**GET INFORMED!**

# LOANS

When we are short on funds, we may turn to a loan to finance the purchase of a desired good or service. Clearly, this will make the desired goods and services more expensive. A loan transaction is an obligatory relation where a creditor lends money to a debtor for a specific period of time under specific conditions and these conditions include the cost of borrowing money which is called interest. Most commonly negotiated loans by citizens in Croatia are those offered by credit institutions – banks, savings banks and housing savings banks. Before entering into a loan agreement, one should carefully examine the lending terms offered both in respect of the actual financial abilities of consumers and materialisation of risks associated with individual types of loans (interest rate risk, currency risk).

## WHERE TO START?

The goods or services that we wish to obtain serve as a starting point in the process of loan selection as they will determine whether we need a specific purpose loan or a general-purpose loan. Lines of purpose loans, as their name suggests, serve a specific purpose and the funds obtained under such a loan may not be used for other purposes. General-purpose loans are paid to the loan user's account and may be used freely; there is no clause stipulating their specific purpose and no obligation to account for the funds used.

EXAMPLES OF PURPOSE LOANS:

- Housing loans
- Home improvement loans
- Car purchase loans
- Education loans

## LOAN OFFER

After we have determined the loan's purpose, we have to look into the offer of such loans on the market. We can find an Information list of the credit institutions' loan offer on the market on the Croatian National Bank website or on a free mobile application mHNB. It provides a simple to use list of loan options available, from which we can select the type of loan we are interested in, in respect of the purpose, the currency (HRK/EUR) and the type of interest rate, after which we get an offer based on the criteria selected. This will enable us to compare loans of the same purpose in different credit institutions.

https://www.hnb.hr/informativna-lista-ponude-kredita-potrosacima

**mHNB**

## ATTENTION SHOULD BE PAID TO:

Loans may be viewed as any other good or service in the market. It is up to the consumer to determine and decide on the agreement that he or she wishes to enter into, but timely information on and knowledge of the key elements and terms of a credit transaction can help the consumer greatly in making this decision. The consumer will have to decide on the loan amount, term and currency, type of interest rate, **have an understanding of the difference** between the effective and nominal interest rate, **bear in mind** the interest rate and currency risk, **obtain timely information** on fees and costs and all the rights and obligations of both parties under the loan agreement.

## LOAN AMOUNT

The amount of loan we need will be determined by the price of goods or services we wish to obtain, i.e. that part of the required price we wish to finance by a loan. However, there are other elements which also have to be taken into account when determining the amount of loan. First, it is important to determine if we really need goods or services we wish to obtain – make an assessment of the reasons for the purchase, followed by an assessment of other ways (for instance, a combination of savings and a smaller loan) in which the desired goods or services can be obtained. If we eventually do decide to obtain the goods or services partly or fully by means of a loan, we should also make sure that we have a say in the decision on the loan amount rather than leaving the matter to the assessment of the credit institution. This means that we should take care to make a good estimate of our present and future financial abilities and base our decision on that.

Prior to entry in a credit relationship make sure to assess if the purchase is justified!

As mentioned above, the credit institution will decide on the maximum loan amount based on the assessment of our creditworthiness, with a current account overdraft and all credit card debts also being included in our total debt.

## LOAN CURRENCY

Loans may be negotiated in the domestic currency (kuna), domestic currency with a currency clause (most commonly in euro) or in a foreign currency. By negotiating a loan in a currency other than that of our income (salary, pension), we expose ourselves to a *currency risk*, the materialisation of which may lead to an increase or a decrease in our monthly annuities or instalments due to changes in the exchange rate of the currency of our income and the exchange rate of the currency of our loan instalment or annuity.

