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Should You Co-Sign Your Mortgage?

Posted by Daibhead O'Ceallacháin under Buying a Home, Mortgages

Recent data released by Statistics Canada does not paint a pretty picture regarding this country's personal debt levels. The federal agency reported that in the final quarter of 2016, the average Canadian's debt-to-income ratio was 167.3 – a new record.

Total household debt exceeded $2 trillion, with 65% of that amount locked up in mortgage loans. With the price of property in cities like Toronto skyrocketing, it has creating a worrying situation for policymakers.

A Helping Hand Needed for Housing

One consequence of such mammoth levels of debt is that more and more young people are turning towards their parents for assistance. The bank of mom and dad has never been busier, as Canadians entering their golden years are being asked to offer financial assistance to their offspring.

Mark Halpern of WEALTHinsurance.com is a financial advisor based in Markham, Ontario and trust and estate planning is a major part of his practise. With many baby boomer clients, this phenomenon of parents helping their children to gain a foothold on the property ladder is something he sees often.

"This is the first generation that the children are not expected to do as well as the parents," he states. "When our parents were buying houses it cost two to three years of their salary. Now you are talking about 10 to 14 years. It means parents are going to be helping out way more going forward."

The Gift of Good Credit

Helping out in this case may come in a number of different forms. For those parents with considerable personal wealth and a nice retirement nest egg, buying a home for their kids could be an attractive option from a tax perspective.

"It may mean giving a gift to their kids; if you gift cash to a child there's no tax on that," says Halpern. "Alternatively, the parents might buy a house, the kid lives in the house, but the parents still own it as an investment property."

A third option, which would be more viable for most people, is when the parents decide to co-sign on a mortgage with their child. Not surprisingly, given the size of the purchase, there is a lot of paperwork involved and plenty to consider. That's especially the case if the property is sold later on down the line.

"If the parents co-sign on a house then it is considered a non-registered investment for them," he says. "If the property then goes up in value, they will be subject to capital gains tax if the property is sold."

What to Consider When Co-Signing Your Mortgage

Another factor to take into consideration is if a marriage occurs, which especially complicates matters if it ends prematurely. This certainly isn't beyond the realms of possibility with a divorce rate in Canada of 48%.

"If it is a case of the parents and their son owning the home, but it is the matrimonial home, their son's wife would be entitled to half his share in the event of divorce. It's something parents need to consider if they plan on co-signing."

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Likewise if the child you are co-signing with has personal issues you are unaware of - gambling addiction or drug/alcohol dependence for instance.

"If you give the house entirely to your kid, and they have some financial issues with creditors, or litigation issues, the house could be attachable by those creditors," says Halpern.

Due Diligence Required

The way to protect yourself from such problems arising is through proper paperwork and counsel from a professional. That goes for both sides of a co-signing agreement.

"This all needs to be documented properly," says Halpern. "People need to get legal advice on how to set up a contract between parent and kid. That would deal with what

happens on death, disability, divorce or divesture. You need to know who has first rights on a house."

One eventuality that you can be sure of, apart from taxes, is death. This is something that needs to be accounted for to protect both parties should one side pass away.

"There needs to be proper estate planning," he says. "If the parents die with taxes due, then the house will be considered an asset. For the child, they need to ensure they have a proper will and a power of attorney."

Should one party to the agreement die, it is at the lender's discretion if the other side continues to pay the mortgage, or if they have to re-qualify. If the home is owned in a 'joint tenancy' agreement, the deceased party's interest simply switches to the other owner.

Things are more complicated, however, if ownership of the home is under a 'tenancy in common' agreement. This would mean the property would form part of the deceased party's estate and be distributed according to the terms of the will. This could ultimately lead to the home having to be sold, if the original co-signor can not buy out the estate's inherited share.

About Daibhead O'Ceallacháin

Daibhead O'Ceallacháin is a freelance writer from Ireland that moved to Toronto in 2010. Writing for his local newspaper, he covered real estate during Ireland's "Celtic Tiger" era and the subsequent housing crash and financial crisis. Today he writes about real estate, finance and politics in Canada, the U.S., Ireland and England.