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SMSFA POLICY POSITION PAPER ON INFRASTRUCTURE

Who is the SMSF Association?

The SMSF Association is the peak body representing the Self-Managed Superannuation Funds (SMSF) sector which is comprised of over one million SMSF members and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisers and education standards for trustees.

The SMSF Association membership consists of professional members, principally accountants, auditors, lawyers, financial advisers and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them access to independent education materials to assist them in the running of their SMSF.

The SMSF sector

SMSFs accounted for 99.7% of all super funds in Australia and collectively hold around 26% of the $2.7 trillion in super assets under management. SMSFs therefore, continue to be an integral and significant part of the superannuation system.

The nearly 600,000 SMSFs have an average fund balance of $1.3 million and a median fund balance of $720,000 (the median value is more reflective of the typical SMSF as a small minority of very large SMSFs distort the average figure).

SMSFs are typically made up of a couple with an average of 1.9 people in an SMSF and 43% of SMSFs are in some form of pension phase. The median age for all SMSF members is 60 years, but the largest cohort of new establishments occurs from individuals aged 35 to 44.

SMSF asset allocations have remained steady over time with a significant proportion of assets invested in listed shares (29%) and cash investments (22%). The key drivers for this asset allocation include tax preferences for domestic equities and a desire for liquidity to pay pensions in retirement – this is especially relevant to the SMSF sector where 43% of funds are in retirement phase.

How can SMSFs fund infrastructure investment in Australia?

Currently, the superannuation sector plays an important role in funding infrastructure investment in Australia. However, the SMSF sector is largely precluded from investing in and funding infrastructure.

Of the $2.7 trillion superannuation pool, large APRA-regulated super funds had $105 billion invested in Australian and overseas infrastructure at March 2020. Of this figure, two superannuation sectors, industry funds and public sector funds, dominate with $91 billion (87 per cent).

The SMSF Association believes that SMSFs could have a substantial impact by providing capital funding for existing infrastructure investments and there is likely to be an increase in demand by SMSF investors for infrastructure assets if appropriate products are developed.

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ATTRACTIVENESS TO SMSFS

The SMSF Association believes that opening up infrastructure investments to SMSFs in a unitised, liquid form would provide a new avenue for SMSF investment that could help fund Australia's recovery and future infrastructure investment needs.

At the same time, it will also assist SMSFs in managing longevity risks in retirement. The desire for control through direct investing and the desire to use alternatives to cash and term deposits by SMSF trustees will encourage investing in infrastructure as a long-term investment option.

Infrastructure investments act as an important investment class that offers a risk-return point between cash/fixed interest and equity investments. This is attractive as younger demographics enter the SMSF space and a need for longer term investments arises.

With SMSFs predicted to grow to asset holdings of over $1 trillion by 2029[1], and as highlighted above, 20% of assets held in low-risk assets, we expect the SMSF low risk capital to continue to grow. This large pool of low-risk preferred capital would be a viable and stable source of infrastructure funding in years to come.

SMSF investors are also traditionally "sticky investors" that undertake investments with long-term investment time frames in mind. This makes SMSFs suitable for investing in infrastructure if the product is appropriately structured.

Opening infrastructure investment to SMSFs would also have another benefit of offering SMSFs investments that can be used to fund income streams in retirement. SMSF trustees are looking to manage longevity risk by accessing long term investment options with low volatility, moderate yield relative to inflation and moderate capital growth. Infrastructure investments meet this profile. Allowing SMSF trustees greater access to investment types that allow them to generate stable income streams will allow them to self-manage longevity risk and generate retirement income.

However, it is also important that infrastructure investments are suitable for retail investors. That means that the infrastructure assets are completed and income-generating, rather than blueprint plans which may provide a poor return and be unable to be liquidated. For example, completed infrastructure assets would allow conservative investors, many of which are in retirement phase, the ability to purchase stable, long term cashflow-positive infrastructure from State and Federal Governments.

