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PRIVATE WEALTH MANAGEMENT

Investing in property **using Superannuation**

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Nexus Private Wealth Management is your personal financial concierge service that provides access to the right professionals, for the right job, at the right time. We can assist with everything from finding, financing, forecasting, negotiating, and case managing property purchases. We can also provide accounting, financial planning, mortgage broking and legal services if needed, taking a coordinated approach to the implementation and ongoing management of your property portfolio. Our end-to-end service and expertise makes it easy to build wealth through property.

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Welcome to...
Investing in Property using Superannuation

The complexity of our superannuation system and compliance obligations of trustees means **buying property in super** is very different to **buying property in your own name**. This guide 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 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 25 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.

Contents

Who is this guide for?

This guide is for anyone who would like a better understanding of how their superannuation funds can be used to invest in property.

This guide will be relevant for those who are:

01 Dissatisfied with the performance of their current super fund

02 Considering alternate investment options for their super

03 Wanting to take advantage of available tax concessions

04 Wanting to utilise the benefits of gearing to create wealth

05 Wanting to take control of their superannuation entitlements

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

The ability to borrow money and acquire property within the superannuation environment has seen the rapid rise of self-managed super to now be the largest sector of the superannuation industry (measured by funds invested), eclipsing both retail funds and industry funds.

However, the strategy usually requires assistance from various financial professionals and the lack of experience in this area can result in costly mistakes, hefty fines or even prosecution for the worst breaches of legislation.

Because this strategy requires the coordination of various professionals, often advice in this area can seem conflicted or confusing.

This guide will give you a better understanding of the strategy 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 there is much to consider before implementing the strategy.

Questions answered within this guide:

01 Who can buy property in Super?

02 How much Super is needed to get started?

03 How does borrowing in a SMSF operate?

04 How is property in a SMSF structured?

05 What are the tax incentives?

06 What type of property can be purchased in a SMSF?

07 How does the strategy compare to non-geared funds?

08 Who can set this up and manage it for you?

Investing in property using Superannuation

Q1. Who can buy property in super?

The first thing you will need to do to acquire property using borrowed funds 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 criminal record relating to dishonesty offenses

Combine Super balances

You can have up to 4 members of a SMSF and effectively pool your resources to buy larger assets. 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

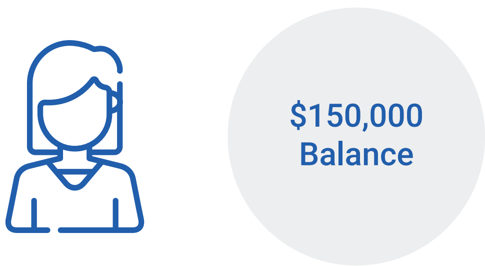
Each member's relative balance is quarantined within the fund so you're always able to identify individual balances, even when there's borrowing involved.

Q2. How much super is needed to get started?

With recent changes to Bank 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.

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

There are only a handful of lenders that lend to SMSFs and they all have their quirks so it's best to seek advice from an experienced SMSF mortgage broker to calculate your fund's borrowing capacity.



