Helping your child buy a house: when you should and shouldn't lend a hand

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Overheated housing markets like those in Vancouver and Toronto may make headlines, but it's not just those real-estate scenes that can pose a challenge for first-time buyers. For many Canadians, scraping together enough money for a down payment is a task that's as monumental as it is drawn-out.

So, it's not uncommon to hear of parents helping their grown children fund a home of their own. For some moms and dads, that kind support is part of a "living inheritance," a chance to see their offspring make good use of what's passed down to them. Others may be motivated by more practical reasons, wanting to see their kids to put their money toward their own property and not their landlord's.

No matter what's driving it, there's plenty to consider when it comes to parents helping their grown children buy a home so that both parties can stay protected, legally and financially.

It's easy to understand the appeal of helping adult kids in this way, says Edmonton certified money coach Barbara Knoblach with Money Coaches Canada; she has seen it in her own work.

"'Better give with a warm hand than with a cold one'" is what I have been told by many of my clients," Knoblach says. "They want to be around to see the fruits of their work handed down to the next generation.

"Not only do parents want their children to benefit from their wealth, but many parents want to be around to enjoy how well they have set up their kids. It is therefore only natural that many parents want to help their children achieve the dream of home ownership."

However, she cautions that such a move could affect family dynamics and emphasizes that parents considering it be certain that they can afford it. Say the parents are 50 years old and looking at putting up $50,000 of their own funds to help their child purchase her first condo. Assuming a five per cent rate of return and not considering taxes, that chunk of dough would grow to about $104,000 by the time they turn 65 if they were to keep it and invest in themselves.

"The parents absolutely, positively have to be sure that they do not need these funds to support themselves in their own retirement," Knoblach says. "There is nothing worse from an emotional point of view than becoming financially dependent on your children in your old age."

Edmonton real-estate lawyer Mark Hillenbrand, of Hillenbrand Kozicki LLP, says he often sees one or both parents agreeing to be responsible for a mortgage loan when their adult children don't qualify for financing on their own for a home.

Financing can be handled in one of two ways: the parents can act as guarantors or they can be "co-signors" on the mortgage itself, meaning they are shown on title as a co-owner and on the mortgage directly.

"Banks tend to have more success getting approval from their credit departments when the parents are co-signors rather than guarantors, so that is by far the more common approach," Hillenbrand says.

However, he notes that being co-signors raises several questions, such as: What is the actual ownership interest of the parents, if any? If the parents have contributed funds, are the funds a “gift” or a “loan” and, if a loan, do the parents require security for the debt? What happens if one of the parties passes away? What happens if the child is or gets married then divorces or separates?

“In most cases, the parents are simply going on title and the mortgage for the sake of convenience to facilitate the financing, have not contributed any funds, and do not claim any ownership interest,” Hillenbrand says. “The parents then ‘come off’ title and the mortgage as soon as possible, typically when the children refinance at the end of the term. In that circumstance, we would often describe the parent on title as a ‘Tenant in Common’ holding a nominal interest – say one per cent – and then ensure their Will gifts that interest to the child in question upon their death.”

Other times, the child and the parents hold the property as “Joint Tenants”. This kind of ownership ensures a right of survivorship, and, assuming life takes its normal course (the parents die first), the parents’ interest would then automatically flow to the surviving child.

“In all cases, we also recommend a ‘Co-ownership’ Agreement that sets forth the specific rules that govern the relationship, including commentary on what is to happen in all the worst-case scenarios, such as death or divorce,” Hillenbrand adds.

There are other ways to stay protected. If parents will be on the title, they should make sure there is a clear record of both parties’ mutual intentions, with legal documentation to back it up, says Doug Carroll, Tax, Estate & Financial Planning practice lead at Meridian credit union.

In the case of co-signing, Carroll cautions that although parents may feel that they’re second in line, it’s possible, even likely, that they will have a concurrent primary obligation with their child.

“As you [the parents] likely have the deeper pockets, a mortgagee may not even bother with your child, and come to you immediately,” Carroll says. “Review the documents carefully with your lawyer. Even if you are not in that primary position, any event that brings this into the realm of possibility will be a financial crisis to some degree, so think carefully before placing yourself in that position.

“Remember that it is ultimately a legal relationship between you and the lender, regardless of the nature of the relationship with your child,” he adds.