

Hire-purchase contracts for cars

This article considers a number of questions about hire-purchase contracts for cars. First, what is the normal intended length for such contracts? Secondly, what is their *actual* length: that is, to what extent are contracts terminated other than at their contractual date? Thirdly, do people tend to buy another car on hire purchase when the contract on their old car is ended—and are they more, or less, likely to do this if the contract is being terminated early? The answers to these questions are very relevant for economic policy, but as yet they can only be tentative, mainly because the period studied has so far been short, and perhaps not typical.

Background Since April 1963 an enquiry into the length of hire-purchase contracts for cars and commercial vehicles has been carried out jointly by the Bank of England and Hire Purchase Information Limited, the industry's central registry of vehicles subject to hire-purchase agreements. The basic data have been supplied to Hire Purchase Information by finance houses, whose helpful co-operation is gratefully acknowledged. The origin of this enquiry and some preliminary findings were described in the March 1964 issue of *Credit*, the quarterly review of the Finance Houses Association, and summarised in the Bank's *Bulletin* of the same date. A further progress report was given in *Credit* in September 1964. The present article considers the subject a little more fully now that the figures cover more than two years, in fact from April 1963 to June 1965.

The source material is contained in two sets of cards: the registration cards that Hire Purchase Information receive from finance houses and others when contracts are taken out, and the clearance cards that are sent in when the contracts are ended. The two together give the actual length of contract; while since April 1963 both cards have also given the intended length of contract. Some forms of instalment credit other than hire purchase have recently become more common, especially credit-sales agreements. Details of most of these are, however, recorded by Hire Purchase Information in the same way as for hire-purchase contracts.

It is clearly in the interests of the finance houses that Hire Purchase Information should be enabled to record contracts fully and promptly, and in general the source may be accounted a reliable one. It is possible, however, that the records of contracts completed are not quite so comprehensive as those of contracts begun. Individual finance houses have a stronger incentive to check that a particular car is not already subject to a hire-purchase agreement, by sending in the registration card, than they have to inform others, by sending in the clearance card, that they no longer have an interest in the car. There may therefore be some bias in the records in favour of new contracts. Nevertheless, the main reason for the excess of new contracts over terminations shown in the appendix is no doubt the growth in business. During the year to March 1964 terminations were only 70% as numerous as fresh contracts, and the corresponding figure for the following year was 65%. The rate of growth in the number of contracts outstanding, as given by the cards filed with Hire Purchase Information, was about 12½% between March 1963 and March 1964 and 16% in the following twelve months.

Intended length of contracts Contracts on cars may be taken out for any length of time up to the maximum prescribed by law, which until recently was three years. At the end of July 1965 the maximum contract period was reduced to thirty months, but this had no effect in the period surveyed. In practice, contracts are nearly always drawn up in multiples of six months, and there are practically none for less than one year.

Table I overleaf shows the distribution since 1963. It will be seen that contracts for the full period allowed by law are more common for new than for used cars, and that the average intended length of contracts for new cars is normally two or three months longer than for used. For example, between April and June 1965 contracts for new cars averaged thirty months and for used cars twenty-eight months. In each case this was slightly longer than two years before.

Table I
Intended length of contracts

Contracts taken out in :	Distribution by number of years (<i>per cent</i>)										Average length in months	
	New cars					Used cars					New cars	Used cars
	1	1½	2	2½	3	1	1½	2	2½	3		
1963												
2nd quarter	13	6	19	4	57	12	10	27	18	32	29	27
3rd "	9	3	21	3	63	13	10	28	17	31	30	27
4th "	10	5	21	4	59	15	10	26	15	33	30	26
1964												
1st quarter	13	5	20	2	60	14	10	18	15	42	29	28
2nd "	10	5	18	3	63	9	7	19	16	48	30	29
3rd "	6	4	15	3	71	11	8	21	14	46	31	28
4th "	7	4	19	2	67	12	8	20	15	44	31	28
1965												
1st quarter	9	4	25	2	58	11	10	21	16	42	30	28
2nd "	10	6	19	3	62	10	9	21	11	47	30	28

Actual length of contracts The average actual life of contracts is much shorter than the average intended length of twenty-eight or thirty months. Table II shows that the average actual life of all contracts ended since April 1963 has been from nineteen to twenty-two months for new cars and from eighteen to twenty months for used cars.

These averages depend on two quite separate considerations: firstly, current attitudes to and opportunities for terminating contracts in advance; and secondly, the number of contracts of varying lengths taken out at different dates in the past. It is probably the second of these which mainly accounts for a slight drop which occurs in the average life of new-car contracts which ended between May 1963 and January 1964. At the end of April 1960 terms control had been reimposed, limiting contracts to a maximum of two years; and in January 1961 this maximum had been extended to three years. It was not possible therefore for the

contracts completed between May 1963 and January 1964 to include any three-year contracts which had run their full course.

