Current Challenges For Home Loans In India

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INTRODUCTION

Home loans are means through which an employed person can realize his/her dream to own a home. This is a great product because it allows a person to own a home; the value of which increases, giving financial means and security. Government is also taking various steps to encourage people to go toward home loans **(Haavio, Kauppi 2000)**. Three years ago, not only in India, but also in other countries, the property boom was on height. The banks and other financers offered low interest rates loans to borrowers, but they were low only in nomenclature. The result was observed in 2008 in terms of a global crisis which led to a rise in the cost of credit. The home loans offered to the customers were fixed only for short-term, but they remained floating in the long-term. People are going more towards home loans than private mortgage insurance **(Bersian David 2008)**. Good credit in good times becomes bad credit in bad times, especially for customers who go for the type of loans being offered today. And there is no hedge to these loans except foreclosure. Property prices, as observed during last couple of years, are volatile and can remain depressed for long duration. When the previous bubble in India burst in the 1990s, prices took almost a decade to recover.

Most of the major nationalized banks have made housing a priority area and added the housing loan segment to their existing category to reach the individuals. The cut-throat competition in the housing finance market forced the lending institutions to come up with an array of products for the potential customers **(Pathak B.V. 2008)**. In such a scenario, buyers need to adopt a prudent approach and evaluate the available options in the market before choosing a particular home loan.

This paper seeks to contribute to the abundant works that have depicted the operation of the housing loan market as an institution rife with discrimination. The purpose is to determine the degree to which the banks have or have not observed fair and equitable lending practices toward borrowers. This task is very important in several aspects, for example, it sheds light on the issue of housing affordability as a major aspect of the overall poverty problem and ways to combat it; and, it enables us to stress the importance of the need for more flexible lending practices among banks **(Sinha N.K. 2004)**. The major objective of this paper is to provide crucial information for getting home loans for housing in our country and improve the living standard of communities. Growth of home loans is due to increase of living standard of people, shifting from joint family to nuclear family **(Lacour, Micheal 2007)**. This work highlights and analyzes the challenges faced by borrowers. Also, it presents best available options for borrowers as per their financial capacity. Effect of inflation on home loan rate is analyzed. The work presented here is based on the current market scenario, past trends and rules & regulations laid down by RBI.

COMMON PROBLEMS OF BORROWERS

The one's ability to repay the home loan depends entirely on salary from a permanent service or regular income from a stable business. Most financial companies finance up to a maximum of 85% of the cost of the house and Equated Monthly Installment (EMI) for repayment are usually up to 50- 65% of the customer's gross monthly salary. In addition to the issues such as interest rates, repayment period, home loan agreement, and eligibility, customers need to check the hidden costs that the Housing Finance Companies (**HFC**) applies. Prepayment penalty is undoubtly one of the most expensive hidden costs encountered by customers. Moreover, most companies insist on a registered mortgage that will increase cost of acquiring the loan **(Bersian David 2008)**.

In a nutshell, a borrower should first analyze the various aspects of home loans. Getting a home loan may not only be a

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lengthy procedure, but also, there may be lots of hiccups in the entire process. The common problems faced by borrowers are :

a) After choosing a particular type of home loan, the customer submits an application form along with other relevant documents as required by the HFC e.g. certificates of income, age, residence, employment, investment etc. Due to incompatibility between the borrower's qualification and lender's requirement, the home loan application may be rejected.

b) Before applying for a home loan, a borrower must understand the various charges, fees and penalties that the bank will charge at the beginning of the loan, during the loan tenure, and at the time of termination of the loan. The Borrower must look at the flexibility of charges on EMI revisions, part-prepayments and foreclosure of home loan. Since a housing loan is a long-term relationship between the bank and the borrower, therefore, a borrower must look at the track record of revising the home loan interest rates, in the last few years.

c) The customer also needs to hand over a cheque for payment of an upfront (non-refundable) processing fee of about 0.5-1% of the loan amount to the HFC.

d) The Repayment capacity is determined by factors such as income, age, qualification, number of dependents, spouse income, assets, liabilities, stability and continuity of occupation and savings history. These factors help the bank to decide whether they can sanction the loan or not. If yes, then how much amount can be sanctioned which can be recovered.

e) The choice of going for a fixed or floating rate loan depends on customers' view. And decision to opt for a fixed or floating rate of interest depends on whether the rates will increase further or may taper off in a short period of time. It is must to study the terms and conditions of a home loan carefully. In case of floating interest rates, the facts can be verified by checking how the interest rates on home loan dropped during low interest periods. Ask the bank for some historic floating rate changes.

