

# SUPER GUIDE: HOW TO BUY PROPERTY USING YOUR SUPERANNUATION



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This guide is brought to you by **THE SMSF CLUB**

## About The SMSF Club

The SMSF Club is a membership program designed specifically for anyone who has or wants a SMSF.

*“Business and investing are team sports. The average investor or small business loses financially because they do not have a team. Instead of a team, they act as individuals who are trampled by very smart teams.”* **Richard Branson**

With an extensive network throughout Australia, The SMSF Club integrates a tailored education program with administrative, compliance, and investment support. We help members throughout every stage of the SMSF process. This includes the establishment of a SMSF, full ongoing bookkeeping, ongoing accounting, legal and compliance support, plus investment education. We ensure our members are informed, responsible, and compliant trustees of their SMSF. Having the right team to support you in meeting your obligations is critical to the success of running your own SMSF. With the guidance of The SMSF Club you can be in control of your retirement savings for yourself – not by yourself.





# How to Buy Property Using Your Superannuation

## Acquiring Property with your Superannuation Funds

Australians are among the most passionate property lovers in the world. The great Australian dream is to own property, and there is no doubt property has been a great way to grow wealth over the past few decades. However, direct property has traditionally been difficult to invest in using your super due to the high upfront capital investment required. Thankfully new laws have been introduced to make buying property easier with your super. Between 2008 and 2012 the value of real property ownership held by SMSFs grew to over \$55 billion.

## Can I Borrow to Buy Property Inside of Superannuation?

Yes. Changes to the Superannuation laws made in 2007 mean SMSFs can borrow to purchase real estate using a special structure established for this purpose and so long as you follow the strict legal requirements. Generally, it is possible to borrow up to 80% for residential property and 70% for commercial.

## The Process



**FOR SALE**

**1** Complete The SMSF Club Application Form

**2** SMSF & SMSF Trustee Company Establishment

**3** Rollover of your existing superannuation to your SMSF

**4** Obtain loan preapproval for your SMSF

**5** Source the property

**6** Establish Property Trust & Property Trust Trustee Company

**7** Final loan approval & vetting of documents

**8** Property settlement

## Borrowing Arrangements for SMSF Property

Effective October 2007, legislation was passed to allow SMSFs to borrow on a limited recourse basis. Further amendments were made to this legislation in 2010 to tighten the rules allowing SMSFs to borrow funds to purchase direct property. However there are very strict conditions that need to be met to use borrowed funds. These changes in legislation have resulted in a boom in the number of SMSFs holding direct real property as a means to secure the retirement future of super fund members.

SMSFs must satisfy the following conditions for arrangements entered into on or after 7 July 2010 to purchase direct property using borrowing:

- The borrowed money must be used to acquire a 'Single Acquirable Asset' ('the asset');
- The money used to purchase the asset must be borrowed under a 'Limited Recourse Borrowing Arrangement' (LRBA);
- The asset must be held in a specially designed trust commonly called a 'Property Trust'; or 'Bare Trust';
- The SMSF must have the right to acquire legal ownership of the asset, from the property trust, upon repayment of the outstanding loan;
- The borrowed money can be used to carry out 'Repairs' and 'Maintenance'; however it must not be used make 'Improvements' to the asset;
- An SMSF must not purchase a property from a 'Related Party' unless it is 'Business Real Property' acquired at market value.

All trustees of a SMSF that are considering purchasing property using borrowed money need to be aware of these rules. Contravention may have civil and maybe criminal consequences, and also place at risk the status of the SMSF as a complying superannuation fund. Loss of complying status means the income and assets of the SMSF are taxed at 46.5%

### What is a Single Acquirable Asset?

Put simply, a single acquirable asset can be defined as a single object of property; for example an apartment, residential property, or a block of vacant land.

Further, the single acquirable asset can comprise two separate assets at law and be treated as the one asset

for the purpose of borrowing in an SMSF. This often happens when two assets are inseparable, such as an apartment with a car park on separate title that cannot be sold separately, or two assets that are acquired under a single contract, such as a house and land package. Under both scenarios the two assets will be treated as one single acquirable asset, and as such, borrowing can be used to acquire them.

