COUNCIL OF FINANCIAL REGULATORS AND ATO REPORT TO GOVERNMENT: LEVERAGE AND RISK IN THE SUPERANNUATION SYSTEM

February 2019

EXECUTIVE SUMMARY

The 2014 Financial System Inquiry (FSI) recommended removing the exception to the prohibition on direct borrowing by superannuation funds for limited recourse borrowing arrangements (LRBAs). The FSI considered that prohibiting direct borrowing by superannuation funds would prevent unnecessary build-up of risk in the superannuation system and the financial system more broadly. It would also fulfil the objective of superannuation to be a savings vehicle for retirement income, rather than a broader wealth management vehicle.

In its 2015 response to the FSI, the Government did not agree with this recommendation, but commissioned the Council of Financial Regulators (CFR) and the Australian Tax Office (ATO) to monitor leverage and risk in the superannuation system and report back to Government after three years.

Borrowing by superannuation funds can have implications for the financial system and for the retirement income of individual members. The key findings of this report are set out below.

Financial system

- ATO and APRA data indicate use of LRBAs is almost entirely restricted to Self-managed super funds (SMSFs). The number of funds with LRBAs has increased since the FSI. Assets held under LRBAs form a relatively low but not insignificant proportion of SMSF assets overall. These arrangements are most common in lower balance funds, which as a result tend to have lower levels of asset diversification.
- The current levels of borrowing by SMSFs are unlikely to pose systemic risk to the SMSF system at this time.
  - The number of SMSFs using LRBAs has increased significantly from 13,929 (or 2.9 per cent of all SMSFs) in 2013, to 42,102 (or 8.9 per cent of all SMSFs) in 2017.
  - LRBA assets represent 68 per cent of total assets for those SMSFs with LRBAs. The value of assets held under LRBAs has increased from $8.8 billion in June 2013 to $38.9 billion in June 2018. As at June 2018 this represented 5.2 per cent of total SMSF assets, up from 1.9 per cent in June 2013. The total borrowing amount outstanding for SMSFs is around $18.1 billion.
  - Real property represents a significant proportion of the assets held by SMSFs with LRBAs. SMSFs remain a small, but not insignificant, driver of growth in the property market. A change in the property cycle or rising interest rates could increase incidents of default or personal guarantees being called upon.
  - The Productivity Commission's *'Superannuation: Assessing Efficiency and Competitiveness'* report also found that the relatively small number of SMSFs using LRBAs means that such borrowing is at present unlikely to pose a material systemic risk.

Superannuation members

- LRBAs can represent a significant risk to some individuals' retirement savings, particularly where they have low-balance SMSFs with high asset concentration and/or personal guarantees.

  - LRBAs are most common in SMSFs with a net fund size (total assets excluding the value of the amount borrowed) of between $200,000 and $500,000. In 2017 the average borrowing under a LRBA was $380,000 and the average value of assets was $768,600.
  - Less diversified SMSFs with LRBAs are thus exposed to asset concentration risk, which in the event of a fall in the asset's price, could lead to a significant loss in value of the SMSF. Further, this high degree of asset concentration could exacerbate risks to SMSF members if personal guarantees are involved, leading to a loss of personal wealth beyond superannuation.

- Since the FSI, there have been a number of regulatory and market condition changes which may influence demand and supply of LRBAs going forward.
  - APRA has taken action to strengthen lending standards for authorised deposit-taking institutions (ADIs), and established temporary benchmarks on the growth in lending to investors. ASIC has increased its scrutiny of lenders compliance with responsible lending obligations.
  - Several major banks (including Westpac, Commonwealth Bank, National Australia Bank and AMP) have withdrawn from lending to SMSFs. This is likely to result in non-ADI lenders making up a greater share of lending to SMSFs. These non-ADI lenders are subject to responsible lending obligations and ASIC oversight, but are not subject to APRA regulatory oversight. APRA has been given authority under the Banking Act to regulate lending practices by non-ADIs only in order to address systemic risk concerns.
- The Government announced two tax integrity measures relating to LRBAs and non-arm's length income. In addition, the ATO issued guidance on the safe harbour terms for LRBAs to be consistent with arm's length dealings.
- There continues to be evidence of individuals using LRBAs for risky or inappropriate arrangements, potentially putting their retirement savings at risk.
  - There are still a number of financial institutions that offer loans to SMSFs, and the incentives for SMSFs to borrow still exist.
  - Conflicted and poor quality financial advice, including through property one-stop-shops (that is, businesses that present SMSFs and LRBAs as a bundled product, recommending that individuals set up a SMSF in order to purchase a property), has led to some SMSFs borrowing in inappropriate and risky circumstances.
  - ASIC Report 575 noted that 51 per cent of financial advice relating to SMSFs recommended or implied use of a LRBA and 91 per cent of advice given to SMSFs recommending a LRBA did not comply with the best interest duty.
  - The final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) has also illustrated these concerns.

To this end, this report sets out a range of policy options that could reduce or eliminate completely the risks of LRBAs to individual consumers. These include:

- no longer allowing LRBAs;
- restricting related party borrowing;
- broader reforms to financial advice;
- reducing LRBA asset concentration in SMSF portfolios;
- introducing maximum loan-to-value ratios for SMSF lending; and
- prohibiting the use of personal guarantees.

A number of these options also address broader concerns identified by the Royal Commission. Regulator members of the CFR and the ATO note that no longer allowing limited recourse borrowing arrangements will address a number of significant risks which could be detrimental to individuals' retirement incomes, in the event of adverse movements in the property market or a severe economic decline, particularly for those with high levels of leverage and low diversification of assets. No longer allowing LRBAs would also remove the risk that rising leverage in the superannuation system may pose to financial stability.

The Government has announced as part of its response to the Royal Commission a number of reforms that go to these options. This includes prohibiting the hawking of superannuation products, extending the product intervention powers and design and distribution obligations to SMSFs, and to review the measures to improve the quality of advice in three years' time.

Treasury notes that any policy options should be considered in the context of the Government's response to the final reports of the Royal Commission and the Productivity Commission.

Continued monitoring of LRBAs and a further report to Government by the CFR and the ATO in three years will allow assessment of recent regulatory changes and of several years of data from the improved data collection which has only recently become available.

1 Introduction

Superannuation funds are generally prohibited from direct borrowing, a long-standing feature of the investment rules in the superannuation legislation. However, there are some limited exceptions to this, in particular through the use of LRBAs. A timeline of the evolution of borrowing in the superannuation system is at Appendix A.

Superannuation is a significant component of Australia's financial system and the wealth of Australians. At June 2018, superannuation assets totalled $2.7 trillion, or 147 per cent of GDP. This is projected to increase to $9 trillion by 2040. Superannuation is now the second largest asset for many Australians, and is growing in importance.

The FSI considered that the absence of leverage in superannuation funds provided stability to the financial system and the economy during the Global Financial Crisis (GFC). In line with this, the FSI recommended removing the exception that allows superannuation funds to borrow through LRBAs.

The FSI recommended:

> **Recommendation 8:**
>
> Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by superannuation funds.

The Government's response to this FSI recommendation was:

> While the Government notes that there are anecdotal concerns about limited recourse borrowing arrangements, at this time the Government does not consider the data sufficient to justify significant policy intervention.
>
> The Government will however commission the Council of Financial Regulators and the Australian Taxation Office (ATO) to monitor leverage and risk in the superannuation system and report back to Government after three years.
>
> The timing allows recent improvements in ATO data collection to wash through the system. The agencies' analysis will be used to inform any consideration of whether changes to the borrowing regulations might be appropriate.

This report contains analysis by the CFR agencies (Reserve Bank of Australia (RBA), Treasury, Australian Prudential Regulation Authority (APRA) and Australian Securities and Investment Commission (ASIC)) and the Australian Taxation Office (ATO) to inform consideration by the Government of whether any changes are required to the borrowing regulations for superannuation trustees.

2 Background

Although all superannuation funds can use LRBAs, ATO and APRA data indicates that the use of LRBAs is almost entirely restricted to SMSFs. LRBAs were first explicitly allowed under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) in 2007 to permit SMSFs to invest in instalment warrants, following increased use of these warrants in earlier years.

The size of APRA-regulated funds means they are able to invest in asset classes such as property without needing to borrow. They can also deliver a diversified portfolio and access leverage, if they want to, indirectly through shares and managed funds. Prudential Standards (notably on risk management, investment governance and operational risk financial requirements) have also significantly influenced the behaviour of APRA-regulated fund trustees in this space.

2.1 FSI recommendation

In recommending the removal of the exception to the general prohibition on direct borrowing by superannuation funds, the FSI considered that continuing to restrict leverage in the sector will be important for mitigating future risks.

The FSI's main concern was that borrowing, even in a limited recourse arrangement, would magnify the gains and losses from fluctuations in the market, and increase the probability of large losses within a fund. Further, the FSI noted that because of the higher risks for lenders associated with limited recourse lending, lenders charge higher interest rates and sometimes require personal guarantees from trustees. If there is a significant reduction in the valuation of an asset purchased using a loan, trustees are likely to sell other assets of the fund to repay a lender, particularly if a personal guarantee is involved. The FSI concluded that LRBAs were generally unlikely to be effective in limiting losses on one asset from flowing through to other assets, either inside or outside the fund. In addition, borrowing by superannuation funds implicitly transfers the risk from an individual to the Government's balance sheet because retirement incomes are effectively underwritten by the Age Pension.

The FSI noted that further growth in direct borrowing by superannuation funds would, over time, increase risk in the financial system. At the time of the FSI, ATO data illustrated that use of LRBAs was rising rapidly. By December 2014, assets held under LRBAs constituted around 3 per cent of total SMSF assets, up from around 0.1 per cent in June 2008.

The increase in the value of assets held under LRBAs reflects increases in both the use of LRBAs and the value of existing assets held under LRBAs. SMSF assets increased from around 21 per cent of total superannuation assets in June 2005 to 28 per cent in June 2017. This growth was supported by a number of legislative changes including the 'Choice of Fund' legislation in 2005, 'Simplified Superannuation' in 2006, and the 2007 decision allowing borrowing by SMSFs. The FSI noted that with the increased growth in SMSFs, use of LRBAs was likely to grow and potentially exacerbate risks in the financial system.

3 Current use of LRBAs and associated risks

Summary

As at June 2018, total LRBA assets represented 5.2 per cent of total SMSF assets. Based on 2017 financial year lodgements, around 8.9 per cent of SMSFs use LRBAs. Data suggests that borrowing activity is most prevalent in small to medium-sized funds, specifically funds with net assets less than $500,000.

A significant number of SMSFs with LRBAs use such arrangements to acquire real property, both residential and commercial property. There are concerns that increased investment in property by SMSFs is a result aggressive marketing of LRBAs to SMSFs – especially to SMSFs with small balances.

Although the majority of funds sought independent financial advice before entering into a LRBA, research conducted by ASIC found that advice received by SMSFs is regularly of poor quality, leading to substantial risks that individuals may suffer detriment and be significantly worse off in retirement.

Real property assets purchased with a LRBA can represent a significant proportion of the SMSFs total assets, given high purchase prices. This exposes SMSF members to higher concentration and liquidity risks. The use of personal guarantees can also lead to a loss in broader personal wealth outside superannuation.

Continual growth in SMSF borrowing will increase leverage in the superannuation system and, combined with a high degree of concentration in a single asset and the use of personal guarantees as collateral against loans, could pose greater financial risks to SMSFs, and in turn individuals' retirement incomes.

In its report the Productivity Commission found that the relatively small number of SMSFs using LRBAs means that such borrowing is unlikely to pose a material systemic risk. The report noted that active monitoring (along with public reporting and discussion by CFR) is warranted to ensure that SMSF borrowing does not have the potential to generate systemic risks in the future.

3.1 Data sources

This report uses data collected by the ATO from SMSF annual returns (SAR) for 2013-2017, supplemented with insights drawn from the ATO's 2016 and 2017 survey of SMSFs with LRBA assets. Detailed data collected by the ATO is at Appendix B.

