# To Guarantee or Not To Guarantee

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Over the years I have seen many issues faced by people who sign guarantees for someone else's debts. The two types I see most often are family members helping out another family member or a director / shareholder guaranteeing a company's debt. Both types have their place but they do come with dangers and pitfalls that the uninitiated should be weary of.

Arguably the most common that people know about are guarantees provided by parents for their children's loans for things such as homes, cars, personal loans and even business debts.

With the price of housing being a barrier to getting into the market it is common and not unreasonable for parents to help children with purchasing their first home. It's hard for a lot of young people to be stuck in the rent cycle and having to try to save a large enough deposit to keep themselves out of trouble. So lenders allow a guarantee by a parent to cover the cost of a deposit and ultimately reducing the costs by avoiding mortgage insurance. The problem is a lot tend to sign and forget without really understanding what they are getting in to and usually the problems start when they don't cap the exposure or forget to remove it when it is no longer required. If something goes wrong and their child can no longer meet the repayments then the parent suddenly up for the total outstanding loan.

So to avoid trouble later, parents should consider if they have capped their exposure such as only being liable for the $50,000 (for example) deposit. They should also reassess their position every year or so until the difference between the reduction of the loan and the capital growth creates an equity position of 20% which is when they should request the guarantee to be removed as it is no longer required. Most lenders allow this, so it isn't uncommon.

Those types of guarantees aren't that hard to deal with. However, when it comes to business it gets complicated. For one thing, there are a lot more triggers which allow a lender to call in a guarantee. Even missing a scheduled payment may be enough to call in a guarantee and there goes your parent's house. I've seen houses being sold because a child has heavily borrowed for a business while mum and dad naively supported the business without really knowing what was going on. They basically didn't monitor their risk and exposure.

Another example I see often is when a director, while trying starting up their business, sign a pile of service agreements and supplier contracts without realising they've just signed a guarantee or simply years later they've just forgotten they did. So the first time they know they're exposed is when it is too late to do anything about it.

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But the worst type of guarantee is those business people that have sold out, retired or just simply moved on from a company but forgot about the guarantees they signed. How would you feel if you sold your business five years ago but when that business got wound up last month a supplier has called on the guarantee you singed ten years ago because it is still valid. It does happen. So if you're contemplating selling your business you need to consider, amongst everything else, the formal replacement of guarantees.

I hope I haven't scared too many of you as I'd be the first to agree that guarantees can be beneficial and have a place. However, if you enter one you need to continually monitor your risk and exposure.

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