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SMART MONEY PROPERTY

Opening the door to DIY funds

It's more common to borrow for commercial property but self-managed funds can hold residential bricks and mortar too, writes **Jackie Pearson**.

Borrowing to invest in residential real estate through a do-it-yourself superannuation fund is now possible but the rules are so complex that often investors are dissuaded from the strategy.

Not only are there additional compliance and ongoing costs but investors must ask if the costs associated with owning the property can be covered sufficiently as well as other costs of running a fund.

If a property goes without tenants for a significant time and a fund is paying a pension, it may be difficult to pay the minimum pension income required by law.

There are also restrictions that fund trustees must understand before investing in residential real estate through super.

"The fund can't purchase residential real estate from the trustee, nor can they or any relatives live in a property owned by the super fund, even if they pay commercial rent," says Olivia Long, chief executive officer of SuperGuardian.

"Provided residential real estate is purchased at arm's length from a non-related party and subsequently rented to an independent third party, then residential real estate is a suitable investment for a DIY fund," Long says.

She says it's more common to see commercial real estate in DIY funds. Providing the premises meet the rules, a fund can purchase or be in receipt of commercial property from its members.

This gives business owners the opportunity to transfer their business property into their super fund via way of a contribution (subject to annual contribution caps).

DIY funds are also allowed to borrow from a financial institution or a related party to buy property. But it is quite a complex set-up and requires the property to be held on trust for the fund by a security trust.

Loan documentation needs to be prepared by a legal professional and the fund's deed needs to explicitly allow for borrowing.

The rental income is earned by the super fund and all expenses relating to the property are to be paid by it. While a fund's members are still saving super, interest on the loan repayments is deductible to the fund along with any expenses.

Rental income is assessable at a rate of 15 per cent tax. Any net rental losses can be offset against other income of the super fund.

Once a fund is paying a pension, the fund is given tax-exempt status. The rental income is tax free, as is any capital gain made on the sale of the property.

So the expenses and interest payments aren't tax-deductible. There is little tax benefit in negatively gearing a fund paying pensions to all its members.

> **Provided residential real estate is purchased and rented at arm's length, it is a suitable investment for a DIY fund.**
>
> Olivia Long, SuperGuardian

No improvements are allowed to be made to the property while the loan is in place.

This is regardless of whether the tenant pays for these improvements or non-borrowed funds are used.

If a property requires significant work or a fit-out to attract new tenants, it can't be done until the loan is repaid in full.

Increased compliance and administration costs are applicable when a DIY fund holds commercial property, and if the rental income and outgoings are more than $75,000 a year, then GST registration is required.

But Long says if you can still meet the needs of a fund, it can be prudent to hold direct property investment, even though the rules are complex, "especially given that in the pension phase the income is tax free and any capital gains on the sale of the property are tax free also," she says.

Olivia Long
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