

Car loans



Factsheet

August 2011

Apart from your home, a car is one of the biggest single purchases you're ever likely to make.

If you don't have the cash to pay for it upfront, you'll need to borrow money. And, depending on the type of car you choose, you could be paying off your loan for some time.

So don't let the thrill of owning a car get in the way of making good financial decisions.



Richie found it pays to shop around

Richie went into a car dealership to look at a red sports car. It was sleek and very very fast. Richie went for a test drive and just had to have the car. He got all the optional extras and then the car salesman arranged a loan for him. Richie drove away from the dealership with a loan for over \$45,000 and an interest rate of 22% per year. When he got home he spoke to his dad and realised he had paid way too much for the car and the car loan was very uncompetitive.



How do car loans work?

- ▶ A **car loan** is a personal loan for the specific purpose of buying a new or used car. You borrow an amount of money that you agree to repay within a certain period of time (called the **term**). This can vary, but is usually 12 months to 5 years. You will have to sign a credit contract which will specify the amount borrowed and how you will repay it.
- ▶ You pay interest on the amount you borrow, which may be at a **fixed rate** (where the interest rate is locked in for the term) or a **variable rate** (where the rate may go up or down over the term), plus any fees and charges. While a fixed rate loan offers the benefit of set repayments, if you want to make extra payments from time to time, and pay out the loan early, you may be charged an early termination fee.
- ▶ A car loan may be **secured** or **unsecured**, depending on whether you put up your car (or other asset) as security for the loan. With a secured loan, you usually pay a lower interest rate than for other kinds of lending – but it also means that if you fall seriously behind on your repayments, your credit provider has the right to sell your car (or other asset) to get their money back. Secured loans are usually only available for newer cars, because they are more valuable as an asset. With an unsecured loan, you do not need to **mortgage** your car as security, but you will likely pay a higher rate of interest because the credit provider is taking a bigger risk.
- ▶ If you buy from a car yard, the car dealer might offer to arrange finance for you. While dealer finance might seem more convenient, it's usually cheaper to get a loan elsewhere. Banks, building societies, credit unions and specialist lending and leasing companies also offer car loans, so check out what's on offer.



Choosing a car loan

	How it works	What to watch out for
Secured loan	<ul style="list-style-type: none"> You offer an asset, such as the car you are buying, as security or collateral for the loan. 	<ul style="list-style-type: none"> If you don't make repayments, the credit provider can repossess and sell your asset to get their money back (without going to court). The age of your car will affect its resale value. If your car is sold for less than you owe, you can end up having to pay the credit provider the difference.
Unsecured loan	<ul style="list-style-type: none"> You do not need to have an asset to offer as security. Unsecured loans are usually harder to get, as you need to convince credit providers that your credit worthiness and financial position are good enough for them to give you a loan without you having an asset to sell if you can't pay your debt. 	<ul style="list-style-type: none"> If you fail to repay the loan, the credit provider can still take you to court in order to sell your property and recover the money. Interest rates are usually higher than for secured loans, since the credit provider is taking a bigger risk.



TIP

Interest rates and fees and charges can stack up, so do your homework before you sign up for a loan.

Shopping around for the best deal

Get the best credit deal before you buy	<ul style="list-style-type: none"> Be sure to get the best credit deal. This is as important as getting the best price on the car. By shopping around for credit first, you can find the best deal for you without your mind being distracted by that new set of wheels. Check out your loan options before you go shopping for your car. Many credit providers will give you in principle approval for a loan before you find your car, so that you know exactly how much you've got to spend and you'll only have one high-pressure decision to make at the car dealership. Beware of getting a car lease when you really wanted to get a loan. With a lease you rent the car for an agreed period of time, but do not have a right or option to purchase the car. At the end of the period, the lease is terminated and the car sold. You could make an offer for the car, but you will usually need to come up with a large sum of money to buy it – and the credit provider does not have to accept your offer. So, if you want to own the car, do not get a lease.
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Shopping around for the best deal

Budget for the full costs of owning a car

- ▶ Before you get your loan, budget for the full costs of owning a car. There are **annual fees** for registration and insurance. You may also choose to join a motoring organisation for roadside assistance. On top of that there are **ongoing costs** like petrol, repairs and maintenance – even road tolls.
- ▶ You might decide to get **third-party property insurance** or full **comprehensive insurance** for your car. Third-party property insurance covers you for damage to other people's vehicles or property that is not covered by your compulsory **comprehensive third party** (CTP) insurance. Full comprehensive insurance also covers you for damage to your own car.
- ▶ While insurance can be expensive, think how much not having it could cost you later if you have an accident. But make sure you shop around for the best deal – it is often cheaper to arrange your own insurance, rather than going through the car dealership. Be aware that if your car loan is secured by a mortgage over your car, you will usually need to get comprehensive insurance for your car.

