Property and super – beware the pitfalls

Recent years have seen a rush of investors buying property through super. But while the strategy has its advantages, there are also some potential risks to be aware of.

**The pitfalls**

While property has been a good performer in recent years, property investing still involves a number of risks.

Some hidden costs in owning direct property can catch buyers unaware, such as building maintenance costs and or levies. A property’s rental income may also not be sufficient to cover your mortgage payments or expenses, and what would happen if your property was vacant? Do you have enough disposable income to cover the costs yourself? And while interest rates are currently at record lows, an eventual switch in interest rate policy would lead to higher repayments.

In addition, past performance is not indicator of future performance so there are no guarantees your property will increase in value. You should also weigh up the impact of notoriously high entry and exit costs such as stamp duties, legal fees, agent’s fees and advertising costs on your investment.

One of the most important principles of investing is the benefits of diversification. So, if you invest the entirety or a large part of your SMSF in property you will have all or most of your wealth concentrated in the property market, leaving you highly exposed to a market downturn.
The pros versus the regulations
Investing in direct property, whether residential or commercial, can provide diversification benefits for a portfolio that may otherwise be dominated by listed shares, and offers the potential benefit of rental income and the opportunity for capital growth.¹

However, investing in property inside SMSFs is highly technical in terms of regulations and potential tax implications. In particular, there are strict rules around purchasing property through an SMSF specific to buying and or renting to “related” parties. As such, it’s prudent to seek professional advice on this area.

Commercial property
The strategy of using your SMSF to buy commercial property to lease back through their business is again subject to strict regulations and if you are thinking of replicating this you should discuss the regulatory requirements with your adviser. According to the ATO, you can invest in commercial property, including your own business premises, through your SMSF, however the overall fund must still meet the sole-purpose test of providing retirement benefits to its members.² When dealing with commercial property, an SMSF can generally buy the property and lease it back to a member or a related party of the fund – including the member’s business. Another regulatory hurdle to be particularly aware of includes having an arm’s length sale price and lease arrangement for the property in question when acquiring and or leasing the property to a member or related party of the fund.³

Beware the scammers
Unfortunately there have been instances of scammers operating in Australia using tactics such as:

- persuading people to access their super early to buy property;
- seminars where salespeople use pressure selling tactics to encourage you to make quick decisions; and
- cold calling from companies offering free financial advice or unreasonable returns on properties which are often located overseas.

What next?
Bricks and mortar can be a great long-term investment and may help to set you up well for retirement, but any such plan should be considered in the context of your overall financial plan and discussed at length with a trusted financial adviser. In addition, it is also prudent to do your own research by visiting the Australian Taxation Office’s webpage on self managed super funds.

Source:

Disclaimer: The information provided in this document, including any tax information, is general information only and does not constitute personal advice. It has been prepared without taking into account any of your individual objectives, financial situation or needs. Before acting on this information you should consider its appropriateness, having regard to your own objectives, financial situation and needs. You should read the relevant Product Disclosure Statements and seek personal advice from a qualified financial adviser. From time to time we may send you informative updates and details of the range of services we can provide. If you no longer want to receive this information please contact our office to opt out. Millennium3 Financial Services Pty Ltd ABN 61 094 529 987 AFSL 244252