CENTRIC Wealth

your interests, our focus

Getting your children started on the property ladder

Many young people struggle to buy a home. By contrast, parents may be in a comfortable position and are often keen to help their children get started on the property ladder. As a result, a growing number of parents are putting their hands in their pocket to give their kids an early inheritance by helping them to buy their first home.

What you need to think about

- What options do I have to help my children buy a home?
- How financially involved do I want to be?
- How much will it cost?
- What about tax?

Finding the right solution

At Centric Wealth we have the breadth of knowledge and expertise to help you find the solution that works best for your unique situation. Let's start with some of the options available to you before looking at how it can work in practice.

Gifting money

One of the most common ways to help children buy a home is gifting money towards their deposit. The gifted money can be given to the child directly or parents could contribute to a First Home Saver Account (FHSA). FHSAs offer a tax effective way of saving for your child's first home through a combination of government contributions and concessional tax rates. Alternatively, parents can also gift a property that has been purchased outright to their children.

The main problem with gifting is that parents have no further legal entitlement to the money or property should things go wrong. Divorce and separation are common and parents who help their children buy a home may want to protect it from claims by their children's future or former partners. In the event of a split, the gift becomes part of the joint property of the relationship, with both parties potentially claiming it in equal shares.

Loaning money

Instead of gifting money, parents can lend money to their children. This is often the best option for parents, as a loan is more transparent and will tend to give parents greater security against a claim by their children's future or former partners. Parents must obtain proper legal advice about how to document the terms of the loan if they want to keep the money in the family should things go wrong.

Parents can establish their own terms when drawing up the loan agreement. For example, parents may reserve the right to charge interest from when the child first borrowed the money. If the child's relationship ends, the parents can invoke the loan and the loan must be repaid. This may require the house to be sold leaving very little to the former spouse's claims. This does not mean parents have to demand interest payments from their child–the key is to establish the money as a loan that is repayable in certain events.

Protecting the gift/loan

Parents who gift or loan a child a home deposit can recommend the child use a binding financial agreement (BFA) to ensure the gift/loan is repaid if the child separates from their partner. Often known as a "pre-nuptial agreement", a BFA can be made before or during a marriage or de facto relationship. Put simply, a BFA deals with how a gift or loan is to be dealt with in the event of separation.

Buying the property yourself

Parents can buy a property outright in their own name and let their child live in it rent free, or have their child pay rent at reduced rates or at market rates. If market rent is charged, interest payments and maintenance costs are likely to be tax deductible for the parents. The advantage of this option is that it will protect parents in the event their child's relationship breaks down.

Getting your children started on the property ladder

Buying the property co-jointly

Another option for parents and children is to purchase property together. Parents can provide their children with money either by way of cash or by way of a loan against their existing property.

Some parents choose to be joint applicants on a loan to boost a child's ability to service a loan. However, this would mean the parents would have a financial interest in the property and have their names on the title. Parents must be aware that they are 100% liable if their child fails to meet their loan obligations. This would also occur if parents are guarantors on their child's mortgage. Further, where one party has contributed more to the property than the other, there are ways to structure loans to maintain parity.

Credit enhancing bank debt

Credit enhancing is a home buying solution offered by a number of lenders. It allows parents who are considering becoming guarantors for their children to provide security support only rather than providing their existing home as security. Security guarantees can be against term deposits and can therefore limit the guarantor's (parents) potential liability to a specific agreed amount. Security guarantees also remove the need for lenders mortgage insurance (LMI) and should be limited to borrowings that represent above 80% of the house value.

An example

Bert and Patty want to help their son Matthew buy his first home. The purchase price is $500,000 and after property expenses (ie stamp duty, etc) of $20,000, the total cost is $520,000. Matthew only has a $40,000 deposit saved (8%) which means he will need to borrow $480,000 ($520,000–$40,000) to purchase the house.

The diagram below illustrates how credit enhancing works in practice:

House Market Value $500,000		
	Bank lends 80% against new property. No LMI	**Loan 1:** $400,000. Security is new home (no involvement from parents) can be Interest only
	Bank lends 16% against new house plus either term deposit or a property owned by parents	**Loan 2:** $80,000 guarantee from parents. Potential liability limited to lesser debt*

* Plus potential interest, penalties and recovery costs.

As the bank is only willing to lend up to 80% of the new property (ie. $500,000 x 80% = $400,000), one loan of $400,000 is established with security being the new home and no involvement from Bert and Patty. A second loan is also established for $80,000 with a guarantee from Bert and Patty. When this loan is retired/repaid, the reliance under the guarantee will no longer be required.

Taxation implications

Where parents buy a property outright and let their children live in the home, this leaves the parents liable for tax on any rental income received, capital gains tax, stamp duty and other fees and charges. Conversely, if the property was bought in the child's name, there are no tax implications for the parents. However, the downside is that parents lose control as the property is not in their name.

Social security implications

When gifting money, if parents receive or plan to receive the age pension within the next five years, parents will be limited in how much they can give before they lose some of their entitlements. Gifting rules apply as the allowable gifting (disposal) amount for a single person or a couple is $10,000 in each financial year or $30,000 in any five consecutive financial years. Any subsequent gifts over these amounts are assessed as deprived assets for pension entitlements for five years.

Also, if parents have a financial interest in the property (including if money was lent), this will also count as an asset when assessing pension entitlements.

Estate planning implications

When purchasing a property with one or more persons, you will need to determine whether you will own the property as joint tenants or as tenants in common.

If you own a property as joint tenants, it means that you all own the property in equal shares. If one of the owners passes away, then their share automatically passes to the other owners. If however, you own a property as tenants in common, you can choose to own the property in equal shares, or unequally. For example, if one of you has contributed more to the property than the other, you could hold shares of say, 1/3 and 2/3. If one of the owners die, your Will decides who receives your ownership share. Thus it is vital that the type of ownership you choose to own property is right for you.

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