

Be Super Careful – Borrowing for Property in your Superfund

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July 2008

You want to borrow to buy property, banks are keen to lend, but advisers are cautious. Let's look at the opportunities and pitfalls of using your Self Managed Superannuation Fund ("SMSF") to borrow to buy property.

Getting good advice

Be clear that I am focussing on the finance aspects of borrowing within your superfund. I am not qualified to make comment on the investment, taxation, legal or superannuation impact of borrowing nor does this article substitute for specialist advice on these areas.

And this is exactly one of the hurdles for you and your advisers. You will need, as a minimum, to get sign off from a solicitor and accountant declaring that the transaction is compliant with the superannuation rules. Sometimes a financial planner may need to be involved too.

There is a whole little specialty developing for SMSF Property Trust packs drafted by lawyers and they do not come cheap.

Be prepared to spend about \$10,000 on establishing a special property trust and accompanying documentation and getting sign off from your advisers before even applying for any funding from a lender.

How does it work?

Your SMSF can purchase a property through a specially established Property Trustee - who holds the property in trust for your SMSF. The property Trustee holds the legal interest in the property while the SMSF holds the beneficial interest. The SMSF must have the right to acquire legal ownership in the property through making the loan payments.

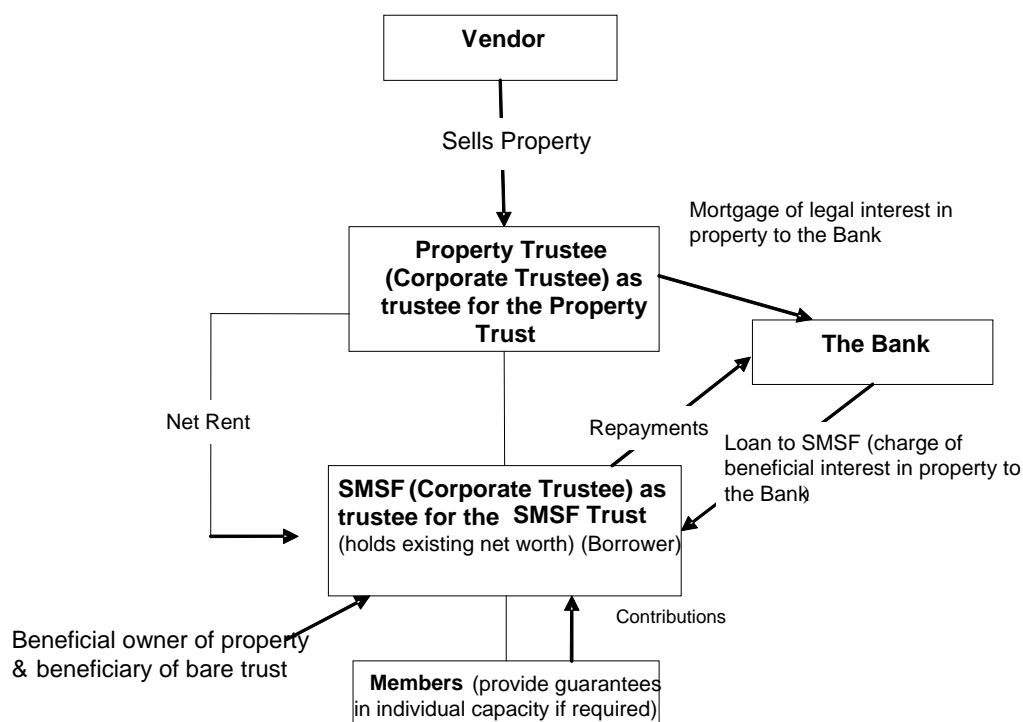
The SMSF is the entity that applies for the funding from the lender. The security for the funding is a mortgage over the property purchased by the Property Trustee.

It is important to note that the lender only has recourse to this property in the case of a default on the loan. The lender cannot have recourse to the other assets of the SMSF. However, most lenders will seek personal guarantees from you (in your individual capacity, not in your capacity as a superfund member) – although there is some concern from the ATO whether personal guarantees should be given at all.

