



Low interest car finance is it really what it seems?

In today's new car market, we are seeing low rate finance deals being offered by an ever increasing number of car dealers. Rates as low as 0.50% have been available in recent times.

Before you rush out and sign on the dotted line, it's important to understand what is happening behind the scenes with these low rate finance packages.

Firstly, there is no doubt the interest rate being advertised to finance the vehicle purchase is legitimate. However, these finance offers are typically part of what the industry calls a 'subvention' finance program as the interest rate for the finance package is being subsidised by the dealer or manufacturer out of the profit made on the sale of the car.

Let's look at a simple example to illustrate how subvention works.

Assume you purchase a new \$35,000 car which is being sold in conjunction with subvention finance at an interest rate of 1.9%. The loan term is 48 months with a nil residual at the end of the contract.

Depending on the lender who is providing the finance, the 'subvented' amount in this scenario may be anywhere between \$2,500 and \$2,900.

In other words, once the transaction has been finalised, the car dealer or manufacturer must 'pay' the subvented amount to the lender to enable a realistic rate of return to be made on the finance contract.

Ever noticed why a car dealer is less likely to discount the price of a car being sold subject to subvention finance?

It is now clear that the dealer needs to make a larger margin on the car to be able to pay the subvented amount and maintain their normal margin. You may have otherwise been able to negotiate a larger discount to the asking price if the purchase was not subject to subvention finance.

Remember: The higher the purchase price of the car, the more you will pay for items such as GST, stamp duty and potentially luxury car tax.

A more prudent approach is to negotiate a cash sale with the car dealer leaving the low interest rate finance offer out of the equation. It is not unrealistic to obtain a discount of approximately 8% to 10% off the asking price if it is not subject to such finance arrangements.

We often find that once a discounted purchase price has been negotiated, our clients who arrange finance through us at 'normal' market rates typically end up paying lower monthly repayments (thus lower total repayments) over the term of the finance contract than they would through obtaining subvention finance.

The old maxim that 'there is no such thing as a free lunch' certainly applies to low rate car finance deals.



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