Single Members with a balance of $150,000

OR

2-4 Members with a balance of $150,000

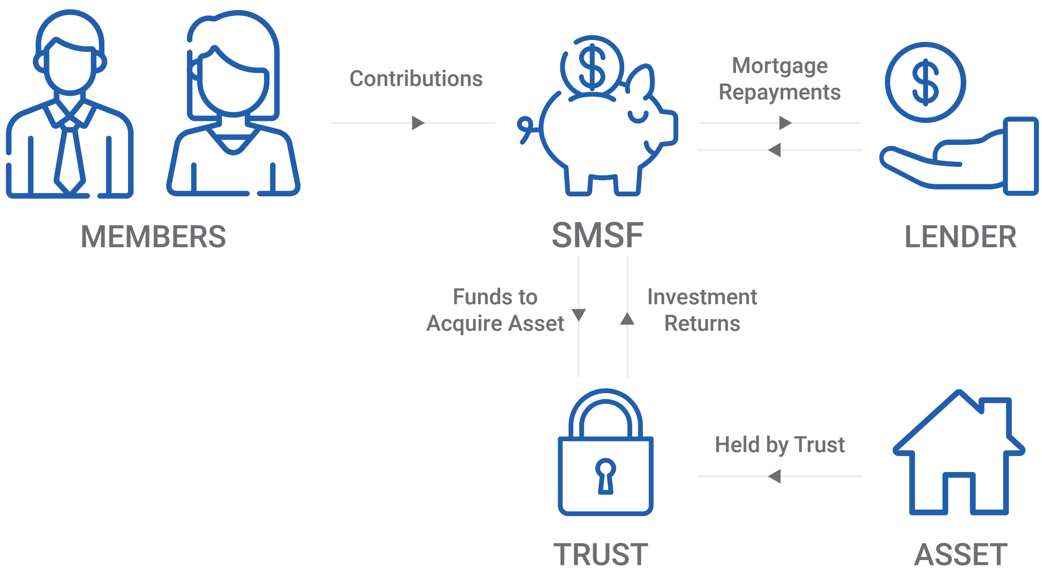
Q3. How does borrowing in an SMSF operate?

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

Due to the extra risks associated with geared investments, 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 or the property is sold.

A Limited Recourse Borrowing Arrangement (LRBA) limits the lender's recourse (rights of recovery) against your SMSF to the asset securing the 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. Once the loan is fully repaid or the property is sold, the ownership or the proceeds can be transfered to the SMSF.



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

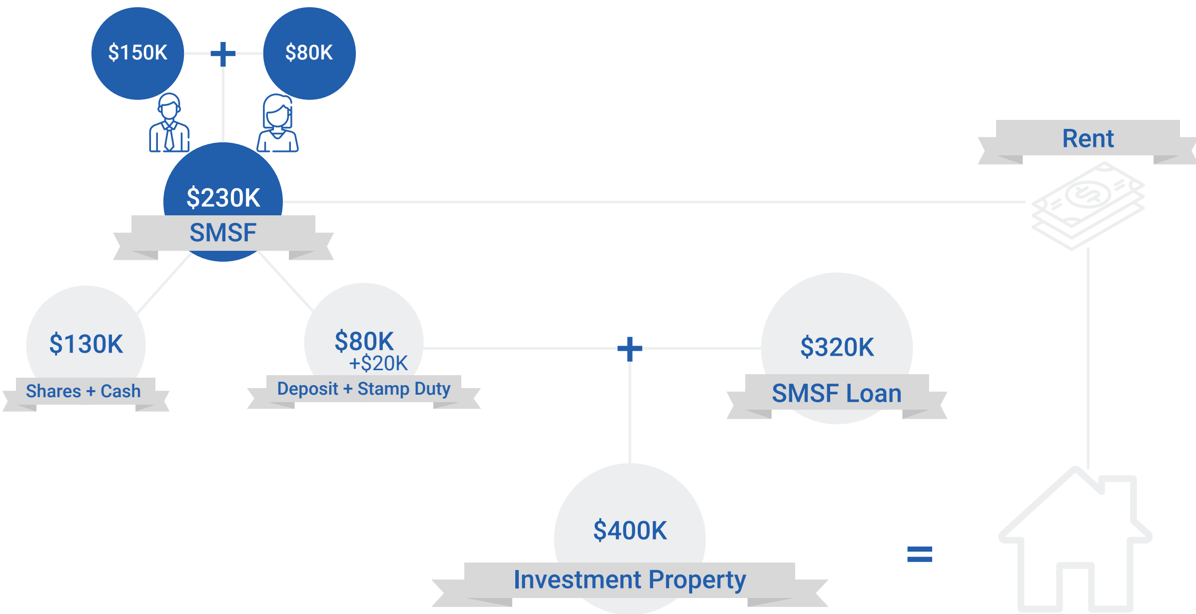
1. The amount of paperwork required to setup a loan significantly increases.
2. Lenders will often impose tighter lending requirements and charge higher fees or interest costs.

