NEXUS

PRIVATE WEALTH MANAGEMENT

The Beginners Guide to Successful Property Investing using Superannuation Funds

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Welcome to...

The **Beginners Guide** to Successful **Property Investing** using **Superannuation Funds**

Due to the superannuation regulatory framework and compliance obligations, **buying property in super** is very different to **buying property in your own name**... This report answers important questions about purchasing property in super and exposes some of the myths and misconceptions surrounding this strategy.

About the author

Stephen Vick is the Managing Director and founder of Nexus Private Wealth Management. Stephen holds a Bachelor of Business majoring in Banking/Finance & Accounting, a Diploma of Financial Planning, and a Diploma of Finance & Mortgage Broking Management. He also holds Specialist SMSF accreditation, a Real Estate Agency License, is an Authorised Credit Representative, and is a member of the Real Estate Institute of Queensland (REIQ).

Stephen has spent over 20 years in the finance industry and has held senior positions with Australian Finance Group (AFG), Australian Unity, and Lawfund Australia. His last institutional role was with MLC as an adviser to financial planners.

Who is this report for?

This report is for anyone or any group (of up to 4 investors) with a combined superannuation balance of over $150,000 and who would like a better understanding of how their superannuation funds can be used to invest in property.

This Guide will be extremely relevant for anyone:

- Dissatisfied with the performance of their current super fund
- Considering alternate investment options for their super
- Wanting to take advantage of available tax concessions
- Wanting to take control of their superannuation entitlements

Why this report is a '**must read**' for anyone wanting to invest in property using their superannuation...

The ability to borrow money and buy property within super is a fairly recent development (September 2007) and requires connecting a number of different financial services. Lack of experience in this area of any of the professionals involved in these transactions can result in costly mistakes, hefty fines or even prosecution for the worst breaches of legislation.

...And because this strategy requires the coordination of a number of different professionals, often advice in this area can seem conflicted or confusing.

This report aims to provide an easy-to-follow guide to help you better understand how you can use your super to invest in property.

> In the **15 minutes** that it will take you to read through this report you will gain a better understanding of the property in super requirements, how much super you will need to get started, how it operates and the potential benefits.

If you believe, on completion of this guide, that you may be in a position to use your superannuation funds to invest in property, we highly recommend seeking professional advice before starting any part of the process.

Buying property inside super is not for everyone and a detailed needs analysis should be performed before implementing.

What is covered within this **beginners guide** to successful **property investing** using **Superannuation funds**:

Q1. Who can buy property in Super?

Q2. How much Super do I need to get started?

Q3. How does borrowing in a SMSF operate?

Q4. How is an SMSF Structured?

Q5. What are the tax incentives?

Q6. What type of property can I buy?

Q7. How does the strategy compare to a current super fund?

Q8. Who can set this up and look after it for me

Bonus Video Resources:

[Video #1] How to Buy Property In Super

[Video #2] Self Managed Super Funds Made Easy

[Video #3] What is Private Wealth Management?

The **Beginners Guide** to Successful **Property Investing** Using **Superannuation Funds...**

Q1. Who can buy property in super?

The first thing you will need to do to buy property with your super is to establish a Self-Managed Super Fund (SMSF).

You must meet the following criteria in order for you to be a member of your own Self-Managed Super Fund:

1. 18 years or older,
2. An Australian resident,
3. Not bankrupt, and
4. Have no a criminal record relating dishonesty offenses

You can combine Super balances

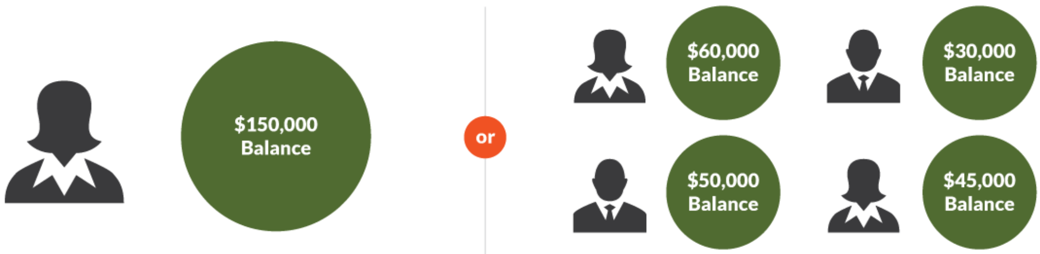
You can have up to 4 members of an SMSF and effectively pool your resources to buy larger assets. And whilst we usually see a husband and wife team, the four members can be siblings, adult children, friends or really anyone who's eligible.

