

SUPER INVESTING

Since Rod Cedaro started investing in property through his self-managed super fund he hasn't looked back. VANESSA DE GROOT

ROD CEDARO has done the hard yards – or kilometres – to become a champion athlete and he's done the same when it comes to building a property portfolio.

He's no stranger to property investing; he's been buying and selling property for nearly 30 years.

Now 47, Rod bought his first investment property when he was about 18 and in that time he's owned homes in Melbourne, Canberra and most recently in Queensland.

"I purchased an investment property at South Stradbroke Island which I sat on for about two or three years and then liquidated that to purchase some land in about 2001 or 2002," says Rod.

"We did nothing with that until about two years ago and then we built a house on it which is in the throes of being completed."

The land was at Mt Coot-tha in Brisbane and Rod now lives in the house with his wife and their two-year-old child.

Rod's plan is to hang onto that property for the foreseeable future, with the hope that it will become part of his long-term financial security.

In the meantime he wants to build up a portfolio to add to that long-term financial vision and has already started with the purchase of an apartment in Brisbane.

This latest property purchase was different from all the others Rod has made over the years though because it was done through his self-managed super fund (SMSF).

It was only in the past couple of years that he was introduced to the concept of borrowing through an SMSF to invest in property and he now foresees it's probably the way he'll make all his purchases in the future.

In September 2007 the Federal Government changed the superannuation legislation so that SMSFs could borrow to buy assets, including investment properties.

So gearing into property through super is now legally allowed, but it can only be done through an instalment warrant style of arrangement.

These arrangements comprise a property purchase, a loan to help fund it, interest payments on the loan and rental income from the property.

In many cases investors can buy the property of their choosing and they can also pick a property manager to take care of the property for them.

The property is purchased and held by a trustee on the investor's behalf.

"BEING SELF-EMPLOYED, MY SUPER LAY DORMANT FOR A NUMBER OF YEARS AND I CAME TO A POINT WHERE I NEEDED TO ACCELERATE MY SUPER AHEAD OF RETIREMENT."

Rental income is used to meet any costs for the property as well as interest payments for the loan with any remaining interest payments to be paid by the SMSF.

Funds are loaned on these arrangements on a limited recourse basis, so that means the risk to the investor is lower because they only stand to lose their original deposit; no other assets can be touched including other investments within your SMSF.

In addition to lower risk, there are also significant tax advantages to be gained when borrowing through an SMSF to invest in property, including rent taxed at a concessional rate of 15 per cent and interest costs being fully tax deductible to the SMSF.

In addition there are tax advantages when it comes to capital gains tax (CGT) – if the

property is sold before retirement CGT is only at 10 per cent and if it's sold in retirement, there will be no CGT payable.

SETTING UP AN SMSF

A former Australian ironman champion triathlete and multiple Brisbane marathon champion, Rod is an accomplished athlete and has built a career as an exercise physiologist.

Like many of us, he was working in jobs where an employer was making contributions to his superannuation but in 1991 he set up a business and was self-employed until about 10 months ago.

Naturally, when he set up the business there were no longer employer contributions into his super fund but the company paid money into it instead.

Rod decided to set up an SMSF, otherwise known as a DIY super fund, about two years ago when he discovered it was possible to invest in property via that avenue.

Wanting to accelerate his earnings prior to retirement Rod decided to take his super – which had accumulated to an amount of around \$150,000 in total – out of the different funds it was in and create an SMSF.

"Being self-employed, my super lay dormant for a number of years and I came to a point where I needed to accelerate my super ahead of retirement," he says.

"I saw the ability to leverage in the super

fund; it was an interesting option of accelerating my earnings."

The money that was in his super funds prior to when he set up an SMSF was returning about 12 or 14 per cent a year, says Rod, and he was paying management fees that would never be seen again.

"With the SMSF all of the expenses I have are deductions, the fee structure is a lot lower and based on the return to date, if I had left the money in the other funds it would probably be worth about \$80,000 compared to \$150,000.

"I've been able to grow that \$150,000 and now have more than \$200,000.

"That's quite an appreciable benefit and it's good that I got out when I did."

