

YOUR ACTIVE WEALTH PODCAST

Borrow Like a Billionaire

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Featuring:

Rick Calero, *Head of Banking and Lending, BNY Mellon Wealth Management*

VO [00:00:01] Is your wealth strategy supporting your long-term goals? Welcome to *Your Active Wealth* with BNY Mellon Wealth Management, where we offer insights that can help you move closer to your goals. We'll tackle timely topics through the lens of the five pillars that comprise our Active Wealth framework, Invest, Spend, Manage, Borrow and Protect, and provide guidance on navigating the unpredictable, to help you build and sustain wealth.

Ben [00:00:34] Hi and welcome back to *Your Active Wealth*. I'm your host, Ben McGloin, and today we're going to reveal how billionaires multiply their wealth, and how you too may be able to do the same thing. It's all about borrowing. Yes, that's taking on debt to build your wealth. And so, to help explain what the term strategic borrowing means, I have the pleasure of introducing you to Rick Calero, head of banking and lending for BNY Mellon Wealth Management. Welcome, Rick.

Rick [00:01:01] Hi Ben, how are you?

Ben [00:01:02] So let's jump right into this, Rick. So there obviously has been a lot of recent media attention and political rhetoric around some of the recent revelations on how some high-profile billionaires fund their lifestyle while paying little to no tax. But can you provide some context on how the wealth of this demographic looks like today compared to perhaps what it was 5 or 10 years ago?

Rick [00:01:21] Sure, Ben. Clearly, given what we've seen in the markets, wealth creation has gone to new levels over the past decade, just a function of new industries, new activities, and just very effective planning, if you will, all kind of supported by very strong capital markets.

Ben [00:01:44] So let's dig into that a little bit and maybe kind of break that down more, right? So obviously, we talked about or you mentioned kind of reference to capital markets, equity markets. Can we just talk a little about the spending and maybe some of the investing habits of this demographic?

Rick [00:01:59] Yeah. With the with the demographic, call it ultra-high net worth individuals or family offices, what they've been able to do is manage their finances similar to the way a company would manage their finances. So, they're not looking just at assets, but at liabilities, the cost of capital overall. And they're leveraging that to get even greater returns than they would have by just looking at one side of the balance sheet.

Ben [00:02:28] So maybe paint me a picture, right? Without naming names, what does the average billionaire do to manage their personal financial affairs?

Rick [00:02:35] So millionaires and billionaires manage their personal financials the same way, as I mentioned a business would by utilizing their entire balance sheet, including the use of, as you said, strategic borrowing or leverage to fund their spending and their investing. By doing so, they also effectively minimize their tax obligations and the hefty tax bills that would come from liquidating much of the gains that they've earned. So again, a very strategic approach to funding lifestyle and further investments.

Ben [00:03:05] So if you kind of think about maybe, unlike ordinary income, right, asset appreciation is not taxed until a gain is realized. Can you maybe talk through the benefits? I think you were kind of alluding to that, but, maybe, kind of talk specifically through the benefits there?

Rick [00:03:19] Oh, exactly right, Ben. Billionaires generally derive most of their income, of course, from asset appreciation rather than salaries or bonuses. Unlike ordinary income, asset appreciation, as you mentioned, is not taxed until a gain is realized through the sale of the asset. So in order to avoid or delay the hefty tax obligation resulting from the capital gains incurred, they borrow against their wealth and use the proceeds just to pay their expenses, but also to reinvest in new ventures. Effectively, they keep their tax bills low, continue to benefit from the appreciation of invested assets and increase their overall net worth, which is the additional investment made in many cases from the loan proceeds.

Ben [00:03:59] And, you know, billionaires, obviously by definition, right, they have billions of dollars, right? And they're using their investments really in their own companies to borrow like a company, as you said. But maybe how could someone with less wealth still, as you mentioned, the ultra-high net worth, what can they do? How can they do that?

