HOLM TRUTHS
Down to earth advice for New Zealand savers and investors from independent journalist Mary Holm
AUTUMN 2002

Burrowing Into Borrowing

"He that goes a borrowing goes a sorrowing", said Benjamin Franklin a couple of hundred years ago.

But we seem to be more in sympathy with a mid-nineteenth century writer, Artemus Ward, who said "Let us be happy and live within our means – even if we have to borrow the money to do it with."

Through the 1990s, New Zealanders' household debt, relative to our income, has doubled. Is that good or bad? It depends on what the borrowing is for.

If it's to fund tertiary education, or to set up or grow a business, borrowing might well be a good move. You expect to generate higher income later, because of the loan.

Similarly, it probably makes sense to borrow to buy a car if that's the only way to get to a job, or to a higher-paying job.

It can also be wise to borrow to buy an asset that is likely to increase in value, such as a house.

This was particularly true in the 1970s and 80s, when high inflation pushed up house values fast. Inflation also boosted incomes, so debt repayment became easier.

These days, asset values and incomes don't rise so quickly. But borrowing to buy appreciating assets can still make sense financially.

We'll explore this more in the next issue of Holm Truths.

Let's concentrate here on borrowing to buy other goods and services – immediately consumed items such as travel and entertainment, and items that we use up over a number of years, such as appliances and cars.

Borrowing to travel, eat out and so on – which many people do through credit cards – is clearly not clever financially. You're paying back the amount borrowed, plus interest, months after the pleasure is a fading memory.

There's more logic to borrowing for appliances, cars, boats and so on. You're repaying the loan as you use the product. It's a pay-as-you-go scheme.

Even so, you must pay interest. And – particularly if the interest rate is high and there are fees and perhaps compulsory insurance involved – you can wind up paying double the price of the product, or even more.

Do that frequently enough, and you'll retire with thousands of dollars less.

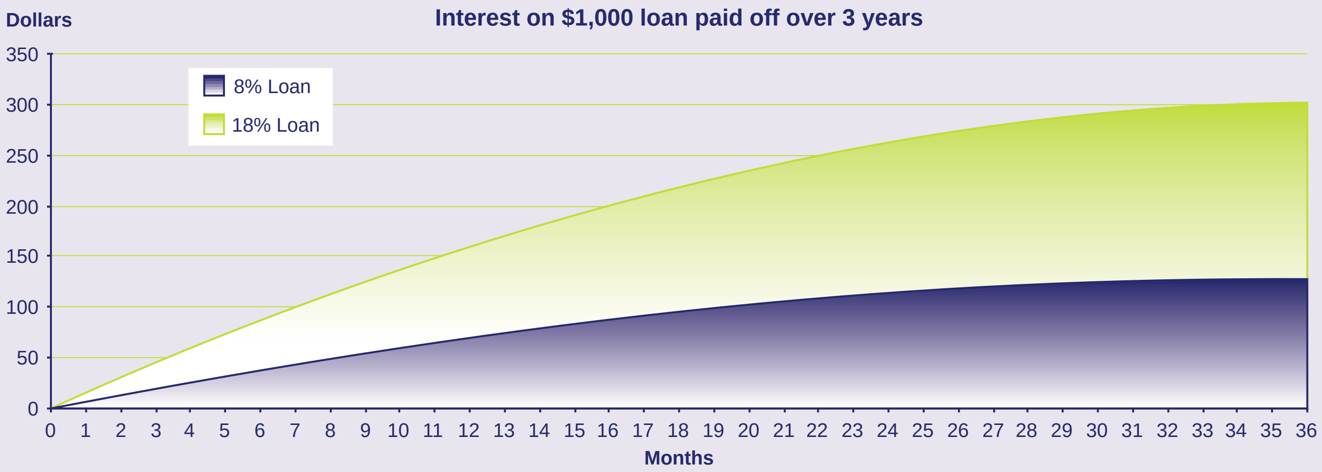
It's far smarter to save for such spending before you buy. That way, interest is your friend, boosting your savings, rather than your enemy. *(CONTINUED PAGE 2)*

AN EXPERT OPINION?

