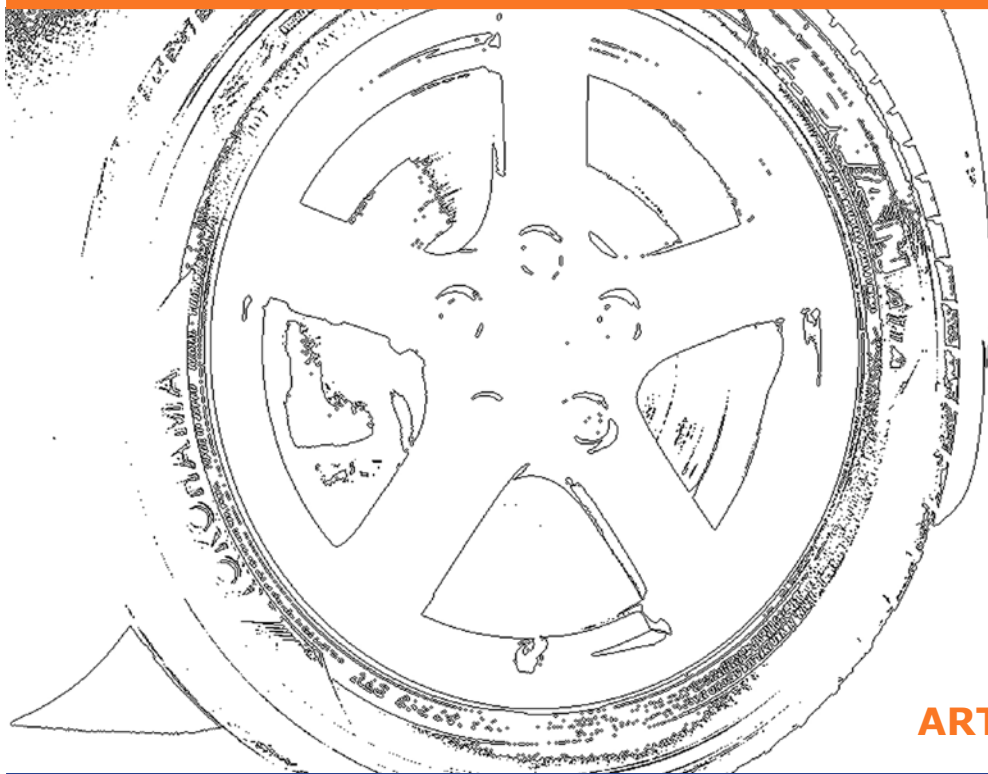


Knowledge

BANK



ARTICLE 4

Personal Contract Purchase (PCP)

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Features

Personal contract purchase is a method of finance that allows a consumer (a private individual, sole trader or partnership) to buy a vehicle on deferred payment terms that allow them a series of options at the end of the agreement.

While the expression 'personal contract purchase' is relatively new, the underlying legal agreement will be either a conditional sale or a hire purchase agreement, both of which are long-standing legal structures.

Regardless of the underlying agreement that is used, the normal arrangement is that the client (the buyer) agrees to buy the vehicle and to make payments over a period of time. At the end of that period they have three choices:

- Make the final payment and keep the vehicle
- Hand back the vehicle and have no further obligation
- Use the equity in the vehicle (the difference between the amount still owed and the market value of the vehicle) as a deposit for another vehicle

A feature of contract purchase agreements is the guaranteed minimum future value (GMFV). This is an undertaking by the funder to buy the vehicle back at the end of the contract at a pre-agreed price. This is a very valuable option as it allows the buyer to decide whether it is worthwhile or not to retain the vehicle.

Normally, if the vehicle is worth more than the GMFV the buyer will opt to retain it. If less, he will hand it back and allow the funder to take any loss.

The Consumer Credit Act 1974 requires the Annual Percentage Rate of interest, (APR) to be stated prominently on consumer credit quotations and some adverts.

Some funders add an amount to the balloon payment to protect them against the risk of loss should the client return a vehicle at the end of the agreement. This means that the total payments look high in relation to the value of the vehicle and the APR becomes inflated.

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However, the customer will not be paying this high APR if he or she chooses simply to hand back the vehicle rather than pay the balloon.

Some PCP agreements offer maintenance options similar to those provided to companies in maintenance-inclusive contract hire agreements.

Most PCPs are sold by motor dealers, using the finance facilities provided by car manufacturers' captive finance houses.

Benefits of PCP

PCPs are a widely available form of personal finance. As the funder has title in the vehicle the consumer can be offered a lower interest rate than if the lending was unsecured.

The purchase option can be valuable to the client.

Rather than just providing finance and leaving the client to find the vehicle, suppliers of PCPs invariably supply the vehicle.

Disadvantages of PCP

There are few disadvantages with PCPs. However, there has been some adverse publicity surrounding the GMFV from time to time.

Customers who buy vehicles using PCPs expect that the vehicles will be worth at least the amount of the GMFV. When used vehicle values are falling sharply (as they did from 1999 to 2002 and in 2008), consumers discovered their vehicles were worth much less at the end of the contract than they had expected. So it was not worthwhile for them to pay the balloon payments and take ownership of the vehicles. Instead, they elected to use the GMFV and to return the vehicles to the funders. The customers then realised that they had paid a deposit and monthly payments for their vehicles, handed the vehicles back and now had neither the vehicle nor a deposit to put down on another vehicle.

For some reason, the occasional press reports on this topic cast the funders in a poor light and sometimes refer to 'negative equity' in the vehicle. In fact, the funders lose too but this is rarely mentioned. Generally, PCPs are bought as a modern alternative to hire purchase, against which they offer clear advantages to the customer.