SMSF market focus

December 2022

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The following represents a monthly snapshot of how we see the SMSF sector and developments with respect to regulation and investments. We provide brief comments on the Economy and Sentiment but for more in depth commentary on property, please visit our website thinktank.net.au for our latest Quarterly Market Update and our Monthly Market Focus. This month in SMSF Update we take a look at the recent release by the Australian Tax Office (ATO) of the latest quarterly SMSF statistics for 30 September 2022.

With respect to the Economy and Sentiment, the Westpac-MI Consumer Sentiment Index fell in its recent November release by 6.9% to 78.0 as it remained near historic lows well below the 100 (neutral) level of confidence, impacted by inflation and interest rate increases. The six-month annualised growth rate in the Westpac-Melbourne Institute Leading Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, fell from -1.09% in September to -1.19% in October. The AiG PMI for October fell slightly by 0.6% to 49.6 as did the PSI Services Index which was down 0.3% to 47.7. The PCI Construction Index was down 3.2 points to 47.7 leaving all three AiG indices in negative territory below 50 points. At its November meeting the RBA Board raised the OCR by 0.25% for the second straight month after four 0.50% increases in a row. This takes the rate from 2.60% to 2.85%. While further increases are expected this year the continued slowing of the pace of increase was welcomed by most commentators.

The ATO recently released its quarterly statistical update for SMSFs and we discuss those numbers overleaf with our usual graphs and commentary. The good news in the sector is that there appears to be little in the way of legislative or regulatory change on the horizon. The concern of six months ago that with the change in federal government there may be efforts to explore changes that had previously been mooted and then withdrawn and an example of that would be the status of franking credits which are an important issue for SMSFs.

CoreLogic dwelling prices for November continued their decline but at a slightly slower pace. National Housing values posted a 1.4% fall for the month compared to 1.6% in August. The fall was 4.1% for the quarter nationally compared to last month's figure of 3.4% with a fall of 6.1% in Sydney and 3.7% in Melbourne. In Sydney, House prices were down 2.1% for the month with units down 1.0% and the results were similar in Melbourne with houses down for the month 1.2% while units were down by 0.8%. Adelaide and Perth also fell into negative territory this month with dwellings down 0.2% and 0.4% respectively and Brisbane Houses fell 1.7% for the month but as noted below Perth and Adelaide were well rated in the monthly Herron Todd White (HTW) Property Report released mid-month. Rents continue to rise up 0.6% for the month with yields at 3.6% nationally.

We have continued to reflect the further decline of Residential in almost all areas and have maintained our ratings and trends accordingly across most capitals. We have made some updates with the release of the HTW Property Report with positive indications for Perth and Adelaide. However, Sydney and Melbourne houses and units remain Weak and Declining. Retail continues to be showing the signs of volatility as sales improved up 17.9% in September from a year ago and then fell 0.2% in October but up 12.5% from 2021. Office continues its slow recovery from the pandemic lockdowns and is just Fair. Industrial remains very strong and we are maintaining our Ratings and Trends which are either Strong or Good with an Improving Trend in each of the capitals. It still remains to be seen how interest rate increases will impact on commercial capitalisation rates but a relatively flat yield curve appears to be encouraging as well as strong rental growth in the Industrial sector.

	SYDNEY		MELBOURNE		ADELAIDE		BRISBANE (SEQ)		PERTH	
Resi- Homes	Weak	Declining	Weak	Declining	Good	Stable	Soft	Declining	Good	Stable
Resi- Units	Weak	Declining	Weak	Declining	Good	Stable	Soft	Declining	Good	Stable
Office	Fair	Stable	Fair	Stable	Good	Stable	Fair	Stable	Good	Stable
Retail	Weak	Stable	Weak	Stable	Good	Stable	Fair	Stable	Fair	Stable
Industrial	Strong	Improving	Strong	Improving	Strong	Improving	Good	Improving	Good	Improving

Sources: ABS, ACCI, AiG, ABS, AFR, ANZ Research, ATO, CBA, CBRE, Colliers International, CoreLogic, Cushman & Wakefield, HTW, IMF, MSCI, JLL, Knight Frank, OECD, PCA, Preston Rowe Patterson, RBA, RLB, Savills Research, Westpac Economics, World Bank

