CARISMA SOLUTIONS

RENTAL INCOME AND EXPENSES

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Rental Income - Introduction

Rental income refers to the money earned from leasing out property owned by the SMSF.

Using a Self-Managed Superannuation Fund (SMSF) to generate rental income can be an effective strategy for retirement planning.

This can include various types of properties, such as residential, commercial, or industrial real estate.

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Rental Income - How it Works

Purchase Property: The SMSF can buy property, either residential or commercial, to generate rental income. This property is then owned by the SMSF.

Rental Income: Any rent received from the property goes into the SMSF's account. This income is generally taxed at a concessional rate within the fund.

Property Management: The SMSF trustees need to manage the property in accordance with the fund's investment strategy and the rules set by the Australian Taxation Office (ATO). This includes ensuring that any property expenses and income are appropriately accounted for.

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Rental Income - Types

Residential Property Rental Income:

- **Single-Family Homes:** Rent received from residential houses owned by the SMSF.
- **Apartments:** Income from renting out residential units or apartments.
- **Vacation Rentals:** Income from short-term vacation rentals if permitted by SMSF regulations.

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Rental Income - Types

Commercial Property Rental Income

- **Office Space:** Rent from commercial office buildings or individual office suites.
- **Retail Space:** Income from leasing retail shops or spaces within shopping centres.
- **Industrial Property:** Rent from warehouses, factories, or other industrial spaces.

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Rental Income -Types

Industrial and Specialized Property

- **Warehouses and Distribution Centres:** Rental income from properties used for storage and logistics.
- **Specialized Facilities:** Income from properties such as medical centres, laboratories, or other specialized uses.

Mixed-Use Property Rental Income

- **Properties with Residential and Commercial Elements:** Rental income from properties that combine residential and commercial uses.

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Rental Income -Types

Land Rental Income

- **Agricultural Land:** Income from leasing land for farming or agricultural purposes.
- **Vacant Land:** Income from leasing land for future development or other uses.

Lease Agreements

- **Long-Term Leases:** Rental income from long-term leases where tenants commit to renting the property for an extended period.
- **Short-Term Leases:** Income from short-term leases, though this is less common for SMSFs due to regulatory constraints.

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Rental Income - Commercial Property Introduction

"Commercial property" refers to real estate that is used primarily for business purposes, rather than residential living.

This can include various types of properties such as:

- **Office Buildings:** Spaces used for corporate or professional services**.**
- **Retail Spaces:** Properties used for shops, malls, or other retail activities**.**
- **Industrial Properties:** Warehouses, factories, or other properties used for manufacturing or distribution**.**
- **Medical Centers:** Properties used for health services like clinics or hospitals.

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Rental Income - Commercial Property - Advantages

- **Diversification**: Commercial property can diversify the SMSF's investment portfolio, which may reduce overall risk and improve returns. It adds a different asset class compared to traditional investments like shares and bonds.
- **Potential for Higher Yields**: Commercial properties often offer higher rental yields compared to residential properties, potentially providing better income returns for the SMSF.
- **Long-Term Appreciation**: Commercial properties may appreciate over the long term, contributing to the growth of the SMSF's capital.

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Rental Income -Commercial Property Risks and Challenges

What are the risks associated with investing in commercial property through an SMSF?

- **Market Fluctuations:** Commercial property values and rental income can be affected by market conditions, impacting returns.
- **Vacancy Risk:** Prolonged vacancies can affect rental income and the SMSF's cash flow.
- **Regulatory Changes:** Changes in superannuation or property laws can impact how commercial property is managed and taxed.

Rental Income -Commercial Property – Risks Mitigation

How can these risks be mitigated?

- **Diversification:** Diversify the SMSF's investments across different asset classes to manage risk.
- **Professional Management:** Engage property professionals to ensure effective management and compliance**.**
- **Regular Monitoring:** Monitor the property's performance and the SMSF's investment strategy regularly to adapt to changes and mitigate risks

Rental Income -Residential Property Introduction

Residential property refers to real estate that is used primarily for housing and living purposes.

