



CHALLINOR

Residual Values and Balloon Payments

Having a residual value/balloon will lower your regular repayments



If you are a regular to financing, then no doubt you would have come across these terms once or twice. For those that haven't, this article may be of particular use to you. The definition of residual value/balloon payment is a lump sum owed to the financier at the end of a loan term, after all regular monthly repayments have been made. In other words, you can elect to hold back a chunk of the loan until the end. An example of this is:

A client wishes to purchase a new 4WD for \$50K over five years and elects to have a \$15K (30%) residual/balloon on their loan. By doing this, the client will lower their loan payments than if they had no residual/balloon, however, they will still owe the bank \$15K at the end of the five-year loan.

On a finance lease product, having a residual/balloon payment is mandatory and is usually set to the 'effective life' of the asset as advised by the ATO. For Asset Purchase, (formerly Hire Purchase), Chattel Mortgage and Consumer Loans a residual/balloon payment is optional.

Some of the benefits of having a residual/balloon payment include reducing the size of your monthly payments, increasing affordability or the size of the loan amount, assist with cash flow management, and you can even match the loan balance to the vehicle's

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value over the life of the loan.

What happens at the end of the loan term and your residual/balloon payment is due? Well, there are three options.

1. You can either pay it out in full from your own cash reserves.
2. Refinance the residual/balloon payment with the current bank (provided your repayment history is 'A' class, this will be easy for most lenders).
3. Refinance the residual/balloon payment with another bank.

When considering adding a residual/balloon payments to your loan, you should take these two important facts into consideration.

1. You are in fact increasing the loan term, thus paying the bank more interest over the life of the loan.

2. By having a residual/balloon payment, you can run the risk of owing more on the loan than the vehicle is actually worth.

Your finance specialist should make you aware of the 'pros and cons' of adding a residual/balloon payment to your loan. Where possible, you should always consider paying back the loan in full over the term, ie, no residual/balloon payment. By doing so, it will allow you to repay the loan in full and at the end of the loan term, your vehicle will be debt free.

Another benefit of this is should the worst case scenario happen and you lose your job and are forced to sell the vehicle, half way through your loan, you should be able to clear your loan in full and have some spare cash in your pocket as a result from the equity built up over time.

Dave Challinor

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With over 20 years of banking and finance experience, Dave has been exposed to and witnessed every possible change in the financial environment. From bank policy shifts to continually increasing governmental legislation, there is really no form of lending that Dave has dealt with. Being the owner of Fortified Finance & Leasing in Brisbane's North, Dave stays abreast of any changes in lending requirements that affects any consumer.