If light is to be thrown on the incidence of early completions, the confusing effects of changes in the mix of terminating contracts must be eliminated. One obvious approach is illustrated in the right-hand half of Table II. The life of each contract was compared with its intended length, and contracts were classed as having ended "early", "on time" or "late".⁽¹⁾ As may be seen, only about one-third or less are completed on time, while between one-half and two-thirds are terminated early.

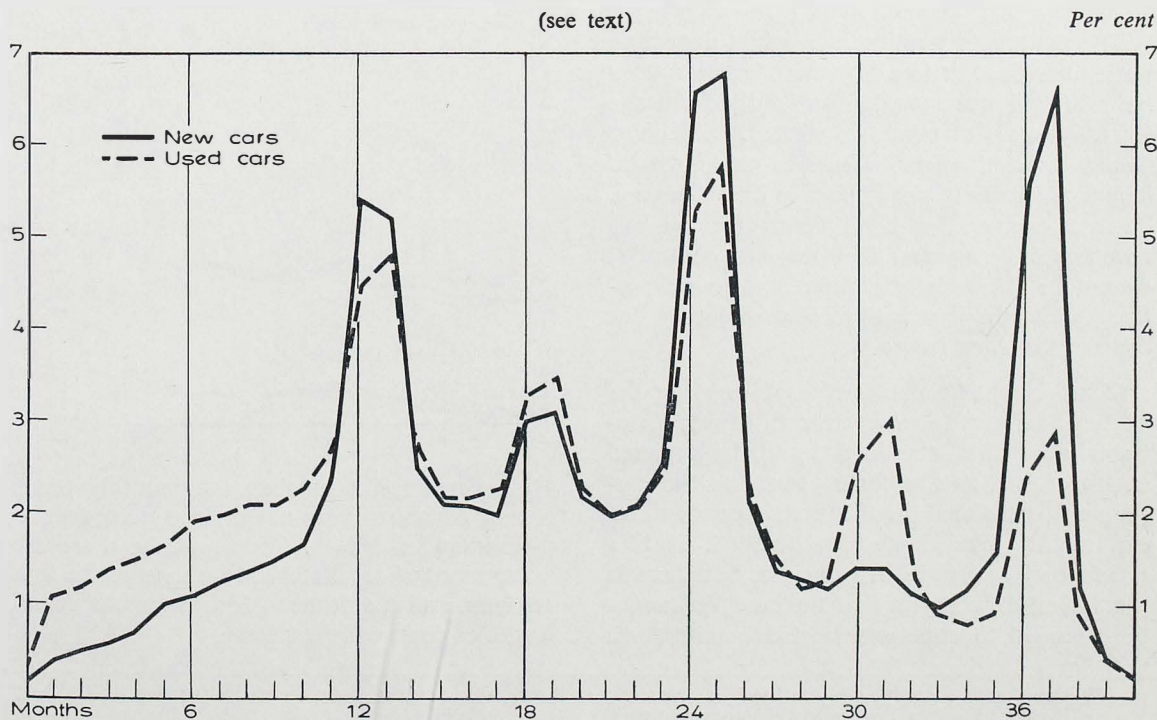
The analysis of actual length can be carried further by classifying the terminated contracts according to the month in which they were taken out, and then noting how many were terminated in the first, second and each subsequent month of their life. Chart I shows the results of classifying in this way all contracts

⁽¹⁾ A contract was regarded as being completed on time if the relative clearance card was received by Hire Purchase Information either in the month in which the last instalment was due or in the following month. The two months were taken because as many cards are usually received in the later month as in the earlier, no doubt because a little time is required to complete the transaction and send in the clearance card. Contracts subject to more than one month's delay were regarded as late completions, even though for some of these, too, it may be that the delay was no more than was required to deal with the documents.

