

Pay Your Bond Faster



Slash interest and time in debt

Buying a property is the biggest investment most people ever make. Similarly, if you utilise a loan from a bank to finance the transaction, it will most likely be the biggest debt you will ever take on. This debt could stay with you for 20 to 30 years, depending how long the bank will grant you to pay back the home loan.

The interest burden

The reason why a home loan becomes such an extensive debt burden is the interest payable. Consider these two scenarios, in which the impact of a 2% higher interest rate is highlighted.

Scenario 1 – Interest rate 9.5%	
Home loan amount	R500 000
Home loan term	20 years
Interest rate	9.5%
Monthly repayment	R4 661
Total repayment	R1 118 557

Scenario 2 – Interest rate 11.5%	
Home loan amount	R500 000
Home loan term	20 years
Interest rate	11.5%
Monthly repayment	R5 332
Total repayment	R1 279 715

While a 2% increase in the interest rate on a R500 000 home loan only results in a R670 increase in the monthly repayment, it adds a staggering R161 158 of additional interest payable over the 20-year period. If, instead of paying off a higher interest rate, this additional R600 a month is paid into the bond as an extra monthly payment on a lower interest rate loan, it makes an enormous difference to the interest payable and the term of the loan, as we will see below.

So, if you want to reduce the debt burden of a home loan significantly, ensure that you get the best interest rate possible when negotiating the loan. Do this by saving up a deposit and by keeping your credit profile strong and healthy, as these are factors the banks consider when deciding on the interest rate they will offer you on a home loan.

The term

The term of the loan also has a huge impact on the total repayment. Consider the two scenarios below, comparing a 20-year loan term to a 30-year loan term.

Scenario 1 – 20-year term	
Home loan amount	R500 000
Home loan term	20 years
Interest rate	9.5%
Monthly repayment	R4 661
Total repayment	R1 118 557

Scenario 2 – 30-year term	
Home loan amount	R500 000
Home loan term	30 years
Interest rate	9.5%
Monthly repayment	R4 204
Total repayment	R1 513 538

Over 20 years, the total amount in interest payable is R618 557. If you stretch your R500 000 bond repayment over a 30 year repayment, with the same prime interest rate, you will end up paying R1 013 537 in interest – more than double the capital of R500 000 initially borrowed!

It therefore makes sense to keep the repayment term as short as possible. Consider, for example, that when you buy a car on credit, the repayments are usually structured over a 60-month (5-year) repayment period.

A car buyer can thus easily repay the credit for a R300 000 car bought over 5 years, but will take 20 years to pay off a home loan of R500 000. Why not apply a similar reduced repayment structure for a home loan?

The way to do this is to make extra monthly payments into your bond.

Extra monthly payments

Paying extra money into your bond every month reduces the bond term – and if you shorten your bond term, you save thousands of rands in interest. Consider these two scenarios, comparing the effect of paying the minimum monthly instalment vs paying an addition R500 per month.

Scenario 1 – Minimum monthly instalment	
Home loan amount	R500 000
Home loan term	20 years
Interest rate	9.5%
Monthly repayment	R4 661
Total repayment	R1 118 557

Scenario 2 – R500 monthly additional payment	
Home loan amount	R500 000
Reduced term	15.5 years
Interest rate	9.5%
Monthly repayment	R5 161
Total repayment	R955 051

If you pay just R500 extra into your bond every month, you will shorten the term by four and half years and save R163 506 in interest. How easily R500 per month can be wasted on unnecessary expenses! Using just R500 more wisely each month can significantly improve your financial situation. And if you increase the extra amount from R500 to R750 per month, you can save a whopping R214 081 in interest and pay off your home loan in just 14 years.

Once-off payment

If you receive a bonus or a cash windfall, consider paying that into your bond account. Consider the impact illustrated below.

Scenario 1 – No lump sum	
Home loan amount	R500 000
Home loan term	20 years
Interest rate	9.5%
Monthly repayment	R4 661
Total repayment	R1 118 557

Scenario 2 – Once-off R6 000 lump sum	
Home loan amount	R500 000
Reduced term	19.4 years
Interest rate	9.5%
Monthly repayment	R4 661
Once-off lump sum	R6 000
Total repayment	R1 086 175

On a bond of R500 000, paid back over 20 years at an interest rate of 9.5%, an extra once-off payment of R6 000 will slash your total bond repayments by R32 382 and shave eight months off your bond repayment term. It translates into a 539% return on your R6 000 investment over 20 years – certainly a smart way to invest R6 000!

With proper planning, you can slash the interest burden of a home loan by thousands of rands and reduce the time period you are indebted to the bank by years. Start by getting the best interest rate and the shortest loan term possible, and then reduce both the term and the interest payable by making any extra payment you can each month and investing any bonus or cash windfall into the biggest investment you have made. 🏠

RESOURCES

Oosthuizen & Co Meyer de Waal
Avid Fireflyfly