The Solution Loans Guide to Car Finance

If you're looking for a new car, there are a myriad of ways to finance it - from bank loans, to finance packages offered by the dealership, to hire purchase agreements. In recent years there has been a huge growth in the number of Hire Purchase (HP) and Personal Contract Plans (PCP). Both of them allow people who would otherwise be unable to afford a new car to drive the vehicle of their choice for a series of monthly payments regardless of their credit history.

How Hire Purchase works

Under HP, a motorist chooses their new vehicle and it is bought from the car dealership by the finance company. The lender then owns the car and the motorist hires it by making a series of monthly payments. Once the final monthly payment is made, the lender transfers ownership of the vehicle to the motorist who is then free to keep it or sell it. HP is generally more expensive than PCP because the motorist will eventually own the vehicle. Under PCP the motorist has to make a final 'balloon' payment to gain ownership of the car.

How Personal Contract Plans work

A PCP is a leasing arrangement between the borrower and the finance company. The motorist chooses a new vehicle and the lender then buys it from the dealership. The motorist will decide how big a deposit he or she can afford and then the vehicle is leased back in return for a series of monthly payments. The larger the initial deposit the lower the size of the monthly payments will be.

At the end of the leasing agreement - provided all the monthly payments have been made - the motorist has the following options:

- handing back the vehicle without incurring any additional financial cost
- part exchanging it for a another car under a new PCP deal
- purchase it outright with a final 'balloon' payment. The size of the balloon payment is made clear at the start of the leasing agreement.

PCP is normally cheaper than HP because the motorist is not working to own the vehicle unless he or she chooses to make the final balloon payment. There are other advantages to PCP, not least that many arrangements include vehicle maintenance.

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Why should I consider one of these car finance deals?

The outright purchase and then the running and maintenance of a new car can be too expensive for many people. HP and PCP agreements have made driving a new car a reality for millions of people in the UK. They offer a route to reduced monthly costs compared to bank loans or dealership finance. You may not want to own a car outright or you may have a less-than-perfect credit history meaning that bank loans and dealership finance are unattainable. In both of these cases, PCP and HP might help you drive the new car of your choice.

Choosing one of these schemes will free you to concentrate on finding the right car for you. You can choose your own dealership (as long as it is reputable) or you can use one of the finance company's preferred network of dealers. You don't even need a part exchange vehicle or deposit because many finance companies will fund the entire purchase of your new car.

What are the downsides?

Both PCP and HP are credit agreements and you should ensure that you can afford the monthly payments before entering into one of them. Because you don't own the car outright until the final or balloon payment is made, if you fail to keep up with repayments then you could end up having the car repossessed. The typical interest costs of both of these forms of finance are higher than taking out a personal loan and buying the car outright.

Under PCP, you have to estimate your annual mileage at the start of the credit agreement. Should you end up doing more miles than your initial estimate, then you'll have to pay a penalty charge for every mile over your estimate. This could be as high as 10p per mile meaning that you might have to pay a substantial penalty that you didn't originally budget for. Finally, when you hand back the vehicle at the end of the agreement, you may have to pay for any damage to it to be repaired.

Conclusion

Both Hire Purchase and Personal Contract Plans bring the ability to drive a new car every two or three years to millions more people than personal loans or dealer finance packages. There are a large number of options available with lenders able to finance cars from £1,000 to £75,000 and repayment plans stretching from one to five years.

For the online version of this guide visit www.solution-loans.co.uk/car-finance/guide/

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