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/ Limited recourse borrowing arrangements - questions and answers

Is limited recourse borrowing right for your SMSF?

If you already have an SMSF and are thinking of using limited recourse borrowing to make an investment, you need to consider if this is the right kind of investment for your SMSF.

Limited recourse borrowing loans may be presented to you in various ways. You may be given a product disclosure statement that talks about property warrants or instalment warrants. These often package property, shares or some other asset with a loan product that meets the limited recourse borrowing requirements. Your financial adviser may also offer to set up a limited recourse borrowing facility for you.

As with any investment decision, evaluate exactly what you are being offered. Some questions you might ask include:

- who will be the lender and what will happen if borrowing rates reduce or rise?
- can the loan be called in early?
- can your loan be sold to another party and the terms of the loan altered?

Don't decide until you understand how the investment works.

Is the asset being offered of good quality and what is the value of the asset you intend to buy? If you are given a valuation, can you check that the valuation is reasonable? You can check online or in the paper to find the price of similar assets.

Look at the fees and costs of the loan. If shown as a percentage, work out how much they amount to in dollar terms. Setting up a limited recourse borrowing investment can be costly. The set-up costs and ongoing interest and fees may wipe out potential profits.

Will you be paying commissions? Sometimes the person who arranges your loan may receive a commission for the life of the loan. If someone sources a property or asset for you they may also receive a payment. These may be in addition to the fees and costs you are paying for the loan arrangement. Are you comfortable with this?

Does the asset need to be insured and if so will the SMSF have the money available to pay insurance costs each year? If the asset is a property to be leased or rented will your SMSF have enough money to pay maintenance costs or make repayments if the property is unoccupied for a period of time and no rental money is received?

LRBAs are generally long-term investments. Consider whether your SMSF will be able to maintain the loan repayment and fees over that term. Will your SMSF have enough money left over to pay the other expenses of the fund such as accountant and auditor fees? Also consider what would happen if one of the members wants to leave the fund or retire and take their money out or start a pension?

Your SMSF can still hold an asset under an LRBA while it is paying a pension to one or more of its members. However, if fewer or no contributions are made, will the SMSF have enough money available to continue repaying the loan and meet its pension payment requirements? Will the asset purchased with the loan have to be sold? Can the loan asset be sold quickly?

Most importantly, we recommend that you seek advice from a qualified, licensed professional to help you decide if limited recourse borrowing is right for your SMSF.

See also:

- [moneysmart.gov.au \(https://www.moneysmart.gov.au/\)](https://www.moneysmart.gov.au/)

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