Rick [00:04:16] The same way, really, it's the same mechanics, if you will, just at different levels, of course. And it's important to note that many people have been doing this, families, high net worth individuals, they've been doing it for years. It was more common, perhaps to borrow against a home, if you will, you know, using that asset and that appreciation. So, we've always heard of people either getting a home equity line of credit or getting a cash out refinance, for example. What's unique here is that the assets we're talking about, even at, for example, at the \$20 million level, that has significant benefit if you look at where interest rates are at and where, discussed earlier, where the equity markets are at, you know, you can effectively borrow at call it 2% right now. And again, there's a lot of talk as we all know about interest rates rising, but it's still historically low rates offset by very strong equity markets. So, you effectively remain reinvested regardless of the level, you're remaining invested at, say, 6-10%, and you're borrowing at effectively 2%. And the dynamics will always change, and I think it's important to, as we've discussed in the past, is to actively manage your wealth, but you can see immediately the benefit, not even incurring the capital gains, just the benefits of remaining reinvested and borrowing either to leverage or get some leverage for additional gains or to fund a lifestyle. So, it's just now I think that we are because equity markets have been so strong for so long, it's only now that people are looking at their entire balance sheet. As I mentioned in the past, it might have been just a home, but clearly security-based lending or other forms of lending also provide real advantages.

Ben [00:06:09] So Rick, with all of these techniques as relates to strategic borrowing, can anyone do this if they have a reasonable amount of investments to leverage?

Rick [00:06:16] For the most part. It always comes down to, it's less sometimes about the level of wealth, as it is about the assets, if you will. So, think of your home as an asset for a moment. There'll always be some equity in the home. For the most part, right? If you're fully leveraged on your home, you probably don't have much to be able to borrow against. If you're in a fully diversified portfolio, almost regardless of the amounts, there is some leverage that you can gain from that portfolio. So, it's less about-It's two things, I guess. The type of assets that you're borrowing against and the liquidity of those assets. Those are probably the key drivers more often than not. But from a million or higher, yes, there's always opportunity for the most part. And lastly, I just want to, on this point, it also comes down to the client and how they view leverage, how comfortable they are with it, because, let's face it, it does have to be paid back as well. So, you want to make sure that before you borrow, you understand process or you understand the type of leverage that you're utilizing, its impact and what the risks are. So, for example, if you're if you're heavily leveraged and the markets go down, how will you pay the loan? Which I think is what always causes a lot of the anxiety? But if you're if you have a low level of debt relative to your assets, even a significant level, even a significant correction in the market would not impact you at all.

Ben [00:07:50] So along those lines, what if, as an investor, an investment portfolio is really the sole asset in that situation, what can one be doing?

Rick [00:07:57] No, exactly, but we've seen a lot in the past two years, especially given the pandemic, many wealthy individuals we saw in the great demographic shifts that have been occurring over the past two years. Many have used their equity assets to effectively get a security space loan. They'll borrow the money again, roughly 2%, buy a home in cash and then put a mortgage on that afterwards. So now there's real power, effectively making a cash offer on a home or on some purchase, and then perhaps substituting the type of loan that gets put in. But clearly, now you have someone, without dipping into their assets, effectively buying a home as if they were buying it in cash, giving them real buying power, remaining invested in the markets throughout the pandemic and paying some of the lowest rates we have ever seen in the interest rate environment. So very simply, if someone, let's say at the \$20 million mark borrowed \$5 million, our research and our analysis has shown-and all of this thought leadership is available on our website-you can see how much the benefit of that, financially, has benefited the borrowers who did this. We've seen, if you can imagine, rather than liquidating \$5 million of your portfolio in March, April, June of 2020, using your assets to buy a home, for example, remaining invested in that almost two-year period, you would have had significantly different outcomes 24 months later than if you had liquidated. So, I think it's and it's less pronounced over the long term, but in the short term, it was a true financial gain and the future is always going to be different. Again, I always go back to being active about it and deliberate in any given environment. Obviously, there's a lot of volatility out there today, but, in a thoughtful approach, in a well-diversified portfolio, not maximizing your leverage but prudently using your leverage, I think is always the best approach.