Never assume, just because somebody will lend you money or give you a credit card, that an expert has judged that you are able to repay it.

These days, many lenders have plenty of money available, and some of them don't pay much attention to your financial situation before lending.

You are the only good judge of whether you can handle debt.



High-interest debt is expensive. On a $1000 three-year loan at 8%, your monthly payments will be $31.34 and you will pay just under $130 in interest over the life of the loan. But if the loan is at 18%, your monthly payments rise to $36.15, and your interest will total more than twice as much, at just over $300. On a longer-term loan, the differences will be even bigger. For a $2000 loan, double all figures. For a $10,000 loan, multiply all figures by 10.

(BURROWING INTO BORROWING, CONTINUED)

Having said all this, there are times when you must borrow for a consumption item. Perhaps your washing machine has broken down and isn't worth repairing, or you want to travel to see a sick relative.

Here are some tips on how to do it:

• Avoid running up your credit card balance or taking a car loan, hire purchase, or other high-interest loan.

If you can get a cheaper loan elsewhere, not only will you pay less interest, but you'll be a cash buyer, so you may be able to negotiate a price cut.

The cheapest loans are mortgages, and many lenders will permit you to add to your mortgage.

There's one trap to this, though. You're converting, say, a three-year consumer finance loan to a 20-year home loan. And the longer a loan runs, the more interest you will pay over the years.

Unless you take steps to pay off the extra mortgage amount quickly – preferably as quickly as if you'd stuck with the consumer loan – you could end up paying more total interest.

If you haven't got a mortgage, try to get a personal loan from a bank or credit union. These will probably charge higher interest than on a mortgage, but lower than many alternative loan sources.

See "On-line card info" on the back page to find out about another option.

• When you're comparing loans, use the finance rate.

This is like an interest rate, but it also takes into account upfront fees and charges. It lets you compare a low-interest loan with high fees with a high-interest loan with low fees.

The finance rate has some flaws. For instance, when calculated on mortgages, it doesn't include legal fees and valuation charges. But it's still a useful number – the lower, the better.

• Check the costs of repaying the loan early.

You might unexpectedly receive a pay rise, redundancy package, inheritance, or lottery win and be able to get rid of your debts.

Sometimes, though, you must pay fees or penalties to do this. Avoid them if possible.

• If you're having trouble repaying a loan, you'll get into less trouble if you contact the lender.

They may arrange for you to repay more slowly. And it's less likely that your credit record will be marred.

The Best Investment Of All

Paying back debt might not seem like an investment. But it can be the best one you ever make – and not just because it will give you peace of mind.

Your wealth – often called your net worth – can be measured by adding up your assets and subtracting your debts.

To boost your wealth, then, you need to either add to your assets or reduce your debts.

It doesn't really matter which side you work on. Paying off a debt that charges 8% interest will improve your wealth to the same extent as gaining an investment with an 8% return.

Note, too, that there are no taxes or fees involved in reducing debt (except perhaps early repayment penalties). To do as well with an investment, you need to earn 8% after taxes and fees.

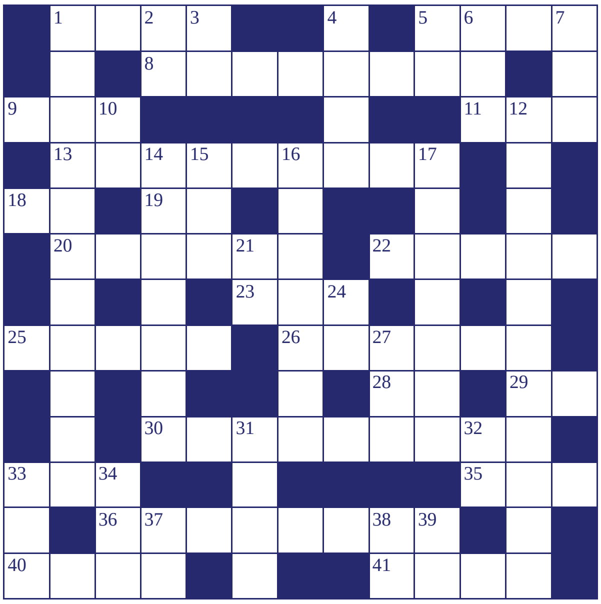
That's a pretty high return in today's environment. There's no way you'll get that much without taking on a risky investment. But repaying debt is risk-free.

