Helping your kids buy their own property sooner

This e-book was prepared to help parents and adult children who are interested in starting in the property market. In this book we have explained how it all works and how to make this possible without risking the parent's home. We have also discussed the $20,000 grant currently being offered by the Queensland Government to encourage first homeowners to build a new property.

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There is always a challenge in getting into the property market. We have designed a programme to help young people get into the property market. The Government has come to the party recently by offering $20,000 grant for anyone who builds their own first home. Another bonus is that there is no stamp duty payable if this first home owner spends less than $505,000 for the house and land. This is another saving of $8,750.

N.B. There is still a reduction in stamp duty over $505,000 but it runs out after $550,000.

So there is a total of $28,750 being offered this year for first homeowners to buy their own property. The catch is that the purchaser has to live in the property for at least 12 months. This can be a real problem for some as it means buying a property and either paying for the loan payments out of current income or supplementing this cost with a few flat mates.

Part of our plan is to use properties that have two separate units to rent out. This means that the purchaser can live in one unit to meet the Government requirement for 12 months and then still rent the other unit out to generate some additional income. Sure, the purchaser could still have some flat mates but there is not as much need to do this while the other unit it being rented out.

Finding the deposit can be the other challenge for the first home buyer. This is where the parents come in. There is nothing new about parents wanting to help their kids get into their own home. The general thinking for this is the parents go 'guarantor' on the loan. Effectively this is offering their home as security for the young adult's loan. This is ok on the surface but there is a sting in the tail if the young person's world turns upside down and they don't keep up all the payments. There is a risk that the young person could lose their home and the parent's home is at risk as well. This is where these ideas fall apart.

As a parent myself I wouldn't want to see my kids lose the house and I would help out where I could but I certainly wouldn't want to put my home in jeopardy.

Here's an idea we have.

Let's tackle the two problems. The deposit and the payments.

The deposit

Instead of being the 'guarantor' for the loan you create a separate part of your home loan and lend this to your young adult. This would be like a line of credit for the deposit. Then there will be a loan repayment management system that we put in place with the young person so the loan can be repaid every month to the parents. Based on our figures this should be fully repaid in about 3½ years.

If something goes wrong in the young person's world the parents are exposed by the amount that hasn't been paid back. That's not great but at least it is limited to that amount, the parent's house is not at risk. To give you an idea, half the loan should be repaid in 26 months and it should be fully repaid in 38 months. So the parent's exposure reduces pretty quickly after the first 18 months or so.

The payments

Because this needs to be a new house there can be a few months lag between signing a contract to buy and actually paying for the loan when the house is finished. We would use this time to start repaying the loan to the parents. This starts the new pattern of repaying the loan.

When the house is finished and one unit is rented out and the loan is being repaid to the bank, that's the highest amount of strain on the cash flow. Even at that point it will only cost $143 per week. That's still less than a lot of young people are paying in rent in their current situation.

At this point the young person is living in one unit in the property at a cost of $143 per week and the tenant in the other unit is paying their rent and all this money is enough to cover the interest on the loan, the rates and the insurance on the property.

After 12 months when the young person moves out that unit can be rented out and the whole property will make $94 per week after all costs. Instead of this extra money being spent there should be a plan in place where this is allocated to repaying the loan to the parents.

The benefits

We designed this programme to provide a benefit to families. In this strategy we believe there is a benefit to the parents to help their kids without risking their own home.

The benefits to the kids are:

- They get into the housing market sooner, before they get priced out
- They establish a regular repayment programme to their parents.
- They get a real sense of financial accomplishment in buying their first home.
- They can build their asset base with the cash they save once they repay their parents plus as the property increases in value.

The results

As with all financial matters we made some assumptions so that we could show how this plan could work. In this case we assumed that the property purchased is a dual occupancy or dual living house at a cost of $481,400. Also we assumed that the parents could borrow $42,000 from their home loan and the young adult has $5,000 in savings at the start of this plan. The young person has to have an income of at least $40,000 per year. There are more assumptions on the following pages for more detail.

We also assumed that the young person is currently saving $200 per week and is paying $250 per week in rent.

- The parent's loan will be repaid in 38 months.
- In 5 years the young person will have $37,161 in their bank, that's after repaying their parents.
- In 5 years there will be $100,000 of equity in the property if it grows by 2.0% per year.

NB We have assumed the rent, savings, interest, rates, insurance and salaries all stay constant during that 5 years.

The impact of these results is that the young person could be in a position to either sell this property and buy another one or just use this as equity to buy a second property to either live in or rent out.

The property

The dual occupancy property looks like a 5-bedroom house that is split down the middle. One unit has 3 bedrooms and the other unit has 1 or 2 bedrooms. These can be highset or lowset houses. Each city council has different rules about what size these properties can be and where they can be located. For example, Logan City Council will allow a 3 and a 2-bedroom configuration while Ipswich City Council will only allow a 3 and a 1-bedroom configuration. Some councils won't allow these at all yet.

