Investment Options for Self Managed Super Funds

Self Managed Superannuation Funds (SMSF's) give its members complete control over where their superannuation is invested. While having drawbacks (for instance in a commercial super fund there are expert financial advisors picking the investments), many people choose SMSF's because they have a particular type of investment in mind (e.g. property) or possibly they simply like the concept of living or dying by their own sword.

In this brochure we will outline some of the investment options available to SMSF's along with some of the related rules and traps. We can not and do not recommend any products listed in this brochure, any references to actual products are there for example only.

Investment Restrictions

We'll start with some of the restrictions imposed on SMSF's. This isn't an exhaustive list but some of the more relevant:

- A SMSF cannot loan money to members or associates;
- Investments cannot be purchased from a member or associate (listed shares and business property are exceptions);
- A SMSF cannot invest in an asset that is used by a member or associate (e.g. classic car, paintings, golf memberships);
- Investments must always be purchased and sold at market value;
- A SMSF must always operate with the sole purpose of providing funds at retirement (so investments must be chosen based on what will give the SMSF returns, not what will give members other benefits);
- It is vital that the investment is purchased in the name of all trustees. If you run a SMSF with 4 members, then all 4 names need to be on the asset title. If you have a company trustee, then the company name needs to be on it;
- A SMSF must formulate and implement an investment strategy, and this needs to be reviewed and updated at least every 3 years;
- A SMSF can only borrow to buy investments under limited and strict conditions, and generally assets cannot have a charge against them (so you can't use them as security on a loan in your name); and
- Collectables are subject to additional documentation requirements and must be insured.

Breaches of the investment rules come with penalties ranging from around $2,000 to as high as the ATO making the SMSF "non-compliant" and being taxed at up to 49% of the value of the fund (yes, you could lose half of your super).

Diversification

One of the most important factors to consider is the diversification of your investments. This means having a wide range of investments to protect yourself from the fluctuations of one category of asset or industry.

For example, if your money is invested 100% in property, you are at the mercy of the property market. What may occur is that at the time you need to sell your property to provide money in your retirement, the market may be down and you are effectively forced to sell at a bad time which can cost tens or hundreds of thousands.

If you split your money between property, cash, Australian shares, international shares, etc, you are protected from a crash in one sector. You also have your yearly rate of return averaged across all sectors.

Proper risk profiling and planning would help you determine how diversified your portfolio should be. For instance if you are nearing retirement and your super balance is just enough for you to live on, chances are a portfolio focused more on assets that cannot decline in value (cash / term deposits) would be more appropriate so you don't risk your lifestyle.

Common Investment Options

Some investments require little to no explanation:

- Bank accounts & term deposits;
- Listed shares – just set up an account with a broker (such as CommSec, E-Trade) and away you go;
- Property – yes an SMSF can invest directly in property, or indirectly through other entities (via managed funds or via a structure such as a unit trust where the SMSF holds say half and you personally hold half);
- Managed funds – you can place an amount of money with a managed fund (such as AMP, BT) and they will add it to the pool of money they have invested among shares, property, fixed interest, etc;

Left-Field Options and New Opportunities

Alternative investments that you may not have thought of:

Lending to non-associated people

When you loan money, you are creating an asset or investment being the interest you expect to receive (along with the principal of the loan). There are a few businesses that help facilitate private loans, in the past RMBL Investments have provided this option, but in the new digital age there are many peer-to-peer lending websites that make it easy and provide pretty good returns (such as Rate Setter and Society One).

Traps: Loans must be fully documented and must be on commercial terms. This not only means interest rate but consequences for the lender should they be late on payments, or fail to pay. For this reason using a commercial service is generally recommended.

Gold (or any Precious Material)

Yes, there's nothing stopping your SMSF from purchasing materials that are expected to rise in value such as gold. It helps if there is a market for the purchase and sale.

Traps: Documentation, storage, and insurance. Every SMSF must be audited, and the auditor will want to be certain that the gold exists and is secure. Having it stored in a mint depository would probably be your best bet.

