Investing in property within an SMSF

Self-managed Super Fund

About this guide:

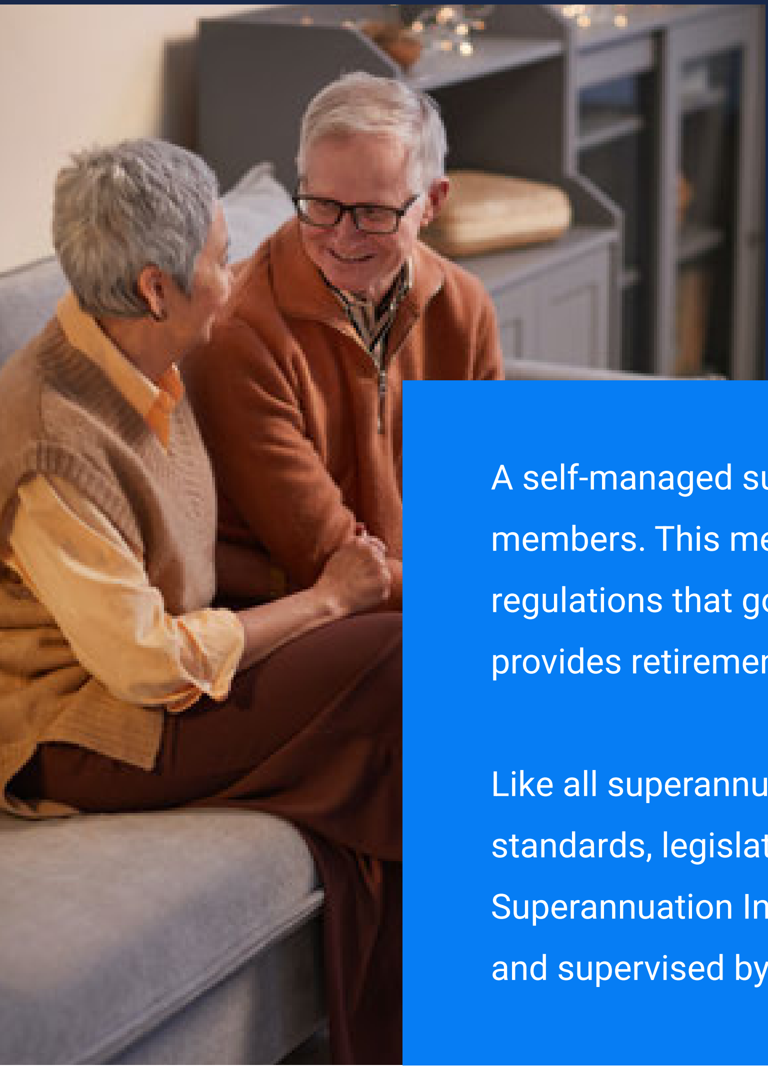
The information presented in this document is **general advice**, and has been prepared without knowledge of the reader's personal circumstances. This means that **advice should be sought** if you wish to implement any financial planning strategy as a result of the information learned here.

Many Australians are setting up their own self-managed super funds

With government regulation, most Australians regularly contribute a portion of our wages to either an Industry Super Fund or Retail Fund. These funds invest the collective contributions, hopefully leading to retirement funds for the contributors.

However, today, many Australians are going down the path of setting up their own Self-Managed Super Funds (SMSFs)**. This allows those who opt for SMSFs to increase control over their superannuation, and use their accumulated savings and ongoing contributions to gear into property.** It may also result in tax benefits for their pension.

While buying a property with your SMSF relies on complying with many regulations and ongoing attention to ensure that they are met, setting up an SMSF is now easier than ever. It does, however, require significant preparation, including ensuring that this strategy suits your long-term goals.
This eBook hopes to give an overview of this strategy, such that interested potential investors may consider seeking financial aid to investigate this option.



What is an SMSF?

A self-managed super fund is, simply-put, a trust run by its members. This metaphorical trust fund is subject to special regulations that govern Australia's superannuation system, and provides retirement benefits to the beneficiaries of the trust.

