LAPs are given on freehold property and the owner must have a clear title to it," informs Rajan Ahuja, director, Realty & Verticals, a Gurgaon-based real estate consultancy. To reduce risk, most banks offer loans up to 50-65% of the value of the property, while some non-banking financial companies (NBFCs) go up to 75%. The processing fee ranges from 1.5%. Loans are approved only when the self-employed can show an earning track record of three years, usually via ome tax returns.

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antages LAPs allow property owners to monetise an idle asset. Loans can be taken against both, self-occupied and property that has been leased out. The tenure of an LAP is longer and you can also get a larger amount as compared to a personal loan, which cannot exceed Rs 10 lakhs.

Disadvantages The key risk in an LAP is that you could lose the property you have borrowed against if you default on the loan payment. Also, unlike a home loan, there's no tax benefit to the salaried individual on the principal amount and interest paid.

Points to remember Before taking a loan, assess your cashflows and repayment capacity. "People often take an LAP because it is cheaper but deploy it in avenues that are risky," points out Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors. Taking this loan to start a new venture, could be riskier than if the money is used to expand an established business. If you default, your credit score will be affected, a penalty will be charged, and in the worst-case scenario, you could lose the property.

"People tend to put at risk an asset that is worth much more, for a loan of a smaller amount," points out Dhawan. For instance, a home worth Rs 5 crores is put up as security for a Rs 50 lakh loan. Instead, explore taking a loan against share certificates, insurance policies, gold, etc. Sometimes, businessmen opt for LAPs to avail of tax deduction on interest paid. "Borrowers must get good tax advice. The funds have to be clearly identifiable as having been deployed for the expansion of the business to be able to avail of the tax deduction," informs Dhawan. Finally, if you expect some cash flows soon, take the loan as an overdraft facility and not as a term loan. Whatever surpluses you get can be parked in the overdraft account. This will enable you to lower your interest cost.

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