The ATO modified the SAR in 2013 to improve data collection on LRBAs. The SAR was modified to collect additional data on the amount of leverage associated with LRBAs, the use of personal guarantees or other security and the use of lenders used to acquire LRBAs. These changes were made to the 2016-17 SAR, meaning the improved data is only available for one year.

The ATO also conducted two surveys of a sample of SMSFs who reported LRBA assets on their 2015-16 and 2016-17 SARs. The survey looked at LRBA borrowings, the funding source of LRBAs, and the use of personal guarantees or other security for LRBAs.

Notwithstanding the conclusions drawn in this report, there would be benefit from using a longer time series of data to meaningfully compare across years.

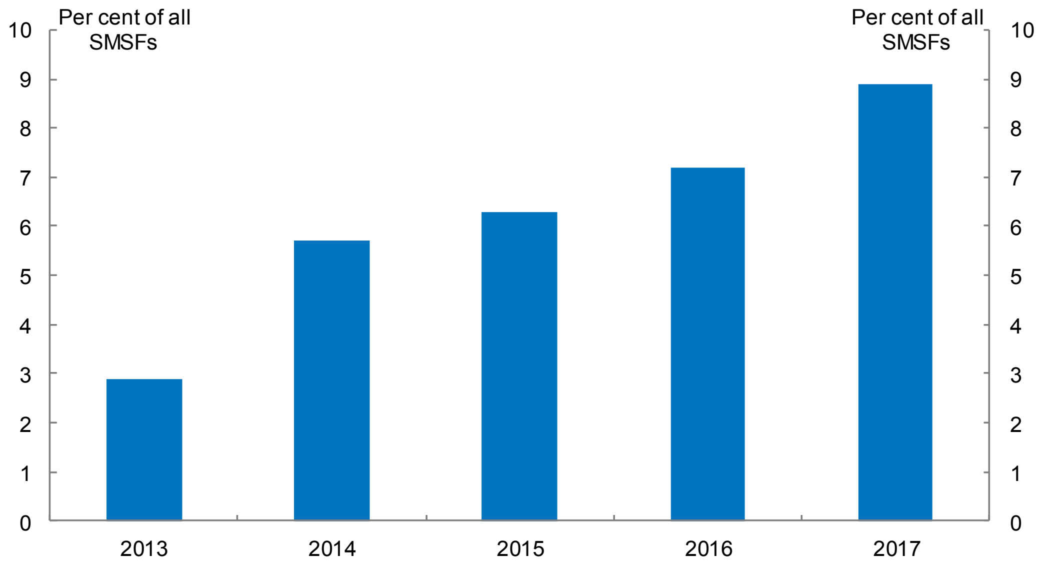
There would also be benefit in considering data on lending to SMSFs by authorised deposit-taking institutions (ADIs) and other financial institutions, the conditions of these loans (for example, interest rates charged), the security requested by the lender as collateral, as well as defaults associated with SMSF loans.

The Productivity Commission's '*Superannuation: Assessing Efficiency and Competitiveness*' report also found that the relatively small number of SMSFs using LRBAs means that such borrowing is at present unlikely to pose a material systemic risk. However they went on to say that continued growth, coupled with any gross underperformance of the LRBA being underwritten by the age pension could generate systemic risk in the future.

3.2 Use of LRBAs by SMSFs

As noted earlier, LRBAs are only used by SMSFs. In 2017, 8.9 per cent of SMSFs (or 42,102 SMSFs), reported using LRBAs (up from 3 per cent, or 13,929 in 2013) (Chart 1).

Chart 1: Per cent of SMSFs using LRBAs



Source: Australian Taxation Office, 2018.

Although LRBAs are used by SMSFs of all sizes, they are most commonly used by SMSFs with a gross fund size (that is, the total value of all assets held by the fund) between $500,000 and $1 million. In 2017, 41 per cent of SMSFs with LRBAs had a gross fund size between $500,000 and $1 million. However, given LRBAs constitute both an increase in asset holdings and an increase in borrowing, it is more appropriate to consider net fund size (that is, the total value of all assets held in the fund less the amount borrowed).

In 2017, the majority of SMSFs with LRBAs (44 per cent) had total assets with a net value of between $200,000 and $500,000. The number of small funds using LRBAs has increased over time (Table 1). Funds with a net value between $200,000 and $500,000 comprise 24.2 per cent of all SMSFs.

Table 1 - Per cent of SMSFs with LRBAs, by net fund size, 2013 to 2017

Net fund size*^	2013	2014	2015	2016	2017
$1–$50,000	1	1	1	1	1
>$50,000–$100,000	5	5	4	3	2
>$100,000–$200,000	23	24	24	23	20
>$200,000–$500,000	39	40	41	42	44
>$500,000–$1m	17	16	16	17	18
Net fund size*^	**2013**	**2014**	**2015**	**2016**	**2017**
>$1m–$2m	9	8	8	8	9
>$2m–$5m	5	4	4	4	4
>$5m–$10m	1	1	1	1	1
>$10m	..	..	..	..	1

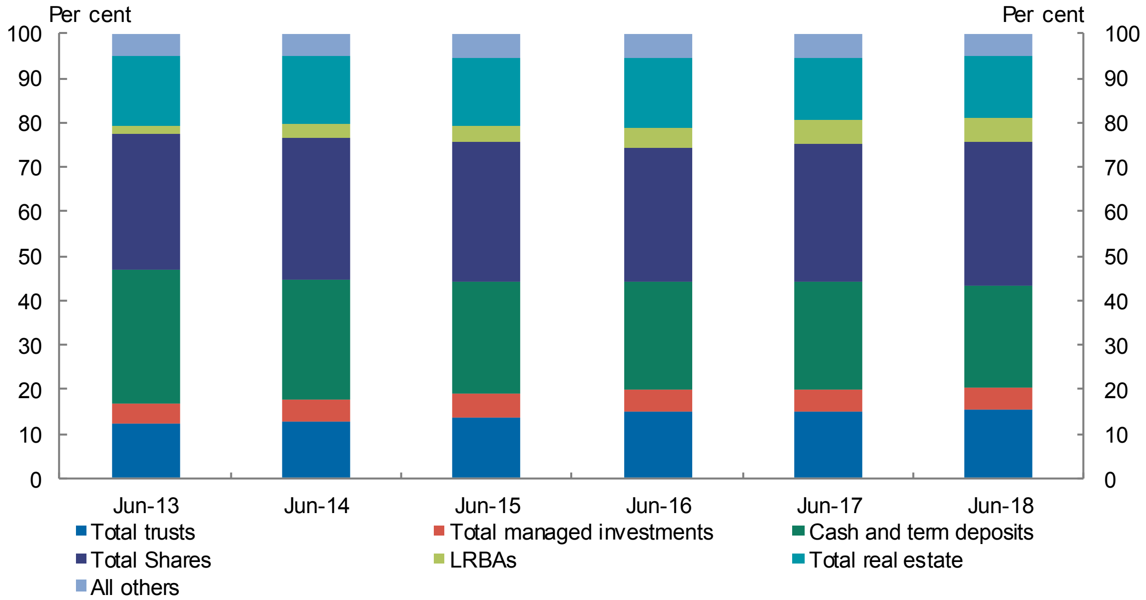
Source: Australian Taxation Office, SAR data 2013-2017. ^ 2017 figures calculated using total value of assets less the amount borrowed under LRBA. *2013-2016 figures calculated using total value of assets less total amount borrowed by SMSF.

The majority of SMSFs with LRBAs are in the accumulation phase, with a very small proportion in either the pension phase or in both pension and accumulation phase. In 2017, around 90 per cent of SMSFs with LRBAs were in the accumulation phase, compared with 53 per cent of all SMSFs. Approximately 5 per cent of SMSFs with LRBAs were in full pension phase. SMSFs with LRBAs also tend to have a larger proportion of younger members (aged 35 to 54) and considerably fewer members aged over 60 years.

3.3 SMSF investment by asset class

SMSF asset allocation has been fairly stable between June 2013 and June 2018, with a large proportion invested in shares and cash and term deposits (Chart 2). The two exceptions are LRBAs, which in dollar terms increased over four-fold between June 2013 and June 2018, from $8.8 billion to $38.9 billion, or from 1.9 to 5.2 per cent of total SMSF assets, and cash and term deposits, which decreased from 29.8 per cent to 23.2 per cent of assets. A LRBA asset refers to the value of that asset that is held in trust under the arrangement. A LRBA borrowing refers to the amount borrowed under the arrangement.

Chart 2: Composition of total SMSF assets

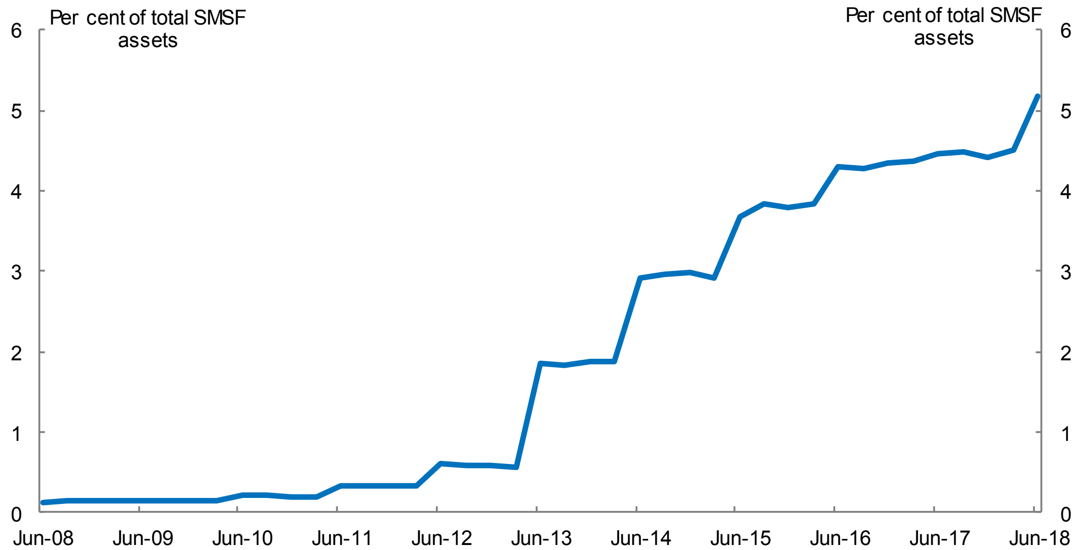


Source: Treasury; Self-managed super fund statistical report June 2018, Australian Taxation Office.
Note: Where possible, asset classes summed across domestic and international assets, and across listed and unlisted assets. June 2018 figures are calculated based on ATO projections from 2017 and asset prices over 2017-18.

The total estimated borrowings (including LRBAs) by SMSFs as at June 2018 is $22 billion, representing a small proportion (2.9 per cent) of the estimated $749.9 billion total SMSF assets. However, the total value of assets held under LRBAs is estimated to be 5.2 per cent of total SMSF assets, up from around 1.8 per cent in 2013 (Chart 3).

Although it is clear that there has been growth in the use of LRBAs by SMSFs since the final FSI report, ATO data cannot distinguish between growth in total value of LRBA assets resulting from an increased use of LRBAs and growth due to improved data collection as a result of changes made subsequent to the Government's response to the FSI. The growth in the value of assets under LRBAs is a combination of increasing property prices in Australia, increased use of LRBAs by SMSFs and improved data collection.

Chart 3:Total value of assets under LRBAs as a per cent of total SMSF assets



Source: Treasury; Self-managed super fund statistical report June 2018, Australian Taxation Office.

