Breaking your fixed loan: How prepayment fees work.

Maybe you're considering a fixed rate home loan or maybe you have one already? Regardless, fixing or locking in your interest rate for an agreed period of time can provide peace of mind.

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 ME, you lock in your interest rate for an agreed 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, we may receive less interest than we were expecting. This is where a prepayment fee comes in – we charge it to cover the difference between your current prepayment and a repayment where the interest is based on the sum of the current wholesale market rate and our lending margin. This is why prepayment fees can also be referred to as 'break costs'.

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 can 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 several factors including the remaining fixed rate period, the repayment amount, the current repayment, and the difference between the current repayment and a repayment where the interest is based on the sum of the current wholesale market rate and our lending margin.

Let's look at the details.

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 estimate.

His break costs 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 wholesale market rate (or ME's costs of funds) and our lending margin.

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

Here's another way to look at it.

When you prepay your fixed rate loan by more than the prepayment limit ($30,000 over the fixed rate period) or end your fixed rate loan early, we will not receive the interest we were expecting. If on the date of prepayment the wholesale market rate plus our lending margin for the period remaining of your term is lower than your current rate, then ME will suffer a loss and a prepayment fee will be charged to compensate us for this loss.

Here's an example of how it works:

A $500,000 loan is fixed for 3 years at 4% but paid out after 2 years. On the prepayment date, the wholesale market rate plus our lending margin is 2%. This means a difference of 2% and a potential loss in return to ME for the remaining year of $10,000.

It's important to understand that this calculation differs from simply looking at the current fixed and variable rates being advertised by ME or other banks at the time you are considering early repayment. Instead, it reflects the wholesale market rates (or ME's costs of funds) plus our lending margin. We strongly recommend you to request an estimate of your applicable prepayment fee from us prior to considering early repayment so that there are no surprises in relation to whether a prepayment fee is triggered or not. Please note that these quotes are valid for a short time and if not accepted, may change by the time you're in a position to break the fixed rate term.

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. 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).

ME0219.v03/202002/215290