Tighter rules apply for bank of mum and dad

JAMES GERRARD

Last weekend's auction clearance rate of just above 70 per cent in both Sydney and Melbourne has sparked new interest in the struggling property market. But alas, the looming recovery means more loans looming for what might be the only lender in the nation that doesn't want to lend more money — the bank of mum and dad.

Over the past four years, figures from consultancy Digital Finance Analytics show that loans from parents to their children have increased from about $5 billion to more than $20bn, making parents across the nation a bigger lender than Bank of Queensland, HSBC Bank, Citigroup and Teachers Mutual Bank combined.

DFA says in its report that while parent help comes in a number of ways (from a loan to a gift or ongoing help with mortgage repayments or other expenses), where a cash injection is involved, the average is about $88,000.

In addition to these direct loans and gifts, parents are also signing up to bank guarantees for their children where the child does not have the required 20 per cent deposit plus stamp duty for a normal mortgage. The guarantee provided by the parent is

executed by the bank via a registered mortgage over the parents' property or requiring them to hold a term deposit in a quarantined account.

Even after a 10-15 per cent drop in prices over the past two years, housing affordability remains poor for the younger generation and, with these arrangements becoming increasingly popular, banks are now implementing more rigour when loans are approved that involve a parental guarantee.

Sydney mortgage broker Wayne Dive from Smartline says: "The problem is that parents are normally in their 50s and 60s when guaranteeing their children's loans so there are big questions around the parents' ability to absorb any liability in the event their children default without being detrimental to their own retirement."

In extreme cases, if the bank comes knocking because of a defaulted loan for which the parents guaranteed, if the parents have no other liquid assets, their own home can be sold to cover the outstanding loan and fees with the bank. Although this may be unlikely to occur, recent declines in the property market coupled with generous arrangements around family guarantees make this scenario more likely than many may think.

Dive says: "Most of the major lenders allow young borrowers to purchase with a loan-to-value ratio of up to 107 per cent with no cash if a family guarantee is provided." In other words, people in their 20s and 30s who have no savings are able to lean on their parents for a guarantee.

In a rising property market, default problems don't usually arise. However, in the current sluggish market, cracks are starting to appear.

Dive says: "Off-the-plan properties purchased over the past few years will be particularly troublesome. One client purchased an off-the-plan apartment in 2018 for $650,000 and as we now near completion and are preparing the loan documentation, the bank valuation came in at $550,000."

If a family guarantee was used and the child decided to walk away from the property, the parent would be up for close to $150,000 to the bank once stamp duty, penalties and interest have been taken into account.

At present, parents and their advisers sign guarantee acknowledgment forms towards the end of the loan process, but Dive believes this needs to change.

NAB this week introduced tougher guidelines for parents in these situations following the Banking Code of Practice: parents will now have to give more information on their own finances to the bank before helping their children.

Says Dive: "Although banks such as NAB require parents to prove they can service the guaranteed loan amount, I see the industry moving towards an upfront legal and advice process for the parents. Banks are likely to insist in the future that parents receive independent financial and legal advice before the children's loan application is able to be lodged with the bank."

But what if financial advisers and lawyers pull out of giving advice to parents looking to provide a family guarantee?

In my experience, most in the industry don't want to be caught up in legal disputes resulting from defaults on loans involving family guarantees, especially when most provide the advice and sign these forms for a nominal fee or at no charge given a pre-existing relationship with the parents. If this occurs, we may see a reduction in the number of family guarantees or alternatively a spike in the cost to get the legal and financial advice that the parents are required to get.

In something that seemed rushed and was dangled to voters at the last minute in the federal election, the government plans to step in and provide 10,000 guarantees to first-home buyers each year where the buyers will only need a 5 per cent deposit.

With family guarantees becoming increasingly harder to obtain, the first-home loan deposit scheme is likely to receive a lot of interest, contrary to the first-home super saver scheme, which has been a flop.

And if all else fails, Dive says: "Kids will simply have to wait for their inheritance before buying a property or maybe do that uncommon thing in today's world called saving".

