Self-managed funds defy the stereotypes

TONY NEGLINE

There's a common perception out there that self-managed super funds almost always have two members, usually married to each other, but the cohort is much wider than that.

For a start, they can have a maximum of four members. Again, they are usually from two generations, but just as each family is unique, each SMSF is unique.

A dangerous aspect of these funds is that we often talk about them in generalities, but a significant proportion of SMSFs will have very different characteristics from those sweeping statements.

For example, ATO statistics for June 2013 (the most accurate data available) show that almost 62 per cent of SMSFs owned $150 billion of ASX-listed shares which accounted for 30 per cent of total SMSF assets. Clearly there are a large number of SMSFs that own ASX-listed shares but, equally, many of these funds avoid this asset class.

This ATO data also shows that 97 per cent of SMSFs have money in a bank account or term deposit. (Given you need a bank account to run your SMSF, you wonder what happened to the other 3 per cent).

The SMSF sector's competitors and adversaries use generalised statements to make big, bold statements that are often inaccurate.

For example, the common refrain that SMSFs are mostly invested in bank accounts and ASX-listed shares is clearly only true in a broad sense.

Another example involves SMSFs and borrowing. This has often been spoken about as being highly dangerous not only for individual investors but for the whole Australian financial system. For March 2015 the ATO has estimated that SMSFs have borrowings of about $10 billion — that is, less than 2 per cent of total self-managed super's total assets.

By comparison, in the month of June 2015, the ABS said that there were $18.8 billion of new owner-occupied housing loans.

If the proportionately small amount of money SMSFs have borrowed might cause a financial market meltdown then, in all seriousness, it might be time to think about getting your money out of this country. So the bottom line is that while generalised research can guide us as to what might be happening in SMSFs, we should never be so foolish as to think we have a complete picture.

At the recent Chartered Accountants Australia and New Zealand SMSF national conference, Recep Peker from the market research house Investment Trends offered some fascinating insights into the firm's work in the SMSF space over at least the last six years.

His latest work found that on average accounting firms charge SMSFs $2900 each year to administer their funds, whereas SMSF administration firms charge $1800 to perform the same task.

There are two fascinating impacts of this finding. First, back in 2012 Peker's research found that accountants earned 22 per cent of their revenue from administering SMSFs. At the time they said they would like to administer more funds and thereby earn 30 per cent of their revenue from SMSF administration. However, accountants haven't achieved this objective and seem stuck at

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about 22 per cent.

As a result of this, he found that the number of new SMSFs has been growing faster than the number of funds using accountant's administration services. To make this point he said that between 2006 and 2010, accountant set up 54 per cent of new SMSFs. But between 2013 and this year accountants established 42 per cent of SMSFs.

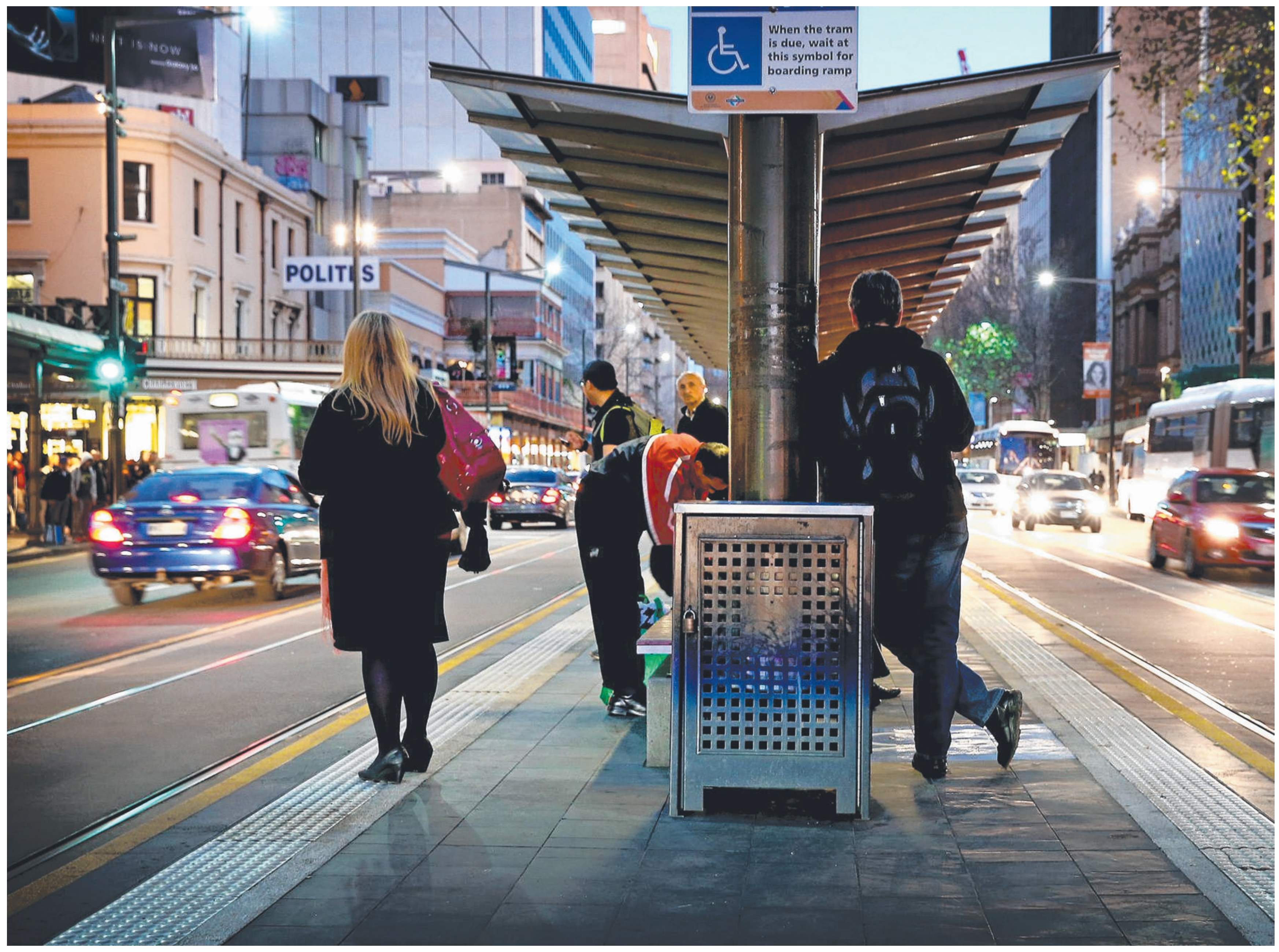
Second, he found that in relation to SMSF administrators, investors put a priority on customer service: assistance in complying with the law and legislative updates. They valued access to information, ongoing monitoring of a fund's activities and reporting on this, efficient administration and timeliness in preparing year-end financial accounts.

