Banks revise rates, but don't transfer your home loan yet

Only a cut of at least 50 basis points in the interest rate will help lower home loan EMIs significantly

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Almost a month after the Reserve Bank of India (RBI) reduced the repo rate by 25 basis points (bps) in February, banks have started revising the marginal cost of funds-based lending rate (MCLR) downwards, though marginally. MCLR is the lowest possible interest rate that a bank can charge for a home loan, and one bps is one-hundredth of a percentage point. Since 1 March, banks, including Punjab National Bank, Bank of Baroda and Kotak Mahindra Bank, have reduced their MCLR for various tenures by 5-10 bps. More rate cuts may follow in the next few months, with RBI expected to cut rates in its forthcoming monetary policy review in April.

As more banks cut MCLR rates, you may get tempted to switch to a home loan that costs less. However, a reduction in rate may not always mean you will save in terms of overall costs. So do a cost-benefit analysis to ensure the switch benefits you in the long run.

THE COSTS

Though RBI cut the repo rate by 25 bps, banks have reduced MCLR only by 5-10 bps, another example of poor rate transmission.

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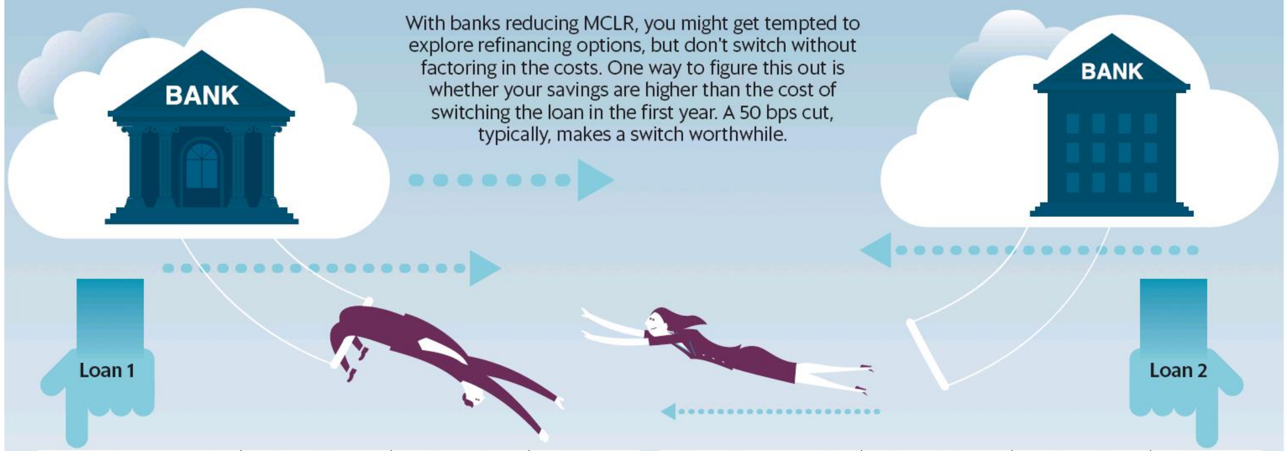
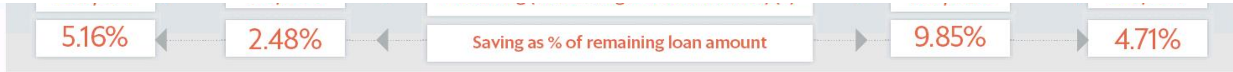
HOW MUCH CAN YOU GAIN WITH A HOME LOAN TRANSFER?

With banks reducing MCLR, you might get tempted to explore refinancing options, but don't switch without factoring in the costs. One way to figure this out is whether your savings are higher than the cost of switching the loan in the first year. A 50 bps cut, typically, makes a switch worthwhile.



	Home loan amount outstanding	Remaining tenure	Rate of interest	EMI (₹)
Loan 1	₹35 lakh	15 years	9.40%	36,337
Loan 2	₹20 lakh	25 years	9.40%	17,335

Loan 1: With 50 bps rate cut	Loan 1: With 25 bps rate cut		Loan 2: With 50 bps rate cut	Loan 2: With 25 bps rate cut
8.90%	9.15%	Rate of interest	8.90%	9.15%
35,291	35,812	EMI (₹)	16,647	16,990
1,046	525	EMI saving (original EMI - new EMI) (₹)	688	345
7,670	7,670	Cost of transfer* (₹)	7,670	7,670
12,546	6,296	Annual EMI saving (EMI saving x 12) (₹)	8,256	4,128
188,197	94,436	EMI saving over loan term (Annual EMI saving x remaining tenure) (₹)	206,378	103,581
180,527	86,766	Net saving (total savings - cost of transfer) (₹)	197,028	94,231



