

Rates of Interest

Low interest rates might make now the perfect time to restructure your clients' financing

By **Robert W. Dudek**, chief lending officer, Statewide Home Loan Corp.

WHERE INTEREST RATES ARE heading seems to be one of the most-popular questions borrowers ask. Conventional wisdom says that slow economic growth and a presidential election indicate lower mortgage rates. This year has both. But that does not necessarily mean rates will fall any more.

What does this mean for mortgage professionals? Commercial mortgage brokers must be aware of the state of interest rates and the residential market as it affects their duties. So when commercial clients ask about where interest rates are headed, brokers can advise them on the state of the economy, interest rates and how these factors could affect their bottom line.

In the first half of this year, fixed interest rates on conforming residential mortgages ranged from 5.8 percent to 6.5 percent, low by historical standards. As important as the slow economy and election may be to the state of interest rates, there is another overriding issue that changes everything: the prospect of stagflation.

Stagflation is a quandary that occurs when the economy is a mixture of stagnation, slow growth, escalating unemployment and highly inflationary price increases.

The U.S. economy has not seen a full-blown stagflation since the late 1970s and early '80s. How painful was it then? Consider the following statistics from the Federal Reserve and the Bureau of Labor Statistics: The prime rate reached 20 percent in April 1980; 30-year fixed-interest rates were at 18.4 percent in October 1981; the inflation rate reached 14.7 percent in

April 1980; and the unemployment rate hit 9.6 percent in 1983.

Although root causes of stagflation are subject to debate, most economists agree that it occurs because of excessive money supply and disproportionate government spending. To stave off the prospect of stagflation, the Federal Reserve's monetary policy often should include a delicate balancing act of containing inflationary pressures and stimulating economic growth.

Inflation control can be accomplished by limiting the money supply, increasing interest rates, and strengthening the value of the U.S. dollar. On the other hand, reviving an economy requires the availability of inexpensive capital, as well as sound fiscal policy.

In my view, the Federal Reserve has to choose the greater benefit as its long-term monetary policy. The first priority must be reducing inflation and strengthening the dollar. This means increasing interest rates and limiting money supply. In addition, unfunded government spending and the budget deficit greatly affect the dollar.

Higher interest rates and a stronger dollar will cause some real, yet temporary, economic pain. This will include increased mortgage-borrowing costs, as well as a higher trade deficit because of reduced exports. Eventually, however, substantially reduced inflation and a stronger dollar could help drive down interest rates.

The U.S. real estate market, including the residential and commercial sectors, faces remarkable challenges. An oversupply of unsold properties is the main problem with the residential market. Unless the number of properties for sale is reduced to manageable levels, values will continue to further deteriorate. Current inventory levels are estimated at 11 months, and they must go down to about six months before prices will regain some traction.

In the case of commercial real estate, dwindling income streams, a direct result of the economic slowdown in which the residential market has played a large role, are the primary concern. The impact of the current economic conditions

has not been reflected in commercial property values. But it likely is safe to assume that prices have peaked and are due for correction.

When appropriate, commercial mortgage professionals must educate their clients that current low mortgage rates are likely to increase in the future. If it is difficult to qualify for loans now, it will be even harder once interest rates increase.

With this in mind, it is wise to plan ahead, review and — if advisable — restructure your clients' mortgage financing now while the interest rates are still low. **■**



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