

Cosigning a Loan: Better Think Twice

You might think you are only doing your friend a favor—helping him get a start just like somebody helped you when you were younger. All you are thinking of doing is putting your name on a piece of paper, right? How could that hurt? Certainly he will pay off the loan—he promised he would.

Real life isn't always as neat and clear-cut as we would like it to be. Therefore, people who plan to cosign a loan for a friend or relative should be prepared to pay off the loan. Chances are, that is what they will have to do. A study shows that three out of four people who cosign loans end up repaying them.

With odds like those, it is no wonder that more people might think twice whether they want to cosign a loan at all. Too often people sign their names without realizing they can be held responsible if the borrower does not pay. The cosigner is legally obligated to pay if the borrower does not.



In addition to the debt itself, the cosigner might also have to pay:

- heavy late charges
- court costs
- attorney fees

Co-signing for a friend who does not pay the loan as required can cost you a job opportunity. Some employers review credit reports and will not hire employees whose records show signs of trouble, such as co-signing a loan that has late payments. In addition, liability of the loan will affect your debt-to-income ratio. Your ability to borrow money will decrease due to your friend's loan being listed on your credit report. Remember that a co-signer is required when a lender believes a person is not able to repay a loan. However, if you do decide to co-sign a loan, ask the lender if you can be released from the loan after a specific period of on-time payments.

When might you cosign a loan?

You might consider cosigning a loan for a young adult son or daughter who has never borrowed money and, therefore, does not have a credit history to qualify for a loan.

The following are some conditions you might want to consider before cosigning the loan.

- The borrower has saved enough money to pay six monthly payments, in case they lose their job or become ill and cannot work.
- The borrower has a steady permanent job at the time of the loan; a good record of responsibility; and the ability to keep a job.
- The borrower has paid you back in the past when you have loaned him or her money.

- The borrower spends money wisely.

The cosigner can improve his or her odds by knowing certain danger signals that indicate the borrower may not be able to repay the loan. These include:

- the borrower's tendency to put off paying bills he used to pay promptly;
- charging day-to-day items and then not paying in full when the bill is due;
- dipping into savings account to meet current expenses or doesn't have a savings account;
- regularly receives past-due notices;
- never out of debt with local department stores; and
- more than 20 percent of his monthly take-home pay is used for monthly installment debts.

If you still decide to cosign the loan, you should never sign a blank contract, rather:

- read and understand the contract;
- know exactly what will happen if the borrower cannot pay;
- check the contract for each amount, date, and terms; and
- get a copy of all important papers, including the loan contract, the Truth-in-Lending Disclosure Statement, and any warranties (if you cosign for a purchase).



According to the Federal Trade Commission, you might also be able to negotiate specific terms of your obligation under the contract. "For example, you may want to limit your liability to the principal on the loan, and not include late charges, court costs, or attorneys' fees. In this case, ask the lender to include a statement in the contract similar to: 'The cosigner will be responsible only for the principal balance on this loan at the time of default.'"

In addition, the FTC recommends asking the lender "to agree, in writing, to notify you if the borrower misses a payment." This can save you the hardship of having to repay the entire balance right away.

Reference:

Coleman, C. (2010, July 15). Cosigning for a loan is asking for trouble. *Own the Dollar*. Retrieved August 4, 2010, from <http://ownthedollar.com/2010/07/cosigning-for-a-loan-is-asking-for-trouble/>.

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