26 September 2024

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

Dear Sir/Madam,

SMSF ASSOCIATION SUBMISSION – FINANCIAL REGULATORY FRAMEWORK AND HOME OWNERSHIP

The SMSF Association welcomes the opportunity to provide this submission in response to the Senate Economics References Committee inquiry into Australia's financial regulatory framework and home ownership.

Historically, myths and misconceptions have surrounded self managed superannuation fund (SMSF) investment in residential property and the impact that has on housing prices and the broader housing market. These persist despite empirical data clearly illustrating that the concentration of SMSF investment in residential property, in relative terms, is very low, as evidenced from the statistical data we provide in Appendix 3 of this submission.

Further, the level of gearing in SMSFs under the limited recourse borrowing arrangements (LRBA) is another area surrounded by misinformation. The use of LRBAs is subject to stringent rules and regulatory oversight. The legislated compliance obligations that apply to these arrangements are detailed in Appendix 1, and the findings of recent reviews undertaken by the Council of Financial Regulators are provided in Appendix 2.

Greater understanding of these two elements demonstrates why these are not factors of significant influence on the accessibility, and affordability of residential housing.

Direct property investment allows for investment diversification and choice for SMSF trustees. It is an investment choice available to the larger APRA regulated superannuation funds though it is acknowledged this is likely to occur in larger scale investments, rather than an individual house, unit or apartment. This is due to the differing size and scale of individual superannuation funds across the sector when we consider the whole of the superannuation ecosystem.

SMSFs have an important role to play in the long-term retirement plans of many small business owners and families. As long-term investment vehicles, those that invest in residential property contributes to essential rental housing supply.

SMSF trustees invested in residential property will do so directly themselves or they may seek out programs such as those offered through *Defence Housing Australia* (DHA). DHA is a Government Business Enterprise, the purpose of *'providing housing, and housing related services, to Australian Defence Force (ADF) members and their families to support Defence capability.'* [i] Those services include to *'provide adequate and suitable housing for members…, officers…, and contractors of the Department of Defence'*[ii] and their families. The DHA has included SMSFs in its target market as a source of investment capital to fulfill their purpose.

Inquiries and feedback from our members show that there is interest in the SMSF market to invest in NDIS housing. This interest is driven by a desire to provide for this segment as part of their social and ethical investment philosophies. It also provides stability for the fund, given the long-term tenancy requirements and the reliable, consistent income paid.

As a recent Reserve Bank research paper noted that the housing crisis is fundamentally an issue of supply, explaining why it has failed to keep up with demand.[iii] This and the location specific issues that arise in certain markets such as Sydney, must not be overlooked.

Further details and information are included in the appendices to this submission.

We would be pleased to further discuss any elements of our submission and to assist the Committee with any questions it may have. Please direct any queries to Tracey Scotchbrook, Head of Policy and Advocacy on traceyscotchbrook@smsfassociation.com.

We thank you again for the opportunity to provide this submission.

Yours sincerely,

Peter Burgess
Chief Executive Officer

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak body representing the self-managed superannuation fund (SMSF) sector which is comprised of over 1.1 million SMSF members and a diverse range of financial professionals. The SMSF Association continues to build integrity through professional and education standards for practitioners who service the SMSF sector. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial advisers, tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them with access to independent education materials to assist them in the running of their SMSF.

Table of Appendices

Appendix 1: Legislated Compliance Obligations

Strict compliance obligations apply under the *Superannuation Industry (Supervision) Act 1993* (SISA) and the *Superannuation Industry (Supervision) Regulations 1994* (SISR).

These rules strictly limit how a SMSF can invest, acquire or use its investments. Strict penalties apply for non-compliance.

Sole purpose test: SISA s. 62

The sole purpose test prohibits trustees from maintaining an SMSF for purposes other than for the provision of specified benefits. The core purposes relate to providing retirement or death benefits for, or in relation to, SMSF members.

The SMSF can also maintain the fund for one or more of these purposes and other specified ancillary purposes, which relate to the provision of benefits on the cessation of a member's employment and other death benefits and approved benefits not specified under the core purposes.

Prohibition on Lending or Providing Financial Assistance: SISA s. 65

SMSFs are expressly prohibited from lending money or providing any other financial assistance using the resources of the fund to a member or a relative of a member of the fund.

Acquisition of certain assets from members of regulated superannuation funds prohibited: SISA s. 66

Residential property, whether as a principal place of residence or as an investment property can not be acquired from a member, a relative of a member or an associated entity which includes partnerships, trusts and companies.

SMSF trustees are expressly prohibited from acquiring assets or investments from a related party, unless one of the limited exceptions applies (e.g. ASX listed shares, business real property).

In-House Asset Rules: SISA Part 8

Broadly, an in-house asset is an asset of the fund that is a loan to, or an investment in, a related party of the fund, an investment in a related trust of the fund, or an asset of the fund subject to a lease or lease arrangement between a trustee of the fund and a related party of the fund.[iv]

The total of all in-house assets held by a SMSF can not exceed 5% of the market value of the assets of the fund. A transaction to acquire an asset that would cause the fund to exceed the in-house asset threshold is prohibited.

The value of in-house assets are tested on an ongoing basis at 30 June each financial year. Where the market valuation of in-house assets exceeds the 5% threshold, trustees are required to document a plan and divest the fund of in-house assets sufficient to restore compliance by 30 June of the following year.

Under the in-house asset rules, a residential property cannot be occupied, leased or used by a member, a relative of a member or an associated entity (e.g. partnership, trust or company).

Appendix 2: SMSFs and Residential Property Investment via Limited Recourse Borrowing Arrangements

Background

Limited recourse borrowing arrangements (LRBA) were first made available to SMSF trustees from 24 September 2007.

