Secured vs. Unsecured Loans

How do I use this document?

This resource is intended to be an overview and comparison of traditional secured and unsecured loans. Secured and unsecured loans represent the largest categories of loan types in the market today. Most financing can typically be categorized as either secured or unsecured. Information contained in this document is generalized and may have exceptions.

Please see below for a more detailed look into the differences between secured and unsecured loans, as well as an index of many secured and unsecured loans available today.

What are the differences?

There are a variety of financing options available to consumers today which generally fall into two main categories: secured and unsecured. Often a borrower's credit history (FICO score, debt, income sources, etc) is taken into account by the lender when determining if financing will be offered. While creditworthiness is a factor in the approval process for secured loans, it plays an even bigger role when approving an unsecured loan. This is because an unsecured loan has no collateral attached as security against non-repayment. In addition to the promise to repay the loan, secured loans require an asset to act as collateral, usually the property itself and occasionally the installed equipment.

Which type of loan is right for you?

Secured Loans	Unsecured Loans
How do credit scores affect these two loan types?	
Because the lender requires collateral to secure the loan, the borrower's credit is less of a determining factor than in unsecured loans. Typically factors such as down payment amount and Loan to Value (LTV) ratios are more important for secured loans. The amount offered through a secured loan is partially based off of the equity, the difference between the amount owed and the sale value, of the property or collateral.	The amount offered through an unsecured loan product is typically based off of the borrower's credit score, sometimes called a FICO score, and their Debt to Income (DTI) ratio. Lenders consider a good credit score to be above 680 and those customers may have a better chance at being approved for an unsecured loan. A common unsecured financial product people use every day is a credit card, which normally has higher interest rates (15%-25%), which may increase considerably if even one payment is late.. **NOTE**: The State's Residential Energy Efficiency Loan (REEL) program aims to expand access to customers who might not otherwise qualify for unsecured products at attractive rates.

Secured Loans	Unsecured Loans
What kind of interest rate can be expected?	
Secured loans have collateral attached to them and are more likely to have lower interest rates due to the reduced risk to the lender. However, because the loan needs to be legally secured to property or collateral, the lender's origination fees may be higher than with an unsecured loan.	Since there is no collateral attached to an unsecured loan, it carries a bigger risk for lenders. To make up for that risk, lenders often charge higher interest rates. Interest rates for unsecured loans often exceed 10%, but vary depending on the lender. Unsecured loans typically have quicker processing times making funds available more immediately, and they usually don't have high closing costs or origination fees.
Does a borrower need to provide collateral?	
Secured loans require collateral. Collateral may sometimes come in the form of the property in question, an alternate unencumbered property or equipment installed on a property. A lien is placed against the collateral, and, in the case of foreclosure, may be seized. Secured loans typically have longer loan repayment terms available and allow one to borrow more money because it is partially based on the equity in the collateral. Property Assessed Clean Energy (PACE) Financing is an example of a secured financing product rising in popularity throughout the nation. The PACE lien utilizes the property tax payment mechanism for reducing the risk to the lender since property taxes get paid first in the case of a foreclosure.	If a borrower doesn't have any or doesn't want to provide collateral for financing, an unsecured loan may be a good option. Unsecured loans are usually offered for smaller dollar amounts with a shorter payback period. The interest rates and terms for an unsecured loan are typically determined by the borrower's credit score and Debt to Income (DTI) ratio. These two numbers help to determine the borrower's "risk profile" since there is no collateral that secures this type of loan.
How much money can be borrowed?	
Secured loans typically offer more money to the borrower since with collateral, lenders are more likely to take a higher risk on a loan. A mortgage or a home equity line of credit are secured loans that often start at $25,000 and can loan much higher sums of money. Secured loans often take the loan to value (LTV) of the collateral or property into consideration and may require an appraisal as part of the underwriting process. Most common forms of secured loans are mortgages, Home Equity Loans or Home Equity Lines of Credit (HELOC).	Unsecured loans are typically issued for $1,000-$25,000, but vary depending on the lender. Many home energy improvements fall into this category unless one is planning to do a substantial upgrade or additional renovations.

gogreen FINANCING

<table>
<tr><th>Secured Loans</th><th>Unsecured Loans</th></tr>
<tr><td colspan="2">How long will a borrower need to repay the loan?</td></tr>
<tr><td>Secured loans generally have a longer repayment period, sometimes as long as 30 years. An advantage of this is that a longer repayment period results in smaller monthly loan payments, which may have less impact on one’s monthly cash flow and budget.

A disadvantage for a longer repayment term is that the borrower may pay back more money due to interest over the life of loan. It is important to read the loan terms and conditions because some loans may have prepayment penalties if the loan is paid back early.</td><td>Unsecured loans typically have shorter repayment periods, usually 1-15 years. With energy financing, the repayment period is typically no longer than the expected useful life of the equipment installed.

