REGIONS

Regions Insights Podcast

Episode 3: The Role of Debt When Interest Rates Are Up

Episode 3 of The Regions Insights Podcast's series is all about what happens when the cost of money increases, and offers insights and ideas that will leave you with a fresh outlook on your relationship with debt. The conversation features advice from Regions specialists Trevor Skelley, VP of Private Wealth Lending, and Maya Brill, SVP and Senior Wealth Strategist.

Episode Transcript

Chris Blose: Welcome to The Regions Insights Podcast. I'm your host, Chris Blose, and on this show, we look at trends, tips and triumphs around your money.

Few words in the financial world elicit a reaction quite as dramatic as "debt."

We might instantly think of debt as negative — as something that causes anxiety. Debt feels like irresponsibility, or the inability to crawl out of a hole. That anxiety rises when we see big numbers, like the fact that American household debt hit a record high of $16.9 trillion by the end of 2022.

But debt is more complex than that. Managing and leveraging it properly allows you to accomplish things that otherwise might not be possible, like taking out a loan to start a new business or a mortgage to finance a dream home. It's never a simple equation — especially in a time of rising inflation and high interest rates.

So how should consumers and businesses adjust their approach to debt now and in the coming year?

Trevor Skelley, Vice President, Private Wealth Lending Advisor at Regions Bank, had this to say.

Trevor Skelley, VP, Private Wealth Lending Advisor at Regions Bank: In general there are a couple of ways that debt can be used that would be considered good debt and in general it's to use to finance appreciating or income-producing assets such as real estate or privately owned businesses also can make sense and and can be used to be beneficial to clients to provide liquidity for short-term capital needs rather than selling existing highly appreciated assets or income-producing investments to avoid realizing capital gains and missing out on future cash flow from those assets.

Chris Blose: We'll hear more from Trevor in a bit, but first, let's turn to his Regions colleague Maya Brill, a Senior Vice President and Senior Wealth Strategist. She helps clients with wealth, estate, business planning — and more. First, we asked for her take on where interest rates stand now, and how that affects our choices about money.

Maya Brill, **Senior Vice President and Senior Wealth Strategist at Regions Bank:** Obviously, with interest rates getting higher, it makes debt more expensive and so it makes it more of a thought process that you have to go through when making the decision of whether or not you wanna acquire something new. The cost of funds is more expensive of course.

Maya Brill: Clients are definitely going to be more risk averse and have a greater analysis when looking at cash flow projections for acquiring things. They're gonna be concentrating more on, does it make sense to maybe lock in a fixed interest rate as opposed to going with a floating rate and what the spread's gonna be between, whatever they're investing in, is the expected rate of return on that versus what the interest rate is gonna cost them.

Chris Blose: And what consideration should people make when they're managing existing debt in such a scenario?

Maya Brill: For existing debt clients need to start looking at whether or not it makes sense to refinance some of that debt into something that's fixed, whether it makes sense to start potentially repaying, accelerating repayment on that debt, so that it's not gonna be out there for as long, or as big of a burden on them. They need to start looking at whether it makes sense to put some kind of a swap in place to fix those interest rates. So those are the things that clients really should be taking into consideration when stress testing their plans, for what their debt service is gonna look like.

Chris Blose: And does that approach vary depending on whether we're talking about an individual or a business, for example?

Maya Brill: Yeah, so the businesses are really the ones that are gonna have more opportunity with swaps to take those floating rate debt and make them fixed. For individuals, we're really looking more at, like I said, the refinancing they're gonna be looking at potentially paying it down quicker if they can. They're gonna be looking at credit card debt, trying to find, if they're really in a bind, looking at zero rate debt, where you can transfer your debt onto another credit card and it'll have a zero rate for 12 to 24 months. But making sure to try to keep paying that balance down because when that zero rate lifts, you're gonna go back into having problems. So making sure that they're managing their debt service.

Chris Blose: So in an environment like this, what are the sort of factors that affect the decision of whether or not to take on new debt, either for an individual or for a business?

Maya Brill: So some of the biggest factors that you're gonna be looking at is of course gonna be that spread between how much interest costs you to take the loan versus what your expected rate of return is, right? So if it's gonna cost you 5% to take the loan but you're only gonna earn 2% on the investment, obviously that's not a wise financial decision to make. But other things that you're gonna want to take into consideration is the taxability of the interest expense that you're taking, cause that may actually help mitigate the actual expense of the interest rate for example, we have things such as Graegin loans for estates that need to pay estate tax. Those, that interest on those loans is actually deductible against the estate tax and so it may make sense to take that out because the interest isn't actually harming you as much as you would originally think.

Chris Blose: So I'm glad you brought up the example of estate tax, right? That's one specific use case. Are there specific types of debt or other use cases that are maybe more sensitive to high interest rates or to the kind of current environment that we're in?

