

HOW YOU CAN AVOID PAYING 30 % MORE FOR YOUR HOME

Save R320 000 on a R1 million property

You may be well aware of the strict lending criteria applied by the banks since the introduction of the National Credit Act and the potentially intimidating process that you have to go through for home loan approval. As such, you may be only too pleased when the bank finally grants you a home loan – and in fact so thankful for the “approval” from the bank that you do not challenge the interest rate “proposed” by the bank.

For example: If your interest rate is 2% above the prime lending rate, then your R1 million rand home loan can cost you a whopping 32% (R320 000.00) extra at the end of your home loan repayment period. This is surely indication enough to make you rethink the approach you take before you ask the bank for a home loan, advises Meyer de Waal, conveyancing attorney.

The factors that will have a major impact on your home loan approval will be your current credit rating and profile, as well as your exposure to debt and affordability.

If you first take the necessary steps to investigate your own credit profile and affordability before you approach the bank for a home loan, you may be in a better position to rectify mistakes on your credit profile, identify expensive debt (and make plans to first settle such debt), make sure that you have no late or non-payments reflected on your credit score-card and remove paid-up judgements against your name, as all these factors contribute to downgrading your credit profile. The lower your credit score, the higher your risk to the bank and thus the higher your bond interest rate, says Meyer.

An example of interest applicable on a bond of R1 million rand, paid off over 20 years:

9.25 % interest rate	R1 198 080	
10.25 % interest rate	R1 355 944	R 157 864 more = 15 % more
11.25 % interest rate	R 1 518 214	R 320 134 more = 32 % more

Buying your own property is most likely the biggest investment you will ever make. Similarly, if you utilise a loan from a bank to finance the transaction, it will most likely be the biggest debt of your life. This debt could stay with you for a period of between 20 to 30 years, as this is usually how long the repayment period is that is granted by the bank..

If you stretch your bond repayment over a 30 year repayment, with the same prime interest rate, you will end up paying almost more than double the initial capital of the R1 million borrowed.

20 years x 9.25 % interest rate	R1 198 080	
30 years x 9.25 % interest rate	R1 961 631	R 763 551 more

It is thus blatantly clear that it is prudent to repay your loan in as short a period as possible. The question is - why wait the full 20 years to pay back your bond?

Before we start to look at a shorter period to repay your home loan, let us look at what you need to qualify for a home loan. Remember that the amount of the home loan that you need to borrow is the first bit of information that you require, as this will determine whether you will be granted a 100% loan to pay for the property that wish to buy, or only 80% . If you only qualify for an 80% home loan, then you will need, with your own money, to contribute the balance of 20% to make up the full purchase price. The average deposit required by the banks at the moment appears to be 15% of the purchase price.

There are three basic requirements a bank will consider when granting a home loan. The first requirement is your “affordability”. Prior to the implementation of the National Credit Act (NCA) in 2007, the lending institutions applied the “30% of income rule”. It meant that if you wanted to raise a home loan of R500 000, you had to earn at least 3 times the amount needed to be paid back every month. When the NCA was introduced, the lending criteria was supposed to be calculated only on the borrower’s actual affordability, that is income less expenses, but we see that notwithstanding the directive of the NCA, the “30% of income” rule is still applied to determine the affordability of a borrower.

The second criteria of banks, which a home buyer often overlooks or neglects when submitting a home loan application, is the “credit profile” of a borrower, which is a very important factor.. The credit profile of a client will determine the risk that a bank is willing to take to lend out money to a client. For obvious reasons, the lower your risk to a bank, the lower your interest rate may be. The reverse is also true – the higher your risk, the higher your interest rate will be. If the bank is of the opinion that your debt exposure, your payment history of past accounts or late or non-payment of accounts will be a risk to them lending you money, they may decide to add between 2 to 4% interest points to the base home loan rate (currently 9.25%). You may think that your first priority is just to get a home loan, regardless of the interest rate being one or two percent above prime, but if you consider that you may end up paying this higher interest rate over 20 years, you will end up losing thousands of rands due to an inflated interest rate.

