

## Super Series 1: Super Property

Many people are focusing on superannuation returns this year: employees, the super industry and the government. APRA (the government body that regulates some super funds) released a damning report this week which suggested that superannuation investors aren't getting value from fund managers and that they would be nearly 1% per year better off investing in low-cost index funds (by the way, we are strong believers in the passive (index) methodology but that's another newsletter for another day). Many people are sick of lining the big fund managers (read: banks) pockets with their retirement savings. There's a solution that you may not have considered... take control and invest your super in direct property.

### What's changed?

In September 2007, the Federal government changed the super legislation to allow super funds to borrow money under certain arrangements to purchase investments. The change was made to legitimise share warrant products that were being sold to super funds at the time. A consequence of this change is that super funds can now borrow money to invest in direct property. Before this change, the only way super funds could invest in direct property is if they had enough cash to pay for the property outright and not many people are in that position. This change is good news for super investors because it gives people different options and potentially more control over their investments. Also, it affords investors the opportunity to diversify their investments and invest some of their money in direct property (which is not the same as investing in property trusts despite what some financial planners might tell you!).

### What's required?

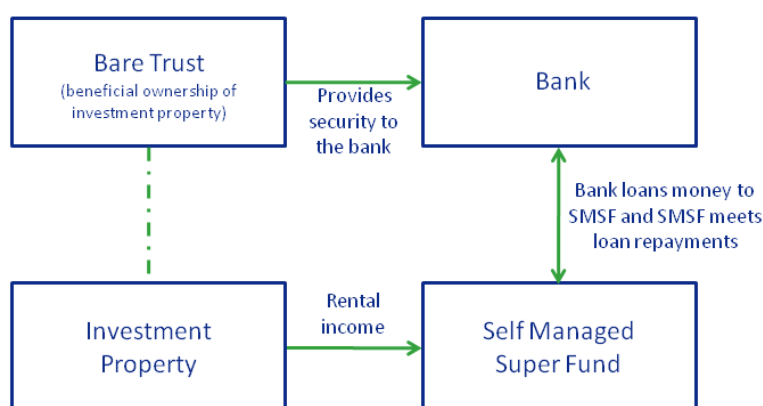
You will need to establish a Self Managed Super Fund (SMSF) to invest in direct property. The larger funds (retail and industry) can't really offer you this ability as it would be too difficult to administer. That's why you need your own super fund.

At the moment, most SMSF lending products limit the amount you can borrow to 72% of a property's value. Therefore, you will need a deposit of 28% plus costs. Costs will include stamp duty, legal fees, set up fees, buyers' agent fees (if applicable) and so on. I suggest you allow around 8% of the property's value for costs. Therefore, to invest in a property worth \$350,000 say (which is probably the minimum you need to spend to obtain a good quality property), superannuation investors need to have approximately \$120,000 in

super to use as a deposit. You can obtain the deposit by combining up to 4 people's super savings into one SMSF.

### Complex structure

To protect the assets of a super fund, the property is held in a Bare Trust whilst a loan exists. After the last loan repayment is made (and debt is zero), the property will automatically transfer from the Bare Trust into the super fund. The lender can only take the property held inside the Bare Trust as security. The super fund will receive the rental income from the property and will make the loan repayments. See structure below.



### Untested issues

As with any new laws, a certain amount of compliance risk exists. That is, until the law has been tested in court we do not really have a full appreciation of the laws interpretation and application. There are two main issues of contention:

1. Some lenders request personal guarantees as security for a SMSF. Does the provision of personal guarantees contravene the law?
2. When the loan against the property is repaid and the property automatically transfers from the Bare Trust into the SMSF, will Capital Gains Tax (CGT) and/or stamp duty be payable?

In regards to the first issue, the ATO issued a Taxpayers Alert in April 2008 which specifically said that they have concerns with the provision of personal guarantees. It is for this reason that we recommend clients do not enter into loan arrangements that require personal guarantees.

In regards to the second issue, we have obtained independent advice from one of the Big 4 international accounting firms which indicated that the wording of the trust documents is absolutely

critical. If worded correctly, no stamp duty or CGT issues should arise. As such, your choice of legal adviser is very important.

## The benefits

- Taxation savings – a 15% maximum tax rate on earnings during the SMSF's accumulation phase and zero tax in pension or retirement phase. Therefore, upon retirement, you could sell an investment property and avoid having to pay for any Capital Gains Tax. A common strategy might involve using the sale proceeds to repay all existing investment loans held outside of your SMSF.
- Asset protection – superannuation assets are protected from a trustee in bankruptcy. A SMSF is probably the best asset protection vehicle available.
- Income tax effective – you can achieve the same income tax savings through making tax deductible superannuation contributions.
- Improve cash flow – your compulsory super contributions (i.e. 9% which employer contributes) can be used to fund property holding costs thereby increasing your borrowing capacity.

## What's the downside?

- Money is locked away – investing in super means the investments are locked away inside your super fund until you reach retirement age. This may not suit you if you plan to retire early.
- Land tax – a super fund is a trust and therefore could attract higher land tax rates in some States.
- Cost – the set up costs and ongoing costs may be higher compared to holding an investment in your own name. These costs will be met by your super fund.
- Asset allocation – if you purchase a residential investment property within your SMSF, your overall investment allocation may be overweight in property (depending on the overall fund's investment balances). This could also be a benefit depending on the size of your fund.

## It's the small things

With a SMSF lending transaction, it is the small things that can cause major problems such as double or even triple the stamp duty! The timing of establishing SMSF and Bare Trust documentation, payment of the deposit, how the Contract of Sale is signed are all issues that must be done correctly. Therefore, before going out and finding a property to buy, we suggest you give us a month's notice (if possible) so that we can get everything organised and ensure you don't make any costly mistakes.

## Two lending options

When it comes to arranging a loan for the SMSF, there are two options or structures we can utilise. Firstly, we can obtain a specific SMSF lending product from a bank. Of course, as noted above, we will not use a lender that will require personal guarantees. Secondly, we can structure a related party loan which avoids the need to use a bank SMSF lending product. This structure is more cost effective and, in my opinion, significantly reduces any compliance risks. However, there are downsides to this structure which must be considered. We can advise you which lending structure might suit you best.

***ProSolution SMSF Lending Solution:** should you require any further information about buying a property within a SMSF, please contact Jodi McKeown on (03) 8624 4615 or by [email](#). Jodi is our SMSF lending specialist.*

## Our Best Rates

Basic variable	4.75%
Offset (> \$700k)	4.94% (0.80% disc.)
Offset (> \$1 million)	4.89% (0.85% disc.)
Offset (> \$1.5 million)	4.84% (0.90% disc.)
2 years fixed	5.49%
3 years fixed	6.29%
5 years fixed	6.99%
10 years fixed	7.79%

Rates current as at 06/07/09 and are subject to change without notice. Standard lenders terms and conditions apply.

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