YOUR GUIDE TO GUARANTEES
When your bank requests a guarantee, the reasons may not always be clear. Sandy Richardson explains what they mean and why they’re necessary.

In New Zealand, residential property investment will typically see borrowing and property ownership structures involving one or more entities. In most of these cases it’s likely that additional income over and above the rent received will be required to help support servicing of the debt — income that will, more than likely, come personally from those involved.

In situations such as this, a bank will need to be able to link the income, security and liabilities of these parties to enable it to appraise the whole picture. This is where guarantees come in; they allow a bank to create links and legal obligations to connect the various elements involved in the transaction

What We See Most Often
There are a number of scenarios in which a guarantee would be required. One of the most common is where an investor wants to purchase a property under their LAQC—here’s an example

The rental income alone won’t cover the repayments so the personal income of the investors is also required. In addition, the investors want to use existing equity in their owner-occupied property instead of a cash deposit.

In this situation a guarantee is required to link in the two aspects of their personal holdings — income to help service the debt, and their owner occupied property, which has effectively become their deposit. The guarantee will also link in their liability as directors of the LAQC.

If we expand the scenario a little and say the property being used as security was owned by a family trust, a second guarantee would also be required. The first (as above) would cover the personal income while the second would need to come from the family trust as the owner of the property being used as security.

If you’re providing the guarantee for another party, bear in mind the implications of joint and several liability. This means that each individual party can be held personally liable for the full extent of the guarantee. This is a common clause in both loan documentation and guarantees and could potentially mean one guarantor is liable for the full exposure.

Furthermore, even if you arrange to cancel the guarantee, the parties involved are likely to be held to an expiry period. The bank needs to protect its position should insolvency or bankruptcy proceedings against the guarantors occur at some stage in the future and the appropriateness of the funds used for any debt repayment comes into question. The expiry period is generally two years.

Types of Guarantees
Two options exist here, limited and unlimited guarantees. A limited guarantee sets a specific dollar figure at the outset and is only applicable to those securities disclosed in the document. The advantage here is that there is a clear understanding of what it covers, but it has limited flexibility for the future.

An unlimited guarantee provides benefits to both banks and customers through flexibility — helpful should an investor intend on expanding their portfolio in the future as the guarantee won’t have to be renegotiated. It’s worthwhile outlining your plans to your bank and solicitor beforehand so they can help you decide which option suits best.

Legal Responsibilities and Pitfalls
If you’re a party to a guarantee, be aware that you are responsible for repaying any outstanding debts (including interest) covered by the guarantee as well as any costs incurred by the bank when calling on the guarantee. Costs such as these are not a set figure and can change depending on a number of variables.

Should the worst happen, the bank can resort to any security which it holds from you at any time and over any part of your property or assets (unless they’re expressly excluded from the guarantee) to recover its costs.

Sandy Richardson is a sales manager at Bank of New Zealand and heads a team of property managers who specialise in Residential Property Investment. Visit bnz.co.nz/rentalproperty or phone 0800 269 009 to find out more.

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