# Should equity in the bond be used for debt?

By Adrian Goslett

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Often car loans and credit cards accrue interest at a much higher rate than a home loan, which is why many people decide to take equity out of their home loan to pay off their other debts. Focusing on paying off debt with the highest interest rate is a very good financial strategy to implement, but is using a home loan to do it the best idea?



The answer to that question largely depends on the term left on the home loan. If the individual decides to pay off a big ticket such as a car by using the access facility on their home loan, they need to consider the fact that although the interest on a bond is generally the lower, the term of the loan in much longer. Essentially this could result in them paying more interest over the term of the loan.

## Building up equity

While the interest on a car loan is usually higher than a bond, the term of the loan is much shorter. Typically, vehicles are financed over a 54-month period, sometimes 60 months depending on the agreement. On the other hand, most bonds will be financed over a 20-year period or in some cases a 30-year period. It takes time to build up equity in a bond, so it is likely that a homeowner will only be able to use their bond account to pay off their car debt after a few years. Even so, unless the bond is only five years or less away from being fully paid off, the consumer has extended the term of their car loan, which could increase the total amount of interest paid. If the objective is to save on the overall interest paid, a lower interest rate over a much longer term is not the answer.

In the instance where the consumer has a 20-year home loan with an interest rate at prime being 10.5%, and they have ten years left to go, an additional R100,000 will cost them R1349 extra a month and accrue an interest amount of R61,922 over the term of the loan. However, if the consumer takes out vehicle finance for the same amount over 54 months at an interest rate of 12.5%, they will pay R2431 a month, but pay R31 254 in interest over the term of the loan. Using their bond account will cost them an extra R30,668 in interest. While the monthly repayment is reduced, the overall interest paid on the debt is twice as much. If the consumer has longer to pay on their home loan, the overall interest amount is even higher.

## Go through the numbers

For a consumer to benefit from the lower interest rate of the bond, they would need to add the total monthly amount they were paying on their vehicle finance to the bond repayment. The additional monthly payments would reduce the outstanding bond amount far quicker, along with the total interest paid over the term of the loan. The consumer would in effect be paying off their car in the same amount of time, but then they would see the positive impact of the lower interest rate. In fact, if the consumer keeps up with the additional payments for the remainder of their bond, they will reduce the term of their home loan and pay off their house faster.

Before using home equity for any debt, it is best to go through the numbers and work out whether it will put you in a better financial position or a worse one. Consumers should look at the long-term impact of their financial choices and do the necessary research and calculations before making any final decisions.

## ABOUT ADRIAN GOSLETT

Adrian Goslett is CEO and regional director of RE/MAX Southern Africa. He joined RE/MAX Southern Africa in 2005 as a franchise development consultant, supporting various regions and offices. Throughout his career at RE/MAX he has held various positions. In 2010, after successfully leading 160 offices and over 1500 agents in six countries through the worst years real estate has ever seen in South Africa in 30 years, Goslett was appointed as CEO of RE/MAX Southern Africa.


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