Business Standard

Buying a house? Keep an eye on your bank's marginal cost of lending rate

Check if you are on the best possible loan rate and also make part prepayment to counter the rise in interest rate

Sanjay Kumar Singh January 23, 2018 Last Updated at 23:02 IST

Representative Image

Several banks like Axis, IndusInd, Yes and Kotak Mahindra have hiked their marginal cost of lending rate (MCLR) by 5-10 basis points. It is expected that public sector banks may also follow suit. While it is hard to predict whether this is just a temporary spike or rates will continue to move upward, home loan borrowers need to take note of this development and respond to it.

Interest rates within the economy have moved up, as is evident from the rise in the 10-year G-Sec yield. From around 6.41 per cent on July 24, 2017, the 10-year G-Sec moved to a high of 7.40 per cent on December 28, and is currently at 7.29 per cent. Most banks had investments in G-Secs that were in excess of their SLR (statutory liquidity ratio) requirement. They have taken a hit on their bond portfolios due to the rise in G-Sec yields. To maintain their margins, they have responded by raising their MCLR.

Banks' cost of funds has also gone up. According to Ajay Mishra, vice president and business head, secured loans, Paisabazaar.com, "Many banks have recently increased their fixed deposit and certificates of deposit rates, which has pushed their cost of funds up. As the cost of funds has a major weight in the calculation of the MCLR, the latter has gone up." With deposit growth not being robust, banks also have to pay more to get funds for the exact duration for which they need them.

Borrowers need to track liquidity and inflation to get a sense of how interest rates will move in the future.

The impact on individual customers will depend on whether their loan is benchmarked against the base rate or the MCLR. The State Bank of India, for instance, had cut its base rate recently and it has also not raised its MCLR. According to Mishra, "The recent MCLR hikes will primarily affect fresh home loan borrowers. Existing borrowers will continue to avail lower interest rates till the next reset date of their home loans.

INCREASE IN LOAN LIABILITY

Loan amount (₹ mn)	If rate increases to (%)...		
	8.40	8.45	8.60
3.5	18,395	36,818	92,252
5	26,279	52,597	131,790
7.5	39,418	78,895	197,684
10	52,557	105,194	263,579

Note: Initial home loan rate is taken to be 8.35%; tenure 15 years; figures for added liability in ₹

Currently, if you have excess funds available, either because you have received your variable salary or a bonus, make a part prepayment on the loan. "Though the upward movement in MCLR is small, the alternative investment fixed-income options are also not very attractive at this point of time," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

Sometimes borrowers may not want to use up their funds. Once they prepay the loan, the money gets used up. "Such borrowers should consider shifting to smart home loans that come with an overdraft facility. They can put their excess funds in that account and thereby bring down their principal, while still retaining the flexibility to withdraw the money whenever they wish to," says Dhawan.

Borrowers should also check if their lender is offering them the best rate available in the market. Mumbai-based financial planner Arnav Pandya suggests that if the difference in rates is substantial, and they can make considerable savings, they should try to move to the best rate of their own lender by paying a fee. If that option doesn't work out, they should try shifting to another lender who will offer them a better rate.

If the MCLR continues to rise, the impact at the time of reset could be considerable. When interest rates go up, banks tend to hike the loan tenure rather than the EMI. But this also means that the borrower's total interest outgo increases. If you can afford to, ask your bank to hike your EMI rather than the tenure.