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A Note on Equivalent Fixed Rate and Variable Rate Loans; Borrower's Perspective

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A common situation is where a borrower is offered the choice of two types of loans—a fixed interest rate loan for a fixed period or a variable interest (floating interest) rate loan. Usual wisdom and advice is that the borrower opts for the fixed rate loan if interest rates are anticipated to rise in the future or opts for the variable rate loan if interest rates are anticipated to fall. However, depending on the magnitude of the rates offered, the borrower may be well served by the fixed rate, low-maturity loan or the variable rate loan. In other words, the borrower's choice depends on the interest rate differential between the two loans.



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Additional information

David G. Carmichael

DAVID G. CARMICHAEL is Professor of Civil Engineering and former Head of the Department of Engineering Construction and Management at the University of New South Wales, Australia. He is a graduate of the Universities of Sydney and Canterbury; a Fellow of the Institution of Engineers, Australia; a Member of the American Society of Civil Engineers; and a former graded arbitrator and mediator. Professor Carmichael publishes, teaches, and consults widely in most aspects of project management, construction management, systems engineering, and problem solving. He is known for his leftfield thinking on project and risk management (Project Management Framework, A. A. Balkema, Rotterdam, 2004), project planning (Project Planning, and Control, Taylor & Francis, London, 2006), and problem solving (Problem Solving for Engineers, CRC Press, London, 2013).

Lachlan B. Handford

LACHLAN B. HANDFORD holds a first class honors bachelor of engineering degree in civil engineering and a bachelor of commerce degree with distinction, majoring in finance, both degrees from the University of New South Wales. His current work interests are in structural design and finance.

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