IN PARTNERSHIP WITH

CHARLES DERBY

THE FAMILY BUILDING SOCIETY

BANK OF MUM AND DAD

A FINANCIAL GUIDE

BANK OF MUM AND DAD
A FINANCIAL GUIDE

A simple guide to the financial considerations of helping your child onto the property ladder.

CONTENTS

OUR EXPERIENCE, CONFIRMED BY THE RESEARCH WE CARRIED OUT WITH THE LONDON SCHOOL OF ECONOMICS, HAS SHOWN JUST HOW COMMON IT IS FOR YOUNG PEOPLE, AND PARTICULARLY FIRST TIME BUYERS, TO RECEIVE A FINANCIAL LEG UP FROM PARENTS OR OTHER FAMILY MEMBERS TO HELP WITH A PROPERTY PURCHASE.

There are many financial considerations when helping your loved ones onto the property ladder. Can you afford it? Will it affect your retirement plans? How can you minimise the possible impact of Inheritance Tax?

We don't have all the answers so turned to our partner and financial specialist, **Charles Derby**, to provide some useful guidance.

Lloyd Nunn,
Group Development Director, Financial Adviser for Charles Derby.

We're seeing more and more parents wanting to help their children to buy a home. Whilst this is great for their kids, it's really important parents understand the implications of their financial help. It could have a big impact on their savings, retirement planning or even day-to-day lifestyle.

There are various ways parents can give financial help. Let's picture a couple; Mr and Mrs Smith. They're both in their 50's, own their own home outright, and recently inherited some money from an aunt. Their daughter Victoria is looking to buy her first house but she is on a modest income and house prices in their area are relatively high.

There are a number of ways Mr and Mrs Smith can help their daughter. We'll look at each one in turn throughout this guide and consider the implications and additional planning that they'd need to take into account.

MAKING A FINANCIAL GIFT

This is generally the first option parents consider when a child needs help to buy their home. In many ways it's the simplest. The parent gives their child a sum of money to act as a deposit to allow them to purchase. As long as the lender has written confirmation of this, and there is no expectation that the parent wants the money back then the process is complete.

CONSIDERATIONS

- **Allows the widest possible choice of mortgage deals available.**
- **Lowers mortgage payments.**
- **May mean the purchase of a "better" home.**
- **The only tax implication is if Mr and Mrs Smith do not live for seven years after the gift is made, as Inheritance Tax (IHT) may be payable if the estate exceeds the nil rate band at the time.**

In our example, Victoria plans to buy a property on her own. However, if your child is taking out a mortgage with a friend or partner, then legal consideration should be made to who the gift was made to. It's a good idea to speak to a solicitor about what you want to happen in the event of a relationship breakdown, to ensure your child retains the gift by formalising the arrangement with a contract or trust document. This simply recognises in law the rights of your child to retain the amount of the original gift in the event of a breakdown. This may take the form of creating a trust document called a "Deed of Trust".

Both parent and child should make a Will in the first part to recognize the gift, and in the event of the child dying the money could be returned to the parent.

Inheritance Tax may be payable on gifts in some circumstances.

INHERITANCE TAX (IHT)

The current IHT threshold (2019/20) is £325,000 per person. It doubles to £650,000 for a married couple - as long as the first person to die leaves their entire estate to their partner. Anything over this limit is subject to a 40% tax bill.

IHT THRESHOLDS

YEARS BETWEEN GIFT AND DEATH	TAX DUE
DEATH LESS THAN 3 YEARS	40%
3-4 YEARS	32%
4-5 YEARS	24%
5-6 YEARS	16%
6-7 YEARS	8%
7+ YEARS	0%

HOW CAN YOU REDUCE THE IMPACT OF IHT USING CURRENT ALLOWANCES?

1. Use the allowance for individuals to give gifts worth up to £3,000 a year without incurring any IHT.
2. Individuals can pass on larger amounts of money free of IHT, so long as they live for seven years after making the gift.
3. Take account of the 'normal expenditure out of income' rule – if you give gifts out of your income and, in doing so, don't damage your standard of living, they are exempt from IHT, and there is no upper limit.
4. Spread your giving over a number of years, rather than paying out a lump sum.
5. Leave something to charity in your will. This "Gift" is not taxable and also has the added benefit of lowering the tax rate on the rest of your estate from 40% to 36%.
6. Trusts are often used in IHT mitigation but they do need careful consideration. Assets placed into trusts are not exempt from taxes as they could attract entry, exit and 10 year periodic charges.
7. Don't give away too much too soon – otherwise you could be dependent on your children.

MAKING A LOAN

An alternative to an outright gift is to make a loan. In the Smiths' case, they would have the certainty of knowing when they could expect the money back – because they may need it for retirement for example.

