

Super Series 2: Self Managed Super Funds: Why, when to use, who they suit

In March 2009, there was nearly \$330 billion invested in Self Managed Super Funds (SMSF) representing about 32% of the whole superannuation industry's investments. It's the largest sector of the superannuation industry. Interestingly, the value of corporate, industry, retail and public sector funds fell by an average of 15% from March 2008 to March 2009. The value of SMSF fell by only 4% over the same period which is probably reflective of the types of investments made within a SMSF (more in direct property and cash and less in shares). With over 400,000 SMSF in existence in Australia you have to ask, what's the benefit, to whom and when?

What is a SMSF?

A SMSF is a specialised trust that can be established for up to four people for the sole purpose of providing retirement benefits to its members. A SMSF needs to have:

- A trust deed. This establishes what the fund can or can't do. SMSF trust deeds need to be updated every few years.
- A trustee. All members of the fund have to be trustees. You can act as individual trustees (i.e. in your personal name) or appoint a company as a trustee (and all members need to be directors). We highly recommend appointing a company.
- An investment strategy. This is a document which sets out how the SMSF will invest (addresses risk, return, diversification, liquidity, cash flow, asset allocation and the ability to discharge existing and prospective liabilities).

Under the 'choice of fund' legislation, the majority of people can request their employer to pay contributions into their own SMSF.

What's involved in setting up and running a SMSF?

It is pretty simple to set up your own SMSF. All you need to do is establish a company (as trustee) and buy a SMSF trust deed. This normally costs around \$800 to \$1,500 and takes about one week. There are many businesses that sell SMSF trust deeds but choose carefully as not all deeds are created equal. You need a deed that is fully up-to-date with the laws and provides maximum flexibility (e.g. fund has ability to borrow, pay a pension and so on).

Once your Fund is established you will need to apply for a Tax File Number and Australian Business Number. You can then establish a bank account in the Fund's name.

Once all this has been done, you might like to roll over your existing super account/s into your new Fund and change your payroll details (so your employer contributes into the new fund).

You will need to appoint an accountant and auditor (probably from the same firm) to prepare your SMSF accounts, tax return and audit every year.

Two major benefits

There are two main benefits of establishing a SMSF.

Cost

For some people, SMSF's can be very cost effective but it really depends on the investments you hold. Let's look at the costs you can expect to pay:

Cost	Frequency	Amount
Establish the fund	Once-off	\$800 to \$1,500
Deed updates	Every 2 years or so	\$100 to \$400
Accounting & audit	Annually	\$1,000 to \$2,000
ASIC fee (trustee)	Annually	\$33

Therefore, over a 20 year period, a SMSF will cost in the range of \$1,100 to \$2,300 per year to 'maintain'. Therefore, if you have say \$250,000 in a SMSF invested in cash and direct shares, the total cost is in the range of 0.50 to 0.90% which is very cost effective and cheaper than most industry funds (which generally costs over 1% per year) and certainly a lot cheaper than retail funds (which can cost over 2% per year).

Some SMSF administration providers (that will look after your Fund's income and expenses and prepare accounts, audit and so on) charge 1% of the Fund's asset value per annum. Don't get sucked into these percentage-based fee arrangements. It often ends up being more costly.

Control

With your own SMSF you have absolute control over what you invest in, when you invest and when you divest (subject to the legislation of course). But isn't it better for 'experts' to manage my super? The answer might surprise you. A technical paper release by the Australian Prudential Regulatory Authority (APRA) in July 2009 suggests that the average firm under-performed its net benchmark by 0.9% and the net under performance of the average firm appears more pronounced in down markets. In English, this means that the experts can't beat the 'average' return so why pay them big money for something they can't do? It would be like paying champion golfer Tiger Wood \$1 million to play a round of golf and score par – you could pay your neighbour \$50 to achieve that ordinary result! In many situations, you will probably be better off not having the so called 'experts'

manage your money on a daily basis – although the funds management industry would, of course, argue otherwise.

The main investment that is generally only available via SMSF's is direct property (residential and commercial). You have control of which property you invest in, when, how much you pay and you can sell it whenever you think it's appropriate. This element of 'control' can give you a tremendous amount of comfort as you no longer have to rely on a fund manager investing your money.

The other benefit of a SMSF is that you can use borrowings to increase the amount of investments (through instalment warrant borrowing provisions – refer to July 2009's newsletter for more).

When to use? Not for everyone

In my opinion, a SMSF is a great vehicle if you want the flexibility to invest in direct investments such as property. However, if you only want to invest in managed funds (well, as the APRA report mentioned above suggests, you should be investing in passive index funds) then a SMSF's probably not necessary. Some investment platforms offer good quality passive share market investments at an annual cost of between 0.44% and 1% per annum (if arranged by a commission-free financial planner) – once again, cheaper than industry funds and a lot cheaper than retail funds!

Strategic advice is critical

One hotly debated issue when 'choice of fund' legislation was being considered was "is giving people a choice of where their money is invested a good idea?" The rationale behind the question is that some people may not make an informed decision (either through not dedicating enough time, lack of understanding or being sold a dodgy product by a slick salesman). The same debate could be entered into when considering SMSF. If you have a SMSF, you have more control and that could work for, and against you.

In my opinion, if you have a SMSF it is even more important to receive good quality, conflict-free strategic financial advice. This is why smart investors choose to pay a fee to a 'fee-for-service' financial adviser. Removing commissions and vested interests not only saves you money but ensures your receive impartial and

independent advice. Can you imagine a doctor who derived his income according to the amount of medication he prescribed? As demonstrated above, investing in the 'right' products can improve investment returns and lower costs (significantly improving 'net' returns).

If your situation is pretty straightforward you may not need ongoing advice. For example, if you invest in a direct residential property it is pretty much "set and forget". Of course, you need to review the property's performance but you probably don't need a financial adviser for that. Imagine if you had your super invested in direct property prior to the GFC. Wouldn't that have been nice!

In closing...

Some articles and advisers suggest that SMSF's are only worthwhile when you have over say \$250,000 in super. I think that approach is too simplistic. For example, someone with say \$150,000 in super that is looking for more control may like to establish a SMSF and purchase an investment property for around \$400,000 (the SMSF would take out a loan). In this situation, their annual costs would be around 0.50% which is very competitive. However, once again, SMSF are generally only worthwhile when you want to make direct investments. Something to think about...

ProSolution Wealth Advisory: should you require any further information about SMSF's or any investment matters, please contact Jery Mourelatos on (03) 8624 4606 or by [email](#).

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Offset (> \$1 million)	4.89% (0.85% disc.)
Offset (> \$1.5 million)	4.84% (0.90% disc.)
2 years fixed	6.04%
3 years fixed	6.49%
5 years fixed	7.04%
10 years fixed	8.24%

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