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SMSF COLUMN

SMSF with Julian Fadini
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COMMERCIAL VERSUS RESIDENTIAL

Are self-managed super funds more suited to investing in commercial or residential properties? **Julian Fadini** investigates

Borrowing to buy residential property with an SMSF may appear to be hugely popular, but the reality is that more money from self-managed super funds is going into commercial property.

If you consider the Australian Taxation Office (ATO) statistics for SMSFs, about \$54 billion is invested in non-residential property compared with about \$17 billion in direct residential properties.

Since 1998, SMSF trustees have been allowed to invest up to 100 per cent of their money into a commercial property. A fund member can then run their business from this property.

Prior to this, the maximum an SMSF could invest in such a property was 40 per cent of its savings. However, since 2008, funds have had the ability to borrow money to finance these properties.

A special concession allows SMSF trustee business owners to purchase and occupy the commercial property they operate from.

It also allows trustees to lease a property from which a business is being run to a fund member or a related party.

On the flip side, trustees are not permitted to buy and occupy residential property owned by a fund member or anyone related to a fund member. This is one of the major differences when comparing commercial to residential property within an SMSF structure.



SMSF TRUSTEES CAN PURCHASE AND RUN THEIR BUSINESS FROM A COMMERCIAL PROPERTY

Most of the SMSF trustees who buy commercial property do so because their businesses are renting the property. By doing so, the rent being paid goes into their fund, rather than paying a landlord.

This strategy is especially appealing because when the time comes to retire, trustees can choose to sell the property with the business and receive a capital gains tax exemption if the fund has moved to the pension phase before the sale.

Alternatively, the trustees can continue to own the property and collect the rental income from the new tenant. However, there are some real risks in this part of the strategy and these should be carefully considered.

Whether or not trustees plan to occupy the property, the exit strategy is critically important. If a commercial property is vacant when the time comes to sell, the

value of the property will be called into question. In these instances, it may not achieve the capital growth expected.

In addition, if the property is vacant it may not have the ability to fund its pension liabilities, which could cause problems for trustees wishing to retire.

When comparing commercial and residential properties, the rental yields on commercial properties tend to be higher. Some will argue that makes commercial property an attractive option. However, this generally comes with a trade-off involving lower capital growth.

Investors should be aware that commercial properties generally carry higher levels of risk, and vacancy and delinquency rates are far higher than that of residential property. This explains why banks generally only consider lending at a loan-to-value ratio of 70 per cent or less.

Commercial property can be difficult to get right and can require a significantly higher degree of research and expertise. ■

“ MOST OF THE SMSF TRUSTEES WHO BUY COMMERCIAL PROPERTY DO SO BECAUSE THEIR BUSINESSES ARE RENTING THE PROPERTY ”

Julian Fadini is the director of Bellevue Capital Financial Services

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SMSF ASK THE EXPERTS

ASK THE EXPERTS

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? *I want to invest in property with my three siblings through my SMSF. They are all older than I am and I'm concerned how this will affect me when it comes to releasing the funds. How do I ensure I don't trip up?*

CONSOLIDATING SMALLER superannuation balances amongst family members to pool in an SMSF and buy property is a growing strategy. While it may allow you to pool sufficient funds to buy into a property, you are right to consider the issue of your siblings wanting to draw on their funds before you do.

There are many questions you should be asking, the most important being whether or not you believe all four of you will be able to make decisions collectively. Control is likely to be the biggest issue, as there will be differences in superannuation balances, ages and no doubt, investment objectives and risk profiles. How will a dispute or stalemate be resolved?

The super fund's trust deed will need to be reviewed to see how these issues are addressed. If you have any concerns, it may be beneficial for all of you to meet with a specialist to discuss your options, which can then be reflected in the deed.

The retirement plans of you and your siblings will most likely determine the investment property purchased and its eventual sale. Understanding the plans of your siblings may allow you to develop your own contribution and retirement strategies to limit any issues arising from your siblings' earlier access.

Other issues like divorce and death also need to be explored. Pooling super benefits is easy; the challenge is in the administration and management. Make sure you are across all the issues and strategies before you commit.