Table II
Actual length of contracts

Contracts ended in :	Average length in months		Contracts ended early, on time or late (per cent)					
	New cars	Used cars	New cars			Used cars		
			Early	On time	Late	Early	On time	Late
1963								
2nd quarter	21	20	58	35	7	60	28	12
3rd " "	19	19	59	30	11	58	27	15
4th " "	19	19	60	27	13	53	30	17
1964								
1st quarter	21	19	58	32	10	56	29	15
2nd " "	22	19	53	38	9	59	30	11
3rd " "	20	18	55	35	10	60	27	13
4th " "	19	18	61	28	11	59	27	14
1965								
1st quarter	19	18	64	27	9	62	25	13
2nd " "	21	18	60	31	9	64	25	11

Chart I
Analysis of contracts by actual length of life
(see text)



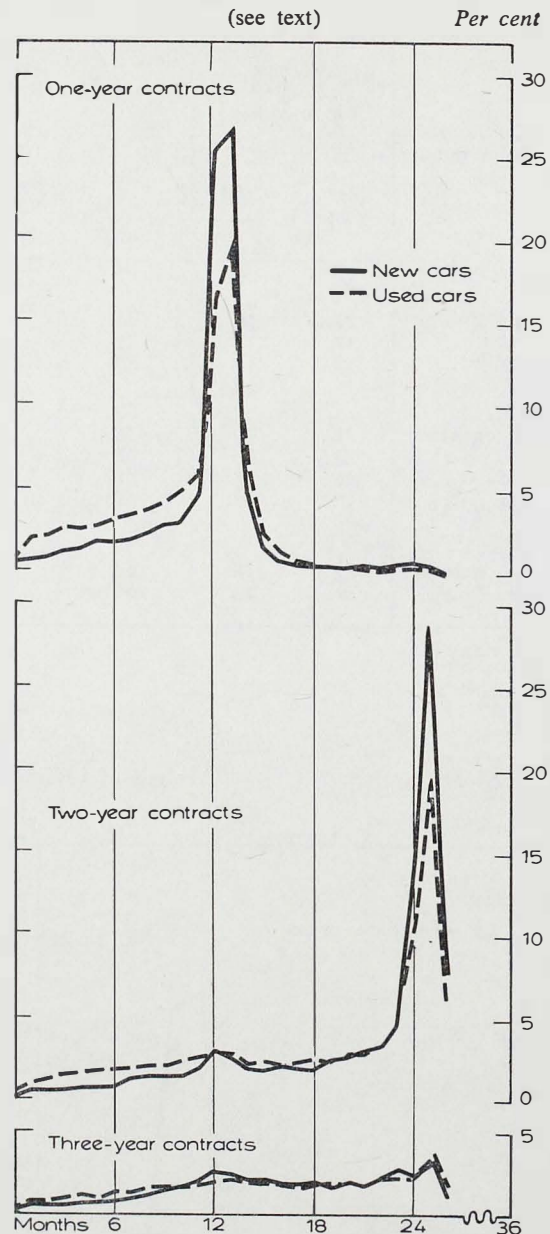
ended between April 1963 and June 1965, regardless of their intended length. It shows the proportions completed after one month, two months, and so on, plotted separately for new and used cars. The humps that occur at half-yearly intervals mainly reflect the completion of contracts on time. Although, as has been seen, contracts are more likely to be ended early than on time, it remains true that many more are ended on time than in any single earlier month. In the case of both new and used cars the percentages for individual months within the whole period April 1963 to June 1965 are fairly closely clustered round the averages; in other words the pattern of completions of contracts taken out in most individual months would not differ very greatly from that shown in the chart.

Although the results for new and used cars clearly have much in common, some differences may be noted. As the earlier analysis of intended lengths showed, contracts for the full three years were more common for new than for used cars, and conversely contracts for two and a half years were less common. The higher proportion of terminations for used cars than for new that occurs in the first year suggests that contracts for used cars are the more likely to be terminated early.

The pattern of terminations might appear to be regular enough to allow their future rate to be predicted quite straightforwardly from the monthly totals of contracts started. Difficulties would arise, however, whenever the *intended* length of contracts was known to have changed. Such a change, for example in the relative numbers of two-year and three-year contracts, cannot be allowed for without knowing something about the past pattern of completions for contracts of each length.

Chart II shows the results of carrying the analysis further to meet this difficulty. Contracts were first classified by their intended length of one, two or three years and the percentages completed in the first, second, third, etc. month were then calculated.⁽¹⁾ This is a satisfactory approach in principle, but there is a practical difficulty in that the analysis cannot be extended to contracts started before April

Chart II
Further analysis by type of contract
(see text)



1963, because before then the monthly totals of new contracts were not divided according to their intended length. Consequently, there are fewer months' results available than in the first analysis, and the number declines as the actual length of contract increases.

⁽¹⁾ This part of the analysis is confined to contracts of these three lengths, because those for one and a half and two and a half years are much less numerous.

