FULLY REVISED AND UPDATED

2ND EDITION

HOW TO INVEST IN PROPERTY

THROUGH YOUR SELF MANAGED SUPER FUND

Martin Murden

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AUTHOR PREFACE

Since the first edition of this book was published in 2011 much has changed. Australia seems to have largely avoided the recessions experienced by the US and many European countries. Our property market has not suffered the falls in values that have been a consequence of the Global Financial Crisis in so many other economies around the world. We have had three changes of Prime Minister and a change of government. Last, but not least, there have been some changes in legislation that affect the subject of this book: *How to Invest in Property Through Your Self Managed Super Fund*. So I was delighted when my publisher contacted me and gave me the opportunity to revise the book and bring it up-to-date for 2014 and beyond.

Two things have not changed since I first wrote the book. First, is the popularity of self managed superannuation. Current statistics show that there are now approximately half a million self managed super funds (SMSFs) with almost one million trustees managing about one-third of Australia's $1.5 trillion in superannuation! Second, is Australia's long-held fascination with property as an investment. Maybe because it's a tangible asset – you can see it and touch it – or maybe because it doesn't display the vagaries and volatility of the stock market. Many believe, sometimes to their detriment, that property will never decline in value and will always remain the best possible long-term investment.

It is hardly surprising that many Australians who have opted to take control of their own superannuation are interested in including property in their SMSF portfolios. However, direct property investing requires access to substantial sums of money. It was only in September 2007 that the Commonwealth government gave self managed super funds the green-light to purchase property and other assets with borrowings, making entry to the property market considerably easier.

These legislative changes have only been in place for just over six years and there have already been modifications. Despite this uncertainty there has so far been strong interest from trustees of existing SMSFs and other investors looking to set up SMSFs to use their retirement savings to invest in property.

While it is hard to determine exactly how many people have started an SMSF as a result of the legislation, what we can ascertain is that the number of such funds being created has continued to grow in recent years. In mid-2013 it was estimated banks had loaned 30,000 SMSFs a total of $7 billion to acquire property.

And, interestingly enough, not all of these superannuants conform with the traditional SMSF member profile – sophisticated investors, typically professionals, small business owners (but not exclusively so), looking for additional flexibility and control over their super savings.

Instead, many are property investors looking to invest in property via SMSFs and many are people who previously would never have contemplated managing their own fund.

We are seeing people of younger ages than in the past look at using an SMSF as an investment vehicle to fund their lifestyle in retirement.

What they and many others are discovering is that not only is super an excellent vehicle for accumulating wealth and saving for retirement but that purchasing property via super brings with it considerable tax advantages.

Over the 41 years that I have been working with clients on their tax and superannuation, I have never seen such an interest in new legislation. With all new things comes a learning curve. I hope this book will play some part in your self-education as you decide whether investing in property through your self managed super fund is the right path for you.

The book starts by discussing why there is such an interest in self-managed (or do-it-yourself (DIY)) superannuation. It walks you through setting up a fund and then explains the different stages of the fund. Then we take a look at all the options available to investors – buying directly or indirectly; the breadth of property investments; buying with cash or borrowings. Next we consider the tax implications of your investments and make comparisons between investing as an individual, through an SMSF or with partners. The final chapters are concerned with retirement, succession planning and compliance.

Unavoidably there is some jargon associated with superannuation, so we have included a glossary at the back of the book to refer to should you come across a term, concept or abbreviation that you are not familiar with.

Equally as unavoidable are the changes to Australia's tax system. From 1st July 2014, the Medicare Levy will increase to 2 per cent to help fund the National Disability Scheme. The Medicare Levy is quoted throughout the book at the rate at time of writing – 1.5 per cent. If you are reading this book in the financial year 2014-15 and later, you will have to take this increase into account in your calculations.

I hope you find the book useful but, remember, there is no substitute for professional advice from an expert who is familiar with your individual circumstances. Throughout the book I will remind you of this.

Happy reading!

Martin Murden
Melbourne, November 2013

CHAPTER 1

Why Do-It-Yourself?

ALMOST ONE million people cannot be wrong. At March 2013, according to the Australian Tax Office (ATO), there were 503,320 self managed superannuation funds in Australia with assets of $496,024 million. A total of 958,095 people were members of an SMSF. The most common number of members per fund was two.

These funds represent 99 per cent of all super funds and about one-third of Australia's total superannuation assets.

So, what is it that makes the self managed or do-it-yourself (DIY) approach so attractive?

In addition to providing members with control over how their funds will be invested, those electing to go down the DIY route are generally doing so because it gives them greater investment choice, greater flexibility and lower costs.

Greater investment choice

For the majority of people I have spoken to over my years as an SMSF adviser, the key reason for setting up a self managed fund is because it offers them control and the opportunity to fine-tune their financial future.

