



Self Managed Super Fund (SMSF) Limited Recourse Loans

Memorandum

Have you been searching for someone *you can trust* to assist with arranging both the finance and legal structure that accompanies limited recourse borrowing arrangements?

Ever since the Superannuation Industry (Supervision) Act 1993 (SIS Act) was amended in late 2007, *SMSF Lending* has been arranging Super Fund loans and accompanying legal structures.

For further information, contact *Vic Bulfone* from SMSF Lending
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1. Introduction

Until recently the SIS (*Superannuation Industry Supervision*) Act 1993 prohibited a Self Managed Superannuation Fund (referred to as a 'Super Fund' in this document), from borrowing money to purchase assets.

Recent amendments to the SIS Act were introduced to allow Super Fund's to invest in any kind of asset and to borrow, charging those assets so long as there is no recourse for the borrowing against the Super Fund.

New section's 67A & 67B of the SIS Act permit a Super Fund to borrow money if:

- (a) the money borrowed is applied for the purchase of an asset;
- (b) the asset is held on trust so that the Super Fund acquires a beneficial interest;
- (c) the Super Fund has the right to acquire legal ownership by making payment;
- (d) the rights of the lender against the Super Fund for default are limited to the security.

2. Basic Structure

The Super Fund can only borrow money to purchase an asset if it complies with the following:-

- ✦ The Super Fund may select any property, residential or commercial. The purchase must be an 'arms length transaction' (i.e. the property is purchased from a 'stranger'). There is an exception for 'business assets' (i.e. property leased to a tenant who conducts a business in the property). In this case, the property may be purchased from a 'related party' of the Super Fund.
- ✦ The legal title to the property must be held on trust by an independent trustee.
- ✦ The beneficial title to the property will be held by the Super Fund.
- ✦ The lenders recourse will be limited to the property, thereby providing the Super Fund absolute protection for its other assets). Certain lenders will also require a personal guarantee from all members of the Super Fund.
- ✦ All rents will be paid directly to the Super Fund.
- ✦ The Super Fund will make loan repayments to the lender.
- ✦ The Super Fund will make loan repayments to the lender.
- ✦ Super Fund's can deal with the property however and whenever they like, in the same way as you can deal with 'normal' investment properties (e.g. lease, repair, or sell).

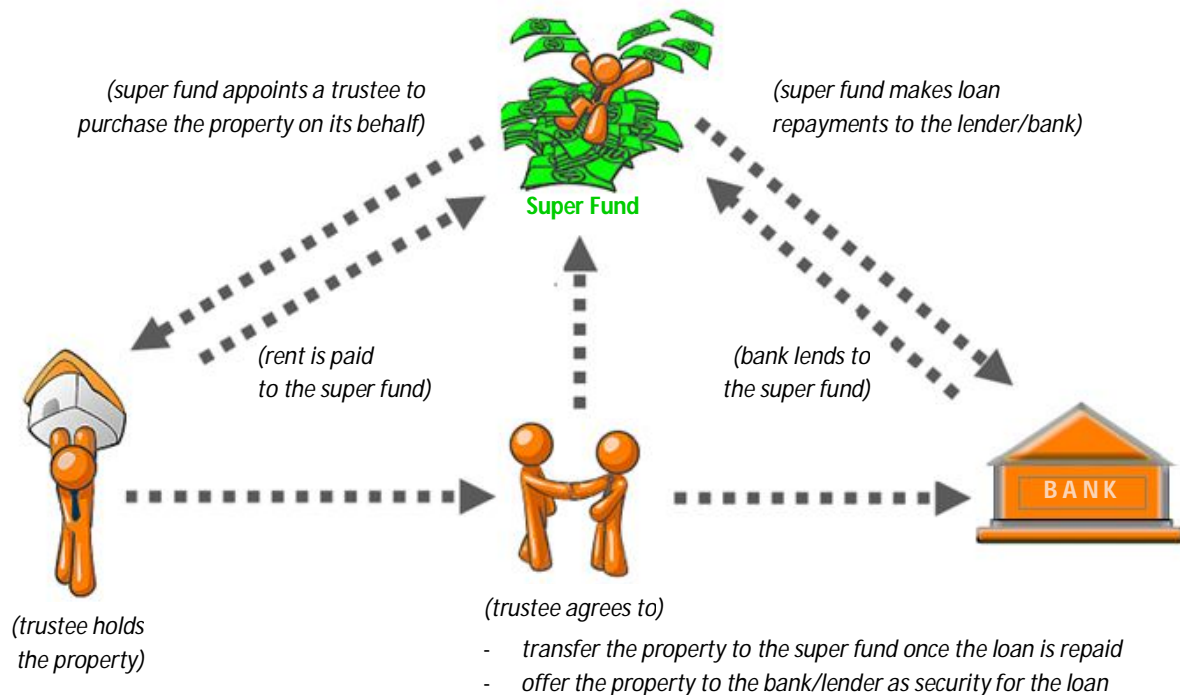
- ✦ The Super Fund can pay out or reduce the mortgage at any time (subject to the terms of the relevant loan).
- ✦ When the mortgage is paid out in full, title to the property may be transferred to the Super Fund by the Property Trustee, or the Property Trustee may continue as registered proprietor.