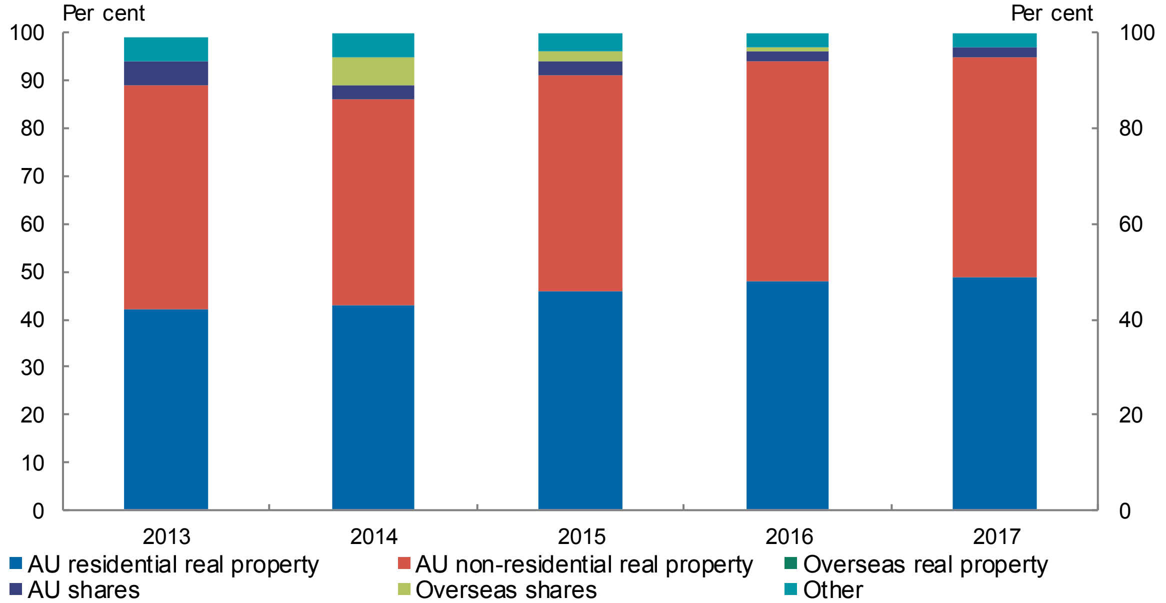
3.4 Asset allocation of SMSFs with LRBAs

A significant proportion of LRBAs are used to acquire real property assets. In terms of value, real property assets collectively made up around $31 billion of $38.9 billion worth of assets held under LRBAs in 2017.[1]

Over time, SMSFs have increased their investment in property assets. In 2017, approximately 49 per cent of SMSF assets held under LRBAs were residential properties (up from 42 per cent in 2013), a further 46 per cent were commercial properties (down from 47 per cent in 2013), and the remaining 5 per cent consisted of domestic equities, overseas equities, overseas property and other assets (down from 10 per cent in 2013) (Chart 4).[2]

A risk of the increase in property investment by SMSFs is that it could potentially exacerbate property price cycles by increasing demand. However, research undertaken by the RBA suggests that SMSFs make up a small share of the overall demand for housing.

Chart 4: Assets acquired under LRBAs by SMSFs with LRBAs



Source: Treasury; Self-managed super fund statistical report June 2018, Australian Taxation Office.

Using a LRBA to purchase property increases leverage in the SMSFs' portfolio. Leveraged property assets are estimated to have grown by around $14 billion between 2013 and 2017, driving an increase in SMSFs' overall property exposure. In 2017, around 64 per cent of those SMSFs with LRBAs had a loan-to-valuation ratio (LVR) of 50 per cent or above.

SMSFs, like APRA-regulated funds, can also gain exposure to real property assets through listed or unlisted property trusts or through direct ownership of commercial and/or residential property. SMSFs can purchase real property assets by using the cash in their portfolio or through a LRBA which allows part of the purchase price to be borrowed.

[1] Australian Taxation Office, data collected for this report. Includes residential, commercial and overseas property assets.

[2] Australian Taxation Office, self-managed superannuation fund annual return data, 2017.

3.5 Asset concentration

In 2017, around 95 per cent of SMSFs with LRBAs had a LRBA over a single asset class – real property.

Given the high purchase price of real property, this asset class often makes up a large proportion of a SMSFs portfolio – leading to a high level of asset concentration. From an investment perspective, concentration in a single asset class, particularly if it is coupled with a concentration in a single asset within that asset class, raises the investment risk for the SMSF.

Using a LRBA to acquire assets increases the risk further, including liquidity and credit risks. As borrowing can magnify losses as well as gains, allocating a large proportion of money to a single asset class or a single asset can endanger a member's retirement savings, and depending on the age of the member, there may be little opportunity to recoup losses.

Of SMSFs with LRBAs in 2017, 41 per cent had 90 per cent or more of their assets under a LRBA (Table 2).

Table 2: SMSFs with LRBAs, by LRBA concentration, 2013 to 2017

	100%	>=90%	>=80%	>=70%	>=60%	>=50%	Less than 50%
2013	1%	33%	49%	58%	66%	72%	28%
2014	1%	28%	42%	50%	55%	60%	40%
2015	1%	34%	52%	62%	69%	75%	25%
2016	2%	35%	55%	66%	73%	79%	21%
2017	2%	41%	62%	74%	81%	87%	13%

Source: Australian Taxation Office, unpublished data, 2018.

In 2017, for SMSFs with a net fund size between $200,000 and $500,000, assets under LRBAs represented, on average, 85 per cent of their total assets. In the event of a property market downturn, the concentrated nature of the SMSFs' portfolio could lead to a significant loss of value, leaving little savings for consumption in retirement. This is especially in the case of small, less diversified funds. If loan repayments cannot be met through rental income or through additional superannuation contributions made to the SMSF, smaller, less diversified funds could also be at risk of default since they are likely to have few liquid assets in their SMSF to draw on. The use of a personal guarantee can extend this loss to assets outside of superannuation.

3.6 Lenders used by SMSFs

The ATO conducted two surveys of SMSFs that reported using LRBAs in their SAR in 2015 and 2016 to provide insights into the use of LRBAs by SMSFs, including on the providers and terms of the loans, the extent of leverage and the use of personal guarantees. Inferences drawn from the survey data may not be fully representative of the population, given the small sample size and reliance on self-reporting.

Lending to SMSFs in respect of residential property represents approximately $11 billion (less than 1 per cent) of ADIs' overall mortgage lending as at June 2018.[3] In the 2016 survey data, 97 per cent of SMSF respondents reported borrowing from a financial institution, up from

[3] APRA unpublished data collection 2018.

89 per cent in 2015. Of 570 SMSF trustees using LRBAs surveyed by the ATO in 2015 and 2016 about 83 per cent reported using a bank for their loan.

Around 33 per cent of survey respondents had loans with interest-only repayments. However, in early 2017, APRA introduced a 30 per cent supervisory benchmark on ADIs' share of new interest-only lending and encouraged ADIs to limit interest-only, high LVR lending and other higher risk mortgage lending. This has resulted in a greater proportion of new lending on principal and interest repayments (which are naturally higher than an interest-only repayment), but this is not specific to SMSFs with LRBAs.

In addition to ADIs, SMSFs also borrow from non-ADI financial institutions and related parties.[4] Respondents to the survey also reported a decrease in borrowing from related parties to the fund, from 10.4 per cent in 2016, to 2.3 per cent in 2017. It is possible that this decrease may be partially attributable to the Safe Harbour Guidelines issued by the ATO in 2016, which allowed SMSFs to review and revise their LRBAs before 31 January 2017 to ensure they were on arm's length terms. However, the withdrawal of the major banks for SMSF lending, discussed below, is likely to lead to an increase in non-ADI lenders in the market.

Despite the intention of LRBAs to limit recourse by lenders to the asset subject to the loan, in practice personal guarantees are often used to provide additional security for the loan. The ATO added an additional label in the 2016-17 SAR to collect data on personal guarantees from all funds that reported using LRBAs. The ATO 2016-17 SAR data found that 30 per cent of respondents provided a personal guarantee or other security to the lender. Trustees who provided a personal guarantee were significantly more likely to have sought advice from a tax agent or mortgage broker.

If the leveraged asset does not produce sufficient returns to service the loan, borrowers can use other assets in their SMSF to service the loan and avoid losing their asset. In situations where a trustee has given a personal guarantee as collateral, they are more likely to want to service the loan to avoid being personally liable, making it more likely that they will draw on other assets in the SMSF. Moreover, where there is high asset concentration in the fund, particularly if the asset is illiquid, the trustee may be forced to make personal contributions to service the loan.

3.7 Financial advice

The decision to borrow is often one informed by financial advice. Respondents to the ATO LRBA 2017 survey reported that around 94 per cent sought financial advice prior to establishing a LRBA. Around 52 per cent of respondents reported that they sought advice from independent financial advisors and 35 per cent reported that they sought advice from a tax agent or accountant. Only 4.1 per cent reported that they sought advice from property sales advisors.

As recent reports have indicated, there is concern about the quality of financial advice provided to SMSFs, particularly the impact of this advice on SMSF investment in real property. ASIC undertook research in 2017 and released two reports in 2018 on the experiences of SMSF

[4] In 2016, related parties to the fund were the lender to 10.4 per cent of the SMSF trustees surveyed, and finance companies accounted for 2.8 per cent. In 2017, 4.9 per cent of lending was from finance companies and 3.4 per cent was from credit unions or building societies.

trustees and the quality of advice provided to individuals establishing an SMSF. ASIC found that investing in property was a motivating factor for a number of individuals who set up an SMSF, as they feared being 'locked out' of the property market. ASIC also found that advice received by SMSFs is regularly of poor quality, leading to substantial risks that individuals may suffer financial detriment and be significantly worse off in retirement. Key risks identified by ASIC included concentration of investment in a single asset class (usually property) and high overall level of gearing within the fund.

ASIC also raised specific concerns about the rise of property one-stop shops. These are businesses that present SMSFs and LRBAs as a bundled product, and recommend that individuals set up an SMSF in order to purchase a property. They often provide individuals with all necessary services to set up a LRBA through their SMSF, including mortgage brokers, lawyers, property management companies and developers. SMSFs are marketed as a way to 'break into the property market', secure high returns and invest in the property market, which is often considered as a 'safe bet'. The integration of services in one-stop shops means that advice provided is inherently prone to conflicts of interest. ASIC's report showed that one-stop shops often misrepresent the benefits and limitations of LRBAs to consumers.

ASIC concluded that the strategy of gearing through an SMSF to invest in property, which is being actively promoted by property one-stop shops, is high risk, and is often likely to result in financial detriment to SMSF members.

In its final report released on 4 February 2019, the Royal Commission specifically addressed the issue of inappropriate financial advice. It observed that the financial advice industry has had an incomplete transformation from an industry dedicated to the sale of financial products to a profession concerned with the provision of financial advice. The report described the Future of Financial Advice reforms as representing an important step towards professionalisation by requiring advisers to act in clients' best interests and to prioritise those interests over their own. The report also found that until something is done to address the conflicts that continue to characterise the financial advice industry that the industry will not be a profession. The Government has agreed to a number of recommendations from the Royal Commission to further improve financial advice.

4 Regulatory and market developments since the FSI

Summary

A number of regulatory changes since the FSI have changed the environment for borrowing by superannuation funds.

APRA has taken actions to strengthen ADI lending standards and imposed a temporary benchmark on lending to property investors. ASIC has increased its scrutiny of lender's compliance with responsible lending obligations. These measures collectively have helped to reduce the riskiness of new borrowing for ADIs.

The Government also announced two tax integrity measures relating to LRBAs and non-arm's length income and the ATO issued guidance on the safe harbour terms for LRBAs to be consistent with arm's length dealings.

Market conditions have also changed since the FSI. In mid-2018, most major banks announced that they were withdrawing from lending to SMSFs. However, SMSFs continue to borrow from a number of other financial institutions and related parties, which are subject to less regulation.

4.1 Regulation changes

Borrowing by SMSFs is regulated in three main ways: prudential regulation on lenders, consumer protection regulation on financial advisors and product providers, and taxation regulation on trustees.

