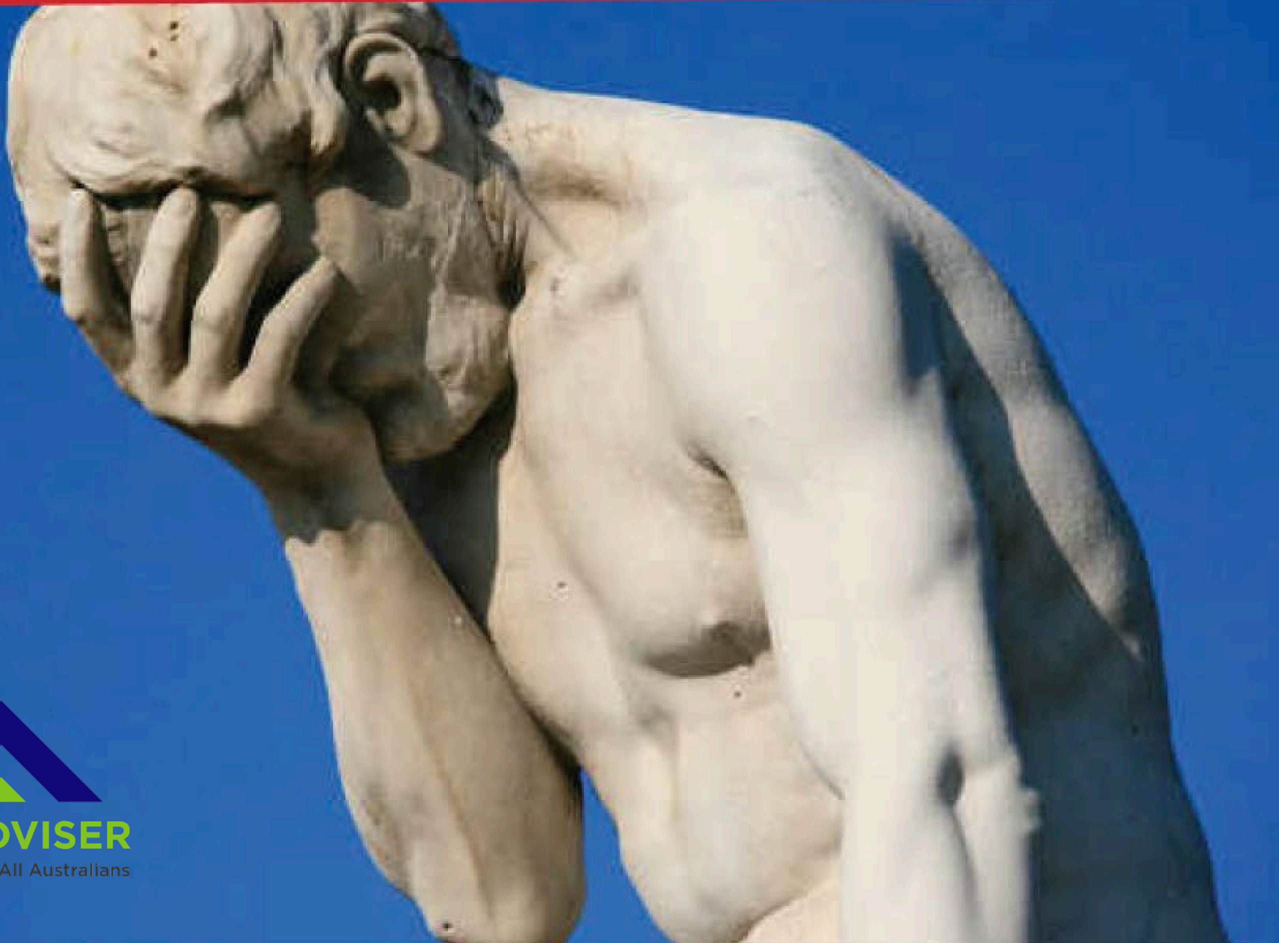
TOP 12 MISTAKES TO AVOID

when setting up an SMSF



WEALTHADVISER

Financial Education for All Australians

Before you get started

This eBook contains general and factual information only.

