

how to buy
property
within your
self managed
superannuation
fund



disclaimer

Please note that the information provided in this booklet is of a general nature only and should not be considered as personal advice. Your personal situation has not been taken into account.

Should you wish to take your personal objectives into account please contact a licensed Financial Advisor.

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contents

1. The Background
2. The Mechanics
3. The Benefits
4. The Risks
5. The Difference
6. Case Study
7. About Ark Total Wealth
8. Contact Us

1. the background

A Self Managed Superannuation Fund (referred to as SMSF in this booklet) is a superannuation fund where its members control all investment decisions, assets and administration responsibilities of the fund. All members are trustees of the fund, and the fund is governed by the Trust Deed, Superannuation Industry Supervision (S.I.S. Act) and regulated by the ATO. A SMSF gives the members control and flexibility when allocating their investment assets.

Investment Property has always been an available asset class for SMSF to invest in; however in the past you required 100% cash to purchase the property. Late in 2007, the SIS Act was amended to allow SMSF to gear within their fund via a warrant structure. These changes effectively now allow SMSF to borrow to invest directly into residential property.

These changes have created an opportunity for investors to diversify their current superannuation holdings and utilise the benefits of leverage. However, with this benefit comes an abundance of complexity and regulation that must be abided by to ensure your fund remains compliant. This booklet is designed to give you a high level idea of how you can purchase property through your SMSF, the benefits but also the risks.

It is important you receive professional advice from a licensed Financial Advisor before you proceed so you can determine if this is appropriate for you.

Setting up an SMSF may be an option for you if;

- You have more than \$200,000 in super (can be joint with partner or include potential money you can contribute to super)
- You can make regular contributions to the fund (either compulsory or voluntary)
- You want the flexibility and control over your investment assets
- You have experience in handling your own investments



2. the mechanics

The structure that is used to purchase the property is known as an ‘instalment warrant’.

An instalment warrant allows an investor to make a down payment (deposit) to purchase an investment (e.g. property/shares) and borrow the remainder against the asset (using a non-recourse loan). The SMSF doesn’t legally own the asset but they are entitled to all the benefits of the investment (e.g. rent, tax benefits and dividends).

In relation to a ‘property warrant structure’, the SMSF will make a deposit (minimum 30%) into a Bare Trust, where the property is legally held. The financier will provide the remainder of the payment through a non-recourse loan (up to 72% Lending to Value Ratio). This means the loan is only limited to the asset itself. The SMSF will receive all of the rent and tax benefits of the property but it will also be liable to pay the interest costs on the non-recourse loan to the Financier and all other associated expenses (e.g. strata, rates). Once the loan has been repaid, the Bare Trust collapses and the investment property is transferred into the SMSF.

This structure is graphically shown below:

