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Regions Wealth Podcast

Episode 36: Strategic Borrowing in a Low Interest Rate Environment

A low interest rate environment can present significant opportunities for Americans of all income brackets to buy their first home, purchase a new car, or even refinance student loan debt. For *high income earners*, a low interest rate environment presents an opportunity to borrow at historically low rates in order to free up cash and remain invested in rising markets. In this episode, we're discussing strategic borrowing, and what factors you should consider before engaging in this particular financial strategy.

Sarah Fister Gale:

Welcome to Regions Wealth Podcast, the podcast that tackles life's challenges with financial experience. I'm your host, Sarah Fister Gale.

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Joining me remotely is Jeff Winick. He's Senior Wealth Strategist at Regions Bank. Jeff, thanks for joining us today.

Jeff Winick:

You're welcome.

Sarah Fister Gale:

So, in this episode of Regions Wealth Podcast, we're discussing strategic borrowing during a low-rate environment. We've taken some frequently asked questions from a bunch of people and developed a character who needs your help. Let's listen.

KYLE:

"Hi I'm Kyle. I'm 46 years old, and I'm a head programmer at a tech company that went public a few years ago. You know, I made a decent chunk of change from that, and wound up investing much of it. It's a fun hobby for me, and I've been able to raise my assets to around $2.7 million.

My wife and I are looking for a new home. We bought a starter home back when our financial situation was much different, so it's pretty small. However we recently found out that we're going to have twins, so we're definitely in need of a significant upgrade. Our budget is $1.3 million, and I was planning on paying cash. Here's the thing: my buddy's been trying to convince me that I should keep my cash and take out a mortgage instead. He's a smart guy and I get why he's saying that: rates are super low at the moment and I'd probably come out ahead if I just kept my cash in the markets. However, it just seems crazy to take on unnecessary debt, so I really need more info on this particular strategy.

Sarah Fister Gale:

So, Jeff, let's start with some background. Why are interest rates low right now?

Jeff Winick:

Well, they've been low for quite a while and there's been a trend for over a decade or more. We've been able to manage inflation. In fact, deflation has actually been a problem in some countries, and so we've had the benefit of long term growth of, industries and our economy as a result of those rates and right now, we're in this transition period with the pandemic where there's a lot of talk about interest rates and where they might be going in the future, but they've been very steady and consistently low for quite a long time, which is one of the reasons we've had such a robust economy over the last many years.

Sarah Fister Gale:

And how much longer can we expect rates to stay low?

Jeff Winick:

Well, that's the real question, isn't it? (laughs) So, the Federal Reserve has announced they are planning a couple of interest rate hikes between now and 2023. Most recently, Fed chairman Powell reinforced the fact that there will be increasing interest rates coming but also reinforced how great the economy's doing, so it's still in that fine balance where there's nothing to indicate interest rates are going up any time immediately soon.

Sarah Fister Gale:
If they do go up, is it going to be a big jump or is it likely to be in tiny increments that you can keep track of?

Jeff Winick:

Well, from the Federal Reserve's point of view, it's very small increments, but there's a lot of other factors in there. And, of course, that's also dependent on how quickly inflation continues to grow. Right now, it's considered transitory but there's some concern - is that really just temporary or is this really a sign of an upward trend? So, it may be that the Federal Reserve's in a position where they have to move more quickly, but right now, it's anticipated mall steps and small increments.

Sarah Fister Gale:

Okay. So, how can low interest rates benefit Kyle in the short term?

Jeff Winick:

Well, in the short term, since their immediate concern is to purchase a new residence, we are at historically low rates and a real advantage for anyone looking to purchase a house. Of course, houses right now are in short supply, and as many of the listeners may know, because of that housing prices are inflated. Some buyers are paying more than market price. It's not just the interest rate. You've got to factor what price you're getting the house for.

Sarah Fister Gale:

And what about the long term? How do low interest rates today benefit Kyle in the long term?

Jeff Winick:

Well, in the long term, he's able to lock in an asset that has appreciation potential at a low cost borrowing rate and to have the use of those funds that he's not dedicated to the purchase of the house itself, that's a real advantage over a long period of time, whether it's 15 years or 30 years, depending on how long the mortgage is. That's a great advantage from both a cash flow standpoint and investment standpoint.