James Gerrard is the principal and director of financial planning firm FinancialAdvisor.com.au

Secrets in dealing with top advisers

Finding one who is right for you is only half the battle

JAMES KIRBY
WEALTH EDITOR

Here at *The Australian* we have just produced our third version of The List: Top 50 Financial Advisers. This year's list has some real surprises — we had a female adviser take the top spot, which is all the more impressive when the list is 86 per cent male. Moreover, we had 20 new entrants, which suggests the sector is anything but stagnant.

A list like this is a major affair for the adviser industry, but it can also be useful for the investor who wants advice and, more importantly, wants to take the first steps in finding an adviser. After all, the best investors always take advice, especially on tax, asset allocation and investment structures.

The List: Top 50 Financial Advisers is created in conjunction with Barron's, the New York-based investment magazine that has been running the US version of this list for decades. (Barron's is a New Corporation subsidiary.)

After running this exercise since 2017, it is clear that the best advisers in Australia tend to fall into one of three categories: (1) There are big brand names such as Morgan Stanley or Macquarie; (2) There are partnerships such as Escala, Koda or Pitcher (home of our new No 1-ranked adviser, Sue Dahn); and (3) There are smaller practices where one adviser has built a great reputation and they are the keystone of the business — people such as Neil Herriot at Sanctuary Cove or Doug Turek in Melbourne.

Individually, we find advisers from all walks of life and many have spent their early career in another area of finance — often stockbroking — before specialising in advice.

We also note they can play an active role in the world around them. Dahn is a case in point, being chair of industry super fund MTAA and on the investment committee of Melbourne University's Trinity College, the Australian Communities Foundation and indigenous group Victorian Traditional Owner's Fund.

Which type would suit you?

Successful adviser/client relationships hinge upon trust. If you use a larger operation you won't be depending on one person and the team will certainly have access to more deals and more research. But in dealing with larger organisations you may not get the same person each time, you may be asked to trust the partnership rather than any individual.

What the top advisers have in common is fee-for-service and they are committed to achieving real diversification in client portfolios. In other words, they will make sure you get Australian and overseas investments, active and passive investments, listed and unlisted investments. Of course, Australian shares and real estate investments are on the menu, but they are not central to the agenda. This broader view would seem to be a separator between a sophisticated financial adviser and some of the barely qualified operators who masquerade under the title.

TOP 10 FINANCIAL ADVISERS

Name	Firm	2019	2018
Sue Dahn	*Pitcher Partners*	1	3
Garth Hu	*Morgan Stanley Wealth*	2	2
Scott Carmichael	*Escala Partners*	3	5
Charlie Viola	*Pitcher Partners*	4	1
Adam Stanley	*Pitcher Partners*	5	NR
Ben James	*Escala Partners*	6	8
Mason Allamby	*Escala Partners*	7	NR
Anita Beckers	*Macquarie Private Bank*	8	NR
Craig Emanuel	*Morgan Stanley Wealth*	9	9
Matthew Gartrell	*Macquarie Private Bank*	10	NR

What do they want from you?

You might reasonably expect that these top advisers have a minimum amount of investable funds they want to see in your account before you get in the door. And this is true to a point, especially because you need to be able to pay for their services. The reality is that 11 of our advisers say they have no minimum, while others put out a minimum figure ranging from $250,000 to $5 million (yes, there are three advisers on the list with a $5m minimum).

But what most advisers really want is a long-term relationship and ideally one that spans a family or, better still, spans that family over multiple generations. So while you are wondering whether they will help you make money, they are wondering if you — over the course of your life, with your family included — will offer them a line of business worth taking on board.

> What most advisers really want is a long-term relationship and ideally one that spans a family, or better still spans that family over multiple generations

For the record, the average client portfolio run by our top advisers is $1.9m "investable" — you cannot include your home in that calculation.

What do you need to avoid?

Every week I do The Money Cafe podcast for *The Australian* with Alan Kohler and on each episode we take questions from listeners. Barely a week passes without someone asking whether recent suggestions they have followed from a financial adviser were actually the best idea in their situation.

Looking at this week's batch of questions, I see one that goes as follows: "My financial adviser has moved our (husband and wife) super across to a wrap platform as well as setting up new insurance — is this just a way for financial advisers to make revenue or have we just been sold to?"

