



GUARANTEES

Guarantees are required by a bank or other lending institution to ensure that the liabilities of the borrower will be met. They are useful financial tools and are commonly used across a range of transactions. However, guaranteeing someone else's debt can expose you to significant risk and it is vital that you understand the implications of what you are entering into.

If you are to accept the role of a guarantor (and sign a guarantee to this effect), you are saying to the lender that, if the borrower fails to pay the lender, you will step in and cover this. Clearly, this can have wide reaching implications. This guide is intended to highlight some of the key considerations around guarantees, and acting as a guarantor.

WHAT IS A GUARANTEE?

A **guarantee** is a **promise** by a **person** ('**guarantor**') to settle a debt or fulfil the promise of someone else.

WOULD YOUR BUSINESS SURVIVE A RELATIONSHIP BREAKDOWN?

Generally, any ownership interest in a business will be regarded as relationship property, even where it is held in the sole name of one party to the relationship. Therefore it must be dealt with on the breakdown of the relationship. The effect a relationship breakdown can have on a business is often misunderstood. It invariably causes a significant disruption to the business, which not only affects the person experiencing the break up, but also their business partner(s).

It may also mean the sudden withdrawal of capital from the business on the division of the relationship property, which might threaten the viability of the business or threaten relationships with other business owners.

A Contracting Out Agreement can protect and preserve an individual's business interest as their 'separate property' in the event of a relationship breakdown. However, caution needs to be taken where an attempt is made to classify future income and gains and business assets acquired during the course of the relationships as 'separate property', particularly where it is anticipated that these will be unusually high. Such a goal maybe difficult to achieve without exposing the Contracting Out Agreement to potential avoidance as being 'seriously unjust'.

Before agreeing to act as a guarantor, the first question a potential guarantor should always ask is why is a guarantee required? This may be the first indication that the lender has concerns about the ability of the borrower to repay a loan.

KEY INFORMATION

As tempting as it may be (especially in the case of family arrangements) to assist a borrower by agreeing to be a guarantor, you need to seriously consider:

- ◆ Whether you can assist the borrower in any other way. Is a guarantee essential?
- ◆ What is your relationship with the borrower and do you know enough about their financial position and their ability to repay a loan?
- ◆ Is the borrower likely to keep you informed of their financial position, and whether they are facing any difficulties?
- ◆ What is the borrower's credit history like?
- ◆ What other obligations does the borrower already have, and what is the extent of those obligations? For example, has the borrower given the lender a guarantee in respect of another person or company?
- ◆ If the borrower cannot meet the loan repayments, are you in a position to meet them and are you prepared to?

ENTERING INTO A GUARANTEE

If you decide to enter into a guarantee, be aware:

1. Guarantees are **not** usually limited to a specific advance from the lender to the borrower. Guarantees generally guarantee all the obligations the borrower may have to the lender. While it is common for the lender to require guarantees which are unlimited as to the amount guaranteed, in some circumstances the lender will allow the liability under the guarantee to be limited to a specific amount. Additionally, it may be possible to negotiate with the lender to limit the guarantee to a particular loan, so that the guarantee will not cover all the obligations the borrower has to the lender. However, this needs to be agreed with the lender and recorded in writing;
2. The lender does **not** need to inform guarantors if the borrower takes out more debt. This can mean the guarantor can end up guaranteeing a much larger debt than initially anticipated;
3. A guarantee is **not** always the 'last option' for lenders in seeking repayment of an outstanding debt. The lender can approach a guarantor at any time once the debt becomes due. The lender does **not** need to try and get this money back from the borrower first, and the lender often chooses which guarantor(s) they will seek repayment from. However, if the lender receives payment from one guarantor only, that guarantor may have the right to seek contributions from the borrower and any other guarantors;
4. If the guarantor is also a customer of the lender (i.e. the guarantor also has a bank account with the lender), then the lender usually has the right to appropriate funds from that account in order to recover any amounts payable under the guarantee; and
5. Furthermore, where a guarantor has granted an 'all obligations mortgage' (which is the standard mortgage security for New Zealand banks and lending institutions) to the lender as security for a loan made to the guarantor (eg. your typical home loan), that mortgage security will also extend to the debts for which the guarantor has given a guarantee to the lender.

CANCELLING A GUARANTEE

While you can cancel a guarantee at any time, this will have significant implications for the borrower. You will, however, remain liable for any guaranteed debt which is outstanding at the time you asked for the guarantee to be cancelled.

MORE INFORMATION

If you're thinking about entering into a guarantee, you need some advice or have any questions — please give us a call or send us an email for more information.

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Disclaimer: This information is intended as a guide only. We always recommend you speak with a lawyer regarding your specific situation and needs.

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