f) Most HFCs/Banks today offer floating rate loans as the default. It means it is assumed that the interest rate on the loan will change with each revision in the Benchmark Prime Landing Rate (**BPLR**) of the HFC. This may have serious implications for repayment obligations over a 10 to 15 years' period. Every percentage point increase in the interest rate could be seen as a balloon of thousands of rupees in total payment. If one needs a fixed rate loan, then at the time of applying, it is must to request specifically about it. Usually, the interest rate charged on a fixed loan is 0.5-1 % higher than that on a floating rate.

g) A Bank evaluates the property as per its own expert's opinion, its own established parameters and assigns a value to it. This value can be lower than the market price and the bank will lend only up to the amount it is valued. That makes a difference between what one needs and what the bank is willing to lend. Therefore, before applying for the home loan, it is must for a borrower to get the property valued from a bank's authorized valuator.

The above mentioned problems are very common or general, and if a borrower applies for the loan carefully and follows proper procedure, these problems can be tackled smoothly.

There are some economic factors which affect the home loan interest rates. The Housing sector is closely connected to the economy and if there is instability in the economy, then it has a negative effect on the housing sector. Due to the volatile financial market, national and international economic trends affect the home loan rates. The major economic factors which influence home loan rates are inflation and interest rate. However, both of these factors are not independent, rather, these are interrelated and described in detail below.

INFLUENCE OF INFLATION ON INTEREST RATES OF HOME LOANS

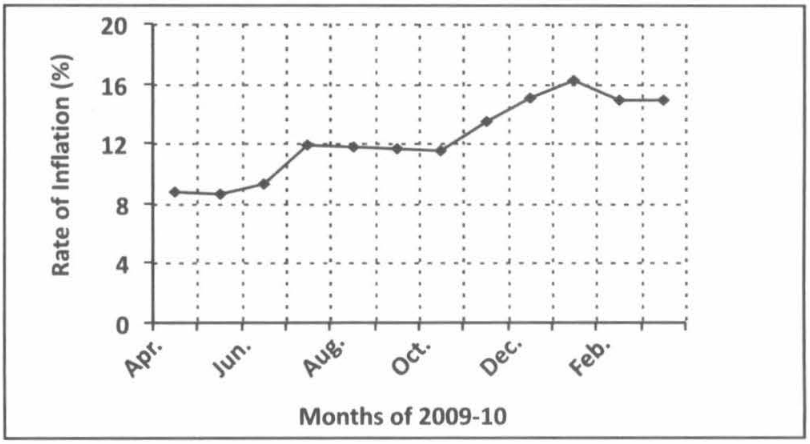
The most important economic factor that influences home loan interest rates is inflation. Inflation is defined as an increase in the price of goods and services that forecast the nation's economy. An increase in inflation figures occurs when there is an increase in the average level of prices in goods and services. In India, the government gets involved in it to control the inflation by adjusting the level of money in our economical system. Inflation is the result of the presence of too much money in circulation in relation to the volume of production, and it can be controlled by regulating the total stock of money in the country **(Gomez, Clifford 2008)**. Higher inflation is often adverse for growth of the economy and it badly affects the housing sector. The Table 1 shows the monthly average of rate of inflation in India for last four years. It can be observed from Table 1 that there is large variation in the rate of inflation in last 4 years. It was minimum (4.39%) during January 2006 and jumped to 16.22% in January 2010 i.e. almost four times.

Table 1: Percentage rate of inflation in India during last 4 years*

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2010	16.22	14.86	14.86	-	-	-	-	-	-	-	-	-
2009	10.45	9.63	8.03	8.70	8.63	9.29	11.89	11.72	11.64	11.49	13.51	14.97
2008	5.51	5.47	7.87	7.81	7.75	7.69	8.33	9.02	9.77	10.45	10.45	9.70
2007	6.72	7.56	6.72	6.67	6.61	5.69	6.45	7.26	6.40	5.51	5.51	5.51
2006	4.39	5.31	5.31	5.26	6.14	7.89	6.90	5.98	6.84	7.63	6.72	6.72

*Source: Indian Ministry of Labor (www.tradingeconomics.com)

Figure 1: Variation in Rate of Inflation for F.Y. 2009-10



Such large variation in inflation causes much fluctuation in the interest rate of home loans. It is shown later that higher rate of inflation leads to increase in the rates of housing loans.The Fig. 1 shows variation in rate of inflation in last financial year (2009-10). It can be observed that the inflation was at its peak (16.22%) during January 2010, while it was minimum (8.63%) in May 2009.