On 7 July 2010, the rules for LRBAs were modified and limited to a single asset. This substantially explains why property is the dominant asset class invested via a LRBA.

Data gaps are present in historical sector data with some reported as estimates. The available data for the 2007 to 2012 financial years on LRBAs is limited, as this information could not be separately reported in the SMSF Annual Return lodged with the Commissioner.

SMSFs were first required to report the value of LRBAs in their SMSF annual returns starting from the 2012–13 financial year. This requirement was introduced as part of broader changes to improve data collection and the transparency of SMSFs and to enable the Australian Taxation Office (ATO) to monitor the use of LRBAs within the SMSF sector. Trustees are required to report the details of LRBAs, including the loan amount and assets acquired under these arrangements, in the annual return.

Review - Council of Financial Regulators

In 2015, following the Financial System Inquiry (2014), the Government commissioned the Council of Financial Regulators (CFR) and the ATO to monitor leverage and risk in the superannuation system and report back to Government after three years. Reviews conducted in 2019 and 2022 found '*that LRBAs are unlikely to pose a material risk to the superannuation system or broader financial system and recommends continued monitoring and reporting on an 'as needed' basis to ensure appropriate oversight of these risks.*'[v]

In the 2022, the CFR noted that 'LRBAs continue to be a significant risk to some individuals' retirement savings.'[vi] The SMSF Association has long advocated that LRBAs are not suitable for everyone, and Trustees should seek independent, professional advice.

Limited Recourse Borrowings - SISA Compliance

SMSFs are prohibited from borrowing, unless that borrowing meets the strict requirements of a limited exemption. One such exemption is the LRBA.

- LRBAs prohibit the use of existing fund assets as security.
- A borrowing is strictly limited to a single asset.
- A borrowing can only be used when first acquiring the asset.
- Recourse is strictly limited to the asset acquired, protecting all other fund assets.
- The asset acquired is held in a bare trust (a holding trust).
- Strict loan to asset valuation ratios are imposed by lenders and the ATO.
- Redraw facilities are expressly prohibited.
- Borrowings cannot be increased.
- Borrowings cannot be used to improve an asset.

Appendix 3: Key SMSF Statistics

Australian Bureau of Statistics data shows that the value of Australian residential property is around $10.9 trillion.[vii]

In 2021-22, SMSF investment in residential property, both directly and through LRBAs, stood at $76.9 billion. [viii]

SMSFs hold **0.7%** of the residential property market.	**11%** of SMSFs have a limited recourse borrowing	LRBA borrowings represent **2.7%** of total assets for the sector

Source: Australian Taxation Office[ix]

Value of SMSF Assets Held in a LRBA: [x]

Total SMSF Assets in an LRBA **$56,306m**	Total value of LRBA debt **$22,625m**	Sector loan to value ratio: **40.2%**

Source: Australian Taxation Office[xi]

[Continued Overleaf]

The following statistics have been extracted from the Australian Taxation Office *Self-managed superannuation funds: A statistical overview 2021-22* and the *Self-managed superannuation funds: A statistical overview 2013-14.* These provide a practical comparison of the sector for the 2014 and 2022 financial years.

ATO SMSF Annual Overview – Key Metrics

Metric	2014	2022
# Members	991,621	1,084,603
# SMSFs	526,275	585,696
Total Gross Assets ($ m)	**556,039**	**843,700**

Comparative Data – LRBAs

LRBA investments by asset type	2014 ($m)	2022 ($m)
Australian residential real property	6,308	30,867
Australian non-residential real property	6,519	23,524
Overseas real property	28	25
Australian shares	551	512
Overseas shares	967	19
Other	699	1,359
Total Assets	**15,072**	**56,306**
Total LRBA Liability	13,047	22,625
LVR	**86.56%**	**40.18%**
LRBA as a % of total gross assets	**0.23%**	**0.26%**

Total Property Investments

Residential Property	2014 ($m)	2022 ($m)
No LRBA	19,632	46,080
Via LRBA	6,308	30,867
Total Sector Investment:	**25,940**	**76,947**
Investment as a % of total gross assets	**4.66%**	**9.12%**

Non-Residential Property	2014 ($m)	2022 ($m)
No LRBA	60,443	83,457
Via LRBA	6,519	23,524
Total Sector Investment:	**66,962**	**106,981**
Investment as a % of total gross assets	**12.04%**	**12.68%**

References

[i] 'Our Organisation', *Defence Housing Australia* (Web Page) < https://www.dha.gov.au/about-us/our-organisation >

[ii] Ibid.

[iii] Sarah Hunter, 'Housing Market Cycles and Fundamentals' (Speech, REIA Centennial Congress, 16 May 2024): https://www.rba.gov.au/speeches/2024/sp-ag-2024-05-16.html

[iv] *Superannuation Industry (Supervision) Act 1993* (Cth), s 71(1).

[v] Council of Financial Regulators, *2022 Report to Government on Leverage and Risk in the Superannuation System,* (Report, September 2022): < https://www.cfr.gov.au/publications/policy-statements-and-other-reports/2022/report-on-leverage-and-risk-in-the-superannuation-system/ >.

[vi] Ibid.

[vii] Australian Bureau of Statistics, *Total Value of Dwellings* (June Quarter 2024; 10 September 2024): < https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/total-value-dwellings/latest-release>

[viii] Australian Taxation Office, *SMSF Statistical Overview 2021*-22 (19 August 2024), Table 28: < https://data.gov.au/data/dataset/self-managed-superannuation-funds >

[ix] Ibid.

[x] Ibid.

[xi] Ibid.