It is important that the structure clearly complies with all the above requirements. Failure to do so may result in the Super Fund being declared 'non-compliant' within the meaning of the SIS Act.

It is also important to adhere to the lenders varying trustee requirements when establishing the legal structure. For example, certain lenders require a corporate trustee for the Super Fund, whilst the others will allow individual trustees.

3. How Does It All Work?

There are several entities that complete the purchase/borrowing structure, the diagram below illustrates each including their duties & responsibilities.



4. The Loan

We will guide you through the maze of Super Fund lending products available in the market today and negotiate 'favourable terms' on your behalf which ensures you receive the best possible deal.

- ✦ It's an ordinary loan that enables you to purchase residential or commercial property with the Super Fund paying the deposit and any other cost/s, i.e. stamp duty;
- ✦ Complies with the Government Legislation (SIS Act - s67A, 67B);
- ✦ It is a 'Limited Recourse Loan', meaning the lender cannot touch any other Super Fund assets other than the property held as security;
- ✦ Loan to Value ratios are available up to 80% for residential and 65% for commercial property purchasers;
- ✦ Up to a maximum 30 year loan term for residential & 15 years for commercial purchasers;
- ✦ Deposit 'Mortgage Offset' accounts are available (with certain lenders).

Loan products are restricted by nature and typically limited to:

- ✦ A variable rate loan; or
- ✦ A fixed rate loan, 1-5 years.

What other restrictions are there?

It is important to remember that there are loan restrictions associated with this borrowing arrangement, including the 'type/s' of security lenders will accept:-

- ✦ No construction / refurbishment;
- ✦ No vacant land;
- ✦ No increase in the loan amount post settlement;
- ✦ All Super Fund property purchasers must be on a 'stand alone' basis, no other assets inside or outside the Super Fund can be utilised.

5. How Do I Qualify For A Super Fund Property Loan?

Lenders have varying loan servicing, legal structure, assessment principals and qualifying credit criteria that must be met, care must be taken when selecting your lender of choice, for example:-

Loan Servicing

Lender **(A)** - confirms loan servicing utilising super fund contributions and rental income only;

Lender **(B)** - includes personal income streams and offsets with personal liabilities.

Interest Rate Charged

Lender **(A)** - will apply a standard variable mortgage interest rate for residentially secured loans;

Lender **(B)** - will apply a commercial interest rate to residentially secured loans.

Disclosure Requirements

Lender **(A)** - does not require details of any personal/business assets & liabilities;

Lender **(B)** - requires all personal/business assets & liabilities to be noted on the application.