Prudential regulation

Since the FSI, APRA has undertaken a number of activities with respect to mortgage lending by ADIs aimed at promoting sound residential mortgage lending practices. APRA's actions have focused on improving lending standards through the introduction of specific prudential guidance for ADIs. APRA also established two temporary benchmarks – one focused on investor lending growth (announced in late 2014 and removed in mid-2018) and the other on new interest-only lending (announced in early 2017). APRA's activities have resulted in improvements in risk characteristics of new residential mortgage lending, including a reduction in proportion of new housing loans that are high LVR loans, investor lending and interest-only lending.

For purposes of APRA's investor loan benchmark, loans to SMSFs were classified as investor loans). Any new SMSF interest-only loans would be separately captured within the interest-only benchmark. Both of these benchmarks however are not targeted specifically at SMSF lending. Outside of these benchmarks, APRA's prudential guidance *(Prudential Practice Guide APS 223 Residential Mortgage Lending)* includes specific expectations in relation to lending to SMSFs, due to the unique lending risks arising from the legal structure of the entity. Because of these risks, these loans also attract a higher capital requirement from APRA than other types of mortgage lending.

Regulation of financial advice

Many consumers decide to set-up a SMSF after seeking financial advice. Financial advice regarding SMSFs represents about one fifth of all revenue generated by the financial advice industry.[5] In recent years, there has been considerable legislative reform to address concerns about the quality of financial advice:

- The FOFA reforms, which commenced in 2012 and became mandatory from 1 July 2013, introduced requirements designed to improve the quality of financial advice and reduce conflicts of interest in the financial advice industry.
  - Relevantly this includes an obligation for advice providers providing personal financial advice to retail clients to act in the best interests of their client, provide appropriate advice, and place the client's interests ahead of their own when providing advice. The FOFA reforms also included a ban on most conflicted remuneration, including commissions and volume-based payments.

[5] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, p 103.

- The Australian Financial Services (AFS) licensing exemption applying to accountants was removed and, from 1 July 2016, all accountants who give advice to clients about acquiring or disposing of an interest in an SMSF must operate under an AFS licence.

- The financial advisers register was introduced on 31 March 2015, and provides key information on all individuals who have, since this date, provided personal advice to retail clients on relevant financial products.

- The *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017*, which commenced on 15 March 2017 and will come into effect between 1 January 2019 and 1 January 2024, seeks to increase the professional, ethical and education standards for financial advisers.

In response to the active promotion of SMSFs and LRBAs by property one-stop shops, ASIC and the ATO are increasingly focusing on this area, including through building and sharing data and intelligence and taking enforcement action against unscrupulous behaviour.

Taxation regulation

In 2017, the Government introduced a range of superannuation taxation reforms to improve the sustainability, fairness and integrity of the superannuation system. This included the introduction of the $1.6 million transfer balance cap, which limits the amount of superannuation that can be held tax-free in retirement, and the Total Superannuation Balance (TSB) cap, which among other things, places a limit on the ability to make non-concessional contributions or catch-up concessional contributions.

To address a concern that SMSFs may use borrowings to circumvent these caps, the Government announced that from 1 July 2018 a member's share of the outstanding balance of a LRBA will be included in their TSB. This means if their TSB exceeds $1.6 million, the member will not be able to make non-concessional contributions, and will not be able to make 'catch-up' concessional contributions if their TSB, including outstanding LRBA's, is above $500,000. This legislation is currently before Parliament.

Non-arm's length arrangements (NALI)

The ATO issued Practical Compliance Guideline 2016/52016, which sets out the 'Safe Harbour' terms which will be consistent with arms-length dealings. It provides that, where SMSF trustees have used a LRBA to acquire real property, the LRBA will be taken to be at arm's length if the terms of the borrowing are established and maintained according to a prescribed set of terms. Among other things, these terms include:

- RBA Indicator Lending Rates for banks providing standard variable home loans (and provisions for fixed interest rates);

- the maximum loan to market value ratio (LVR) for commercial and residential property (70 per cent); and

- requirements for the term of the loan not to exceed 15 years.

Furthermore, the Government has announced changes to provisions relating to non-arm's length arrangements. While the existing NALI rules ensure that non-arm's length income is captured, it does not extend to non-arm's length expenses. This means superannuation fund trustees can use non-arm's length arrangements to shift money into superannuation by charging lower expenses than an arms-length arrangement would involve. This may include a related party lending to the fund through a LRBA at a below market interest rate or selling an asset to the fund at a below market price. However, the legislation before Parliament will prevent trustees from using non-commercial expenses to inflate overall superannuation fund earnings.

4.2 Changes in market conditions

As noted above, a significant proportion of SMSFs reported using banks for their LRBAs. However, several major banks, including National Australia Bank (NAB), Commonwealth Bank of Australia, AMP, Westpac and its subsidiaries St George, Bank of Melbourne and Bank South Australia, have recently withdrawn from lending to superannuation funds.[6]

Banks have cited tighter regulations, the difficulty and reputational risks associated with enforcing debts against SMSFs, and an anticipated reduction in appetite from SMSFs due to the complexity and expense of setting up LRBAs. LRBA exposures attract a 100 per cent risk weighting for capital purposes (roughly three times more than standard residential mortgage loans), and are generally offered at significantly higher interest rates, reflecting the higher risks and costs in SMSF lending.

APRA has only recently begun collecting data on ADI lending to SMSFs. Preliminary data collected by APRA shows that the number of loans from ADIs to SMSFs originating every quarter has been falling since June quarter 2017, and while the time period covered is insufficient to establish a trend, this is expected to continue as major banks withdraw from lending to SMSFs. However, there is some evidence that non-ADI lenders are stepping in to fill the vacuum.

5 Policy Options

As noted above, LRBAs can represent a significant risk to some individuals' retirement income. A key area of concern is the use of LRBAs by low-balance SMSFs, which can be exposed to a number of risks. As the majority of LRBAs are used to purchase real property, a property market correction could pose a significant risk, in particular where a personal guarantee is involved. These risks can be exacerbated where the decision to enter into a LRBA is based on poor-quality advice, as recently demonstrated through the Royal Commission's hearings.

These risks can be addressed through a range of policy interventions, many of which could also address broader concerns with financial advice that may be considered following the Royal Commission's final report or stability risks if there is rapid growth in lending by non-ADIs.

Each of these options has benefits and limitations and target the risks in a variety of ways, leading to different implications for the superannuation system and its members.

No longer allowing limited recourse borrowing removes the risk that rising leverage in the superannuation system could have on financial stability. It will also mitigate risks to individual retirement savings. However, it will limit the investment choices available to SMSFs, and the ability to invest in particular assets. This change would not just restrict small or insufficiently

[6] NAB announced in July 2018 that it would no longer offer LRBAs for property, and will only lend to SMSFs for shares and managed funds. AMP and CBA announced shortly after that they would no longer lend to SMSFs. Westpac announced on 31 July 2018 that its SMSF investment property loan would be removed from sale, and its subsidiaries St George, Bank of Melbourne and Bank SA also withdrew from lending. ANZ have always had a very limited appetite for lending to SMSFs.

diversified funds, but would prevent all SMSFs from using LRBAs. Setting a maximum LVR or reducing concentration of assets would be a more targeted way of addressing the risk to individuals, but would introduce further complexity to the regulation of superannuation and may be difficult to implement.

5.1 No longer allowing limited recourse borrowing arrangements

Removing the exception for limited recourse borrowing would prohibit SMSFs from borrowing other than for the other exceptions in the SIS Act for short-term cash flow purposes. Removing the LRBA exception would require consideration of grandfathering rules so that existing funds with LRBAs were not placed in a detrimental position.

Removing LRBAs mitigates risks to individual retirement savings, including those raised by investing in assets as a result of poor and/or conflicted advice and high levels of asset concentration.

No longer allowing LRBAs would remove the risk rising leverage in the superannuation system may pose to financial stability, and limit the contagion impact from risks that may arise out of a leveraged superannuation sector. As noted by the FSI, the absence of leverage in superannuation was a key source of resilience for the financial system in the global financial crisis.

Removing LRBAs also reduces risks that may rise from leveraged property investment which can exacerbate property price cycles.

However, removing the exception for borrowing could have an adverse impact on some trustees who use LRBAs as part of a well-diversified broader investment or business strategy, and may limit their ability to invest in a particular property, such as trustees' own business real property. Borrowing to purchase an asset which can generate strong returns, for example a property with an established rental yield, allows a SMSF member to increase their self-sufficiency in retirement, provided they properly manage the concentration risks noted above and have sufficient savings to manage ongoing maintenance and any detrimental changes in property values, or the rental market in the future.

The regulator members of CFR and the ATO note that no longer allowing limited recourse borrowing will address a number of significant risks which could be detrimental to individuals' retirement incomes due to shifts in the property market, particularly for those with high levels of leverage and low diversification of assets.

5.2 Restricting related party borrowing

There is a concern that the withdrawal of major ADIs from the SMSF lending market could lead to an increase in non-ADI lending and related party arrangements to secure finance. Under this option, SMSFs would be restricted from engaging in related party loans. As evidenced in the recent case of *Aussiegolfa v Federal Court of Taxation,* elaborate structures are being developed to facilitate residential investment through superannuation funds. While recent reforms have sought to respond to integrity concerns about related party lending, their growth could be a threat to the integrity of the tax system.

This option however would not reduce many of the risks posed by property one-stop shops, lack of diversification of SMSFs and poor financial advice, or possible risks associated with using non-ADI lenders.

5.3 Broader reforms to the financial advice sector

As discussed earlier in the report, the Royal Commission's final report and recent work by ASIC has identified conflicts of interest in the financial advice industry resulting in poor consumer outcomes. In particular, issues have arisen with respect to 'one-stop shops' for SMSFs. The Productivity Commission also found that the quality of advice provided to some members – including those with SMSFs – is questionable, and not in the clients best interest.

Broader reforms to the financial advice sector as well as further reforms to lift the professional, education and ethical standards for financial advisers would go some way towards addressing the underlying issues highlighted in the Royal Commission and by ASIC.

The Government has announced as part of its response to the Royal Commission a number of reforms to address conflicts of interest and quality of financial advice. This includes:

- prohibiting the hawking of superannuation products;
- establish a new disciplinary system for financial advisers;
- ending grandfathering of conflicted remuneration from 1 January 2021; and
- to review the measures to improve the quality of advice in three years'

The Productivity Commission report has also recommended extending the product intervention powers and design and distribution obligations to SMSFs.

However, many people enter SMSFs, often in order to purchase property, without having received financial advice. One stop shops usually limit their spruiking to 'general advice', not 'personal advice', which means they do not have to consider the personal circumstances of the individual they are targeting. Reforms to the financial advice sector, including Financial Adviser Standards and Ethics Authority adviser education standards, are mostly related to personal advice and will not help protect these people from entering into LRBAs in inappropriate or risky circumstances based on general advice.

5.4 Reducing LRBA concentration in SMSFs

To reduce an individual fund's exposure, SMSFs with LRBAs could be limited to holding a LRBA over an asset that is no more than 50 per cent of their portfolio. SMSFs are currently required to have an investment strategy and a trustee must give effect to the composition of the fund's investment including the extent to which investments are diversified.

This would be a significant departure for superannuation regulation. Notwithstanding the SIS Act requirement on investment covenants (s.52(2)) that applies to all superannuation funds and *Superannuation Prudential Standard SPS 530 Investment Governance* that applies to the trustees of APRA-regulated funds, Australian law largely leaves decisions relating to the formulation and execution of fund investment strategy in the hands of the trustee. There are a few important exceptions to this rule, including restrictions on the level of in-house assets and the general prohibition on borrowing.

As with the policy option to impose maximum LVRs for SMSF lending, this measure would add significant administrative complexity, and would be difficult to implement as the ATO would need to assess every funds' asset holdings.

5.5 Introducing maximum loan-to-valuation ratios for SMSF lending

Introducing maximum LVRs for SMSF lending at low levels could help increase borrower resilience and lower bank losses during downturns.

