



Taking on risk for your children

Inter vivos estate planning - The pros and cons of going guarantor and giving your adult children a 'heads up' in life.

We describe inter vivos estate planning as giving your family part of their inheritance while you're alive to see them enjoy it. With the affordability of housing continuing to be out of reach, parents are increasingly offering financial assistance to children and their spouses, particularly to purchase residential property.

Those of us who have children would all agree that helping them make the most of life's opportunities is a great motivator to give, but sadly, many of us lack a body of objective experience against which to temper the nature and extent of our giving.

People usually only have one case study to work from: their own experience. Occasionally, they will share the experience of other family members or close personal friends, but that too provides only a narrow view of the issues that need to be considered.

The fine line that everyone seeks to identify is where constructive assistance ceases and where indulgence or waste begins. When it comes to providing financial assistance to our children we would recommend taking some of the emotion and personal bias out of the decision making process by seeking professional advice and employing an objective framework to find where that fine line is.

Some Ground Rules

There is no fashion in either inter vivos or testamentary estate planning solutions because the dynamics of each family are unique. There are, however, some ground rules that can help define

how you should approach giving to your children.

Gifting or lending?

There is a difference.

Gifting places no responsibility on the donor and experience has shown us that frequently the donor's expectations are not met. The X and Y generations have a reputation for being blasé, which often time leads their parents to believe they are being taken for granted.

Experience in working with clients has shown us that gifting any more than modest amounts is counterproductive. In fact, we generally advise clients not to gift money to their adult children unless those children are parents themselves.

Children under 30? Only a lender be

It is strongly recommended that if your child is less than 30 years of age, you be a lender.

The lending should be used not just to assist, but also to educate. The objective of the education is to leave adult children financially competent and with a healthy respect for their financial affairs. As a lender, you can choose to charge interest or not; to secure or not; or to demand repayment of capital or not.

It is healthy to dis-intermediate within a family, in other words to cut out the bank wherever possible. If the parent has to borrow to provide the loan, they should not seek to profit by it, but only to be fully reimbursed for their expense. Parents can generally borrow at cheaper rates than adult children. For example, you can lend to adult children the funds to buy a car

under the same terms and conditions as a bank loan, but take advantage of cheaper mortgage lending rates.

If the parents are not borrowing to provide the loan, then the charge should be the interest they were receiving plus 50% of the difference between that rate and the rate the adult child could secure using their own resources.

Where there is substantial assistance being provided for housing and there is an external lender, we advise that where it is affordable for the parent, that the loan be conditional to the extent that interest foregone be applied as voluntary additional payments to accelerate repayment of the non-deductible bank debt.

Documentation? Always put it in writing

Whether you are considering lending or gifting to your children, it is vital that it be properly and formally documented. The primary reasons are control, risk management and asset protection. It would be negligent of both parent and child to assume that there will never be any conflict that may create discord. Additionally, the fluid nature of relationships today means that others may become unintended beneficiaries in the event of divorce or relationship breakdown.

Control triggers should be clearly outlined in documentation. For example, if a child accepts assistance from a parent to purchase a real asset and decides six months later to dispose of the asset, it is important that the parent's interest in the property to the extent of the loan be documented formally to guarantee return of that capital.

Should the loan be stamped or registered against the asset?

There is no prescriptive answer to this question and it depends entirely on the circumstances. Generally though, if the loan is being made to purchase a real asset, such as a property, it makes good sense for the lender to register a first mortgage over that asset. The case study below examines what can go wrong if a child defaults on the mortgage and parents have not registered their interest.

Divorce and relationship breakdown

The Family Court hears most property disputes involving de facto spouses. With binding financial agreements becoming a favoured tool of high-income earners to mitigate the costs associated with divorce and relationship breakdown, such agreements may now have greater implications for parents who provide financial assistance to children in de facto relationships. Having amounts lent to your children properly documented and secured will help protect this capital and ensure it remains within the family in cases of relationship breakdown.

