Client Fact Sheet

FIRST HOME BUYERS FAMILY PLEDGE GUARANTEE

Saving the deposit for your first home can be difficult and take a number of years. One way to potentially get into your own home sooner is by having a family member act as a guarantor.

Many lenders allow parents or someone who is close to you, to use the equity in their property as security for your home in lieu of you saving the full deposit required. This person is known as a guarantor.

How does it work?

With a family pledge guarantee, your mum and dad can provide their home as security to the loan, so you don't need to save the full deposit required by the lender.

The easiest way to explain this is to give you an example.

If you were looking to buy a house valued at $600,000, you would need to save a minimum 5% deposit or $30,000.

To avoid paying mortgage insurance you need a deposit of at least 20% of the purchase price of $600,000 or $120,000. That's another $90,000 you would need to save!

Now, your mum and dad have a home valued at $900,000 and are willing to help you out. They offer you the $90,000, but not as cash, as security for the loan. This means the lender will take the offered security of $90,000 in your parents' home so you don't have to pay the mortgage insurance premium and don't have to save that extra money!

Once the equity in your home reaches 20%, you and your parents can apply to the lender to release the guarantee.

The guarantor's security (i.e. mum and dad's home) does not cover the entire loan amount. Just a portion of it in lieu of you having to save the full deposit. The guarantee is limited to this amount.

How is it different to being a co-borrower?

A co-borrower on the loan is someone who is responsible for the entire loan until the debt is repaid in full as compared to a guarantor who is linked to the loan by a guarantee and is responsible for the amount specified in the guarantee.

A guarantor is linked to the loan by a guarantee. This guarantee can be released and the guarantor's responsibility will cease without the loan being repaid in full.

Who can be a guarantor?

Guarantors are generally limited to immediate family members. Normally, this would be a parent, but it can include siblings and grandparents.

There are obviously conditions around this, for example your parents or the person acting as guarantor must have the equity available in their property and an income. If we use the above example, if your parents' home was valued at $900,000 but they had a mortgage of $800,000 then the equity is not there to offer this to you.

Benefits for first home buyers

The main benefit of having a family pledge guarantee is that it may be able to help you avoid Lenders Mortgage Insurance (LMI), or considerably reduce the premium that you would otherwise need to pay. This is typically a one-off fee paid by the borrower to the lender to protect the lender against financial loss should you be unable to meet your mortgage repayments. Lenders typically require borrowers to pay LMI on loans where the borrower has a deposit of less than 20% of the property's value. For more information on LMI refer to our LMI fact sheet or speak to your mortgage broker.

It is important to remember that as the borrower, you will be responsible for your loan repayments and you'll need to be able to service the entire loan with your income. You should always speak with your broker about ensuring you are comfortable that you can afford the loan repayments that will be required.

Other possible benefits of a guarantor home loan include:

- You may not have to save as much for a deposit
- You could get into the property market faster and more easily
- You can get the home you have fallen in love with and not have to settle for a cheaper alternative

While there are clearly some benefits to going guarantor, given it's such a large financial commitment, it's also worth weighing up the potential risks.

Considerations for guarantors

While it may sound like a great option to getting you in to your first home quicker, there are always risks that you and the guarantor need to be comfortable with.

The main consideration for the guarantor is ultimately, they will be liable to cover the mortgage repayment and fees if you are unable to. It pays to consider how they would cope financially if the unexpected happens and have to make those repayments. Specifically, parents on the path to retirement could be financially compromised and at worst, they could risk losing their own home if you were unable to make the repayment.

Taking on the role of a guarantor is not something that should be taken lightly. Anyone considering being a guarantor for a property loan is advised to seek independent legal and financial advice before accepting the role. In fact, most lenders will insist on this, prior to accepting a guarantee.

Understand your obligations

The last thing you want is to cause any family tensions, so fully consider whether this is the right option for you and the person you are asking to be guarantor.

It's very important that both you and your guarantor understand all of the conditions and obligations of a family guarantee before signing. For this reason it is essential that guarantors seek legal advice before entering into any guarantee agreement.

More information

Normal lending criteria and bank policy applies to guarantor loans, so you should discuss your borrowing eligibility with your mortgage broker.

It's important to remember this is only a guide to help you ask the right questions and highlight the important considerations.