What's more, with less debt, it's easier to cope with temporary setbacks, such as illness or loss of a job.

For most people, then, debt repayment is the best investment option.

The choice becomes even clearer if you have credit card or other debt, on which the interest may be 18% or even higher.

Paying off 18% debt boosts your wealth as much as a risk-free investment that pays 18% after tax and fees. Such brilliant investments don't exist anywhere else.



HOLM TRUTHS CROSSWORD Autumn 2002

ACROSS
1. Charges for services (4)
5. God of love (4)
8. Home loan (8)
9. African antelope (3)
11. A benefit (initials) (3)
13. Eg. Stove, fridge (9)
18. Not out (2)
19. About (2)
20 & 41. Financial friend or foe (6,4)
22. A meal (5)
23. Faucet (3)
25. A rind (anagram) (5)
26. Gambling parlour (6)
28. Computing (initials) (2)
29. Type of radio signal (initials) (2)
30. Halfway across (9)
33. Fresh, unused (3)
35. Dull (3)
36. Price of money (8)
40. Wine in Italy (4)
41. See 20 across (4)

Solution: Back page

DOWN
1. Use to compare loans (7,4)
2. Printer's measure (2)
3. Very (2)
4. Against (4)
5. For example (initials) (2)
6. Embarrassing colour (3)
7. Cry (3)
10. Not down (2)
12. Serenity (5,2,4)
14. Insurance payment (7)
15. Went in front (3)
16. Raids (7)
17. Knowledgeable (7)
21. Same as 28 across (2)
24. Dad (2)
27. Knight (3)
31. Tide (anagram) (4)
32. After B.C. (2)
33. Man's name (abbrev.) (3)
34. Your goal at 26 across (3)
37. Toddler's favourite word (2)
38. Old NZ exam (initials) (2)
39. Thank you in the nursery (2)

GREAT DEBATE • GREAT DEBATE • GREAT DEBATE

CREDIT CARDS vs EFTPOS

EFTPOS has made life easier for everyone. The same cannot be said for credit cards.

For some people, credit cards are convenient and financially advantageous. But for too many others they are a big financial drain.

While credit card pros outnumber cons in our list, the first con, "Debt can get out of hand", is hugely important.

By using several credit cards, some New Zealanders have run up many thousands of dollars of debt that they cannot repay quickly.

And credit card debt is particularly burdensome because interest rates are so high.

On top of that, there's an annual fee, often $15 to $25 per card. Some cards, such as those with lower interest rates, charge annual fees of around $60 or $70. And gold cards, which offer extra features, charge up to $95.

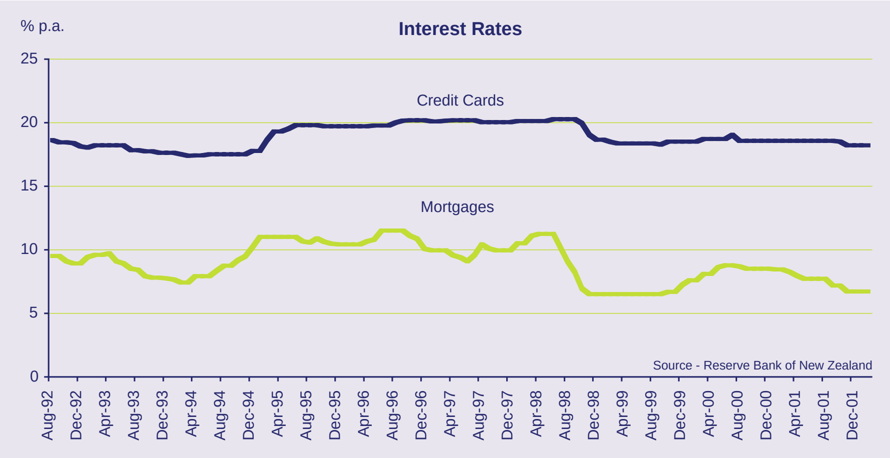
Then there are often fees if you don't make the minimum payment on time, if you go over your credit limit, and so on.

