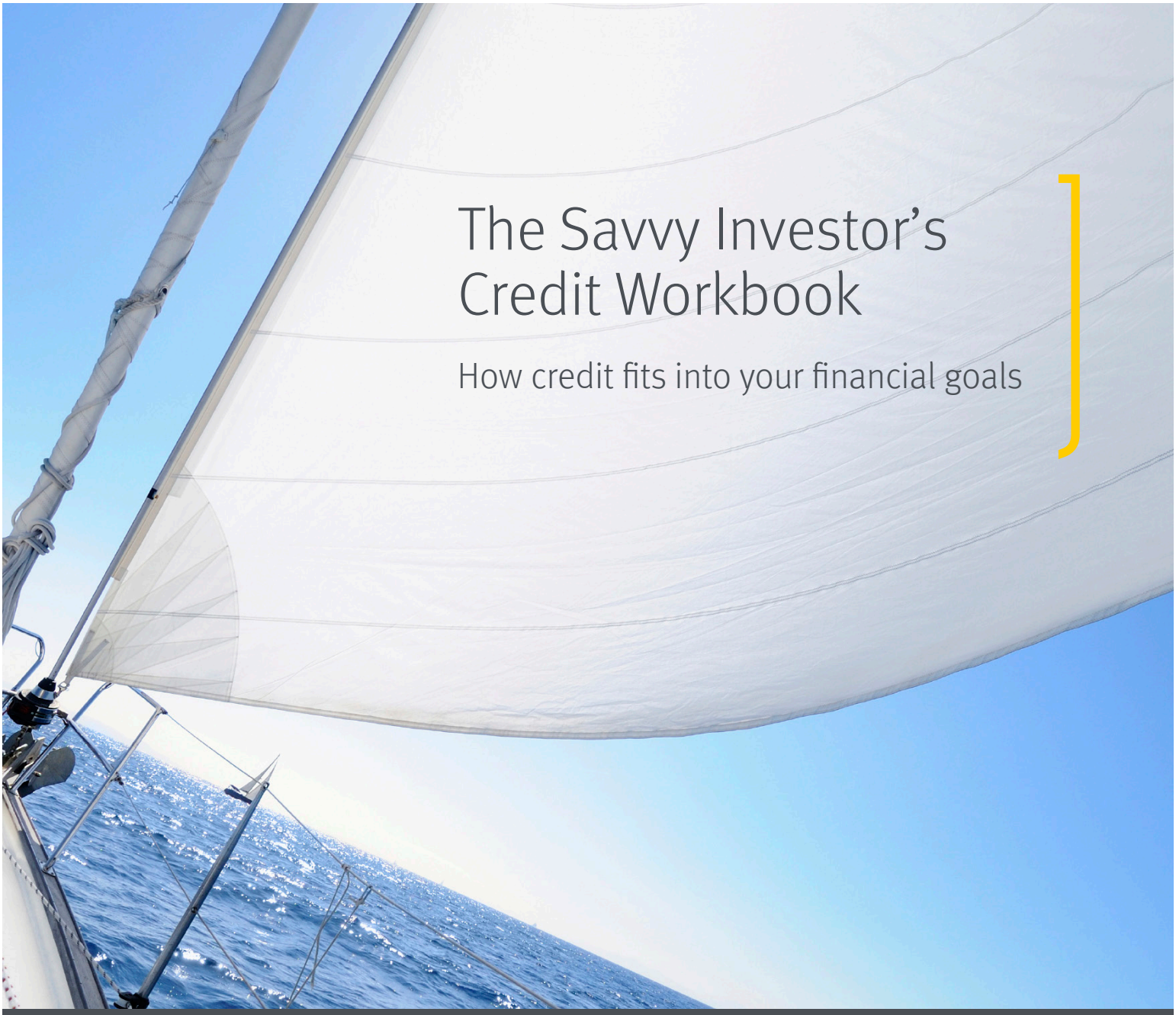
The Savvy Investor's Credit Workbook

How credit fits into your financial goals



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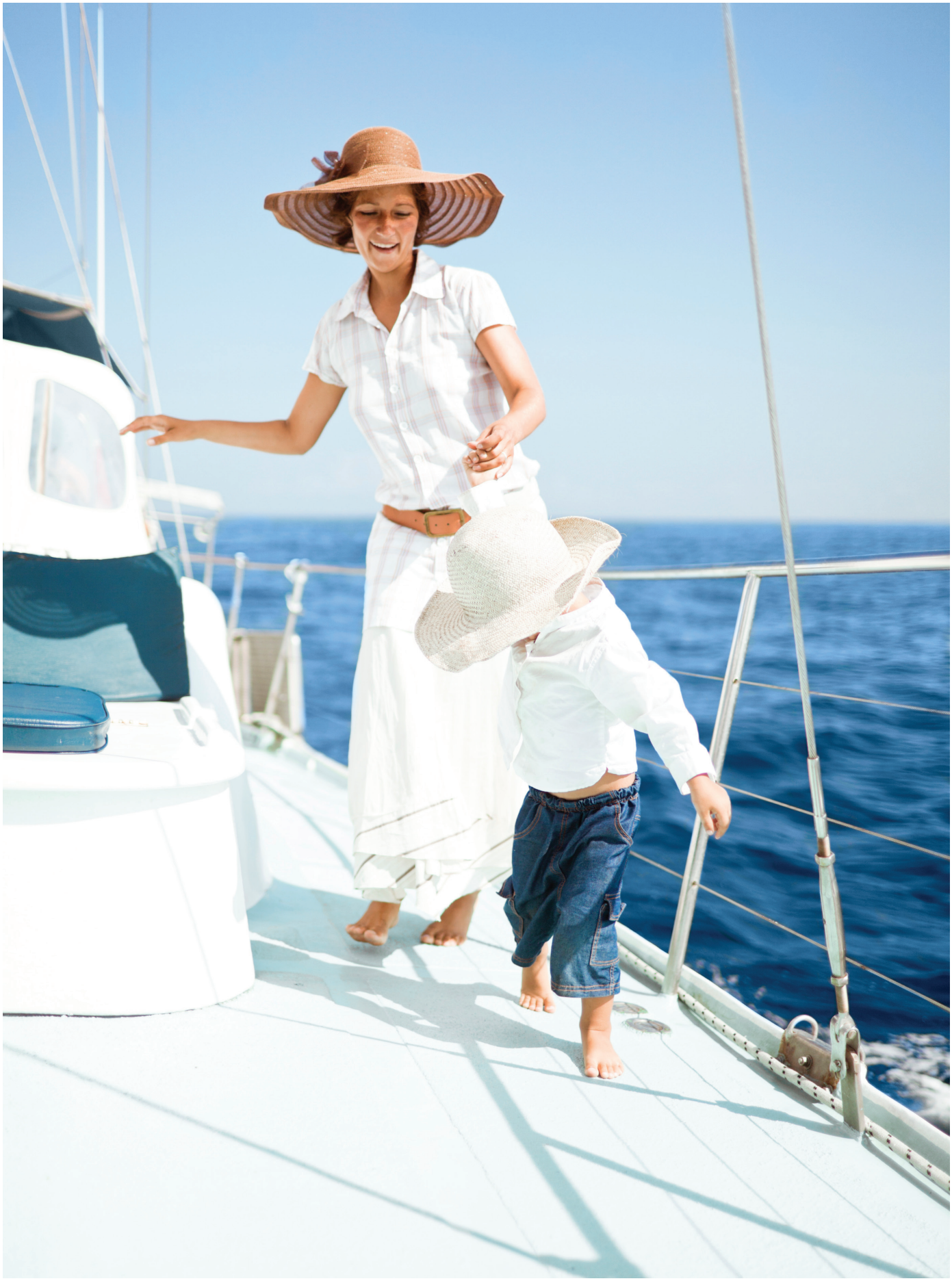


A fresh look at credit

Chances are good that when you think about managing your wealth, your attention immediately goes to the asset side of your personal balance sheet. After all, you and your RBC Wealth Management financial advisor likely put much time and care into selecting investments to help you build, preserve, enjoy and share your wealth.

