



EXPLAINER:

Pros & Cons of Line of Credit



A LINE OF CREDIT CAN BE A VERY APPEALING IDEA, WITH IMMEDIATE ACCESS TO THE LIMIT OF A MORTGAGE AND NO EXTRA APPROVALS NECESSARY. USED WISELY, IT CAN MAKE INVESTMENT AND PURCHASE OF COMMERCIAL EQUIPMENT SIMPLE, BUT IT CAN ALSO SPELL DISASTER FOR THE UNPREPARED.

A line of credit (LOC), also called a home equity loan, allows mortgagees to access the equity in their property as needed. It can be a standalone product or almost any type of existing loan can be split with an LOC. Interest is usually slightly higher than the standard variable rate.

LOCs may be useful for property investors, who can finance further property purchases or renovations using their existing properties' equity without applying for new loans, or business owners who can use an LOC in place of a business overdraft to make large equipment purchases at lower interest rates.

Used smartly by owner-occupiers, an LOC can be an ideal way to reduce the total interest paid on a loan. An entire salary can be deposited into the LOC account, with everyday purchases being made with the account balance in the same way as they would with a regular savings account or credit card,

as long as the minimum repayments, usually only interest, are maintained.

For the term that the amount repaid stays above what it would be on a regular mortgage, the total interest charged is, obviously, lower. Owner-occupiers, however, can come to think of their LOC home loan as a credit card-like facility. It has risks that must be carefully managed.

While it can be a boon for mortgagees who deposit their entire income and use only what they need, resulting in extra repayments being made each month, the lack of requirements beyond paying the interest when due and staying within the credit limit can spell disaster for those with poor financial discipline. If mortgage payments are treated as available credit for everyday expenses, the loan principle may never actually be paid down.

And, while post-GFC lending criteria has certainly tightened, many lenders are happy to extend an LOC when a property's value increases. In a best-case scenario, this provides access to cash that can be used as a deposit for an investment property or for renovations that will further increase the property's value. In a worst-case scenario, a mortgagee can quite easily use this for everyday purchases or a holiday, and be left with a loan

they cannot actually service beyond interest payments.

There are many situations where a line of credit is ideal, but, as with all mortgage products, the key to assessing whether an LOC suits your needs is to speak to an expert about your goals, financial situation, lifestyle, needs and wants.

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