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Family Guarantees

5 Ways You Can Help Your Kids Buy a House

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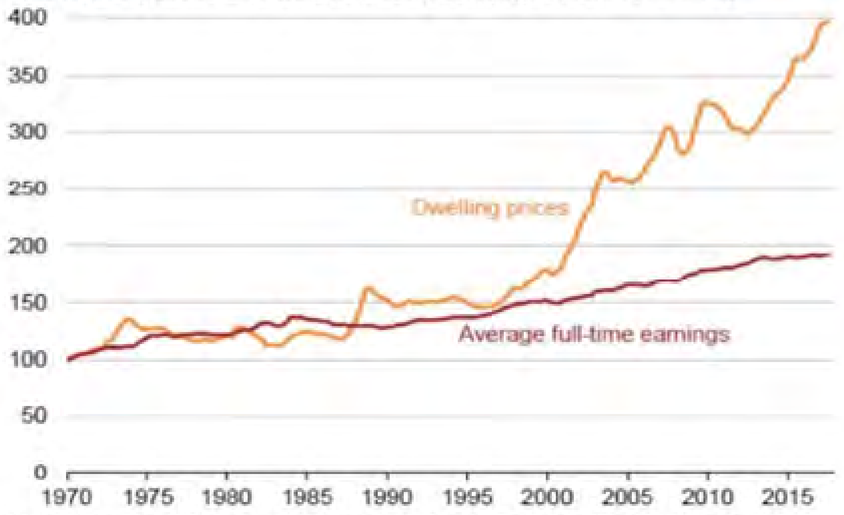
Help!

With the property market staying strong, First Home Buyers (FHBs) are finding it increasingly difficult to get a foot in the door. For parents, this is a bitter sweet experience. The boom has seen the value of their property (or properties) increase significantly, and who wouldn't be happy about that? But they can see how the Aussie dream of home ownership is slipping further and further away from their kids grasp.

For Gen Y and Millennials, the next time a Baby Boomer says something like "When I was your age, I just knuckled down and worked hard and saved my deposit", show them the following graph:

Figure 2.3: House prices have grown much faster than incomes since the mid-1990s
Real dwelling prices and full-time weekly earnings, index: 1970 = 100



Notes: Data for 1970 to 2010 is from Yates (2011). Data from 2010 is six-monthly growth in the residential property price index from ABS (2017c), deflated by the CPI. Earnings data is full-time ordinary time earnings from ABS (2017d), deflated by the CPI.

Sources: Yates (2011), ABS (2017c) and ABS (2017d).

Income has risen steadily over the last 4 decades, but property prices have taken a sharp turn north and put the afterburners on. Today, there is NO correlation between house prices and income. It is significantly more difficult for your generation to get into the property market now than it ever was for previous generations.

So don't feel guilty about asking for help. You are not a lesser person for needing help that your parents probably didn't.

For parents (and if you are a Baby Boomer, I'm really sorry for the generational warfare comments), this guide is mainly for you. Helping your kids get into property is not an easy decision to make. You may need to part with a large sum on money or put your own property up as security for the bank, and you should never make any such decision lightly.

I will explain the various ways that parents can help their FHB kids break out of the rental rat race. Some are crap. Others are even crappier. Let's be honest, for you none of these options are the kind of financial opportunity you would even consider entering into if your current circumstances were different. If you didn't have kids, then we wouldn't even be having this conversation. So let's keep that in mind. You are helping and in doing so you are taking on a level of risk. I hope this guide clarifies the various options you have and the risks each entail. Ultimately, it is up to you which road you go down.

Why FHBs are struggling to get into the market is due to two factors:

1. They don't earn enough money to make the repayments on the proposed home loan
2. They don't have a big enough deposit

There are some banks and brokers that help clients that fall into the first category, however this broker is not one of them. My 2 cents? If you can't afford it, don't buy it.

So the purpose of this guide is to explain the various ways parents can help their FHB kids stump up a deposit.

Option #1 – A gift

The simplest option. Kids are buying a $400,000 home and need a 10% deposit. Just give them $40,000 and be done with it. Consider it an early inheritance. They are going to get it anyway, right?

Easy for some, impossible for others. What if you don't have a lazy $40k under the mattress? What if you are considering giving such a gift to your first born, and then glance at the family portrait which may (but hopefully not) look like the family below.

