

THE SUNDAY TIMES | **GUIDE TO**

FINANCING A PRESTIGE CAR

In association with

Car-Finance4Less

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INTRODUCTION

The last thing most of us want to think about when buying a new car is how we are going to pay for it. While we may be distracted by the alloy wheels, integrated satellite navigation system and the 0-60mph time, the showroom salesman may be leading you gently down the path towards a wrong finance solution. While we are thinking mph he is thinking APR.

Car finance is just like any other product. If you want the best you have to shop around and take the time to understand the industry jargon. For example, do you know the difference between an annualised percentage rate (APR) and an Effective Annual Rate (EAR)? Or what a 'balloon' payment is and whether it is any different from the Guaranteed Minimum Future Value?

For as long as we have been in love with the motor car there has been a finance industry helping us to own our dream machines. As more of us coveted horseless travel as the ultimate 20th century symbol of freedom and affluence, demand for credit increased. In the 1920s the motor car was largely a plaything for the rich, but mass-production techniques brought it closer to the general populace, and as the car manufacturing industry took off, so did the car finance industry.

As both industries matured they became more sophisticated. There is a bewildering array of finance plans now available from finance houses, each with its own bells, whistles and small print. Car dealerships might not offer you the deal or product most suited to your needs, because they are usually tied to one or two finance companies. They have to offer those products regardless of whether they are the best, so it pays to shop around.

The difficulty with car finance is that it is often tricky to compare products on a like-for-like basis. When it comes to borrowing we are usually told to compare the total cost of credit, so as to stop us focusing on the monthly repayments. The total cost of credit depends on the contract length, deposit size, APR and other, possibly hidden, charges.

The fact is that different financial products are designed to help us achieve different goals; it is not just about cost, it's also about convenience, suitability and security.

This guide aims to take you through all the available car finance options, from hard cash to purchase contract plans, pointing out the pros and cons of each method along the way.



FUNDING OPTIONS

CASH

In most cases the cheapest way to buy is by not borrowing at all. Pay for your prestige car out of savings and you will not have to pay any interest to finance houses. However, you will lose the benefit of gaining interest on your cash reserves. Unfortunately, very few of us are in this 'cash-rich' position.

More seriously, using up a big chunk of your savings just to avoid a few hundred pounds' worth of interest could leave you exposed in other areas of your finances. For example, most financial experts recommend keeping at least three months' wages worth of savings on hand for emergencies. Paying for your car with cash could leave you short, should your circumstances change.

Pros

- No credit interest to pay
- You own the car outright from the start

Cons

- Could leave you financially exposed in other areas
- You could miss out on compound interest on savings

0% FINANCE & 50/50 DEALS

Some manufacturers are so desperate to sell you their cars that they may lend you the money and not even charge you any interest on it. That may sound crazy, but with such a competitive car market – particularly the new car market – and many manufacturers suffering financial hardship, desperate measures are sometimes called for.

With a 50/50 deal you can trade-in your old car or pay a cash lump sum, providing it is worth roughly 50% of the cost of the new car. You then do not have to pay the balance until the end of the special-offer period – whatever that may be. You pay no interest on the 50% that the company has effectively loaned you.

This means that you can instead put the money you would have spent in a high-interest savings account, until it is time to repay. In this way such deals can be even cheaper than paying for your new car with straight cash, because you can earn interest rather than paying it. It is the ideal situation.

Other versions of such 0% interest or low-rate schemes involve slightly lower deposits – say 35% to 40% – and then monthly repayments for a set period.

Of course, the catch with such schemes is that they are offered primarily by franchised dealerships, so your choice of car is often limited. If you do not like what is on offer the fact that you do not have to pay interest will not be much of an incentive. The final factor to consider is that popular cars with good residual values do not usually have to be marketed so aggressively.

Even if the dealer is an independent offering a range of makes, it may only be able to offer low-rate or 0% finance deals by increasing the overall cost of the cars it sells.

Pros

- No interest to pay on the loan
- Your savings can earn interest up to the repayment date

Cons

- High deposits usually required
- Limited choice of cars
- Big lump sums required to complete payment of car on 50/50 deals

PERSONAL LOAN

Many car buyers simply take out an unsecured personal loan to pay for their new car. The term 'unsecured' means that if you default on the payments the lender cannot take the car or any other asset (such as your home) from you in lieu of payment.