Finally, SMSF administrator clients said they looked for well-prepared year-end financial accounts and the range of investments that an administrator's systems could handle.

Price isn't even mentioned.

Tony Negline is author of The Essential SMSF Guide 2015/16

Trust in lowly geared vehicles



Adelaide has one of the weakest office rental markets in Australia, a key factor when considering a property trust

In a low interest rate world property trusts are an attractive idea

BRAD NEWCOMBE

The important question facing investors in listed property trusts is that, after outperforming the broader equity market in recent years, do they still represent attractive value?

One reason given for avoiding them is that falling capitalisation or "cap" rates — the key valuation measure for commercial property — are a sign that the property cycle has peaked

There are also some macroeconomic risks that must be considered. Office towers in Brisbane, Adelaide and Perth, which have high exposure to the resources sector, are seeing high vacancy rates and declining lease prices per square metre. Avoiding, or at least factoring in, these risks in the price paid for a property trust with a high proportion of properties in these regions is paramount.

Probably the easiest point to argue for those who believe property trusts are overvalued is that many are trading at prices well above the value of their net tangible assets. After all, why would anyone want to pay $1.20 for units in a property trust if the assets, when liquidated, would only realise $1? Unit prices at a 20 per cent premium to NTA are common.

The counterargument is that a strong brand can justify this premium. While it might sound counterintuitive for a business model as simple as a property trust, the presence of an established brand or compelling business theme can add value to these assets, making them worth more than a stand-alone investment.

Some notable examples are the Westfield-related shopping centre trusts Scentre Group and Westfield Corporation, as well as an asset-specific trust such as BWP Trust. The Westfield brand is known throughout Australia, New Zealand, the US and Britain as an iconic shopping centre brand. Simply placing the Westfield moniker on a shopping centre arguably makes it more valuable.

BWP Trust's point of differentiation is its affiliation with hardware juggernaut, Bunnings. BWP Trust's portfolio almost exclusively comprises industrial sheds tenanted to Bunnings. While industrial property trusts are normally avoided, the long-term leases BWP Trust locks in with a secure tenant such as Bunnings changes these investment dynamics and also justifies the premium to NTA.

Another reason to invest in property trusts is that they offer high yields compared to the historically low cash rate. While the cash rate will inevitably rise in the future, investors in property trusts are currently earning a huge premium to cash and other low-yielding fixed-income investments.

While property trusts are undoubtedly riskier than most fixed-income products, the difference between the current yield on property trusts and the 10-year government bond is significant.

A final plus is that property trusts are typically "low beta" securities, those less affected by broader market movements. Most property trusts have suffered only modest falls in the recent equity market rout.

Overall, property trusts appear reasonable value in the current market. While we would not be surprised to see falls of between 10 and 15 per cent for some of the blue-chip trusts in a market downturn, any sell-off presents a possible buying opportunity.