INTEREST RATES

Interest rates control money flow within the economy. If there is increase or decrease in inflation, there will be an increase or decrease in interest rate also. Higher interest rates may restraint inflation, but it may slow down the economy. Lower interest rates may stimulate the economy, but eventually lead to inflation. Home loan interest rates are determined by the supply and demand of house mortgages. From the last one and half years, there has been a sudden spurt in inflation.To control inflation, the Reserve Bank of India (RBI) has increased the repo rate and the cash reserve ratio (CRR). By increasing these rates indirectly, the RBI increased the cost of funds for banks. But these measures are ineffective as inflation has touched a peak. The steep competition in the home loan industry is one reason that why higher interest rates do not always lead to higher home loan rates. Marginal interest rate hikes are usually absorbed by banks. They are currently absorbing the increase in costs of CRR and Repo rate.

Table 2: Rate of Interest in % (Flexible Housing) up to ₹ 20 lakhs for PNB*

Tenure	2006-07 (1.8.06)	2007-08 (1.7.07)	2008-09 (1.8.08)	2009-10 (1.3.10)
Up to 5 Years	8.75	9.0	10.0	9.00
5-10 Years	8.75	9.0	10.50	9.00
10-20 Years	9.00	9.25	10.75	9.25
20-25 Years	9.50	9.75	11.0	9.50

*Source: Maheshwari, Neeta and Patodiya, Pawan (2008-09), the date in parenthesis indicates effective date of rate of interest.

Table 2 shows variation in rate of interest for home loans in last 4 years for PNB. It can be observed that the interest rate is increasing with tenure. Also, it can be observed that the interest rate was on its peak during August 2009. From Table 1, it can be observed that during this period, inflation stagnated at a quite high value (about 12%). Later in Nov.-Dec. 2009, though inflation increased further, however, interest rate did not increase, rather, they decreased. The reason behind this decrease in interest rates were the measures taken by RBI (i.e. hike in CRR and Repo rate) and stiff competition in the home loan industry.

THE LOANABLE FUNDS THEORY AND THE RATE OF INTEREST

The Loanable Funds theory has been central to the theory of interest rates. The loan-able funds approach views the interest rate as being determined by the supply and demand for loanable funds in the financial market. The theory explains that investments and savings determine the long-term level of interest rate, whereas, the financial and monetary conditions in the economy determine the short-term interest rate. The increase in the supply of loanable funds necessitates downward trend in the cost of funds and interest rate, all other things being equal. Interest rates charged on different loans vary across various banks. Most commonly offered interest rates can be classified in 3 ways

- Floating interest rate
- Fixed interest rate with reset clause
- Mixed interest rate

Floating Interest Rate Loans and Inflation: Variable rate loans are often used to compensate for changes in inflation. Variable rate loans will see higher interest rates when inflation is higher. Unfortunately, interest rates rarely drop when inflation goes back down. To protect the borrowers against high adjustable rates, borrower must set a limit on how high rates can climb. One can set the limit as a certain amount over initial interest. The prime lending rate will adjust with inflation, and this should protect both the borrower and the lender.

Table 3: Interest Rates of Home Loans For Various HFCs In India (During 2009-10)*

Bank Name	Interest type	Interest Rates for various loan amount (Tenure 10-15 Years)					
		up to .5 million	.5-2.0 million	2.0-3.0 million	3.0-5.0 million	5.0-7.5 million	>7.5 million
1. Allahabad Bank	Fixed	12.25	12.25	12.25	12.25	12.75	12.75
	Floating	9.25	9.25	10.0	10.0	10.5	10.5
2. Andhra Bank	Floating	9.75	9.75	10.5	10.5	10.5	10.5
3. Axis Bank	Floating	8.75	8.75	8.75	9.25	NA	NA
	Fixed	14.0	14.0	14.0	14.0	NA	NA
4. Bank of Baroda	Floating	9.0	9.0	9.0	9.75	9.75	9.75
5. Bank of India	Floating	9.25	9.25	9.25	10.25	11.0	11.0
	Fixed	8.5	9.25	NA	NA	NA	NA
6. Bank of Maharashtra	Floating	9.25	9.25	9.25	9.75	9.75	9.75
	Floating (Festive offer)	8.0	8.0	8.0	8.25	8.25	8.25
7. Bank of Rajasthan	Fixed	9.0	9.0	9.0	9.0	9.0	9.0
	Floating	7.5	7.5	7.5	8.0	8.0	8.0
8. Canara Bank	Fixed	11.5	11.5	11.5	11.75	11.75	11.75
	Floating	9.25	9.25	9.25	10.0	10.0	10.0
9. Catholic Syrian Bank	Floating	12.25	12.25	14.25	14.25	NA	NA
10. Central Bank of India	Floating	10.0	10.0	10.0	11.25	11.25	11.25
	Floating (Special Sch.)	8.0	8.0	NA	NA	NA	NA
11. Corporation Bank	Floating	9.75	9.75	9.75	10.5	10.75	10.75
	Fixed	11.0	11.0	11.0	11.5	11.5	11.5
12. Dena Bank	Floating	9.25	9.75	9.75	9.75	9.75	9.75
	Fixed	10.25	10.75	11.0	11.0	11.0	11.0
13. Deutsche Bank	Fixed	13.5	13.5	13.5	13.5	13.5	13.5
	Floating	11.25	11.25	11.25	11.25	11.25	11.25