The good news is that the personal loan market is very competitive at the moment with many lenders now offering headline interest rates at or around 6%. At these rates a loan of £15,000 repayable over five years will cost between £2,200 and £2,700 in interest.

You cannot assume you will be successful in obtaining the headline interest rate advertised by the lender. The small print often says this rate is subject to the applicant's credit rating; if your risk profile does not match their criteria, or you have failed to pay on time in the past, you may end up being offered a loan at a much higher rate. There have even been cases of highly credit-worthy applicants being refused loans at the advertised headline rate, so be sure you know the applicable rate before signing.

Another trap to watch out for is expensive payment-protection insurance sold alongside the loan. This is a lucrative sideline for lenders and you may find yourself coming up against hard-sell tactics. Check whether the repayment figures include or exclude this insurance.

One of the main restrictions of unsecured personal loans is that you are usually limited to borrowing sums up to £15,000 (maybe more depending on your financial circumstances). This may not be enough to buy the car outright, requiring you to use cash reserves. Should you take this option all you need do is work out if you can afford the monthly repayments.

If you wish to borrow a higher amount you may do so using a secured personal loan. This means that security will be required – possibly against the value of your home. Ask yourself whether it is worth putting your home at risk in the event that your future circumstances change and you are unable to repay the loan. Increasingly, lenders are introducing flexible loans that allow borrowers to overpay or underpay. This gives the option of paying off the loan early, keeping interest payments low. But some lenders still cling to the outdated practice of charging early-repayment penalties. As this can be as much as three months' interest, check the policy before signing.



Also watch out for loans that are marketed specifically as car loans. These usually come with attractive extras, such as free breakdown insurance or other car-related benefits.

Try to work out the value of these extra benefits before committing yourself. It may be that the total cost of credit is still higher than other loans on the market, even after taking these benefits into account.

Pros

- Relatively simple and quick to arrange
- Can be a cheap form of credit
- Easy to compare products
- You get to own the car outright from the start

Cons

- You might not get the advertised headline interest rate
- Watch out for early-repayment penalties
- Watch out for 'hard sell' of credit-protection insurance
- Larger personal loans often require security
- May restrict your ability to take out credit on other items



FLEXIBLE OR 'OFFSET' MORTGAGE

Flexible mortgages, sometimes known as offset or current account mortgages, work by adding up all the cash you have in the bank and using this to reduce the nominal amount you owe on the mortgage. Depending on the lender, you can usually overpay and underpay, take holidays from repaying, and even borrow more money – up to an agreed total loan size, of course.

The main attraction of borrowing this way is that you are only paying interest at mortgage rates rather than at the typically higher rates charged on standalone credit products. And as flexible mortgages are just that – flexible – you can pay off the extra borrowing whenever you like, without incurring penalties. This is particularly good for keeping interest payments at an absolute minimum.

But the downside of this method of borrowing is that it can be very easy to roll the loan extension into the mortgage and then simply end up repaying it over exactly the same period as the mortgage. The total cost of credit will obviously be much higher if you borrow over a period of, say, 20 years, rather than just three or four.

Also, flexible mortgages usually have variable interest rates. If bank base-rates rise, mortgage rates generally rise as well, so you could end up paying more for your loan

extension. Other credit products tend to have interest rates that are fixed for the duration of the contract period.

So, to make the most of flexible mortgage borrowing you have to be very disciplined and set yourself a target date for full repayment of the car loan, otherwise you could end up paying far more in the long run than with any of the alternative car finance products on the market. Of course, not all of us have flexible mortgages, so this type of borrowing is only a viable option for a minority of car buyers.

Pros

- Easy to set up
- Flexible repayments
- Potentially one of the cheapest ways to borrow

Cons

- Not much use if you do not have a flexible mortgage in the first place
- Could be expensive if you fail to repay the loan by a target date
- Mortgage rates could go up, making the loan extension more expensive

HIRER PURCHASE HP

This traditional form of finance is still resiliently popular with car buyers as it is fairly easy to understand. With a hire purchase agreement you usually make a deposit, typically 10% to 50% of the purchase price, although zero-deposit deals are sometimes available. You then make fixed monthly payments over a set period, between 12 and 60 months.

