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A new SMSF Property Boom Ahead

The ability of a SMSF Trustee to borrow from a bank, credit union or related party in order to finance the acquisition of an asset has sparked a lot of interest in the SMSF industry.

Importantly it has seen a renewed interest by SMSF trustees in diversifying their share and managed fund investments into residential and commercial property. With in excess of \$280 billion in assets in Australia's 380,000 SMSFs, even a small shift by trustees to invest in property will provide a large boost to the property sector. A larger reweighting by SMSF trustees may provide the much needed "housing affordability" solution that the government is searching for.

In this SMSF Strategies newsletter we will review the latest on SMSF borrowings including recent ATO rulings on the matter and consider where to from here for SMSF trustees looking to utilise SMSF borrowing to acquire property or other assets in their fund.

What do SMSF Trustees invest in?

The following table highlights the large holdings SMSF trustees have in equities and cash compared to property:

Asset	\$ million
Cash	63,517
Shares	161,895
Property	30,325
Unit Trusts	19,156

Source: ATO SMSF Statistics - 2007

The reasons SMSFs and property did not mix under the old super laws

Prior to 1 July 2007 the Superannuation Laws prevented many SMSFs from acquiring residential or commercial property for the following reasons:

- The lack of borrowing capacity by the trustee meant that a SMSF had to buy property investment with the direct resources of the fund. For the majority of SMSFs, property required too much cash and was also an illiquid investment.
- Once over age 65 a member had to commence an allocated pension – they could not stay in the accumulation phase of their fund. The problem with an allocated pension from a long term investment perspective was that the draw down requirements for the pension grew higher as a person got older. If a property was used to fund the pension at some stage the rent would not cover the pension payments thereby creating a cash problem for the trustee and possibly insolvency.



“For some SMSFs with large and growing accumulation balances on behalf of retiree members, development land may now be a suitable investment.”

The Simpler Super revolution brings property back into play

The Simpler Super revolution has ushered in significant changes to the superannuation, bankruptcy and taxation laws – including the ability of the trustee of a fund to borrow (see the next page).

Importantly from a SMSF trustee perspective, the Simpler Super laws now favour long term investments such as property for many large SMSFs. This is due to the Simpler Super laws, as enacted, allow a member of a SMSF to retain benefits in their superannuation fund past age 65 without having to pay a pension or take a lump sum. Members can still access a pension with some of their superannuation benefits but they can limit their draw downs to suit their lifestyle budget. For some SMSFs with large and growing accumulation balances on behalf of retiree members, this may make development land a suitable SMSF investment.

The new SMSF borrowing rules

The new SMSF borrowing rules are simple:

1. The trustee of the SMSF may invest in a special "Security Trust" that will hold the legal title of an asset the fund wants to acquire, such as residential property.
2. A lender will commit funds to the Security Trust.
3. The asset acquired must fit with the fund's investment strategy and if it is to be acquired from a member or related party such as a family trust it can only be listed shares, managed funds and business real property (not residential property except in limited circumstances).
4. If all payments are made under the borrowing, legal title in the asset will be transferred from the Security Trust to the trustee of the SMSF.
5. At no time does the lender have the right to sue the trustee of the fund if the trustee fails to make any payments under the Security Trust payment arrangement. The only recourse the lender has is to the asset itself.

ATO Guidelines

The ATO has issued a Guideline as well as a special Taxpayer Alert to keep SMSF trustees well informed on SMSF borrowings. Some of the key points raised in the ATO publications are:

1. Related parties may act as the lender however all loans should be at arm's length including interest rates, term, payments, etc.
2. There should be no recourse against the trustee of the fund which may see personal guarantees provided by fund members, the feature of some commercial loans now being offered, breaching the rules.
3. The fund's trust deed may need upgrading to allow SMSF borrowing and any investment should be in line with the fund's investment strategy.



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SMSF borrowing options

There are a number of commercial lenders that offer SMSF lending packages on assets ranging from commercial and residential property to shares and managed funds. Packages are more of a commercial loan style and various legal documents need to be put in place in order to effect the SMSF borrowing arrangement. Fees range widely across lenders.

Where related party financing is involved, various documents including a Security Trust Deed must be executed with loan documents in place.

Our firm has experience in both commercial and related party financing for SMSF borrowing purposes. In addition we have a number of important SMSF borrowing strategies that can be put into place by our SMSF clients.

For many of our SMSF clients that have previously held property investments outside of their fund it may be time to go out looking for property for the SMSF. Remember if you own business or commercial property, including farms outside of the fund it may be time to switch it into the fund. There are possible stamp duty, capital gains tax and borrowing strategies that can be employed to make any transfer or acquisition of a new property simple and cost effective.



If you like property as an investment and have a SMSF now may be the time to consider whether property might form part of your fund's investment strategy.

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