Sarah Fister Gale:

And that's a good point. Let's talk a little bit more about the pros and cons of buying a new house or any asset using cash versus borrowed funds. What factor should he be considering before he makes this decision?

Jeff Winick:

Well, first of all, Kyle's been obviously very fortunate, made a good sum of money, and is starting off at this point in life with a really nice nest egg. They're looking at purchasing a, house that could have a pretty significant mortgage payment, so the question's always, can I do better in the markets, leaving my money there and taking out a significant mortgage, or am I better off paying as much cash down as possible and, therefore, my mortgage payment's lower and cash flow is greater. And with some strategic planning, working with one of our wealth planning teams, you might come up with a balance.

Sarah Fister Gale:

That's really interesting, so it's not just whether or not to put the money in the house, right? It's an opportunity cost. Do you want to invest in the house or do you want to use that money to invest in something else that might drive more value?

Jeff Winick:

Perfectly said, and the question is, whatever else you're investing in, can you do it on a what we call leverage basis at such a low interest rate, that's tax-deductible. There's a school of thought that says the less money I have to put into an appreciating asset like a house, the more I have cash flow to direct to other things, that is, if the markets continue to go up. But as we also know from the 2008 bubble, we can't always depend on real estate going up. We also don't know the time horizon that Kyle will need for staying in that house or change of lifestyle that might require a move to a different residence.

Sarah Fister Gale:

So, when Kyle is considering these factors, should he talk with a professional advisor to determine the best course of action?

Jeff Winick:

Absolutely. I mean, one of the great things about our wealth planners is that they come with a full team behind them. One of those team members includes myself as a wealth strategist, as well as trust advisor, portfolio manager and together, we all kind of bring different perspectives to help our clients balance their different short and long term goals, looking at a lot of different factors. Family dynamics, cash flow needs, overall circumstances and it's something that we like to refer to as perpetual discovery. We're always asking questions and learning about our clients and the more that we know about Kyle and the family, the more we can help customize those recommendations that can help Kyle make a final decision regarding, not just a mortgage, but how much down payment and the size of the mortgage and the term of the mortgage.

Sarah Fister Gale:

Okay, so let's listen to the next part of Kyle's story.

Kyle:

I guess you could call me risk-averse these days. After a decade of investing, I'm pretty financially savvy -- you know, I read market news and that sort of thing -- but I'm not an expert. I've made some sound investment choices in the past, yeah, but there have been a few bungles too. What if the market crashes, and I'm stuck with a huge mortgage? Also, these low rates aren't going to be around for long. Say I get an adjustable rate mortgage -- then what?

I was talking with my boss about this, and his advice was to go for it. He said this could be a good strategy for lowering my taxable income. I gotta admit, that alone right there might make this worth it.

Sarah Fister Gale:
So, Kyle says he's worried about interest rates rising. Would an adjustable rate mortgage even be the right option for him?

Jeff Winick:

Well, actually, quite the opposite. You know, you have the opportunity right now to lock in what will probably be as I mentioned before, one of the lower interest rates Kyle may ever be able to get in a mortgage, for many years to come. It'd just make no sense to take an interest rate risk unless the interest rates have potential for lowering below where they are today. Nobody has a crystal ball, but the general consensus with the announcement from the Federal Reserve and concern about inflation, that interest rates will likely go up short term rather than go down.

Sarah Fister Gale:

So, choosing an adjustable rate mortgage is more, you're hedging the bet that the interest rates would go down rather than up?

Jeff Winick:

Absolutely, an investor who is looking at a short term real estate investment might be willing to risk interest rates going up because it's such a short term, but for a long term homeowner to take that risk in today's environment doesn't make sense. There was a period of time when interest rates were thought to go lower and, as you know, it was a very long term trend. Anybody that had an adjustable rate mortgage during that time came out ahead because they took advantage of those lowering interest rates over time.

