ICICI BANK CUSTOMER FIRST SERIES

TIMES BUSINESS ASSOCIATE COMMUNICATION

A consumer education initiative

Locked into the House?

A most cherished house may not generate money when need arises.

Budgeting for a house is one thing; actually buying one is another. Even the most carefully planned budgets can derail during execution. As it happened with Sonal and Sunil, who decided to buy a house soon after their wedding. After animated discussions, they agreed that a two-bedroom flat was all they could afford. They already had a car loan EMI to take care of. But when they went house hunting, they liked a three-bedroom flat that seemed perfect. Peer pressure also played a role. Many of their friends had bought a three-bedroom flat, planning ahead for the family. The occasional guest also needed a room. Thus began their overshooting of budgets. By the time their house was ready, the floors were more expensive than planned; the bath fittings were imported, and the interiors were 30% above budget.

STRETCHED OUT

Sunil's home loan, earlier planned at about 40% of his take-home salary was now a mind boggling 70%, after all the 'stretching' that had been done. Not unusual for a new house, his friends comforted him. Sonal had agreed to run the home on a tight budget and not ask for any renovation for the next three years. She was expecting a promotion and a raise in salary and that would give them some leeway. They agreed to keep expenses in check until the finances were back on track.

SUMMARY

- Stick to your budget while making your house purchase.
- Buying the house is a long-term decision; estimate future liabilities well.
- Borrow responsibly and make sure you can afford it. If a large proportion of regular income goes towards repaying loans, borrowing more to meet regular expenses may become inevitable.
- The house is an asset, but it is illiquid as it cannot be encashed in part in case funds are required and it does not yield any regular return either, unless it is rented out.

UNEXPECTED EVENTS

Within the first six months of moving into the house, they were expecting their first baby. The multiple trips to the doctor were tiring, so Sunil decided to hire a driver. The part-time house-help was extended to a staff of three. The hospital bills were larger than planned. Sunil and Sonal wanted only the best for their precious baby and lavished the new-born's room with accessories and toys. Sonal decided to give up her job after the child was born.

LOAN TO RESCUE?

That summer, their friends were taking a holiday to Mauritius. Sonal so badly needed an outing, having been confined to the home and the baby for months. Sunil swiped his credit card for the expenses and took a loan to fund the holiday. The baby's first birthday had to be a big bash. They took a large personal loan. The credit card balances now became a monthly regularity, because Sunil was unable to pay all his EMIs and also have enough money for the regular expenses.

LOCKED IN

The large house was something they were proud of, but it was not generating any income they badly needed. The house had appreciated in value, but they could not sell parts of it to meet their regular needs. They were wary of taking any fresh loan because repaying what they had already borrowed was getting tougher. Moving into a smaller house was a come-down, for which they were not ready. Sonal has since made the reluctant decision to go back to work, leaving their baby in day-care.

We have several Sunils and Sonals amongst us. A large amount of our wealth is locked into our house. We save some rent and tax, but receive no income from an asset that is more than half our savings. The joys of owning a house are soon lost to the travails of everyday living.

BREAKING FREE

A diet may seem painful for someone who is overweight; but in the long run, anyone who has lost those extra pounds will tell you that it was all for the best. If Sunil and Sonal had just decided to tighten their belts a little – go to Mahabaleshwar for a break instead of Mauritus, celebrate the baby's fifth birthday in style instead of his first, temporarily move into a two bedroom house on rent while they rented out their spacious 3BHK, etc. they could easily have become financially comfortable again. Managing a loan is all about being practical.

Kindly send us your suggestions and comments by visiting the "Email Us" link at www.icicibank.com

FAQs

If the value of a house appreciates after it has been bought, can a loan be taken against such appreciation?
Yes, it is possible to take a top-up loan, if the value of the house is higher than the loan that is outstanding against it. In fact, it would be better to take a top-up loan than extend oneself on a credit card. Nevertheless, the EMIs on the ongoing home loan should have been paid regularly and on time. The amount of loan and the interest rate are decided by the bank considering these factors.

If a credit card is used to meet the gap in monthly income and expenses, what is the harm?
If a credit card is used and only the minimum balance is repaid, the amount that is rolled over becomes a loan. It is an unsecured loan and is therefore charged a higher interest rate. Therefore it may not be wise to meet regular expenses in this manner.

How does the lending bank consider the amount of loan that a borrower can avail?
The bank basically considers the borrower's ability to repay the loan based on his income/earning. But if subsequent events and further loans taken by the borrower make the EMIs a bigger chunk of his income, there is no way in which the bank can take into account these new situations. It is up to the borrower to manage his finances and not default on the loan.

QUICK TIP

If you own a property, you can take a loan from most banks by offering it as a security. A 'secured' loan i.e. a loan taken by offering a security such as a home, shares, etc., is cheaper than an 'unsecured' loan i.e. a loan taken without offering any security.