

Penalty Interest on Home Loans

"Industry players note that banks have become far more stringent about imposing their termination notice periods since the introduction of the National Credit Act (NCA) in mid-2007. Section 125 of the NCA stipulates that banks are entitled to receive 90 days notice from a client of their intention to cancel their mortgage bond, regardless of when the loan was granted.

The penalty charge on early termination is equal to 90 days interest payable on the balance outstanding in the home loan – not the original loan amount. Alternatively, interest is charged on the difference between 90 days and the notice period given.

As such, penalty charges can run into thousands. For instance, someone who owes the bank R1m at an interest rate of 10% could end up paying close to R25k in penalty fees if they cancel their bond early without giving prior notice to the bank.

Penalty interest is usually charged from the day that the bank receives a request by the borrower's attorney to provide mortgage cancellation figures. If the client didn't give notice of his intention to cancel the loan prior to this date, the 90-day early termination fee will be included in the cancellation figures.

Another penalty that may arise is when certain fees, such as bond registration or initial administration costs, are waived by the bank when the home loan agreement is signed. Banks usually stipulate in the loan agreement that these costs will be recouped from customers if the loan is terminated within a certain period, often within the first three years after the loan was granted.

Banks motivate early termination penalties as a way to recover costs associated with setting up a home loan facility and the loss of interest that the bank could have earned over the full 20-year contractual period.

Homeowners are advised to inform their bank in writing if they intend cancelling a bond as soon as they have sold their house, instead of waiting for the transfer attorney to do so a month or two down the line.

Despite the possibility of paying an early termination penalty, it still makes financial sense for consumers to pay off their home loans as soon as they can, particularly for those approaching retirement."

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