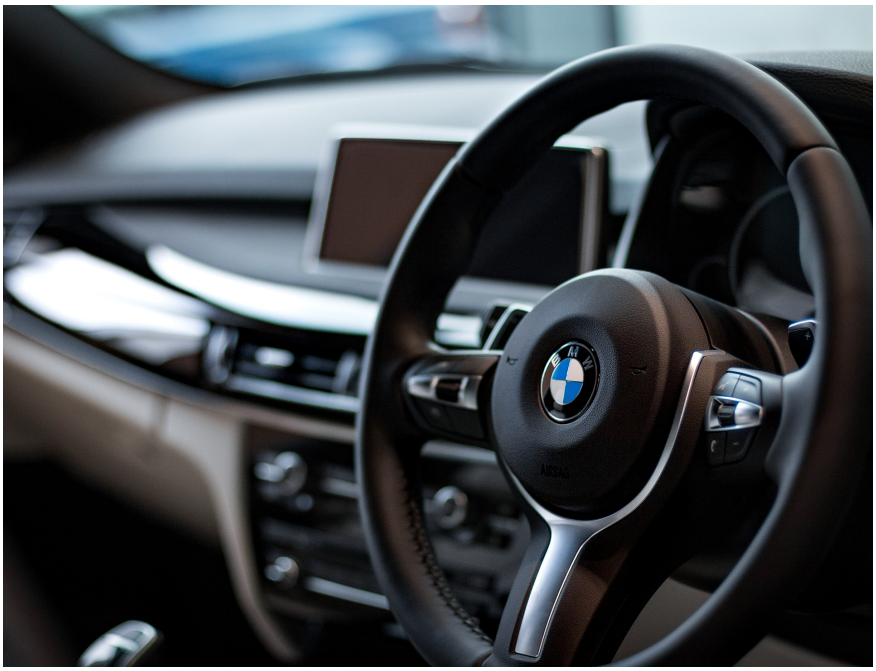
Avoid Car Financing's Pit Stops



Australians are by and large an unapologetic nation of car owners and car lovers. Whether it's our need to traverse vast open spaces, commute to work from distant satellite suburbs or simply our love of independence, cars do it for most of us.

That is right up until we need to replace our car. Then the nightmare begins. Ironically, after a bank account and a credit card, a car loan is usually the third financial encounter Australians have with our financial services system.

So Many Options

Question is, whether to go with a personal loan or is dealer finance a viable option? There are seemingly attractive great deals on offer, which on the surface, look fabulous until you read the fine print in the contracts. Then you discover that fine print could end up costing you more than the price of the original car!

Ironically, a generation ago when times were less complex, many parents advised their children to take out a car loan as a smart way to establish a credit rating.

Today, most of encounter car finance when we need to replace our old car. Even taking into consideration the added costs of interest and fees, taking out a car loan can be thousands of dollars cheaper than continuously repairing an old car that is on its last legs.

Effectively our options are two types of finance offered by car dealerships; dealer finance and factory finance from the car manufacturer. It's important to understand the tangible differences between these finance options and a traditional car loan or personal loan from a bank or credit union.

1. Dealer Finance

Most car dealerships will offer you on the spot finance. Car dealers rely on the instant gratification aspect of buying a car. We see it and we want to drive it home right then and there.

Whilst some car dealerships enjoy a financial tie-up with a mainstream bank, others do not. So, when exploring the attractiveness of dealer finance, there are several potential pitfalls to watch out for:

- Interest rates are typically higher than if you shopped around at a bank directly
- There are hidden penalties for early loan repayment. Often early repayment triggers payment of the full interest due over the full term of the loan
- Additions including insurance are usually bundled into the loan and are frequently far more expensive than if you shopped around on the market.

It is possible to negotiate and have those clauses deleted or amended to reduce the overall cost. Also always buy from a car dealer near the end of the month. Dealers are paid a commission on loans as well as the cars they sell and are often keen to cement their monthly bonus at the end of the month, making them far more inclined to be negotiable.

It is also possible to horse trade the upgrading of optional extras on your car worth thousands if it means the dealer makes their end of month bonus based on the sales and your loan.

2. Factory Finance

Car manufacturers frequently offer factory finance to boost sales of their vehicles. Rather than channelling the car's finance through the car dealership, the car manufacturer offers competitive finance.