Yet it is equally important to remember that credit can be a useful tool to help achieve these goals.

Indeed, many of the successful companies in your stock portfolio borrow money to grow their business. And the companies, governments and agencies in your bond portfolio use debt effectively to accomplish their goals.

You may be able to do the same thing by borrowing against eligible securities in your portfolio. Many of the assets you hold have a defined lending value. Your RBC Wealth Management® financial advisor can work with you to determine the total lending value of your investment portfolio.

Once you know how much you can borrow, this securities-based form of credit can be used to help you:

- Optimize cash flows
- Seize timely investment opportunities
- Fund real estate purchases
- Fund business investments
- Refinance higher-interest debt
- Fund major purchases
- Manage unexpected expenses
- Finance education

The good news is that when used properly, credit strategies may actually provide fast, convenient access to funds for these purposes without disrupting your progress toward your other wealth management goals.

Your RBC Wealth Management financial advisor can help you identify and implement a credit strategy that is appropriate for your needs and circumstances.

Understanding lending values

Lending values are based on the value[1] of the securities in your portfolio. Common examples include municipal bonds, investment-grade corporate bonds and diversified equity portfolios. Cash, money market funds, mutual funds, exchange-traded funds and stocks trading on many foreign exchanges are also eligible to receive a lending value. Note that retirement accounts and custodial accounts are not eligible securities.

1. The lending value of a given asset is determined by RBC at its discretion.

Evaluating your credit needs

Credit is often overlooked as a wealth management tool. The following checklist may help you determine which financial goals may be appropriate for a securities-based lending solution.

Possible short-term credit needs	Yes	No
Do you have seasonal cash flow requirements such as property taxes or insurance premiums?	☐	☐
Have you had a recent change in income or has your cash flow been affected?	☐	☐
Are there any luxury items such as cars, boats, art or wine you want to purchase or collect?	☐	☐
Are you looking for financial flexibility to take advantage of investment opportunities when they occur?	☐	☐
If you are a business owner, are you planning changes or making investments in your business (buying equipment, entering new markets, buying out a partner, etc.)?	☐	☐
Total short-term credit needs		

Possible long-term credit needs	Yes	No
Do you have high-interest debt that would benefit from being refinanced at a lower rate?	☐	☐
Are you thinking about refinancing your home?	☐	☐
Are you thinking about purchasing real estate or a vacation home?	☐	☐
Do you want to help your children or grandchildren pay for their education, start a business or buy a home?	☐	☐
Are you planning to acquire or invest in a business?	☐	☐
Total long-term credit needs		

If you have short-term credit needs, talk with your RBC Wealth Management financial advisor today about how to qualify your portfolio for an appropriate securities-based lending solution. If you anticipate having long-term credit needs, now may still be the time to speak with your RBC Wealth Management financial advisor about how to best prepare for them when they arise.

Managing your credit

You may have complicated feelings about debt. Many of us grew up learning that debt is something to be feared and avoided. If you are hesitant about borrowing to achieve a financial goal, it may help to look at the topic differently.

In some cases, securities-based lending can actually be a cost-efficient source of funding for major expenses that may contribute to your overall financial well-being in the long run. Home ownership, business purchase and education funding for a professional career may be good reasons to borrow.

