



# SUPERANNUATION

# Q&A

## Borrowing to buy property in a super fund

A superannuation fund borrowing directly to buy property is a relatively new concept gaining in popularity, particularly with self managed super funds.

Borrowing arrangements have the potential to increase your retirement benefits by offering 'gearing' in a tax advantaged structure. However, care must be taken to ensure that any borrowing arrangement represents a sound investment decision and that all legal and compliance requirements are met.

### **Concessional tax rates**

As with all super fund investment returns, rental income and any gain on disposal of a property will be taxed at concessional rates being a maximum of 15%. If your super fund is in pension phase, you will pay no tax.

### **Access existing equity**

Direct property investments can impose a significant cash burden. It generally costs a lot to get into the market.

By using your super fund you can access your existing balance as seed capital to finance the investment. Future contributions, which may also qualify for tax concessions, can be used to pay down debt.

### **Size & diversification**

You are often limited in the range and size of investments you can hold in a super fund. Contribution limits and the restrictions on member numbers effectively limits the speed with which your super fund can grow.

Being able to borrow to acquire property means your super fund could buy an asset it otherwise wouldn't be able to afford. Similarly, borrowing to buy property may allow a level of diversification within your portfolio that you wouldn't otherwise be able to achieve.

### **Cash flow**

One of the key considerations in structuring a geared property investment in a super fund is cash flow within the fund. There are limits on the amount you can put into a super fund each year.

As a result, it is crucial that the super fund has sufficient cash to meet repayment requirements and all costs associated with the investment as well as other ordinary outgoings such as

minimum pension payments. The higher the proportion of the purchase price the fund borrows, the greater the pressure on the fund's cash flow.

### **Borrowing limits**

Cash flow considerations place an effective limit on the level of borrowing you can commit to and banks set lending criteria that generally require the income generated from the property to exceed interest costs and other outgoings associated with the property. Combined, the maximum level of gearing is generally limited to 60% to 70% of the property value.

There is comparatively little value in negatively gearing within a super fund anyway. Any loss from the investment would generate a tax deduction for the super fund but as a super fund only pays a maximum of 15% tax and possibly nothing, the tax break the fund obtains from negative gearing is small compared to other structures that might be available, such as investing personally or through a trust.

### **When it works best**

Borrowing in a super fund works best when the investment is cash flow positive and profitable. This means the concessional rate of no more than 15% applies on the profit. From our experience, borrowing arrangements work best when a super fund borrows less than 60% of the property value.

### **Counting the cost**

Costs associated with a borrowing arrangement are likely to be larger than you expect. There is a legal structure requiring the property to be held on trust. Putting in place a trust structure typically costs between \$2,500 and \$5,000.

## Borrowing to buy property in a super fund

Banks will charge their own establishment fees, typically in the order of 0.8% of the amount financed. Interest rates may also be higher than rates applying on standard property investment loans as the lender only has recourse against the property on default, although rates are becoming more competitive over time.

Add to that other direct costs, such as stamp duty and government fees.

### Related party lending

If you have cash available in the family group, a related party can lend to the super fund provided the loan is on commercial terms. The advantage of related party lending is it may reduce costs by eliminating the fees charged by banks and by keeping interest payments in the family group.

Another popular structure is for a related party to borrow from a bank on standard property investment terms by giving security on existing assets and then on-lending to the super fund. This can avoid extra costs banks may look to charge.

### The structure

A special purpose 'custodian trust' holds the property for the super fund until the loan is repaid. The trust has no other role, the super fund retains beneficial ownership of the property and

all income and expenses related to the property go through the super fund. There is no requirement to prepare accounts or returns for the trust. When the loan is repaid, legal title passes to the super fund and no tax consequences generally arise.

The loan must be established on a limited recourse basis meaning the recourse in the event of default is limited to the property acquired with the borrowed funds and not to other super fund assets. Banks will generally require personal guarantees however.

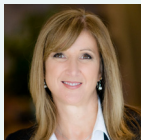
### Limitations

A super fund can borrow to buy commercial or residential property however a residential property could generally not be acquired if already owned by the family group. You must be borrowing to acquire a single asset or group of identical assets. This rule causes complexity if the property may encompass more than one title. Generally any development plans will also have to wait until the loan has been repaid.

## Further information

Please ask your regular Pitcher Partners contact or any of the contacts below for further information.

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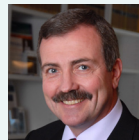


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