Robo-Advisors & Exchange Traded Funds (ETF's)

You may have heard of the term "robo-advice". Basically it's the digital worlds attempt to automate the fact finding and risk profiling that financial planners do, and then recommend a product for you which is normally an EFT (these are quite similar to managed funds). An example would be Ignition Direct.

The benefits to using a robo-advisor is that its cheaper than seeing a financial planner. You will get a good guide as to whether you should be invested in growth assets, in assets that are of low risk of losing its capital, or a riskier profile. The downside is that robo-advice is limited in scope and won't consider many other factors that a real person would (such as insurances, assets outside super, and many retirement goals).

Traps: Look out for fees. Running a SMSF has costs, and then using any sort of managed platform to invest comes with additional fees. If you run a SMSF and invest largely in managed funds or ETF's, it may actually be cheaper to simply put your super into a commercial super fund and achieve the same result.

Fractional Property Investment

Typically investing in property requires a large amount of money to invest (given you need to buy a whole property). While managed funds often had property as part of their diversified portfolio, choosing the level of your investment in property was difficult.

Like the ETF's above, there are new "fractional property investment" options that allow you to invest in property (and in some cases not only specific types of property, specific properties) without requiring you to purchase the entire property. What sets these apart from getting a group of people you know together is that often these investments have a type of secondary market where they can help you find a buyer from within their pool of clients.

One example of such investment is DomaCom.

Of course there are many other property syndicates that you can get involved in. Often these are for larger developments, but regardless it gives you a chance to get into the property market. Wallis Watson is one such example (*disclaimer: one of our Directors has an ownership in Wallis Watson*).

Traps: Check the secondary market to see how liquid your investment is (how quickly you can sell if need be). If you've selected a specific property to invest in (as opposed to going into a larger pool), you may have difficulty selling the property should it not perform.

Marina Berths / Car Parks / Taxi Licenses

Aside from Taxi licenses being heavily devalued due to Uber, it meets all the criteria as an allowable investment. Same goes for other items such as marina berths and car parks. Both provide regular income streams and are often limited in supply (i.e. limited waterfront to build extra marina's), so the capital outlay may be fairly secure.

Traps: Personal usage is not allowed, so if you plan on purchasing a car park or marina with the aim of using it, shelve that idea quickly.

Businesses

Despite all the rumors, there is nothing stopping a SMSF investing in (or running) a business. There are however very strict rules around these activities that may in reality prevent many of these investments. For instance, the rules that prevent a SMSF borrowing effectively prevent it running a business that involves purchasing things on credit (because a line of credit is a borrowing).

However opportunities arise where the SMSF has a small shareholding in the business and has no control. We have a number of SMSF's investing in property development entities. The entity buys the block of land, develops it, sells the land, and at the end returns the money to the shareholders.

Traps: There are many. Go and see your accountant – that's the best advice we can give here.

Collectables

Paintings, classic cars, coins, and other items of that nature.

Traps: They can't be stored at your premises (or your business, or anywhere that you can view them really), they must be insured, you need professional valuations, and the documentation requirements are onerous. Unless you have purchased a high-priced item, it's probably safest to avoid.

Anything Really…

Your SMSF is able to invest its money in anything that you genuinely believe will (or may) rise in value or provide income – as long as it's within the rules. Most rules prevent investments being used by, sold to, or purchased from

members and associates, so you can be imaginative. The ATO have reported items such as moon rocks, portable toilets, and lions as assets in SMSF's (and allowed).

Traps: Proving that the investment is actually genuine will be your greatest worry. This would include documentation, insurance, and storage. Be prepared for your auditor to scrutinise it greatly.

Disclaimer

We have provided this document as a very basic guide which is intended to assist people in improving their understanding of the tax laws and how they operate. When considering what actions to take however, there are more factors that should be considered.

This is not intended to be a comprehensive document that can be taken as tax advice, financial advice, or any other kind of advice. The content does not consider any of your personal circumstances and is only generic in nature.

This document is not to be taken as advice under any circumstances. If you are considering acting based on anything written in this document, we suggest you seek professional advice first.

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