

Borrowing to invest? – then consider margin lending



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Growing your wealth isn't new, but how you go about it could be

There is an old saying in investment that “Money makes money.” It underlines a simple investment truth – that you need an initial capital base in order to generate future wealth.

While the principle still rings true in today's market, what's changing is that investors can now boost the amount available for investment. Or to put it another way, investors can seek to grow their own wealth using other people's money.

Borrowing to invest is often called gearing. You can gear your investments in different ways, some more complex than others.

Margin lending is a way of gearing that lets you borrow money based on the value of your investments, generally to invest more into managed funds or shares.

Colonial First State, through FirstChoice Investments, now gives personal investors access to a simple, flexible and competitive margin lending facility that can be added to new and existing investments.

Borrowing to invest may not be a suitable strategy for you. While gearing has the potential to magnify gains, it will always magnify any losses suffered if the value of your investments falls. You may have to cope with potentially large fluctuations both up and down in the value of your investments.

Although it can lower your tax liability, the tax implications will depend on your personal situation and the type of investments you choose. Geared investments generally involve much higher risk than non geared investments and you should seek financial advice before borrowing money to invest.

What is margin lending?

With a margin loan, the borrowed funds are secured against the value of the investments being purchased or held, typically managed funds or shares.

As with most loans, the lender requires some form of security, in this case your investment. As such, the maximum amount you can borrow or draw down to invest is determined by a percentage of the amount of your capital, known as the loan to value ratio (LVR).

If the value of your investment rises it reduces the LVR and you may be able to increase your borrowing.

Conversely, if the investment value falls, and the LVR exceeds the agreed limit, your borrowing capacity will decrease and you may be required to reduce your loan to inject more capital, otherwise known as a margin call.

Calculating the LVR on a margin loan

The maximum amount you can borrow or draw down to invest is determined by the amount of your money (your capital) and the loan to value ratio (LVR) allowed for the investment option you choose. The LVR is the maximum loan expressed as a percentage of your total investment value.

For example, a LVR of 50% means that for every \$1 of your own money, you can borrow up to an additional \$1 to invest a total of \$2.¹ For example if you have \$50,000 to invest you could borrow up to a maximum of \$50,000 to invest a total of \$100,000.

$$\begin{array}{ccccc} & & 50\% \text{ loan to} & & \\ & & \text{value ratio} & & \\ \text{Your capital} & + & \text{Margin loan} & = & \text{Total investment} \\ \$50,000 & & \$50,000 & & \$100,000 \end{array}$$

¹ LVRs may change.

Why borrow to invest?

Gearing through margin lending allows you to:

- **Increase your investment base** – adding borrowed funds to your existing investments gives you a larger investment ‘footprint’ and more investment opportunities. With a larger investment base you have the potential for higher dollar returns than if you just invested your own money.
- **Diversify easily** – with a larger total investment you can spread your portfolio across a greater range of investments, giving more diversification.
- **Unlock your equity** – by borrowing against the equity in your investment, you can take advantage of other investment opportunities without having to sell any investments and possibly incur Capital Gains Tax (CGT) liabilities.
- **Increase the potential franking credits** – by magnifying your total investment, gearing increases the potential franking credits if you invest into Australian share options that pay a portion of franked income. Franking credits reduce the tax you pay on dividends or distributions.
- **Access tax deductions** – while gearing’s primary objective is wealth creation, it also offers the potential to claim interest costs as a tax deduction providing you invest the borrowed funds in assets that produce an income. It is also possible to pay up to 12 months interest in advance and bring forward the tax deduction. This depends on your own personal tax situation and a taxation specialist is best placed to determine whether this is appropriate for you.

“ Adding borrowed funds to your existing investments gives you a larger investment ‘footprint’.”

What are the main risks of margin lending?

Like all geared investments, margin lending presents risks that you should be aware of.

- Just as gearing can magnify the potential investment gains, it always magnifies any investments losses if the value of your investment portfolio falls. This can then lead to a loss of capital and a margin call.
- If the value of your investment falls below a certain level, you will be subject to a 'margin call'. If this happens, you will be required to contribute additional funds or sell down investments to bring your loan to value ratio (LVR) back to the set maximum.
- If you use margin lending to invest in a geared investment, you will further increase your losses as your level of gearing is even higher. And because geared investments are generally more volatile the investment income may fall, making it more difficult to service the loan.
- Interest rates may rise and you could have to pay more interest than you anticipated.
- In the worst case you could lose all of your investment and still have the loan remaining which needs to be repaid.

It is important to talk to your financial adviser to fully understand the risks and how you can mitigate against them.

Is margin lending right for me?

An adviser is best placed to answer this question. Before adding margin lending to your wealth creation plans, you and your adviser should consider:

