Guarantor Obligations - Why and Why Not

A practical Australian guide before you promise to pay

What is a guarantee?

A guarantee is a promise to a lender or creditor that another person or business will meet specified obligations. If the borrower defaults, the guarantor may become personally responsible for the guaranteed debt, interest and enforcement costs, subject to the wording of the documents and applicable law.

A guarantee can relate to a home loan, business loan, lease, trade account or another obligation. Some guarantees are limited; others are continuing or cover all money owed now and in the future.

Guarantor or co-borrower?

A guarantor supports another person?s obligation. A co-borrower receives or shares the benefit of the credit and is directly responsible from the outset. Labels are not decisive: the substance of the arrangement matters.

Why does a lender ask?

- The borrower does not meet the lender?s serviceability, security or credit criteria alone.
- The lender wants additional assets or another financially reliable person available if default occurs.
- A company or trust borrower has limited assets, so directors or associated people are asked for personal guarantees.
- A landlord or supplier wants protection before extending a lease or trade credit.

Why might someone agree?

Possible reasons

- To help an adult child or family member obtain housing or other important finance.
- To support a viable business, company or trust in which the guarantor has a genuine interest.
- To help a borrower establish a credit history or satisfy a limited security shortfall.
- To secure commercial premises, equipment or supplier terms needed for operations.

When the decision may be manageable

A guarantee may be more manageable where the guarantor fully understands the borrower?s finances, can absorb the worst-case loss without jeopardising retirement or housing, receives independent advice, and negotiates a clear limit on amount, duration and facilities covered.

Questions behind the ?why?

- Why will the lender not proceed without a guarantee?
- What benefit, if any, does the guarantor receive?
- Is the borrower?s budget or business plan realistic under higher costs or lower income?
- Could a smaller loan, additional borrower deposit or different security remove the need?
- Is the guarantee limited to a specific amount and facility?
- What event will release the guarantor, and is release automatic or subject to lender approval?

Family support is still a commercial risk

Love, trust or optimism does not reduce the legal exposure. The decision should be tested as if the borrower were unrelated and the guarantee might be enforced tomorrow.

Why might someone decline?

Major risks

- You may have to pay the guaranteed debt, interest, fees and reasonable enforcement expenses.
- If your home or another asset secures the guarantee, enforcement may put that asset at risk.
- A demand or judgment can affect cash flow, credit standing, future borrowing and retirement plans.
- Enforcement may lead to court proceedings, sale of secured assets or bankruptcy consequences.
- Family or business relationships can deteriorate when repayment problems arise.
- A continuing or all-moneys guarantee may extend beyond the transaction you thought you were supporting.
- Loan variations, refinancing, further advances or changed business circumstances may affect exposure.
- Your right to recover from the borrower may have little value if the borrower is insolvent.

Strong reasons not to sign

- You feel pressured, rushed, emotionally responsible or unable to say no.
- You have not received the full guarantee, credit contract and disclosure documents.
- You do not understand the maximum exposure or when the guarantee ends.
- You cannot comfortably meet the full worst-case liability.
- Your home, essential savings or retirement security would be placed at risk.
- The borrower will not provide reliable financial information or independent verification.
- The lender or borrower discourages independent legal or financial advice.

Protecting yourself before signing

Documents and advice

- Obtain and read the guarantee, credit contract, security documents and required information statements.
- Get independent legal advice from a solicitor who acts only for you.
- Consider independent financial advice and test the effect of the worst-case liability.
- Make your own inquiries about the borrower?s creditworthiness, income, debts and business position.
- Keep copies of all signed documents, advice statements, valuations and correspondence.

Terms to discuss or negotiate

- A fixed dollar cap, rather than an unlimited guarantee.
- Coverage limited to one identified facility and no future advances without consent.
- A clear end date or release event, with written confirmation of release.
- Notice of default, missed payments, variations and proposed enforcement.
- Limits on security and careful consideration before offering a home.
- Whether the lender must first pursue the borrower or other security, noting many guarantees allow direct demand.

Protections vary

Consumer credit law, the Banking Code of Practice, contract law and equitable principles may provide protections in some circumstances. Their application depends on the transaction, lender, borrower, documents and conduct. Do not assume a guarantee can easily be cancelled after signing.

If you cannot afford the worst case, do not sign

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