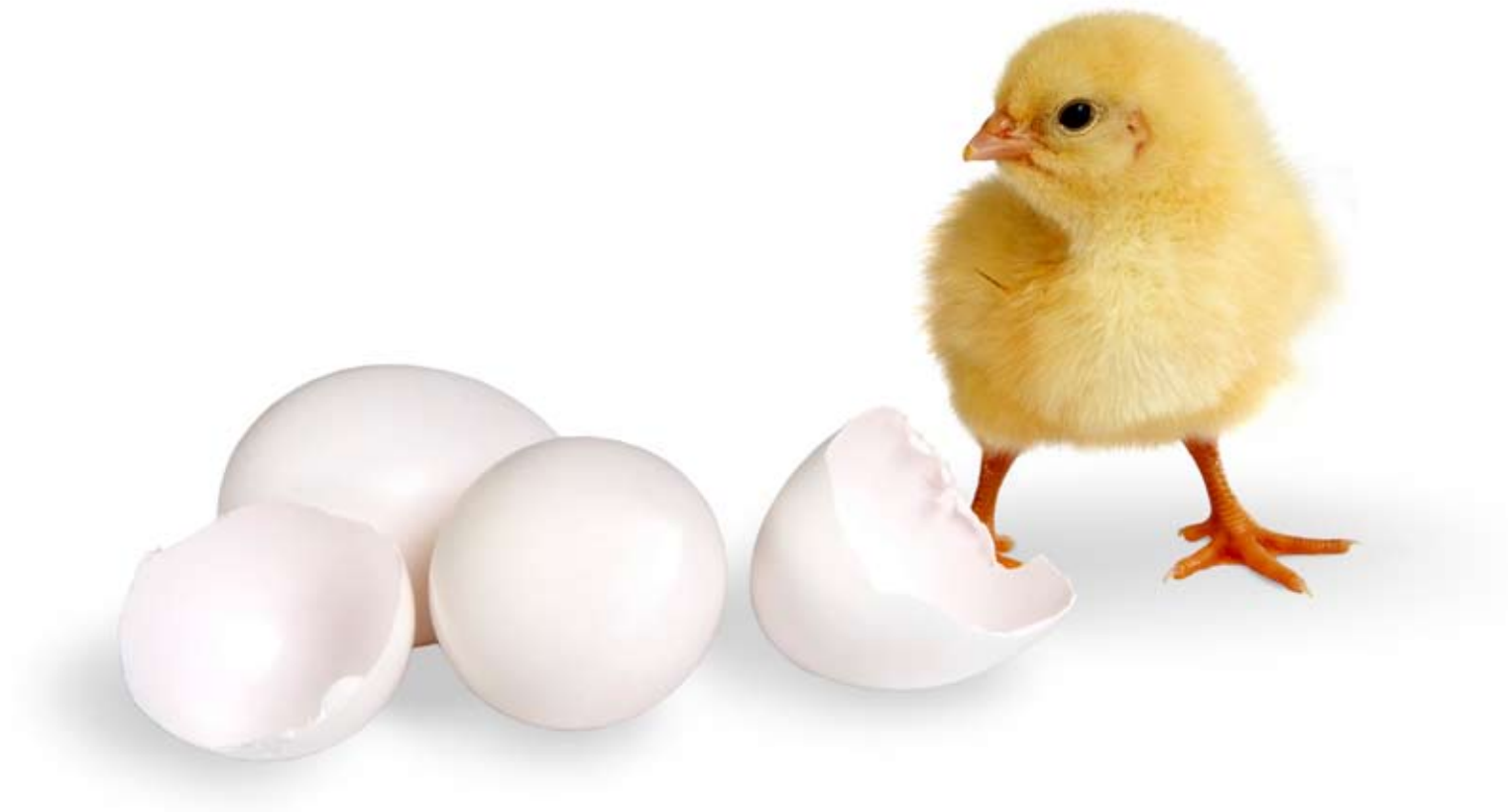


The property can then be cash flowed from the cash reserves/rent within the SMSF or from additional contributions to the SMSF (e.g. Superannuation Guarantee, Salary Sacrifice, After Tax contributions)

