

strategies for self managed superannuation funds - acquiring a residential investment property with borrowed funds

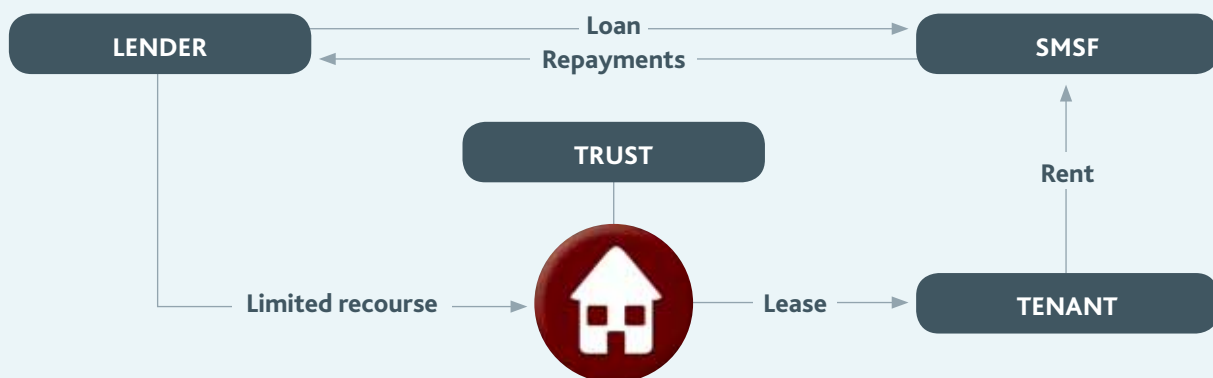
Changes to superannuation legislation now allow self managed superannuation funds (SMSFs) to borrow to invest, providing certain conditions are met.

If you have a SMSF you are now able to use these arrangements to help you buy a residential investment property through your fund.

How does it work?

Your SMSF wants to buy residential property but does not have enough funds for a full purchase. It does, however, have enough funds to make a partial payment. The SMSF can purchase the property under an instalment arrangement, but it must meet certain criteria.

The SMSF makes a partial payment on the property and borrows funds to pay the balance plus the other acquisition costs, using the property as security under a limited recourse loan. In the event of default, the lender only has recourse to the property and can not claim any other SMSF assets. The property is held in trust for the SMSF which is entitled to its income. Your SMSF makes the loan repayments, paying off the loan over the agreed period. After the loan is repaid, the legal ownership of the property can be transferred to the SMSF.



This strategy works best if you:

- are a trustee of a SMSF;
- want to invest in a property within superannuation;
- have a long-term investment timeframe.

purchasing property through super

Changes to super legislation now allow SMSFs to borrow to invest in residential investment property.

Want more information?

Visit westpac.com.au or your Relationship Manager can put you in touch with a Westpac Financial Planner.

The benefits of this strategy

- Your SMSF can acquire property worth more than its available funds through multiple instalments over the long-term.
- SMSF assets are secure as the lender does not have recourse to your SMSF's assets in the event of default.
- Your SMSF receives all income and capital growth even if the property has not been paid off.
- Your SMSF can use income from the property to help pay off the loan.
- Interest expense may be claimed as tax deductions by the SMSF and potentially reduce your SMSF's tax liability.
- You can walk away from the arrangement if it is not in the interest of your SMSF to continue with the arrangement. In this case the fund will receive the residual value after the loan is repaid.

Some things you should consider

- Your SMSF trust deed must allow borrowing under an instalment arrangement.
- Investment in residential property must be consistent with your SMSF's investment strategy. You should consider risk, return, diversification and loan interest rates.
- The instalment arrangement must meet certain requirements to ensure that the SMSF remains complying.
- As trustee, you must be acting in the best interests of the SMSF beneficiaries.
- The ability of the SMSF to make the instalments over the term of the loan. Cash flow may be sourced from investment earnings or member contributions. Consider limits to contributions that are eligible for concessional tax treatment.
- You must purchase the property from an unrelated party. Arrangements must be at arm's-length and transacted at market rates.
- You should weigh the benefits of the strategy against the costs of setting up and maintaining the instalment arrangement.

Case Study

Suppose your SMSF has \$150,000 in the cash account. As the SMSF trustee, you want to buy an investment property worth \$350,000. A trustee buys the property on behalf of your SMSF under an instalment arrangement. The \$150,000 is used to make an initial payment for the property. The shortfall of \$200,000 plus \$25,000 in stamp duty and acquisition costs is funded by a limited recourse loan, using the property as security.

The trustee arranges for the property to be leased to an unrelated party and the rent, together with other SMSF income and/or member contributions are used to make instalment payments. Once the loan is paid off, the legal ownership of the property can be transferred to the SMSF.

The importance of financial planning

There are a number of rules and regulations surrounding superannuation and planning for retirement. Your Westpac Financial Planner can provide advice about borrowing strategies for SMSFs that is personalised to your situation and goals. You should also seek professional tax and legal advice.

Things you should know: This information is current as at February 2008. This information has been prepared without taking into account your objectives, financial situation or needs. Because of this, you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation and needs. The taxation position described is a general statement and should only be used as a guide. It does not constitute tax advice and is based on current tax laws and their interpretation. Your individual situation may differ and you should seek independent professional tax advice on any taxation matters. Any loan arrangements may be subject to the provision of personal guarantees which would expose the individual guarantors to potential personal liability. Westpac Financial Planners are representatives of Westpac Banking Corporation ABN 33 007 457 141 AFSL No 233714. Westpac's Financial Services Guide can be obtained by calling 131 817, visiting www.westpac.com.au or visiting any of our branches.

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