3 Ways to get into Property Investing with an SMSF

Introduction

Investing in property through a Self-Managed Super Fund (SMSF) remains a popular topic, as many Trustees are keen to include property in their SMSF portfolios. However, not all Trustees can afford to buy property outright. This guide explores three structured ways to invest in property within your SMSF: through a Limited Recourse Borrowing Arrangement (LRBA), a Unit Trust structure, or a Tenants in Common arrangement.

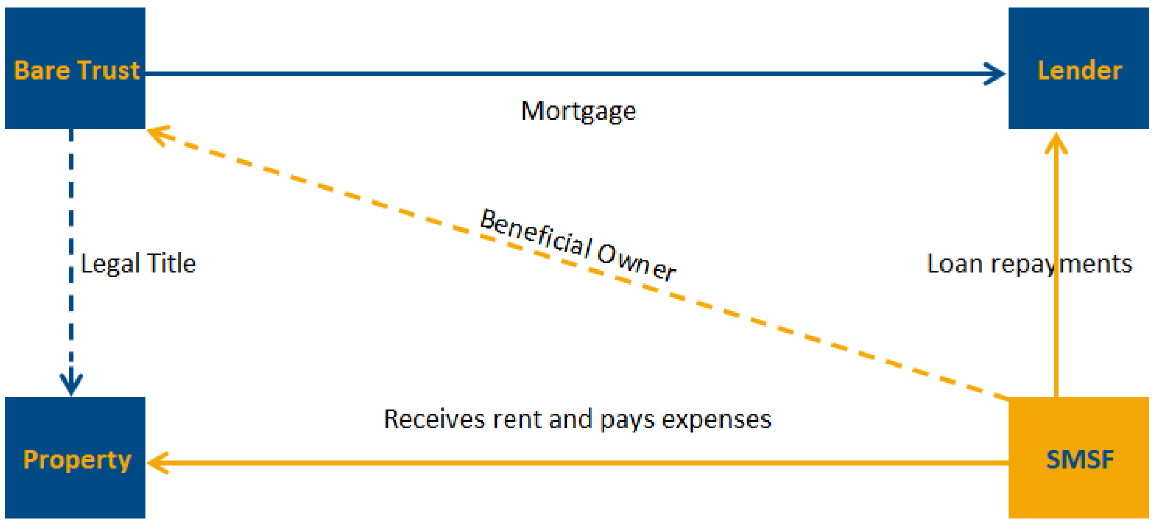
1. Limited Recourse Borrowing Arrangement (LRBA)

SMSFs can borrow funds from banks, financial institutions or related parties to purchase property under an LRBA, which involves setting up a separate custodian (bare) trust to hold the property.

This ensures that:

- The lender's claim is limited to the borrowed amount.
- Other SMSF assets are protected in case of default.

The diagram below provides a visual representation of this structure:



If borrowings are provided by a related party lender, such as the members of the fund, these must adhere to ATO guidelines to ensure they are on commercial terms and at market rates.

The ATO guidelines can be summarised as below:

Interest rate	See the ATO's published interest rate here.
Fixed / Variable	The interest rate can be fixed or variable. It can be fixed up to a maximum of 5 years.
Term of the loan	15-year maximum loan term (for both residential and commercial).
Loan to Market Value ratio (LVR)	Maximum 70% LVR for both commercial and residential property.
Security	A registered mortgage over the property is required.
Personal guarantee	Not required.
Nature & frequency of repayments	Each repayment is of both principal and interest. Repayments are monthly.
Loan agreement	A written and executed loan agreement is required.

These guidelines are set out in *Practical Compliance Guidelines (PCG) 2016/5 – Income tax arm's-length terms for limited recourse borrowing arrangements* found here.

Note that LRBAs may affect a member's total super balance and contribution caps.

