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The Best Way to Finance a New Car

Q: I need a car loan, and I'm thinking of using my home equity instead of taking a loan with the dealer. How can I decide which is a better deal?

A: There are pros and cons to every borrowing situation.
Including the strategy of using the equity in your home to buy a car.
People who use home equity lines of credit (HELOC) often make the choice because of the potential tax savings. "The interest rates on home equity loans are often tax-deductible while the interest on a car loan is not," said Kim Viscuso, a certified financial planner with Stonegate Wealth Management in Oakland. "This tax advantage is only beneficial to those tax payers that itemize their deductions, and there may be limits if you exceed $100,000 on the loan." A HELOC functions like a credit card, Viscuso said. It makes a certain amount of credit available on an as-needed basis for a limited term then follows with a repayment period.

The interest rate on a home equity loan is probably going to be lower than that of a traditional car loan, but it will be variable after some period of time, said **Claudia Mott, a certified financial planner with Epona Financial Solutions in Basking Ridge**. Although we have been in a period of very low interest rates for a long time, you need to consider the likelihood that the HELOC rate will probably increase over its lifetime, she said.

The potential for rising interest rates isn't something to ignore. A higher move for rates could force you to be make larger payments for the car down the road, Viscuso said. Also, if you decide to make interest-only or smaller payments on the amount borrowed, the repayment period could last longer than the life of the asset itself.

Choosing to borrow through a home equity loan can also be a cash flow decision.

Mott said the option to repay on the interest might enable you to have a new car with lower payments, but you will still need to be in a position to pay off the loan when the term ends. "Keep in mind that the value of the car will continue to depreciate from the moment you drive it off the dealer's lot and may have no salable value when it comes time to pay off the HELOC obligation," she said. "If cash flow is an issue and the ability to make a balloon payment is going to be a problem, you may need to re-think the idea of a new car entirely."

Another potential negative is that you will have to pay closing costs for the home loan, Mott said, so make sure you run the numbers so you understand the cost of borrowing for all your lending options.

Another disadvantage to using funds from the HELOC to purchase a car is that the borrowed funds are no longer available for other uses, Viscuso said. "Many people use their HELOC for emergency situations," she said. "If you eat up the funds by paying for a car, they may no longer be available for unforeseen future emergency situations."

And finally, Mott said, if it turns out that the auto loan is a better option for you, make sure you shop around because the dealership's offerings may not be the most attractive.

"If you have good credit and meet the qualifications, using a local bank, credit union or an online loan provider may get you a better rate and hence savings over the long term," she said.
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