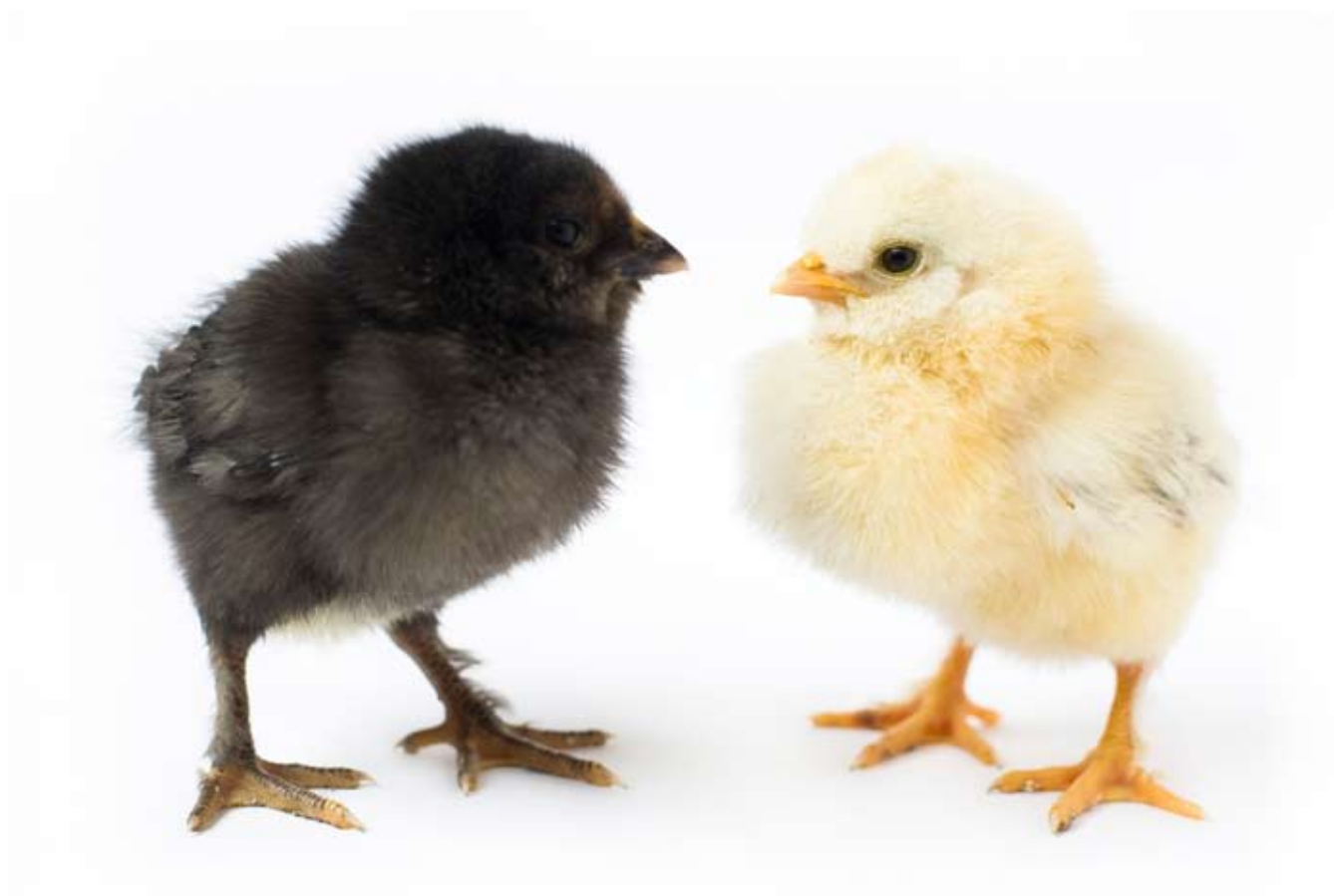
3. the benefits

The main benefits of purchasing a property through a SMSF are:

- **Concessional Tax Treatment** – Within the super environment, income is taxed at 15% and capital gains tax 10% (if held longer than 12 months). If you sell the asset at the age of 60 and are retired or are over the age of 65, all income and capital gains are tax free. Within the super environment, you have ability to hold assets until you are in the pension phase when there is no income or capital gains tax.
- **Diversification** – This warrant structure allows you to diversify your investments within the super environment away from the more traditional super assets such as shares, cash and fixed interest.
- **Leverage** – This is the ability to use borrowed money to purchase a larger asset base. This is one of the most effective wealth creation strategies and most commonly used with Direct Residential Property.
- **Estate Planning** – An SMSF has significant Estate Planning benefits due to its flexibility. This need to be structured correctly to ensure that all benefits will be received in the most tax effective manner and assets are distributed to your nominated beneficiaries
- **Borrowing Capacity** – When you purchase a property within an SMSF, it is the SMSF that is assessed for the servicing capacity not you as the individual. This means, if you have reached your borrowing capacity threshold outside of super, you can continue to leverage within your SMSF. This will allow you to continue to increase your asset base.
- **Asset Protection** – Generally, assets within an SMSF are protected from bankruptcy proceedings. Specialist advice must be sought within this area.



4. the difference



The main differences between holding an investment property inside versus outside of super are:

- **Deposits** – Outside of the superannuation environment, property deposits can be as little as 5% in order to receive loan approval. This differs to deposits made within the super environment as the non-recourse loan requires a minimum of 30% to be made.
- **Cash flow** – If your property is negatively geared, it will be cheaper to hold the investment outside of super if you have a Marginal Tax Rate greater than 15%. On the contrary, if the property is positively geared (it may start out negative and then become positive overtime) and your Marginal Tax rate is greater than 15%, it is more tax efficient to hold it within the SMSF. Every individual's situation is different as there are multiple factors which influence your cash flow (e.g. Salary Sacrificing). We therefore recommend consult with a qualified advisor to determine the best option for you.
- **Capital Gains Tax** – Upon the eventual sale of the property, outside of the superannuation environment, 50% of the capital gain will be taxed at your Marginal Tax Rate (provided you have held the asset for more than 12 months). Within the SMSF environment, in the accumulation phase, you will be subject to only 10% capital gain or if you are in Pension mode (above 60 and retired) the gains will be tax free.
- **Borrowing Capacity** – The SMSF borrowing capacity is treated differently to your borrowing capacity as an individual. It is based on your regular contributions made into the SMSF as opposed to your income received.