This makes the typical SMSF loan more difficult to establish compared to a standard mortgage and this should be accounted for when considering the time frames required when purchasing property.

Q4. How is property in SMSF structured?

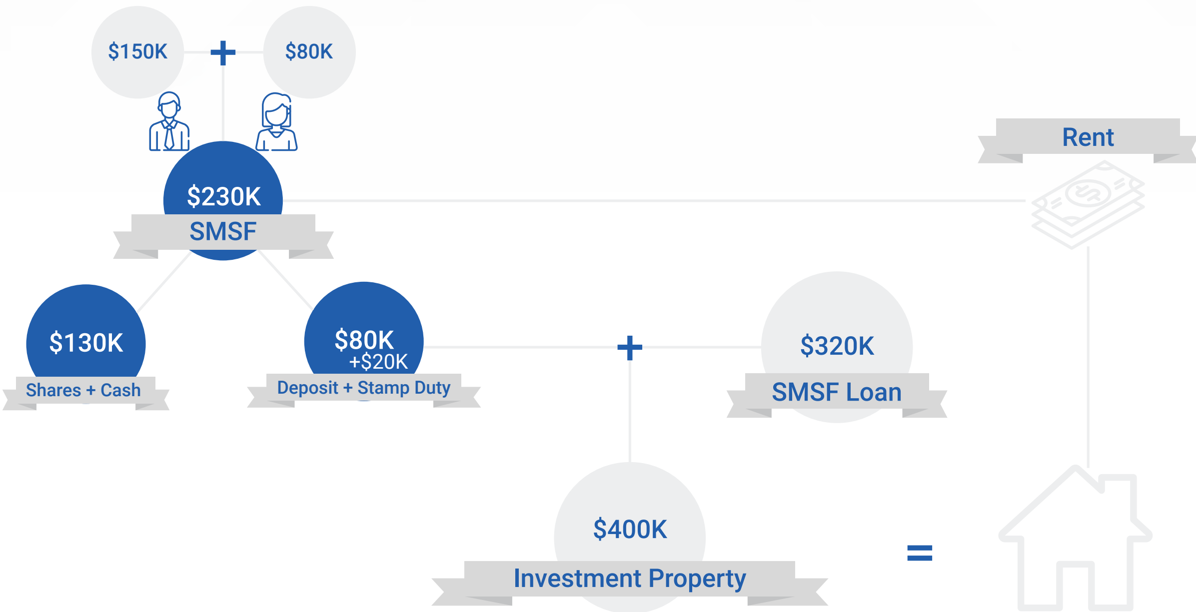
To help illustrate how a property purchased in a SMSF is structured, we have used an example of a married couple in their early 40's.

John and Mary 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.

