Things you should know about Break Costs

On Fixed Rate Residential and Portfolio Loans.

Effective: 18 June 2018
Break Costs on fixed rate loans

This document gives further clarification to the break costs explanation as described in the Residential and Portfolio Loan Agreement General Terms and Conditions.

Break costs can be quite high. This brochure explains what break costs are and when they are payable. Please read carefully and if you do not understand any part of the information provided, we suggest you seek independent financial advice.

What are break costs?

When St. George lends you money at a fixed rate for a set term, the risk associated with movements in interest rates is accepted by St. George. We then manage this risk based on the understanding that all the required repayments due over the whole of the fixed rate period will be made in full and on time. We obtain funding on this basis through transactions at wholesale interest rates.

If you make a prepayment (that is, you repay ahead of the due date or you pay an extra or higher amount) or change to another interest rate option or product or another repayment type, that will change our funding position. If wholesale market interest rates have dropped, this causes a loss to St. George. The estimated amount of this loss is passed on to you as a break cost (subject to the prepayment threshold described below).

When are break costs payable?

Break costs ARE payable on your fixed rate loan when wholesale market interest rates have fallen during the fixed rate period on your loan AND:

- you prepay the total amount owing on your loan; or
- you make prepayments in excess of the prepayment threshold; or
- the total amount owing on your loan becomes immediately due for payment because you are in default; or
- you change to another interest rate option (fixed or variable); or
- you change the repayment type.
Each of these events is a “break”

The prepayment threshold is the maximum amount we allow you to prepay in each 12 month period without charging you a break cost.

Your prepayment threshold is $10,000 in each 12 month period. You will reach your prepayment threshold for a 12 month period once the total prepayments during that 12 month period, after taking into account any amounts you have already redrawn during that 12 month period, reach $10,000 or more on a day during that 12 month period.

A prepayment is any regular or lump sum payment of any amount in excess of your contractual obligation.

For this purpose a “12 month period” is the period from the date the fixed rate period starts to the first anniversary of that date and each consecutive 12 month period after that during the fixed rate period.

Note: Redraw is not applicable to any fixed rate sub-account within a Portfolio Loan.

How are break costs calculated?

1. Break costs are calculated based on the movements in the rates at which we determine we can get fixed rate funds from the wholesale markets on the relevant day (the “Wholesale Market Interest Rates”).

The method we use to calculate break costs is to calculate two amounts.

- The first amount A is calculated using discount rates based upon Wholesale Market Interest Rates on the date of the break plus the applicable interest rate margin.
- The applicable interest rate margin is the difference between the annual percentage rate under your loan agreement and the Wholesale Market Interest Rates on the first day of the fixed rate period or as at the rate lock date if there is a rate lock facility.
- The second amount B is calculated using discount rates based on the annual percentage rate as stated in your loan agreement.

A and B are both the sum of the present values of all expected future cash flows, calculated using the interest rates as defined above.
Expected future cash flows consist of:

- each repayment that we would have received from the time of the break to the end of the fixed rate period; and
- the principal balance that would have been owing at the end of the fixed rate period.

The present values are calculated on the assumption that you would have made all, and only, the repayments required by your loan agreement.

The break costs method estimates our loss but may not necessarily reflect any actual transaction that we may enter into (either before or at the time of the break).

2. If you prepay your loan in full or are required to repay your loan in full because you are in default or you change to another interest rate option (fixed or variable) or another repayment type, then break costs are calculated by subtracting $B$ from $A$.

The precise mathematical formula for the calculation of $A$ and $B$ is set out below. If you do not understand this formula, we strongly recommend that you seek financial advice.

$$A = \sum_{t=1}^{T} \frac{P_t}{(1+d_t)^T}$$

$$B = \sum_{t=1}^{T} \frac{P_t}{(1+r_d)}$$

If $A$ exceeds $B$, break costs are payable. If $B$ exceeds $A$ no amount is payable to you. This is because we allow you to make partial prepayments up to the prepayment threshold without charging a break cost (see 3 below).