Unlike commercial or industrial properties, residential properties are designed to provide accommodation for individuals or families.

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Rental Income -Residential Property - Types

- **Single-Family Homes**: These are standalone houses designed to accommodate one family. They can be detached (not sharing walls with other homes) or semi-detached (sharing one wall with another house).
- **Apartments**: These are individual units within a larger building or complex. They are typically rented or owned and may include amenities such as gyms, pools, and shared common areas.
- **Townhouses**: These are multi-story homes that share one or two walls with adjacent properties but have their own separate entrances. They often feature small yards and can be part of a community with shared amenities.
- **Condominiums (Condos)**: Similar to apartments, condos are units within a larger building or complex. However, owners hold title to their individual units and share ownership of common areas with other unit owners.

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Rental Income -Residential Property - Types

- **Duplexes and Triplexes**: These are buildings divided into two or three separate living units, each with its own entrance. They can be owner-occupied or rented out.
- **Villas**: Typically found in suburban or rural areas, villas are often larger single-family homes with substantial outdoor space.
- **Units**: In some regions, the term "unit" can refer to any residential property within a larger complex, including apartments and condos.

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Rental Income -Residential Property- Benefits

Tax Benefits

- **Concessional Tax Rates:** Rental income and capital gains from the property are taxed at concessional rates within the SMSF. In the accumulation phase, income is taxed at 15%, and capital gains are taxed at 10% (if the property is held for more than 12 months). In the pension phase, income and capital gains are tax-free.
- **Tax Deductions:** Expenses related to the property, such as maintenance, property management fees, and interest on loans, are tax-deductible, which can reduce the taxable income of the SMSF.

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Rental Income -Residential Property- Benefits

Diversification and Control

- **Investment Diversification:** Adding residential property to an SMSF portfolio can diversify investments beyond traditional asset classes like stocks and bonds, potentially reducing overall risk.
- **Control Over Investments:** SMSF trustees have full control over property selection, management, and sale decisions, allowing them to tailor the investment strategy to their specific retirement goals and risk tolerance.

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Rental Income -Residential Property- Benefits

Potential for Capital Growth

- **Long-Term Growth:** Residential property has the potential for significant long-term capital appreciation, which can contribute substantially to the growth of the SMSF's assets over time.
- **Leverage:** SMSFs can use limited recourse borrowing arrangements (LRBAs) to leverage the purchase of residential property, potentially increasing the returns on investment if property values rise.

Inflation Hedge

Property Value Growth: Residential property can act as a hedge against inflation. Historically, property values and rents tend to rise with inflation, potentially preserving purchasing power over time.

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Rental Income -Residential Property- Benefits

Income Generation

- **Rental Income:** Residential property can provide a steady stream of rental income, which can be reinvested within the SMSF or used to fund retirement benefits. Rental income can be more stable compared to dividends from equities.

Retirement Planning

- **Asset for Retirement:** Owning property in an SMSF can be a valuable asset for retirement planning. Upon reaching retirement age, the property can be sold to provide a lump sum or used to generate rental income during retirement.
- **Pension Phase Benefits:** Once in the pension phase, income and capital gains from the property are tax-free, which can enhance the retirement income and financial stability.

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Rental Income -Rules To consider

- Residential property **cannot** be:
  - purchased by the fund from a member or a related party of a fund member
  - rented by a fund member or any related party of a fund member.
- Commercial property that is used solely for business purposes **can** be:
  - acquired by the fund from a member or a related party, providing the acquisition is at market value. If the trustees are not able to show evidence that their property is used solely for business purposes or is reported at market value in the financial statements this is a breach of the super laws
  - leased at market value to a fund member or related parties of a fund member.

