3 Ways to Get into Property with an SMSF

Many trustees would like to acquire property as part of their SMSF portfolio however, some trustees cannot afford to purchase a property outright in their SMSF. This article sets out 3 ways in which you can acquire property in your SMSF. Of course there are other structures that can be used for this purpose. What structure is appropriate for you will ultimately depend on your circumstances.

The three structures we will outline are using a Limited Recourse Borrowing Arrangement (LRBA), Unit Trust structure and Tenants in Common arrangement.

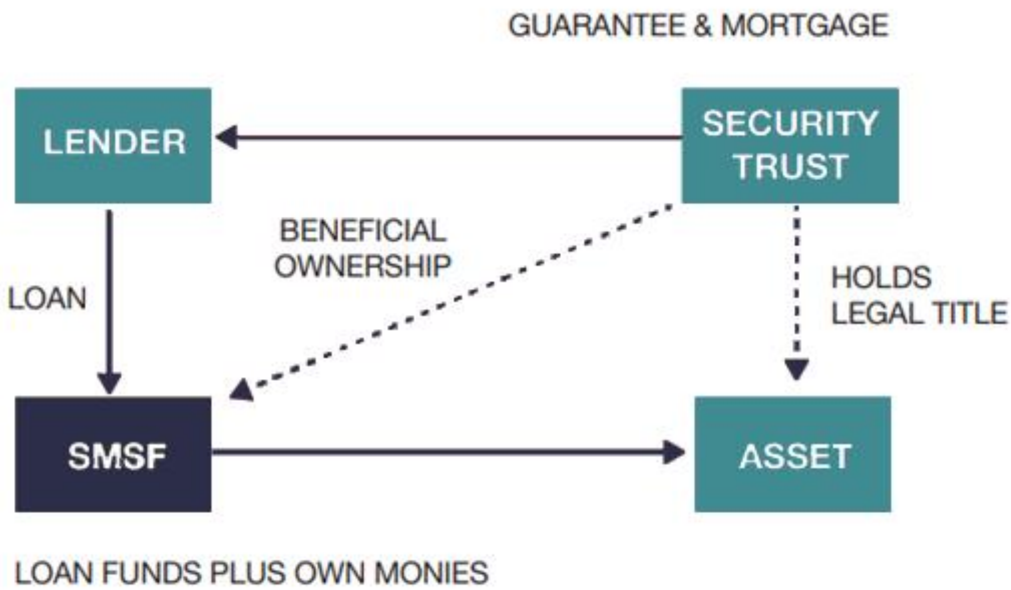
1. Limited recourse borrowing arrangement (LRBA) – bank loan or related party loan

An SMSF is permitted to borrow from lenders like banks or from related parties, including members of the fund, to acquire a property. The property must be purchased under a Limited Recourse Borrowing Arrangement (LRBA) whereby a separate custodian trust is established to hold the property.

Ultimately, this structure ensures:

- The lender has limited claim on the borrowing and
- All other assets in the SMSF are not at risk in the event of default

The diagram below explains this structure:



With the royal commission inquiry, and tightening of banking lending criteria, it is increasingly challenging to obtain finance through a commercial lender. Related party loans can be an alternative. Related parties such as members of the fund may be able to lend funds to the SMSF. Caution and care need to be taken as specific ATO guidelines are set out for a related party loan to ensure it is on commercial terms and at market rates.

A summary of the ATO recommended terms and conditions of a related party loan is set out below:

Fixed / Variable	Interest rate may be variable or fixed. It can be fixed up to a maximum period of 5 years
Term of the loan	15 year maximum loan term
Loan to Market Value Ratio (LVR)	Maximum 70% LVR
Security	A registered mortgage over the property is required
Personal guarantee	Not required
Nature & frequency of repayments	Each repayment includes both principal and interest Repayments are monthly
Loan agreement	A written and executed loan agreement is required

The safe harbour interest rate applicable for the 2023/24 financial year is 8.85% for real property and changes annually.

