



Tom Keuler

Be careful: Guaranty agreements can bite you

If you have a family, or just a bunch of good friends, chances are somebody will ask you to guaranty a loan. It might be a son who wants to buy a house, a daughter who wants a new car, or a friend with bills to pay.

We all want to help our family and friends. It's in our nature. We take pride in our ability to help them get what they otherwise could not have. And if we don't help them, we will suffer that inevitable feeling of guilt. Often we will do anything just to avoid guilt.

That's why many of us end up signing guaranties. Signing a guaranty is easy enough, and if all goes well we can help someone without having to pay a dime. That's a good return in anyone's book. But it doesn't always work that way. Despite good intentions and efforts of the beneficiary, you may very well be the one having to pay the loan.

There is a good reason why lenders want your guaranty. They want you to assume the risk of the loan. Lenders make loans to those who can pay. They don't want to lend money to someone with bad credit or no credit history. And

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they don't like borrowers who don't have a good, solid job. Whatever the reason, lenders want you to be responsible for the repayment of the loan.

If you agree to guaranty a loan, the lender will have you sign an absolute guaranty. Signing that guaranty is like signing the note itself. If the borrower defaults, you will have to pay the loan. The lender doesn't have to go after the borrower or even the collateral. The lender simply picks up the phone and demands that you pay the loan. That's it. And if you don't, the lender will come after you and your property. Worse yet, you now have a credit default on a loan that wasn't even yours. You might as well kiss your good credit rating goodbye.

Lowering risk

Before you sign a guaranty, make sure you know what you're getting into. You better ask yourself if you can afford to pay the debt. Once you sign that guaranty, you better be in a position to pay it.

However, there are some things you can do to minimize risk. Here are a few recommendations for your consideration:

Ask the lender to accept a guaranty of collection. This is a limited type of guaranty — you only guaranty the deficiency. In this case, your guaranty kicks in after the lender has sued the borrower and liquidated the collateral. Once that's done, you will be required to pay the deficiency balance. That's a heck of a lot better than paying the entire loan. But here's the catch: You must also pay the lender's costs and attorney's fees during liquidation. That's an acceptable consequence. When all is said

and done, those costs and fees were incurred for your ultimate benefit. Would you rather sue the borrower?

Ask the borrower to obtain other guarantors. The more the merrier. The more guarantors, the less you have to pay. Under law, each guarantor must pay his fair share of the loan. But there's a catch here, too. The lender can ignore other guarantors and simply go after you. You may not be able to stop that, but at least you have the right to demand contribution from the other guarantors.

If you have to pay off a loan, get an assignment of the loan documents. An assignment gives you the same rights and remedies as the lender. True, you may never sue the borrower, but that assignment will protect your position from other creditors. It will keep other creditors away from the collateral. It will also protect you in the event the borrower files for bankruptcy. If you own the loan documents, you will be accorded the favored secured creditor status. That's a whole lot better than being a general unsecured creditor.

No doubt, helping old friends and loved ones is an honorable thing. And signing a guaranty will give them something they would not otherwise have. But always remember why you're guaranteeing the loan. You're assuming a risk the lender didn't want — a risk may very well come back to bite you.

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