



## Strategy 10 Investing with borrowed money

This table summarises the key advantages and disadvantages of three forms of gearing.

	Home equity loan	Margin loan	Internally geared share fund
<b>Description</b>	<ul style="list-style-type: none"> <li>Allows you to use the equity in your home to borrow money to invest where you choose. Can range from a standard principal and interest loan through to a line of credit (interest only).</li> </ul>	<ul style="list-style-type: none"> <li>Allows you to borrow to invest in approved shares or managed funds, as a lump sum or in regular instalments. This is secured against the value of that investment and any other capital provided as security.</li> </ul>	<ul style="list-style-type: none"> <li>A managed investment where the fund borrows money to make a larger investment in Australian and/or global shares.</li> <li>Usually managed so that it remains positively geared (ie fund income is sufficient to cover interest and fees).</li> </ul>
<b>Advantages</b>	<ul style="list-style-type: none"> <li>You have control over gearing levels</li> <li>No margin calls are required if there is an investment market downturn.</li> <li>Low interest rate (small premium for line of credit).</li> <li>Features can include a 100% offset account, redraw facility and salary crediting.</li> <li>Option of either a fixed, variable or split interest rate loan.</li> <li>No investment restrictions.</li> <li>Ability to make interest-only payments.</li> <li>Ability to pre-pay interest for up to 12 months and allowing you to manage your cash-flow more efficiently.</li> <li>Line of credit allows multiple loan accounts within a facility, so you can track deductible and non-deductible interest.</li> <li>If you are negatively geared, you may be able to offset excess deductions against other income.</li> </ul>	<ul style="list-style-type: none"> <li>You have control over gearing levels</li> <li>Instalment gearing reduces risk through dollar cost averaging (investments are acquired at an average market price).</li> <li>Option of either a fixed, variable or split interest rate loan.</li> <li>Ability to make interest- only payments.</li> <li>Ability to pre-pay interest for up to 12 months and allowing you to manage your cash-flow more efficiently.</li> <li>If you are negatively geared, you may be able to offset excess deductions against other income.</li> <li>You may be able to arrange for another person (or company) to provide third-party security for your margin loan</li> </ul>	<ul style="list-style-type: none"> <li>The fund is able to borrow at wholesale interest rates, which are generally lower than those available to individuals.</li> <li>No margin calls are required if there is an investment market downturn.</li> <li>The loan is limited recourse, which means your liability is limited to the value of your initial investment.</li> <li>Investing in the fund is much simpler than establishing a borrowing facility yourself.</li> <li>Enables you to access gearing in superannuation without having to establish your own super fund.</li> </ul>
<b>Disadvantages</b>	<ul style="list-style-type: none"> <li>Needs equity in a residential property.</li> <li>Interest premium with a line of credit.</li> <li>Where credit cards and cheque accounts are attached, you need discipline to prevent eroding your equity.</li> </ul>	<ul style="list-style-type: none"> <li>Higher interest rate than standard home equity loan.</li> <li>Potential for margin calls if there is an investment market downturn.</li> <li>Maximum gearing ratio limited to around 75% (you need to make your own initial contribution).</li> <li>Investment options limited to investment menu of the lender (can include hundreds of direct shares or managed funds).</li> </ul>	<ul style="list-style-type: none"> <li>Limited control over the gearing level.</li> <li>Limited number of providers and investment options.</li> <li>Interest on the fund borrowings is generally offset against fund income.</li> <li>No tax deduction for interest is available to investors unless they borrow personally to invest in these funds themselves, which can significantly increase risk.</li> </ul>
<b>Investors who may be suited to this approach</b>	<ul style="list-style-type: none"> <li>Investors who have equity in their home and are comfortable borrowing against it.</li> <li>Investors who have non tax deductible debt, as they can take advantage of the loan features for debt reduction and recycling.</li> <li>Investors who wish to avoid margin calls.</li> </ul>	<ul style="list-style-type: none"> <li>Investors who do not own a home or do not have sufficient equity within their home.</li> <li>Investors who do own a home but are uncomfortable with using it as security.</li> <li>Instalment margin loans are suitable for investors with regular income but no lump sum to invest.</li> </ul>	<ul style="list-style-type: none"> <li>Members of super funds that offer these options.</li> <li>Investors who do not own a home or do not have sufficient equity within their home.</li> <li>Investors who are uncomfortable with using their home as security.</li> <li>Investors looking for the simplicity of a pre-packaged geared investment.</li> <li>Investors who want to limit potential losses.</li> </ul>

For more information contact;

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Note: This is for general information purposes only and does not constitute advice. With all of these options there are a number of considerations outside the scope of what is covered in this article that you need to understand to ensure your personal circumstances are taken into consideration.

