A GUIDE TO INVESTING IN PROPERTY WITHIN YOUR SMSF

by Ken Raiss

SERIES

Grow your Wealth

Metropole
WEALTH ADVISORY

About this guide: this document is of a general advice nature and is 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.

IT SEEMS LIKE EVERYONE IS BUYING PROPERTY WITH SUPER THESE DAYS...

More investors are going down the path of setting up a Self Managed Superannuation Fund (SMSF) because they maintain control of their finances and, if set-up and structured correctly, it's a tax-free heaven in the pension stage.

But what are the pros and cons of using a self-managed super fund to expand your portfolio?

In this eBook we'll explain some of the super and a few of the not-so-super rules to buying an investment property in your SMSF.

1. Superannuation today

While most Australians love property and over 2 million Australians have become property investors to help secure their financial future, most of us are less passionate about another important wealth creation vehicle – superannuation.

If it wasn't compulsory most people wouldn't contribute to their super, but government regulation means that most of us regularly have a significant portion of our wages placed in either an Industry Super Fund or Retail Fund which invests our money, as well as that of all the other members, hopefully giving us a nice sum at retirement.

However today many Australian's are setting up their own Self-Managed Super Fund (or SMSF for short) to increase control of their money, to manage costs and to use their accumulated savings and ongoing contributions to gear into property.

While there are a lot of rules to comply with, and buying a property in your SMSF requires a great deal of preparation (to ensure this strategy suits your long term goals) and ongoing attention (to ensure that the various SMSF regulations are met), setting up a SMSF is now easier than ever.

Yet is requires specialist advice, so if you're considering setting up your own SMSF you'll need professional help, so if you'd like to know if setting up a SMSF would suit your circumstances, why not chat with the team at **Metropole Wealth Advisory** – give us a call on **1300 20 30 30** – or check us out at **www.Metropole.com.au**

2. What is a SMSF?

A self managed super fund is basically a trust run by its members, that is subject to the special rules that govern Australia's superannuation system and provides retirement benefits to the beneficiaries of the trust.

Like all superannuation funds, a SMSF must adhere to the same legislation and regulations set down by the Superannuation Industry Supervision Act but they are administered and supervised by the Australian Taxation Office.

Creating and managing an SMSF is a serious business and all trustees must understand they are responsible for making investment decisions and ensuring implementation of an investment strategy for their fund.

3. What are some of the benefits of setting up an SMSF?

Some of the benefits of setting up an SMSF could include:

- **Increased transparency and control.** You're in control of your SMSFs meaning you can chose where and how you invest.
- **The cost of administration could be reduced** using an SMSF.
- You can increase the size of your nest egg through **leverage**.
- You can **purchase residential property with debt** in your SMSF.
- You can borrow to **purchase your business premises.**
- An SMSF allows a trustee to consolidate the Super assets of **up to four members** (usually family members or business partners).
- SMSFs can provide **flexibility with more investment options.**
- **Tax Effectiveness:** like all super funds, SMSFs benefit from concessional tax rates ranging from 0- 15% rather than your marginal tax rate. And the income to you may be tax free when in pension phase.
- **Concessional Superannuation Contributions**: extra contributions from either your employer or you are seen as income to the Super Fund and therefore taxed at 15% but can be 30% depending on the contributor's income level.
- **Asset protection**: A property owned by your SMSF would not be available to creditors if the purchase was in the ordinary course of your investment life and sufficient time had passed between the purchase and your insolvency.

4. Why consider buying a property in your SMSF

Many investors feel that 'bricks and mortar' offers a more secure investment option than other asset types, while still generating healthy long term returns.

Some of the benefits of using your super fund to invest in property include:

- The ability to diversify your asset portfolio
- Well located investment grade properties are likely to produce solid investments returns in the way of long term capital growth plus rental yields
- You have more control over direct property than with other investments
- You can increase the value of a property in your SMSF and therefore the rents through renovations – but you can't use borrowed funds for this

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

As with all investment there are also **risks** which need to be carefully factored into your personal circumstances when considering whether to buy property with an SMSF.

That's why we recommend you have a chat with **Metropole Wealth Advisory** to see if this strategy suits you.

