

## Interest Rates – Choosing Fixed or Variable

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One of the benefits of Lannock's funding for strata corporations is that you can choose to have a fixed or variable rate. Of course, this flexibility creates its own problem – which should you choose and why?

It's easy to see the potential issue with having a variable rate – if rates go up then you will have to pay more in interest.

However, many people forget that having a fixed rate is exactly the same problem but in reverse – if rates go down then you will not have the benefit of paying less.

In financial terms, having all your Advances either fixed or variable exposes you to the same interest rate risk.

The logical response then is to have half of your borrowings at a fixed rate and half at a variable rate. If rates go up, then you only feel the pain on half of your loan balance, the other half is protected. And if rates go down, you will feel the joy on the variable rate portion of the loans, but not on the fixed rate portions.

The next step is to consider the position of your strata scheme and of the owners in it.

There are several reasons why you might increase the proportion of the borrowing that is at a fixed rate:

1. You think market interest rates are more likely to go up than down over the term of your borrowing
2. You are keen to have a predictable budget where the numbers never change
3. The pain you will feel if rates go up will in your view be more than the joy you will not experience if rates go down

Reasons to have more of the borrowing at a variable rate are:

1. The amount you have borrowed is not substantial and so the effect of interest rate changes is not significant in dollar terms – it's easy to get very concerned about apparently large differences in rates which in reality only change the repayments by the cost of a cup of coffee
2. The cost of fixing the rate is not worth the benefit

Regarding this last point, remember that it's not just a matter of choosing fixed or variable, but of considering what the cost of having a fixed rate is. Fixing a rate is like buying insurance, you are paying for protection. It's your own subjective assessment as to whether the protection is worth the cost.

Finally, please remember that with Lannock you can have a fixed or variable rate, but that it applies to the entire amount of each Advance. To have some of your borrowings fixed and some variable, you will have to have at least two Advances and choose the ones that you want to be subject to a fixed rate.