



SELF MANAGED SUPER FUNDS

THE BENEFITS OF BUYING RESIDENTIAL PROPERTY

When it was introduced in September 2007, it was described as the biggest thing to happen to the property investment sector since the introduction of negative gearing. Today, the rules governing self managed super funds (SMSFs) effectively allowing funds to borrow to buy an asset have seen an increase in the number of people purchasing property.

The old rules meant you had to buy property outright in your fund, whereas under the changed rules, you can borrow anywhere from 60% to 75% of the value of the property you are looking to buy. You can buy any sort of property, however residential property must be an arm's length transaction from a third party. And you cannot rent a residential property from your SMSF. You can, however, transfer the property from the fund to your own name after you retire and at that time move in and make it your primary residence.

Recently I've noticed an increase in the number of investors purchasing property as part of their SMSF. The changed rules, combined with the uncertainty in the Australian and global financial markets have led more people to diversify their risk through property investment.

Let's look at an example case study, prepared by chartered accountancy firm Clinton McDonald of McBride Hinton & Co.

Bill, who is 50 years of age, has decided

to purchase a unit for \$500,000. The unit qualifies for building allowances of \$100,000 and has fixtures worth \$50,000.

To purchase the unit and pay for transaction costs, Bill has decided to contribute \$145,000 and borrow \$375,000* (the loan will have a term of 10 years). Bill has two options to acquire the property:

1. In his own name
2. In his SMSF

The following cashflow shows that if the unit is held in Bill's SMSF, compared

with being held by Bill personally, the net outflow of cash is \$36,563 less in year one. Subsequent years will have similar savings in cashflow. In addition, if the asset is sold after a pension has commenced, there is no capital gains tax.

*Loan calculated on an interest rate of 6.5% personally or 7.5% for a SMSF

N.B.: To establish an SMSF and an SMSF limited recourse loan, the upfront cost is about \$6,000 and then \$2,500 per annum to prepare financial statements, tax return, and complete the audit.

CASHFLOW

	Option 1	Option 2	Difference
Rent	22500	22500	
<i>Less Expenses</i>			
Interest	-24375	-28125	3750
Other Outgoings	-7500	-7500	
Total Cash Expenses	-31875	-35625	3750
Non Cash Tax Adjustments			
Building Capital Allowances	-2500	-2500	
Depreciation	-10000	-10000	
Total Capital Allowances	-12500	-12500	
Total Tax Deductions	-44375	-48125	3750
Tax Loss	-21875	-25625	3750
Tax Saving	10171.88	3843.75	6328.125
Capital Allowances Non Cash	12500	12500	
Debt Reduction	-37500	-37500	
Tax Cost / Saving Debt Reduction	-32593	11812	-44405
Total Net Outflow of Cash	-69296.1	-34969.3	-34326.9

SOME THINGS TO KNOW ABOUT PURCHASING PROPERTY THROUGH YOUR SMSF

- The deposit, balance of purchase price, associated legal costs and stamp duty are all paid by the SMSF, as they would be in a normal investment property purchase. Similarly, the lawyer or conveyancer is chosen and appointed by the SMSF and they complete all necessary legal work as usual.
- All costs associated with the property are paid by the SMSF. This includes council rates, land tax (if it applies), loan fees and repayments, maintenance and repairs conducted on the property and the property management costs
- As the property is 'beneficially owned' by the SMSF, outside of the legal ownership of the property trusts, it receives all proceeds of rent or other income, and the fund can improve or renovate like any other investor can with their property.
- At any time, the SMSF is able to pay extra into the mortgage, or pay it out entirely—subject to the lender's terms and/or associated fees. And once the mortgage has been repaid in its entirety, the title to the property can then be transferred to the SMSF, or the property trustee can continue as registered proprietor.

Obviously before you make the decision that your SMSF is going to buy property, it's important to consult a certified financial planner, your accountant or the Australian Taxation Office for a summary of the legislation.



THE CHALLENGES OF HOUSING

I was most interested to hear the opinions of three of Australia's most successful developers, who were part of the *Australian Financial Review's* Residential Property Conference 2010. Obviously the housing affordability and availability debate continues to rage, and these three players were very honest in their outlook.

Nigel Satterley of Satterley Property Group, Brendan Gore from Peet Limited, and David Keir from Devine participated in the conference, and were of the combined view that smaller developers have been locked out of the market because of stringent equity demands from the banks.

According to Nigel Satterley, between 40% and 50% of the country's dwellings had traditionally been built by second-tier developers and other smaller players.

However, such groups have been unable to meet the bank's demand for 50% equity and a strong track record.

The conference found that new – and growing – demands have been placed on housing stocks. These include changing social trends, population growth which far exceeds the number of housing starts, and the rising proportion of single person households, couples without children, and one-parent families, which means fewer people per house.

Supply of housing isn't the only issue. Prices are also on the rise, which impacts affordability, as we've covered in the Charles+Stuart Newsletter many a time.

The banks have proven to be obstacles for developers, particularly for apartment developments. Mr Keir called the banks "dreadful", because they wouldn't touch residential developments that required lending terms beyond three years, unless the property was a high-rise in Melbourne.

It's a catch 22 situation for developers. As they have to shoulder the higher burden of the investment, it takes longer to generate a profit, plus it also locks up equity, so developers are restricted to fewer projects at a time.

Mr Satterley called on the Federal Government to offer guarantees to banks, so they would be more comfortable about lending with lower equity requirements.

If nothing is done, then we'll continue to have this worsening situation of not enough housing for the growing population, plus home prices which are out of the reach of many.



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