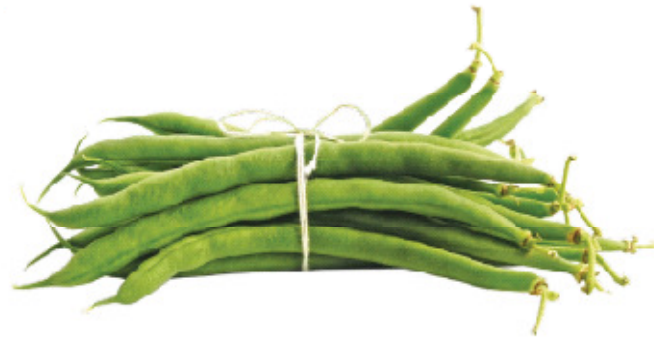


SUPER + BORROWING = ?

UHY Haines Norton
Chartered Accountants



not your average *Bean* counters

Michael Garrone

Background

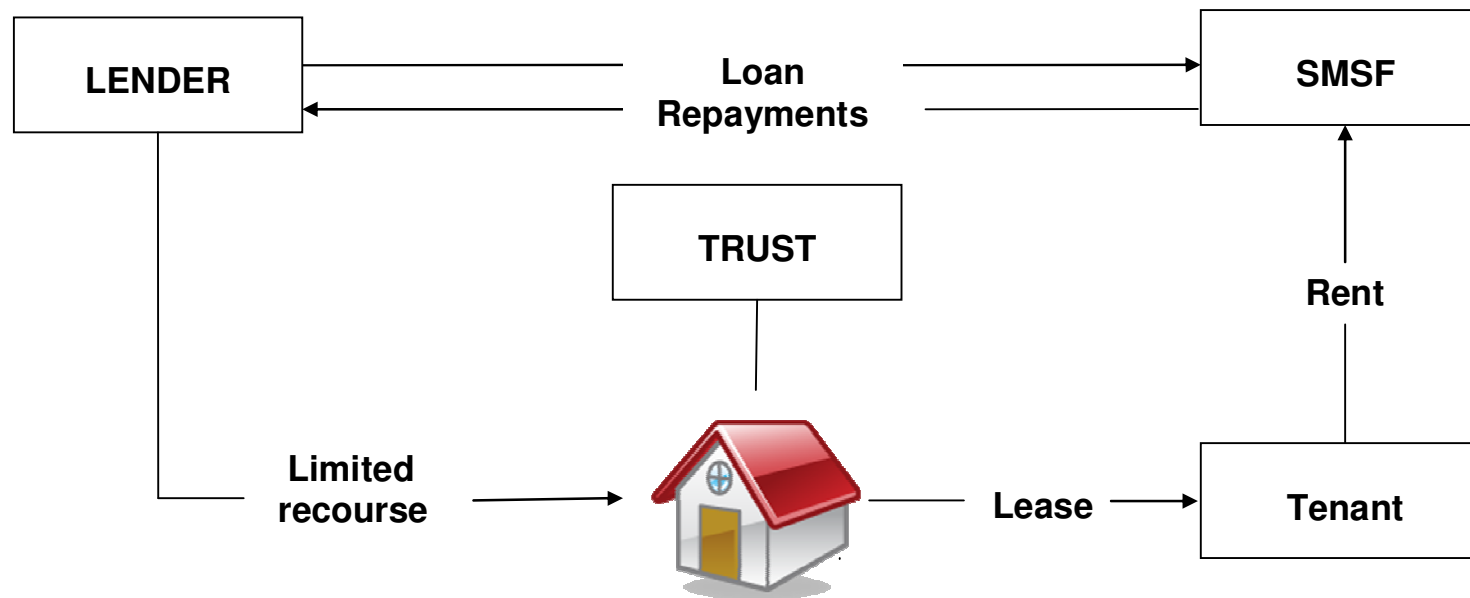
- How
- When
- Why

Background

- Sep 2007 borrowing allowed - “Instalment Warrant Structure”
- Jul 2010 – “Limited Recourse Borrowing”
- Here to stay – ATO and Cooper review again in 2 yr’s)

The Borrowing Structure

The basic borrowing structure is (detailed):



Must haves

- > A SMSF – only for SMSF's
- > A Corporate Trustee for the SMSF
- > A Bare Trust
- > A Corporate Trustee for the bare trust (must not be a trustee for any other entity)
- > SMSF Deed must allow borrowing

Be organised ! You cannot sign a contract before the SMSF and Bare trust are all set up.