The SMSF pays the lender each month the mortgage repayment.

Please note that you don't have to borrow money from a bank. If you have the financial capacity, you could borrow the money in your business and on lend it to the superfund under a well documented and compliant lending agreement. You might be able to borrow at a better rate than that offered through the special bank SMSF products.

The diagram below summarises the structure and cash flows.



What to look out for

There are a couple of traps and limitations that will catch those that rush into this.

- **Type of Property**

The property being purchased must be for investment purposes. There are rules prohibiting superfund assets being used for personal use so this would rule out purchasing a home to live in or a holiday investment house that you may use occasionally.

Residential property can be purchased but the vendor must be a non-related party and it is a bona fide income producing investment property. Some lenders will not lend for this purpose because of worries that superfund members may use the property and breach the superannuation rules.

Commercial property can be purchased from a related party as long as it is let for business purposes. This would cover the situation where the business owner's SMSF buys the existing business premises and leases them back to the business at a commercial rate.

- **Borrowing for a purchase**

The borrowing of funds can only be for the 'purchase' of property and not the 'refinance' of existing SMSF property.

This has consequences when choosing your loan product and your lender because you cannot refinance the loan to a different lender in a couple of years time.

- **Legal Structure**

The property must be purchased by the Property Trustee. Please get advice from your solicitor if you have not yet established the Property Trustee and you are negotiating a purchase or entering into options to buy.

Many lenders will require that the trustee of the SMSF and the trustee of the Property Trust be corporate trustees. Also check that the trust deed for the SMSF allows the power to borrow funds.

What can be borrowed?

The banks are viewing this type of borrowing more conservatively because they only have recourse to the property asset. Accordingly, the loan-to-value ratios are generally lower than for normal borrowing – commercial property is 60-65%, residential property is 70-75%.

The interest rate margins and the interest cover/serviceability requirements are similar to normal borrowing situations.

The real limitations to the amount of borrowings that a SMSF can carry will be access to cash for a deposit and the ability to repay the loan.

- **Deposit**

The SMSF will need about 30-40% of the property price readily accessible in the form of cash for a deposit on the property. In addition it will need cash for stamp duties and charges and for professional costs to establish the structure.

For a \$1M commercial property the SMSF would need about \$450,000 in cash for deposit and expenses.

- **Repayments**

For the same \$1M commercial property, if you borrowed \$600,000 then the interest repayments would be about \$70,000 per year (at July 08 rates). Most lenders would require interest coverage of at least 1.5 times which would mean the SMSF would need about \$110,000 of annual income to service the debt.

If you had a net rental yield of 7% on the commercial property, this would produce \$70,000 income. This is still \$40,000 per year short of the \$110,000 needed. You would need to rely on the income generated by other assets in the SMSF and the historical level of member superannuation contributions to prove the SMSF has the capacity to repay the debt.

To prove the consistency of member contributions we would look to the financial performance of the underlying business or contract that is making the superannuation contributions on your behalf.

Are there opportunities?

The majority of SMSFs are for business owners. There are opportunities to buy commercial property in your superfund and have your business as a stable rent paying tenant. Your adviser may think it is a good strategy to separate the business from the property assets and take advantage of the different tax regimes for superfunds.

Also, many business owners may be at their maximum leverage of debt and their superfund could be their only opportunity to take advantage of strategic property investments.

My advice is talk to your accountant and financial planner about the appropriateness of your superfund borrowing to purchase property and whether it meets your wealth and investment strategies.

Arranging funding for a superfund is a specialised area and involves working closely with your advisers. Make sure you a dealing with a reputable finance professional.

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Bespoke Finance specialises in reviewing, restructuring, renegotiating and arranging finance facilities for businesses and property investors. Should you wish to contact Peter Sullivan from Bespoke Finance then phone (07) 3218 2118 or email psullivan@bespokefinance.com.au or visit www.bespokefinance.com.au .