CASE STUDY: FAMILY SUPER FUNDS & BORROWING

Family Super Funds & Borrowing

Family Super Funds – Brief Overview

A Family Super Fund (FSF), which is the name that we use to refer to Self-Managed Super Funds that we have tailored to suit a particular family's circumstances and objectives, are superannuation funds in which the Trustees or Directors of the Corporate Trustee of the FSF are also the Members of the Fund. The Trustees are responsible for the operation of the superannuation fund for the benefit of the Members. Trustees can seek advice and assistance from professional advisers, such as Mammoth Financial, to assist with meeting compliance requirements and making the most of the opportunities made available by FSFs.

For further details relating to FSF, please refer to our Strategic Concept Summary – Family Super Funds and the ATO's SMSF Trustee Guides which are available on our website or we can provide them to you.

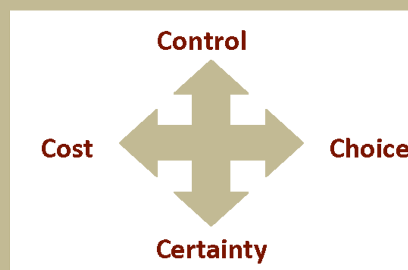
There are many benefits of FSFs for those who are comfortable with the responsibility of acting as Trustee of their own superannuation fund, including greater control and choice, including a wider array of financial strategies that are available in FSFs and a wider array of means via which those strategies may be implemented. One example of these additional strategies is the ability to borrow using superannuation monies via strategies not generally available to other types of super funds in order to acquire investments with the aim of increasing net assets in a potentially tax effective manner, and therefore potentially enhancing the ability to achieve your particular retirement objectives.

Superannuation Borrowing Options

FSFs have access to more borrowing options than most other type of superannuation funds. The options available to use borrowing, or gearing, within super include:

1. Internally geared investments
2. Limited Recourse Borrowing Arrangements
3. Instalment Warrants
4. Instalment Receipts

Family Super Funds



Borrowing to Invest - Benefits

- Access a larger amount invested
- Accumulate greater wealth
- Obtain greater diversification of your portfolio
- Access tax benefits

However please note that borrowing to invest magnifies both positive and negative returns

SMSF Specialist Advisor™

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In this case study, we provide an overview of these options and an illustration of how borrowing in general, and instalment receipts in particular, may enhance the ability to achieve retirement objectives.

As with any gearing or borrowing to invest arrangement, it is imperative to appreciate that gearing magnifies both positive and negative returns. Gearing also introduces a break-even rate of return that needs to be achieved if the borrowing strategy is to add value over the costs to maintain the strategy. This will often be the after-tax interest rate, however also needs to factor in other costs. Accordingly, it is generally only appropriate to borrow to invest in assets with higher potential returns, which means growth assets such as shares and property, rather than defensive assets such as cash and fixed interest. As a result of the higher risk and this hurdle rate of return, our opinion is that gearing strategies should only be considered when the intended investment timeframe is long term – say, 7 years or more. This intended timeframe can be even longer if the transaction costs to establish the borrowing arrangement and acquire the asset are higher, as will often be the case when borrowing to invest to acquire real property. In this regard, borrowing to invest and superannuation can be quite well suited to work in combination given the very lengthy timeframe for which most people's superannuation will be invested.

Please refer to our Strategic Concept Summary – Borrowing & Gearing, which is available on our website or by contacting us, for further information regarding borrowing and gearing in general.

Interest on the funds borrowed to buy investments will often be tax deductible to the borrower if the asset acquired with borrowed funds is likely to generate taxable income, however specific taxation advice from a qualified tax adviser will be necessary. In the borrowing arrangements detailed below the FSF will either directly or indirectly benefit from this tax deduction. Given that a superannuation fund, such as a FSF, is taxed on net earnings at a maximum of 15%, many might argue that it is more effective to borrow outside of super, such as in your personal name or a family trust, in order to access a tax deduction at a higher tax rate such as your marginal tax rate which can be as high as 47%. We agree that borrowing to invest external to super can be a beneficial strategy, and if you wish to consider this option further please contact us to discuss. However, while it is certainly true that the benefit of the tax deduction is higher at higher tax rates, it is also true that the tax applicable to income and investment returns that exceed the interest cost and capital gains tax on sale of the investments will similarly be taxed at higher tax rates.

