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Property schemes not a super option

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THERE are three certainties in life: death, taxes and the inevitability of another get-rich-quick scheme lurking around the corner.

Self-managed super funds are at risk of becoming the latest hunting ground for get-rich-quick merchants, with property spruikers seizing on the government's recent clarification of the borrowing rules for do-it-yourself funds.

Property developers and salespeople are increasingly promoting self-managed super funds as a tax-effective way to invest in property - preferably the properties they have on their books. Instead of entrusting your retirement savings to a public super fund, why not set up your own fund and leverage into the property market instead? As every Australian knows, property is the king of investments and borrowing through your fund to buy it is a fast-track path to living the good life in your dotage. Or so the theory goes.

A report by researcher Investment Trends has found borrowing by self-managed super funds is growing fast. Use of gearing has more than doubled during the past two years and is set to grow by another 40 per cent in the next 12 months, with commercial and residential property heading the list of desired investments. While only 7 per cent of funds are now using geared investments, Investment Trends predicts that will hit double digits within the next couple of years.

While Investment Trends says gearing within super is a niche and more than half the existing self-managed fund investors surveyed (54 per cent) were unlikely to use geared products, some advisers are becoming concerned at self-managed funds being sold as a borrowing tool for new investors.

The national manager for advice development at Ipac Securities, John Dani, says his advisers are seeing both existing and new clients asking about setting up a self-managed fund to gear into property.

''The warning bells are starting to ring,'' he says. ''It makes me think back to 2007, when investors were borrowing to put $1 million into super [before lower contribution caps came in].''

Dani says he is not opposed to property investments, self-managed funds or even a combination of the two. But he does think it's time for a reality check.

The reality is that the borrowing rules were never intended to open the floodgates for everyone to punt their super on the property market. Indeed, the landmark Cooper review into the super system earlier this year decided not to recommend further restrictions on funds borrowing only because the practice was not widespread and it believed new government safeguards should be given time to settle in.

The review recommended the government revisit the issue in two years to ensure borrowing was not becoming a significant focus for self-managed funds.

In its own words: ''In principle, the panel has concerns with the concept of direct borrowing within any superannuation funds … The panel is concerned that if direct borrowing had been more widespread before the recent GFC then a substantial amount of retirement savings could have been lost. The panel therefore believes that the 2007 amendments to the

SIS Act, which relaxed the borrowing provisions, are inconsistent with Australia's retirement policy.''

As these quotes indicate, being allowed to borrow is only a recent development for Australia's super funds. Until 2007 there was a blanket ban on any super fund borrowing - except for short-term loans to meet cash-flow requirements.

The Howard government, in its dying days, introduced new rules to overcome uncertainty about whether self-managed funds could invest in instalment warrants - a share-based investment with inbuilt borrowings. But instead of just giving the nod to instalment warrants, it extended this to any investment where the borrowing was taken through a similar limited-recourse loan arrangement. (These arrangements limit the lenders' rights if the fund defaults to the asset bought with the loan; the lender can't touch any of the fund's other assets.)

There was a widespread expectation that the Labor government would reverse this measure but it has instead moved to ensure the loans can only be offered by licensed providers and to introduce legislation clarifying how they should work.

To Dani and others, it is this clarification that has ignited interest in borrowing through self-managed funds. The government has given the strategy its imprimatur and cleared up worrying grey areas, such as whether fund members could give a personal guarantee for the loan, as is required by many lenders.

But Dani says there are still risks and special responsibilities the promoters don't always talk about. Because this is a super fund, investors are still governed by the superannuation rules that prevent you, for example, from renting out your residential unit to family or using the money to buy a holiday house. You have a list of duties as the fund's trustee and the Tax Office has been active in ensuring these obligations are met.

The borrowing legislation also prevents you from spending borrowed money on improving a property, though you can use it for repairs and maintenance. And with bodies such as the International Monetary Fund suggesting Australian house prices are overvalued, it is important to keep in mind that property prices can - and do - go down. Liquidity is also a consideration for super funds, especially if they have more than one member and may be required to pay out retirement benefits.

But the big question is motivation. Traditionally, Dani says, people have set up self-managed funds because they want more control, more diversification, lower fees, or a combination of these things. Investors establishing funds on the back of property promotions are a new breed and one that is all too likely to get burnt if this trend gets out of hand.

This story was found at: ***http://www.smh.com.au/business/property-schemes-not-a-super-option-20101112-17r4b.html***