14. Dhanlakshmi Bank Ltd	Floating	12.0	12.0	13.0	13.0	13.0	13.0
15. Federal Bank	Floating	8.5	9.0	9.0	9.5	9.75	9.75
	Fixed	9.5	10.0	10.0	10.5	10.75	10.75
16. GIC Housing Finance	Fixed	15.0	15.0	15.0	15.0	15.0	15.0
	Floating	10.5	10.5	10.5	10.5	10.5	10.5
17. HDFC	Floating	8.75	8.75	8.75	9.0	9.25	9.25
	Fixed	14.25	14.25	14.25	14.25	14.25	14.25
18. HSBC Bank	Floating	9.0 - 14.0	9.0 - 14.0	9.0 - 14.0	9.0 - 14.0	9.0 - 14.0	9.0 - 14.0
19. ICICI Bank	Floating	8.75	8.75	8.75	9.0	9.5	9.5
	Fixed	16.0	16.0	16.0	16.0	16.0	16.0
20. IDBI Bank	Fixed	11.0	11.0	11.0	11.0	11.0	11.0
	Floating	8.25	8.25	8.25	8.25	8.25	8.25
21. Indian Bank	Floating	9.75	9.75	10.0	10.5	10.5	10.5
22. IOB	Floating	8.75	8.75	8.75	10.25	NA	NA
23. J & K Bank	Floating	11.5	11.5	12.25	12.25	12.25	NA
24. Kotak Bank	Floating	8.5	8.5	8.5	8.5	8.5	NA
25. LIC Housing Finance	Floating	9.75	9.75	9.75	9.75	9.75	9.75
26. Oriental Bank of Commerce	Floating	9.25	9.25	9.5	10.25	10.25	10.25
	Fixed	10.25	10.25	10.5	NA	NA	NA
27. Punjab & Sind Bank	Floating	8.25	8.25	8.5	10.0	10.0	10.0
28. Punjab National Bank	Fixed	10.5	10.5	10.75	10.75	10.75	10.75
	Floating	9.25	9.25	9.75	9.75	9.75	9.75
29. PNB Housing Finance Ltd	Floating	9.5	9.5	10.0	10.0	10.0	10.0
	Fixed	13.0	13.0	13.0	13.0	13.0	13.0
30. Punjab National Bank- Festive offer	Fixed	8.5	8.5	8.5	8.5	8.5	8.5
	Floating	8.5	8.5	8.5	8.5	NA	NA
31. Reliance Home Finance	Floating	8.25	8.25	8.25	8.25	8.25	8.25
32. SBBJ	Floating	11.75	11.75	11.75	12.5	12.5	12.5
33. SBBJ Easy Home Loan	Fixed	8.0	8.0	8.0	8.0	NA	NA
	Floating	8.0	8.0	8.0	8.0	NA	NA
34. SBI	Floating	9.75	9.75	9.75	10.25	10.25	10.5
35. SBI Easy Home Loan	Fixed	8.0	8.0	8.0	8.0	NA	NA
	Floating	8.0	8.0	8.0	8.0	NA	NA
36. South Indian Bank	Fixed	12.75	12.75	12.75	13.5	13.5	13.5
	Floating	11.75	11.75	11.75	12.5	12.5	12.5
37. State Bank of Hyderabad	Floating	9.5	9.5	9.5	10.75	10.75	10.75
38. State Bank of Indore	Floating	9.75	9.75	9.75	11.75	11.75	12.0
39. State Bank of Mysore	Floating	9.5	9.5	9.5	9.75	9.75	9.75
40. State Bank of Patiala	Floating	9.25	9.25	9.25	NA	NA	NA
41. State Bank of Travancore	Floating	9.75	9.75	9.75	10.5	10.5	10.5
42. Syndicate Bank	Floating	8.75	8.75	9.5	10.0	10.0	10.0
43. Tamilnadu Mercantile Bank Ltd	Floating	10.75	10.75	10.75	11.5	11.5	11.5
44. UCO Bank	Fixed	12.25 - 12.5	12.25 - 12.5	12.25 - 12.5	12.25	12.25	12.25
	Floating	8.75 - 9.25	8.75 - 9.25	8.75 - 9.25	9.5 - 10.0	9.5 - 10.0	9.5 - 10.0
45. Union Bank of India	Floating	9.5	9.5	9.5	9.75	10.25	10.25
46. United Bank of India	Fixed	8.0	8.0	8.0	8.0	8.0	8.0
	Floating	8.0	8.0	8.0	8.0	8.0	8.0
47. Vijaya Bank	Fixed	10.75	10.75	10.75	11.5	11.5	11.5
	Floating	8.0	8.0	8.0	8.5	8.5	8.5