We often see that people acquire investment properties using borrowed funds in their personal names or via a family trust as they wish to access the short term benefit of a tax deduction against their income from employment. However, if the property is held for the long term, often the income from the property grows to exceed the interest cost and then they are left paying tax on the net income at their marginal tax rate. It is also the case that they will pay tax on the capital gain, generally subject to a 50% discount if they have owned the asset for longer than 12 months, when selling the asset in their personal name. The assessable capital gain will be added to any other taxable income and taxed at marginal tax rates which can be as high as 47%, or effectively 23.50% if the 50% discount for having owned the asset for longer than 12 months is applicable. Given that a property generally can only be sold in one transaction, this means that the capital gain is also realised in one transaction and taxed in a single tax year. For couples, we often see that the property was bought in one of their names only which also means the realised capital gain is assessed against only one set of progressive income tax rates. Even if the asset was sold after retirement, this can easily result in tax being applied at relatively high rates due to our progressive income tax rate system.

We also consider that the most effective situation for many Australian's in retirement is to own their home and their cash reserve in their personal names, and to own all other assets via the superannuation

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ownership structure. This is due to the tax concessions which provide the opportunity in retirement to pay no tax on any investment income, capital gains, lump sum withdrawals from super and super pension income paid to you. These tax concessions mean that the same amount of assets will likely be able to support a higher income in retirement or the same income for a longer period if they are owned within super than if they are owned in any other asset ownership structure.

By contrast, if the property were acquired within the super ownership structure in the first instance, the tax deductions for the interest would be lower (although that statement does ignore the tax benefits of contributing income to super in the first place, which can often be done from pre-tax salary or be claimed as a personal tax deduction up to a certain limit each year), however tax relating to positive net income and capital gains is likely to be considerably lower as it is assessed against the super tax rate of a maximum of 15% on income and capital gains relating to assets held for less than 12 months, or 10% relating to capital gains on assets owned for longer than 12 months, rather than an individual's marginal tax rate if the same asset were owned personally. Furthermore, it may even be possible that a capital gain could have no tax applied to it if the asset were owned by a super fund and was sold after the member was age 60 or over and when the asset that is sold was supporting a retirement phase super pension. Please see our Strategic Concept Summary – Super for further details relating to super in general and specifically to contributions to super and taxes relating to assets owned by super.

Given this, it is therefore imperative to consider the potential tax outcome over the total ownership period, rather than merely the initial deduction for the interest. This is especially the case if the purpose of borrowing to invest in the first place was to contribute towards the ability to achieve retirement objectives because borrowing to acquire the investment within super places the asset in the asset ownership structure that we consider to be the most favourable throughout retirement in the first place. This may obviate the need to sell the asset to enable it to contribute towards the achievement of retirement objectives. If the intention is the use the asset to provide income in retirement and you are able to and wish to own the asset via super throughout retirement, acquiring the asset via super ownership in the first place not only likely reduces tax, it also likely reduces transaction costs by avoiding the need to sell an asset and contribute the sale proceeds to super if you had instead acquired the asset in your personal name, or in selected cases transfer the asset itself from personal (or other) ownership to super ownership. The transaction costs can be especially high when real property is involved.

Please refer to our Strategic Concept Summary – Asset Ownership and Strategic Concept Summary – Super for further information. These documents are available on our website or by contacting us.

1. Superannuation Borrowing Options – Internally Geared Investments

Superannuation funds, of many kinds, have long had the ability to obtain geared exposure by investing in internally geared investments. This could be via a managed fund that uses existing investments as security for a loan that it obtains to then acquire more investments. The FSF, as the investor, acquires units in the managed fund which then provides a larger exposure to the underlying investments, as a result of the loan within the fund, than is the case when investing in an ungeared managed fund. As it is the managed fund, rather than the FSF, borrowing, investing via internally geared investments does not require the FSF to comply with the specific superannuation borrowing laws.