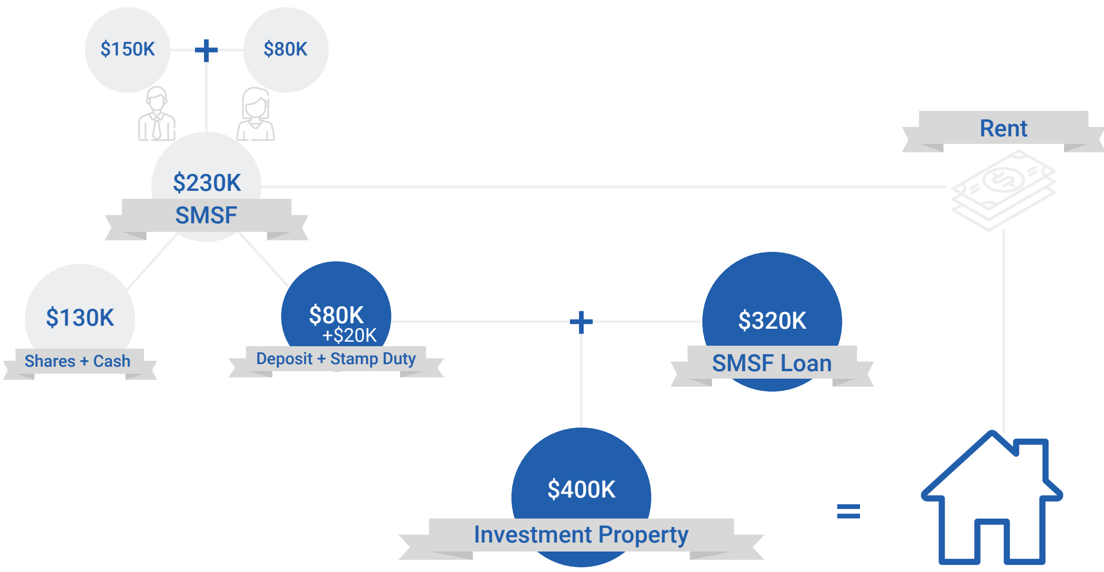


If you don't have the choice of where your super gets paid, you can usually transfer the majority of your funds into the SMSF, leaving just the minimum balance required in your existing fund. Transfers from your employer sponsored super fund to your SMSF (rollovers), are usually allowed at least once annually.

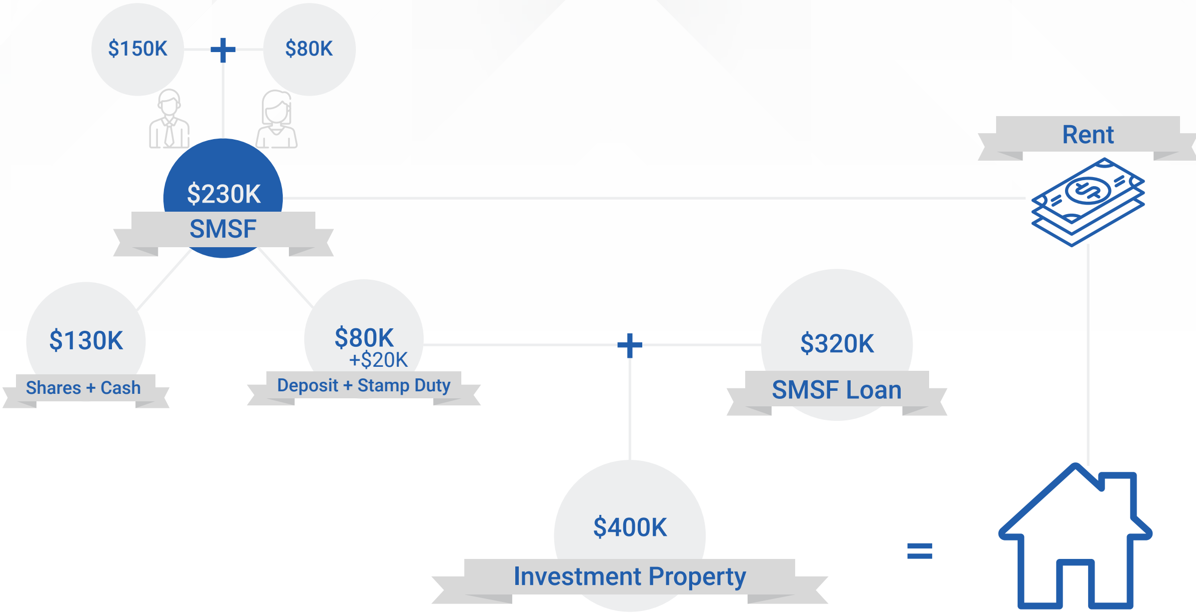
John and Mary decide to invest $130,000 of the fund into a combination of shares and cash and use the remaining $100,000 for deposit and costs on a new investment property. $80,000 of which will go towards the deposit and $20,000 will go towards the stamp duty and costs.



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, John and Mary 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, insurance etc.) could be more than the rent received from the tenant. This loss can be used to offset the tax payable on other investment income earned in the SMSF such as dividends earned on the shares/managed funds. This process is similar to how negative gearing is taxed.

If structured correctly with the right assets, the fund can continue to a have a positive cashflow without requiring any additional personal contributions to sustain the structure.

For a better understanding of gearing and how you can use borrowed funds to leverage your wealth accumulation, download the Advanced Debt Management Strategies guide.