**Definitions**

- $\Sigma$ represents the mathematical summation operator. This means that the mathematical expression appearing to the right of the $\Sigma$ is calculated and summed for each and every value of $\Sigma$’s subscript “t” for which the mathematical expression has a value other than zero.
- $t$ represents number of the repayments to be made, $t=1, 2, 3, 4……, n.$
\( n \) represents the number of the repayments to be made to the end of the fixed rate period as well as the remaining balance at the end of the fixed rate period.

\( T \) represents the number of days from the break until the due date for the relevant repayment.

\( P_t \) represents each repayment falling due under your loan agreement during the remainder of the fixed rate period at times \( T \) days after the break and the balance that would have been owing on your loan account at the end of the fixed rate period assuming that, after and but for the break, each repayment would have been made when due.

\( r \) represents the annual percentage rate under your loan agreement for the fixed rate period.

\( r_d \) represents \( r \) divided by 365.

\( d_t \) represents \( (z_t + m) \) divided by 365.

\( z_t \) represents the zero coupon interest rates applicable to a term of \( T \) days for each repayment commencing on the date of the break, being the rates at which we determine we can get fixed rate funds from the wholesale markets on the relevant day.

\( m \) represents the difference between \( r \) and the applicable zero coupon interest rates. The applicable zero coupon interest rates are based on the Wholesale Market Interest Rates on the first day of your fixed rate period or the rate lock date if there is a rate lock facility.

3. If you make a partial prepayment then break costs are calculated as follows:

\[
\text{Break Costs} = \frac{B}{A} x (1 - \frac{B}{A})
\]

\( A \) and \( B \) are calculated as in 2 above. We calculate break costs as at the date of the break. Break costs are only payable if \( A \) exceeds \( B \).
If $B$ exceeds $A$ no amount is payable to you. This is because we allow you to make prepayments up to the **prepayment threshold** without charging a break cost. If for any calculation $X$ is negative no break cost is payable.

The **prepayment threshold** is the maximum amount we allow you to prepay in each 12 month period without charging you a break cost. Your **prepayment threshold** is $10,000 in each 12 month period.

You will reach your **prepayment threshold** for a 12 month period once the total prepayments during that 12 month period, after taking into account any amounts you have already redrawn during that 12 month period, reach $10,000 or more on a day during that 12 month period. After that, each prepayment during that 12 month period will trigger a break cost calculation unless the prepayment is less than or equal to the aggregate amount redrawn since the last break cost calculation.

A prepayment is any regular or lump sum payment of any amount in excess of your contractual obligation.

For this purpose, a “12 month period” is the period from the date the fixed rate period starts to the first anniversary of that date and each consecutive 12 month period after that during the fixed rate period.

**Note:** Redraw is not applicable to any fixed rate sub-account within a Portfolio Loan.

For example, say you had a 3 year fixed rate period and in year 1 you:
- prepaid $9,000 in month 3;
- redraw $8,000 in month 6;
- prepaid $5,000 in month 8,

you will not exceed your **prepayment threshold** during year 1 because, while you have prepaid a total of $14,000, at no time have the prepayments, taking into account any redraws made, reached the threshold of $10,000.

If in year 2, you:
- prepaid $8,000 in month 3;
- redraw $5,000 in month 6;
- prepaid $9,000 in month 8,

you would exceed your **prepayment threshold** by $2,000 in month 8, thus a break cost calculation would be done then. To work out the break cost $X$ would be $2,000 (being $12,000 less $10,000).
If in year 3, you:
• prepaid $15,000 in month 3;
• redrew $8,000 in month 6;
you would exceed your **prepayment threshold** by $5,000 in month 3 and a break cost calculation would be done then, notwithstanding that your later redrawing of $8,000 brought the net prepayments during year 3 down to $7,000. To work out the break cost in month 3 $X would be $5,000 (being $15,000 less $10,000).