You could be setting a very dangerous precedent that your other kids may see as something they will also be entitled to.

Pros:

1. It's easy if you have the cash lying around

Cons:

1. You'll never see the money again
2. You could be setting a dangerous precedent if you have other kids
3. You may need to transfer it to your kid's bank account months before they buy in order for them to meet the genuine savings policies of most banks

Option #2 – A Loan

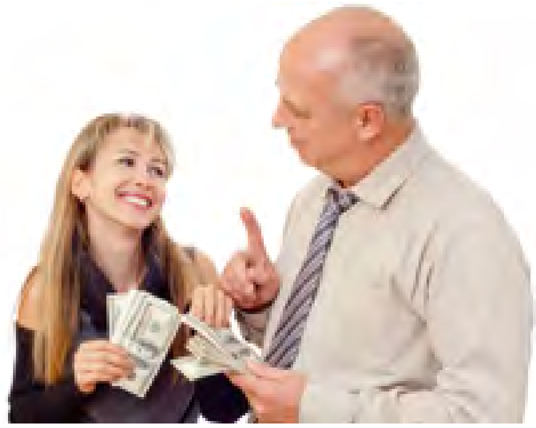
Lending your kids the money and having a written agreement for how they will pay you back is also very common. Personally, I see very few benefits to this option.

Pros:

1. The kids receive the cash

Cons:

1. You'll need to work out a loan repayment agreement between yourselves
2. If tough times call, guess which debt is the first to go on a holiday? It won't be the mortgage to the bank as this could ruin their credit file for the next 5-7 years
3. Such a loan would need to be disclosed to the bank who will assume it is a personal loan that is being repaid over 5 years at the personal loan interest rate of around 13%. This can massively affect the kids borrowing power and their credit scoring
4. Another dangerous precedent for large families.



Option #3 – A “Gift” (wink, wink)

So you want to help them out with a cash injection, but you’d really like to get it back one day. You’re not sure about the whole personal loan thing as this will affect the kids borrowing power. Solution? Give them a gift that you will then get back. A handshake agreement that they will “gift” it back to you at some point in the future.

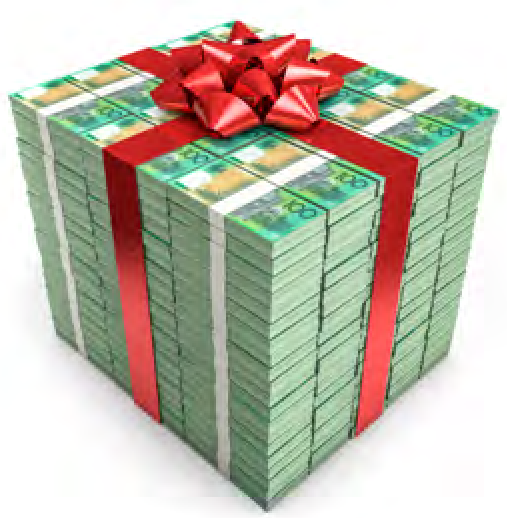
To be honest, I think this is what most parents do as it is often the easiest solution. But I’m not a massive fan. The banks are also onto this so if you choose this option, you’ll need to sign a statutory declaration stating that the money is a gift, that it is not repayable, and that you’ll have no interest in the property once it is purchased.

Pros:

1. Kids get the cash
2. Kids will try to “gift” it back to parents in the future

Cons:

1. There’s no written loan agreement showing that the kids are responsible for paying it back
2. You’ll be required to complete a legal document saying the gift is not refundable



Option #4 – The Family Guarantee

This is the bank's preferred option, and it will become obvious why. The best way to look at this option is to use a scenario:

Kids want to buy a $500,000 property and have no deposit.

Mum and Dad own a $800,000 property outright.

Bank lends the whole $500,000 to kids and takes both properties as security for the loan. That's $1.3 million worth of security for a loan of $500,000.

No wonder the banks love this option, it is completely risk-free for them.

There's a lot to digest with this scenario so I'll unpack it with pros and cons for all parties.

The Bank

Pros:

1. Risk free lending. They are holding $1.3 million worth of security for a loan of $500,000. If anything goes pear-shaped, they can sell either or even both properties to get their money back
2. If kids stop paying the mortgage, they can chase mum and dad for the monthly payments.

