

The Risks Associated With a Personal Guarantee

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It's important for business owners to understand the risks behind signing personally on a business loan or line of credit. Most lenders require that small businesses sign personally. If the business defaults the debt, it will not only hurt their business but also their personal finances and credit.

The process of applying for a loan can be tedious. It requires an abundance of paperwork and financial records to prove you are a sound investment. Most lenders, whether they're a bank, an online lender or a usurer, want to know their money will be put to good use and paid back.

When applying for a loan, line of credit, equipment financing or business credit card, many business owners are surprised to learn that a personal guarantee is required to secure the financing. There is nothing inherently wrong with issuing a guarantee – in fact, it is a standard for most business financing – but you should have a clear understanding of the possible consequences of personal liability on business debts.

What does it mean to offer a personal guarantee?

A personal guarantee from a business owner or executive who has at least 20 percent stake in the company is used to secure funding by promising the lender that if the business defaults, they will pick up the remaining debt. Most business lenders want to see that both the small business and business owner have a strong credit history and are financially stable. For instance, the SBA requires a personal guarantor on all their loans and has minimum credit score requirements. The stronger the credit, the better the chance of successful approval and better pricing on most financing.

Why do lenders require a personal guarantee?

Lenders want extra assurance that you are committed to paying back the loan and a responsible business owner who is personally invested in the company.

For some business loans and lines, it's possible that, with a significant commercial credit profile, you'll be able to get a business line without a personal guarantee. But as a rule of thumb, when reviewing a loan applicant, most lenders look at revenue to judge whether the guarantee is required or not. If you are an SMB with revenue under \$25 million a year, you'll likely be required to sign personally. Both your business credit scores and personal credit FICO scores may be reviewed and analyzed for risk.

What impact does a personal guarantee have on personal and business credit?

The impact of a business loan on your credit will depend on how you manage paying it back and the amount of debt you already have.

If the account is reported to personal credit, the heavy debt will lower your available credit and can make it harder to take out a personal loan or mortgage. If the loan defaults and you have a personal guarantee, the collection, charge-off and eventually judgments will be reported and drastically impact your scores. When you offer a personal guarantee, you are putting your personal finances, credit and company credit on the line. (To be clear – for business financing with a personal guarantee, any negative information would report to both the business and personal credit bureaus.)

If you have never separated company finances from personal and failed to build up company credit profiles, your business credit reports will be bare. Not only will they show you as a high-risk borrower, but you will be more susceptible to damaged credit. Any negative information that reports on naked profiles will wreak havoc on your scores.

Unfortunately, situations like this are common, and if the business was to fail, you would be left with crippling debt and critically damaged credit. Before offering a personal guarantee, it's important to speak with an attorney and investigate unlimited vs. limited personal guarantees.

Unlimited personal guarantee

With an unlimited guarantee, you are authorizing the lender to collect on 100 percent of the loan amount and usually any legal fees that arise from your failure to pay. In other words, the lender could collect on personal assets such as your home, vacation homes, saving accounts, cars and retirement funds. Many states have [homestead laws](#) in place that keep your primary home and retirement accounts off-limits to most creditors.

Limited personal guarantee

With a limited guarantee, the borrower and lender agree on a set limit. If you were ever to default on a loan, you would only be responsible for that predetermined liability. In most cases, a limited guarantee is used when multiple executives with 20 percent or more stake in the company are personally signing for the loan.

Before you sign on the dotted line, make sure you know what will happen if you sell your portion of the business and understand that your business model will not supersede your liability on the loan. In other words, just because you set up an LLC to limit personal liability does not protect you from liability in an unlimited personal guarantee.

A business loan, line or lease is a long-term commitment that should not be taken lightly. It can have ramifications on you personally for years to come. Banks take on a lot of risk when issuing loans, and they want to make sure you are serious about the business and willing to risk your own financial future on it. It is also important to remember that loans with a personal guarantee are usually less expensive (depending on the state of the business and personal credit scores of the company), since the risk is lower for the lender.

Just because there could be risk in personally guaranteeing does not mean there isn't great reward. If you are paying 7 percent interest on a loan that is personally guaranteed, as opposed to a higher-risk loan with interest at 20-plus percent, there is a great savings that can equal more profits and success.

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For 30 years, I have owned and operated the most sophisticated Credit Restoration & Education Company. With an intense desire to help individuals/businesses reach their credit scoring goals I have developed and cultivated an impeccable reputation and level of success. My company is known in both finance related and real estate industries for our boutique style credit repair services which are second to none. Improvements have taken as little as 7-40 days with increases in FICO scores as much as 40-280 points & business credit index/score improvement into the lowest risk threshold . With our wealth of expertise & experience in business, rest assured that through our programs clients will be getting the services of an expert staff committed to working towards their credit goals. Using our vast experience we tailor a strategy which will deliver the best results. North Shore Advisory, Inc. does not outsource personal information to third parties or offer any type of financing as many credit repair companies do. And because we stand by our record of excellence our refund policy provides our clients with pricing based on success. That's our guarantee. I enjoy Public Speaking across the country where I educate bankers, CPA's, realtor's, financial planners, and all kinds of professionals, helping them find solutions to credit problems. I am a Certified Fico Professional and trained as a Credit Expert Witness with expertise in personal and business credit. I have published two books the most recent, "Credit Score Power". I am consistently interviewed for both national TV & major news publications where I write/contribute. I am the featured "Credit Coach" for "Eye on Real Estate" a popular 970 AM radio show as well as Credit Coach for Douglas Elliman. Contact me: tracy@northshoreadvisory.com