Property investing in SMSF can 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, including direct property investments:

- 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 ongoing property expenses and building depreciation.
- Your Life, Total & Permanent Disability, and Income Protection insurance policies can be paid for by the SMSF and these premiums can also offset the funds taxable income.
- In some circumstances the tax off-sets can reduce the income tax payable by the fund to zero.
- It is possible to negatively gear inside super whilst still maintaining a positive cashflow 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 **zero capital gains tax** to pay, for the entire time the asset is held, if the property is sold once you reach age 60 and enter pension phase.
- There is **zero income tax** to pay on rent or other investment income once you reach age 60 and enter pension phase.

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 diversify away from shares and stock market volatility.
- Using gearing strategies within a SMSF 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 be purchased?

There are a number of rules that relate to Self-Managed Super Funds generally.

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

- You cannot purchase property from a related entity, which includes yourself.
- You cannot transfer a property you already own into your SMSF unless it's a commercial property.
- You cannot 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 generally unable to alter the nature of the property or do renovations.
- The asset must be deemed a single acquirable asset.
- You cannot buy land and build on it.
- You cannot subdivide a property.

4 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. Signing property contracts before all proper arrangements are in place.
4. Not having a documented investment strategy.

Accessing your Superannuation funds...

- ✗ You cannot 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 non-geared funds?

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...

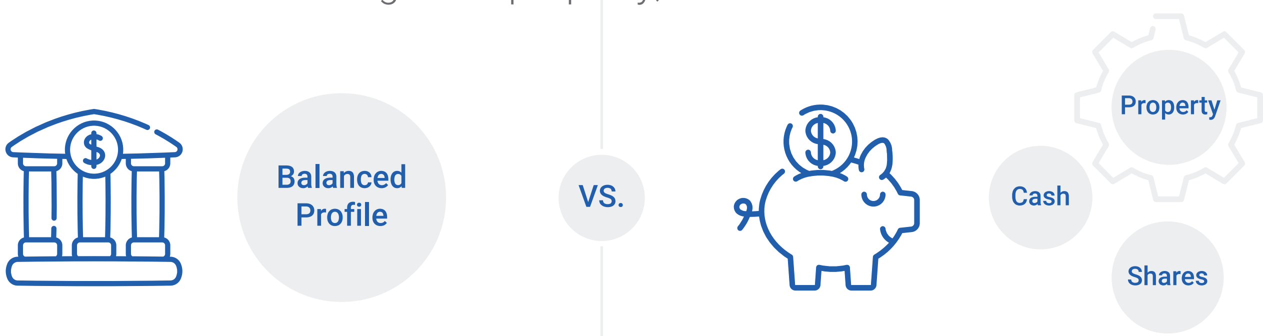
1. Conservative
2. Moderately conservative
3. Balanced
4. Growth
5. High growth

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 (after costs).

**Historical returns are no guarantee of future returns.*

Fund performance comparison

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



NON-GEARED RETAIL SUPER FUND | GEARED SELF-MANAGED SUPER FUND

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.