How it works

- **Bare trust** contracts for or purchases the asset
Eg, Property and Shares
“Corporate Trustee P/L atf Bare Trust”
- **Settlement**
SMSF pays instalment (eg, the deposit),
SMSF gets loan from bank

How it works

➤ **Loan**

Must be “limited recourse”

Security only over asset being purchased.

Personal guarantees - Yes

How it works

➤ **Loan**

SMSF members cannot seek recourse from SMSF if guarantee called except to value of asset

Super fund's assets cannot be at risk

Is it that different to a normal loan?

How it works

- Accounting – SMSF accounts only
- Use SMSF ABN & TFN
- No stamp duty on transfer from Bare Trust to SMSF?
- No CGT on transfer from Bare Trust to SMSF
- No GST on transfer from Bare Trust to SMSF

What type of Assets?

- > **“Single asset”** – since July 2010
- > Most common asset will be property
- > Can only be over one title. ie. Cannot buy a 6 pack of units with strata titling.

Common Questions???

- Cannot use an existing SMSF asset
- Use a related party asset – only if Business Real Property
- Cannot borrow again on an asset when loan paid out
- Can refinance existing debt
- Can borrow to do repairs
- Cannot borrow to make improvements

Common Questions???

- Cannot capitalise interest
- Cannot do a development
- Can buy a parcel of identical shares
eg, 1000 BHP shares
cannot dividend re-invest
if sell one share must sell all shares

What are the Tax Savings!

- Interest & holding costs deduction
- Income on asset
- Net Income – can use negative gearing loss
 - 15% tax
 - 0% pension phase > 55 or > 60
- > Capital gains
 - 10% tax
 - 0% pension phase

Tax Treatment & Benefits

- Greater exposure to market, therefore get the advantage of higher returns within the super fund. (i.e. can grow your fund faster)
- Long term – more in super will last longer in retirement

Tax Treatment & Benefits

- Example: SMSF \$1 million comm property
Extra Net cash inflow after all costs \$100k to \$140k
Tax saved on sale \$130k
= \$165k to \$205k better off

Main Assumptions:

1. Pension phase at sale after 10 yr's with min P&I payments
2. 5% pa capital growth & 50% LVR
3. 15% v 46.5% tax rates

Tax Treatment & Benefits

- Example: SMSF \$500k rental property
Extra Net cash outflow after all costs \$125k to \$150k
Tax saved on sale \$75k
= \$50k to \$75k worse off (gearing at 15% v 46.5%)

Main Assumptions:

1. Pension phase at sale after 10 yr's with min P&I payments
2. 5% pa capital growth & 80% LVR
3. 15% v 46.5% tax rates

Tax Treatment & Benefits

- Example: SMSF \$500k rental property
- 1. Be Careful with over gearing
- 2. 50% LVR would break even long term on sale
- 3. But bad for cashflow for first 10 yr's
- 4. But does not show benefit of more in super long term

Disadvantages

- Gearing risk – potential to increase losses
- Not always the best structure from a tax perspective
- May be more tax effective to simply purchase a negative geared property outside of super
- Expensive
- Funds locked up in super
- Pension phase – No gearing benefit

SIS Compliance Issues

- Sole Purpose Test
- Investment Strategy –
Diversification
- Related party acquisitions
- Related party tenants
- Breaches of lending rules

Other Issues to Consider

➤ Cash flow of SMSF & Members

Member ages

Ability to contribute to super

Retirement plans

Diversification within SMSF

Contingency plans for loss of a tenant

Death – Insurance funding – if Deed allows

Costs Involved

1. Bare Trust
 2. Corporate Trustee
 3. Bank review costs
 4. SMSF review costs – can it borrow
 5. SMSF corporate trustee
-
- > \$8,000 to \$12,000 for a standard borrowing structure
 - > There must be a payoff to balance the costs!

Who?