*Includes processing fee of ₹5,000, legal and technical fee of ₹1,000, documentation charges of ₹500, and GST; Above illustration is for a loan transfer in a place like Delhi NCR where there is no stamp duty on mortgage. In places like Mumbai, Pune, Hyderabad, Bengaluru, Chennai and Kolkata, there would be an additional spend of 0.2-0.5% of loan amount on stamp duty, which needs to be borne by the borrower

Source: myloancare.in

Financial advisers and experts do not see merit in switching a home loan for such a narrow difference. Melvin Joseph, an investment adviser registered with the Securities and Exchange Board of India and founder, Finvin Financial Planners, said that the interest rate difference should be at least 50 bps compared to your existing home loan interest rate in order to make any meaningful impact on your overall savings.

A rate cut can be a good nudge for home loan borrowers of non-banking financial companies (NBFCs) to switch their loans to banks. “What happens in many cases is that people want to take a home loan from a public sector bank but are unable to do so because of time constraints or lack of income-related documents. Such consumers go to an NBFC for the loan and are charged a higher price,” said Virendra Sethi, head, mortgages and other retail assets, Bank of Baroda. If they maintain a good repayment track record, their credit score would improve, and they will be able to approach a bank to refinance their outstanding loan at a lower rate.

“You can compare only if you know all the charges. Look for promotional offers from banks that waive off the charges

Melvin Joseph
Sebi-registered investment adviser and founder, Finvin Financial Planners

Bank of Baroda is currently offering home loan balance transfer to borrowers having a credit score of over 725 and a repayment record of at least 12 months, without asking for their income proof documents. However, this is not applicable on under-construction properties and properties that do not have a clear title. Borrowers with a score of 760 and above get the loan at 1-year MCLR and those having a score of 725-759 get the loan at a premium of 25 bps over 1-year MCLR.

COST-BENEFIT ANALYSIS

Switching a loan entails costs, such as processing fee, documentation charges and stamp duty charges that varies across states. It is important that you clearly understand the charges and make sure that the net gains that will accrue to you after the switch are higher than the switching charges.

“You can make a comparison only if you know all the charges involved. Look for promotional offers from banks that waive off these charges. Even banks like State Bank of India, taking a loan from which is considered tedious by many people, is aggressive in this segment now. Banks are likely to waive off at least some charges if you are a customer with a good credit profile,” Joseph said.

Once you know the interest rates and the charges, the next step is to calculate how much you will be able to save by switching your loan over the remaining tenure (*see graph*). “Though any difference in total interest repayment over the same remaining tenure is a gain, a borrower should look at it as a percentage of the loan amount. The savings being generated out of the switch should be meaningful and should also factor in the possibility of an increase in interest rates in the future. Suppose the interest rate goes up by 1% in the future, it should be compensated with the savings,” said Prakash Praharaj, founder, MaxSecure Financial Planners. Even if you plan to go for a longer tenure for the transferred loan amount, the comparison needs to be done over the original tenure.

But if you plan to prepay your home loan in the near future, don't consider refinancing. Instead, focus on aggressive repayment, Joseph said.

THE OPTIONS

In December 2018, RBI had announced that all new floating rate loans from banks will be benchmarked to an external benchmark from April 2019. Once this gets implemented, transmission of rate changes in home loans is expected to be transparent and faster.

“The savings generated from the switch should be meaningful and should also factor in the possibility of an increase in rates in the future

Prakash Praharaj
Founder, MaxSecure Financial Planners

So instead of going for a home loan balance transfer now, it would be better to wait for the new regime to kick in. “Our sense is that it will come through soon. Even if it does not happen from 1 April, it will happen soon,” said Gaurav Gupta, founder and CEO, myloancare.in.

However, external benchmarking will only cover loans taken from banks. “Even if delayed, a change in rate gets transmitted over time in banks. But yes, in case of housing finance companies (HFCs), the rate cuts rarely get transmitted, while the rate increases get transmitted quickly. People who have borrowed from HFCs can switch to banks in the long term. They shouldn't switch to another lender with a lower rate, but to a bank with a lower rate, to ensure future transmission of rate cuts,” Gupta said.

However, if your applicable interest rate is higher than the options available in the market and you have a good credit profile, it is possible to negotiate and get a lower rate from your existing lender. If that does not work, wait for the rates to go down further.