Guarantee Requirements

Lender **(A)** - requires a personal guarantee from all applicants/members;

Lender **(B)** - does not require any personal guarantee/s

Which Bank/Lender?

Are you seeking a better understanding of your position with a Super Fund property purchase?, wondering which lender is best suited for you?, curious who offers the lowest interest rates in the market?, seeking a second opinion?

If you answered yes to any of these questions, contact us for an obligation free discussion with our Super Fund lending specialist *Vic Bulfone* you'll be glad you did.



6. The Legal Structure

In order for a Super Fund to purchase an investment property and borrow money, it will be necessary to have a special legal structure in place.

It is estimated that 55 to 60% of legal structures fail to satisfy the lenders requirements, which quite often leads to delayed settlements and penalty interest being applied, this is as a result of the deed rules not containing specific wording/clauses that is unique to each and every lender.

You will have comfort in knowing that NTAA Super Fund deeds have adopted significant changes over the last four years to not only ensure SIS Act and regulatory compliance, but to also accommodate the individual requirements of the lenders.

We guarantee that our Super Fund deeds will pass legal vetting by any lender, however in the rare instance that a particular lenders requirements change without notice, we will make the necessary amendments speedily, and free of charge.

Property/Bare Trust Deed

The Property/Bare Trust Deed is a key component within the legal structure and extreme care is required so to ensure there are no adverse GST, taxation or stamp duty consequences.

The SIS Act requires where an asset is acquired with the proceeds from a loan, the asset "is held on trust" with the Super Fund being the beneficial owner to the asset at all times. Once the loan is repaid in full the asset can then be transferred to the Super Fund.

We can assist with structuring the required legal structure which may include a new Super Fund or updating the governing rules of an existing fund, a new trustee company etc.

Property Trust Service

Our 'Property Trust Service' will equip you with the Property/Bare Trust deed and various other legal documents required to ensure compliance together with a smooth transition to settlement.

The cost for this service is **\$995** and has the following inclusions:-

- ✓ Property/Bare Trust Deed;
- ✓ SIS Act S67A & 67B, Auditors 'Letter of Compliance';
- ✓ Full Legal Backup (at no additional cost);
- ✓ Minutes of Meeting for any/all Corporate Trustees;
- ✓ Beneficial Owner Statutory Declarations;
- ✓ Trustee Statutory Declarations;
- ✓ Trust Deed/s 'signed off' by major banks/lenders;
- ✓ All documentation individually prepared by a Lawyer.

Superfund's Trust Deed

The Super Fund's Trust Deed contains the rules that govern the Super Fund. This being the case, the Trustee of the Fund must ensure that the Trust Deed contains all of the provisions required under the section 67(A&B) of the SIS Act.

7. Case Study - Residential Property Purchase

Peter is 45 years old and has been thinking about purchasing an investment property for around \$450,000, he recently became aware of the changes to the borrowing rules that now permits Super Fund's to invest in residential property and decided to investigate further.

He met with his financial planner who recommended he weigh up the alternative strategies of a "normal" negatively-gearred investment or setting up a Super Fund to purchase the investment.

Peter concluded that it would be a great way to generate wealth for his retirement by using his Super Fund to pay the deposit and any other purchasing costs, i.e. stamp duty, bank fees etc.

He was astonished to find that, by utilising a Super Fund to purchase the residential investment property, the total projected Capital Gains Tax savings alone on selling the property at age 65 would amount to \$180,416

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Assumptions: Purchase price \$450,000, Property value increases by 5% pa, Marginal Tax Rate of 38%, Current Taxation & SMSF laws remain unchanged

8. Case Study - Commercial Property Purchase

Bob is 62 years old and runs a successful hardware store from a building he bought in 1992 and has now fully paid off. Bob wants to retire and let his son James take over the business. But James can't get a loan to buy the property because, at a value of \$1M, like most people his age James doesn't have enough deposit.

