PERSONAL**FINANCE**

Thinking of prepaying your home loan? **Anil Kothuri** has some advice for you

HOME AND HEARTH

Of the three basic needs, the need for shelter is the most difficult one to fulfil. Most peoples' aspiration is to live in their own home. Increasingly, it is more the norm than the exception to take a home loan to finance one's property.

A home loan is typically an individual's largest liability and one that lasts for a long time. Most borrowers want to close the loan as quickly as possible and ensure that their home is free of any encumbrance.

However, our lives are not linear. There are periods of windfall where we have some extra funds where the temptation to prepay the loan is high. Also, there are some situations of distress where paying the monthly instalment becomes difficult.

Let's look at some of the most common questions that people with home loans have regarding managing their loan accounts.

Planning for contingency

A home loan is a long-term commitment and not honouring it has repercussions on the credit standing of the borrower. Getting another loan in the future could become difficult. Also the loan will be more expensive for people who have previously defaulted.

However, in the course of one's life, there could be emergencies that could impair one's ability to repay the loan. Hence it is advisable to keep at least six months' instalments in a fixed deposit or any other liquid instrument. Any funds over and above this can be used for prepayment. Taking a medical insurance policy is another way of meeting the same requirement.

The lenders also assist customers in funding the insurance premium by increasing the loan limit; do consider the best plans to suit your requirement to get the added protection.

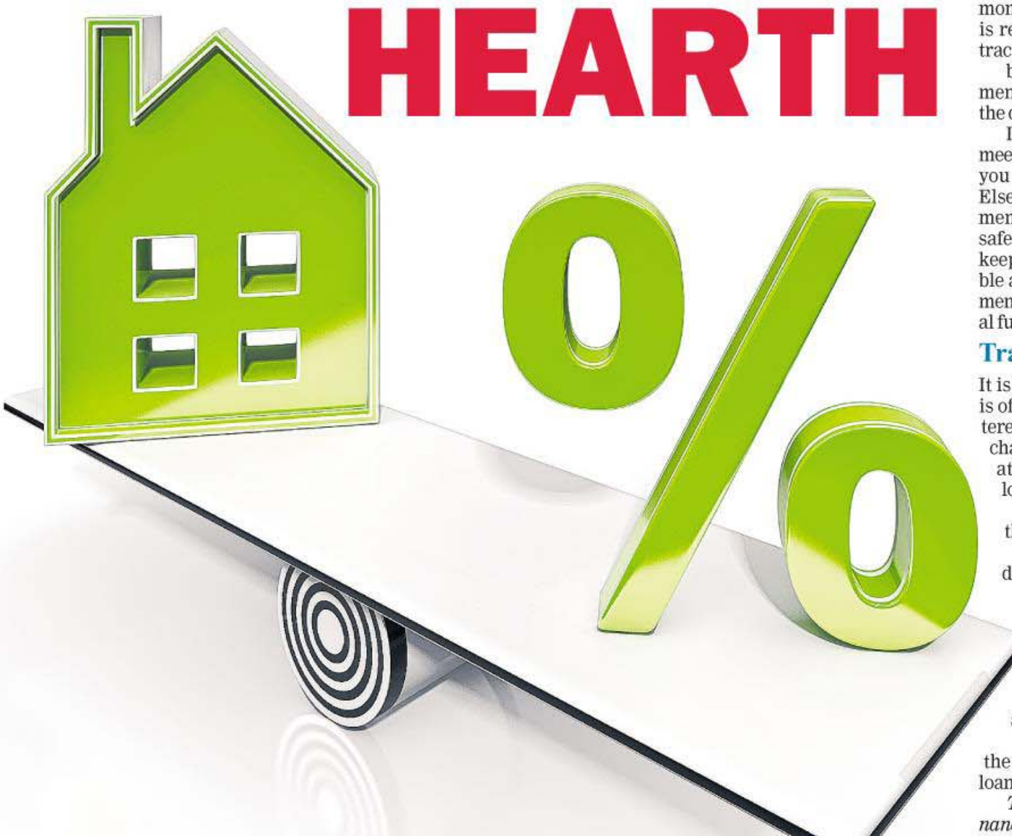
Despite everything, there could be a situation where it is difficult to pay your monthly instalment. When such circumstances arise check with your home loan provider whether a top-up loan is possible on your home loan. This could provide you additional liquidity. Else, see if you can raise a temporary personal loan which you can use to repay your home loan instalment.

If the stress is long term, try to get your home loan restructured by your lender.

Liquidate your financial/non financial assets to muster some liquidity.

Prepaying the home loan

The most common use of windfalls is to prepay the home loan. While this has the obvious advantage of reducing the loan outstanding and the remaining tenure of the loan, there are a few other factors to consider before committing to the prepayment.



Loan prepayment cannot be reversed. You lose the chance to access your money once you've used it to prepay your home loan. Hence, it will not be available to use either during an emergency or to take advantage of any opportunity.

The eagerness to close the loan quickly and become debt free should not cause us to ignore the value of the home loan in financial planning. A home loan is the cheapest form of debt; for most people, it is the only form of significant debt available. You could build a portfolio of assets which could be financed using the amount that you set aside from prepaying the home loan.

The tax benefits on the home loan lower the effective rate of interest on the funds used. It may be worth evaluating any investment opportunities which yield more than the effective rate of interest on the home loan. For example, the current yield on tax free bonds is 7.5 per cent, whereas the effective interest rate on home loans is 6.3 per cent (calculated as 9.6 per cent with a tax break of 33 per cent). Not only is one financially better off, but the money is also available for use, should the need arise.

Repaying a fixed rate loan may result in the levy of a prepayment penalty. This should be factored into the repayment decision.

Choices post prepayment

So, after considering all the above, you have finally decided to prepay part of the loan outstanding. You now have two choices:

a) Continue to pay the same monthly instalment so that the loan is repaid before the originally contracted date;

b) Pay a lower monthly instalment so that the loan terminates on the date originally envisaged.

If you need additional cash to meet your (rising) monthly expenses, you could lower your instalment. Else, you can pay the same instalment and close the loan early. The safe and prudent thing to do is to keep the instalment as low as possible and make an additional prepayment as and when you have additional funds.

Transferring the loan

It is possible that some other lender is offering new home loans at an interest rate lower than what is being charged on your loan. In such a situation you should consider the following:

i) Processing fee charged by the new lender ;

ii) Stamp duty payable on the documentation.

You could approach your existing lender for reducing the interest rate on your loan. It may be possible to do the same at a fee that is lower than the cost of moving the loan to another lender.

Wish you all the best as you get the most value out of your home loan.

The author is head — retail finance at the Edelweiss Group and the chief executive officer of Edelweiss Housing Finance Limited