Thus the figures for June 1965 show what proportion of contracts, of each intended length, taken out in May 1965 had in fact been terminated after one month. A similar sum can be done for those ended in May 1965 and taken out a month earlier, and so on back to May 1963 (relating to April 1963 contracts). This makes a total of twenty-six months' observations for contracts ended after one month. But for contracts completed after twelve months, for instance, experience is confined to those ended between April 1964 and June 1965 (relating to contracts taken out between April 1963 and June 1964), fifteen months' observations in all. By the same process, there were only three months' observations for contracts ended after twenty-four months and only one for those ended after twenty-six months. There were none at all for contracts running for twenty-seven months or more.

The percentages shown in Chart II are therefore based on a diminishing number of monthly observations tapering off on the right to only a single observation. This means that whereas information about one-year contracts is reasonably good, little is yet known about the later stages of two-year contracts, and nothing at all about those of three-year contracts.

Chart II has nevertheless several interesting features. Almost from the start there is a relatively steady stream of terminations month by month with only a slight acceleration in advance of the due date. The monthly rate of early termination is remarkably similar for two and three-year contracts and only a little higher for those of one year. It follows that the longer the intended term of the contract the greater will be the proportion of early terminations. Taking new cars as an example, 23% of one-year contracts were completed early and 41% of two-year contracts, while already after twenty-six months almost one-half of three-year contracts have been terminated. This suggests that eventually nearly three-quarters may be completed before the due date.

Like Chart I, Chart II shows that contracts for used cars are more likely to be terminated early than those for new cars. This seems to apply, however, only to one and two-year contracts; the lines for three-year contracts run fairly close together. Finally, there is some slight sign of an "anniversary effect", that is

of a tendency for two-year contracts to be terminated after exactly one year or three-year contracts after exactly one or two years.

Reasons for early termination What bearing have these facts on the incurring of new hire-purchase debt? Early termination of a hire-purchase agreement will nearly always be on the initiative of the borrower. There seems little doubt that this will happen most commonly when he decides to trade in his existing car, still subject to a hire-purchase agreement, for another. This can usually be done with very little formality.

The relationship between the trade-in value of the car and the value of the outstanding debt is complex and normally changes during the life of the agreement. The amount of depreciation, especially on new cars, is likely to diminish from year to year, while debt is repaid at a constant rate; so the margin between the value of the car and the amount of debt outstanding may narrow during the period of heavy initial depreciation, but it will usually widen thereafter. However, the margin is always likely to be positive; that is, throughout the currency of the agreement the trade-in value of the old car is likely to exceed the debt outstanding, and this margin will contribute a part, if not the whole, of the deposit on its replacement. In many cases therefore the change of car will be achieved without a cash settlement, but usually of course with a different rate of monthly instalment in the future.

Although the most likely motive for the termination is the desire to buy a new car, there may sometimes be a financial incentive. For example, a borrower may find during the currency of the hire-purchase agreement that he is able to borrow more cheaply elsewhere, perhaps from a bank. Naturally a termination of this kind may occur at any time and need not coincide with a change of car.

It has often been assumed that the completion at its final date of a hire-purchase contract would be the natural occasion to buy another car on hire purchase, if only because the owner has by then become accustomed to devoting part of his income to meeting instalments. This may indeed often happen when contracts run to maturity. Where an early termination is followed by a fresh contract, however, the

desire to replace the car will have provided the spur. This may sometimes still be connected with the date of the original contract, as for example when a car, still subject to an agreement for a longer period, is replaced exactly a year or two years after it has been bought. But many other reasons for a change of car are quite unrelated to the progress of existing agreements. They include a rise in a person's income, greater security of employment, lower purchase tax (or the expectation of higher purchase tax), the introduction of new models, and so on. It is evident that the more important these factors are, the more difficult it will be to predict the rate of fresh contracts in the future from their rate in the past.

Relationship between terminations and fresh contracts Some attempt has been made to see whether a close relationship can be established between terminations and fresh contracts. The numbers of fresh contracts for all cars, for new cars and for used cars were related in turn to terminations of existing contracts, distinguishing between early terminations and those on time, and between new and used cars. The calculations included a rough allowance for seasonal differences between the behaviour of terminations and fresh contracts. The upward trend in fresh contracts, over and above that which reflected the rise in the number of contracts ended, was also allowed for.

Taking all cars together, 80% of the average monthly variation in the numbers of fresh contracts can be explained by changes in the numbers of contracts ended. This proportion rises to 89% if the effects of seasonal differences and the steady upward trend are also taken into account—though forecasts based on these will be vulnerable to changes in the upward trend. When fresh contracts for new cars alone are related to completed contracts for new cars the proportion is 86%, while the comparable figure for used cars (related to completed used-car contracts) is 89%. In other words, fresh contracts for new cars can be predicted a little less reliably from contracts ended than can those for used cars, but for both a high correlation exists.