Individual balances and performances are easy to track

Each member's relative balance is quarantined within the fund so you're always able to identify individual balances, even when there's borrowing involved.

Q2. How much Super do I need to get started?

With the recent changes to the Bank's lending policies, all members will now need a combined minimum super balance of between **around $150,000 to $200,000 to get started or approximately 40% of the intended property purchase price.**



Single Members with a balance > $150,000

2 - 4 Members with a combined balance > $150,000

This will depend on a few things such as the value of the property, your income, and the bank you choose.

There's only a handful of banks that lend to SMSFs and they all have their quirks (more information in the following section).

For specific lending requirements seek advice from an experienced SMSF mortgage broker to calculate your fund's borrowing capacity.

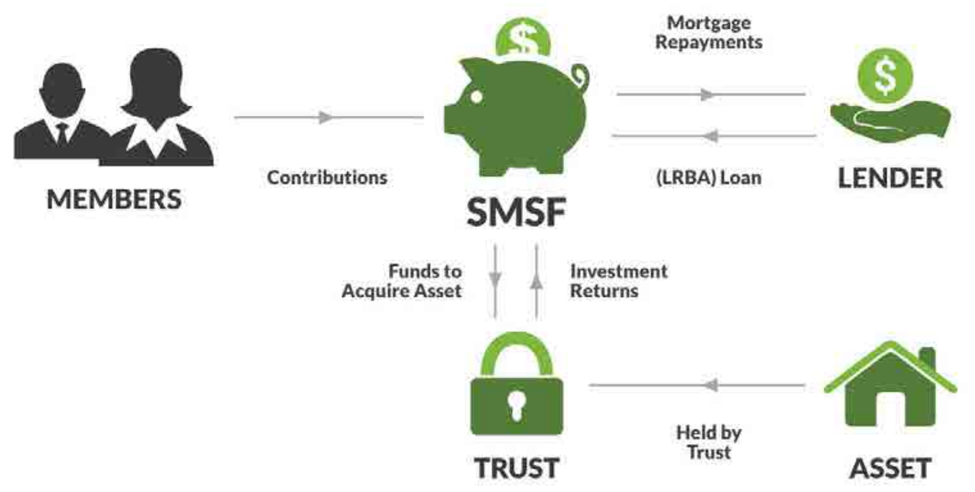
Q3. How does borrowing in an SMSF operate?

Borrowing in an SMSF to purchase an investment requires a strict set of rules to be followed.

Due to the risk associated with geared investments, your other investments held in the SMSF need to be protected. To achieve this, geared investments are purchased using a limited recourse borrowing arrangement (LRBA) and are held in a specific holding trust until the loan is repaid.

> A Limited Recourse Borrowing Arrangement (LRBA) limits the lender's (recourse) rights of recovery against your SMSF to the asset you purchased with borrowed money.

Even though your geared investment is contained in a specific holding trust, the SMSF will have **beneficial ownership** (meaning your SMSF will be credited with income and capital growth) of the asset while the trust has **legal ownership**. Legal ownership can be transferred to the SMSF once the asset is fully repaid.



The fact that this type of arrangement needs to be in place has two very important implications.