The Wealth Adviser library (including this eBook) is published by:

- Wealth Today (AFSL 340289)
- Sentry Advice (AFSL 227748)
- Synchron (AFSL 243313)

The library, and this eBook, contains general and factual information only.

Before acting on any information contained herein you should consider if it is suitable for you. You should also consider consulting a suitably qualified financial, tax and/or legal adviser.

Information in this eBook is no substitute for professional financial advice.

We encourage you to seek professional financial advice before making any investment or financial decisions. We would obviously love the opportunity to have that conversation with you, and at the rear of this eBook you will find information about our authorised representative and how to go about booking an appointment.

If ultimately you decide not to meet with us we still encourage you to consult with another suitably licensed and qualified financial adviser.

In any circumstance, before investing in any financial product you should obtain and read a Product Disclosure Statement and consider whether it is appropriate for your objectives, situation and needs.

WEALTHADVISER
Financial Education for All Australians

Letter from the Wealth Adviser Library

Dear **Reader**

WELCOME TO THE WEALTH ADVISER LIBRARY.

This library was built specifically to facilitate the provision of sound financial information to everyday Australians.

Our mission is to build an accessible, comprehensively supported team of members who share our vision and commitment to providing tailored financial advice and a new foundation of financial understanding and security for everyone.

With a national network of likeminded experts, we have the potential to provide the financial building blocks for future generations.

KNOWLEDGE GIVES YOU A HUGE ADVANTAGE

We believe that knowledge gives you a huge advantage in creating and effectively managing wealth; in planning to reach your goals; and in being prepared for whatever unexpected twists and turns life may present.

That's why our team of experts has created this series of eBooks that seek to inform you of not only the benefits but also the potential risks and pitfalls of various strategies and investments.

We trust you enjoy this publication and find it informative and professionally presented. Of course, your feedback is always welcome as we strive to continually offer content in a format that is relevant to you.

TAKE THE NEXT STEP

We invite you to meet with one of our advisers to discuss what it was you were hoping to achieve when you obtained this document, and to establish if they can help you achieve your goals and objectives.

At the rear of this handbook you will find the details on how to book an appointment with one of our experts.

We look forward to meeting you soon.

Wealth Adviser Library

Contents

Introduction

Life has certainly become much more complex in the area of financial planning over the past few decades but this is, as we shall see, not necessarily a bad thing. In the past, planning for your retirement was often simply a matter of regularly paying into your employer's super fund and hoping for the best. You can certainly still follow the same approach, by taking the path of least resistance and paying into a basic super fund (perhaps even one recommended by your employer).

It is quite likely that there are other options available to you but you will have to actively do your homework in order to make the best decisions in this regard. One possibility, and one pursued by more and more Australians, is setting up a Self-Managed Super Fund (SMSF).

In the past SMSFs have been regarded as something of a niche activity only reserved for those who had the skills and knowledge to navigate the complexities of managing their own fund. Now, however, the sector has developed to such an extent that it has essentially become a very respectable and mainstream way of preparing for retirement. This is certainly reflected in the development of many tools to assist investors in setting up and maintaining SMSFs.

The growing popularity of this type of investment can be gauged by looking at the 30 June 2019 statistics[1]:

- SMSF's form the largest and fastest growing part of the $2.9 trillion Australian superannuation sector with over 17,000 new funds (net) set up in the past year.
- SMSFs have about $748 billion of assets under administration.
- As at 30 June 2019 there are 599,678 SMSFs in existence with an estimated 1.125 million members.
- Many Self-Managed funds have significant assets under their control with the average fund balance now exceeding $1.27 million, with the average account balance for an SMSF member around $678,000. This does not mean, however, that the sector is totally dominated by high net worth individuals. About 28% of all SMSFs have less than $500,000 in assets.
- It is interesting to note that more and more younger people are also entering the sector with about 45% of new SMSF trustees being under 45 years of age. This bodes well for the growth of the SMSF sector into the future.

