FINANCIAL SNACKS

When hire purchase loans can help

At current rates, it may make more sense for you to lengthen or increase your hire purchase loan. It may put more money into your pocket, writes JOYCE CHUAH

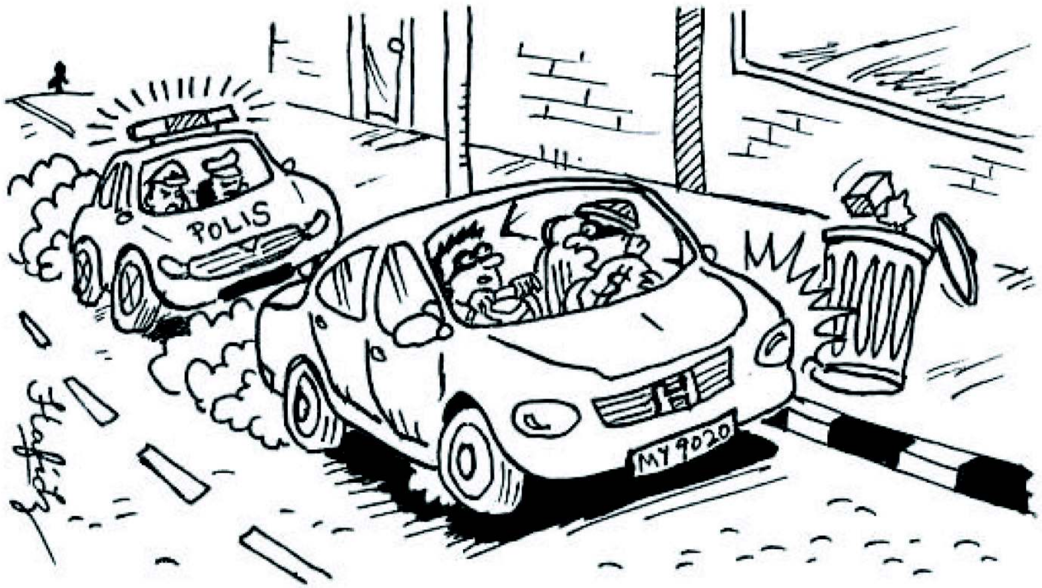

Illustration by HAFIDZ MAHPAR

"Hey, be careful! I haven't even finished paying the loan on this car yet!"

MOST of us buy our motor vehicles using hire purchase. I remember being told to buy it using cash if I could afford it or at least, minimise the loan tenure so that I will eventually pay less interest on my car.

True. However, have you noticed something different lately? Do you know that the average percentage rate for our hire purchase loans (APR or "the effective rate") is almost as low as your mortgage rates these days? What does that mean?

Firstly, it means you can afford to lengthen your hire purchase loan and lower your monthly repayment amount. Although it means eventually paying more interests on your car, a lower monthly repayment amount frees up some cash that can be stashed away in an investment portfolio. For example, a bond portfolio can provide 5% to 6.5% p.a. return. Compare this with your average APR of 4.3% to 4.8%; you are still positive on your cash flow over the seven to nine-year HP tenure. If you add some local or Asian equities into your investment account, returns can be driven higher to 8% to 12% p.a. or more.

Secondly, you can free up your cash which you intended for a bigger deposit on your car to clear some older loans which have a higher interest rate than your hire purchase APR. For example, your approved hire purchase loan is RM100,000 at a rate of 2.33% for seven years. The effective rate works out to be 4.38%. You have an old mortgage loan at BLR-0.2% = 6.4%. If you had intended to only take RM50,000 hire purchase loan, you're probably not putting money into your pockets.

A better way is to take the RM100,000 hire purchase loan which has a fixed APR and utilise it to pay off or reduce a more expensive loan. This may mean eventually paying more for your car, but you have also reduced the interests on your more expensive mortgage via capital repayment. The net effect on your pocket between these two is still positive.

A word of caution though – your cashflow must be able to support your higher hire purchase commitments. Speak to a financial planner before you commit to a debt management plan such as this.

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