



Borrowing to Buy Property in your Self Managed Super Fund

Part of the:

Wealth Education Series

by

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How to read this document

Managing your finances to meet your day to day requirements as well as your long-term goals can be a complex task. There are all sorts of issues you need to consider such as taxation, legislation, protecting your wealth and assets, associated costs and the inherent risks of investment. When undertaking a financial plan it is important that you understand how these issues will impact on you and what you should expect over time.

As your financial adviser, we will provide you with a Statement of Advice (SOA) which sets out the details of the advice to you and how it will achieve your goals and objectives.

This document provides some additional information to help you understand the financial planning concepts discussed during our Financial Planning Process and in your SOA.

It is very important that you read this document to help you understand the benefits of the strategies recommended to you, and the associated costs and risks. If you do not understand something or need further clarification, please contact us.

The Family Super Fund

One of the key benefits of being running a Self Managed Super Fund (SMSF) is the control and flexibility you can exercise in the investment choices you make and the strategies you use to grow wealth for retirement.

Control, Flexibility, Power to determine your wealth building strategy are the main reasons our clients choose to grow their retirement wealth via a SMSF.

As a Trustee of your SMSF, you have the power to create wealth with the full support of the Australian Superannuation System. This ability extends to creating wealth within a Family and across the generations of a Family. For our clients with Family Businesses or the desire to build for the next generation, the SMSF is an opportunity to build a "Family Super Fund".

Property as a Preferred Retirement Asset

Owning property remains a well trodden path to wealth building. Australians have a cultural desire to own property starting with our family home and also becoming landlords by building a property portfolio. Rental income and capital growth are the driving factors behind property ownership outside of our family home.

Owning property in a Family Super Fund fuses the best vehicle for building retirement wealth and owning a preferred Asset.

There are strategies available to incorporate property ownership into your Family Super Fund. For many SMSFs the ability to buy a property using the combined balances of each member's account may put some of the best properties out of reach. That's where Borrowing to buy property can overcome a capital shortfall.

Borrowing to buy property in your Family Super Fund is possible but you need to consider that firstly you are a SMSF Trustee, secondly a rental property investor and lastly a borrower. You need to:

- know the borrowing rules for SMSF Trustees,
- understand the benefits and accept the risks associated with investing in rental property,
- understand the benefits and accept the risks of borrowing to buy property and holding this investment in a Family Super Fund.

Your SMSF Investment Strategy

Remember that when you become an SMSF Trustee you take on the responsibility of growing your own wealth for retirement. SMSFs are kept in line by the ATO. As the Regulator of SMSFs the ATO and Superannuation Law requires you to have a documented Investment Strategy that can demonstrate how and why you invest your SMSF money.

As a Trustee, you need to prepare and implement an Investment Strategy for your fund, and review it regularly. The ATO and most seasoned investors accept that Diversification is the key to sustained capital growth for a long-term investment strategy. The strategy needs to reflect the purpose and circumstances of your fund and must:

- invest in a way to maximise your returns taking into account the risk associated with the investment,
- invest across a mixed portfolio of assets (for example, shares, property and fixed deposit).
- invest so it can pay benefits as you retire and pay other costs incurred by your fund
- invest for the needs of its members (for example, age, income level, employment pattern and retirement needs).

The investment strategy should set out your investment objectives, target returns and detail the investment methods you'll adopt to achieve these objectives. *Source: Running A Self Managed Super Fund ATO March 2009.*

As a Trustee you must ensure the asset would not breach any of the superannuation investment rules and requirements, such as:

- the sole purpose test
- the fund's governing rules (i.e. the fund's trust deed and investment strategy)
- the arm's length dealings rules
- the acquisition of asset from related party rules
- the in-house asset rules, and
- the trustee general covenants, such as the duty to exercise care, skill and diligence.

For more information on these Investment Rules visit our Wealth Education Page and the "Understanding SMSF" Brochure at www.carnegie.com.au.

Choosing an SMSF Rental Property

There are so many features and considerations that determine a good rental property such as:

- the type of property
- your ideal tenant
- the cost of owning the property (including rates, strata levies, landlords insurance, property insurance) relative to the rental income earned and
- location, location, location

you need to consider all of these features and factors. For a Family Super Fund, the following factors also deserve special attention:

Rental Income

Remember that you are investing for retirement wealth that means growing money that can produce a retirement income. Rental income relies on the quality of the asset itself and the ongoing maintenance of that quality.

Your Rental Property should have rental income that is sustainable, recurring and with the potential to grow with inflation.

Most Family Super Funds will rely on their rental income to fund a retirement pension.

Established Property

The limited recourse borrowing rules heavily favour established properties or newly completed properties.

You are not able to "borrow to improve" which means buying a quality rental property is crucial. Family Super Funds cannot engage in property development under current Superannuation Investment Rules.

Timeframe to Retirement

All investments need time to grow, rental property is no exception. You need to consider how borrowing to invest in a rental property will impact your retirement plans.

Loan repayments will need to be met by rental income and in most cases by using some of your future contributions to superannuation.

You also need to consider your exit strategy from the loan.

- Will you repay it in full over time?
- How will you do so?
- What other assets will you invest in to diversify your risk?

So provided that you follow the Investment Rules, your own Investment Strategy and find an ideal property here's how to borrow to buy property in your Family Super Fund.

Limited Recourse Arrangements

A Family Super Fund can establish and maintain a loan in limited circumstances. One of these circumstances is when a Family Super Fund borrows (on a limited recourse basis) to purchase an investment. Let's assume this is a rental property.

A limited recourse arrangement allows a Family Super Fund to purchase a rental property using instalments.