VARIABILITY PARAMETERS IN THE RC

- EURIBOR
- LIBOR
- NRS (national reference rate of the average financing cost of the Croatian banking system)
- yield on T-bills of the Ministry of Finance
- average interest rate on household deposits in the respective currency

## INTEREST RATE

Interest as the price of borrowed money is expressed by means of interest rate. One should distinguish between a nominal interest rate (NIR), specified in the loan agreement, and an effective interest rate (EIR) which is calculated before loan negotiation. In addition to the nominal interest rate, the EIR also includes loan-granting fees and thus gives a more realistic picture of the total loan price. As regards interest rates, commonly offered are loans with a fixed, variable and a combination of fixed and variable interest rates. Once negotiated, fixed interest rates may not be changed for the duration of the contractual relationship. Variable interest rates may rise or fall during the period defined in advance, depending on whether the agreed variability parameters are rising or falling, while combined interest rates are generally negotiated by defining the period of fixed interest rate and period of variable interest rate use.

Can you tell the difference between the NIR and EIR?

## POSSIBLE RISKS

### WHAT IS INTEREST RATE RISK?

Interest rate risk is the risk of a rise or fall in interest rates which may lead to an increase in loan instalment or annuity. It occurs in periods of negotiated variable interest rate. If a variable interest rate has been negotiated for the entire loan period, the consumer is exposed to an interest rate risk throughout the duration of such a loan agreement. Where a combined interest rate has been negotiated for a loan, which implies a period of fixed interest rate and a period of variable interest rate, the consumer is exposed to interest rate risk during the period for which a variable interest rate has been negotiated. To avoid interest rate risk, one can negotiate a fixed interest rate throughout the duration of the loan agreement.

- variable interest rate = interest rate risk
- fixed interest rate ≠ interest rate risk
- combined fixed and variable interest rate = interest rate risk

## WHAT IS CURRENCY RISK?

Currency risk is present in loans denominated in a foreign currency or loans with a currency clause. Loans with a currency clause means loans the amount of which is linked to the value of the exchange rate of a foreign currency but the payment of which is made in the domestic currency. For the purposes of this document, foreign currency means currency other than that of our income or other means from which the loan is repaid. With reference to currency risk, a change in the exchange rate of the negotiated loan currency in relation to the currency of our income may lead to an increase or a decrease in the monthly instalment or annuity. To avoid currency risk, one can negotiate a loan in the currency of our income.

- pension in kuna + loan in euro = currency risk
- salary in euro + loan in kuna = currency risk
- salary in kuna + loan in kuna ≠ currency risk

## INFORMATION TO BE CONSIDERED BEFORE NEGOTIATING A LOAN

Before negotiating a loan, one should consider all the listed information. One should also examine in particular the general operating conditions and general conditions for credit operations of credit institutions, commonly referred to by credit institutions in loan agreements. All information on costs and fees is available in Tariff of service fees. The European Standardised Information Sheet that will be presented to us before negotiating a loan can serve as one of the most important sources of information. This sheet contains all key information on individual credit lines of our interest. Since all credit institutions are obligated to produce this sheet, it can serve as a good tool for a comparison of the same credit line with different creditors. The information provided in the sheet has to be read carefully and more importantly, it must be understood. Bearing in mind the importance and long-term character of a loan decision, one is advised to discuss in detail any ambiguities in respect of the loan and request explanations from authorised persons.

European Standardised Information Sheet – an important tool available to consumers for use prior to negotiating a loan or a deposit

## LOAN REPAYMENT

Loans may be repaid in instalments or annuities. In both annuity and instalment repayment plans the monthly instalment consists of one portion principal and one portion interest repayments. In the case of annuity repayment, the monthly instalment is always the same as principal repayment increases as the part of interest repayment decreases. In the case of instalment repayment, the monthly instalment decreases as repayments progress since the part of the principal remains the same and interest repayment decreases. This information can be found in the repayment plan received with the loans.

## EARLY LOAN REPAYMENT

We can make a full or partial early loan repayment at any time. In the case of early repayment, we need to have the full amount of the debt on a particular day calculated and the information on any charges for early loan repayment provided. Worth noting is that after the remaining part of the loan is paid to the creditor's account, a calculation has to be made and the loan has to be closed, thus formally ending the process of early loan repayment.