Many trusts had near-death experiences during the GFC because of ill-fated acquisitions and excessive gearing, but these entities have now returned to being the boring low-risk securities they were always supposed to be, providing solid distributions to investors, as the recent profit reporting season demonstrated.

Given the current low interest rate environment and the relatively low-risk income stream lowly geared trusts provide, they remain attractive investments, especially given their low volatility.

Brad Newcombe is head of research at Millinium Capital Managers, which owns units in BWP and the Westfield trusts.

FLOAT WATCH

Tapping into a wealthy market

Mainstream BPO
ASX Code: MAI
Shares on Offer: 25 million
Listing Price: $0.40
Market Capitalisation: $34.8 million
Listing Date: September 23

TIM MORRIS

Behind the US and Luxembourg, Australia commands the world's third-largest funds management industry. It is one of only a few countries with pension assets worth more than annual gross domestic product. At the end of FY2014, total superannuation assets were $1.84 trillion, about 116 per cent of GDP.

The largest individual share of these assets is held by self-managed super funds, and the remaining two-thirds are held by a mix of retail, not-for-profit, corporate and public-sector funds. Within these commercial and not-for-profit segments of the industry, outsourcing is well established with 75 per cent of fund managers and more than 80 per cent of large superannuation funds using a third party in their back office. Outsourcing also allows an investment manager to focus on their core competency, investment performance, and accomplish the administrative function more efficiently.

Demand for outsourced services in the wealth management industry is driving the coming listing of Mainstream BPO. In addition to administration services for fund managers, the company provides share registry services for listed companies and funds. Established in 2006, Mainstream BPO is on course to post its fourth consecutive year of profit and third year of increasing revenue.

Proceeds from its float are scheduled to finance completion of recent acquisitions and reduce borrowings. Incentive for new investors is the company's potential to sustain recent revenue momentum and increase profitability. Mainstream BPO has recently expanded its geographical reach and service offering, acquiring Hong Kong-based middle office service provider HFO last year. While the majority of wealth managers currently outsource their back office functions, only 20 per cent outsource their middle office functions.

Principal risks are the company's volatile earnings history and the influence of financial markets on its performance. Mainstream BPO's revenue is linked to its clients' funds under management. However, with its expanded service offering potentially addressing a large segment of unmet demand, the outlook appears well balanced for investors seeking a mix of income and capital growth.

Tim Morris is an analyst at wise-owl.com

You can lend to your cousin and a former spouse — just not to other relatives

MONICA RULE

I have always found it odd that self-managed superannuation fund members can have their trustee provide financial assistance to members' cousins and former spouses, but not to other relatives.

How is this possible, you ask?

I'm not sure if it was intended, but there is a loophole in the superannuation law.

You see, super law prohibits SMSF members from providing financial assistance to members and relatives of the members of an SMSF.

However, the definition of a relative of a member of an SMSF is a parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of the individual, or of their spouse, or a spouse of the individual, or of any other individual referred to previously. Notice with this definition a cousin and a former spouse are not mentioned.

Therefore, SMSF trustees can provide financial assistance to their cousins and former spouses as long as it is at arm's length and is in accordance with their SMSF's investment strategy.

This means the loan should be documented so it is enforceable by the trustees should there be a problem, and interest at the market rate must be charged on the loan.

Now, you may think cousins and former spouses are included

> There are these inconsistencies with some of the defining terms in the super law

in the definition of a related party under super law.

Well, they are.

In fact, cousins and former spouses are included in the definition of a related party in the area of super law that outlines with whom an individual can establish an SMSF.

The area of the law that describes the legal structure of an SMSF states you can establish an SMSF with a relative.

The definition here of a relative of an SMSF member is a parent, child, grandparent, grandchild, sibling, aunt, uncle, great-aunt, great-uncle, niece, nephew, first cousin or second cousin of the individual, or of their spouse or former spouse, or a spouse or former spouse of the individual, or of an individual referred to previously.

So as long as none of the members of an SMSF is a child of a cousin or of a former spouse, and none of the other members of the SMSF is directly related to the cousins — such as by being the spouse of the cousin or being a parent of the cousins — the SMSF would not be prohibited from providing financial assistance to these people.

Otherwise they will fall within the parameters of being a relative because of the parent relationship or spousal relationship existing between the two parties.

I love working with super law, but when an important defining term can include one relationship under one area of the law and exclude it in another; I can understand why many people can find it frustrating.

It has always seemed odd to me that there are these inconsistencies with some of the defining terms in super law.

It makes things tricky for the average SMSF investor.

The important thing to remember is it's always best to talk to an SMSF specialist before proceeding with any related-party transactions.

Monica Rule is an SMSF specialist and author.
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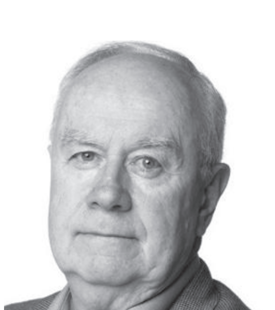
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