Bob, his wife and James have a Super Fund with total assets of \$500K. In discussions with his Accountant Bob learns that his super fund can acquire the property using a super fund loan.

The family's super fund invests in the property by taking out a \$650K loan and the Super Fund uses its existing funds for the \$350K deposit and other transaction costs. Bob and his wife receive \$1M, which they use to top up their super and produce a retirement income stream.

No CGT is payable as the sale was exempt under the small business retirement provisions. Bob and his wife each get a tax deduction for up to \$50K of the super contribution and can receive up to \$85K p.a. tax-free income.

James' business pays the same tax deductible rent as previously except now the \$75K p.a. goes to the super fund. Bob doesn't have to worry about selling the business or premises to an outsider and James doesn't have to worry about being evicted or suffering 'unfair' rent increases.

"James' business pays the same tax deductible rent as previously except now the \$75K p.a. goes to the super fund."

9. Commonly Asked Questions

Q1. How does my Super Fund purchase a property?

- ✦ The Super Fund chooses the property it wishes to invest in, in the ordinary way. Residential property must be purchased from an arm's length vendor. Non-residential property can be purchased for full value from "related vendors" so long as the property is let for business purposes. **The Contract for Sale to purchase the property must be entered into in the name of the Property Trustee (as owner of the legal interest in the property).**
- ✦ The Super Fund obtains a loan approval. The loan will be in the name of the Super Fund.
- ✦ The Super Fund 's own lawyer/conveyancer acts on the purchase in the ordinary way.
- ✦ The Super Fund pays the deposit, stamp duty and any other associated cost's (i.e. legal fee/s), with the balance of monies required to effect settlement funded by the bank/lender.
- ✦ On completion of the purchase, the Super Fund borrows from the Lender and charges its beneficial interest in the property to the Lender, the Property Trustee mortgages the legal title to the property to the Lender.
- ✦ The Property Trustee then manages the asset in the same way as you would with any other real estate investment.

Q2. Can fund members occupy Residential property?

No. If fund members or related persons occupy the property, the "in-house asset rule" will have been breached.

Q3. Can fund members occupy Commercial property?

Yes. Fund members or related persons can occupy 'real business' commercial property.

Q4. Who pays what and when?

As the beneficial owner of the property and the borrower of the loan, the Super Fund is responsible for paying all the usual amounts that you would expect to if you had bought an investment property and borrowed money on it outside a Super Fund.

For example, the Super Fund will be required to pay the following costs, that is unless the tenant assumes responsibility for covering these costs:-

- ✦ council rates, water rates, and land tax (if any);
- ✦ interest and other loan repayments;
- ✦ Lender's fees;
- ✦ repairs;
- ✦ property management costs; and
- ✦ insurance premiums.

Q5. What about land tax?

As the Super Fund is the beneficial owner of the property, land tax is payable by the Super Fund and not by the Property Trustee. The Super Fund upper Fund will only have to pay land tax if the total land value of properties owned by the fund exceeds the prescribed amount. Land tax is payable in all States and Territories except the Northern Territory.

Q6. How can I sell the property?

The Super Fund can direct the Property Trustee to sell the property to any third party (subject to paying out the loan and any other amounts which might be outstanding).

10. ATO Rulings/Borrowing Provisions

The asset being acquired

Old law

The ATO acknowledged that pre-7 July 2010, more than one asset could be acquired under a particular arrangement and the assets acquired did not all have to be of the same form or type. Thus, a portfolio of shares in different companies or more than one title over real property could be acquired under a single limited recourse borrowing arrangement.

New law

Under the amended law, however, the original asset being acquired must be a single asset or collection of identical assets that have the same market value (eg a collection of ordinary shares in a single company).