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Rental Income -Considerations for SMSF

- **Regulatory Compliance:** SMSFs must adhere to strict regulations set by the Australian Taxation Office (ATO). This includes ensuring that the property investments are made for the sole purpose of providing retirement benefits to members.
- **Arm's Length Transactions:** All transactions involving SMSF property must be conducted on an arm's length basis. This means that any rental agreements must be at market rates and must not involve related parties unless specific conditions are met.
- **Property Management:** The SMSF must manage the property according to SMSF rules, including maintaining accurate records and ensuring the property is maintained in good condition.
- **Investment Strategy:** The SMSF's investment strategy must include property investments, and the properties must align with the fund's overall investment strategy and risk profile.
- **Income and Expenses:** Rental income generated must be reported as part of the SMSF's income, and related expenses (such as maintenance, management fees, and property taxes) can typically be deducted.

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Rental Expenses -Introduction

Rental expenses typically refer to the costs associated with owning and managing property within the fund.

These expenses are crucial for the fund's compliance and financial management.

These expenses are essential for the effective management and upkeep of the property and can impact the overall profitability of rental income.

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Rental Expenses - Categories

Property Management Fees

- **Management Fees:** Professional property managers typically charge a fee for managing the property. This can be a percentage of the rental income or a flat fee.

Tenant Placement Fees:

Fees may also be charged for finding and placing tenants, including advertising and application processing

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Rental Expenses - Categories

Maintenance and Repairs

- **Routine Maintenance:** Regular maintenance expenses include costs for upkeep such as lawn care, cleaning, and minor repairs to ensure the property remains in good condition.
- **Repairs:** Unexpected repairs, such as fixing plumbing issues, electrical problems, or roof damage, are necessary to address wear and tear or damage.

Insurance Costs

- **Property Insurance:** Comprehensive insurance coverage for the property to protect against risks such as fire, theft, and natural disasters.
- **Landlord Insurance:** Coverage for loss of rental income due to tenant default or property damage. This insurance can help mitigate the financial impact of tenant-related issues.

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Rental Expenses - Categories

Council Rates and Taxes

- **Council Rates:** Local government charges for property services such as waste collection, street maintenance, and infrastructure.
- **Land Tax:** Depending on the property's location and value, land tax may be applicable. This is a tax levied on the value of the land owned by the SMSF.

Utilities and Services

- **Utility Payments:** If the SMSF is responsible for paying utilities such as water, gas, and electricity, these costs must be covered. Often, these expenses are passed on to tenants, but it depends on the lease agreement.
- **Service Contracts:** Costs for regular services such as pest control, cleaning, or security systems.

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Rental Income & Expenses -Documents Required

Rental Income Documents

- **Lease Agreements:** Copies of all lease agreements with tenants, including terms and conditions, rental amounts, and lease durations.
- **Rental Invoices and Receipts:** Documentation of rental payments received, including invoices issued to tenants and receipts confirming payments.
- **Bank Statements:** SMSF bank statements showing rental income deposits**.**

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Rental Income & Expenses -Documents Required

Expenses and Payments Documents

- **Maintenance and Repair Invoices:** Detailed invoices for all maintenance and repair work done on the property, including dates, service providers, and costs.
- **Property Management Fees:** Invoices and statements from property management companies detailing their fees and services**.**
- **Insurance Premiums:** Documents related to property insurance, including policy details and payment receipts**.**
- **Council Rates and Land Tax:** Notices and payment receipts for council rates and land tax.
- **Utility Bills:** Copies of utility bills if the SMSF is responsible for paying these, including water, gas, and electricity bills**.**
- **Loan Documents:** Statements and documentation related to any SMSF loans used to finance the property, including interest payments, principal repayments, and loan fees**.**

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Rental Income & Expenses -Documents Required

Depreciation and Capital Improvements Documents

- **Depreciation Schedule:** A depreciation report from a qualified quantity surveyor detailing the depreciation of the property and its fixtures.
- **Capital Improvement Invoices:** Invoices and receipts for any major improvements or renovations made to the property.

Legal and Professional Fees Documents

- **Legal Fees:** Invoices and receipts for legal services related to property transactions, lease agreements, or disputes.
- **Accounting Fees:** Documentation of fees paid for accounting services, including preparation of SMSF financial statements and tax returns.

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THANK YOU!