? *I have a super fund with \$130,000. I'm 39 and looking to invest in property in an SMSF structure. Is this going to be possible and what do I need to do to start it up?*

A GREAT place to start is to seek out a qualified financial adviser who can provide advice to help determine if the strategy is actually possible for you. The only way to make sure the strategy is right for you is for the person providing the advice to have a complete and thorough understanding of your current financial position. If, for example, you will be using a loan to fund any shortfall in the purchase price, then you will need to know if yourself and the fund can afford the loan repayments without placing you in a position of hardship.

A professional adviser has legal, ethical and moral responsibility to make sure you fully understand the benefits, as well as the

potential risks and downsides to investing in property via an SMSF. There are some very strict rules around operating an SMSF and if you get poor advice or if you try and go it alone and get it wrong, the penalties could be as high as 46.5 per cent of your fund balance.

When seeking a professional adviser to assist you, avoid any company or adviser offering free SMSF set-ups or SMSF advice, as this will most likely come with a catch - free advice will most likely end up costing you the most.

The first investment to get you and your SMSF on the right track should be in the cost of professional advice.



Julian Fadini, director,
Bellevue Capital Financial Services

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Protect your golden egg; five steps to help set up an SMSF: Julian Fadini

By Julian Fadini
 Wednesday, 18 September 2013

If you are thinking about setting up a SMSF, then there are five things that you must do:

1. Seek professional advice

If you set up an SMSF, you're in control – you make the investment decisions for the fund and you are responsible for complying with the law.

Your personal circumstances will determine the effectiveness of a SMSF strategy, so seek out qualified licensed professionals to help you. Licensed financial planners and accountants can help you understand what's involved and advise you on your options. Advice provided to you at a BBQ is not considered professional, so be very wary of free advice or free SMSF set ups as these can be traps and could ruin your retirement plans.

2. Know the laws and understand the risks

Think carefully about your investment options and how you can manage the associated risks.

You need to consider the short, medium and long term investment strategy of the fund and the level of risk each member is comfortable with.

All funds must maintain a degree of liquidity so be aware of this, spreading risk by diversifying a portfolio will require previous investment knowledge or expert advice.

With control also comes responsibility and in a SMSF that lands squarely on the shoulders of the trustees. If you decide to set up an SMSF, you're legally responsible for all the decisions made, even if you get professional advice.

Remember that superannuation has one purpose, saving for your retirement; this means using your super funds for anything else prior to retirement could be deemed illegal and fraudulent.

3. Ask yourself, 'do I have what it takes?'

The main responsibility of a trustee is making sure that your funds are invested appropriately, so ask yourself:

- Do I have the time and knowledge required to maintain and operate a fund?
- Do I have the confidence and ability to make sound investment decisions?
- Can I meet the obligations that are required to be a trustee?
- Can I outperform the professional funds managers?

PROPERTYobserver

If you're not sure you can get the best result, you will need to employ the services of professionals. Choose these professionals wisely.

4. Make sure it's right for you

Just because you can set up a SMSF doesn't mean you should. Establishing and maintaining a fund is not for everyone, so if you are not happy with your existing funds poor returns seek professional advice and make sure that a SMSF is right for you.

5. Build your A-team of professionals

After you have thoroughly considered your options, and you decide that a SMSF is the way to go, get to work on building your A-team. Most successful SMSF investors will have a team that they have put in place to get the best results; this will generally be made up of a financial planner, accountant, auditor, mortgage broker, and solicitor. Also more recently qualified property investment advisers, buyer's agents and property managers have been playing very important roles in the process for investors.

Julian Fadini is director of Bellevue Capital Financial Services.

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SMSF COLUMN

SMSF with Julian Fadini

 For more SMSF information visit www.spionline.com.au


SMSF LENDING: THE GAME CHANGER

Very few Australians could report a satisfactory or even positive return from their super fund's performance in recent years, writes **Julian Fadini**

In a lot of cases I think you would find that most investors had previously given up hope that their super fund alone would provide them with a comfortable quality of life in retirement.