ADI lending practices have traditionally required a more conservative LVR for SMSF lending, ranging between 60-75 per cent, compared with other forms of lending. This measure would set the maximum LVR to 50 per cent through prudential lending benchmarks, providing protection against serviceability issues during economic downturns

However, as discussed earlier, there is some evidence non-ADI lenders are stepping in to fill the vacuum in the SMSF lending market created by the exit of major ADIs. The current regulatory framework allows APRA to make lending rules for non-ADI lenders where their activities are judged to pose a material risk to financial stability. Given that SMSF lending is not currently significant enough to trigger traditional financial stability concerns, such an action would require a much broader interpretation of 'financial stability' to include, for example, the potential for widespread consumer detriment.

5.6 Banning the use of personal guarantees

Banks often require SMSF trustees to provide personal guarantees as collateral for lending purposes. The use of personal guarantees to acquire a LRBA however circumvents the 'limited recourse' nature of a LRBA, and can put other individual assets (including those outside the SMSF portfolio) at risk. Personal guarantees given by SMSF trustees also enable SMSFs to undertake larger borrowings with higher LVRs.

This option would remove the ability of superannuation trustees to provide personal guarantees, limiting the extent of potential individual losses. Banning the use of personal guarantees is likely to discourage banks from lending to SMSFs more generally.

6 Conclusion

To address the Government's concern that there was insufficient data to consider a policy change with respect to LRBAs, the ATO improved data collection on leverage and risk of LRBAs reported by SMSFs through improvements to the SMSF annual return.

This data shows that the number of funds using LRBAs and the value of assets leveraged under this type of arrangement continues to grow. Data shows that 8.9 per cent of all SMSFs now have an LRBA, holding 5.2 per cent (over $38 billion) of the total of SMSF assets. Given this magnitude, LRBAs are unlikely to pose systemic risk to the financial system at this time.

However of concern is the prevalence of property as the main asset purchased under an LRBA, most commonly by low balance SMSFs (those under $500,000) who have little investment diversification and high LVRs making these funds particularly susceptible to shifts in the property market.

APRA regulatory changes since the FSI have also influenced the environment. The subsequent withdrawal of most major banks from SMSF lending is likely to change market conditions further, including through increased lending by non-ADI lenders and related parties. This sector does not have the same prudential scrutiny as larger ADIs. This further adds to concern around highly leveraged low diversified funds.

Evidence presented to the Royal Commission, along with ASIC findings (*Report 575: SMSF: Improving the quality of advice and member experiences*) into the rise of 'SMSF one stop shops' have raised concerns with the number of funds that have entered into a LRBA on the basis of poor and/or conflicted advice.

The regulators agree that the presence of leverage in SMSFs through LRBAs has significant implications for the security of individuals' retirement savings. Other than the regulators' preferred option of removing the exception to allow SMSFs access to LRBAs, some potential policy interventions could address these concerns. These range from truly limiting the recourse of the lender over the asset by prohibiting the use of personal guarantees, to reducing high leverage and concentration risk within the fund by creating prudential responsibilities for the regulator.

Where the regulators' preferred option to remove the exception to allow LRBAs is not accepted, further monitoring to track the future growth of leverage and identified risks within the SMSF environment is recommended, which the Productivity Commission also recommended. A further report to Government in three years would provide further analysis of the ATO's enhanced SAR data collection and the impact of major banks' withdrawing from lending to SMSFs.

Treasury's view is that any policy options outlined in this report should be considered in the context of the Government's response to the final reports of the Royal Commission and the Productivity Commission.

APPRENDIX A – Timeline

Date	Details
1987	Regulation 16(1)(b) of the *Occupational Superannuation Standards Regulations 1987* prohibits borrowing in superannuation.
30 Nov 1993	**Section 67 of the SIS Act prohibits superannuation funds from borrowing money**, with certain exceptions to address short term cash flow needs.
24 Sep 2007	**LRBA exception legislated** Schedule 3 of the *Tax Laws Amendment (2007 Measures No.4) Act 2007* inserted an exception to the borrowing restrictions to allow investments of a limited recourse nature over any asset a fund would be permitted to invest in directly.
7 Dec 2014	**Financial System Inquiry 2014 Final Report released** In the final report, the FSI recommended removing '…*the exception to the general prohibition on direct borrowings for limited recourse borrowing arrangements by superannuation funds*' - *Recommendation 8: Direct borrowing by superannuation funds*
20 Oct 2015	**Government response to the Financial System Inquiry** In response to the FSI's recommendation, the Government stated that: • they do not agree with the recommendation to prohibit LRBAs; • there is insufficient data to justify this policy change • they will commission the Council of Financial Regulators and the ATO to monitor leverage and risk in the superannuation system and report back in 2018 (allowing time for the ATOs improved data collection on LRBAs).
9 May 2017	**The Government Budget announces two integrity measures for LRBAs and non-arm's length income:** • LRBAs entered into after 30 June 2017 will be treated differently. • Outstanding balance of a relevant LRBA will be included in a member's Total Superannuation Balance. • Repayments of a relevant LRBA from a member's accumulation account that result in an increase in the value of a retirement phase account will become credits for Transfer Balance Account purposes. • From 1 July 2018, non-arm's length income provisions that apply to superannuation fund earnings will be amended to consider expenses associated with a transaction.

APPENDIX B – Summary of ATO data on LRBAs

In preparation for the CFR and ATO report to Government on LRBAs, the ATO compiled a report on the use of LRBAs by SMSFs. This report mostly uses data from self-managed superannuation fund annual reports (SAR). Other data sources used are:

- SMSF registrations
- Auditor contravention reports (ACRs) lodged by SMSF auditors
- ATO's June 2018 SMSF Quarterly Statistical Report (currently unpublished at the time of writing this report)

This report uses data from 2012-13 through to 2016-17. The 2016-17 SAR data is based on all SAR lodgements received to 17 July 2018, accounting for 82 per cent of lodgements received to this date.

A Data collection methodology

- To address the Government's concern that there was insufficient data to consider a policy change in respect of LRBAs, the ATO modified the SMSF annual return (SAR) from the 2016-17 income year to gather additional data on leverage and risk of LRBAs reported by SMSFs. This enhanced data collection aims to inform Government and support future policy decisions.

- The 2016-17 reporting year is the first year in which this data could be collected due to the time necessary to update the SAR and associated ATO systems. Therefore to supplement the data collected in the 2016-17 SAR the ATO also conducted two surveys to gather similar insights on SMSFs that reported LRBAs in their 2015 and 2016 SARs.

- Prior to the modifications made, the SAR only captured a SMSFs total borrowing (under all the relevant exceptions) at one label. Therefore new labels were included in the SAR to capture additional data on the types of borrowings by SMSFs including LRBA borrowings, the funding source of LRBAs, and the use of personal guarantees or other security for LRBAs by SMSFs.

- In the 'liabilities' section of the SAR, three sub-labels were added to the borrowings label to specifically collect data on borrowings related to LRBAs, and facilitate the calculation of the leverage ratio of assets under LRBAs.

- To understand the level of risk taken on by SMSFs with LRBAs, the 'assets' section of the SAR was amended to include two new questions. The first question identifies whether the LRBA borrowings were from a licensed financial institution, and the second identifies whether the member or related parties of the SMSF used a personal guarantee or other security for the LRBA.

- The enhanced data collection via new and expanded SAR labels commenced from the 2016-17 SAR. Trustees were required to lodge the 2016-17 SAR by 2 July 2018.

B Number and value of assets under LRBAs

Estimated current statistics

The total estimated borrowings (including LRBAs) by SMSFs as at 30 June 2018 is $22 billion, representing a small proportion (2.9 per cent) of the estimated $749.9 billion total SMSF assets as at 30 June 2018.[7]

- However, the value of the assets held under LRBAs is estimated to be 5.2 per cent of total SMSF assets. This is because the asset value includes the borrowing as well as the equity (Table 1).

Table 1: Estimates of 'total SMSF LRBA assets' and 'total SMSF assets'

June Quarter	LRBA assets ($billion)	Total SMSF Assets ($billion)	LRBA assets as % of Total SMSF assets
2014	15.6	533.2	2.9%
2015	21.4	582.4	3.7%
2016	26.9	618.4	4.3%
2017	37.2	704.6	5.3%
2018	38.9*	749.9*	5.2%*

Source: ATO, June 2018 SMSF Statistical report. The 2018 figures are estimates extrapolated from data of SMSF annual return lodgements for the 2017 year.

Number of SMSFs with LRBAs

- In 2016-2017, based on SAR data received to 17 July 2018, 8.9 per cent (or 42,102) of all SMSFs reported holding assets under a LRBA. This shows a 1.7 per cent increase from the SMSF LRBA population in 2016 (7.2 per cent) (Table 2).
- Label changes made to the 2017 SMSF annual is a contributor to the increase in the number of funds reporting LRBAs in 2017.
- Over the five year period there has been annual growth in the value of LRBA assets with the largest increase from 2013 to 2014 of 75 per cent. More recent annual increases of have been 35 per cent or less.

Table 2: SMSF LRBA population, 2013 to 2017

	2013	2014	2015	2016	2017
No. SMSFs with LRBAs	13,929	28,501	31,918	36,397	42,102
% of SMSF population	2.9%	5.7%	6.3%	7.2%	8.9%
Asset values ($m)					
LRBA assets ($m)	$8,560	$14,968	$20,226	$24,119	$32,360
Total SMSF assets ($m)	$15,151	$35,222	$35,835	$39,677	$47,504

[7] In its SMSF quarterly statistical report, the ATO uses SAR data to estimate figures, using indices to simulate growth between June quarters.

Percentage change from previous year					
No. SMSFs with LRBAs		105%	12%	14%	16%
LRBA assets ($m)		75%	35%	19%	34%
Total SMSF assets ($m)		132%	2%	11%	20%
SMSF annual return lodgements per year *					
% of Lodgements	96%	95%	93%	89%	82%

* 2013 to 2016 lodgements as at 30 June 2018; 2017 lodgements as at 17 July 2018.
Source: ATO unpublished data

- The average value of assets held under LRBAs has increased from $614,600 in 2013 to $731,000 $768,600 in 2017. The median LRBA asset was $402,500 and $486,800 in these years respectively. This suggests that in addition to more SMSF investing via LRBAs over the period, the value of LRBA assets also increased.

Table 3: Average and median LRBA asset value, 2013 to 2017

LRBA asset value	2013	2014	2015	2016	2017
Average LRBA asset value	$614,561	$525,156	$633,693	$664,874	768,600
Median LRBA asset value	$402,517	$360,000	$424,505	$441,402	$486,800

C Value of LRBA assets

- Over the five years to 2017, the majority of the SMSF LRBA population held LRBA assets worth $200,000 to $1 million. The proportion of the SMSF LRBA population with LRBA assets valued within these ranges increased from 67% in 2013 to 80% in 2017.
- The proportion of the SMSF LRBA population with LRBA assets valued from $1 to $200,000 has continually declined from 31% in 2014 to 6% in 2017.
- The average value of LRBA assets increased from approximately $614,600 in 2013 to $769,000 in 2017. The median value of LRBA assets was $402,500 in 2013 and $487,000 in 2017.

Table 4: SMSF LRBA population by value of LRBA assets, 2013 to 2017

LRBA asset range	2013	2014	2015	2016	2017
$1–$50k	10%	18%	9%	7%	1%
>$50k–$100k	4%	6%	3%	3%	1%
>$100k–$200k	7%	7%	6%	5%	4%
>$200k–$500k	42%	37%	44%	44%	47%
>$500k–$1m	25%	21%	26%	28%	33%
>$1m–$2m	8%	7%	8%	9%	10%
>$2m–$5m	3%	2%	3%	3%	3%
LRBA asset range	**2013**	**2014**	**2015**	**2016**	**2017**
>$5m–$10m	1%	..	1%	1%	1%
>$10m	..	..	..	..	..
Total	100%	100%	100%	100%	100%

“..” denotes a value that is greater than zero.

