

Fact Sheet

Limited Recourse Borrowing Arrangements (LRBA)

SMSF's are generally not allowed to borrow money but there are some limited exceptions. One exception is where trustees borrow to purchase a single asset under a "Limited Recourse Borrowing Arrangement" (LRBA).

The borrowing must be a limited recourse loan, which means that in the event of default, the lender's recourse (right to pay off the loan) is limited to the investment purchased under the LRBA. The lender is not able to make a claim on other fund assets. Because the lender is not able to make a claim on other assets owned by the SMSF, it is common for lenders to ask SMSF trustees to provide a personal guarantee.

Under an LRBA structure, the legal title to the investment is held by a third party on trust for the SMSF trustees. The SMSF trustees will have a beneficial interest in, and right to acquire legal ownership of the investment when the loan is paid off.

This structure is different to the standard ownership of assets by SMSFs, which involves the assets being held by the SMSF trustees as trustee for the fund.

How is the borrowing arrangement structured?

The key elements of an LRBA borrowing arrangement are as follows:

SMSF trustee

- Selects the investment to be acquired
- Organises the limited recourse loan with the lender
- Establishes the holding trust
- Pays the deposit for the purchase of the investment from the SMSF bank account
- Receives income from and pays the expenses associated with the investment
- Makes repayments on the loan

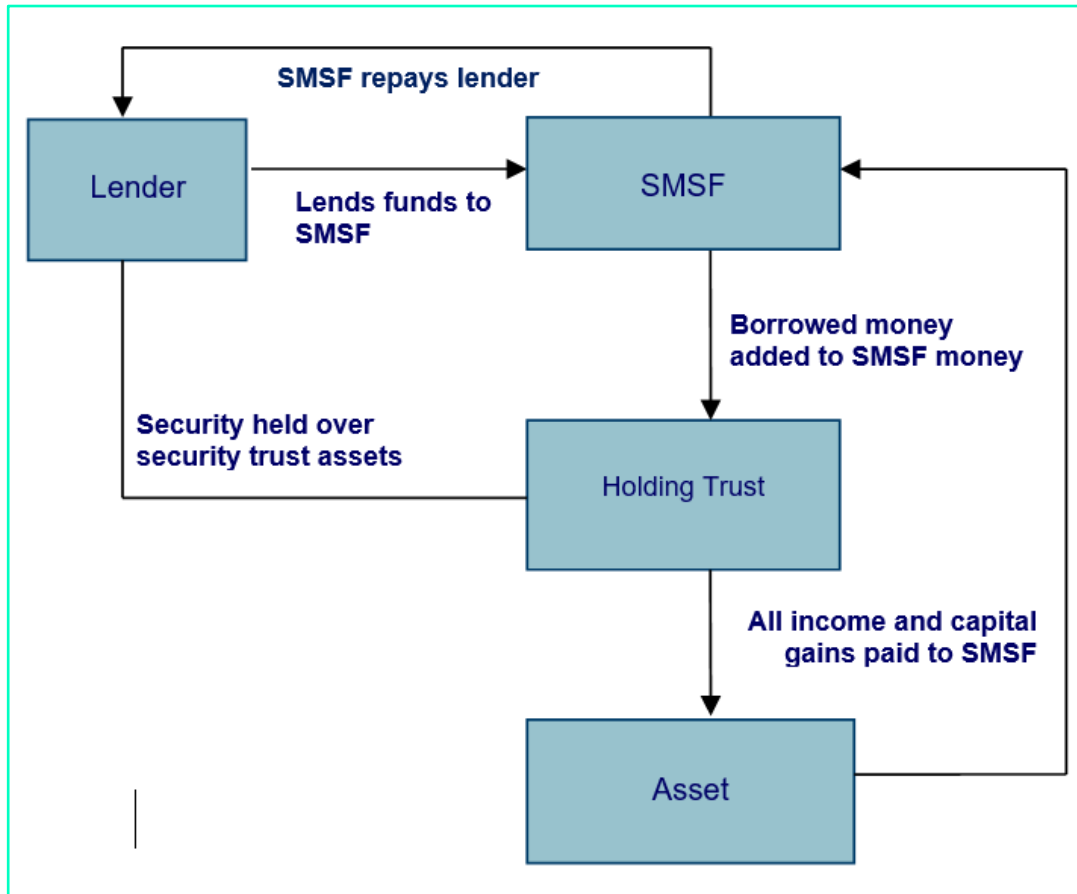
The holding trustee

- Purchases the asset under the holding trust
- Holds the asset as the legal owner until the loan is repaid or the asset is sold

The Lender

- Provides finance and can be a related party lender or a commercial lender

The following diagram outlines the typical structure of an SMSF limited recourse borrowing arrangement:



Establishing a holding trust

The holding trust is also commonly referred to as custodian trust or bare trust, its purpose is to hold legal title to the property. It is not an operating trust and therefore doesn't lodge a tax return or have any assets such as a bank account. The holding trust merely holds legal title to the property during the time the loan is in place. All transactions in relation to the property occur on the SMSF bank account.

The holding trust is established by deed. The trustees can be either a company or one or more individuals. However, the holding trustee **cannot** be the same entity (individuals or company) as the SMSF trustee. For example, where the SMSF has 2 individual trustees, it would be possible for the holding trust to have one these individuals act as trustee for the holding trust. Some commercial lenders may require the holding trustee to be a company.

Types of assets that can be purchased

An SMSF can invest in a wide range of assets through a borrowing arrangement, including:

- Commercial property
- Residential property
- Shares or managed funds
- Any other asset an SMSF can normally invest in, such as bullion.

It is important to note the LRBA rules only allow the acquisition of a “single acquirable asset”.

