the new australian dream

How to Purchase Property with a Self Managed Super Fund

The New Australian Dream

It wasn't so long ago that people used to say if you own your own property you'd be right for life but times have changed.

Everyone needs an investment plan and some way of looking forward in their vision to the future. The question we all have to ask ourselves is, how am I going to earn a retirement income independent of pensions that are based off my own assets?

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Have you thought about your superannuation?

Over the last couple of years, particularly in the area of superannuation, the laws and regulations have really become much more favourable to investors.

A lot of the inflexibility and controls have been relaxed such that superannuation is now a legitimate way to grow your assets in a tax-free environment. For example, contributions to superannuation are now tax-free for investors over the age of 60.

Further, when you salary sacrifice into super, you are taxed at 15 cents to the dollar instead of 30 - 50 cents. So over a period of time, a property can be paid off through that 15 cents to the dollar tax instalment which is a great way to build assets in property. Your super is a valuable asset and it could be working for you. In the not too distant past, a self-managed super fund (SMSF) was not able to obtain a loan. With a recent change in legislation however, The New Australian Dream has been created and it is now possible to go out there and purchase a property to develop your asset base with your self-managed super fund.

Take an integrated strategic approach

To find out how you can maximise your super, and if you are interested in your SMSF purchasing a property, it's best to bring in the experts. It will pay to consult with a qualified financial planner to help you look at the big picture to both examine the potential rewards of a particular investment and to also look at the risks. Anyone who gives advice on an SMSF must have an Australian Financial Services Licence (AFSL). ASIC Connect's Professional Registers will tell you if the company or person holds an AFSL.

Every part of a particular financial situation has a domino effect. Borrowing affects your tax and it also affects your level of debt and your estate planning. Any investment decision should be considered as part of an integrated approach. When considering investment, there are two old adages. The first is that cash is king and the second is that it's a good idea to spread your risk.

People who have money tied up in the share market can be quite restricted in what they can invest in whereas people who have cash in their self-managed super funds are more likely to have greater flexibility.

Where you should invest your money probably comes down to discussions with your financial planner on what the best investment strategy is for you. If you have 20 years until retirement, for example, the share market will probably out-perform most asset classes over that time. However, if you're nearing retirement, you don't want any sort of super fund that is volatile or risky.

Case study

A business owner with a very strong asset base owned their own business premises and used their self-managed super fund to buy the premises. The whole group was restructured through a trust structure and the business premises was sold into the self-managed super fund.

This was done for two reasons. Firstly, the self-managed super fund contributed proceeds back across to the company. Those proceeds were then used to pay out some personal debt. Thus the non-tax deductible debt was converted across to deductible debt in the super fund.

The second reason was for asset protection. Once that asset left the company and moved into the self-managed super fund, it was protected from bankruptcy. The business owner sold the property, retained their premises and became their own blue chip tenant, taking away a lot of that tenancy risk.

The business owner set up a formal lease between their business and the self-managed super fund at market rates. The property moved across at market rates.

Purchasing a property with a SMSF has special conditions

Buying property with a self-managed super fund is different to just going out and buying any property you like. The first thing to know is that if you purchase a residential property from your self-managed fund you cannot live in it or even holiday in it. If you're looking at buying it for holiday letting, you can't stay in it during the off-peak season for example.

The Superannuation Industry (Supervision) Act 1993 (SIS Act) is the superannuation legislation and the statutory bible for all superannuation funds. It governs everything to do with superannuation. The SIS Act, has a sole purpose test.

The sole purpose test is basically your predetermining factor for any self-managed super fund or super fund in general, and the super fund needs to provide solely for members in their retirement. So if a strategy or an investment or anything that the super fund does, doesn't meet that sole purpose test, then it's generally prohibited by the SIS Act. The sole purpose test says that you must buy an asset for your superannuation fund for the benefit of the members in their retirement. And holiday letting, unfortunately, doesn't actually fall into that category.

The property:

- Must meet the 'sole purpose test' of solely providing retirement benefits to fund members
- Must not be acquired from a related party of a member
- Must not be lived in by a fund member or any fund members' related parties
- Must not be rented by a fund member or any fund members' related parties

However, your SMSF could potentially purchase your business premises, allowing you to pay rent directly to your SMSF at the market rate.

Further, it is important to understand that under the current legislation, purchasing a property through a SMSF is what is known as a stand alone transaction. What that means is that once it is established, it is set in stone. It basically means that, for example,if you decide to pay the loan down more quickly than you're contracted to do and you want redraw access to those funds, you have no redraw. Be very, very careful. It is like layby. If you were to walk into Kmart, for example, and put something on layby with a deposit and the next day walk in and pay $50 off that layby, you can't then walk in the day after and say, "Can I have my $50 back?". It

just doesn't work like that. So effectively it's almost a layby where the custodian is holding that property for the super fund until that outstanding obligation is repaid.

Also, this investment strategy is what is known as a limited recourse transaction, which means the property you are buying is the only property of the super fund that is at risk. If everything went pear shaped and you had to sell that property or the bank had to sell the property for you, they cannot access any other assets within the super fund. The fact that the assets are protected is one of the key considerations for restructuring or looking at your long-term strategies in regard to your super fund. You do not want to set up a transaction that will risk any of the other assets in your superannuation fund.

But I'm under 40?

If you are under 40, it is possible to form a joint self-managed super fund with up to four people and pool assets to increase borrowing capacity.

These are the costs involved:

The initial step in establishing your own do-it-yourself super fund has expenses involved as you'll have to set up the trust deed and engage the right compliance and tax services. With your financial planner, assess the fees against what you're paying at the moment, just to see whether the do-it-yourself structure is going to be the best long-term vehicle for your retirement savings.

