

Guarantor loans

What is a guarantor?

Many lenders will allow a related third party (such as a family member) to provide additional security to help a borrower buy their own home. That person 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 it is repaid in full. A guarantor is linked to a loan by a guarantee.

This guarantee can be released and the guarantor's responsibility stopped without the loan being repaid in full. At this point, the borrower's property must be able to secure the whole loan.

How does it work?

While the primary security for the loan will be the borrower's property, a guarantor allows the equity in their own property to be used as additional security for the borrower's loan. This means the lender will also take out a mortgage over the guarantor's property. This mortgage will not support the loan directly but will be used as a guarantee from the guarantor.

Using a guarantor to avoid LMI

A borrower wishes to buy a \$400,000 property and will need to borrow \$380,000. This loan has a loan-to-value ratio (LVR) of 95%, which would incur Lenders Mortgage Insurance (LMI).

If a family member is willing to provide a guarantee for the home loan, using the equity in their own property as additional security, the LVR would reduce and avoid the need for LMI, saving borrower about \$11,600.

The amount of the guarantee will depend on the lender's policy. 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 ask to be released from the loan. Depending on the lender, the borrower may need to pay additional fees when they ask to release the guarantor. These may include a fee for the lender to revalue the primary security property as well as lender discharge fees.

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 can assist homebuyers who have been unable to save a sufficient deposit but have enough income to make the required loan repayments.

By having a guarantor, the borrower may be able to borrow funds for a property's full purchase price and associated costs. However, all lenders are different. Some will still insist that borrowers contribute some of their own equity towards the purchase, even if there is a guarantor.

Another benefit of having a guarantor is that the borrower may save thousands of dollars by avoiding Lenders Mortgage Insurance (LMI). LMI is generally required for home loans where the loan is greater than 80% of the value of the property. A borrower with a guarantor may seem 'safer' to the lender, so they may waive LMI.

What are the implications for the guarantor if the borrower cannot repay 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 will be liable for the amount specified in the guarantee.

Anyone who is considering becoming a guarantor is advised to seek independent legal and financial advice before accepting the role of guarantor. Most lenders will insist on this before 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.

For expert mortgage advice, talk to your local broker today.

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