Like all superannuation funds, an SMSF must adhere to the same standards, legislation and regulations set down by the Superannuation Industry Supervision Act. These are administered and supervised by the Australian Taxation Office (ATO).

Some possible benefits of doing so are:

- Increased transparency and control
- Increase retirement savings and assets through leverage
- Purchase residential property
- Purchase your business premises
- Consolidate the super assets of up to four members
- Flexibility in investment options
- Tax effectiveness
- Concessional super contributions
- Asset protection

Why consider buying property?

Well-located, investment-grade properties are likely to produce solid returns. through long-term capital growth and rental yields. These can function as an extremely secure investment, generating long-term, healthy returns.

Investors often feel that they have more direct control over "bricks and mortar" than over other types of investment,. Using an SMSF may be a strategy that allows you to **kickstart or diversify your asset portfolio.**

Although limited by being unable to use loaned funds for this purpose, you are able to additionally increase the value and rental income of any property, including those in your SMSF, through renovations.

While investments should never be made for tax benefits alone, there are also significant tax incentives for properties held in an SMSF.

However, with all investments, there are risks which need to be carefully factored into your personal circumstances. When considering whether to buy property with an SMSF, potential investors are heavily encouraged to seek specialist advice.

Residential properties can be purchased in your SMSF. Commercial and industrial real estate can also be purchased. These decisions will be made according to the investment strategy that SMSF investors come to develop.

Rental returns are an important facet of any investment strategy, but investors should also not minimise the significance of capital growth in their SMSF. This is because eventually creating a large asset base can be of significant benefit in later life phases, including retirement.

However, **not all types of properties are SMSF-compliant**, meaning that investors can purchase approved properties only. Investors must also manage these properties,, including improvements and renovations made to the property, in compliance with the legislation.

How does borrowing differ?

While there are similarities between a typical mortgage and SMSF-borrowing, there are also fundamental differences that **impact an investor's borrowing capacity.**

Loans for properties purchased through SMSFs are required to be Limited Recourse Borrowing Arrangements (LRBAs).

LRBAs effectively quarantine the loan and investment within a specific holding trust to protect other cash and investments in the SMSF, until the loan is paid. This is called a Bare Trust.

The lending institution's rights of recovery are also restricted to the asset that was purchased with the loan.

This is one of the reasons lenders will protect themselves by **only offering lower Loan to Value Ratios.**

The end result of this is that the paperwork required to set up a loan is significantly greater than with a traditional mortgage.

Funds borrowed by an SMSF can only be used to:

- **Purchase the property, or**
- **Pay for repairs and maintenance.**

This means a SMSF cannot borrow money for substantial improvements to the property or for development of a property.

When the value of the property increases, the SMSF cannot refinance to withdraw equity for other purposes. However, the loan can be refinanced in the event that the new loan is not more than the original borrowings.

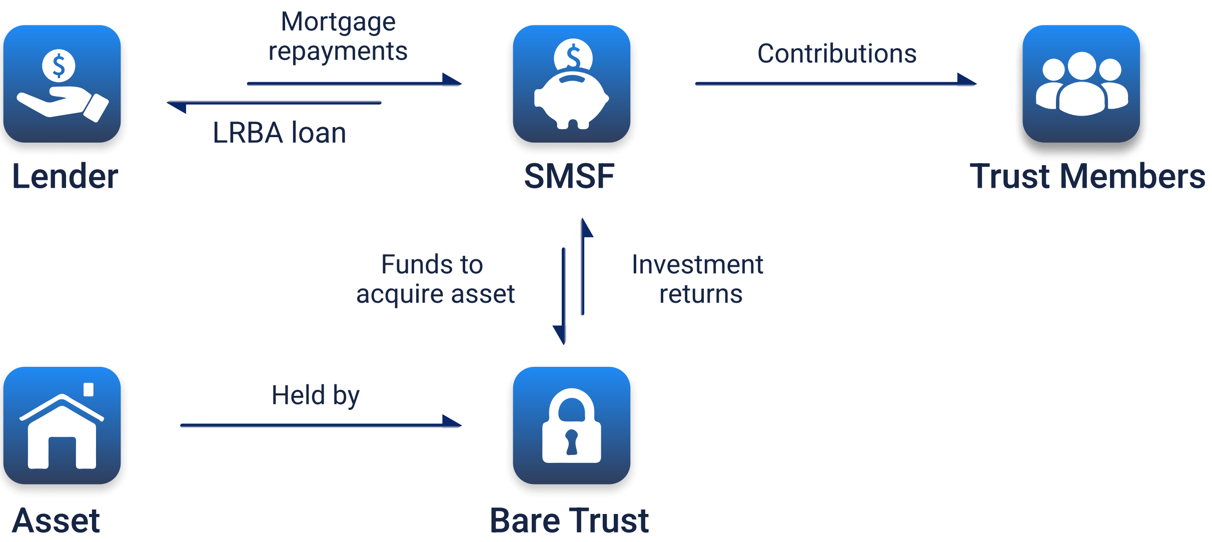
How does purchasing differ?