We have used the following assumptions for all three scenarios

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

For the Retail Super Fund

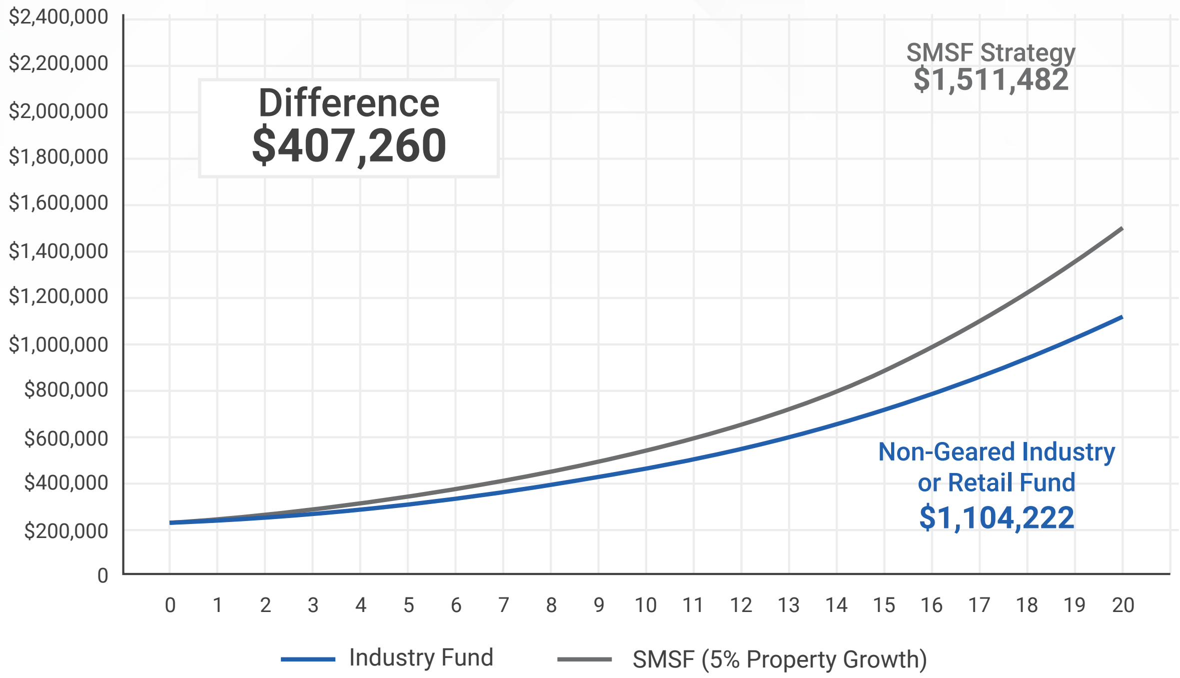
- Fund administration costs 0.6% pa
- Total returns on shares within Industry fund 7.2% pa

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

The following graph shows the net asset values of both funds over 20 years…

Non-Geared Retail or Industry Fund vs Geared SMSF



Key Observations...

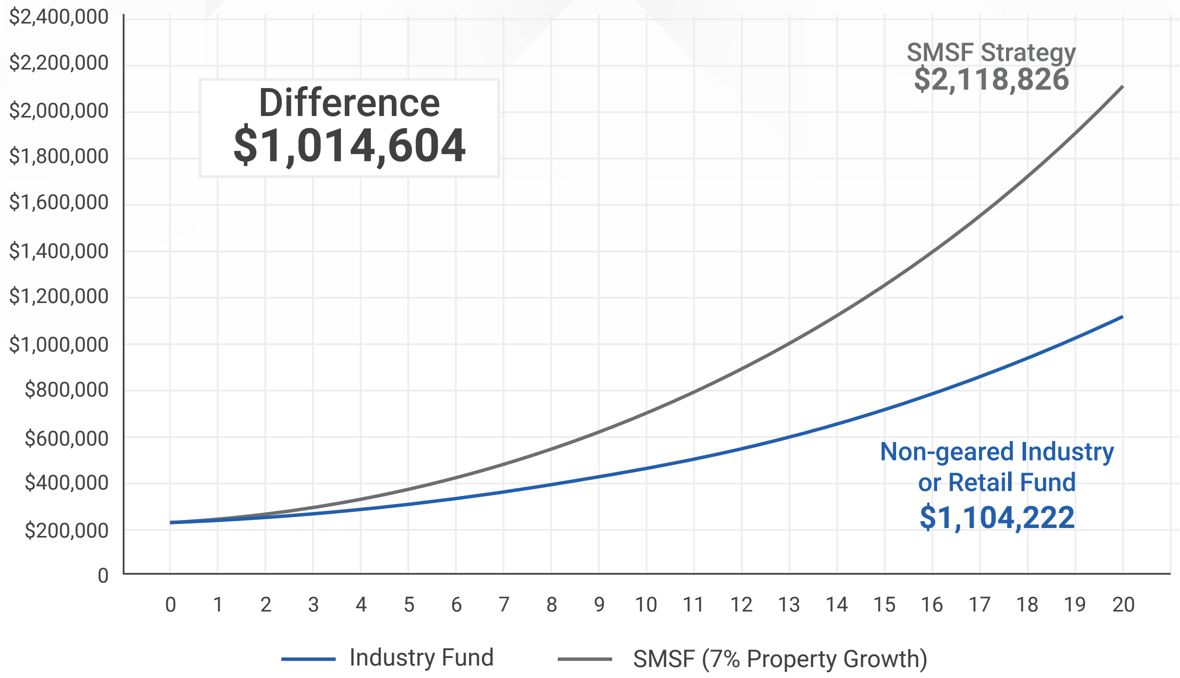
1. After twenty years, assuming an average property growth rate of 5% pa, the SMSFs net value (after repayment of the loan) has grown to **$1,511,482**.
2. Compare this to **$1,104,222** for the non-geared fund.
3. That's **$407,260** difference in favour of the SMSF gearing strategy.