Thankfully, this outlook has changed and there appear to be better times ahead.

Over the past few years the government has relaxed some of the rules around setting up and running your own super fund, known as a self-managed super fund or SMSF. Under these recent changes, investors now have the option to take control of their own retirement savings and can also borrow to purchase residential and commercial property.

The appeal of having control over your own retirement savings has seen the SMSF market become the fastest growing sector of the superannuation industry, which at 30 June 2012 had a total of \$430 billion in assets.

However, direct investments in residential and commercial real estate only represented 3.5 per cent of that market.

If we look back over the past 10 years, almost all residential property investors and homeowners have well and truly outperformed the professional fund managers that are employed to manage our retirement savings.

To make a point, if we take the Australian direct residential property



AN SMSF CAN HELP YOU TAKE CONTROL OF YOUR RETIREMENT PROSPECTS

return over the past 10 years of eight per cent and compare it against the average return of all superannuation fund options, such as balanced, growth or cash for the same period of time, the result is 5.5 per cent. It is clear to see why more investors are seeking ways to replicate some of these direct property gains within their SMSFs.

Further good news for property investors is that over the last 12 months almost all banks and lending institutions have introduced an SMSF borrowing product to the market, and the SMSF lending space is becoming increasingly competitive, with some lenders now offering loan to value ratios of up to 80 per cent, as well as offset accounts. As more lenders and products come into the market it makes the process of investing in residential property easier.

Most investors will say that control is the main reason they have set up an SMSF. However, with control also comes responsibility, so if you are considering the SMSF option for yourself, you would be wise to seek out expert and professional advice from your advisers.

Additional information and resources can be found on the ATO's website at www.ato.gov.au to assist you in navigating your way through the process, making sure that the fund is set up correctly and that you stay within the law.

In addition to control, the other incentive for SMSF investing is the concessional tax environment that allows all assessable income to be taxed at 15 per cent during the accumulation phase of the fund. When members reach age 60, they can access their funds tax-free either by lump sum or income withdrawals.

With all these changes this could be the perfect time to speak to your adviser and consider your superannuation options. ■

“ OVER THE LAST 12 MONTHS ALMOST ALL BANKS AND LENDING INSTITUTIONS HAVE INTRODUCED AN SMSF PRODUCT

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Julian Fadini is director of Bellevue Capital Financial Services

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INSIDE



FEATURE STRATEGY

A MEETING OF MINDS

The most successful investors know to get their knowledge from those who have been successful before them. *Smart Property Investment* brought together six of the leading minds in property, and asked them to share their views



EVERYONE HAS an opinion about property, but it is the most experienced and proven investment professionals, involved with property daily, who are really aware of what is happening in the market.

Smart Property Investment's editor, Phillip Tarrant, facilitated discussion between six industry professionals at the magazine's location in Sydney to ask the questions that are pertinent right now in property.

Smart Property Investment would like to thank the Property Investment Professionals of Australia (PIPA), the peak property investment industry association, which co-hosted this discussion.

IMPROVING THE QUALITY OF ADVICE

THERE ARE an estimated 80,000 professionals directly and indirectly related to the property investment industry.

Combined with 1.75 million Australians claiming deductions for property in their tax return (according to the Australian Taxation Office) and 29 per cent of Australians renting, it is a significant industry.

BEN KINGSLEY

From those who are directly involved, the buyers' agents and mortgage brokers who are putting the deals together, to the ancillaries - valuers and banks - you've got quite a big spectrum of players out there. There's no doubt in my mind that we are an immature industry. [There] has got to be an ongoing education in order to give people the talent and skills they need, and PIPA has to take responsibility for it.

PHILLIP TARRANT

What are some of the misconceptions around 'I need a property investment adviser, what do I do?'

BEN KINGSLEY

I don't think they work out that they need one - that's the biggest challenge. They'll go and see their accountant, mortgage broker and their financial planner and they'll meet a friend at a BBQ and ask them a couple of questions and the light will come on. So there's no real 'property investment adviser' - it needs to be defined as a profession. The beautiful part about our industry is that we are quite young, and people have different views about what makes values grow. Over time those views will become tighter and you'll start to see some better analysis and some fundamentals come out.

