Debt management.

Strategy Information Flyer

At some point in our lives, we borrow money to help us to achieve our goals; buying our dream home, a new car or an investment portfolio. There are numerous types of debt, each with their unique characteristics.

Non-deductible debt.

The main types of non-deductible debt are home loans, car loans and credit cards. As they are for personal use, the interest on the debt is not deductible hence the name, non-deductible debt.

Deductible debt.

Interest is generally tax-deductible where borrowed funds are used for income-producing purposes (based on the use of the loan, not the assets itself). As such you can claim the interest as a tax deduction.

Common types of deductible debt are property loans, investment lines of credit and margin loans.

Important Note: From 1 July 2027, the ability to offset rental losses from residential investment properties against other income (referred to as negative gearing) will be limited to newly constructed properties. Residential properties owned at 7:30pm AEST on 12 May 2026 are exempt from these changes. As a result, future residential property investments may provide lower tax benefits and different after-tax outcomes than under the current rules.

The cost of borrowing can be higher, so you need to be disciplined and consider strategies to reduce the total interest cost. You also need to have a reliable cash flow to support this type of debt. If you have a change in your cash flow, you need to reconsider any investment debt strategies such as this.

Often deductible debt is set up as interest-only, meaning you only pay the interest amount rather than repaying the capital of the loan.

Offset account.

An offset account is a transaction bank account linked to your mortgage. The funds in this account are offset daily against the money you owe on your home loan. The effect of this is a reduction in the amount of interest you must pay on your home loan. For example, if your loan is $450,000 and you have $50,000 in savings, by using an offset account you only pay interest on the outstanding home loan balance of $400,000 ($450,000 loan less the $50,000 savings).

The advantages of an offset account are:

- Reduction in the amount of interest paid against a home loan;
- Ability to have access to the savings in the transaction account - not locked up like extra repayments on an ordinary loan can be;
- Savings effectively earn the rate of the loan, rather than the low-interest rate of a transaction account; and
- Savings do not earn taxable interest; instead, the reduce the interest payable on the loan.

The disadvantages of an offset account are:

- Discipline is required not to spend the savings in the transaction account;
- Most offset accounts are only available with variable rate home loans that may have a higher interest rate than a fixed-rate loan; and
- There may be extra fees and charges which can negate the tax benefits of an offset facility if you do not have a lot of cash in your account.

Debt consolidation.

Debt consolidation involves combining several loans into one loan account. By combining loans, the goal is to consolidate into a lower interest rate loan and have one repayment amount.

For example, you may increase your home loan at 5% to repay your car loan at 10% and credit card 20% interest rate debt.

Debt consolidation may provide advantages such as:

- Eased cash flow – annual repayments may be less than the total previous repayments;
- Reduced fees – you will only have one loan account which may reduce account fees and transaction costs; and
- Improved manageability – you will only have one monthly statement and one monthly repayment.

Potential disadvantages include:

- Longer repayment period – a loan which might have been paid over a shorter period, will now be extended unless total repayment levels are maintained;
- Increased interest cost – if the term of a loan is increased, this may result in an increase in total interest cost over the term;
- Fees – the restructure may incur additional fees and charges; and
- You need to be disciplined when consolidating your debt to ensure that you do not simply re-accumulate debt from other sources. In particular, be careful with how you use credit cards. You may wish to lower your credit limit or make sure you pay off the balance every month.

Margin lending.

How it works

In margin lending, the loan is secured against shares and property trusts listed on the stock exchange or unlisted managed funds. Some of these could be existing investments which

represent the borrower's equity, with the balance being new investments purchased with the proceeds of the loan.

The lender provides a list of specific securities that it will accept and nominates a percentage of the market value for each security, which is the maximum amount that it will lend against that security. This is known as the loan to value ratio (LVR).

Margin loans are generally arranged as a line of credit and are very flexible. They do not usually specify a repayment that must be made. The only requirement is to satisfy a margin call if the level of security falls too low. Repayments can be made on a regular or ad hoc basis, or the interest from the investments can be credited to the account. Interest will be debited to the account and if not paid, will be capitalised as part of the loan balance. If repayments from all sources do not cover the interest, the amount of the loan will increase, which could lead to margin calls.

Loans can be partly or fully repaid and subsequently redrawn with little, if any cost. This can be done regularly, which allows the borrower to take advantage of opportunities to buy or sell investments on short notice.

Margin loans are generally full recourse, meaning the borrower remains personally liable if the value of the secured asset is insufficient to repay the loan.