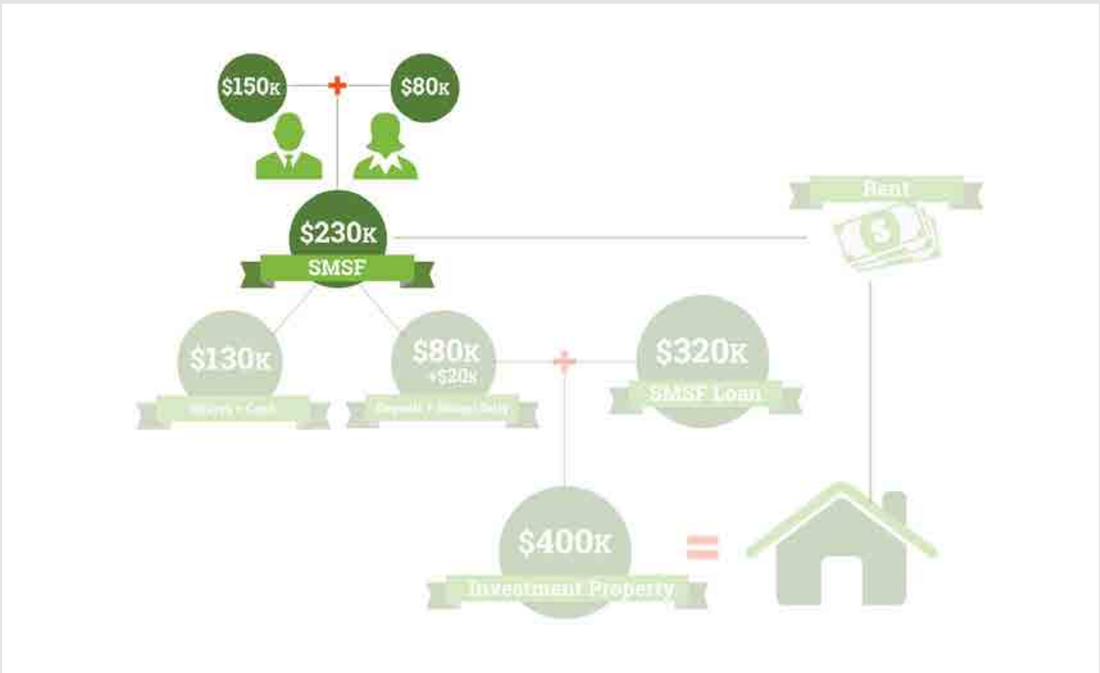
1. The amount of paperwork required to setup a loan significantly increases
2. In order to minimize their exposure to excessive risk banks and lenders are far more stringent in following due diligence procedures.

This makes the typical SMSF loan more difficult to setup compared to a standard mortgage and should be accounted for when considering a property in super.

Q4. How a property in SMSF is structured?

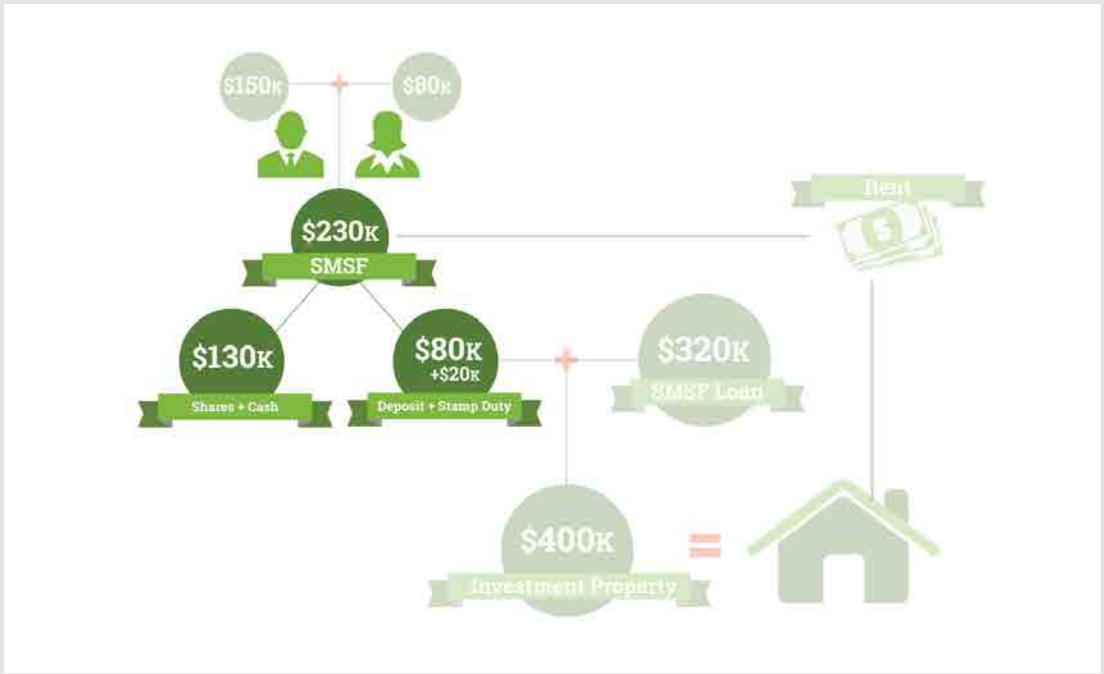
To help illustrate how a property purchased in SMSF is structured, we have used a married couple in their early 40's.

Mum and Dad combine their super balances of $150,000 and $80,000 and roll them out of their existing funds and into the SMSF giving the SMSF a balance of $230,000.