With the above as background it should be obvious that investors should, at the very least, consider the option of using an SMSF as part of their retirement planning. It is with this in mind that we offer this eBook. By carefully looking at the process and possible pitfalls associated with going down the SMSF route you will be much better placed to decide whether this is the right approach for you and to make better decisions regarding the management of your SMSF if you make the decision to start one.

Editor's Note:

This 2019 edition has been updated to include:

- The latest SMSF statistics from the Australian Taxation Office (30 June 2019)

Mistake #1 – Not clearly spelling out your objectives

There is an old bit of wisdom that states that 'Those who aim at nothing hit it every time!' This is certainly true in the area of investments and financial strategy.

With any investment, it is of the utmost importance to sit down and think about what we really want to achieve. The answers to these questions will help us to determine whether a particular investment type will help us to achieve the objectives that we set. It is, furthermore, the case that these objectives could prove to be very valuable in terms of guiding the decisions that we make once the investment have been entered into.

[1] Source: https://www.ato.gov.au/Super/Sup/Highlights--SMSF-quarterly-statistical-report-June-2019/

In the case of the particular strategy under discussion in this eBook we would like to suggest that you ask the question 'Why would I possibly want to set up an SMSF?'

Giving careful thought to the questions listed below can help to bring you to the point where you can make an informed decision on whether an SMSF will be the right fit in terms of your own financial position, personality and risk profile.

- ***Do I want to be more in control of my super and retirement planning?***
  Some people are very 'hands-on' when it comes to financial matters. An SMSF is an ideal option for them while other alternatives may have to be considered for those who find the idea of taking such direct control of their retirement savings off-putting or even downright scary. Personality and attitude to risk will play a significant role in thinking about this question.
- ***Would I like to have more choices in terms of investment options and strategies?***
  Members of mainstream superannuation funds often find that the investment options open to them can be limited. They also have very little control over the strategies that are being followed to maximise their investments. Investors who value choice and personal involvement could consider an SMSF.
- ***Do I think that I can invest my funds better than the person managing it at the moment?***
  It may sound pretentious to even ask this question but ultimately you have a level of insight into your own financial position and needs that no outsider has. It may well be possible to translate this into financial decisions that could maximise returns. This is obviously a tough call to make but if you think you can do better an SMSF may be for you.
- ***Would I like to diversify into investment areas not available through regular superannuation solutions?***
  There are a variety of investment options (e.g. residential property) that are not accessible through standard superannuation products. If it is your considered opinion that one or more of these areas will deliver the kind of returns that you would like to see in your retirement portfolio an SMSF may be the way to go.
- ***Should gearing be part of my investment strategy?***
  Gearing is where money is borrowed to finance the acquisition of an asset. If properly employed gearing can be an effective wealth building tool as it could in the long-term lead to full and unencumbered control of an income producing asset once the loan had been paid off. Gearing is not available in general superannuation products but an SMSF can engage in this practice (if certain ground rules are strictly observed).
- ***Am I a 'hands-on' money manager?***
  If you have the temperament, the knowledge and the skills to effectively manage financial assets then it would make sense to consider an SMSF.

Once you have gone through this exercise there are obviously still some other questions to ask and mistakes to avoid. It is to these that we now turn.

Mistake #2 – Misunderstanding the nature of 'Self-Management'

It is probably fair to say that one of the main obstacles that prevent people from making use of SMSF's as a key part of their retirement planning is the term 'Self-Managed'. For many people this evokes images of hard work; doing things that you do not feel totally qualified to do. The reality is, however, that most SMSF trustees outsource a significant percentage of the activities required for the efficient running of their funds to experts, while retaining overall control over investment and strategic decisions.

One of the most positive aspects of using an SMSF is precisely the fact that there is a great deal of control over just how involved you are with the hands-on running of the fund. A useful way to express this is to think of activities related to the SMSF management as being on a scale from 1-10. 1 would be the kind of 'set and forget' funds available in the retail superannuation sector that require virtually no investor involvement at all. 9 or 10 would be where the investor takes personal control over every single aspect of the running of the fund. For most investors, an SMSF would probably rank around 5 - 7 as it will require some extra work but it certainly need not be a 9! Then again, some people (perhaps those who just entered retirement looking for new challenges) would appreciate the opportunity to 'do a 9' by taking a very active role in managing their money.

