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When parents help their kids buy a home

With the average home price in the Toronto area hovering around $250,000, it is not easy these days for young, first-time buyers to break into the home market.

Often, the only way today's 20-somethings can arrange to buy a home is with a little help from their parents, grandparents or the proverbial rich uncle. Today, parent power is an increasingly popular way for first-time buyers to get a jumpstart into the housing market.

Parents who want to help their children with that first purchase can either tap into their own savings, or use the equity built up in their own homes to borrow the downpayment on their children's homes. In some cases, lenders on the child's home will require a gift letter to confirm that the parents do not expect repayment of the downpayment.

The first, and probably most common, instance of parent power is for the parent to become a joint owner with the child and his or her spouse.

This scenario is often dictated by the mortgage lender. If the child fails to qualify financially for a mortgage loan, most banks will require the parent to go on title along with the child, rather than simply guaranteeing the loan.

Whether the parent is a co-owner or a guarantor, the risk is that if the child defaults on the mortgage, the parent is responsible for repayment of principal and interest until the mortgage is paid in full. If the bank sells the house under power of sale at a loss, the parent is on the hook for the shortfall.

If, however, the child never defaults on the mortgage, there is minimal risk to the parent. On the death of the parent, title will automatically transfer to the child if the property was held in joint ownership.

A second scenario is for the parents to buy the house outright in their own names, and "rent" it back to the son or daughter at, or near, actual cost.

They may hold it in trust for the child, so he or she will ultimately benefit from the capital gains tax exemption on a principal residence, or they may keep it as their own revenue-neutral investment.

One advantage of this arrangement is that it avoids what could be a complicated real estate joint venture if the parties fail to agree on things such as repairs, carrying costs, improvements, bringing in roomers or the timing of a sale or refinancing.

A third scenario is for the child and mate to purchase the property without a parental co-owner. Depending on the child's income, the parent may or may not have to co-sign on the mortgage loan.

If the parent in any of these three cases does not charge interest on his or her downpayment contribution, or charges below the market rate, the total carrying costs to the child can be lower than rent on a similar home.

In any situation where the parent guarantees the mortgage, it is extremely important that he or she obtain full disclosure of the circumstances of the purchase and the debt, and obtain legal advice from a lawyer separate and independent from the child's lawyer.

As well, when the downpayment has been provided by the parent - either by loan or gift - independent legal advice is important to protect that money from any possible future claim by the creditors of the child, or from a family law claim by the child's spouse or partner.

Whenever a parent and child go on title together, legal advice should be sought on a joint venture or partnership agreement to protect the interests and expectations of all parties.

In all cases where the child is receiving a gift or loan of the downpayment, the arrangement should be carefully documented so it is clear whether the debt is ultimately owing to the parent's estate, was forgiven during his or her lifetime, or is forgiven on the parent's death.

"Parent power" home arrangements are more complicated than they seem. Independent legal advice is always a necessity.
