The Bank of Mum and Dad

Generous lending conditions, high rates of forgiven loans, and a personal relationship with your branch manager... is it any wonder that the 'Bank of Mum and Dad' has such loyal and regular customers?

When we talk about the Bank of Mum and Dad, we are effectively talking about handing money over to your children. There are many reasons why your descendants might look to you for financial support, and many routes you could take in funding them, if you so choose. It's no surprise, then, that such a large number of our customers come to us seeking advice in this area.

How are people giving money to their children?

Some ways of passing money on to your children can start very early, including putting money into a Junior ISA for your child. The current annual allowance for contributions is £9,000, meaning that if you start paying into an ISA when your child is young, they could find themselves with a sizeable sum of money by the age of 18.

Focusing on later life stages, some parents might also consider contributing to their children's pension pots. Covering school fees and other expenses for grandchildren is another possible way to help out younger generations financially. But with house prices at historically high levels, the most common 'Bank of Mum and Dad' queries we receive concern helping the younger generation onto the property ladder.

According to national statistics, in February 2023, the average UK house price was £288,000 – £6,000 higher than at the same point in 2022. In London – the UK's most expensive region – the average price was £532,000 (though prices are rising more slowly in the capital). With even the most generous mortgages typically requiring a deposit of at least 5-10% of the house value, using the prices above as a guide, the necessary deposits can quickly run into the tens of thousands.

Meanwhile, developments in relatively recent history – such as new pension freedoms – have unlocked previously inaccessible money for many. As more people consolidate their pension pots and move money around, some have chosen to use a portion of their retirement funds to help their children onto the property ladder.

However, we would advise caution in this regard. It is important to ask yourself (and ideally a regulated adviser) if taking such a course of action will leave you unable to

> “It can be helpful for financial gifts to children to be documented. We often suggest writing an accompanying letter to your child, setting out the date and value of the gift, and perhaps the purpose for which this is intended.”

fund your retirement. Very few people have more in their pension funds than they will need to meet their future income requirements during a potentially very long retirement. What’s more, once retired, you are unlikely to have the opportunity to generate significant levels of savings in the future.

To gift or to loan, that is the question

With this in mind, if you do want to help your child onto the property ladder, it is important to ask yourself whether you can afford to give these funds away as a gift to your child, or whether you would be better placed to offer them a loan.

There is a balancing act to be found here between planning effectively for inheritance tax purposes (giving away money reduces the value of your estate, and potentially its tax liabilities) and wanting to be certain that you can afford to make the gift. If you opt for a loan, you must also factor in the true likelihood of this loan being repaid.

Making a gift of your money

If you have reasonable notice of your child’s property purchase plans, you could consider gifting money to your child on a regular basis. If this is funded from your surplus income (rather than savings), it could well be exempt from inheritance tax under current tax rules. ‘Income’ could also refer to dividend income from an investment portfolio.

If gifts are made using your £3,000 annual exemption (allowing gifts up to this value to be made each year) this too will immediately be outside of the scope of inheritance tax. More significant gifts of capital, in excess of this amount, will generally fall outside of your estate after seven years; should you pass away within this time period, the gift could be exposed to inheritance tax.

Whatever their size or regularity, it can be helpful for financial gifts to children to be documented. We often suggest writing an accompanying letter to your child, setting out the date and value of the gift, and perhaps the purpose for which this is intended. Besides the emotional value of this act, it can be helpful – in the event of your death – for your executors to have these records.

Importantly, making a gift to your child to fund a housing deposit should not affect the mortgage they are offered. The mortgage lender must be satisfied that your child can repay the loan, even if interest rates rise, which does not relate to the source of their deposit. If you have concerns in this area, speaking to a regulated mortgage adviser is the best course of action.

Loaning capital to your child

It’s possible that while you have the means to offer some financial liquidity to your child in the near term, you are not confident in parting with those funds indefinitely. Perhaps you are still paying off your own mortgage, or foresee property costs or other significant expenditure ahead. Maybe you are not confident about funding your own retirement without these funds. It is quite conceivable that you are concerned about the longer-term security of this money under your child’s management.

In such instances, you might want to consider making a loan to your child, rather than a gift. It is possible to draw up a simple loan agreement that is signed by all parties and witnessed independently. This agreement could include the terms under which the loan will be repaid, whether interest is payable and on what basis, and in some cases a stipulation as to the purpose of the loan (e.g. to buy a first home).

Over time, you might choose to ‘forgive’ part or all of the loan, ultimately making a gift of the money instead. It can be helpful to set expectations around this (your own and your child’s) in advance, but of course this is not always achievable in reality. If you do decide to convert all or part of your loan to a gift, the seven-year period relating to inheritance tax (mentioned above) would begin at the point of the loan’s forgiveness.

Protecting your family relationships and your capital

We advise that, as far as possible, you discuss matters like these openly within your family. If you feel unable to help your child onto the property ladder – either at all, or at this time, or to the extent requested – then it is probably more helpful to make this clear at outset.

If you have concerns about mixing your financial affairs with your child's partner's, rest assured that these are very common worries. There are plenty of options that could mitigate against the risk of money being lost to your family through changes in your child's personal life, like (as we mentioned above) making a loan of your capital rather than a gift. Many other steps can be taken too: from co-habitation agreements for live-in partners, to prenuptial agreements for spouses, there are lots of other potential choices. If you've made a substantial contribution towards your child's property, it could be a good idea to encourage your offspring to enter into agreements like these, and to seek legal advice for peace of mind (yours and theirs!).

If you are divorced or separated from your child's other parent, it may be that one of you is in a better financial position, and more able to help out. Perhaps, if you have more than one child, you would like to offer more financial help to one of your children than another. This could be the result of a wide range of factors, including differences in your children's earning potential and personal circumstances.

While these conversations can be daunting, we normally advise being as transparent as possible with those involved. All families are different, and it is important to find the arrangements that work best for you.

Christine Ross
Head of Private Office (North) & Client Director