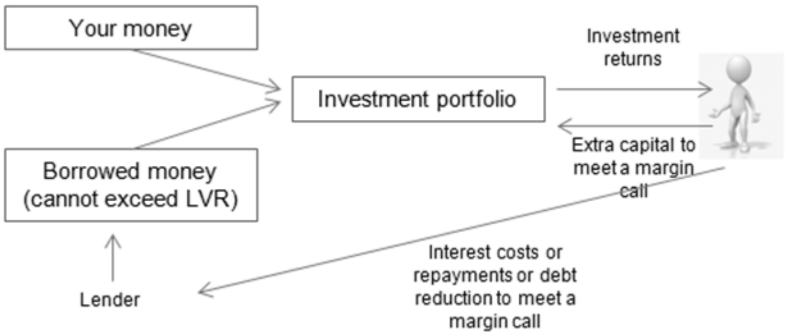
Margin Lending

A margin loan can be used to borrow for investment in shares or managed funds using the investments as security for the loan.

The amount you can borrow will be limited to a certain percentage of the investments used as security (loan value ratio). This is generally limited to 70% which means you need to also invest some of your own money.



The loan can be borrowed as a lump sum. Alternatively, it can be borrowed in regular instalments to help take advantage of dollar cost averaging or if you want to gradually build your savings.

Due to the volatile nature of shares and managed funds over the short term, the recommended investment term of a geared portfolio should be a minimum of five to seven years.

Loan to Value Ratio

The maximum that you can borrow will be limited to a certain percentage of the investments used as security (generally up to 70%). This is called the Loan to Value Ratio (LVR).

Your loan must stay below the LVR at all times. If the value of the loan goes over the allowed LVR either due to interest accumulating on the debt or falls in the market value of your investments, you will need to make a margin call to bring the ratio back into line.

Margin Calls

Regular repayments do not have to be paid on a margin loan but you must ensure the specified loan value ratio is not exceeded.

If the market falls or interest is accumulating on the loan and the LVR is exceeded you will need to make a margin call to return the ratio to the appropriate level. A margin call request must generally be acted upon within 24 hours.

To make a margin call you may need to:

- Sell assets to repay some of the loan and reduce the level of debt
- Add extra money to repay some of the loan
- Add additional money/investments to the security pool to reduce the debt proportion

Careful planning on how you will deal with a margin call is required. Selling underlying assets may result in selling assets at an unfavourable time and may give rise to a capital loss.

If you take no action or are unable to meet a margin call, the lender can sell your assets to meet the margin call.

The risk of a margin call arising can be reduced by:

- Ensuring the loan is set at an appropriate level below the LVR to minimise the chance of having a margin call.
- Diversifying your portfolio.
- Reinvesting investment income to reduce the debt proportion.
- Not allowing the interest to capitalize by making interest repayments on the loan.

Example

Troy has purchased a share portfolio of $200,000 using a margin loan. The maximum LVR is 60%.

Troy needs to ensure that the value of his outstanding loan does not exceed 60% of his share portfolio at any time. This means his loan cannot exceed $120,000 at commencement.

If the value of his investments falls to $150,000 Troy needs to ensure his loan is not more than $90,000. If the outstanding loan is higher he will need to meet a margin call. This will require him to either sell investments to pay off some debt or he will need to use other money to reduce the debt or to increase his share portfolio.

Tax Implications of Gearing

The taxable income generated by the investment is added to your assessable income. Generally, costs associated with borrowing, such as interest and expenses, are allowable tax deductions to reduce tax payable on income from the investment and/or other sources.

Tax minimisation should not be the reason for gearing. This is just an added advantage.

Other Considerations

Gearing must be considered in light of your investment risk profile. Given that investment returns are variable, it is essential to view a geared investment strategy as a long-term commitment, as this enables you to benefit from the returns of growth assets and to manage any short-term negative market fluctuations.

Your investments are likely to provide you with income each year. This is added to your assessable income. Upon the sale of the investments you may have a taxable capital gain which is added to your assessable income and may impact your entitlements to other tax offsets or other benefits.