

Limited Recourse Borrowing Arrangements

Information Sheet

Self-managed Superannuation Funds (SMSFs) are popular with people who like to have direct control over their savings. One of the benefits is a SMSF can borrow money to invest in commercial or residential property. This is a great way to grow your assets and plan for your future financial security.

Amendments to the *Superannuation Industry (Supervision) Act* legislation have made it possible for a super fund trustee to borrow money to acquire a beneficial interest in an asset. The legislation referring to this is a 'limited recourse borrowing' arrangement.

What is a limited recourse borrowing arrangement?

The limited recourse borrowing arrangement permitted via a SMSF is a complicated matter. However, in simple terms, it involves the super fund trustee borrowing money to acquire an interest in an asset. This acquired asset must be held on trust for the SMSF trustee, who is the beneficial owner of the asset. The SMSF trustee will have a right, but not an obligation, to acquire legal ownership of the asset once the loan is repaid.

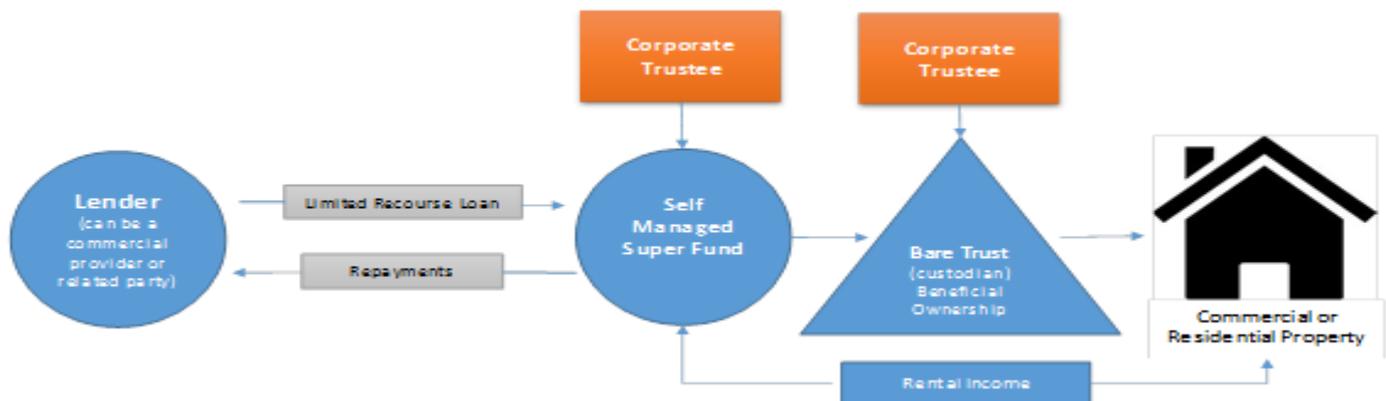
To meet the legislative requirements, the borrowing must be a 'limited recourse' arrangement. This means that in the event that the trustee defaults on the loan the lender's rights are limited to the particular asset only.

Why consider borrowing in super to invest?

There can be many potential benefits to this type of investment. One common strategy is to borrow to invest in the purchase of an investment property. This typically involves:

- Paying the deposit using monies from superannuation
- Borrowing the remaining funds from a lender (such as a bank)
- Purchasing the selected investment property
- Income earned from the property goes towards paying off the loan over time
- Income earned is taxed at an advantageous 15% or less
- When the property is later sold, any potential capital gain is taxed at 10% or less

The diagram below outlines the limited recourse borrowing arrangement:



To set up a limited recourse borrowing arrangement, you will need to seek the assistance of a number of qualified professionals to help with the legal paperwork. This may include your accountant, lawyer, financial planner and bank/mortgage broker.

Some of the *benefits* of a limited recourse borrowing arrangement

- Using a limited recourse borrowing arrangement (and borrowing money) may allow you to buy assets that are otherwise unaffordable for your SMSF.
- Your SMSF will receive all of the income and deductions, without having to fund the entire purchase price upfront.

- Growth of the asset occurs in the concessional tax superannuation environment. Capital Gains Tax is limited to a maximum of 15%.
- There is no risk to your other fund assets if the value of the underlying asset fails.
- Building your savings in superannuation may protect them in the event that you go bankrupt.

Some of the *disadvantages* of a limited recourse borrowing arrangement

- Limited recourse borrowing arrangements are complex and require the assistance of suitably qualified professionals. As such, they will typically be more expensive than a typical non-SMSF property loan to put in place.
- If the strict requirements of the limited recourse borrowing arrangement rules are not met, this could result in severe penalties for your superannuation fund.
- If the asset does not perform as expected, the losses will be magnified. This is because you have borrowed money to purchase the asset and, even though the asset reduces in value you still have to continue making loan repayments. This means that the loan will represent a greater proportion of the asset's value.
- Circumstances may change. The fund may not be able to meet the loan repayments. If this happens, the holding trust may be forced to sell the investment at an inappropriate time, such as when it is valued at less than the amount outstanding on the loan.
- This type of arrangement is based on current laws and regulations. These may change in the future which could affect the success of your SMSF.
- There are restrictions on the type of work that can be carried out on a property while the limited recourse loan is still in place. For example, a vacant block of land could not be built on, nor subdivided, while the loan is still in place.
- There are restrictions with regards to the types of assets you can purchase. Borrowing arrangements put in place after 7 July 2010 require that the borrowed funds be used to purchase a 'single acquirable asset'.

Two common limited recourse borrowing arrangement mistakes

- LRBA funds cannot be used to refinance an existing super fund property or asset; and
- Signing a contract to purchase an asset using a LRBA prior to seeking appropriate legal and professional advice and approvals beforehand.

Seek professional advice

If you are considering a limited recourse borrowing arrangement using your SMSF, it is important that you have met with a qualified financial planner to ensure that:

1. your SMSF trust deed allows this type of arrangement; and
2. you fully understand how the arrangement works and what your legal, tax and administrative obligations will be.



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