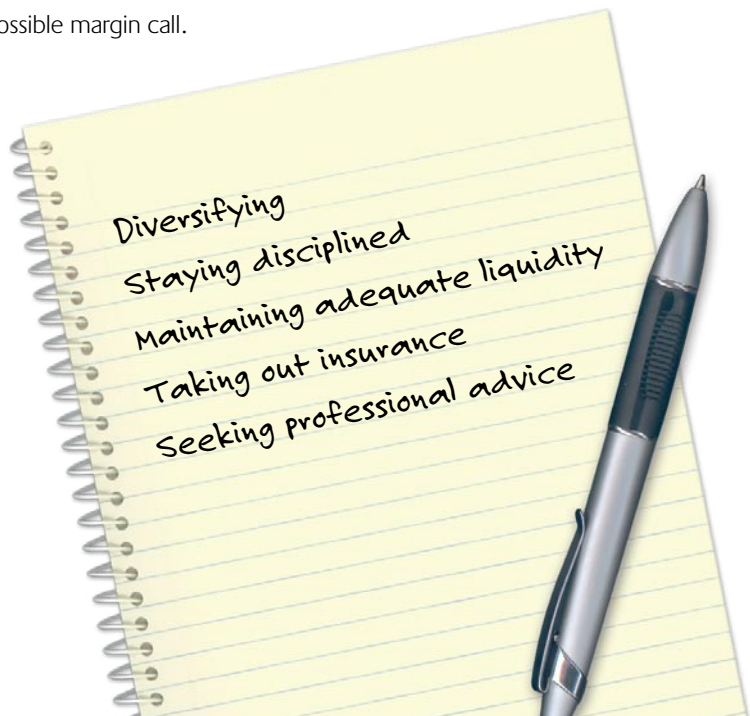
- **Your goals** – what are your goals for the next 5, 10 or even 15 years? How does a long-term strategy like margin lending gel with your plans?
- **Your risk profile** – are you comfortable with potentially large fluctuations in your investment value, both up and down?
- **Your assets** – you'll generally need to have an existing investment base or capital to secure the funding. Also, regardless of how the investment performs you must repay the loan and meet interest repayments. And if you incur a margin call, you may have to draw upon a cash reserve or sell assets at short notice.



Tips for managing your margin loan

When you take on a margin loan, useful strategies to consider in managing your loan include:

- **Diversifying** – can help manage investment risk and fluctuations, both up and down, in the value of your investment.
- **Staying disciplined** – keeping your borrowing below the maximum LVR reduces the potential risk if the investments fall in value. Also, paying interest regularly and reinvesting any investment income can help.
- **Maintaining adequate liquidity** – it is prudent to actively monitor your cash flow and maintain a cash reserve that can act as a buffer against a possible margin call.
- **Taking out insurance** – if you rely on your personal income to service the loan, you can protect yourself against a loss of future earnings with income protection, trauma insurance and life insurance.
- **Seeking professional advice** – even if you're a confident and experienced investor, you should speak to a professional financial adviser.



What does FirstChoice Margin Lending offer?

Take a close look at FirstChoice Margin Lending, and you'll discover that the same qualities that have made FirstChoice one of Australia's most widely-used investment platforms have been woven into the versatile margin lending facility.

Simplicity

With FirstChoice Margin Lending there is a single, maximum LVR of 50%*. In other words, for every \$1 of your FirstChoice investment you can borrow up to another \$1. Each loan has an additional buffer of 10% above the LVR and we will attempt to contact you or your financial adviser before a margin call is made.

Competitive interest rates and no loan administration fees

With FirstChoice Margin Lending you will be able to borrow at highly competitive interest rates. Moreover, you have the choice of a variable or fixed rate loan.

And with no loan application or loan administration fees, you save money from day one and know that every dollar of your investment is working for you.

Wide investment choice

There are no restrictions on the asset allocation of your margin lending funds within FirstChoice, giving you a choice of over 90 different fund options.

Speedy loan approval and set-up

In the past, applying for margin lending for managed funds has meant two application forms, two call centres and two administration teams to process transactions. No longer! With FirstChoice Margin Lending, we've streamlined the application process making it faster and easier. To apply, simply complete the margin lending section in the application form. You can even apply online. Approved loans will usually be made available and invested within 48 hours.

* Currently 50%. An LVR may change at any time.

No 'red tape'

Once your margin loan is in place, it's up to you to decide when, which investment options and how much to invest. You can choose to borrow either a lump sum amount or set up a regular monthly amount in line with your regular investment plan. And we won't hold you to a minimum loan balance or insist on a minimum drawdown or regular drawdown amount.

Day-to-day control

Using our secure website, FirstNet, you can track your investments online (including your margin loan facility) and switch investments. And because your loan and investments are managed within the one organisation, with one phone call you can get an accurate picture of your investments and loan information.

FirstChoice Margin Lending at a glance

Single 50% LVR	For every \$1 of your FirstChoice investment you can borrow up to an additional \$1*
10% buffer	If you exceed the maximum LVR there is a buffer of 10% to give you some breathing room to allow for market fluctuations
Cash drawdown	You can request a cash drawdown for investment purposes outside FirstChoice Investments
Interest rate option	1 year fixed rate or variable rate loans – at competitive rates**
Minimum loan balance	None
Minimum drawdown	None
Loan approval	Loans approved and invested in two working days of receipt of correctly completed application
Loan application fee	Nil
Loan administration fees	Nil
Borrowing options	Borrow a lump sum or invest a regular monthly amount

* LVRs may change.

** Fixed rate loan will be offered for a limited period prior to 30 June commencement date each year.

We're at your service.

Ready now?

Ask for an information pack containing:

- a copy of the FirstChoice Investments product brochure (called a Product Disclosure Statement), and
- a copy of the 'What is FirstChoice?' brochure.

Not quite ready?

If you feel you need some more information there are lots of resources you can use, and people who can help.

- Speak with a financial adviser.
- Ask for a copy of the 'FirstChoice – the easy way to invest in managed funds' or 'Investing – seven clever strategies' booklets.

Need more information?

Please speak with your financial adviser or visit our website at colonialfirststate.com.au. Alternatively, you can contact us:

Enquiries about existing investments, please call

13 13 36

Enquiries about new investments, please call

1300 360 645

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