An explanation of early repayment charge

Early Repayment of Fixed Rate Home Loans

for loans fixed prior to 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 before the end of its fixed rate period. It may also apply if a lump sum reduction is made, or if the 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 before the end of the fixed rate period.

For example, when a customer takes out a fixed rate loan at say 10% p.a. the Bank will borrow the money (from its depositors or other banks) to fund the 10% p.a. loan over the same fixed rate period. 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 market interest rates have fallen to 8% p.a. at the time of the proposed repayment, the Bank is still committed to pay the depositor (or other bank) for the remainder of the fixed rate period, and must therefore re-lend the money for that remaining period at the new lower market rate of 8%.

Since the Bank will not be able to re-lend the money at 10%, it charges an early repayment charge to recover the loss.

When is an early repayment charge incurred?

An early repayment charge will be charged when the rate on the loan being repaid is higher than the current market rate which the Bank re-lends the money for the remainder of the fixed rate period.

For example

A three year fixed rate loan of $100,000 is taken out at 10% p.a. After two years the customer repays the loan, even though there is still one year left to run of the fixed rate period. As the Bank has had to borrow money for three years from its depositors or other banks at the beginning of the loan, the Bank is left with money it has to re-lend for one year. However, by this time the rate on a one year fixed rate loan is 8% p.a. An early repayment charge will apply because the current interest rate on a one year fixed rate loan is lower than that of the original loan. In this case the early repayment cost will be approximately $1,900.

How is the early repayment charge calculated?

The early repayment charge is generally based on three key factors:

> The amount of the loan being repaid;
> How much lower current interest rates are compared to the original rate on the loan;
> The time left on the fixed rate period.

A larger early repayment charge will apply if a larger loan with many years left in the applicable fixed rate period is fully repaid and interest rates have fallen a great deal.

A smaller early repayment charge will apply if a small loan is fully repaid with only a few months left and interest rates have fallen by a small amount.

Under what conditions will no charge apply?

No early repayment charge will be charged if interest rates for the remainder of the fixed rate period are higher than, or the same rate as the original interest rate on the loan.

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 year of the loan during the applicable fixed rate period, as long as the extra repayments and lump sum repayments do not exceed 5% p.a. of the original loan amount. With Classic Home Loan fixed rate loans and Treasury Loans, 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, you can avoid repaying the fixed rate loan early.

If you want to pay the early repayment charge and take a new loan at a lower rate for a longer term, 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 1: 25-year Term

Months before fixed period of loan expires

% Current Fixed Rate has fallen below Loan Rate	0	6	12	18	24	30	36	42	48	54	60	66	72	78	84	90	96	102	108	114	120
1.0%	–	5	10	14	18	22	26	30	33	37	40	43	46	49	52	54	57	59	62	64	66
2.0%	–	10	19	28	37	45	53	61	68	75	82	88	95	101	107	112	118	123	128	133	138
3.0%	–	15	29	42	56	68	81	92	104	115	126	136	146	156	165	175	184	192	201	209	217
4.0%	–	20	39	57	75	92	109	125	141	157	172	186	200	214	228	241	254	266	279	291	302
5.0%	–	25	49	72	95	117	138	159	180	200	220	239	258	276	294	312	329	346	363	379	395
6.0%	–	30	59	87	115	142	169	195	220	246	270	295	319	342	365	388	410	433	454	476	497

Example 2: 10-year Term

Months before fixed period of loan expires

% Current Fixed Rate has fallen below Loan Rate	0	6	12	18	24	30	36	42	48	54	60	66	72	78	84	90	96	102	108	114	120
1.0%	–	5	9	13	17	20	23	26	29	32	34	37	39	42	44	46	48	50	52	54	56
2.0%	–	10	18	26	33	40	47	53	59	65	70	76	81	86	90	95	100	104	108	113	117
3.0%	–	14	27	39	51	61	71	81	90	99	108	116	124	132	140	147	155	162	169	176	182
4.0%	–	19	37	53	68	83	96	110	123	135	147	159	170	181	192	203	213	223	234	243	253
5.0%	–	24	46	67	86	105	122	139	156	172	188	203	218	233	247	262	276	290	303	317	330
6.0%	–	29	56	81	104	127	149	170	191	211	230	250	269	288	306	324	342	360	378	396	413

Scale denotes payment cost per thousand dollars of the loan principal repaid

For example

A customer takes a one year fixed rate loan of $123,000 at a rate of 8% p.a. After six months they decide to repay the loan. The six month fixed rate at that time is 7% 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 a remaining period of 6 months. The early repayment charge to the customer would be approximately $615.

So, using the tables above:

> Six months are remaining before the fixed period of the loan expires

> The current fixed rate for the remaining fixed rate period has fallen below the original loan 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 x 123 = $615

If the customer wanted to repay 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 and will therefore be calculated as follows:

> $5 x 35 = $175

The information in this fact sheet is designed to give a general overview of how early repayment charges are calculated and why the Bank charges them. For full information or actual early repayment charge quotes, talk to your Bank of New Zealand representative.

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