Sarah Fister Gale:

Kyle mentions becoming more risk averse with his assets. What are the risks, if any, associated with taking on debt at a low rate and keeping his cash in the markets?

Jeff Winick:
Well, the flip side of putting the money into a mortgage is market risk. Right now, I think the consensus among most professional advisors are that we still have upside in the stock market, and we don't know if we're going to be reaching the top soon or if there is more runway. So, the risk is, making a decision to invest the money and possibly the market performance is not as good as anticipated, it may not be the return that he might've hoped for, which is one of the reasons our wealth teams take a diversification approach. it's not just a matter of putting it all

in the stock market. It's a matter of diversifying into different asset classes, looking for an overall return that hedges against different downside risks.

Sarah Fister Gale:

So, he should really be looking at his house as one of the many assets he's accumulating in his portfolio and what that risk tolerance is.

Jeff Winick:

Yes. But, I would also point out that a home is also a lifestyle choice and, again, going back through the experience of 2008 when the real estate market crashed, you can't always count on a residence to be a long term investment. In many instances, historically, it's been for people who retire and have paid off the mortgage and have the equity to apply in retirement. But the difference is, on a home that you're committed to a mortgage and committed to living in, you don't have the ability to react quickly if there's a market change whereas, with other asset classes, you may be able to react a little more quickly, and so that's one of the differences, but, yes, it is considered one of the asset classes in the overall portfolio.

Sarah Fister Gale:

Okay. That makes sense. So, Kyle is understandably worried about market fluctuations. What factors should he consider if he decides to pursue this strategy?

Jeff Winick:

Well, one of the biggest factors is liquidity and time horizon, and how that comes into play is, at 46 years old, I'm not sure Kyle's, children's ages but college is probably coming up. There could be wedding expenses. Maybe there's some bucket list things that the family wants to do. Especially coming out of the pandemic, there might be some stored up travel goals that they're looking forward to. They might want to be purchasing a ski chalet or a beach home. You have to balance the investment in the market versus cash flow and a lot of that will then depend on Kyle's salary and if it stays at the current levels and what their overall household expenses are, etc. So, I think that if they get a good grasp on their cash flow needs, it can help them determine how much they have available to invest in the market. Kyle's made a good sum of money. I don't know what their lifestyle is right now and how it's adjusted to current circumstances, but all that has to be in balance, in looking for what to invest versus how much to keep liquid.

The other thing is, for those investments, how liquid are they? If I need to get to those investments, what's the time horizon for holding onto them to yield the rate of return that's expected. So, all those are factors that our wealth teams look at to really explore short and long term goals from all different perspectives.

Sarah Fister Gale:

And what about taxes? In what ways can this strategy help reduce his taxable income?

Jeff Winick:

First of all, Congress has encouraged home ownership by allowing a tax deduction on the Federal Income Tax return, as well as the state returns. So, it's a great way to reduce taxable income, and especially with the size house that Kyle's looking at purchasing. There'd be a significant interest rate deduction for that mortgage, which is also a factor whether we do a 15-year mortgage or a 30-year. Obviously, there's more interest deductible on a 30-year then 15, but much more cash flow needed to make a payment on a 15-year mortgage versus 30, but it does remain one of the best ways to reduce your income from an incentive standpoint put out there by Congress.

Sarah Fister Gale:

And this is, again, something he should talk to his wealth advisor about.

Jeff Winick:

Yeah, and not just his wealth advisor, but, you know, CPA and any other tax advisor, as well, because there's a lot of other factors that go into tax planning and we stay on the overall global perspective and wealth planning side. We really like to team with CPAs and other professional advisors and that's a decision that the CPA would be integral in helping Kyle make a decision.

Sarah Fister Gale:

Ok, let's listen to the last part of Kyle's question.

Kyle:

OK, last question: can this strategy work with other types of debt? My wife has some student loan debt from med school that I was planning on paying off, but maybe refinancing would be a better route to take. My boss also keeps pushing for me to get a wealth advisor to help with this kind of thing. I'm thinking about it. Now that my family is getting bigger, I do want to make sure I'm making smart financial decisions.