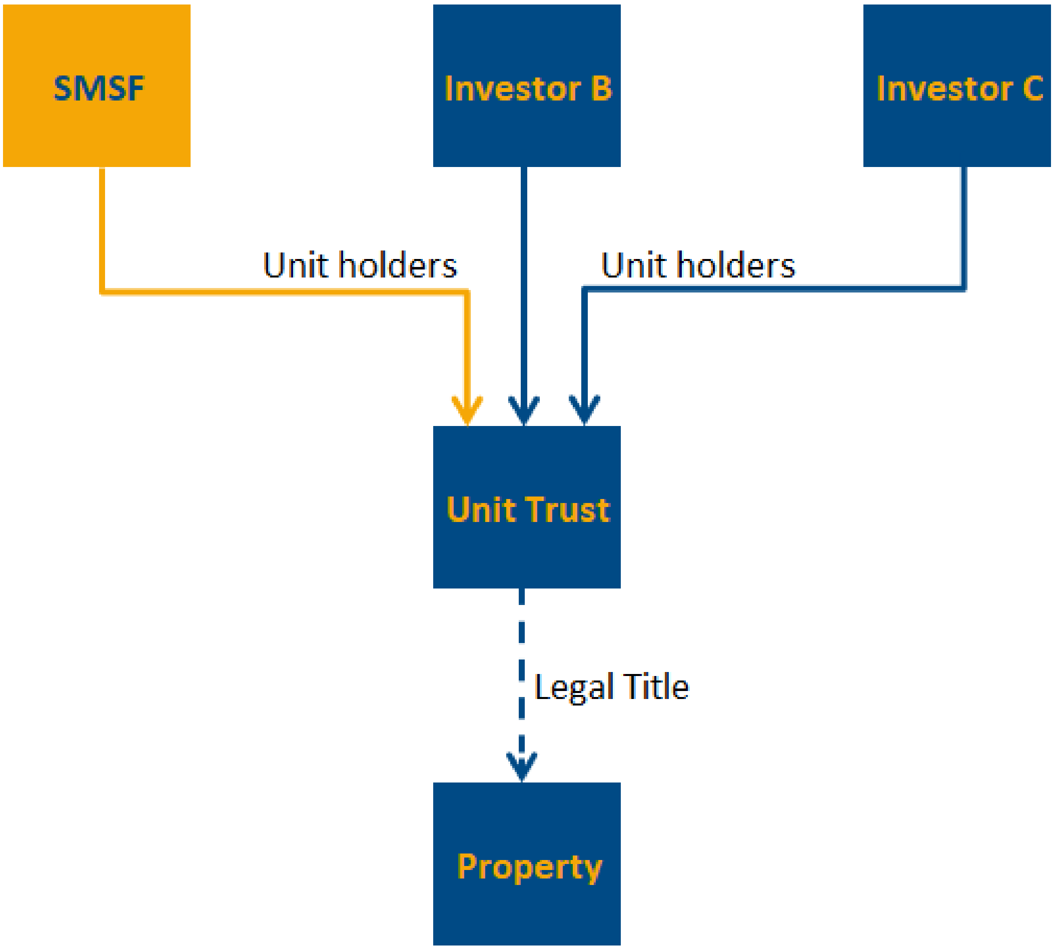
2. Unit Trust

A Unit Trust allows an SMSF to co-own property with other investors, who may be related or unrelated. The SMSF indirectly owns the property by holding units in the Trust.

This arrangement allows for the potential acquisition of additional units from other unitholders in certain circumstances, with a potential saving on stamp duty.

A Unit Trust operates under its own tax file number, requiring a separate set of financial statements and tax returns to be prepared and lodged.

The diagram below provides a visual representation of this structure:

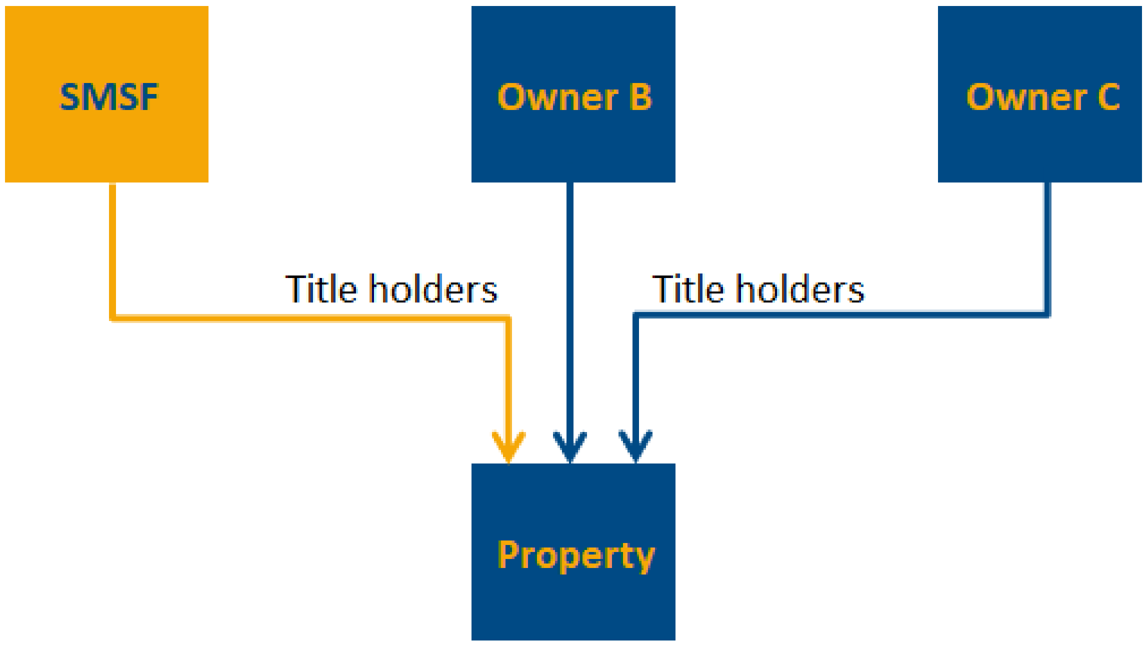


If an SMSF and its related parties hold a majority of the equity or have substantial influence over the Trust, the Unit Trust is classified as a related party investment. Consequently, an SMSF is limited to investing no more than 5% in such Trusts, unless it qualifies as a Non-Geared Unit Trust (13.22C Trust). To be classified as a Non-Geared Unit Trust, the Trust must adhere to the following strict criteria:

- It must not borrow funds or have any encumbrances placed against the property.
- It cannot invest in or loan funds to other entities, for example, by acquiring shares in a company.
- It is prohibited from leasing the property to, or purchasing property from, a related party unless the property qualifies as 'business real property.'

3. Tenants in Common

Under this arrangement, an SMSF can hold a share of the ownership of a property along with other investors, who can include related parties. Ownership proportions may be displayed as a percentage (%) of the title held by each investor. The diagram below provides a visual representation of this structure:



This method typically requires fewer administrative obligations than a Unit Trust, as the proportion of income and expenditure associated with the SMSF's share of ownership is included in the SMSF's financial statements and annual return.

Acquiring additional ownership from other titleholders can be complex due to tax implications and superannuation acquisition rules. Complications may include the application of stamp duty, GST, and Capital Gains Tax (CGT).

Conclusion

Property investments within an SMSF can be complex due to the superannuation rules that apply, but with suitable planning, the structure can be adapted to fit different investment objectives.