A final word

If your financial position truly allows you to be unconstrained in your capacity to enhance the quality of your life, then it makes sense to extend that same privilege to other family members. But, for both the giver's and receiver's peace of mind, it's important to apply commercial principles when setting the ground rules.

Case Study: Failure to register a mortgage

Angus is 25 years old and single. He is in the process of starting an IT business so savings are scarce. However Angus, like many of his friends, has a dream of owning his own home and soon. He has found a property for sale at \$450,000 and his parents, John and Christine have offered financial assistance to Angus to purchase the property. Given Angus's current financial position, he gratefully accepts the offer.

John and Christine are able to fully fund the purchase price on Angus's behalf. Under the loan agreement, the newly purchased home is offered as security for repayment of the debt to John and Christine. John and Christine see this as a way of protecting their capital in the event Angus's new business does not perform as well as expected. However, due to their unfailing confidence in his ability to succeed in business, John and Christine fail to register their security on title.

Angus, not wanting to borrow further money from his parents, obtained a loan of \$200,000 from the bank to help develop his business. He didn't tell John and Christine because he wanted to prove to them he could manage on his own. The bank, with Angus's consent, immediately registered an all monies mortgage over Angus's home.

John and Christine now find themselves in a dangerous predicament. Although they have security over Angus's home, it is not registered. As a start-up business, statistics show that it is more likely to fail than succeed. If that happens, then the bank, having a registered mortgage, will be able to exercise its security over the home in priority to John and Christine, whose security is unregistered. Even if they register their security now, they will only have a second registered mortgage since priority is based on the date of registration, not on the date of the loan.

If the home is sold to repay Angus's loan, then the bank will be paid its \$200,000 first and John and Christine will be second in line. Assuming the house is still worth \$450,000, John and Christine will be able to recover \$250,000 but in order to recover the balance of their loan (\$200,000) they will rank equally with all of Angus's other unsecured creditors e.g. employees, suppliers, etc. This could have been avoided if they registered a first mortgage over the property when they entered into the loan agreement with Angus principles when setting the ground rules.

LACHLAN PARTNERS is a Private Advisory Firm focused on client needs and financial goals with offices in Melbourne, Sydney and Brisbane www.lachlanpartners.com.au. The following can assist you with your Estate Planning needs; Roger Wilson (Partner); Eric Maillard (Partner)

Protect your investments in 2011

2011 is shaping up to be a challenging year for investors
- getting the right advice will make all the difference.

Lachlan Partners is bringing together some of Australia's foremost experts at their key seminars to be held in March 2011 across the Eastern Seaboard. Our eminent speaking panel includes

Chris Caton
Chief Economist
BT Financial Group
'Global Economic and Market Outlook'

John Marasco
CEO
Colliers
'Investing in Commercial and Residential Properties what is happening in Australia and Globally'

Paul Saliba
Chief Investment Officer
Lachlan Partners
'Dynamic Approach to Asset Allocation - Applying the new Zone System'

Seminars are being held in the following locations

Brisbane
Tuesday March 8th 2011
2 - 4pm
The Novotel Brisbane
200 Creek St, Brisbane QLD

Sydney
Wednesday March 16th 2011
7.30 - 9.30am
The Portside Centre,
Level 5, Symantec House,
207 Kent Street, Sydney NSW

Melbourne
Thursday March 31st 2011
4.30 - 6.30pm
Level 1, Crown Towers,
8 Whiteman Street, Southbank VIC
(Free Parking Available)

Lachlan Partners is a Private Client Advisory Firm focused on client needs and financial goals with offices in Melbourne, Sydney and Brisbane.

REGISTER NOW

To attend **OR** obtain a Seminar DVD and receive a **3 month complimentary subscription** to Investing Times email your details to **update@lachlanpartners.com.au**

Investing Times, Australia's foremost independent newsletter providing financial and investment wealth creation strategies since 1971.

www.lachlanpartners.com.au
Telephone 1800 643 631 (Freecall)



LACHLAN PARTNERS
Chartered Accountants, Business & Financial Advisors

