Borrowing to invest

Borrowing to invest, also known as gearing or leverage, is a risky business. While you get bigger returns when markets go up, it leads to larger losses when markets fall. You still have to repay the investment loan and interest, even if your investment falls in value.

How borrowing to invest works

Borrowing to invest is a medium to long term strategy (at least five to ten years). It's typically done through margin loans for shares or investment property loans. The investment is usually the security for the loan.

Margin loans

A margin loan lets you borrow money to invest in shares.

Margin lenders require you to keep the loan to value ratio (LVR) below an agreed level, usually 70%.

The LVR goes up if your investments fall in value or if your loan gets bigger. If your LVR goes above the agreed level, you'll get a margin call. You'll generally have 24 hours to lower the LVR back to the agreed level.

To lower your LVR you can:

- Deposit money to reduce your margin loan balance
- Add more shares or managed funds to increase your portfolio value.
- Sell part of your portfolio and pay off part of your loan balance.

If you can't lower your LVR, your margin lender will sell some of your investments to lower your LVR.
Margin loans are a high risk investment. You can lose a lot more than you invest if things go sour. If you don't fully understand how margin loans work and the risks involved, avoid them and don't take one out.

Investment property loans

Investment property loans can be used to invest in land, houses, apartments or commercial property. You earn income through rent, but you have to pay interest and the costs to own the property. These can include council rates, insurance and repairs.

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Borrowing to invest is high risk

Borrowing to invest gives you access to more money to invest. This can help increase your returns or allow you to buy bigger investments, such as property. There may also be tax benefits if you're on a high marginal tax rate, such as tax deductions on interest payments.

But, the more you borrow the more you can lose. The major risks of borrowing to invest are:

- **Bigger losses** — Borrowing to invest increases the amount you'll lose if your investments falls in value. You need to repay the loan and interest regardless of how your investment goes.
- **Capital risk** — The value of your investment can go down. If you have to sell the investment quickly it may not cover the loan balance.
- **Investment income risk** — The income from an investment may be lower than expected. For example, a renter may move out or a company may not pay a dividend. Make sure you can cover living costs and loan repayments if you don't get any investment income.
- **Interest rate risk** — If you have a variable rate loan, the interest rate and interest payments can increase. If interest rates went up by 2% or 4%, could you still afford the repayments?

Borrowing to invest only makes sense if the return (after tax) is greater than all the costs of the investment and the loan. If not, you're taking on a lot of risk for a low or negative return.

Managing the risk of an investment loan

If you borrow to invest, follow our tips to get the right investment loan and protect yourself from large losses.

Shop around for the best investment loan

Don't just look into the loan your lender or trading platform offers. By shopping around, you could save a lot in interest and fees or find a loan with better features.

Don't get the maximum loan amount

Borrow less than the maximum amount the lender offers. The more you borrow, the bigger your interest repayments and potential losses.

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Pay the interest

Making interest repayments will prevent your loan and interest payments getting bigger each month.

Have cash set aside

Have an emergency fund or cash you can quickly access. You don't want to have to sell your investments if you need cash quickly.

Diversify your investments

Diversification will help to protect you if a single company or investment falls in value.

Gearing and tax

Borrowing to invest is also known as 'gearing'. Before you borrow to invest, check:

- if you will be positively or negatively geared, and
- how this will impact your cash flow and tax

See investing and tax for more information about positive and negative gearing.

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