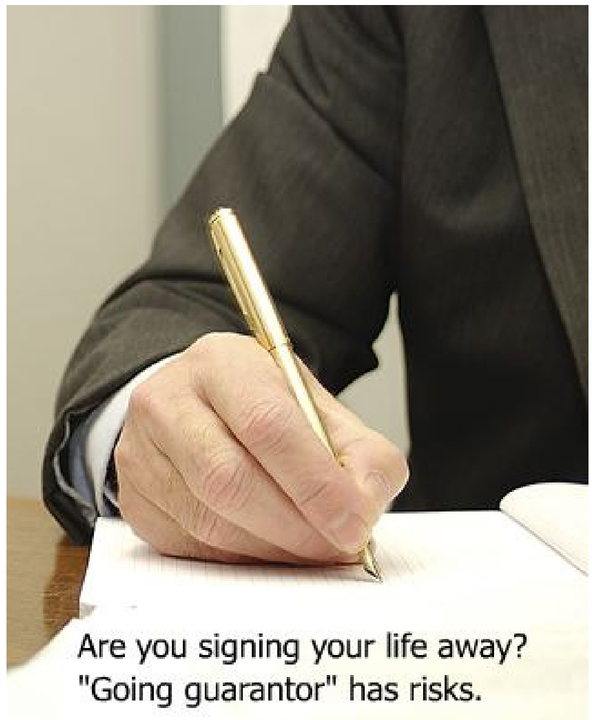
No guarantees for guarantors

In a tough first home-buyers' market it's tempting for parents to offer the family home as collateral for their kid's mortgage. Going guarantor can give your kids a great start in life, but also carries an element of risk. Just what are your legal rights if they default?

Helping a borrower meet repayments is probably the easiest way to settle a default situation and avoid paying court costs. If that's not an option, you'll be in a better position to defend yourself and keep your home if you have kept a record of all the details surrounding the guarantee process in writing, including all conversations and actions.



Here are some helpful tips to help protect yourself in the unfortunate event of a default situation occurring.

›› At the time of giving a guarantee make careful notes of conversations and discussions. If you receive no financial benefit from the loan you should put that in your note. If you were put under any pressure from your son or daughter to guarantee the debt, you should make a record of it.

you should also document whether or not you received any independent advice or whether the bank or financial institution gave you any advice about the loan. If you did not understand the transaction and the financial institution did not take steps to inform you, you should also note this.

›› Record carefully what the bank says to you, particularly if you are not represented by a solicitor or accountant. It may be that you act on the bank's advice and the bank may later be found to have offered bad advice.

›› Check to see that the bank has complied with the Code of Banking Practice.

With the introduction of the Code of Banking Practice, guarantors have an added layer of protection against potential dangers such as a child defaulting or a loan being recalled. The Code applies to most lenders' customer contracts, giving potential guarantors some level of protection against default. For example, under the Code, lenders must update guarantors on changes to the borrower's financial position and any future demands for money. The guarantee itself must also be limited to a specific loan amount.

The case of Mr. and Mrs. Healey

Consider the case of Healey v Australia and New Zealand Banking Group Ltd. Mr. and Mrs. Healey agreed to sign a mortgage as a guarantee for their children's debts. The same solicitor who acted for the children also acted for the parents. Six months later the bank found that the mortgage documents did not secure the debts of the son and daughter-in-law. It asked Mr. and Mrs. Healey to sign another mortgage, with the same solicitor again acting on behalf of both parties. The problem was the children were in serious financial difficulty.

When the case went to court, both the bank and the solicitor were found to be negligent. The court held that the bank acted unfairly as it was aware of the children's present debt and had failed to require that the parents get truly independent legal advice for the guarantee they were giving. The court held that the solicitor was negligent in not explaining to the parents that they were not obliged to sign the guarantee and if they did, it would probably mean a large sum of money would be deducted from a property that they were about to sell.

When parents act as guarantor, another piece of legislation offers them protection. The Consumer Credit code requires a copy of the guarantee and an information statement to be given to the parents as to the need for independent legal advice. Failure to do so may result in the guarantee not being enforceable.

Although guaranteed loans are risky, the reality is many parents, relatives and friends will continue to act as guarantors. If you know your rights and record all discussions relating to the transaction, you will be in a better position legally should your son or daughter get themselves into financial strife.

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Reproduced from Your Mortgage Magazine No. 55 April 2005.