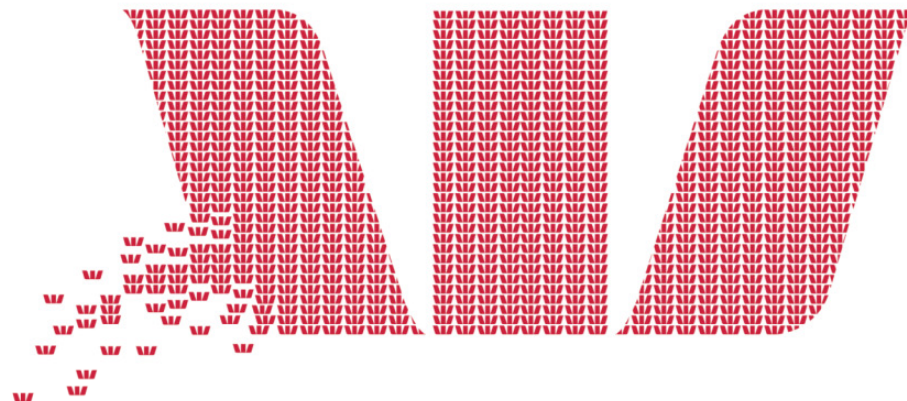
- > Those with equity outside super
- > Mid 40's to mid 50's
- > Businesses wanting to own bus property
- > Retirement strategy to boost super
- > Sell bus property into super tax free to boost savings?

Other structures?

- > Non geared unit trusts – no borrowings
- > Unrelated Unit Trust – can borrow
- > Tenants in common

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Self Managed Superannuation Fund (SMSF)

Issued Feb, 2011

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SMSF Opportunity



- As a result of amendments in September 2007 to the Superannuation Industry (Supervision) (SIS) Act 1993, it is now possible for a regulated SMSF to borrow to acquire an asset under strict specific conditions: - the asset must be acquired by a third party and held on trust for the SMSF.
- The SMSF segment of the Superannuation industry is the 2nd largest in terms of assets, with \$384.3bn in assets as at December, 2009 (31% of the total Superannuation assets).
- SMSF's have also been growing faster than the total superannuation industry with the latest per annum growth rate for FY2008-2009 of 28%.
- The SMSF segment of the superannuation industry is expected to continue to grow above the total superannuation industry average.

Source: "APRA Quarterly Superannuation Performance December 2009" p7

Financial Advice



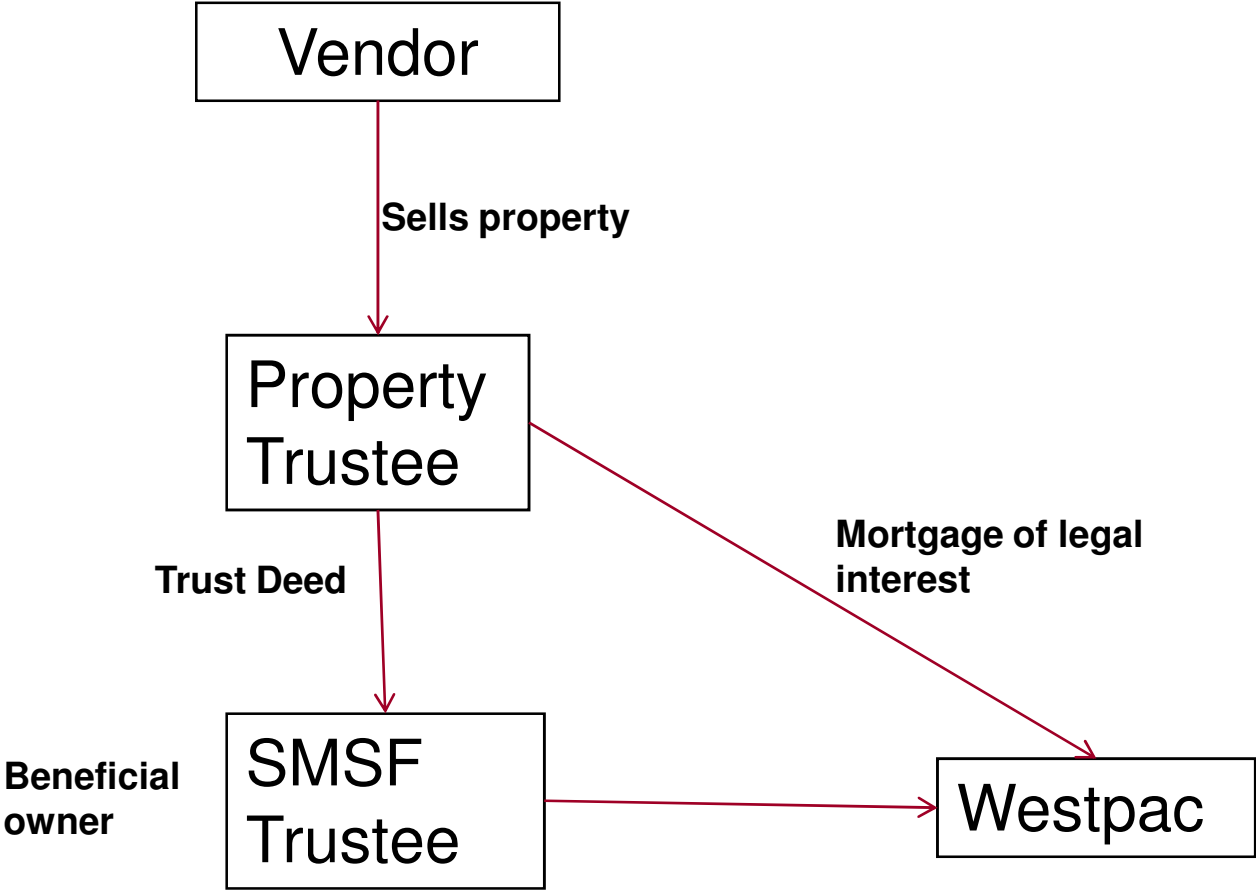
-
- As part of the financing arrangements, the borrower **must** discuss their investment strategy with their accountant (or financial adviser).
 - The accountant must provide a signed certificate to confirm his or her *support* of the SMSF's decision to purchase real property through a geared arrangement.
 - Westpac does NOT need to receive a copy of any Statement of Advice that a borrower may receive.