Internally geared investments are simple from the investors perspective as the borrowing is maintained by the investment manager / fund manager, and the interest rate may be lower than the individual

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themselves could access as the investment manager can often access wholesale lending rates. Investors also do not have any ongoing management requirements relating to the loan as is the case with other lending arrangements. Investors in internally geared managed funds place their capital invested to that individual investment at risk, however there is no recourse of the lender against any of their other assets.

Internally geared investments are available in many different superannuation funds, however certainly not all superannuation funds. Availability depends on the particular superannuation funds' investment menu. While acquiring an internally geared investment will often provide a diversified exposure to a portfolio of underlying securities, it means that diversifying the fund manager risk requires the purchase of multiple, separate internally geared investments. There is also relatively less choice with internally geared investments than with ungeared investments (that can be included in one of the other gearing arrangements below)

2. Superannuation Borrowing Options - Limited Recourse Borrowing Arrangements (LRBA's)

Since 2007, superannuation funds have been able to borrow to invest subject to strict conditions. These conditions were amended in 2010. The current LRBA arrangements are quite complex, and specialist advice is required if considering this option. However, in short, they require the establishment of a separate trust to hold the asset that is acquired with the borrowed funds in order to keep it, and the lenders' recourse, separate from the other assets of the FSF. In some cases, lenders may require a personal guarantee from the Trustee Members of FSF which may mean that there is additional risk to other personally owned assets in the event that the loan cannot be repaid. The establishment of the Trust to hold the asset requires legal advice to prepare this documentation and therefore there are establishment costs that need to be taken into account.

Another key requirement of the LRBA rules, since 2010, is that the asset acquired with borrowed funds is a 'single acquirable asset'. This effectively means that if the FSF wishes to acquire multiple assets, then it is likely to be necessary to have one LRBA established per asset, with the associated additional costs for each LRBA. For example, if a FSF wishes to acquire two investment properties, there will need to be two LRBA's set up, one for each property, and therefore the establishment and ongoing management costs may be higher. The 'single acquirable asset' rules provide for the ability to hold multiple assets if they are identical and treated as a single asset, which appears to include a collection of shares in one company or units in managed funds or exchange traded funds (ETFs), however care needs to be exercised to ensure that all shares/units can be acquired at the same time and price, and sold at the same time and price. The end result of the introduction of the 'single acquirable asset' rules is that LRBA's are simpler to use for real property investments than for other types of investments. Having said that, this certainly doesn't rule out other types of investments especially where the intention is to acquire a larger number of such other investments.

As is always the case, transaction costs need to be factored in when acquiring any asset, however they tend to be particularly high for real property investments. Such transaction costs include legal fees, agent's fees and stamp duty. Additionally, the ongoing management costs such as maintenance, repairs, strata/body corporate fees, etc, not to mention time and effort, relating to property investments also needs to be considered.

An LRBA often requires a bank loan (unless there is a related party willing and able to lend to the FSF and this loan is structure on an arms' length basis (i.e. with similar terms to loans available from third party

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lenders)) and therefore comes with the requirement to meet the lenders requirements, which differ for these loans to non-super investment property loans. Generally, the Loan to Value Ratio (LVR) the bank requires will be lower than on their other property loans, for example 65% or 70%. Interest rates will often be higher than those for residential owner-occupied or investor loans, however still relatively competitive.

LRBA's used to acquire a real property will also often also result in a high concentration of the FSF's portfolio in a single asset in a single asset class, which is based in a single place, that can only be traded as a single unit (i.e. the total investment sold at once) and which may take some time to sell at fair value (i.e. low liquidity). The impact of this lack of diversification needs to be considered, and a plan developed to reduce this risk over time, perhaps by directing future cash flows into the FSF, including contributions to the FSF, to other types of assets and asset classes. It is also true that LRBA's generally require the largest financial commitment of the gearing options available to superannuation funds both due to the establishment costs and the prices of property in Australia, especially in the major cities.

