

# What is a personal loan?

PERSONAL LOANS CAN BE A GOOD SOURCE FOR QUICK CASH OR A PRACTICAL TOOL FOR DEBT CONSOLIDATION — AS LONG AS YOU UNDERSTAND WHAT YOU'RE SIGNING UP FOR.

By [Matt Alderton](#)

When you want to buy a car, you seek an auto loan. When you want to buy a house, you apply for a mortgage loan. When you need college tuition, you get a student loan. When you're starting a business, you look for a small business loan.

But what about everything else?

Enter the personal loan. A Jack of all trades — or rather, transactions — it's the "Renaissance man" of loans, according to Katie Ross, manager of education and development at American Consumer Credit Counseling (ACCC) in Auburndale, Massachusetts. "Personal loans are just that: personal," she says. "The money you borrow can be used at your discretion."



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Their flexibility is making [personal loans an increasingly attractive choice for Americans](#) in need of a financial stopgap, suggests a January 2016 survey by Bankrate.com, which found that 10 percent of American adults, approximately 24 million consumers, are either "very likely" or "somewhat likely" to seek a personal loan in the next 12 months. Among 18- to 29-year-olds, that number nearly doubles, to 18 percent.

If you're among those considering a loan of the personal variety, knowing the answers to these common questions can help you decide whether or not to sign the dotted line:

## WHAT CAN PERSONAL LOANS BE USED FOR?

As Ross said, personal loans can be used for almost anything. Popular uses, for instance, include medical bills, the down payment on a car or house, home renovations, a wedding or even a dream vacation.

Perhaps the best use, however, is for debt consolidation, according to personal finance expert Laura Adams, author of "Money Girl's Smart Moves to Grow Rich" and host of the weekly "Money Girl" podcast. "Most personal loans are closed-end loans, which means there's a loan term with a payoff date," explains Adams, who estimates that half of all people who take out personal loans do so for the purpose of consolidating credit card debt. "Having a closed-end loan for credit card consolidation is really smart because it gives you structure: If your credit card debt has gotten out of hand, consolidating it in a personal loan allows you to know exactly what payment you have to make each month and on what date. If you follow the loan schedule, all your debt will be paid off in full at the end of the loan term."



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## WHAT DO I NEED IN ORDER TO GET A PERSONAL LOAN?

One thing you typically *don't* need is collateral, according to Ross. "These types of loans are generally unsecured loans, meaning there is no collateral taken against the loan in the event you default," she explains. "With a secured loan, there is collateral, such as a home or a car."

Although you won't need collateral, you'll still need to demonstrate your ability to repay the loan. "Personal loans are generally made based on your credit score," Adams says. "However, I'm seeing more companies like SoFi that promise they won't use your credit score to evaluate you; instead, they're looking more at things like your income and employment stability. That's good for consumers, because it means you may be able to get a low interest rate even if you have a poor credit score."

Underwriting criteria vary from lender to lender, but barriers are typically low. "Really, it just comes down to your signature, which is why a personal loan is sometimes called a 'signature loan' — you sign the papers, and you've got the financing in your bank account typically within a week or two," Adams continues.

## WHAT ARE PERSONAL LOANS' BIGGEST ADVANTAGES?

Personal loans have a lot of attractive features, according to Ross, including aforementioned benefits like fixed repayment terms (typically three to five years), fast processing, minimal paperwork, flexible usage and lack of collateral.

Interest rates also can be favorable, according to Andrew Schrage, co-owner of the personal finance website MoneyCrashers.com. "Interest rates can be fixed or variable, but will usually be lower than if you try to meet your needs using credit cards," he says. Also: "There are usually no fees if you pay the loan off early, and there may not be a charge for originating the loan, as well. You can get a loan for a small amount or large — as much as \$100,000 — and you will usually receive a decision on your application in a rather short period of time — sometimes as little as one business day. You might also receive a discount or special promotion if you go with a bank or institution you already have a relationship with."



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## WHAT ARE PERSONAL LOANS' BIGGEST DISADVANTAGES?

Depending on your qualifications and lender, cons may include high interest rates and strict credit score requirements. Although it's generally considered a benefit, some people might also view the loans' fixed repayment terms as a negative, too.

"If you're used to using credit cards, where you can make the minimum monthly payment and get by, you should know that your monthly payment on a personal loan is going to be much higher," Adams cautions. "Ultimately, that's good because it means you're paying off the debt faster. But if you haven't budgeted for that monthly payment, you could really get yourself into trouble."

As with any type of debt, failure to repay it will send the account into collections. "If your account ends up in collections, your credit score is going to tank," Adams continues.

## WHAT ALTERNATIVES ARE THERE TO PERSONAL LOANS?

If you decide a personal loan isn't right for you, there are several other types of loans you can consider, ranging from a business loan to a mortgage refinance loan to a line of credit. The following terms will help you navigate the loan marketplace as you shop:

- **Unsecured Loan:** As previously indicated, a personal loan is an example of an unsecured loan. "It is not backed by any of your own possessions, such as a car or home, and your ability to qualify is normally based solely off of your credit history and ability to repay," Schrage says.
- **Secured Loan:** With a secured loan, the borrower pledges an asset, such as a car or property, as collateral. Auto loans and mortgage loans are the most common types. "In the event of default, the lender takes possession of the asset to regain some or all of the value of the loan," Ross explains.
- **Installment Loan:** An installment — or closed-end — loan can be secured, in the case of a mortgage or auto loan, or unsecured, in the case of a personal loan. Either way, it is repaid with a set number of scheduled payments. "The term can range from a few months up to 30 years," Ross says.
- **Revolving Loan:** Unlike an installment loan, with a revolving — or open-end — loan, you have a pool of money from which you can withdraw again and again for the duration of your agreement with your lender. "A revolving loan ... does not have a set number of payments and you can borrow as much as you need up to a predetermined limit set by the lending institution," Schrage says. Credit cards and home equity loans are examples.

## WHERE CAN I GET A PERSONAL LOAN?

Your bank or credit union can be a good choice because they already know you, although there also are online lenders that specialize in personal loans. [What you don't want to do: only shop at one bank.](#) Why? Because you can get better rates by shopping around.

[\[Related: How to know if a P2P loan is right for you\]](#)

Interest rates, loan amounts and repayment terms will vary, so Adams recommends getting multiple quotes. "It won't be apples to apples, so you really need to shop rates," she says.

Wherever you turn for your loan, proceed with caution. "Taking out a personal loan is a decision you have to make based on your current financial condition," Ross concludes. "Take out only what you need and for the shortest amount of time as possible. Know and understand what you are trying to accomplish and don't let anyone influence your goals. Consult others that have taken out personal loans, research online to get advice on shopping for a loan and never sign until you have a plan in place to pay the loan back."

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