INTEREST RATES SERIES PART 3:

TO FIX OR NOT TO FIX – THAT IS THE QUESTION!

With interest rates at an all-time low, it's understandable that homeowners are wondering if a fixed rate home loan is the right product for them. And if a fixed rate loan is more financially viable over variable, should they wait for rates to drop even further... If they do, that is?

Unfortunately, there is no crystal ball to predict that rates will continue to fall – despite the Reserve Bank indicating they are likely to drop them even further. As history has shown, a cut by the Reserve Bank doesn't mean the banks will necessarily follow suit - largely due to the higher lending standards imposed by the Government Regulator, APRA.

So based on the above, and assuming the current interest rate is what homeowners can expect to see for a while yet, should a fixed rate home loan be a serious consideration?

In our opinion and as a general rule... probably not. While taking advantage of a lower interest rate and moving to a fixed loan can seem financially smart, and provides certainty when managing the household budget and cash flow, there are two key reasons to indicate you won't be winning in the long-term.

- **Reason 1: It's a gambling game**

  The Reserve Bank has recently indicated that interest rates are likely to be cut lower by them. That doesn't mean that all banks will pass on the interest rate cut, as other things are going on in the background of banks. The Government Regulator, APRA, has been setting higher lending standards. That means it is harder for banks to lend, which in turn means that they may not pass on the whole interest rate cut. Interest rates as a whole are likely to go down, or at least be maintained at these current levels.

- **Reason 2: Capped annual repayments**

  Fixed loans typically only allow an additional $10,000 per year to be repaid off the loan, without homeowners being charged an early payout penalty. While this may not be an issue for some people, we do recommend homeowners review their contracts and confirm this clause with their bank before moving to a fixed interest rate. This is one trap that is easy to fall into.

Still thinking of going ahead with a fixed interest rate?

If you do decide to fix your interest rate, AAG recommends the following food for thought:

- Think shorter term and choose a period of time that allows you to change back to variable sooner. When a fixed interest rate period expires you can usually lock away another fixed rate term if that is what you want to do, but by thinking short-term you have the option of moving back to a variable rate sooner.
- Consider splitting your loan into two separate loans, one with a fixed interest rate and the other variable. This gives you the benefit of a fixed rate that is not going up on part of your debt, while taking advantage of a rate drop if it happens on the other loan. You can also make additional repayments on your variable loan if you're in a position to do so.
- If you do split your loan, you can also consider interest-only for your fixed rate loan versus principal and interest on your variable rate loan. The subsequent boost to your cash flow from not paying any principal off the fixed loan, may allow you to pay additional capital off your variable loan.

There are other loan types that offer fixed and/or variable interest rates, and in these situations individuals can be strategic. For investment loans and tax planning, it's worth considering an 'interest in advance' option, which requires an individual to pay a whole year's worth of interest in advance. Another benefit of this strategy is that by fixing the interest rate for your tax deductible investment loan and leaving your owner-occupied home loan variable, you can work on paying down the home loan debt where there is no tax benefit.

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At the end of the day, choosing fixed over variable is a personal choice, with individual circumstances playing a large part in determining the risk factors involved with either option. As always, the AAG team recommends seeking professional advice before making any big changes to your loan structure, and that individuals consider their overall financial goals, tax structure, cash flow and income to ensure they're making an informed decision.

If you have any further questions regarding home loan options, please contact us on (08) 9227 6300 or email clientservices@austasiagroup.com.

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