Pre-pay home loan to tackle repo rate hike

WHAT IT MEANS FOR YOUR EMIs

Outstanding principal: ₹50 lakh; remaining tenor: 20 years

Interest rate (%)	Increase in EMI (₹)	Increase in interest cost (₹lakh)	New tenor if EMI remains same (months)
7.00			240
7.40	1,209	2.90	258
7.90	2,746	6.59	288
8.40	4,310	10.34	334
8.90	5,900	14.16	424

This is an illustrative example. Actual rates may vary.
Source: Bankbazaar

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New Delhi, 30 September

Home loan borrowers will again have to bear the brunt of Friday's 50-basis point (bp) hike in the repo rate by the Reserve Bank of India. The benchmark rate, which now stands at 5.9 per cent, has risen 190 bps in the current rate hike cycle so far.

Prepare for longer tenor

Suppose that a borrower took a home loan that has a principal outstanding of ₹50 lakh and remaining tenor of 20 years. The starting interest rate was 7 per cent. With the rate rising to 8.9 per cent, the tenor could, in theory, rise to 424 months, assuming the EMI remains constant. "At 424 months, the tenure of this loan increases by 184 months over the original," says Adhil Shetty, chief executive officer (CEO), Bankbazaar.com.

Prepay loan

Borrowers who have surpluses should pre-pay their loans. "They should prioritise pre-payments to control their interest cost. This will help them reduce their loan tenor and EMI," says Shetty.

Opt for higher EMI

When home loan rates are reset, the lender usually hikes the tenor while keeping the EMI cost. After the 190-bp increase in the current rate cycle, however, many borrowers, especially the older ones with large principal outstanding, may find their EMIs being hiked.

Borrowers who have the option should go for an increase in EMI rather than a rise in tenor.

"The total interest cost incurred would be lower if a borrower goes for the EMI increase option than if he goes for the tenor increase option," says Gaurav Aggarwal, senior director, Paisabazaar.

Home-saver loans

Under this facility, an overdraft account is opened in the form of a savings or current account. The borrower can park his surpluses into this account or withdraw from it, depending on his financial requirements. "The interest on the home loan is calculated after deducting the surplus parked in the savings or current account from the outstanding home loan amount. This facility allows home loan borrowers to derive the benefit of making pre-payments without sacrificing liquidity," says Aggarwal.

Existing home loan borrowers who have witnessed a substantial improvement in their credit profile after taking their home loan can opt for home loan balance transfer to reduce their interest cost. Their improved credit profile may make them eligible for availing of home loans from another lender at a lower interest rate. "Borrowers must periodically examine the option of switching to the best possible interest rate they can get for their credit profile," says Aditya Mishra, director–home loan desk, 4B Networks. With pre-payments becoming so crucial in the current scenario, go for a lender whose terms for prepayment of loan are not stringent.

Ladder your FDs

Banks are likely to hike fixed deposit (FD) rates. "With credit growth rate at a high of 16.2 per cent year-on-year, they may be quicker in raising FD rates now," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors. The peak of this credit cycle is near. "Instead of trying to predict the peak, ladder your investments in FDs," says Dhawan.