



Break Costs & Advance Repayment Costs for Fixed Rate Home Loans

This document has been prepared to help you better understand the calculation of break costs and advance repayment costs for fixed rate home loans at IMB. Although the definitions of break costs and advance repayment costs may be difficult to understand, we have attempted to clarify these definitions by providing examples of their application.

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1. Break Costs

1.1 Break costs – definition

Depending largely on movements in market interest rates, IMB may suffer a loss if you are under a fixed rate home loan option and, before the end of your fixed rate period:

- (a) convert to the variable rate option; or
- (b) convert to another fixed rate option; or
- (c) repay all of the total amount owing; or
- (d) are in default and the total amount owing becomes immediately due for payment; or
- (e) partially repay the total amount owing and have your minimum monthly repayments recalculated.

You are deemed to have repaid early if any of the above occur.

We calculate break costs and our calculation binds you and us. Generally we calculate break costs as follows:

1. We calculate the present day value of the repayments we would have received from the time of the break to the end of the fixed rate period (assuming that you had not “broken the loan”, had not paid any amounts in advance prior to the break, had no amount due but unpaid at the time of the break, and had made all repayments when due). If these repayments would not have repaid the loan in full, we then add the present day value of the amount that would have been needed to repay the loan in full on the last day of the fixed rate period. To determine the discount rate to be used to calculate present day values, we use the current fixed loan rates offered by us at the time of the break;
2. We then calculate the total amount owing and, depending on whether your loan is in advance or in arrears, either add any amount paid in advance prior to the time of the break, or deduct any amount that is due but unpaid at the time of the break (excluding amounts that are due because you repay the total amount owing early or are in default, so that the total amount owing has become immediately due for payment); and
3. If the amount we calculate under 1 is greater than the amount we calculate under 2, then:
 - (i) where any of events (a) to (d) above occurred, the break costs you must pay us will be the difference between the amounts calculated under 1 and 2; or
 - (ii) where event (e) above occurred, we determine the proportion which the partial repayment represented of the amount calculated in 2, and the break costs you must pay us will be that proportion of the difference between the amounts calculated under 1 and 2;
4. Otherwise, if the amount we calculate under 1 is less than the amount we calculate under 2, then there are no break costs payable to us.

Warning

Break costs can be quite high. We suggest you ask us for an estimate of the break costs and seek independent financial advice before you repay early during a fixed rate period.

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1.2 Break costs – example

An IMB member takes out a \$100,000 home loan with principal and interest repayments to be made over 25 years. This member chooses to fix the interest rate for 5 years and makes the minimum monthly loan repayment of \$703.59 each month. However, 3 years later on the repayment date, this member decides to break out of their 5 year fixed rate period to either repay the loan in full or convert the loan to another interest rate option.

Break costs are not automatically payable in these circumstances. Break costs will become payable where you are under a fixed rate option, and you convert your loan to any other rate option, repay your loan in full or partially repay your loan and have your repayments recalculated, and this causes IMB to suffer a loss.

To determine whether IMB has suffered a loss in these circumstances, we use the break cost formula outlined in the break costs definition (section 1.1). The basic variables used in this formula are as follows:

Original loan amount	\$100,000
Loan term	25 years
Fixed rate period	5 years
Fixed interest rate	6.95%p.a.
Remaining term of fixed rate period (at time of break)	2 years
Discount interest rate*	6.25%p.a.

* This is IMB's applicable fixed interest rate (at the time of the break) which would apply to the remaining period of the fixed rate term (ie the initial 5 year fixed rate period had 2 years remaining, and hence, the discount interest rate used in the break cost calculation would be IMB's 2 year fixed interest rate).

Using the break cost formula and the above details, in these circumstances IMB would have suffered a loss when the member broke out of their 5 year fixed rate period after 3 years. The break costs payable by this member would be approximately \$1214.22 (see example (ii) below).

Further examples of break costs that would be payable by this member if they broke out of their 5 year fixed rate period after 1, 2, 3 or 4 years are shown below. These examples assume the same circumstances as above, however varying future interest rate scenarios have been provided. That is, the discount rate has been adjusted to reflect the situation where interest rates increased, remained the same, or decreased over the initial 4 years of the fixed rate period.

