Helping the kids to buy property

Understanding co-ownership arrangements

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With soaring house prices in all Australian capital cities and many popular regional areas, more young people than ever are requiring support to enter the property market. The 'bank of mum and dad' has never been more popular as a way to help kids get their first step onto the property market ladder, whether to buy a first home to live in or a first real estate investment.

This paper looks at various options by which parents can assist their children and what should be considered in each case.

Financial assistance from parents often comes in the form of a loan or a gift to help with the deposit. According to a survey conducted by financial comparison site Mozo in July 2021, the average amount parents contributed towards property purchases for their children was a cool $134,200.

For parents who do not have the ability to raise that level of cash, an alternative has been to go guarantor for their child when they apply for a loan from the bank. According to Foster Ramsay Finance, in September 2021 the average family guarantee varied from $150,000 to $200,000.

However, it seems that parents who extend such generosity to their children may do so at their own risk. In June 2021, Digital Finance Analytics reported that first home buyers who borrow from the 'bank of mum and dad' are between three and five times more likely to default on their loans within the first five years.

Each of these methods of parental assistance comes with its own particular set of downsides.

Parental loans and gifts

A parental loan to a child will typically be interest-free and often expressed to be repayable on demand—in case the child gets into any relationship difficulties—so that the parent might be able to call for the money back. Alternatively, the amount may be given as a gift, or the original loan is simply forgiven after the passage of time. It may also be expressed to be forgiven automatically on the death of the parent.

One major issue is that a loan expressed to be repayable on demand often becomes unenforceable automatically after several years, subject to state or territory statutes of limitation. In New South Wales for instance, the limitation period for unsecured personal loans is six years. This period starts from the date the debt becomes due—which is day one for a loan repayable on demand.

A further consideration is, that if the loan is interest-free, then the parent is missing out on the opportunity cost of having that cash invested for themselves to earn a return. This could result in a reduced lifestyle for the parent, especially if the parent is relying on social security support in their retirement. As such support is typically means-tested, it may be that the interest-free loan is deemed to be earning a return for Centrelink income test purposes, resulting in a reduced level of government support for the parent.

Even if the parent makes an outright gift to their child, the amount of the gift may be subject to the gifting or deprivation rules and thereby still impact the parents' eligibility for government support.

Then when the parent dies, if the amount of the loan has not been repaid, how is it taken into account in the division of the parent's estate—especially where the parent has other children who may not have received the same level of support? This can be a particular concern if the parent does not have enough assets in their estate to 'balance things up' with other children by making compensatory gifts to them. Further, how do you take into account the benefit of the interest that has been forgone on the loan during all that time?

Parental guarantees

For parents who do not have the cash to lend or give to their child, another popular option has been to go guarantor for the child's bank borrowing. But there are dangers for the parent. If the child defaults on the loan, the parent may be up for repayment of the full outstanding amount of the loan plus all accrued interest, fees and late payment penalties.

Often the parent may have to provide security for their guarantee by way of a mortgage over their own family home. This exposes them to the possibility of losing their own home due to their child's default, even if they had paid off their home loan many years before. Not to mention, of course, the very serious impact that such an event would have on their estate plan, and their ability to even things up with their other children in their Will if the parental home—often the major asset—is not available as an estate asset for equalisation purposes.

Parent as co-owner

Another option that may address many of these issues is for a parent to become a co-owner of the property with their child.

Rather than simply gifting or lending a sum of money to their child, the parent becomes a co-owner with their child as a legal 'tenant in common'. For example, if the child needs a 20% deposit to buy a house and can borrow the rest, their parent could instead take a 20% interest in the house as a co-owner, with the child—and possibly the child's partner—buying the other 80%.

This would mean that the parent is receiving something of tangible value in return for their support, and it is an asset that they can pass down in their Will. They could leave their share to the child who is the co-owner, especially if the child is residing in the property, and make adjustments in their Will to ensure their other children receive equalising value from other assets. In the event that there are insufficient assets in the estate, the parent could leave their interest in the house to their other children. Alternatively, if all the children are financially independent, the parents may choose to leave their interest in the house to their grandchildren.

A co-ownership arrangement is also the most transparent type of financial support a parent can give to their child. At any time, the parent or child, or for that matter one of the siblings, could conduct a title search to confirm their parent's interest in the home, and the proportion or share of that interest. They could talk to any local real estate agent, or look up any number of real estate websites, to ascertain what the market value of that interest is at any point in time.

The parent could choose to charge their child a proportionate amount of rent for their use of the parent's interest in the house. But even if they did not do this, the parent will still be sharing in the capital appreciation of the market value of the house.

When considering becoming a co-owner of a property with a child, it is very important for both the parent and child—and the child's partner—to enter into a co-ownership agreement. This agreement deals with issues such as the sharing of income and expenses of the property and what to do if one party wishes or needs to sell their interest in the house. This situation could arise due to a disagreement, death or divorce. A co-ownership agreement should cover, among other things, the remaining co-owner's first right of refusal to buy out the leaving co-owner at the prevailing market value of the property.

There are other potential downsides to such an arrangement, including the following:

- The value of the parent's interest in the home may be counted as an asset for any means-tested Centrelink support.
- As an interest in real estate, the value of the parent's interest is subject to the vagaries of the property market—which can, for instance, complicate how the parent might seek to equalise the inheritances of their other children under their Will.
- Should the parent undergo a financial or personal crisis, such as bankruptcy, or divorce, requiring that the parent's interest must be sold, this may mean that their child is also forced to sell their share at a time that is inopportune for them. The child and their own family may have planted roots in their local community, so that it is disruptive for them to have to sell, especially if they are unlikely to be able to repurchase another home in the same neighbourhood.
- There may be additional tax implications for the parent in relation to their interest in the property, such as having to pay land tax. Also, their interest will likely attract capital gains tax if the property is later sold for a profit.

Notwithstanding these potential concerns, the option of a parent becoming a real estate co-owner with their child can be the better option where the risks and challenges of making a loan or a gift to their child, or going guarantor for them, are too great. **FS**

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