

# What is a guarantor?

Many lenders will allow a related third party to provide additional security to help a family member buy their own home. The person providing this assistance is known as a guarantor.

This is different to being a co-applicant or co-signer. A co-applicant will be included on the loan and will be responsible for the entire loan until such time as it is repaid in full. A guarantor, on the other hand, is linked to a loan by a guarantee. This guarantee can be released and the guarantor's responsibility stopped without the loan having to be repaid in full.

## How does it work?

A guarantor allows the equity in his or her own property to be used as additional security for the borrower's loan. The primary security for the loan will be the borrower's property. The lender will also take a mortgage over the guarantor's property. This mortgage will not support the loan directly but will be used to support a guarantee from the guarantor.

## Who can be a guarantor?

Guarantors are generally limited to immediate family members. Normally, this would be a parent but guarantors can include siblings and grandparents. Some lenders will allow extended family members and even ex-spouses to be a guarantor to a loan.

## How will having a guarantor help the loan application?

Having a guarantor may allow homebuyers who have insufficient deposit but have the ability to make the loan repayments required for the chosen property, to secure additional funds for upfront loan costs and expenses related to purchasing a home.

Saving a deposit can be the most daunting aspect for many purchasers and it can be very hard to do when you are also paying rent. By having a guarantor, the borrower may be able to borrow the full purchase price and sometimes even the costs associated with purchasing property. Again this varies across lenders and some lenders will still insist that borrowers contribute some of their own equity towards the purchase, even if there is a guarantor.

Another of the main benefits of having a guarantor for a property loan is that the borrower may save thousands of dollars by avoiding Lenders Mortgage Insurance (LMI). Generally LMI is required for home loans where the loan is greater than 80% of the value of the property. LMI is a type of insurance which lenders take out to cover the additional risk of high Loan to Value Ratio (LVR) lending. Although this insurance covers the lender against the borrower defaulting on the loan, the borrower pays the premium.

## Example of avoiding LMI due to guarantor providing security

A borrower wishes to purchase a \$400,000 property and will need to borrow \$380,000. This loan has an LVR of 95%, which would incur LMI.

If a family member is willing to provide a guarantee for the home loan, using their own property as additional security, the LVR would reduce and avoid the need for LMI, saving the borrower approximately \$9,700.

The amount of the guarantee will depend on the policy of the lender. The guarantee can vary from the full loan amount to as little as 20% of the loan where the loan is for 100% of the purchase price.

After the borrower has built up equity in their property, the guarantor can request to be released from the loan. The time frame to achieve this can vary depending on: the original deposit saved, the number of extra repayments made and whether the property has appreciated in value over the time period.

Depending on the lender, the borrower may be required to pay some additional fees at the time of a request to release the guarantor. This can include a fee for the lender to revalue the primary security property as well as lender discharge fees.

## What are the implications for the guarantor if the borrower cannot pay back the loan?

If the borrower is unable to pay back the loan according to the terms of the contract, the lender can take legal action against the borrower, and in some circumstances, the guarantor. The guarantor may be liable for the amount of the loan secured by their property, or the entire loan amount, depending on the terms of the guarantee.

Anyone who is considering being a guarantor for a property loan is advised to seek independent legal and financial advice before accepting the role of guarantor. Most lenders will insist on this, prior to accepting a guarantee.

It is important to note that a guarantor's ability to borrow will be reduced after they have agreed to act as a guarantor.

## What if a borrower cannot cover the monthly repayments on their current income?

The other less common type of guarantor assists the borrower by contributing to the monthly repayments of the home loan. If the borrower defaults on the loan repayments, the guarantor will be liable for the full repayment amount.

The guarantors may apply to be released from the guarantee when the borrower is able to display to the lender they have sufficient capacity to service the debt on their own.

In some cases, the guarantor may assist with both repayments and putting their own property up as security for the loan to assist with the purchase.

## Example of guarantor providing servicing support

A borrower wishes to purchase a \$400,000 property and has already saved \$100,000 for a deposit on the property. The borrower will need a \$300,000 home loan.

However, when the repayments are calculated, the borrower realises that they cannot afford the monthly repayments on the \$300,000 loan, so the borrower's parents guarantee to assist the borrower with the repayments until the borrower's income improves.