While the LRBA laws apply equally to all super funds, it is not currently possible to utilise a LRBA via any type of super fund other than a FSF or a Small APRA Fund (SAF). SAFs are similar to FSFs however a third-party entity, such as a professional trustee company, acts as Trustee instead of the Members themselves.

LRBA's to acquire property or other investments can be a great option in the right circumstances and for the right people. They can also be a means via which business owners may be able to acquire the premises that they operate from. If you wish to discuss how a LRBA strategy could benefit you, please contact us. Please note that we do not provide advice in relation to specific property investments, specific loans, taxation or legal advice, however our advice can recommend the appropriate overall structure to use and we can work closely with professionals in those other areas to provide a streamlined outcome for you.

3. Superannuation Borrowing Options - Instalment Warrants

Superannuation funds have also long been able borrow by investing in instalment warrants. An instalment warrant is where an investment is acquired in two or more stages, with an upfront payment and a subsequent payment(s) at a later stage, meaning that this later payment(s) is effectively borrowed. Instalment warrants are generally issued over a particular share / security and therefore diversifying the portfolio often requires the purchase of multiple instalment warrants. Instalment warrants come in many shapes and sizes, and degrees of risk (i.e. gearing ratios or LVRs). Some require that dividend / investment income is used to reduce the loan progressively, while others do not.

Instalment warrants are generally listed on the share market and therefore they are bought and sold in the same manner as ordinary shares, and therefore are generally quite liquid. The interest rate will often be higher than that applicable to LRBA's or internally geared investments.

Investors in instalment warrants place their initial investment at risk, and generally can't be required to contribute further funds to support the arrangement if investment values fall and the loan can't be repaid. That is, they are limited in recourse to the amount initially invested, and the lender cannot access other assets of the super fund or of any other related entity. As they are off-the-shelf products, instalment warrants are quite cost effective to establish, especially relative to LRBA's.

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It is important to note that instalment warrants operate under different rules to the LRBA rules and were available prior to the introduction of those rules. They therefore would not likely be affected by a change to the superannuation borrowing laws.

4. Superannuation Borrowing Options – Instalment Receipts

Instalment receipts are somewhat similar to instalment warrants in that they also involve an upfront payment, with a further payment required in the future, and therefore that amount that is to be paid at a later date has been borrowed. A key differentiating feature is that instalment receipts can be established over a portfolio of shares / securities via a single facility with an overall LVR. In this way, a change in value of an individual share or security within the portfolio may be offset by changes in the value of other shares or securities. This allows simpler diversification of the portfolio than with any of the other gearing arrangements discussed above.

Instalment receipts will often require that investment income is used to pay interest and reduce the loan balance, at least until the LVR reaches a particular level. One example of instalment receipts offers a maximum LVR of 50% and that investment income is used to reduce the loan until the LVR reaches 40%, after which the investment income can be paid out of the gearing facility and therefore reinvested elsewhere.

Interest rates will often be higher than for LRBA arrangements and broadly comparable with instalment warrants.

Instalment receipts can enable a portfolio of listed securities and exchange traded funds to be designed to provide diversified exposure to different asset classes in different global regions, while also provide high levels of liquidity. There are also lower ongoing costs and ongoing management requirements relative to LRBAs used to acquire real property.

At the end of the instalment receipt facility term, there is generally an option to repay the loan and retain the shares, or to rollover to another instalment receipt facility provided one is available at that time. Otherwise, the investments can be sold, the loan repaid and the net equity received as cash. However, the option to retain the underlying securities or to rollover to a new facility may provide a preferable tax outcome by deferring, avoiding or limiting the realisation of capital gains, including potentially to as time when the superannuation funds tax rate is below 15% or even 0%.

As with instalment warrants, instalment receipts are quite cost effective to establish, especially compared with LRBA's and real property investments.

