WHEN TO INVEST IN PROPERTY VIA YOUR SMSF

Many people reeling from the recent turmoil in global financial markets are looking for different ways to invest their superannuation. We are being asked more often these days if there are ways to make our “hard earned money” work in more creative ways, such as superannuation into bricks and mortar.

As it happens, there is, by using a Self Managed Super Fund (SMSF) and what has made this even more attractive is you can now borrow to buy property through a SMSF.

THE RULES HAVE CHANGED

Back in September 2007 the rules governing SMSF changed so that you can now use your super funds to borrow to invest in an asset, including property. Before these changes (2007), if you wanted to buy property, your super fund had to purchase it outright which was out of reach of many SMSF’s if they did not have the cash.
But with these changes, you can now borrow up to 70% (for residential) & 65% (for commercial) of the property value depending on the type of property and mortgage lender.

So if you have a SMSF, or are considering one, this could be a great way to leverage super and grow your assets, not to mention, create a greater sense of control and influence over your own destiny.

WHAT SORT OF PROPERTY CAN I BUY WITH SMSF?

Through your SMSF, you can get a home loan (or investment loan) to purchase property, including residential, commercial, retail, rural and even holiday apartments!

It's important to remember that this is for investment property only so you can't live in it.

WHAT ARE THE BENEFITS?

The headline benefit of a super fund being able to gear (or borrow) is that assets can now be purchased that the fund could not otherwise afford given its assets and level of contributions.

However, there are many other benefits that we believe are important to be aware of:

1. Diversification for your investment portfolio.
2. 10% capital gains if you hold the property for more than 12 months and potentially NIL if the property is sold when the SMSF is in pension phase. When you consider that many people are in the 30-40% and even 46.5% tax bracket, those savings have the potential to be huge.
3. There is a maximum of 15% tax on rental income as opposed to the above tax rates if the property was held individually.
4. Interest costs associated with any borrowings are tax deductible.
5. The mortgage lender has no access to other assets in your SMSF, they are protected.
6. Rent generated from the property does not count as a taxed contribution.

7. Servicing on the loan can be funded not only from tenants' rental payments, but also from employers' compulsory 9% super contributions. You can also make additional salary sacrifice contributions, and personal contributions over and above the minimum 9% compulsory employer contribution.
8. The government co-contribution (if eligible) can add up to $1000 per annum.
9. There is also absolutely no restriction on how much you can withdraw in retirement.
10. By building a geared property portfolio inside super you can maximise your super benefits by allowing you to grow wealth within a concessional taxed environment.
11. The loan does not record a liability against your name personally, so typically, borrowing capacity for investing or business interests outside your SMSF are not affected.
12. Legislation prohibits banks coming after you if the loan "goes bad" for some reason. This is called a "limited recourse or non-recourse" loan, so the only amount you stand to lose is your original deposit and not any other investments in your SMSF portfolio. The only exception to this is if the bank requires a personal guarantee then they could come after you in the event of a shortfall.

PLEASE NOTE:

Your age impacts on your maximum deductible contributions:

• If you're under 50 years old then the maximum tax-deductible contributions you can make are limited to $25,000 per annum.

• If you're 50 years old or over then your maximum tax-deductible contributions you can make are limited to $50,000 per annum

• Obviously, this means that more than one family member contributing to a combined SMSF has more potential leverage based on the maximum deductible contributions (per person) allowable.

RISKS

Although there are many great tax benefits and an opportunity to leverage into direct property, there are risks to be considered.

Risk 1
In terms of investment risk, while borrowing to invest can magnify your returns it can also magnify your losses if the investment makes a negative return, and you need to ensure that the fund has adequate cash flow to meet interest payments. This will also contribute to the determination of your serviceability to lenders.

Risk 2
You can't access your superannuation until you meet a condition of release, which for most people is being over 55 and semi retired and, apart from your commercial property, you cannot buy existing properties from yourself or your relatives, and you cannot live in the property or use it for your own enjoyment, for example, a holiday house.

Risk 3
Remember, it is vital that you seek professional advice from a qualified adviser when structuring your finance within Superannuation. Superannuation laws may change at some point in the future and we are unsure as to the longer term view with regards to gearing (borrowing) to invest in your SMSF but generally when super laws change, SMSF's that already have an existing strategy are provided exemptions.

Questions you need to take into account before you get a loan and purchase investment properties with your SMSF:

Q1. **Do you have the cash flow and capacity to service the home loan?**
The bank will value the property and decide whether the rental income and any additional super contributions you make can cover the home loan.

Q2. **Does your SMSF allow for this type of borrowing?**
You need to make sure that your Trust Deed has been constructed in the appropriate manner to allow it to borrow, and if not then getting good advice is important to correct this properly.

Q3. **Does it tie in with your investment strategy?**
Do you have an investment strategy? Do you have a retirement income planning strategy? Do you know how to balance your investment strategy between the two?

Q4. **Can you cover additional costs associated with buying an investment property?**
Your SMSF is responsible for council rates, land tax, home loan interest and loan repayments, lender's fees, legal and accounting fees, repairs, property management costs, insurances, etc

HOW DOES IT WORK? GETTING STARTED
(A Layman's guide)

Step 1 Obtain finance approval for your SMSF
Step 2 Establish a Property Trust (known as a BARE Trust) outside your super fund
Step 3 Establish an instalment warrant
Step 4 Find an investment property, pay a deposit and borrow the rest from a mortgage lender through your SMSF
Step 5 The Property Trustee purchases the property and becomes the legal owner
Step 6 The Property Trustee grants a real property mortgage over to your mortgage lender
Step 7 A Property Manager is appointed and tenants obtain a lease
Step 8 Rent from the property is paid into your SMSF
Step 9 The home loan is paid to the mortgage lender through your SMSF
Step 10 The beneficiary of the property is your SMSF

Note: Some of the above steps can be running in conjunction with each other so consult us before starting this process.

INVESTMENT PROPERTY OPPORTUNITIES

If you would like to book a meeting with us to discuss this issue further then please return to the email and click on the link in the email to book a meeting with one of our advisers.

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