The bank of mum and dad

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As a parent, you are used to giving handouts to your children. From a couple of dollars to buy mixed lollies from the milk bar when they were young, to putting them through school, clothing and feeding them and even pocket money along the way. With any luck they may have washed your car or mowed the lawn for it?!

You may now be considering helping your children out with a more significant purchase, their first house. You wouldn't be alone, as according to Digital Finance Analytics (DFA), the Bank of Mum and Dad is estimated to be one of the top 10 lenders in Australia.

As an example, let's assume you have contributed $500,000 to your child to assist them buy a $1 million property and they have saved up a deposit of $50,000. The balance is loaned by a bank.

Looking ahead a few years, their partner has moved in and unfortunately the relationship has broken down. What happens to the property?

Assuming they were married or in a de facto relationship (remembering that time passes very quickly and it only takes two years to 'qualify' for a claim for a de facto property settlement – and a de facto relationship can exist even if the parties are not living together fulltime) the house may form part of the property settlement.

So up to half of the money contributed by you to assist your child to buy that property could now be in the hands of the ex-partner. Clearly not what you intended when assisting your child.

There are ways to avoid this situation, and with the right advice, structure and documentation, the hard earned money lent to your children can stay in bloodlines as intended, even if the relationship with their partner ends.

The following steps details an appropriate structure when assisting your children to purchase a property.

1. Mum and Dad loan money to their child; $500,000 in this case, and the property is purchased in the name of the child.

2. A formal loan agreement * is prepared by a lawyer and is signed by all parties. The loan agreement may include repayment terms at the discretion of the lender as well as the ability to charge interest.

3. A legal mortgage is registered on the property as security against the loan (again this needs to be prepared by a lawyer). Where the bank already has a mortgage over the property, a second mortgage would be granted to Mum and Dad.

The advantages of this structure are as follows:

– In the case of a relationship breakdown, the loan amount is a liability of your child and thus taken into consideration prior to a property settlement. That is, if the property had to be sold, the loan would be repaid before the asset pool is determined and split between both parties.

– The ability to charge interest under the loan agreement provides the flexibility to capture some of the equity uplift in the value of the property.

Note, if a family trust exists, that entity could lend the money to the child following the same steps above.

The paperwork shouldn't end there though! As a further consideration a binding financial agreement (prenuptial agreement) should be entered into between the couple.

Agreements are binding – provided the requirements are met (and a lawyer is essential to formalise the agreement) – and they have the effect of ousting the jurisdiction of the Family Court – allowing the spouses to determine what happens to their assets and finances in the event of a separation.

The agreement can be looked at as a form of 'insurance', with the hope that it is never called upon. If it is, it can significantly reduce the financial and emotional costs of legal proceedings as it provides certainty on the distribution of assets which was agreed upon in happier times.

Should you have any questions regarding asset protection or you are considering assisting your children with the purchase of an asset please do not hesitate to contact your Fordham Partner.

* If you have advanced money to your children already, whether months or years ago and did not document it, it's never too late to document the advance – better late than never!

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