



Our Expertise

SMSF Borrowing for Property

► *Overview*

Did you know your self managed superannuation fund (SMSF) is able to borrow money to invest in property, shares or other assets? The new borrowing exception in section 67(4A) of the SIS Act allows your SMSF to borrow money to acquire assets under an arrangement that meets certain specific conditions.

Madgwicks has developed a full suite of complying legal documentation that is flexible to meet your individual needs and straight-forward to implement. We liaise with your other professional advisers to ensure that the borrowing arrangement is implemented in a seamless, efficient and fully compliant manner.

It is a commonly understood investment principle that when asset values rise, gearing (or leverage) will enhance returns, however if asset values fall, gearing increases the losses. Therefore SMSF borrowing is not for everyone. It's a case by case assessment. Whilst it may well appeal to people in their 40s with a longer time to retirement, it may not appeal to SMSF retirees who have already accumulated sufficient assets in the fund for retirement and do not seek any risk of borrowing.

The following are some of the reasons why SMSF borrowing is a current hot topic:

- SMSFs are the largest and fastest growing segment of the Australian superannuation industry. Over \$320 billion is in self-managed super; comprising over 32% of all super money; and the average size of a self-managed fund is about \$880,000 and expected to grow to over \$1.9M over 5 years.
- Superannuation continues to provide the most tax effective vehicle for wealth accumulation with the concessional treatment on income and capital gains. However, in light of the Government's reduction in contribution limits, there is a recognition that SMSF members may need to look at alternative ways to increase in size, such as by borrowing.
- As we come out of the GFC, Australia's economy generally, and the residential property market in particular, appear to be resilient and favourable for investment.



▶ *The Process*

The following is a brief outline of a typical process for a SMSF borrowing:

Step 1 - Is SMSF Borrowing Right for you?

The first step is to discuss with your financial adviser or accountant whether this opportunity is appropriate for your superannuation strategy and your investment goals. Your adviser will undertake basic modeling and cash flows to confirm whether a borrowing is suitable for your SMSF having regard to your overall wealth management strategy. This includes determining what type of asset is to be acquired and what level of borrowing is appropriate.

Step 2 - Trust Deed and Investment Strategy Review

Next, we review your fund's existing investment strategy and trust deed to ensure they allow for a super fund borrowing, and amend them if they do not do so.

Step 3 - Identify the Lender (Finance Approval)

One of the standout features of SMSF borrowing is that the lender can either be a bank or other financial institution or the lender can be a related party (eg members of the SMSF, other family members or a family trust). If you use an unrelated lender (ie bank), you should seek some form of written finance approval offer so that you have certainty as to the terms and amount of available finance. If you are using a related party lender, you need to confirm that the lender has access to the required loan funds in order to be able to make the loan to the SMSF.

Step 4 - Sign Purchase Contract

Typically, the next step is to sign a contract to purchase the asset. The contract will typically be entered into by the SMSF trustee but will also allow for nominating a substituted purchaser (ie the custodian of the borrowing arrangement) prior to settlement of the acquisition.

Step 5 - Complete Borrowing Documents

We then prepare the suite of required legal documents, including a Limited Recourse Loan Agreement and Mortgage, Bare Trust Deed, and Minutes of Resolutions. We also provide a legal opinion confirming that the borrowing arrangement complies with the SIS Act.

Step 6 - Settlement of Acquisition

Finally, settlement of the asset acquisition occurs much like any other settlement. The SMSF will use a combination of the loan and its own funds to provide sufficient funds (ie balance of the purchase price) to complete the acquisition.