5. the risks

The main risks associated with purchasing a property through an SMSF are:

- **Trustee Responsibility** – The Trustee (also the members) are responsible for creating an investment strategy and ensuring the fund keeps within the legislative requirements. Breaching these rules can have serious consequences for the fund and also the Trustees. Professional advice should be sought on how to set up and maintain a compliant fund.
- **Loan/Property Structure** – Creating the appropriate structure and loan agreement can be quite complex. It is important that the warrant structure is set up correctly to ensure the SMSF remains compliant.
- **Investment** – Regardless of whether you are purchasing a property inside or outside of super, you are still exposed to the risk of purchasing property. It is important to complete your due diligence on the specific property you purchase in order to minimise these associated risks.
- **Cash Flow** – Managing your cash flow is one of the most important aspects of investing in property. You need to ensure you can sufficiently cash flow your investment and adequately fund the property. Once your money is contributed to the superannuation environment you cannot withdraw it until you meet a condition of release.
- **Liquidity** – Property is a very illiquid asset. The purpose of superannuation is to provide an income stream for your retirement so when you are setting up your investment strategy you need to ensure you have enough liquidity within your SMSF to fund required income payments. The last outcome you want is that you have to sell your investment property to fund a short term income shortfall.





6. case study

John and Joan are both aged 47 and they have been active investors for the last 15 years. They currently own two investment properties and their home. They have built up approximately \$350,000 in their superannuation accounts and make no additional contributions other than the contributions made by their employers. They feel like they want to take more control over their superannuation benefits and continue to invest in property.

John and Joan only have excess savings of approximately \$1,000 per month after tax and their living/investment expenses. These additional savings would not be sufficient to fund another property outside of Super and would place considerable strain on their cash flow.

After speaking with their advisor, John and Joan set up an SMSF and invested \$150,000 into the share market at different intervals. They also found a property worth \$400,000 that they wanted to buy.

They put down the minimum deposit of \$120,000 and purchased the property via the 'warrant structure' with a non-recourse loan of \$280,000. With the rent and depreciation deductions received, the property runs cash flow neutral. John and Joan still have the option of Salary Sacrificing their spare cash flow to reduce their tax and also increase their SMSF balance.

After their purchase they are still left with \$80,000 in cash which they will use as a buffer and to pay themselves an income stream when they reach age 55.

The result for John and Joan was that they were able to take control of their super assets, purchase an investment property they couldn't have comfortably funded outside of super but still reduce their tax through salary sacrificing.

7. who is ark total wealth?



Ark Total Wealth is an independently owned boutique Financial Planning practice which has been creating and implementing wealth and investment strategies for its individual and corporate clients for over 18 years.

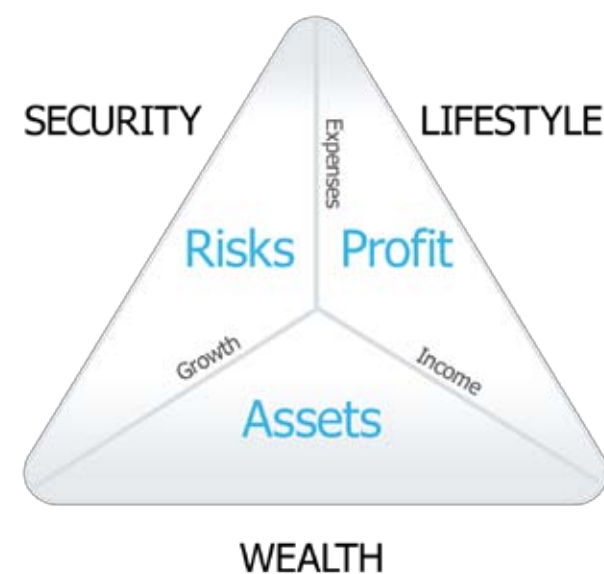
In holding its own Australian Financial Services License, Ark Total Wealth plays an autonomous role in advising clients on how they can build, manage and protect their wealth. Ark Total Wealth strategies are holistic as they cover a range of asset classes and services, including direct residential property, equities, superannuation, debt, cash flow and risk management.

Ark Total Wealth's strategic financial planning advice draws these elements into a comprehensive plan for their clients' future that is tailored to their specific situation, whether just getting started, building equity or planning for retirement.

Ark has considerable experience in dealing with direct property and Self Managed Superannuation Funds and ensuring they can be integrated seamlessly within the legislative requirements.

Ark Total Wealth is integrated with the following businesses:

- **Pulse Property** (www.pulseproperty.com.au) – Property Research house for direct residential property across Australia
- **Liquidity Finance** (www.liquidityfinance.com.au) – Mortgage Broking and Loan Structuring



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If you would like more information about integrating property into your SMSF or to find out if it is applicable to you, please call 02 9262 3333 and speak to one of our qualified advisors



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