



# SELF MANAGED SUPER FOR YOUNG WEALTH ACCUMULATORS

Why it's Becoming  
So Popular

Everyone seems to be jumping on the self managed super bandwagon. But is it appropriate for young investors? And if it is, what are the ground rules for building wealth successfully? We explain why self managed super funds are quickly becoming the number one choice of young wealth accumulators.

#### SELF MANAGED SUPER IS ON THE RISE

**S**elf managed super is the fastest growing sector of the superannuation market, with about 428,000 SMSFs holding \$390.9 billion – almost one-third of the total super pool in Australia, according to the Australian Prudential Regulation Authority's latest super bulletin. Once considered to be the exclusive domain of the over 50s, self managed super funds are slowly gaining popularity among young wealth accumulators.

#### WHY CHOOSE AN SMSF OVER A TRADITIONAL SUPER FUND?

Better returns.

The average annual return over 10 years for funds with more than four members (in other words, any super fund other than an SMSF) is 3.3%. This dismal return, along with the allure of flexibility, control and the ability to link super assets to estate planning strategies has led to the rise of SMSFs over traditional super funds.

But without a doubt, the Government's back flip on borrowing within SMSFs in 2007 has been the catalyst in bringing SMSFs within the radar of young investors as a smart, long-term wealth-building vehicle.

Latest research suggests an additional 40% of SMSF trustees plan to use gearing in the coming 12 months. The Investment Trends 2010 SMSF Borrowing Report found 29,000 SMSFs used a gearing strategy in 2009 compared with 13,500 in 2008. This is a 115% jump in less than two years. And the most favoured assets

are, not surprisingly, property (41%) and shares (30%).

#### SO, WHAT ARE THE GROUND RULES?

**Rule No.1 – Never lose money**

**Rule No.2 – Never forget Rule No.1**

Legendary investor Warren Buffet passed on this gem – like many others – and it is as relevant to borrowing within an SMSF as it is to any other form of investment. Why would you borrow in your SMSF if the interest cost of the loan exceeds the return on the investment? For example, if you believe share markets return on average 8% a year, it makes no sense to pay 10% to borrow money to invest in shares. And with the cost of borrowing still relatively high, if you do decide to borrow, it's vital you choose the right investment that will deliver both income and capital growth.

#### CASE STUDY

##### BUILDING WEALTH IN YOUR SMSF WITHOUT SACRIFICING YOUR LIFESTYLE

One of the real benefits of gearing within an SMSF is the ability to repay debt more quickly, cheaply and tax effectively, without impacting your cash flow.

Take the simple case of Mr and Mrs Smith. Mr Smith is a 32-year-old obstetrician operating in private practice and currently earning \$150,000 per annum. Mrs Smith works part-time as a practice manager and earns \$50,000 per annum.

With a \$200,000 super balance, Mr and Mrs Smith set up their own SMSF and borrow to invest in a quality \$600,000 property (plus \$40,000 stamp duty and legals), returning 4% rental income.

CASE STUDY

	SUPER BALANCE	SUPER INCOME
Mr Smith	\$ 150,000	\$13,500 (9% SG contributions)
Mrs Smith	\$ 50,000	\$ 4,500 (9% SG contributions)
Total super balance	\$ 200,000	\$18,000
<b>Add</b>		
Investment property	\$ 600,000	\$24,000 (4% rental income)
<b>Less</b>		
Deposit	-\$ 120,000	
Stamp duty & legal costs	-\$ 40,000	
Non-recourse borrowing for investment property	-\$ 480,000	-\$38,400 (8% interest cost on borrowing of \$480,000)

Rental income 4%	\$24,000
Return on remaining \$40,000 cash 4%	\$ 1,600
Super contributions 9%	\$18,000
Gross income	\$43,600
Less Interest costs	-\$38,400
Net Income	\$ 5,200
Superannuation tax @ 15%	-\$ 780
Net cash flow	\$ 4,420

They use \$160,000 capital from their super balance and borrow \$480,000.

**OUTCOME**

**Income** No effect on lifestyle income

**Capital** Assuming the asset doubles in value every 10 years, by age 60 (28 years later) the asset should be worth \$4,178,000

**Tax** Within super: 10% if sold in accumulation phase OR 0% in pension phase  
Outside super: assuming asset is held for more than 1 year 23.25%

The case study does not take account of inflation or salary growth, nor does it consider the positive cash flow / tax impacts of depreciation deductions – all of which would most likely result in no tax being payable.

Importantly, in the real world, investing in one asset alone would be considered a high risk strategy. Mr and Mrs Smith should allocate future super savings towards other asset classes to reduce risk and diversify their investment portfolio.

**SMSFS ARE GOOD FOR FAMILY SUCCESSION PLANNING**

Statistics show that most self managed funds are owned by married couples, who also act as trustees. As SMSF owners age, the risk posed by the onset of dementia and ultimately death of trustees is another just argument to allow younger family members to join their parent's SMSF and seamlessly transition wealth over generations.

**SHIFTING GOAL POSTS**

Self managed super law is continually evolving. Without admitting it had 'let the genie out of the bottle', the Government acknowledged the potential dangers of excessive gearing in SMSFs when it announced last December it would review gearing practices in two years' time to see if 'leverage posed a risk to superannuation fund assets ... in SMSFs'. So, stay tuned for developments in this space.

If you are considering setting up a self managed super fund, it makes sense to consult a specialist adviser who can not only help you navigate complex super tax and estate planning laws, but also approach asset selection with financial rigour and independence.

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*Disclaimer: This document is of a general nature and does not take into account your personal objectives, situation or needs. Before making a decision about setting up a self managed super fund, you should consider your financial requirements. Speaking with a qualified financial adviser may help.*



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