Plus, securities-based lending can be a practical way to enhance the wealth you hold in non-investable assets by helping facilitate transactions that require fast and easy access to cash. In addition to offering competitive interest rates, this form of credit provides capital without liquidating securities which can help keep your portfolio working toward your long-term goals. And since there are flexible repayment terms, this form of borrowing can also be attractive for bridge loans to provide interim funding for emergency or unexpected financial needs in the short term.

Securities-based lending may be an appropriate wealth management tool for you in certain circumstances.

To help manage your credit, you may want to determine your debt service ratio. One way to calculate it is by comparing your total monthly loan payments to your gross monthly income using the equation below.

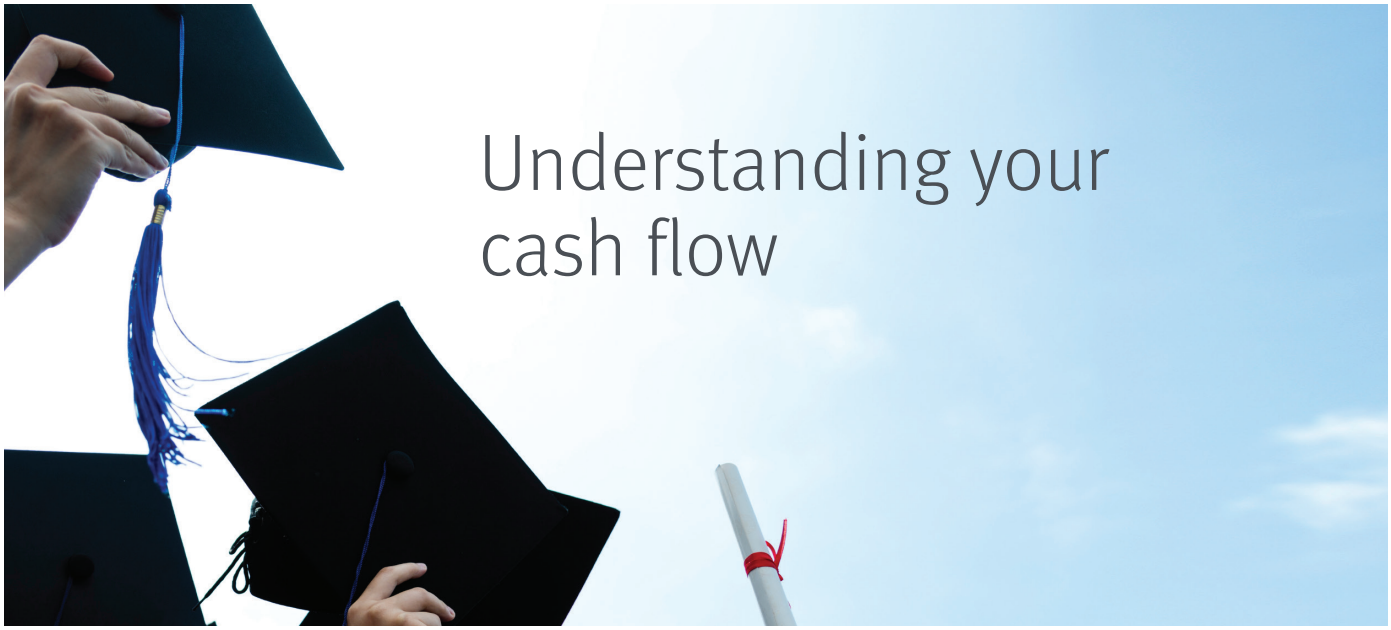
Your debt service ratio

$$= \frac{\text{Total monthly loan payments}}{\text{Monthly gross income}}$$

Example: If you have a monthly mortgage payment of $1,200, a $200 car loan payment, $250 in credit card payments and a $100 student loan payment, then you have total monthly loan payments of $1,750. If your monthly gross income is $6,500, then you have a total debt service ratio of 27% ($1,750/$6,500 = 0.27 or 27%).

