What to know about SMSF property rules

The Australian Taxation Office (ATO) revealed there are close to 600,000 SMSF funds in Australia, making it the fastest growing superannuation sector[i]. Reportedly, residential property holdings within SMSFs increased by 2.7 per cent in the quarter to March 2016, from $ 607.1 to $621.7 billion.

Managing a SMSF is not for everyone, but one of the key benefits is the funds ability to invest in property and the ability for the fund to borrow to make a purchase[ii]. With the rise in property investment using a SMSF, it is wise to understand the rules and regulations to avoid heavy fines that apply for breaching the strict requirements.

What sort of property can a SMSF buy?

There are many rules that apply when investing in property through your SMSF. The primary rule being that a property must meet the Sole Purpose Test[iii] , meaning that any rental income or sales revenue must be used solely for the purpose of funding the retirement of Fund members.

In addition to this, the following SMSF property investment guidelines will help you to choose a property to invest in:

- The property purchased must be a single acquirable asset as defined by the superannuation law, rather than several assets, or several properties.
- The property can be a residential or commercial property, but cannot be vacant land, and must be a single title of more than 50sqm.
- Residential property cannot be purchased from a member of the SMSF, or a related party, like a business partner or spouse.
- Residential property must be strictly for investment purposes and cannot be your place of residence, or your holiday home.
- Residential property must be tenanted, but not by a member of the fund or any family member.
- Commercial property can be your place of business where the SMSF buys the property, then leases the property to a fund member or a related party.
- Overseas property investments are permitted. however, you will need to consider the laws in that country.

Renovating SMSF property investments

The level of renovations that are permitted to a SMSF property depend on if there is a loan in place or not. If the property is owned outright by the SMSF, renovations can be made to improve the property. However, where money has been borrowed to buy the property, known as a limited recourse borrowing arrangement (LRBA)[iv], and the loan is still in place, the property cannot generally be improved upon or replaced during the term of the loan. In other words, borrowed money can be used for repairs and maintenance on the property only, but not to change the character of the property.

Borrowing to buy from a SMSF

On the financial side, the SMSF fund must have a minimum balance of $120,000 to be able to purchase a property and there must be an annual contribution of at least $15,000. You can normally borrow up-to 70 per cent of the property's value, with the balance being contributed from the fund itself[v].

In this situation, banks and lenders do not have recourse or right on other assets in the SMSF, so any recourse is limited to the single asset purchased using the LRBA.

Depending on the size of the deposit made by the SMSF, security may not be required from the trustees as the property itself will be the sole security for the loan under the LRBA. This removes your personal liability over the asset and its associated debt, making it a more risk- free option for investors.

There are also many tax benefits available when investing in property with your SMSF that can create a potentially tax-free environment. But the most attractive advantage of investing using a SMSF is the ability to have greater control over where and how your money is being invested.

DHA property investment with a SMSF

Many of the rules and regulations that apply when investing through your SMSF are met by Defence Housing Australia properties[1]. All DHA investment properties, which provide housing to members of the Australian Defence Force and their families, are residential properties located in most capital cities and regional areas. Rental income is guaranteed for the lease of the term,[2] even when the property is not occupied, and this provides a level of certainty and stability for the investor. At the end of the lease, the property is restored to good order, fitting in with the renovation requirements for a SMSF property investment. DHA's investment products are considered low-risk and because DHA is backed by the Australian Government, it's secure.

Learn more about investing with DHA.

The advice contained in this article is for general information only and should not be taken as financial advice. Prospective investors should seek independent advice. Investment is subject to DHA's lease terms and conditions of sale. Investors retain some responsibilities and risks including property market fluctuations

1. Whether or not a DHA property is suitable for purchase through your SMSF will depend on the SMSF's investment strategy and the circumstances of the purchase. 2. Rent may be subject to abatement in limited circumstances.

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