PARENT'S CONSIDERATIONS CHECKLIST

How much can you afford?

At 2Be, we believe that helping family is the best type of finance.

Parents Risk Guidance Questionnaire

Remember that a good rule of thumb is to only give what you can afford to lose, both today and tomorrow:

- **Don't risk your future dreams and plans.**
- **Take the time to assess your risks, and understand what you can REALLY afford.**

It's wonderful to help your children but you don't want to risk your financial future or your relationship with the kids. In this document we guide you through both.

The emphasis in this guide is on risks (bad things that could go wrong) rather than returns (great things that result when all goes well).

While some of these questions may be confronting, they could stop family heartbreak and financial catastrophes down the track.

You will get the most out of this document if you take some time filling out the answer sections, to make yourself think through every question fully.

This risk questionnaire consists of two parts:

- Checking that the relationship between you and the kids is strong enough to weather any storms that may occur.
- Assessing your financial capacity to withstand the catastrophic event in which the child doesn't make repayments.

RELATIONSHIP RISK QUESTIONS

Your Reason for Lending

Parents should be clear why they are gifting or lending money. For example, the borrower (child) can't get funds elsewhere (either for a deposit or to make ongoing repayments); and wants to avoid costs such as Lenders Mortgage Insurance.

List the main reasons you are lending money:

Financial Risk Appetite

Risk appetite refers to the level of risk a person is comfortable taking on in the pursuit of their goals and objectives. Some people tend to be financial risk-takers – they will seek out higher risk ventures which could have higher returns. Other people are more risk-averse – that is, they are hesitant to take on risk even for higher potential returns.

For example, risk-takers might invest in a friend's speculative start-up business, while risk-averse people are more likely to invest in bank deposits or established businesses.

This propensity to take on financial risk applies regardless of whether people are in a strong or more challenging financial situation. Likewise, neither approach is right or wrong.

Typically, are you more likely to be risk-averse or a risk taker when managing your financial decisions?

Relationship Obligation

Parents often feel obligated to help with a loan/gift out of a sense of duty, guilt or pressure being applied or love and concern for the borrower. Socially isolated adults may be more vulnerable to such pressures.

You should consider whether the emotional benefit of helping justifies the risk to your financial position.

To what extent do you feel obliged to make the loan/gift, even if there is a material risk to you financially? And why do you feel obliged to provide this support?

Rules – Tax and Legal

There may be legal and tax implications associated with a home loan, which can vary by State or Territory.

Do you understand all the potential legal and tax implications of your gift or family loan?

Difficult Conversations

Many parents find conversations with their children about money to be very difficult. The discussions have to cover things that may go wrong and lead to financial stress (e.g. ill-health, relationship breakdown, unemployment, excessive gambling). Other considerations might include discussing an extravagant lifestyle, or a family member's susceptibility to influence from others, including their partners.

To what extent are you comfortable having open discussions in advance of setting up the loan and dealing with conflict if there is a subsequent problem with repayments?

Repayment Issues: Dealing with the Child

If the child is having problems making ongoing repayments to you, or repaying the loan completely when it becomes due, they may not be prepared to listen to the 'difficult conversation' or act in a way to resolve the issues. This could be affected by their partner/spouse and any other household financial decision makers who may disagree with the steps needed to resolve the issue.

You may have to convince them to act on your requests and find the right course of action, even to the extent of taking legal action.

Moreover, your own circumstances may change, and you may need the loan to be repaid earlier than anticipated.

If there is a problem with repayment/repaying the loan, to what extent do you think the child and any related decision makers will do everything they possibly can to understand and take action to resolve the issue?

Are you confident you can have those awkward conversations with them easily, and will be able to seek legal recourse in extreme circumstances?

FINANCIAL RISK QUESTIONS

Right Loan Amounts and Concentration of Funds

If you are using savings, investments, or taking a loan to fund the child's deposit, the amount that you can comfortably provide should reflect what you can afford.

Unless you have uncommitted savings, you may need to forego the income on some investments or incur interest costs associated with borrowing against your home equity.

Note: In a direct loan, if the child is paying you a higher interest rate than you're earning on your investments, this is not an issue.

To what extent are you in a comfortable enough financial situation to make a loan or gift that it won't materially affect your cash flow, lifestyle or future plans?

Income Stability

Looking forward, there are many factors that can affect the stability of your income, expenses or debt repayments. For example, you may be thinking of moving to part-time (instead of full time) work, or retiring—or you may have concerns about ill-health, a relationship breakdown, or unemployment. Clearly, it's impossible to forecast the future.

Apart from the impact of the loan to what extent do you expect your cashflow will change. What level of change in your income is likely to happen over the next five years?

Are you expecting an increase, decrease, or for it to remain stable?

Repayment Reserves

Circumstances may arise that mean the child is unable to meet their repayment obligations. So, it's important to know if you want or can afford to take over the child's loan repayments (if there is a bank involved) and/or live without the investment income (if it is a loan directly between you and the child).

In the shorter term, you may need to curb your lifestyle or get more income (from a second job, for example). In the longer term, you may need to find another way to recoup your funds by selling assets, such as shares or an investment property. It's important to understand your ability to do this; in the worst case, it may even result in you having to sell your house.

To what extent would the borrower being unable to make repayments/ repay you affect your lifestyle and assets in both the short term and the longer run?

Risk of Concentration

By giving your child a loan, you may expose yourself to 'concentration risk' — having a high proportion of your assets tied up in one investment. As you approach retirement age, or retire, the potential effect on your portfolio becomes important, as you won't have as many years to earn offsetting income.

What would be the impact on your retirement income and the proportion of your assets if the loan was never repaid by the borrower?

If lending or gifting, will the impact on your total wealth be affordable in the long run?

Resetting Payments Over Time

Typically, if the child is going to have difficulty making payments, it will occur in the first few years. So, if you can afford it, it may be helpful to charge a lower interest rate to the borrower for the first few years or provide an interest free loan for a while and structure repayments to increase over time.

To what extent are you in the position to afford lower repayments (i.e. accept reduced investment income) to help out the child?

A Good Rule of Thumb...

...used by commercial bankers is that loan repayments should be a maximum of 30% to 35% of your take-home income. If you're taking out a personal loan or are helping your child with their loan repayments, it's good to assess how much of your take-home income it will take. Make sure to account for other loans including any credit cards, personal loans, equity loans, mortgage payments.

What is the ratio of the amount of your total loan repayments as a percentage of your total income?

NEXT STEPS

Finding Agreement

Are you confident your child fully understands and agrees to all aspects of the loan? It might be useful to ask them to "play back" what they believe has been agreed upon to avoid any misunderstandings later.

Getting Advice

We suggest getting advice from a trusted source — like a legal or financial advisor.

Document Everything

Every conclusion you and your child come to in terms of the loan conditions and structure should be documented and kept by both parties in a safe place. With any luck you will never require these documents, but sometimes memories fade and distort so get everything in writing!

To learn more about the Bank of Mum and Dad, and to explore innovate finance options available to parents, visit 2Be.com.au

Important:

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