Should bond equity be used for debt?

By Adrian Goslett

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Focusing on paying off debt with the highest interest rate is a very good financial strategy. For this reason, many choose to use the equity in their home loan to pay off other debts with higher interest charges. While this can be a sound financial move, it can also be a very risky decision - knowing when and how to use the equity in the home loan will make all the difference.


Adrian Goslett, regional director and CEO of RE/MAX of Southern Africa

Car loans and credit cards usually accrue interest at a much higher rate than a home loan. Before using home equity to cover these debts, go through the numbers to work out whether it will put you in a better financial position or a worse one. Homeowners need to consider the long-term impact of this decision and do the necessary calculations before making any final decisions. The last thing a homeowner wants is to fall behind on repayments and lose their home because they have used their equity to cover other debts.

To work out whether it is safe to use the equity to cover other debts largely depends on the term left on the home loan. When homeowners use the access facility in the bond to pay off a big-ticket item, such as a car, they need to consider that although the interest on a bond is usually lower, the term of the loan is much longer. If in the early stages of their bond term, essentially this could result in the homeowner paying more interest over the term of their home loan.

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.

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Unless the bond is only five years or less away from being fully paid off, homeowners will have extended the term of the 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.

To provide an example, BetterBond explains that if you have a 20-year home loan of R1m with an interest rate at prime being 7%, with ten years left to go, an additional R100,000 will cost R1,161 extra a month and accrue an interest amount of R139,330 over the term of the loan. However, if you take out vehicle finance for the same amount over 54 months at an interest rate of 12.5% you will pay between R2,516 – R2,528 a month but pay R 35,357.82 in total interest and service fees over the term of the loan. In this scenario, using the bond account will cost you an extra R26,565 in interest. While the monthly repayment is reduced, the overall interest paid on the debt is twice as much.

To benefit from the lower interest rate of the bond, homeowners will need to add the total monthly amount they were paying on the 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. Homeowners would then in effect be paying off the car in the same amount of time but would see the positive impact of the lower interest rate.

Using the equity in a home loan to cover debt is a big decision for homeowners to make and should not be undertaken lightly. Finally, homeowners should speak to a financial advisor to find out what would work best for their unique situation. While the above provides a simplified example, each homeowner's financial situation is different. Homeowner's will need to do the calculations themselves to ensure that they make the right decision in this regard.

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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