Cons:

1. None

The Kids

Pros:

1. They get to buy a house
2. They avoid paying Lenders Mortgage Insurance (LMI), or at least drastically reduce the amount they have to pay
3. The loan is completely in their names, so they are responsible for the repayments
4. Less guilt than getting a gift or a “gift”. Mum and dad haven’t stumped up any cash

Cons:

1. They know it is a great risk to their parents
2. If they sell the property, they have to negotiate the release of the mortgage over their parents’ house as well

The Parents

Pros:

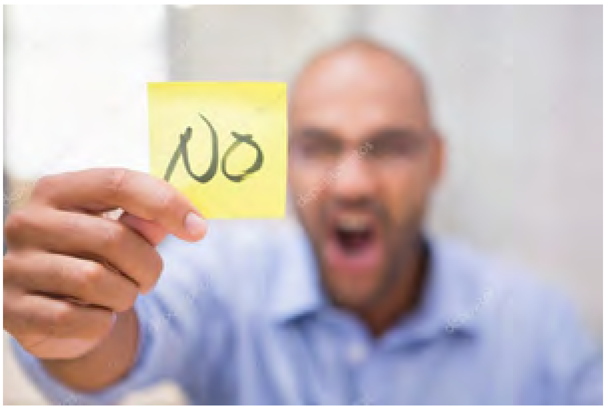
1. They help their kids get into the market and avoid or reduce LMI
2. The warm-fuzzies
3. They have not had to part with any cash

Cons:

1. They are putting up their home as security, effectively handing the title over to the bank
2. They are responsible for making the repayments on the whole loan if the kids are unable to
3. If they can't make the payments either, then the bank could force them to sell their property to pay back the loan
4. If this is not done in a timeframe that is acceptable to the bank, defaults may be listed on their credit files
5. Banks might not accept your property as security. Many banks will not take your owner-occupied property as security and instead will only take an investment property. The last thing they want is to be on A Current Affair kicking retirees out of their own home because their kids didn't pay their mortgage

So any guesses where I sit on this option?

It's low risk to the kids, no risk to the bank, massive risk for the parents. I don't like it, and as such, I won't help any of my clients do it. If they want to go down this road, I'll recommend them to another broker, but I won't do it myself.



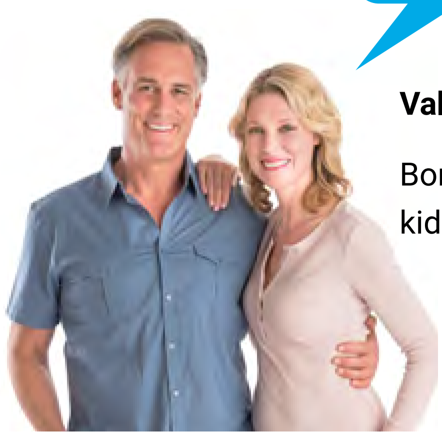
Option #5 – A More Equitable Solution

This option is probably a little more complicated and takes a bit more work, but the safety valves are a little more reliable.

Purchase $500,000

Borrow $400,000 in own names against property being purchased.

Bank only takes this property as security for $400,000 loan.



Value $800,000

Borrow $100,000 to use as kid's deposit.

Bank only takes this property as security for $100,000 loan.

This scenario allows the parents to limit their risk to just $100,000 rather than the whole $500,000. The kids make the repayments on both debts and ideally focus on paying off the $100,000 first, releasing the parents of their liability. In many cases, we can have the kids property revalued after a year or two and if it has gone up in value, they can borrow against the increased equity to pay down the loan against their parent's property. The sooner they pay off the parent's property, the better. The parents can then use the redraw in that loan to repeat the process for any other children who may be in the same boat.

Pros:

1. The kids buy a house and avoid or reduce LMI
2. They are responsible for the payment of the whole debt
3. If the kids can't keep up with repayments on the main loan, the bank only has recourse to the kid's property
4. The parents have limited their exposure to only $100,000 instead of the whole $500,000 debt
5. Banks have not cross-collateralised the properties, meaning either property can be sold without affecting the other

Cons:

1. Parents still exposed to risk
2. If kids can't make repayments on the $100,000 loan, then parents will need to pay it
3. If that is not possible, parents may have a default listed and be forced to sell their home to repay the debt
4. The loan against parent's house is in the name of the parents so they would need to apply to the bank and disclose all their financial information
5. Involves two applications rather than the Family Guarantee option which is a single application.

