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The Security Based Line of Credit Difference

Securities-based lines of credit (SBLOC's) can be valuable tools as advisors aim to meet clients' liquidity needs

Clients all across the wealth spectrum come to advisors with liquidity needs. Whether they want to make an offer on the vacation home of their dreams or need a quick infusion of cash to avoid penalties on a high tax bill, the funding has to come from somewhere. "And while advisors have a variety of ways to meet immediate liquidity needs, some options may be more appealing than others," says Gary Basso, head of institutional sales and distribution at Goldman Sachs Private Bank Select®, or, GS Select®.

For example, liquidating an investment might trigger transaction costs and tax implications. It also could create opportunity costs, since the client will be out of the market until they build that position back up. At the same time, an advisor may need to make additional changes to a client's portfolio to keep it aligned with the client's long-term financial strategy.

Tapping a home equity line of credit (HELOC) is another common alternative for filling a short-term liquidity need. But it presents a different set of challenges. "Since the financial crisis, HELOCs have been harder to get, and the new tax laws mean interest expenses might not be deductible," says Basso. Opening a HELOC can also be a cumbersome and slow process, taking weeks or even months to set up. Selling or leveraging other types of assets may be possible, but matching an asset that has the right value and as a source of liquidity to fund a current need can be a tricky proposition.

A securities-based line of credit (SBLOC) can be an excellent solution for bridging liquidity gaps with fewer complications. While advisors have traditionally been more likely to encounter SBLOCs in a wirehouse setting, GS Select has integrated them into its digital platform, giving a broader range of advisors and their clients more convenient access to these products. And with a streamlined approval process, the funds can be available in a fraction of the time required by other lending options.

"The key feature of an SBLOC is that it gives clients opportunistic access to liquidity," Basso says. That capability allows clients to act quickly in a range of common scenarios, typically associated with a lifestyle purchase, life event or business investment. However, Basso cautions that advisors and clients should consider the potential risks of this approach, especially for loans where principal may be outstanding over a longer period of time. In particular, interest rate fluctuations could change the overall cost of borrowing and market declines could reduce the amount a client can borrow using a given security as collateral, resulting in a call for partial repayment or additional collateral.

Real estate purchases

Real estate is one of the most common areas in which SBLOCs can demonstrate their utility. "Whether residential or commercial real estate, moving fast with cash might allow you to seize an opportunity more quickly," says Basso. In the residential sector, access to liquidity can mean greater flexibility, since buyers don't feel obligated to sell their old home before purchasing a new one.

Basso also points out that while retirees may have substantial wealth, they can also run into difficulties getting a mortgage because of limited income. "That situation can make a conventional lending strategy a lot more difficult," he says.

Tax obligations

SBLOCs give advisors another tool for clients have unexpected tax obligations. "For instance, the sale of a business can incur a sizable tax obligation" says Basso. The tax liability must be paid when due to avoid penalties, but there's often a question as to whether it's better to borrow money or simply pay the taxes outright by liquidating investment. "We can often demonstrate that it's more beneficial to borrow, especially in today's low-rate environment," says Basso. "In many cases, an SBLOC could easily be more cost-effective than being out of the market on a substantial amount of your investment assets."

Business needs

For business owners, SBLOCs can free up cash to purchase equipment or even finance accounts receivable, smoothing out cash flow. Basso points out that access to cash can be critical for a young business without enough of a financial history to qualify for more traditional financing. "As businesses grow, SBLOCs can also provide the capital they need to make targeted acquisitions," he adds. "For example, a younger dentist or financial advisor may want to purchase the practice of a sunsetting practitioner."

Other short-term opportunities

Basso also sees SBLOCs as a useful alternative to traditional consumer financing options in some cases. "These lines of credit can be tens of millions of dollars, but they can also be quite small, making them a good fit for a down payment on a child's first home, paying a tuition bill or financing a wedding," he says. This alternative can be especially appealing for people with variable income. People with large, one-time income from the sale of a business or real estate, for instance, could invest the proceeds of that sale immediately, while securing an SBLOC with those investments to make tax payments when they come due.

Emergency funds

In an unexpected disaster, SBLOCs can be useful source of emergency cash. Basso knows of a commercial property owner heavily invested in retail who used an SBLOC to help offset rent that his tenants were unable to pay when the coronavirus pandemic hit. "It was potentially a risky move, but it may have been less risky than letting tenants give up their spaces entirely, leaving them vacant," he says. In other cases, Basso has seen clients draw down an SBLOC in advance of an insurance payout to jump-start the repair process following a natural disaster such as a hurricane or tornado.

Ease of access

Recognizing the utility of SBLOCs for clients is only half the battle. "GS Select has worked to make these products much more client-friendly, making it easier for clients to weigh the merits of them compared to other options," says Basso. A digital-focused design makes the application and approval process both streamlined and transparent, giving both clients and advisors easy access to information about the product.

Basso hopes this ease of use will bring these flexible products to a wider client base. "It's exciting that these products and services that advisors might only have seen in a wirehouse or regional private bank environment are now available to independent advisors in an easy-to-use platform," he says.

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