When you purchase your property, the legal ownership will be contained within your Bare Trust. However, your SMSF will have beneficial ownership, meaning that your SMSF will be credited with income, and that the capital growth of this property will form part of your SMSF's assets.

As you can see from the diagram below, the property is held by the Holding Trust while the loan is taken out by the SMSF.

All this makes the typical SMSF loan more time consuming and difficult to set up. It requires that an SMSF and that a Bare Trust are in place, with individual corporate trustees, before you are able to purchase your property.

The timing and sequencing of events is critical to the process, which is why financial specialists familiar with SMSF lending are essential and will need to be engaged.



How to purchase a property within your SMSF

01

See a financial planner, accountant, or consultant

This should be any SMSF investor's first step. The specialist will need to prepare your new fund’s accounts, its annual financial position, operating statements and annual return. The specialist will also provide tax advice.

02

Work out the structure of the fund

Decisions will need to be made at this stage about the structure of your new SMSF.

A company may act as a trustee, which is called a **corporate trustee**. You may also have up to four individual trustees within the fund.

A corporate trustee is recommended. A key reason is that loaning institutions generally prefer lending to corporate trusts.

In addition, corporate trustees are better protected against safety concerns. In an example, where a tenant sues a trustee, a corporate trustee owns no assets itself. With an individual trustee, on the other hand, all their assets would be potentially at risk.

Both the SMSF and the Bare Trust require a trustee: a corporate trustee is recommended for both of these bodies. Al members of the fund must be eligible trustees. All members of the fund who are 18 years or over need to be either individual trustees, or **directors of the fund's corporate trustee**. These members must also declare and sign to indicate understanding of their responsibilities.

03

Set up the trust deed

An SMSF is essentially a trusts, and need trustees, assets, beneficiaries (members), and **trust deed** to operate.

The trust deed is a legal document that sets out procedures for establishing and operating your fund. The deed includes what the fund's objectives are, who can be a member, and how benefits are paid.

The fund needs to meet the definition of an 'Australian superannuation fund'. If it is non-compliant, the fund's assets and its income would be taxed at the highest marginal rate.

We recommend you seek legal advice and create a purpose-built deed to suit your requirements.

04

Open a bank account for your fund

A bank account will need to be opened in your fund's name. This bank account will then manage operations, and accept cash contributions and rollovers of super benefits. These acquired funds can then be invested, according to the fund's investment strategy, and used to pay the fund's expenses and liabilities.

The fund's bank account needs to be kept separate from each of the trustee's individual bank accounts and any related employers' bank accounts.

05

Register with the ATO

Once your fund is legally established and all trustees have completed a trustee declaration, the fund will need to be registered with the ATO.

You will then get an ABN (Australian Business Number).and a TFN (Tax File Number).

You can now operate your SMSF

Running your SMSF

The main tasks of the trustees of your SMSF will include:

- Accepting contributions from the fund's members.
- Establishing a written investment strategy and invest the fund's assets and income in line with this strategy.
- Keeping detailed records and making sure the fund complies with all the rules and regulations.
- Deciding whether it is advisable for some or all of the fund's members to take out life insurance through the fund.
- Organising the preparation of annual financial statements, tax returns, and audits.
- Paying member benefits as required and appropriate.

