MONEY

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CAR CONTRACT DEALS

Low upfront costs make PCP look good, but the terms could drive you bananas if you don't think before signing, writes *Linda Daly*

A car bought under PCP may not have a mind of its own like Herbie, but it won't belong to you either, and when the plan ends you may decide to give it the heave-ho

How to steer clear of perils of hire purchase

Right now, you can get your hands on a new Ford Fiesta for as little as €176 a month. There will be a few catches when you leave that showroom, however. Chief among them that is you will not own the car. You will have paid a deposit of about €5,000 but for the first two years (25 months) you will be renting the vehicle at a cost of just under €11,800.

At the end of the two years you have three options. Option one is that you return the vehicle and start taking the bus. Under option two, you keep your Ford after paying a balloon payment of €8,300 – at that stage you'll become the owner of the car. With option three, you renew the Ford Fiesta for the latest model or an even better one, by entering into a new personal contract plan (PCP).

This is one of Ford's current options for PCP, a type of hire purchase agreement, which it offers to buyers on a two- or three-year basis.

Michelle Perry, 38, had just moved back to Ireland from the UK in 2016 when she opted to buy a car from Audi through PCP. For a €4,000 deposit – 10% of the value of the car – and a €488 monthly payment over three years, she was able to walk away with a brand new 161 Audi A4.

"That suited me because I had just bought a new place and wanted to invest as much money as I could into that," she said.

Perry has already made her mind up about which route to take in 2019, when her three-year PCP term ends: she will hand the car back.

"I'll then decide if I want to opt for a brand new car or a second-hand car," she said. "I don't expect to have the €18,000 for the balloon payment at that stage but I do expect to have more savings and more options for how I want to finance my next purchase."

A contract killing?

PCPs are quick and easy to arrange, generally require small deposits – usually between 10% and 30% – and usually have low monthly payments attached. The initial repayment terms tend to last three to five years. Ford Ireland now offers a two-year plan.

Volkswagen, which has its own bank and provides finance to other dealers, has a 0% PCP rate. Ford Ireland offers two- and three-year PCP deals at 3.9% APR, backed by Bank of Ireland.

Since the start of the year the total number of Volkswagen Group Ireland vehicles (that includes the Audi, Sea and Skoda brands) registered is 24,187, of which 7,000 (28.9%) are covered by a PCP.

Mark Whelan, communications manager at the price comparison website Bonkers.ie, said customers should consider the expected overall cost of the PCP deal and the alternative of a traditional personal loan before signing on the dotted line.

"If a customer doesn't think they will buy the car at the end of the contract, they should be prepared to walk away with nothing to show for it," said Whelan.

"At least with a personal loan, a borrower gets to hold on to the value of the equity they've built up in their car. This can be particularly beneficial if some unexpected financial difficulty should arise and the car needs to be sold."

A car loan of between €2,500 and €25,000 over three to five years would have an APR of about 6% to 15%, depending on the organisation with which you're taking it out. Some credit unions offer rates as low as 6%.

"I would suggest that if you want to own a car, it's not for you," said Frank Donnellan, managing director of First Auto Finance, a dealer-focused motor finance provider. "If you're doing high mileage, it's probably not for you. If you want a brand spanking new car every three years, it's worth serious consideration."

Donnellan added: "There's been an awful lot of positive press in the past three years for PCP but in the past month there's been a lot of negative press. We're not driving anybody into PCP."

The Consumer and Competition Protection Commission encourages buyers to do their due diligence before committing to PCP. It has raised concerns about the plans with the Department of Finance and the Central Bank of Ireland.

The commission wants to ensure that customers are not being misled or badly advised when they enter the contract. It fears that people are getting their hands on luxury cars on the never-never.

Aine Carroll, a spokeswoman for the commission, said when consumers looked at different finance options, they focused solely on monthly payments.

So far this year, the commission has fielded 37 calls from consumers about PCP, the majority of which have been on the subject of consumer rights. The organisation has made PCP a priority campaign for 2017, just as the first wave of contracts taken out in 2013 and 2014 start to mature.