The best advice is to get a copy of your credit profile before you apply for a home loan and investigate all the entries listed thereon. Check how many enquiries have been made against your name over the past 2 years, as excessive enquiries for debt leads to the assumption that you may be shopping around for funding, which indicates that you may be relying on debt to fund your lifestyle - which again reduces your credit score.

An example of this scenario, was a teacher who applied for a home loan to buy five different properties in one year. Once a home loan was declined, she started looking for another property a few months later. Each application was unsuccessful. With each application the mortgage originator submitted her home loan application to all four banks and each time each bank declined her home loan application. No-one ever assisted her in investigating why the loan was declined and as such, she re-applied a few months later to buy a property from another seller. After one year, she had 5 x 4 credit application enquiries on her credit profile. The 6th time that she applied for her home loan it was approved, as it came to light that the previous 5 applications were declined due to the fact that during such applications she was not permanently employed with the Department of Education. Once she had her permanent

employment confirmed, the loan was granted. The problem however was that due to all the past credit enquiries against her name, the bank regarded her as a high risk and added 4 interest points to the prime lending rate. The result was that the higher interest rate made the repayment of the home loan too high and she herself had to decline the home loan.

A stronger credit profile may assist you in negotiating a lower interest rate. It is thus worth your efforts in making sure that your credit profile is strong and healthy before you apply for a home loan. This will enable you to use the extra money that you would have paid as an interest repayment, to rather pay into your bond each month as an extra payment, enabling you to pay off your bond much faster.

If you have a deposit available when you buy your own home, this deposit will lower the amount which the bank must lend to you and again this reduces the risk to the bank. The lower the risk to the bank, the lower your interest rate ought to be. It thus makes good sense to save towards a deposit before you go out to buy your property, as it improves your negotiation power and can reduce not only your risk to the bank but also your subsequent interest rate.

Home owners will soon see the advantage to negotiating the best possible interest rate and if your affordability (meaning your cash flow) allows it, start paying off your bond faster by either paying in an extra amount every month, or deposit occasional once-off payments into your bond. Every bit helps, advises Meyer.

INCREASE YOUR PAYMENT PER MONTH AND SAVE

When you buy a car on credit, the repayments are usually structured over a 60 month (5 year) repayment period. A car buyer will thus easily repay the credit of a R300 000 car bought over 5 years, but it will take 20 years to pay off a home loan of R500 000.00. Why not apply a similar reduced repayment structure for a home loan?

Paying extra money into your bond every month reduces the bond term and similarly, if you shorten your bond term, you again save thousands of rands over the term.

Home loan R1 million x 20 years x 9.25 %				
Monthly payment	R9 158 pm	Interest paid over 20 years	R1 198 000	
add R500 per month more	R9 658 pm	Interest paid over 17.5 years	R 1 012 368	R185 711 saved & 2 years 7 months
Add R 1 000 per month more	R10 158 pm	Interest paid over 15.6 years	R 881 382	R316 697 saved & 4 years 6 months

ONCE-OFF EXTRA PAYMENT

Rather than going on a spending spree with a bonus or unexpected windfall, consider paying that money into your bond to save thousands says Meyer.

Home loan R1 million x 20 years x 9.25 %				
No lump sum payment				
Monthly payment	R9 158 pm	Interest paid over 20 years	R1 198 000	
One extra lump sum payment				
	R10 000	Interest paid over 18.11 years	R 1 097 597	R100 482 saved & 1 year & 1 month

Few investment opportunities will do better than the R10 000 paid into your bond account to enable you to save R100 482, says Meyer and the best is – you invest in the security of your own property.

Summary – Prepare and empower yourself before you approach the bank/s and you will save thousands of rands on your home loan.

Meyer de Waal

Oosthuizen and Co Meyer de Waal

My Budget Fitness

021 461 0065

meyer@oostco.co.za

www.oostco.co.za www.budgetfitness.co.za

www.irent2buy.co.za

Calculations done with the help of Avid Firefly

<http://www.avidfirefly.co.za/>