Investment Lending explained

CommSec Adviser Services

An investment loan lets you borrow money to invest in accepted shares and managed funds, using existing investments or cash as security. By enabling you to invest more money, an investment loan has the potential to improve your investment returns and help you reach your financial goals sooner.

COMMSEC ADVISER SERVICES INVESTMENT LOAN AT A GLANCE

GROW WEALTH AT A FASTER RATE	Increase the size of your investment portfolio by using borrowed money.
UNLOCK EQUITY	Borrow against your equity in existing investments as an alternative to selling and potentially triggering capital gains.
WIDE RANGE OF ACCEPTED SECURITIES	Our accepted list consists of over 500 ASX listed securities, 1,600 managed funds and 350 investment platforms and SMAs.
10% BUFFER	An allowance for fluctuations in the market value of your investment portfolio before a margin call is triggered.
NO APPLICATION FEES*	There are no application fees for individuals or company applicants.
CHOICE OF COMPETITIVE VARIABLE OR FIXED INTEREST RATES	Fixed interest rate options are available for 1, 2, 3 and 5 year periods with interest payable yearly in advance or monthly in arrears.
ONLINE SERVICES	Online services include access to account information for you and your financial adviser, as well as a range of helpful reference material.
OTHER SERVICES	A Regular Gearing option is also available.

**Fees apply for trust structures. Government charges may apply.*

WHAT IS AN INVESTMENT LOAN?

An investment loan allows you to borrow to invest using accepted shares, managed funds and cash investments as security and provides you with the opportunity to invest more than you could using your own money, thereby increasing your potential for higher returns.

The amount you can borrow depends on the investments you provide as security. Each investment we accept as security has a borrowing limit, which is the percentage of the investment's value that you can borrow. The borrowing limits are generally between 40% and 75%.

A borrowing limit of 75% means you can borrow three quarters of the total value of the investment, provided that you use the total investment as security. So if you had $10,000 of your own money and wanted to invest in a managed fund which currently has a borrowing limit of 75%, you could borrow up to $30,000, provided you use the total $40,000 investment as security.

WHY USE AN INVESTMENT LOAN?

Borrowing to invest can allow you to:

- increase the size of your investment portfolio which can allow you to grow your wealth at a faster rate. An investment loan increases the amount of money you can invest. As your investment capacity rises, so too does your ability to increase wealth.
- diversify your investments. As you have more money to invest you can spread it across a variety of shares and managed funds. Losses in one investment may be offset by gains in another. Diversification may reduce the investment risk of your portfolio and make your returns less volatile.
- access cash without selling your existing shares or managed funds. An investment loan allows you to borrow against the equity you have in existing investments without triggering capital gains.
- reduce your taxable income because interest paid on an investment loan is generally tax deductible (depending on your circumstances) when the loan is used to invest in managed funds or shares.

HOW DOES AN INVESTMENT LOAN WORK?

The CommSec Adviser Services Investment Loan offers you two options:

- **Lump Sum Gearing**

  Investing a lump sum amount up-front puts your money to work immediately and provides full exposure to any positive (or negative) growth in asset values. The flexibility of the facility also allows you to increase or decrease your investment exposure at any time.
- **Regular Gearing**

  Combine the power of an investment loan with all the benefits of a disciplined savings plan. A Regular Gearing plan offers a simple and automatic approach to investing. It allows you to increase the size of your monthly investments into managed funds by adding a borrowed amount to your personal contributions.

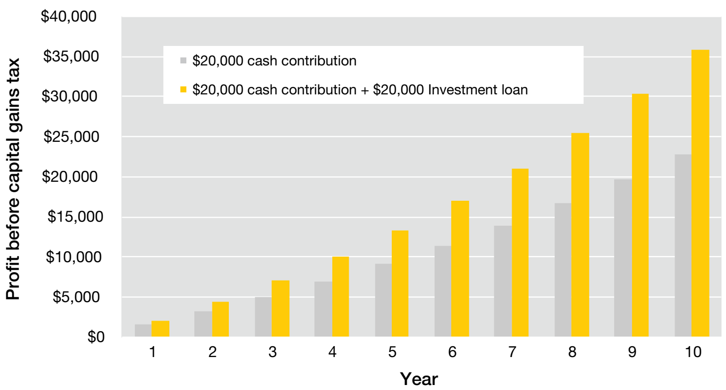
  A Regular Gearing plan may be suitable if you do not have a large lump sum amount to invest, wish to use a more conservative entry strategy or want to adopt a 'dollar cost averaging' strategy.

THE POWER OF AN INVESTMENT LOAN

In this example we compare two strategies which invest in a portfolio of securities over a ten year period:

- Investing $20,000 of your own money.
- Investing $20,000 of your own money and borrowing $20,000 using an investment loan. Therefore, a total initial investment of $40,000.

