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Case Study

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Financial Implications of Loan Moratorium: A Case Study

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Mr. Dev is currently working as a financial planner. He is very successful in his profession. He is known for providing financial advice by understanding the requirements of each client. Mr. Kiran is a very successful lawyer who seeks financial advice from Dev. Kiran has just taken a mortgage of Rs 99,90,000 at a fixed rate of interest of 8.65%(APR) for a period of 25 years. His EMI is fixed at Rs 81527.89. He is yet to make the first payment. The economy of the country is currently going through a slowdown. In order to boost the economy, the government has announcement a moratorium of 6 months for the repayment of loans below Rs 1 crore. Hence, Kiran is eligible for the loan moratorium. As an incentive, only simple interest will be charged on the outstanding loan amount during the 6 months of loan moratorium. Kiran approached Dev for understanding the financial implications of the 6-month loan moratorium. Dev agreed to help out Kiran. After doing some initial calculations, Dev become more interested in the task at hand.

As a person who is well versed with the concept of time value to money, Dev realizes that the calculation is slightly complex. Kiran has not yet started with the EMI. But for most of the customers the 6-month loan moratorium occurs in between the loan. The specific concept applied here is annuities and using the concept various scenarios could be recreated. Dev immediately realizes that even if the loan moratorium is there only for 6 months, it can have implications for the entire tenure of the mortgage. The financial implications will be different for compound interest and simple interest charged during the 6-month moratorium period. There is a need to further adjust the calculation if the loan moratorium occurs after some EMI payments. Dev decided to break down the problem at hand to following questions:

1) What is the cost a customer would end up paying during the entire tenure of the mortgage due to the 6-month moratorium?
2) What is the cost a customer would end up paying during the entire tenure of the mortgage if compound interest is waived off and only simple interest is charged during the 6-month moratorium?
3) How much is the net benefit of the compound interest waiver during the 6-month moratorium?
4) What is the cost a customer would end up paying during the entire tenure of the mortgage if 6-month moratorium occurs in between the loan?

Please help Dev in the calculations. Assume that there is no prepayment of loan. Also assume that additional monthly amount saved in case of no moratorium could be invested at 3%(APR)

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