Two common mistakes made by SMSFs using borrowed funds to buy property include:

- Building a house on an existing block of land owned by the SMSF. A house is not a single acquirable asset in its own right. Money borrowed to build the house effectively results in the acquisition of services and building materials, not a single acquirable asset.
- Serviced apartments. The apartment without the furniture is a single acquirable asset. However, the apartment and the furnishings package, even if purchased together under the one contract, is not a single acquirable asset. The furnishings package, even if purchased under a separate contract is not a single acquirable asset as it would include multiple items.

### What is a Limited Recourse Borrowing Arrangement ('LRBA')?

An LRBA is an agreement between the lender and the SMSF that carries with it special conditions. Under an LRBA any recourse that the lender or any other person has against the SMSF is limited to the asset, and any rights to that asset (eg rent), that the SMSF borrowed funds to acquire.

### What is a Bare Trust or Property Trust?

A Bare Trust or Property Trust is a trust structure used to split the beneficial ownership and legal title of an asset. Under these specifically designed trusts, the beneficiary (ie the SMSF) has the beneficial rights to both income and capital of the asset, that is, the property purchased with the borrowings. However, the SMSF does not hold legal title until after the borrowings are fully repaid. Then the title to the property is transferred from the bare trust to the trustee of the SMSF. If your documentation was not executed correctly when the property was first purchased further stamp duty will be paid on this transfer.



## What constitutes Repairs and Maintenance to the asset?

The trustee of an SMSF can use money borrowed under an LRBA for carrying out repairs and maintenance on the asset, whether necessary at the time of the acquisition or at a later date.

### What is a Repair?

A repair restores the function of the asset without changing its character and may include restoration to its former appearance, form, state or condition.

### What is Maintenance?

The term 'maintaining' ordinarily means work done to prevent defects, damage or deterioration of an asset, or in anticipation of future defects, damage or deterioration, provided that the work merely ensures the continued functioning of the asset in its present state.

## What constitutes an Improvement to the asset?

Borrowings under an LRBA cannot be used to fund improvements to the asset. However, money from other sources can be used to improve the asset. For example, accumulated funds held by the SMSF may be used to fund the improvements.

However, any improvements cannot result in the asset becoming a 'different asset,' as the asset identified when the LRBA is put in place must continue to be the asset that is held on trust under the LRBA.

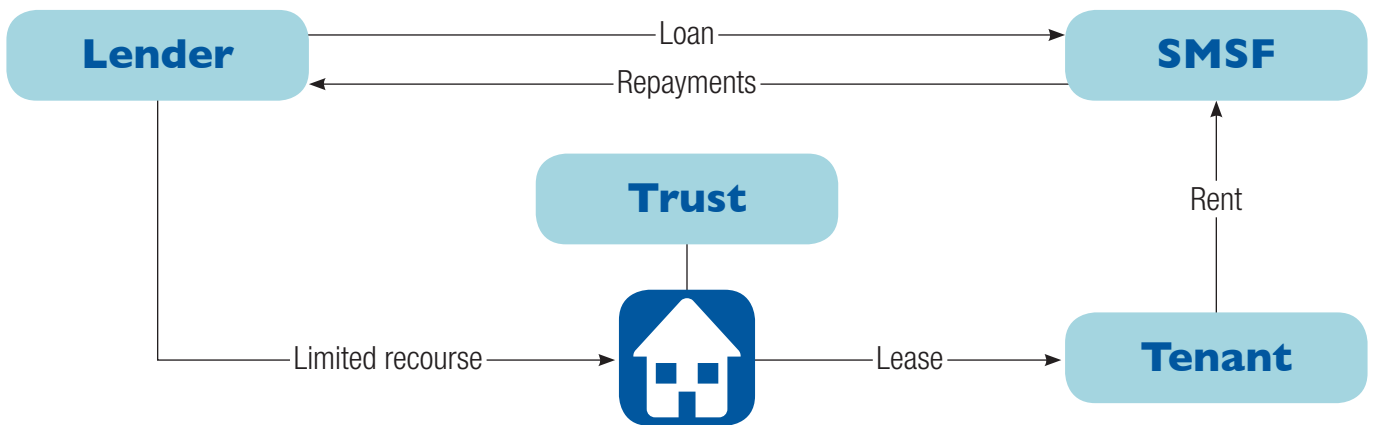
General test: If an improvement will fundamentally change the character of the asset as a whole, then this will result in a different asset being held on trust under the LRBA. If this happens, you will be in contravention of the superannuation laws.