In this case study the property would have to experience a total return (both yield and growth) of under 3.15% pa for the SMSFs net position to finish below that of the non-geared fund.

In an environment whereby property only returned 3.15% pa, it's likely that the returns on shares would be lower also.

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

Non-Geared Retail or Industry Fund vs Geared SMSF



Key Observations...

1. If the property grew at a rate of 7% pa and not 5% the funds value would grow to $2,118,826.
2. This would represent a difference of $1,014,604 net profit in favour of the SMSF strategy.

Note: This profit would also 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 currently available to Australians.

Q8. Who can set this up and manage it for you?

Who does what in an SMSF strategy: To set up and run this strategy effectively, usually requires an Accountant, Financial Planner, Mortgage Broker, Property 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 Investments for the SMSF.

They can also organise the rollovers, help meet your insurance obligations, transfer existing SG contribution arrangements, and close old funds. But be aware...

Approximately 60% 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 planner 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 may be able to establish 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 usually left to your own devices here.

The ongoing administration, audits, and annual tax returns can also 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. However, the mortgage broker must be authorised and have experience in SMSF lending. Mistakes made by mortgage brokers in this area can prove to be very expensive to you.

Your lender may insist that, a qualified financial planner or independent solicitor, be required to sign off on the loan documentation to acknowledge that you're aware of your obligations as Trustee of the fund.

Property Agent

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 have limited access to new projects. Buyer's agents or advocates are a better option here but you'll still require a financial planner or accountant to calculate the true holding costs of the property and impact on the SMSF cashflow, to know if the property fits within your SMSF strategy.

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

Solicitor - Establishing Trust Deeds

A Solicitor will generally be able to establish the trust deeds required for borrowing to purchase property in a SMSF. Some Solicitors will also offer to establish the cash accounts and effect the rollovers. However, it's important they don't inadvertently cancel your existing insurance policies before you've established new policies for the SMSF - especially if you've suffered medical ailments since your insurances were originally offered.

Solicitor - Estate Planning

Most people aren't aware that their superannuation is not covered by their Will. Given that a lot of 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.

