

THE NAVIGATOR

A FINANCIAL PLANNING RESOURCE FROM APPLESEED CAPITAL



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In our financial advisory role, we seek to work with clients to address the full spectrum of their financial needs. The investments we manage are on the asset side of our clients' balance sheets, but it is just as important to make good judgments on the liability side. This Navigator is intended to provide useful and actionable information regarding the lending capabilities available at the two main custodians our clients use: Pershing, a division of Bank of New York Mellon, and Charles Schwab. In addition, we discuss other services that these custodians, and their affiliates, offer to Pekin Singer clients.¹

CUSTODIAL SERVICES

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In our discussion of custodial lending capabilities, we will address two different custom lending options available to clients through Pershing and Schwab: asset-based lending and mortgages. Those clients who hold their assets at one or both of these custodians may have access to custom lending solutions at preferred interest rates that may not be available elsewhere.

By way of disclosure, we want to note that this Navigator is being presented for informational purposes only. Appleseed Capital is *not* compensated by any of the lending services our clients use (or intend to use) at either custodian, and clients always have the option of selecting their custodian,

¹ BNY Mellon and Charles Schwab Bank provide banking services for Pershing and Schwab, respectively.

whether it is Pershing, Schwab or another entity. Our goal in sharing this information is simply to make clients aware of the lending services and other services provided by Pershing and Schwab.

ASSET BASED LINES OF CREDIT

Both of our clients' primary custodians (Pershing and Schwab) offer asset-based lines of credit to customers that maintain taxable investment portfolios with that custodian. An asset-based line of credit allows an investor to borrow money and use his or her investable assets as collateral for that loan. Therefore, an investor can access a credit line and the associated liquidity without selling off assets, realizing capital gains, incurring associated tax liabilities, or disrupting existing investment strategies.

Common characteristics of asset-based loans include the following:

- The loan is collateralized by liquid investments in taxable portfolios.
- The amount of the loan generally cannot exceed the value of the collateralizing portfolio.
- Interest rates are based on a specific spread over LIBOR and are therefore variable. Rates are often quite competitive and can be lower than standard bank loans or credit card advance rates.²
- No set-up, wire transfer, or maintenance fees.
- Interest is charged only on the amount of money borrowed, not the total credit line available.

² Because asset-based lines of credit are collateralized, they are also generally accompanied by lower interest rates; in the event of a loan default, the custodian can theoretically recoup its investment by seizing and liquidating the assets tied to the loan.



Asset-Based Lending Example

John currently owns a summer home, and another summer home with beachfront access has become available. John wants to purchase the second home prior to selling his first home. John has a \$2 million taxable investment portfolio with sizeable unrealized capital gains.

In this scenario, the advantages to using an asset-based loan include low (yet variable) interest rates, no origination costs, no disruption to John's investment portfolio, no requirement to move assets, and no taxable gains are realized. John borrows \$1 million for the purchase of the second home using an asset-based loan from his custodian. He is not required to sell any securities, nor must he realize any taxable gains; there was no disruption to the investment portfolio as a result of this loan. John can then subsequently sell his first summer home and repay the asset-based loan with the proceeds of the sale once it occurs.

MORTGAGES

The mortgage market is highly competitive, and many providers of mortgage services, including Pershing and Schwab, provide excellent rates. With that said, we believe there are two reasons for clients to consider obtaining a mortgage through their securities custodian.

First, custodians typically consider a client's investable assets as collateral, which often results in more competitive financing terms. Custodians examine a borrower's investment net worth, asset allocation, and investment history to help better determine the credit risk faced in the mortgage underwriting process.

Second, per our conversations with representatives from both Pershing and Schwab, each custodian places a strong emphasis on making the underwriting process as smooth and painless as possible for their clients. Because of the existing investment relationship between our clients and their custodians, the banking representatives of these custodians have a strong incentive to provide a high level of service throughout the underwriting process.

OTHER CUSTODIAN SERVICES/CAPABILITIES

In addition to the lending solutions available through Pershing and Schwab, these custodians also provide a

number of other services that may be of use for some of our clients. Below we have outlined some of the more popular services offered by Pershing and Schwab.

Escrow Services³

Escrow services involve hiring a third-party agent to custody funds (or other assets) as a means of facilitating a specific transaction between two different parties. The assets being exchanged are held with a third-party until all obligations from both parties are fulfilled. Escrow services are often used in the process of purchasing or selling a home. Once both parties have signed a mutually acceptable purchase agreement, earnest money is then deposited into an escrow account while the closing process continues. Other examples include car purchases, construction services, real estate property rentals, and auction transactions.

Donor-Advised Funds

A Donor-Advised fund (or Charitable Account) is a tax-advantaged investment account in which the underlying assets are specifically earmarked for charitable purposes. Individuals receive a tax deduction upfront when irrevocable contributions are made to the portfolio. Meanwhile, the funds are invested for potential tax-free growth for future use, and decisions about exactly how the funds will be used (e.g., the amount, timing, and recipient of donations) can occur over time. Keep in mind that investors can contribute long-term appreciated securities to charities, thereby avoiding the taxes associated with capital gains on those securities. Therefore, if a client has the intention of donating to qualified charities, one could transfer securities with unrealized gains into a Donor-Advised fund and distribute the proceeds to the selected charities in a tax-free manner over time. Furthermore, clients may also contribute illiquid assets such as real estate, closely-held business ownership, or private equity to a Donor-Advised fund. This capability can provide great flexibility in the estate planning process.

Administrative Trustee Services

Many clients construct trusts as a means to protect and enhance their wealth, minimize future estate tax liabilities, and ensure the efficient transfer of their assets upon their demise. The trustee allocates the assets on behalf of the beneficiary and eventually transfers those assets according to the trust documents. Clients who prefer to use corporate professional fiduciaries to act as trustee, as opposed to an individual family member, may wish to have their respective custodian carry out those responsibilities.

The benefits of having a custodian act as an administrative

³ As of the publication of this Navigator, Pershing/BNY Mellon provides Escrow Services; Charles Schwab does not.



trustee include the following:

- Administrative trustees are generally able to avoid the potential conflicts and compromises to objectivity that may arise in trust administration.
- Administrative trustees bring professional knowledge, expertise, and experience.
- Employing a custodian as an administrative trustee helps to streamline the collaborative relationship among trustee, client, and Appleseed Capital.
- Time consuming responsibilities, such as tax filing, income and principal distributions, accounting and recordkeeping, and account activity reporting can all be delegated to the administrative trustee.

CLOSING THOUGHTS

We would like to conclude this Navigator by sharing two important points. First, while the lending services offered by our clients' custodians are useful, one should be careful about the amount of leverage employed. Leverage amplifies investment returns, both on the upside and on the downside; it is therefore prudent to keep personal leverage to a reasonably low level. Second, our analysis intentionally covered these topics at a high, summary level; should you have additional questions about any of these services, please do not hesitate to contact your Portfolio Manager.

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