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# Using Credit to Build and Maintain Your Wealth

If you own substantial liquid assets, either in a business or in your investment portfolio, you might not see any reason to borrow money. Why take out a loan when you already have funds available to you?

**There are a number of situations, however, where there could be a distinct advantage to utilizing a line of credit or a mortgage, even if you have sufficient personal resources available:**

- To cover large or unexpected personal expenses
- To help grow your business without incurring additional expenses
- To take advantage of an investment opportunity
- To purchase a primary home or vacation property

Though it may seem counterintuitive, borrowing can be beneficial to your overall wealth plan and investment strategy.

## Covering Big Expenses

Dealing with large or unexpected expenses can be challenging, whether you need to pay for a major tax bill, an emergency medical expense or fund an investment opportunity. Your first inclination may be to draw from your savings or sell off some investments to raise the funds. While this may seem straightforward, there can be hidden costs that aren't immediately obvious to you.

By liquidating investments, you are likely to incur brokerage fees and may expose yourself to additional tax consequences in the form of capital gains. Right away, the transaction is costing you money. And it doesn't end there. By liquidating investments, you also risk throwing your asset allocation off balance, which can impact your long-term wealth plan.

Studies have shown that over 90% of a portfolio's variance of investment return can be attributed to how assets are spread across different asset classes.[1] A properly tuned asset allocation ensures that you're able to pursue the level of growth you want while exposing yourself to a level of risk you are comfortable with—and selling investments can upset that balance.

[1] Gary P. Brinson, Brian D. Singer, and Gilbert L. Beebower, "Determinants of Portfolio Performance II: An Update," Financial Analysts Journal, May-June 1991, pp. 40-48.

Furthermore, rebalancing may require you to sell off more assets in order to get back to your desired asset allocation, thus incurring more fees and capital gains tax. On top of all this, you have to consider the opportunity cost of taking money out of the market—you'll miss out on any potential growth that you would have enjoyed had the money remained invested.

***Leverage Your Portfolio, Don't Liquidate It***

Rather than selling investments, you may want to consider using your portfolio as collateral in order to finance 100% of your loan or mortgage. That way, you can borrow against your assets while allowing them to continue to generate returns, which could more than offset the overall cost of the loan given the current interest rate environment is still relatively low.

This strategy isn't just for unexpected or obligatory expenses. You can use it to pay for major purchases, as well. For example, you may have your eye on an expensive work of art or the vacation home you've been dreaming about, but don't have the cash on hand to buy it. Perhaps you're expecting a big bonus in several months, and are worried that you'll miss out on a unique opportunity if you wait. If that's the case, you could leverage your portfolio to secure a loan that provides the cash you need immediately, allowing you to make the purchase now and either repay the debt later when your cash flow improves, or put longer-term mortgage financing in place.

## Borrowing for a Business

You can also take out a mortgage on your personal property or borrow against your personal investment portfolio to help your company make an acquisition, purchase equipment or buy real estate to house the firm.

Consider this scenario: Tom is an entrepreneur who has a $10 million portfolio of diversified stocks and bonds. He also owns a controlling interest in a booming company that makes audio components. He would like to acquire another company in a complementary business that makes hardware to connect computers with stereos to play back digitally recorded music.

Tom was tempted at first to just liquidate a portion of his portfolio and buy the company outright with the resulting cash. But after crunching the numbers, he realized that this would be quite costly. For one thing, capital gains tax would be due on the pro ts from the sale of stock. He also worried about the cost of being out of the stock market for any length of time and missing out on potential growth.

On the other hand, if Tom's audio company borrowed money to make the acquisition, there would be other hurdles. Because its assets are less diversified than the investment portfolio, the company may have to pay a higher interest rate for the loan. The company would also face costly legal and accounting fees to complete the transaction.

Ultimately, Tom took out a low, variable-rate loan, secured by his personal $10 million investment portfolio. He then loaned the proceeds to his company, which used the funds to acquire the target firm. If Tom had been concerned with rising interest rates, he could have obtained the funds by doing a cash-out refinance of his primary residence. This would have allowed him to lock in his borrowing expense over a longer period of time, typically from 5 to 30 years.

He now stands to earn a handsome profit as the company repays the loan. And because Tom kept his investment portfolio fully invested in the market, he was able to capitalize on the market's recent rise.

## Capitalizing on Investment Opportunities

Mortgage financing and secured lines of credit can also allow you to expand into new investment opportunities, such as purchasing a piece of property. The property not only has the potential to appreciate in value, but could also provide you with a steady stream of income were you to rent it out.

Investing in commercial real estate is another way to utilize a secured line of credit. Consider this example: David is an investor who owns two apartment buildings, both of which are performing well, and he is interested in purchasing a third in a depressed market. David already has a secured line of credit in place, which gives him a competitive edge over other potential buyers.

David decides to use his line of credit to make a cash offer, which is much more efficient than going through the typical process that's required for a commercial real estate loan. His cash offer is attractive to the seller, who has the opportunity to make a quick sale. The seller doesn't have to worry about another buyer who may be waiting on financing, or the deal falling through if the loan is not approved.

Once the transaction is complete and David owns the property, he can set up a permanent financing structure. He can still secure a traditional commercial real estate loan with longer terms and a fixed interest rate, and use the loan proceeds to pay down the line of credit.

With his line of credit, David was able to act quickly and capitalize on an opportunity to expand his investments.

## Financing a Real Estate Purchase

A mortgage is one of the most inexpensive kinds of debt. Interest rates are still historically low and federal and state tax breaks make it possible for you to pay even less after taking the mortgage deduction. Instead of putting all your cash into the purchase or refinance of your home, you can invest it wisely in long-term, diversified assets; and in the event of an emergency, you'll have easier access to cash if it's not all tied up in the home.

Investors who have a liquidity need and are considering financing options often limit their choices to one specific type of financing — they may select a mortgage when buying a home, or an auto loan when purchasing a car. However, combining multiple financing solutions, such as a secured line of credit and a mortgage, may yield a number of benefits, such as lowering the cost of financing to maximized tax deductibility, and better control in managing the liability side of your balance sheet.

Consider the following examples of combination financing when purchasing real estate.

- **Construction financing**—You can finance preconstruction expenses (such as the purchase of a building lot, permit payments and other planning costs) by taking out a secured line of credit, then obtain a construction-to-permanent mortgage that's more aligned to the beginning of the actual work.
- **Bridge financing**—Use a line of credit to cover closing costs, moving expenses and other needs prior to the sale of your existing property.
- **Tax-efficient financing**—Take a laddered approach to managing your debt by combining a cost-effective, short-term line of credit with a longer-term mortgage. This allows you to maximize your tax-deductible mortgage-interest expense.

## The Convenience of a Credit Relationship

Wealthy investors value a credit relationship with a strong financial institution, as it provides them with peace of mind. With customized financing, such as a secured line of credit, mortgage or commercial real estate financing, they know that they have convenient access to liquidity in the event they need it. Whether the objective is to pay off a large expense, grow a business or pursue an investment opportunity, the effective use of credit is one way to seize an opportunity without disrupting your long-term investment plan.

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