BARRIERS TO ENTRY AND A NEED FOR APPROPRIATE INVESTMENT PRODUCTS

Currently SMSFs are extremely limited in investing directly in infrastructure due to the high dollar threshold for infrastructure investment and the illiquid nature of the required investment. The SMSF Association believes that addressing these liquidity issues and removing administrative barriers will provide the most significant challenges in allowing SMSFs to have better opportunities to invest in infrastructure projects.

[1] Rice Warner (Superannuation Market Projections 2019)

SMSF capital needs aggregation to fund large infrastructure projects which has led to their exclusion from infrastructure projects. This can lead to a bias of funding infrastructure projects from a consortium of large institutions with significant capital, depriving SMSF investors from exposure to infrastructure investments. We believe it would be of benefit for the Government and the National COVID-19 Coordination Commission to consider how aggregation of SMSF capital could be facilitated.

One example is the creation of the affordable housing bond aggregator[2]. We believe that this model would facilitate this aggregation of SMSF capital under its current model if it offered retail bonds. This framework would also be easily transitioned and applicable in its design for infrastructure projects.

Recently, SMSFs have also been offered to pool their funds with certain APRA-regulated superannuation funds, as unitholders in some of their investment options, through the Pooled Superannuation Fund (PST) structure.

Unitising investment in infrastructure projects in smaller parcels or lower value products for SMSFs (e.g. $25,000 units) would be one way to overcome current limitations, as would be issuing small-scale infrastructure bonds. Developing a secondary market in these products would allow SMSFs to manage liquidity risks, especially when they are in the retirement phase, so they can meet changing needs to realise their SMSF capital to generate income.

Alternatively, Australian Stock Exchange listed infrastructure funds could provide SMSFs access to infrastructure, and infrastructure projects access to SMSF funds, plus address the liquidity issue. The use of exchange traded funds (ETFs) continues to grow at a significant rate and requires further consideration in the development of infrastructure investments products.

NEW SOURCE OF INVESTMENT FUNDING – FUELING THE RECOVERY

Opening up SMSF capital to infrastructure investments could allow capital to flow to some suitable projects that are currently unfunded due to the increasing need for infrastructure investment and the hesitance of large institutional investors to invest in smaller projects.

In addition, SMSFs could form a reliable source of long-term debt funding that has not been available through traditional lenders for infrastructure projects. The long-term investment horizons of SMSFs match well with the long-term nature of infrastructure investments, and SMSFs can play an important role in providing longer-term debt financing.

Accordingly, we believe there is a significant opportunity for SMSFs to help finance existing infrastructure projects and help free up other sources of capital for other proposed infrastructure projects that are not currently being funded.

The SMSF Association welcomes the superannuation industry and businesses supporting and creating new vehicles to encourage the availability of capital for business lending, especially to small business. Given SMSFs are such a large part of the superannuation industry they should be part of this conversation.

[2] https://www.nhfic.gov.au/

SPURRING INNOVATION

Extending the concept of SMSFs funding infrastructure investment, SMSF capital also has the potential to be an important source of finance to fund innovation, which will be particularly important in a post COVID-19 economy.

SMSFs as long-term investors can provide the patient capital needed for innovation. Similar to infrastructure, the key barrier for SMSFs to funding commercialisation of innovation is the need for aggregation of capital so that they can access a diversified portfolio of such investments of varying sizes that fit sensibly into their portfolio, having appropriate regard to desired risk and return characteristics.

MANAGING THE LIQUIDITY RISK

It is also important that any developments with regards to infrastructure investments enable investors to manage liquidity risks appropriately. The liquidity shock triggered by the economic impacts of COVID-19 are a wake-up call for many superannuation funds, especially those focussed on a higher allocation of unlisted assets.

Developments which support further investment in infrastructure must not allow for this cycle to be repeated yet again in the future. New products, therefore, must manage this risk by ensuring that they are easily tradable on secondary markets and to a wider group of participants.

As noted, developing a secondary market in these products would allow investors to manage liquidity risks, especially when they are in the retirement phase, so they can meet changing needs to realise their SMSF capital to generate cashflow when needed.