Superannuation Borrowing Options - Comparison

Feature	Internally Geared Investments	LRBAs & Property	Instalment Warrant	Instalment Receipt
Available Investments	Managed Funds Listed Investment Companies (LICs)	Property Shares– larger holdings of single shares	Listed property Shares ETFs	Listed Property Shares ETFs

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		Exchange Traded Funds (ETFs)		
Ability to diversify	Moderate	Low	High – via multiple arrangements	High – via a consolidated arrangement
Liquidity	High	Low	High	High
Establishment Costs	Low	High	Low	Low
Transaction Costs	Low	High	Low	Low
Maintenance Costs	Low	Property – High Shares/ETFs – Low	Low	Low
Cash Flow Impact	Nil	May require additional contributions (likely if a property has been acquired)	Nil	Nil
Interest Rate	Wholesale	Low	Higher	Higher
Financial Commitment Required	Minimal – eg $5,000	Large – hundreds of thousands of dollars	Minimal – eg $10,000	Minimal – eg $20,000

Case Study: FSF Borrowing – Instalment Receipts

Meet Judy & Jackson: Judy and Jackson are both age 40. Judy earns $125,000 pa plus super and Jackson earns $75,000 plus super. Judy has $200,000 and Jackson has $100,000 of accumulated superannuation that they have recently moved into a Family Super Fund. Judy and Jackson wish to retire at age 65 with a net income in retirement of $70,000 per annum in today's dollars. Judy and Jackson have a significant mortgage and their children attend private high school. As a result, they do not wish to utilise any of their personal cash flow to contribute towards the achievement of their retirement objectives at this time. They therefore do not pay any additional super contributions over and above the super guarantee contributions their employers must pay in relation to their salaries. Judy and Jackson expect that they will wish to continue directing their cash flow towards their debt reduction and children's education objectives for at least the next 10 years. Realising that time is the best friend of all investments, via the 8th wonder of the world – ***compound investment returns*** – Judy and Jackson wish to take further steps towards the achievement of their retirement objectives sooner rather than waiting until their cash flow permits further investments.

Judy and Jackson would also like to gain a clear understanding of what amount may be required to achieve their specific retirement objectives.

Throughout their discussions, Mammoth Financial discusses the following options with Judy and Jackson:

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1. **Retirement Adequacy** – we consider it beneficial for all people planning for retirement (and therefore pretty much everyone) to have a clear estimate of the amount required to provide the required retirement income from the desired retirement age for a sufficiently lengthy timeframe. We generally regard it appropriate to plan for this income to continue to age 95-100 based on life expectancy and the desire to build in a buffer to enable adjustment to unforeseen circumstances. Mammoth therefore agreed to complete a Retirement Adequacy analysis for Judy and Jackson seeking to identify the amount required to achieve their retirement objectives. In retirement, we have assumed that they invest in accordance with a Balanced level of risk, which is lower than their current Balanced Growth level of risk tolerance, which we have assumed as often willingness to take risk reduces in retirement.
2. **Strategy #1 - Family Super Fund – No Borrowing** – in this strategic alternative Judy and Jackson continue with the existing arrangements whereby they has their super invested in accordance with a Growth level of risk tolerance within their FSF, which is one level of risk higher than their Balanced Growth level of risk tolerance. Judy and Jackson have maintained this higher level of risk with their super for some years now as they appreciate that their investment timeframe for their super is their remaining lifetimes which is therefore 40-50+ years, and that time mitigates risk. Both Judy and Jackson have their super guarantee (SG) contributions paid into their FSF. That is, they do not make any additional contributions to super and no borrowing is included.
3. **Strategy #2 - Family Super Fund & Borrowing** – in this strategic alternative, Judy and Jackson establish a borrowing arrangement within the FSF (via an arrangement similar to instalment receipts) in an effort to close the gap between the amount they may have at retirement by maintaining their existing arrangements and the amount required to achieve their retirement objectives. Judy and Jackson both continue to receive only SG contributions, without making any additional contributions. Judy and Jackson maintain a buffer within the FSF external to the geared portfolio to provide additional funds to reduce the loan balance if the investments reduce in value, and maintain an overall asset allocation broadly in line with a Growth level of risk. Although certainly the inclusion of borrowing in this strategic alternative results in a higher level of risk

Judy and Jackson's personal income and expenses are the same in both scenarios. That is, neither strategy utilises any of Judy and Jackson's cash flow, in accordance with their wishes to continue to use their personal cash flow towards the achievement of their other objectives, including debt reduction and funding the education of their children.

