THE PERILS OF USING UNSECURED LOANS OR CREDIT CARDS FOR A DEPOSIT

Seasoned financial planner, James Gerrard, highlights some of the potential traps of using credit cards or personal loans as a deposit

Generally, the first step in buying a property is to save money for a deposit. Depending on the bank and your circumstances, the minimum deposit required can vary between five to twenty per cent. High rents and cost of living pressures can cause many people to struggle when saving this amount of money, causing some to look for 'quick fix' alternatives. One such alternative is to put together a deposit financed by debt.

Though it can be tempting to enter the property market and finance the deposit using debt, it's important to understand the risks and costs associated with doing so.

Some people may be tempted to use funds from an unsecured loan, or the cash advance from a credit card to do this. Whether or not either of these strategies is a good idea is another question. Let's look a little closer.

UNSECURED LOANS

An unsecured loan is one that is obtained without any legal ties to a property or any assets in the event of default. The loan is only supported by your creditworthiness. Consequently, there is a high risk for the lender which results in higher interest rates compared to secured loans (such as home and vehicle loans). However, interest rates are generally lower on unsecured personal loans than on credit cards.

To be approved for an unsecured loan you must have a good credit rating, which may not be achieved if you have bills unpaid in the last five years, or other defaults on your credit file.

CREDIT CARDS

Prospective home buyers who cannot access an unsecured loan may instead turn to a credit card for the necessary funds to put together a deposit. Credit cards may seem attractive as they are generally easier to obtain than personal loans: many can be applied for and approved automatically with an online application.

Interest rates for these generally sit above 18 per cent, not including the additional cash advance fees paid on top, and interest is charged from the moment you draw down the advance.

HELP OR HINDRANCE?

Outside of the range of costs associated with using debt to put together a deposit, another issue with this strategy is that the lender may not view this type of deposit as acceptable. The lender may wish to see proof of a savings history, which would not be possible if all of the deposit was obtained via a credit card cash advance, or a cash injection from an unsecured personal loan. Furthermore, the credit card or personal loan balance would need to be disclosed to the lender in the loan application process, and may reduce the borrowing capability of the applicant.

Under responsible lending guidelines, which all lenders must adhere to, it must be ensured that you can afford the loan being applied for, as well as be able to service any existing debt and general living expenses.

Using a credit card or unsecured personal loan for the deposit may actually hurt the chances of securing a loan, rather than improving it.

CONCLUSION

My advice is to avoid accumulating multiple loans to buy a property, because this may result in a struggle to meet repayments and can be high risk. Managing multiple debt sources can also be a headache as you will have to make multiple repayments each month, and keep track of each loan balance.

Paying off a property loan is a challenge in itself considering current property prices in Australia, but adding repayment of additional debt on top of this can make the feat even more difficult.

Using unsecured personal loans and credit cards for property deposits is a risky move and may end in disaster.

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This article was first published in 'It's My Home', Summer 2015 edition, proudly brought to you by Genworth Australia.