(i) Examples of break costs where fixed rates have increased:

Years remaining on fixed rate term (at the time of break)	Scheduled loan balance at the time of the break	Discount interest rate	Break cost payable
4	\$98,458.39	7.25%	Nil
3	\$96,806.17	7.00%	Nil
2	\$95,035.38	6.75%	\$345.02
1	\$93,137.53	6.50%	\$397.03

Note: Where this member breaks out of their fixed rate after 1 or 2 years, IMB does not suffer a loss, and hence, no break costs are payable.

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(ii) Examples of break costs payable where fixed rates remain the same:

Years remaining on fixed rate term (at the time of break)	Scheduled loan balance at the time of the break	Discount interest rate	Break cost payable
4	\$98,458.39	6.90%	\$164.65
3	\$96,806.17	6.75%	\$506.40
2	\$95,035.38	6.25%	\$1214.22
1	\$93,137.53	6.10%	\$751.81

(iii) Examples of break costs where fixed rates have decreased:

Years remaining on fixed rate term (at the time of break)	Scheduled loan balance at the time of the break	Discount interest rate	Break cost payable
4	\$98,458.39	5.90%	\$3527.66
3	\$96,806.17	5.75%	\$3086.15
2	\$95,035.38	5.25%	\$2981.38
1	\$93,137.53	5.10%	\$1646.54

Note: All of the above scenarios and all other amounts in this document are intended as a guide only. A number of assumptions have been made in these calculations, for example, we have assumed that the member only makes the minimum loan repayments during the periods shown, however break costs may be payable regardless of the amount of loan repayments made. For an accurate assessment of any potential break costs payable for your loan if you decided to switch rate options, please contact IMB DIRECT on 133 IMB (133 462).

2. Advance Repayment Costs

2.1 Advance repayment costs – definition

If the schedule states your account is under a standard fixed rate home loan option and, at any time during the fixed rate period, repayments you have made to date exceed your scheduled monthly repayments by more than twelve (12) times the scheduled monthly repayment, you may be required to pay us an amount equal to our reasonable estimate of any loss we suffer. This amount is called “advance repayment costs”. We calculate the advance repayment costs and our calculation binds you and us.

Where you are required to pay advance repayment costs these will be calculated in respect of each day and debited to your loan account on the last calendar day of each month.

Note that advance repayment costs are not payable by you if you do not make any extra repayments on your loan, or if you make extra repayments but the total repayments which you have made to date do not exceed the scheduled monthly repayments to date by more than twelve (12) times the scheduled monthly repayment.

Generally, we calculate advance repayment costs as follows:

- (1) We determine the advance repayment rate to be used for each day during the month by calculating the difference between the fixed rate applying to your loan and the 30 day Bank Bill Swap rate for the last day of the previous calendar month, and then dividing this difference by 365. Note that if the relevant 30 day Bank Bill Swap rate for the last day of a month is greater than the fixed rate applying to your loan, then no advance repayment costs will be payable by you in respect of the following month;
- (2) We determine the advance repayment amount for each day during the month by calculating, at the end of the day, the amount by which the total loan repayments you have made to date is greater than the total of the scheduled repayments to date plus twelve (12) scheduled monthly repayments; and
- (3) For any particular day, the amount of the advance repayment costs payable by you is the amount calculated by applying the advance repayment rate calculated under (a) to the advance repayment amount calculated under (b).

2.2 Advance repayment costs – example

There is no limit to how many extra loan repayments a member may make on their loan. However, if a member is in a fixed rate period and makes extra loan repayments which amount to more than twelve (12) extra scheduled loan repayments, then this member may have to pay advance repayment costs.

Using the same member as in the break cost example (section 1.2), their scheduled monthly loan repayment during the fixed rate period was \$703.59 (the 5 year fixed rate being 6.95%pa). If this member had made *extra* loan repayments which at all times during this fixed rate period amounted to less than \$8,443.08 (which is 12 x \$703.59), then no advance repayment costs would be payable.

However, if this member made extra loan repayments which at any time in the fixed rate period amounted to *more than* \$8,443.08, then advance repayment costs may be payable (but only for the days on which the extra repayments amounted to more than \$8,443.08 and only on the amount which was in excess of the twelve extra repayments – not the whole extra amount repaid).

