

In a fix over rates

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RECORD low interest rates could be the signal to lock in a fixed mortgage -- although for thousands of households it has proved a major financial mistake.

Break fees to get out of fixed loan contracts can cost tens of thousands of dollars, while the alternative is to keep paying hundreds of dollars more every month for these now expensive fixed-rate mortgages.

But as the Reserve Bank of Australia pauses in its round of interest rate cuts, the big question arises again: fix or float?

Is a variable mortgage the right way to go or should you take a chance with historically low interest rates and lock them in now?

Even if the RBA cuts interest rates again, will any of the lenders pass it on to borrowers or will they skim it off as extra profit?

And what about the global financial crisis? It is not only households getting nervous about which way interest rates will go, but the experts too.

YourMoney canvassed industry leaders to get their take on fixing rates and break fees in these unusual times.

The broker

"The trend at the moment is a very small minority -- less than about 2 per cent -- are choosing to fix, presumably because they think rates are going to fall further," Mortgage Finance Association of Australia chief executive Phil Naylor said.

"If you fix now you are betting that rates are going to go up.

"If you go variable then you think that they are probably going to stay the same or go down.

"It gets back to being an individual choice. However, before fixing a loan always find out and factor in what the break fees will be," Mr Naylor said.

The consultant

"Break fees are often very large, because the banks have to match their funding and then unwind it," Fujitsu Consulting managing director Martin North said.

"One of our focus group members got a surprise with a break fee of over \$50,000.

“It's hard for people to navigate all this now and even harder to make the right choice on day one.

“We need better disclosure at the time loans are agreed in my view,” Mr North said.

“Should you fix? If you need certainty of repayment amount you might want to fix. Go for as long as you can aligned with your future plans.”

And what about those already suffering with a high-rate fixed loan?

“If your motivation is to lower your costs as much as possible, I would look at the difference between your break cost and the annual savings you would make,” Mr North said.

“If it's positive, then refinance into a variable loan because for the next few months I think rates will drift lower.

“Remember, fixed rates are synthesised from the variable rate and generally you will end up paying slightly more than on a variable rate.”

The strategist

“When you fix you're making a judgment that the thing that will hurt you the most -- higher interest rates -- needs to be insured against. That's what you're doing,” Macquarie Bank interest rate strategist Rory Robertson said.

“It's a matter of having your eyes wide open, but personally, I wouldn't be in a rush to fix.

“Put it this way: the RBA is under pressure to cut rates, not hike them.”

And on the subject of expensive break fees, it appears everyone is vulnerable.

“Break fees are the market value of reducing a risk,” Mr Robertson said.

“I've been there and done that. I've had a fixed mortgage and my experience is that if it doesn't go your way then you just have to suck it up. You've made a bad bet.”

“One of the big lessons in all of this is that no one is really that good at forecasting anything -- that's true of everyone, economists and analysts at the moment.

“We are in a global credit crunch, this is not just the pesky old banks being annoying. We are smack bang in the middle of a global credit crunch the likes of which we have never seen before.”

The analyst

“At the moment one-year fixed rates are at similar levels to the standard variable,” Canstar Cannex financial analyst Frank Lopez said.

“Three-year fixed rates are slightly higher and five-year slightly higher again.

“This indicates at the moment lenders feel that the rates now are going to be the average over the next 12 months.

“So the current rates will be the average rates for the next year or so,” Mr Lopez said.

“On a five-year basis the outlook is for the average rate to be about 1 per cent up from where it is now, so assume an average official rate of 4.25 per cent over the next five years.”

The lender

Non-bank lender Myrate.com.au said the lower interest rates went, the more expensive it was for people to break their fixed mortgage contracts.

“Probably the time to break a fixed loan was when rates first started to come down,” myrate.com.au managing director Kevin Sherman said.

“But having held on all the way down to pretty much near the bottom, you’ll essentially now be paying a big lump sum to break. In turn, you will then have to pay it off over the next five years, so it could be similar to just staying fixed.

“The worst decision would be if you break it and go variable and then interest rates quickly go back up again.”

However, Mr Sherman also said that in most situations the break fee, up to \$100,000 in some cases, would have to be refinanced into the new loan and some lenders might not want to provide such a big increase.

As to whether people should fix or float, the decision was ultimately their own.

“Even if the RBA does go another 2 per cent, lenders might not go anywhere near that. I’d say it was unlikely to see actual retail mortgage rates at 3 per cent, irrespective of the cash rate,” Mr Sherman said.

“The flip side to waiting is that once lenders start to feel themselves at the bottom, fixed rates will start to get more expensive.

“The downside of fixing now is fairly limited but there is no guarantee that they won’t go lower. But are we going to drop to 1 per cent? Probably not.

“Softening of interest rates is nearing an end so fixing now might start to be worth a look.”