

theloanhöund

theloanhound.com.au

Breaking a fixed loan... yes or no?

With some significant interest rate drops over the last few months there has been a lot of talk about the costs involved in breaking a fixed rate loans, switching to variable or a lower fixed rate loan. There seems to be a lot of confusion about the subject so I thought I would put something together which explains things in simple terms. So here goes!

What is a fixed loan?

When you take out a fixed loan you enter into an agreement with the bank to pay a fixed interest rate over a set period of time, generally between 1 and 5 years. While you are in a fixed period you are required to make the same minimum repayment on your loan each month - you may choose to pay more off of the loan but we are talking about the minimum here. It doesn't matter what happens with variable rates, your minimum monthly payments and the amount of interest you pay always stays the same. If you decide to break this agreement with the bank you will have to pay for this (of course... we are dealing with a bank after all!), this is called the economic loss cost or break cost.

So why do banks charge breaking costs on fixed loan?

Put simply, by having you enter into a fixed term agreement the bank can then determine exactly how much money they will make from your loan over the fixed period. That is, if you enter into a fixed loan for 2 years then the bank know that every month over the next 2 years they will receive 'X' amount of money from your loan and they can use this money elsewhere. If you decide to break the fixed loan then the bank will no longer be receiving a set amount of profit from your loan so they expect to be reimbursed to recoupe the loss.

Another handy hint brought to you by ***theloanhöund***

theloanhöund

theloanhound.com.au

How does the bank calculate breaking costs?

Breaking costs on fixed loans can vary significantly and the following factors are taken into account:

1. The size of your fixed loan.
2. How long you have until the fixed term ends.
3. The interest rate your loan is fixed at compared to the cash rate (which is set by the Reserve Bank of Australia) at the time you want to break the contract.

Is it worth breaking my fixed loan?

Ultimately, if you are trying to free up cashflow, that is reduce your overall monthly mortgage payment and putting more money back in your pocket the answer could be YES! By breaking your fixed loan and switching to a low cost variable rate loan, or a re-fixing at a lower rate you could literally save hundreds of dollars each month.

So if you need more money in your pocket to help with the rising cost of living then breaking your fixed rate may be a good option.

Will it cost more to break a fixed loan if the Reserve Bank cuts interest rates next month?

The simple answer is **YES!** As outlined above, as interest rates fall the gap between your fixed rate and the current wholesale rate becomes larger, meaning that your breakcosts become higher.

What do I need to do to break my fixed loan?

Each bank has a different process for breaking fixed rate loans. Your Mortgage Consultant from ***theloanhöund*** can guide you through the process and help you with the paperwork required for your bank. Please contact us to discuss your situation.

Another handy hint brought to you by ***theloanhöund***