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Legal update ——— November 2016

Residential private client
Top tips for "'The bank of Mum and Dad"

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According to a 2015 Legal & General report, lending from parents to their children to help get them on the property ladder will amount to £5 billion this year.

The Legal & General report also claims that if parental contributions were combined into a formal business, the "bank" would be one of the top ten mortgage lenders in the UK. With rising property prices and reduced mainstream lending, it is hardly surprising that twenty somethings need this additional financial assistance.

With recent changes to the pension rules, which may allow parents and grandparents greater access to their pension pots, this may be an increasing trend. For parents looking to help the next generation on to the property ladder, some creative thinking is often required and it is not without pitfalls. Here we examine some top tips for those considering joining the "Bank of Mum and Dad".

- **Making a gift**

  This is often the simplest option and can assist in inheritance tax planning. It may also enable the buyer to obtain a mortgage at a better rate as it will increase their deposit bringing down the required loan to value. The difficulty with this option, however, is a lack of control for the parents, and often comes down to an exercise of trust. Is the buyer financially responsible? Is the buyer making the purchase with a friend or partner you may not approve of?

- **Loan**

  The buyer will be obliged to declare the source of their funds to their solicitor and the mortgage company which may impact on the mortgage rate they are offered. A number of lenders will not lend where there is a parental loan in the background and will insist on seeing a signed a gift declaration. The advantage of a loan is that the money is due back to the parents at a later date (usually on the sale or refinance of the property). There is also the opportunity for the lender to protect their interest with an appropriate restriction on the Land Registry title, subject to the approval of the first lender.

  The first lender will almost certainly insist that their loan will take priority over any parental loan, meaning that the mortgage company will recover their loan and costs before any private lender. Conversion of the loan to a gift at this stage would have to be done by deed in order for the clock to start counting for inheritance tax purposes. Lending to home owners is regulated by the Financial Conduct Authority and documenting a loan between children and parents needs to be specially drafted so as not to fall foul of the rules.

Source: Fotolia

- **Parental guarantee**

  If funds for a deposit are not available, a parent/parents could be party to a first mortgage of another asset or guarantee that the mortgage is paid by the children. This is not without financial risk to parents and they will be required to take legal advice independently of the children to avoid any conflicts of interest or claims of duress.

- **Parent as Co-Owner**

  Alternatively, one may agree to be listed as a co-owner and also be on the mortgage too. Some

Published by
Trowers & Hamlins

Trowers & Hamlins LLP
3 Bunhill Row
London
EC1Y 8YZ

t +44 (0)20 7423 8000
f +44 (0)20 7423 8001

www.trowers.com

lenders are increasingly offering specialist mortgages which allow a parent to have their name removed after a fixed period. As ever, each party to such a transaction should obtain their own independent legal and financial advice to ensure they are entering into any agreement with their eyes wide open.

Such agreements are not to be taken lightly. If the child or grandchild divorces or runs into financial difficulty and cannot pay the mortgage the mortgage company can turn to the guarantor or co-mortgagee for the outstanding payments and in the worst case, the entire outstanding balance. In turn, the financial security and credit rating of the guarantor or co-mortgagee could be adversely affected.

There is one word of caution: recent changes to the rules around stamp duty will have impact on how parents choose to provide financial support to their children's home purchases. A three percentage point residential property surcharge in respect of stamp duty was imposed on people buying second properties including landlords, on 1 April in England, Wales and Northern Ireland. These changes could affect those who only purchase a minority share in the property. Stamp duty has been abolished in Scotland, but similar tax increases were also introduced there to prevent distortions in the housing market. Families should take advice from their advisors to ensure they are not caught out by these changes.

It is only natural that parents and other family members should want to help the younger generation as much as they can, including getting them on the property ladder. The key is to find the method that suits you all best, and to employ the best professional advice you can to ensure you do not fall into any hidden traps.

For more information please contact

Katharine Lewis
Partner
t +44 (0)20 7423 8041
e klewis@trowers.com

Denielle Rickman
Senior Associate
t +44 (0)20 7423 8022
e drickman@trowers.com

Andrew Williams
Professional Support Lawyer
t +44 (0)20 7423 8019
e ajwilliams@trowers.com