It is important to read the loan terms and conditions because some loans may have prepayment penalties if the loan is paid back early.</td></tr>
<tr><td colspan="2">What happens if a borrower can’t repay the loan?</td></tr>
<tr><td>With a secured loan, nonpayment may result in loss of the borrower’s collateral as part of the default process. In many cases, the lender will sell the collateral asset to recoup the cost of the loan.

Often, the collateral may sell for less than the outstanding debt and the lender will experience a loss or try to recoup the remaining debt from the borrower via legal action. In addition, the default will negatively affect the borrower’s credit score making it more difficult to borrow money in the future.</td><td>Since an unsecured loan does not have collateral attached to it, If the borrower defaults on the loan, there is nothing the lender can take back to recover their loss.

The lender’s only recourse is to go through the collections process. In addition, the default will negatively affect the borrower’s credit score making it more difficult to borrow money in the future.</td></tr>
</table>

gogreen FINANCING

Secured vs Unsecured Loans

	Unsecured Loans	Secured Loans
Description	An unsecured loan is financing offered by lenders which is based solely on the credit worthiness of the borrower.	A secured loan is financing offered by lenders that require collateral for security.
Examples	Credit Cards, Bank Signature Loans	PACE financing, Home Mortgage Products
No Collateral Needed	✓ No collateral	✗ Collateral needed
Low/Fixed Interest Rates	✗ Variable/Fixed Higher rate	✓ Fixed Lower rate
No Closing Costs No Fees	? No closing costs May have fees	✗ Yes closing costs Yes fees
No Down Payment Required	✓ No down payment	? May need down payment
Loan Amount	$0 - $25,000 Credit dependent	$5,000+ Collateral dependent
Loan Terms	1 -15 years	5 - 30 years
No Credit Requirements	✓ Lower credit & income requirements	✗ Credit and income requirements
Loan Approval Timing	✓ Immediate	? Varies May be up to 1 month

gogreen FINANCING

Common Types of Loans

NOTE: PACE Financing, California Hub for Energy Efficiency Financing (CHEEF) and solar financing are discussed in greater detail in separate resources.

Home Equity Line of Credit (HELOC)

HELOC is a secured loan in which the borrower's home serves as the collateral. The credit limit for the HELOC is set by allowing a percentage of the equity in the home. The equity in a home is usually calculated by subtracting the balance owed on the home through a mortgage(s) from the appraised value of the home. A HELOC differs from a more conventional home loan in that the borrower is not advanced all the money up front, but uses a line of credit to draw portions of the money as it is needed, similar to a credit card. Repayment is of the amount drawn plus interest and any fees. With HELOCs, the interest rate may be variable or fixed; however, the interest is typically eligible for a deduction on the borrower's annual tax return.

Green Loans from a Credit Union or Bank

Many banks and credit unions offer a green, or energy, loan for members seeking to purchase upgrades for their home. Each bank or credit union has its own loan requirements, eligibility and terms. Green loans are generally unsecured or if the amount is larger, the financial institution may place a UCC-1 equipment lien on the property. Depending on the specific product, green loans can cover energy efficiency improvements, water-saving measures, renewable energy projects like solar panels or solar water heating and/or electric vehicles and their charging stations.

Conventional Home Improvement Loans

Conventional home improvement loans are offered through many financial institutions and come in both secured and unsecured financing. These loans can be used for energy projects as well as many other types of home improvements or renovations. Most conventional loans require a significant down payment.

FHA-Insured Loans

Some FHA-approved lenders offer mortgage loan products that are insured by the U.S. Federal Housing Administration (FHA) and can be used to finance energy projects. The actual mortgage loan is provided through an FHA-approved lender and the FHA provides mortgage insurance to reduce the risk of the additional project cost to the lender. FHA-insured loan products include the Title 1 Home Improvement Loan, Energy Efficient Mortgages and Section 203(k) Rehab Loans to name a few.

Dealer Financing

Dealer financing provides loans utilizing dealers, usually contractors, as the salespeople. Often contractors pay for the ability to offer this kind of dealer financing, which normally offers flexible terms that may be made more attractive through dealer interest rate buy-downs. One thing to keep in mind is that these dealer fees are not always transparent to the borrower and may affect the total cost of the project.

Depending on the company providing the financing, both secured and unsecured products may be available and the dealer may offer options allowing credit challenged borrowers to receive financing. Some dealer financing, especially in non-residential, are financed directly through an equipment manufacturer - using the equipment as collateral. By utilizing the equipment being financed as collateral, the lender minimizes their risk and can offer more attractive loans and interest rates than basic unsecured loans.