Capital improvements and associated expenses

Old law

The ATO considered that a Super Fund trustee could draw down under a limited recourse borrowing arrangement to make capital improvements to real property held by the Property Trustee under that arrangement, maintain the asset and meet other costs of the arrangement without contravening the pre-7 July 2010 law. However, a Super Fund trustee could not make a drawdown to extract cash from the arrangement.

New law

The amendments clarify that money under a limited recourse borrowing arrangement applied for the acquisition of an asset can be used for expenses incurred in maintaining or repairing the asset, to ensure that its functional value is not diminished, but not to improve the asset.

Hence, a borrowing cannot, under the amended law, be used to construct a building on land or to renovate, other than to make repairs which do no more than ensure that the functional value of the property is not diminished.

Associated expenses that are considered to be intrinsically linked to the purchase of the acquirable asset can, under the amended law, also be included as part of the borrowing. The examples provided in the Amending Act (ie conveyancing fees, stamp duty, brokerage or loan establishment costs) are specifically allowed as part of the borrowing arrangement.

Limited recourse and charging the asset being acquired

Old law

The ATO accepted that pre-7 July 2010, a fund member could provide a personal guarantee to the lender in a limited recourse borrowing arrangement.

While recourse of the lender against the fund trustee in the event of a default on the borrowing had to be limited to the asset that was being acquired under the arrangement, the ATO accepted that a third party could put up their own assets as a guarantee or mortgage one of their assets (in which the fund did not have an interest) to the lender to provide additional security to the lender and, significantly, that a third party guarantor was not required to waive their usual rights of indemnity against the principal debtor (the fund trustee) in the event of a call on the guarantee.

New law

The amendments were designed to protect fund assets from claims in connection with a default on a borrowing to acquire an asset under an arrangement by limiting the rights of the lender or any other person against the fund trustee, for or in connection with or as a result (direct or indirect) of a default on the borrowing or charges related to the borrowing, to rights relating to the asset acquired.

In this way, a guarantor's rights against a fund trustee are limited as the rights of the lender are limited, so that no claim against the fund trustee should arise which could give rise to a claim for indemnity from fund assets.

Further, the asset being acquired under an arrangement cannot be subjected to a charge other than in relation to the fund trustee's borrowing or rights in relation to the asset, eg the asset cannot be used as security for another loan.

11. Why Choose InterPrac & SMSF Lending?



We offer a 'turn-key' service and can assist in all aspects relating to Super Fund Loans/Limited Recourse Borrowing Arrangements.

By using our services you can be sure to get the best advice for your super fund loan and our experience in this field will also ensure the legal structure is established correctly, at minimal cost and in line with the banks individual requirements .

SMSF Lending will guide you through the maze of Super Fund lending products available in the market today. We will negotiate 'favourable terms' on your behalf which ensures you receive the best possible deal.

To gain a better understanding of what your position is with purchasing an investment property through your super fund, or to discuss the various lending options available to you, contact us for further information .

12. Our Partners



NTAA Corporate is an incorporated legal practice dedicated to the establishment of Companies, Trusts and Super Funds.

Our products are supported by in-house legal council and the NTAA (National Tax & Accountants Association), and have been created by specialist tax, corporate and trust lawyers and are updated to keep abreast of legislative changes.



InterPrac Financial Planning offers a very broad range of financial products and our planners are provided with current and historical research to enable them to ensure clients' needs are addressed.

It is now a requirement that Super Fund Trustee/s receive professional advice from an authorised Financial Planner, i.e. statement of advice, investment strategy, financial plan etc. With our expertise in this field, you can be sure to receive the best and most appropriate advice based on your individual circumstances.

The information provided within this memorandum is general information only and provided as a guide to the steps involved in borrowing money and buying property through a Self Managed Superannuation Fund (SMSF). This information is not legal or financial advice and you should obtain professional legal, financial and taxation advice before applying for any loan or purchasing any property through your SMSF. SMSF Lending excludes all liability for any losses suffered by you as a result of your reliance on the information contained within this memorandum.