- The number of SMSFs that hold LRBA assets greater than $1 million has grown from 1,636 SMSF in 2013 to 6,414 in 2017. As a proportion this remains unchanged, at approximately 12% of the SMSF LRBA population.

- The value of the largest LRBA assets also continued to grow, from $69 million in 2013 to $180 million in 2017 (Table 5).

Table 5: SMSFs investing greater than $1 million in LRBA assets (sensitive data), 2013 to 2017

Year	No. of SMSFs invested greater than $1m in LRBAs	Largest LRBA investment ($m)
2013	1,636	$69
2014	2,784	$80
2015	3,911	$95
2016	4,727	$98
2017	6,414	$180

D Types of assets under LRBAs

- The most popular LRBA asset is real property. In 2016-17, LRBAs were used to acquire Australian real property by 95 per cent of the SMSF LRBA population. 67 per cent of LRBAs were over residential property, and 28 per cent were over commercial property.

Table 6: SMSF LRBA population and SMSFs commencing LRBAs, by asset type, 2013 to 2017

LRBA asset type	2013	2014	2015	2016	2017
SMSF LRBA population by asset type*					
Australian residential property	52%	45%	58%	61%	67%
Australian non-residential property	28%	21%	26%	26%	28%
Overseas property	..	..	..	..	..
Australian shares	12%	6%	6%	6%	4%
Overseas shares	..	24%	7%	5%	..
Other	10%	5%	5%	4%	3%
SMSFs commencing LRBAs by asset type					
Australian residential property	55%	39%	58%	58%	67%
Australian non-residential property	30%	17%	24%	24%	29%
Overseas property	1%	1%	..	..	..
Australian shares	9%	4%	6%	6%	2%
Overseas shares	..	38%	9%	9%	..
Other	8%	4%	5%	4%	3%

* Note: the totals of the table do not add up to 100% as some SMSFs acquired multiple types of LRBA assets indicating multiple LRBAs within the one SMSF. ".." denotes a value that is greater than zero.

   – The value of property assets held under LRBAs is fairly evenly split between residential and commercial properties: in 2016-17, the value of total residential property held under LRBAs was $15.896 billion while the value of non-residential property was $15.047 billion.

- Residential property is favoured by SMSFs in accumulation phase, whereas non-residential property is favoured by SMSFs with members in the retirement phase.
- Residential property is favoured by SMSFs with fund sizes between $200,001 and $2 million, whereas non-residential property is favoured by funds with over $2 million.

• Approximately 9% of the SMSF LRBA population acquired listed shares (Australian and/or overseas). This proportion accounts for 3% of the total value of LRBA assets, and both mean and median amounts were among the smallest of the asset sub-types.

• In 2017, 67% of SMSFs that established a LRBA for the first time invested in Australian residential property. This is the same proportion as the SMSF LRBA population.

Table 7: Total LRBA asset value, by asset type, 2013 to 2017

LRBA asset type	2013	2014	2015	2016	2017
Total value of LRBA assets by type ($ m)					
Australian residential property	$3,630	$6,408	$9,392	$11,605	$15,896
Australian non-residential property	$4,030	$6,492	$9,008	$10,983	$15,047
Overseas property	$26	$39	$47	$49	$33
Australian shares	$391	$514	$593	$521	$502
Overseas shares	$13	$838	$345	$218	$14
Other	$470	$677	$841	$823	$868
Total	$8,560	$14,968	$20,226	$24,119	$32,360
LRBA assets by type (as % of total LRBA assets)					
Australian residential property	42%	43%	46%	48%	49%
Australian non-residential property	47%	43%	45%	46%	46%
Overseas property	..	..	..	..	..
Australian shares	5%	3%	3%	2%	2%
LRBA asset type	**2013**	**2014**	**2015**	**2016**	**2017**
Overseas shares	..	6%	2%	1%	..
Other	5%	5%	4%	3%	3%
Total	100%	100%	100%	100%	100%

".." denotes a value that is greater than zero.

- From 2015 the total value of residential real properties overtook non-residential real properties. The increasing trend continued in 2017 with residential real properties remaining the most popular asset to be acquired under a LRBA (61 per cent of SMSF LRBA population) and the highest proportion of the value of LRBAs assets (49 per cent).

- In 2017, although the proportion of the value of LRBA assets held in non-residential real properties is marginally lower (46 per cent) than residential real properties

(49 per cent), the median value of these non-residential property assets tend to be higher which is in keeping with the value of residential vs non-residential property generally. The median asset value for non-residential properties is $692,000 as compared to $451,500 for residential real properties.

Single vs multiple asset types acquired under LRBAs

This section provides insight into the number of the SMSF LRBA population that report different types of LRBA assets.

It should be noted the ATO's data collection via the SAR cannot identify where LRBAs are used to acquire multiple assets of the same type. For example the data from the SAR cannot identify that the SMSF has two LRBAs in respect of two different residential properties. The data can only identify SMSFs that report different LRBA asset types held under LRBAs. See Appendix 2: Data collection. However, since the regulatory rules requires that a LRBA be over a single acquirable asset, meaning a single property or a single class of shares, the incidence of multiple LRBA assets is indicative of multiple LRBAs by one SMSF.

- In 2017, 98 per cent of the SMSF LRBA population reported one type of asset. This is consistent with the trend over the 5 year period, with only 3 per cent or less of the SMSF LRBA population reporting different types of assets under LRBAs.

Table 8: Proportion of SMSFs reporting one or more LRBA assets by type, 2013 to 2017

Number of LRBA asset types	2013	2014	2015	2016	2017
1	97%	97%	97%	97%	98%
2	3%	3%	3%	3%	2%
3 to 6	..	..	..	..	..

".." denotes a value that is greater than zero.

The ATO's SMSF LRBA and borrowings survey on the 2016 SMSF LRBA population provided some insight into the acquisition of single or multiple assets under these arrangements regardless of type of asset. The survey findings showed:

- Of 259 SMSF respondents, 15.83% held multiple LRBAs and 84.17% held a single LRBA as at 30 June 2016.

- SMSFs with multiple LRBAs, rather than a single LRBA, were significantly less likely to have an Australian residential real property (65.9% vs 80.3%).

LRBA asset types by phase

- In 2017, for the SMSF LRBA population, regardless of phase, Australian real property accounts for a substantial component of LRBA assets held. This proportion is slightly higher for SMSFs in accumulation phase (97 per cent of all SMSFs with a LRBA in accumulation phase) compared with SMSFs in full or partial pension phase (92 per cent of all SMSF with a LRBA in pension phase).

- For the SMSF LRBA population that is either in full or partial pension phase, the majority of the value of total LRBA assets is attributable to Australian non-residential real property (72 per cent and 65 per cent respectively).

- For the SMSF LRBA population in accumulation phase, the majority of the value of total LRBA assets is attributable to Australian residential real property assets (58 per cent) though these SMSFs still hold a significant proportion on non-residential real property (39 per cent).

Table 9: LRBA asset type as a proportion of total value of LRBA assets by phase, 2017

LRBA asset type	Payment phase		
	Full pension	Partial pension	Accumulation
Australian residential real property	19%	28%	58%
Australian non-residential real property	72%	65%	39%
Overseas real property*	..	..	..
Australian shares	3%	2%	1%
Overseas shares*	..	..	..
Other	6%	6%	2%
Total	100%	100%	100%

* ".." indicates the proportion that has been rounded to zero, but is not equal to zero.

LRBA asset type, by fund size

- The table below shows the top LRBA asset held by the SMSF LRBA population by fund size. As expected, it reflected the general market value of the asset types held, given that the LRBA asset is for most of the SMSF LRBA population, their primary asset.
- The top LRBA asset by value for SMSFs with fund sizes between $200,001 and $2 million was Australian real property while the top LRBA asset by value for SMSFs with fund sizes of $200,000 or less was Australian shares.
- The top LRBA asset by value for SMSFs with fund sizes greater than $2 million was Australian non-residential real property. This is likely reflective of the fact that non-residential property has a higher market value which is more accessible as an investment by SMSF with a greater fund size.

Table 10: Type of LRBA asset acquired by SMSFs with LRBAs by fund size, 2017

Fund size range	Top LRBA asset held (by value) 2017	Proportion of SMSFs in the range with this asset
$1–$50k	AU shares	67%
>$50k–$100k	AU shares	70%
>$100k–$200k	AU shares	57%
>$200k–$500k	AU residential real property	77%
>$500k–$1m	AU residential real property	74%
>$1m–$2m	AU residential real property	55%
>$2m–$5m	AU non-residential real property	61%
>$5m–$10m	AU non-residential real property	75%
>$10m	AU non-residential real property	75%

LRBA asset types, by age of SMSF members

Due to LRBA assets being reported at the fund level, there are limitations to our analysis on the types of assets acquired by the age of SMSF fund members. The below table distributes the SMSF LRBA population by the age of their oldest member in the SAR year.

Table 11: Proportion of SMSFs with LRBA by age of oldest member, 2013 to 2017

Age range	2013	2014	2015	2016	2017
<25	..	..	..	..	..
25-34	1%	1%	2%	1%	1%
35-44	17%	15%	17%	17%	17%
45-49	17%	15%	17%	18%	19%
50-54	24%	20%	22%	21%	22%
55-59	20%	19%	20%	20%	22%
60-64	12%	13%	11%	11%	11%
65-69	6%	9%	7%	6%	2%
70-74	3%	5%	3%	3%	1%
75-84	1%	3%	2%	2%	..
85+	..	..	..	..	..

*“..” indicates the proportion that has been rounded to zero, but is not equal to zero.

The table below shows the types of LRBA assets acquired by SMSFs, distributed by their oldest member in the 2017 SAR. The information intends to provide insight into any differences in the types of assets being acquired under LRBAs by SMSFs with members across different age ranges.

- In 2017, the age of members did not show any large difference in preference of assets acquired through LRBAs.

Table 12: Proportion of the SMSF LRBA population by asset type and age of oldest member^, 2017

Age range	Australian residential real property	Australian non-residential real property	Overseas property	Australian shares	Overseas shares	Other assets
<25	86%	14%	0%	0%	0%	0%
25-34	60%	29%	..	7%	0%	4%
35-44*	69%	26%	..	4%	..	3%
45-49*	69%	27%	..	4%	..	3%
50-54*	70%	27%	..	3%	..	2%
55-59*	70%	26%	..	3%	..	3%
60-64*	63%	32%	..	4%	..	3%
65-69*	51%	42%	..	5%	..	5%
70-74*	34%	57%	0%	7%	1%	6%

75-84	28%	60%	..	6%	1%	7%
85+	41%	41%	0%	6%	0%	12%
Unknown	74%	26%	0%	0%	0%	2%
All*	67%	28%	..%	4%	..%	3%

^ All is over 100% due to the small proportion of funds that hold LRBAs in more than one asset type.“..” denotes a value that is greater than zero.

E Fund size of SMSFs with LRBAs

Gross fund size

- Gross fund size includes the full value of the asset under the LRBA, regardless of what percentage of its value is owned outright by the SMSF.

Table 13: SMSF LRBA population average and median gross fund size, 2013 to 2017

Fund size	2013	2014	2015	2016	2017
Average fund size	$1,087,714	$1,235,811	$1,122,706	$1,090,111	$1,128,300
Median fund size	$ 584,431	$ 634,049	$ 610,589	$ 610,255	$634,619

- The majority of the SMSF LRBA population had a gross fund size between $200,001 and $1 million. The proportion of the SMSF LRBA population within this range has been increasing from 67 per cent in 2013 to 73 per cent in 2017. The majority of this increase was within the $500,001 to $1 million range.
- There has been a continued decline in the proportion of the SMSF LRBA population that had a gross fund size of $1 to $200,000, from 6 per cent in 2013 to 1 per cent in 2017.
- The proportion of the SMSF LRBA population from 2013 to 2017 that had a gross fund size greater than $2 million is around 10 per cent, with the exception of 2014 where it was 14 per cent.