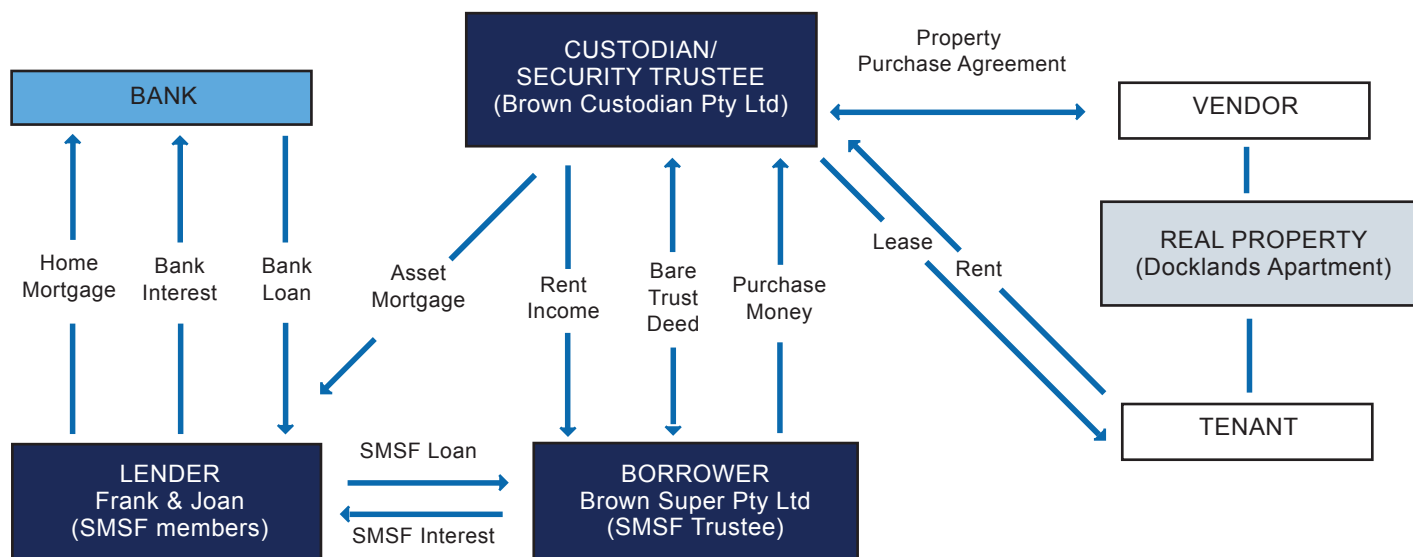


▶ Case Study Example

This case study example is for illustration purposes only and is based on the law as at today:

- ▶ The Brown Family SMSF has a value of \$900,000 comprising \$500,000 in listed growth assets, and \$400,000 in cash and fixed interest deposits. It currently does not own any direct real property.
- ▶ Frank and Joan are the members of the Brown SMSF. They are both aged 50. They own their large suburban family home worth \$1.5M with no mortgage and kids still living at home. Their vision is to become “empty nesters” in about 10 years and move into a Docklands apartment. However, they have seen the perfect apartment currently for sale with a \$1million price tag.
- ▶ After taking professional advice, they see the opportunity is to purchase the apartment now through the SMSF with a borrowing arrangement. The strategy involves the fund using \$300,000 of its existing cash and borrowing \$700,000 (a 70% loan to valuation ratio). Frank and Joan take a \$700,000 interest only line of credit from their bank secured against their home. They then lend the \$700,000 to their SMSF.
- ▶ After the Docklands apartment is purchased, the SMSF leases it to unrelated tenants. The rent received by the SMSF from the tenants is used to service the loan repayments to Frank and Joan. Frank and Joan use the loan payments received from the SMSF towards servicing the interest to the bank under the line of credit.
- ▶ The strategy in 10 years time would be for the SMSF to payout the balance of the loan (if any) and then transfer the apartment to Frank and Joan as a in specie lump sum superannuation benefit after they reach age 60. That transfer will be exempt from stamp duty and will be capital gains tax free. Frank and Joan will sell their family home, repay the balance of the line of credit (if any) and move into the apartment.

▶ An Illustration of the Borrowing Arrangement





▶ *Madgwicks & Self-Managed Superannuation Funds*

Madgwicks treats self-managed superannuation as an integral part of our wealth management services to our private clients. Our superannuation team assists our private clients with a “holistic” solution to their wealth management issues. The structure and implementation of clients’ superannuation is integrated with: their estate planning, asset protection, other family group structures such as trusts, and takes account of taxation and insurance issues.

We work closely with our client’s other financial service providers (eg. accountant, financial planner, insurance broker, stockbroker etc.) to achieve best superannuation solutions for the client. Our aim is to assist our clients to structure their superannuation so as to achieve their commercial and investment objectives, whilst always ensuring that their fund maintains its strict compliance with the regulatory requirements of relevant legislation.

Our services include providing advice, drafting documentation and negotiating commercial transactions on all aspects of superannuation law, including:

- ▶ regulatory compliance advice under the Superannuation Industry (Supervision) Act including issues concerning sole purpose test, in-house assets, borrowing and other prudential restrictions;
- ▶ advice on contribution, benefit and pension strategies, taking account of Tax Act and SIS Act requirements;
- ▶ advising and documenting section 67(4A) borrowing arrangements;
- ▶ fund design, establishment and constituent documents including trust deeds, other governing rules and ancillary documents;
- ▶ advice on binding nominations as part of the estate planning;
- ▶ advice on trustee structure issues, including residency requirements;
- ▶ advising clients on property and other asset transactions between their SMSF and related parties, including claiming stamp duty exemptions; and
- ▶ submissions, applications and other dealings with relevant regulators including the ATO and APRA.

To discuss SMSF Borrowing or any aspect of superannuation and funds management, please contact a member of our team.

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