

Business owners often balk at giving personal guarantees but they are a fact of life in most banking relationships for small to medium-sized businesses. What guarantors often overlook is the benefit to them of the bank having adequate collateral for the loan and ensuring that it has been properly perfected.

While it is important not to give the bank collateral which could limit the company's ability to borrow elsewhere, it is worth considering what would happen in the worst case if the company were to fail.

In that case it is in the guarantor's interest that the bank has unfettered legal access to its assets so that the loan can be repaid ahead of other creditors. If there is a shortfall between what the bank realizes from its collateral and the amount owed, the guarantor will be firmly on the hook and that can be a daunting prospect.

Many guarantors seem to feel that it is some kind of triumph if the bank fails to perfect its collateral, but in fact the exact opposite is true and it is a positive benefit to them if the borrowing is properly secured. The time to avoid a potentially messy situation is by insisting on providing collateral when the loan is taken out in the first place... and making sure that the bank perfects their collateral properly.

The next stage, of course is to get off the personal guarantees as soon as you can. Banks are unwilling to take this step but it can be accomplished if you push. When I was a banker in England years ago one of my customers asked me for a formula for when his guarantee would be released. The bank resisted but was unable, in the end, to avoid giving him a formula of debt to equity that would trigger the release of the personal guarantee. As a side note, we also wanted his house as collateral supporting his guarantee and he gave me the memorable line "Houses are for living in...not giving to Banks".

In my own case, I was once guaranteeing a company debt of \$7 million. The bank was becoming uneasy and "encouraged" me to find another bank. I was able to move to a full-fledged (and very restrictive) asset-based lending facility 20% higher. Because that bank had full confidence in their collateral they released my personal guarantee, which was something of a relief.