



YOUR MONEY

Retain EMI, shorten tenure for greater interest-cost savings

SANJAY KUMAR SINGH & KARTHIK JEROME

The Reserve Bank of India (RBI) has cut the repo rate by 50 basis points to 5.5 per cent. Since February, the repo rate has fallen by 100 basis points. Interest rates on new home loans, already below 8 per cent following the April cut, will decline further.

The latest repo rate reduction will lower EMIs on home loans. For instance, on a ₹75 crore loan for 20 years with an initial rate of 8.5 per cent before the February cut, the EMI would have been ₹65,087. Once the latest cut is passed on, the interest rate will drop to 7.5 per cent and the EMI to ₹60,420—a decrease of ₹5,387.

Quicker gains for repo-linked borrowers

The pace and quantum of transmission depend on the benchmark used by the lender and the reset dates. “The transmission will be quickest and absolute in the case of existing home loans linked to the repo rate,” says

Santosh Agarwal, chief executive officer (CEO), Paisabazaar. The RBI mandates that interest rates of repo rate and other external benchmark-linked home loans be reset at least once every three months. “In recent times, public-sector banks have been faster in passing on benefits to borrowers than private banks,” says Abhishek Kumar, Securities and Exchange Board of India (Sebi) registered investment advisor and founder,

SahajMoney.com.

Impact on new borrowers

Whether new borrowers benefit to the same extent as existing ones depends on the spread or credit risk premium. “If banks continue with the same spread, the rate reduction for new home loan borrowers will be the same as for existing borrowers,” says Agarwal. When credit demand is high, banks increase their spread over the repo rate, which reduces the benefit for new borrowers. “Some banks might also take time to adjust their pricing for new loans based on their net interest margin (NIM) projection,” says Kumar. Lower rates also increase the loan eligibility of new borrowers.

Reduce tenure or EMI?

When rates fall, banks typically keep the EMI unchanged and reduce the tenure. “Borrowers can choose between reducing the EMI or the tenure,” says Adhil Shetty, CEO, BankBazaar.com.

Kumar suggests that main-

taining the current EMI and reducing the tenure results in greater savings in interest cost over the long term. “The decision to maintain EMI must be taken only if the borrower’s cash flows permit,” says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

Switch from older benchmark-linked loans

For home loans linked to internal benchmarks like the marginal cost of funds-based lending rate (MCLR) and the base rate, the rate cut may not be passed on fully. “Lenders’ cost of funds plays a major role in determining internal benchmark rates,” says Agarwal. Transmission is also slower. Kumar informs that the reset period ranges from three months to one year for MCLR-linked loans. “If you are on an older benchmark, switch to a loan linked to an external benchmark,” says Shetty.

Dhawan adds that those loans are more transparent. Borrowers on repo-linked loans should also periodically check if they are on the best rate available in the market, particularly if their credit score has improved.

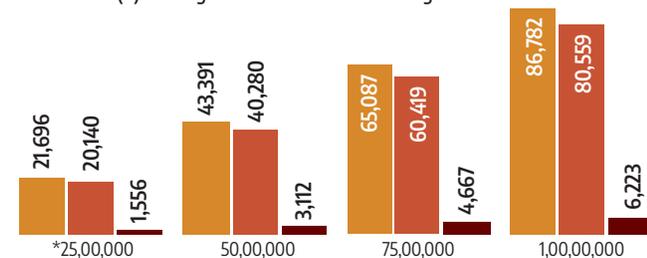
Consider prepaying

Existing borrowers should consider prepaying their home loans. “By doing this amid falling interest rates, you can reduce your overall interest liability significantly,” says Shetty. However, if you can invest the money in equity mutual funds to earn higher post-tax returns, do so rather than prepay. Finally, do not overstretch yourself to prepay.

Gain from 100-bp cut since February

Loan tenure is 20 years. Original interest rate taken to be 8.5%; 7.5% after 3 cuts; *Principal amount

EMI Amount (₹) ■ Original ■ Revised ■ Savings



Source: Bankbazaar.com