What residual car values really mean

Buying a car on residual or a balloon payment may seems like an affordable way to finance your vehicle, but only if you understand the implications of the deal.

Many car dealers offer vehicles on residual, with monthly payments that sound too good to be true, given the make and model of the vehicle in question.

Some salespeople do not explain how the residual agreement works because of the commission they get after the deal is sealed.

Zamageda Manzini bought her first car, a Volkswagen Beetle, five years ago, which cost R195,000. She was a first-time buyer.

She said she told the salesman that she wanted a good deal with manageable repayments. Manzini, 36, of Ixopo in KwaZulu-Natal, paid the required 10% deposit after passing her affordability test in terms of the National Credit Act and her monthly instalments amounted to R4,200.

The salesperson did not tell her she was buying the car on residual, nor did he explain its implications, she says.

Manzini did not check the terms of her contract after signing or taking possession of the car. She got the shock of her life last month when she wanted to pay the last instalment and found out she still owes R90,000.

She says she would not have entered into such a deal had she known the implications. Her bank has agreed to grant her R90,000 to re-finance the balloon payment she owes.

Glenn Stead, head of the personal segment at Standard Bank Vehicle Asset Finance, says a residual or balloon payment allows a consumer not to pay a portion of the amount owing on the vehicle until the end of the loan period and then pay it off in one lump sum.

Balloon payments

So if a car was valued at R200,000, you might choose a balloon option of 25%, which means that when the loan agreement ends you would be liable for a lump sum of R50,000.

"This isn't necessarily a reason not to take the offer, but consumers need to have a clear understanding of the process," he says.

Stead says there are two different types of balloon payments. They are known as ownership and non-ownership residuals.

In an ownership situation, a consumer is buying the car and is responsible for the lump sum at the end of the loan term.

"With non-ownership residual, the bank or lender still owns the car at the end of the loan period and is also responsible for reselling it to cover the balloon payment," he says.

Stead says with a non-ownership deal the lender is responsible for the balloon payment so you don't have to worry about finding the money.

But there might be certain restrictions you have to comply with, like a mileage ceiling on the vehicle to ensure its resale value.

With an ownership option you would be responsible for the payment at the end of the loan and once paid, ownership of the vehicle will be transferred to you.

He says it is possible to re-finance the car and pay off the balloon payment over a longer period or you can sell the car.

In some instances, the value of the car can be less than the residual owing. "This means that even if you sell the car, you'll still owe money to your lender," said Stead

In both scenarios you will be required to have insurance to cover you and the lender.

"For folks who want to drive a newest model all the time, residual payment is an option. But if you keep on buying on residual, you are allocating a portion of your income to your car indefinitely," he says.

Residual payments can cost you more in the long term. "Rather try to buy a cheaper vehicle with more affordable monthly payments," advises Stead.

Source: Sowetan via I-Net Bridge