Below are some examples of a different asset being created:

Scenario	Result
Buying a vacant block of land under an LRBA and subdividing it into multiple titles	✗ The improvement has resulted in a different asset
Buying a vacant block of land under an LRBA and building a house on the vacant land	✗ The improvement has resulted in a different asset
Fire demolishes house under an LRBA and is replaced by three strata titled units	✗ The improvement has resulted in 3 different assets
A residential house under an LRBA is converted into a restaurant	✗ The improvement has resulted in a different asset
A room in a residential house under an LRBA is converted into a home office	✓ The improvement would NOT result in a different asset
The following improvements to residential house under an LRBA: A kitchen renovation, an extension to add two bedrooms, a swimming pool, a garage or an outdoor entertainment area	✓ The improvements would NOT result in a different asset
The addition of a fully functional 'Granny Flat'	✓ The improvement would NOT result in a different asset

## How the Structure Works

The Property Trust becomes the legal owner of the property, while the SMSF is the beneficial owner and receives the rental income. The rent, and other income received by the SMSF such as investment income and super contributions, can be used to make the loan repayments. The loan is a limited recourse loan. The lender will not have recourse to any other assets held in the SMSF.



## Main Restrictions

There are restrictions on SMSF loans which prevent some transactions from taking place. For example:

- Construction loans may not be available. However the SMSF can pay for renovations out of its own funds, but cannot borrow additional funds for this purpose.
- Buying a residential property in your SMSF that you or a related party intend to live in is not allowable and will result in your SMSF becoming a non-complying fund.
- Selling a residential property to your SMSF, that you or a related party own is not allowed.

However, business real property that you or a related party own is acceptable and is an exception to the rules regarding related party acquisitions.

## What is a Related Party?

A related party is a member or trustee of the SMSF, a relative of the member or trustee, an entity which the trustee or member controls, or an employer who pays into the SMSF.

## What is Business Real Property?

Business real property is real estate which is used wholly and exclusively for business purposes. The business can be run by a member of the fund, a related party or any other party. An SMSF can acquire business real property from a related party so long as it is acquired at market value.

## Case Study



**While the process of buying an investment property using your super sounds daunting, with the right team to help you it can be quite simple. See how easy it can be!**

George is 37 years old and earns approximately \$80,000 per year. He currently has approximately \$100,000 in his super fund.

George wishes to buy a residential investment property. The property is valued at \$350,000. George does not have the funds in his own name, or the income to service the loan to buy the property. George's wife, Bonnie, has an additional \$80,000 in her superannuation fund.

George and Bonnie decide to combine their super and establish a SMSF to fund the purchase of the investment property. Once their SMSF is established they roll over both of their super funds into their newly created SMSF giving them \$180,000 in available funds to invest. The bank is willing to lend their SMSF up to \$280,000 to fund the purchase, being 80% of the purchase price of the property. George and Bonnie therefore only require \$70,000 of their SMSF cash to fund the remainder of the property. They also require additional funds to cover stamp duty and other costs associated with the purchase.