It is critical that anyone taking out a margin lending loan, fully understands how it operates, including the possibility of having to make a margin call. All borrowers must be able to satisfy any margin call within this time.

Margin calls

The borrower must satisfy a margin call (often immediate/next business day), or the lender can sell a sufficient quantity of the assets lodged as security to satisfy the call. A margin call can be satisfied by:

- Lodging further assets as security;
- Lodging cash or other funds to reduce the loan; or
- Selling assets and using the proceeds to reduce the loan.

Instalment gearing

Some margin lending facilities have a regular or instalment gearing option. For practical reasons, investments may be restricted to managed funds, but the initial investment can start from approximately $3,000, equity of $1,000 and borrowing of $2,000. The investor then increases the equity by regular monthly amounts which are matched $1 for $1 (or the agreed proportion) by borrowed funds, subject to the credit limit approved for the borrower.

Instalment gearing can be a convenient way to start accumulating geared investments by instalments, although expenses and the interest rate are likely to be higher because of the small amount of the loan in the early years.

Debt recycling / Gearing.

This strategy involves the conversion of the non-deductible debt of a home loan, into the tax-deductible debt of a wealth-building investment loan. The primary objective is to reduce the non-deductible debt faster than just making regular repayments while accumulating wealth.

Broadly, debt recycling works as follows:

- Drawing down available equity in your home to up to 80% and investing these funds into investments, which are designed to produce income and growth;
- All surplus income available is directed towards reducing the non-deductible home loan debt. Thus, saving on interest costs and reducing the non-deductible loan amount;
- All investment earnings, franking credits, tax refunds and other surplus cash flow, after paying the investment loan interest, should be used to reduce the home loan further and increase equity in the home. The investment income/tax refund provides additional repayment also; and
- At regular intervals, draw out this excess equity in the home, so the deductible loan increases back to up to 80% and invest these funds into investments. This regular interval is usually every quarter, six months or yearly.

Once all the non-deductible debt has been repaid, the borrower is left with only deductible debt.

Care must be taken to structure borrowings correctly (e.g. separates loan splits) to ensure interest deductibility is not compromised.

At this point, the borrower can focus on repaying the deductible debt. This can be done through excess cashflow or selling down of investments to repay the debt.

This strategy does require:

- A long-term investment timeframe and discipline;
- Regular surplus income;
- Tolerance for risk and short-term fluctuations in the market; and
- Income protection insurance to help provide a replacement income source in case the borrower becomes sick or injured.

The key disadvantages of gearing are:

- Using the equity in your home means your home will be used as security, and if the loan is not repaid, the lender may force a sale of your home;
- Investments do not provide guaranteed income or growth and may not perform as expected; and
- Interest rates may rise beyond a level you could afford or are comfortable with.

Some key advantages of using debt to purchase investments:

- Ability to purchase a more substantial investment portfolio than what would be possible if using only your own funds;
- Larger investments increase your growth and earning potential in the form of dividends;
- Access to more capital allows you to diversify your investments;
- Generally, investments held outside super may be more accessible that superannuation benefits, although liquidity will depend on the type of investment;
- If you reinvest the generated income, you will compound your returns over time, further enhancing the growth potential of your portfolio; and
- Regular contributions allow you to benefit from dollar-cost averaging. In simple terms, this means growing your portfolio, regardless of market conditions. When prices are low, you can secure larger investments than when they are high. Although there are no profit guarantees, this averages out share or unit price movements from market volatility.

Some key tax benefits of debt recycling include:

- Interest costs are generally tax-deductible to the owner(s) of the investment. The interest you pay to finance your investment serves to reduce your overall tax liability. This is more effective with higher marginal tax rates.
- You receive imputation credits for many income distributions from Australian shares. These further reduce your tax liability.
- If the investment is held jointly, any income distributions and capital sales are divided between you and your spouse/partner, reducing your combined tax liability.

The benefits of reducing non-deductible debt:

- Less interest payable over the life of the loan (this is because interest is calculated on a lower daily outstanding loan balance);
- You will be able to repay your loan faster;
- You will not take unnecessary investment risk trying to achieve a return higher than the interest rate in an alternative investment vehicle (on which you will pay tax at your marginal tax rate); and
- This may be a lower risk than alternative investment strategies where no gearing is used, however it still involves investment and borrowing risk. However, you need first to check your loan contract to see if there are any restrictions on additional repayments. For example, some fixed-term loans may not allow additional repayments, or they may charge a penalty.



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