PROPERTYBUYER

EBOOK

SMSF PROPERTY INVESTMENT STRATEGIES - YOUR ESSENTIAL GUIDE

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The number of self-managed super funds (SMSFs) has grown significantly over recent years as more and more Australians take control of their financial futures.

Back in 2011, there were about 435,000 SMSFs. That number is now closer to 600,000, according to the latest official statistics, and they manage nearly $700 billion in assets collectively. The average balance now also exceeds $1.1 million.

So why are so many Aussies setting up a SMSF?

There's no doubt that the ability to control their own funds is one of the main motivations, but it's vital to also recognise that SMSF operate within a strict regulatory framework so it's hardly money for nothing. That said, as long as you access professional advice, setting up an SMSF can result in a number of financial wins if you manage it properly.

The key benefits include:

• You take control of your own investment strategy.

• You can minimise the amount of tax you pay.

• You are not at the mercy of fees charged by large institutional investment companies.

• You can invest in a wide range of assets (including shares, property, bonds, etc.)

• Your SMSF can borrow to invest in certain property assets, which can accelerate your wealth.

• You can buy a commercial property within an SMSF and lease it back to your business.

• Buying property reduces the amount of volatility you may experience if you had all your funds in the share market.

• You can salary sacrifice into SMSF and help fast-track your debt repayments on investment loans

TWILIGHT YEARS TROUBLE

For generations, we've been taught that we if work hard, we can look forward to a comfortable retirement sipping cocktails on cruises or travelling around our Great Brown Land as a grey nomad.

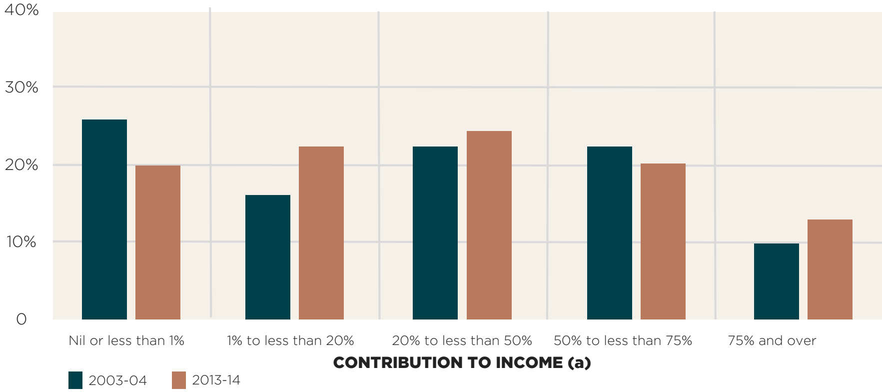
The reality is unfortunately nothing like this fairytale.

According to the Australian Bureau of Statistics, there has been some improvement in the past decade in the amount of superannuation held by people approaching retirement age (i.e. 55–64 years), and those just beyond retirement age (65–74 years).

However, according to the latest research, most of these people still had less than $100,000 in their superannuation accounts (60 per cent and 71 per cent respectively).

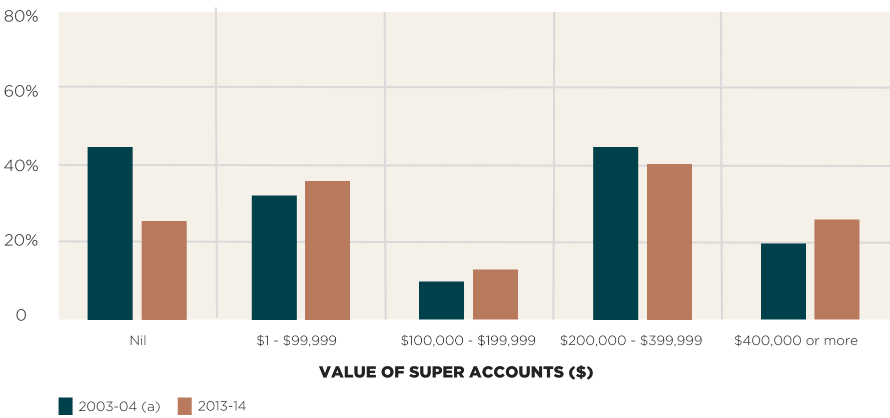
While superannuation balances are growing, the reliance on government pensions in retirement has changed.

In fact, in the 10-year period to 2013/14, there was no significant change in the proportion of superannuants aged over 65 who received 50 per cent or more of their personal income from government pensions or allowances.



The average superannuation balances for Australians aged 55 and over is shown below, and while it has improved over a 10-year period, it is still a long way off providing anything like a comfortable retirement.

