



# The ABCs of SMSF loans

Self-managed super fund loans may still be in their infancy, but technical consultant Vince Scully of SMSF Finance Specialists says demand from borrowers is growing

“It’s just a loan,” insists Vince Scully, technical consultant with SMSF Finance Specialists.

Scully has been actively educating brokers and borrowers on the merits of self-managed super fund loans since the government gave these products the green light in September 2007.

And despite having hit the market two years ago, it really wasn’t until early 2009 that the person on the street really started to demand the product, he says.

“When we first started, when I had a discussion with a client or an accountant, the question was ‘Can I really do that?’ Whereas when we got to July 2008 it was ‘Tell me how it works’ – and now it’s the client that’s driving it.”

The slow progress of the SMSF loan sector can partly be attributed to the timing of its release, which coincided with the onset of the GFC in Australia.

“It’s interesting, because if I think back on my 25 years in financial services, this is the product that has taken the longest to come into maturity,” says Scully. “When government changes the law, usually there’s a plethora of products that arrive very quickly after. It was really March of [last] year when consumer interest picked up. And we’re seeing a lot. Since July in particular – and I think that’s people getting their statements and saying, ‘My God, how much have I lost this year and how much in fees do those clowns take?’ And they’re saying, ‘Hey now I can do better than that – I can buy real estate.’”

SMSF products may be ‘just a loan’, but there are two fundamental differences that set a SMSF

apart from your average home loan. The first is it must be ‘limited recourse’ – or in other words, include a no negative equity guarantee.

It’s great for borrowers, in that they’ll never have to pay the bank more than the property is worth, but it comes with a price – generally borrowers can expect to pay about 1% more for these loans.

The second difference is borrowers can’t hold the property themselves – it must be placed in the name of a special trust.

As it’s ‘just a loan’ (with a few differences), Scully says from a regulatory perspective all brokers need to do to sell these products is to be a broker. He does recommend having a good background in superannuation and property investment, “partly to be able to sound credible with the clients and partly to provide comfort to your referral partners, particularly accountants”.

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He adds: "It's not particularly difficult but it does take an investment in time and effort. But it is a natural extension to what we do as brokers, because it is just another funding product for property investment. If brokers are looking for new opportunities, this is really an extension of what we do today."

Sometimes there is advice structuring that needs to go around the loan, which of course would have to be done by an accountant or a financial planner, but Scully says this is an excellent way for brokers to build their centres of influence.

"So if you were depending on accountants for referrals for your loans, now you've got something to give back because you can refer them to the super fund loans."

While cooperation with accountants on these products was tough as first, Scully says most advisors are slowly warming to its merits.

"Accountants are naturally conservative, so it takes a while for that message to get through, but it is getting through."

Typical clients are in three categories, he explains. The first is the small businessperson who is looking to buy their own business premises – doctors, lawyers, vets and so on. About 70% of Scully's business is made up of this market segment and typically they're borrowing \$500,000 to purchase an \$800,000–\$1m property.

The next category is the property investor who simply wants to use their super fund to invest in real estate. That is a growing portion of the market and one that has taken a little longer to mature. But they're motivated just like any other investor, Scully says, adding that they are typically looking for long-term holds.

And the third category is the sea changers, who want to use their super fund to buy their property today, rent it out for the next 10 years and make tax deductible contributions to their super fund to pay it off until they are ready to move in.

Scully's main source of referrals come from accountants and financial planners.

"We don't have much of a direct client base," he says. "And our pitch to the accountant is about providing a specialist service. Just as they bring in a specialist to do estate planning, we encourage them to bring in a specialist for these products. They know their clients, we know the product. We also do some work with the brokers too."

Currently there are about 10 lenders offering SMSF products to the market. But unlike home loans, you can't simply line them up on price and features.

"All of the products are quite different," Scully says. "So you've got to focus on the clients' needs. So if you've got a client that's low-doc there's not a lot of choice; if you've got a rural loan, there's only one place to go."

#### Issues

There are a couple of design issues that remain unclear with these products – one of them is the use of guarantees from members of the super fund. "We've always believed that they're bad and we avoid them wherever possible," Scully says. "And we're in continuous dialogue with the ATO on this issue. Most of the banks will have that as an initial requirement but they can usually be talked into not taking them for the right circumstances."

#### Change?

Scully says he doesn't see the upcoming regulation having a big effect on the sector.

"The real difference is going to be the disappearance of the part-timers in the industry, so we'll be left with professional brokers, who are by their very nature more educated, more experienced and more dedicated and therefore more professional. So I don't really think the regulation itself is an issue. But it depends on how they actually bring it into the licensing. If they try to force-fit it into the financial services licensing regime then maybe it will [be an issue], but we'll have to wait and see." **MPA**

#### Key points to consider

- Brokers should limit themselves to selling the loan - the moment you get into tax strategies, you've overstepped your legal boundaries
- Most lenders require brokers to receive independent financial advice before they will give the green light
- To sell SMSF loans, brokers should first get accredited with respective lenders. These include Westpac/St.George, CBA, NAB, BankWest, Rabo, Firstfolio, among others
- Most lenders run these products through their commercial arm, so generally commercial accreditation is required