



THE ASSOCIATION OF BANKS
IN SINGAPORE

Car financing

What you
should
know...

An initiative of



MoneySENSE

A National Financial Education Programme for Singapore

A. Car Financing Under Hire Purchase

When you obtain a car loan from a bank, you are entering into a “hire purchase”. This is an extended repayment scheme for the car. You can use the car once you have paid a deposit, but the bank owns the car until you have paid up all amounts owed.

B. Banks’ Terms And Conditions For Financing Your Car

The terms and conditions will depend on the price of your car. To determine whether a car falls under the Hire Purchase Act (HP Act), the bank will compute the net cash price of the car by taking the purchase price less any discounts and the value of the COE.

Illustration 1 – Computation of Net Car Price

Purchase Price of Car		\$80,000
Less		
Discounts	\$ 500	
Value of COE	\$32,500	
		(\$33,000)
Net Car Price		\$47,000
(to determine if the loan falls under the HP Act or Common Law)		

If the price is equal to or below \$55,000, the terms and conditions of the loan will be in compliance with the HP Act.

Price of car (excluding COE) \leq \$55,000

- Terms and conditions come under the HP Act.
- Interest is computed on Flat Rate Basis

Price of car (excluding COE) $>$ \$55,000

- Terms and conditions governed by Common Law
- Interest may be computed on Flat Rate Basis OR Monthly Rest Basis

Please check with your bank for the terms and conditions applicable to your car loan.

C. Computing Interest On Flat Rate Basis

A flat rate basis means that the interest rate, and therefore the amount of your monthly instalment, remain the same

throughout the duration of the loan. This protects you against interest rate fluctuations.

Illustration 2 – Computation of Interest Payable

Suppose you take out a loan of \$30,000 over 5 years at an interest rate of 2.6% p.a. The computations would be as follows:

- (i) Total interest payable over 5 years
 $\$30,000 \times 2.6\% \times 5 \text{ years} = \$3,900$
- (ii) Monthly instalment
 $(\$30,000 + \$3,900) / 60 \text{ months} = \565

D. Computing Interest On Monthly Rest Basis

Computations for monthly rest options are more complex. Please check with your bank for information on monthly rest options.

E. Financial Implications Of Early Repayment

(i) Car loans under the Hire Purchase Act

Your Hire Purchase Agreement requires you to pay all the principal and interest that would have accrued over the entire loan period. However, if you repay the outstanding loan before the loan period ends, you will receive a rebate on the interest. This is calculated using the Rule of 78 formula.

Illustration 3 – Early Redemption of Car Loan under HP Act

Suppose you took out a car loan of \$30,000 over 5 years at an interest rate of 2.6% p.a. If you repay your entire loan after making 25 monthly instalments on due dates, the computation is as follows:

Original Car Loan Amount	\$ 30,000.00
Add Interest for 5 years (Illustration 2(i))	\$ 3,900.00
Principal + Interest	\$ 33,900.00
Less : Instalments Paid (\$565 X 25)	(\$ 14,125.00)
Less: Rebate of Unearned Interest using Rule of 78*	(\$ 1,342.62)
Total amount payable to bank to fully redeem the Car Loan	\$ 18,432.38

***Formula Used for Rule of 78**

$$R = \frac{n(n+1)}{N(N+1)} \times TC = \frac{35(35+1)}{60(60+1)} \times \$3,900.00 = \$1,342.62$$

Where:

R represents the interest charges rebate;

n represents the unexpired loan period expressed in months;

N represents the original loan period expressed in months;

TC represents the total amount of interest over the loan period

(ii) Car loans under Common Law

If your loan was taken up on a flat rate basis, the Rule of 78 rebate will usually apply.

However, there may be a fee/penalty for early repayment of a car loan under Common Law. This is to cover some of the costs which the bank will incur whenever a loan is repaid early.

Illustration 4 – Early Redemption of Car Loan under Common Law

Assuming you took a car loan of \$60,000 over a 5 year loan period at an interest rate of 2.60% p.a.

If you want to redeem your car loan after making 25 monthly instalments on due dates, the computation is as follows:-

Original Car Loan Amount	\$ 60,000.00
Add Interest for 5 years (\$60,000 X 2.6% X 5 years)	\$ 7,800.00
Principal + Interest	\$ 67,800.00
Less : Instalments Paid (\$1,130 X 25)	(\$ 28,250.00)
Less: Rebate of Unearned Interest using Rule of 78*	(\$ 2,685.25)
Add: 20% Penalty Fee (20% of \$2,685.25) (for illustration only)	\$ 537.05

(Please check with your bank on the amount of penalty fee as this may vary from bank to bank)

Total Amount Payable to Bank to fully redeem the Car Loan \$ 37,401.80

If your loan was taken up on a monthly rest basis, the bank will compute the outstanding principal, interest payable till the redemption date and any applicable fee/penalty.

Please check with your bank for the early redemption fee/penalty.

F. Comparing Interest Rates Between Banks

As interest rates may not be quoted on the same basis, always compare the Effective Interest Rate (EIR). This reflects the actual interest cost of your loan. If your loan is quoted on a flat rate basis, ask the bank for the EIR.

Illustration 5 – Effective Interest Rates

A car loan of \$60,000 repayable over 5 years at a flat rate of 2.6% p.a. has an EIR of 5.092% p.a.

A car loan of \$60,000 repayable over 7 years at a flat rate of 2.6% p.a. has an EIR of 4.992% p.a.

The EIR is higher than the nominal flat rate charged because flat rate computations do not give any consideration to the monthly principal repayments made throughout the loan period.

Note also that the loan period affects the EIR even when the nominal flat rate is the same.

G. Car Financing Worksheet (Flat Rate Basis)

For comparison purposes, you should ask your bank/car dealer to complete this worksheet. As this worksheet is for computations on a flat rate basis, please check with your bank if your car loan is computed on a monthly rest basis.

Loan information

a) Loan Amount \$ _____

b) Interest Payable

(Principal X Interest Rate X Loan Period)

\$ _____ x _____ %p.a. x _____ years \$ _____

(Effective Interest Rate is _____ % p.a.)

c) Total Amount Payable (a) + (b) \$ _____

d) Monthly Repayments \$ _____
(Total Amount Payable/Loan Period in months)

Please note that completing a worksheet does not constitute a loan offer by the bank.

H. IMPORTANT QUESTIONS TO ASK YOUR BANK

1. What is the rebate if I decide to redeem my car loan before the end of the loan period?
2. How is the rebate computed?
3. Is there any penalty for early redemption of my car loan?
4. If I opt for early redemption, will I have to give up any benefits which I received from the bank when I applied for the loan?

Remember:

A loan is a legal and financial commitment. Always feel free to ask your bank for more information before you commit yourself.

For more information, please contact your bank.