Take control of your balance sheet

Strategic uses of debt

UBS Financial Services Inc.

Why is this important?

- Many Americans have or leverage debt throughout various stages of their financial lives. In fact, American household debt reached $14.6 trillion in 2021.[1]
- Different types of debt allow you to pursue your goals without disrupting your portfolio strategy or long-term investment objectives. Some debt may provide you with benefits from an income tax perspective, funds to help you in a difficult period and may diversify your portfolio against concentration risk.

What do I need to know?

Depending on your life stage, there are a number of factors to consider as you think about the role of debt in pursuing your wealth management goals.

Young adults and working individuals

Student loans

- Student loans can offer the following potential benefits in addition to helping you cover secondary education costs, including books and supplies:
  - Interest on student loan debt may be deductible to the lesser of $2,500 or the amount of interest you actually paid during the year if you meet certain qualifications.
  - Consider refinancing your high interest student loans to lower your monthly payment. This will allow you to pay off your loans faster and will save you money on interest.
- Be sure to make payments on time because missing or late payments can negatively impact your credit score and potentially hinder your ability to build your net worth.

Credit cards

- While credit cards offer access to immediate liquidity for near-term purchases and emergencies, keep in mind:
  - Credit card interest rates are often higher compared to mortgage or auto loans, so make sure you are paying off the highest interest rate debt first.
  - Responsible use of credit cards can help to build credit or rebuild credit if you experienced financial difficulties in the past.
- Strong credit scores can lead to better loan rates on mortgages or improved chances in renting an apartment.

Credit lines

- Consider a credit line to give yourself liquidity and financial flexibility without selling assets or using cash saved in emergency funds.
  - Credit lines can be used to:
    > Consolidate higher interest rate debt
    > Pay annual or periodic tax payments
    > Invest in or expand your business
    > Purchase real estate or renovate your home

- Credit lines will not charge interest until you actually borrow for your designated purpose, so consider opening a credit line now to prepare for potential future needs.
- Borrowing using securities as collateral may provide access to competitive rates that can be lower than traditional bank loans; however, this type of borrowing involves special risks and is not suitable for everyone.

Homeowners

Home equity line of credit

- Consider a Home Equity Line of Credit (HELOC) secured by your home for revolving credit you can use for home improvement projects, purchasing a second home and other purposes.
  - Your home is the collateral backing payments on the loan.
  - HELOCs can have adjustable rates, so be aware that your monthly payments may increase over time.
  - Payments may also increase over time as some HELOCs are interest only in the beginning and then principal and interest must be paid when the repayment period begins.

Mortgages

- Use a mortgage to help you purchase a home or real estate without having to use cash for the full purchase.
- Fixed rate mortgages maintain the same interest rate over the life of the loan. These loans typically come in terms of 15 or 30 years.
  - Consider the use of a fixed mortgage if you would like the comfort of knowing monthly payments will not change for the life of the loan.
  - Fixed mortgages can also be a more favorable option if you plan on living in the home for an extended amount of time (i.e., longer than 10 years).
  - These loans are more straightforward than adjustable rate mortgages and easier to budget for the borrowers.
- Adjustable Rate Mortgages (ARMs) have fluctuating interest rates that can go up or down with market conditions. These loans usually have a fixed interest rate for a few years before the loan resets to a variable rate for the remainder of the loan's term.
  - Consider the use of adjustable rate mortgages if you want to take advantage of maximum possible savings given the lower monthly payment before the reset period.
  - Adjustable rate mortgages may be more beneficial for individuals who plan on living in the home for a short period of time or paying off the loan prior to the loan reset period.
  - These loans have lower interest rates than fixed rate mortgages for the period before the reset period. They can also allow the borrower to benefit from not refinancing if interest rates continue to fall after the reset period.

Alternative uses of debt

- Consider the use of a credit line to make charitable donations or other gifts. You may choose this option to give to your favorite organization or pay for your grandchildren to go to college.[2]
- Refinance an existing mortgage or purchase property.
  - Your credit score and income from sources such as your portfolio, Social Security and pension will be evaluated to determine if you qualify for better terms upon the refinancing.
  - Pay attention to the costs associated with the refinancing (typically 2% – 5%).
- For specialized borrowing needs, you may want to consider the following programs:
  - Concentrated and restricted stock
  - Unsecured loans
  - Private stock liquidity
  - Hedge fund-backed loans

Important terms

- **Credit score:** Having a high credit score may allow you to qualify for better rates and will give lenders more confidence in loaning you money. A good credit score is typically higher than 700.
- **Debt-to-income ratio:** Your debt-to-income ratio compares how much you earn each month to how much you owe. You can use this ratio to determine if taking on more debt is the right choice for you. This ratio should typically be between 30% – 35%.
- **Down payment:** A down payment is the initial payment made in cash that represents the difference between the selling price and the amount borrowed for the purchase of a home, car, etc.
- **Interest rate:** An interest rate is the amount the bank charges you to borrow money from them. The lower the rate, the less you are charged. When selecting a liability, such as a mortgage, research to find the lowest rate.
- **Principal:** The initial value of a loan.
- **Refinance:** The process of obtaining a new mortgage in an effort to reduce monthly payments or lower your interest rate.

What should my next steps be?

- ☐ Let's review your current debt situation.
- ☐ If you have debt, let's discuss your strategy for managing it and reflect this in your financial plan.
- ☐ If you don't have debt, let's discuss if leveraging debt makes sense for you.

[1] Source: *debt.org*; "Demographics of Debt" 2021.
[2] Payment of tuition directly to an educational institution may qualify as a non-taxable gift.

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2022-664252
Exp.: 01/31/2023, IS220160