For assets such as shares, each LRBA must be for a parcel of shares in a single company with identical rights, or units in a managed fund with identical fixed rights. Each parcel must be treated as a single asset at all times.

For example, if the LRBA is for the acquisition of 100 shares in ACB Pty Ltd, the trustees cannot sell just 20 shares. They would need to sell the full parcel of 100 shares. In addition, if the trustees participated in a dividend reinvestment plan there would be a breach of the borrowing rules as the asset would increase the holding to a parcel of 102 shares.

In relation to property, a single asset is usually considered a single title for land and the accompanying buildings. For properties where there are multiple titles involved (i.e. a factory sitting across two titles, or a farm consisting of 3 titles) it is necessary to consider both the legal form and substance of the asset to determine if it will qualify as a “single acquirable asset”.

For example, an apartment with a carpark on 2 separate titles which cannot be sold separately, would normally be considered a single asset. However if it is possible for the carpark to be sold separately, trustees may need to consider alternative holding structures. This could include establishing two separate LRBA’s, one for each title, or potentially acquiring one of the titles directly by the fund without a borrowing.

Related Party loans

Any party can provide finance for an LRBA structure, including a related party provided the terms of the loan are commercial. The ATO has issued Practical Compliance Guideline [PCG 2016/5](#), also referred to as the “safe harbour guidelines”. It outlines what the ATO considers to be commercial terms for related party LRBA loan agreements and covers:

- A benchmark interest rate, linked to an annual figure issued just prior to the end of each financial year by the RBA
- The maximum term of the loan
- The type of repayments
- Guidance in relation to security for the loan

Adopting the safe harbour terms will normally mean the ATO and fund auditor will be satisfied the terms of the loan are commercial.

Limited recourse borrowing arrangement checklist

	Action	Checked	Date
1	Determine that purchase of the asset and any associated borrowing is an appropriate strategy.		
2	Ensure that the SMSF trust deed allows borrowing through a limited recourse loan.		
3	Review and if necessary revise the Investment strategy.		
4	Identify an investment and ensure that: <ul style="list-style-type: none"> The investment can be acquired under the SIS legislation where the investment is acquired from a related party, it should be valued by an independent valuer to confirm the market value 		
5	Organise pre-approval for the loan with the lender. In most cases, banks do not provide finance unless a financial advisor is able to provide a declaration confirming the trustees have obtained advice and the strategy is appropriate based on their circumstances.		
6	Before any documents are signed and any deposit is paid, ensure advice has been sought from a practitioner in the jurisdiction where the asset is located to ensure the correct procedures are followed and no unnecessary stamp duty liability arises.		
7	Have the LRBA documents prepared including: <ul style="list-style-type: none"> Formation of security trustee Contracts for purchase of the single investment Security trust deed Loan agreement 		
8	Exchange contracts for sale in the name of the security trustee. Ensure advice is obtained to ensure all documents refer to the correct parties and all documents are executed in the correct order.		
9	Complete the purchase of the investment using only the SMSFs money and the amount borrowed.		
10	If required, arrange for the holding trust deed to be stamped by the relevant stamp duty authority.		

Frequently asked questions

Can I lease a property subject to an SMSF loan from my SMSF?

A related party generally cannot lease residential property from an SMSF. However, a related party can lease a commercial property from an SMSF, subject to certain conditions being met. Any lease must be in writing.

Can I repair a property subject to an SMSF loan with borrowed funds?

Properties can be repaired with borrowed funds, as restoring something to its original form and function will not contravene the borrowing rules. But rundown buildings that are substantially renovated could be considered an improvement of property (see below). Trustees cannot borrow to pay for repairs to an existing asset.

Can I improve a property subject to an SMSF loan with borrowed funds?

No. But a property subject to an SMSF loan can be improved with the Fund's own cash resources, so long as the improvements do not create a new physical or legal asset.

Can I develop property subject to an SMSF loan?

No. An SMSF cannot borrow to buy a vacant block of land and develop it. This will change the nature of the original acquirable asset; that being the vacant block of land. The nature of the originally purchased asset cannot change to create a new physical or legal asset.

Who can lend to my SMSF?

There is no restriction on the type of lender that can lend money to the Fund. The lender can either be a commercial lender such as a bank, or a related party lender, such as a member of the Fund or a relative of that member.

Can the loan include additional money in the amount of the loan to cover expenses incurred in acquisition?

Yes, for expenses that are incurred in connection with the borrowing or acquisition of the asset. Expenses must be intrinsically linked to the purchase of the acquirable asset can be included as part of the borrowing. E.G. Stamp Duty, conveyancer fees, brokerage, loan establishment fees etc.

What happens when the loan has been repaid?

Upon the Fund's repayment of the limited recourse loan, the SMSF Trustees have the option of acquiring title to the asset directly. The legal title of the property can be transferred from the holding

trustee to the SMSF trustees, and if structured correctly there should be no tax, capital gains or stamp duty consequences.

The trustee may decide for the title of the investment to remain in the holding trust without breaching the borrowing rules. This is on the proviso that all other conditions surrounding the requirements of a limited recourse borrowing are maintained. The ATO's 'look through provisions' for the in-house asset exemption has been extended so it continues after the loan has been repaid.

What documentation can Super Concepts provide?

We provide a comprehensive SMSF borrowing arrangement documentation service for property, which includes:

- Written resolutions to establish the arrangement and appoint the Holding Trustee
- Holding Trust Deed (Custodian Trust)
- Detailed information pack, including guidelines for conveyancers
- Loan agreement (related party loans only)
- Step by step completion instructions

For more information

Contact your Client Service Manager via 1300 023 170. Additional resources and insights can be found on our website page <http://www.superconcepts.com.au/news-insights/SMSF-tech-hub>.

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