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What Is an Open End Loan?

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Open end loans are a line of credit that allows you to borrow money when you need it and leaves you with available funds when you don't. This is different from closed end loans, where you borrow a specific sum of money and then pay it back in a series of installments. Credit cards and home equity lines of credit are common examples of open end loans.

Function

Open end loans are valuable when the full amount of the credit line isn't needed right away, but may be needed at various times in the future. With an open end loan, you take only the amount you currently need, leaving the rest available for future use. As you make payments to the loan, those amounts become available to you again, and you can borrow against them. You're not required to take money until you need it.

Features

Open end loans provide you with more credit as you repay previously borrowed amounts. This eliminates the need to apply for new credit every time you need it. As long as there are funds available, you can borrow against them. Many open end loans require only interest payments, or interest plus a small amount of principal, resulting in lower monthly payments. However, you will still have to pay back the principal amount at some point.

Benefits

With an open end loan, you're only paying interest on the portion of the loan that you're currently using. This is different from closed end loans, where you're making principal and interest payments on the full amount, regardless of when you actually use the funds. If you need to borrow money that doesn't need to be spent all at once, for instance to pay a contractor at various phases of a job, you aren't paying interest until you spend the money.

Considerations

While making only interest payments may be advantageous for a while, at some point you will have to pay back the original amount borrowed. You should understand the terms of an open end loan, including when principal amounts are to be paid back, under what terms and what will happen if you close the loan. If you need to borrow a specific amount all at once, you may prefer the predictable monthly payments of a closed end loan.

Warning

Open end loans generally have variable interest rates. While the initial rate on the loan may be low, they could rise if economic conditions change. Ask your lender about the terms of your loan. There may be a cap on how much the rate can rise, or it may be a "teaser" rate that will increase significantly after an introductory period. Always be sure you can make payments on your loan, to avoid damaging your credit.