Over the years, interest payments and fees can make a credit card holder much worse off than if they had stuck with EFTPOS, buying items only when they already had money in the bank. *(CONTINUED PAGE 4)*

CREDIT CARD PROS	CREDIT CARD CONS
✓ Up to 55 days' free credit	✗ Debt can get out of hand
✓ Flexibility on when you pay	✗ High interest rates
✓ Acceptable overseas	✗ Not all traders accept them
✓ Some consumer protection	✗ Pay annual fee
✓ Instant credit in emergencies	
✓ Loyalty rewards	

EFTPOS PROS	EFTPOS CONS
✓ Some retailers give discounts for cash	✗ You pay immediately
✓ Better for budgeting and debt control	✗ Not as useful overseas

Whatever you have, spend less.
Samuel Johnson, 1709-84



(CREDIT CARDS vs EFTPOS, CONTINUED)

On the other hand, those who play the credit card game wisely can end up better off for doing so.

Rule number one in the game is to always pay off your card in full, on or before the due date.

It's important not to be even a day late or a dollar short. The way the card companies calculate interest, you can pay dearly for such minor shortcomings.

To avoid that, it's best to have your bill paid by automatic transfer out of a bank account on the due date.

Rule number two is to try to buy big-ticket items near the beginning of your billing cycle. Find out when that is by looking at the dates of your first purchases on past statements.

If you time your purchases properly, you won't be billed for the items until about a month later. Then you get almost a month before you must pay.

On many cards this amounts to up to 55 days of free credit. It gives you longer to find the money. Or, if you have the money, it can be earning interest in the meantime.

Note, though, that free credit doesn't apply to cash advances. Interest on those is charged from the day you get the money.

Rule number three, then, is to avoid cash advances.

If you're among those who can play the credit card game to win, you'll find it more useful than EFTPOS when you're travelling overseas.

Generally you cannot buy items overseas using EFTPOS, but traders in many countries accept payment by credit card.

With either card, you can get cash from ATMs in many countries, normally for a fee of around $5 to $7.50.

On a credit card, you will also pay interest immediately, as with other cash advances.

However, if you deposit money into your credit card account before travelling, to give it a positive balance, many card companies will waive the fee and interest on withdrawals up to the amount deposited.

Credit cards also offer some consumer protection.

If, for instance, you order a product that is not delivered and you notify the card company soon after you're billed, they will remove the charge.

And many cards give rewards such as air points, travel or gift vouchers or cash rebates. Heavy card users can benefit considerably from them.

All of these advantages are eclipsed, though, if you can't manage to pay your credit card bills in full every month – or at least almost every month.

If you can't, it's better if you get rid of your credit card and stick with EFTPOS.

Holm Truths Crossword Solution

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G	N	U					I			D	P	B
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I	N		R	E		T			R		A	
	C	R	E	D	I	T		L	U	N	C	H
	E		M		T	A	P		D		E	
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V	I	N	O		T			C	A	R	D	

On-line Card Info

For a list of current interest rates charged on credit cards, see www.interest.co.nz.

For more detail, see www.eloannz.co.nz.

Click on "Find the best credit card for you", and answer questions on your typical monthly balance, whether you pay your card in full each month, what rewards you would like and so on.

The website comes up with information on cards that would best suit you. You can then apply for a card on-line.

Elsewhere on the website is information on a possible option if you're looking for a personal loan or considering hire purchase.

Click on "Want personal finance?" to learn about a different type of lower-interest credit card, the BNZ's Activator or the National Bank's Freestyle Card.

There are no establishment or annual fees on these cards. You pay a monthly charge – $20 with BNZ, $10 or more with National – if you use the card; nothing if you don't. There is no interest-free period.

Loans using these cards are more flexible than alternatives. And in some cases they will be cheaper.

WRITER AND PUBLISHER

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