What's best... Should I take a floating or fixed interest rate?

What are floating and fixed interest rates?

You have the choice of whether you 'float' or 'fix' (or a mix of both) the interest rate you pay on your home loan. What this means is if you choose a:

1. **Floating interest rate:** then the interest rate you pay can change at any time and go up or down. Typically, the floating interest rate goes:
   - **UP -** If we have to pay more for the money that members invest with us. Those investment/savings rates usually go up when the Reserve Bank's Official Cash Rate (OCR) goes up. We also keep a very close eye on the major banks to make sure what we're offering is competitive.
   - **DOWN -** If we have to pay less for the money that members invest with us. The savings rates we pay usually go down when the Reserve Bank's Official Cash Rate (OCR) goes down.
2. **Fixed interest rate**: we "lock in" your interest rate for 1, 2 or 3 years (or a mix of any of these). Through that entire time the interest rate does **not** change, which means you always know exactly what your repayments are on your loan.

What makes interest rates go up and down?

You may have heard about the **Official Cash Rate** or **OCR**. This is the rate the Reserve Bank of NZ (RBNZ) uses to guide the interest rates the big banks pay/charge their customers.

When the OCR goes up, interest rates typically go up, and the reverse when the OCR goes down. Right now, the RBNZ is trying to drive inflation down. One way to do this is to increase the OCR so a loan's more expensive, which discourages borrowing.

For the big banks, one of the other important indicators is something called "swap rates". You can find out more about them here: Interest Rate Swaps – the definitive NZ guide. In short, if swap rates are rising, then typically the rate you pay for your fixed rate also goes up, and vice versa.

Fixed or floating – what's better?

That's for you to decide. We've got some information below to help with your decision.

Fixed interest rate	Floating interest rate
Interest rate is fixed and **won't change** for either 1, 2 or 3 years depending on the option you choose.	Interest rate fluctuates up and down and can change several times a year.
Generally **lower** than the floating rate when you first compare them.	Generally **higher** than fixed interest rates when you first compare them.
Great for budgeting – you know exactly what your repayments are, and how long they will stay that way.	Tougher for budgeting as the amount you pay can go up and down each time the interest rate changes.
Can 'break' the fixed rate and change some/all to another rate, however this could incur a fixed rate break fee.	Can change at any time to a fixed interest rate.
Comes with a lock-in period of 1, 2 or 3 years.	No lock-in period.

Should I fix for 1-year, 2-years, or 3-years?

This comes down to whether you believe, after reading comments from key people like economists or a financial adviser, whether rates are likely to keep going up, flatten out, or drop over time. For example, if you believe rates will be lower in a year's time, you might fix for just 1 year to take advantage of (hopefully!) lower rates in a year's time. As you'll see in "**What are my options for structuring my loan**", you can also split your home loan.

What are my options for structuring my loan?

1. You could fix or float 100% of your home loan.
2. You could divide your home loan into smaller loan portions on different interest rate types so you might have one loan portion floating, and one or more portions fixed for different terms. Some people divide their home loan into smaller portions to help manage interest rate increases over time e.g.:
    - You have one home loan of $500,000 fixed for 1 year, and interest rates increase during the year. When it's time to refix, your new repayments would increase based on the whole $500,000 loan.
    - If you split your home loan say into $250,000 fixed for 1 year and $250,000 fixed for 2 years, you might soften the blow of market changes on your home loan repayment amounts. There's no cost for dividing your loan into smaller loans.

Let's say you had a home loan of $500,000. Here's some examples of what you could do:

Example One	**$500,000** Fixed for 3 years		
Example Two	**$250,000** Floating	**$250,000** Fixed for 1 year	
Example Three	**$100,000** Floating	**$200,000** Fixed for 1 year	**$200,000** Fixed for 2 years

What happens at the end of my fixed rate term?

When your loan gets to the end of its fixed rate term, you decide again whether to fix or float. You can treat it as one loan or divide it as we showed above. Your new interest rate will be the rate on the day you fix your interest rate again; this could be higher or lower than your original fixed interest rate.