Sarah Fister Gale:

So, Jeff, Kyle mentions that he was planning on paying off his wife's student loan debt. Would this same strategy, in this case refinancing at a lower rate versus paying off the debt in full, be a smart move?

Jeff Winick:

Well, first let me say that we run into clients all the time that, strategically, it makes sense from an investment standpoint to retain debt. Yet, there's a greater comfort of not having debt. So, student loans I don't know what the interest rate is in that or the payment requirements, but that could be, typically, a longer term debt at a low interest rate any type of consumer debt, credit cards, anything of a high interest rate, especially not deductible we try to keep to a minimum when looking at cash flow and expenses.

I also want to point out that there's a difference between debt and leverage. In the situation with a personal residence - that's a lifestyle choice, you're taking on debt. You're not really looking at it as leverage to make money. If I'm a real estate investor looking to flip a commercial piece of real estate in five years, I'm looking at taking on a loan as leverage to be able to make money. Sometimes, it's a hybrid between both scenarios but, you know, again, we typically try to encourage taking on debt as little as possible as needed, mainly driven by lifestyle, and leverage more strategically when it's used for making money on investments.

Sarah Fister Gale:

Now, finally, Kyle's considering consulting a professional. Can a wealth advisor help him with decisions like these?

Jeff Winick:

Oh, absolutely. Our local teams in private wealth management are generally well-connected to the professional community. We work with a lot of different CPAs, transactional attorneys, estate planning attorneys, tax attorneys in each of our markets and, in many instances, have long standing relationships. So if Kyle doesn't currently have a particular professional advisor, we can generally make multiple recommendations to let Kyle interview and choose which personality and approach fits with his and his family.

The other thing is that one thing we try to encourage is our involvement with those professional advisors to just bring a different point of view. Sometimes, we can quantify different strategies and decisions that are being made by our professional advisors. For instance, we have financial planning software that might be able to project out cash flow needs and the result of investing a certain percentage versus how much mortgage to take on, answering some of these questions. So, we tend to work hand in hand with professional advisors and think that, by bringing all those perspectives together, it tends to, as a general rule, come out with a great result.

Sarah Fister Gale:

So, Jeff, at the end of each of these podcasts, we like to ask our guests for some key takeaways that we can share with our listeners. What key takeaways would you share with them from this conversation?

Jeff Winick:

Well, first, I'd say that, you have to weigh timing versus where the market is and, as I mentioned at the beginning of the podcast, right now, it just so happens the market is a seller's market and prices are inflated. The question is timing. We are still at historic low interest rates. For right now, this is a real advantage for anyone looking to purchase a house. Of course, the counterbalance of that is the fact that it's not just now an interest rate. You gotta factor what price you're getting the house for. Second of all, look at your personal goals, your expenses, your cash flow needs, immediate and long term.

So, you can really determine, how much is the right strategic amount for you to pay in a mortgage as one of your cash flow expenses for the household, and when you're making those decisions, cash flow is really the most important factor from our perspective as a wealth planning team, and that's something that we work with our clients to help determine. What are your short term goals as a family? How much cashflow do you have available to dedicate to a mortgage payment, and you have to consider, am I looking at some major purchases? Do I have college expenses coming up? What are the things that I might need liquidity for that might, otherwise, be locked up if I put too much cash into that residence?

Getting equity in your home is only one way to accumulate wealth. The counterbalance is how much to invest in the market and what the expected rates of return are. So, a lot of different factors to consider for right now, even though there's talk about inflation going up, in the near term, interest rates still continue to be low.

Sarah Fister Gale:

Thank you so much. That was Jeff Winick, Senior Wealth Strategist for Regions Bank. That was great information.

Jeff Winick:

It's been a real pleasure. I really enjoyed today's conversation, and I really hope that our listeners have some takeaways that come from our conversation today that will help them in their decision.

Sarah Fister Gale:
And thank you for joining us today. In our next episode, we're discussing tips for building generational wealth with financial advisor Rachel Tatum. It's part one of our two-part series on building and maintaining generational wealth, so be sure to check back. You can subscribe to Regions Wealth Podcast on your favorite podcast player, or visit regions.com/wealthpodcast to explore past episodes.

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