Usually these properties cost between $450,000 and $650,000. They can pay a rental income of up to 6.4% of the purchase price. So a $500,000 property would pay $615 rent per week.

Here is a picture of some of the dual occupancy properties we have built for our clients.

These properties are attractive to a tenant because they are part of a real house instead of a unit complex. They usually have a small yard and secure car accommodation. These properties are the same as a duplex but they are not on separate titles so they are less expensive to build and complete. Duplex properties have been very popular for years and now dual occupancy or dual living houses are becoming available for less cost.

The loan repayment programme

There are 3 stages of the cash flow management system of this project. They are:

Stage 1. Contract is signed and the house is being built. *Construction stage.*

Stage 2. When the property and the young person moves in to their own unit. *Occupying stage.*

Stage 3. When the young person moves out and both units are rented. *Fully rented stage.*

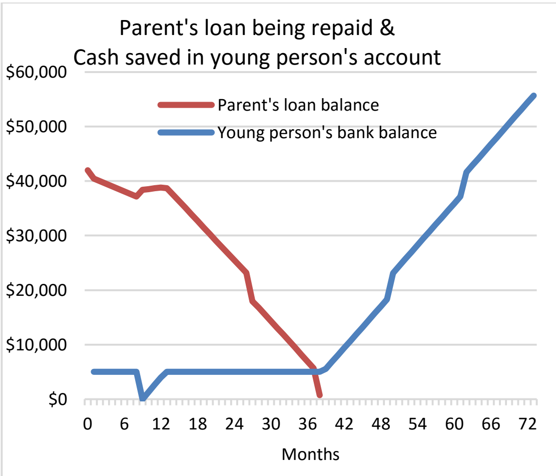
During each of these stages it is important to capture the income that is moving around between everyone. For example, during the construction phase the money that was being saved in the young person's account before this started is now being automatically paid directly to the parent's loan after paying for rates on the land.

In the next stage the money from the rent and savings is being paid to the bank loan and to the parent's loan, again automatically every month.

Then in the last stage all the surplus income is being directed to the bank loan and the parent's loan. When the parent's loan is repaid fully this money will go to an offset account to reduce the interest on the home loan until it is needed.

To make this work it is essential that realistic figures are being used in the cash flows. Often we see people use high rental income and low interest payments which only sets up a high chance of falling short of the forecast cash flows. You may want to calculate a lower rental income or higher interest payments or no tax refunds just to make sure all the cash flow targets are met.

In our assumptions we only included the tax benefit of the depreciation after the first year when both units are being rented. There could be other tax benefits but we decided not to include these in our example.



The chart above shows the parent's loan being repaid and the young person's bank account growing over the next 6 years (72 months on the chart).

The system

There are a number of components to making this complete programme work. Here are the main points.

1. **Property management.** Some people may want to manage the property and collect the rent themselves but we believe it is better to have a property manager do all this. Not only is this less hassle it creates a point of separation between the property owner and the tenant who is living next door. It will cost about 8.5% of the rental income for the property manager but you should simply include that in your figures.
2. **Owner and tenant separation.** It could be difficult to live next to your own tenant. Unless you approach this properly, every time the tenant next door leaves their bin out or doesn't weed the garden then you could get frustrated. It would be best to assume that you are renting the unit as well. Sure, we know you are the property owner but it could open up unnecessary stress if you don't make the separation.
3. **Cash flow system.** A system should be put in place, and in writing, so everyone knows what is going on.
4. **The parent's loan.** It will help to make the lines very clear about the loan and everyone's responsibilities. You may even want to put a loan agreement in writing. As added security you may want to put a second mortgage on the property, this will give both the young person and the parents the comfort of some added security.
5. **First Home Owner's Grant and Stamp Duty exemption.** These applications are made when applying for the bank loan and the money is paid by the government at property settlement.
6. **Responsibilities and obligations.** To remove any subtle obligations that could exist it will be important to ensure that each party is doing this for the right reasons. For example, the young adult may be more interested in not risking their parent's assets and repaying the parents as quickly as possible.

   The parents may not be as concerned about this because they have more experience in these sorts of financial transactions. The parents may feel a sense of obligation to protect the young adult from the investment risks. To do this they may need to tread carefully so that the young person is fully empowered to make their own decisions with or without the parent's involvement.

   From a financial perspective the parents should only be concerned that their loan will be repaid and just like a banker they should make sure there is a system and capacity to ensure that the loan will be repaid on time.

What's next?

You will need to find the right property to meet all the objectives and government guidelines. We specialise in this area and we have a good knowledge of what to build and where to find the best value for money. We also have the cash flow and budgeting system in place ready to go.

So if you want a hand then call us. If you want to do this on your own then start looking for this new property. *Time is running out.* The Government has only offered this money to people who sign a contract between now and June 30, 2017. It will be best to put the time in now to understand how all this works and not leave it to the last minute when there is a chance of missing out or potentially paying more than necessary because of the pressure on the demand in the last few months of this government offer.

If you want to know more then give me a call me on (07) 3420 5888 or email to craig@picgroup.com.au.

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