Ben [00:10:03] Right, and you made reference there to the pandemic, the early onslaught of the pandemic. Kind of back to your comments around companies where we saw a large number of companies borrow and just kind of keep cash on balance. And then, as you mentioned, kind of looking forward, I'm curious, you know, as it relates to kind of the interest rate, right? So obviously, we're coming out of a period of a relatively low historic, not relatively but historic, low interest rates, you know, as it relates to going forward and potential changes in interest rates, how do you think that plays into strategic borrowing?

Rick [00:10:35] Yes, so I think there's a couple of approaches. I think we're seeing clients obviously look to fixed rates where possible to take out some of the variability that might be expected going forward. So rather than, for example, on a home, rather than just refinancing them, they may do a cash out refinance on a 15- or 30-year fixed mortgage, for example. With securities-based lending, there are some options that you can try to do to fix your rate to take out some of that volatility or that expected rise in the interest rate. And then it's forward looking on both interest rates and the markets. That's where the decision point is at if you will. What do you expect market to do, especially given the volatility that we've seen since the start of the year. And where do we think interest rates are going to go? And, ultimately, it comes down to, as we've always discussed, is the need to be active to be deliberate in your approach to this. Similar example to what you gave, Ben, with companies rushing to strengthen their balance sheet early on in the pandemic. There may be different decisions as we come out of the pandemic, and we continue to see either inflation or interest rates rise, being ahead of it, if you will, is always the best approach. And to be prudent at the end of the day, don't overly extend, minimize your taxes and remain invested.

Ben [00:11:57] OK, so Rick, strategic borrowing obviously requires taking on debt. So how do you approach an individual who maybe loathes or is anxious about taking on debt?

Rick [00:12:06] It's a great question, and it's a little bit of how an individual manages their balance sheet, just like we've discussed before. Very few companies, if any, in the US who don't use leverage in some form or fashion, it just it helps, if you can think of it as using leverage to acquire more wealth, that goes a little bit to an asset that appreciates versus an asset that depreciates, which I think is very often the way we think of debt, right? You buy a car, you want to pay it off as soon as possible, et cetera. But then there's leverage that builds wealth. So, if you're using your wealth to effectively invest more or to purchase other assets or to minimize your taxes, then you're effectively using leverage to accomplish what companies throughout the United States do. They're using

their balance sheet, optimizing their leverage to effectively earn more, either by increasing their balance sheet and their assets overall or by mitigating the tax consequences of liquidating for whatever their needs are. So, while it seems counterintuitive to go into debt, it always comes down to the purpose of the debt. The benefits of it, for example, not liquidating your assets or by to minimize your taxes. That's what makes debt or strategic borrowing so powerful. And it speaks a little bit to, as we mentioned, just the way you look at your entire assets and liabilities, not just your assets.

Ben [00:13:41] And Rick, along those lines, many of our teams and advisors work with entrepreneurs, either, you know, founders, closely-held businesses or founders who have some liquidity event. Any kind of words of wisdom as it relates to founders maybe perhaps that are, you know, still have a lot of their net worth tied up in closely-held shares or companies as it relates to employing strategic borrowing?

Rick [00:14:05] Yeah, it's a little bit it's a little more difficult with pre-IPOs or restricted shares, for example, to borrow against because, effectively, they are not liquid, if you will, right? There are some options that we can provide, that the market can provide, but that is a unique situation in a pre-IPO, call it, or in a recent transaction. It's the, it comes down to effectively the liquidity of the assets. Illiquid assets of any sort are just much more difficult to work with, if you will, and our single stock position, which add a layer of risk and complexity to them as well, so while there's an affinity towards, you know, the firm that you built or the company that you created, recognize that that single position could also be risky in the long term, if you will. So, it's an active deliberate approach to advice, but they do provide they, there are options, they're just, they require some very thoughtful analysis. So, for example Ben, it could be that there's just a lower loan to value that can be extended to those, I would kind of call it singles or restricted shares and or pre-IPO shares just to account for that risk, if you will. But this is still a actionable strategy that almost anyone with any level of wealth can employ.