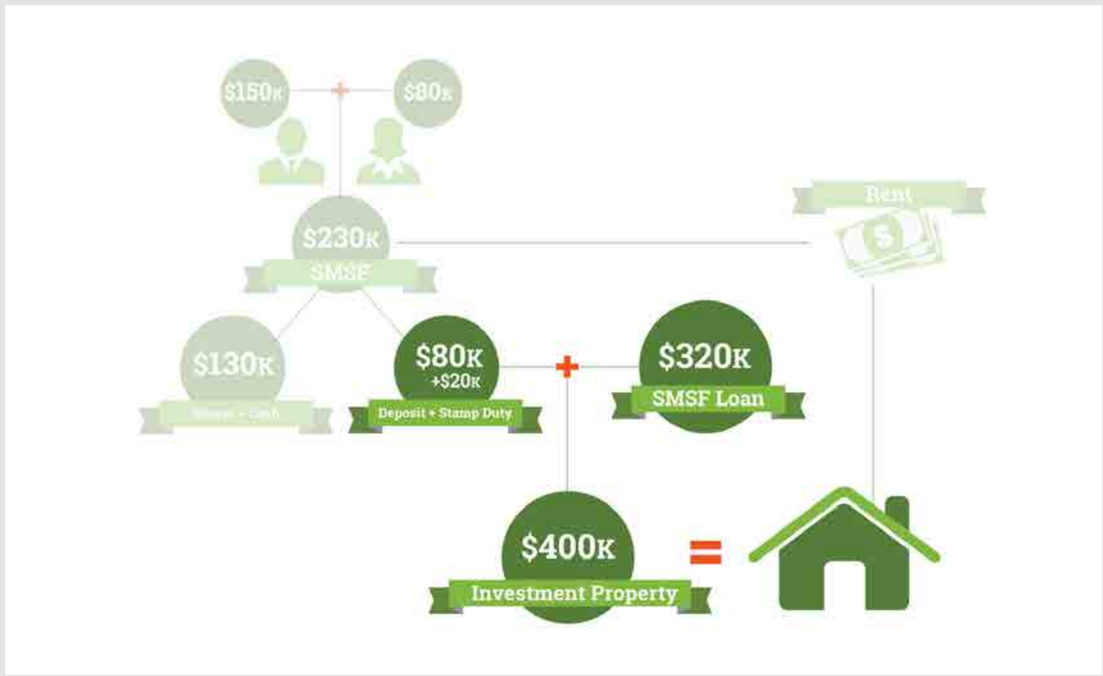
If you're a government employee or don't have the choice of where your super gets paid, you can usually transfer the majority of your funds into the SMSF, leaving just the minimum balance required in your existing fund.

Mum & Dad decide to invest $130,000 of the fund into a combination of shares and cash and use the remaining $100,000 as deposit and costs on a new investment property. $80,000 of which will go towards the deposit and $20,000 will go towards the stamp duty and costs.