Rod says he was lucky enough to get his

JOSH KELLY/LIME.NET.AU



5 steps to buying a property in super

- You need to have a self-managed super fund (SMSF) or have an accountant set one up on your behalf.
- Ensure you have sufficient rollover funds within your super fund for the deposit and decide on how much you want to borrow. Generally loans can be arranged from 65 per cent up to 80 per cent of the value of the property, on a non-recourse basis (i.e. only the property is used as security, no other assets or personal guarantees are required).
- Select a suitable investment property and obtain advice from a financial planner on the suitability of the investment and complete a financial plan.
- Obtain approval for the amount of gearing and the actual property you want to buy.

Source: Peter Gribble, Quantum Warrants

Avoiding the traps

Financial planner Paul Benson of Guidance Financial Services says property investors may need to reconsider the usual strategies when using their super to buy property.

Borrowing by SMSFs, he says, has some unique aspects that investors must consider before heading down this path.

Investors must be aware that in order for an SMSF to be allowed to borrow for investment purposes it must satisfy certain legal requirements and Benson advises seeking some expert assistance in this area.

Given the combination of the legislated investment rules for SMSFs and the peculiarities of the borrowing rules, he says the following are some traps best avoided:

■ It's important for investors to have their SMSF established before going property hunting. SMSFs generally can't buy an asset from a member, so if you sign a contract in your personal name and then try to establish an SMSF, the SMSF won't be able to buy the property off you.

■ Another thing to be aware of is that a property once owned by the SMSF can't then be provided as security for another loan. "The common strategy therefore of purchasing a property, paying interest only, waiting until there's some capital appreciation and then using the equity to acquire a second property simply won't work in the superannuation environment," he says.

■ Another restriction that can catch people out involves an SMSF purchasing a vacant block of land with cash in the fund with the intention of borrowing to fund development activity. "Unfortunately the new rules don't permit borrowing for development purposes," says Benson. "In this situation the fund would be left with an asset it couldn't afford to develop."

Benson suggests investors considering buying property through their superannuation adhere to one over-arching rule – the sole purpose test.

"The sole purpose test states that whatever investments you enter into with your SMSF, they must be for the sole purpose of providing for the fund's members in retirement," he says.

"So the dinner party strategy I hear at least once every six months of using your SMSF to buy a holiday home is out. The investment clearly has a purpose beyond providing for you in retirement.

"Using your SMSF to purchase your daughter's property in a messy divorce would also raise concerns.

"Basically, if your motivation for entering into the transaction is anything other than to benefit you in retirement, stop and seek some advice."

money out of the super fund and the sharemarket before the global financial crisis hit and values plunged.

Rod's financial advisor Brad Gunn of daVinci Advisors points out that before he set up an SMSF, Rod was forking out thousands in fees because he had multiple super funds running at one time.

"He was paying \$4500 a year in administration fees to respective super funds," he says. "By consolidating them into one it certainly saved him a lot of money in administration fees."

While Rod still has his sport physiology company and continues to do some work for it, he is now employed by another company and that employer makes contributions on his behalf into a state-run super fund.

So Rod has that fund, which he says looks after itself, as well as his SMSF, which his sports physiology company continues to pay money into.

If he were to ever leave his employer before he retires Rod says he'll roll that straight into his SMSF.

Once the concept of borrowing through his SMSF to invest in property had been fully explained to Rod he says he could clearly see the benefits.

"I thought longer-term the sharemarket would come back again but coming from a European background, I was always led to believe bricks and mortar are always going to be a useful and ready investment.

"I could see if my super fund could leverage against itself for the next 10 or 15 years, I could potentially not put anything into it and still end up with a nice portfolio of property down the road."

BUYING THE PROPERTY

In order to borrow through an SMSF to invest in property, it's imperative you have enough money in the fund to begin with.

"I had to have enough in my super policy to actually be able to do it," says Rod. "I needed around \$150,000 in super as a starting point, otherwise there's nothing to leverage."

While Rod had that much in his super fund to work with, Brad says it's probably not necessary to have quite that much.

"Some say you need to have over \$200,000, but personally I think if you had \$120,000 and you were going to use it actively to gear into property or shares or a managed fund, then that would be sufficient."

Brad points out that it comes back to the annual running costs – there's no use doing it if you only have \$10,000 because for a \$300,000 property it would be unviable.

Although the laws were changed to allow borrowing through your SMSF to invest in property in September of 2007, Rod was able to buy a property through his SMSF prior to that time.

According to Quantum Warrants, for more than 10 years investors have been able to use traditional instalment warrant structures designed by the major investment banks to gear into shares. But when superannuation legislation was changed in September 2007 it meant investors could implement gearing strategies, on a limited recourse basis, with legislative certainty for the first time in their SMSF. Before then it was a grey area.

