

Guarantors vs. Co-Borrowers: Avoiding Pitfalls in Loan Structuring

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By Keith Mundrick on June 23, 2025

In commercial lending, the decision to designate a party as a guarantor or co-borrower is more than a technicality—it can significantly impact a lender's ability to enforce a loan.

Mislabeling a guarantor as a co-borrower, particularly when they do not receive loan proceeds, often weakens a lender's position in the event of default. This is a common point of confusion in loan structuring, and it may even seem counterintuitive, but missteps in this area can lead to costly challenges.

Defining the Roles: Guarantors and Co-Borrowers

A guarantor is a party that does not receive the loan proceeds, but rather commits to repaying a loan if the primary borrower defaults. By contrast, a co-borrower is directly liable to repay the loan and generally a recipient or direct beneficiary of the loan proceeds.

Lenders may believe that labeling a party as co-borrower enhances their leverage. However, courts generally look to substance over form. If a “co-borrower” does not receive or use the loan proceeds, courts are likely to recharacterize them as a guarantor or surety, which opens the door to a number of specific defenses.

The Risk of Guarantor Defenses

Guarantors can leverage common law suretyship defenses to challenge liability. These include arguments that the lender materially altered loan terms without consent, such as extending repayment deadlines, or impaired the value of collateral securing the loan. A guarantor might also claim the lender failed to diligently pursue the primary borrower.

A properly drafted guaranty agreement waives these defenses, providing lenders with a clearer path to enforcement. Simply adding an intended guarantor as a “co-borrower” to a standard note or loan agreement will rarely accomplish such waivers, unless carefully drafted by counsel, leaving lenders vulnerable if a court classifies the party as a guarantor.

Strategic Structuring: When to Use Each Designation

Guarantors are appropriate when a party provides credit support without receiving loan proceeds. Common scenarios include a parent company guaranteeing a subsidiary's loan or a business owner backing a company's debt.

Co-borrowers, conversely, should be designated when parties actively use the funds. Aligning the loan structure with the parties' actual roles is critical to avoid disputes and ensure enforceability.

The Power of Precise Documentation

Effective loan documentation is a lender's best defense against enforcement risks. A robust guaranty agreement should include explicit waivers of common law defenses, ensuring courts uphold the lender's rights. Loan agreements with "co-borrowers" must clearly reflect the party's use and benefit from the loan proceeds to withstand judicial scrutiny.

Most courts focus on the economic reality of the transaction, making tailored documentation essential to prevent recharacterization and preserve a lender's position.

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