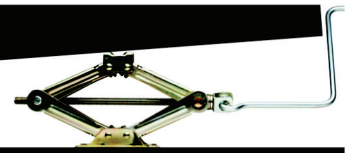

Macquarie Property Lever

MACQUARIE BANK

Case Study

Shift your thinking – Gearing inside a Self Managed Super Fund (SMSF)

Maximising the potential of a SMSF before retirement

Kevin is 52 and looking to retire in ten years. During that time he would like to purchase an investment property to provide him with income during retirement.

Age	52
Income	$200,000
Marginal tax rate	46.5%

Investing inside vs outside a SMSF

Kevin is considering whether to purchase the property in his SMSF or outside of super. He considers the following figures (Table 1) showing the deposit needed to purchase a $450,000 property and the earnings required to achieve that deposit. Kevin is aware that a high level of gearing provides little benefit in the superannuation environment due to the low tax rate applicable to complying superannuation funds.

Table 1: Gearing inside a SMSF compared to gearing outside super

	SMSF	Outside Super
Property value	$450,000	$450,000
LVR	55%	80%
Capital required (inc stamp duty)	$218,240	$105,740
Earnings required to achieve capital	$256,753	$197,645
Additional earnings required	$59,108	
Out of pocket cost of additional capital	$31,623	

As a result of the lower leverage limits in superannuation, Kevin learns that he requires approximately $113,000 more capital to buy the property in his SMSF. However, due to the lower tax on accumulating capital within super in the first place (15%) the after tax difference shrinks to around $32,000. In return for this $32,000 after tax cost, Kevin's equity in the property increases from 20% to 45%. Kevin does not want to subject his investment to a high level of risk, so the higher level of equity suits him.

Kevin's financial planner provides him with additional comfort by outlining that the increase in equity further mitigates the risk involved in borrowing (Table 2).

Table 2: Equity versus risk

Decrease in property value	Decrease in equity value for 55% LVR	Decrease in equity value for 80% LVR
-2%	-4%	-10%
-5%	-11%	-25%
-10%	-22%	-50%
-15%	-33%	-75%

Return on investment

Kevin also asks his adviser for the likely return on investment inside and outside the SMSF using the assumptions below.

Table 3: Investment Assumptions

Investment	$450k
Annual growth	7.8%
Annual yield	5.0%
Fixed Interest rate	SMSF: 10.95% Investment: 9.40%
Term	9.5 years
LVR	SMSF: 55% Investment: 80%

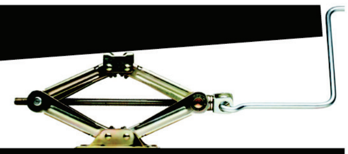

Table 4 demonstrates that despite the lower gearing, the return on the equity invested via the SMSF is *higher* than that outside of super (12.2% pa compared to 11.3% pa). Assuming the property is sold after Kevin enters the pension phase, potential tax efficiency may be achieved.

Table 4: Return on investment, investing inside a SMSF compared to investing outside super

	SMSF	Outside Super
Final property value	$918,524	$918,524
Loan to be repaid	$247,500	$360,000
Net investment value	$671,024	$558,524
Capital gain on sale	$468,524	$468,524
Assessable gain	$312,350	$234,262
CGT	$0	-$108,932
Income received	$302,640	$302,640
Interest paid	-$257,462	-$321,480
Potential tax savings/ (tax payable)	-$6,777	$8,761
Net profit	$506,925	$349,513
Annualised rate of return on required pre-tax earnings (from table 1)	12.2%	11.3%

Higher returns in a low risk environment

By gearing inside of super Kevin has benefited from higher returns in a lower risk environment compared to the outcome had he geared outside of super. This is as a result of the 55% gearing ratio and the tax environment.

The outcome

- By gearing inside of his SMSF Kevin has a moderately leveraged exposure to property compared to gearing outside his SMSF.
- To gear inside his SMSF Kevin requires more equity but the after tax cost is modest.
- It will be possible for Kevin to experience superior returns on his investment because of potential tax efficiency for property held upon transition to pension.
- Kevin has enhanced his return with a limited risk solution.

Additional Assumptions

No capital expenditure on properties because no material impact on comparison.
0% administration fee has been assumed for simplicity.