Table 14: SMSF LRBA population by gross fund size, 2013 to 2017

Fund size	2013	2014	2015	2016	2017
$1–$50k	..	1%	..	..	..
>$50k–$100k	1%	1%	1%	1%	..
>$100k–$200k	5%	4%	4%	3%	1%
>$200k–$500k	35%	31%	33%	33%	32%
>$500k–$1m	32%	32%	35%	37%	41%
>$1m–$2m	16%	17%	16%	16%	17%
>$2m–$5m	8%	10%	8%	7%	7%
>$5m–$10m	2%	3%	2%	2%	2%
>$10m	1%	1%	1%	1%	1%
Total	100%	100%	100%	100%	100%

“..” denotes a value that is greater than zero.

Net fund size

- Net fund size means the gross value of all assets held in the SMSF less any borrowings.8

Table 15: SMSF LRBA population by net fund size, 2013 to 2017

Net fund size*^	2013	2014	2015	2016	2017
$1–$50k	1%	1%	1%	1%	1%
>$50k–$100k	5%	5%	4%	3%	2%
>$100k–$200k	23%	24%	24%	23%	20%
>$200k–$500k	39%	40%	41%	42%	44%
>$500k–$1m	17%	16%	16%	17%	18%
Net fund size*^	**2013**	**2014**	**2015**	**2016**	**2017**
>$1m–$2m	9%	8%	8%	8%	9%
>$2m–$5m	5%	4%	4%	4%	4%
>$5m–$10m	1%	1%	1%	1%	1%
>$10m	..	..	..	..	1%
Total	100%	100%	100%	100%	100%

* For 2013 to 2016 net fund size has been calculated as total assets minus total borrowings, and for 2017 total assets minus borrowings from LRBAs
^ For 2013 to 2016, only includes SMSFs which reported a value at total borrowings
“..” denotes a value that is greater than zero.

- There was a higher proportion of SMSFs in the lower net fund size ranges of $1 to $500,000 compared to SMSFs by fund size in those ranges.
- The most prevalent fund size in the SMSF LRBA population was the $500,000 to $1 million (41 per cent) range whereas the most prevalent net fund size was the $200,000 to $500,000 (44 per cent) range.
- The proportion of the SMSF LRBA population that had net fund sizes of $1 to $200,000 has decreased from 29 per cent in 2013 to 23 per cent in 2017.

F Demographics of SMSFs with LRBAs

Phases of members

- The majority of the SMSF LRBA population were in accumulation phase, ranging from 83 per cent in 2013 to 90 per cent in 2017. A small proportion of the SMSF LRBA population were in full pension phase (meaning all assets in the fund are supporting pension liabilities to members) with around 10 per cent in 2013 and 5 per cent in 2017.
- The proportion of the SMSF LRBA population in accumulation phase differs considerably from the demographics of total SMSFs population (90 per cent and 53 per cent respectively).
- There were only a handful of members in each year who were in receipt of the age pension.

[8] Due to changes in labelling, for 2013 to 2016 net fund size has been calculated as total assets minus total borrowings, and for 2017 total assets minus borrowings from LRBAs.

Table 16: SMSF LRBA population and SMSF population by phase, 2013 to 2017

Phase	2013	2014	2015	2016	2017	Total SMSF population*
Full pension	10%	17%	11%	9%	5%	36%
Partial pension	7%	8%	6%	7%	5%	11%
Accumulation	83%	75%	83%	84%	90%	53%
Total	100%	100%	100%	100%	100%	100%

*SMSF population as at 30 June 2016, *SMSF statistical overview 2015-16*

Number of members in SMSF

- In 2017, the majority of the SMSF LRBA population had 2 or more members (86 per cent) with the remaining 14 per cent being single member SMSFs. This is consistent with demographics of the total SMSF population.

Table 17: SMSF LRBA population by number of members, 2013 to 2017

Number of members	2013	2014	2015	2016	2017	Total SMSF population*
1	15%	16%	15%	15%	14%	22.9%
2	76%	75%	76%	77%	78%	69.8%
3	4%	4%	3%	3%	3%	3.6%
4	6%	5%	5%	5%	5%	3.7%
Total	100%	100%	100%	100%	100%	100%

*SMSF population as at 30 June 2017, June 2018 *SMSF statistical report*

Contributions

- Total contributions to the SMSF LRBA population over the five years grew significantly by 242 per cent, approximately 163 per cent higher than the growth of total contributions to the SMSF population (79 per cent) over the same period.

- The value of both member and employer contributions received by the SMSF LRBA population grew significantly over the period, reaching $1,473 million (member) and $842 million (employer) respectively in 2017.

- In 2017, member contributions into the SMSF LRBA population made up 64 per cent of their total contributions; this is consistent with the trend of the SMSF population where member contributions represent the majority of all SMSF contributions (83 per cent in 2016).

Table 18: Contributions received by SMSF LRBA population^, 2013 to 2017

Contribution type	2013	2014	2015	2016	2017
Total SMSF contributions ($m)					
Member	$427	$998	$1,104	$1,114	$1,473
Employer	$250	$467	$610	$702	$842
Average SMSF contributions ($m)*					
Member	$62,934	$77,922	$80,617	$75,911	$88,610
Employer	$22,915	$23,162	$25,450	$25,415	$25,443

Median SMSF contributions ($m)*					
Member	$11,987	$19,336	$14,262	$12,438	$12,753
Employer	$18,947	$19,102	$19,214	$19,200	$19,362

^ Calculated at the SMSF level, for contributions received by all members.
*Calculated only on SMSFs that reported a value greater than 0.

- In 2017, inwards rollovers to the SMSF LRBA population totalled $1,114 million and outward rollovers totalled $186 million. The total value of rollovers in and out of the SMSF LRBA population have grown significantly over the period, by 81% and 288% respectively however, these values have been relatively stable since 2014.
- In 2017 the median value of inward rollovers to the SMSF LRBA population was $33,166, a decrease of 67% from $100,000 in 2013 and 2014. The median value of outward rollovers has remained relatively stable over the period at approximately $20,000.

Rollovers in and out

Table 19: Rollovers in and out by SMSF LRBA population^, 2013 to 2017

Rollover type	2013	2014	2015	2016	2017
Total SMSF rollovers ($m)					
Inward	$616	$1,168	$1,141	$994	$1,114
Outward	$48	$137	$132	$132	$186
Average SMSF rollovers ($m)*					
Inward	$144,470	$165,364	$147,823	$125,672	$127,773
Outward	$158,319	$216,520	$187,622	$150,877	$181,046
Median SMSF rollovers ($m)*					
Inward	$100,000	$100,000	$71,049	$43,967	$33,166
Outward	$21,250	$21,250	$20,400	$20,000	$17,000

^ Calculated at the SMSF level, for rollovers in and out by all members. *Calculated only on SMSFs that reported a value greater than 0.

Member age ranges

Table 20: Members of SMSF LRBA population by age range, 2013 to 2017

Age range	2013	2014	2015	2016	2017	Total SMSF population*
<25	2%	1%	1%	1%	1%	1%
25-34	5%	5%	5%	4%	4%	4%
35-44	22%	20%	23%	22%	23%	12%
45-49	18%	16%	18%	19%	20%	11%
50-54	21%	19%	20%	20%	21%	12%
55-59	16%	16%	16%	17%	18%	14%
60-64	9%	10%	9%	9%	8%	14%
65-69	5%	7%	5%	4%	3%	14%
70-74	2%	3%	2%	2%	1%	11%
75-84	1%	2%	1%	1%	..	8%
85+	..	..	..	..	..	1%

*SMSF population as at 30 June 2017, *SMSF statistical overview 2015-16.* ".." denotes a value that is greater than zero.

Member closing account balances

- There were a larger proportion of members of the SMSF LRBA population with account balances of between $1 and $200,000 (57% as compared to 32% of the SMSF population).
- The average and median closing account balance of members of the SMSF LRBA population is lower than that of members of the SMSF population.

Table 21: Members of SMSFs with LRBA by closing account balance ranges, 2013-2017

Closing account balance range	2013	2014	2015	2016	2017	Total SMSF population*
>$0–$50k	16%	15%	15%	14%	12%	7%
>$50k–$100k	18%	16%	18%	17%	17%	9%
>$100k–$200k	24%	22%	26%	27%	28%	16%
>$200k–$500k	23%	23%	24%	25%	27%	32%
>$500k–$1m	10%	12%	10%	10%	9%	20%
>$1m–$2m	5%	7%	5%	5%	4%	11%
>$2m–$5m	2%	4%	2%	2%	2%	4%
>$5m–$10m	..	1%	..	..	..	1%
>$10m	..	..	..	..	..	..
Total	100%	100%	100%	100%	100%	100%

*SMSF population as at 30 June 2016, *SMSF statistical overview 2015-16,* Table 14".." denotes a value that is greater than zero.

Table 22: Average and median closing member balance of SMSF LRBA population, 2013 to 2017

Closing balance range	2013	2014	2015	2016	2017	Total SMSF population*
Average member balance	$376,396	$488,530	$392,361	$376,427	$375,199	$605,903
Median member balance	$154,909	$180,838	$160,257	$164,367	$169,597	$298,479

*SMSF population as at 30 June 2016, *SMSF statistical overview 2015-16*, Table 11

Member taxable incomes

- The taxable income of members of the SMSF LRBA population tended to have higher average and median taxable incomes than the SMSF population. This is reflective of the fact that 90% of the SMSF LRBA population are in accumulation phase and have members who are likely to still be working. Conversely, the SMSF population is 47% in pension phase, which may explain the lower taxable incomes.
- In 2017, majority of members of the SMSF LRBA population (58%) had taxable incomes within the $40,001 to $150,000 ranges.

Table 23: Members of SMSF LRBA population by taxable income range, 2013 to 2017

Taxable income range	2013	2014	2015	2016	2017	Total SMSF population*
$0-$20k	9%	11%	9%	8%	7%	22%
>$20k-$40k	14%	15%	14%	14%	13%	19%
Taxable income range	**2013**	**2014**	**2015**	**2016**	**2017**	**Total SMSF population***
>$40k-$60k	14%	14%	14%	14%	14%	12%
>$60k-$80k	16%	14%	15%	14%	14%	11%
Taxable income range	**2013**	**2014**	**2015**	**2016**	**2017**	**Total SMSF population***
>$80k-$100k	11%	11%	11%	12%	13%	8%
>$100k-$150k	14%	14%	15%	16%	17%	10%
>$150k-$200k	9%	9%	10%	10%	10%	6%
>$200k-$500k	9%	9%	9%	9%	9%	6%
>$500k	2%	3%	2%	2%	2%	2%
Unknown	2%	2%	1%	2%	1%	4%
Total	100%	100%	100%	100%	100%	100%

*SMSF population as at 30 June 2017, *SMSF quarterly statistical report June 2017*, Table 8

Table 24: Members of SMSF LRBA population by taxable income range, 2013 to 2017

Taxable income range	2013	2014	2015	2016	2017	Total SMSF population*
Average taxable income	$122,983	$130,039	$124,054	$123,799	$121,832	$108,705
Median taxable income	$76,822	$76,453	$78,564	$79,846	$82,965	$58,968

*SMSF population as at 30 June 2016, *SMSF statistical overview 2015-16*, Table 11

G LRBA Investment and Performance

- For the SMSF LRBA population, the value of LRBA assets as a proportion of their total assets has been increasing, with the exception of a drop in 2014. LRBAs assets represented approximately 56.5% of the SMSF LRBA population's total assets for 2013, increasing to 68.1% in 2017.

Table 25: SMSF LRBA population, total LRBA assets and total SMSF assets, 2013 to 2017

	2013	2014	2015	2016	2017
LRBA assets ($m)	$8,560	$14,968	$20,226	$24,119	$32,360
Total SMSF assets ($m)	$15,151	$35,222	$35,835	$39,677	$47,504
LRBAs as a proportion of total assets	56.5%	42.5%	56.4%	60.8%	68.1%

LRBA concentration

- Approximately a third of the SMSF LRBA population held equal to or greater than 90% of their assets in LRBAs, increasing to 41% in 2017. The proportion of the SMSF LRBA population with greater than 50% of their assets held in LRBAs progressively increased from 72% in 2013 to 87% in 2017.
- From 2014 to 2016, a larger proportion of SMSFs reporting LRBAs for the first time have less than 50% of their assets in LRBAs, as compared to the total LRBA population. In 2017 the proportion in both populations is consistent at 13%.

