

5 Ways you can own property in your Self Managed Super Fund

Monday, 28 May 2012

Most Self Managed Super Fund (SMSF) investment strategies include an allocation to property.

Depending on the type of investor and the risk that they are willing to accept, there are a number of ways that you can gain that exposure. Here we discuss 5 different ways of including property in your SMSF portfolio, along with some of the risks and advantages of each.

Invest in a property fund or trust

Property funds and trusts are a common way of investing in property. Due to their comparatively low costs when compared with the high transactional costs and large investment amounts required for traditional (direct) property investment. These types of investments can come in many different forms including listed and unlisted property trusts, managed funds and indexed funds. These trusts may include a portfolio of certain types of property, such as commercial properties, retail centers, hospitals, leisure centers etc.

Invest in a property syndicate

Much like a managed fund or trust, a syndicate will involve purchasing units in a trust that pools investor's money to purchase a specific property/ies that will make up the portfolio. Often property syndicates will be offered with minimum investment amounts and can be exclusive to access.

Examples of property syndicates can be the pooling of investor funds in order to purchase a shopping centre, where the tenants will provide the trust with an ongoing income stream whilst the asset grows in capital value over time.

Direct Property Investment

Direct property investment involves purchasing a residential or commercial property for the purpose of leasing the property to tenants (and hopefully capital growth in the longer term). The most common barriers to entry to this type of investing are the large amount of capital needed to purchase the property and the ongoing maintenance and compliance required.

Also, this often means concentration risk, as the SMSF takes the risk of relying solely/ mainly on the performance of one asset for sufficient returns to fund member's retirement benefits.

Owning a residential property also comes with liquidity risk, where should the investor require a quick sale and be unable to find a buyer. The lending costs of acquiring this type of property are treated favorably by the Australian tax system, offsetting against the income earned and potentially allowing the investor to utilise a "negative gearing" strategy.

Owning your business property in your SMSF

Owning your business property premises in your SMSF can make a lot of sense for the fund, and also for the business. As Business Real Property is exempt from rules that govern the purchase of assets from related parties, it is often an asset that can be easily acquired by a fund from its members.

The benefit of this asset is that it will provide a reliable (what better tenant than yourself?) ongoing source of income, a generous tax benefit for the rental paid and the potential for future capital growth that can be realised in the tax advantaged environment of a SMSF.

Using borrowed monies to purchase property in your SMSF

Purchasing a property with borrowed money (commonly known as 'gearing') is possible in a SMSF, through the use of a Limited Recourse Borrowing Arrangement. It's important to note that these arrangements are however complex and require carefully planned advice, documentation and execution.

The advantages of this type of arrangement is that your SMSF can have more money invested than if it had not borrowed, and can therefore benefit from a higher return and capital growth over the longer term. And of course, the investment is owned in the tax advantaged environment of a SMSF.

This type of arrangement requires the use of a specialised trust which acts as the owner of the property in which the SMSF is invested. Generally, banks will also require you to personally guarantee the loan for the purchase. The risk is that you will be personally responsible in the case of default, not the SMSF. Also, if you are required to make a personal payment, this may be counted against your contribution limits, potentially giving rise to tax penalties and further increasing costs.

It is critical to seek expert advice before considering this type of arrangement.

Ben Rossi, Principal - Wealth Management