Under these circumstances it needs to be very clear what the expectations are around when it is to be repaid. The only safe way to do this is via a solicitor who will draw up a contract detailing how the loan is to be repaid and by when. Another point to think about is if you'd be prepared to write the loan off in the future, and under what circumstances?

While loaning money to your child can go a long way in helping them onto the ladder, there are some additional complications:

1. **Can you afford it?**
2. **If you are loaning with a partner, are you both in agreement?**
3. **A good rule is to lend only what you can afford to lose.**
4. **Put it all in writing – what the money is for, the terms of repayment, how much interest (if any) you'll charge.**
5. **What happens if payments are missed?**
6. **As with a gift make sure all parties make a Will.**

An alternative to an outright gift is to make a loan. It needs to be very clear what the expectations are around when it is to be repaid.

CAN YOU AFFORD IT?

Whether you're gifting or loaning money to your child, or jointly purchasing a property with them, it's likely to reduce your savings and may have an impact on your lifestyle. Before making that decision you need to be sure you won't need that money now, but more importantly, you'll have sufficient income in retirement. Do you know what pension income you're forecast to receive, or how much you may need to save for later life care?

A good rule of thumb is to ask the question, if I was retiring today how much of my current income would I need, and do my current provisions provide that? Everyone's level will be different, but working out how much is required to meet basic needs, then how much on top of that you might need, is the best way to consider it.

If there is a shortfall, then careful consideration needs to be made before making a significant gift or loan. In our example, the Smiths only have one child, but if there are siblings it becomes even more expensive and/or complicated.

CONSIDERATIONS

- **Not all lenders will accept this arrangement as it affects affordability of the applicant.**
- **It may limit the number of mortgage deals available.**
- **There may be additional solicitor costs.**
- **It may place a strain on the parent / child relationship, especially if payments are missed, or the loan is not repaid when expected.**
- **Consideration needs to be made about what will happen in the event of death of any of the parties involved.**

ACTING AS A GUARANTOR

If, after the Smiths have looked at their current financial position and what they'll need in retirement, they decide they can't earmark any of their capital to Victoria's mortgage, they do have the option of acting as guarantors.

CONSIDERATIONS

- **It will limit the number of lenders and deals available.**
- **There may be an effect on future borrowing of the parent as this would probably need to be declared on any loan / credit agreements the parent wanted to take out subsequently.**
- **The Smiths would need to consider if they could afford to pay Victoria's monthly mortgage payment if she is unable to.**
- **The length of time they are acting as guarantors could mean the Smiths have to delay their retirement date.**

The parent can act as "Guarantor" for the mortgage which means that in the event of non-payment the parent(s) becomes liable for the mortgage payment, or settlement of the mortgage.

However, the Smiths need not act as guarantors for the entire term of the mortgage loan. As soon as the affordability criteria have been met – by salary increase for example of Victoria, the lender could remove the parent(s) from the loan thereby freeing them from any ongoing liability.

A sensible view would be to ensure that Victoria has taken out Income Protection Insurance, to provide cover if she was unable to work due to illness or made redundant.

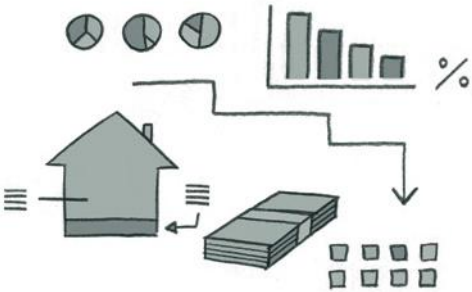
Although the Smith's capital is preserved, they have taken on the responsibility for payment of the mortgage if Victoria couldn't, so they may also need to consider their own Income Protection Insurance.

You may have the option of acting as guarantors for your child's mortgage.

TAKING OUT A JOINT MORTGAGE

As an extension to being a guarantor, Mr and Mrs Smith could take out a joint mortgage with Victoria.

Whichever parent has the highest income, could take out a joint mortgage with the child using their income to improve affordability. This is generally not a first choice as there are additional costs involved.



Tax legislation and the levels of relief depend on your individual circumstances and may be subject to change at any time.

