LRBA: Drawing down monies for repairs under a Limited Recourse Borrowing Arrangement

**Issue raised**

Where a LRBA is established after 6 July 2010 and an asset is acquired under an arrangement which meets all of the requirements of section 67A of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act), would further loan drawings to make repairs to that asset as described in each of the following separate scenarios fall within section 67A?

a. The terms of the original loan specifically provide for redraws / additional borrowings under the one loan arrangement and additional borrowings are made under those terms, or

b. The terms of the original loan and borrowing trust documentation are silent on additional drawings but the bank is happy to provide that facility several years after the establishment of the arrangement (they have revalued the asset they already hold as security and concluded that their risk is still acceptable even with additional borrowings), or

c. The terms of the original loan specifically provide for redraws / additional borrowings under the one loan arrangement but the trustee is able to negotiate more favourable terms by approaching a different lender.  The existing loan (for the purchase of the original asset) remains in place with the original lender and the loan for repairs is a completely separate loan. No security is provided - the new loan for the repairs is unsecured.

d. The terms of the original loan are silent on additional borrowings but the trustee is able to refinance with a new lender who will not only replace the original borrowings but will also allow further borrowings for repairs.

**Background information provided by member**

Section 67(1) of the SIS Act generally prohibits regulated funds from borrowing money or maintaining an existing borrowing of money.

Section 67A of the SIS Act contains an exception which allows funds to borrow money for the purpose of acquiring a single acquirable asset, including:

* + 67A(1)(a)(i) expenses incurred in connection with maintaining and repairing the asset, and
  + 67A(1)(a)(ii) money applied to refinance a borrowing which was previously used to acquire an asset and which met the requirements of section 67(A)

In each of the scenarios above, a fund has borrowed to purchase a single acquirable asset (as defined in section 67A of the SIS Act) under a LRBA which meets all of the requirements of section 67A of the SIS Act. The various scenarios seek to identify when further borrowings will be permitted in order to either make repairs or refinance.

**Industry view / suggested treatment provided by member**

In each of the above scenarios, the trustee of the superannuation fund meets the key requirements of section 67A in that:

* + the asset which is the subject of the repairs has been acquired under a limited recourse borrowing arrangement, and
  + the repairs have not resulted in the fund providing any additional security over and above the original single acquirable asset.

Where the scenarios differ is in the extent to which the new borrowing was contemplated in the original arrangement and whether or not changes to that arrangement necessarily result in refinancing or a new arrangement.

Scenario (a) would appear to be directly in line with the simplest interpretation of section 67A and is therefore something of a "control" case. In our view, this drawing is entirely consistent with the requirements of section 67A and hence the borrowing to make repairs would be permitted.

Scenario (b) is different in that the arrangement does not specifically permit additional borrowings for repairs. Nonetheless, in our view, the essential requirements of 67A are still met - the repairs are in relation to an asset acquired under a LRBA and no additional security is being offered over and above the security already available to the lender. The only actual difference between this and Scenario (a) is that the various parties will need to agree to some changes to the precise terms and conditions. In our view, this does not result in a new arrangement and hence the borrowings are consistent with section 67A.

Scenario (c) involves a second lender and will therefore necessarily result in a new loan agreement with another party. However, we argue that this does not necessarily result in a new Limited Recourse Borrowing Arrangement - multiple loans could easily be considered to form part of a single overall "arrangement". (We note that at the June 2012 NTLG, that the ATO took the view that it is possible to have more than one lender under a single LRBA - confirming views previously expressed via web content etc that the arrangement is broader than simply the loan itself.)

Scenario (d) involves refinancing (specifically permitted under sub-paragraph 67A(1)(a)(ii)) but at the same time expanding the potential scope of the borrowings to include borrowing for repairs. In our view, this too falls within the requirements of section 67A.

**Technical reference**

As outlined above.

**Impact on clients suggested by member**

Improves clarity as to what can and cannot be accommodated within a single LRBA and the extent to which the LRBA can be changed over time without resulting in a new arrangement.

