BOQ SPECIALIST
Distinctive banking

Break Cost Fact Sheet

July 2019

A fixed rate loan gives you the certainty of knowing exactly what your repayments will be for the term that you choose. If variable rates rise and you are on a fixed rate loan you won't face higher repayments. On the flip side, when variable rates fall and you have a fixed rate loan, you do not receive the benefit of lower rates and repayments.

What is a break cost?

A Break Cost is the calculated amount of the loss which we suffer if you choose to break your fixed rate loan contract with us. This loss is passed onto you as a Break Cost.

Why does the bank charge break costs?

When you decide to fix your loan interest rate, we enter into a contract with you to fix the interest rate for your loan for a specified period. To enable us to fund your loan, we enter into a contract with a third party to lock in our funding costs at a fixed rate for the same period as your contract with us. Under Australian law if someone breaks their contract and the other party suffers a loss as a result, the person who breaks the contract is required to compensate the other party for that loss.

When does the bank charge a break cost?

When you switch or pay out your loan early (in part or full) you are choosing to break your contract with us by exceeding your extra payment limit. In turn, this forces us to break our funding contract with the third party.

How do we calculate break costs?

We use a formula to calculate whether we have incurred a loss as a result of the extra payment or switch. The formula is complex, but in general terms if our current wholesale rate for the remaining part of the fixed term is lower than the original wholesale rate when the fixed rate period started, then a Break Cost will be charged. The difference between the wholesale rate at the start of the fixed rate period for the contracted fixed rate term and the rate on the day of the extra payment for the remaining fixed rate term is known as the Interest Rate Differential.

The formula can be approximately expressed as:

Break Cost = Loan amount prepaid * (Interest Rate Differential) * Remaining Term.

Example 1

- A customer enters into a Motor Vehicle Chattel Mortgage Loan Agreement for 3 years on a fixed rate of at 3.99% p.a. The amount financed is $30,000.
- The customer decides to fully repay the outstanding principal amount with 1.5 years of the loan's original fixed term remaining.
- The 3 year wholesale rate on the date the loan was fixed was 3.45% p.a. but the rates have fallen since then. The current 1.5 year wholesale rate when the contract was broken was 2.23% p.a.
- The difference between the wholesale rates on the date the loan was fixed and when the contract was broken is 3.45% less 2.23% = 1.22% Interest Rate Differential
- The approximate Break Cost would therefore be: $30,000 x 1.22% x Remaining 1.5 Years = $549

Example 2

- A customer enters into an Equipment Finance Lease Agreement for 4 years on a fixed repayment amount of $3,427 per month. The amount financed is $150,000.
- The customer decides to terminate the finance lease 1 year before expiry date.
- The 4 year wholesale rate on the date the lease was fixed was 3.85% p.a. but the rates have fallen since then. The current 1 year wholesale rate when the contract was broken was 2.89% p.a.
- The difference between the wholesale rates on the date the lease was fixed and when the contract was broken is 3.85% less 2.89% = 0.96% Interest Rate Differential
- The approximate Break Cost would therefore be: $150,000 x 0.96% x Remaining 1 Year = $1,440

Example 3

- A customer enters into a Goodwill Loan Agreement for 5 years on a fixed rate of 5.80% p.a. The amount financed is $750,000 with principal and interest repayments.
- The wholesale rate to the bank to secure the "funds" for the customer for the 5 year term is 3.80% p.a. The 3.80% p.a is the cost to the bank.
- The customer then choses to fully repay their outstanding principal amount in full before the end of the 5 year term. The remaining fixed term is 2 years at date of early termination.
- The wholesale rate to the bank for the remaining 2 years has decreased from 3.80% p.a to 3.25%.
- The difference of 0.55% needs to be applied against the amount financed by customer as the Interest Rate Differential.
- The drop in wholesale rates is a loss to the Bank. This is passed onto the customer.
- The approximate Break Cost would therefore be: $750,000 x 0.55% x Remaining 2 Years = $8,250.

Example 4

- A customer enters into a Property Mortgage Loan Agreement for 5 years on a fixed rate of 4.80% p.a. The amount financed is $1,000,000 with principal and interest repayments.
- The 4.80% p.a is the interest rate to the customer. However, the wholesale rate to the bank to secure the "funds" for the customer for the 5 year term is 3.80% p.a. The 3.80% p.a is the cost to the bank.
- The customer then choses to fully repay their outstanding principal amount in full before the end of the 5 year term. The remaining fixed term is 3 years at date of early termination.
- The wholesale rate to the bank for the remaining 3 years has decreased from 3.80% p.a to 3.60% resulting in a 0.20% Interest Rate Differential.
- The difference of 0.20% needs to be applied against the amount financed by customer as a "Break Cost" to the 5 year fixed rate contract.
- The drop in wholesale rates is a loss to the Bank. This is passed onto the customer.
- The approximate Break Cost would therefore be: $1,000,000 x 0.20% x Remaining 3 Years = $6,000.

Termination fee

A termination fee applies in addition to the calculated Break Cost amount.

How can you minimise break costs?

Entering into a fixed rate term contract implies you are seeking protection against rising rates and higher repayments. If you want flexible payment alternatives discuss your needs with us and we can look at restructuring your loan to meet your needs.

Important Information

You can obtain details of the Break Costs payable on your loan at any time from your Finance Consultant.

These Break Costs will only apply for the moment in time that you switch or payout your loan. As the wholesale rates change from time to time the actual Break Cost amount can vary from moment to moment.

Should you require further explanation on the detailed formula for how your Break Cost was calculated you should seek qualified independent advice.