



# REFIXING YOUR MORTGAGE

A Comprehensive eBook Guide



**MORTGAGELAB**

.CO.NZ



# REFIXING YOUR MORTGAGE

Refixing your mortgage is a bit like brushing your teeth, it can feel like a chore but it's worth doing promptly and doing it right. This ebook will give you everything you need to know to keep your mortgage sparkling and with no cavities. Okay, the teeth metaphor only works to a point but we know you get it.

## In this book, you'll learn:

- What you need to ask yourself when it comes time to refix
- Whether it is worth breaking a fixed-term early if interest rates are
  - on the rise
- Whether it is worth refinancing to another bank for a better interest rate
- Refixing short term vs long term
- The basics everyone should know about refixing
- How Mortgage Lab can help you manage your refixes





## 3 QUESTIONS YOU NEED TO ASK WHEN REFIXING YOUR MORTGAGE RATE

Deciding whether to fix your mortgage for a short term (one to two years) or lock in a longer term (three to five years) is one of the key decisions for anyone with an interest rate that is due to mature. With interest rates looking likely to continue to rise, what questions need to be considered when deciding how long you fix for?

Here are the 3 key questions to ask before you refix your mortgage:

### 1. AM I GOING TO SELL MY HOUSE PRIOR TO A FIXED-TERM MATURING?

This question should always be considered because fixing your mortgage can mean break costs if you sell before the next maturity date.

Leaving your mortgage on a 'floating rate' - which is what occurs if you don't fix your mortgage - means paying a higher interest rate. You would want to decide whether you're selling reasonably quickly. And you would want to plan to put your house on the market in the following three months (meaning settlement would usually be four to five months), for a floating rate to be a better option than fixing for one year.

Tip: If you have an estimated sell date for your property, try not to fix for much longer than that date. Eg; if you're looking to sell in 9 months, you could fix for a year but not several years.





## 2. HOW CONFIDENT AM I IN MY REGULAR INCOME OVER THE NEXT YEAR?

It is always good to make additional payments on your mortgage, but if your income is uncertain you may not want to commit to higher payments on your fixed rates for the next year. There are a few other ways that extra payments can be made onto a mortgage, either through lump sum payments or through revolving credit/offset accounts. If you are not confident in your employment or income stability, consider paying off your mortgage in a way that you still have access to those payments if you lose your job.

While getting the cheapest interest rate is great for your mortgage, make sure to spend 10 minutes planning out your next one to two years and running through a few worst-case scenarios to make sure, if unexpected changes occur - particularly in your income - that you have the means to carry on paying your mortgage.

## 3. SHOULD I MAKE MY MORTGAGE INTEREST ONLY FOR A SHORT TIME?

By default, the banks like home-owners to be paying down their mortgage. As your debt reduces, the bank's loan to you is more secure (they are loaning you a lower percentage of the house's value). So for quite a while now, they have enforced a maximum of two years of interest only on mortgages for your own home and five years of interest only for your investment property (this varies from bank-to-bank).

But if you are uncertain of your income or have some unexpected increases in your expenses (illness or maternity leave are typical examples of this), it can sometimes be beneficial to ask to put your mortgage onto interest only for a short time. It reduces the minimum amount that you regularly need to pay the bank and means you can divert your income to the more pressing expenses. You can also mix this interest only option with the revolving credit option above meaning you can still pay down your mortgage in the meantime but if you really need to reduce your payments, you'll only be paying interest only .

Note: Some care should be taken with this strategy; most importantly make sure you're choosing interest only for financially sound reasons.





## SHOULD YOU BREAK YOUR RATE EARLY IN CASE **INTEREST RATES** RISE EVEN MORE?

A question that is common in the market is; should homeowners break their current low rate to lock in these higher rates on the off-chance that mortgage rates continue up even further? In other words, pay a little penalty now, to save even more pain in the future.

### HERE'S WHAT YOU NEED TO THINK ABOUT IF YOU'RE LOOKING AT THIS STRATEGY:

**1: How long do you have to go on your current fixed rate?** It may be one month, it may be a couple of years. You need to know this because in the next section you're going to try and guess (and it will absolutely be a guess) what the interest rate will be when your fixed rate is due to mature.

