Thinking of becoming a Guarantor?

How to buy a house with little or no deposit is a more common query than most would think, especially as the cost of living just keeps getting more expensive. The good news is that with a few terms and conditions attached – it can be done – and one method growing in popularity is obtaining a guarantor loan.

Going down the path of a guarantor loan is how many people buy a house with little or no deposit, especially first home owners. With the median house price in Brisbane now sitting between $550, 000 to $900, 000 depending on the suburb – once we factor in rent, bills and even groceries, the mammoth task of saving for a deposit is only getting harder.

Whether we care to admit it or not, a lot of first home owners receive some form of assistance from their parents. This might be a contribution towards a house deposit, assisting with the home contents, or even allowing their children to move back home to save on rent. Another method that is gaining increasing levels of popularity is the option of a guarantor loan.

? WHAT IS A GUARANTOR LOAN?

A guarantor mortgage loan is mostly quite similar to a standard home loan, only a selected guarantor (usually a parent or guardian) signs the loan as your "backer", even though they have no rights over the property itself. While guarantor loans increase your equity and chances of approval, in the event that you should default on the loan – the guarantor is responsible for paying it back. It's their own property that is acting as security against your loan, so being a guarantor is a big commitment, and not one to be taken lightly.

Should the buyer not have the full 20% deposit, this path is a popular option to avoid Lenders Mortgage Insurance (LMI). Depending on the lender, some require the buyers to have a minimum 5% deposit, while others will allow the buyer to borrow up to 100% of the purchase price and fees. The guarantor doesn't have to commit to the full term of the loan – they can choose to only secure part of the loan. Most lenders we deal with allow the guarantor to only guarantee a minimum amount of the loan, usually 20% plus fees. This is referred to as a limited guarantee.

The process on how to buy a house with no deposit is not a straightforward one, as you will still need to produce evidence that you can budget and pay the loan back. Most lenders will look favourably on buyers that have at least 5% of a deposit saved.

HOW DOES IT WORK

Tim and Annie want to purchase their home with additional security support from Mary (Tim's mother). They do not have enough genuine savings to enable a 20% deposit, however can service the loan amount they require. Mary has offered to provide a guarantee over her unencumbered property to enable them to purchase their home without the need to pay Lender's Mortgage Insurance (which they may be required to pay if their Loan to Value Ratio (LVR) is greater than 80%.)

Tim and Annie are purchasing their home for

$700,000

The additional costs (stamp duty, bank and legal fees) amount to

$25,000

They have a deposit saved amount of

$30,000

And are looking to borrow a total of

$695,000

Their loan will be split as follows:

LOAN A - $560,000

Secured by purchase property value $500,000

LVR: 80%

(Loan A $560,000 / Purchase Property $700,000 secured against Tim and Annie's house only.)

LOAN B - $135,000

Secured by guarantor's security value $650,000 plus purchase property value $700,000.

LVR: 51.48%

(Loan A $560,000 + Loan B $135,000 / Purchase Property $700,000 + Mary's Property $650,000)

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LIMITED GUARANTEE

Both loans are in Tim and Annie's name only.

SCENARIO 1

Three years after Tim and Annie purchased their property Tim is made redundant and they are unable to keep up with the repayments, defaulting on the loan. With no other option available they decide to sell their home. Due to a market downturn, the property sold at a lower price than what they originally purchased it for. A total loan balance of $452,000 is still owing. With the property selling for $415,000 and costs of $10,000 associated with the sale of the property this leaves a difference of $47,000 still owing after the sale.

Tim and Annie are unable to repay the debt, which leaves Mary responsible for the remaining $47,000 owing on the loan contract. If Mary is unable to pay the loan or cover the repayments, the bank may seek to sell her security property which was guaranteeing the loan to repay the remaining debt.

SCENARIO 2

After three years of making repayments (including some additional repayments) and an increase in property values, Tim and Annie have enough equity in their property to release Mary as the guarantor. Mary is now no longer part of the loan contract and has no ongoing liability.

THINGS TO KNOW ABOUT GUARANTOR LOANS

If you're considering your options in regards to guarantor loans, it's important to note that not everybody has access to them. As it's such a big responsibility, lending providers will generally only accept guarantors who are able to meet the following criteria:

- Have equity in their property and a stable income to satisfy lenders
- Have a good personal credit rating
- Be an Australian citizen or a permanent resident

As a general rule, most lending providers will only allow immediate family members to act as a guarantor on a loan or mortgage.

One thing that most people are unaware of is that there are actually many different forms of guaranteeing a loan for an immediate family member, as it doesn't necessarily need to cover the entire mortgage amount.

SECURITY GUARANTEE

First time home buyers with an excellent credit history but with little to no deposit will often opt for this type of guarantee. The guarantor, referred to as an "equity guarantor" by some lenders, uses real estate that they already own as additional security for the mortgage in question. If the guarantor has a loan on their property already, the bank can often take a second mortgage as security.

SECURITY & INCOME GUARANTEE

Guarantors of this variety are commonly parents helping their child who is a student, or who has insufficient income to purchase a property on their own. The lender will then use the parents' property as additional security, and rely on the income of the guardians to sufficiently prove that the loan is affordable and can be repaid.

FAMILY GUARANTEE

As the name suggests, the guarantor is a direct relation to the borrower, and usually comes in the form of a parent, sibling, grandparent, spouse or de facto partner. As these are assessed based on the same criteria as outlined above, they are still considered on a case by case scenario.

LIMITED GUARANTEE

Here, the guarantor only consents to cover a part of the loan. Most often, this guarantee is used with security guarantors to reduce the potential liability secured on the guarantor's property, or to cover only the downpayment of the deposit. Depending on both the guarantor's wants and the lender's requirements, guarantees can either be limited or unlimited. If you opt for a limited guarantee as a borrower, then you are usually reducing the guarantor's exposure to potential financial strife in regards to your own mortgage.

BEFORE BECOMING A GUARANTOR

Volunteering your home, property or financial status as a means to be a guarantor for a loved one is a big responsibility, and one that shouldn't be taken on lightheartedly. If you're weighing up this commitment, consider the following before signing the dotted line.

- Assess if you can afford to be a guarantor, and whether the borrower can overall afford the loan
- Consider the nature of your relationship with the borrower
- Seek independent legal and financial advice, to ensure that you understand the loan process and its impact on your financial situation
- Think about any potential loans you might need for yourself in the future, as your guarantor loan obligations may impact this
- If you are asked to guarantee a business loan, learn everything you can about the company involved, especially it's financial status
- Determine the extent of your liability and responsibilities if the borrower defaults
- If possible, limit your guarantee in terms of amount and time required
- Make sure you can cover the monthly repayments without outside help
- Reduce your risk exposure by ensuring that the loan is not more than 90% of the total value of the property
- Get guarantor protection and insurance

WHERE TO SEEK ADVICE ABOUT GUARANTOR LOANS

Since their inception in 2012, the team at Madd have worked tirelessly in providing over 1700 Queenslanders with finance options to help turn their dreams into reality. With the entire brand being built on referrals, George takes great pride in making the mortgage process both fun, educational and stress free – and he has a swag of awards to prove it.

An independent operator can be your greatest asset when it comes to navigating guarantor loan options, as brokers are there to make you happy – not the banks. To speak to a Brisbane based mortgage professional, please get in touch with the team at Madd Loans today to help turn your financial dreams into reality.

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