

An explanation of early repayment charge

# Early Repayment of Fixed Rate Home Loans

for loans fixed on or after 26 September 2011



*Bank of New Zealand offers fixed rate loans with fixed terms of up to seven years to home owners.*

Although fixed rate loans offer interest rate certainty, borrowers need to be aware of the early repayment charge which may apply if they make a partial or full repayment of a loan before the end of its fixed rate period.

## What is an early repayment charge?

An early repayment charge may apply if a loan is fully repaid or you decide to switch to another interest rate before the end of its fixed rate period. It may also apply if a lump sum reduction is made, or if the overall repayment levels are increased before the end of the applicable fixed rate period.

## Why does the Bank charge an early repayment charge?

The Bank charges borrowers an early repayment charge to recover the loss the Bank incurs when a loan is partially or fully repaid, the customer switches to another interest rate, or a loan is repaid at an accelerated rate before the end of the fixed rate period.

When a customer takes out a fixed rate loan the Bank will exchange fixed interest for floating interest in the wholesale market. This is done to match the interest it must pay on the money it borrows (from its depositors or other banks) to fund loans to customers. In return for offering the customer certainty of interest rates, the Bank requires certainty of income. Suppose the customer repays the loan before the end of its fixed rate period, and relevant wholesale rates have fallen at the time of the proposed repayment. The Bank is still committed to pay fixed interest to the depositor (or other bank) for the remainder of the fixed rate period but is no longer receiving its fixed income from the customer. The early repayment charge calculates the loss to the Bank arising from this.

## When is an early repayment charge incurred?

An early repayment charge will be incurred when the wholesale rate for the remainder of the fixed rate period (at the time of early repayment) is lower than the original wholesale rate at the commencement of the fixed rate period (at the time the loan was fixed).

### For example

A three year fixed rate loan of \$100,000 is taken out. If the wholesale rate for three years at commencement of the loan is 8%, the Bank exchanges three years of 8% fixed interest for floating interest in the wholesale market. After two years the customer fully repays the loan, even though there is still one year left to run of the fixed rate period. The Bank is left with the obligation to pay 8% interest for one year in return for floating interest, but it can exchange this back again. However, suppose by this time the one year wholesale rate is 6% p.a. An early repayment charge will apply because the current wholesale rate is lower than that of the original exchange.

## How is the early repayment charge calculated?

An early repayment charge will apply if the wholesale rate at the time of early repayment is lower than the wholesale rate at commencement of the fixed rate period. The early repayment charge is based on the following three key factors:

- > The amount of the loan being repaid
- > How much lower current wholesale rates are compared to the original wholesale rate at the commencement of the fixed rate period
- > The time left on the fixed rate period

## Under what conditions will no charge apply?

No early repayment charge will apply if the relevant wholesale rate for the remainder of the fixed rate period is higher than, or the same rate as the original wholesale rate. No early repayment charge will be charged for customers with fixed rate loans (other than the Classic Home Loan), where they make a lump sum repayment and/or increase their repayments in any 12 month period during the applicable fixed rate period, as long as the extra repayments and lump sum repayments do not exceed 5% p.a. of the loan amount at the start of the fixed rate period. With our Classic Home Loan early repayment charges may apply to any lump sum repayment made during a fixed rate period.

## Options available

If you have a fixed rate home loan and are moving houses, you can avoid paying an early repayment charge using our Portable Home Loan feature by taking your home loan with you.

If you want to pay the early repayment charge and take a new loan at a lower rate for a longer period, or for more information, talk to your BNZ representative. The tables on the next page give an indication of the early repayment charge for every \$1,000 principal repaid early.

# Early repayment of fixed rate home loans

## Quick reference table

### Example: 25-year amortisation with a wholesale rate of 7%

(All charges are per \$1000 of principal repaid)

		Months before fixed rate period expires																			
		6	12	18	24	30	36	42	48	54	60	66	72	78	84	90	96	102	108	114	120
% current wholesale rate has fallen below the wholesale rate at the start of the fixed rate period	1%	5	10	14	19	24	28	32	36	40	44	47	51	54	57	60	63	66	68	71	73
	2%	10	20	29	38	47	56	64	72	80	87	94	101	108	114	120	126	131	136	141	146
	3%	15	29	43	57	71	84	96	108	120	131	141	152	161	171	180	188	197	204	212	219
	4%	20	39	58	76	94	111	128	144	159	174	189	202	215	228	240	251	262	272	282	292
	5%	25	49	72	95	118	139	160	180	199	218	236	253	269	285	300	314	328	341	353	365
	6%	30	59	87	115	141	167	192	216	239	261	283	303	323	342	360	377	393	409	424	438

Note: Results change with amortisation period, wholesale rate & discount curve. For example if the wholesale rate is higher the early repayment charge rate will be marginally higher.

### Example: 10-year amortisation with a wholesale rate of 7%

(All charges are per \$1000 of principal repaid)

		Months before fixed rate period expires																			
		6	12	18	24	30	36	42	48	54	60	66	72	78	84	90	96	102	108	114	120
% current wholesale rate has fallen below the wholesale rate at the start of the fixed rate period	1%	5	9	14	18	22	25	29	32	34	37	39	41	43	44	45	46	47	47	48	48
	2%	10	19	28	36	44	51	57	63	69	74	78	82	85	88	90	92	94	95	95	96
	3%	15	28	42	54	65	76	86	95	103	110	117	123	128	132	136	138	141	142	143	143
	4%	19	38	55	72	87	101	114	126	137	147	156	164	170	176	181	185	188	190	191	191
	5%	24	47	69	90	109	127	143	158	172	184	195	205	213	220	226	231	234	237	239	239
	6%	29	57	83	108	131	152	172	190	206	221	234	245	255	264	271	277	281	284	286	287

Note: Results change with amortisation period, wholesale rate & discount curve. For example if the wholesale rate is higher the early repayment charge rate will be marginally higher.

A customer takes a one year fixed rate loan of \$123,000 and the Bank exchanges fixed interest at a rate of 7% p.a. for floating interest for one year. After six months the customer decides to repay the loan early. The six month wholesale rate at that time is 6% p.a. In this instance the early repayment charge is based on a \$123,000 repayment with a rate difference of 1% p.a. over the remaining six months of the fixed rate period. The early repayment charge to the customer would be approximately \$615.

So, using the tables above:

- > Six months are remaining before the fixed rate period expires
- > The current wholesale rate for the remainder of the fixed rate period has fallen below the original wholesale rate by 1% p.a.
- > Therefore the early repayment charge is \$5 per \$1,000 of the loan principal amount
- > So the approximate early repayment charge is  $\$5 \times 123 = \$615$

If the customer wanted to prepay only \$35,000 of the loan (i.e. a partial repayment), then the approximate early repayment charge will still be \$5 per \$1,000 of the loan principal amount repaid and will therefore be calculated as follows:

- >  $\$5 \times 35 = \$175$