The thing is if you want to maintain your lifestyle in retirement and receive about $80,000 in passive income every year, you need about $1.6 million invested in an asset that returns a five per cent yield conservatively



HOW TO USE SMSFS TO GROW WEALTH

A SMSF can invest in all types of real property including residential property, commercial property, industrial property or rural property, but there are a number of limitations that investors must understand.

The first one is that you cannot buy your own principal place of residence in a SMSF, and you can't purchase an investment property and lease to family or friends – it has to be an arm's length transaction.

However, you can purchase a commercial premise in your SMSF and then lease it back to your own business.

In fact, many small businesses are adopting this strategy to get a foothold in the commercial property market.

With any investment decisions it's vital that you access professional advice, and especially when it comes to investing in your SMSF given its heavily regulated environment

WHAT ARE THE DISADVANTAGES OF SMSF?

So far so good, right?

Investing in property within your SMSF does offer a number of advantages – such as potentially supercharging your return on investment – but there are a number of potential downsides that it pays to understand.

- Income earned by the SMSF property must stay in the fund (i.e. you can't access funds until retirement).

- You can't redraw the increased equity created. Unlike property outside super where you can use the equity as a deposit to purchase more property, SMSF loans do not permit this. However, as you are contributing more to your super via compulsory amounts and possibly via increased contributions, your SMSF should grow at a rate that may permit the purchase of additional properties in the future.

- If there is a shortfall in the fund (such as insufficient funds required for a special levy in an apartment building), those monies put into the fund are non- retrievable.

COMPARING PROPERTY IN SMSF AND OUTSIDE SUPER

Whether investing within your SMSF is the right strategy for you will depend on a number of variables which you should discuss with a specialist.

In the meantime, however, let's consider properties bought inside and outside of super.

Let's say you have $200,000 in your SMSF, which is earning an average return of seven per cent per annum.

If you used some of that balance to fund a deposit on a property, the returns are likely to be superior.

Perhaps you buy a $500,000 property in an affordable location and use $175,000 to fund the deposit and expenses, which represents 30 per cent of the total cost of the property.

You then borrow $350,000 from a lender to complete the purchase. Essentially, your SMSF balance has increased from $200,000 to $525,000, which means your annual return has changed from just $14,000 to about $36,750.

That's a staggering $21,000 or 162.5 per cent difference in return!

Before you ask about the loan repayments, well, these will be repaid by your tenant in rent, plus you can also use your personal, employer or tax-deductible super contributions if needed.

As you can see in our simple example, you can substantially increase your SMSF's return on investment every year – plus you will have the benefit of the capital growth in the property, which you can realise when you've retired.

	Outside Super	Within SMSF
Super Fund Balance	$200,000	$200,000 and buys investment property valued at $500,000 (borrows $350,000 from bank and deposit + costs from fund)
7% Return/ 7% Capital Growth	$14,000	$36,750
Comparison	$21,000 difference in return or 162.5%	

WHAT PROPERTY INVESTMENT STRATEGIES CAN YOU USE WITH SMSFS?

Depending on your age as well as your super balance, then investing in property within an SMSF may be a strategy for you.

As a general rule, if you are approaching retirement age, say you're aged between 50 to 60, then a sound strategy would be target properties with a higher yield – that is they are cash flow positive.

If you are younger and are still in the accumulation phase of your investing journey, then targeting high capital growth properties will help to increase the size of your portfolio.

If you are choosing properties that are high growth but negative cash flow, you must ensure your SMSF has sufficient reserves to cover any shortfall and other expenses, otherwise this will put a drain on your personal cash flow reserves.

Below is a summary of what the ATO considers permissible and not permissible using borrowings in SMSFs.

As we've mentioned, there are a large number of rules and regulations that you must abide, including which renovations are permissible and which are not.

Essentially you can repair or maintain a property investment with borrowed funds in SMSF, but you are not allowed to significantly "improve" the asset

1. REPAIRS & MAINTENANCE VS "IMPROVEMENTS"

Project	Repair or maintenance (OK under LRBA*)	Improvement (NOT OK under LRBA)
Fire damage to kitchen (cooktop, benches, walls and ceiling)	Restore damaged part of kitchen, including adding a dishwasher, even if there wasn't one there before	Added an extension to the kitchen as part of the restoration
Replace guttering	OK	
Paint house	OK	
Replace fence	OK	
Install fire alarm (due to council requirements)	OK	
Install a swimming pool		NOT OK
Cyclone damage to roof	Replace roof	Add a second storey at the same time as replacing roof
Build a pergola		NOT OK
Add a second bathroom		NOT OK
Replace house destroyed by fire	Rebuild comparable house	Rebuild house not comparable (although if built from insureance proceeds does not affect LRBA)

