

LENDING TO SELF MANAGED SUPERANNUATION FUNDS

Lending to SMSF's

Section 67 of the Superannuation Industry (Supervision) Act 1993 (SIS Act) prohibits the trustee of a superannuation fund from borrowing money, however, there are exemptions to this; one of which allows '**limited recourse borrowing arrangements**'. It is this exemption that allows a SMSF to borrow for investment purposes and is further explained as follows:

A trustee is permitted to borrow money to fund the acquisition of investment assets where the borrowing is taken out under an arrangement where:

- The money is used for the acquisition of 'a single acquirable asset'.
- The acquirable asset is held on trust so that the super fund trustee acquires a beneficial interest in the acquirable asset.
- The trustee has the right to acquire the legal ownership of the acquirable asset by making one or more payments after acquiring the beneficial ownership.
- The rights of the lender against the trustee in relation to the total borrowing plus any related charges are limited to the rights in relation to the acquirable asset (in the event of a property loan secured by a mortgage, this will be the net sale proceeds of the mortgaged property).
- The acquirable asset is not subject to any charge other than that provided in relation to the borrowing.
- Borrowings can be used to purchase, cover transaction costs and to maintain and repair the acquirable asset it cannot be used to fund any improvements.

Further clarification on these conditions:

Single Acquirable Asset – is an asset, other than money, that a trustee is not prohibited from acquiring by the SIS Act or other law. The definition extends to allow a group of identical assets with the same market value (e.g. shares in a company traded on the ASX), a group of residential units on different titles would not qualify under this definition.

Asset Held on Trust – a trust is established (known as a Bare Trust or a Property Trust) to hold the asset and this trust in turn provides the security to the lender. The provisions of the trust deed will provide a beneficial ownership to the trustee of the SMSF and also provide for the transfer of ownership to the SMSF on receipt of payment/s. In practice (context of a property loan) this would be the loan repayments.

Security – The security, over the asset, provided to support the loan in favour of the lender must be single transaction in nature and the associated loan documentation cannot provide recourse to any other SMSF assets. In addition the trustee cannot provide any other charge over the subject asset, e.g. a 2nd mortgage to another lender for a top up loan.

Purpose – The SIS Act excludes borrowed monies being used to improve a property however a SMSF can use its own funds to carry out the improvements but on the proviso that the asset is not seen as a different asset once the improvements are completed.

- For example if a 4 bedroom home had an extension which increased the size of the living area it would still be a 4 bedroom home on completion. If that 4 bedroom home was divided into 2 x 2 bedroom flats this would be considered as a change in the type of property and not permitted under the SIS Act. Payment for repairs and maintenance as defined by the act is an acceptable use of borrowed monies.

Use – When considering the type of asset to be purchased the SIS Act borrowing rules will also need to be considered. In context the requirements of arm's length dealings and investing for retirement benefit means that a property acquired cannot be used as a permanent or holiday residence for any member or relative.

- Business premises are excluded under some circumstances.

Structuring – Bare Trust

Most lenders will accept a trust that has been set up by yourself however they will require the trust deed to be vetted to ensure it is compliant.

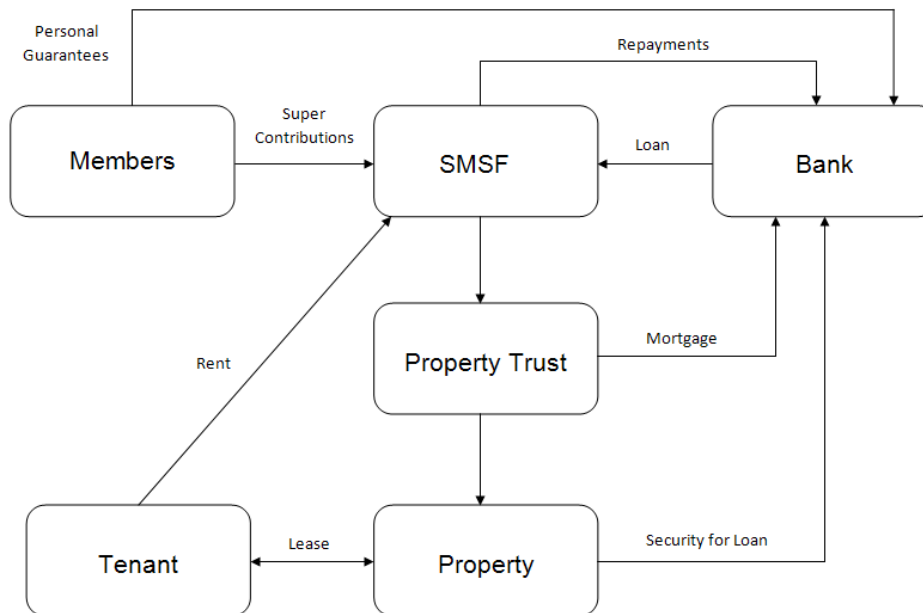
There will be a cost associated with vetting the deed and if it is not compliant the Bank will require a variation to the deed prior to proceeding to settlement (some lenders will actually provide a template document as a guide to show what is acceptable).

Loan Structure

Here is a diagram of a Standard loan structure for a SMSF loan:

While the basic principle will remain the same there will be some variation dependant on the lender.

STANDARD LOAN STRUCTURE



Key points to understand here are:

- The property trust owns the property and provides the mortgage to the Lender. Requirements for when the Bare Trust should be established (relative to when the purchase contract is executed) varies between states and can have stamp duty implications for the borrower. Legal advice on this aspect should be sought.
- The loan is made to the SMSF and the fund receives the rent (and other) income from which payments are made.

- The Trustee of the SMSF must be different from the Trustee of the Bare Trust. This is a legislative (not lender) requirement so the Trustees can be seen to be acting independently.
- Lender policies as to acceptable borrowing structures will vary e.g. some allow individual trustees others will only lend to a corporate trustee, and this is an important consideration when assessing the suitability of a loan product.
- Once the loan is repaid the property can be transferred to the Super Fund. Legal advice on this aspect should be sought.

Parties Involved in a Typical Transaction

The following summary is not exhaustive and while each transaction will not necessarily involve all parties their roles are summarised for your information.

It will be common to find some parties operating in conjunction with other specialists to offer a complimentary one stop shop service for clients:

Counterparty	Role
Solicitor	Prepare and advise on the Trust Deeds for the SMSF and any property holding trust
Accountant	Provide financial product advice on establishment, operation, structuring and / or valuation of an SMSF. Unless they are an authorised rep of an AFSL with the appropriate qualifications they cannot provide specific advice in relation to investment strategy. Some accountants may also provide a SMSF management service which assists the trustee meet their obligations.
Financial Planner	Provides advice on investments and works with the Trustee to develop, implement and monitor the Investment strategy for the SMSF.

Finance Broker	Provides access to lenders who lend to SMSF's and advice on loan product/s in addition to making an assessment and recommendation of which product is 'not unsuitable' to meet their financing needs.
Lender	In addition to providing the loan product the Lender in a SMSF loan structure will need to vet the various trust deeds to ensure they are suitable for their purposes which may involve further interaction with the solicitors and / or accountants. Some lenders require the SMSF to use the Bank's property trust structure.
SMSF Administrator	Trustees may elect to outsource the management of fund to a specialist firm which may include all aspects

Disclaimer

Any advice given is of a general nature only and it not based on any consideration of your objectives, financial situation and needs. To decided if a product is right for you, please carefully ready the Product Disclosure Statement ("PDS") for the product. A PDS can be obtained from your credit provider(s).

This document is current as at 01/01/2015. Please refer to your financial planner or accountant for the recent changes to SMSF.