*Source: Apnaloan Research Bureau (www.apnaloan.com)

❁Fixed Rate Loans and High Inflation: When borrowers have a fixed rate loan, then the loan becomes more competitive.

❁Fixed Rate Loans and Low Inflation: On the contrary, if the rate of inflation decreases while the borrower's loan is active, then the lender makes more profit because the prime lending rate goes down. If they approached the same lender for the same loan today, then it may be possible that they would get a lower interest rate.

Table 3 shows the home loan interest rates of various HFCs during the financial year 2009-10 for 10-15 years tenure. The rates given in Table 3 are indicative in nature and are based on market research conducted by the Apnaloan Research Bureau. The actual rate at which an individual will be able to get a home loan depends on the individual's financial profile and negotiating ability. Still, Table 3 demonstrates the general trend of home loan interest rates. It can be observed that the rate of interest increases with amount of loan. Fixed interest rates are higher than the floating interest rates. Also, the rates of interest for nationalized banks (e.g. SBI, PNB) are significantly lower than the rates of interest for public sector banks (e.g. IDBI) and private banks.

OPTIONS FOR BORROWERS

Most home loan borrowers in the last ten years (2001-10) have taken floating rate loans. This option paid them rich dividends in the initial five years (2001-05) as interest rates kept falling and their cost of borrowing came down to as low as seven percent. The added advantage was also that floating rates are usually 75-100 basis points lower than fixed rates. However, the hardening of interest rates in the last four years (2006-10) has changed the scenario completely (e.g. see Table 2). Floating interest rates has gone up to 11-11 .5 percent during 2008-09 and home loan borrowers who choose pure fixed interest loans in the last few years are now sitting pretty with lower cost of borrowings.

Hence, the crucial issue is what should the floating rate borrowers do now? What are their options? Pay higher EMI/ Increase the tenure of the loan/ Prepay part of the loan to retain the original EMI. These issues are discussed in detail in following subsections. Also, options for new borrowers are discussed separately.

❁PREPAYMENT

In case interest rises, the borrower has an option to pay some lump sum immediately, and this amount is adjusted against the outstanding principal of the home loan. To retain the original Equated Monthly Installment (EMI) and tenure of the loan, this is the best option. However, the draw back of this option is the borrower's ability to raise the funds for this purpose. Also, in case of prepayments, the bank may charge some amount as penalty. Most home loan borrowers opted for floating rate loans in the past five years. Unfortunately, banks increased the rate on these loans. Those who thought themselves to have sailed safely by buying floating rate loan at 7% in 2003 are now highly tensed, as the banks have charged up to 11.50% as interest rate.If one has surplus funds, then it is always advisable to pre-pay home loan. The major proportion of the initial EMIs goes to pay interest on the funds borrowed. However, later, interest component falls down and principal component goes up as a proportion of the EMI with the loan tenure. Therefore, many of the home loan borrowers prefer not to make prepayment after half way through the loan tenure. The option of prepayment largely depends on current interest rate and the amount of spare fund with borrowers.Most of the financial institutions allow prepayment of housing loans. Prepayment is the extra repayment, (partially or fully) of the loan capital, in addition to the EMI, prior to the maturity of the loan. Prepayment results in decrease in the interest burden on the borrower. For a financial institution, a prepayment results in the loss of interest income and therefore, prepayment charges are sometimes applicable. Prepayment fees varies depending on the type of loan and the institution. Sometimes, no prepayment fees are charged on variable rate loans. Fixed rate loans, however, attract prepayment penalties usually in the range of one to two percent of amount prepaid. Some institutions ,however, charge additional penalties in case the loan is being closed, especially if it is being taken over by another institution.Usually, on prepayment, the EMI is kept constant, but the term of the loan is reduced to reflect the reduced principal. This eliminates the tedious procedure of replacing old post-dated cheques (PDCs) for the original EMI amount with new PDCs for repayment of the reduced amount. However, in some cases, financial institutions allow the borrower to keep the term constant and reduce the EMI, especially if the borrower has trouble in paying a higher EMI.