An instalment can be a loan repayment to a Financial Institution or in some cases a related party to the Family Super Fund. To ensure the integrity of the instalment and borrowing arrangements, the rental property is held in a Holding Trust until all the instalments are made meaning that the loan is repaid in full.

The Holding Trust aside from "holding" the property until all instalments are paid also provides security (i.e. the rental property) for the outstanding loan to the lender. This loan security or mortgage is held until the remaining instalments are paid in full.

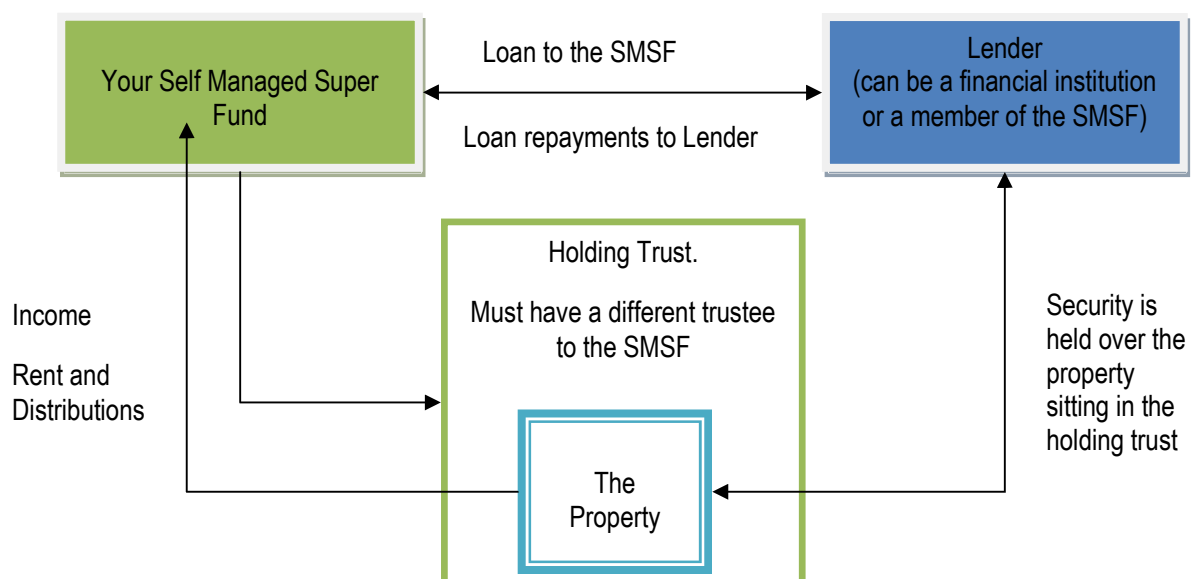
The benefits of owning the rental property such as the rent and capital growth flow to the Family Super Fund.

If the SMSF defaults on the loan there is an extra layer of asset protection because the rental property is held separately (in a Holding Trust) away from the other investments of your SMSF. The rights of the Lender to get their money back are limited to the rental property in the Holding Trust.

The diagram below illustrates the relationships between the SMSF, Holding Trust, Lender and the Rental Property.

How it works:

1. SMSF arranges to borrow money on a limited recourse basis which it would then transfer to a Holding Trust along with its contributions to the purchase.
2. The Holding Trust would then arrange to purchase and hold the property for the SMSF until the final instalment is made.
3. The Holding Trust is controlled by the SMSF, in actual fact it is an asset owned by the SMSF. This means that the SMSF would receive the rent and any other beneficial interest in the asset.
4. Once the SMSF repays the loan it can then arrange for the legal ownership of the asset to be transferred from the Holding Trust to the fund.



On 7 July 2010 Super Laws were amended for new borrowing arrangements. These changes meant that:

- super fund assets are better protected in the event of a default on a borrowing,
- the asset within the arrangement can only be replaced by a different asset in very limited circumstances specified in the law,
- super fund trustee cannot borrow to improve an asset,
- the borrowing is permitted only over a single asset or a collection of identical assets that have the same market value,
- the asset within the arrangement is not subjected to a charge other than to the lender in respect of the borrowing by the super fund trustee.

Advice to Make Smart Decisions

Your decisions as the Trustee of your Family Super Fund need to be made with full consideration of your personal retirement goals and your responsibilities as a Trustee. You can draw on the knowledge and expertise available to you as valued clients of Carnegie.

You are the driver and the centre of our Advice. Our goal is get you to focus on Protecting, Building and Managing your Wealth with a clear direction and purpose for the future.

We'll work in harmony with our in-house Accountant and Mortgage Broker in a professional business partnership to benefit you our client.

The result is integrated solutions that will help protect, build and manage your wealth.

Our Advice Process

Our Advice Process starts with a **Discovery Meeting**. Think of it like a first date. We gather information about your current financial situation and your life and wealth goals. We ask you five very important questions and we use a **Financial Road Map** which you can take home with you.

When we meet we will ask you:

- What is most important to you in life?
- What goals do you have that need time, money and a plan to achieve?
- Where are you now?
- Where do you want to be?
- What's in your way or stopping you?

After our Discovery Meeting we mutually agree to work together to achieve the goals you've identified and address the issues crucial to your financial wellbeing.

This agreement is documented in our **Terms of Engagement** which is a joint commitment to each other. We then begin the detailed process to prepare and present our Advice to you.

Presenting our Advice and gaining your consent to "Make it Happen" commits you to our Strategies and Recommendations. We then implement our Recommendations and agree on an **Ongoing Service Arrangement** with You.

You are the driver at the centre of Our Advice Process. Our role is get you to focus on Protecting, Building and Managing your Wealth now and with a clear direction and purpose for the future.

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