Credit Cards vs. Personal Loans vs. Refinancing Your Mortgage

Know your loan: *What is the difference between Credits Cards, Personal Loans, and Refinancing?*

When it comes to managing your finances, it’s important to have options. Maybe you want to borrow some cash to remodel the kitchen, or simply need to pay an unexpected bill a week from payday. Credit cards, personal loans and refinancing your home loan are all potential ways of accessing credit, depending on your needs.

To help you decide which one might be right for you, here's a closer look at these three different financing options.

Breaking it down

Credit cards, personal loans and refinancing your home loan all function in different ways.

Credit Cards. Allow you to make as many purchases as you wish, up to a certain limit. Credit cards are an unsecured loan, which means you are provided the funding without using an asset as security. With plastic, you're required to make a minimum payment towards your outstanding credit card balance every month, but you can take as long as you need to pay it off. However, depending on the type of credit card you have, not paying on time might result in significant interest charges.

Personal loans. A credit facility that can either be secured or unsecured. Secured loans, where you put up an asset, such as the title to your car, for security, often have a lower interest rate. A personal loan is a short-term loan from your bank or financial institution, which often has to be used for a specific purpose. You're required to make ongoing payments of a predetermined amount to repay the loan in full by the end of the term, usually between one and five years. Personal loans are typically available for one-off purchases or significant expenses.

Refinancing a home loan. You may be able to access extra funds by moving your home loan to a new provider who will pay out your existing home loan. This may give you the opportunity to increase your current loan amount if the new provider is prepared to lend you more money against your home. If you shop around carefully, you might find a better value home loan with lower interest rates.

Knowing how to choose

Which one you choose will depend on what you're using it for, how much you need to borrow, and how much time you need to pay it back.

Credit cards pros and cons

Credit cards are a good fit for everyday purchases and work best when you can pay off your balance every month. Or, if you're taking advantage of a special credit card offer with an initial interest free period, make sure you pay off any purchases within the introductory period.

The benefit of taking out a credit card with an interest free period is you can make major purchases and pay them off, without interest, provided you pay out the balance before the interest free period ends. Interest free periods will vary depending on the offer, but can be typically between six and 18 months.

However, while credit card purchases during an interest free period won't accrue interest (for a limited time), any cash withdrawals will be charged at the standard cash rate. This could be as high as 25%. Don't forget that you'll start to accrue interest at the standard purchase rate for any amount you still owe after the interest free period has ended.

Pros:

- With an interest free credit card, you can pay off your balance gradually without accruing interest charges on existing debt until the promotional period ends.
- You can pay off your credit card balance early with no penalties or fees.
- You can continue to access your credit line for as long as you own the card.

Cons:

- After a card's interest free period ends, your purchases will start accruing interest at the standard purchase rate.
- If you miscalculate how long it will take you to pay back your outstanding balance, it could end up costing you.
- You can only borrow up to your credit limit, which will vary from person to person.
- Interest rates tend to be higher than other forms of accessing credit

Personal loan pros and cons

If you have a one-off purchase of something specific, such as a car or home renovations, and think it will take you longer than 18 months to repay the debt, a personal loan may be suitable. While they don't offer an interest free period, personal loans typically have lower interest rates than credit cards, and you can customise the repayment schedule to your needs.

Bear in mind that personal loans often come with additional fees and charges. Be sure to look at the comparison rate, not just the standard rate, in order to understand the true cost of the loan.

Pros:

- You can work out a customised payment plan that fits with your budget.
- Repayments are predetermined, so you'll know exactly how much you need to pay back every month and can budget accordingly.

Personal loans can be used to consolidate other types of debt.

Cons:

- There are minimum and maximum amounts you can borrow.

- You generally cannot pay off a personal loan early without penalty.
- You may need to provide collateral to secure the loan.

Refinancing a home loan pros and cons

If you have built up equity in your home, refinancing your home loan may be a viable option.

Interest rates on home loans are generally much lower than you'd pay on a credit card or personal loan. This makes them better suited for large purchases that will take you longer to repay, such as remodelling your home or education fees, compared to a new refrigerator or mattress.

However, between application costs and closing fees, refinancing can cost you. A good, general rule of thumb is to only refinance if you plan on keeping your property for at least 12 months or more, so you have enough time to recoup the costs of refinancing.

Pros:

- Refinancing your home loan may help you access larger loan amounts compared to other types of credit.
- You may be able to take advantage of a lower interest rate when refinancing.
- Your new loan may have better features and more flexibility, such as an offset account or the ability to make extra payments.

Cons:

- Any cash you borrow will become part of your new home loan, which may result in a higher monthly repayment.
- Your new home loan provider will need to assess your application against its lending criteria, which can be a time-consuming process.

- You’ll probably need to pay an application fee for the new loan, and you’ll need to pay your current provider to close your old loan.
- You’ll have to provide security for the loan, which is usually a mortgage over your home.

As always, when considering accessing any type of credit, think about which option suits your needs – and always shop around for a great deal.

From interest free offers on credit cards to 0%p.a. balance transfers to low and no annual fee credit cards, iSelect makes it easier to find what you’re after. Compare cards from different lenders to find a credit card that’s right for you.