



SMSF borrowing for land development is not fertile ground

The ability of SMSFs to borrow money for investments and especially property has led to many client enquiries on how the limited recourse borrowing arrangements (LRBA) operate under the superannuation laws.

Many SMSF investors believe they can borrow money to purchase vacant land and build a residential house on it. Some are even considering purchasing a property (i.e. house and land) with the intention of demolishing the existing dwelling and building a new house or rezoning to build residential units.

Under LRBA, the borrowed money can be used to purchase a single acquirable asset as well as to cover expenses related to the purchase, such as conveyancing fees, stamp duty, brokerage and loan establishment costs.



Borrowings can also be used to pay for expenses incurred in maintaining or repairing the asset to ensure its financial value is not diminished. However, the borrowings must not be used to improve the single acquirable asset.

An SMSF trustee **CANNOT** enter into a LRBA to purchase a single acquirable asset that is:

- Vacant land, then use some of the borrowed money to build a residential property on the land. This is because the building of the residential property would be an improvement to the single acquirable asset.
- Vacant land, then use money accumulated in the SMSF to build a residential property on the land. Although you can use money in the SMSF for improvements, you cannot change the nature and character of the single acquirable asset so that it becomes a different asset. The property acquired under a LRBA will no longer be vacant land.
- A property consisting of a house and land, then use some of the borrowed money to demolish the existing house and build a new house on the land. Again, this is because the borrowed money is used to improve the property.



- A property consisting of a house and land, then decide to use the money accumulated in the SMSF to demolish the existing dwelling, rezone the land and build new units on the land. This would also be treated as an improvement to the single acquirable asset.

If a trustee wants to develop anything on vacant land purchased under a LRBA, demolish, rezone or build a new dwelling where it would amount to changing the nature and character of the acquired asset, then the loan under the LRBA must be fully repaid prior to making any improvements or changes.

The reason for this law is because improvements would fundamentally change the nature of the asset which is being held as security for the loan, and potentially increase the risk to the SMSF in the event of a default on the loan by the SMSF. Remember, the lender only has recourse to the asset which the borrowed money has been used for. If the lender seeks repayment of the unpaid loan, and the SMSF is not in a position to make any additional payments on the loan, the lender could seize the asset acquired. If that asset happens to have a brand new house sitting on top of it that's going to be a big problem for the SMSF.

By **Monica Rule**

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