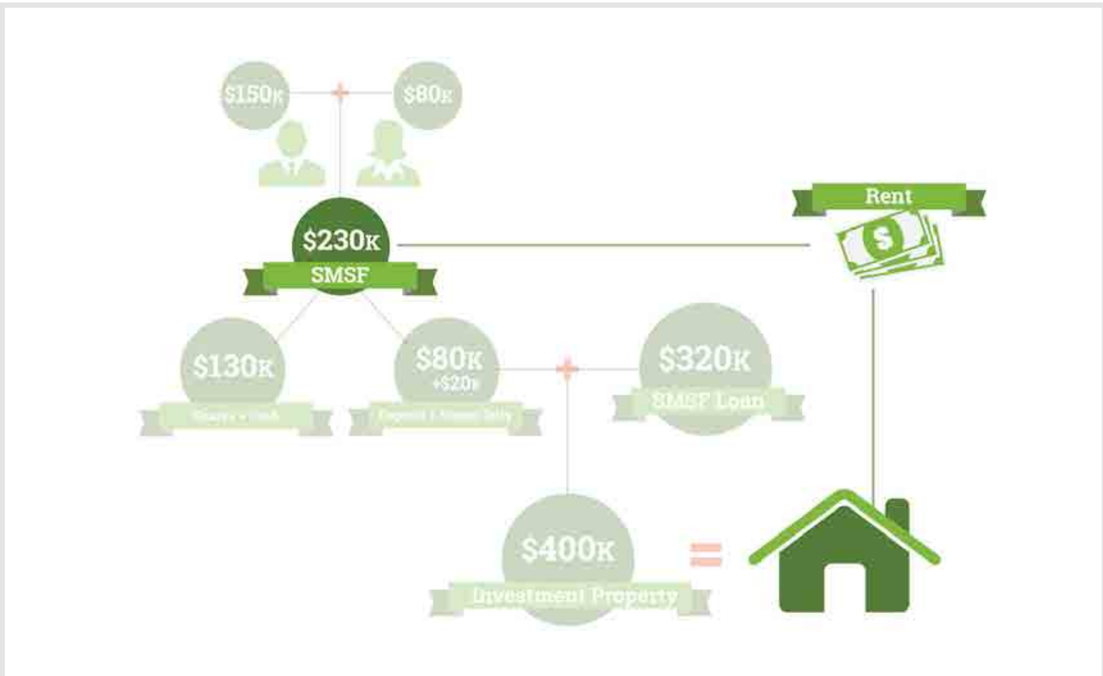


They'll then apply for a $320,000 limited recourse loan from a bank – meaning the bank takes security over the property only and not the balance of funds in the SMSF.

With the loan approved, Mum and Dad have $400,000 to spend on an investment property.



This investment of course earns an income in the form of rent, which is paid back into the SMSF cash account.



All Employer contributions and any dividends from shares also get paid into the SMSF cash account. While all ongoing costs associated with the property ie. mortgage repayments, maintenance costs, insurance etc are paid out of the cash account.

With any geared investment, structure is vital.

The costs incurred in holding the property (interest, maintenance, rates etc.) could possibly produce a 'negative' income that you can use to offset against the tax payable on other investment income earned in your SMSF.

If structured correctly with the right assets, the fund will continue to a have a positive cash-flow and will never require any additional personal contributions to sustain the structure.

For a better understanding of gearing and how you can **apply lenders resources to leverage your wealth accumulation** efforts, see gearing strategies...

Property investing in SMSF should be a long-term set and forget strategy with minimal stress or involvement.

Q5. What are the tax incentives?

There are significant tax concessions for any assets held inside super, and this includes property:

- Rental income is taxed at a maximum rate of 15% within your SMSF and not at your personal tax rate.
- This 15% can be reduced even further by claiming all property expenses and depreciation, against the income.
- Your Life and Income Protection insurance policies can be paid for by the fund and these premiums can also off-set the taxable income.
- In some circumstances the costs incurred in managing the property (interest, depreciation, rates etc.) can potentially reduce the income tax payable by the fund to zero.
- It is possible to negatively gear inside Super whilst still maintaining a positive cash-flow to the fund.
- The capital gains tax rate on the sale of assets in accumulation phase is a maximum of 10% if the asset is held for more than 12 months.
- There is no income tax to pay on rent or other investment income once you reach age 60 and enter pension phase.
- There is no capital gains tax to pay if the property is sold once you reach age 60 and enter pension phase.

So you can see that buying property in super can mean saving hundreds of thousands of dollars in tax over the long-term.

Key benefits in addition to favourable tax incentives:

- Buying property is an excellent way to reduce the impact of stock market volatility and overall risk on your retirement portfolio.
- Through gearing inside SMSF you can accelerate the process of wealth creation by enabling you to make larger investments than would otherwise be possible.

Q6. What type of Property can I buy?

There are a number of rules that relate to Self-Managed Super Funds generally, and it's worth watching our video entitled '[Self-Managed Super Funds Made Easy]' (included in the bonus video section) to understand your obligations as trustee of the fund.

However, when it comes to buying property within super, not all properties are compliant – for instance,

- You can't buy the property from a related entity, which includes yourself.
- You can't transfer a property you already own into your SMSF unless it's a commercial property.
- You can't rent the property to a related entity or anyone you know.
- The SMSF cannot accept loans that are not made on commercial terms.
- If you've used a loan to fund the purchase, you're not allowed to improve the value of the property or make renovations.
- The asset must be deemed a single acquirable asset.
- You cannot buy land and build on it.
- You cannot buy a block of apartments or small development opportunity.

3 Common Mistakes That Lead to Non-Compliance...

1. Buying property in the name of an individual rather than the fund.
2. Purchasing a property with more than one title.
3. Transferring legal ownership of properties before all proper arrangements are in place.

Accessing your Superannuation funds...

- ✗ You can't take money out of your super to buy property in your own name.
- ✓ Your super monies must stay within the superannuation environment until you meet a condition of release.

