KEYSTONE
ADVICE GROUP

The Revolving Line of Credit

We have put together a Keystone 2 Minute Guide to Revolving Lines of Credit.

What is a Revolving Line of Credit?

A revolving line of credit is where a bank will lend a specific amount to a borrower, and after it has been repaid allow the amount to be borrowed again and again. Revolving lines of credit work like a large overdraft. Your pay goes straight into the account. Bills are paid out of the account only when they are due. By keeping the loan as low as you can at any time, you pay less interest because lenders calculate interest daily.

For Loan Flexibility, nothing beats a revolving line of credit. You can make lump sum repayments and re-draw money up to your limit. Some revolving lines of credit gradually reduce the credit limit to help you pay off the mortgage (called a Reducing Revolving Line of Credit).

Who does it suit?

A revolving line of credit is not for everyone. It is best suited to people in the following situations:

- People that earn large bonuses or who receive lump sum payments on an irregular basis
- People wanting to consolidating debt from a high-interest credit card to a cheaper interest rate with the intention of repaying the debt rapidly
- People with equity in their home and on the look out for an investment property and want to have the funds ready to go
- People in a position to repay their mortgage faster than the timeframe set by the bank

Pros:

- If you're well organised, you can pay off the mortgage faster and drastically reduce interest charges
- Putting surplus funds into this account rather than a separate savings account will give bigger interest savings and also avoids the tax on the savings account interest (in the current climate, you're effectively doubling your return by moving funds from a savings account to your loan)

Who doesn't it suit?

As we said, a revolving line of credit is not for everyone. It is not suited to:

- Poor money managers or those with little financial discipline
- People who can't afford additional repayments to the amount set by the bank
- People who spend more than they earn each month

Cons:

- It can be tempting to spend up to your credit limit (effectively increase your mortgage) and stay in debt longer
- Floating Interest Rates – unfortunately you can't fix the interest rate on a Revolving Line of Credit so you are paying the higher Variable rate
- Application fees on revolving credit home loans can be up to $500 and there is typically a fee for the day-to-day banking transactions you do through the account (e.g. $12.50 per month), like any bank account.

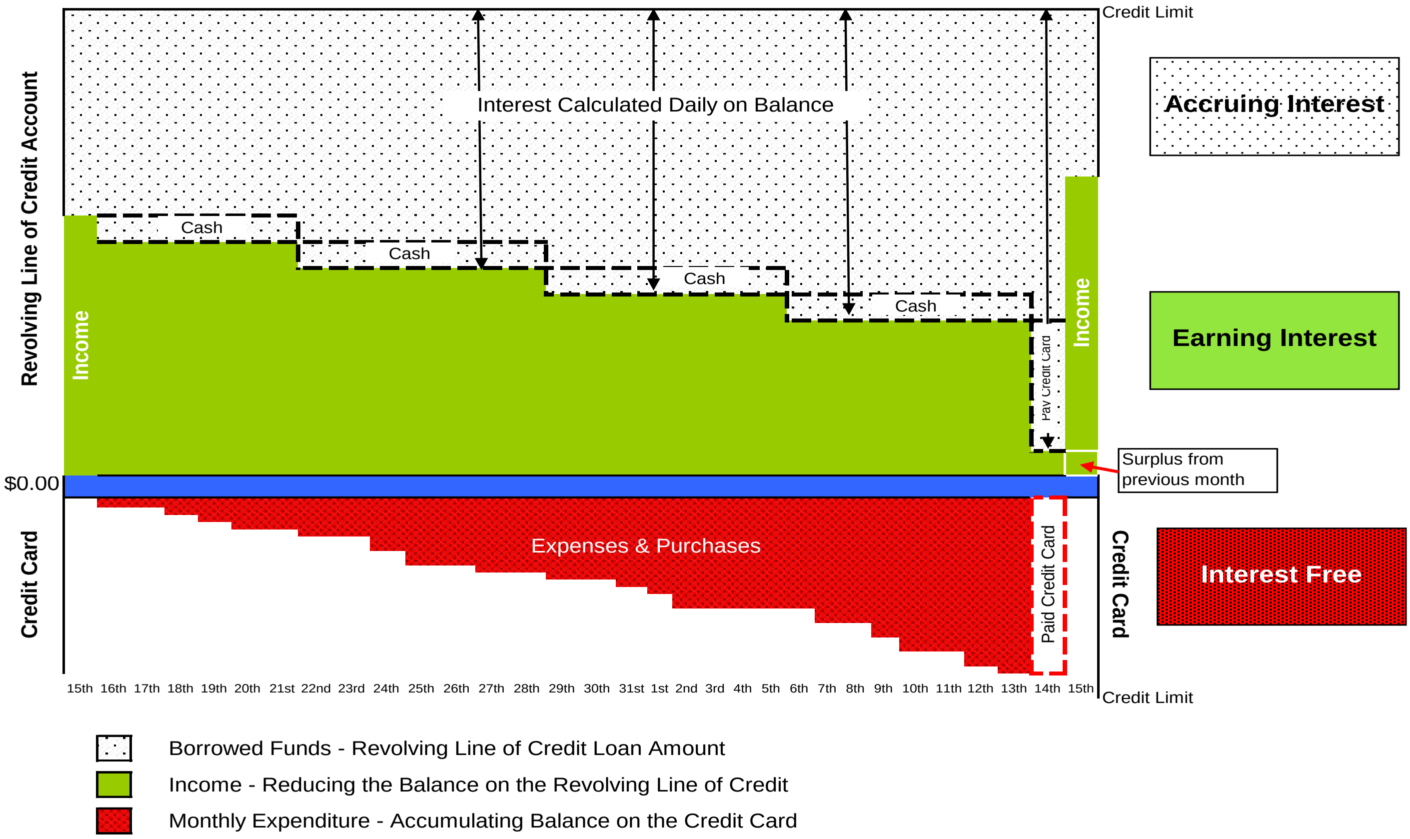
How to get the most from your Revolving Line of Credit

Interest on loans is calculated by all banks daily. They take your balance that day, apply the interest rate, and add it to your loan. Therefore, everyday your balance is lower than normal, the lower the interest you are charged.

To minimise your interest bill and maximise the benefits of a Revolving Line of Credit, you manage your finances as follows:

1. Establish your true real budget
2. Make sure your income is higher than your expenses (if not, do not apply for this loan until it is)
3. Change the payment date on this loan to the day before you get paid each month
4. Change the payment due date on your credit card to the same day as above (i.e. if you get paid on the 15th, call your credit card provider and ask them to set the billing date so that the due date falls on the 14th.
5. Establish a Direct Debit from your Revolving Line of Credit to your Credit Card for full repayment each month.
6. Move all of your bills, transactions, spending – everything – to your credit card. Don't spend any more than you used to, just change the method of payment from AP, Cash, DD, Internet Transfer etc to your credit card (you may want to think about a card with Air Miles).

Here's what happens:



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