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Interest Rate Faster Than Inflation

AN INVESTMENT expert writing in a national magazine says the highest yields in the fixed-income market place right now, on top quality investments, come from mortgage-backed securities.

The reasoning behind this is quite simple and quite expensive for the family borrowing money to buy a house.

Inflation has forced the cost of building upward so a house that may have sold for $20,000 in 1970 might cost $60,000 or more now. Everything that goes into the house costs more. That especially includes interest on the mortgage.

Tom Costello of Oklahoma City points out that it would take 12 years for a dollar to double at 6 percent, with interest compounded. At 12 percent, a dollar will double in only six years. At 18 percent, common rate on retail accounts, a dollar doubles in four years.

It is easy to see that 12 to 18 percent interest ought to be a profitable investment for those who are lending money.

It should be just as easy to see that it could be disastrous for those who must pay these rates. Their dollars are disappearing at two or three times previous rates, and when further eroded by inflation, this rapid evaporation of money could lead to bankruptcy.

Costello compares cost of borrowing $50,000 for 30 years to finance a home. At 6 percent, amortizing the loan at $300 per month, total amount paid in interest would be $58,000.

At 10 percent, with payments of $439 per month, total interest on a 30-year loan of $50,000 would be $108,040, Costello says.

Note the borrower is not receiving any more money, although he would be paying more for his house. Increased cost of interest would exceed the increased cost of the house itself.

Home buyers around the country are watching with concern a test case, filed in Virginia, challenging the right of lending institutions to collect escrow funds without paying interest.

While this might not show up as part of the interest cost of buying a home, it could add considerably to it. The practice of lenders collecting monthly amounts to pay insurance and taxes began in the 1930s as a convenience for borrowers and to make loans more secure.

In those days, amounts involved were relatively small and interest rates low.

Interest rates affect citizens in other ways, too, Costello notes. Businessmen must also pay prime rates or more, passing along costs to their customers. And the federal government is paying high rates for money to finance the national debt, passing the cost to citizens in the form of high income and other taxes.

No wonder home buyers look at the monthly payments and close their eyes to total amounts! They also might be overlooking advantages to be gained in saving in advance, collecting interest on savings and avoiding payment of interest later.