I hope all of this helps clarify the main options available to parents who find themselves in this situation.

This guide is still only a draft so I'm sure I've made mistakes and overlooked other pros and cons. Any feedback that helps me improve this document would be greatly appreciated. If you have any questions, please contact me directly on 0401 612 298.

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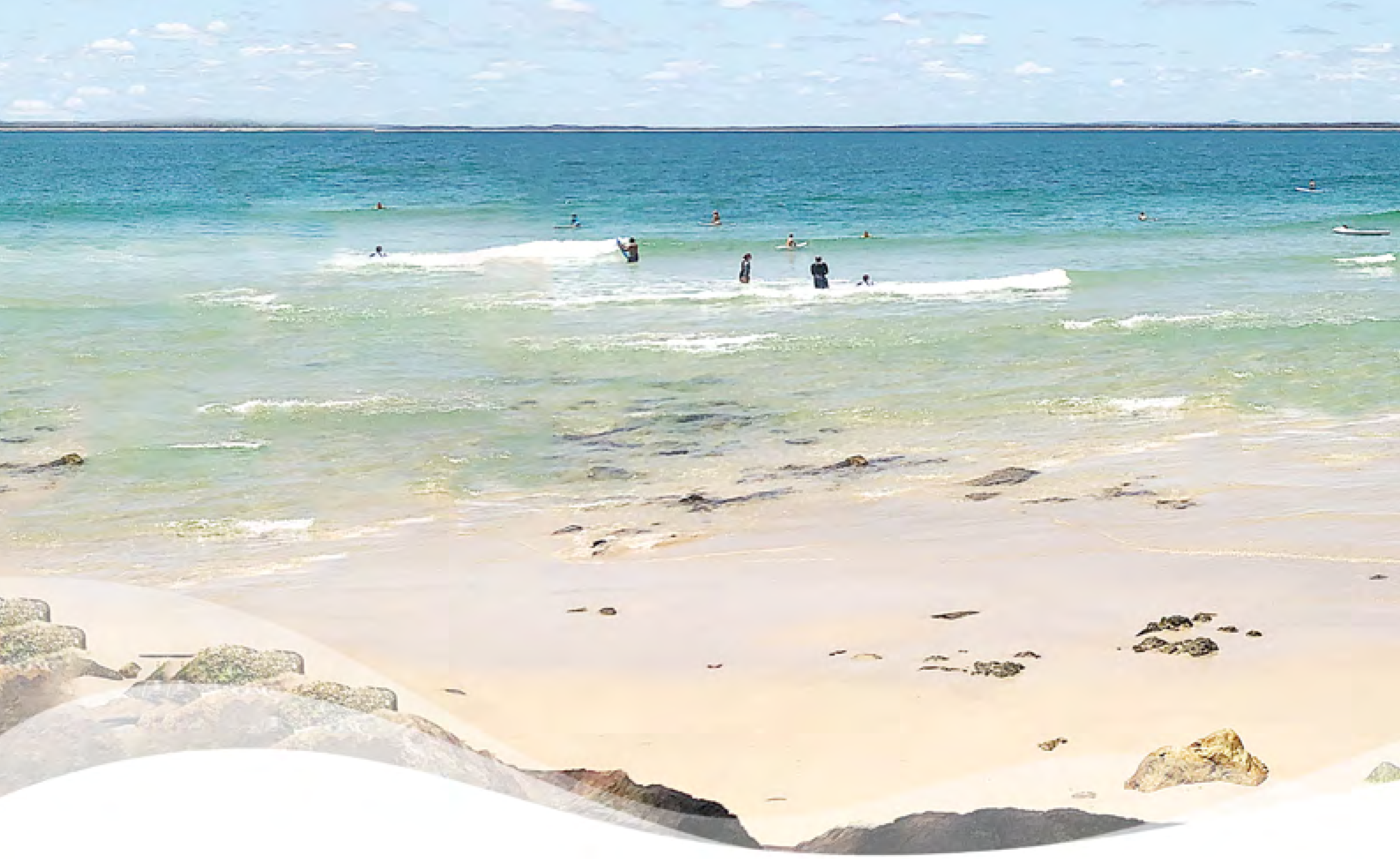

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