Fixed vs Floating Home Loan: Which is the best option for buying your home?

One of the most important factors to take into consideration when choosing a home loan is the interest rate.

Fixed and floating home loan rates come with their own set of perks and disadvantages.

Choosing a loan to invest in your dream home can be complicated, especially for first-time home buyers. One of the most important factors to take into consideration when choosing a home loan is the interest rate. Potential home buyers have two types of interest rates they can choose from: fixed interest rate and floating interest rate. All major banks offer both these types of interest rates. Choosing the best type of interest repayment for your home loan will depend upon a number of factors. Here is everything you need to know about fixed and floating interest rates to help you make the best decision.

1. What is a fixed interest rate?

To keep it short and simple, a fixed interest rate is one where the interest amount is fixed and does not vary depending upon market fluctuations. Interest rates are paid on a monthly basis at the start of every month.

Advantages

Now that we have covered the basics of what a fixed home loan is, let's run through the advantages of taking out a fixed home loan.

 # Greater predictability

Since the interest rate remains stable and does not change, you will be able to budget all your financial expenses properly. This will help you manage your household finances and forecast your annual expenses more accurately.

 # Suitable for short-term loans

Since the market is more predictable in the short term, fixed interest rates are perfect for loans that can be repaid in a short period of time (3-10 years). For long repayment dates, the volatility of the market can make it difficult to predict whether interest rates could potentially fall in the future. The second advantage would be that it is an extremely suitable option for short and medium term between 3 and10 years.

 # Greater security

The third advantage is that it also brings a sense of security. If you are unsure of where your career path will lead while buying a new home, a fixed home loan will give you the financial back-up you need.

Disadvantages

While fixed interest rates have their advantages, there are also several drawbacks.

 # Higher rate of interest

Fixed interest rates include a higher rate of interest as opposed to floating home rates. The typical rate would be between 1 and 1.25% higher than that of a floating interest rate.

 # Limited repayment tenure

Fixed interest rates last for only a couple of years and might not last the entire tenure of the loan. This makes the borrower more vulnerable, as they would have to pay floating rates until the tenure of the loan is done.

 # Prepayment penalty

In the case of fixed loans, you might incur a prepayment penalty if you close or transfer the loan before the original repayment period. This can be a deterrent for borrowers who want to clear their debt faster.

2. What is a floating interest rate?

Floating home loans, also known as 'adjustable rate home loans', can be defined as a home loan where the interest rate keeps changing over the course of the fixed loan, due to differences in the market rate.

This specific loan is associated with the bank's Benchmark rate, which in turn moves according to the market interest rates. Floating home loans have interest rates that get reset at specific intervals, and this could vary from calendar periods like every quarter or every 6 months. It will also be unique for each customer, as it depends upon the date of the first disbursement of his home loan.

Advantages:

 # Lower interest rates

Floating interest rates have a much lower interest rate compared to fixed interest rates. This difference means that even if the floating interest rate does increase due to market volatility, it is unlikely to exceed the fixed interest rate.

 # Can reduce the total interest payable

If you expect interest rates to drop over a period of time, choosing a loan with a floating rate results in the interest rate on your loan falling too, which in return reduces the cost of the loan.

 # No prepayment penalty

Unlike a fixed loan, there is no prepayment penalty for a floating home loan. This means that even if you pay back your loan in less time than expected, you won't be charged a fee for it.

Disadvantages

 # Difficult to budget

It is extremely difficult to plan out and budget your finances properly, due to the constant change in interest rates. Floating interest rates offer little to no predictability, so it will be unclear exactly how much you need to pay as interest.

 # Highly subjective to market factors

A floating rate will only benefit you as long as the interest rate doesn't go beyond 11.5%. Beyond this, it can exceed the amount you would otherwise have to pay with a fixed rate.

Fixed and floating home loan rates come with their own set of perks and disadvantages. They can vary with the type of individuals. For example, if a person is fixed on allocating his /her budget and expenses, it would make sense for them to go with a fixed home loan, to fund their dream home. On the other hand, if a person doesn't really have a set budget and would like a larger loan amount, he/she should opt for a floating home loan to purchase their ideal home.

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