The first and only property Rod has bought so far through his SMSF was a new apartment in the inner Brisbane suburb of Spring Hill, neighbouring the CBD, for which he paid \$260,000 in August 2007.

It was initially rented for \$350 a week which equated to a yield of seven per cent but the rental rate has since increased to \$410 per week, so the yield has increased to more than eight per cent.

The apartment is fully furnished and is leased to a doctor working at the Royal Brisbane Hospital; it's in walking distance of less than one kilometre.

Brad points out that Rod's Spring Hill property is positively geared, due to the good equity that was put into it to begin with as well as the high rent it's getting.

He says the standard tax deductions apply to the property owned by the SMSF that would apply to a property held outside a super fund.

Rod used \$91,000 of the \$150,000 he had in his SMSF to put towards the purchase of the Spring Hill property and he used \$32,000 of the remaining money in his super to put into an unlisted property trust which was used to raise capital for a development in Hervey Bay.

The investment was for two years and from that, Brad says, Rod will get about an 18 per cent return per annum.

Based on the initial investment of \$32,000, at the end of that time Rod will end up with more than \$43,500 back in total.

"When he gets that back we'll be looking at reducing the debt he currently has on the Spring Hill property he bought back in 2007," says Brad.

An alternative to using that money to repay the debt for the apartment and build more equity is for Rod to use that money to buy another property through his super fund and add to his portfolio.

When using the instalment warrant style of arrangement to buy shares however, it's important to bear in mind that not all the interest will be deductible because SMSF loans are higher than normal housing loans due to their non-recourse nature.

Rod believes a great deal of the population is still ignorant about the fact that it's possible to invest in property by borrowing through your SMSF.

But Rod says there are a lot of benefits, one of the main ones being the tax breaks.

He says it can minimise the tax burden and what the investor has to pay out in compari-

THE NUMBERS | SPRING HILL

Description	1-bedroom, 1-bathroom apartment
Purchased	August 2007
Purchase price	\$260,000
Super fund investment	\$91,000
Borrowings	\$169,000
Loan-to-value ratio	65%
Rent per week	\$410
Yield	8.2%
Current value	\$320,000
Equity gain	\$60,000
Gain as percentage of cost	23%
Yield = annual rent/total cost; equity gain = current value – total cost	

son to having a normal investment property.

Rod says there are also implications for CGT, with the potential that you'll pay no CGT if your property is sold when your SMSF has reached pension mode.

"If the property improves by 50 per cent

I'm not going to be paying tax on that, whereas if it was an investment property I'd be paying CGT," says Rod.

WHERE TO FROM HERE?

All of the money in Rod's SMSF is currently tied up in property-related investments and he plans to leave it like that and continue building a portfolio that way.

"I've continued making voluntary contributions into super so I'm now in a position to buy a second investment property somewhere with equally high rental yields and property appreciation," says Rod.

In the past 12 months Rod has put \$10,000 in voluntary payments into his SMSF and he has plans to put another \$20,000 in soon.

"I always try to put between \$15,000 and \$20,000 a year into it," he says.

"When I was purely self-employed the nice thing about the SMSF was that I could put in as much or as little as I wanted. If I had a lean year I didn't have to put anything in and I was still meeting statutory obligations but if I had a good year I could put as much into it as I wanted and benefit as well.

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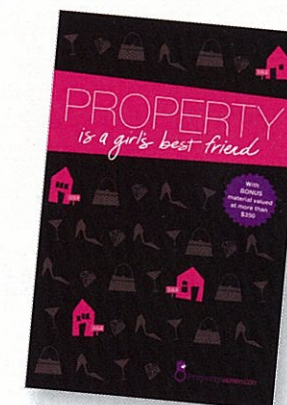
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"It gave me the flexibility I wouldn't have always had."

In the future, Rod says it's unlikely he'll buy property outside his SMSF.

"I'll probably keep buying within the super fund."

"From what I understand and from what my financial advisor and accountant have said it makes better financial sense to do it that way."

Rod explains that he has an annual general meeting (AGM) with his wife and

financial advisor to look at what the current position with the SMSF is and where they can go from there.

They're due to have their next AGM soon and Rod says that will involve determining when and what their next property investment will be.

