

LOCK IN RATES?

As home owners and investors, we are aware of all the headlines associated with the Reserve Bank of Australia (RBA) reducing the official cash rate to an all-time historical low of just 0.25% and the passing on from lenders to borrowers these reductions in the form of lower variable and fixed term interest rates.

However, what most borrowers have not been aware of is the widening gap in interest rates between variable and fixed interest home loans.

While over the last five years fixed interest rates have been on average about 30 basis points lower than variable rates, this difference grew to 57 basis points over the second half of last year¹. According to an analysis by Canstar¹, fixed interest rates then stretched to 84 basis points during March and April.

It's no wonder that 68.5% of recent mortgage activity has been for refinancing purposes², particularly given that many fixed interest rates are now between 2% and 3%.

Even a slight change in interest rates can make thousands of dollars of difference over the life of a home loan.

Take this example of a \$500,000 home loan with principal and interest repayments over a 30 year loan term. Lowering the interest rate by just 0.25% could result in a saving of more than \$24,000. Please note, this is a general example.

Granted this is calculated over the entire term of the loan, it shows that by closely watching and responding to interest rates on offer, you can potentially save thousands in repayments.

With all this in mind, should you choose to fix your home loan interest rate to take advantage of the lower rates?

The answer depends on your individual circumstances and the features of the loan.

Fixed and variable interest rate home loans both offer unique advantages and particular conditions that can impact your decision, depending on your personal and financial circumstances.

	LOAN A	LOAN B
Interest Rate	3.00% p.a	2.75% p.a
Loan Amount	\$500,000	\$500,000
Monthly Repayment Amount	\$2,108.02	\$2,041.21
Total Cost of Loan	\$758,887.26	\$734,834.13
Total Interest Paid	\$258,887.26	\$234,834.13

Before considering locking into a fixed interest rate loan, you need to consider all the pros and cons before taking action, including but not limited to the following:

Benefits Of Fixing

- Potential savings – The opportunity to take advantage of the difference in fixed and variable interest rates could potentially save you thousands.
- Payment certainty – Your repayments will not change during the fixed period regardless of whether interest rates go up or down. Accordingly there will be no unexpected surprises with your repayments.
- On track budget - Given there will be no unexpected surprises in your repayments you will be in a better position to keep your budget in order.

Downside Of Fixing

- Less flexibility - Generally, fixed rate home loans have a lot less features and flexibility. For example, if you come into additional money you will not be able to use this to pay down your loan to reduce future interest costs.

The majority of lenders will only allow a partial interest offset during a fixed rate period while some offer a 100% offset. Redraw may only be available for excess funds paid into the loan during the current fixed rate period up to the value of the prepayment threshold.

- Break costs – If your circumstances do change and you need to get out of the loan during the fixed term period, there are 'break' or 'exit' costs

that could cost you significantly more money than the savings afforded.

- Higher reversionary rate – This is the rate that your loan moves to at the end of the fixed term period. You may wish to renegotiate this at the end of the fixed term.

How do I get the best of both worlds? Many people choose to split their loan to benefit from having a proportion with fixed repayment certainty as well as the flexibility associated with a variable proportion.

What Is The Right Decision For You?

When it comes to your home loan, the best strategy is to talk with us first. If you're thinking about switching your loan to a fixed rate, call us to talk about your personal best option.

1 www.domain.com.au – Money Markets–star, Why a gulf has formed between fixed and variable interest rates – May 18, 2020

2 www.corelogic.com.au - Early Market Indicators, Clarity in uncertain times Report – June 28, 2020