*(Note that, if your fixed mortgage rate is within one to two months of maturing, you may be able to fix your new rate today. Ask your bank how far out you can fix - banks range from 30-60 days from maturity date. If the maturity date is further away than that, you'll need to move to the next section.)*

**2: Where do you, or what does the market, think interest rates will be when your current fixed rate is due to expire?**

For example, if your maturity date is six months away from expiring, what will mortgage rates be like in six months' time? Could they be 1% higher? Let's say, for this example, you thought the interest rates were going to be 0.5% higher in six months' time. Now you've guessed what the cost in the future is, it's time to figure out what the cost will be in taking today's rates.





### 3: How much premium will you pay in the meantime to lock in today's mortgage rates?

In other words, if you are currently fixed at 5% and you can break that rate and fix it at 5.5% you will be paying a 0.5% premium (5.5% minus 5%). But in the example above, the fixed rate was half a year away, so the premium is actually half that. For this example, the premium is 0.25%.

*(Note: In a market where interest rates are rising, it's unlikely that you will pay any serious break fees as rates have increased so much, but it's always worth asking just to make sure. Factor this in as a cost if necessary.)*

So for this example, you'll pay an additional 0.25% of your mortgage to save yourself from a further increase of (what you believe to be) a 0.5% p.a. increase in the future. On the face of it, that looks like a good reason to break...

...If you're still with us, thanks for sticking around.

## HERE'S WHY WE THINK THIS STRATEGY IS NOT GREAT AND ALMOST ALL HOMEOWNERS SHOULD AVOID IT:

- We're currently in quite turbulent economic times and forecasting interest rates is pure guesswork. It's almost as likely that the interest rates will be near to where we are now as it is that they will have increased 1% or 2%. The only thing you can be 100% sure of is that, by breaking the current lower rates, you are definitely paying a premium. All potential savings are just a roll of the dice.
- In the example on the previous page, you're shifting the refix date forward by six months but what happens when that refix date matures in, say a year or two years. You're just as likely to have gotten yourself on the wrong side of an interest rate upswing then. Leaving the refix as it was might have protected you from this upswing for a little longer. There's simply no way to accurately time significant increases in interest rates, particularly more than a year out.





## SHOULD YOU BREAK YOUR RATE EARLY IN CASE **INTEREST RATES** RISE EVEN MORE? *(cont.)*

Our suggestion is that, rather than worrying about interest rates now versus interest rates later, homeowners concentrate on decreasing unnecessary spending and getting themselves in a position that they can pay their mortgage off at much higher rates - for example 7%. Actually, 8% is ideal but will take longer for some people to achieve.

Calculate what your mortgage repayments will be at those levels and aim to be able to pay your mortgage at 7% in the next 12 months and 8% in the next 24 months. If you know you can afford that, then it won't matter what interest rates do in the meantime - it's likely they'll be less than 8% for quite a few years - and you can deal with whatever the rates are when they're ready to be refixed on their normal cycle.





# SHOULD YOU REFINANCE TO ANOTHER BANK TO GET A BETTER INTEREST RATE?

So you've got an account fixed-term rate maturing soon and the bank or your broker has sent you some interest rates. Maybe your current bank is offering 0.1% higher than another bank in the market; should you refinance your mortgage to get the better rate?

## WHAT DOES 0.1% INTEREST RATE DIFFERENCE MEAN IN REAL NUMBERS?

Instinctively, it makes sense to move to a cheaper bank. However, but it is worth calculating whether it's worth the bother.

0.1% means for every \$100,000 that you owe to the bank, you will pay an additional \$100 per year or just under \$2 per week.

In other words, a \$700,000 mortgage would save \$700 per year by moving to another bank that was offering 0.1% less. If the difference is 0.2% it might start to get a little more tempting at a saving of \$1,400 over the year. Except...

## WHAT COSTS ARE INVOLVED WITH REFINANCING TO ANOTHER BANK?

You'll remember from when you bought your property that you needed a solicitor to review the mortgage documents as well as updating the Title. This is true when refinancing too. The typical cost for a solicitor to refinance a mortgage varies, but \$1,500 would be a good estimate for most houses. In the example above, the savings for a \$700,000 mortgage with a 0.2% cheaper rate was \$1,400 meaning you wouldn't even break even by refinancing. This is before you even account for the value of your time spent applying for a mortgage and swapping all your accounts over to the new bank. And speaking of time...





## TIMING ISSUES

Advertised interest rates from the banks are subject to change without notice. In fact, banks specifically don't give notice to avoid major rushes. Imagine if the public heard an interest rate was going to go up tomorrow at a bank; every applicant would try to call the bank that day. Interest rate announcements are typically done at 5pm and are enforced from that day.

