



Portfolio-Based Loans

A primer on borrowing against your investments

Kate Grace

Happy holiday week. In the spirit of the impending 250th, I want to expound on a classic American tradition—debt. Joking aside, at Sankala Group, our mission is to deliver equity-like returns with less risk while providing comprehensive wealth and financial management. A core part of that mission is education, helping you understand the tools at your disposal so you can stay in control of your financial life.

In this letter we will cover the various uses of portfolio-based loans. Using your stocks and bonds as collateral can let you borrow at lower rates than most other methods, and also with far less administrative setup and hassle. As fiduciaries, our instinct is often to counsel restraint. There are plenty of situations where the prudent advice is to avoid borrowing. But debt is a tool, and in the right environment, leverage can be a financially sound or even optimal decision.

- If borrowing at a low rate allows you to avoid selling appreciated securities, and the capital gains taxes that sale would trigger, it could leave you better off than liquidating.
- A short-term loan to bridge the gap between buying one home and selling another can spare you from forcing a sale on someone else's timeline, and onerous bank "bridge loan" costs and rates.
- Borrowing to fund a business expansion or cover a large tax bill can keep a long-term investment strategy intact rather than interrupting it.

In each case, the question is not "debt or no debt," but whether this debt, at this cost, for this purpose, makes sense. We will cover three approaches, from the most familiar to the most specialized: margin lending, the Pledged Asset Line (a term for a securities-backed line of credit) and a box spread synthetic loan. These strategies carry their own risks, so please treat this letter as a starting point for a conversation with your advisor if you believe one of them might fit your situation. Of course, we will raise ideas as we see opportunities as well. One deciding factor is usually whether the cost of borrowing sits below what your capital can earn if it stays invested, and also identifying a clear source of final repayment.

Margin Lending

When people hear "margin," they usually picture borrowing to buy more stock. But that traditional use is only one of many applications. You can borrow up to ~50% of your portfolio's value in cash for short-term liquidity needs. To be clear, we do not recommend borrowing anywhere near that level in almost any circumstance. What makes margin compelling is not its size but its simplicity and immediacy. You get the ability to access funds the same day, as long as you have this capability on your account.

Advantages

- **Competitive, negotiated rates:** The margin interest rate on our accounts is 2.75% over the Fed Funds rate, which is currently 3.75%. Thus, at the time of this letter, the margin rate is 6.5%. In certain cases, we can push that lower.
- **Convenience:** No applications and essentially no administration, as long as margin is enabled on your account.
- **Same-day availability by wire** for requests placed before 2:30 p.m. Eastern.

- Potential tax deductibility: Margin interest is generally deductible when used for business or investment purposes, though not for purely personal use. In fact, under IRS rules, you can deduct interest for margin loans used in your business, despite the collateral being personal in nature. Always consult your advisor about your specific circumstances.
- One tax document: All interest details are shown on your customary account-related 1099 form.
- Stay invested: For short-term liquidity, you do not have to sell stocks with appreciated gains.
- Clarity: You can find the margin balance and requirements on the Balances tab in your account.
- No set maturity or repayment schedule, provided the account maintains its minimum required equity.

Risks

- Interest-rate risk: Like any loan, you repay the balance plus interest regardless of what the underlying securities are worth, and margin rates are floating rates, which can move while the loan is outstanding. If the Fed Funds rate falls, your interest due will fall. If rates rise, your interest due will increase.
- Market risk: If your securities fall significantly, you may face a margin call, requiring you to immediately repay part of the loan or add money to the account.

Example use case

Because of the interest and market risk, we recommend margin only for short-term bridging or liquidity needs, and at levels well below the maximum allowable.

Suppose a large, unexpected expense arrives about four weeks ahead of an expected payment. You sell \$10,000 of equities in your brokerage account to cover the cost. You've held this for a few years, and the long-term capital gain is \$4,000. At the 15% tax rate, the tax on that money is \$600.

Alternatively, with margin already enabled, you withdraw \$10,000 at the current margin loan rate of 6.5% to cover the obligation. That is an annual percentage. It comes out to a little more than \$1.78 per day. As soon as the cash arrives, you repay the loan. The loan exists only for those few weeks, at a low fraction of your available margin, with an obvious

repayment source. And for the four weeks, you owe about \$50. Clearly this was a wise use of the loan facility, saving you ~\$550 in taxes.

Pledged Asset Line (PAL)

A PAL is another term for a securities-backed line of credit. This looks very similar to a margin loan on your brokerage account: you borrow cash against your securities as collateral, without selling positions. The difference is that a PAL involves setting up a separate account, which has a bit more time cost upfront, and tighter rules on what the account can hold. In exchange, the rate is slightly lower than the margin lending rate.

The pros and cons mirror those of the margin loan. The reduced rate makes a PAL the better option if you expect to borrow significant amounts or use the line frequently; in those cases, the additional setup time is worth it.