❁EXAMPLE ILLUSTRATING THE EFFECT OF PREPAYMENT

We assume that a borrower availed a ₹ 10 lakh loan for 15 years (180 months) at 8% interest on monthly reducing balance with an EMI of ₹ 9,557. If the borrower pays EMI regularly for 15 years without any prepayment, then the total payments towards the loan work out to be ₹17,20,260. On the other hand, if the borrower makes a one-time prepayment of ₹ 2 lakhs at various stages of the loan, then the impact on total payment made would be:

- If the prepayment is made after 1 year, the term of the loan would go down to 127 months. Then total repayment, including the prepayment, would therefore, work out to ₹14,13,739 resulting in a total saving of over ₹ 3.06 lakhs.
- If the prepayment is made after 5 years, the term of the loan would go down to 140 months. Then total repayment would therefore, work out to ₹ 15,37,980 resulting in a total saving of over ₹1.82 lakhs.
- If the prepayment is made after 10 years, the term of the loan would go down to 152 months. The total repayment would therefore, work out to ₹ 16,52,664 resulting in a total saving of a little less than ₹ 68,000.

Now let us assume that borrower opts to keep the tenure of the loan constant and change the EMI instead. The impact on repayment is:

- If the prepayment is made after 12 months, the EMI reduces to ₹ 7,574, and the total repayment to about ₹ 15.87 lakhs, resulting in a saving of approximately ₹ 1.33 lakhs.
- If the prepayment is made after 60 months, the EMI reduces to ₹ 7,130, total repayment to ₹ 16,29,020 resulting in a saving of approximately ₹ 91,240.
- If the prepayment is made after 120 months, the EMI reduces to ₹ 5,500, total repayment to ₹ 16,76,840 resulting in a saving of approximately ₹ 43,420.

Thus, it is obvious that the saving resulting from prepayment is considerably larger than the prepayment penalty (if any), which on ₹ 2 lakhs @ 2% work out to be just ₹ 4,000. The sooner the borrower prepays, the more he is likely to save. By keeping the EMI constant and reducing the tenure on prepayment, the borrower will save a larger amount than by keeping the tenure constant and reducing the EMI. This is because the extra EMI that is paid every month in the first case goes towards reducing the principal even further.

The formalities for making prepayment of a loan are simple. The Borrower has to merely submit a letter along with a cheque for the prepayment amount and penalties, if any. The financial institution will apprise the new, reduced term of the loan (or the reduced EMI) and provide to borrower with a new repayment schedule. However, with the rising interest rates and mounting inflation, the home loan customers are bit annoyed. To counter this, banks are encouraging borrowers to partly prepay their loans without any penalty or a decreased penalty. The Borrower shall consider the following points before choosing to make pre-payment :

- Check if there is any penalty for the partial pre-payment of loan.
- Take into account the loss of tax benefits because tax-deductible interest payments would be lower after pre-payment.
- Repayment ability

INCREASING TENURE OF LOAN AMOUNT

Tenure is the duration for which a loan amount is sanctioned. Following parameters helps in deciding the home loan tenure:

Amount of Loan: If the homeowner has borrowed a huge sum of money, the EMI outflow would be high. Hence, to make EMI repayment comfortable, the borrower may have to go for longer loan tenure. Longer the loan tenure, lesser is the EMI outflow. For example, considering a loan of ₹ 25 lakhs borrowed at 12% interest rate. If the tenure is 15 years, the EMI outflow would come to around ₹ 30,000. If the borrower can afford to take a shorter tenure loan, of say 10 years, his EMI outflow would be around ₹ 36,000.

Purpose of Loan: If the borrower has purchased the property solely as an investment and wishes to sell it when he gets a good deal. In such cases, most buyers prefer to keep the loan tenure as short as possible. This way, there is no need to pay any penalties towards prepayment or exiting loan before end of tenure. Those, who have purchased the property only to live in, may prefer longer loan tenures. They may not be very keen on very short loan tenure. They benefit from tax deductions on their home loans. However, borrowers must keep in mind that longer the loan tenure, greater is the associated cost of borrowing.