The point is that you will be able to make the decision as to how active you will be in managing your fund. For investors who would like to reap the benefits of placing their funds in an SMSF but who do not desire to be totally immersed in the running of their funds there are several options available to reduce the time commitment associated with their SMSF. The two most common among these are the outsourcing of some functions to professionals or a conscious decision to follow a 'buy and hold' strategy with blue chip investments.

Keep in mind, however, that you ultimately remain responsible for the fund, even when outsourcing certain functions to others.

Ultimately 'Self-Managed' can mean what you would like it to mean and this can range from funds where almost everything is outsourced to funds where the exact opposite is true and just about everything is done by investors themselves. The choice will be yours.

Mistake #3 – Not seriously considering whether you have the time and inclination to manage your retirement funds

Despite what was said above, it needs to be acknowledged that SMSF investments are different from the 'set and forget' funds that can be accessed through the retail investment sector. Yes, you will be able to outsource many functions and activities but final decisions will still be down to the investors (trustees) belonging to the fund and some work will be required from them to ensure compliance and optimal investment performance. You will, therefore, have to ask yourself whether you will have the time available to do justice to the proper management of your fund.

If you think that you can make the time to play a role in the management of the fund (possibly with some or most activities outsourced) then an SMSF may be the way to go.

Mistake #4 – Not taking your temperament and personality into account

It should be acknowledged that there are some spruikers out there who claim that SMSF's are the perfect investment solution for just about everybody. The reality is a bit more complex however. While it is certainly the case that there are many investors who would benefit greatly from going down the SMSF route, it is certainly not the case that every single investor will necessarily benefit from switching to an SMSF. Besides all the financial considerations, it has to be acknowledged that some people will perhaps be temperamentally disinclined towards taking such an active role in the management of their investments.

One of the main areas where temperament and personality comes into play is decision making. Being an SMSF trustee will require constant, decisive and active decision making from the investor. Prospective investors who struggle with being decisive and who constantly agonise about whether past decisions were the right ones will, therefore, find involvement in an SMSF quite stressful.

Mistake #5 – Not giving careful thought to whether a geared or ungeared strategy would be most appropriate

One of the most fundamental decisions that you will have to make as a new SMSF trustee is whether you will be making use of gearing (i.e. using borrowed funds to gain control of an appreciating and/or income generating asset) as part of your superannuation strategy.

If you do decide on a strategy that includes gearing, then an SMSF is one of the best ways to access low cost borrowed funds. Especially when it comes to direct property purchases within an SMSF.

Gearing can work both ways. On the one hand it has the potential of significantly increasing returns (since you will have both your own and borrowed funds working for you), on the other hand it can also increase risk as you will be exposing borrowed funds to adverse investment outcomes. So ultimately gearing can be either rewarding or punishing. This aspect of gearing should receive serious consideration before you decide to use it and it goes without saying that you will need to consider your own investment profile (e.g. what kind of risk exposure you are comfortable at this stage of your investment journey) and your general level of comfort (or otherwise) with risk.

If you do decide upon a strategy that includes gearing the following components should be included:

- ***An adequate timeline.*** In other words, there should be enough time for the gearing strategy to bear fruit. This is generally not a strategy that you should enter into right before retirement.
- ***Good cash flow.*** There should be enough assets and cash flow in your fund so as not to overexpose you to the risks associated with borrowed funds.
- ***A well-thought-out debt repayment strategy.*** This is not an area where 'hoping for the best' will suffice. You need to ask yourself how the debt will eventually be cleared. Will it, for example, be through gradual repayment or through an eventual asset sale?
- ***The right temperament.*** The points made above about investor temperament are doubly important when it comes to geared investments as some people will probably struggle with the idea of taking on a significant level of debt as part of their retirement planning.
- ***Good buffers.*** Investors should make sure that there is a bit of 'fat' in their portfolios in case things do not go quite as planned with their geared investments.
- ***Appropriate gearing ratios.*** Investors should not get carried away with the possibility of borrowing to gain control of assets. It is certainly possible to overdo it and expose yourself to very high levels of debt and risk.

