

TO FIX OR NOT TO FIX – 18 September 2009

We have had an unprecedented period of low interest rates in Australia's history. These rates were dropped by the Reserve Bank of Australia during 2008 in response to the global financial crisis and its desire to stimulate the economy to avoid recession.

However, now that Australia has avoided a recession, it is probably likely that rates will start to rise as the economy gathers momentum and inflation again becomes a concern for the Reserve Bank. Remember that part of the Reserve Bank's function is to set monetary policy and they try to keep the rate of inflation within a band between 2% to about 4%. To do this they will adjust the cash rate up or down to keep the economy growth rate at levels that keeps the inflation rate within the band.

On everyone's mind is that eventually the rates have to go up. Already, we see the average fixed rates as follows:-

3 year fixed rate	7.24%pa
5 year fixed rate	7.79%pa
10 year fixed rate	8.24%pa

Currently the average basic home loan variable rate is 5.09%pa.

So to fix your rate now means that you are going to pay above the variable rate that you would otherwise pay on a basic home loan. So it becomes a difficult decision whether you should fix your home loan rate now or not at all.

There are a number of factors you should consider before making this decision.

- Do you intend to sell your property in the near future? – It is probably not worth fixing and then incur a break cost.
- If rates were to go up could you still afford to make the payments? – If not, then consider fixing.
- If you are employing mortgage reduction strategies and regularly have offset cash – then it would not be worth fixing.
- Do you lie awake at night worrying that rates are going to hit the roof over the next 5 or so years? – Then, you should consider fixing.
- Will you be severely impacted by the inflexibility of a fixed loan? – Then, don't fix.
- If you are looking at investment property loans, then it may be more advantageous to fix because you are getting a tax deduction for the interest. This reduces the cost after tax and you are gaining certainty in the rate.

Some disadvantages of fixing your loan:-

- Fixed loans are inflexible.
- Your ability to make extra payments is severely limited.
- If you break the loan for whatever reason, you will be charged break costs although this could be reduced in an environment of rising rates.
- You cannot employ mortgage reduction strategies such as balance offset accounts and lines of credit.
- Fixed loans generally are not portable from property to property. Doing so generally triggers a break in the loan contract.
- You cannot top up fixed loans – you can add variable loans though.
- They generally have no redraw ability.

As you can see in the following simulation, one should not fix their rates based on trying to predict the future rise of the variable rate. This is fraught with danger. It is highly speculative to attempt to predict whether you will save interest based on a decision to fix or not. When viewing the following simulator, we have attempted to predict future variable rates. From this you can see that there is no advantage in fixing. However, this is a simulation only and you need to predict future rises in variable rates over 5 years to be able to calculate this simulation. We will **not** attempt to assist you in predicting future variable rates.

There are some ways where if you do want to fix, you can mitigate some of the disadvantages as follows:-

- Fix part of the loan only. Set the splits based on how much you expect to pay off over 5 years and keep that component variable. All lenders allow loan splits.
- There is one lender that allows offsetting against a fixed loan with limited re-draw.
- Choose a lender with fixed loans that allow some limited ability to pay off extra over the term.

We are happy to discuss with any client any concerns about how rates can affect your lending situation. Please call us for a free consultation on **07 3396 7757**

Derek Miles
Principal

Loan Amount	\$250,000
Term	5
Fixed Rate	7.79
Variable rate year 1	5.09
Variable rate year 2	6.25
Variable rate year 3	7.90
variable rate year 4	9.50
variable rate year 5	10.50

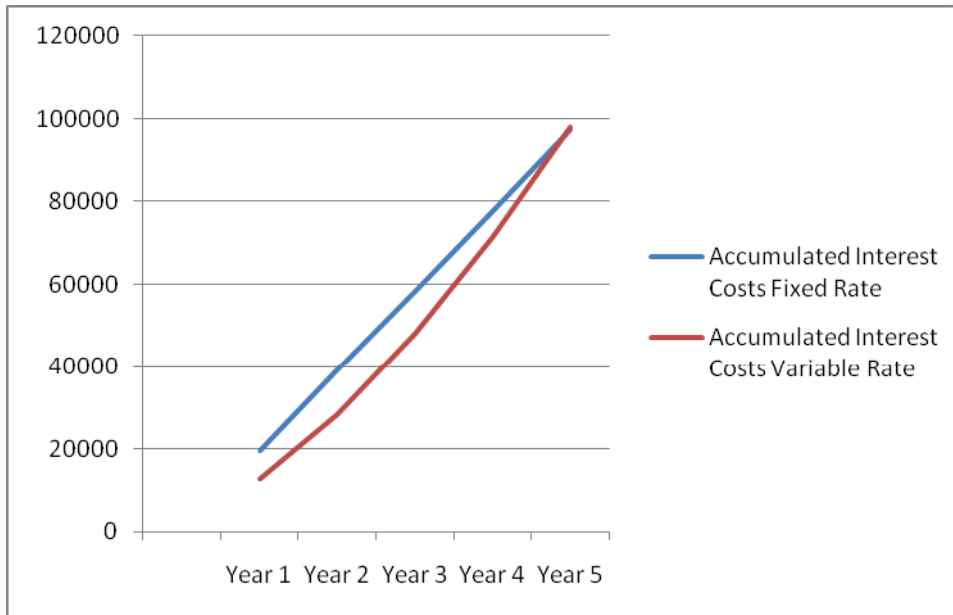
Accumulated Interest Costs

	Fixed Rate	Variable Rate
Year 1	\$19,475	\$12,725
Year 2	\$38,950	\$28,350
Year 3	\$58,425	\$48,100
Year 4	\$77,900	\$71,850
Year 5	\$97,375	\$98,100

Annualised Interest Costs

	Fixed Rate	Variable Rate
Year 1	\$19,475	\$12,725
Year 2	\$19,475	\$15,625
Year 3	\$19,475	\$19,750
Year 4	\$19,475	\$23,750
Year 5	\$19,475	\$26,250

Accumulated Interest Costs



Annualised Interest Costs