Your debt service ratio only counts debt obligations, like your mortgage payment and other personal obligations that will not be paid off by minimum required payments within 10 months. It does not include current liabilities, such as insurance premiums or utility payments.

Many financial advisors suggest a debt service ratio of around 25% and no more than 35%.



Understanding your cash flow

Understanding your cash flow is another important consideration in the savvy use of credit. Complete the following assessment to see how much income you bring in from various sources every month, as well as how your monthly expenses stack up.

Monthly income	
Salary, bonus, commissions	
Investment income from marketable securities	
Rental income (net)	
Business/professional income	
Income from trust(s)	
Other	
Total income	

Monthly expenses	
Housing — includes mortgages, property taxes, insurance premiums, association fees, etc.	
Food	
Education	
Transportation – includes loans, gas, insurance, etc.	
Medical – includes insurance, prescriptions, etc.	
Utilities	
Other – includes clothing, entertainment, pets, club memberships	
Total expenses	

Now that you have a clearer picture of your cash flow, speak with your RBC Wealth Management financial advisor for help deciding if using credit may be appropriate for your financial goals.

Using credit strategically

Like all financial strategies, there are risks associated with credit. In the case of securities-based lending, it's important to remember that when an investment portfolio is used as collateral for a loan, if the value of securities falls below a certain level, you'll need to deposit more money or additional securities to eliminate the shortfall.

On a $1,000,000 Loan:

Amount of annual interest based on 2.8%* for a securities-based loan based on LIBOR** = $28,000

Amount of annual interest based on 3.5% for a fixed-rate amortizing mortgage based on the posted US 30-year mortgage rate = $35,000

This generates savings of $7,000 over the course of one year.

Rates as of 10/04/2016. All rates shown are for illustrative purposes and are in effect only at the date/time indicated.

However, with careful planning and prudent use, there are a number of innovative ways securities-based lending may help you access capital for a broad range of wealth management goals. The following are two common examples.

Using leverage to expand your portfolio

A leverage loan is borrowing funds to purchase additional securities, with the objective of obtaining a higher total return on the original investment. Thoughtful and prudent investing using leverage has the potential to significantly increase your net worth by:

- **Enhancing diversification —** Without disposing of or reducing existing investments, investors may leverage their existing portfolio in order to take advantage of additional investment opportunities.
- **Improving returns —** Leverage loans increase your total market exposure — as a result, the potential for gains (but also losses) is magnified.

Leverage loans typically appeal to sophisticated investors who are seeking potentially higher returns. But it is important that investors understand the way leverage works and that the potential for increased rewards is accompanied by potential risks.

Financing residential real estate

If you are trying to decide whether to obtain a traditional 30-year amortizing mortgage versus using securities-based lending to finance your real estate purchase, consider which approach will put you further ahead in the long term.

One of the key benefits of a securities-based loan is the ability to offer competitive interest rates. In addition, you can avoid the property appraisal and legal costs associated with a more traditional property financing option.

This example is for illustrative purposes only.

*Rate represents applicable LIBOR rate plus spread. Actual rates can change depending on, but not limited to, the creditworthiness of the borrower. **LIBOR is derived from an average of daily self-estimates of borrowing costs supplied by a small group of large global banks. Royal Bank of Canada is a participant in the LIBOR-setting panels tied to the US dollar, the British Pound and the euro. Loans made in Canadian dollars are CDOR-based. CDOR, or Canadian Dollar Offered Rate, is derived from an average of daily self-estimates of borrowing costs supplied by a small group of Canadian market makers in bankers' acceptances, including Royal Bank of Canada.

Next steps

Savvy investors have long used credit strategies as part of their holistic wealth management plan. As you can see, securities-based lending may also be a practical solution for you to consider.

Contact your RBC Wealth Management financial advisor today to discuss the prudent use of credit and how it may benefit you. He or she can help you determine which solutions may be appropriate for your unique situation, as well as help you implement them in a careful, well-informed manner.

Wealth Management

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