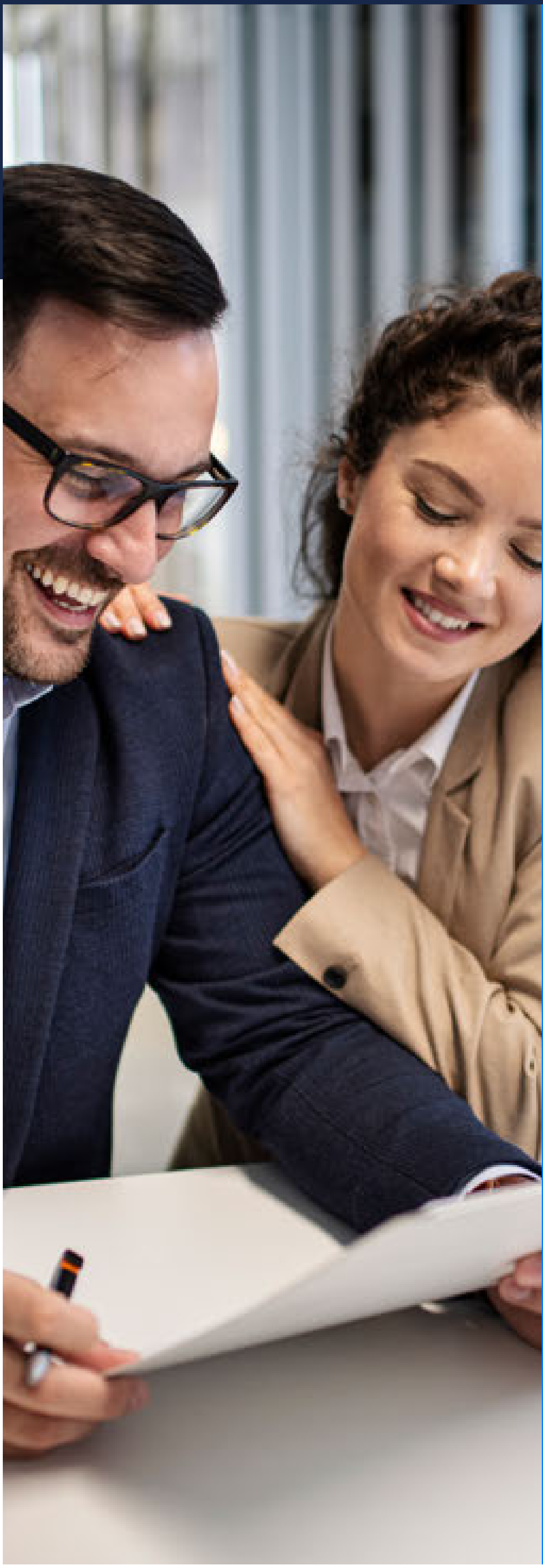
06

Prepare an investment strategy

You will require a written investment strategy before you make investments through your SMSF. This strategy will provide you and the other trustees with a framework for making investment decisions to increase members' benefits. It must be in writing, to best show that your investment decisions comply with it and SMSF laws.

You should also consider whether to hold insurance cover for one or more members of your SMSF.

Formulating the investment strategy for your fund is yet another key role of a financial advisor, accountant, or other consultant.



07

Get loan pre-approval

By having a pre approval, you will be able to know the upper limits of the property purchase you are able to make.

This loan will need to be in the name of the correct entity.

08

Ensure you only consider allowable properties.

As previously mentioned, SMSFs are subject to restrictions in the type of property that can be purchased.

One such restriction to note is that no individual connected with the fund can use a residential property owned by the fund.

Another key point is that an SMSF can only borrow to acquire a 'single asset'.

When buying an asset with borrowed funds in an SMSF, it must be considered as unable to split upon a further sale. This means that an apartment and its car space on a separate title, for example, may be noncompliant.

Therefore, professional advice is critical.

09

Purchase the property

Purchase your property in the correct entity, which a financial specialist can help you to do.

From this point on, you can continue to manage and acquire assets in your SMSF.

Investing in property within a Self-managed Super Fund

This booklet contains general advice. To find out how this could apply to your circumstances, seek financial specialist advice.