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NEWSLETTER

SEPTEMBER 2017

Borrowing to invest within your SMSF

Self-managed superannuation funds (SMSFs) open up a whole new world of investment opportunities for your retirement savings, including direct property. But what if you simply don't have enough money in super to buy an asset outright?

Traditionally, you may have had to consider borrowing the balance yourself and then becoming joint owner of the investment with your super fund. Perhaps this would have been set up through a trust structure to give you flexibility later on.

However, changes to legislation now permit SMSFs to borrow money directly to help purchase investments such as direct property and shares. As with any SMSF investment, for this to be allowed, strict criteria must first be met.

Compliance is essential

The burgeoning growth in SMSFs combined with low interest rates has encouraged more SMSF owners to invest in property. Although these combined factors have made it more appealing, the need to comply with the borrowing rules is essential, specifically:

- Only commercial property or residential property used for investment purposes can be purchased and these transactions need to be made at "arm's length" on a strictly commercial basis.
- Any property must be purchased as a single asset.
- Loans used for purchasing property need to be made on a non-recourse basis.
- The property title must be held in the name of the trustee of a Bare Trust, not the trustee of the SMSF or any member of the SMSF.

To assist in enforcing compliance the ATO is armed with a range of powers including the imposition of administrative penalties and rectification and education orders against SMSF trustees.

How it might work

We will use a case study to demonstrate how this might work for small business owners.

Owners of CSJ Architects, Craig and Sarah James, currently lease their business premises. They want to buy the premises but with their current home mortgage, they don't have the available money to do so.

Craig and Sarah's SMSF has a balance of $430,000. They are interested in how they can use some of these savings to purchase the premises (valued at $500,000); eliminating future rental payments whilst building up a sound asset in their fund.

Can their SMSF borrow?

In this example, one of the benefits of investing through their SMSF is that the couple can use a portion of their existing superannuation balance as a deposit on the purchase of the business premises.

On these types of loans, banks are not likely to lend up to 80% or 90% of the property value as with normal investment loans. The deposit is more likely to be around 60% to 65%.

Here, the SMSF has borrowed $200,000 from the bank to make up the difference between the James' deposit of $300,000 (60%) from their super fund and the purchase price of the premises. Over time, the SMSF will use rental income, plus super contributions received from Craig and Sarah, to repay the debt to the bank.

The remainder of their SMSF balance is invested across other asset classes to meet their Fund's investment strategy.

Is it better to borrow personally if you can?

Within the SMSF environment, the tax benefits of negative gearing are not so obvious. The excess deductions cannot be claimed by the individual members, only by the fund itself. This outcome should be weighed against the advantages of SMSF borrowing, as well as having a sufficient deposit as noted above.

Like Craig and Sarah, the decision you make depends on your particular financial circumstances and arrangements. Don't get caught up in all the marketing hype. Always consult a qualified SMSF adviser to ensure your fund has the most appropriate structure and investments for your retirement.

What you need to know about refinancing

A home loan is generally a long-term proposition, but in some situations it can make sense to refinance your mortgage. Read this guide to the refinancing process, and speak to your broker, before deciding whether it's right for you.

Refinancing involves taking out a new mortgage and using those funds to pay off your existing mortgage. Doing so can save money and result in significant financial gains over time.

Why you might refinance

You might want a lower interest rate.

The lending products market is highly competitive and interest rates can vary significantly between banks. One of the most common reasons people choose to refinance their mortgage is to secure a lower interest rate from another lender. This could assist you to pay off your home loan sooner, potentially saving you thousands of dollars

That makes sense, but before taking any action it's a good idea to speak with your broker. They can not only look for a better interest rate for you but also help find you the type of lending facility that suits your lifestyle. This may even mean renegotiating a better deal with your existing lender. Either way your broker will help with the right advice.

Keep in mind that not all mortgage products are the same. A mortgage with a lower interest rate may not have all the benefits of your existing loan.

The interest rates, fees and the features need to be carefully considered and your broker can help you to navigate the options.

You want to change your loan type

You may want to switch from a variable loan to a fixed loan with your existing lender, to lock in a low interest rate. Depending on the type of mortgage you have, this may require refinancing into a different product. You might also have to refinance if you want to change to a split loan, which has part variable and part fixed rates.

You want to renovate or purchase an investment property

Another reason refinancing might be an option is because you want to renovate your home or buy an investment property. If you have equity in your home, you may be able to access some of the equity by refinancing your mortgage. (Note that you could also do this by redrawing or increasing the limit on your existing mortgage.) Your broker can help advise on the best option for you. Before going ahead with an increase or refinance, your home may need to be revalued and your broker will advise how much you can borrow.

Your circumstances have changed

Refinancing could also be suitable if your circumstances have changed – for example, a significant change in your income. By taking out a new mortgage (or increasing your limit on the existing mortgage) through your current broker, you may be able to consolidate other debts, including personal loans and credit cards, into one facility, lowering your monthly payments and saving you interest.

While refinancing can save money, it may not be right for everyone. Consider your financial situation and ask yourself whether refinancing is right for you .

The refinancing process

Getting the refinancing ball rolling is simple once you've determined your needs and done your research through your broker.

The application. Your broker will evaluate your circumstances and assist you in submitting your application. You'll be asked to provide identification documentation and proof of income such as pay slips, and to list your assets and liabilities. If you're staying with your existing lender, you may not need to provide as much information.

Getting a valuation. Lenders will often require a valuation on your existing home to determine how much you can borrow. This bank valuation happens during the loan approval process and generally requires an inspection of the property by a licensed valuer.

Receiving approval. Once the lender is completely satisfied, full loan approval is granted. You'll receive an approval letter with a copy of the loan contract to review, sign and return to the lender.

Your funds will be cleared once all the signed documentation is reviewed. Your lender (or your new lender if you're changing lenders) will arrange settlement of your existing loan and establishment of your new loan.

There are many reasons why you may want to refinance your mortgage. Before taking any action it's important to talk with your broker. They can help you to select the best loan product for your needs, based on your individual circumstances.

Contact Mick Doyle in the Accountplan team to find out how he could better your situation.

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