

Maximizing your wealth: “Should I pay cash or finance my cars?”

In an earlier *BizWest* article, “[Investors shouldn’t take the path of least resistance](#),” I shared several scenarios in which the easy way isn’t always the best way to maximize your wealth. I’ve got one more scenario to cover today: If you’ve got the money available, it’s *easier* to buy your cars with cash instead of on credit. But which is the wiser way for your wallet in a low-rate environment?

Contrary to your initial “neither a borrower nor a lender be” instincts, the current answer is likely to be: Take the credit ... especially if it’s available at zero percent. One need only scan the car dealers’ ads to see that zero percent financing is a frequent incentive these days for basic and luxury vehicles alike.

Before we consider the choice empirically, think about it theoretically. If someone is offering you *anything* at zero percent, you’re basically being invited enjoy whatever it is you’ve purchased before you have to pay for it. As long as you have the discipline to let those dollars earn a little interest or a few investment returns until payment is due, when would that *not* play out in your favor?

With that in mind, let’s explore a few scenarios and make sure the numbers jive with the logic.

A typical (simplified) choice current car buyers face is as follows: Do you want to pay cash upfront in exchange for a discounted sticker price? Or would you rather take a zero percent or low-interest loan instead of the discount?

The specific dollar amounts don’t really matter. Whether the choice involves tying up \$10,000, \$50,000 or \$100,000 in an automobile ... or keeping the same amount in your pocket to save or invest during the time you own the vehicle, the math and its relative outcomes are the same.

The essential question thus becomes: At what points do the scales tip one way or the other between cash or credit? I’ve done some math on that, assuming a six-year timeframe for all comparisons. That is, each loan is a six-year loan, and the saving/investment periods are eight years. Cars are replaced every 8 years over the next 32 years.

Scenario One: A zero percent loan with kept assets invested at 6%. Let’s imagine you took a zero percent loan and invested the cash that would otherwise have gone to the car purchase into the stock market. Fortune smiles on your investments and you earn 6% annualized market returns across the next six years. ***For paying upfront cash to be the better bargain, the dealer would have to offer you at least a 30% discount on the car purchase.***

Scenario Two: A zero percent loan with kept assets saved at 2%. Let's say you weren't so keen to invest the assets earmarked for car costs. After all, if those dollars will eventually be needed to pay off the balance on the loan and you happen to invest just prior to a market downturn, you could just as readily lose instead of gain 6% annualized on your investments. What if you instead put the reserved assets in a CD or similar savings account, offering a lower but more dependable 2% annualized return? ***You'll still come out ahead taking the loan until the dealer offers you at least an 11.5% discount to pay cash.***

Scenario Three: Three percent financing with kept assets invested at 6%. Admittedly, the zero-percent loan incentives are unlikely to last forever. So what if auto loans are in the range of 3%? It still may pencil out in favor of keeping the cash and investing it in the market. ***Assuming 6% annualized market returns, the dealer would have to offer you at least a 23% discount before it would make sense to pay cash upfront instead.***

