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HOUSE MONEY

Parents must carefully weigh giving adult kids a down payment

By LISA MORRIS JOSEFAK

Thinking of giving your adult children a down payment for their first house? Financial advisors say think carefully.

Amid an uptick in the practice of parents contributing to down payments, financial advisors caution their clients to carefully weigh both the financial and emotional costs before entering into these financial agreements. This proactive stance follows a trend reported in a loanDepot survey, commissioned by Freddie Mac in November 2014, where 17 percent of the 2,000 parents polled expected to help their adult children buy a home within the next five years — this was up four percentage points from five years earlier.

Parents and children should be on the same page and keep the lines of communication open, said Lawrence Sprung, president of Mitlin Financial in Hauppauge.

"It can't just be a phone call to the parents from a child asking for money and the parents agree, write a check and are done with it," Sprung said.

Parents need to explore and understand the potential repercussions of giving their child this money, Sprung said.

"If parents give $50,000 to buy a house, my first question to them isn't necessarily about their financial situation. It is, 'Why does your child need this $50,000?'" Sprung said. "If a child cannot buy the house without help and the parents give them the money, parents could be putting the child in a very precarious, long-term financial situation."

Parents may unintentionally place their child in a situation where he or she will be keeping up with the Joneses, Sprung noted.

"What is the child going to do when all the neighbors are driving BMWs and they are driving a Chevy?" Sprung said. "So, giving money to children isn't just about lending money for a house – it is everything that goes along with it."

There is no one-size-fits-all answer to whether parents should provide financial assistance.

"It is case by case based on that family's facts and circumstances," Sprung said.

Jeff Neeck, managing director of Strategies for Wealth in Jericho, reminds parents this is an opportunity for them to teach and model prudent financial decisions.

"Parents can help children determine if the house being purchased is too large or what an appropriate down payment should be," Neeck said.

If parents decide to give money for a down payment, they must then choose either to gift the money or lend it.

"The loan versus gift path needs to be clearly thought out," Neeck said.

If parents take the gift route they need to speak with their financial professional, as the size of the gift is important, Neeck noted.

"Factors to keep in mind are New York State estate and gift tax regulations," he said.

There are two gifting 'rules' parents should pay heed to, Sprung said.

"Anyone can give an annual gift of $14,000 per person per year," Sprung said. "Assuming you are a married couple and you want to give your child and his/her spouse money — a husband and wife can give their child $28,000 and then they can give their child's spouse $28,000 — so they can currently gift $56,000 without having to file any type of gift tax return."

By gifting anything above $56,000 per year, parents start using their lifetime exclusion, which is about $5.4 million per person over their lifetime, Sprung noted.

"There won't be any taxes owed unless they go above the $5.4 million," he said.

If parents take the loan route, a written agreement signed by both parties is imperative, Neeck noted.

Evan Branfman, financial advisor at Kuttin Wealth Management in Melville, also recommends parents seek an attorney and create a legal contract.

"The stipulations of this loan should be clear and concise, with the request that these funds be paid back by automatic deposit from their bank," he said.

All financial transactions should always be in writing, said Jeffrey Greener, a partner at the law firm Rivkin Radler in Uniondale, whose practice focuses on trusts, estates and taxation.

"From a family perspective, it is important to have it in writing because people's memories have a way of becoming foggy," Greener said. "From the IRS perspective, it is important because they will not consider it a valid loan unless it is documented and interest is paid, even though the interest may be nominal."

Photo by Bob Giglione

A contract also protects in the event of a divorce.

"The in-law – who is now an out-law – gets half of that equity," Greener said. "I don't think the parents would want their ex son- or daughter-in-law to walk away from the marriage with the parents' money."

Financial advisors understand parents want to help their children. However, Branfman said parents should not risk their own financial security.

"Lending children a large sum of money is acceptable and recommended only if the parents' financial situation, aka retirement, is secure," Branfman said. "I strongly recommend assuming that this loan is defaulted on in order to show how the parents' situation in retirement will look without these assets funding retirement. From there, we can make a determination to see if a default on the loan may jeopardize my client's long-term scenario."

Family dynamics are also a factor during these financial situations.

"If parents give money to child A, they're setting a precedent," Sprung said. "Whether implied or otherwise, future children are going to think they're entitled to similar treatment."

Parents must ask themselves if they're prepared to say 'No' if they can't give to their other children, Sprung noted.

The choice to give or not give money to children is ultimately the parents' decision, Sprung explained. However, he recommends parents turn to financial advisors who will bring up questions and points they are not thinking about during this emotional decision-making process.