Mistake #6 – Not doing your homework in the area of direct vs managed assets

Some investors are quite happy with the idea of placing their retirement funds in ungeared and entirely managed portfolios. In such a scenario, no assets will be directly owned but funds will essentially engage in non-arm's-length investments (most often in the form of shares or other money market products). For those who prefer this kind of investment an SMSF may not necessarily be the best option.

There are a variety of platforms and products that can deliver a wide range of Exchange Traded Funds (ETFs) or managed funds for you to choose from. Many of these will offer tailored investment strategies to tie in with your investment and risk profile. If, however, you would prefer direct ownership of unlisted funds, syndicates or property then you would consider the possibility of an SMSF.

Mistake #7 – Not factoring in the optimal level of responsibility and investment control

A recurring theme throughout this eBook so far is the idea that one of the main reasons behind setting up an SMSF is the fact that it allows investors to gain a greater level of control over how their funds are invested and managed. Going down the SMSF route certainly brings with it a wide range of options to the extent that you will be able to invest your retirement funds in almost anything that you could invest in if you were simply investing with your regular (i.e. non-retirement) funds.

Many investors have found this a good place to be, but this freedom also comes with a significant level of responsibility. When you opt for an SMSF your investments become your own responsibility in a very direct sense. Yes, you will be able to outsource some of the activities associated with it but ultimately the final responsibility for ensuring that your fund is properly managed and that an appropriate investment strategy is being followed rests with you.

If you are not ready to assume this level of responsibility, then an SMSF is probably not the right option for you at the moment.

Mistake #8 – Not carefully tallying up costs

While an SMSF can bring significant benefits in the long run it should certainly not be seen as a 'cheap and cheerful' way to save on superannuation fees. You will have to pay for a variety of things including setup fees, accounting fees and legal fees. A breakdown of costs for a typical SMSF may look something like this:

- Setup fees
- If you have a corporate trustee you will have to bear some additional costs associated with having a trustee company structure.
- If you intend to borrow within the fund, there will be costs associated with applying for finance and for setting up the required structure (a 'bare trust') to facilitate borrowing.
- Ongoing auditing costs
- Ongoing accounting cost
- Transaction costs (e.g. stamp duty if you are going to buy property and transaction fees if you will be investing in shares)
- Costs associated with gaining expert advice (if applicable).

It is highly advisable that you get good advice as to what all the above items will be in 'dollar and cents' terms in your case and then crunching the numbers as to whether an SMSF is a viable and economical option.

Mistake #9 – Not having an appropriate starting balance in place

There is a significant level of debate in investment circles as to what the appropriate level of initial funds with which to start an SMSF is. As with so much in the world of investment the answer is 'it depends'.

There is no legal minimum balance for an SMSF but this does not mean that those with relatively low balances should immediately transfer their super from retail to self-managed funds. If, for example, you have $50,000 in your super fund you will have to factor in that running an SMSF could cost you between $2,000 and $4,000 per annum (depending on the level of professional assistance you make use of). This will clearly make a significant dent in your relatively small fund making it a decidedly uneconomical proposition.

The ongoing amount that you can invest should also be taken into consideration. A person with $125,000 but able to contribute $50,000 per year is obviously in a very different position from someone with a fund that is currently larger (e.g. $225,000) but that is not being added to on an annual basis.

In terms of ball-park figures an opening balance of between $200,000 and $250,000 would be a reasonable starting point to begin considering an SMSF. This is not to say that everyone with a balance in this range should automatically go down the SMSF route, all the other factors mentioned above will still have to be considered. It is, however, a good place to begin having the conversation and to get expert advice on your options.