In all scenarios, we assume that Judy and Jackson's income in retirement is provided via a super pension in which they holds all of their investment assets that are used to provide income in retirement.

Judy and Jackson also confirm that their intention is to spend most of their accumulated funds throughout their lifetimes and they are comfortable that their children will receive a benefit from their Estate via the value in their home, and any of their investment assets that they do not utilise themselves.

Mammoth Financial discusses the Age Pension with Judy and Jackson and it is agreed to exclude Age Pension entitlements from the analysis of the amount required to achieve their retirement objectives on the basis that recent changes to the Age Pension rules indicate a likelihood that the current Age Pension rules may not apply in 25 years when they are ready to retire. Excluding the Age Pension also means that any entitlement that they receive, perhaps in the later years of retirement as their assets reduce, will be in addition to the amount that they are providing from their accumulated assets and therefore serves as a supplement to those amounts.

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Please note that this Case Study is an illustration and actual results will vary. You should seek specialist personal financial advice before taking any action in relation to the strategies considered in this Case Study.

Assumptions:

- Start date – 01/07/2018
- Retirement date – 01/07/2043 – age 65
- Inflation: 2.3% pa
- Judy - Salary - $125,000 pa plus super indexed to AWOTE
- Jackson - Salary - $75,000 pa plus super indexed to AWOTE
- Salary increases – AWOTE: 3.5% pa
- Living Expenses – Pre-Retirement – equal to net income
- Living Expenses – Post-Retirement - $70,000 pa indexed to inflation
- Super Contributions - Current: super guarantee (SG) only - 9.50% ($11,875 pa for Judy and $7,125 for Jackson in 2019 FY), increasing to 12% in accordance with the current law
- Existing super – Judy - $200,000; Jackson $100,000
- Investment Profile – Pre-Retirement - Growth - return 6.96% pa
- Investment Profile – Post-Retirement – Balanced – 5.47% pa
- FSF Administration Expenses – Pre-Retirement - $2,220 pa + CPI
- Judy & Jackson have and maintain private health insurance
- Current legislation
- Age Pension – ignored
- Strategy #1 – FSF – No Borrowing – initial amount invested $300,000
- Strategy #2 – FSF & Borrowing – initial amount invested $300,000 comprised of $80,000 ungeared plus $440,000 in the geared component funded by the remaining $220,000 of the current balance plus $220,000 of borrowed funds (i.e. a 50% LVR for the geared portfolio & 41.5% for the FSF as a whole)
- Actions at Retirement – sell the Pre-Retirement portfolio and reinvest (after repaying the loan in Strategy #3) in the Balanced portfolio
- Action at Retirement – New Account Based Pensions – rollover 100% of the super balance to a single super pension each & select an income to meet retirement income requirements
- Strategy #2 – FSF & Borrowing – Loan interest rate – 7.00% (100% deductible) (0.50% higher than the current rate)
- Strategy #2 – FSF & Borrowing – Loan Drawdowns - $25,000 pa indexed at 7.5% pa – this is estimated to maintain the gearing ratio at 40-50%
- Strategy #1 - Adviser Fees – 1.0% pa; ICR – 1.0% pa
- Strategy #2 – Adviser Fees – 0.60% pa; ICR 0.60% pa (lower due to the higher amount invested)

Retirement Adequacy

Our analysis of Judy and Jackson's retirement objectives indicates that they will require assets at retirement to be invested for the sole purpose of providing their income throughout retirement of approximately ***$2.5m in today's dollars*** provided this amount is owned via the super ownership structure**.**

This amount is estimated, according to the assumptions made, to be sufficient to sustain an income of $70,000 pa in today's dollars (which is estimated to be approximately $123,000 pa in 2043 when Judy and Jackson are age 65) until age 100.