Table 26: SMSF LRBA population, by LRBA concentration, 2013 to 2017

	LRBA concentration						
	100%	>=90%	>=80%	>=70%	>=60%	>=50%	Less than 50%
2013	1%	33%	49%	58%	66%	72%	28%
2014	1%	28%	42%	50%	55%	60%	40%
2015	1%	34%	52%	62%	69%	75%	25%
2016	2%	35%	55%	66%	73%	79%	21%
2017	2%	41%	62%	74%	81%	87%	13%

Table 27: SMSFs with LRBAs for the first time, by LRBA concentration, 2013 to 2017*

	LRBA concentration						
	100%	>=90%	>=80%	>=70%	>=60%	>=50%	Less than 50%
2013	..	35%	52%	63%	70%	76%	24%
2014	..	23%	35%	42%	47%	51%	49%
2015	..	32%	51%	61%	68%	73%	27%
2016	..	30%	50%	61%	68%	73%	27%
2017	..	38%	61%	73%	81%	87%	13%

* Note: this data does not account for SMSFs with an existing LRBA that set ups a new LRBA to acquire an additional asset of the same type e.g. a fund holds property under an existing LRBA and acquired a new property under a new arrangement.
".." denotes a value that is greater than zero.

- Over 90% of the SMSF LRBA population within the $200,001 to $1 million fund size ranges had a LRBA concentration of greater than 50%. The largest proportion of these funds fell in the between 90% to less than 100% range.

- While the proportion of the SMSF LRBA population whose fund size is between $50,000 to $200,000 still had a high LRBA concentration (at least 83%% of each fund size range), this proportion of the population also had a higher proportion of funds with a more diverse range in their portfolios (lower LRBA concentration) compared to the greater than $200,000 to $1 million range.

- For the SMSF LRBA population whose fund size is greater than $2 million, there were a larger proportion (38% or more) that held LRBAs less than 50% of their total asset holdings (lower LRBA concentration).

Table 28: SMSF LRBA population, by fund size and LRBA concentration (2017 financial year)

LRBA concentration (2017)							
Fund size	**100%**	**>=90%**	**>=80%**	**>=70%**	**>=60%**	**>=50%**	**<50%**
$1–$50k	..	..	33%	33%	50%	50%	50%
>$50k–$100k	3%	23%	53%	70%	78%	83%	18%
>$100k–$200k	1%	34%	67%	78%	84%	86%	14%
>$200k–$500k	2%	51%	78%	89%	93%	95%	5%
>$500k–$1m	2%	39%	61%	76%	86%	92%	8%
>$1m–$2m	2%	34%	48%	58%	67%	76%	24%
>$2m–$5m	3%	26%	34%	43%	53%	62%	38%
>$5m–$10m	2%	19%	25%	32%	40%	50%	50%
>$10m	3%	18%	28%	35%	42%	51%	49%

“..” denotes a value that is greater than zero.

Table 29: SMSF LRBA population, average LRBA concentration (2017 financial year)

	2017	
Fund size	**Average LRBA concentration**	**Proportion of SMSF LRBA population**
$1–$50k	55%	..
>$50k–$100k	71%	..
>$100k–$200k	78%	1%
>$200k–$500k	85%	32%
>$500k–$1m	79%	41%
>$1m–$2m	70%	17%
>$2m–$5m	60%	7%
>$5m–$10m	52%	2%
>$10m	55%	1%
Total	**68%**	**100%**

“..” denotes a value that is greater than zero.

- The fund size range with the lowest average LRBA concentration was the greater than $5 million to $10 million range with 52%, followed by the fund size ranges of $1 to $50,000 and greater than $10 million (55%).

- The highest average LRBA concentration was for the SMSF LRBA population with in the fund size ranges $200,001 to $500,000 and $500,001 to $1 million, where LRBAs represented 85% and 79% of these SMSFs' total assets in 2017 respectively.

H LRBAs over Australian residential property

- This table shows that the proportion of Australian real property as a LRBA asset across the range of fund sizes appears consistent with the spread of the SMSF LRBA population by fund size. That is, the proportion of both Australian residential real property and SMSFs with a LRBA in the $200,001 to $1 million fund size range is consistent.
- It should also be noted that there are some SMSFs with fund sizes of less than $200,000 with residential real property LRBAs.

Table 30: SMSFs with LRBA asset of Australian residential real property by fund size, 2013 to 2017

Fund size	2013	2014	2015	2016	2017
$1–$50k	..	..	..	..	0%
>$50k–$100k	1%	..	..	..	..
>$100k–$200k	3%	3%	2%	2%	..
>$200k–$500k	42%	42%	41%	39%	36%
>$500k–$1m	35%	38%	40%	42%	45%
>$1m–$2m	13%	12%	13%	13%	14%
>$2m–$5m	5%	4%	4%	4%	4%
>$5m–$10m	1%	1%	1%	1%	..
Fund size	**2013**	**2014**	**2015**	**2016**	**2017**
>$10m	..	..	..	..	..
Total	100%	100%	100%	100%	100%

".." denotes a value that is greater than zero.

Table 31: SMSFs with LRBA assets of Australian residential real property by LRBA concentration, 2013 to 2017

Asset concentration	2013	2014	2015	2016	2017
>=50%	84%	85%	86%	88%	90%
>=60%	78%	79%	80%	82%	84%
>=70%	70%	72%	73%	74%	76%
>=80%	58%	59 %	60%	60%	62%
>=90%	38%	39%	38%	38%	39%
=100%	..	..	..	..	..

".." denotes a value that is greater than zero.

- Compared to the total SMSF LRBA population, there is a larger proportion of SMSFs with LRBA assets of residential real property with greater than or equal to 50% leverage ratio (73% vs 64%).

Table 32: SMSFs with LRBA assets of Australian residential real property by leverage ratios, 2013 to 2017

Leverage ratios	2013	2014	2015	2016	2017
>=50%	68%	70%	70%	69%	73%
>=60%	53%	55%	56%	53%	55%
>=70%	27%	31%	33%	29%	26%
Leverage ratios	**2013**	**2014**	**2015**	**2016**	**2017**
>=80%	7%	8%	8%	7%	9%
>=90%	3%	3%	3%	3%	6%
>=100%	2%	2%	2%	2%	4%

SMSFs that use LRBAs to acquire Australian residential property are using these arrangements early in their lifecycle, with 50% or more funds that established a LRBA each year from 2013 to 2017 being in their second year after establishment or earlier.

Table 33: SMSFs with LRBA asset of Australian residential real property by the year of commencement of the LRBA and the SMSF's establishment, 2013 to 2017

	LRBAs year of establishment				
SMSF year of establishment	**2013**	**2014**	**2015**	**2016**	**2017**
Year of establishment	20%	21%	22%	21%	14%
1st year after establishment	25%	29%	27%	27%	21%
2nd year after establishment	13%	15%	16%	15%	16%
3rd year after establishment	9%	7%	9%	11%	12%
4th year after establishment	6%	5%	5%	6%	9%
5th year or more after establishment	27%	23%	20%	21%	28%
Total	100%	100%	100%	100%	100%

I Longitudinal analysis of SMSF LRBA population

This section looks at the SMSF LRBA population in 2013 and tracks their reporting of LRBA assets to 2016, with a focus on the change in value of the LRBA assets and LRBA borrowings over the three year period.

13,914 SMSFs reported a LRBA in 2013, of which:

- 92% of theses SMSFs lodged their 2016 SAR, indicating most continued to be in the SMSF sector.
- 56% of these SMSFs continued to report LRBA assets in 2016. This indicates a continued use of LRBAs in subsequent years and high likelihood of LRBA asset retention, though the SAR data cannot identify if the same LRBA or LRBA asset was retained.

Table 34: Starting population, SMSFs reporting LRBAs in 2013

	Total	Proportion
SMSFs reporting a LRBA in 2013	13,914	100%
Reported a LRBA in 2016	7,860	56%
Stopped reporting a LRBA by 2016	4,713	34%
Fund wound up by 2016	286	2%
SAR for 2016 not lodged	1,055	8%

- Of SMSFs that held a LRBA in 2013 to 2016, the total assets held in these SMSFs grew by $2.1billion (or by 25%), of which $1.3billion (or 60%) of the growth was attributed to an increase in the total value of the LRBAs assets.
- The average value of LRBA assets in this population grew by 23% over the 3 year period.

Table 35: SMSFs reporting LRBAs in both 2013 and 2016

	2013	2016	Change (%)
No. of SMSFs with LRBAs in both years	7,860	7,860	-
Total assets ($m)	$8,378	$10,435	+25%
Average assets ($m)	$1.07	$1.33	+25%
Total LRBA assets ($m)	$5,370	$6,624	+23%
Average LRBA asset ($)	$683,151	$842,696	+23%

Of the 6,576 SMSFs that reported a LRBA and borrowings in 2013 to 2016, the data reported on the SAR indicates that:

- Average borrowing and total borrowing values decreased by 7% over the 3 year period.
- Leverage ratio decreased by 14% over the 3 year period.
- Total LRBA asset value increased by 19% over the 3 year period.

Table 36: SMSFs reporting LRBAs and borrowings in both 2013 and 2016

	2013	2016	Change (%)
No. of SMSFs with LRBAs and borrowings	6,576	6,576	-
Total borrowings ($m)	$2,925	$2,710	-7%
Average borrowings	$444,765	$412,133	-7%
Total LRBA assets ($m)	$4,817	$5,742	+19%
Leverage ratio	61%	47%	-14%

- Of SMSFs that reported LRBA assets in 2013 and 2016, there was a shift of 9.5% of these SMSFs from the low fund size ranges of $500,000 or less to higher fund size ranges of above $500,000 in 2016.

Table 37: SMSFs reporting LRBAs in both 2013 and 2016, by fund size

Fund size	2013	2016	Change (%)
$1–$50k	0.2%	0.1%	-0.1%
>$50k–$100k	0.7%	0.3%	-0.4%
>$100k–$200k	3.7%	1.8%	-1.9%
>$200k–$500k	37.4%	30.3%	-7.1%
>$500k–$1m	33.9%	35.4%	1.5%
>$1m–$2m	14.3%	18.9%	4.6%
>$2m–$5m	7.1%	9.5%	2.4%
>$5m–$10m	1.9%	2.5%	0.6%
>$10m	0.8%	1.2%	0.4%
Total	100.0%	100.0%	0.0%

J Glossary

Terminology	Definition
Fund size	Gross value of all assets held in the SMSF
LRBA asset	Refers to the asset that is held in trust under the arrangement. When we refer to the value of LRBA assets it is the gross value of those assets.
LRBA borrowing	Refers to the amount borrowed under the arrangement. When we refer to the value of LRBA borrowings it is the value of the outstanding amount borrowed.
LRBA concentration	Proportion of assets held under LRBAs as compared to SMSF's total assets. The higher the proportion indicates a high LRBA asset concentration
Net fund size	The gross value of all assets held in the SMSF less any borrowings – this gives the net asset position of the SMSF at that time. For 2013 to 2016 net fund size has been calculated as total assets minus total borrowings, and for 2017 total assets minus borrowings from LRBAs
Phase	Refers to the payment phase of the SMSF. There are three payment phases: Accumulation – where no members are receiving pensions nor reporting exempt current pension income. Full pension – where all members are receiving a pension (including transition to retirement) and the SMSF reports exempt current pension income. Partial pension – where not all members are receiving a pension (including transition to retirement) and the SMSF reports some exempt current pension income.
SMSF LRBA population	Total population SMSFs who are currently reporting a LRBA in the SAR
SMSF population	Total population of SMSF in an income year