How to get the best interest rate on your home loan

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Buying a house is one of the biggest decisions we all have to make in life. Although this is an exciting decision it should not be taken lightly especially when it concerns home loans, interest/lending rates and loan repayments.
Financial institutions use two main factors to determine the interest rate on your home loan or mortgage bond and these are the cost of funding and the borrower's credit risk.

Before we dip in further let us define what is home loan interest rate? This is the rate that determines how much you will be paying the bank, over and above the amount or value of the property you are buying and this rate is not flat, it is determined by each client's financial behaviour.

The first cost included in an interest rate charged is the cost of funds and this is the main source of finance from which commercial banks obtained the funds to grant different customer loans. These funds are repaid at a certain interest rate and the banks will eventually charge their clients to recover borrowed funds and with a profit margin.The second factor affecting the interest rate is credit risk (this is the borrower's risk to the lender). In simplest terms this is a risk that you might default on this loan and if this risk increases to the lender, so is the interest rate to that particular client. Local banks use several variables to work out each client's interest rate, and this will be comprised of past credit records, loan-to-value ratio, and type of employment.

Your credit record plays a big role in home loan financing. This is how you dealt with all forms of credit in general and may include your credit cards, vehicle finance, to the way you swiped and managed your bank accounts in the past. The bank will assess your last five years of credit history and give it a credit score which will assess your default likelihood.

The bank uses a wide range of information to score you, including the information you disclosed when you applied for the loan and other past information the bank may have on you as a result of a long-term banking relationship with the bank, swiping history, your overdrawing, late payments, overdrafts history, consolidation history and credit bureau information. As far as your bank is concerned, your credit score determines how risky a client you are to them. Any improvement in your credit score can work in your favour. One can clear their credit record by mostly paying off outstanding debt, paying your bills on time and never allowing your account to go in the negative.

The second key consideration is the loan-to-value ratio which means the percentage ratio of the sum of money borrowed from a bank to buy a property vis-a-vis the price of the property or its valuation, whichever is lower. Deposit plays a bigger role since the rule of thumb is that the greater your deposit, the less risky your loan is viewed by the bank. Thirdly, most local banks take into account your employment history including things like where and how you are employed, whether on permanent or short-term contract. Research shows that self-employed people are considered more risky than people in formal employment and this tends to attract higher interest rates. When one is applying for a home loan, one of your most important goals should be to secure the lowest home loan interest rate possible.

So, one will ask what can I do to improve the interest rate offered to me by the banks? And the answer is: make sure you have a good credit record. One should always manage their credit affairs carefully, by ensuring that you make your required payments on time for things like your clothing accounts, vehicle finance, personal loans, etc., and it is important to avoid exceeding the credit limits made available to you on facilities such as overdrafts, credit cards, and short-term ATM loans. If you know that you have a bad credit profile, I rather recommend you settle all your debts and give yourself a grace period of up to six months before applying for a home loan because this will lead to higher interest payments should your loan application be approved.

Lastly, some ways to lower your interest rate include paying a big deposit on the home loan and applying to multiple banks so as to secure the best deal. For example, a N$20 000 deposit on a N$1 million home loan, at the interest rate of 10.25% will reduce your total repayments by N$47 119 over 20 years. And one more thing, the bigger your deposit, the better your chances of getting a lower interest rate and reducing the total interest charged on your bond. Consider the term of the bond carefully, as home loans financed over 20 years are usually offered at lower interest rates than 25 and 30-year finance.

For those that are already homeowners, I recommend making extra repayments whenever you can since interest on a mortgage loan is calculated daily and rolled out monthly. With additional payments into your home loan, you will reduce the outstanding balance as well as the interest that you pay in the long run. Use extra cash such as your tax refund and annual bonus to pay into your bond account.

In conclusion, you are not obliged to source or stay with the same bank you have been banking with for your home loan. Source quotations every once in a while, since another bank may offer you a better interest rate a few years down the line. This can be a result of loan-to-value ratio change or repo rate decrease just like the Bank of Namibia has relaxed the loan-to-value ratio and repo rate adjustment in light of the Covid-19 pandemic, which will now create greater competitiveness between local banks.

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