

Early Repayment Adjustment (ERA) Fact Sheet & Calculation Example

When you take out a fixed rate loan with us, you sign a contract to lock in your interest rate for an agreed period of time. If you then decide to switch or prepay your loan early, either partially or in full, you are effectively breaking that fixed rate agreement.

It is widely accepted that if you break a contract and the other party to that contract loses money, you need to compensate them for that loss. Using that same principle, if we lose money as a result of you breaking your fixed rate loan term, we charge an ERA to recover our loss. This is also covered in the terms and conditions of your loan (see clause HL11.5).

How do we calculate our loss?

The process of funding loans is technical and complex, but we've tried to keep the following description as simple as we can.

When you take out a fixed rate home loan, we lock in our funding costs at a fixed rate.

If you decide to switch or prepay your loan early, either partially or in full, we need to unwind our fixed rate funding.

To calculate whether or not we have made a loss, we refer to the inter-bank lending rates known as "wholesale market swap rates". We do this because the wholesale market swap rates effectively equalise the difference in the cost of funds between fixed rate loans and variable rate loans and also between fixed rates loans from time to time and from term to term.

As they're published daily, the wholesale market swap rates are also the most transparent fixed rate cost of funds we can use to calculate our loss from you prepaying your loan early. These swap rates change throughout the day but a daily snapshot is published every day in the Australian Financial Review under the heading "Swap Rates: Quarterly in arrears versus mean Bank Bill" and they can be used to approximate our ERA calculation.

On the day you switch or prepay your loan early, if the wholesale market swap rate for a term equal to your remaining fixed rate period is less than the wholesale market swap rate applied at the start of your fixed rate period, we will make a loss and we will charge you an ERA.

The ERA is not a penalty, it is not a fee and we do not make a profit from it. It is simply an adjustment to recoup our loss from you breaking your fixed rate agreement.

Please see over for an explanation of the above via a working example.

Please note: the Financial Ombudsman Service has examined early repayment adjustments and in a paper posted on their web-site on 29 January 2009 they concluded that this method results in the best pre-estimate of the Bank's loss.

Important Information

Financial markets are volatile and interest rates can change daily. For this reason, an ERA is valid only for the day it was issued.

Working Example

Say, for example, you borrowed \$300,000 from us on 9 February 2007 fixed for five years. For the purposes of this example, you also chose to pay interest only.

On 9 February 2007 the wholesale market swap rate for 5 year fixed terms was 6.39%.

Two years later on 9 Feb 2009, you come back and want to pay out your fixed loan in full, as you have decided to sell your property. By that time, you had also paid off \$10,500 of the principal, so your loan balance is \$289,500 and you have 3 years of your fixed rate term remaining.

Your loan was fixed for 5 years and still has 3 years remaining. We therefore refer to the wholesale market swap rate for 3 years (ie your remaining term). On 9 February 2009 it was 3.73%.

So, we are still obliged to pay 6.39% on the money we lent to you for a further 3 years. But the money you've paid back to us has a market value to us of only 3.73% for that same 3 year period. Therefore, we effectively lose 2.66% for 3 years from you paying back the money early (ie $6.39\% - 3.73\% = 2.66\%$).

ERA calculation example:

The "prepaid amount (adjusted for any scheduled principal repayments - which reduces the ERA)" is multiplied by the difference between "the wholesale market swap rate for the length of the fixed term at the time the loan was fixed" and "the wholesale market swap rate for the remainder of the fixed term at the time of the prepayment" and by the "remaining fixed rate term". The result is then reduced to a present day value - and this is your ERA.

- (i) In our example above, the loan is being prepaid in full. Therefore the prepaid amount is equal to the remaining balance. Additionally, as the loan is interest only, there are no scheduled principal repayments (and therefore no adjustment):
\$289,500
- (ii) The difference between the wholesale market swap rates at the time of fixing and the time of breaking:
 $6.39\% \text{ less } 3.73\% = 2.66\%$
- (iii) The remaining fixed term of contract:
3 years
- (iv) The calculation is:
 $\$289,500 \times 2.66\% \times 3 = \$23,102.10$
- (v) Finally, we reduce the \$23,102.10 to a present day value:
ERA = \$21,824.39

