Wealth Planning Update

Credit Strategies in a Rising-Rate Environment

SEPTEMBER 2018

Parrish L. Peddrick
Senior Wealth Planning Strategist
Wells Fargo Private Bank

Brian J. Singsank
Senior Private Banker
NMLSR ID 519462
Wells Fargo Private Bank

In this Wealth Planning Update:

» *Rate increases are expected to continue, potentially affecting your wealth plan.*

» *Increases in interest rates affect more than loans—your investment portfolio, liquidity needs, and wealth transfer planning also may be affected.*

» *There are various strategies to consider in a rising-interest-rate environment; we recommend speaking with your advisor to determine possible impacts and potential next steps.*

After more than nine years of navigating the historically low interest rates in the U.S., the long-predicted cycle of rising interest rates and changing fiscal policy has arrived and settled in. The Federal Reserve (Fed) has started slowly increasing interest rates, and we expect several more rate increases in the coming months and years. The Wells Fargo Investment Institute's rate forecast for the Federal Funds Rate, the Fed's primary tool for influencing economic growth, is predicated to be between 2.00% and 2.25% at year-end 2018. Given that interest rates should continue to rise, now is an opportune time to discuss these changes with your wealth team and review their impact on your wealth plan.

The potential impact of a rising-interest-rate environment

Rising interest rates can have a direct impact on three important financial areas: investment portfolios, credit portfolios, and liquidity needs. In a rising-interest-rate environment, you could benefit from reevaluating your investment portfolios, factoring in the potential associated portfolio risks. We recommend speaking with your investment professional to help ensure your strategic asset allocation is aligned with your investment objectives and risk profile.

Likewise, consider the potential impact of rising interest rates on your existing credit portfolios and future borrowing needs. Leverage can be a tool to help address and manage financial goals, such as increasing cash flow, increasing tax efficiencies, financing purchases, managing investment allocations, and realizing wealth planning goals. Clearly, the outlook for interest rates may affect how you use credit to address these goals. Also, consider your liquidity position, which can help you navigate the potential impacts of interest-rate changes and take advantage of opportunities that changing rates may present.

We encourage you to proactively review your wealth plan and related credit needs now while rates remain low. There are several important themes to consider in a rising-interest-rate environment:

- While lines of credit may be a great option for managing short-term liquidity needs, you should prudently monitor the benefits and the costs of borrowing as rates continue to rise.
- Over time, higher rates may affect purchasing power for big-ticket items (such as homes, boats, and airplanes) that are traditionally financed over time.
- Short-term yields have materially increased and your savings account is earning a little more in interest each month, although those rates are not likely to increase as quickly as interest rates in instruments are tied to the prime rate or LIBOR.
- Low federal funds rates amplified the success of estate freeze techniques by allowing individuals to move assets to others with little or no gift tax. The higher threshold rate that may now apply to such techniques, like intra-family loans, sales to defective grantor trusts, grantor retained annuity trusts, and certain charitable giving strategies, may alter the effectiveness of such strategies. However, the significantly increased estate and gift tax exemption amount makes now an ideal time to explore wealth transfer, especially before rates rise much more.
- The current environment presents an ideal time to examine your balance sheet and delve deeper into your credit, liquidity, and interest-rate risk management needs.

Credit and liquidity strategies to consider in a rising-rate environment

An effective credit and liquidity strategy should be aligned with your financial goals and wealth plan, and the first step in achieving this is to review your personal balance sheet. Consider these three questions to begin a conversation with your wealth team:

- Based on current balance sheet leverage, what is your exposure to rising interest rates?
- Are you comfortable with the amount you are paying or may pay to service existing variable interest payments in a continued rising-rate environment?
- As part of achieving financial goals, do you anticipate upcoming borrowing or liquidity needs?

Once you have answered these questions, you will better understand whether you need to make changes to your wealth plan and current borrowing strategies to help achieve your short- and long-term goals. In taking a fresh look at your liabilities, there are several strategies that you may want to consider.

Review existing borrowings:

- Have you reviewed and do you understand the terms of your existing credit facilities?
- For those with adjustable-rate mortgages near or in the adjustment period, have you considered refinancing to a longer-term fixed rate that aligns with the time horizon you plan to own the home?
- Are there loans that will need to be renewed in the next three years? Have you explored refinancing or restructuring opportunities for those loans now versus waiting until maturity?

- For those with longer-term borrowing needs, the flat yield curve is presenting value in longer-dated fixed-rate borrowing options.

Evaluate and plan for future liquidity and borrowing needs:

- Are you planning to buy or build a new home or vacation property or considering other commercial real estate investments?
- Do you anticipate needing new or additional liquidity in the near term?
- Do you have a line of credit or source of standby liquidity for unexpected needs?

Assess your risk tolerance and exposure:

- Does this changing fiscal and political environment make you reconsider the terms of your loans? Have you evaluated your exposure to rising interest rates?
- Do you understand how a 1% rise in short-term rates could affect your investment portfolio and any credit facilities tied to variable rates?

Conclusion

Now is a great time to discuss these topics with your wealth team in partnership with your tax professional and private banker. A leverage and liquidity assessment is an important component of your holistic wealth plan, particularly in a rising-interest-rate environment.

Disclosures

Wells Fargo Private Bank provides products and services through Wells Fargo Bank, N.A., and its various affiliates and subsidiaries. Wells Fargo Bank, N.A. is a banking affiliate of Wells Fargo & Company.

Wells Fargo & Company and its affiliates do not provide legal advice. Please consult your legal and tax advisors to determine how this information may apply to your own situation. Whether any planned tax result is realized by you depends on the specific facts of your own situation at the time your taxes are prepared.

All loans are subject to credit approval.

Real estate investments carry unique risks, including lack of liquidity and potential complex tax consequences, and may not be suitable for all investors.

WCR-0618-00266