CRAIG HOGG

Being in the depreciation market, we're generally at the tail end of the buying cycle. It has definitely evolved into a better place. There were times when we had people calling us in tears, back in 2002/2003. But I think that there's now quality advice, as the bar has been raised.

JULIAN FADINI

The misconceptions I come across [are about] quantity over quality, in terms of the client's portfolio. I think that can be something that's misconceived if a client isn't spending enough time researching the numbers and an investor is comparing their portfolio. Also, exit strategies - not that clients are necessarily being advised to sell at any time - are something to consider. For example, some of the rental guarantee properties ... can typically only be sold to investors, so therefore their market is already reduced should they need to sell.

Seventy per cent of the market is already wiped out completely, so the only remaining part of the market is the 30 per cent of investors who could potentially have [an adviser], telling them to make a better offer because a person is clearly in a position of [distress].

MEET THE MINDS OF PIPA MEMBERS



PHILLIP TARRANT

Smart Property Investment
Editor

► An active property investor he has more than 10 years' experience reporting on the mortgage and property markets. He also sits on the board of Publishers Australia.



BEN KINGSLEY

Property Investment Professionals of
Australia (PIPA)
Chair

► With 20 years' in finance, Ben is a regular Smart Property investment contributor and founding director of Empower Wealth.



SIMON PRESSLEY

Propertyology
Accredited advice, market analyst, buyers' agent

► Simon has received four national awards for excellence as the owner of a finance broking business and was recipient of the Buyer's Agent of the Year Award in 2012.



JULIAN FADINI

Bellevue Capital Financial Services
Director

► Dealing largely in the lending and SMSF space, Julian is a licensed real estate agent and also has a background as a buyers' agent. He is a member of PIPA.



STEVE WATSON

Right Property Group
Director and co-founder

► With over 10 years of direct property investment experience, Steve is also an investor himself. He has assessed, inspected and negotiated 1,000 transactions.



ROSS HARVEY

Propertybuyer
Director

► A licensed real estate agent, investor and economist, Ross has over 17 years' experience in property specialising in the prestige, commercial and investment markets.



CRAIG HOGG

Washington Brown
National sales manager

► Craig is the driving force behind AsaleInvestors, a site dedicated to providing information about new developments Australia-wide, flagged as investment assets.

FEATURE STRATEGY



“THE BEAUTIFUL PART ABOUT OUR INDUSTRY IS THAT WE ARE QUITE YOUNG, AND PEOPLE HAVE DIFFERENT VIEWS ABOUT WHAT MAKES VALUES GROW”



DUE DILIGENCE AND CONSUMER EXPECTATION

PHILLIP TARRANT

Do you think people are more informed now about depreciation and how that fits in with their investment?

CRAIG HOGG

It still has a long way to go. Whether it's from the accounting market, or from the property investors and agents, I think there's still more education needed.

There's still a small proportion of people who still don't know about it, but it has gone from a 50 per cent lack of knowledge about the product to about 20 per cent of investors not knowing about depreciation.

Even this morning I received an email from someone claiming completely wrong items in their tax returns – these are things that we deal with all the time, but it's definitely getting better.

RICH HARVEY

I think there's a lot more data out there: RP Data, Domain, Residex, SQM. Consumers have access to that data. But my concern is 'Do investors understand it?' You can diagnose yourself with an injury, but do you know how to fix yourself?

PHILLIP TARRANT

Do you think many investors like the idea of investing but they just don't understand what it entails, and a lot of them go down the wrong path?

CRAIG HOGG

It's a big investment, so a lot of them will take the word of the adviser, agent or accountant, their parents who don't know about depreciation, or whoever is giving them prime advice. So for me it's all about education.

LOOKING INTO THE FUTURE

PHILLIP TARRANT

Everyone's scenario is very different and they need specialised advice for their situation, how does this fit in to the future of the property industry?