Section 67A, *SIS Act*



- Borrowed funds used to purchase an asset
- Asset must be held on trust for SMSF by another entity
- SMSF must have the right to acquire legal ownership of the asset by making payment(s).
- Westpac's recourse against SMSF must be limited to underlying asset

Structure





➤ Property Trustee

- purchaser on Contract for Sale
- provides legal mortgage
- Westpac requires Property Trustee to be a corporate entity

➤ SMSF Trustee

- Borrower under Loan Agreement
- Westpac allows the SMSF Trustee to be individuals, however, the LVR is lower where this is the case
- If SMSF Trustee is a corporate, it must be a different corporate entity to the Property Trustee.

Guarantees



- Property Trustee
 - As Property Trustee gives a mortgage, Westpac requires a guarantee from the Property Trustee

- The Members of the SMSF (in their own right) loan can give a guarantee

- Strict conditions
 - Negate right of subrogation

- The (Member) guarantors can provide collateral security.



- Establish an SMSF
- Establish company that will act as Property Trustee
- Find a property and arrange finance
- SMSF **must** pay deposit
- Purchase in the name of the Property Trustee
- Do **not** mention the trust on the title
- Execute Property Trust Deed
- Settle transaction with borrowed funds

Customer Underwriting Standards



- **This policy is available to qualifying SMSFs to finance the acquisition of investment properties only:**
 - Purchase of residential property for investment
 - Purchase of non-specialised commercial property for investment
 - Purchase of non-specialised rural property for investment
 - Refinance of loans for investment property acquired after September 2007. Loan must be an existing SMSF loan.
 - Specialised commercial properties for investment can be considered on an exception basis provided they are compliant with the SIS Act.

- **This policy specifically excludes transactions excluded under the SIS Act such as:**
 - Non-commercial related party transactions
 - Investment into 'non income-producing' or 'going concern' type assets (i.e. vacant land, hotels, etc.)
 - Finance for, or reliance upon, the development or refurbishment of the investment asset (i.e. property development).
 - Needs to be arms length transaction for residential purchases – family
 - Property development or house and land packages

Repayments



Residential / Commercial

Net rental income (stand alone) from property investment

or

Net rental income from property investment

+

Super Fund Trustee (member) income

(eg. superannuation contributions)

Interest Coverage Requirement for Application

1.5 times must be met

Note:

Future superannuation contributions (based on past contributions otherwise determine future commitment of the member(s) and their ability to meet that obligation).

Transaction Assessment



Property Type	Maximum Loan Amount	Maximum Loan Term	Maximum Lending Value Ratio (LVR)	Interest Only
Residential	\$2m (IPL Product, \$200k minimum) \$5m (Business Product)	30 Years (IPL Product) 25 Years (Business Product) (Minimum Loan Term 1 Year)	•80% (Standard residential and rural residential lending values apply) *72% When SMSF Trustee is an individual	10 years Maximum
Commercial	\$5m Minimum Loan Amount: Business Loan \$250k Bank Bill Bus. Loan \$250k	15 Years non-specialised commercial (minimum loan term 1 year unless specified in the SMSF Trust Deed or Property Deed)	•65% non- specialised commercial security •58.5% When SMSF Trustee is an individual	10 years Maximum
Rural	\$5m Minimum Loan Amount: Business Loan \$250k Bank Bill Bus. Loan \$250k	15 Years non-specialised commercial (minimum loan term 1year unless specified in the SMSF Trust Deed or Property Deed)	•50% non-specialised commercial security • 45% When SMSF Trustee is an individual	10 years Maximum