The problem here is that mortgages take a couple of weeks to process. By the time you've got all the documents together, submitted your full statement of position to the bank and waited for them to approve the loan, it's likely any interest rate differential could have moved or even reversed. Chasing an advertised rate at another bank can often be an exercise in futility as rates change very, very often.

There is a time when it might be worth considering refinancing, but it isn't because one bank is offering a slightly cheaper interest rate.

Hopefully, when you first joined your current bank, you received a cash contribution. This would typically be a lump sum of cash as a thank you for joining the bank. At the time, you will have signed a document to say that if you leave the bank within "x" number of years, you will need to repay this cash amount. Typically the number of years is 3-4 years.

But if you've been with the bank for longer than that, you can refinance to another bank who will now offer you a new cash contribution to come across to them.

To use the example above, a \$700,000 mortgage will save \$1,400 in interest (0.2% savings) but you would have to pay a solicitor ~\$1,500 to refinance. However, it's possible a new bank will offer about \$4,900 in cash to come over to them. That's a total benefit of \$4,800 for refinancing. Assuming you're out of the contracted repayment period for your current bank, this may be an enticing option.



TALK TO AN ADVISER



# SHORT TERM VERSUS LONG TERM

In the United States, you can fix your mortgage for 30 years. That means you know what you're going to pay for the life of your mortgage. Unfortunately, in New Zealand our system is set up quite differently. Fixed-term rates typically range from 6 months to 5 years, although occasionally banks have offered longer than 5 years as a promotion.

Almost always, the 6 month rate is slightly more expensive than the 1 and 2 year rate. Homeowners who take a 6 month rate are almost always planning to sell or have a major change to the mortgage, so banks see no benefit in offering a cheap rate on this term. From there the 1 and 2 year rates are cheaper with a reasonable jump in cost once you are locking in at the 3-5 year rate.

So how do you know whether to take a shorter term/cheaper rate or a longer term/more expensive rate? Each rate comes with some pros and cons. We can split them up as follows:

	PROS	CONS	WHO WOULD TAKE THIS OPTION?
Shorter Term Rates (1-2 years)	Typically cheaper rates meaning less interest paid. Cheaper rates mean more possibility to make additional payments on top of the minimum required payments	In a rising interest rate market, homeowners are at risk in a year or two of a significant jump in payments	Price conscious mortgage holders; People looking to pay less on interest and pay more off their mortgage
Longer Term Rates (3-5 years)	More certainty for a longer period. Know what your payments will be for the next 3-5 years; In a rising interest rate market, these terms may turn out to be cheaper on average than the short term	Higher interest payments; Making additional payments requires confidence that you can continue these payments over the whole term.	People wanting know what their payments will be over a longer period; People with the view that interest rates continue up sharply, meaning on average these higher rates will be better





## HAVING YOUR CAKE AND EATING IT TOO

Of course, you can have both. Splitting your mortgage into two or more accounts is very common. Undecided homeowners could fix one account for 1 year and another for 5 years getting the benefits of both the long and short terms.

## THINGS WE WISH EVERYONE KNEW ABOUT **REFIXING**

- You can lock in a rate at most banks up to 30-60 days ahead of its maturity. In a rising interest rate market, this is well worth taking advantage of.
- At most banks, you can lock in higher payments (pay your mortgage off faster) when you refix at no penalty BUT you cannot reduce these payments back to the minimum before your fixed rate matures again, without applying to the bank. Make sure you can afford those extra payments for the whole fixed-term period.
- If you were previously >80% LVR (you had less than 20% deposit/equity) you may have been paying a much higher interest rate. At the time of offering rates, banks do not always run a valuation on the property. This means the bank may still be pricing your interest rate at an >80% LVR rate, even if your property has increased in value. If you had some capital gains in your property, check that your bank has given you the accordingly reduced interest rates.

## HOW **MORTGAGE LAB** CAN HELP YOU WITH REFIXING

Our services for refixing are usually at no cost to you. All main banks pay us to work with their clients. Second tier (non bank) lenders may incur a fee if you are moving to them, however you will know any fees before committing to anything with these lenders.

Mortgage Lab helps our clients by:

- discussing how long to fix your mortgage for, given your personal situation
- investigating and managing refinancing to improve your financial position

To get free help with refixing your mortgage, visit: [www.mortgagelab.co.nz/contact-us](http://www.mortgagelab.co.nz/contact-us)

