The bank of MUM & DAD

AUSTRALIA'S 11TH LARGEST LENDER

While the 'bank of mum and dad' may offer an attractive ramp on to the property market, there are important issues to consider for all parties, before committing. Martin North, founder of Digital Finance Analytics, explains why.

IN SYDNEY THE AVERAGE ADVANCE WAS NORTH OF $85,000, AROUND 10 PER CENT OF THE AVERAGE PRICE OF A HOME THERE, MAKING THE 'BANK OF MUM AND DAD' THE 11TH LARGEST LENDER IN AUSTRALIA

BANKING ON MUM AND DAD

Younger households seeking to buy into the Australian home market, are confronted with a range of challenges, from low returns on savings, limited first homeowner grants, and dizzyingly high asking prices, especially in the main Sydney and Melbourne markets. Even those able to save for a deposit are forced to wait for years, whilst watching property moving further from their grasp.

As a result, according to our household surveys, we have seen a significant rise in the number of new purchasers breaking into the market by raiding the 'bank of mum and dad'. In fact, more than half of recent first-time buyers received help from their parents or other family members. This is creating a two-speed market, with those fortunate enough to have parents with financial assets able to benefit, while those without, are left out in the cold.

Assistance may be by way of a gift, a loan which is either interest free or at an agreed rate, or as ongoing assistance with loan repayments, costs of child care, or other means. Whilst some of those in receipt of a loan from the 'bank of mum and dad' had a formal agreement, and an agreed repayment arrangement, many loans were made informally, with no clear repayment plan.

CONSIDER THE RISKS

Many parents tap into the equity they hold in their own properties, thanks to the rise in prices in recent years. But before going down this path, there are a number of important issues to consider.

First, from the parent's point of view, they are essentially tapping into a pool of funds which would normally be used to support retirement. So they need to seriously consider the consequences of giving away some of this equity, especially at a time when home price growth appears to be stalling. Remember prices can fall, as we saw in the US and UK following the Global Financial Crisis.

Next, they need to be clear about

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the basis of making the loan. Are they expecting to be repaid – if so over what term? Will they charge interest? What would happen in the case of unexpected events like a marriage breakup? The basis of the loan should ideally be formally agreed, and documented, so there is less chance of a misunderstanding later.

From the buyer's point of view, getting access to a cash injection has the potential to make the dream of buying property a reality, and in Australia, the appetite is still strong. But it is becoming more likely that the potential lender will ask questions about the source of the deposit, and will be looking for evidence of a clear savings record. In fact, our analysis shows that those who receive money from parents, in lieu of saving for a deposit, are more likely to default later. As a result, it could be the mortgage rate available will be higher. Our research suggests that some potential borrowers claim they saved the deposit, despite it coming from the 'bank of mum and dad'. Such behaviours may lead to issues later, because a savings discipline needs to be learnt. These days lenders are more likely to ask to see bank statements to validate savings behaviour.

CONSIDER THE ALTERNATIVES

Finally, there are alternatives worth exploring. Whilst higher loan-to-value loans are significantly less available now, and many are encouraged to save for a 20 per cent deposit, the availability of lenders mortgage insurance (LMI) makes a smaller deposit possible, and the risks to lenders are lower, potentially offering a better rate of interest, which over the life of a loan may more than offset the costs of using LMI initially. Mum and dad, or other family members, could even offer to pay the LMI fee as an alternative to lending a higher sum to their children.

WHO IS DIGITAL FINANCE ANALYTICS?

Martin North is the founding Principal of Digital Finance Analytics, an independent boutique research and advisory firm focusing on the finance and property industry. Combining primary consumer research, data analytics and modelling, he has been tracking the sector for more than 20 years. His latest research and insights can be found at **digitalfinanceanalytics.com**

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