The amount of your own money invested under each strategy is the same. The chart below compares the potential profit before capital gains tax of the two strategies. The profit before capital gains tax is the value of the investment portfolio less your contributions, loan balance, tax on investment income and interest paid on the loan, where applicable.



Assumptions: The graph compares the potential return of each investment strategy – with and without an investment loan.

- The graphs show the profit before capital gains tax of each strategy.
- It assumes an average annual capital growth rate of 4.50% pa, an income yield of 4.00% pa with all income reinvested, distributions are 70% franked, a company tax rate of 30%, a marginal tax rate of 39% including Medicare levy of 2.0%, an average annual investment loan interest rate of 8.00% pa, an initial investment loan gearing level of 50%, brokerage and any other fees are excluded.
- While capital gains tax implications have been ignored, they should be considered before investing.
- This example is for illustrative purposes only. It does not reflect any particular person or situation and should not be taken as an accurate forecast of any outcome.

It can be seen that the strategy which uses an investment loan leads to a higher profit before capital gains tax.
After 10 years, the investment lending strategy generated a profit before capital gains tax of approximately $35,766 compared to $22,763 for the strategy that didn't use an investment loan.

LOAN-TO-SECURITY RATIOS

Three different loan-to-security ratios are used to determine the position of your loan and make sure the value of the security you have provided remains at an acceptable level.

1. Current Loan-to-Security Ratio (Current LSR)

$$\text{Current LSR} = \frac{\text{Loan Balance}}{\text{Market Value of Accepted Security}} \times 100$$

$$\text{Current LSR} = \frac{\$50{,}000}{\$100{,}000} \times 100 = 50\%$$

The Current LSR is a measure of the size of your loan relative to the value of your accepted security, expressed as a percentage.

Consider an example where your loan balance is $50,000 and the market value of your security is $100,000.

2. Base Loan-to-Security Ratio (Base LSR)

$$\text{Base LSR} = \frac{\text{Maximum Loan Amount}}{\text{Market Value of Accepted Security}} \times 100$$

The Base LSR illustrates the maximum loan amount that you can borrow against your accepted securities, expressed as a percentage.

Using the previous example, consider that your $100,000 portfolio is made up of:

- a $50,000 investment that has a borrowing limit of 60% and
- a $50,000 investment that has a borrowing limit of 70%.

$$\text{Base LSR} = \frac{(\$50{,}000 \times 60\%) + (\$50{,}000 \times 70\%)}{\$50{,}000 + \$50{,}000} \times 100 = 65\%$$

In this example you could borrow $65,000 using your existing portfolio as security. However, you may be able to borrow a greater amount than this if you purchase shares or managed funds from the accepted securities list and provide them as security as well.

3. Margin Call Loan-to-Security Ratio (Margin Call LSR)

The Margin Call LSR is your Base LSR plus the Buffer. The Buffer prevents small fluctuations in market values from placing your loan in margin call.

In the above example, the Margin Call LSR is 75% (i.e. 65% + 10% assuming that the Buffer is set at 10%).

LOAN-TO-SECURITY RATIOS (CONTINUED)

4. Maximum Gearing Ratio

The Maximum Gearing Ratio represents the ceiling that we place on your current borrowing level expressed as a percentage of your accepted securities. This ratio is determined by us and may be above or below your Margin Call LSR. Your Maximum Gearing Level will be the lower of the Maximum Gearing Ratio and your Margin Call LSR.

A Margin Call will therefore be triggered when the value of your accepted securities falls and results in:

i. Your Current LSR being greater than your Margin Call LSR; or

ii. Your Current LSR being greater than the Maximum Gearing Ratio.

If a Margin Call is triggered you will be required to reduce your Current LSR back to your Base LSR within the specified timeframe.

The Maximum Gearing ratio may change from time to time and can be found on our website **www.commsecadviserservices.com.au**.

WHAT ARE THE RISKS INVOLVED?

Borrowing to invest can multiply your investment returns in a rising market. However, if your investments perform poorly, it can also multiply your investment losses.

Other risks associated with an investment loan include:

- dividends or distributions may be lower than expected or none may be paid at all.
- the variable interest rate may increase resulting in higher interest costs.
- margin calls may require investments to be sold quickly at unfavourable prices if you are unprepared.
- tax legislation or marginal tax rates may change.

There are a number of things you can do to reduce the risks associated with an investment loan. For example, borrowing less than the maximum allowed reduces the risk of a margin call.

Before you apply for an investment loan, you should speak to your financial adviser who will be able to help you put an appropriate strategy in place. Investors should also obtain professional taxation advice that addresses their individual circumstances before taking out an investment loan.

GETTING STARTED

For more information, speak with your financial adviser.