A HELPING HAND

Decreasing housing affordability is forcing many first homebuyers to look at guarantor loans. **Andrea Cornish** looks at what kind of responsibility brokers have when writing these loans and what you can do to keep these deals from turning sour

First homebuyers are thinning out across Australia. Participation of this market segment dropped to 14.9% between October 2009 and February 2011 — the lowest monthly ratio observed since August 2004. The statistics reflect growing concerns over housing affordability. And while some are choosing to wait and save a deposit, others are looking to take advantage of products such as guarantor loans to fast-track their housing dreams.

According to Club Financial Services, brokers are experiencing a significant increase in enquiries from parents looking to use the equity in their home to help their kids buy a property. Andrew Clouston, executive general manager of Club Financial Services, says: “With all states reporting a drop in first homebuyer activity and property prices continuing to rise, it appears that cracking into the property market is becoming increasingly difficult for first homebuyers. We’re finding many of our clients are thinking about how they can help their children break into the property market, without having to dip into their own savings or liquidating their assets. In our recent client survey, of the respondents with equity in their property and with older children, 45% said that they would give serious consideration to being a guarantor for their children to purchase a property."

The ability to borrow up to 100% is the big attraction of guarantor loans, says Otto Dargan, director of Home Loan Experts. "Guarantor loans are now the only product that allows a first homebuyer with no deposit to buy a home and as a result, their popularity has increased. The increase in enquiries is also a result of the major banks reducing their maximum LVRs to 90% or 95% and tightening their credit criteria."

But choosing to be a guarantor is a big responsibility for parents as they will have to cover repayments should the mortgagee fail to meet their financial commitments. And while the loan products have been invaluable for some, they've been disastrous arrangements for others – as proven by an increasing number of cases involving guarantor loans going in front of the courts.

WHEN THINGS GO WRONG

Matthew Bransgrove, partner with Bransgroves Lawyers, specialises in mortgage and financial litigation. He says new migrants, and those less financially savvy, are particularly vulnerable when it comes to entering into a guarantor loan arrangement. "What we're seeing in case after case is that many of these parents have little education and they can't speak English."

And when the situation turns sour, the parents end up in court fighting against a default order and the end result is not usually favourable. "In the majority of cases, the defaulting borrower gets thrown out of their house," Bransgrove warns.

"In almost every case, if the borrower doesn't cross-claim against the broker, then the lender does – everybody blames the broker. It's much safer for brokers to avoid these loans if they want to avoid trouble."

HAPPY MEDIUM

But is there a way to help customers realise their housing dreams without risking the financial stability of their parents?

The Mortgage Gallery's Paul Hughes thinks there is, as long as all parties involved enter into the arrangement with both eyes open.

"It is the broker and lender's job to explain all the ins and outs of guarantor loans, plus most lenders make guarantors sign a statement declaring that they have sought independent legal advice," he explains. "If all parties are doing their job properly, there will be no crossed-wires. In terms of guarantors being older and less savvy – I would agree, but it's on the shoulders of the broker and the lender to educate and confirm with the guarantor before proceeding."

Dargan says his company takes into account the suitability of the loan to their client's situation. "We don't really look at the conversion of the enquiries, we tend to focus on the suitability of the customers and guarantors for this product. As with any no-deposit loan, there is the potential to lend to customers who are not ready to handle the commitment of a mortgage. We don't try to approve loans for every customer that calls us. We want to maintain our reputation and build our business through referrals from satisfied customers and guarantors."

In many cases, the guarantors do not initially understand how this style of loan works, but Dargan says Home Loan Experts takes a great deal of time to explain the process to the guarantors and also the steps that they and the borrower can take to reduce their risk.

"We have found that in most cases the guarantors are better at assessing the credit worthiness of the borrowers than the banks are. Usually the guarantors are the parents of the borrower, and naturally they know if their children are ready for the commitment of a mortgage."

After sitting down with customers who are looking to purchase property through a guarantor loan, Troy Davy from The Mortgage Facts, meets with the guarantors separately.

"Once the customers have spoken to the guarantor, I meet with the guarantors, generally without the customers there," he says. "This is so the guarantors don't feel any pressure – usually from their children, who want the parents to guarantee the home loan. This is when I explain the obligations of a security guarantee, and what it means to them.

"I am pretty blunt when I meet with potential guarantors, and speak of the worst-case scenarios. Things like, if the home loan isn't paid, or goes into default, you are liable for X amount of debt, and the bank could sell your home, too, if there is a shortfall from the sale of the property and you can't afford to pay the amount, or the portion of the loan that you have guaranteed. I also speak candidly about how offering a guarantee may limit future borrowing potential. If you want to sell your home, you have to consider the guarantee that you have in place. I think it is important

"Clients want to help their children break into the property market, without having to dip into their own savings" – **ANDREW CLOUSTON**

that a potential guarantor understands their obligations thoroughly." Most lenders require guarantors to seek legal advice prior to settlement of the loan. One potential complication with this arrangement is that at this point in the process, the guarantor is already committed to buying a property. Should the guarantor decide not to proceed with the arrangement after they've met with a lawyer, then the borrower is left unable to complete the purchase. For this reason, Home Loan Experts recommends clients sit down with a lawyer at the time of application and again, when the loan offer has been issued.

GUARANTOR PRODUCTS

There are a number of products aimed at mums and dads looking to help their kids get into the property market. Dargan notes that the credit criteria is so varied that in most cases, borrowers only qualify with one or two lenders. "Some lenders offer pricing discounts on guarantor loans, so we will usually seek a pricing request as part of our preliminary assessment," he adds.

St.George's Family Pledge Loan is one such product. St.George's Advantage Package and Basic Home Loan

Changing times: House prices now and then

	NOW (March 2011)	10 YEARS AGO (March 2001)
Affordability index	55.7	76
Repayment to income %	53.9	39.5
Median dwelling price	$467,800	$204,724
Monthly repayment	$3,008	$1,378
Affordability multiple	1.80	1.32

Source: Housing Industry Association

are both available with the Family Pledge feature, however if the guarantor already has a loan against the property they are pledging as security, then the Advantage Package may not be an option.

Another popular guarantor loan available through a major bank is CBA's Family Support loan. One unique aspect of this product is that it allows any member of the borrower's immediate family to act as a guarantor. CBA offers its basic home loan and professional package discounts for Family Support Loans.

While the products of the major banks are quite popular, Dargan says several of them require the borrower to have savings, and are complicated and inflexible. Some of the medium-sized lenders such as Suncorp and ING have competitive products he adds, but their credit criteria is relatively strict. According to Dargan, the majority of non-bank lenders do not have a guarantor loan product.

EXIT STRATEGY

There is confusion in the marketplace about how long you need to be guarantor for, according to Clouston. Parents may only have to act as guarantor for the first few years. As the value of the property increases and the children pay down their loan, parents should be able to withdraw their support. This frees up the parents to consider other options for the use of their property equity – such as their own investment purchase.

Dargan says they like to discuss an exit strategy with the borrower to try to remove the guarantee within three to four years. "They can remove the guarantee once they owe less than 90% of the property value if they meet the LMI and bank lending criteria at that time," he explains. "However, it is better to remove the guarantee when the loan has been paid down to 80% of the property value, as this will avoid the need for the borrower to pay LMI."

And if a guarantor loan just isn't right, then brokers can always suggest alternatives. Quite a few parents decide to give their children a gift as a deposit instead of being a guarantor. In most cases a gift of 10% of the purchase price is enough to allow the borrower to qualify for a loan on their own. This option is suitable for parents who are in a strong financial position or who are not comfortable providing a guarantee secured by a property that they own. MPA