Book a consultation with Ken and formulate a Strategic Wealth Plan for you, your family or business

Give us a call on **1300 20 30 30**
Or check us out at **www.Metropole.com.au**

5. What type of property can be purchased in an SMSF?

At Metropole we've always advocated that you should only buy "investment grade" properties and this is obviously just as important when buying a property in your SMSF.

While rental returns are important, investors should not minimise the significance of capital growth in their SMSF as the large asset base this eventually creates can be of benefit in retirement.

One of the ways some of our clients have accessed this equity in their properties was to sell their property when they were in pension phase, as **no tax is payable** at this stage, and they could withdraw the funds (subject to meeting a condition of release) and use them to pay down debt outside their SMSF, for example the non-deductible debt on their home.

As well as residential properties, commercial and industrial real estate can **also** be bought in your SMSF and the extra cash flow from these types of properties may suit your SMSF investment strategy.

However, not all properties are compliant and care is needed to purchase an approved property and to manage it (including what improvements are made to the property) in compliance with the legislation.

6. How does borrowing in an SMSF differ?

While borrowing to buy a property in an SMSF is similar to a typical mortgage, there are some fundamental differences that can impact your borrowing capacity and, as you might expect, a strict set of rules needs to be followed.

Due to the potential risk associated with geared investments, loans for property being purchased in a SMSF are what are called Limited Recourse Borrowing Arrangement which limits the lender's rights of recovery against your SMSF to the asset you purchased with borrowed money. This is one of the reasons lenders will protect themselves by only offering lower Loan to Value Ratios.

And as further protection, the property is held in a specific holding trust (**Bare Trust**) until the loan is repaid.

The end result of this is that the amount of paperwork required to setup a loan significantly increases.

When the value of the property increases, the SMSF **cannot refinance to withdraw equity** for other purposes like you could if you owned the property in your personal name, but they can refinance the loan as long as the new loan is no more than the original borrowings.

Funds borrowed by a SMSF can only be used to:

- Purchase the property including costs 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.

7. Purchasing a Property in SMSF

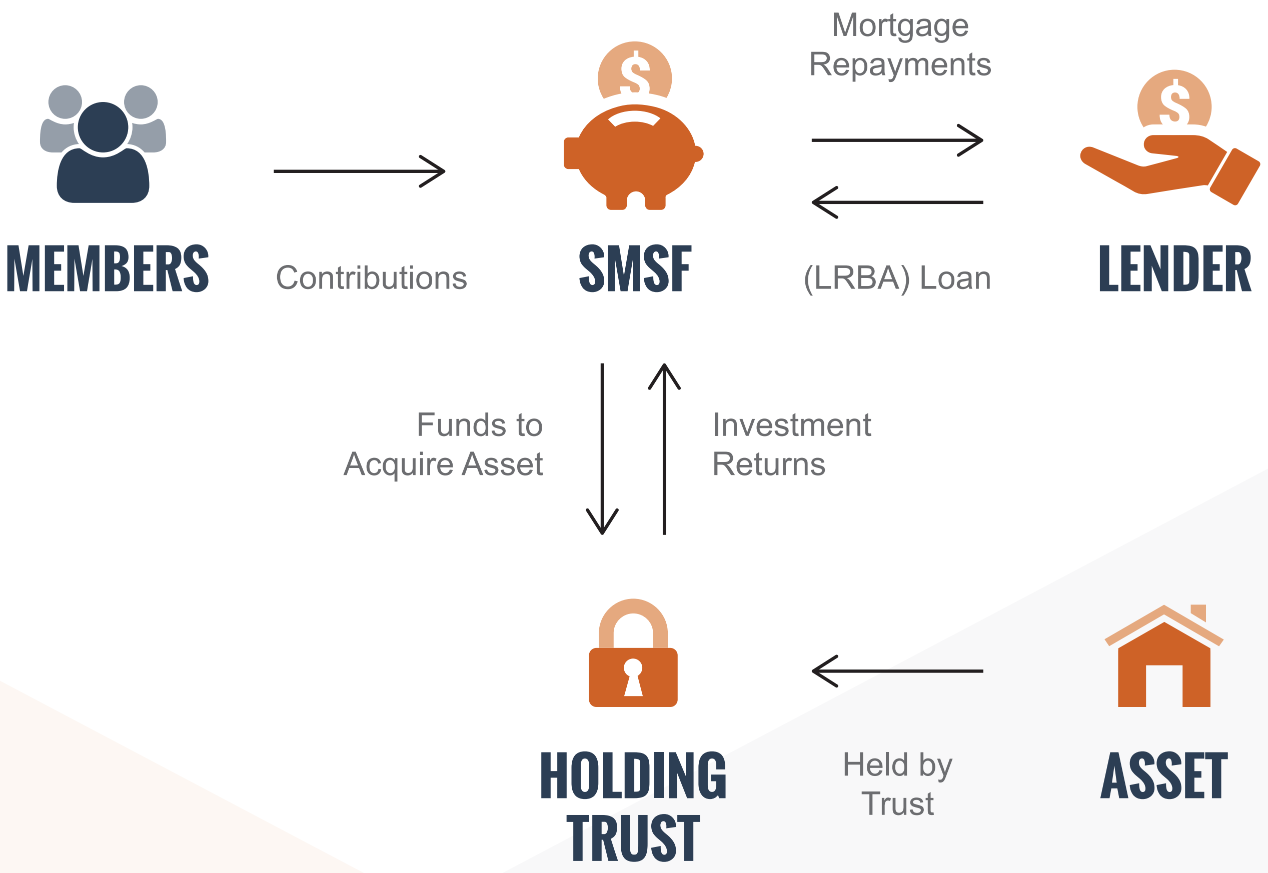
When you buy your property the legal owner will be a specific holding (Bare) Trust, but your SMSF will have beneficial ownership, meaning your SMSF will be credited with income and the capital growth will form part of its assets.