SMSF update

- The Chart below shows the ATO's statistics on the growth of SMSFs with an LRBA. The cessation by the major banks of new lending to SMSFs since 2018 has coincided with growth in non-ADI lending to SMSFs. Rising house prices and low interest rates have supported growth in demand for LRBAs since the 2019 report. The economic recession caused by the COVID-19 pandemic likely contributed to slower growth in SMSF borrowing and asset values between June 2019 and June 2020, including due to weak economic conditions and tighter lending in place during the initial market volatility in early to mid-2020. The proportion of SMSFs with at least one asset under an LRBA has increased significantly from 2.9% in 2013 to 11.8% in 2020.

- **Chart 1** opposite reflects the breakdown of Resi assets and commercial (non-resi) . For funds with total assets between $100,000 and $2 million, the highest value assets under LRBAs were mostly residential properties, whereas for SMSFs using LRBAs with more than $2 million in total assets the highest value assets under LRBAs were mostly non-residential properties. This suggests SMSFs using LRBAs with balances between $100,000 and $2 million have greater exposure to the housing market, while SMSFs with larger balances above $2 million are more exposed to non-residential property.

- **Chart 2** breaks down the leverage levels of SMSFs with LRBAs and the implied risk. In 2020 of SMSFs with LRBAs the average amount borrowed was $350,492 and the average value of LRBA assets was $778,600, representing an average leverage ratio (total LRBA borrowings to total LRBA assets) of 45.0%. The share of SMSFs with LRBAs with a leverage ratio above 60% declined between 2017 and 2020 from 48.9% to 36.9%. This likely reflects rising asset values exceeding largely stable borrowing levels over this period. SMSFs with LRBAs over residential property tend to acquire those assets at higher leverage ratios compared to SMSFs with LRBAs over non-residential property. In 2020, 42.2% of LRBA SMSFs holding only residential properties under LRBAs had a leverage ratio of more than 60%. In comparison, only 18.4% of LRBA SMSFs holding only non-residential properties under LRBAs did so with a leverage ratio of more than 60%.

- As demonstrated by the findings of the current report and previous report in 2019, borrowing by SMSFs through LRBAs has not posed a material risk to the superannuation system or broader financial system since it was first permitted in 2007. It is worth noting that the statistics used by the CFR in their report are the annual data released by the ATO and these are quite a bit older than the quarterly estimates provided which we report on regularly. This is explained simply by the delay in the submission and processing of SMSF Annual Returns to the ATO. We will provide an update next month of the current data as at 30 September 2022.