Advantages

- Non-purpose loan: Use the funds for whatever you see fit.
- Lower rates than margin lending - often ~1.0% lower.
- No administrative fees (unlike a home equity line of credit, which carries several).
- You pay interest only on the amount borrowed: interest is due monthly, with no set repayment schedule on the principal.
- Similar to margin loans, interest may be tax-deductible if used for business purposes.

Risks

- Market and interest-rate risk make a PAL advisable only when you have enough assets to pledge that you are borrowing a reasonable percentage of them.
- A separate annual statement on the loan (a new tax document).
- Pledged assets cannot be margined in the normal way, so the account cannot short sell and is limited to covered options strategies.
- It is a demand loan, meaning the bank can ask for repayment at any time (like in a margin call when the value of the collateral drops).

Example use case

Smoothing out uneven income streams. For a business owner or consultant paid on a per-project basis, rather than holding excessive cash for the lean months, you can stay invested and draw modestly on a Pledged Asset Line to bridge the gap, then pay it back down when the next distribution lands. The line flexes naturally with your cash flow, keeping the long-term strategy on track instead of interrupting it due to an inconsistent income calendar.

Box Spreads

At one time only available to sophisticated institutions or large family offices, and then championed on finance Reddit, the box spread synthetic loan is gaining in popularity. The idea is to use an options “box,” two puts, and two calls that go both long and short on a common index like the S&P 500. The legs always add up to the same fixed amount, and the pricing dynamics let the borrower access remarkably low rates.

How it works

When you execute a box spread, you receive a set amount of cash up front and owe a single, fixed repayment when the options expire, and there are no monthly payments in between. In this sense, it operates like a zero-coupon bond. For example, you might receive roughly \$95,700 today and owe \$100,000 a year from now; the \$4,300 difference is your interest, an implied rate of ~4.5% on the initial amount. Because the repayment is fixed at the outset, the rate is locked for the life of the trade, unlike the floating rates on a margin loan or a PAL where the rate moves with the rates market and is not set when you open the position).

Advantages

- The best rates of the three, very close to the U.S. Treasury bill rate, and fixed for the full term rather than floating.
- Unlike a margin loan or a PAL, the “interest” is generally tax-deductible even for personal use. As always, confirm the specifics with your tax advisor. The nature of the tax treatment makes this approach most attractive to investors with high capital gains liabilities.
- No monthly payments; a single lump sum is due at expiration.

Drawbacks

- Material refinancing risk: these contracts generally cannot run longer than about five years, so a longer borrowing need means rolling into a new box at whatever rate prevails then.
- The headline rate is not the whole cost: providers charge a fee on top of the market's implied rate, so the all-in cost sits above the figure you first see advertised.
- It is still borrowing against your portfolio: the position is supported by the rest of your assets, so a large enough market decline can still trigger a margin call or forced liquidation, just as with the other two strategies.
- Repayment discipline: because nothing is due until the end, it is easy to borrow carelessly and reach expiration without having saved for the lump sum.
- Reliant on broker margin policy: it is possible your broker could alter the treatment of this strategy under its margin rules and force the loan back in. Such changes would not be account-specific, but would be firmwide policy updates, likely with some advanced warning.

Example use case

Box spreads are increasingly marketed as an alternative to a traditional mortgage or auto loans. We have some real hesitations here, mostly because of that refinancing risk and the temptation the zero-coupon structure creates to treat borrowed money as free until the bill comes due. As with any tool, we believe it is important for clients to understand their options, and especially for reasonably sized projects, these risks could be mitigated with a repayment plan that we agree on together.

Using these tools responsibly

A few principles tie these strategies together:

- Borrow well below what your account allows. Keeping the balance under 25% of your portfolio sharply reduces the risk of a margin call.
- Pledge a diversified portfolio rather than a concentrated position (in the case of Sankala Group's clients, this is a given).

- Stay in communication about market conditions, and reassess your tolerance as conditions change.
- Never draw without knowing your repayment source or plan, with a contingency ready in case the market turns, maintenance requirements rise, or rates climb.

Used modestly, against a sound portfolio, and with a clear way out, borrowing stops being a hazard to avoid and becomes simply another tool in service of your plan. There is a time and purpose for all things, including intelligent use of debt. As always, reach out if you think one of these strategies may be a solution in your situation, and we'll talk through the best options.

Best,



Kate Grace
Sankala Group LLC
T: (720) 340-2103



Sankala Group LLC's communications should not be considered by any client or prospective client as a solicitation or recommendation to affect any transactions in securities. Any direct communication by Sankala Group LLC with a client or prospective client will be carried out by a representative that is either registered with or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. Sankala Group LLC does not make any representations or warranties as to the accuracy, timeliness, suitability, completeness, or relevance of any information presented in this communication, or by any unaffiliated third party. All such information is provided solely for illustrative purposes.