Portfolio

Property takes funds into higher gear

DIY super
John Wasiliev

For mortgage broker Richard Sheppard, do-it-yourself super is a new experience made attractive by being able to leverage investments through superannuation.

Sheppard, managing director of Sydney-based inSynergy Financial Solutions, is putting his super money where his beliefs lie by establishing his own DIY fund specifically to invest in geared property investments. One of the first investments he is making on behalf of his new super fund is the commercial property from which he runs his property finance business.

He is one of 16 brokers and property specialists who have got together to set up their own DIY funds to invest in residential and commercial investment properties since the rules that allow super funds to gear into property were clarified in September.

"I haven't been that interested in super before because I understand the advantages of gearing property but now that you can leverage it makes more sense," he says.

Sheppard is using property warrants developed and promoted by Sydney group Quantum Warrants, which have been sanctioned for more than two years by a Tax Office product ruling. The products have been given a big boost by the latest rule changes and according to Quantum national sales manager Andrew Bone most of the 200 property warrants it has approved so far have been set up in the last six months.

Sheppard says while he is aware there are hands-on strategies for property gearing being talked about, he has chosen a commercial product for his first super gearing foray because the accountants, lawyers and financial planners he has spoken to are not yet that confident about more direct gearing strategies. "None were that confident about their advice without the support of a specific ruling," he says.

While he is aware that using a commercial product is more expensive, he is prepared to accept this for regulatory certainty. In addition to the standard borrowing costs associated with property investing, property warrant investors must pay borrowing and arrangement fees to the promoter. Promoters may also be involved in property leasing arrangements.

The higher costs are a major reason why property warrants are a super investment rather than an outside-

Now might be a good time to consider property, given the volatile sharemarket and the fact that property market is down in many areas. Photo: GLEN McCURTAYNE

super strategy, says Sheppard.

"Maybe in a couple of years when the tax position becomes more generic we will shop around for something cheaper," he says.

Sheppard says the research he has done suggests property gearing through super should be a cash flow-neutral strategy – where the costs such as interest and other expenses match the income – or better still, cash flow-positive. That's why commercial property, which pays higher income yields, is very suitable. But so is well-located residential investment property such as places near golf courses or the beach, he adds. Cash flow neutrality is encouraged by equity requirements of around 25 per cent for residential property and up to 45 per cent for commercial property.

Bone says DIY funds that wish to invest in property through property warrants need a reasonable level of assets. For example, a fund looking to invest in a residential investment property will need to also have the resources to cover the first year's interest in advance as well as stamp duty and borrowing costs. The first instalment is likely to require an outlay of between 37 and 40 per cent of the property purchase price, of which 25 per cent will represent the equity in the investment.

Sheppard says an integral part of a property gearing strategy is to be confident about property market prospects. He thinks now is a good time to consider property given the volatile sharemarket and the property market being down in many areas.

Sheppard expects to see good quality residential property on Australia's east side deliver 12 to 18 per cent per annum capital growth returns over the next four to six years and 9 to 12 per cent over the longer term.

His outlook for commercial property is less growth-focused because of the higher rental yields and he expects to see capital appreciation of between 4 and 9 per cent per annum with similar increases in rental yield.

Sheppard says that as a property professional investing in super, while he will be a long-term holder he will use the equity to regear to make further investments rather than pay off the loans. His DIY fund won't have an all-property investment portfolio. The other assets will be highly liquid blue chip shares.

An important part of the strategy will be holding the investments until retirement, when the greatest capital gains tax saving will be made.