The results also suggest that for new cars early terminations and completions on time are both equally likely to be followed by a fresh

contract for a new car. For used cars, however, it seems that an early termination is more likely to be followed by a fresh contract for a used car than is a completion on time. To some extent no doubt this difference reflects the greater proportion of contracts for new cars that run to their maturity.

Broadly speaking, the implication is that fresh contracts for both new and used cars could be inferred as reliably from all terminations as from any combination of early terminations and completions on time.

Conclusion The enquiry has provided information on an aspect of hire purchase about which little was known hitherto. Perhaps the most striking point is that more than half of all contracts for cars have been terminated before the due date. The occasion will usually have been a change of car, but sometimes there may have been a financial incentive. Much has also been learnt about the average life of contracts and about the likelihood of a termination of a contract leading immediately to a fresh contract.

The remarkable stability of many of the results might suggest that they would be a reliable guide to the future. Thus the pattern shown in Charts I and II could be used to estimate the rate at which contracts taken out in the past, and still outstanding, are likely to be terminated. And from this estimate the number of fresh contracts in the future could be forecast.

As yet, however, there are difficulties in putting such a forecast to practical use. In the first place, as has been seen, the enquiry has so far covered only a comparatively short period. Moreover this was a period of continuous boom in the car trade following the sharp reduction of purchase tax in November 1962; in some of its later stages, too, sales may have been helped by fears of an increase in purchase tax. In these circumstances car owners may have been encouraged to an unusual extent to trade in their existing cars for better ones. Looking to the future, too, recent developments mean that past experience is unlikely to be a good guide and the same rate of turnover cannot be expected to continue. In May the Governor of

the Bank wrote to the main hire-purchase associations, as well as to banking and other financial associations, asking them to restrict the expansion of credit in the year to March 1966. Early in June the minimum down-payment required under hire-purchase agreements for cars was raised from 20% to 25%

and at the end of July the maximum repayment period was reduced from three to two and a half years. Although most contracts are already completed within the new maximum period, the reduction of the maximum will restrain demand by increasing the size of the monthly instalments that purchasers have to pay.

Appendix

Thousands

	Contracts begun					Contracts ended									
	Total	Cars		Commercial vehicles		Total	Cars						Commercial vehicles		
		New	Used	New	Used		New		Used		New	Used			
1963							(a)		(a)		(a)				
Apr.	115	26	74	5	10	76	66	12	46	50	68	5	9		
May	138	31	87	7	13	105	76	17	55	70	80	7	11		
June	120	26	78	6	10	70	58	11	42	48	62	4	7		
July	128	26	84	6	12	85	66	12	46	59	70	5	9		
Aug.	116	20	81	4	11	76	66	10	50	54	67	4	8		
Sept.	101	19	68	4	10	78	77	10	53	55	81	4	9		
Oct.	117	24	76	5	12	84	72	11	46	59	78	5	9		
Nov.	105	21	69	5	10	81	77	11	52	56	81	5	9		
Dec.	76	14	50	4	8	61	80	8	57	44	88	3	6		
1964															
Jan.	107	23	69	5	10	78	73	12	52	53	77	5	8		
Feb.	124	27	80	5	12	77	62	13	48	51	64	5	8		
Mar.	131	31	84	5	11	85	65	15	48	57	68	5	8		
Apr.	163	37	106	6	14	102	63	19	51	67	63	6	10		
May	158	34	105	6	13	91	58	17	50	62	59	5	7		
June	156	33	104	6	13	100	64	18	55	66	63	6	10		
July	156	32	105	6	13	80	51	14	44	54	51	4	8		
Aug.	135	24	94	5	12	91	67	16	67	61	65	5	9		
Sept.	130	24	88	6	12	90	69	15	63	63	72	4	8		
Oct.	134	26	90	6	12	96	72	16	62	66	73	5	9		
Nov.	115	24	75	6	10	81	70	14	58	54	72	5	8		
Dec.	95	16	65	5	9	75	79	13	81	51	78	4	7		
1965															
Jan.	110	25	70	6	9	77	70	14	56	52	74	4	7		
Feb.	130	28	87	5	10	77	59	16	57	52	60	3	6		
Mar.	158	35	105	6	12	95	60	21	60	63	60	4	7		
Apr.	169	36	115	6	12	87	51	17	47	61	53	3	6		
May	160	33	110	6	11	103	64	20	61	70	64	5	8		
June	153	34	102	6	11	65	42	12	35	45	44	3	5		

(a) Percentage of contracts begun.

Note: For interest, the table includes information relating to contracts for commercial vehicles, although these are not discussed in the text.