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Higher Interest Rates Push Firms Into Action

Faced with the prospect of rising interest rates, Hester Decorating Co. decided to act sooner rather than later to expand its fleet of delivery trucks.

“We have already taken advantage of the previous lower rates to expand our corporate offices and add another showroom location,” said Steve Hester, owner of the Skokie firm. “However, with the pending increases on the horizon, we will also probably accelerate the purchase of one or two more vehicles.”

Economists and policymakers use national studies and analysis to measure the impact of each decision made by the Federal Reserve. For business owners and managers, responding to the Fed’s decisions means being ready to switch strategies and respond to change.

The latest upward tick in rates came Tuesday, when Federal Reserve policymakers boosted the key short-term interest rate another quarter-percent, to 1.75.

Chicago-based Prime Property Investors Ltd., for example, is planning to beef up its portfolio.

Because of rising interest rates, “our firm is aggressively seeking apartment building properties in the city to acquire,” said Barbara Gaffen, Prime Property’s co-chief executive.

By taking advantage of current low rates, the company has been able to ensure it has attractive financing rates already in place to guard against future increases. Other businesses know the rate hike will ultimately mean greater earnings for their business. Elk Grove Village-based Paylocity Corp. processes payroll checks for businesses, government units and non-profits. The business makes money on the float earned on its clients’ tax money, said president Steve Sarowitz.

“Our business has been hurt by the low short-term rates in the past few years,” he said. “We are looking forward to the coming increases.”

Economists expect the Fed will approve another quarter-point rate hike before the end of the year.

Although the Fed’s move this week doesn’t have a direct effect on interest rates charged for short- and long-term loans, changes in the federal funds rate always reverberate to other segments of the economy.

Technically, the Fed’s move raised the interest rate charged between banks for overnight loans. That affects the prime rate banks charge, which influences other interest rates.

“So far, we actually have not seen interest rates affecting our business or our client’s business,” said Ron Kahn, managing director of Lincoln Partners’ private placement group. “People, at least psychologically, they know it’s so much lower than it’s normally been. Coming up a little bit to more normal rates is not any reason for alarm.”

The mergers and acquisitions market will start to feel the impact of rising interest rates when rates reach a level where they have an impact on companies’ earnings, Kahn said.

At that point, banks will begin to lower the key earnings multiples they are willing to lend against, he said.

Borrowers anticipate rates inching upward, but they are not expecting dramatic changes, said Allen Koranda, chairman and chief executive officer of Mid America Bank.

“When it was a 1 percent fed funds rate, those rates were so out of the normal pattern for the U.S. economy that they couldn’t stay there forever,” Koranda said. “It was also hard on the depositor side. An awful lot of attention was given to the fact that mortgage-borrowing rates were really low and it was a great time to refinance.

“The tough side was for people trying to live off their deposits and bonds, those kinds of investments for their retirement. Rates got down so low, it was difficult for those folks.”

The Fed’s recent actions have not had a big impact on home building and condominium conversions, said John Timmer, Cole Taylor Bank executive vice president.

“The profits that home builders are making are at an all-time high, and the profits the condo converters are getting are at an all-time high,” he said. “They’re more than happy to pay an extra quarter- or half- or three-quarters [point] to borrow the money in the short run.”

In the general business arena, the market also is better. “Generally speaking, it’s still profitable for them to borrow money, even though it’s costing them a half- or three-quarters of a point more today,” Timmer said. “Their gross margins are significantly greater than that.”

Consumers will have to realize that rates are unlikely to again fall to recent levels, said Patricia Vlasis, president of the Illinois Association of Mortgage Brokers.

“The consumers have also enjoyed this period of time but have become complacent with the rates low and will have a harder time than the companies adjusting,” she said, noting that many home buyers won’t even look at a deal with an interest rate of more than 6 percent.

Others who have taken out home equity lines of credit but never paid down the principal part of the loan will begin to see their expenses rise, Vlasis warned.