Family Pledge or Limited Guarantee Loans

If you're finding it hard to come up with a deposit for your next home or investment property, you may want to consider a Family Pledge or Limited Guarantee Loan.

Saving for a deposit can be tough, particularly with the added costs of stamp duty, legal fees and other expenses. And mortgage insurance can be very expensive, especially if you're looking at 100% lending.

A Family Pledge makes it easy for a family member to guarantee part of your home loan – with the added peace of mind that they can set the guaranteed amount. It will usually be set at an 80%/20% split with the Guarantor being responsible for the 20% amount.

Family members with equity in their own property, help another family member, by providing a limited guarantee to the lender on behalf of the family member.

The family pledge is a way for your parents or family to help purchase a home without them actually providing cash for a deposit. In contrast, your family use their own homes equity to provide security for a portion of your loan amount, which, reduces your loan to value ratio and also saving you large amounts of money on Lenders Mortgage Insurance (LMI).

Here are some key features;

For the Borrower:

- Can help people with good income but insufficient savings or deposit get into their own home
- With a Family Pledge loan, you can borrow up to the full purchase price of the new property, plus additional funds to cover the costs associated with buying, such as stamp duty, legal costs and other expenses.
- The borrower(s) must be able to meet overall repayment commitments and service the loan based on their own income(s) so there should not be a reliance on the Guarantors income to service the loan
- A Family Pledge loan allows you to avoid paying large Lenders' Mortgage Insurance
- No high interest rates, or exit fees.

PO Box 893 St Ives NSW 2075 Ph: 02 9487 8200 Fax: 02 9487 8201 Email: yourfinancialcoach@lifestrategies.net.au ABN 7049 090 2616 Life Strategies Financial Services is a Corporate Authorised Representative No. 298686 of Financial Planning Services Australia Pty Ltd AFSL Licence No. 225982 ABN: 5501 052 1810 www.fpsa.com.au

- With a Family Pledge loan, you're eligible for First Home Owners grant and are able to take the majority of products offered by the lender

- The loan can be split into separate components where the 20% guaranteed amount is set up as a principal and interest repayment structure and the other 80% the borrower repays at interest only. This can help speed up the repayment of the guarantor's liability and therefore release the parents from their obligations much sooner.

For the Guarantor:

- As a parent or family member, you can limit the amount of the guarantee, rather than opting for a traditional "open" guarantee for the entire loan amount. Nevertheless, you as a guarantor do put yourself and your assets at risk, even if the risk is limited, should the borrower default on the loan.

- The guarantee is limited to a fixed amount at the outset and cannot be increased for instance if the homes valuation should fall. The amount of the guarantee is calculated by taking 20% of the purchase price (this can also include costs) and then multiplying that by 1.25%. This will ensure that the LVR is 80% or below.

- The Guarantor Family member does not need to change from their bank or 2nd Mortgage their property

- You can be released from the guarantee much sooner than normal and the Guarantor can usually request the guarantee be removed at any time. This can occur where the LVR is reduced to below 80% due to repayment of the loan or an increase in the home's valuation.

- Should the Guarantor want to sell their home or refinance, they can be released from the guarantee where the LVR remains above 80% however, the loan will be reassessed and LMI may then be charged to the borrowers

- As a guarantor you cannot provide servicing support but some lenders will require the guarantor be able to show they have income to service their guaranteed amount if need be.

How Family Pledge/Guarantee actually works

Generally, when you borrow more than 80% of the value of the property, it's deemed as a high risk. When this occurs, the lender will take out Lenders' Mortgage Insurance to cover them for possible loss.

The higher the risk, the higher the Lenders' Mortgage Insurance premium will be. It's important to remember, Lenders' Mortgage Insurance covers the lender, not you.

By taking out a Family Pledge/Guarantee you will avoid the Lenders' Mortgage Insurance cost. Let's take a look at an example:

Say you decide to buy a property for $500,000 and want to borrow the full amount. Your loan would be $500,000 but your parents would also need to guarantee $125,000

The security to the lender would be $625,000; $500,000 (new property) + $125,000 (Pledge amount from family residence)

$500,000 divided by $625,000 = 80% LVR (Loan divided by Value Ratio). With a loan at 80% LVR or lower, Lenders' Mortgage Insurance (LMI) would no longer be required, offering you significant savings.

The cost of the LMI will vary depending on the amount of your loan and how much higher your LVR is above the 80% mark. For example, on a $500,000 loan with an LVR of say 95%, you could expect the LMI to cost you approximately an extra $16,000 on top of your loan. That's an additional and unnecessary cost worth avoiding! Note the LMI can also vary somewhat between insurance providers.