The commission believes that PCP agreements are "among the least flexible forms of finance", with repayments fixed for the term of the agreement.

Protecting the value of the car

Donnellan said PCPs could be beneficial to buyers as the "only finance product that you can get that protects the value of a used car if the value falls. You won't get it with the credit union or with a bank loan".

The dealer may offer you a guaranteed minimal value, yet some consumers may be holding the belief that the car will be worth more than that in three years' time and thereby finance the purchase of their next car. This may not be the case.

Carroll warned values could be eroded by a drop in second-hand prices because of future higher taxes on diesel cars, for example. Weaker sterling is also driving up the number of imports from the UK.

John Byrne, legal and public relations manager at the vehicles records website Cartell.ie, said if the manufacturer had guaranteed a certain price but values dropped, the company, not the consumer, would take the hit.

The conditions

For your car to meet the guaranteed minimum future value, it would have to meet the fair wear-and-tear standards and the agreed annual mileage.

"If you go over what is in your contract, you will have to pay per kilometre," said Carroll. "It's quite a forensic analysis of your usage."

For example, if you had agreed that you will drive 15,000km a year but you have driven 16,000km a year, at the end of the three-year contract you will owe your car dealer money. In Ford's case, you will have to pay 6c a kilometre, so that would work out at €180.

Ford uses a points method to evaluate the amount of damage done to your car. With its cheaper models, such as Ka and Fiesta, it charges €40 per damage point. With its more expensive ranges, from the Focus to the S-Max, it's €50 a point.

Over the three-year contract, you'll have to get the car serviced at a Ford dealership. If the car is involved in an accident you will have to return it to its "pre-accident" condition.

Perry, an engineer, works from home a lot so her mileage on the car is not high. "Audi did offer me three additional extras at the time; one was to protect the alloys on the car at an extra cost of €399 for the three years.

"One was to cover the cost of cleaning any spillages, and the third was cover that would make up the difference in my PCP payments and insurance cover in the event of a crash. I chose the third option. My first scratch [to the alloys] was within the first three days."

Rival views

Some credit unions offer finance to cover balloon payments on PCPs. Emmet Oliver, head of marketing and communications at the Irish League of Credit Unions, wrote by email that, crucially, on a PCP your options are restricted while you are still "hiring" the car.

"Should your financial circumstances change and you find you can no longer afford the monthly repayments, you cannot sell the car to pay your debt. It is not yours to sell. In contrast, with a personal loan from a credit union, the consumer borrows the money to pay for a car, which they own immediately, and which they can sell at any time.

> If you can't afford the repayments, you cannot sell the car. It is not yours to sell

MARKET MOVER GAUTAM BATRA

Gautam Batra is head of investments at Mediolanum Asset Management Limited (MAML), which is one of the investment arms of the Italian banking group Banca Mediolanum SpA MAML, which has offices in Ireland. It manages €37bn in assets entrusted to it by Mediolanum International Funds Limited (MIFL). Both MAML and MIFL are subsidiaries of the Italian banking group.

Batra joined MAML in June 2015. He has spent 25 years working in the asset management industry. Previously, he led client investment propositions of Citi Private Bank; he co-founded the ultra-high net worth investment boutique Signia Wealth, and he created the high net worth and mass affluent propositions at Royal Bank of Scotland (Coutts).

Investment philosophy

Mediolanum manages a range of funds in Ireland, which are registered for distribution in Italy, Spain and Germany. They are managed in line with Mediolanum's proprietary Med³ investment process, which is based on the "premise of active investment and that capital markets are not perfectly efficient in the short or medium term".

"MAML's investment process has built cognitive optimisation into the process to avoid behavioural biases evident in investment decision-making in asset management," said Batra. The firm is able to adapt to changing market conditions by constantly evolving the existing investment process.

Performance

Batra said MAML's broad range of products allows the company to deliver a diverse range of return streams to clients to build their investment portfolios.

