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MortgageMax
The Future of Homeloans

Fix it – yes or no? What to do with the interest rate on your home loan?

The debate about whether or not to fix the interest rate on your home loan has been reignited by two 100-basis-point rate cuts in response to the Coronavirus outbreak. This has brought interest rates to the lowest point in nearly half a century.

However, each person's financial situation and their individual set of circumstances are unique, so there isn't a simple answer to the question of fixing, or not fixing, the interest rate on your home loan. Here are some of the most important factors to consider.

Know your rates

• The repo rate is set by the South African Reserve Bank Monetary Policy Committee and indicates the rate at which they loan to the commercial banks.

• The prime lending rate is the rate at which the banks lend to us as consumers. The repo rate and the prime lending rate are not the same because banks have running costs, infrastructure, admin fees and they take the risk of loaning money, so that must be built into the margins they set. Remember, a bank is a business like any other in this regard!

• The interest rates the banks offer you is determined by several factors related to your profile as a client – it's about affordability and your credit standing. Your credit profile is determined by how you have conducted your finances and whether you have kept up your regular payments. The banks will calculate your interest rate in line with your credit profile, to determine monthly repayments on your home loan.

• If you take a variable interest rate it means the rate at which you repay will fluctuate over the term of your home loan, in line with repo rate changes.

• As a rule, a fixed interest rate is higher than a variable one because it poses more of a risk for the bank. A fixed interest rate is usually set for a period of up to 5 years, after which you will have to renegotiate it.

When you apply for a home loan, it is by default based on a variable interest rate. Only once your bond has registered, can you apply for a fixed interest rate and then there is a strict time limit attached before the offer lapses.

Determining factors

Some of the most important factors in deciding whether to fix your interest rate or not, are:

1. **Market conditions** at the time of securing the loan.

2. **Loan term.** Fixed interest rates are usually for up to five years. So, with a home loan spanning 20 years, you will soon need to renegotiate terms, which could then be less favourable than before.

3. **Amortisation period.** This is the total length of time it takes to pay off a loan. By extension, the longer the amortisation period, the bigger influence a change in the interest rate will have on your repayments.

What does history teach us?

Most historical sources seem to agree that you are probably likely to pay a little less with a variable interest rate than on a fixed interest rate, over time. But, while this is useful to consider, it is even more important to remember that past trends are not necessarily good indicators of future performance. The determining factor must always be affordability, so look carefully at your financial situation, to see what you can afford and consider your financial commitments. Buying a home is probably the largest purchase you will ever make, so think carefully!