2. SIGNIFICANT CHANGE IN ASSET IDENTITY (I.E. BECOMES A DIFFERENT ASSET)

Project	Retain identity of existing asset (OK under LRBA)	Becomes different asset (NOT OK under LRBA)
Vacant block of land on single title		Subdivided land resulting in multiple titles
Vacant block of land on single title		A residential house is built on that vacant land (even though remains single title) which fundamentally changes character of asset
A house and land		House is demolished and following fire and replaced by three strata units
A house and land		Conversion of house into restaurant, with commercial kitchen
A house and land	One bedroom converted into home office	
Four-bedroom house and land	Fire destroys the house and rebuild house with insurance proceeds and SMSF cash, even when add a garage that was not there before	

A house and land	The following changes are improvements (so couldn’t finance them via the LRBA) but do not change the character of the asset (so would not make the existing LRBA void): • Extension adding 2 bedrooms • Addition of swimming pool • Addition of garage, shed and driveway • Addition of garden shed	
A house and land	Compulsory acquisition of part of front yard for road widening	
A house and land	Adding a granny flat does not change the character of the property (although the building costs for the granny flat could not be financed via the LRBA)	

Source: ATO Ruling SMSFR 2012/1

FIRST HOME SUPER SAVER SCHEME

The First Home Super Saver (FHSS) scheme was introduced by the Australian Government in the Federal Budget 2017–18 to reduce pressure on housing affordability.

It’s important to note that it doesn’t require a SMSF, but since it’s a policy that allows you to use your super to buy a property we thought we’d include it in our guide!

The FHSS scheme allows first-time buyers to save money for their first home inside their superannuation fund, which will help them save faster due to the concessional tax treatment within super.

From 1 July 2017, eligible first home buyers could make voluntary concessional (before-tax) and non-concessional (after-tax) contributions into their super fund to save for their first home.

From 1 July 2018, they could apply to release their voluntary contributions, along with associated earnings, to help them purchase their first home.

From 1 July 2018, they could apply to release their voluntary contributions, along with associated earnings, to help them purchase their first home.

Like any grant or scheme, first home buyers must meet the eligibility requirements to apply for the release of these amounts.

According to the ATO, the scheme is suitable for first home buyers if:

• They either live or intend to live in the premises they are buying as soon as practicable.

• They intend to live in the property for at least six months of the first 12 months they own it, after it is practical to move in.

They can apply to have a maximum of $15,000 of their voluntary contributions from any one financial year included in their eligible contributions to be released under the FHSS scheme, up to a total of $30,000 contributions across all years. They will also receive an amount of earnings that relate to those contributions.

Please check the eligibility criteria with the ATO as well as all other associated bits and pieces for this policy.

HOW MUCH DO YOU NEED IN A SMSF TO GET STARTED?

With the super balances of Australians slowly growing, more people will opt to transfer those monies into SMSFs, so they can take charge of their financial futures.

However, you still need to have enough money to invest in properties using your SMSF.

Most banks will only lend up to 70 per cent of the value of a property that is bought with an SMSF, which is less than what they'll lend for a property bought outside of super.

So, that means that to buy a $500,000 property, you need funds for the deposit ($150,000) plus costs such as stamp duty, which means your balance ideally should be at least $200,000.

Again, it's vital that you access professional advice when choosing to set up or invest with your SMSF.

At propertybuyer, we have handpicked specialist SMSF advisors we can refer you to, so you can receive qualified financial advice.

WHY SHOULD YOU BUY PROPERTY IN AN SMSF?

There are a number of reasons why you should consider investing by using funds within your SMSF.

• You can't do much to control the performance of a standard super fund, but you have the ability to borrow to invest and leverage the returns in a SMSF. Not only can you boost your super balance without any additional contributions, you can also take advantage of compound growth over time.

• Loans used for borrowing in a SMSF are classed as "non-recourse" , which means if the worst happens and you default on the loan, the lender only has recourse to the relevant property and not your fund.

• You fund the investment as well as ongoing costs from rental costs but also from your ongoing compulsory superannuation contributions rather than from your own pocket, which protects your cash flow.

• You only pay 15 per cent tax on net rental income.

• All the purchase costs such as stamp duty, solicitors, buyer's agent fees, and accounting fees can be paid from your super fund, instead of your personal cash flow.

• You can repay the investment loans significantly faster inside your super because of concessional tax advantages

Investing in property via your SMSF can be a smart strategy, as long as you select the best properties from the outset.

It's imperative that investors don't take a punt when it comes to any property investment, but especially when buying within a SMSF because of the rules and regulations involved.

We'd love to help and assist you with SMSF (Self-Managed Super Funds) Property Service. Please call us today on 1300 655 615 or tell us your enquiry / wishlist today. We'd be delighted to be on your team.

If you would like us to help and assist you in buying a home or investment property, then please call us today on

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