



# Financing the Farm

*A law bulletin series on legal arrangements for farm financing*

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## Personal Guarantees and Agricultural Loans

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Lenders often ask a farm operator to sign a personal guarantee when extending credit to the operator's business entity. Why does a lender do so, and what are the implications of entering into a personal guarantee? This bulletin explains personal guarantees and what a farmer should know before entering into a personal guarantee.

### What is a personal guarantee?

A personal guarantee is a legal promise by a third party "**guarantor**" to be liable for a borrower's loan with a lender. If the borrower fails to repay any portion of the loan, the lender can seek payment from the guarantor. By adding the guarantor as a third party to the transaction between a lender and a borrower, a personal guarantee provides the lender another party to turn to for repayment of the loan funds. Unlike a "co-signing" situation, the guarantor is not an applicant for the loan but is guaranteeing payment for the loan.

There are two different types of personal guarantees. A **limited personal guarantee** is often used when there are multiple business owners. If the business defaults on its loan, the business owners share the burden of repayment. An **unlimited personal guarantee** is an agreement by a single guarantor to be responsible for repaying the entire amount owed to the lender.

### When do lenders use personal guarantees?

It is common to use a personal guaranty in several different types of loan situations. One is when the borrower is a **formal business entity** such as a corporation or a limited liability company. Organizing as a formal entity can legally shield the entity's owners from personal liability for the affairs of the business. Because of this legal protection from personal liability, the lender may require the owners to individually guarantee a loan for their business entity.

A lender might also want a personal guarantee when dealing with a **new business** that may not have an established credit history or own assets to secure the loan. Requiring the business owners to enter into personal guarantees would assure the lender that individual assets are available to recoup the outstanding loan if the business assets are insufficient.

Another scenario for using a personal guarantee is when the assets of an established business are subject to **other creditor and lender obligations**. The personal guarantee brings personal assets and funds into the financial picture. If other creditors use up the business assets, the lender may pursue the guarantor's personal assets for repayment purposes.

### How does a personal guarantee work?

A lender might advise a business during the loan application process that a personal guarantee is necessary. A guarantor's willingness to sign a personal guarantee for a borrower can be a determining factor in whether the borrower receives a loan. But some business loans automatically include business owners or

members as guarantors within the loan documents without formal discussion of the arrangement.

Most states require that any promise to repay another's debt, as is the case with a personal guarantee, must be **in writing and signed** to be legally enforceable. But there is no standard written form or separate document a lender must use, and it is common for personal guarantee language to be included along with other provisions within a loan document. The words "guarantee" or "guaranty" are not required for formation of the guarantee and might not appear in the document. Instead, any words that clearly establish a promise of the guarantor to pay for the debts of the borrower will suffice.

Examples of language sufficient to create a personal guarantee promise include:

- "Party agrees to immediately undertake the obligations of borrower upon written notice of default from the creditor."
- "Creditor has the right to 'call' upon LLC manager to make payments due."
- "LLC member agrees to be 'responsible for' an obligation when due."

### **Signing a personal guarantee: issues and implications**

Nearly any type of extension of credit can involve a personal guarantee, so it is imperative that farmers understand the significance of signing a document that includes a personal guarantee.

Here are several issues and implications to consider:

*A personal guarantee trumps LLC and corporation protection.* As explained above, formally organizing as an LLC or corporation means that the debts and liabilities of the business are solely the responsibility of the business and the personal assets of the business owners are not subject to liability. A

business owner or member who signs a personal guarantee loses this personal liability "shield." But the personal guarantee applies only to the loan and the personal asset shield remains in place for liabilities arising out of other contracts or torts.

*The personal guarantee might live beyond the original transaction.* A personal guarantee might apply not only to the current loan but also to future loans from the lender. Clear language such as "now or at any time hereafter" or "all obligations however and whenever incurred" express the intent for a guarantor to repay additional future obligations with the lender. However, many states like Ohio allow a guarantor to revoke a continuing personal guarantee prior to additional future loans.

*Many personal guarantees are "unlimited."* Where there are multiple owners, members or managers of a business, it is common to use the "unlimited" personal guarantee explained above. Doing so establishes joint and several liability for all who sign the document, and each person who signs will be responsible for the full amount of the debt.

*There could be ways to negotiate a personal guarantee.* A lender might be willing to negotiate the personal guarantee requirement. Alternatives to securing the lender's interest might be possible, such as a larger deposit or a letter of credit. A lender might be willing to limit the personal guarantee to certain identifiable personal assets or to remove the guarantee at a certain endpoint, such as when the debt reaches a stated amount.

*Ignorance is not bliss.* A guarantor who signs a contract containing personal guarantee language will have an uphill battle if claiming unawareness that the contract contained a personal guarantee. Unless the lender made a fraudulent representation or omission during the loan process, it is difficult to void a personal guarantee based upon ignorance.

## Legal review is critical

A personal guarantee might be necessary for many business loans, but it can have lasting financial consequences for a guarantor who becomes legally responsible for business debt. Yet because there is no standard form or language used to create a personal guaranty, it might not be obvious when someone is entering into this type of agreement. The terms of personal guarantees can vary from lender to lender and loan to loan and may be negotiable.

The issues and implications of personal guarantees highlight the importance of legal review of loan documents. Working with an attorney to fully understand the implications of a personal guarantee is an excellent financial risk management tool and is likely to be money well spent.

## Other titles in the *Financing the Farm* series

To learn more about common legal documents for farm financing, see our law bulletins on Mortgages, Promissory Notes, Installment Contracts, Leasing Arrangements, Secured Transactions, Statutory Liens and Farm Operating Loans, available in the OSU Farm Office library at <https://farmoffice.osu.edu/ag-law-library/farm-finance-law>.

## References and additional resources

“Finance and Credit,” NATIONAL AGRICULTURAL LAW CENTER, <https://nationalaglawcenter.org/research-by-topic/finance-credit/>.

Peggy Kirk Hall and Erin Porta, “Will a Personal Guaranty Trump LLC Financial Liability Protection?” Ohio Agricultural Law Blog, THE OHIO STATE UNIVERSITY AGRICULTURAL & RESOURCE LAW PROGRAM, <https://farmoffice.osu.edu/blog/fri-07192013-1230/will-personal-guaranty-trump-llc-financial-liability-protection>.

Philip L. Kunkel and Jeffrey A. Peterson, “Contracts, Notes and Guaranties,” Agricultural Business Management Farm Legal Series, UNIVERSITY OF MINNESOTA EXTENSION, <https://hdl.handle.net/11299/213012>.