Maya Brill: Sure. Obviously the variable rates are what's really being impacted the most. Looking at credit cards, looking at mortgages, those types of things. And so when you're looking at acquiring new debt at this point you're looking at stuff that maybe is gonna be more short term debt that's really there to fix a liquidity issue that you're having. So looking at something like an operating line of credit for a business that's got cyclical deliverables and receivables and so they're gonna be receiving that income at a later date, but you need the income, you need the liquidity now to actually do the business, but it will be paid off. Looking at stuff like bridge loans when you're looking at, purchasing other things that you'll be able to pay off or replace with a fixed rate debt.

Chris Blose: That really kind of covers some of that short-term debt and that short-term thinking. What about long-term debt and, and how is that affected in a time like this?

Maya Brill: I think for long-term debt, you're definitely gonna wanna sit there and look at what your options are for how high you think interest rates are gonna go. Are we at the top of this? Are we gonna be coming back down? And so does it make sense to potentially get a fixed rate if you're worried that rates are gonna go up or does it make sense to maybe take that floating rate if you think things are gonna come back down. But of course always stress testing to see whether or not you can afford it. If rates go up when you think they're gonna go down.

Chris Blose: Now keeping with that idea of the sort of balance between the short term and the long term, what impact do high interest rates have on people's investment decisions in your experience?

Maya Brill: So high interest rates can actually help, right? When we're looking at it with regards to debt, high interest rates are bad, but when we're looking at it with regards to investments and fixed income, those high interest rates really help. I think fixed income is definitely something that's come back on the table recently and has been gone for a while. They just haven't been paying any kind of interest rate returns. And so people that have traditionally looked at fixed income as a conservative investment to be able to live off of had to move out of that into alternative options. But with interest rates coming back up, people are able to go back into that fixed income. I think the key consideration when looking at that though is making sure that you don't go all in into fixed income because historically fixed income has not been able to keep up with inflation. So you're still gonna wanna have some sliver that is in some other investments, equities, alternatives to be able to offset that inflation that you're gonna have to be combating.

Chris Blose: So I think people hear debt and they automatically have a negative connotation with that, but are there any potential benefits for actually taking on debt during a high interest rate period? Whether that's leveraging it for investment or even from a tax standpoint as well?

Maya Brill: Sure. I definitely think that there's opportunities to leverage the debt. I mean, I think in today's environment there's definitely opportunities for real estate, there's opportunities for other things. On a historical basis the interest rates that we're looking at at the moment aren't actually that high. And if you can fix some of that, go into those investments that again you think are gonna outperform what interest rates are if they go down, you can always refinance in the future, even if you're just looking at at doing some short term debt to help leverage things, there's definitely always an opportunity to to leverage debt.

Chris Blose: It's interesting that you mentioned that they're really not that historically high right now. Is a lot of this relativity because we're coming out of a period of relatively low interest rates? So it just seems like things are quite high right now?

Maya Brill: I definitely think so, yes. I mean if you go back into pre 2008 period, interest rates were much higher than they are right now. And so I think on a relative scale that's what we're just getting back adjusted to.

Chris Blose: So how do you help people make that sort of mental adjustment when you've had a long period of a certain sort of financial environment and now suddenly that environment changes a little bit? How do you help people make that mental adjustment both in terms of their investment portfolio and in terms of their sort of level of risk as well?

Maya Brill: I mean, we're definitely living in a time where pretty much every day is a new historical event, right, <laugh>. And so there's a lot of volatility, there's a lot of having to navigate all of these changes and variations. And I think the key to that is really trying to see what the opportunities are in each of the events and try to take advantage of those as best as possible. And so I think we're constantly adapting as opposed to getting used to it. It's more of adapting cause it's constantly changing.

Chris Blose: Now in the world of debt management and you want people to make informed decisions. How much of a role does financial education and financial literacy play with your clients?

Maya Brill: Oh my gosh. I think it plays such an important role to have financial literacy and I kind of smile at the idea that you sit there and you think of it now when we're in trouble, right? When the financial literacy really needed to happen, way back when interest rates were really low and everything was really attractive and people were getting tons of debt and they were going off and buying all sorts of things. And that's when you're potentially getting yourself into trouble, right? That's when you need to actually have the financial literacy and knowledge to sit there and say, hey, interest rates are low right now, but that doesn't mean they're gonna stay this way forever. And I need to make sure that whatever debt I'm taking on right now is something that I can ultimately afford if interest rates go back up. And so there definitely needs to always be an exit plan when you're working with any investments or any ideas that you're going into. Does it make sense for me to get it at this rate, stress test my cash flow projection, see if I can continue to do the debt service even if rates go up and if I can't, what's my exit plan to get to make this work?

Chris Blose: Maya, you mentioned this idea of stress testing your financial plan. How can people go about testing their plan and making sure that it's sound for the future?

