

Creating long term wealth within super

July 2011



With the introduction of contribution caps, gearing has become increasingly important in the wealth accumulation and creation process for self managed super funds (SMSFs). SMSFs are now able to enhance the potential for capital growth, increased dividend yields and franking credits through borrowing. But with the right advice it may be possible to achieve your retirement goals sooner and improve the overall financial position of your SMSF.

Introducing Scott and Natalie

Scott and Natalie are both 45 years of age and have recently consolidated their superannuation assets to start the 'Scott and Natalie Family Superannuation Fund'. Their aim is to invest in assets which provide potential for capital growth.

The strategy

Scott and Natalie visit their financial planner to explore their available investment options. After discussing their situation and also carefully considering the fund's risk profile and time horizon, their adviser recommends a Protected Loan (PL) as part of an overall strategy.

As Scott and Natalie believe that equity markets will rise over the next 5 years, they agree to a \$100,000 PL with an LVR of 50%. This means that their SMSF will contribute \$50,000 with the balance of \$50,000 borrowed under the PL.

Importantly, the loan amount is protected on the maturity date, so there is no risk of losing the loan amount of \$50,000 at that time, nor is there any chance of a margin call. A one-off upfront protection premium of \$4,448 is also payable.

The \$100,000 is invested into STW, an ASX-listed exchange traded fund which tracks the performance of the S&P/ASX 200 Index.

The terms of Scott and Natalie's PL are:

Portfolio value	\$100,000
Equity contribution	\$50,000
Loan amount	\$50,000
Loan to valuation ratio (LVR)	50%
Portfolio	STW
Protection premium paid in advance	\$4,448
Tax rate of SMSF	15%
Term	5 years
Variable interest rate	8.09%
Estimated deductible rate	8.80%
Net after tax benefit over term	\$9,592

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The result

Once the protection premium is paid, the SMSF will be required to pay interest at the variable rate of 8.09% p.a. on the loan amount of \$50,000 (estimated to be \$4,045 p.a. or \$20,225 over the five year term). In this case the SMSF will be able to offset a large portion of this expense against the assessable income of the fund.

To further offset the interest expense, the SMSF will receive estimated dividends and franking credits of \$36,763 over the term.

On an after tax basis, the strategy will produce a benefit of approximately \$9,592 to the 'Scott and Natalie Family Superannuation Fund'. This means that in this example the strategy is cash flow positive.

The real benefit to Scott and Natalie's fund will be any capital growth over the term. If STW rises in line with historical returns of 7.7% p.a.* over a five year term, the \$100,000 investment would be worth approximately \$145,000 in five years, representing a profit of \$45,000.

At maturity

At maturity, the fund can pay back the loan amount of \$50,000 out of its own funds and take delivery of the shares worth \$145,000.

Alternatively, the fund can instruct CBA to sell the shares and repay the loan. In this instance, CBA will pay back the initial equity contribution of \$50,000 as well as the \$45,000 profit to the fund.

In either case, the \$4,448 protection premium which was paid in advance will be available as an offset to any capital gain in the fund.

Conclusion

By using a Protected Loan Scott and Natalie's SMSF has gained exposure to a larger portfolio than otherwise possible. In addition, their SMSF has also benefited from:

- ➔ capital growth potential on a larger share portfolio
- ➔ income and potential tax benefits
- ➔ protection to the level of the loan amount
- ➔ no margin calls

Getting the right advice

As with any financial strategy, using a Protected Loan to borrow and invest is not without its risks. One of the key risks of using a Protected Loan is that your return could be negative, after taking into account the performance of your shares and borrowing costs over the term. That's why it's important to read the Product Disclosure Statement to ensure you are fully informed.

Call us on 1300 786 039 for more information about how you can create long term wealth for your SMSF clients

*Source – Standard & Poor's. Returns are based on the S&P/ASX 200 Price Index rolling 5 year returns for the period from 1992 to 2010. Past performance is not a reliable indicator of future performance.

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