Taking Stock: Father may not know best about parent-backed mortgage

by Malcolm_Berko

Dear Mr. Berko: My son and his wife, who don't have the best credit, need a larger home but don't have the money or credit to own a bigger home. So my wife and I may help them and our two grandchildren. We have decent pensions, $110,000 in certificates of deposit, no investments, Social Security, little debt and a condominium with a mortgage. I'm 69 and my wife is 71. The lending bank (my kids already found a home) suggested a parent-backed mortgage (PBM) because our kids have bad credit. The kids just sold their current home and after they pay off their home equity loans, they will have zero cash to put down on this newer home, which is $240,000. The bank suggested that I put down $60,000 so we would only have to borrow $180,000, which at 6.25 percent would cost the kids $1,100 a month plus taxes and insurance. It would be tight but my son says he can manage it. The bank wants all four of us (my son, his wife, me and my wife) to sign the mortgage and the bank has prepared a series of papers that would give me a 25 percent equity interest in the appreciation of the new home. So in five to eight years when the new home should be worth $340,000, I would get 25 percent of the $100,000 gain plus my money back when the kids refinance or sell this home. There seems to be very little risk here but I can't afford to gamble and may possibly need this money in the future.

M.P.

Boca Raton, Fla.

Dear M.P.: A larger home would certainly give those kids more room and allow them to live in a better neighborhood than they must be able to afford. Because you and your wife would be co-signers on the mortgage, you're certain to get a lower interest rate. Of course, your generous $60,000 down payment lowers the size of the mortgage, which also reduces the interest payments each month.

But I believe that a PBM may be an incredibly stupid financial mistake that could be injurious to your financial health. Your kindness may rupture the good relationship you have with your kids and their kids - and you may discover (as have many parents) that family members make the worst business partners in the entire galaxy. The price of love can be enormously steep.

I promise you, when it's time to refinance or sell the home, that the kids will figure a way to inveigle you and the wife out of that $60,000. In fact, after a couple of years, they'll come to believe that 60 grand is their money, not yours. So you might be left with a part-empty bag that may hold a lot of hard feelings.

While most folks are still encouraged to believe that home prices will rise strongly over the next five to eight years, I believe that this assumption is pure balderdash and wishful thinking. Home prices in South Florida are melting like white snow in hot summer sun so it's more likely that the home your kids are buying will also decline in value. In fact, the consensus is that home prices (in South Florida) will continue falling for 12 to 18 months and then prices may be flat as a Frisbee for another couple of years.

So between the fourth and eighth years, prices may rise at a much tamer 2 percent to 3 percent - certainly not at the high double-digit rates of the past few years. These assumptions preclude high unemployment, rising interest rates and a recession. Therefore, it's enormously unlikely that this home will increase in value to $340,000 (40 percent) in this remaining four years. So if your kids continue making the $1,100 P&I payments plus $850 a month (taxes, insurance and maintenance) for the next seven or eight years, you may have a hard time convincing them to refinance or sell the home just to get your $60,000 back. This may not be possible in South Florida because the middle class folks (who would buy that house) are disappearing under an onslaught of drugs, homicides, political payoffs and the highest crime rate in the country plus a lousy school system.

I suspect your kids are a bad credit risk and you'll probably have to assist them with their finances (I'm sure you have in the past) so they can maintain their mortgage payments. A PBM may complicate matters for you, create enormous angst and at your age and stage you need this aggravation about as much as you'd want a root canal. In my opinion, this is a risky investment. I think that $60,000 should remain safe and accessible in a CD. If you haven't raised your son to be self-sufficient by now, then it's obvious to me that this PBM is a bad idea.

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