Their interest rates are often low and frequently include insurance. Consequently, your repayments are also lower and at the end of the loan, there is a residual lump sum payment to be made or you are obliged to hand the car back.

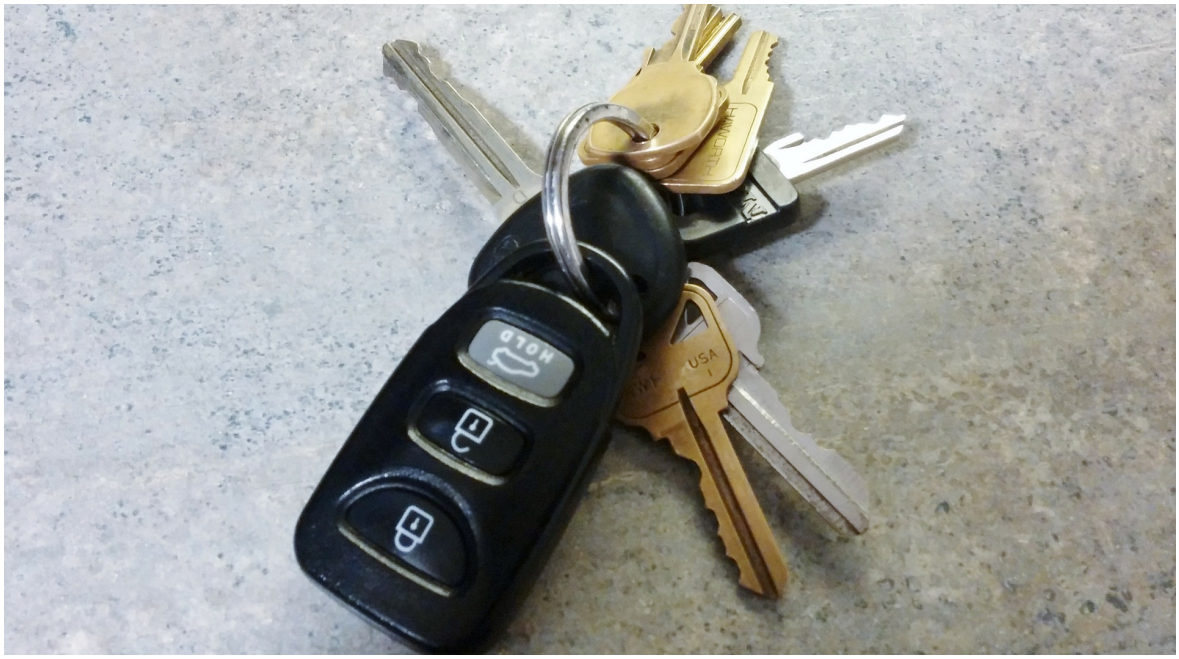
These cheap deals are usually restricted to specified makes and models, rather than the entire range of cars. The interest saved may often be less than if you negotiated a lower finance rate from a bank or credit union. So, while some are attractive on the surface, they are not always a fabulous deal.

3. Secured Car Loans Compared To Unsecured Car Loans

Car loans can take the form of either a secured or unsecured loan. With secured car loans, the lender takes out a lien on the borrower's asset, usually the car being purchased. However, some forms of secured car loans may place a lien on an alternative car or property the borrower owns.

A lien enables a lender to repossess the car if payments fail to be made as per the contract. The lien lowers the risk of a default for the lender and enables consumers to enjoy lower interest rates than they would with an unsecured loan.

Unsecured loans do not provide lenders with security. Instead, lenders have to recover the loan through other legal avenues. This increases their costs and the interest rates on many unsecured loans reflect this increased risk factor.



4 Potential Car Loan Crashes To Avoid

If you're considering purchasing a car, but can't pay for it in cash, you may need to finance your new car through a car loan. Car loans are common and the finance market is highly competitive.

However, look out for these four potential car loan crashes to avoid:

1. Buying A Car You Can't Afford

If you grapple with regularly making your car loan payments, you run the risk of damaging your credit rating through missed payments or a default. The higher the loan, the more it may negatively impact your credit score.

Loading yourself up with debt on a depreciating asset like a car is never a sound financial strategy.