**Priority of issue where ATO view is required suggested by member**

Medium

Many LRBAs have now been in place for several years and the recently released SMSFR 2012/1 has provided significantly greater clarity on the meaning of "repair" v "improvement". Many clients will therefore seek to use borrowed funds to make repairs and further guidance is needed on when this can be accommodated under existing arrangements.

**ATO initial response**

**Where an LRBA is established after 6 July 2010 and an asset is acquired under an arrangement which meets all of the requirements of section 67A of the SISA, would further loan drawings to make repairs to that asset as described in each of the following separate scenarios fall within section 67A?**

**a. The terms of the original loan specifically provide for redraws / additional borrowings under the one loan arrangement and additional borrowings are made under those terms**

Yes. As indicated at paragraph 28 of SMSF Ruling SMSFR 2012/1:

Subsequent draw downs under an LRBA give rise to additional borrowings. However, an LRBA that satisfies the requirements of section 67A when entered into will continue to satisfy those requirements if:

* + the additional borrowings are applied in maintaining or repairing the asset held under the LRBA; and
  + the draw downs are provided for under the terms of that LRBA.

That is, the original borrowing and each such subsequent draw down are all capable of being "under an arrangement under which the money is or has been applied for the acquisition of a single acquirable asset, including … in maintaining or repairing the acquirable asset". Each such additional borrowing can satisfy the requirements of paragraph 67A(1)(a) because the arrangement entered into expressly provided for the additional borrowing.

**b. The terms of the original loan and borrowing trust documentation are silent on additional drawings but the bank is happy to provide that facility several years after the establishment of the arrangement (they have revalued the asset they already hold as security and concluded that their risk is still acceptable even with additional borrowings)**

No. As the additional borrowings were not provided for under the terms of the LRBA entered into, they do not constitute a borrowing of money "under an arrangement under which the money is or has been applied for the acquisition of a single acquirable asset, including … in maintaining or repairing the acquirable asset".

**c. The terms of the original loan specifically provide for redraws / additional borrowings under the one loan arrangement but the trustee is able to negotiate more favourable terms by approaching a different lender.  The existing loan (for the purchase of the original asset) remains in place with the original lender and the loan for repairs is a completely separate loan. No security is provided - the new loan for the repairs is unsecured.**

No. The additional borrowings were not provided for under the terms of the LRBA entered into and do not satisfy paragraph 67A(1)(a) for the same reasons as in scenario b. Further, with the new loan being unsecured, paragraph 67A(1)(d) of the SIS Act would not, in any event, be satisfied. That paragraph requires that under the arrangement:

the rights of the lender or any other person against the RSF trustee [the trustee of the SMSF concerned] for, in connection with, or as a result of, (whether directly or indirectly) default on:

i. the borrowing; or

ii. the sum of the borrowing and charges relating to the borrowing;

are limited to rights relating to the acquirable asset.

**d. The terms of the original loan are silent on additional borrowings but the trustee is able to refinance with a new lender who will not only replace the original borrowings but will also allow further borrowings for repairs.**

Yes, provided that the amount of the new borrowing is no more than the sum of:

* + the amount needed to repay the existing borrowing,
  + expenses incurred in connection with the new borrowing, and
  + expenses incurred in maintaining or repairing (but not improving) the acquirable asset,
  + and the amount of the new borrowing is applied to those things and only those things.

Meeting Discussion

The ATO was asked to clarify the answer contained in paragraph (c) of the initial response. Specifically, it was asked what is meant by the sentence "Further, with the new loan being unsecured, paragraph 67A(1)(d) of the SIS Act would not, in any event, be satisfied". The ATO explained that the fact that the additional loan outlined in the example is unsecured might mean that it is subject to general recourse rather than the recourse being limited to the single acquirable asset. It was suggested by several members that this would depend on the terms of the actual borrowing agreement. In light of the ATO's view that paragraph 67A(1)(a) would not be satisfied in any event, it was not necessary to explore further the question of the nature of the recourse of the loan in this example.

There was a further comment on whether the position taken in the answers contained in paragraphs (b) and (c) took a too strict or narrow view of the arrangement. The ATO stated that these views are consistent with the principles contained in SMSFR 2012/1.

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