Leveraged
The professional's choice

Certainty in an uncertain environment: Fix and Prepay

Borrowing to invest is a popular strategy for wealth creation. Although it carries risk of magnifying losses during market downturns, by borrowing to purchase a larger amount of assets, investors can potentially increase their overall returns, and reach their goals faster. When borrowing, however, there are two important considerations:

- **Interest Rates - Fixed or Variable**
- **Tax treatment**

Changes in the interest rate that you borrow money at can affect your investment returns. Especially in a rising interest rate environment, higher interest rates can increase your borrowing costs. Second, interest costs on the loan may be tax-deductible, meaning you may be eligible to offset this against tax payable on assessable income you have earned in the current financial year.

If you require certainty around budgeting for interest costs with the potential for tax benefits, a Fix and Prepay strategy may be something for you to consider before 30th June.

What is Fix and Prepay?

Across all margin loan products issued by Leveraged, you can choose to pre-pay 12 months of fixed interest costs in advance. This lets you lock in an interest rate and receive the benefit of certainty over your interest costs for the chosen period.

Introducing: Viraj

Viraj is a junior software developer and is an Australian tax resident on the middle tax bracket. His medium-term goal is to purchase a house in Melbourne, for which he estimates he will need a $150,000 deposit.

With a secure, well-paying job, he has taken out a $80,000 margin loan where he has borrowed the loan at a variable interest rate to invest in a range of shares and exchange traded funds to accelerate his progress towards his financial goal.

Viraj is concerned that interest rates will rise and needs more certainty around the interest costs on his margin loan. He's also received tax advice from his accountant that prepaid interest may help to minimise tax payable on his income, which saw some healthy growth in the current financial year.

He has a choice:

A) Fix and Prepay all or some of his variable margin loan interest costs

B) Stay Variable

A) Fix and Prepay

By fixing and prepaying the interest on his current variable margin loan, Viraj gains certainty over his interest costs. He may also be able to claim a tax deduction for the prepaid interest cost of the next 12 months to potentially reduce the tax payable on his assessable income and any capital gains generated in the current financial year.

Alternatively, Viraj may fix and prepay the interest on a smaller portion (e.g., half) of his margin loan, increasing certainty over the cost of some of the loan. The remainder will still be subject to changes in variable interest rates.

B) Stay Variable

By staying on a variable interest rate, Viraj's total interest costs can change, and in the current environment this will potentially increase. Viraj may still be able to claim a tax deduction on the variable interest costs he incurred this financial year but will have to wait until the following financial year's tax return to claim the interest costs on his variable loan if he chooses not to fix and prepay.

Here's how you can think about the benefits:

	Certainty in a rising interest rate environment	May bring forward tax deduction	Requires lump sum payment before 30th June
Fix and Prepay	✓	✓	Yes
Stay variable	✗	✗	Not required

Other features of Fix and Prepay with margin loans from Leveraged

1. Future proof with a higher loan balance

You are not restricted to Fix and Prepay your current variable loan. You can choose to Fix and Prepay a higher loan amount (subject to your credit limit) that you intend to use within the next 12 months (subject to equity available). If you are yet to decide on which investments to acquire, the Sweep feature can manage the unused portion of your Fixed Rate Loan into a linked Adelaide Cash Management Account until you are ready to transact.

2. Manage your Fix and Prepay loan with a Sweep feature

We can help you manage any unutilised Fixed Rate Loan by sweeping funds between your margin loan and a linked Adelaide Cash Management Account which forms part of your Secured Portfolio. Typically, you will nominate a Target Facility Balance equal to your Fixed Rate Loan. If the total amount borrowed under your margin loan (both fixed and variable rate loans) is less than your Target Facility Balance, then we will sweep the excess loan funds to your Adelaide Cash Management account to earn credit interest on the excess funds. Equally, if the total amount borrowed under your margin loan is greater than your Target Facility Balance, we will sweep funds from your Adelaide Cash Management account into your margin loan to reduce the loan to the Target Facility Balance. The aim is to maintain the loan balance around your nominated Target Facility Balance amount. In this way you can maximise the interest return on any temporarily unutilised loan balances.

Fix and Prepay is a popular and well-known end of financial year planning strategy for some investors using a margin loan. At Leveraged we're proud to continue offering this to our clients for over 30 years.

Need more information?

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