Where a member makes extra repayments which amount to more than 12 times their scheduled loan repayment, the actual amount of the advance repayment cost will be calculated for each day that this occurs. This requires a comparison of the fixed rate on their loan with the 30 day Bank Bill Swap Rate (refer to section 3 for more information regarding this rate).

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To calculate the total advance repayment cost for any month, we add together the advance repayment cost for each day of the month.

For example, if we assume that:

- the member made *extra* loan repayments which amounted to 14 times their scheduled loan repayment (ie 14 x \$703.59 = \$9,850.26);
- these extra repayments remained in the loan account for the whole of the month of May; and
- the relevant 30 day Bank Bill Swap Rate was 4.83% during this period,

then the amount of the advance repayment costs for each day would be calculated as follows:

$$\text{Advance Repayment Amount (ARA)} = \$9,850.28 - \$8,443.08 = \mathbf{\$1,407.20}$$

$$\text{Advance Repayment Rate (ARR)} = 6.95\% - 4.83\% = \mathbf{2.12\%}$$

$$\begin{aligned} \text{Advance Repayment Costs} &= \text{ARA} \times (\text{ARR} / 365) \\ &= \$1,407.20 \times (2.12\% / 365) \\ &= \mathbf{\$0.0817} \end{aligned}$$

The same process is followed to calculate the advance repayment cost for each day of May.

In this example, the amount of extra repayments in the account remained the same for the whole of the month of May, so the advance repayment cost for each other day of May would also be \$0.0817. The total advance repayment cost for the month (31 days) is then: \$0.0817 x 31 = \$2.53.

Thus, the advance repayment costs payable by this member for being in advance on their loan throughout May by 14 times their scheduled loan repayment would be **\$2.53**. This amount would be debited to the member's loan account. See over for more examples.

The following examples are all based on the previous member's loan details, however to show the amount of advance repayment costs payable in various situations, we have varied the amount of extra amounts this member has repaid and the fixed interest rate that applies on their loan. Note that the repayment amounts listed are the *extra* amounts that the member has repaid in *excess* of four times their scheduled monthly repayment and this extra amount existed for the whole of a 31 day month.

Scheduled monthly repayment amount	Amount the loan repayments are in excess of twelve times the scheduled monthly repayment	Some of the potential fixed interest rates on the loan	30 day Bank Bill Swap Rate (actual rate for April 1999)	Advance repayment cost payable for the whole month (31 days)
\$703.59	\$1,000.00	5.40%	4.83%	\$0.48
		6.95%	4.83%	\$1.80
\$703.59	\$2,110.77	6.95%	4.83%	\$3.80
\$703.59	\$5,000.00	5.40%	4.83%	\$2.42
		6.10%	4.83%	\$5.39
		6.95%	4.83%	\$9.00
\$703.59	\$10,000.00	5.40%	4.83%	\$4.84
		6.10%	4.83%	\$10.78
		6.95%	4.83%	\$18.00
\$703.59	\$20,000.00	5.40%	4.83%	\$9.68
		6.10%	4.83%	\$21.57
		6.95%	4.83%	\$36.01

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3. Bank Bill Swap Rate

What is the 30 day Bank Bill Swap Rate?

This is one of the wholesale short-term interest rates used by financial institutions to determine interest rates for loans.

Why does IMB use the 30 day Bank Bill Swap Rate to calculate advance repayment costs?

Where a borrower makes extra loan repayment amounts on their fixed rate loan, IMB is not sure if or when the borrower may want to redraw these extra loan repayments in the future.

To ensure that IMB has sufficient funds available for members if they wish to redraw their extra loan repayments, IMB cannot re-loan or invest these amounts for any long periods of time – the funds must be available to meet our borrowers' redraw needs if and when they arise. Therefore IMB can only invest these funds in the short-term money market. The interest rate IMB receives for these investments is based on the 30 day Bank Bill Swap Rate. The cost to IMB for allowing loan repayments in excess of the scheduled loan repayment amounts is calculated by comparing the fixed interest rate on the relevant loan and the 30 day Bank Bill Swap Rate at that time.