



Housing affordability is at the worst levels since 2006; thus, there are necessary lessons for the Bank of Mom and Dad to take to heart. Well, limited heart, less emotion, and more critical thought.

The rising prices and higher mortgage rates have frustrated a new generation of home buyers, especially those hoping to acquire their first homes.

So, your kid needs a mortgage? What about the Bank of Mom and Dad?

It exists! Parents are assisting their kids through intra-family mortgage loans, and the demand is growing. However, as much as we love our children, parents must assess the risks objectively.

Thus, RIA provides crucial lessons for the Bank of Mom and Dad.

As astute readers know, rents aren't a bargain either. Shelter comprises roughly 42% of the Consumer Price Index. The sad reality is that lower and middle-class households find that housing makes up over 50% of their paychecks.

Fannie Mae's Home Purchase Sentiment Index fell to its lowest level since 2011 as rates on 30-year-fixed mortgages have nearly doubled; however, we stand firm with our mortgage debt guardrails. Let's face it – homeownership isn't a right. The wrong housing decision can set a buyer back decades financially.

According to the National Association of Realtors, house sales dropped 20% in June compared to last year. Their chief economist believes we're in a housing recession.

At RIA, our mortgage debt guardrail = *Primary residence mortgage = 2X gross salary*. No excuses. This tenet is tough and means young homebuyers must buckle down, sacrifice, and save to meet this threshold. Overall, we recommend smaller homes and fewer furnishings whether you're starting out or retiring.

Check out [all RIA's Financial Guardrails](#).

So, your kid needs a mortgage? Here are Six Lessons for the Bank of Mom and Dad.

Know your limits. We often witness clients forsake their financial health and well-being to assist their children. While it's understandable, parents must objectively review their financial limitations and act accordingly. Mom and dad should consider goal-based financial planning to determine a household's fiscal bandwidth and clarify the loan dollars allowable for family loan purposes.

Don't forsake retirement security. Even though we're talking about a loan, there's always a risk of unforeseen circumstances that can jeopardize retirement income security or liquidity. From experience, retirees who undertake intrafamily loans have more than enough assets to cover needs and cash for emergencies. One must look at a family mortgage loan as a long-term illiquid asset. A child will likely not remain in a home for thirty years, but those considering this option must prepare even for such a rarity.

Think like a loan officer. What's your child's credit score? Have you objectively analyzed your children's relationship with money? If not, you must. A child with poor credit probably shouldn't qualify for a loan at the bank of mom and dad. If you want to understand credit scores and their ranges, [read this article](#).

What would I do?

I'd only make a loan to my daughter if her credit score were 739 or better (and I know her score). If your child falls within the poor credit score range, realize that a loan may inevitably be a gift, and gifts could be a hassle.

For 2022, the annual gift exclusion is \$16,000 for each recipient. For example, mom and dad can each gift \$16,000 to each child and avoid the hassles of filing a gift tax return. However, that's a far cry from financing a mortgage, but it can help. According to a recent National Association of Realtors report, 29 percent of younger millennials received down payment assistance in the form of a gift or loan from a friend or relative.

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What about the impact of taxes? If a parent sits on excess after-tax cash and seeks a return on it, then an intra-family mortgage can work. As of this writing, the [IRS? Applicable Federal Rate](#) or 30-year AFR is 3.30%.

What is the Applicable Federal Rate?

The Applicable Federal Rate is the minimum interest rate the IRS deems allowable for private loans. Now comes the hard part: What if mom and dad must sell profitable investments or take retirement account withdrawals? In that case, it's crucial to analyze the overall impact on household cash flows and future Medicare [IRMAA charges](#) first. Seek out the advice of a tax specialist and keep the emotions out of your decision to move forward.

Less hassle for the kids. Per RIA's Senior Risk Management Consultant Chris Liebum: Since the parents fund the mortgage loan, no credit qualification is necessary. Also, when a primary residence mortgage loan from mom and pop is formalized correctly, children can deduct the mortgage interest paid just as with a bank-offered mortgage.

Think balance. What exactly is your child's "skin in the game"? Recent insight from a client sparked this idea. He's an advocate for intrafamily loans. However, he believes the down payment is mostly the child's responsibility. I like this idea. Nothing wrong with skin in the game. Observe how children practice financial discipline and delayed gratification. Owning a home isn't a right; it's a privilege and great responsibility. So, children should have their cash on the line, too.

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So, the kids qualify, and you do too! ?? What's next?

Many of the parental ?loan officers? I know undertake the administrative process themselves. As mentioned, the IRS AFR tables are available at IRS.gov. Also, [Family Loan Agreement templates](#) are readily available at e.forms.com. Select your state, complete the form, sign in the presence of two witnesses unrelated to the family and begin the process.

Since I expect intrafamily loans to receive increased IRS unwarranted scrutiny under the Inflation Reduction Act, consider working with your tax professional to ensure proper compliance.

For those more comfortable using an intermediary, [National Family Mortgage](#), a widely recognized specialist in intrafamily mortgages, can assist with initiating, processing, and servicing a family mortgage loan. Their website is a hub of comprehensive information and printable guides.

Setup fees range from \$725 to \$2,100, depending on the loan size. The one-time cost includes a dedicated Family Mortgage Team Member, the promissory note that establishes the legal debt, real estate lien security, and coordination with the borrower?s settlement agent (title, escrow company).

NFM offers optional loan servicing for a one-time fee of \$55. In addition, there are affordable monthly servicing charges that start at \$15. Loan servicing includes monthly statements, annual IRS tax forms, electronic payment processing, customer support, online access, and Lien Release prep and filing.

Their free guide has a comprehensive FAQ section with every question about family mortgages.

Last, this option is not for everyone.

Yet, family mortgages could be part of a diversified portfolio for wealthier families and parents with excess cash seeking a return.