

Property and SMF's

A Growing Industry

INSIGHTS

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Investors are using self managed super funds (SMSFs) to drive a new wave of residential property investment.

SMSF's investing in property has grown rapidly since 2007 when laws were first introduced allowing gearing to be used in superannuation to buy property and shares. According to the ATO, at June 2010, the exposure of SMSF's to property has almost doubled in just over two years to \$58.4 billion. The Investment Trends 2010 SMSF Borrowing Report survey of SMSF's identified a 115% increase to 29,000 in the number of SMSF's using a gearing strategy.

The clarification around the rules for gearing into SMSF's in July this year, on-going concerns about sharemarket volatility and the recent strong performance of residential property has continued to fuel the boom. Of the SMSF's using gearing, 41% have used it to invest in property and 30% to invest in shares.

The Investment Trends 2010 SMSF Borrowing Report also found that 75,500 SMSF's intended to acquire assets through the use of borrowings in the next twelve months.

There is no doubt that residential property is a legitimate investment. According to UBS, since 1971 Australian house prices have grown at 9.1% p.a (compound annual growth rate) . Whilst the property market has had a great run over the past few years, fears that a crash are coming are off-the mark. That's not to say one does not need to be cautious going forward. See my October article: Australian Housing Bubble – Fact or Fiction - www.thesmsfreview.com.au/exp-property-investor.html

Property held through SMSF's can be very tax effective. Firstly, the maximum tax rate your SMSF will pay on rental income is 15%. Secondly, there is little or no capital gains tax. If your SMSF owns the investment property for more than 12 months, any capital gains made on the sale will be taxed at a maximum rate of 10% or 0% if in the pension phase. It's the latter that offers the most attractive tax outcome for holding residential property in a SMSF. As a rule of thumb, we believe across a cycle, residential property will generally yield around 3-4% per annum, with capital growth of between 5-6% per annum. If one considers the performance of the median house price in Sydney since 1970, they have effectively doubled every seven to nine years.

Trustees wanting to include property into a SMSF will need to consider their fund's investment strategy. An investment strategy is a set of rules or guidelines as to how a trustee intends to invest on behalf of the members to achieve their objectives. The investment strategy must include strategies to maximise member investments, provide diversification across asset classes, paying benefits and managing liquidity, at the same time as taking into account each member's risk tolerance and term to retirement.

Trustees really do need to consider diversification within their funds. By buying a single residential property using gearing, the Trustee maybe hinging the performance of the SMSF towards a single investment and asset class. Trustees need to consider whether their fund is of sufficient size to warrant such exposure, and if not, consider getting property exposure through listed REITs or an unlisted property fund.

1. Investor Daily – SMSF Gearing Strategies on the Rise – 9 November 2010
2. UBS Investment Research – Are We Banking on a Bubble? 31 August 2010

Should an SMSF Trustees decide to invest in residential property, they need to appreciate the importance of seeking appropriate financial and property advice. Unfortunately, there is 'genuine' advice provided by qualified practitioners and there is spruiking.

In response to the surge in SMSF investing, a growth industry of property advice is occurring. Some of it looks and smells very much like the property spruikers of the past. Backed by glossy marketing materials, extensive newspaper advertising and websites that look very professional, property investment seminars promoted as "education seminars" are popping up everywhere. These seminars are luring unsuspecting/inexperienced investors to invest in property driven by the financial metrics - "own property for as little as \$25 a week", "minimise your tax by investing in residential property" and "become a millionaire". These spruikers also play to the audience's fear by citing that the majority Australian retirees won't have enough to retire on.

In many cases, the spruikers are driven by the commission being paid by the residential developer to push their projects - typically this is 6% of the purchase price but can be higher.

These spruikers have little or no regard to the location, the type and quality of the property, demographics, the local rental market, and local supply or the individual financial circumstances of the investor. Remember not all properties or investors are the same.

Unfortunately, there are a number of prospective investors who will prove susceptible to these self-seeking, money grabbing schemes.

SMSF's can be an effective way to invest in residential property. In the current environment, the Trustee's of a SMSF need to focus more than ever on making informed investment decisions. To be a successful investor, Trustee's need to surround themselves with a team of independent and unbiased qualified professionals - a team of people who are known, proven and trusted both in property and financial advisory/planning.

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