

Get a car loan that's in your best interest

If you are seeking financing for a new or used car, you could have many options even if you have a poor financial history. However, late payments and other credit problems signal lenders that you are a risky customer, which will increase the interest rate on the loans available to you. There are differences between lenders—so shop around to find the best deal.

About auto loans

Car loans can be obtained from a variety of sources: credit unions, banks, online direct lenders, loan brokers and auto finance companies. Manufacturer-related auto financing companies are prohibited by law from selling loans directly to borrowers, so their loans usually are transacted at auto showrooms and are known as dealer financing.

Dealers advertise special loans that often seem too attractive to pass up. However, only people with the best credit can qualify for “zero percent” financing and other attractive dealership loans.

Interest rates on loans for people with so-so credit can be 60 percent higher than the rates available to people with excellent credit. People with poor credit may be asked to pay a rate that is two to four times higher. They may also be required to have a co-signer—someone with a good credit history who is willing to be responsible for repaying the loan without having ownership of the car (unless buyer and co-signer agree to put the co-signer on the title).

The time you can take to pay back a car loan (the term) varies—usually you can choose terms of 36 months (three years), 48 months (four years) or 60 months (five years). In recent years, term options have continued to increase, so that now loans of six years are common, and some are even longer than that. You can lower your monthly payments by choosing a longer loan period. However, the longer the term, the higher the total interest you will pay over the life of the loan. Also, when you have a very

long loan term, you risk the chance of still owing on your current car when you are ready to purchase your next one. Check the weekly interest rate roundup on www.Bankrate.com to find national averages on auto loan rates.

DID YOU KNOW? Free online calculators can help you determine how much you can afford to borrow and how different interest rates and loan terms will affect your monthly payment. Go to www.Bankrate.com and click on the Auto tab near the top of the page—then scroll down to Auto Loan Calculator. Principal Financial Services (www.principal.com/calculators/auto.htm) also has a good selection of interactive calculators on its site.

Get preapproved

It's a good idea to get preapproved for a loan before looking for a car. This allows you to compare the rates you found with what the dealer might offer.

If you haven't pulled your free annual credit reports this year at www.AnnualCreditReport.com, get at least one of them right away. A negative item on your credit report may cause a dealer to raise the interest rate of a loan even after you've signed a contract for the car and driven it off the lot—another good reason to arrange financing from a bank, credit union or other lender before shopping.

Consider getting quotes from online lenders before venturing into a dealership. (Sites such as www.eLoan.com and www.LendingTree.com provide individualized interest rate quotes online.)

When you are preapproved, many lenders give you a blank check to take to the dealership when you shop. The check has a price limit and an expiration date. Dealers like to complete a transaction the same day and may give you a lower price if you can close the deal immediately.

If you don't get preapproved and you don't want dealer financing, ask the salesperson for a purchase order that you can take to the bank or credit union to apply for a loan. You will have to wait for your



loan to be approved before you can buy the car.

DID YOU KNOW? The three major credit reporting agencies—Equifax, Experian and TransUnion—charge a fee for your credit score, but you can get it for free at www.CreditKarma.com. In most cases, people with a credit score above about 620 have good credit, and consumers with scores above 700 or 720 are considered “prime” borrowers. Those with scores below 550 may have trouble getting a loan at all. Paying for your credit score at www.myFICO.com will give you access to the actual score that auto lenders use to vet customers.

The markup game

Most auto finance companies that work with dealers let the dealers mark up the interest rate the company will charge by one or more percentage points. To explain the difference between the quoted rate and any advertised rates, salespeople tell customers they don’t qualify for the lower rates. This extra finance charge tacked on by dealers is pure profit that is split between the dealer and the lender.

The markup is not illegal, but it is unfair because it’s hidden. To make the practice even worse, studies have found that especially high markups are charged to African American and Latino customers.

General industry practice now is to limit the markup to 2.5% in places where state law doesn’t already limit it. Even a markup of just a couple of points can result in hundreds or thousands of dollars in additional interest charges over the life of the loan. Fortunately, the markup is negotiable (but the base rate isn’t).

The best way to avoid a dealer markup is to determine your credit rating and what loan rates you would qualify for with an online lender, bank or credit union before visiting dealerships. Armed with this knowledge, you will be in a stronger position to negotiate the best deal.

Choose the right car

If you are going to finance a vehicle, look for one that will retain its value over time. You can find historical information on specific models online at

Kelley Blue Book (www.kbb.org) or from Consumer Reports (<http://consumerreports.org/cro/2012/12/best-worst-values/index.htm>).

Auto insurers don’t publish the fact, but they have a rating system to determine how much it will cost you to insure different makes and models. Since you will be required to carry collision and comprehensive insurance coverage on your financed vehicle, contact your insurance company in advance to ask about differences in premiums for the cars you are considering.

Buy or lease?

Leasing rarely makes as much financial sense as buying a car, especially a good used vehicle. Leasing is like a long-term rental, but car leases come with strict rules about how many miles you can drive, and they require you to keep the car in excellent condition.

Leasing costs you more in the long run because at the end of the lease you don’t own the car. But leasing still attracts many car shoppers because, on the same car, monthly leasing fees are lower than monthly loan payments.

When the lease term expires, you can return the vehicle, buy the car from the dealership for an additional sum or trade it in on a new leased model.

Lease agreements usually allow you to drive 12,000 miles per year, though some allow more or less. For additional miles, you’ll pay between 10¢ and 25¢ per mile.

DID YOU KNOW? Lenders may look more favorably on your loan application if you can prove you have lived in the same place and worked for the same employer for at least six months to a year and you can verify your income with two or more consecutive pay stubs.

