

‘Good debt’ versus ‘bad debt’

Case study: for financial advisers only

Objective

- Generate cash to pay off a home loan.

Assumptions

- Angela's current mortgage on her home is \$200,000
- Angela's remaining mortgage term is 20 years and the interest rate is 7.5 per cent
- Angela is currently on the top marginal tax rate and is registered for Goods and Services Tax (GST).

Possible investment strategy

Angela's adviser recommends the following investment strategy:

- Angela invests 50 Interests (\$129,250 including GST) in the Tree Project
- Angela borrows 100 per cent of the investment amount using a Macquarie Bank Limited Investment Loan* at a rate of 10.99 per cent per annum
- Angela uses the potential tax refund to reduce her outstanding home loan.

Angela has read the Macquarie Forestry Investment 2011 Product Disclosure Statement (PDS) and is comfortable with the terms and risks of the investment.

Potential benefits

By implementing this simple investment strategy, Angela has achieved the following benefits:

- portfolio diversity by investing in an alternative asset class (that historically has a low correlation with traditional asset classes)

- generated cash to reduce her outstanding home loan balance
- total loan balance increased by \$62,863 however Angela has increased her asset base through her \$129,250 investment in the Tree Project.

By using her tax refunds to pay off some of her outstanding mortgage, Angela can:

- reduce her non-deductible home loan debt now by \$66,388*
- reduce the time taken to pay off her existing home loan by approximately four years (see chart).

Please note this does incorporate the effect of potential deductions from interest paid on the Tree Project investment loan.

	With strategy	Without strategy
Home loan debt (7.50%)	\$133,613	\$200,000
Investment debt (10.99%)	\$129,250	–
Total debt	\$262,863	\$200,000
Total assets (excluding home)	\$129,250	–
Pre tax interest on debt	\$24,226	\$15,000
Post tax cost of interest	\$17,620	\$15,000
Increase in post tax funding cost	\$2,620	

For more information regarding the Investment Loan please refer to Section 9 of the PDS.

- * $\$117,500 \times 46.5\% = \$54,638$ plus $\$11,750$ GST which is refunded as this example assumes that the client is a member of the class of entities specified in the ATO Product Ruling, PR 2011/2. Also assumes top marginal tax rate for an Australian tax resident for the 2011 financial year and the Medicare Levy of 1.5 per cent is payable.

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1800 617 900



macquarie.com.au/forestry



agribusiness@macquarie.com