The main catch is that the finance company actually owns the car until you have completed the payments; you are effectively hiring the car until the end of the contract period. This means that if you fail to keep up the payments the finance company could take the car back, and for this reason you must make sure you can comfortably afford the repayments before entering into such a deal.

With hire purchase agreements the finance company will carry out an HPI check. This identifies whether or not the car has any outstanding finance or has been an insurance write off

Pros

- Wide choice of deposit and payment terms
- Fixed repayments help you to budget
- Leaves you free to borrow using other forms of credit
- Free HPI check

Cons

- Car may be repossessed if you do not keep up the repayments



HIRER PURCHASE With balloon payment

This modern variation of the traditional HP plan involves deferring part of the car's cost to the very end of the contract period. This deferred amount is known as the 'balloon' payment and is usually the assumed resale value of the car.

By deferring a portion of the repayment this way you can go for even lower fixed monthly repayments, which gives you the chance to own a higher-specification car if you want. At the end of the period you can either make the balloon payment to own the car outright, refinance, part-exchange or sell privately to pay off the loan.

Pros

- Lower fixed monthly repayments help you to budget
- Low deposit
- Chance to own a higher-specification car
- Leaves you free to borrow using other forms of credit
- Free HPI check

Cons

- Total cost of credit can be higher than simpler forms of borrowing
- Car may be repossessed if you do not keep up the repayments
- Financial penalties imposed if you terminate the agreement early



PERSONAL CONTRACT PURCHASE_{PCP}

The now ubiquitous PCP was dreamt up by the motor industry to encourage people to buy higher-specification cars than they could traditionally afford. It works by deferring a large portion of the purchase price – equivalent to the guaranteed minimum future value (GMFV) of the car – to the end of the contract period.

You pay a deposit – typically 10% to 25% of the car's value – then fixed monthly repayments for the duration of the contract period (typically two to five years). You also agree to keep within an annual mileage limit.

This means the monthly repayments can be kept much lower than under a standard hire purchase scheme, because you are only repaying a portion of the purchase price, plus interest.

When the contract period is up you can hand the car back to the retailer and walk away if you like. This is an important option because the car may have devalued more rapidly than the finance company had originally anticipated. It may be worth less than the GMFV on the open market and so paying the GMFV – the 'balloon' payment – might not make financial sense.

Instead you might want to buy the same make and model of car second-hand and save money. The disadvantage of this is that the manufacturer's warranty will probably have expired by then and repair costs are likely to be much higher.

Alternatively, the open-market value of the car may be higher than the GMFV when the contract period ends. In this case you can sell the car privately and use the proceeds to make the 'balloon' payment, pocketing the difference or using it to make a deposit on your next car. You can also simply part-exchange the car for a new one and set up a new PCP.

Watch out for extra charges though, such as 'finance acceptance fees' and 'purchase fees', and bear in mind that a PCP is seldom the cheapest way to finance a car purchase, with typical APRs currently around 10%. But at least it does give you the chance to drive a car that you may not have thought you could ever afford. In these status-obsessed times the PCP is appealing to many for this reason.



Pros

- Low deposit helping cashflow
- Low fixed monthly repayments
- Chance to drive a higher-specification car
- Flexibility: buy, part-exchange, sell or return the car
- Tax: if you are opting out of a company car scheme, the cash alternative is not subject to tax
- Free HPI check

Cons

- Can be an expensive way to finance a car purchase
- Pence-per-mile penalties imposed for exceeding the agreed annual mileage limit

BALANCED PAYMENTS PLAN



A balanced payments plan is similar to an HP agreement for car purchases of £25,000 or more. The main difference is that the interest rate you are charged is not fixed but tracks the prevailing rate offered by the finance company. As rates rise and fall so does the interest charged on your debt.

You still pay a deposit and repay the balance plus interest in fixed monthly instalments, but at the end of the contract any variation in interest is worked out and settled as a final charge.