Watch for add-ons and only pay for those you need

- ▶ Be careful of **loan protection insurance** sold as an add-on when you get the loan. With this type of coverage, the insurance provider pays or contributes to your loan repayments if you are unable to work due to injury, sickness or involuntary unemployment. In the event of your death, life cover will repay your outstanding loan balance. This type of insurance is usually poor value for the cost, so shop around.
- ▶ Some car dealers also offer **gap cover** (or **shortfall insurance**). If your car is stolen, written off or damaged beyond repair before you have paid off your car loan, this insurance is designed to cover the 'gap' between the market or agreed value that your comprehensive insurer pays and the amount needed to pay out the remainder of your loan (up to a specified limit), plus some additional costs. Think carefully about whether you need this additional coverage and make sure you shop around.
- ▶ You may also be offered an **extended warranty** (also called **mechanical breakdown cover**). This is really extra insurance, to cover the costs of unexpected mechanical repairs, parts and labour (with the exclusion of normal wear and tear). But before buying an extended warranty, make sure it is really worth the money. Does the extended warranty offer more protection than the warranty that comes with the car? When does the extended warranty start? Are there any important restrictions or conditions? Check that the benefits are worth the extra money and that the extended warranty does not simply repeat items covered under the warranty that comes with the car.
- ▶ You do not have to take up any of these extra options if you don't want to, and car dealers must not mislead or deceive you about the real benefits of additional insurance coverage or your need for it. Always check the **terms and conditions** of any additional coverage, as they may vary from those included in your comprehensive insurance coverage. Take your time to work out what you really need and don't let a pushy salesperson pressure you into making an on-the-spot decision.

Only sign a business purpose declaration if you are really using it for business

- ▶ Do not sign a **business purpose declaration** unless you are really using the car for business and are eligible to claim your payments as a valid business expense for taxation purposes.
- ▶ By signing a business purpose declaration, you may lose valuable rights under the credit law.



Six steps to smarter borrowing

Step 1.

Work out if you can afford to borrow

- ▶ Before you borrow, use our **budget planner** at moneysmart.gov.au to see exactly where you are spending your money and how much you can afford in repayments.
- ▶ If your job is not secure, it may be better to build up a bigger deposit before getting a loan.
- ▶ Save up as much as you can, so you can borrow less and save on interest.
- ▶ Remember to allow for interest rate rises and anything that might affect your future income (such as changing jobs).

Step 2.

Shop around for the best deal

- ▶ If you decide to borrow, take time to compare interest rates, product features, and fees and charges. Even a small difference in the interest rate can make a big difference to what you have to pay.
- ▶ Shop around online to **compare products** or use our multi-loan calculator at moneysmart.gov.au.
- ▶ Research published by the independent consumer group CHOICE can also help you find the right product for your needs and budget – see choice.com.au.
- ▶ If you want to borrow a small amount (less than \$5,000), you may have difficulty getting a loan from a bank or other mainstream credit provider. Some credit providers offer small personal loans in return for comparatively high interest rates and fees. See our factsheet *Payday loans and other high-cost credit* at moneysmart.gov.au for what to watch out for with these kinds of loans.
- ▶ Check the **terms and conditions** of your car loan before you go ahead, so you know exactly what you're getting into – including penalties for missed repayments or for paying off a loan early.
- ▶ If you feel like you're being pressured into signing something you're not sure about, take more time to think things through. See our tips for resisting pressure selling at moneysmart.gov.au.

Step 3.

Know who and what you're dealing with

- ▶ Anyone who wants to engage in credit activities (including brokers) must be licensed with ASIC, or be an authorised representative of someone who is licensed. If they aren't, they are operating illegally.
- ▶ There is currently an exemption from licensing for credit assistance provided through some businesses (for example, retail stores and car yards). While the store may be exempt, the actual credit provider must still be licensed. If you are unsure who the credit provider is, ask the person you are dealing with to point out the name in your credit contract.
- ▶ To find out if a credit provider is licensed, visit moneysmart.gov.au or call ASIC's Infoline on 1300 300 630.
- ▶ Anyone engaging in credit activities (for example, by providing credit or assistance to you) must give you either a **credit guide** (with information such as their licence number, fees and details of your right to complain) or a written notice with details of your right to complain about their activities.



Six steps to smarter borrowing

Step 4.

Keep up with your repayments

- ▶ Keep your repayments up-to-date to avoid being charged any penalty fees.
- ▶ Make extra payments when you can to save on interest (provided there is no penalty for doing this).
- ▶ Make sure you keep the car **comprehensively insured**. If you have a secured loan for your car, you will usually need to get comprehensive car insurance. But whether your car is security for your loan or not, accidents and thefts do occur and you do not want to be left with no car and a large loan still to repay.

Step 5.

Get help if you can't pay your debts

- ▶ **Act quickly** if you are having trouble making repayments. It may be difficult to face the problem, but ignoring it will only make things worse.
- ▶ If you can't make the full repayment, pay what you can. Contact your credit provider without delay.
- ▶ If you are experiencing financial difficulties, you have the right to apply to the credit provider for a **hardship variation**. If the credit provider refuses, you can complain to its independent dispute resolution scheme (see step 6 below).
- ▶ There are places you can go for help – visit **moneySMART.gov.au** for sample letters and information about support services such as financial counselling and legal assistance, call the National Debt Helpline on 1800 007 007 or ASIC's Infoline on 1300 300 630.
- ▶ See our factsheet *Can't pay your debts?* at **moneySMART.gov.au**.

Step 6.

Complain if things go wrong

- ▶ Try to resolve your problem with your credit provider first.
- ▶ If you aren't satisfied, take your complaint to your provider's **independent dispute resolution scheme**. This will be either the Financial Ombudsman Service (FOS) at **fos.org.au** (call 1800 367 287) or the Credit and Investments Ombudsman (CIO) at **cio.org.au** (call 1800 138 422).
- ▶ If you think that a credit provider has acted unlawfully or in a misleading way, you can complain to ASIC online at **asic.gov.au** or call ASIC's Infoline on 1300 300 630.



moneysmart.gov.au

ASIC Infoline: **1300 300 630**

Disclaimer

Please note that this is a summary giving you basic information about a particular topic. It does not cover the whole of the relevant law regarding that topic, and it is not a substitute for professional advice.

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