

4 Ways Business Loans Can Affect Personal Credit Scores



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If you own a small business and need to take out a small business loan, keep in mind that a personally guaranteed business loan can impact your personal credit scores, sometimes for better, sometimes for worse. But if you default on the loan, the negative impact could be devastating. That's because lenders sometimes report these loans on your personal credit reports. Even some small business credit cards, for example, require a personal guarantee and will report a default on the owner's credit reports.

Business debt can also affect your personal credit if you use personal credit cards to fund your business. The same goes for tapping a home equity line of credit. Again, the impact could be positive or negative, but failing to make payments if your business is struggling will definitely be negative.

For these reasons, some entrepreneurs prefer to keep their professional and personal life separate when it comes to their credit. If that applies to you, here are four of the best ways to do that.



- 1. Incorporate your business.** This can include an LLC, S Corporation or C Corporation. If you instead operate as a sole proprietor, your business and personal credit will be one and the same.
- 2. Get a business credit card.** Make sure it doesn't routinely report activity to consumer credit reporting agencies. Be sure to then pay all of your bills on time, because virtually all major small business cards will report if you default on the card.
- 3. Ask before you apply.** Ask the lender whether it will check your personal credit reports for a business loan or payment plan (those inquiries affect your scores), and also ask about the policy for reporting those loans.

4. Consider other alternatives. Before you tap your home equity line or personal credit cards, talk with a tax or financial adviser about alternatives such as a loan against your 401K or other retirement plans. (You cannot borrow against an IRA.) These loans don't show up on consumer credit reports.

Which loan is right for you?

It's also good to keep in mind that there are literally dozens of different small business loans to choose from, so figuring out where to start can be tough. You can break down the process into three stages: deciding what you need, learning where to find it and shopping around for the final product. Once you complete the first part and take stock of your needs, the second step will likely be less intimidating.

Of course, first you'll need a business plan explaining the management skills of the owner, a cash-flow projection for the next 12 to 24 months, a good description of what the business does, a list of potential loan collateral and, if the business exists, two to three years of financial statements or tax returns. Once you've gone through those details and know how much money you need (and for how long), there are three main sectors to search for financing: conventional, Small Business Administration and alternative loans.

Finally, your credit scores as they now stand will play a large part in whether you qualify for a loan and what kind of terms you'll be offered. Whether you're concerned about qualifying or not, it's good to know where your credit stands before applying for a loan.

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