"Two of our most popular actively managed funds are multi-asset fund-of-funds: Mediolanum Best Brands Premium Coupon Fund and the Mediolanum Best Brands Coupon Strategy Fund," he said.

In the last three years the Premium Coupon fund, with a typical asset allocation of 30% in global equities and 70% fixed income, has paid annually a dividend of 2.5%. The Coupon Strategy fund, with a historical asset allocation of 60% global equities and 40% fixed income, has generated an annual dividend of at least 3.75%.

Buying and Selling

Global equity markets have enjoyed strong gains in recent months in local currencies, buoyed by improving global economic growth.

"Technology stocks have led gains this year with the likes of Amazon and Google parent, Alphabet, fast approaching the $1,000 (€896) per share milestone.

Defensive sectors such as high-dividend paying utilities have also been able to command a premium in a continuing low interest rate environment."

Outlook

The outlook for risk assets remains relatively favourable when compared with fixed income securities, despite investor concerns regarding higher valuations, according to Batra.

"Our robust investment process means that we stress-test all of our decisions such that we can outperform in positive markets. It also means we can gain insights to provide ample warning to change our positioning and provide downside protection when needed."

Gary Connolly

Investing your cash is easy – true or false?

This column, and others like it, assumes a level of financial knowledge that may be unwarranted. A recent Organisation for Economic Co-operation and Development (OECD) financial literacy survey asked seven questions.

Here are three of them.

1: High inflation means the cost of living is increasing rapidly. True or false?

2: It is usually possible to reduce investing risks by buying a wide range of stocks and shares. True or false?

3: You put €100 in a savings account that earns 2% annually. How much would there be at the end of the year – €100, €102, or €120?

The answers: true, true, €102.

You may consider these to be basic questions, but of the 51,650 adults surveyed just 56% achieved the minimum target score of five correct answers.

Some 78% correctly answered the first question; one in three didn't realise you could reduce risk via diversification. Astonishingly, 42% of people were unable to calculate what 2% interest for a year delivered on a €100 deposit.

Thirty countries were included in the survey; Ireland wasn't one of them, but the UK was, scoring below the overall average. I have mixed feelings towards the survey results.

In terms of general financial knowledge, I'm concerned. Findings from the US confirm that low levels of financial literacy are associated with the usage of high-cost products such as pawnbrokers or payday lending. Surveys show those with the lowest levels of financial literacy are overwhelmingly more likely to use these kinds of products even when cheaper products are available to them.

In addition, failure to plan for retirement and lack of participation in the stock market are both linked to ignorance of basic financial concepts. Those who are financially literate tend to hold a more balanced portfolio, tend to be more aware of issues around the need for proper pension planning, and tend to be more financially resilient.

So there seems to be a strong argument for the state to ensure its citizens are as financially literate as possible.

I take a more sanguine view in relation to the OECD survey as it relates to the more complex area of investing.

Investment markets are one of those intricate areas where a little bit of knowledge can be more dangerous than no knowledge at all.

The great menace in investment markets, according to renowned psychologist at Cornell University David Dunning, "is not ignorance, but illusion of knowledge".

Self-perceived expertise causes people to think they know more than they really do, leading to uninformed financial decisions with potentially devastating consequences.

The advice trotted out to would-be investors by advisers is usually some variant of the glib "take a long-term view". The long term is not where life is lived. The long term is made up of a series of short terms. Plenty of investors commit to investing for a 10-year period, but behave as though this were made up of 20 six-month periods.

To get to the long term, it is important that you survive all of these short-term periods along the way. That advice is easy to articulate but difficult to follow because of psychological constraints.

It's quite clear that deposit interest rates being close to zero have propelled a sense of urgency among investors. In addition, investment product providers seem to be embedding products with increasing complexity, making the job of deciphering value ever more difficult.

The lessons from the three opening questions are simple: be mindful of the impact of inflation on your returns, reduce risk by diversifying and watch the proceeds snowball over time due to the magic of compound interest.

Simple? Yes. Easy? Not in my experience.

> The great menace is not ignorance but illusion of knowledge

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