Secured vs. Unsecured Loans

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There are two basic categories that most loan types fall into – Secured and Unsecured.

Secured Loan

Secured loans are those loans that are protected by an asset or collateral of some sort. The item purchased, such as a home or a car, can be used as collateral, and a lien is placed on such item. The finance company or bank will hold the deed or title until the loan has been paid in full, including interest and all applicable fees. Other items such as stocks, bonds, or personal property can be put up to secure a loan as well.

Secured loans are usually the best (and only) way to obtain large amounts of money. A lender is not likely to loan a large amount with assurance that the money will be repaid. Putting your home or other property on the line is a fairly safe guarantee that you will do everything in your power to repay the loan.

Secured loans are not just for new purchases either. Secured loans can also be home equity loans or home equity lines of credit. Such loans are based on the amount of home equity, which is simply the current market value of your home minus the amount still owed. Your home is used as collateral and failure to make timely payments could result in losing your home.

Secured loans usually offer lower rates, higher borrowing limits and longer repayment terms than unsecured loans. As the term implies, a secured loan means you are providing "security" that your loan will be repaid according to the agreed terms and conditions. It's important to remember, if you are unable to repay a secured loan, the lender has recourse to the collateral you have pledged and may be able to sell it to pay off the loan.

Examples of Secured Loans:

- Mortgage
- Home Equity Line of Credit
- Auto Loan (New and Used)
- Boat Loan
- Recreational Vehicle Loan

Unsecured Loan

On the other hand, unsecured loans are the opposite of secured loans and include things like credit card purchases, education loans, or personal (signature) loans. Lenders take more of a risk by making such a loan, with no property or assets to recover in case of default, which is why the interest rates are considerably higher. If you have been turned down for unsecured credit, you may still be able to obtain secured loans, as long as you have something of value or if the purchase you wish to make can be used as collateral.

When you apply for a loan that is unsecured, the lender believes that you can repay the loan on the basis of your financial resources. You will be judged based on the five (5) C's of credit -- character, capacity, capital, collateral, and conditions – these are all criteria used to assess a borrower's creditworthiness.

Character, capacity, capital, and collateral refer to the borrower's willingness and ability to repay the debt. Conditions include the borrower's situation as well as general economic factors.

Examples of Unsecured Loans:

- Credit Cards
- Personal (Signature) Loans
- Personal Lines of Credit
- Student Loans (note that tax returns can be garnished to repay delinquent student loans)
- Some Home Improvement Loans