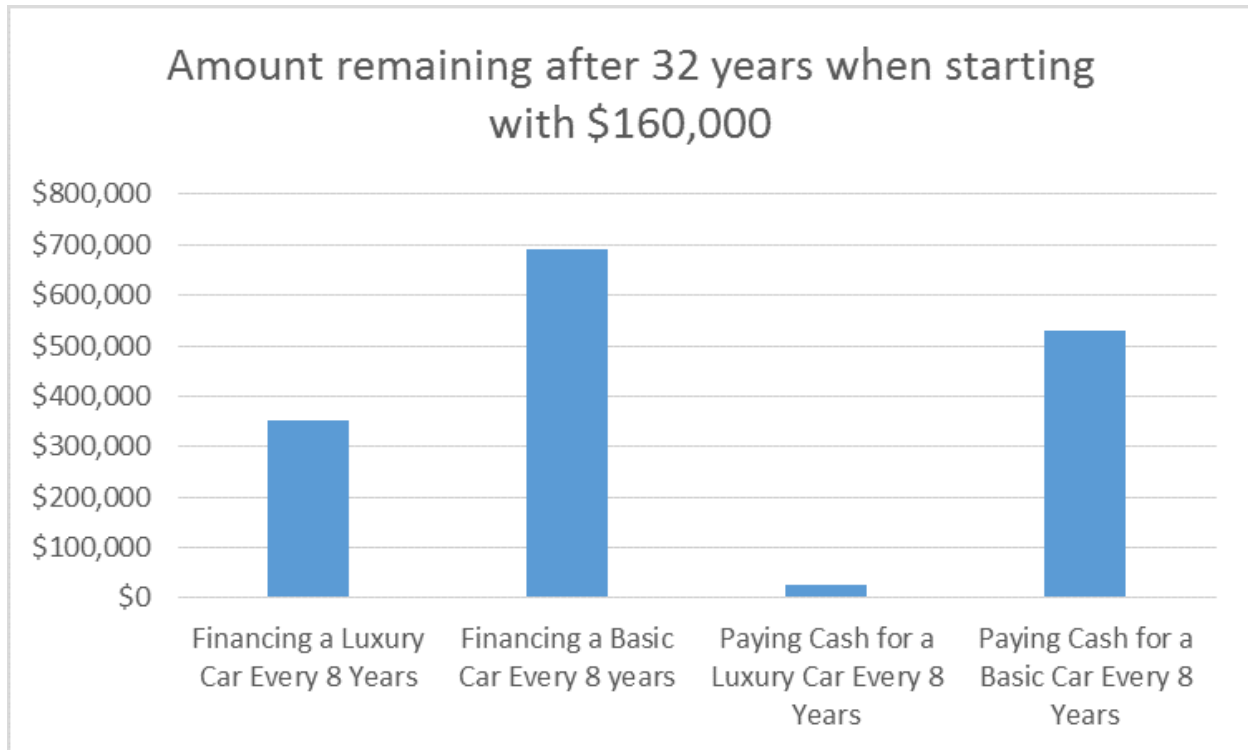
Scenario Four: Three percent financing with kept assets saved at 3%. But again, that 6% annualized market return isn't guaranteed. But if loan rates rise, you'll probably also earn more interest in a CD or savings account too. That said, here, the scales begin to even out. Assuming you could earn 3% returns in your savings account, ***if the dealer is willing to offer you at least a 9% discount to pay cash, then the cash up front may become your better choice.***

Still weighing your options? If you're willing to take a deeper dive, here's one more illustration, offering a more detailed analysis of financing new cars versus paying cash for them.

Here, we've looked at purchasing \$50,000 luxury vehicles versus more basic, \$25,000 models, assuming a replacement cycle of every eight years across 32 years. (That is, you buy a new car every eight years.) We've assumed zero percent financing for the cars with a 6% annualized market return on the money not used to purchase them. The calculations also include:

- A 10% down payment if you were financing the cars
- A 5% discount if you instead pay cash
- A 15% annual depreciation on the cars
- A 3% inflation rate when replacing cars
- A sufficient starting amount of investable cash (about \$160,000), to cover paying for a luxury vehicle with cash every eight years

The following graph shows the residuals:



As you can see, the results vary wildly based on the scenarios. In the worst-case scenario, you would be left with about \$27,000 after 32 years of purchasing a luxury vehicle for cash in a zero-interest-rate environment.

Mathematics aside, I get why families may still choose to pay cash for their cars. There's less paperwork, no ongoing obligation, and that unquantifiable sense of satisfaction in knowing that what's yours is yours. On the other hand, if you do decide to let the numbers be your guide, in a zero-interest-rate environment, I hope I've demonstrated how likely you are to end up with more money in your pocket for future car purchases if you let the lender be your friend.