As with the HP plan you can incorporate a 'balloon' payment option to obtain lower monthly payments. Arranged overpayments can be made during the agreement, reducing the capital outstanding

Pros

- Low deposit
- Fixed monthly repayments to help with budgeting
- Ability to make lump-sum payments and end the contract early
- You could save money if interest rates fall during the contract period
- Tax allowances for business users

Cons

- Car may be repossessed if you do not keep up the payments
- You could end up paying more if interest rates rise during the contract period
- Leaves you free to borrow using other forms of credit

PERSONAL CONTRACT HIRE

Leasing, traditionally reserved for company car fleets, is also growing in popularity among private individuals. You never own the car, you simply rent it for a fixed period – typically one to five years – and agree to keep within a set mileage each year. You pay a relatively small deposit equivalent to three-to-six months of the quoted monthly rental amount, and, for an extra fee, you can usually include maintenance in the contract, and sometimes a replacement vehicle facility.

Although with leasing you do not gain ownership of the asset at the end of the contract period, at least you get to drive a brand new car without having to shell out a big deposit, and you do not have the hassle of selling it, or worries about depreciation.

As long as you have not exceeded the agreed annual mileage limit and have kept the car in reasonable condition you can simply hand it back and then shop around for a replacement car. If you do go over the mileage limit there is usually a pence-per-mile penalty of between 4p and 6p.

One point to bear in mind is that some insurance companies have not yet caught up with the growing popularity of contract hire leasing deals and still insist that policyholders must be the registered owners of the vehicles being insured. If you are set on personal contract hire as a finance option you may have to shop around to find a tolerant insurance company.



Pros

- Virtually hassle-free driving: use without ownership
- Chance to drive a high-specification car without forking out a big deposit
- Optional maintenance packages
- Fixed monthly payments
- No depreciation or sale worries
- If opting out of company car scheme, cash alternative not subject to company car tax

Cons

- No asset to own at the end of the contract
- Excess-mileage penalties
- Some insurance companies might not accept you as a leaseholder driver

CONTRACT HIRE



Contract hire is almost exactly the same as personal contract hire except for the tax treatment. It is aimed at Vat-registered businesses and sole traders who like the fixed-cost element of the scheme and the fact that it is considered to be 'off balance sheet' for accounting purposes.

Also, business users can reclaim 100% of the Vat charged on the monthly rental and maintenance payments. If there is some private use of the car as well you can only reclaim 50% of the Vat on the rental payments, but 100% of the maintenance element.

Pros

- Virtually hassle-free driving: use without ownership
- Chance to drive a high-specification car without forking out a big deposit
- Optional maintenance packages
- Fixed monthly payments
- No depreciation or sale worries
- Vat efficient: can reclaim up to 100% of Vat on rental and maintenance payments

Cons

- No asset to own at the end of the contract
- Excess-mileage penalties
- Some insurance companies might not accept you as a leaseholder driver

FINANCE LEASE

Like other leasing schemes finance leasing is a way of enjoying the benefit of driving a car without all the attendant issues of actually owning it. But in this case the monthly payments are calculated assuming a future value of the car at the end of the contract period. This future value takes into account the annual mileage you agree to and the length of the contract term.

The difference is that this estimated future value is not guaranteed. At the end of the contract you have to sell the car to a third party. If the amount realised is more than the original valuation you get to pocket the extra. If it is sold for less you have to cough up the difference.

Alternatively you can sometimes enter into a new finance lease contract based on a revised valuation of the car at the end of the first contract. Your monthly payments should become even lower, reflecting the reduced value of the car.

Maintenance contracts are not normally included in finance lease contracts, although some finance houses may offer a maintenance package for an extra fee.

The main advantage of finance lease deals is their tax treatment. The rentals are calculated on the Vat-exclusive price of the car, leading to lower costs. Drivers who use the car exclusively for business use can reclaim 100% of the Vat charged on the rental. Private use will result in the tax relief being restricted to 50%. As such this type of plan is most suitable for Vat-registered businesses.

Pros

- Small deposit in the form of advance rentals
- Fixed monthly costs
- Car is classed as a tax-deductible asset on the balance sheet
- Up to 100% of Vat on rental recoverable for business users

Cons

- Only available to Vat-registered businesses
- No asset owned at the end of the contract
- Maintenance not usually included



ELIGIBLE FOR FINANCE?

