

UNDERSTANDING COSTS AND RISKS OF GEARING

You must take risks, both with your own money or with borrowed money. Risk taking is essential to business growth.



This document provides some additional information to help you understand the financial planning concepts discussed in your Statement of Advice (SOA).

How It Works

Borrowing for investment purposes is also known as 'gearing'. The aim of gearing is to increase your investment return by investing borrowed funds in addition to your own capital.

Although gearing can deliver benefits, the risks associated with gearing may mean it is unsuitable for you. It is essential to carefully consider these risks before proceeding with a gearing strategy.

Gearing involves taking out a loan to invest in growth investments such as shares or property. Borrowing gives you more money to invest, which may provide greater potential to diversify and build wealth. However, it is important to remember that whilst investing more money gives you opportunity to increase capital gains, it can lead to increased losses if the investments do not perform well.

Interest and related borrowing costs are usually tax-deductible if the loan is used to acquire an income-producing asset. If you are repaying the principal as well as interest, only the interest amount is tax-deductible. Although the tax benefits of gearing can seem attractive, it is important that the primary purpose of implementing a gearing strategy is to maximise your wealth accumulation, not to minimise tax.

Gearing is often discussed as negative, positive or neutral, referring to the cost of the investment relative to the investment income generated:

- **Negative gearing** – where interest payable on borrowed funds and related expenses exceed the income received from the investment. The investor must have surplus income from other sources to meet the shortfall.
- **Positive gearing** – where expenses are less than the income generated. The strategy is 'self-funded' because investment income covers the costs. Additional tax will generally be payable.
- **Neutral gearing** – where the costs of the loan are approximately the same as the income generated.

Gearing is generally only appropriate for investors who have a growth-oriented risk profile. For gearing to be effective, the overall return from investments should exceed the cost of the loan and other expenses over the life of the investment – typically only achieved through growth-oriented assets such as shares and property.

You should also meet all of the following criteria before considering gearing:

- Have sufficient disposable income to comfortably meet loan repayments, even if interest rates increase
- Have life insurance in place for a value equal to the outstanding loan, or sufficient liquid assets to repay the loan or continue repayments in the event of illness or death, and
- Have a strategy in place to repay the outstanding loan at some point in the future.

Gearing May Magnify Returns — And Losses

Gearing may magnify investment returns, as shown below in Example 1*:

Starting Values	Geared	Non-Geared
Investor Equity	\$40,000	\$40,000
Amount borrowed	\$60,000	\$0
Total Investment	\$100,000	\$40,000
Market Rises 10%		
Value of Portfolio	\$110,000	\$44,000
Loan outstanding	-\$60,000	\$0
Investors Equity	\$50,000	\$44,000
GAIN in Investors Equity	25%	10%

However, gearing may also magnify losses, as shown below in Example 2*:

Starting Values	Geared	Non-Geared
Investor Equity	\$40,000	\$40,000
Amount borrowed	\$60,000	\$0
Total Investment	\$100,000	\$40,000
Market Falls 10%		
Value of Portfolio	\$90,000	\$36,000
Loan outstanding	-\$60,000	\$0
Investors Equity	\$30,000	\$36,000
LOSS in Investors Equity	-25%	-10%

*In addition, if the income return from the geared part of the investment (together with tax benefit) is less than the interest cost from the loan and any other associated costs, then this cash flow shortfall will reduce your overall return.

If the income return from the geared part of the investment (together with tax benefit) is less than the interest cost of the loan and any other associated costs, this cash flow shortfall will reduce your overall return. This is a simplified illustration only and does not account for interest, fees or tax.

Gearing Is a Long-Term Strategy

Gearing should only be considered as a long-term strategy, because of the greater level of market volatility associated with growth assets such as shares and property. Investors should have an investment time horizon of at least 7 years. If you have to cancel a gearing strategy sooner than the recommended timeframe, you may find that the values of your assets are lower than when you established the facility.

Wealth Protection Insurance

Wealth protection insurance is important for everyone to consider, and particularly important when you implement a gearing strategy.

- Income protection insurance can help you meet investment expenses such as interest repayments in the event that illness or injury prevents you from working for an extended period.
- Total and permanent disability (TPD) cover can help you repay the loan if you are unable to work again due to ill health.
- Term life cover can provide additional financial help to dependants in the event of your untimely death, since outstanding debt must generally be repaid and reduces the value of your estate.
- Critical illness cover can help you meet interest repayments if you suffer a specified illness or injury.
- Note that wealth protection insurance will not protect your income where it is reduced for reasons other than illness or injury.

