Shopping Around for a Line of Credit

What is a line of credit?

A line of credit is a type of loan that lets you borrow money up to a preset limit.

How does a line of credit work?

You can withdraw or transfer funds from your line of credit at any time by:

- writing a cheque,
- withdrawing funds from a bank machine, or
- telephone or online banking.

Similar to a credit card, as you pay off your line of credit, you can draw on it again, up to the limit you are allowed. However, a key difference between a line of credit and a credit card is that with a line of credit there is no interest-free grace period. **You will have to pay interest on the amount you borrow from the day you take the money out.**

You will receive a monthly statement that shows the amount that you owe on your line of credit. You must make at least a minimum payment on that balance every month.

Different types of lines of credit

Lines of credit can be either secured or unsecured.

A secured line of credit uses an asset owned by the borrower as collateral for the loan – often a home. If you default on your secured line of credit, the lender can take possession of whatever asset you used as security. The advantage of a secured line of credit is that the interest rate is lower than with an unsecured line of credit.

An unsecured line of credit is not secured by an asset owned by the borrower.

The table below gives you a general overview of some of the common types of lines of credit available.

Type of line of credit	Description	Commonly used for
Home equity lines of credit	Secured by your home – your home acts as collateral for the loan. Usually has a higher credit limit and lower interest rate than other types of loans or lines of credit	Financing major purchases, such as home renovations or a car.
Personal lines of credit	Unsecured. Interest rates are usually lower than for credit cards, personal loans or other short-term loans	Consolidating higher interest rate loans or unexpected expenses.
Student lines of credit	Unsecured. Specifically for students. Similar interest rate to a personal line of credit. Often a parent or guardian will co-sign	Supplementing savings and income from part-time jobs to pay for basic expenses such as tuition, books, room and board, etc.

Note: For more information on home equity lines of credit, see FCAC's publication "Borrowing on Home Equity."

Advantages of a line of credit

1) Interest rates for lines of credit are usually lower than they are for credit cards (even low-rate credit cards), personal loans or other short-term loans.

2) There are usually no set-up fees, annual fees or penalty charges for paying off your line of credit at any time, depending on the product and the financial institution.

3) If you have a bank account with the same financial institution that you use for your line of credit, you can set it up so that any overdraft on your regular bank account is transferred to your line of credit, which can help avoid unnecessary fees.

Disadvantages of a line of credit

1) With easy access to borrow money from a line of credit, some people can get into serious financial trouble because they don't control their spending.

2) The interest rate on a line of credit can go up or down, depending on market conditions.

3) If interest rates increase a lot, you may have difficulty paying back your loan.

How do you get a line of credit?

You have to apply for a line of credit from a financial institution. When you apply, a financial institution will determine your credit worthiness, which is how likely you are to pay back the loan. Some of the things they will consider include:

- your income – usually, financial institutions require a minimum household income of $35,000 to $50,000 for a line of credit;
- your current level of debt with other financial institutions;
- your credit rating – your record of paying your bills or paying back money you borrowed.

These factors will also determine your credit limit – how much the financial institution will allow you to borrow on your line of credit – and can also influence the interest rate that you will to pay.

Remember that the interest rate and the terms of the credit agreement are negotiable.

Things to consider:

1) How will you control spending on your line of credit so that you live within your budget?

2) Are there any fees with this line of credit? If so, what are they?

3) How much do you want to borrow? How much can you afford?

4) Do you need to make this purchase now using a line of credit, or could it wait until you have saved the money to pay for it?

5) How much will you be able to pay back each month?

6) Do you need extra insurance to cover your line of credit, to protect you and your family if you become disabled or die?

Other FCAC information of interest

Tip sheets

- Before You Sign Any Contract: 10 Things You Need To Know
- Know Your Responsibilities as a Joint Borrower

Publications

- Understanding your Credit Report and Credit Score

For more information

For more information on lines of credit, visit FCAC's website at fcac.gc.ca or contact your financial institution.

Notes

About Financial Consumer Agency of Canada (FCAC)

With educational materials and interactive tools, the Financial Consumer Agency of Canada (FCAC) provides objective information about financial products and services to help Canadians increase their financial knowledge and confidence in managing their personal finances. FCAC informs consumers about their rights and responsibilities when dealing with banks and federally regulated trust, loan and insurance companies. FCAC also makes sure that federally regulated financial institutions, payment card network operators and external complaints bodies comply with legislation and industry commitments intended to protect consumers.

Contact Us:

Website: fcac.gc.ca

Toll-free: 1-866-461-3222

TTY: 613-947-7771 or 1-866-914-6097

Follow @FCACan on Twitter

Subscribe to FCACan YouTube Channel

This tip sheet is part of a series. To view FCAC's other tip sheets, please visit our website.

Cat. No.: FC5-8/8-2007E-PDF ISBN: 978-0-662-45785-5

March 2012