How a guarantor can help securing finance for a home loan

With the housing loan affordability is becoming an issue and first home buyers' attempt to enter the market is becoming a mission impossible, it is probably unwise to do nothing and hope things will get better. This is where home loan guarantee comes into play and can be very helpful.

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, but this varies depending on the lender.

Facts about the guarantee

- The Guarantors can limit the amount of the guarantee, rather than opting for a traditional "open" guarantee for the entire loan amount. Nevertheless, the guarantors do put themselves and their assets at risk, even if the risk is limited, should the borrower default on the loan. **Anyone who is considering being a guarantor for a property loan should seek independent legal and financial advice before accepting the role**. Most lenders will insist on this, prior to accepting a guarantee.
- The guarantee is limited to a fixed amount at the outset and cannot be increased for instance if the homes valuation should fall. The amount of the guarantee is calculated by taking 20% of the purchase price (this can also include costs) and then multiplying that by 1.25%. This will ensure that the LVR is 80% or below.
- The Guarantor can be released from the guarantee much sooner than normal and the Guarantor can usually request the guarantee be removed at any time. This can occur where the LVR is reduced to below 80% due to repayment of the loan or an increase in the home's valuation.
- Should the Guarantor want to sell their home or refinance, they can be released from the guarantee where the LVR remains below 80%; however, the loan will be reassessed and LMI may then be charged to the borrowers.
- If the borrower/s defaults, the lender can take legal action against the borrower/s, and in some circumstances, the guarantor who will be liable for the amount specified in the guarantee.

Types of guarantee

There are two different ways of guaranteeing a loan, which are known as family pledges and they are **service** guarantees and **security** guarantees. The former is less common than the latter and it involves a family member guaranteeing all of the repayments on a loan as well as being named on the title. The latter is more popular option where borrowers have a limited deposit, and the parents are prepared to use the equity in their own home to guarantee the deposit of the borrower. It is a great option as long as the parents are comfortable with their son/daughter's ability to pay back the loan.

For example, for a total loan amount of $600,000, in a security guarantor situation the borrower/s would take on the debt of 80 per cent of the value of the loan, which would be $480,000, in their own names. The balance of the loan, which is $120,000, is then guaranteed in the names of the guarantor/s and borrower/s, limiting the guarantor's liability while providing security for the lender, meaning that lender's mortgage insurance is not necessary.

Further, the loan can be split into separate components where the 20% guaranteed amount is set up as a principal and interest repayment structure and the other 80% the borrower repays at interest only.

This can help speed up the repayment of the guarantor's liability and therefore release the guarantor/s from their obligations much sooner.

For more information, please call me on **04 3984 1952** or email **info@eleganceaccounting.com.au**