Drop in home loan interest rates

Mimi Partha Sarathy, Dec 26, 2016, DEC 25 2016, 22:21 IST | UPDATED: DEC 26 2016, 01:08 IST

With the banks now flushed with cash deposits every day post- demonetisation, this ample liquidity has made banks lower their deposit rates being offered to customers. As per the data released by the RBI, banks have crossed collection of Rs 12.44 lakh crore of the demonetised currency as on December 10.

This amount is nearly 80% of the value of demonetised notes estimated in the market as on November 8 (Rs 15.44 lakh crore). The banking sector is clearly gaining from this move as the cost of this debt is quite low. Most of the banks have already reduced their deposit rates.

They can easily earn incremental income from this money by lending it. And for getting more customers to borrow from them, banks will have to reduce their interest rates.

It is good time for first-time borrowers to start looking at buying a house or property of their choice. Again, due to demonetisation, property prices have already come down, and are expected to remain range-bound or may get lower. Because of demonetisation, large amounts of cash which was under circulation has come under the umbrella of the banking system in the form of deposits.

Cost of funds

This directly reduces a bank's dependence on borrowings from the RBI hence reducing its cost of funds. And the current lending system formulated by the RBI (banks are using MCLR method) also considers cost of funds as a major component for calculating prevailing interest rate. Hence, banks will have to lower existing interest rate on loans.

Even the Central Government is devising a scheme for first-time home loan borrowers with reduced interest rates from the money collected through the demonetisation drive. This new scheme may be announced in the Union Budget 2017, which is expected on February 1.

It is good news for people having existing home loans with floating or variable interest rates. For people who have taken loans after April, 2016, their loans follow the MCLR method, hence they can see the change in their home loan interest rate.

But for people, who have taken loans before April 2016, and their home loan mechanism is still based on base rate or prime lending rate, they will have to switch to MCLR mechanism as they are paying higher interest rate in comparison to MCLR method adopters.

MCLR is linked to repo rate and cost of funds, hence the effect of lowering repo rate and lesser cost of funds will pass on sooner to the home loans having this mechanism of interest calculation. Most of the banks charge a one-time conversion fee for this, which may vary from 0.5% to 1% of the outstanding loan.

Non Banking Financial Companies (NBFCs) and Housing Finance Companies (HFCs) don't use the MCLR system, but you can still get your interest rate lowered by paying some conversion fee. Both NBFCs and HFCs work on the spread, so you can get it reduced for your existing home loan by paying some amount.

Once you have got your interest rate lowered, you can enjoy the benefit in the terms of either reduced loan tenure or reduced EMIs. It is better to reduce the loan tenure paying same EMI in comparison to less EMI, as the interest portion of the loan amount reduces in this manner.

You should carefully do analysis before converting your home loan to MCLR methodology. If you have already payed most of your loan amount and are only left with few more EMIs then it might cost you more than the benefit you are going to receive. So, you should always compare the conversion fee with the amount which can be saved post switching. If the conversion fee is higher than the amount saved, then it is not worth the effort.

One can also change the lender if he is not happy with the existing one. But again, you need to do the cost-benefit analysis as it is a very tedious process and should be done only for long tenure loans and if there is an interest rate difference of at least 100 bps between the existing and the new lender.

Therefore, with interest rates now being on the lower trend, it is time for us to study the details of all our loans and take advantage of the lower costs.

(*The writer is Managing Director at Sinhasi Consultants*)