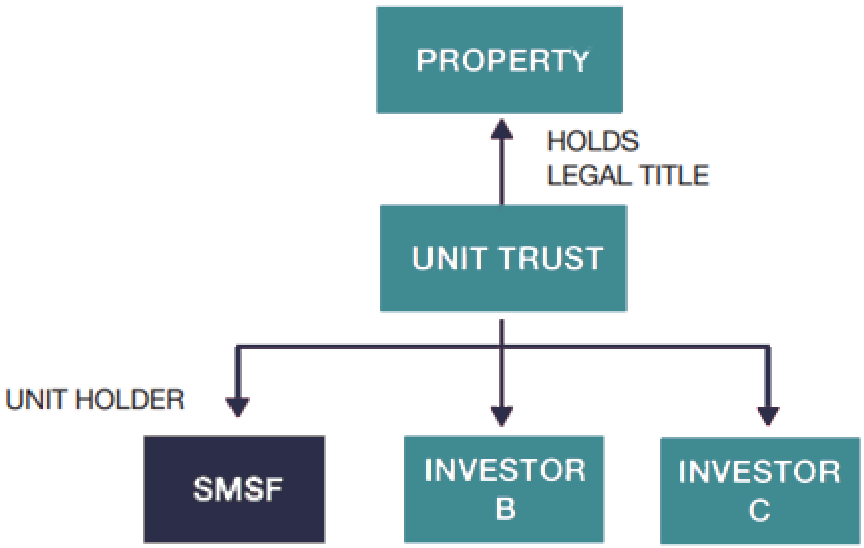
It is also important to note that certain outstanding LRBA balances that commenced on or after 1 July 2018 might impact a member's total superannuation balance and contribution eligibility.

2. Unit trust

A Unit Trust structure can be a viable path to co-own a property with other investors who can be related or unrelated to a SMSF. The Unit Trust would possess direct ownership of the property while the investors, including SMSFs, indirectly own the property by holding units in the Trust.

This structure provides flexibility for a SMSF to acquire more units from other unitholders in some (limited) cases, with a potential saving of stamp duty on the unit transfer.

As the Unit Trust is a separate entity which has its own tax file number, a set of financial statements and annual tax return need to be prepared and lodged with the Tax Office.

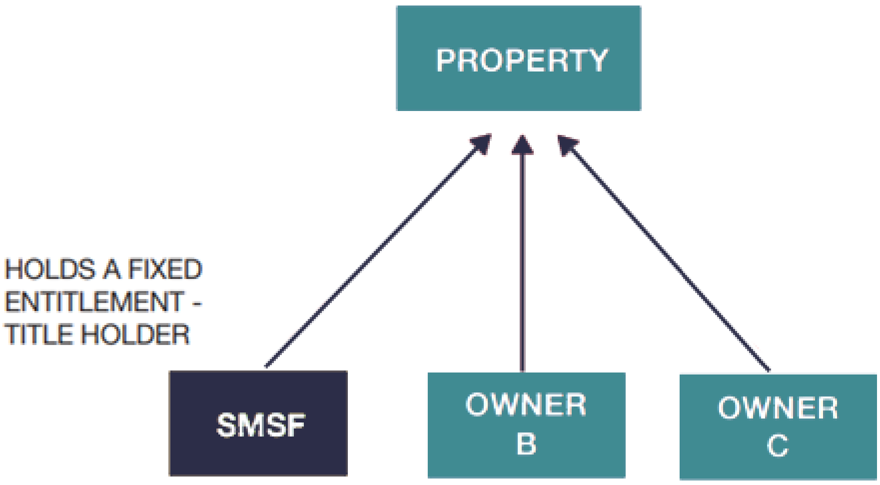


If a SMSF and its related parties have majority equity holdings or can exercise significant influence over the Trust, the Unit Trust would be regarded as a related party investment. With this in mind, a SMSF is not allowed to invest more than 5% in a related party Trust unless it is a Non-Geared Unit Trust (13.22C Trust). The Non-Geared Unit Trust (13.22C Trust) must.

- Not borrow or have any charge over the property
- Not invest in another entity (e.g. acquiring shares in a company)
- Not lease the property to or acquire a property from a related party unless it is 'business real property

3. Tenants in common

Another option to co-invest in property through a SMSF is via a Tenants in Common arrangement. A SMSF holds a fixed entitlement in a property with other investors, who can even be a related party, such as a member of the Fund. Relative to Unit Trust structures, Tenants in Common arrangements do not generally require a separate set of financial statements and tax return. The SMSF share of net income and expenses are disclosed in the tax return of the fund.



Under a Tenants in Common arrangement, it can be potentially difficult to acquire additional ownership from other titleholders due to stamp duty, GST, Capital Gains Tax implications and acquisition rules for superannuation funds.

Conclusion

Using a SMSF to purchase property can be a complex field and a raft of superannuation rules must be complied with. It can however open investment opportunities you may not have thought possible, by utilising your assets in the superannuation environment. Trustees need consider their personal circumstances, long-term goals, and objectives in deciding the right structure for their SMSF.