

SHOULD I FIX OR FLOAT?

- Allistar Walker

It gets harder to breathe easier when you are still paying over 9% as interest rates sink to below 7% and look like sinking lower. Then you ask your broker or bank what is the cost to break and find out it is in the thousands! You curse the banks as 'greedy and so's, vowing that when the opportunity arises you will switch lenders.

Unfortunately, there is more to it. Often not enough thought goes into how long one should fix for, or what amounts to fix. Different situations may require different actions. Just because one lender has a cheap rate for a particular term, doesn't mean to say that will be the right option or strategy, long term, for you.

It is a contract between you and the bank. They buy money for a certain price at a certain term. They then lend that money at that price plus a margin.

Take that a step further. The rates go down, but you think you should be able to waltz out of your contract (remember you were keen enough to do it when taken out) without cost and take a newer cheaper contract. Well, it wouldn't be a contract if you could do that, would it? The bank is equally tied by contract and couldn't go back to their lender, which could be your Mum and Dad with a fixed term deposit and say 'You know that 8%pa we agreed to pay you for your money for 3 years, well, we have just changed the rates and will only give you 6% pa now, sorry.'

Will it pay me to break my existing fixed rate?

Currently, I would say probably not. We are in a still downward trending interest rate environment and there are some points to observe or understand in making such a decision.

- The low point in the interest rate cycle will possibly be reached sometime next year – it is not a science and therefore not exactly predictable. It may even be hindsight when we know where the low point is/was.
- There is no point in re-fixing unless you are re-fixing for a longer (lot longer) term than is left on the existing term.
- There will almost definitely be a cost breaking from a higher interest rate to a lower interest rate. That cost will depend on the difference between the two rates and the time that your existing rate has to run. The bigger the difference and the longer the time, the greater the cost.
- The term you elect to fix for is a gamble. Economists, bankers, brokers etc cannot accurately predict where rates will be 6 months, one year or in five years time. We can all make 'best guesses' based on economic and other data held at the time. But, as I said earlier, it is not a science and influencing factors beyond our control, change such forecasts. There are no gurus.
- If you are an investor, tax remedies for loss are available and could make a break in fixed rates worthwhile.

If I were floating at the moment, I would fix for no more than 6 months at under 7%. After 6 months I would be looking to either float (possibly around 7.25%) until I thought a low point had been reached or fix long term, particularly if long term rates were under 7%. If the low point was reached before my 6 months was up, I would probably break it as the cost for this term and at current rates would be minimal.

Alternative Strategy

This is to split up the loan into different fixed rate maturities. Given that no one really knows what is going to happen, you are taking an insurance against having all your eggs in the one decision basket.

A good broker will have you on a 'rate watch' to help you through this process. Always remember though, it is up to you to understand what you are doing and for what reasons.

We are happy to help people through this process or structure their borrowing to benefit them and help quit the mortgage stranglehold earlier.

Allistar Walker is a Senior Fellow of Financial Services Institute of Australasia and an accredited mortgage and insurance advisor. His full disclosure is available at www.mortgagehelp.co.nz or he can be contacted at 410 6023 and enquiry@mortgagehelp.co.nz