Maya Brill: Yeah, great question. This is where it's really important to work with a financial advisor or a wealth strategist, something along those lines where they can help take all of your financial information, input it into a software system that can then project out what your finances will look like over a period of time and run different scenarios to illustrate what would happen if interest rates on your loans debt, those types of things went up. And to see, if you're starting to get a bunch of red numbers in your financial plan, then it's maybe not the right move for you to make and you need to make sure that you have an exit plan when you're walking into, taking on this kind of debt.

Chris Blose: Yeah. And with that in mind, is there any general guidance you offer in terms of balancing your debt management strategy with your investment strategy when we're in a time period like this?

Maya Brill: Sure. So oftentimes, depending on the client, we'll sit there and we'll look at what the options are to help start repaying the loan. And primarily we're looking at is making sure that we're not taking investments that are potentially decreased in value that have the ability to come back up. We don't wanna sell those to pay off debt because you're basically double hurting yourself. What we really want to do is look at the options of taking things that you would traditionally reinvest. So something like the dividends or the interest that you're receiving off these investments and using that to help accelerate paying down the debt as opposed to just reinvesting them into the market.

Chris Blose: Interesting. Well, thank you so much for joining us today, Maya. We really appreciate your perspective.

Maya Brill: Yeah, happy to do it. Thanks for having me

Chris Blose: As we've heard from Maya, there are a number of reasons to be careful when it comes to taking on debt, and making sure we are financially sound in our decisions. But as she also noted, sometimes taking on debt makes sense. To help us think about that calculus, we have more from Trevor Skelley—who you heard from at the top of the show.

Now I know you spend time working with high net worth families and people who may be either working on major purchases or even in the realm of business ownership as well. You know, we're in an environment of high interest rates. How do you work with or advise high net worth families to leverage good debt effectively when we're in a period like this?

Trevor Skelley: I think first it is important to understand the client's priorities and their overall financial plan and what their objectives are, so depending on what the answers to those questions would be, we want to make sure that we customize our financing solutions to meet those needs and specifically in a higher interest rate environment. It's not as simple to make the case to use credit but there are still plenty of opportunities to use credit to expand wealth and and continue to help our clients achieve their long-term objectives and financial goals.

We work with clients every day as part of my responsibility as private wealth lending advisor to enhance wealth creation by financing investments and new privately owned businesses. One example that comes to my mind is a client who was able to retire from his role as corporate executive after his stock in the company became liquid when the company was sold. He was able to live comfortably on his income from his investment portfolio but he became interested in. opening a new franchise that he had heard about from another business associate of his and through that process we worked with him and discussed what his priorities were and what his business plan was for that and the new investment opportunity. And rather than selling out of his investment portfolio and reducing the income that he was receiving from that portfolio, it made more sense to leverage that portfolio as well as the business assets and provide financing for the startup cost and equipment purchases for this new business franchise that he opened.

It's been successfully running now and generating positive returns of greater than 20% annually because of that.

And the fact that he didn't have to liquidate his investment portfolio to start that business, he's now more than doubled his income, his recurring cash flow, as well as significantly increased his net worth by adding this new profitable business to his balance sheet. All maintaining his existing appreciating assets.

Chris Blose: What other factors do you consider when determining whether it's viable and sustainable to leverage debt when you're in a high interest rate environment?

Trevor Skelley: It's important to consider current debt levels and existing and future cash flow needs, cash flow constraints and how elevated interest rates may impact your overall financial plan if interest rates do remain high for longer than expected and before making those important financial decisions. It's good to consult with your trust advisors to get their opinions and consider best case or worst case scenarios.

Chris Blose: And I'm curious too, in a period of high interest rates, how do the borrowing costs change both for individuals and for businesses, and how does that affect their ability, either their purchasing power, or their ability to grow if that's what they're desiring to do?

Trevor Skelley: Well, the obvious answer is that as interest rates increase and remain high the cost of interest expense increases that's going to have a negative impact on a client's or a businesses cash flow, their free cash flow, and so that might impact their willingness to move forward with expansion opportunities to grow their business or to acquire new investment assets. And it also potentially could impact the bank's ability to lend to them access to credit could be limited as well in that type of an environment, the environment we're currently in.

Chris Blose: Do you find that with the people you work with, is there a tendency to become more risk averse with high interest rates or a little bit more reluctant to pursue some of those opportunities?

Trevor Skelley: I would say it depends on the client and the person. With the entrepreneurial-minded client, if they believe firmly in a new business venture or opportunity, they're gonna pursue that opportunity and we want to be there with them to help them along the way and make sure they're making well thought out decisions on which business investments to pursue. But for a lot of clients, yes, it does have an impact and causes them to become more conservative, especially those who are of retirement age and might not be as interested in taking the additional risk that comes with leveraging existing assets.

