As Co-Signor or Guarantor – You're Still on the Hook

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If you've ever been asked to co-sign a loan for someone, you've got one of two responses which are indicative of your experience in doing so. You say yes, because you want to help a family member, or friend, and you've not ever been burned by paying off someone else's debt. Or you say no – maybe even heck no – because you've been down that road before and won't go there again.

Use of a co-signor on an obligation is one way that financial institutions can offer a loan to someone who is not solely credit worthy on their own. Usually, this would be someone of a younger age who hasn't been in the workforce long enough to establish income capacity or any prior credit. But it could also be an older person who's never had credit in their own name and might have good job stability but needs an assist for their first loan. I see that sometimes on widows who've only had credit in their deceased spouse's name.

If a lender is requiring a co-signor on someone, it's because the loan can't be made without someone else standing good for the debt. So if you are a co-signor, you need to be aware of that going into the deal – you will be asked to pay the obligation if the debtor fails to do so. Make sure your budget and discretionary spending can handle the additional debt, which may be due in a lump sum if the lender doesn't agree to allow you to take over a payment once it becomes delinquent.

The other down-side to being a co-signor for someone is that their payment history becomes your payment history on a credit report. So if the primary borrower is a slow-pay customer, it could impact your own ability to borrow money. Co-signing a loan for your grown child to obtain their first credit is probably less of a risk than say, co-signing a loan for a co-worker. You still have some influence with a child to ensure the payments are made on time, and with a co-worker, not so much. If you're ever called upon to take over someone's debt as a co-signor, it's best to actually refinance the debt into your own name. In this way, there will be a clear point at which the bad payment history stopped when you assumed the obligation for the debt. It doesn't prevent the hickey on your credit from the bad loan, but it's easily explained and will reflect the dates accordingly on a credit report.

Lending institutions will also sometimes use a guarantor on a loan, rather than a co-signor. In this case, the primary borrower may be a business, and the owners of the business are asked to guarantee the debt in the event the business would fail. This provides some incentive for the lending institution to extend credit to the business, knowing the individual owners will be responsible for the payments.

We rarely see or use co-signors or guarantors on mortgage loans. When it comes to real estate loans, the primary borrowers need to be credit worthy and capable of making payments without dependence on a third party. That said, small community banks can make an exception to allow guarantors on a mortgage loan if the circumstances warrant. However, current regulations would require all income sources and all obligations on every party to the loan to be considered in the qualification process. Once again, the debt would be responsibility of the guarantor with payment history impacting the credit of the guarantor, and you'd have to furnish your financial information for loan documentation.

When it comes to signing for debt, whether as a co-signor or as a guarantor, folks need to understand that the lending institution is obtaining your signature to make sure the debt is paid. Use discretion, and I assure you that your experience as a co-signor or guarantor will impact your future decisions when asked to co-sign or guarantee a loan. Even though the loan may not be in your name, when it comes to the payment and the debt, as co-signor or guarantor, you’re on the hook.