Penalties for not complying with these rules are severe and should be taken seriously.

> **Note:** the Vendor or Developer you're purchasing from must accept SMSF transactions. SMSF property purchases aren't as simple as normal property transfers and usually require longer settlement times.

Lack of experience in this area often causes lengthy delays and can prove costly for the uninitiated.

Q7. How does this strategy compare to my current super fund?

When you join any industry or retail super fund you're presented with a range of investment options, these options will not include access to direct property, and can generally be categorized into one of 5 fund profiles...

1. Conservative
2. Moderately conservative
3. Balanced
4. Growth
5. High growth

People who have not taken an active interest in their super previously will likely fall into the balanced category, and should expect returns of about 4.4% pa paid as dividends and about 2.8% pa capital growth.

Fund performance comparison

For this case study we compare an Industry fund with a balanced profile, against a SMSF invested in a combination of property, cash and shares...

Case Study Assumptions

There are a number of ways to compare super funds and it can be a daunting process especially if you're not sure what to look for. We have used average performance data to illustrate how much better off you could be with an SMSF looking forward 20 years.

For all three funds we have used the following assumptions

- Super balance at start $230,000
- Income of SMSF Member $100,000 pa
- Employer Contributions 9.5% pa
- Salary Sacrifice $0 pa

For the Retail Super Fund

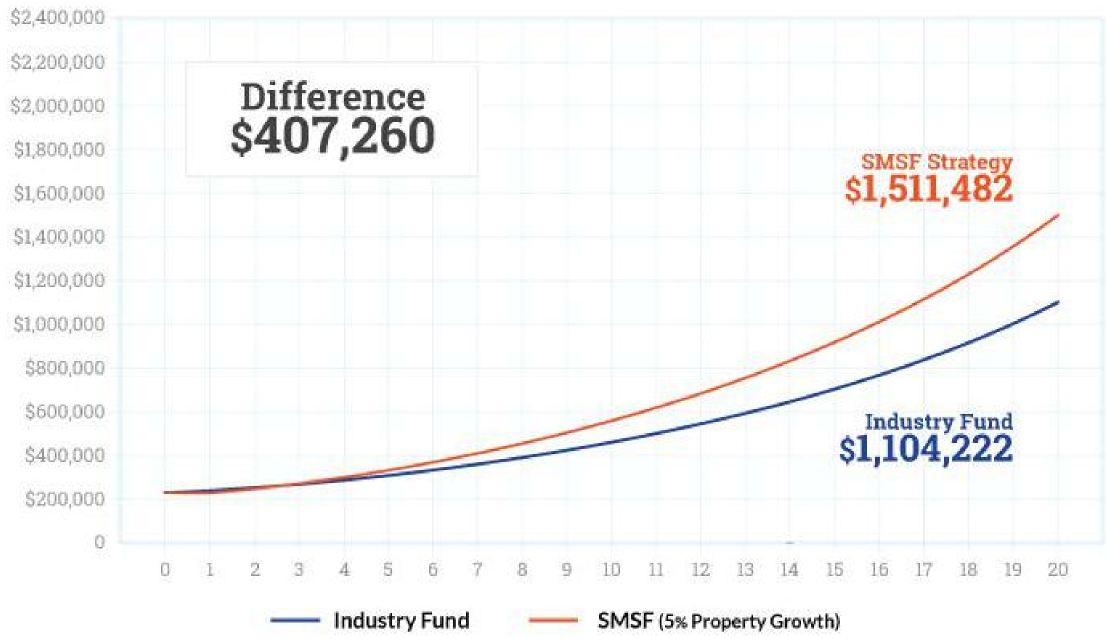
- Industry fund running costs 0.6% pa
- Total returns on shares within Industry fund 7.2% pa

For the SMSF

- Total SMSF administration running costs $3,000 pa
- Total returns on shares within SMSF 7.2% pa
- Purchase price of property in SMSF $400,000
- Loan amount on SMSF property $320,000 @ 5.8% interest
- Net rental return on property 3.2% pa
- Total capital growth on property 5% pa
- Stamp duty and purchase costs of property $20,000

As you can see from the following graph...

Net Asset Value - Retail or Industry Fund vs SMSF



Key Observations...