BEN KINGSLEY

A financial planner has to give a statement of advice that has to have the scope of the advice given ... What we have is a situation where property investment advisers should be giving out reports or plans that should cover off on their cash flows, the scope

... and the reasons why they made their recommendations. They will have to give some projections.

In terms of how that's implemented, that's another service.

We're getting squeezed into this [regulated] space, which is probably not a bad thing as it then defines a line in terms of who can give the advice and who can't.

SIMON PRESSLEY

I think the industry needs to head towards fee for service. A real estate agent is

charging a fee for service to sell a home. We might call it a commission, but it's coming out of the owner's pocket when they sell.

People who sell property need stock, people who advise make money for their clients. We need legislation that says if the role of your business is to help investors make money, then do what a solicitor does and disclose – say 'these are my fees, now let's get that out of the way and let's get on with my objective of making you money'.



CATEGORIES OF INVESTOR



PHILLIP TARRANT

You see a lot of people who want to invest in property. What's your sentiment on just how aware people are when they come to be an investor?

STEVE WATERS

I break them into three categories. There are those who actually do a bit of diligence themselves, so they have some idea about property investing and their interpretation of data. The next level is those who have had the family conversation, and then there are those who have been cold-called. Usually, it's that category, as well as the family category, who have got themselves in trouble.

RICH HARVEY

We [also] get three broad categories. We get those who are keen and reasonably well educated, engaging us to provide a service. They know the type of property they want and what's going to fit - there might have been a referral, so we've got a warm introduction.

The second category is the procrastinators; they've read a few books and magazines and think 'I should do something' but they need extra hand holding.

Then there's the complete newbie, who has no idea and they're likely to be taken advantage of.

PHILLIP TARRANT

So in terms of who's buying property right now ... are there any trends we can identify?

STEVE WATERS

The demographic is changing, I think, and it's because they're influenced by the baby boomer generation. Our clients are aged between 30 and 50 and I think they're seeing the unfortunate legacy from their parents who are [often] reliant on government-funded pensions and are not able to live in the nice home they wanted. Despite having all the time, they don't have the money.

The generation below them have seen the consequences from their parents and I think that's directly related to why self-managed super is becoming so popular, and will become even more popular.

JULIAN FADINI

I'm completely flat out with people from around 40 to 50 years old. Generally, it is husbands and wives combining their superannuation together to purchase an investment property. That's 99 per cent of my work at the moment and there doesn't seem to be any slowing down.

STEVE WATERS

It's funny because I'm the complete opposite. If I look at our database of people, 80 per cent of them would be 35 or younger.

They're all keen, they're eager and they have that disposable income to want to get involved.

There is a little bit of scattering from overseas investors as well, but probably the biggest influx of enquiry are those [interested in] self-managed super.

"I SEE A FUTURE WHERE WE'LL SEE ANALYSIS BEING DONE BY PROPERTY TYPE, BY THE NUMBER OF BEDROOMS"

THE FUTURE OF PROPERTY DATA

PHILLIP TARRANT

We just published our Fast 50 report and found that one of the hotspots was Blacktown. So if I'm an investor, what do I do now?

RICH HARVEY

I'd say to that investor, go out and spend every Saturday for the next six weeks there on the ground. Make relationships with agents, look at the price of a three-bedroom house, a two-bedroom house, a four-bedroom house, and keep notes. Identify which streets are the best streets to buy in. Ask the agent; have a list of questions and ask them of six different agents. You'll see a pattern forming. Using that information you'll be able to make a value judgement and start to spot a hot deal.

BEN KINGSLEY

I'll also say here that getting access to data is a real challenge in our space. I see a future where we'll see analysis being done by property type, by number of bedrooms. At the moment, you might have one suburb that has 500 houses and the suburb next door has 15,000. So you're actually dealing with different types of data. I believe where true demand and supply drivers lie, we'll see more analysis taking place at that true demand area. For example, a two-bedroom apartment in this area has a clearance rate of 89 per cent, whereas the whole suburb might have a clearance rate of 60 per cent. Getting median reporting data down to that sort of level is what we need. ■