# Six effective uses for lines of credit

By Deanne Gage | 06-23-14

When we think of lines of credit, we tend to think about convenient access to cash. It just happens to be on the wrong side of the balance sheet. But that doesn't stop many of us from partaking.

Unfortunately, many lack a debt-repayment plan, says Sheila Walkington, co-founder of Money Coaches Canada in Vancouver, and the author of *Unstuck: How to Get Out of Your Money Rut and Start Living the Life You Want*. "It can't be on the never-never plan where you only pay off the interest and never pay off the debt," she says. "It needs to be paid off sooner rather than later." Walkington works with clients to come up with a monthly payment system and suggests things like bonuses and tax refunds go back to repaying any debt.

But for disciplined people, lines of credit can be a godsend. Below are some effective strategies:


Sheila Walkington

**Bridging the gap**
Your mortgage is due today but unfortunately, your client forgot to pay you for that project you completed a month ago. Self-employed professionals, who don't experience the consistency of a biweekly paycheque, have heard this story before. Ideally, you'd have enough cash on hand to cover the unexpected non-payday. If you don't, a line of credit allows you to pay off the bills and rack up minimal interest compared to credit cards, says Walkington. Just remember to repay the amounts borrowed as soon as your client finally cuts the cheque.

**Emergency fund**
Storing three months of savings in an emergency fund is the general rule of thumb for financial experts. But financial planner Jason Heath wonders whether holding so much cash in this low-interest environment really makes sense. For disciplined people, he recommends using your line of credit as your emergency fund. Let's say you have $10,000 earning

1% in your bank account. Meanwhile, you owe $20,000 on your unsecured line of credit and are paying 6% interest. "If you are always sitting on money when you have debt you are ultimately paying more interest charges to the bank just for the privilege of having an emergency fund," says Heath of Objective Financial Partners in Markham, Ont.

**Life-insurance premiums**

Families who hold term or whole-life policies have the option of paying premiums annually or monthly. But in the case of the latter, it's much more expensive. "In some cases, you could be paying as much as a full month's extra premium just for the benefit of paying monthly," says Mark Halpern, CFP, TEP, at illnessPROTECTION.com in Markham, Ont.

For example, a $1-million, 10-year-term policy for a 42-year-old, non-smoking male costs approximately $900 a year. While that translates into $75 a month, the actual monthly premium one would pay is $84, or $9 more each month.

Halpern's solution? If you can't afford to pay the annual premium amount in full, use a secured line of credit to pay it. The interest rate on a home-equity line of credit (HELOC) is about 4% a year. The additional cost of paying monthly premiums works out to $108, or 12% more. Therefore, using the line of credit will save 8% on the cost of insurance, assuming you pay off the line of credit within a year.

**Pay off the mortgage**

You're $15,000 away from paying off your mortgage and anticipate you'll have the funds in the next six months to finally retire this debt. Rather than renewing your mortgage, which often means restrictions and penalties for paying more, a line of credit will give you more flexibility. Yes, the interest will be slighter higher -- 4% versus 2.99%, for instance -- but you have more freedom to pay off as much as you like.

"In circumstances like that, it may make sense to have flexibility," Heath says. "But it doesn't make sense if you take your time [clearing your mortgage payment]."

**Buying a rental property**

Use your HELOC to fund your down payment for a rental property. "The money you borrow for the down payment and the money you take out for the mortgage on the balance of the purchase price are all tax-deductible," Heath notes.

He prefers using HELOCs for this purpose instead of for buying investments. In the latter case, he says people tend to panic when investment performance is volatile and may sell. And since the cost to sell an investment is minimal, they will often do it. "With rental property it's more of an illiquid investment over the longer term and it's more predictable," Heath says.

**Fund business expenses**

For sole proprietors, most, if not all of the personal income comes from business earnings. If they have an outstanding mortgage, Heath suggests they use their line of credit to pay their business expenses. The money borrowed to pay business expenses is specifically tied to an income-producing activity and the interest on that line of credit is tax deductible, he says. Doing so means more available income for them to put toward non-tax-deductible debt, such as a car loan or mortgage.

Business and personal credit lines should not be married, however. Get two separate ones. It keeps everything clean so you're not figuring out what's a legitimate business expense.

Deanne Gage is a Toronto-based writer who has specialized in personal-finance issues since 1999. A recipient of several journalism awards, including one from the Investment Funds Institute of Canada, she is also a former editor of *Advisor's Edge* and Advisor.ca. She can be reached at deannegage@gmail.com.