By Letitia Watson
Send suggestions and requests to yourmoney@you.co.za
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Bond bonanza

Don't blow that money you'll be saving on your bond – pay off your debt instead

IF SERVICING the bond on your home has been crippling you lately, the Reserve Bank announcement that the prime lending rate is being reduced by 50 basis points to 8,5 per cent must have come as a pleasant surprise.

It's the biggest interest rate cut in 39 years and according to the latest report from the Bureau for Economic Research (BER) interest rates should remain pegged at the current low level well into next year, provided there are no unexpected economic upheavals. BER senior economist Hugo Pienaar confirms the chances of an interest rate hike over the next 18 months are slim.

To be able to buy a home most of us need a loan and the interest rate affects how much we repay each month – and the size of the bond we can afford to take out. If your home loan is R1 million, a 0,5 per cent drop in the interest rate could amount to at least a R76 000 saving over a 20-year loan period, according to RE/MAX Southern Africa's figures.

Because your repayments come down it means you could have extra money in your pocket – but don't rush out and blow it! The smart thing to do is to use the extra money to pay off what you owe, whether it's your home loan or any other debt.

If you plough back the extra money into your home loan every month you can pay off your bond sooner – and pay less interest in the process.

ILLUSTRATION: KOBUS GALLOWAY

TIP
Try not to reduce your monthly bond repayment even if interest rates come down.

Do your sums

Let's look at what happens in the case of three home loans of R600 000, R1,5 million and R3 million, each with an interest rate of nine per cent, if the bondholders pay R500 a month extra.

- The repayments on the bond of R600 000 are R5 398,36 a month over 20 years. But if you were to pay an extra R500 a month the bond would be paid in just 16 years and five months, saving you R159 346 in interest.
- The repayments on the bond of R1,5 million are R13 495,89 a month over 20 years. If you were to pay R500 a month extra the loan period would be cut to 18 years, saving you R188 329 in interest.
- The repayments on the bond of R3 million are R26 991,78 a month over 20 years. Paying R500 a month extra will reduce the repayment period to about 19 years and save you a whopping R200 829 in interest.

The lower interest rate also makes it easier for first-time buyers to enter the housing market. But although interest rates are expected to remain low for some time it's not advisable to opt for a bond with the maximum repayment you can afford now. Rather leave a cushion so you'll be able to afford your repayment if there were a sudden interest rate hike. Also make sure you allow for unexpected expenses.

Other debt

You might have other more pressing debt that should be paid off before you consider devoting extra money to paying off your bond.

Which debts take precedence? According to experts it's those that attract the highest interest (usually store accounts and credit cards or short-term loans) or extra levies if you don't repay them fast enough.

Also make sure you won't be penalised if you speed up your repayments and pay off a debt before the end of the loan period. Financial institutions are in the business of making money from interest on loans so it's in their interest if you pay off your loan over the maximum period.

Debt vs income

It's not difficult to calculate the percentage ratio between your income and debts.

Add up your monthly debt repayments (bond, car loan, personal loans, overdraft and credit cards). Divide the total by your monthly disposable income (money left over after tax has been deducted). Multiply this amount by 100 to get a percentage. The result is the ratio of your debt to your disposable income.

Ideally it should be less than 30 per cent, says Gavin Came of the Financial Intermediaries Association.

If it's between 35 and 45 per cent it's cause for concern. And if it's more than 50 per cent you need the help of a professional such as a debt counsellor so you can get on top of your debt. ■

The man who never has money enough to pay his debts has too much of something else

AMERICAN AUTHOR JAMES LENDALL BASFORD