

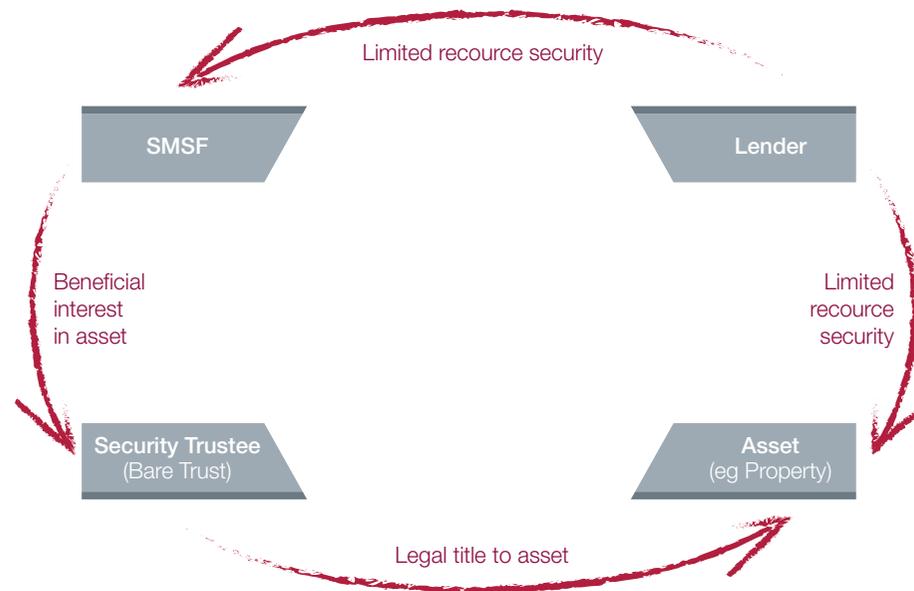
Super funds borrowing to buy real estate

More and more Australians are establishing their own self managed super funds (SMSF) so that they can control how their superannuation is invested. Due to the share market volatility in recent years, many super fund trustees are exploring other investment opportunities including real estate.

The difficulty in investing in real estate is that a large amount of capital is required to purchase the asset. Until 2007, the superannuation laws prevented superannuation funds from borrowing money and using real estate as security. Since then super funds have been able to borrow money to purchase real estate provided that the arrangement meets certain criteria which includes the following:-

- The money borrowed is applied to acquire an investment property.
- The property is purchased by and held on trust by a separate trust (a **bare trust**) and the SMSF is the sole beneficiary of that bare trust.
- The SMSF can have the title to the property transferred to it from the bare trust once the loan is repaid.
- The rights of the lender are against the property only and not the assets of the SMSF generally.
- The property held by the bare trust must be the only asset held by that bare trust.
- The SMSF cannot acquire an asset from a member or a relative of a member unless the asset is business real estate.

Below is a diagram showing the basic structure of how a SMSF can borrow to purchase real estate.



It is necessary to establish the bare trust **before** entering into a contract to purchase property. Lawlab can assist SMSFs in setting up their bare trust structures and the conveyancing of the property.

Example

The Jones Superannuation Fund is a SMSF. The trustees of the SMSF have always been keen on property as a class of investment and the trustees of the SMSF have decided to liquidate the SMSF's position and explore property investment opportunities.

The SMSF generates \$200,000 from its share sales. It has found a suitable residential property to acquire from an unrelated party, but it will cost approximately \$500,000 plus \$25,000 in incidentals such as stamp duty, legal costs and borrowing costs (a total of \$525,000).

It will rent the property to an unrelated person for its market rent. The trustees of the SMSF enter into the following arrangement, enabling the SMSF to borrow and acquire the property.

- An appropriate lender is found who understands the detailed requirements to satisfy SMSF borrowing laws.

- The property at 123 Smith Street, Smithfield is purchased using \$200,000 of the SMSF's money and borrowing the balance of \$325,000 from the lender (i.e., a 65% LVR, being \$325,000 of the \$500,000 purchase price in this case). The SMSF is the borrower of the \$325,000.
- The property must be purchased by and initially be held on trust for the SMSF by another entity (123 Smith Street Pty Ltd as trustee for the 123 Smith Street Bare Trust).
- The SMSF has the right to acquire legal ownership of the property by making payments (the outstanding loan of \$325,000, plus interest). On the final payment, legal title can be transferred to the SMSF.
- The SMSF receives the rent from the residential property directly.

- The SMSF directly pays the loan repayments to the lender.
- The lender's recourse against the SMSF is limited to the property.
- The lender has no right of recourse against other assets of the SMSF.
- To compensate or protect the lender for this limited recourse, the lender may:
 - charge a higher interest rate on the borrowing;
 - insist on a lower LVR; or
 - request a personal guarantee from the members of the SMSF.

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