[superannuation]

The unit trust advantage of investing in property with super

Since September 2007 self-managed super funds (SMSFs) have been able to borrow money to buy property via a 'bare trust', *writes Pat Mannix of Gatherum-Goss & Associates.* This was formerly called a 'property warrant' but the language has been simplified and now they're just called 'SMSF loans'.

For people interested in 'direct property' as an asset class, and if they have a minimum of $150,000 in superannuation, this law change has been a big positive. ('Direct property' is the term used to describe real estate investments which are held through trusts and syndicates.)

Increasingly superannuants are enquiring about this structure and taking it up, however it does have an impediment that the Australian Tax Office (ATO) has instigated. If you're an investor who likes to buy a rundown property and either improve it, renovate it, subdivide it or knock it down and rebuild, then this applies to you. These changes to the original property have been formerly disallowed by the ATO for purchases of property by a SMSF loan, since guidance papers came out in July 2010.

The intention of the ATO is to make sure that you're fixed on retirement savings and that this is the main purpose for gearing or investing into property in superannuation. Its belief is that you're taking on enough risk as a trustee of a SMSF to take out a loan to buy a property. To then go and improve, subdivide or renovate that property would be to take on another form of risk that is just too much for trustees of super funds to bear.

This is making property investing by a SMSF less attractive for those wanting to add value. But for property savvy people who are being affected by this limitation, there is a solution. The solution involves the use of a unit trust and requires equity outside of superannuation.

First, you need to have access to equity outside of your superannuation. This is ideally established through a line of credit from an investment property or your principal place of residence. These funds are then on-lent to the SMSF via a related party borrowing and it's important that the documentation is set up correctly.

The SMSF provides 30 per cent of funds required to purchase the desired property, plus the cost of stamp duty and legals, and it combines this with the on-lent funds from outside superannuation to buy units in a unit trust. The unit trust then has all of its units owned by the SMSF and has enough money in its bank account to buy the property the trustees require, plus enough to spend on the improvement, renovation or subdivision.

For property investors this can be powerful, prudent and risk averse – all qualities the ATO would like to see in the trustees that run SMSFs. A classic example is the investor who has an ability to identify a block where there's a good solid dwelling on the front of the property and enough room at the back to subdivide the property and create another title. The trustees don't then have to take on the risk of building another dwelling; they merely spend the time and effort to work with the neighbours and local council to obtain the permit.

This makes perfect sense for adding value to a property without taking on more risk. It's also an investment for your superannuation that will be patient and steadily add value.

Local councils that have many restrictions and are notorious for taking a long time to get to work on your submission and follow things up are ideal for this investment. SMSFs are set up for one purpose: to provide retirement savings for people. For many of us there's a long time to go before that day arrives, so by law we have to be patient and that's your advantage over other developers and investors needing to get things done faster.

The difficulty and time taken to receive permits for a subdivision in some restrictive areas result in approvals that are worth far more added value than the cost to do the work.

The big kicker for superannuants is when they either sell the back block or the back block and the house at the front; the resulting capital gain on sale will only attract a 10 per cent tax rate if the investors aren't in retirement yet, or zero tax if the investors are in retirement.

Unit trusts are a great way to overcome the restrictions that are placed on borrowing in superannuation, but you need to receive the correct structuring and advice in this specialised area.

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