**George's Super: \$100,000**

**Bonnie's Super: \$80,000**

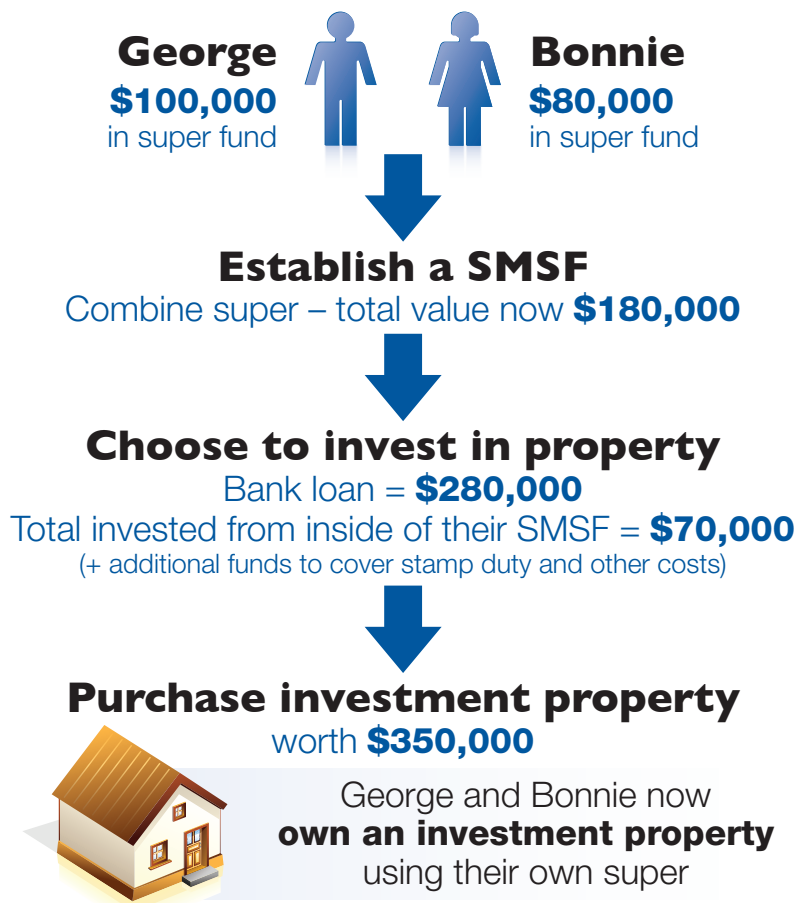
**SMSF Rollover: \$180,000 total super**

**Property Purchase Price: \$350,000**

**Bank Loan: \$280,000**

**Total invested from SMSF: \$70,000 plus costs**

**George and Bonnie now own an investment property worth \$350,000, using \$70,000 of their SMSF.**





# Tips for buying property in a SMSF

## 1. Is it appropriate?

You need to conduct the necessary due diligence to determine whether any direct investment stacks up. This responsibility lies with you as the trustee. Do not take this responsibility lightly as making the wrong investment decision can have a material impact on your lifestyle in retirement.

## 2. Check the SMSF investment strategy

Before making any investment, review your SMSF investment strategy to ensure you can invest in direct property as an asset class and to whether there is any limit on the exposure to any particular asset class. Also ensure the SMSF deed permits borrowing and allows SMSF assets to be held in a related entity, that is, a bare trust.

## 3. Be mindful of the risks of borrowing in your SMSF

When entering into any form of borrowing arrangement, any fall in the property price magnifies the loss. It is critical you seek independent financial advice to determine whether property and any borrowing arrangement is a suitable investment strategy for you in your SMSF. For example, what is your timeframe to retirement?

## Key risks of buying direct property using your super

While an investment into direct property inside of your SMSF offers many benefits, there are many other factors that you need to consider to determine whether such an investment is appropriate. There are costs associated with buying and holding an investment property, liquidity constraints, and other risks which all need to be identified and considered prior to making the big leap into direct property ownership within your Super.

### Increased regulations and restrictions

The SMSF firstly must comply with all superannuation regulations. That is, the investment must be for the sole purpose of providing an income in retirement and cannot be used for any personal benefit.

SMSFs must also ensure that the level of investment in direct property is in line with the fund's investment strategy, including diversification of assets, liquidity, and maximising returns in the SMSF. While there is no specific prohibition on having 100% of a SMSF invested in direct property the government has made it clear that SMSF investing into just direct property must have appropriate risk management measures in place and the trustees must ensure they understand the risks of the investment and any borrowing associated. Direct property ownership should therefore be considered as one asset class of a well diversified portfolio.

### Property prices can fall in value

While property prices have over the long term appreciated in value this is not always the case. Property prices do fall in value and is considered as a high growth/ high risk asset class. It is critical for this reason to employ a team of experts to ensure, firstly that direct property is suitable for your circumstances, and secondly to help you identify the key risks associated.

### Property must be considered a long term investment

Like all investments, property profits take time. The returns achieved through property like any successful investment are gained through extensive research, hard work, and patience.

