Lending a Helping Hand
How to help your child purchase a home.
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With mortgage interest rates exceptionally low, a surplus of bargain-priced real estate on the market, and an economic climate that makes it particularly tough for young people to truly strike out on their own, many parents with considerable wealth are contemplating buying a home for their adult child.

There are a number of circumstances in which buying a home for an adult child may be positive for all family members. It’s a way to help a young adult who perhaps otherwise couldn’t afford to start a career in a city like New York or San Francisco. Indeed, there may never be a comparable time when it may be possible to buy at a reasonable price in the most expensive markets. If the family opts to keep the house past the child’s use, it may be a wise long-term investment.

For most high and ultra-high net worth families, finances aren’t the aspect of the decision that should be weighed first. Usually, the issue that demands consideration up front is how such a move fits with the values parents and grandparents want to communicate to younger generations. Successful families tend to communicate their family values explicitly—and frequently—to their youngest members.

The gift or loan of something as large as a first home, or even a substantial down payment toward one, needs to fit with the other messages parents and grandparents are trying to send. Would it be the puzzle piece that allows a passionate, committed young person to move out into the world? Or would it inadvertently enable a directionless adult child to remain rudderless?

Should you decide that helping an adult child secure a home is a healthy part of your plans, it is important to sort through your options with your wealth management team and structure any transaction to take full advantage of potential tax benefits or investment opportunities.

Some families may choose to make an outright gift for a portion of or for the entire price of the property. One potential advantage of essentially making an advance against an inheritance is to take advantage of the current temporary increase in the federal tax exclusion on gifts and estates. Until the end of 2012, one parent may give up to $5 million free of federal gift tax; for a couple, the amount increases to $10 million.

Other parents may choose to buy a property and rent it to a son or daughter or allow them to live there rent-free. Doing so may allow you to use your wealth to help an adult child now, while you are still alive and when they most need the assistance. Depending on where the home is located, you might even envision hanging onto it as a pied-a-terre after your child has moved on.

There can be tax implications, however. You can deduct such expenses as repairs, mortgage interest, utilities, and depreciation, but you are still likely to end up with some rental income that is subject to taxes. And you are less likely to be eligible for an exemption from capital-gains taxes when you sell a property occupied by a relative instead of by you.

It may ultimately make the most sense to loan your adult child the money to complete the purchase. This has advantages for your son or daughter who may not be credit eligible and who is more likely to be exempt from capital-gains taxes when the property is sold.

If the arrangement has to pass muster with a co-op or condo board, it may require still more strategizing about whose name is on the title and whether the actual occupant is a tenant or is able to reside there as a family member.

Advisors at The Private Client Reserve can also help families explore another option: purchasing a house via a family trust. A trust could allow parents and one or more children to own interests in a home that is seen as one part of a family’s overall portfolio of assets.

A residence trust may allow the owner of a first residence or vacation home to use a property rent-free for a set number of years. After the term has lapsed, ownership transfers to the trust’s beneficiaries. The advantage is that the gift tax value of the transfer is less than the property value because the value of the investor’s continued interest in the property is subtracted from the property value.

No matter the vehicle that makes the most sense for your
family, it’s crucial that the arrangement be structured carefully. Because needs change over time, a property or arrangement that seemed ideal at first can turn into a source of friction. Agree up front on such ground rules as who is responsible for the cost of upkeep, homeowners’ association fees, and property taxes, as well as who accrues any profits.

Because there are pros and cons to each arrangement, we encourage you to discuss the options with your Wealth Management Advisor and tax and legal advisors at the beginning of the process, before expectations and emotions have a chance to run too high. In addition to consulting with you and your advisors with your estate-planning needs, The Private Client Reserve can offer a full array of financing options as part of the U.S. Bank family.

Individuals should consult their tax and/or legal advisor for advice and information concerning their particular situation. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates, and risks related to renting properties (such as rental defaults).