Loan Product Selection



- **Interest Rates – Investment Property Loan (IPL)**

IPL - Residential Security – Maximum Funding \$2.0M

Standard Variable Investment Rate: 7.86%

Interest Rate Effective as at 04/03/2011

- **Interest Rates – Business Loan & Bank Bill Business Loan**

Maximum Funding \$5.0M

Business Loan with Residential Security

Base Rate (BDR)	9.04%
Security Margin	0.00%
SMSF Margin	0.15%
Effective Rate	9.19%

Base Rate Effective as at 04/03/2011

Business Loan with Commercial Security

Base Rate (BDR)	9.04%
Security Margin	0.75%
SMSF Margin	0.15%
Effective Rate	9.94%

Bank Bill Business Loan (BBBL)

Base Rate (BBBL 90 days)	5.45%
SMSF Margin	0.15%
Risk Grade Margin	2.00%
Line Fee	1.00%
Effective rate	8.60%

Base Rate Indicative as at 04/03/2011

Loan Product Selection (Cont)



Notes:

- **Re-draw is not available.**
- **Set off is not available.**
- **Splitting is not available.**
- **Switches are not available.**
- **Increases not permitted.**
- **Interest capitalisation is not permitted.**
- **Premier Advantage package not available (IPL).**
- **Repayment Holiday not available (IPL).**
- **Building Loans not available.**
- **Substitutions of security not permitted.**

Loan Costs



INVESTMENT PROPERTY LOAN (IPL):

- Establishment Fee: \$1500 (includes standard valuation)
- Ongoing Fee: \$10 p.m.

BUSINESS LOAN (BL):

- Establishment Fee: 0.6% of loan amount
- Ongoing Fee: \$10 p.m. Residential Security
\$35 p.m. Commercial Security

BANK BILL BUSINESS LOAN (BBBL):

- Establishment Fee: 0.6% of loan amount
- Ongoing Fee: \$35 p.m. Residential or Commercial Security

Commercial Valuation fees are scaled from \$900 to \$2100 for Commercial Security properties up to \$2.0M in value.

Valuation fee for Commercial Security of \$2.0M+ will be quoted on a case by case basis.

External Solicitor Costs



- Trust deed must be perused by Westpac's external panel lawyers (i.e.: Gadens and Minter Ellison)
- These costs to be paid by the client as an additional cost to the fees detailed in the section: Loan Costs
- As a guide fees will range from \$1,000 to \$3,000 minimum and will increase based on the level of amendments required to amend the deed to enable the trust to participate in the Self Managed Super Fund opportunity.
- If required, our external Solicitors will set up the Property Trust at an additional cost.

Security



- Security provided by the borrower is limited to the underlying property being purchased of either:
 1. Residential
 2. Commercial property (non specialised)
 3. Rural (non specialised)

- Supporting security in the form of a supported or unsupported guarantee is required from member(s) of the SMSF, particularly where reliant on their future superannuation contributions for serviceability.

Customer Assessment



- The trustee of the SMSF and all associated surety(s) are to have a clear credit history and meet the applicable Underwriting standards and financial information rules
- The Property Trustee must be a company and separate to / from the SMSF
- A company search is required for both the property trustee and the super trustee in terms of Credit checks and business searches
- For refinances the customer must provide the following documentation:
 - Copy of contract for original purchase, which must also be post September 2007
 - Customer to provide solicitor certification that initial purchase conformed with SIS Act
 - 6 months loan statements

Tips and Pitfalls



- **Preposition Lead Time:** Due to the additional document preparation / Legal vetting it is advisable to allow additional time for settlement : 8-12 weeks is advisable to avoid disappointment and unnecessary charges.
- From experience we recommend that the customer choose a property and sign a contract *only* when all the other requirements with their Financial Planner, solicitor, accountant and the bank are in place. This is not always possible but is the least stressful approach when dealing with a SMSF borrowing.
- Please note that the Westpac Superfund Loans are not available for:
 - Owner Occupied Property (Residential)
 - Non-standard residential property
 - Specialised Commercial property
 - Trading companies as SMSF trustees (only a limited company set up for the sole and express purpose of being the trustee for a Self Managed super fund can be the borrower on this loan type)

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Things you should know:

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