Parliamentary
Budget Office

Policy costing

Preventing direct borrowing by superannuation funds	
Party:	Australian Labor Party
Summary of proposal: This proposal would prohibit superannuation funds from entering into limited recourse borrowing arrangements (LRBAs). Rules for other borrowing arrangements currently allowed under superannuation law (such as for short term liquidity purposes) would be unchanged. This proposal would have effect from 1 July 2019, and would only apply to new LRBAs.	

Costing overview

Policy background

Limited recourse borrowing arrangements allow superannuation funds to borrow money through a separate trust in order to purchase a single asset, such as a real estate property or a parcel of shares.[1] If the loan defaults, the lender's rights are limited to the asset held in the separate trust. This means there is no recourse to the other assets held in the superannuation fund. This proposal would prohibit superannuation funds from entering into new LRBAs.

The 2017-18 Budget measure *Superannuation – integrity of limited recourse borrowing arrangements* would require superannuation members to include the use of LRBAs as part of their total superannuation balance and transfer balance cap. This measure would be expected to interact strongly with the proposal.

Financial impact

The proposal would be expected to increase the fiscal and underlying cash balances by $6 million over the 2019-20 Budget forward estimates period. This reflects a net increase in revenue, as a result of a decrease in the interest deductions claimed by superannuation funds (a positive revenue impact), partially offset by a reduction in tax from lower superannuation earnings due to a lower level of assets held by funds.

The proposal would not be expected to affect departmental expenses as it would not involve significant changes to the administrative complexity of the tax and superannuation system.

A breakdown of the financial implications of this proposal over the 2019-20 Budget forward estimates period is included at Attachment A. The proposal would be expected to have an ongoing impact beyond the 2019-20 Budget forward estimates period, which would be expected to grow significantly as the proposal matures.

[1] These arrangements are predominately used by self-managed superannuation funds; see Reserve Bank of Australia 2014, *Supplementary Submission to the Financial System Inquiry*, p.20.

Table 1: Financial implications ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	**Total to 2022–23**
Fiscal balance	-	1	2	3	**6**
Underlying cash balance	-	1	2	3	**6**

(a) A positive number represents an increase in the relevant budget balance; a negative number represents a decrease.

(b) Figures may not sum to totals due to rounding.

\- Indicates nil.

Uncertainties

This costing is extremely sensitive to changes in interest rates and the return on invested capital. As such, the magnitude and direction of the financial implications are highly uncertain. There are also significant uncertainties around the extent to which the 2017-18 Budget measure would affect the use of LRBAs by superannuation funds.

Key assumptions

The Parliamentary Budget Office has made the following assumptions in costing this proposal.

Behavioural responses

- Some self-managed superannuation funds (SMSFs) would reduce their LRBA assets and borrowings in response to the recent policy changes to include the use of LRBAs in a member's total superannuation balance and transfer balance cap.
  - This is based on evidence from the Australian Taxation Office's (ATO) *Self-managed super fund quarterly statistical report – December 2018*, which shows that the growth of LRBA assets has slowed dramatically since the commencement of the measure to include LRBAs in the transfer balance cap from 1 July 2017.
- Some SMSFs would utilise alternative investment strategies in response to this proposal, some of which would have preferential tax treatment.
- In the absence of these behavioural responses, the estimated financial implications of this proposal would be around 70 per cent higher over the 2019-20 Budget forward estimates period.

General

- The proposal would have no material impact on Australian Prudential Regulation Authority (APRA) regulated funds.
  - This reflects the fact that LRBAs are predominately used by SMSFs.
- Interest rates and the return on assets would reflect historical data specific to SMSFs and their use of LRBAs, as well as current market conditions.
- There would be no significant bring-forward of borrowing by superannuation funds in response to this policy.

Methodology

- The assets, liabilities, income and interest expenses related to LRBAs were taken from the 2016-17 SMSF returns. These items were projected forward based on assumptions around the historical growth of SMSF assets, interest rates and the return on assets.
- The costing was estimated as the change in revenue resulting from disallowing superannuation funds from entering into new LRBAs, accounting for the behavioural responses outlined above.
- The costing has accounted for the timing of tax collections.
- Revenue estimates have been rounded to the nearest $1 million.

Data sources

The ATO provided a 100 per cent file of de-identified SMSF returns for the 2016-17 tax year.

APRA, 2018. *Annual Superannuation Bulletin*, APRA, Sydney.

ATO, 2018. *Self-managed super fund quarterly statistical report – December 2018*.

Australian Government, 2014. *Financial System Inquiry – Final Report*, Australian Government, Canberra.

Reserve Bank of Australia, 2014. *Supplementary Submission to the Financial System Inquiry*, Reserve Bank of Australia, Sydney.

Attachment A – Preventing direct borrowing by superannuation funds – financial implications

Table A1: Preventing direct borrowing by superannuation funds – Fiscal and underlying cash balances ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	**Total to 2022–23**
Revenue	-	*1*	*2*	*3*	***6***
Total – revenue	**-**	**1**	**2**	**3**	**6**

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms.
A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms.
A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms.
A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

(b) Figures may not sum to totals due to rounding.

\- Indicates nil.