Ben [00:15:25] And Rick, I know a number of our clients will acquire what I call unique assets. Whether that's arts, aircrafts, can you maybe talk a little bit around kind of more specialty financing? And again, really the idea of kind of how to strategically borrow right, leveraging, you know, one's balance sheet, but kind of some of the practices that you see, you know, ultra-high net worth individuals and families that work through?

Rick [00:15:49] Yeah, it's, there are different asset classes, Ben, right? There are those assets that one expects to appreciate. You mentioned art as one, and there are those that are likely to depreciate over time. And so, how they, how you borrow against those is completely different because if one will, one will have a life span, whereas another one will not. They're tied to the underlying value of the collateral. But I think as long as you recognize so, for example, on specialty lending like you mentioned like aircraft, clearly that should be a fixed term for the loan now. Some wealthy individuals or families will purchase aircraft or some of these other unique assets using securities-based lending, rather than the underlying collateral of the aircraft itself, for example. But they still operate in the same fashion, effectively using your assets, using the product or the service with the lowest interest rate and best terms overall to achieve what you're looking to accomplish, regardless of whether it's lifestyle spending or leveraging your assets for additional assets overall. But nevertheless, it's the term, the structure, the rate and the expectations of the market that all kind of come to play.

Ben [00:17:01] Terrific. Switching just as it relates to real estate, which again, I think a high proportion of our clients and advisors to our clients, whether it's residential, commercial, really just looking for any kind of thoughts there as it relates to again, strategic borrowing, looking at from a ultra-high net worth perspective, kind of some of the things that individuals really should be thinking and working through.

Rick [00:17:24] Yeah. So, what we've seen on the chart with the residential side, Ben to your point. Housing continues to be a relatively hot market in geographies or locations that historically have not always been as significant, right? So, middle of the country, away from the coasts, if you will, very, very hot market. We've seen home prices increase dramatically. Conversely, we've also seen interest rates begin to rise. So, year-over-year, there are probably about 50 BPS, as are more closely linked to the 10-year Treasury than some of the other forms of borrowing might be linked to shorter term indexes. And then we're seeing a lot of wealthy individuals begin to pick up real estate, commercial real estate, as to benefit cash flow, if you will, so they can earn that cash

flow over time from a generating asset like that. So commercial real estate, depending on the type of property or the type of use, if you will, is going to, is still kind of soft in the market for the most part, that's really being driven mostly by the pandemic, more so than anything else. So, hotels, for example, is a perfect example. The uncertainty around it, of course, over the past two years, to generate income to effectively address the debt has been a little bit more questionable. But we've seen we're seeing an increase in that space, and it's a terrific asset class. I mean, it's grown dramatically over the past decade as well. The past 24 months have added a little bit of softness to it, but fully expect that to come back in favor, if you will.

Ben [00:18:57] Great. And I know we've talked a lot about, I would say, traditional assets, you know, some specialty unique assets as well, you know, life insurance right now with, you know, folks looking at ultra-high net worth looking at, you know, lifetime exemptions and estate potential estate tax changes forthcoming. Any thoughts there as it relates to strategic borrowing and funding life insurance policies?

Rick [00:19:21] It's an amazingly powerful estate planning tool to be able to effectively fund a life insurance policy based on the cash in the policy or the assets in the policy. We've seen, as part of our client's estate planning process, if you will, they've been able to see the benefit of, again, taking advantage of the low interest rate environment, effectively purchasing life insurance to offset tax liability in the future for other generations, if you will, and effectively using the low interest rate environment to purchase, call it, 7 to 10 years of coverage, if not more, for the purposes of estate planning. So very powerful tool overall between generations. And, clearly, another tool in what our clients are using in terms of how to optimize their balance sheets and minimize their tax liabilities in the future.