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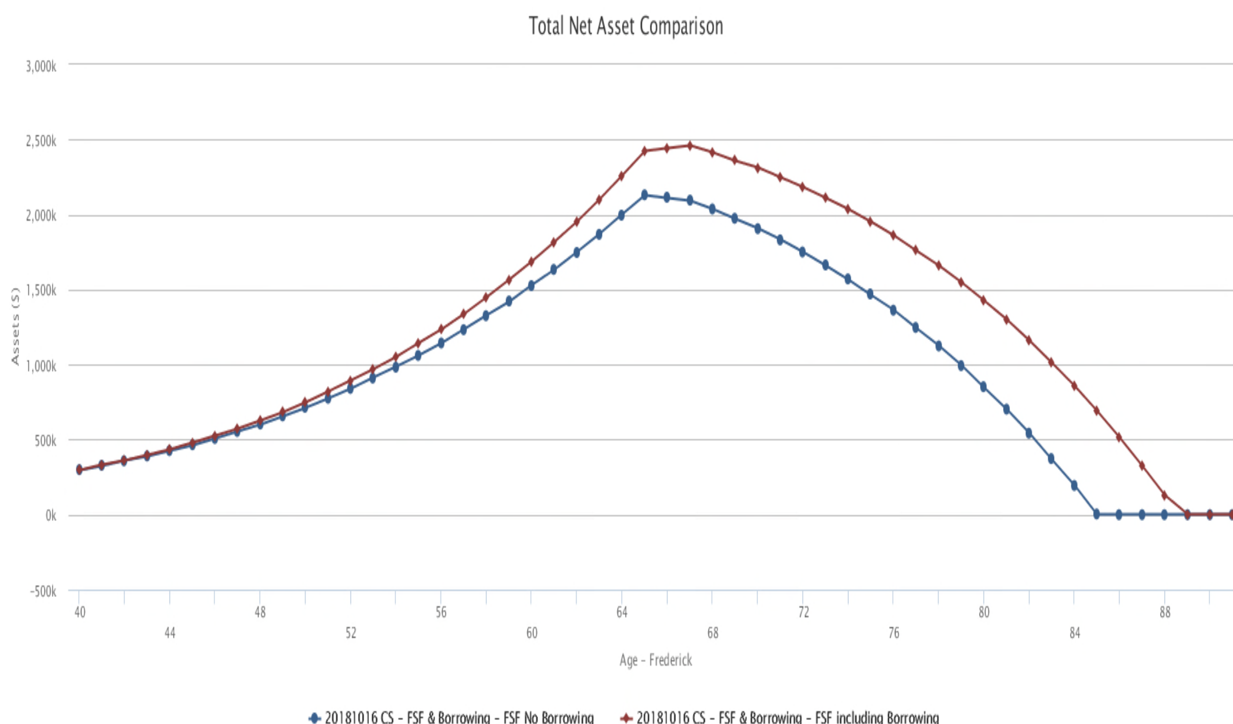
This may seem like a very mature age for which to plan, however the 2012 Australian life expectancy tables show that at age 65 the life expectancy of for a female was 21 years and for a male was 18 years; that is, to age 86 for females and age 83 for males. Firstly, we note that the life expectancy tables have consistently increased life expectancy figures at each successive release so the life expectancy of a 65 year old is likely to be higher in 25 years when Judy and Jackson reach that age. Secondly, life expectancy is a statistical average meaning that half the population pass away before that age and half live longer. We also note that the Australian life expectancy tables in 2012 estimated that a 65 year old female has a 40% and a male has a 26% chance of living to age 90[i]. Thirdly, when planning for such lengthy timeframes within which there can be such significant variations, the conservative approach is to plan for a longer life expectancy as this then affords greater ability if circumstances change and Judy and Jackson require a higher income, for instance because they require medical treatment or ongoing care.

We note, however, that this estimate will need to be regularly re-considered for changes to Judy and Jackson's situation including measuring progress against their goals, changes to the legislative environment and investment markets.

