breaking your loan: how prepayment fees work.

Maybe you're considering a fixed rate home loan, maybe you have one already. Fixing or locking in your interest rate for an agreed period of time gives both of us certainty, which is great.

But there are times when you may need to break that contract and you might have to pay a prepayment fee (or 'break cost').

prepayment fees and why we charge them.

When you sign a fixed rate home loan contract with us, you lock in your interest rate for a period of time.

Fixed rate loans provide you with certainty; you know exactly what your repayments will be and how much interest you'll pay. Locking in a specific interest rate also means, even if the variable rate increases or decreases, your interest rate won't be affected during the time it's fixed.

Fixed rate loans also provide us with certainty. If you break your contract by switching banks, repaying your loan early or for another reason, our funding costs change and we'll likely incur a loss. This is where a prepayment fee comes in – we charge it to cover the loss. This is why prepayment fees can also be referred to as 'break costs'.

It's important to note that ME does not profit from prepayment fees. Our reason for charging a prepayment fee is based on the principle that if you break a contract and the other party loses money, you generally need to compensate them.

when is a prepayment fee charged?

- If your loan is discharged or terminated because of selling, refinancing or for any other reason before the end of the fixed interest rate period.
- If you make changes to your fixed rate loan, including extending your loan term, changing to a variable interest rate or to another fixed interest rate, topping up your fixed loan or switching home loan product type.
- If you pay more of your loan than allowed under your fixed term contract. Technically, you can make a lump sum payment to a fixed rate loan without breaking your contract but it might mean we need to recalculate your repayments and charge you a partial prepayment fee.

These are the main examples of when we may need to charge a prepayment fee. It's not the complete list though – that's in the terms and conditions of your loan.

how is the prepayment fee calculated?

We use two formulas to calculate prepayment fees, depending on whether you are prepaying the entire loan balance or just part of it. These calculations are outlined in 'Annexure A – Fixed interest rate prepayment fee' in Part B of our home loan terms and conditions.

The prepayment fee is a calculation based on factors including the remaining fixed rate period, the repayment amount, the original cost of funds (at the start of the fixed rate term), and the difference between the cost of funds from the date when you first entered into the fixed contract to the date that it is terminated.

let's look at an example:

John has a loan for $500,000 fixed for three years at 5.08% p.a. After one year, with $10,000 paid and $490,000 of the loan still owing, John has decided he'd prefer a variable rate over his current fixed rate and so he rings ME for a break cost.

His break cost will be calculated based on:

- how much time John has remaining on his fixed interest term: 2 years
- how much he still owes on his loan: $490,000
- what his repayments are: $1,221.80 fortnightly
- the fixed rate he locked in: 5.08% p.a.
- how long the loan was taken out for: 30 years; and
- the current market rate (or the cost of funds)

Break costs can range from several hundred dollars to tens of thousands of dollars (or higher) depending upon the scenario.

and here's another way to look at it.

Say you fixed your interest rate at 5.08% p.a., and variable rates are currently 6.10% p.a. If you ended your fixed contract now it's unlikely you'd have to pay a break cost fee as you'd be changing to a higher interest rate and your bank will be earning interest from your loan at a higher rate.

However, if you've fixed your interest rate at 5.08% p.a., and variable rates are currently 4.10% p.a., ending your fixed contract would very likely attract a fee as it means your bank can no longer rely on expecting a fixed repayment amount from you each month at the higher interest rate.

This brochure does not replace or modify your loan contract. It's designed to assist you in understanding how we calculate break costs (prepayment fees). The precise mathematical method of calculation is referred to in Part B of the Home Loan Terms and Conditions.

quotes and questions.

If you're thinking about paying part or all of your fixed rate loan early, or changing it in any way, please get in touch so we can organise a prepayment fee quote for you. Verbal quotes are valid on the day they're provided, and written quotes are valid for 10 business days.

Call us on **13 15 63** Monday to Friday 8am–8pm or Saturday 9am–5pm (AEST/AEDT).

Break costs may be high. This brochure explains the process of fixing interest rates, what break costs are and when they are payable.
Please read this brochure carefully and if you don't understand any part we suggest you seek independent financial advice from an accountant or an actuary.

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