Other superannuation funds can offer members choices about how their money is invested. For example, they can take a conservative approach with a high proportion of their savings invested in bonds and cash; or a more aggressive approach favouring international and Australian equities; and there are options in between these two extremes. But with an SMSF you can customise your investment strategy further and decide exactly where, when and how your money will be invested. You have the flexibility to change specific investments when you consider this is appropriate and are not locked into what a fund manager might authorise, potentially resulting in poor returns.

While many trustees (please see glossary at the back of this book for an explanation of this term) of SMSFs may take advice – and many do seek out professional help – the decisions about which investments they will acquire and how they will be managed ultimately are theirs.

Compared with many superannuation funds, an SMSF allows members a broad investment choice. This includes investing in specific direct equities and property, plus a variety of overseas and alternative assets that could even include appropriate levels of collectables or works of art.

With changes to super legislation that are the subject of this book, SMSFs can borrow to buy property and other assets, effectively broadening their investment landscape even further.

Self managed funds do not require set percentages to be invested in a particular asset classes. Rather, they must be invested according to the SMSF's investment strategy as determined by the trustees according to the needs and aspirations of the members (more about this later). And should these change, the strategy can be altered to suit.

Lower costs and taxation advantages

Costs of compliance and administration of an SMSF can be less than the fees charged by a public offer superannuation fund. Although costs will vary with the size of the SMSF (i.e. how much it holds), the level and cost of advice it takes, the number of transactions it makes and the amounts and types of investments it holds.

Investing through an SMSF (or any superannuation fund) provides investors with the opportunity to legitimately reduce tax on investment income and capital gains.

Members pay just 15 per cent in tax on the taxable income in their funds. Compare this with investing in property personally where taxable income is then taxed at marginal rates (up to 46.5 per cent including the Medicare levy).

In addition, provided the funds hold onto assets for more than 12 months, any realised capital gain will be discounted and taxed at an effective rate of 10 per cent on the gain made (more about taxation of capital gains in Chapter 9).

Another key benefit for self managed super fund members is the ability to structure a tax-effective income stream for themselves or their spouses or partners as they transition into retirement and when a member dies. (We will talk about this in detail in later Chapters 12 and 13.)

However, it is important to note that in exchange for these wonderful tax benefits, legislation generally restricts members accessing their super benefits until they have reached 'preservation' age which is currently 55 and will gradually increase to age 60 by 2024.

Who are our SMSF superannuants?

From my 41 years' experience in the industry, DIY superannuants are generally people who have got considerably more to invest in super than those in industry and retail funds and they are primarily – but not exclusively – small business owners and professionals.

Nationally, the average self managed super fund balance at 31 March 2013 (the latest available figure at time of writing), was approximately $985,000.

As a rule of thumb, SMSFs generally consist of two people – usually a husband and wife or a couple in a de facto relationship. However, the number of male DIYers still outweighs females.

Self managed super fund membership is not restricted to a couple in a relationship and their children. Siblings can establish their own super fund, allowing them to pool their existing account balances for investment purposes.

While more than half of SMSF members are over 55, almost 70 per cent of new SMSF trustees (for funds established during the March 2013 quarter) were aged less than 55 years, with nearly 40 per cent of new SMSF trustees under 45.

Another important part of the SMSF member profile is that those in, or looking at start an SMSF, generally aren't just focused on the here and now. Most have given plenty of thought to retirement. They know when they want to retire, what they will do in retirement and most importantly, how much they will need to maintain their standard of living throughout retirement.

SMSF fast facts

According to the most recent data collected by the tax office, the following facts relate to self managed super funds:

- There are about 503,000 SMSFs in Australia and the number is growing.

- The average SMSF balance is around $985,000.
- Amost 29 per cent of all SMSFs have more than $1 million in fund assets (with 11 per cent holding over $2 million each). Just under 24 per cent had assets of $500,000 to $1 million, a quarter had $200,000 to $500,000 and the remaining group, $200,000 or less (with a little under 6 per cent holding less than $50,000). (These figures are as at 30 June 2011.)
- Approximately 70 per cent of SMSFs have two members, nearly a quarter are single-member funds and the balance have three or four members.
- If you're over 55 and live in New South Wales or Victoria, then you're more likely than any other Australians to run an SMSF.
- With regards to gender balance, females with SMSFs are outnumbered by men, but only just – 52.6 per cent of SMSF trustees are men, and 47.4 per cent are women, generally reflecting that many couples start an SMSF together. In the period since the first edition of this book was published the percentage of SMSF members who are female has increased.

Key Points

- Managing an SMSF offers you greater flexibility and investment choice.
- SMSFs can be less costly to run than public offer super funds.
- All super funds are concessionally taxed, making investing in super very attractive.
- More and more people are seeing the value of starting their own super funds.