Financing your caravan on your home loan? Why it's not such a good idea!

Are you one of the many Aussies that shop solely on interest rate? Hopefully this article will convince you to look beyond that sole interest rate figure that is drilled into us by the media. There is no doubt that people sitting around for dinner or a barbeque will discuss interest rates on their home loan. One person says, 'well, I'm getting "x"', and the other says, 'I'm getting "y"', and while "y" might be cheaper at face value, there are excessive monthly fees with 'y' that make 'x' cheaper. This is where you should ask what the comparative rate is, if you really want to get the the bottom of what the different banks are charging.

Anyway, back to the task at hand. Financing your caravan on your home loan – don't do it! Here's why:

Banks love having home loans, and will encourage you to put everything you wish to purchase on your home loan. Why? Because they make more interest from you for the benefit of their shareholders. The reason is simple. Your home loan goes for a maximum of 30 years. Caravan loans typically go for five years. The longer you owe the bank money, the more interest you pay.

Let's look at an example. For a new caravan, depending upon make and model, you could be charged $110,000. If you were to finance this on your home loan, on current interest rates of 6.5 per cent, your monthly payments would be $695.27 per month. Over 360 payments (30 years), you repay $250,298.94. That's $140,298.94 in interest!

Now, on a caravan loan for $110,000 over five years at 7.85 per cent, your monthly payments would be $2,222.52 per month. Over 60 payments (five years), you would repay $133,350.01. That's $22,350.91 in interest. Which option would you prefer?

I'm not going to elaborate on the above. The figures speak for themselves. Sure, the home loan payments may appear attractive, but you're not really getting ahead (increasing your net worth). If you can't afford a caravan without financing it on your home loan, you really have to ask yourself, 'should I really be getting this? Should I perhaps look at a more affordable model?'

For those of us that like to get a new caravan every three to four years, should you choose the home loan method of financing, you may not realise it, but 10 years can go by and you'll be onto your fourth caravan, and you still won't have paid off the first!

If you're using a financial planner, they definitely won't like you using your property equity to purchase a depreciating item. For the majority of us, property equity contains the bulk of our 'net worth', and this is a significant component of most financial planning strategies. To use this equity to purchase a large capital item, such as a caravan, will significantly put a dent in a retirement strategy.

The essence of this is: use the correct finance product for the asset you wish to purchase to pay it off quickly.

Deposits – should I put this towards my new caravan, or can I better utilise the funds elsewhere?

Using a deposit towards your next caravan is a fantastic idea! Why? Because every dollar you put towards a deposit is a dollar that you don't have to borrow, thus saving you interest. The deposit traditionally comes from either cash, or a trade-in caravan or camper trailer.

When considering a deposit, it's extremely important to consider all aspects. Some people are so 'loan averse' that they only borrow the minimum and will scrimp and save every dollar possible. While this may sound fine in theory, you need to be particularly careful that you're not leaving yourself short; for example, with no back-up cash in the bank. People, just like businesses, need to have some cash in the bank to run the household, have security for emergency situations, and schooling for the kids etc. Also, if you require some modifications to your new caravan, you could consider using the funds you had set aside for the deposit for your modifications.

Now, this is something that many people should consider. Can I better utilise my deposit? The answer to this question is yes.

Consider these two key points:

1. Home loans typically run for 30 years.
2. Caravan loans typically run for five years.

The longer the period over which a loan is taken, the more interest you pay, which goes back to the bank and their shareholders.

If you have a deposit to go towards your new caravan, you are going to benefit through not having to borrow as much, and you will save yourself interest over the life of the loan, assuming a five-year term. If you decided to put your deposit on your home loan, you are going to save even more in interest than you would on your caravan loan. Why? Because you are repaying your home loan over a 30-year period, and the deposit will save you interest over this period versus the interest saved over a five-year period on the caravan loan.

To illustrate this further, lets consider a $100,000 caravan loan over five years at 8.5 per cent. Your total repayment interest over this period would be $23,099.19. Now, if you put down a $30,000 deposit, this would reduce your interest bill to $16,169.43 – a saving of $6,929.76. For a home loan, lets assume a loan of $400,000 over 30 years at 6.5 per cent. Your total interest over this period would be $510,177.95. If you decided put your $30,000 on your loan (thus reducing your balance to $370,000), the total interest over the period would reduce to $471,914.61 – a saving of $38,263.34.

Seeing these figures confirms what you already know! The longer you owe the bank money, the more interest you pay over the life of the loan. So, next time you decide you need a new Caravan, consider putting your deposit on your home loan. It can quite literally save you thousands!

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