Ben [00:20:19] So, Rick, as it relates to life insurance policies, with regards to planning, what specifically are we seeing clients do today? Do you have a specific example you can share?

Rick [00:20:28] Less of a specific example, but a little bit more of a, perhaps a strategy. So, if someone is a high net worth individual, is looking at the tax liability for their heirs, if you will, they can effectively borrow to purchase life insurance. The underlying cash in the life insurance policy would be the collateral. So, effectively, you buy life insurance, you borrow for the premiums, going forward, it's secured by the cash in the life insurance policy, and then the beneficiaries, effectively, get a tax-free benefit from the life insurance policy. So, they're basically using leverage to mitigate the tax liabilities for future heirs. A very, very powerful tool for the ultra-high net worth client base to help their beneficiaries going forward.

Ben [00:21:24] And as it relates, you mentioned kind of families and maybe multigenerational family bank is something that we hear a lot about, particularly in the ultra-high net worth space. Could you maybe talk through, again, maybe what your experience is and what you're seeing families benefit from strategic leverage and strategic borrowing in that space?

Rick [00:21:44] So the concept of family bank is, effectively, where family office or these ultra-high net worth individuals leverage the power of their resources to get the most favorable rates and then pass on some of those rates and those benefits to other generations. So, effectively, using the capability of the entire portfolio and benefit other generations that may not with a wealth head perhaps not yet cascaded, if you will. And so that allows for beneficiaries, other generations, to, effectively, purchase homes at lower rates. Again, lifestyle spending, minimizing taxes across the board and, effectively, provide for larger inheritance in the future at some point. So, the concept of family bank ultimately comes down to using the size of the portfolio overall to benefit other generations.

Ben [00:22:42] So, Rick, with all of these techniques that you've discussed, is it safe to say that anyone can do this if they have a reasonable amount of investments and assets to leverage?

Rick [00:22:50] Again, just being very deliberate about it all, I think every situation is unique. Every entity, every portfolio, different levels of risk tolerance across the board. And we use the term Active Wealth here at BNY Mellon and it's, ultimately, coming down to just the same way we started the conversation is to look at the entire balance sheet and the power the strength of the balance sheet can generate for one's own worth or generational

wealth going forward. And, so, there's unique mechanisms, unique products that can be utilized for all the reasons we've talked about, right, Ben? Whether that's lifestyle, minimizing taxes, leveraging the portfolio to optimize future income. But it's a matter of being deliberate and consistently thoughtful about the best approach to strategic leverage.

Ben [00:23:41] Well, thanks, Rick, for joining me and explaining how strategic borrowing can be used to build wealth.

Rick [00:23:46] Ben, it was always a pleasure to spend time with you and thank you for the opportunity.

Ben [00:23:49] Well, thank you. It may sound counterintuitive that going into debt can make you wealthier, but Rick has shown us here how it can be done. Strategic borrowing is all about staying invested and borrowing at attractive rates. Rates that are lower than: 1) how much it would cost you in capital gains if you sold assets to pay for expenditures, or 2) lower than the returns you expect from reinvesting the proceeds of that borrowing. To learn more about strategic borrowing and our Active Wealth approach. You can visit our website bnymellonwealth.com. Thanks for joining and see you on the next episode of *Your Active Wealth*.

VO [00:24:22] Thank you for listening to this episode of *Your Active Wealth*. Be sure to subscribe to this podcast on Apple Podcasts, Spotify, Google Podcasts or Stitcher and visit bnymellonwealth.com to view the latest insights on the subjects that matter most to you.

As of September 2023, Ben McGloin is no longer working at BNY Mellon Wealth Management.

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