



CORPORATE DEPARTMENT

ALERT

HISTORIC SPIKE IN LIBOR SIGNALS OPPORTUNITY TO SAVE ON SOME COMMERCIAL LOAN RATES

By Mark G. McCreary & Glen W. Fewkes*

Recent uncertainty surrounding the proposed government bailout of financial institutions has sent the London Interbank Offered Rate (LIBOR) soaring, providing an important opportunity for borrowers with existing commercial loans containing an option to elect another loan interest rate or index as a base rate.

LIBOR INCREASES

Many commercial loan rates are tied to LIBOR, which is a bank-to-bank lending rate. Using LIBOR as a base, a margin is added based on the loan amount and the characteristics of the market and borrower to determine a final interest rate. With variable rate loans, this figure is revised quarterly or semiannually to reflect changes in LIBOR. When LIBOR increases, interest rates of loans tied to LIBOR also increase.

As the debate over a proposed government bailout of financial institutions continues, banks have reacted to the uncertainty by shoring up cash reserves and avoiding usual bank-to-bank lending. As a result, LIBOR has risen sharply, with the three-month LIBOR jumping a full percentage point in a matter of days to its highest level since January. Worry that the bailout will not arrive in time to ease the financial crisis is likely to keep this rate high in the near future.

SWITCHING TO A TREASURY INDEX

For commercial borrowers whose existing loans contain the option, the spike in LIBOR represents a chance to save by switching to a rate tied to a Treasury Index or some other alternate, lower interest rate. Historically, LIBOR has traded in tandem with Treasury rates, each reflecting similar changes in the market. In the past week, however, banks have sought out the stability of Treasury bills and the rates associated with them have dropped significantly. Currently, three-month Treasury bills are trading at well under one percent.

WHAT TO DO

Examine the terms of your existing commercial loan. If your loan interest rate is tied to LIBOR but allows you the option to elect another interest rate or index as your base rate, it may be a good time to switch to a Treasury Index. Attorneys in Fox Rothschild's Corporate Department would be happy to look into this possibility for you and help you determine the best plan of action.

For more information about this issue, contact Mark McCreary at mmccreary@foxrothschild.com or 215.299.2010. Visit us on the web at www.foxrothschild.com.

*Glen Fewkes is awaiting admission to the Bar.

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