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 difficult and time consuming to setup and requires significantly more paperwork compared to a standard mortgage and requires that an SMSF and a specific holding trust (Bare Trust) with individual corporate trustees to be in place before you purchase your property.

The timing and sequencing of events is critical to the process.

That's why you will need to engage a Financial Planner like the team at Metropole Wealth Advisory and a Finance Broker who is familiar with SMSF lending to assist you.



8. Not sure if this strategy is right for you?

Buying property by using a Self Managed Superannuation Fund can be tricky to understand due to the various rules and regulations.

It also may or may not be the right strategy for your personal or financial circumstances.

Experts in this field are rare, but at Metropole Wealth Advisory, because we have a unique blned of skills including financial planning, accounting and property, we can assist with all the issues including:

- **Property advice** to ensure you buy an "investment grade" property and one that is allowable within the superannuation environment;
- Ensuring you set up of the **correct structures;**
- The role over of any funds from your retail/ industry fund;
- Setting up adequate and correct **risk insurances** such as life cover Referral to the right finance brokers to establish your borrowing capacity and the obtain the funds to secure your property;
- **Property Asset Management** to ensure your property is well maintained and you obtain and keep tenants.

Metropole Wealth Advisory offers you guidance and support that contribute to seamlessly combining the essential financial areas of your life.

Using our depth of skills in these core disciplines, we adopt a coordinated project management approach and access other specialists as needed to further enhance our integrated advice solution.

If you're looking for independent strategic wealth advice from a team of proven experts, call **Metropole Wealth Advisory** now on **1300 20 30 30** to discover how we can help you – now and in the future.

THE STEPS TO PURCHASING A PROPERTY IN YOUR SMSF

When you set up an SMSF, you become the trustee of the fund, or a director of a company that's the trustee. In either case, you'll be responsible for managing the fund according to its trust deed and the laws and rules that apply to SMSFs. And remember your SMSF will be audited every year, so you need to keep heaps of records.

There are a number of steps that must be taken before you can purchase a property within as an SMSF and the team at Metropole Wealth Advisory can assist with this.

Here is a summary of the steps involved:

1. See a financial planner or your accountant

The first thing you need to do is see a financial planner or your consultant at Metropole Wealth Advisory.

They'll need to prepare your fund's accounts and also its annual financial position, operating statements, SMSF annual return and also provide tax advice.

A legal practitioner can prepare and update your fund's trust deed and your financial planner can help you prepare an investment strategy.

