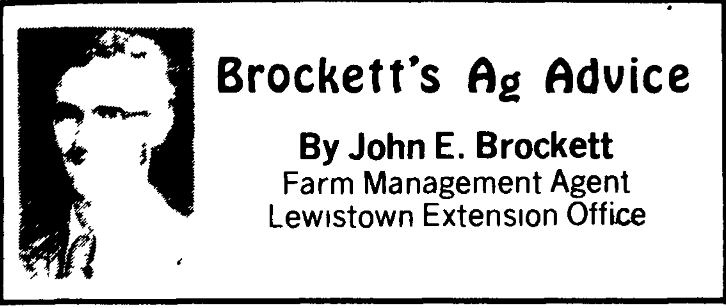

Brockett's Ag Advice

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Making Borrowing Decisions

According to some experts, the new tax reform act should have a depressing affect on interest rates. That will be good news to those who have to borrow money and bad news to those who count on interest income. According to these experts, two of our major industrial rivals have interest rates well below those paid or charged in this country. Japan's rate is in the 3 to 3.5 percent range.

As I mentioned in an earlier column, there has been a lot of activity among banks in offering reduced fixed rate loans to clients. Some of the rates offered have been single digit ones. There are several reasons for the banking industry to be promoting lower fixed rates at this time. One is to win customers that some banks had written off in the past few years when we have had a short supply of loanable money and galloping interest rates. A second one is to lock in interest rates at what appear to be low rates now before they become lower. A third reason is that bankers can see some stability coming in the market value of farm land and other farm assets. So far banks have been moving back into the farm lending field rather cautiously. They are primarily courting the best loan prospects, which are often those who are the most stable borrowers in the Farm Credit system.

Some Possible Scenarios

As a result of this activity, the banks, and in some cases, Farm Credit are seeking borrowers and offering loan changes. Many farmer borrowers are asking the question, "When or how do I make that offered change?" First and foremost this is a move *not* to be taken lightly. It may cost more than will be saved. Let us look at a few scenes with some possible things to consider.

Scene 1: You already have a variable interest rate loan with a present interest rate of 9 percent. You are offered a fixed rate loan at 10 percent. What should you do? First some things to explore before making any moves. (1) What points will the new loan cost? (2) What will the payments be on the new loan? (3) If the new loan is with a new lender, will your present lender match or better the offer? (4) How long will the interest rate of the new loan be fixed? (5) Can the lender call the loan for any reason before the due date of the loan? In other words, there must be a reason other than just interest rate for the change in loans.

Scene 2: You already have a fixed rate loan with a present rate of 12 percent and a monthly payment of $400. You are offered a new fixed rate loan for 10 percent interest with a monthly payment of $300. This becomes intriguing since both interest cost and payment amounts are lowered. Again explore the same questions as listed above. In this scene, one of the above questions has been answered. You know there will be a lowering of the payment. That means this may be a more lucrative deal. Before you leap though, perhaps you should find out what it will cost to make the change (attorney fees, etc.). You may also want to consider whether rates will decline further.

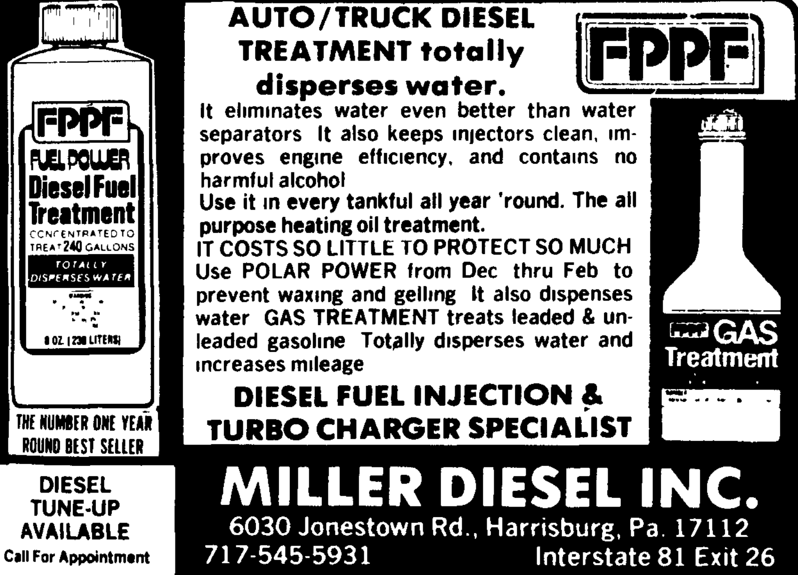
Scene 3: You have a fixed rate mortgage with an interest rate of 10 percent and a payment of $1,150 per month with 11 years of payments remaining. You are offered a variable rate mortgage with rates fixed for one year at 8.75 percent. Payments will be $850 per month for this year and the mortgage stretched out for 15 more years. Go back to those questions above in scene 1. One other point to consider, "What will interest rates do if the national administration changes course after 1988?" Or what will happen to interest rates if Volker leaves the Federal Reserve Board (where money supplies are controlled)?

It Is a Gamble

Those who decide to change in scenes 1 and 2 are betting that we are at or near the bottom of the interest rate swing. They want to lock in a rate that will carry them through to the end of their loan. If they have made a thorough analysis of both their old loan and the new loan and have explored other options, including a new deal with their present lender, the decision would be reasonable. Those who do not change in scenes 1 and 2 are betting on further reductions in interest rates or are concerned about the answers they are receiving from some of the questions they are asking. Or they are content with the present situation. If all questions were answered satisfactorily, I would probably stay with the present loan program in scene 1 until I could get a better handle on the affect of the new tax laws on interest rates. I would be inclined to make a change in scene 2, although I might bargain for a better deal if it was possible.

Scene 3 is a much more complicated decision. Here the borrower would be gambling on a longer period of time. Some of the outside factors that could affect the long term prospects of interest rates are (1) politics, (2) worldwide recessions and/or depression, (3) an oil shortage, (4) a protectionist fever that would increase costs to all consumers, including farmers, and (5) war. The borrower who does make the change in this model would be wise to build a favorable cash reserve in the event interest rates took off again. Those farmers who can handle money well would probably gain financially by making the change. Those who can not handle money well will possibly be taking an undue risk for the long haul.

If I was able to get my questions answered satisfactorily, I would probably be tempted to make a change. If I did make a change, half of the saved monthly payment would go into an escrow account to be used to pay off the loan early if interest rates went up. I would also be watching the effects of the new tax law on long term interest rates (Treasury bond rates are a good indicator of this). If I decided against the change, I would try to use it as leverage to get a better deal with a fixed rate mortgage.



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