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With Interest Rates dropping, should I break my fixed rate loan?

The answer is it depends. I have looked at two examples recently and came up with different answers for each.

The first example was my home. The fee to break my loan 18 months early equated to 2% of my loan, and my savings over the same 18 months (assuming I refixed for the remaining 18 months) was 1.7%. I was reluctant to float as most banks have the floating rate above the fixed rates! However, I will keep an eye on the rates and I might break it to refix for an attractive long term rate sometime in the next 12 months.

The second example was for a farming loan. The fee to break 2½ years early was equivalent to the interest that would be saved in the next 12 months, assuming interest rates remained the same. A betting man would probably pick a further drop when the Reserve Bank reviews rates next on 10 September. Based on this and the farmer’s belief that interest rates will remain low for at least 12 months, they are likely to break this. They are also dairy farmers so capitalising the break fee and paying a lower monthly interest payment is also attractive from a cashflow perspective.

The different outcomes were for different banks and would also reflect different formula’s used between home loans and commercial borrowing. So if you are considering it, request your break fee from the bank and look at the cost versus the benefit for your situation.

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