Have you taken a home loan? Here’s how you can reduce the interest amount

You pay close to 40 per cent in interest over the entire duration of your home loan. Here's how you can save a part of it

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Taking a home loan is a long-term financial commitment, generally ranging between 10-25 years or even more. Ensuring that you pay the EMIs month-aftermonth is a daunting task. But do you know how the EMI is calculated? Did you know that in the initial few years close to 60 per cent of what you pay is directed towards interest? And that you actually may start substantially contributing towards the principal repayment only after five to six years? How can you reduce this interest payment and close the loan sooner? Read on to find out.

EMI is dependent on:

Loan amount;

Interest rate;

Repayment tenure.

HOW IS YOUR EMI CALCULATED?

Avinash Kumar took a home loan of Rs 40 lakh at a six per cent interest for a tenure of 20 years. His EMI is around Rs 28,657 per month. However, Kumar’s EMI will not contribute towards repayment from the very get-go.

Close to 60 per cent of what Kumar pays in the first four-five years is towards the interest amount. In the first month, Kumar’s EMI would roughly contribute Rs 8,657 towards payment of the total principal amount and Rs 20,000 towards interest paid. The figures change to Rs 8,701 and Rs 19,957; Rs 8,744 and Rs 19,913; and Rs 8,788 and Rs 19,869 respectively in subsequent months (see table for yearly view). As time passes, the contribution towards actual repayment increases as the interest amount reduces.

“This is because the interest is calculated on the total outstanding amount on a ‘reducing balance basis’, i.e., as the amount of total outstanding loan reduces with gradual repayments, the interest gets charged on the pending loan amount,” explains Jyoti Prakash Gadia, chairman, BFSI committee, PHD Chamber of Commerce and Industry (PHDCCI).

Kumar’s total repayment for Rs 40 lakh loan, would be Rs 68,77,680 including interest of Rs 28,77,680 for the entire tenure, which would contribute to around 42 per cent of the total repayment amount.

“On an average, the interest component for housing loan would be more than 40 per cent of the total EMI repayment. Further, if the rate of interest increases, the component of interest in the EMI would also increase," says Suresh Surana, founder, RSM India, an audit, tax and consulting service provider. Thus, it is prudent that you try to close your home loan at the earliest.

PLAN YOUR PREPAYMENT BY:

Paying one extra EMI each year

Each year if Kumar starts paying one extra EMI, he will reduce the interest amount by Rs 4,68,458 to approx. Rs 24,09,222. "This is because pre-payment directly reduces the remaining total principal loan amount, thereby also reducing the interest to be charged on it. Such decrease in the principal loan amount causes the loan to be paid back earlier than the initial loan agreement resulting in less interest charged every month," says Gaurav Mohta, CMO, HomeFirst, a housing finance company.

Increasing the EMI by five per cent every year

If Kumar hikes the EMI by five per cent every year, which in this case would be increasing the EMI by Rs 1,433 in the second year and by Rs 2,938 in the third year and so on, he would reduce the interest amount by Rs 9,03,817. "My financial advisor asked me to increase my EMI after I got a salary raise. Hence, every year after I get a hike, I increase my EMI by three per cent. It has helped me not only save on the interest, but also reduce the loan tenure," says Mumbaikar Kartik Patel.

Reducing the tenure

If Kumar decides to close the 20-year loan in 12 years, his monthly EMI increases by Rs 10,377 to Rs 39,034, but the amount he pays towards interest reduces by Rs 12,56,783 to 16,20,897.

In all the above situations, the tenure automatically reduces.

"As the interest component in the EMI is highest during the initial stage of the home loan, it is advisable to prepay the loan at the initial stage, as prepayment of loans at the mid-tolate stage may not give full benefit of interest saving (see table for details)," advises Sneha Padhiar, partner, Bhuta Shah and Co LLP.

However, one must bear in mind the prepayment charges levied on pre-closing your home loan. Check with your lender for details.

Suresh Surana, founder,

RSM India, points out the tax benefits of prepayment:

Under section 24 of the IT Act, a tax payer can claim a deduction for the amount of interest accruing on a home loan upto Rs 2,00,000 for a financial year concerning a self-occupied property;

First-time home-buyers are further eligible for additional tax deduction u/s 80EEA of IT Act, of interest on home loan upto Rs 1,50,000 over and above the benefits availed u/s 24, provided the following conditions are met:

The loan must have been sanctioned by the financial institution between 1st April 2019 and 31st March 2022;

The stamp duty value of the residential property should not exceed Rs 45,00,000;

The tax payer does not own any residential property till the date of loan sanction;

The tax payer should not be claiming deduction under section 80EE of the IT Act.

If the property is let out, then the actual amount of interest accrued on a home loan can be claimed as deduction (i.e. no limit of Rs 2,00,000 would be applicable in case of let out property);

The principal component of the loan, as well as the stamp duty value paid for purchasing the property, can be claimed as deduction u/s 80C of the IT Act to an extent of Rs 1,50,000;

In case a tax payer proposes to repay, partly or fully, the housing loan, he should evaluate whether it would be prudent to repay the housing loan by considering factors such as the requirement of emergency funds, job security, arbitrage opportunity, availability of an alternative investment option providing higher yield/returns, tax efficiency (deduction of housing loan and principal), etc.

The repayment schedule for a person who has taken a home loan of Rs 40 lakh on 1st April, 2020, for a tenure of 20 years at the interest rate of six per cent:

Financial Year	Principal	Interest	EMI	% towards principal	% towards interest
2020-21	106,789	237,095	343,884	31%	69%
2021-22	113,375	230,509	343,884	33%	67%
2022-23	120,368	223,516	343,884	35%	65%
2023-24	127,792	216,092	343,884	37%	63%
2024-25	135,674	208,210	343,884	39%	61%
2025-26	144,042	199,842	343,884	42%	58%
2026-27	152,927	190,957	343,884	44%	56%
2027-28	162,359	181,525	343,884	47%	53%
2028-29	172,373	171,511	343,884	50%	50%
2029-30	183,004	160,880	343,884	53%	47%
2030-31	194,291	149,593	343,884	56%	44%
2031-32	206,275	137,609	343,884	60%	40%
2032-33	218,998	124,886	343,884	64%	36%
2033-34	232,505	111,379	343,884	68%	32%
2034-35	246,845	97,039	343,884	72%	28%
2035-36	262,070	81,814	343,884	76%	24%
2036-37	278,234	65,650	343,884	81%	19%
2037-38	295,395	48,489	343,884	86%	14%
2038-39	313,614	30,270	343,884	91%	9%
2039-40	333,069	10,815	343,884	97%	3%
Total	40,00,000	28,77,680	68,77,680	58%	42%

Sneha Padhiar, partner, Bhuta Shah & Co LLP

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