We have taken you through the various funding options for the purchase or use of your new car. Here we list some of the things influencing the lender's decision to offer you finance:

- Income (annual salary plus any commission or bonuses)
- Other monthly repayment commitments on loans, credit cards etc.
- Employment – occupation and length of service with current employer
- Residence – length of time at current address and owner/tenant status
- Marital status
- Banking history – length of time with current bank
- Car value – purchase price of the car you wish to buy
- Deposit – amount of deposit or part-exchange value of your current car

Successful applicants may be asked for proof of identity/address, which may include:

- Driving licence – showing current residential address
- Utility bills – recent utility bill confirming your name and address



ENSURING FINANCIAL SECURITY

TOTAL LOSS GAP INSURANCE

If your car is stolen and not recovered, or written-off in an accident, your motor insurance policy rarely pays out the full purchase price of the car. Instead, it usually pays out the presumed market value of the car at the time of the claim. As this can be significantly less than the price you originally paid you could be out of pocket.

Total Loss Guaranteed Asset Protection (GAP) insurance covers you for this potential shortfall, thereby enabling you to buy a replacement car of the same specification, age and quality.

For example:

Original Vehicle Purchase price	Max GAP Payout	Policy cost
Up to £25,000	£10,000	£299.00
£25-£75,000	£20,000	£499.00

Cover is available for both new and used vehicle purchases, lasts for three years and must be taken out at the time of purchase.

WARRANTIES

Such has been the improvement in the quality control in the manufacturing process of new prestige cars that many now come with standard three-year warranties. Find out exactly what that warranty covers – there may be loopholes and exclusions that diminish its value.

So when purchasing a high-value car it is worth considering the benefits of a good quality extended warranty policy. For a small percentage of the purchase price you can reduce your exposure to future repair expenses. In addition, if the car has good quality warranty cover when you come to sell it, its value is enhanced.

But be aware that the sale of extended warranties is a valuable source of income for retailers in all sectors, not just the car industry. Car dealers may try to press an extended warranty on you at the point of sale when you are distracted by the big shiny toy you are buying. Be careful: you might be buying an expensive policy with inadequate cover, so shop around. Check what is covered under your motor insurance and breakdown policies, for example.

Typical cover

- Mechanical Breakdown Insurance: covers component failure and includes labour
- Roadside Assistance: covers recovery of the car and up to five passengers in the event of an accident or breakdown (including breakdowns not covered by the mechanical breakdown insurance policy) personal cover even when you are a passenger in other vehicles, and a 24-hour helpline in the event of an emergency
- Accident Legal Assistance: covers you for up to £50,000 of legal costs if your vehicle is involved in an accident which is not your fault
- MoT Test Insurance: covers the cost of the work necessary to rectify the faults that cause your car to fail an MoT test, subject to the limit in the policy document



CREDIT PROTECTION INSURANCE

If you feel you want to protect yourself against future changes in circumstance, such as accident, sickness, redundancy or death, you may want to consider taking out some form of payment protection insurance, either through the car finance company or as a standalone product.

With this type of policy the insurance company keeps up your credit repayments for a set period if you are unable to pay through illness or redundancy.

Policies vary widely in relation to cover, pay-out levels and qualifying periods, so take the time to review the small print or take professional advice.

Typical policy cover

- Accident or sickness: if you were to suffer any sickness or accident that stopped you from working
- Redundancy cover: if you were to be made redundant or permanently unemployed
- Life cover: lump-sum payment to clear outstanding debts if you were to die

FINAL CHECKLIST

Before you sign any agreement or take delivery of your new car, ask yourself the following questions:-

- Are you buying the car from a reputable dealer?
- Does the car have a service history (make sure you check thoroughly)?
- If you are buying privately, can the seller prove ownership of the car?
- Have you checked that there is no outstanding finance on the car?
- Have you considered an independent inspection of the car by a reputable company?
- Is the price of the car fair (look at adverts for similar cars taking into account car age, specification, and mileage)?
- Is there warranty cover on the car? If so, how long does it last and what exactly does it cover? If not, consider the potential benefits of an extended warranty.
- Have you been through all the funding options and chosen the scheme best suited to your financial circumstances?
- Are you confident that you understand the terms of any finance agreement and that you have chosen the product best suited to your needs?
- Are you confident that you can afford the repayments?
- Have you considered protecting yourself financially with insurance products, such as guaranteed asset protection and credit protection? (Explained within this booklet.)
- Have you considered taking advice to help you make the right decisions?

Note: This is obviously not an exhaustive list. There may be other points you should take into consideration depending on your individual requirements and circumstances.

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