2. Work out the structure of the fund

While you can choose a corporate trustee, where a company acts as a trustee for the fund, or have up to four individual trustees within the fund, at **Metropole Wealth Advisory** we generally recommend a corporate trustee. When this happens, every member must be a director of the trustee company.

Remembering the diagram earlier in this eBook, in the end you have your SMSF and a holding trust (where ownership of a property will be held). Each of those needs a trustee and we generally recommend a corporate trustee for both.

Firstly, banks prefer corporate trusts when lending money to a SMSF, and the second reason is for safety.

If a tenant ever sued the fund and insurance doesn't pay, then they'd possibly sue the trustee. If it's an individual, all their assets are potentially at risk. Not so with a corporate trustee that owns no assets itself.

3. Ensure all members are eligible to be trustee

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. As well they must sign a declaration that they understand their responsibilities.

4. Set up the fund

A SMSF is really just a special sort of trust and needs a trust deed and trustees, assets and beneficiaries (members). The trust deed is a legal document that sets out rules for establishing and operating your fund. It includes things like the fund's objectives, who can be a member and how benefits are paid.

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

At Metropole Wealth Advisory we recommend you get a "purpose-built" deed to suit your requirements.

5. Open a bank account for your fund

You need to open a bank account in your fund's name to manage the fund's operations and accept cash contributions and rollovers of super benefits. The money 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.

6. Register with the ATO

Once your fund is legally established and all trustees have signed a trustee declaration, you need to register the fund with the ATO, which is charged with regulating the SMSF sector. You will then get an A.B.N. and a tax file number.

7. Running your SMSF

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

- Accept contributions from the fund's members.
- Establish a written investment strategy and invest the fund's assets and income in line with this strategy.
- Keep good records and make sure the fund complies with all the rules and regulations.
- Decide is it is advisable for some or all of the fund's members to take out life insurance through the fund.
- Organise the preparation of annual financial statements, tax returns and for the fund to be audited.
- Pay appropriate members benefits as required.

8. Prepare an investment strategy

Before you start making investments, you need to have a written investment strategy. It provides you and the other trustees with a framework for making investment decisions to increase members' benefits for their retirement. It should be in writing so you can show your investment decisions comply with it and the SMSF laws. You should also consider whether to hold insurance cover for one or more members of your SMSF.

The team at Metropole Wealth Advisory can help you formulate your fund's investment strategy

9. Get Loan Pre Approval

By having a pre approval you'll know your limit when you go property shopping.

Ensure the loan preapproval is in the correct name.

10. Ensure you only consider a property that is allowable

There are restrictions in the type of property you can purchase in a SMSF.

Firstly, no one connected with the fund can use a residential property owned by the fund.

Then, a rule that has trapped many investors is the fact that an SMSF can only borrow to acquire a **'single acquirable 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 it's car space on a separate title may not comply.

Therefore it is critical to obtain take advice from suitably qualified professionals before you enter into an unconditional contract to invest in property.

11. Purchase the property

Purchase your property in the correct entity. The team at Metropole specialise in helping clients buy investment grade properties in their SMSF.

As this is general information, to find out how this could apply to your circumstances, please get in touch:

Please call us on **1300 20 30 30**

Or access **www.metropole.com.au**

Disclaimer - This report contains general information only
This information has been prepared as a general guideline, and is not intended to be an exhaustive or a complete analysis of the topics in question or issues raised in this e booklet. There are many legal, taxation and accounting matters which have not been dealt with in this e booklet and readers are urged to discuss any aspect of the operation of any of these matters discussed herein with their professional advisers. In particular asset protection, estate planning and superannuation are potentially very litigious areas of law and you will need specific advice before you take any actions if you want your wishes complied with. Before taking any action or implementing any strategy you should seek professional advice from your lawyer, accountant and or financial planner who will take into account your specific circumstances and objectives. Whilst reasonable care has been taken in preparation of this information, subsequent changes in circumstances (including legislative changes) may occur at any time and may impact on the accuracy of this information. Metropole Wealth Advisory Pty Ltd nor its directors, officers or associated and related entities including the author take no responsibility for any omissions or inaccuracies in this information and will not be held liable for any losses or damages that may result in the use of this information. The information contained is accurate at the time of publication being 1st January 2017.

Metropole
WEALTH ADVISORY