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Property in Super

Description

Use leverage in your superannuation fund to borrow to invest in residential property to create long term wealth for retirement.

CASE STUDY – *PHIL & MICHELLE*

- Combined Superannuation Balance $300,000
- Combined Superannuation Guarantee Contributions $13,500 per annum
- Phil and Michelle have significant savings in their superannuation fund, but are not sure if it will be enough to retire on in 20 years' time.
- They are not comfortable with all their retirement funds being invested in equities.

GOAL

Phil and Michelle want to invest in property in their SMSF to diversify their investments and retire comfortably in 20 years and compare alternatives.

OVERVIEW

Recent legislation has clarified a superannuation fund's ability to borrow money to invest. The four specific rules to establish a limited recourse borrowing arrangement are:

- Recourse of the Lender is against the Self-Managed Superannuation Fund (SMSF) is limited to the asset itself
- The asset is held on trust for the SMSF
- The SMSF acquires a beneficial interest in the asset from the outset
- The SMSF has the right to acquire the legal title of the asset on the making of one or more payments

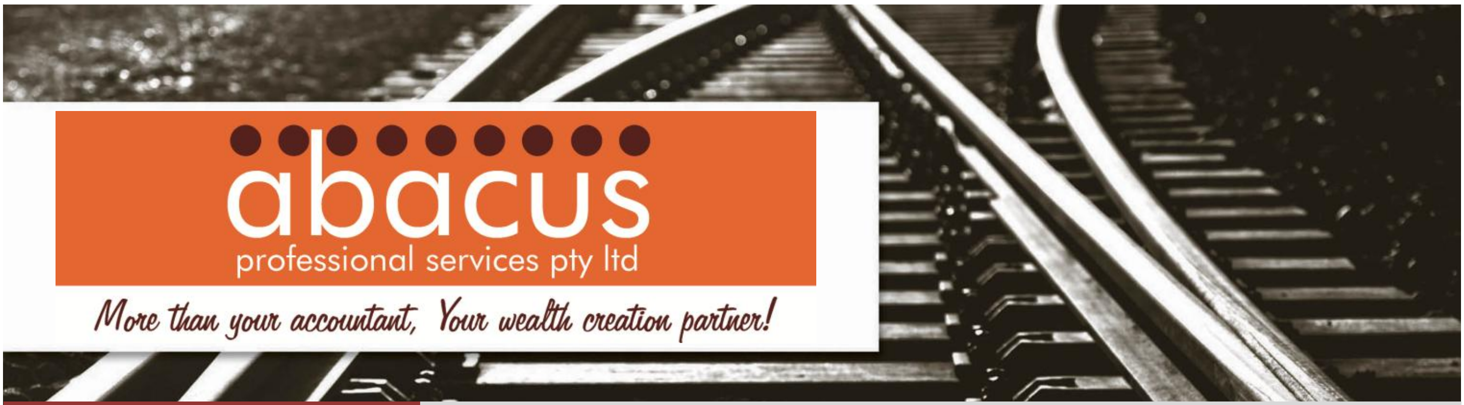
STRATEGY

- Establish a SMSF with a Corporate Trustee
- Establish a Bare trust for the limited recourse loan arrangement
- Purchase a $500,000 off-the-plan investment property using a 20% cash deposit from the SMSF
- Borrow 80% of the purchase price through a limited recourse loan and use cash from the SMSF for the remaining amount and the related expenses
- Superannuation guarantee contributions meet the ongoing difference between the outgoings and the rental income

COSTS

ESTABLISHMENT COSTS	AMOUNT
20% Deposit	$100,000
Stamp Duty	$3,000*
Solicitors Fees (conveyancing)	$1,200
Establishment of Bare Trust	$1,950
Mortgage Application Fee (estimate)	$2,000
TOTAL	**$108,150**

* If Phil & Michelle purchased an established property, the stamp duty would total $25, 070.



CASH FLOW

EXPENSES	COST PER ANNUM
$400,000 Loan (interest only at 7.87%)	$31,480
Rates, Owners Corporation, Maintenance, etc	$4,852

INCOME	PER WEEK	PER ANNUM
Rental income (after fees)	$460	$23,920
Pre-tax cost	$247	$12,872
Tax Refund (at 15% accumulation rate)		$4,004
After Tax Cost	$171	$8,868

The after tax cost is approximately 1.77% of the purchase price of the property.
The property will become cash flow neutral in Year 7.

OUTCOME

In 20 years, as part of their retirement strategy, Phil and Michelle sell the property in their SMSF for $1,934,842 (assuming 7%pa capital growth) achieving an internal rate of return of 16.42%pa, as opposed to a 15.37%pa internal rate of return if they purchased and sold the investment property in their individual names.

Particulars	Individual	SMSF
Current Income	$100,000 (38.5% Tax Rate)	$13,500 (15% Tax Rate)
Loan to Value Ratio	80%	80%
Interest Rate	6.97%	7.87%
Capital Gain after 20 years (investment property sold in retirement)	50% of capital gain will be taxed as assessable income	No capital gain tax
Internal Rate of Return	**15.37%**	**16.42%**

Paul and Michelle achieved a diversified SMSF portfolio balance that included both property and equities investments.

Notes:

- **The higher the capital growth you receive the better the internal rate of return.**
- **If an established property is purchased the internal rate of return would be less due to higher stamp duty and potentially lower depreciation benefits.**