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Borrowing from others

What's really at stake?

Drew Browne

Get clear on what is at stake when you borrow with others.

Understanding 'joint and severally liability loans' and what it means for you

You might think when you take out a joint mortgage with someone else that you are only responsible for your 'half' or 'share' of the loan.

Think again because this is not the case.

By signing a mortgage contract with someone else, you are each agreeing to pay off the whole debt if the other cannot—or will not—pay it.

This is called joint and several liability, and you need to know what it means for you and how to protect yourself.

Buying a property together

Buying a property with your partner is usually straightforward. Combining savings into a single larger deposit can help you both get into a fast-moving property market or reduce (or remove) the need for hefty lenders mortgage insurance fees.

However, the complexity increases when you buy a property with a friend or with a sibling. It becomes even more complicated when you buy a property in a self-managed superannuation fund.

Buying a property and taking out a joint mortgage with your

partner is usually straightforward because you have a common goal to live in the property.

However, when you are buying property with multiple people, such as a sibling, a parent or a friend (or a combination), you will all need to have a bigger conversation with everyone involved to agree on what happens when one of you wants (or needs) out.

Have the joint mortgage conversation

Whenever you are about to become a co-borrower, you must first understand the legal position that you are getting yourself into and agree together on the practical details.

This frank conversation needs to cover the following issues:

- Do you know whether either of you can afford to buy out the other(s) if need be?
- If you later decide to sell, how will you work out and distribute the fair value?
- How will you divide the sale proceeds to reflect the fair value of what was contributed upfront and along the way, or the initial deposit that made it possible in the first place?
- Who is responsible to keep the property insured and in good order?
- What is the ownership structure you will use to hold the property—**tenants in common** [i.e. each co-owner can have equal or unequal shares in a property, provided it adds up to 100%; and if one of the owners dies, their share remains part of their estate and does not automatically pass on to the other owners]

or **joint tenants** [i.e. co-owners have equal shares in the property; and if one of the owners dies, the property is transferred automatically to the surviving owners]?

- Will all the parties to the loan be jointly and severally liable?
- If so, will you use joint and several insurance to protect each borrower from the full debt, or just their portion of the ownership?
- What if you cannot sell later or cannot sell at the price you are hoping to achieve?
- What if one of you loses a job or gets sick or injured (e.g. a car accident) and cannot work for a while?
- What happens if one of the joint borrowers suffers a sickness or accident that requires expensive medical costs, or they need to move into aged care?

Make your decisions legal

There are many different scenarios to discuss and you should try and talk about all of them.

Tip

The following actions are recommended:

- List what you have discussed and what you have agreed upon.
- Nominate to use a mediator in the future if required, just in case you reach an impasse and need to get the help of a third party to talk through a decision.
- Keep master copies of key documents filed with the lawyers.

We also suggest you make a signed legal agreement that records your commitment to 'act in the best and fair interest of all parties'.

So, who is left carrying the joint mortgage?

The answer is everyone.

The joint mortgage contract will have a legal clause making all borrowers joint and severally liable.

Whenever you buy a property with another, your spouse or with a friend or relative, the mortgage contract you sign states all parties are joint and severally liable. Practically, this term means you are all personally, and jointly 100% responsible for the loan.

All parties are 100% responsible

Because all borrowers are 100% joint and severally liable, if one of you cannot—or will not—pay their share, the bank expects the other person (or people) to pay for all of it. Moreover, if a default happens on your loan because of the other person's actions, you still get the default listed on your credit file. Maybe this is unfair, but that is the reality of the joint mortgage you sign.

What is the effect of a joint and several loan when buying a second property?

There is another consequence of this clause in your home mortgage. That is, if you later want to purchase an investment property, when you are calculating what you can afford, because you already have a joint and several mortgage liability, you are assumed to already be responsible for the entire 100% of the first mortgage, not just your portion.

This means co-ownership of a property with a mortgage can significantly reduce your own future borrowing power.

What happens if you break up?

If you break up with your partner, and you are still a co-signatory, guarantor or joint borrower to a mortgage, expect to be held liable for any debt with a joint and several clause in the loan agreement.

What happens if one person dies?

If your partner or a co-borrower dies, you will still be held personally liable for any or any debt that has a joint and several clause in the loan agreement.

How the ownership structure was initially set up now determines if the co-owner's share of the value in the property goes to their estate (as per their Will) to be split up, or simply passes to the surviving joint owners and never falls into their estate to be challenged by others.

The bottom line is that any joint debts mean joint responsibility and liability.

The Australian Securities and Investments Commission (ASIC) Moneysmart website has a useful factsheet titled 'Love and loans' about this issue.

How do you protect family borrowers from a joint and several mortgage debt?

So how do you protect the joint borrowers in a family, especially if one of them does not work?

The life insurance industry traditionally had a difficult time recognising the value a homemaker brings to a relationship and limited the amount of life insurance a homemaker (though not working by choice) could apply for to \$1.5 million life insurance.

This creates potential problems for a typical two-parent household with two kids and a \$2 million mortgage if one of the adults is a full-time homemaker.

This can create a problem for partners doing extensive renovations on a property where one adult is not working but managing the renovation full-time, while their partner continues to work.

If the debt is a joint and several mortgage, both working and non-working borrowers are still liable for the entire debt of \$2 million.

The solution might be a specialised life insurance policy designed to recognise and insure joint and several liability mortgages debt on the family home.



The quote

If you break up with your partner, and you are still a co-signatory, guarantor or joint borrower to a mortgage, expect to be held liable for any debt with a joint and several clause in the loan agreement.

This is where the total amount of the mortgage can be insured, regardless of the working status of the adults in the family.

How do you protect business owners and partnerships from a joint and several debt?

This speciality life insurance is also available to business partnerships.

A four-partner accounting firm may have a debt of \$4 million and needs each partner to completely insure the entire debt, not just one-quarter of it. A joint and several life insurance policy allows each of the four-partner business to completely insure the entire \$4 million debt, not just traditionally one-quarter of the debt.

Conclusion

Borrowing with others can increase your opportunity to get ahead, but can also increase your risks to manage. Therefore, make sure everyone knows what is at stake when you borrow with others. **FS**