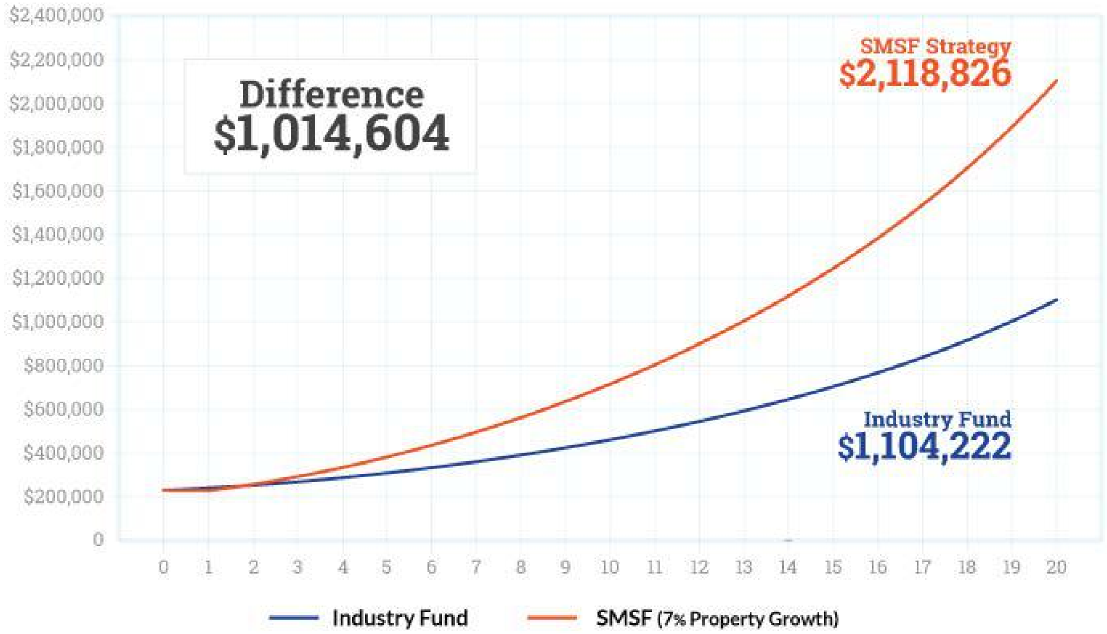
1. After twenty years, assuming an average property growth rate of 5% pa, the SMSFs net value (after repayment of the loan) has grown to **$1,511,482**
2. Compare this to **$1,104,222** for the Industry fund.
3. That's **$407,260** difference in favour of the SMSF strategy.

In this case study the property would have to grow at under 3.15% pa on average for the SMSF value to finish below that of the Industry fund.

In an environment whereby property only grew at 3.15% pa, you might be forgiven for assuming that the returns on shares would also be lower.

Consider the case study utilising 7% property growth...

Net Asset Value - Retail or Industry Fund vs SMSF



Key Observations...

1. On the upside, if the property grew at a rate of 7% pa and not 5% the funds value would grow to a whopping **$2,118,826**
2. This would represent a difference of **$1,014,604** in profit in favor of the SMSF strategy.

Note: this profit would be free from capital gains tax in retirement.

Property in Super is not for everyone, but having the ability to leverage your existing super monies, combined with the favorable tax treatment, makes it undeniably one of the most powerful and tax effective wealth creation strategies available.

Q8. Who can set this up for me?

Who does what in an SMSF strategy: To set up and run this strategy effectively, usually requires an Accountant, Financial Planner, Mortgage Broker, Real Estate Agent, and Solicitor. For optimal results, they should all be working together in a strategic and collaborative way.

Financial Planner

It's generally the financial planner who will model the strategy, explain the rules, and establish the Platforms and Cash Accounts for the new SMSF.

They can also set up the trust deeds, effect the rollovers, help meet your insurance obligations, and close old funds. But here's the thing…

> **You may not be aware, but about 80% of all financial planners in Australia are owned or licensed by the Banks or large Institutions.**

These Institutions make their money by managing share portfolios, and are not licensed to sell real estate. Therefore, they may try to talk you out of running your own fund – as of course will the financial planners from your existing super fund. A SMSF to them simply means losing control of your money.

So look behind the name, you may find that your adviser is owned, partially owned, or licensed by a bank.

Accountant

An Accountant can also set up the trust deeds and explain your obligations, but they're usually not qualified to set up your insurance and investments, do the rollovers, or settle any transactions. You're simply left to your own devices here.