Chris Blose: How do you, in general, advise businesses on managing their existing debt portfolios during a time of high interest rates and are there ways to mitigate the impact on higher borrowing costs?

Trevor Skelley: There are a few different ways to mitigate that impact. Right now we're in an unusual interest rate environment where longer term interest rates are actually lower for a long-term fixed rate loan than they might be for a floating interest rate, revolving line of credit. Let's say, so if an individual or business has existing funded debt that's on a variable interest rate and might be worth looking into fixing that rate for say 3 to 5 years if that debt is going to be outstanding during that period. It's also worth considering potential alternative hedging strategies such as an interest rate swap which would have a similar effect as an on-balance sheet fixed rate for a term loan and there's also interest rate colors and caps to protect against the potential future additional increases in interest rates. But right now I would say that looking at an on-balance sheet fix rate or potentially an interest rate swap would be something for those who could be significantly negatively impacted by further interest rate hikes and need to have that fixed cost and also potentially give some slight relief now with this current inverted yield curve environment we're in.

Chris Blose: With the clients who are business owners. How are they thinking about the effects of a high interest rate environment on their consumers as well, like what ripple effects do we see not just on the kind of higher-level investment but on the people who are their customers as well?

Trevor Skelley: It is something that is top of mind especially with those clients who are business owners that in the retail space or that have a reliance on consumers' ability to access credit such as real estate whether that's a real estate brokerage firm or auto dealers with both brokerage firms. They're relying on banks lending to those consumers to be able to finance home purchases just like auto lenders are relying on consumers to be able to qualify for credit to purchase new vehicles or use vehicles. And so as interest rates have continued rising and we still have a couple more potential rate hikes that are expected before the end of the year, if that impact on those consumers is significant enough for them to no longer be able to afford the monthly payment, that could cause sales to drop or potentially cause those businesses to reduce their prices on those assets they're trying to sell.

I've learned to expect the unexpected when it comes to interest rates, and I advise clients to do that as well. Think through all options, think through all scenarios and make the best decision for them based on what factors they currently know and can control.

Chris Blose: Yeah, I think the idea of thinking through all options is a really sound one and you've mentioned several options that people may or may not be aware of today. So you know that we're in an environment of higher borrowing costs and other factors like that, how do you work with clients to identify what are going to be the most favorable lending opportunities with the best rates and the best terms?

Trevor Skelley: It's important for us to get the best possible understanding of the client's overall financial picture, and once we have that information and the client helps us to help them through that we're able to provide most customized financing options to meet their needs and provide multiple options, go through each one, make sure they understand the pros and cons of each option before we move forward with one over the other. It's very important for us to know what their priorities are, as well as having all the details we need and future expected needs as well as potential future liquidity events that we can help to customize their credit solutions and, ultimately, if it's more customized and tailored to meet their needs. We're going to be able to provide a solution that is most cost effective and best for them.

Chris Blose: Well thank you so much for joining us today, Trevor. We really appreciate your perspective.

Trevor Skelley: Absolutely, thank you for having me.

Chris Blose: Long story short, debt is complicated. The decision on when to take it on, when to manage it, and when to leverage it depends on a number of factors: everything from investment return potential to current interest rates to personal or professional cash flow needs. But know that debt is certainly not always a dirty word, and sound financial planning can help you make the most of it to either grow your own investments or your business.

Thanks to both Maya and Trevor for sharing their perspective today and thank you for listening. If you want to learn more and listen to future episodes of The Regions Insights Podcast, check out URL TK

Regions Legal and Compliance to include Disclaimer Language here.
VO and Art Card (if video is enabled)

Loans and Lines of credit are subject to terms, conditions, documentation requirements and underwriting approval. This material is general in nature, is provided for general marketing and educational purposes only and is not intended to be tax, legal, or investment advice nor is this information intended as an offer or solicitation for the purchase or sale of any security, product or other financial instrument. Regions encourages you to consult a professional for advice applicable to your specific situation and consult irs.gov for current tax rules. Any opinions expressed herein are given in good faith, are subject to change without notice, and are only current as of the stated date of their issue. Certain sections of this publication may contain forward-looking statements that are based on the reasonable expectations, estimates, projections, and assumptions of the authors, but forward-looking statements are not guarantees of future performance and involve risks and uncertainties, which are difficult to predict. In providing this information, Regions is not undertaking to provide impartial investment advice or give advice in a fiduciary capacity. Diversification strategies do not ensure a profit and do not protect against losses in declining markets. Past performance is no guarantee of future results. Regions Bank, its parent company, its subsidiaries or its affiliates do not make any warranty or representation relating to the accuracy, completeness, or timeliness of any information contained in the newsletter and shall not be liable for any damages of any kind relating to such information nor as to the legal, regulatory, financial or tax implications of the matters referred herein. Investment ideas and strategies presented may not be suitable for all investors.