If in year 3 you had instead:
• prepaid $15,000 in month 3;
• redrawn $6,000 in month 6;
• prepaid $9,000 in month 8,
you would exceed your **prepayment threshold** by $5,000 in month 3 and a break cost calculation would be done then. For the purpose of that calculation $X would be $5,000 (being $15,000 less $10,000). When you made the further prepayment of $9,000 in month 8 another break cost calculation would be done then because the prepayment was more than the amount redrawn in month 6. For that calculation $X would be $3,000 (being $18,000 less $10,000 less $5,000).

We do not treat payments of overdue amounts as prepayments. For example, if the overdue amount is $2,000 and you pay $7,000, then only $5,000 is counted towards your **prepayment threshold**.

**Warning**
Break costs can be high and the formula is complex. We suggest you ask the Bank for an estimate of the break costs and seek independent financial advice before you prepay any amount on your loan during a fixed rate period.

St.George also encourages you to seek independent financial advice when considering whether or not to fix the interest rate on your loan.
Examples
The following examples are a guide to the impact of break costs on a home loan:

### Example 1

<table>
<thead>
<tr>
<th>Original loan amount</th>
<th>$250,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original loan term</td>
<td>25 years</td>
</tr>
<tr>
<td>Initial fixed interest rate period</td>
<td>3 years (36 months)</td>
</tr>
<tr>
<td>Fixed interest rate in your contract</td>
<td>8% per annum</td>
</tr>
<tr>
<td>Repayment method</td>
<td>interest only</td>
</tr>
<tr>
<td>Wholesale interest rates fell by 5%</td>
<td></td>
</tr>
</tbody>
</table>

**Break Costs**

<table>
<thead>
<tr>
<th>Month Broken</th>
<th>Break cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>12</td>
<td>$23,528.35</td>
</tr>
<tr>
<td>18</td>
<td>$17,837.14</td>
</tr>
<tr>
<td>24</td>
<td>$11,962.03</td>
</tr>
</tbody>
</table>

### Example 2

<table>
<thead>
<tr>
<th>Original loan amount</th>
<th>$400,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original loan term</td>
<td>25 years</td>
</tr>
<tr>
<td>Initial fixed interest rate period</td>
<td>3 years (36 months)</td>
</tr>
<tr>
<td>Fixed interest rate in your contract</td>
<td>7% per annum</td>
</tr>
<tr>
<td>Monthly repayments</td>
<td>$2,500</td>
</tr>
<tr>
<td>Repayment method</td>
<td>principal and interest</td>
</tr>
<tr>
<td>Wholesale market interest rates fell by 2%</td>
<td></td>
</tr>
</tbody>
</table>

**Break Costs**

<table>
<thead>
<tr>
<th>Month Broken</th>
<th>Break cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>12</td>
<td>$14,653.03</td>
</tr>
<tr>
<td>18</td>
<td>$11,175.75</td>
</tr>
<tr>
<td>24</td>
<td>$7,540.52</td>
</tr>
</tbody>
</table>
We make the following assumptions in the break cost calculation examples:

• for Examples 1 and 2, the loan is repaid in full at 12, 18 and 24 months;
• Wholesale Market Interest Rates fell for home loans by 5% per annum (Example 1) and 2% per annum (Example 2) between the date the fixed rate period started and the date of the break;
• there were no previous partial prepayments on the loan;
• only the required monthly repayments were made – there were no arrears or additional repayments on the loan;
• the loan is repaid immediately after the repayment due on the date of full prepayment (that is after the 12th, 18th or 24th repayment is made);
• fees and charges that may be added to the loan balance are not taken into account;
• there is an equal number of days in each month (that is, 365/12 days in each month).

This brochure is not part of, and does not replace or modify, your loan agreement. It is designed to assist you in understanding how we calculate break costs.

**Note:** In this brochure, the fixed rate period is the time during which the interest rate is fixed on your loan.
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For further information

Ask at any branch.
Call us on 13 33 30, 8.00am to 8.00pm Monday to Saturday (AEST).
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