ASIC's website states that SMSF property sales may have many fees and charges. They advise finding out all the costs before signing up including: upfront fees, legal fees, advice fees, stamp duty, ongoing property management fees and bank fees.

ASIC's website states that You can only buy property through your SMSF if you comply with the rules.

Steps to secure your approach

- Go and See a Reputable Financial Planner
    - Go and see your financial planner and have a needs analysis done. Banks are not qualified to provide advice in this area at all.
    - You need to go and see an expert and have a strategy put in place. A self-managed super fund is a highly prescribed instrument so if you don't have the right documentation in place, you can't even begin the process. Many people think they could just get their accountant to help. But you need an experienced financial planner or an accountant who understands the finance, super and tax sides.
    - You must also understand Loan Valuation Ratio (LVR). Put simply it is the amount of the loan divided by the value of the property. All banks will have differing LVRs for different product classes from residential, generally the highest at 80%, down to standard commercial, which is typically 65%, down to specialised commercial or rural which could be as low as 50% or even less depending on the asset class and what it's used for.
    - Further you must be clear about your personal guarantees and obligations. For example, if you purchase a commercial property, you must satisfy the sole purpose test ensuring that this asset is going to be for the sole purpose of providing retirement benefits for yourself and the fund will need to be audited annually.

- Read Through your Statement Advice
    - Once you've met with your financial planner, they will give you a statement of advice. The statement of advice can be as simple as what the self-managed super fund strategy will be going forward.
    - More often than not, it will detail exact transactions or strategies that you may be looking at in the short-term - and one of these may be buying property. So if you were looking at buying a property inside your self-managed super fund, the statement of advice will actually cover what that strategy involves.

- Create your own SMSF
    - You are now in a position to create your own self-managed super fund, which will be set up by your accountant or the approved financial planner that you are using. A lot of people have an existing self-managed super fund. If your self-managed super fund is older than two years, then

the trust deed will probably need to be amended to give that super fund the ability to borrow because in the past, super funds could never borrow so that provision was never included in a deed.
    - If you don't have an existing self-managed super fund and want to create one, again, it's a fairly prescribed process and you must work it in with your accountant or your financial planner to make sure that everything is documented correctly and you understand the obligations, such as an annual audit.
    - You will also need two companies: a bare trust and the trustee. Two separate entities are involved in a self-managed super fund transaction for property purchases. One is the self-managed super fund itself. It will have a trustee and that trustee must be a company. It could be an existing company or a new one.
    - The bare trust is a separate legal entity and again, it must be a company, and a trustee for whatever trust you want to call it. That trustee acts as a custodian in this whole process. It will own the property for all intents and purposes until such time as the debt is repaid and the property can move across into the self-managed super fund.

- Meet with Your Bank
    - Meet with your banking organisation to confirm the budget and the details. Many people will have this strategy in place for some time before they actually locate a property but they'll want to know whether they have the capacity to do the transaction.
    - Your banker will work out the purchase price within your reach and how much you will be required to contribute, what sort of interest rates will apply, what sort of rental yield you will achieve and how that all sits with banking guidelines.

- Form the Trustee
    - You will now need to engage a lawyer with experience in SMSF to form the trustee. It's important to work with a solicitor who is familiar with this whole process to ensure that the correct name appears on the contract. It's slightly different to a normal transaction. If mum and dad are buying a property in their own name, for example, obviously mum and dad's name will appear on the contract. In these kind of purchases however, you're buying the property for the self-managed super fund, but the bare trust is the custodian, not individuals.
    - The custodian's name appears on the contract. That is the biggest pitfall that people who have attempted to purchase property through SMSF have encountered to date. If the wrong name is on the contract, it is very difficult to alter. Get it right the first time – engage a lawyer with experience in this area.

- Locate The Property
    - This is the most exciting time. You can actually get out there and go shopping. People who have significant funds in their superannuation are in a powerful position to shop. If you've sat down with your bank beforehand and you find a property that ticks all the boxes, you're in a powerful position because you know that you have your bank backing you and you can use that to then negotiate with the agent.
    - Buy in an area you know. Buy where you live. There's nothing like having first-hand experience in investing and you just can't beat first hand knowledge. While the internet makes it easier to access information everywhere, you know your area and it's easy for you to understand local rental prices and keep an eye on the market. If you buy in another state in Australia and things are not going well there, you may not be aware of it, you won't know when to sell or when to hold. Buy property where you understand property.

- The Approval Process
    - Once you have decided on a property, it will be valued, assessed and hopefully loan approval

will be granted.

- The Exchanging of Contracts
    - When you exchange contracts, the deposit must come from the super fund. Exchange on the property is completed and once exchange has happened, trust documents and actions are prepared and finally signed prior to settlement.
    - Subject to the audit process, the easiest way to manage settlement is to have an account in the self-managed super fund's name and simply draw a cheque from that account, so you have a paper trail - but again the cheque must come from the self-managed super fund.

- Settlement is Here
    - The property is now settled. It's owned by the super fund, to the trustee. You can now rent it out. You've done it! You've actually purchased property with your super fund.
    - You are on your way to creating The New Australian Dream!

You are now in a position to create your own self-managed super fund, which will be set up by your accountant or the approved financial planner that you are using.

YOU ARE NOW IN A POSITION TO CREATE YOUR OWN SELF-MANAGED SUPER FUND, WHICH WILL BE SET UP BY YOUR ACCOUNTANT OR THE APPROVED FINANCIAL PLANNER THAT YOU ARE USING

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