

RANDS & SENSE

We all need to borrow money at some stage – say to pay for a car or a house – and we pay interest on that loan. But here's how paying the loan off as quickly as you can will save you thousands of rands ...

This is really interesting

Interest rates affect all of us, whether we are investors or borrowers. Interest is a charge made by a bank on money you have borrowed, or a payment made to you if you are in credit. Consider the following interesting interest related facts:

- Did you know that if you start saving a fixed amount monthly at age 20 and stop at age 30, then somebody starting to save the same fixed amount monthly at age 30 will never catch up with the value of your investment even if they save for the rest of their life?
- Did you know that if you are tempted to take out a R300 000, 12% homeloan for 30 years instead of 20 years, you will only save R210 per month on monthly instalments but will ultimately end up paying R318 000 more interest?
- Did you know that if you manage to put R1 000 a month extra into your R300 000, 12% homeloan you will pay off the loan in 10 years instead of 20 years?



Staying on the ball?

A key concept to understand when talking about interest rates, is the power of compound interest. Compound interest, quite literally has a snowball effect on the original amount invested. As you roll a snowball across a field of snow, it picks up more snow, adds it to the snowball, picks up more snow, adds it to the snowball until you have a huge snowball.

It's the same with compound interest. You start off with an investment, earn some interest and add it to the investment, earn some more interest, add it to the investment until you have a huge investment!

If we take our first example above. You and a friend are the same age. At 20, you start saving R100 per month at 8% interest. By the time you are 30, your investment is worth R18 400. If you now stop saving each month at age 30 and just let your money work for you, the interest you earn is R123 per month and grows each month!

Your friend doesn't save at age 20 and only starts investing R100 per month at age 30. Your friend will never catch up with you because your friend is only investing R100 per month and you are re-investing R123 per month!

Moral of the story: Start saving early and watch the power of compound interest work for you!

In the examples above, we can see how important it is to understand how the interest portion of your fixed instalment is calculated. Quite simply, the longer the term of your loan,

the more interest you will pay. In a fixed instalment loan such as a car or homeloan, each month's interest is calculated on the outstanding loan amount and then the remaining portion of your instalment is deducted from your outstanding loan amount.

For example, a R300 000 loan over 20 years at 12% would require a R3 300 monthly repayment. In the 1st month, your R3 300 instalment is made up of R3 000 interest and only R300 offset against your debt.

After three years, your R3 300 instalment is made up of R2 870 interest and R430 is offset against your debt. At the end of year three, you have paid a total of R119 000 in instalments but you still owe R287 000!

Because interest is calculated on the outstanding debt, it is always wise to pay extra into your homeloan to reduce the debt, as quickly as possible.

South African Interest Rates

At the time of writing this article, the prime interest rate is 13,5%. Prime rate is the overdraft rate that banks will charge their best credit-worthy clients (see the panel below).

In terms of recent legislation (the National Credit Act), maximum interest rates have been set for various credit transactions such as credit cards, personal loans and home loans.

The maximum rate on credit card facilities is 32%, on personal loan transactions it is 42% and on larger loans such as home loans it is 27%.

It is very important to know that these are maximum rates and the better credit record you have, the more power you have to negotiate lower interest rates.

- Next month we will be taking a closer look at the National Credit Act and highlight how you can make the Act work for you.

A practical example of interest paid or saved on a homeloan

The following table illustrates the impact of loan term and paying in extra. Let's stick with our example of a homeloan of R300 000 at 12%:

Term of the home loan in years	10 years	20 years	30 years
Monthly repayment (rounded off)	R4 300	R3 300	R3 090
Total Interest Paid	R217 000	R493 000	R811 000

If you pay R1 000 extra each month, you pay off the loan in 10 years instead of 20 and you save R276 000 in interest! If you pay off over 30 years instead of 20, you save R210 per month in monthly instalments but pay R318 000 more interest!

Moral of the story: Keep your term as short as possible and pay extra monthly instalments whenever possible. Every extra rand you put in will save you a great deal over time.

Who actually sets the interest rate, and why does it work the way it does?

Interest is the price you pay for the privilege of renting money. If Jan lends money to Mary, then Jan does not have the use of that money until Mary repays it. So Jan may charge a fee – interest – as compensation, and Mary pays Jan for the privilege of the loan.

Commercial banks operate on the same principle, but under a complex set of rules and constraints set by the South African

Reserve Bank (SARB), which also sets the interest rate, known as the 'repo' (repurchase) rate.

The SARB lends money to commercial banks, and the repo rate is the 'price' that the banks pay to the SARB for the privilege of borrowing money and lending it on to their own clients at a higher price. The repo rate is 10%, and banks charge their 'prime' (or most credit-worthy) clients at a 'prime rate' of 13,5%.

The repo rate is one of the SARB's most powerful tools for managing the inflation rate and the amount of money circulating in the economy. By raising the repo rate, and thus the cost of money, the SARB can discourage people from borrowing too heavily.

The SARB does this to manage inflation, which is one of its most important tasks as the country's central bank.

New policy on staff housing



Council has adopted a policy on official staff housing to standardise the allocation, use and rentals payable (where applicable) of Council properties set aside for operational use.

The policy states that it is each employee's responsibility to provide him or herself with appropriate accommodation while in the City's service. Thus, Council can only provide accommodation when:

- The employee is required by virtue of occupying an identified post to be accommodated at or within the direct environment of their work centre.
- The employee must be located at a work centre due to the requirements of the post held by him or her, and no housing exists or reasonable housing is unavailable, or private housing is not permitted within the environs of the work centre.
- The employee must inhabit specific accommodation at or within the direct environment of the work centre based on functional necessity as assessed by the executive director of the applicable service unit to which the employee is allocated.

Employees using Council properties for operational reasons will in future be liable for fringe benefit tax and services they receive from the City, namely water, refuse removal and electricity.

This means that they are not liable for taxes and rates levied to property owners. These employees will soon be receiving letters to this effect from their Executive Directors.

The policy also acknowledges that there will be instances where some properties will be surplus of operational requirements. In these cases such properties may be let to other employees or community members, and in such cases, market related rentals will be payable.

- For more information, contact Nomusa Mawela, Manager: Payroll & Personnel Administration, tel 021 400 2511 or send an e-mail to nomusa.mawela@capetown.gov.za

Wellness Week winner

Sibongile Maxwell Bonga from Roads and Stormwater in Goodwood was the delighted winner of a laptop in the City's Wellness Week lucky draw.

The draw prizes, sponsored by the City's Employee Wellness Programme (EAP) and Tholwana-Atfin HealthCare Consulting (Pty) Ltd, included the laptop, a weekend for two at a health spa, a fruit basket and corporate clothing. More than 4 500 entries were received from staff attending the expo.

"It is a time to give the City a hand for the great things it's doing for its workers. We could have our blood pressure and other things checked and enter a competition, which was great," says Sibongile.

"I feel honoured to have received the first prize – it's just what I need to move forward in my education. Thank you!"



First prize: Sibongile Maxwell Bonga with the brand-new laptop he won in the EAP's Wellness Week lucky draw.

• Rands & Sense is written by Paul Barnard of North Star Solutions, specialists in financial education. North Star Solutions runs one-day workshops in financial education. Participants become more confident in money management skills, thereby improving their personal financial lifestyle.