Benefits

- The loan enables you to increase the size of your investment portfolio.
- A larger portfolio enables you to increase the diversity of investments or buy larger assets such as property.
- You may be eligible to claim a tax deduction for some or all of the cost of the loan to help offset the cost of borrowing or reduce tax on other income.

Risks, Consequences and Other Important Things to Consider

- Tax advantages from negative gearing should never be the sole reason for establishing a gearing strategy.
- You should ensure your employment and cash flow are secure so that you aren't forced to sell some or all of your investment portfolio at a time when markets are down.
- An unforeseen event, such as injury or illness that prevents you from working, or a change in employment circumstances, may make it difficult to cover investment expenses including loan repayments. This impact can be reduced by incorporating wealth protection measures.
- You should consider the impact of a rise in interest rates or a reduction in dividends, distributions, or rental income, and ensure you have sufficient cash flow to absorb these changes.
- The value of your investment portfolio may fall to a point where sale proceeds are not sufficient to repay the debt – so even though you have been entitled to tax deductions over time, you could end up carrying a debt once the portfolio has been sold.

- If the income return from the geared part of the investment is less than associated costs, this shortfall will reduce your overall gain (where there has been a capital gain) or increase your overall loss (where there has been a capital loss).

Live policy risk: negative gearing tax treatment

Negative gearing tax deductibility for investment loans has been the subject of recurring political and policy debate in Australia. While no legislated changes to negative gearing were in force as at 1 July 2026, this remains an area of periodic reform proposals. Clients relying on the ongoing deductibility of investment loan interest as part of a long-term (7-year+) gearing strategy should be aware this is a policy setting, not a guaranteed permanent feature of the tax system, and should be reviewed at each annual check-in.

- Legislation may change in the future in relation to tax deductibility of interest payments.

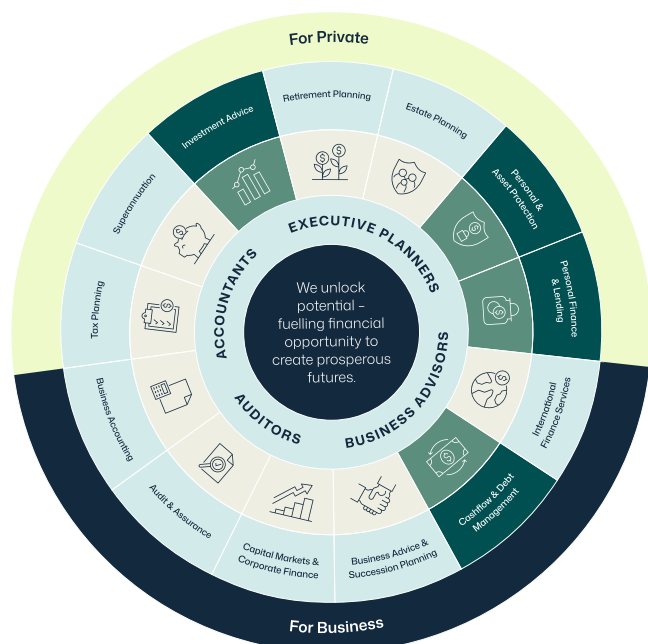
Quick Checklist

- ✓ Confirm you meet the entry criteria: stable disposable income, appropriate insurance, and a defined repayment strategy.
- ✓ Model both a rising and falling market scenario using your own numbers before committing.
- ✓ Put in place life, TPD and income protection insurance appropriate to the size of the loan.
- ✓ Confirm your investment time horizon is at least 7 years and you can sustain the strategy through market downturns.
- ✓ Get tax advice on interest deductibility, especially if the loan purpose is ever mixed (investment and private use).
- ✓ Review the strategy annually, including any legislative or policy changes affecting negative gearing.

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SOURCES AND FURTHER INFORMATION:

ASIC Moneysmart – Borrowing to invest – <https://moneysmart.gov.au/how-to-invest/borrowing-to-invest>

All rates, caps and thresholds in this fact sheet are current as at the 2026–27 income year unless otherwise stated, and may change. Confirm current figures before relying on them.

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All information is as at 01 July 2026