The plan for the future, he says, is to continue down the path they're on now, investing in low-risk property close to the CBD that will rent easily.

"I'm 47 now and if I did that for the next

10 years – if I bought a property every two years – I might end up with a portfolio of five or six properties around the place," says Rod.

"I'll buy them with a view in 10 or 15 years' time of liquidating three of them to pay off the others and use the rent from those for cash flow."

Brad is a little more conservative with the goals for Rod's portfolio, estimating it's feasible for Rod to buy a property through his SMSF about every five years. **api**

Growing popularity

AN INCREASING number of people seem to be taking advantage of the opportunity to get into the property market using their self-managed super funds (SMSFs).

While many people may not have been aware it was possible to invest this way or thought it was too complicated and complex, there is evidence awareness is growing and so is its popularity.

Those who've had heavy exposure to equities over the past 18 months have likely seen their wealth deplete significantly so now, rather than concentrating on shares and bonds, they're focusing more on investing in tangible assets like real estate.

Property has become one of the most popular asset classes for SMSFs with more than \$46 billion invested in property, according to Australian Taxation Office March 2009 data.

Financial planner Paul Benson of Guidance Financial Services says SMSFs are the largest and fastest growing segment of the superannuation landscape.

"With many professionally managed funds delivering negative returns over recent years, more and more people are choosing to take control of their retirement savings," he says.

The recent rule changes to allow SMSFs to borrow for investment purposes, he says, means property investment may become a more popular option for SMSF trustees.

"And why not? Fifteen per cent tax on earnings and capital gains tax of only 10 per cent, reducing to zero if you don't sell until your fund is in pension mode."

Director of Quantum Warrants Peter Gribble believes the number of SMSF trustees buying property will continue to increase as people become aware of tax breaks on investment products such as property warrants.

He says there are significant tax benefits on interest payments, rental income and capital gains that can't be matched outside superannuation.

"Since super laws changed to allow borrowing within super, property warrants have become a popular way for super funds to buy investment properties and pay it back, over time, in a very tax effective way," he says.

"The tax advantage is that all interest paid on the property loan is tax deductible for the super fund and rental income is only taxed at 15 per cent."

"Tax deductions on the interest and paying minimal tax on contributions within super means investors can pay down their property loan a lot quicker."

"With super contributions taxed at the concessional 15 per cent rate instead of the 46.5 per cent marginal rate for individuals, the SMSF has more post-tax dollars available to pay down the property loan faster."

"People are taking advantage of these tax benefits to take full ownership of property faster than you normally could outside of super."

"Most SMSF trustees pay the loan off within the 10 years."

"In addition if clients hold the investment property into retirement they don't pay any capital gains tax."

"This makes this investment strategy one of the most tax effective ways to buy and pay off a property loan."

According to Brad Gunn of daVinci Advisors, it's often quicker to pay a property off when it's bought through your super fund because in the majority of cases not only do you have cash flow coming in from rent but you've also got employer contributions which is something you don't have outside super.

"Nine per cent of your income is being injected as contributions coming from your employer," he says.

"That's funding you just don't get outside of super."

"That's why it's so attractive, because you've got a third party, being the employer, making up the shortfall."

Gribble points out that an SMSF can make additional concessional contributions to further reduce debt.

Concessional contributions – payments made out of pre-tax salary – attract only 15 per cent contribution tax instead of 46.5 per cent.

It's important to bear in mind though that the Federal Government set lower contribution caps in the last budget.

Effective from July 1, 2009 the maximum amount of concessional contributions was halved from \$50,000 to \$25,000 a year for people under 50 and from \$100,000 to \$50,000 for those over 50.

After the 2011-12 financial year, however, all super fund members will have the same cap of \$25,000.

The reduction in the cap may mean that properties bought through superannuation won't be paid off as quickly because there won't be as much incentive to pump money into the fund.

But it's believed the cap could lead more people to consider building a portfolio using super because they'll be looking for alternative strategies to build a nest egg and that's when gearing comes into play because there are still significant tax advantages.

While more people are becoming interested in gearing into property through superannuation, Jim Downes of the Real Estate Investment Network Group says not everyone will be jumping on the bandwagon.

"Borrowing money within an SMSF to invest in property is not for everyone; it is generally best suited to people aged 50 or older as part of their retirement plans and offers great benefits."

The increase in popularity of investing through super has led some analysts to predict it could boost property prices in Australia, making up for a reduction in first homebuyers.

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