Mistake #10 – Misunderstanding the purpose of an SMSF

The primary purpose of an SMSF or any other superannuation fund, is to provide funds to the investor in retirement. The Australian Taxation Office (ATO) and relevant superannuation rules term this the 'sole purpose' requirement. This should be borne in mind when considering whether to use this investment vehicle.

You will, in fact, constantly be asked to show how your fund complies with ATO's 'sole purpose' test. This means that you will have to show that your strategies are designed to maximise retirement income. You should also be aware that you cannot draw down funds from your SMSF before you retire or reach your 'preservation age' (except in some very exceptional circumstances). Once funds are in your SMSF they will be there for the long haul. This certainly should be considered as you decide whether to invest in an SMSF as forgetting the vital link between superannuation and the provision of retirement income can have some very negative consequences.

Mistake #11 – Property traps

One increasing trend is to use your SMSF as a vehicle with which to buy property. This could be a positive financial move, if it is appropriate for your circumstances and is properly set up and managed.

On the downside, however, purchasing a property within an SMSF is relatively complex and there are strict rules that must be followed. Some common mistakes in relation to property investment within an SMSF include:

- Having an inappropriate profile for direct property investment
- Having no debt repayment/ exit strategy in place
- No/ inadequate insurances on the property in place
- Not factoring in the demands of retirement phase
- Poor property selection
- Buying property in the name of an individual rather than the fund
- Not setting up the SMSF and related trust(s) correctly
- Breaching the maintenance and improvement rules
- Changing an asset so that it becomes a 'replacement asset'.

Mistake #12 – Not getting the paperwork right

The following documents are only a sample of the administrative and set up requirements of an SMSF:

- Trust deed
- Australian business number (ABN)
- Tax file number (TFN)
- Goods and Services Tax (GST) registration (when appropriate)
- Consent to act confirmation
- Trustee Declaration Form
- Member advice notices, application forms, and minutes
- Notification of beneficiaries' form

Not adhering to the required forms and timeframes during the set up of the fund could have dire consequences in the future, and worst case scenario, the ATO may find the SMSF in breach of the rules.

Conclusion

It should be clear from the above that an SMSF may not be for every single investor out there. However, it can be a powerful investment tool under the right circumstances and with due consideration of the factors mentioned in this eBook.

We would, therefore, encourage you to get good financial advice on this matter. A good next step in considering whether and SMSF will be right for you will be reading our eBook 'Your Guide to Establishing and Operating a Self-Managed Super Fund'. This can be downloaded here from www.wealthadvsier.com.au.

We trust that this guide was useful in helping you to think through some of the issues associated with SMSFs and that it also sets you thinking about some wider financial planning issues.

It would be impossible, however, to present a complete guide to all your financial planning needs in a document as brief as this. We urge you to continue your explorations by making use of some of the other resources and eBooks from the Wealth Adviser stable.

Readers Notes

Readers Notes

Take the next step

We trust you enjoyed this publication and found it informative and professionally presented. Of course, your feedback is always welcome as we strive to continually offer content in a format that is relevant to you.

We now invite you to take the next step and meet with an adviser to discuss what it was you were hoping to achieve when you downloaded this handbook and to establish if we can help you achieve your goals and objectives.

Next you will find details on how to book an appointment with one of our experts.

We look forward to meeting you soon.

Wealth Adviser Library

Appointment Booking Request form

About the Adviser

Please complete the Appointment Booking Request below and scan and email to:

Appointments are available Monday-to-Friday.

Please nominate your preferred day, date and time to meet with us. One of our client services representatives will call you to confirm your appointment.

Preferred appointment day and time

Day

Date

Time am/pm

Our services

If you would like us to contact you via email to confirm your appointment or to answer any questions you have, please provide a valid email address for our records.

Email

Your Details

Title

First name

Last name

Mobile

Contact details

Email:

Phone:

WEALTHADVISER
Financial Education for All Australians

Wealth Adviser

Wealth Adviser is a division of WT Financial Group Limited
Head Office: Level 5, 95 Pitt Street Sydney NSW 2000
Telephone: 02 9248 0422