2. Missing a Payment

Car loans are not credit cards. Most car loans are secured against the car while credit cards are typically unsecured. This means your car is your collateral against the car loan. If your car loan defaults, your car will almost certainly be repossessed. Assuming you make regular payments for a few years, the bank may

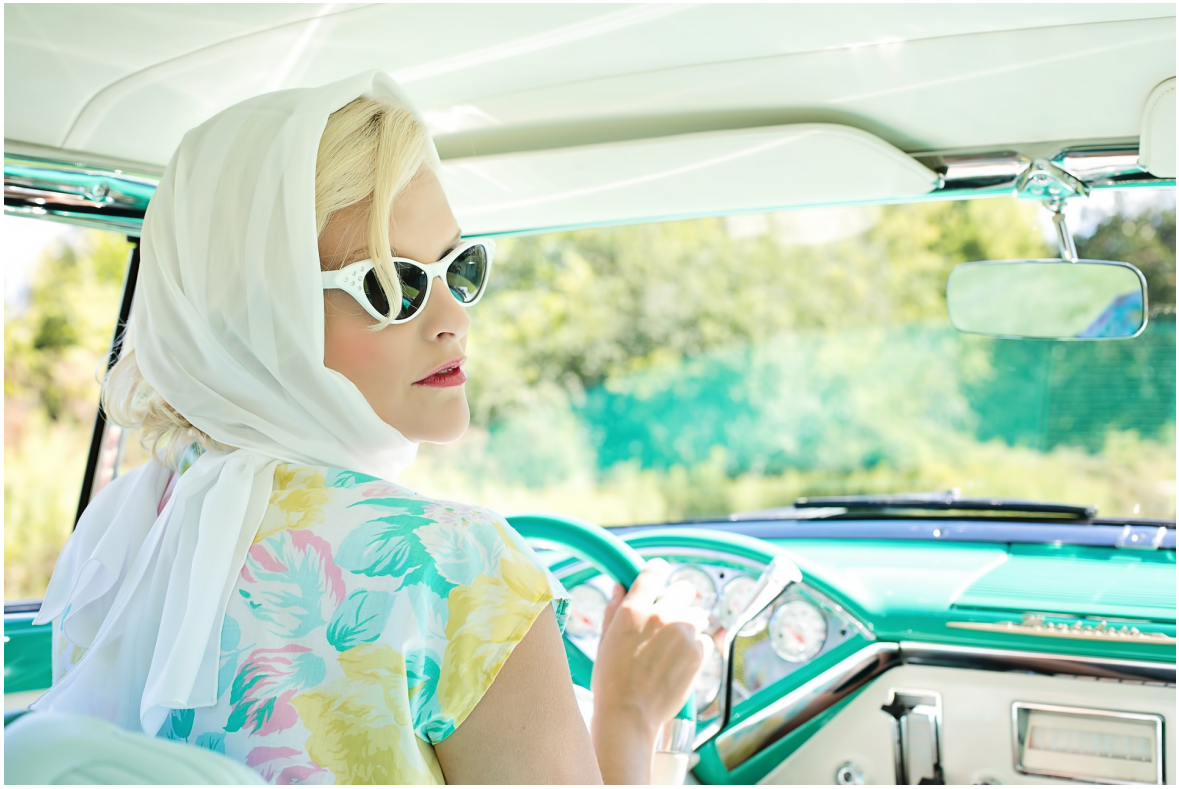
let be lenient with a single missed monthly payment but making a habit of it could result in your car being repossessed.

3. Not Understanding The Implications Of Compound Interest

When you finance a car, you pay car loan interest over time. That means over the life of the loan, you pay more to own the car than the agreed-upon purchase price of the car.

4. A Loan Balances That Exceed The Vehicle's Value

If you take out a long-term car loan, the payments may seem more affordable but your payments will not be applied to paying down the principal as promptly as you would with a shorter-term loan. This is significant if you crash your car or need to sell it, as you may find you still owe more on the loan than the car is worth. Always opt for a maximum loan term of five years or preferably less.



Final Observation

Financing a car can be done reasonably as long as you are prepared to shop around for finance and insurance and scrutinize potential loan contracts. Never buy a more expensive car than you can afford, be aware of the effect of compound interest on your car loan, ensure you never miss a payment and where possible always pay off your car loan in five years or less. Understanding what to look for, what to negotiate on and the differences between the different types of loans, can save yourself thousands, secure a great deal and put you in the driver's seat of the car of your dreams!

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