Loan or Lease? Financing Your New Car

Choose the right one for you and drive away with serious savings

Aside from a home, a car can be one of our most expensive purchases, so careful thought and consideration need to be taken – especially when it comes to funding.

Firstly it's wise to note a few housekeeping considerations that could have a positive impact on your available loan or leasing options:

- **Take stock of your credit score –** Before even approaching a dealership, try to repay as many debts as possible to help improve your credit score. Ensure you also check your credit file for any errors to improve your chances of a loan approval.
- **Pay your biggest deposit –** If it's a new car, it will depreciate quicker than a used vehicle, so try to avoid owing more than what the car is worth. It might be worthwhile considering putting down as much as you can on a deposit.
- **Pay cash for miscellaneous costs –** If you include ad hoc costs such as taxes, 'extras', registration, sales tax, documentation fees etc. into your financing, you're increasing your loan amount and the amount of interest.
- **Going green may yield a discount on your loan –** You may be eligible for a discount on your loan if you purchase a green car[1].

What you need to know about loans and leases

Loans

Personal loan – For personal use, a personal loan from a bank or lending institute may be a good choice. The repayment period is generally fixed as is the interest rate and monthly repayment amount making it easy to manage your budget. Try to negotiate a short loan term. This may mean higher repayments, but you want to avoid paying unnecessary interest for an extended amount of time for what will essentially be a depreciating asset. Personal loans can be secured (where assets secure the loan, usually with a lower interest rate) or unsecured (where there is no security and often a higher interest rate). Depending on the age of the car you purchase, you may use the car as collateral to secure the loan.

Dealer finance – Dealer finance is generally seen as a more expensive option – this is when the dealer contacts their bank or lender of choice to arrange the loan on your behalf. However it is worth discussing this option with your finance specialist as there may be occasions when dealer finance is an appropriate option. Dealer finance can be convenient and fast but be aware that a dealer could potentially mark up the monthly repayments or interest rates. Be careful not to sacrifice responsible financial choices for the sake of convenience.

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Line of credit – A line of credit is an amount of credit (usually between $4K and $50K) extended by a bank or lending institution. You can access this line of credit as you need it and only pay interest on the amount you have borrowed. The approval process is similar to a personal loan and is often secured with your larger assets.

Lease

Car leases typically work on the principle that the vehicle is owned by the finance company and the borrower makes monthly payments to rent the car from the finance company.

There are four leasing options available:

Standard novated lease – If you are a salaried employee, the finance is paid by your employer using your pre-tax salary. This option can have significant positive tax implications, although it is worth remembering that you do not own the car at the end of the lease (unless you arrange to pay the residual). You will receive full income tax benefits for the novated lease and companies can apply off-balance sheet (OBS) finance on the lease.

Fully maintained novated lease – All the costs associated with the car – such as fuel and maintenance - are covered by the finance company. All these expenses are tax deductible. Of course, this convenience comes at a premium. If you take care of fuel and maintenance yourself, you will save money. It's also worth remembering that early termination for a fully maintained novated lease can be expensive if the employment agreement is terminated by either party prior to the term of the loan. Interest rates may also be higher for a fully maintained novated lease compared to a standard lease.

Finance lease – A common option for cars used for business purposes, a finance lease involves the financier purchasing the vehicle and renting it to the borrower who pays in monthly instalments. The instalments are generally fixed and can include maintenance costs. At the end of the lease, the borrower pays the residual amount to own the vehicle outright.

Operating lease – An operating lease functions in much the same way as a finance lease with one major difference – the borrower is not obliged to pay the residual value and does not own the car at the end of the lease. When the term of the lease is over, the borrower simply returns the vehicle. This option can be useful for cars used exclusively for business purposes.

As with all large financial purchases, it is always beneficial to speak to a finance specialist who can assess your assets, liabilities and credit rating to assist you in qualifying for a loan or choosing the most appropriate finance option to suit your unique financial circumstances.

1 *choice.com.au/transport/cars/eco-friendly/articles/green-car-loans*