Age of Borrower and Income: In case there is hike in the interest rate and if the borrower is younger, banks are willing to give extension on loan tenure. However, if the loan borrower is in 40's, usually, the only option given is to increase the EMI. A person close to his retirement years will not be eligible for a long tenure loan. A person with greater disposable income can pay off his debt faster than a person who earns lesser. If the borrower has higher income, he can pay higher EMI's and clear his debts faster. A person having greater financial commitments, other debts or a lower income may find repaying his debt a big challenge. The Borrower's current income level and expected increase in income are factors that can influence the loan tenure.

❁EFFECT OF INCREASE OF INTEREST RATE

If interest rates are rising, then the borrower has to either pay a higher EMI or increase the tenure of home loan.

❁**Pay a higher EMI:** If in the future, there is a possibility to raise the interest rate, then the best option for the borrower is to increase EMI because the borrower has the advantage of not prolonging loan period at higher rates. In addition, the borrower may also be able to get tax breaks on their increased interest outgo. However, its disadvantage is that higher EMI puts pressure on the monthly budget. A Borrower may have to sacrifice some aspect of their lifestyle or reduce financial investments. In case this is financially difficult, then it is better to keep the same EMI and lengthen the tenure.

❁**Increase the Tenure of Home Loan:** If interest rates fall in the future, then a borrower will benefit from this strategy; the opposite is true if the interest rates rise. In a rising interest rate regime, increasing the tenure of the loan will increase the cost of a home. One problem with extending loan is that banks generally don't extend tenure beyond retirement age. Therefore, this option may not be available if the borrower is close to retirement. Another problem is that some banks put a cap on the maximum tenure and it may not be possible to increase it beyond 20 or 25 years.

❁DRAWBACKS IF THE LOAN AMOUNT IS CLEARED IN A SHORT DURATION

When a loan, which was initially sanctioned say for a period of 20 years, is cleared within 2-4 years, it really does not serve the purpose for which the loan was sanctioned. Initially, a major portion of EMI goes in paying the interest and very less to reduce the principal amount borrowed. Therefore, after 2-4 years, a borrower may not see any significant reduction in the outstanding balance. As a result, the borrower has to return almost full amount of loan, even though 24-48 EMIs have been already paid. Beside this, the banks may impose a penalty of about 2% of outstanding amount for prepayment, particularly if it is not paid from the own source. Moreover, the borrower will loose the tax benefits which were otherwise available.In a nutshell, paying a loan of 20 years in just 2-4 years is against the spirit for which the loan was sanctioned. The banks also do not encourage it as they loose a customer who was paying interest every month. This is the reason that they impose a penalty.

❁OPTIONS FOR NEW BORROWERS

The decision on whether to opt for a fixed or a floating rate of interest depends on a borrower's view as well as on the risk appetite and understanding of the economic environment. In such a scenario, the borrower should evaluate the fixed rate for a 3-year period. The interest rate on the loan is locked in at prevailing interest rates, which could be lower than what one may expect after 3 years. The other option would be to consider fixed rates for five years. However, the interest rates for loans under this option are slightly higher by around 50 basis points as compared to the 'fixed for three years' option, if the borrower believes that rates are headed upwards, locking into a 'pure' fixed rate loan may make sense. Borrowers, who don't have a long-term view on interest rates, but believe that home loan interest rates could rise in the short term, should opt for the fixed rate loan, which is subject to revision periodically.

A home loan rate is a very complicated number that oftentimes borrowers will likely leave the calculation to their lender. Here are the different factors that can definitely affect home loan rate. These can increase or decrease the loan rate:

1. Closing Costs: Closing costs are normally paid to mortgage lender, though the borrower's have the option to include it in the total costs. However, if they prefer to have their lender pay for it, then they can expect that the home loan rate would increase.

2. Down Payment: There are lending institutions that would request an initial payment of home mortgage loan. This down payment shall be treated as collateral. Down payment will be one of the ways to show the lender that borrowers are capable of paying the home mortgage loan.

3. Credit Score: In calculating the term of loan, lenders use two things: borrower's credit rating and the level of income. To enjoy lower home loan rate, borrowers shall have at least a decent income and a very excellent credit score-that is, without any sign of default payment in other loans and credit card payments. If they have a bad credit rating, they can still obtain a loan, but can expect the rate to be very high and the term of the loan shortened.