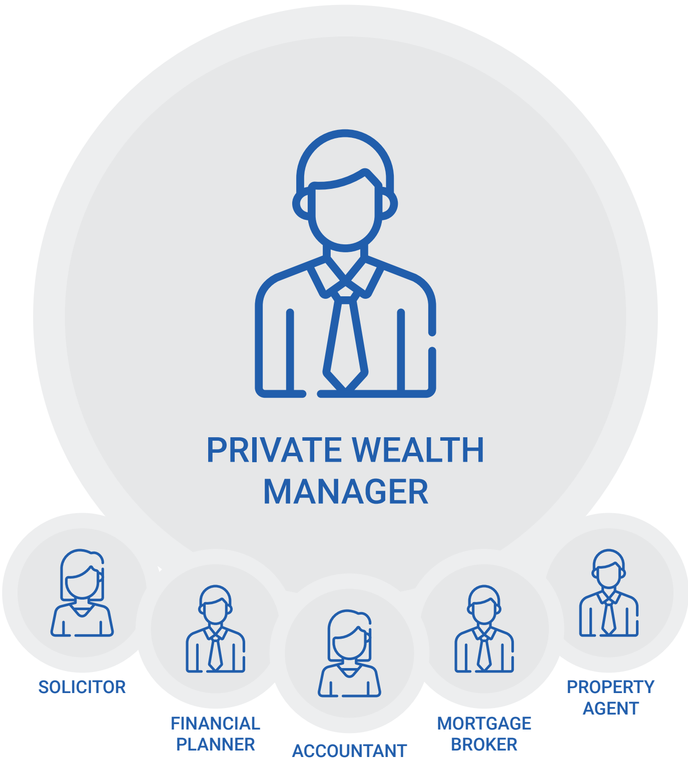
Solicitor - Conveyancing

When buying any property, you will require the services of a conveyance solicitor to perform the usual property searches and act on your behalf in effecting a smooth and timely settlement. A specialist conveyancing solicitor is recommended as they usually have the scale to deliver value, without having to make up fees on often unnecessary advice items.

Coordinating all your SMSF requirements...

In summary, to set up and run this strategy effectively, usually requires the services of an Accountant, Financial Planner, Mortgage Broker, Property Agent, and Solicitor. For optimal results, they should all be working together in a strategic and collaborative way.

Nexus Private Wealth Management can recommend industry professionals that are qualified and experienced in these matters. We will also work with the appropriate professionals to case manage the entire process ensuring a timely and smooth transaction.



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 effect your superannuation will have on achieving your retirement goals?

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

Specialist advice for all investment asset classes, lending, trusts, superannuation, and estate planning can be difficult to find and often investors are unaware of the services and advice they should be receiving.

Nexus Private Wealth Management is your financial services hub!

Acting as your personal financial concierge, your account manager can coordinate all the services you require to ensure a smooth, timely, and hassle-free property in super strategy implementation saving you significant professional costs.

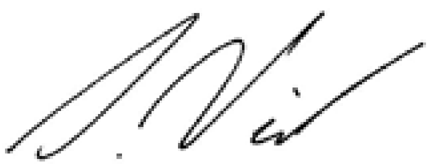
Take the next step, call us on 1300 473 347 or book online by clicking on the button below.

Book a Consultation Online

Whatever you choose to do from here, I hope the information included within this guide has broadened your understanding of property investing within the superannuation environment.

Thanks for reading.

Stephen Vick



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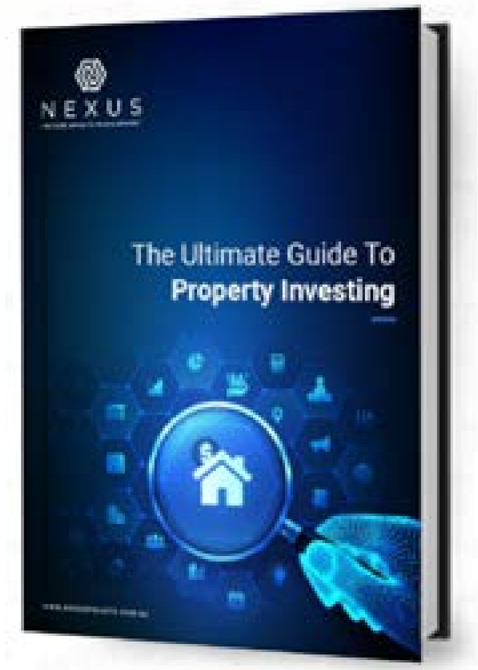
Bonus Resource
The Ultimate Guide To Property Investing



Over 60 pages of no-nonsense property investment education!

This guide will take you through the various investment strategies and how they relate to investors with different personal and financial circumstances. It will guide you through the tax consequences of negative gearing various property types, and show how to calculate the true holding costs of your investments. It contains an exhaustive list of the common risks and mistakes people make when investing in property, and debunks some long-held myths that have plagued the industry. It also raises many other considerations that may have an effect on the ultimate success of your investment portfolio, such as, tax planning, funding, risk management and much more.

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