How borrowing in super has stepped up a gear

By Chris Magnus*

If you've recently heard that you can now borrow within super, it's true. What isn't true, however, is that it's a new concept.

Borrowing within super has been common practice for many years through the use of instalment warrants and geared managed funds. However, in 2006 the regulators came to the view that gearing in super using instalment warrants involved a breach of the borrowing exception in the legislation.

After feedback and consultation with the industry, the Australian Parliament passed legislation in September 2007 which exempted instalment warrants from breaching the borrowing rules. In addition, the legislation broadened the scope of the rules to not only apply to instalment warrant products, but to a wider range of share and property arrangements – hence the reason many people may think that it's 'new'.

However, it's not as simple as a super fund taking out an investment loan. The borrowing arrangement needs to meet a long list of conditions.

Utilising this strategy largely depends on your retirement objectives and appetite for risk and return. It can be a high risk strategy and should only be undertaken if your objectives are for growth in the run up to retirement. In addition, unlike gearing outside of super, generally your capital cannot be accessed until you reach at least 55 years of age and are retired. So, if the capital is required to fund a lifestyle event prior to retirement then this strategy is probably not appropriate for you.

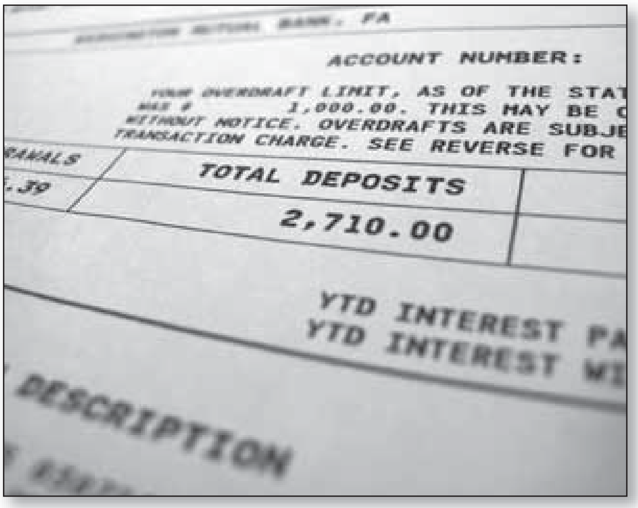
Taking into consideration the above, gearing in superannuation may suit those who:

- have a need to accelerate wealth to fund their retirement;
- have a reasonable super balance and/or adequate cashflow in super;
- are investing for the long term and have an appetite for risk.

Your current super balance and also cashflow position will determine the level of borrowings and whether you can fund the loan repayments. In order to ensure that you can meet the loan repayments, it's essential that your cashflow position is monitored vigilantly.

For instance, you should make sure that you will always have enough cash to avoid a situation should the interest expense on a loan be greater than the investment income earned within the fund. You do not want to encounter a scenario which results in you having to make an injection of capital into the loan, particularly if the contribution limits have been utilised that financial year. This could result in the forced sale of assets.

However, borrowing inside of super can be an efficient means of accumulating wealth as earnings and gains are taxed at concessional rates. It also provides the opportunity to increase your retirement capital further in an environment where your capital can be drawn tax-free after the age of 60. While there are limits on the amount that can be contributed to super there is no limit to the amount that you can accumulate.



Gearing within super can be very effective for assets that are expected to provide good long-term capital growth well in excess of borrowing and other expenses, given the lower tax rates applicable within super on earnings and in particular capital growth (when compared to an individual's marginal tax rate). It may suit assets with a high income expectation or those with a low loan to value ratio which means that the total income may be above the total interest payable. Based on this, growth assets may include shares, private equity and property. Given the current environment, it is important to be selective about the assets that you choose and the way that you finance them.

A number of new products have been released recently to allow you to gear in super and access the above assets. Macquarie Private Wealth has modelled a number of different scenarios and assessed the benefits and risks of each one. There is a wide range of different options to choose from, especially around the borrowing arrangements. Where products are being used, they should generally have a product ruling from the ATO. There is also the option of tailoring your own gearing arrangement using a self managed super fund to suit your needs using specialist legal, taxation and financial planning advisers. With this option, however, there are even more risks to be aware of, especially as there are still some grey areas around the rules that are awaiting clarification.

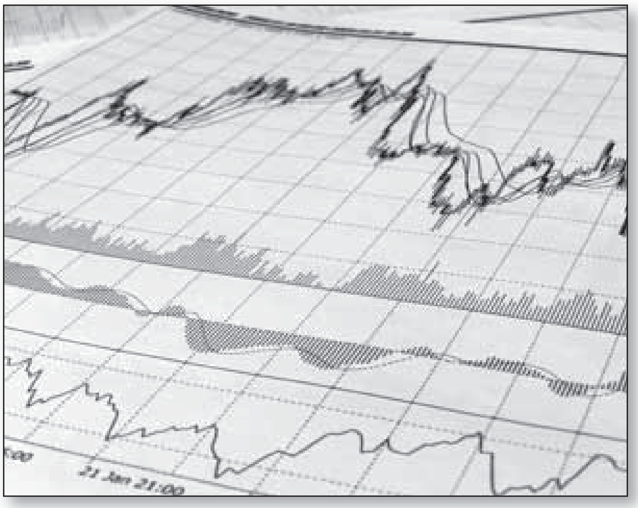
In all cases, however, it is important you talk to an adviser for the most appropriate arrangement for your personal situation.

If you have any questions about the information included in this article, please contact Chris Magnus, private wealth manager, Macquarie Private Wealth on 02 8232 0365 or chris.magnus@macquarie.com

Endnotes

* Chris Magnus is a private wealth manager at Macquarie Private Wealth.

Macquarie Private Wealth's services are provided by Macquarie Equities Limited (MEL) ABN 41 002 574 923, Participant of Australian Securities Exchange Group, AFSL No. 237504, Level 18, 20 Bond Street, Sydney NSW 2000.



MEL is not an authorised deposit-taking institution for the purposes of the Banking Act 1959 (Cth), and MEL's obligations do not represent deposits or other liabilities of Macquarie Bank Limited ABN 46 008 583 542 (MBL). MBL does not guarantee or otherwise provide assurance in respect of the obligations of MEL

This general advice has been prepared by MEL and does not take into account your objectives, financial situation or needs. Before acting on this general advice you should consider whether it is appropriate to your situation. We recommend you obtain financial, legal and taxation advice before making any financial investment decision. Gearing will magnify losses as well as gains. The Macquarie Group does not give, nor does it purport to give, any taxation advice. The application of taxation laws to each investor depends on that investor's individual circumstances. Accordingly, investors should seek independent professional advice on taxation implications before making any investment decisions.

Verbatim

In family law proceedings before Waddy J, it was apparently necessary for a pair of old, slightly battered shoes to be tendered. Debate ensued over how the exhibit should be described. There then followed this exchange:

Hodgson: 'The shoes will speak for themselves, your Honour.'

Waddy J: 'That's why they've got tongues, I suppose.'