

Blessed are the savers

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A flashy new car or overseas holiday might sound like just what the doctor ordered.

However, spending the next five years saving every penny for a jaunt around Europe doesn't sound anywhere near as gratifying as borrowing the money now.

But applying for a loan isn't a step that should be taken lightly.

Financial experts say you should never borrow money to purchase an item that isn't going to grow in value.

Using a credit card can end up costing you twice as much as you paid in the first place, says Brad Callaghan, director of accounting and business advising firm Callaghan Partners.

"You should not borrow money for a wedding or a holiday. These are items you need to save for," he says.

"And you should not borrow money to go shopping. You should not be using credit to purchase luxury items. It is just not worth paying 20 per cent interest on the item."

Callaghan says there is good debt, which is borrowing for something that helps you make money, and bad debt, which just costs you money with no financial return.

"You have to learn to control your finances and reward yourself with the end result. There is also the satisfaction of saving for something that you want. You always learn to appreciate the item more because of what you went through to get it," Callaghan says.

Colin Archard is managing director of wealth-management firm Henderson Matusch. He says too many people have no financial plan in place.

To determine affordability for anything, you need to assess your present situation, goals, cash flow, assets and liabilities, Archard says.

"We see too many people borrow too much money, then, when interest rates increase, they can no longer afford the borrowings, creating stress and perhaps a forced sale at the bottom of the market," Archard says. "Just because a lender will allow someone to borrow, does not mean it is right for them."

Kris Bondin of personal-budgeting program Bills to Pay recommends that if you do decide to borrow, be aware it will cost you a lot in interest.

"My budgeting advice would be that you need to set a strategy before you receive the money to ensure that it can be repaid as quickly as possible," Bondin says.

"That means asking questions to the lender as to the fees and charges for paying the debt off quicker."

Callaghan adds that it's important to shop around for the best finance rate, and reminds borrowers to be sure there are no penalties for paying out the loan quicker.

"I'm not an advocate of borrowing money against equity to purchase luxury or personal items. It is much smarter to make that equity work harder for you by using it to purchase an investment property."

For professional advice, Anchor National Financial Planning managing director Mike Smith explains that a finance broker can help you know if you qualify for lending, a financial planner can help you work out if borrowing will help you build the sort of life you want, while an accountant can help you with tax.

"And if in doubt, ask grandma. She has seen enough financial pain to set you straight," Smith says.

Bad Debt

- Lifestyle assets, such as a swimming pool.
- Borrowing to feed your ego. A small car will get you from A to B just as well as a fancy one.
- Borrowing for holidays, treats and luxury items. Don't go into debt to keep up with your friends.

Good Debt

- Borrowing to invest can be a good idea, but needs careful consideration.
- Tax management - some interest payments can help build your assets while reducing tax.
- Items you need and can't wait for, such as a tradesman needing tools, a salesman needing a car or a student needing a laptop.