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About Cross Collateralization: (extract from Internet Article)

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# What Is Cross Collateralization?

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BUSINESS CREDITBUSINESS FINANCING

At some point in the life of your business, you may need to borrow money. Whether you want to take advantage of a lucrative investment opportunity, expand, or start marketing a new product, it pays to prepare your business credit and educate yourself in advance when it comes to commercial lending.

Often, the better prepared you are, the better your odds of getting a loan. Business owners who know and understand their business credit scores, for example, are 41% more likely to be approved for a loan.

One concept that's especially important to understand before you borrow money for your business is collateral. Collateral is something of value (aka an asset) that a lender may require you to pledge to reduce the risk of loaning your business money. An asset might be cash, investments, inventory, real estate, or something else of value.

Unsecured loans do not require collateral. Secured debt does, whether it's a car loan (where the vehicle is your collateral) or secured business credit cards for those building their credit history. However, there's a third option that's slightly more difficult to understand — cross collateralized loans.

Keep reading below for a breakdown of what cross collateralization is, how it works, and the risks and benefits you should be aware of before you agree to take out a cross collateral loan for your business.

### Cross Collateralization Loan: What Is Cross Collateralization?

You're probably already familiar with the concept of a collateral loan. One example of a collateralized loan is a mortgage. With a mortgage, your house becomes the lender's collateral for the loan. If you fail to repay the loan as agreed, the lender has the right to take the asset (in this case your house) and sell it to someone else to try to recuperate its losses.

Collateral requirements on secured business loans can vary from lender to lender. Some might require you to put up assets that your business owns. Others might want you to put up personal assets. On the other hand, if you borrow money to purchase a large piece of equipment, the equipment itself may serve as collateral.

Cross collateralization is a little different. Sometimes a lender may need or want you to pledge more than one type of collateral (also called security interest) to secure a loan for your business. This might include business assets, personal assets, or some combination of the two.

However, the term cross collateralization can also be used to describe another common practice in lending. If you repeatedly pledge a single asset as collateral to secure an existing loan as well as additional financing, this too is referred to as cross collateralization.

These loans have what's called a cross default provision. If you default on one of the loans, you default on all of them that use the same asset as collateral. Banks may offer cross collateral loans, but they're more common with credit unions.

Keep reading below for a breakdown of how cross collateral loans work.

**How Does a Cross Collateral Loan Work?**

Cross collateral loans often offer more affordable financing, but they aren't without their risks. Should you default on a loan or file bankruptcy, you as the debtor may find yourself with a giant headache.

Here are the two ways that cross collateralization works.

**1. Pledging Multiple Assets.**

Before a lender will loan you or your company money, it has to be comfortable with the risk of doing business with you. In other words, it needs to feel confident that you're going to repay the loan as agreed in your promissory note.

There are multiple ways lenders look to reduce their risk exposure when you apply for a business loan including:

- Checking your credit (business and/or personal)
- Asking for a down payment
- Requiring collateral

If you have stellar credit, you probably qualify for unsecured debt, but if that's not the case, you may need to provide collateral.

Yet sometimes a single asset isn't enough to persuade a lender to loan your company money. Instead, the lender may want you to pledge multiple assets to help offset its risk and add more security to the loan.

If you agree to put up multiple assets, the lender may file a blanket lien with your secretary of state to stake its claim on those assets. This is the first form of cross collateralization.

### 2. A Single Asset Pledged for Multiple Loans

The second type of cross collateralization occurs when a single asset is pledged to back more than one loan. A few common examples of this practice include second mortgages and home equity loans or lines of credit.

A credit union or bank may also ask you to "re-up" an asset as collateral for a second loan as well. For example, your vehicle will serve as collateral for an auto loan. Yet if you take out a personal loan with the same bank or credit union, it might ask you to agree to use the same vehicle as collateral again.

Be aware: a lender should always disclose to you if you're being asked to pledge (or re-pledge) an asset as collateral. However, some borrowers report surprise at the cross collateralization clause in their loan documents. For this reason and others, it's always important to review your loan document carefully before signing.

## How Does Cross Collateralization Impact Borrowers?

If you make your loan payments on time, having cross collateral might not impact you at all. But if you default on one loan, you may be considered to have defaulted on all loans, since that asset or assets would then be seized, and lenders will have to fight to get a piece of the value.

## Pros and Cons of Cross Collateralization

If you don't qualify for the best business loans, maybe because you have bad credit or haven't been in business long enough, cross collateralization loans can be appealing because they provide a way to get affordable financing.

However, know that taking on this kind of loan is risky. If you can't afford to pay one of your loans, you risk losing all your assets that you used as collateral. Ask yourself how much risk you're willing to take.

## Cross Collateralization in Real Estate Mortgages

In commercial financing, it's not uncommon for the equity you have in your house to serve as collateral for both your primary mortgage and yet again for a business loan. Yet although this form of cross collateralization may not be uncommon, it does involve considerably more risk as a borrower.

If you agree to use your home as an asset for multiple loans but can't keep up with the loan payments on your business loan, your commercial lender might be able to initiate a foreclosure on your home. This can be true even if your first mortgage payments are 100% on time. This can be true even if the commercial lender doesn't hold the first lien position.

### Real Estate Investors

Real estate investors may also rely upon cross-collateralization as a financing strategy — especially those who wish to finance or develop multiple investment properties at once. These types of loans are referred to as blanket mortgages.

If you're considering taking out a blanket mortgage as a developer of an investment property, it's smart to look for a cross collateralization agreement with a release clause. Some lenders may allow you to sell or refinance individual properties along the way as you build additional equity in the properties used for collateral.

### Cross Collateralization and Bankruptcy: What to Know

If you are seeking bankruptcy relief, know that any cross collateral loans may be complicated because you'll have multiple lenders trying to seize the same assets to cover their loss. Your best bet is to speak to a bankruptcy attorney who is well-versed in

bankruptcy law. Explain to him which lenders have the same assets as collateral and see if you can work out something so everyone gets a little bit (better than nothing).

### Less Risk for the Lender Equals More Risk for You

Cross collateralized loans and even blanket liens aren't necessarily unusual in the world of business lending. Still, they represent a bigger risk for your business and perhaps even you personally, depending upon the type of assets you pledge to back the loan.

Putting up multiple assets as collateral might help you to secure business financing. You might even save money by securing a potentially lower interest rate and better terms. But you shouldn't enter into this type of arrangement blindly without fully understanding the risks.

It's also worthwhile to research unsecured financing options, or at least options with fewer collateral requirements, before you commit to a cross collateral loan for your business.

### Nav's Verdict: Cross Collateralization Loans

Any kind of financing, from credit card debt to bank loans, comes with risk. As a responsible borrower, it is your job to understand the risks and rewards of the financing you qualify for before taking on the debt of an installment loan. While a cross collateralization loan may save you money on interest, it can also jeopardize the assets you've worked hard to accumulate.

## ABOUT AUTHOR

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Susan Guillory is a Senior Content Writer for Nav. She's written books on business and travel, and blogs about small business on sites including Forbes and AllBusiness.