CONSIDERATIONS

- **As the Smiths own their own home, the new property would be taxed as a second home and an additional 3% Stamp Duty Land Tax would become payable.**
- **When the house is sold in the future, the Smiths share may result in a Capital Gains Tax bill of up to 28% on the increased value, as it is not their main residence.**
- **The mortgage term may take the Smiths past their desired retirement date which may mean the lender requires proof of income in retirement, or delay in the retirement date.**
- **The situation becomes complicated if Victoria has a partner, or subsequently wants to own the home with a partner. Taking the parent(s) off the mortgage and putting the new partner on involves solicitor's costs and would be subject to the agreement of the mortgage lender.**
- **There would also be implications for the Smiths for any future loan / credit arrangements as this new mortgage would likely need to be declared on any future applications. If there is any further lending required by the Smiths – such as for their own second home or for an investment property - then this is likely to be restricted by existing commitments made with Victoria.**

GENERAL CONSIDERATIONS

- It is good financial planning to make a Will, but it is even more important when a parent is looking at ways to help a child buy a house.
- It could become very costly if there's more than one child as siblings would expect similar assistance.
- It could also become quite complicated if the child wants to purchase their home with a friend or partner. Regardless of it being a loan or gift, solicitors should be consulted to decide if a formal contract needs to be put in place, or a Trust used. This can add cost and time to the process, and agreeing who should pay for what could become a matter of family dispute.
- Unless there are significant assets, helping a child will have an impact on current savings and lifestyle. It may be limited if wealth is sufficient, but nevertheless should form part of the consideration.
- If savings are affected, parents should consider how this affects their financial planning for later life, such as supplementing their pension or care home costs.
- The opportunities of the parent(s) may be affected in the future if they have somehow become tied to the child's mortgage which could result in lifetime plans not being met – such as the purchase of a dream holiday home or once in a lifetime trip.
- While the taxation implications are generally limited, they should not be ignored. Becoming party to the mortgage could lead to a Capital Gains Tax bill, and it may increase the stamp duty payable.
- Outright gifts may reduce the overall value of the estate but premature death could result in an Inheritance Tax bill.

It can become complicated if the child wants to purchase their home with a friend.

WE'RE HERE TO HELP

We're sure you'll agree there's a lot to consider when helping a child onto the property ladder. Along with our partners, **Charles Derby,** we're here to help. If you'd like to find out more why not give us a call on **03300 244593.**

FURTHER READING

Earlier this year, and in conjunction with the London School of Economics, we published our report, '**The Bank of Mum and Dad: how it really works'.** This report reveals the results of an extensive academic study into how families approach parental help when buying a property.

We've also produced; '**How to run the Bank of Mum and Dad**', which outlines some of the key issues that parents and adult children need to consider when it comes to providing or receiving family financial help;
'**A Conversation Guide**' to help family members through those difficult discussions when it comes to financial support, and
'**A Legal Guide**' to highlight some of the legal implications you may need to consider.

The guides and report can be downloaded from our website:
familybuildingsociety.co.uk/bomad

OTHER HELP

FAMILY BUILDING SOCIETY

The Bank of Mum and Dad: how it really works
familybuildingsociety.co.uk/bomad

Generational Divide
familybuildingsociety.co.uk/generational-divide

Family Mortgage
familybuildingsociety.co.uk/Family-Mortgage

ADVICE AND CHARITIES

Citizens Advice citizensadvice.org.uk

The Money Advice Service moneyadviceservice.org.uk

National Debtline nationaldebtline.org

BROKERS AND INDEPENDENT FINANCIAL ADVISERS

British Insurance Brokers' Association biba.org.uk

Unbiased.co.uk unbiased.co.uk

Vouchedfor.co.uk vouchedfor.co.uk

FINANCE

Financial Ombudsman Service financial-ombudsman.org.uk

Moneyfacts moneyfacts.co.uk

PROPERTY

Association of Residential Letting Agents arla.co.uk

Deposit Protection Scheme depositprotection.com

Help to Buy helptobuy.org.uk

The Letting Protection Service Northern Ireland
lettingprotectionni.com

The Letting Protection Service Scotland
lettingprotectionscotland.com

National Association of Estate Agents naea.co.uk

National Approved Letting Scheme (NALS)
nalscheme.co.uk

New-homes new-homes.co.uk

Ombudsman Services ombudsman-services.org

Onthemarket onthemarket.com

The Property Ombudsman tpos.co.uk

reallymoving.com reallymoving.com

Rightmove rightmove.co.uk

Royal Institution of Chartered Surveyors rics.org

Self Build Portal selfbuildportal.org.uk

Shelter shelter.org.uk

UK Association of Letting Agents ukala.org.uk

IN PARTNERSHIP WITH

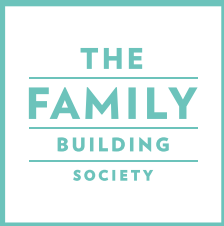
FOR MORE INFORMATION CONTACT OUR FRIENDLY AND HELPFUL TEAM.

03300 244593

FAMILYBUILDINGSOCIETY.CO.UK

This leaflet can be provided in alternative formats on request.

The Family Building Society receives payment from partners where an introduction to their services leads to a transaction taking place.



EBBISHAM HOUSE
30 CHURCH STREET
EPSOM, SURREY
KT17 4NL
familybuildingsociety.co.uk

M/297/0919/FBS/MKTG