Proportion of SMSFs using LRBAs – Australia, 30 June 2020

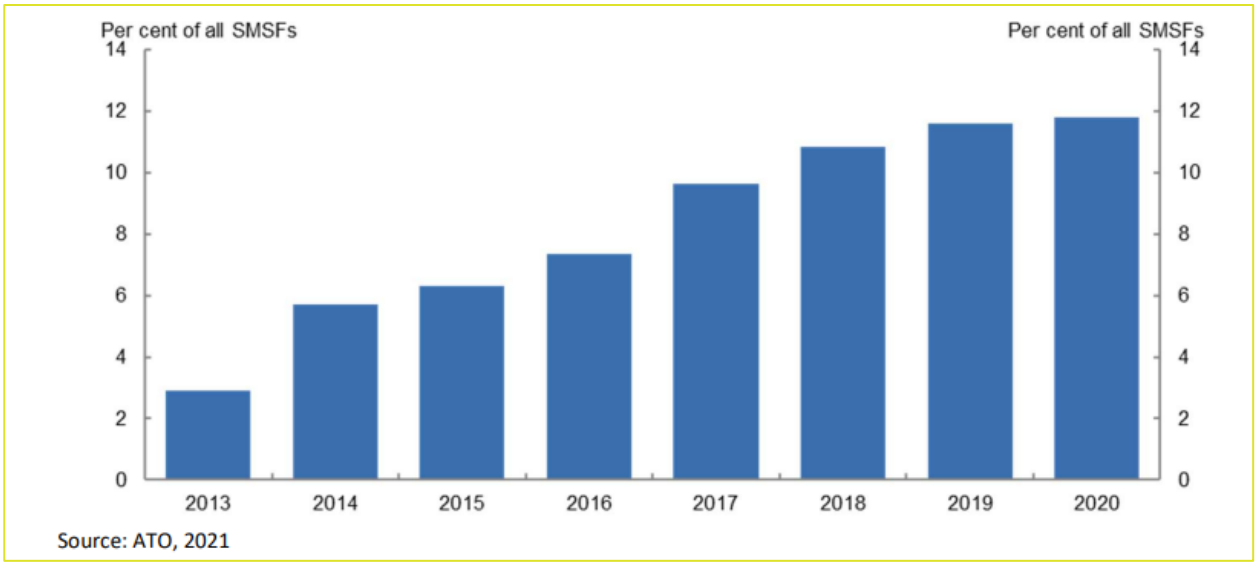
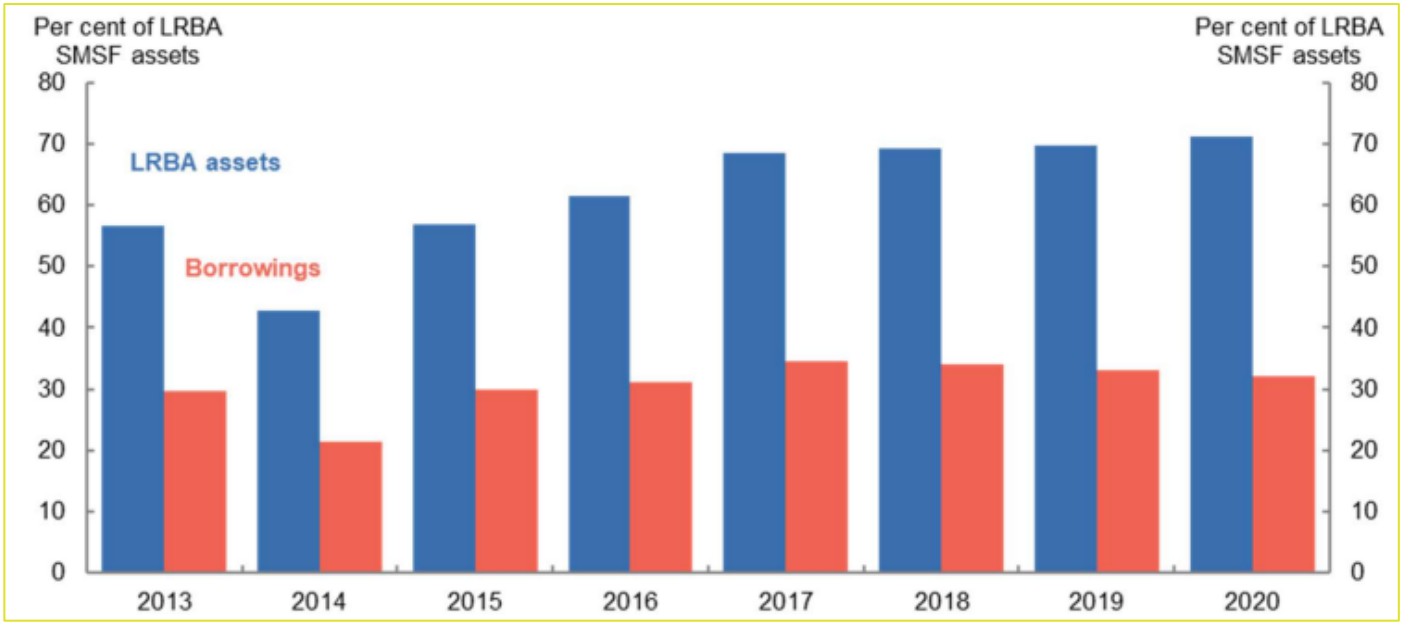


Chart 1: Value of assets under LRBAs by asset class (%of total LRBA assets

Chart 2: Ratio of LRBA assets and borrowings to all assets of SMSFs with LRBAs



Source: ATO

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Thinktank Property Finance is the leading independent lender specialising in property finance in Australia.
Thinktank offers a wide range of tailored mortgage product options for SMSFs including:

- ✓ Finance for the purchase and refinance of commercial and residential property;
- ✓ Limited Recourse Borrowing Arrangement (LRBA) loans with terms up to 30 years with no ongoing fees or annual reviews