The Impact of Borrowing

The table and chart below illustrate the potential impact of borrowing within super on Judy and Jackson's assets and ability to achieve their retirement income objectives. We note that the improvement in the outcomes from the borrowing strategy are achieved without utilising Judy and Jackson's cash flow. In the chart below showing Judy and Jackson's Net Assets over time, the Strategy #1 – FSF – No Borrowing is represented by the blue line and Strategy #2 – FSF & Borrowing by the red line:



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The table below summarises the benefits provided by the borrowing in super strategy:

	FSF – No Borrowing	FSF & Borrowing	Benefit of Borrowing Strategy
FSF Income Tax Payable – to retirement	$164,950	$17,145	**-$147,805** [tax saving]
Investment Assets – at Retirement	$2,131,432	$2,423,054	**+$291,622**

As shown above, there is a considerable reduction in tax paid by Judy and Jackson's FSF and a considerable increase in Judy and Jackson's net assets from incorporating borrowing within super in their financial strategies, however there remains a gap between the assets this strategy provides at retirement and the amount estimated to be required for Judy and Jackson to achieve their stated retirement timing and retirement income objectives for a sufficiently lengthy timeframe. However, because the FSF borrowing strategy did not utilise any of Judy and Jackson's personal cash flow, it is reasonable to expect that they will be able to clear their mortgage and meet their children's education expenses from their employment income, and then take further steps towards the achievement of their retirement objectives, including potential additional contributions to super, well before they retires.

Why does the strategy add value?

At Mammoth we appreciate that understanding why strategies add value increases the opportunities for you to benefit from them, so we have provided the list below summarising what makes the strategy work:

- Larger Amount Invested – borrowing enables the investment of a larger amount to benefit investment returns, which can be both positive and negative, however are expected to be positive over a timeframe as long as 25 years
- Taxation – Tax Deductions - borrowing to invest can be quite tax effective if a tax deduction is able to be claimed for the interest as this reduces the effective cost of the interest.
- Taxation – Income Tax - in this case of borrowing within super, however, the strategy is also tax effective as positive net investment income is taxed at a concessional rate throughout the ownership period, and the capital gain if the assets are sold in the future (as we have assumed they are) are also taxed at rates lower than those that would apply if the asset was owned in a personal name, even if sold after retirement
- Asset ownership & Taxation – borrowing to acquire assets within the super ownership structure results in those assets already being held in super at retirement which obviates the need to sell those assets and contribute them to super, which is a strategy often consider to be beneficial if assets are still owned personally at retirement
- Super Pension Income – income from the super pension in retirement is tax free
- Cash Flow – borrowing within super, in this example, is able to be structured without utilising any personal cash flow. We note, however, that often borrowing within super via LRBA's may require utilisation of super contributions to assist with servicing the loan, which in turn may require additional contributions to be paid into super which will affect personal cash flow

What would alter the effectiveness of the strategy?

- Existing super – a higher existing super balance will generally enhance the value of the strategy or at least provide greater flexibility

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- Starting Point – as with many strategies, time is a key ingredient and therefore starting earlier will generally result in a greater amount of value being created
- Super Contributions – additional super contributions enable greater additions to the investments including both the geared and ungeared portions of the portfolio
- Interest Rates – higher interest rates raise the break-even rate of return and, at first glance, lower the probable benefits of the strategy. However, to the extent that higher interest rates reflect the need to slow the economy down, this may indicate higher economic growth and in turn higher returns from many investments

empowering your financial evolution™

Need more information?

If you wish to discuss how this strategy can apply to your situation & potentially increase your ability to achieve your objectives, please feel welcome to contact Mammoth Financial on:

p 02 8920 9828 **e alex@mammothfinancial.com.au** **www.mammothfinancial.com.au**

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Case Study: please note that the case study presented herein is an illustration and actual results will vary

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[i] Macquarie Big Black Book 2015/16, MASTech July 2015, Australian Life Tables, Australian Government Actuary

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