The question is typical, and typically difficult to answer if you don't know the exact circumstance of the investor. If, for instance, this couple were moved out of a good performing fund such as an industry fund to start an SMSF and they were then put into a wrap platform and in turn lost their insurance in the former fund to start again, well, the whole thing stinks. It may not be that bad, but taken at face value, let's say it does not suggest a win/win.

My point here that is you must tread carefully.

There are two crucial steps to financial advice. One, choose an adviser that is well regarded and that suits you. Two, having made the effort and paid a fee (not a commission), take that advice on board.

The List: Top 50 Financial Advisers should help you get started.

Time to bin idea of a buoyant housing sector as Bingo numbers fall

ROGER MONTGOMERY

The slump in dwelling approvals has now been well documented. At the peak an estimated 280,000 dwellings were approved for construction. That number has now declined almost 40 per cent, to about 170,000 dwellings.

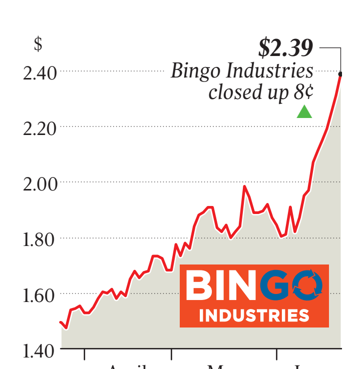
As for the national apartment boom, it's over as we wait for 54,000 new apartments commenced in Sydney during 2018 and 2019 that will be completed by the end of the year.

And while property investors in these apartments can expect high vacancy rates and poor near-term yields, it's the second and third order impacts that may interest share investors.

One company with heavy exposure to the property boom — and now the bust — is, or will be, Bingo Industries.

In February the company announced "a faster than anticipated softening in multi-dwelling residential construction activity across Bingo's key markets in NSW and Victoria", adding: "Volumes in our building and demolition collections business were above the previous corresponding period, but have not grown as much as initially forecast. In addition, competition in the B&D collections market has put downward pressure on pricing, impacting our margins."

It was a double whammy that caused the share price to fall almost 50 per cent in a single day,



Source: Bloomberg

from a high of $2.30 to a low of $1.17. Bingo's shares have since bounced 90 per cent to $2.30.

Indeed, builders including AV Jennings, Villaworld (which has received a takeover bid), Stockland and Mirvac have all seen strong share price performances since their first-quarter lows. Building material suppliers such as CSR, Boral and James Hardie have also recorded strong bounces in share prices.

No doubt these performances have been at least partly attributable to relief following the Coalition victory at the federal election. However, the building game has always been a cyclical one. While investors have done well buying shares in listed builders when they are trading at a discount to their net tangible assets and selling when they revert back to a premium, one must ask whether the recent bout of enthusiasm is justified.

Discussions with the staff of some of Australia's largest home builders, many of which aren't listed, reveals a 30-50 per cent decline in the pipeline by Christmas if significant changes aren't seen.

And that brings us back to Bingo. In February, Bingo simply announced that its previous forecast of a 15-20 per cent increase in profits would be unlikely and its 2019 profit would more likely reflect the previous year's number. The share price halved.

When the company offered its 2019 updated guidance, national housing approvals were already slumping but building activity remained at record levels. That's still the case today — building activity remains at near all-time highs. But that is changing fast. At this stage, I expect the sharp decline in national building approvals to be followed by an equally sharp decline in activity. That means less Bingo bins being required at fewer building sites.

With Bingo raising $420 million to fund its recent acquisition of Dial-a-Dump (according to its half-yearly balance sheet), which in turn gave the vendors of Dial-a-Dump $378m in cash and about $200m in Bingo shares at the time, it is likely returns on equity for Bingo shareholders will fall.

The extent of that fall remains to be seen, but if the company is reporting flat profits at best in 2019 with more than double the equity it had at the end of 2018, it is reasonable to expect the return on equity to at least halve. A business that is twice the size but earning half as much, in terms of profitability, isn't really worth a lot more, irrespective of what the share price does.

With that in mind, caution should be applied to the company's recent share price enthusiasm, especially since the fall in dwelling approvals is yet to be fully felt.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund.

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