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## Libor's Rise May Sock Many Borrowers

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A sharp and unexpected rise in a widely used interest rate is threatening to add billions of dollars to the interest bills of homeowners, companies and other borrowers around the world.

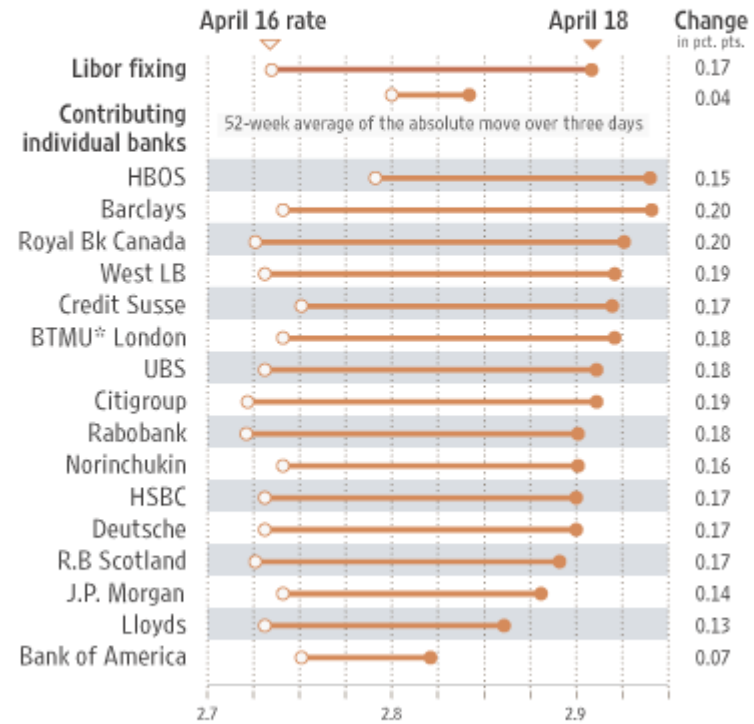
The London interbank offered rate jumped for the second straight day Friday -- two days after the British Bankers' Association, which oversees the calculation of the interest rate, said it was investigating the borrowing rates that banks had been providing to it.

The BBA started its review amid growing concerns among bankers that their rivals weren't reporting their true high borrowing costs, for fear of signaling to the market they were desperate for cash. John Ewan, a manager of the Libor system at the BBA, said Friday the association continues to believe in the accuracy of the Libor system.

Libor is one of the world's most important financial indicators. It serves as a benchmark for \$900 billion in subprime mortgage loans that adjust -- typically every six months -- according to its movements. Companies globally have nearly \$9 trillion in debt with interest payments pegged to Libor, according to data provider Dealogic.

### Shock to the System

The three-month U.S. dollar Libor rate increased, as did the individual fixings that banks provide to reflect borrowing costs, after questions were raised about the reliability of the Libor system.



\* Bank of Tokyo-Mitsubishi

Source: Thomson Reuters

If sustained, the past week's rise of Libor could add roughly \$18 billion in annual interest costs on that corporate debt, or about \$100 to the monthly payment on a \$500,000 adjustable-rate mortgage loan.

John Waite, a mortgage broker in Appleton, Wis., said one of his customers, a house painter, faces a reset on his subprime loan next month and will be affected by the recent Libor gyrations. The painter's interest rate was fixed at 7.25% for the first three years of the loan, and next month the borrower will make its first adjustment based on a margin of 6.5 percentage points over six-month Libor.

With that rate around 3%, the painter's new monthly payment of interest and principal would be about \$1,446, Mr. Waite said, up from the current \$1,173. Six-month Libor was around 2.7% Monday. At that rate, the painter's new payment would be \$1,408.

The Libor rate, which is supposed to reflect the average borrowing costs of banks, had been falling in recent months as the Fed lowered interest rates. At the same time, though, the gap between the interest rates central banks set and Libor has risen -- an indicator of increased concerns about banks' financial health. That, combined with this weeks' moves, counteracts efforts by the Fed to ease pressures on the economy.

While Fed officials see the rise in Libor spreads as predominantly reflecting pressures on European banks, they also see it as symptomatic of a broad reluctance by banks in the U.S. and elsewhere to lend money they think they may need a few weeks from now. They continue to study options for addressing the pressures.

One way might be to expand the Fed's "term auction facility," from the \$100 billion it has currently lent to banks. It could also extend the term of loans made through the facility from the current 28 days, perhaps to three months or as long as six months.

Friday, the closely watched three-month U.S. dollar Libor rose 0.09 percentage point to 2.9075%, its highest in nearly six weeks. Between Wednesday and Friday, the rate rose 0.174 percentage point, an increase that hadn't been seen since August and the start of the financial turndown that has spread from banks into the broader economy. Meanwhile, the six-month U.S. dollar rate -- used as the basis for payments on most subprime mortgages -- rose even more sharply and was quoted Friday at 3.01875%, or 0.33 percentage point more than at the start of the week.

## Course Correction

Three days after the fixing process for the London interbank offered rate was questioned, it rose 0.17 percentage point

### Three-month U.S. Dollar Libor



### Linked to Libor

- Forward rate agreements
- Short-term interest rate
- Futures contracts
- Interest rate swaps
- Floating rate notes
- Syndicated loans
- Variable rate mortgages
- Currencies, U.S. dollar

Source: WSJ Market Data Group

That could prove painful for many companies that are heavily reliant on borrowing, including finance companies and corporations that recently went private in leveraged buyouts.

In commercial real estate, the rise in Libor is bound to have a chilling effect, because many developers borrow

heavily using floating-rate debt linked to Libor. Until recently, declining rates had benefited borrowers, but some lenders were growing wary. Banks have started to include a floor in Libor-linked loans, said Peter Fitzgerald, chief financial officer at Radco Cos., an Atlanta developer. That means borrowers' savings would be limited if Libor continued to sink, but borrowers can be hit by the latest rise.

"If Libor were at 4% instead of under 3%, there would be a disaster that would take years to unwind," he said.

--Greg Ip and Jonathan Karp contributed to this article.