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Credit lines and other personal loan options

Use it wisely and credit can help enhance your lifestyle, save you time and make your life more convenient. Use it carelessly and it can get you into a lot of financial trouble. The most important thing to be aware of is that some debt is bad and some is good.

Bad debt is used to buy things with depreciating value (like furnishings, cars, clothes) or no residual value (like vacations). The worst kinds of debt, as in department store credit or consumer credit card debt, also carries high rates of non tax-deductible interest.

Good debt is used to buy assets that have the potential to appreciate in value (like investments and real estate). Assets like these can act as security for the loan and can allow for a lower interest rate. Interest on good debt may even be deductible for tax purposes.

One excellent purpose for going into debt is to finance your RRSP contribution, a strategy which has been discussed in the section, Should you borrow to make an RRSP contribution?

Line of credit: A valuable financial tool
You have various forms of credit available to you. First and easiest to get are the consumer credit cards, issued by retailers, oil companies, department stores, financial institutions, etc.

Advantages of credit cards are that the terms of repayment and the amount of credit available are often very flexible. Disadvantage is that this is the most expensive kind of debt to carry. However if you pay the amount due each month before the due date, you will in effect have enjoyed free credit from the time of your purchases.

Then there are various forms of personal loans available from your bank. In this case you borrow a specific sum and pay it back over a specified time. Although not as flexible as credit cards, Interest rates are generally much lower.

But if you qualify, the best form of credit you can have is called a "credit line" or "line of credit". This is a service set up by your bank that allows you to draw the funds you need, up to a predetermined amount.

You are charged only on the amount you use, not on the amount available to you. The rate you are charged is linked to the prime rate and depends on your creditworthiness and/or collateral.

For example, let's say you have $50,000 equity in your home. Depending on your income and financial situation, you could probably arrange for a credit line of $25,000 at a rate of 1 or 2 points above prime or even lower if it's secured by the equity in your home..

If you wanted to then buy a home theater system for $10,000, you could do so and still have $15,000 in credit available to you. You would only pay interest on the $10,000. And if you want to make another purchase using that available credit, you don't have to reapply. It's simply there for you to access.

If you were to compare the cost of borrowing $10,000 this way to the cost of using a consumer credit card, you could save $1,000 or more over a two-year period.

The bottom line: If you qualify for a credit line, it may pay you to eliminate all your other debt and consolidate it under your credit line. It could save you thousands of dollars over the years.

If you'd like to know more about establishing a line of credit, click here to find the CPA financial planning professional closest to you.