4. Shorter Loans: Borrowers can actually have the option to shorten the term of their loan. However, they must keep in mind that in doing so, it will also increase the payment of interest every month. This is especially true when one can go for a fixed-rate interest rate. On the other hand, an adjustable-rate home mortgage loan will provide a reduced rate in the first few years of loan, but it has the tendency to tremendously increase over time.

Earlier, the home loan sector in India was solely dependent on nationalized and public sector banks, but the entry of public sector banks into the housing finance business marked the beginning of the first round of interest rate cuts. And this reduction in interest rates has enhanced the borrowing power of customers.

PARAMETERS CREDIT MANGERS TAKE TO SANCTION THE LOAN AMOUNT

Basically, credit managers check borrower's ability to repay, assess borrower's intention to repay. Also, they will like to make sure that the property they are funding is safe. Basic parameters used are described briefly in following paragraphs.

- **Salary/ITR:** Higher the salary of an individual, the more are the chances for greater eligibility of a loan amount.
- **Property Check:** Banks check whether the property selected by the borrower is ideal according to the technical & legal norms. Most importantly, they check whether the authorities have sanctioned the property. Therefore, credit managers would like to make sure that the property has approved sanctioned plans and complies with legal & technical aspects.
- **Borrower Profile, Academic & Professional Background:** Banks' credit manager decisions are leveraged on borrower profile, academic & professional qualification. As it is a long-term commitment with the bank, they analyze the potential growth in the borrower's career graph, industry where he is working. Kind of profile like, call centers/BPOs are not treated at par with other profiles, as they tend to have high attrition rates. Banks generally want an applicant with stable job; hence check for current and total work experience. Doctors, engineers, CA, managers etc., sway banker's decisions due to potential growth in their careers.
- **Borrower Credit/Default Profile:** Banks verify whether the borrower has defaulted any or previous loan repayments. This is done against both internal systems and plus third party systems like Cibil/Satyam. So now, it is not easy to have bad debts with one bank & take loan from other bank.
- **Family Credit History:** Banks also verify the financial records of a borrower's blood relations with the help of Cibil/Satyam.
- **Financial Ability to Repay:** One of the most obvious things that a lender will be interested in is the ability of borrower to financially repay the loan requested. Therefore, it is in favor of borrower, to create a current list of assets, income and liabilities. This list is for both personal finances and business finances. Lenders also like to see assets that will protect them in the event of a defaulted loan.

OPTIONS FOR LENDERS

The lenders have many options to bring the interest rates on home loans down. Some of the options for lenders are:

1. Analysts believe that banks usually do not pass the entire benefits of lower interest rates (especially to existing home loan borrowers). This is because banks fix the interest rates based on the concept of net interest margin (the difference between average yield on advances and average cost of deposits). Usually, banks like to keep this spread (net interest margin) above three percent. This margin may be reduced.

2. Banks are locked-in with higher interest rate deposits from the public for certain maturity periods and these deposits cannot be terminated in view of the prevailing market conditions. Therefore, the interest rates on existing loans cannot be lowered immediately. Meanwhile, the RBI and government are pressurizing banks to slash the interest rates on existing loans as well. For this, the banks have to evolve a long term policy to benefit the customers.

3. The consumer sentiments have dropped drastically due to the global slowdown. The RBI encouraged banks to increase the credit inflow to the economy by increasing the bank credit target. The RBI also increased the money supply target. This will help to increase the liquidity in the market, and also help in easy availability of loans.

CONCLUSION

In this paper, various challenges faced by borrowers for getting home loans are analyzed. Common problems of borrowers are discussed and a number of suggestions have been given to resolve them for smooth sailing of home loans. It was concluded that the home loan rates are greatly affected by economic factors and one of the major factors is inflation. Effect of inflation on the interest rate of home loans is discussed in detail. In general, as inflation increases, home loan interest rate increases. Home loan interest rates are also influenced the terms of loans. Normally, fixed interest rates are higher than the floating interest rates. Interest rate increases with the increase in tenure of the loan. Also, rate is higher for higher amount of loan. Further, the rate may vary among various banks. A comprehensive list indicating the rates of various banks is presented.Decline in interest rates stimulates both the demand and supply of mortgage loans. Advances in information technology with financial innovations have created higher efficiency and when these improvements are combined with increased competition, it has helped to reduce credit institution's margins which resulted in the lowering of mortgage rates. These attributes have contributed to the cost-effective and improved efficient nature of the housing finance system with significant increase in the availability of funds.

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