Certainty in Interest Cost
Fix and Prepay

Borrowing to invest, or gearing, is a medium-to-long-term strategy used by investors to access additional funds for investments, on top of their own capital. Dependent on individual circumstances, interest expenses on the funds borrowed for income-producing purposes are generally tax deductible, and can either be variable or fixed interest. One strategy available for some people by the end of a financial year is to fix the interest rate on the loan, prepay the fixed interest for up to 12 months and then claim a tax deduction on that in the current financial year. This could assist in tax planning by bringing forward a tax deduction from next financial year to current year, when the prepayment is made. Tax advice should be sought from your accountant or financial adviser to determine if this strategy is appropriate and beneficial for you.

What is Fix and Prepay?

Fix and Prepay is fixing the interest rate on your margin loan and prepaying the fixed interest cost in one upfront payment for a maximum term of 12 months. It locks in the interest rate, often at a discount, for the duration of the fixed term and provides certainty to your interest cost for the period. Fix and Prepay is available across all our margin loan products.

Considerations when determining if fixing and prepaying your interest is the right strategy for you:

- ✓ **Interest Rates**
  Changes in interest rates on funds borrowed can affect investment returns. Fixing your interest rate may remove the uncertainty of changes in interest rate during the fixed rate period, giving you more certainty around cashflow management. However, it should also be noted that variable rates may fall during the fixed term period and it is possible your fixed rate may be higher than the variable rate available.

- ✓ **Tax treatment of prepaid interest**
  Prepaid interest may be tax deductible depending on your personal circumstance. By prepaying the fixed interest before the end of the financial year, you may be able to bring any eligible tax deduction to the current tax year. Investors should consider their individual circumstance to determine if this strategy is suitable for them.

Case Study

The below example outlines how a borrower can choose what method of paying interest most aligns with their financial strategy.

Introducing: Viraj

Viraj is a current Leveraged customer and has a variable loan balance of $80,000. He is a long term investor. Viraj is interested in how to obtain more certainty around interest costs and the options available to him.

He has three choices available for payment of interest:

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

B) **Fix the loan without prepaying** (Fixed in Arrears); or

C) **Stay Variable**

A) Fix and Prepay

By fixing and prepaying the interest for 12 months for the total current loan balance of $80,000, Viraj gains certainty of his interest payment for the chosen term. By choosing this method, he may be eligible to bring forward any eligible tax deduction for the interest to the current tax year.

Alternatively, Viraj may fix and prepay the interest on a smaller portion (e.g., $40,000 of his current loan balance, allowing him to gain certainty on the interest costs of half of his current loan). The remaining loan will still be subject to changes in variable interest rates.

As part of this option, Viraj could also consider opening up a cash management account, to help manage the remaining $40,000.

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B) Fix the loan without prepaying

(Fixed in Arrears)

Viraj is also able to fix his loan for any amount above $20,000 without prepaying the interest in advance. In this case, interest is charged monthly in arrears during the loan term. He still gains certainty of interest costs for the fixed amount over the chosen term under this method.

C) Stay Variable

By staying on a variable interest rate, Viraj's total interest costs can change depending on changes in the interest rate, and he retains the flexibility that a variable rate offers. For example, if he intends to reduce his loan in the near future, he will only pay interest on his current borrowings at any time when the loan is variable.

Here's how you can think about the three choices:

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

Other features of Fix and Prepay with margin loans from Leveraged

Ability to fix a higher amount

If you have an existing margin loan with a variable loan component, you are not restricted to fix and prepaying your current variable loan amount. You can choose to fix and prepay a higher loan amount (subject to your credit limit) that you intend to use for the term of the fixed loan (subject to equity available). If you are yet to decide on which investments to acquire using the fixed loan, the sweep feature (dependent on the particular type of loan product) can manage the unused portion of your fixed rate loan into an approved cash management account until you are ready to transact.

Manage your loan account with a sweep feature

We can help you manage any unutilised fixed loan amount by sweeping funds between your margin loan and a cash management account approved by the lender, which will form part of your portfolio secured to the loan. Typically, you will nominate a loan amount as a 'Target Facility Balance' equal to your fixed rate loan. If the total amount borrowed under your margin loan is less than your Target Facility Balance, then we will sweep the unused loan portion between your borrowed amount and the target balance to your approved cash management account to earn credit interest on these funds. Equally, if the total amount borrowed under your margin loan is greater than your Target Facility Balance, we will sweep funds from your approved cash management account into your margin loan to reduce the loan balance to the Target Facility Balance. The aim is to maintain the loan balance around your nominated Target Facility Balance amount. This way you can still earn the interest return on any temporarily unutilised loan balances.

Need more information?

Call 1300 307 807

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