Rebates

Rebates are widely advertised price reductions offered during slow sales periods or on overstocked models. Often, however, dealers will offer you the option of low-cost financing instead. If you get outside financing, you may be able to get both the



rebate and a low interest rate. To make it easy to determine the better deal, use one of the free online calculators. To find many such tools, search the Internet for “auto financing calculators.”

Dealer incentives

On some models, dealers may offer incentives that are not advertised to the public. Dealer incentives are passed on to dealers by car manufacturers. Dealers don't have to pass the savings on to the customer, and sometimes salespeople are not even aware of them. Ask to speak to the sales manager about dealer incentive programs. It can help you negotiate a better deal if you know that the dealership often will adjust its profit margin to make a sale. Check auto websites such as www.Edmunds.com for information on incentive programs.

Know what to ask

When shopping for a car or auto financing, make sure you ask about the:

- Total price for the vehicle
- Available “dealer incentive” discounts
- Trade-in credit for your old car
- Cash downpayment
- Annual interest rate
- Any markup on the interest rate
- Monthly loan payments
- Number of months until the loan is paid off
- Total amount you will pay over the life of your loan
- Early pay-off fees that could cost you more if you decide to refinance your car loan
- Additional fees for things such as “delivery” or title transfer
- Sales tax

The Federal Trade Commission (FTC) (www.consumer.ftc.gov/articles/0056-understanding-vehicle-financing) advises buyers who use dealer financing to ask whether the terms of the loan contract are final and have been fully approved before they sign and leave with the vehicle. If the dealer says they are still working on the approval, consider waiting to sign the contract

and keeping your current vehicle until the financing has been fully approved. Otherwise, you could find that you are required to pay a higher interest rate if you want to keep the car. Or, if you don't qualify for a loan at all, the dealer could take the car back.

Avoid “loan-packing”

It's common for dealers to try to sell you all sorts of extras as you're completing the financing process.

These might include rustproofing, a security system, VIN etching, gap insurance, tire protection and extended warranties.

One way dealers get buyers to agree to these extras is by showing how each purchase, when added into the loan amount, increases the monthly payment by only a few dollars.

What they don't point out is that a few dollars per month over the life of the loan can result in a total price far higher than the add-on is truly worth.

Only buy what you really need, and ask yourself if the purchase would be as attractive if you had to pay cash for it on the spot. Consider rejecting these offers during the financing process and, if you truly want the item or service, shopping around and purchasing it later, either from the dealer or a third party. Likewise, if the car comes with pre-loaded extras you don't need, order the model you prefer.

Check your credit

Your credit is the biggest factor in determining whether you will be approved for a car loan and what the interest rate will be. If you have a poor credit rating, you'll be asked to pay a higher-than-average annual percentage rate (APR) to finance your loan.

Don't go shopping for a car loan or a car until you've ordered a copy of your credit report. Errors on credit reports are common, and by checking your report ahead of time, you'll be able to dispute inaccurate information. It can take time to correct mistakes, so start the process well before you are ready to take out a loan.

If you know what's on your credit report, you'll be on guard for unscrupulous dealers claiming your credit is poor just to justify a higher interest rate.



You can get your credit report from each of the three major credit reporting agencies for free once every 12 months, upon your request. Visit www.AnnualCreditReport.com to order them. If you have already received your free reports for the year, you can purchase all three directly from Equifax (www.equifax.com/three-bureau-credit-report/) for about \$30. At myFICO.com, you can purchase all three reports and three scores for about \$60 (www.myfico.com/Products/FICO-Score-3-Report-View/).

Your credit can be affected by how often you have moved, how steady and how verifiable your employment history is and how many credit applications you have filled out recently. If you've never had a car loan before, or if your current debt is high despite a good credit rating, you may be quoted higher rates.

DID YOU KNOW? Many people are eligible to join a credit union and don't realize it. Credit unions are non-profit financial institutions that exist to provide a safe, convenient place for members to save money and to get loans at reasonable rates. To find out if you are eligible to join a credit union, visit www.aSmarterChoice.org.

Refinancing your loan

Just because you're paying 16% on your car loan doesn't mean there isn't a better deal to be had. Most car loans can be refinanced without a lot of

added cost, and you might be surprised at your savings from a new loan. Before you try to refinance, ask if your current loan has a penalty for early payoff. When shopping for a new loan, ask about hidden fees or processing charges before you apply. You will be required to pay a title transfer fee because during refinancing you will replace the name of your old lender with that of the new one on your car's title.

Avoiding and resolving problems

In some states, the lender can repossess your car without going to court if you miss payments. If you are short on funds, prioritize your expenses to avoid this outcome. If you know you will miss a payment, notify the lender. They will be more likely to work with you if you are upfront about your circumstances and continue to communicate with them as you work toward getting back on track.

If you believe you have been treated unfairly by an auto lender, contact the Consumer Financial Protection Bureau (CFPB) at 855-411-2372 or www.consumerfinance.gov/complaint/.

Consumer Action www.consumer-action.org

Consumer Action has been a champion of underrepresented consumers nationwide since 1971. A non-profit 501(c)(3) organization, Consumer Action focuses on consumer education that empowers low- and moderate-income and limited-English-speaking consumers to financially prosper.

By providing consumer education materials in multiple languages, a free national hotline, a comprehensive website and annual surveys of financial and consumer services, Consumer Action helps consumers assert their rights in the marketplace and make financially savvy choices.

Consumer Action www.consumer-action.org

415-777-9635
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Consumer advice and referral hotline

Submit consumer complaints to our advice and referral hotline: http://www.consumer-action.org/hotline/complaint_form/ or 415-777-9635

Chinese, English and Spanish spoken

This guide is a project of Consumer Action's Managing Money Project for financial literacy.