The ongoing administration, audits, and tax returns can be organised by an Accountant or a specialist SMSF administration team. However, ongoing **advice in relation to your investments and insurance obligations remains the domain of a qualified financial planner.**

Mortgage Broker

A Mortgage Broker is the best person to choose the right SMSF loan and liaise between the vendor, the bank, the financial planner, and three or four sets of solicitors to effect settlement. But the Mortgage Broker must be authorised and have experience in SMSF lending.

> Depending on the bank you choose, a qualified financial planner or independent solicitor, that's not your conveyance solicitor, will often be required to sign off on the loan documentation, to acknowledge that you're aware of your obligations as Trustee.

Property Adviser

Of course we all think of Real Estate Agents when it comes to buying property, but most agents are restricted to only a handful of suburbs and usually don't have access to new projects. Buyer's Agents are a better solution here but you'll still require a financial adviser or accountant to calculate the net yield and impact on the SMSF cash-flow to know if the property fits within your SMSF strategy.

> Beware the Property Spruiker who is simply using SMSF and the services of an 'add-on' financial adviser to sell their own properties.

Estate Planner

Most people aren't aware that their superannuation is not covered by their Will. And given that a lot of our Life insurance policies are held in super, the absence of a superannuation Will or death benefit nomination can mean all sorts of problems for your loved ones on your departure.

SMSFs are a fantastic vehicle for Estate Planning purposes and can be used for asset protection, reducing tax to beneficiaries, or even dealing with issues facing troubled or blended families. An Estate Planning solicitor is best placed to give this advice but it should be done in the context of your overall wealth management and protection plans.

Coordinating all your SMSF requirements...

So, to set up and run this strategy effectively, usually requires an Accountant, Financial Planner, Mortgage Broker, Real Estate Agent, and Solicitor. For optimal results, they should all be working together in a strategic and collaborative way.

In my opinion, the only group of professionals that do this well are, privately owned, and licensed **Private Wealth Managers.**

What is Private Wealth Management?

If you don't know what a Private Wealth Manager is, then watch our video entitled '[What is private wealth management]' (included in the bonus video section). But essentially Private Wealth Managers bring together all of the financial services required to build and protect personal wealth.

Bringing together all your required financial service providers

It's almost impossible to implement this strategy yourself without making mistakes that end up costing you more than it would if you'd just paid the professionals to do it for you. Enlisting the help of experienced and qualified specialists is the best way to ensure the transactions are implemented in a cost effective and compliant way.

Having said all that, if appropriate for your circumstances, this is a strategy that can make an enormous difference to the end balance of your super fund in retirement. Of course, you won't be able to access your super until you turn 60 so it's important to build wealth outside of the superannuation environment as well - especially if you plan on retiring early.

Are you getting the right investment advice from your current superannuation fund?

- When was the last time you heard from your super fund other than receiving an email suggesting you consolidate your funds?
- Do you receive suggestions on ways you can improve your superannuation investment performance?
- Are they interested in your personal finances as a whole and the impact your superannuation efforts will have on achieving your retirement goals?

The most effective treatment of your superannuation requires the consideration of your entire financial circumstances.

Specialist advice for all investment asset classes, lending structures, trusts, and complex super strategies can be difficult to come by, and often investors are **unaware of the services and advice they should be receiving, but are not!**

Find out if your superannuation could be performing better than it is!

Retirement planning is often viewed in a contradictory way - a last minute dash to maximise your superannuation balance. **Take this opportunity to prepare early!**

Take the next step, call us on 1300 473 347

What's the next step...

If you're curious to explore further, then the next step is to set up a time to conduct a complimentary Superannuation review, normally via phone in the first instance.

During that initial chat, we'll evaluate your current superannuation situation and work with you to determine if a property in SMSF strategy is right for you.

If you enjoy the conversation and get value from it, we can discuss working together.

On the other hand, if what we come up with doesn't align with what you need, or for any reason we feel we're not the best team to assist in your situation, then there's no harm done – at least we explored the possibilities.

To take the next step, call us on 1300 473 347.

Or, complete the callback form: www.nexusprivate.com.au/contact/

Whatever you choose to do from here, I hope the information included within this report has broadened your understanding of your requirements to invest in property using your super.

Stephen Vick

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Nexus Private Wealth Management
www.nexusprivate.com.au

Bonus Video Resources

Superannuation and SMSF

Included Video #1

Click to watch the [How to Buy Property in Super.]

Included Video #2

Click to watch [Self Managed Super Funds Made Easy]

Included Video #3

Click to watch [What is Private Wealth Management?]