### Vacancy

If your property sits vacant for an extended period the holding cost of maintaining the property are generally high, especially if you have used borrowed funds to help fund the purchase. If you are relying on the rental income to cover the costs of keeping the property and you do not have a tenant you may be forced to make additional contributions to your SMSF.

### Tenant Risk

Here in Australia if a tenant fails to pay the rental income, as the owner of the property you are required to go through the courts to have them evicted. This process can take up to 7 months. If you do not have any rental income for 7 months and have borrowed funds you need to ensure you have the capacity to pay the monthly interest obligations. You can reduce tenant risk by having land lord insurance.

### Illiquid

Property is usually very illiquid in that it takes time to sell a property and the transaction costs are very high in comparison to other asset classes.

### **Leverage Risk**

In many areas it is common to see short term property price declines of more than 20%. If you are forced to sell a property and you borrowed 80% to fund the purchase of the property using your SMSF, a 20% fall means that you have lost your entire investment (100% of your super funds contribution). So you can lose everything. It is for this reason all investors should ensure you safe guard themselves from being forced to sell at anytime and have a level of buffer within their SMSF loan. You should also consider life/income/and total and permanent disability insurance.

The Australian Taxation Office (ATO) website is a wonderful source of information for SMSF trustees and has a website dedicated to Limited Recourse Borrowing Arrangements for SMSF's. Please go to [www.thesmsfclub.com.au/ato](http://www.thesmsfclub.com.au/ato) for more information.

## **The SMSF Club**

### **The Top Six Membership Privileges of The SMSF Club**

#### **1. Monthly live SMSF online Mentoring workshops**

The SMSF Club provides members with regular monthly education in a webinar format designed specifically to help you learn, grow and protect your SMSF.

#### **2. Quarterly live SMSF seminars across Australia**

These live events give you the opportunity to network and learn from other passionate, like minded, successful individuals including technical updates, legal and compliance obligations, insurance and investment opportunities.

#### **3. Daily access to a dedicated one-on-one SMSF Head Coach**

Your dedicated Head SMSF Coach will be your go to for any SMSF questions to ensure you are regularly updated on Super legislation changes, investment opportunities, and general compliance obligations.

#### **4. An entire professional team to support you in all elements of the SMSF process.**

In addition to your SMSF coach, you will also have an entire team of specialists to support you in all areas of compliance, investing, and wealth protection. These experts include:

- A Property Coach
- Stock market specialists
- An insurance specialist
- Estate planning
- Legal and compliance experts
- SMSF Finance Specialist

#### **5. Access to tailored investments specifically designed for SMSFs**

The SMSF Club members have access to tailored investments specifically designed for SMSF's. From pre negotiated property deals to stock market opportunities such as Initial Public Offerings (IPO's). The bulk buying power The SMSF Club mentoring clients enjoy is one of the greatest advantages of our mentoring program.

#### **6. Full Ongoing accounting and administration\***

If you do not currently have a trusted relationship with an accountant, The SMSF Club gives you access to full SMSF accounting and administration service. This additional service includes: Preparation of financials, lodgement of the tax returns, online reporting 24/7 via your secure login, Mail Box Service, Assistance with rollovers & consolidation making managing the ongoing accounting and compliance of your SMSF stress free.

\*To become a member it is not compulsory to elect these additional services.

## What Can I do now?

*"Opportunity is missed by most because it is dressed in overalls and looks like hard work."* **Warren Buffett**

### The Next Step

The SMSF Club is not designed for everyone, nor is it meant to be. The SMSF Club provides ongoing education or general advice only. Our aim is to empower our clients with the education so they can make informed, compliant, and hopefully successful investment decisions. Whether you are already a share market investor, have a SMSF or are considering a SMSF, it is critical you understand the obligations of being a trustee of a SMSF and the risks of any investment strategy adopted.

If you would like to find out more information about The SMSF Club please arrange a complimentary meeting with a SMSF Club coach on 1300 760 397 or visit our website [www.thesmsfclub.com.au](http://www.thesmsfclub.com.au) to register for an upcoming event.



*An Investment in knowledge pays the highest dividend"*

**Benjamin Franklin**



# THE SMSF CLUB

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