

Getting a Vehicle Loan

Section Objectives

Buying a vehicle is a major purchase. You can borrow the money you need from a bank, a credit union or other financing company, many people like to finance through the dealership from which they purchase the vehicle. Getting a loan for a large amount of money entails research, knowledge, and finally negotiation of the best deal for you. After completing this section you will be able to:

- Understand how a lender decides whether to finance your vehicle loan
- Calculate how much you can afford to borrow
- Recognize companies that make car loans and provide vehicle financing
- Recognize the types of loans that are available for vehicle purchase
- How to shop for the best loans rates and terms
- Understand the loan application process
- Understand the loan approval process
- Recognize your rights as a consumer

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Key Terms

Annual Percentage Rate or APR	Total cost or charge for the financing of a loan yearly expressed as a percentage of the loan amount.
Car Loan	A personal loan to purchase a car.
Co-Borrower	A person that signs a loan contract and shares responsibility for the debt with another borrower.
Conventional Loan	A private loan secured by real estate or personal property, not guaranteed by the government.
Dealer Originated Financing	The loaning of money to an individual or business to purchase a car by a company that works in partnership with the dealer.
Dealership Incentive	Price promotions or discount programs offered by auto manufacturers to increase sales or to reduce excess inventory. Dealers may elect to pass the savings on to the buyer.
Gross Income	The amount of your pay before taxes and payroll deductions.
Interest	The amount paid to a lender for money that is borrowed, usually described as an Annual Percentage Rate (APR).
Lemon Law	Laws in many states that provide remedies to consumers for vehicles that repeatedly fail to meet certain standards of quality and performance during the initial period of ownership of a vehicle.
Super Prime Loans	Loans with the lowest rate of interest on bank loans at a given time and place, offered to preferred borrowers.
Principal	The original amount of the loan or debt on which interest is calculated.
Secured Loan	A loan secured by property.
Sub-prime Loans	A type of loan that is offered to individuals with lower credit scores that do not qualify for prime loans, usually with higher interest rates.

Loan Basics

What is a Car Loan?

Anytime you borrow money you sign a promissory note, which is your written promise to repay the loan. When you get a car loan, you are agreeing to use the car as the loan guarantee. In other words, if you don't make the car payments, the car goes back to the dealer/lender.

A car or mortgage loans are considered secured loans. Secured loans are protected by an asset or collateral of some sort. Once you have applied for a loan and it has been approved, you will sign loan documents that details all of the loan terms including interest, number of payments, and total amount financed. Read everything carefully before signing the paperwork, once you have signed the loan documents, very little can be changed and you are bound by a legal contract.

Principal, Interest and APR

In a previous lesson, we reviewed the APR and interest concepts. However, because your interest can drive your car payment up or down, we will take some time to look at these terms again.

- Interest is the cost paid to a lender for the money that was borrowed.
- Principal is the original amount of the loan or debt on which interest is calculated.
- Annual Percentage Rate or APR is the total cost or charge for the financing of a loan yearly expressed as a percentage of the loan amount.

Prior to signing for a loan, shop around for the best Annual Percentage Rate or APR. Even a 1% of APR can affect the price of your purchase for the life of the loan. The following table shows how much you would pay for a five-year, \$5,000 loan with different APRs.

COMPARING THE ANNUAL PERCENTAGE RATE (APR)

The cost of a 5-year, \$5,000 loan				
APR		Monthly payments		Total Cost
10%		\$106.24		\$6,374.40
11%		\$108.71		\$6,522.60
12%		\$111.22		\$6,673.20
13%		\$113.77		\$6,826.20
14%		\$116.37		\$6,980.00
15%		\$118.95		\$7,137.00
16%		\$121.59		\$7,295.40
21%		\$135.27		\$8,116.20

Your “principal” amount owed is the figure to which the interest is applied to figure your balance and monthly payments. The lower the principal amount is the less interest you will pay. If you pay extra against your loan during the time you have it, make sure that you let the lender know that you want it applied to your principal.

How do I Get a Vehicle Loan?

Obtaining financing can be confusing and intimidating. Lenders have tried to streamline this process as much as possible; however, for some individuals this process might be confusing. As you complete this course you will be able to understand the loan process, and increase your confidence about securing a vehicle loan or any other kind of loan in the future. Below are some of the steps involved:

- **Research:** Shop around for the right lender and loan product. This will take some time and effort, but finding a loan with the best rates for you can save money in the long run.
- **Pre-approval:** Before you begin shopping for your dream car, you will want to know how much you can afford to spend for a car. Meet with a lender at a bank, credit union or dealership of your choice to apply for a car loan, taking all the necessary documentation.
- **Loan Application:** After you have a sales contract, apply for the loan by completing a standard loan application. The form includes questions about your income, assets, debts and credit as well as the vehicle that you want to purchase.
- **Loan Processing:** Once the loan application is completed and processed you will be notified whether you have been approved or not. (Most car loans are processed on line by a loan processor using a computer and might be approved in less than an hour.) If you are approved, you will review and sign your loan documents agreeing to pay the lender for the money borrowed. You will give the lender rights to your car if you fail to repay the loan.



Who can Get a Vehicle Loan?

Most consumers ask the question, can I get a good vehicle loan? How much interest I will have to pay? To answer these questions, look at yourself through the eyes of the creditor. The lender wants to make sure you can afford the loan and that you are likely to repay the loan.

This section explains how lenders decide to whom they will loan money. It will show you how to figure out how much money you can afford to borrow.

The 4 C's of Credit: A Review

Lenders are in business to make loans

The person approving or rejecting the loan relies solely on the information in your credit history. Therefore, it is important to know what is on your credit report and what your credit score is before applying for any loans for financing. This information will enable you to be prepared for the process and attain the best possible loan for your new vehicle.

To decide if you are a good credit risk, a lender looks at four things, called the 4 C's of credit – capital, capacity, credit history, and collateral.

- **Capital**
This is the amount of cash you have available. The more cash you have in savings accounts, certificates of deposit, bonds or any other place where you can access it quickly, the more comfortable the lender is that you can cope with emergencies. What are you worth? Do you have other assets, such as savings account, certificate of deposit that could be used in an emergency to repay the debt?
- **Capacity**
The ability to make the new loan payments and still pay all your other living expenses is called capacity. What is your ability to repay the loan? Do you have a job or another income source? Do you have other debts? How much are your debts and what percentage of your monthly income do you use specifically to pay debts?
- **Character**
A lender will look at your credit and the way that you have repaid any money borrowed in the past. Will you repay the loan? Have you used credit before? Do you pay your bills on time?
- **Collateral**
Your new car will be the collateral or extra security for your loan. If you fail to repay your loan, is there something of value that you agree to forfeit? If you are buying your first car, it could be used as collateral to insure that you will repay the loan. If you default (do not pay the loan as agreed), you lose your car.

Many people do not have a credit history. They do not have a checking account or credit cards and have not borrowed money from banks. If you do not have a credit history, the lender might consider your good payment record on other regular monthly payments such as rent or phone companies. Most car loan companies will mainly look for your capacity to pay, your good credit history and your collateral which will be the same car that you are purchasing.

Keep in mind that the better your credit history and your capacity to pay, the lower the interest rate and the monthly payment you will get.

Calculating your Gross Income

Applying for a loan requires the lender to ask a great amount of your personal information such as “what is your gross income”? Knowing and gathering some of the information beforehand will make your loan application experience a lot easier. Below is a table to calculate your gross income:

In order to figure your gross annual (yearly) and gross monthly income, let’s use the following steps. Gross Income = amount before taxes and payroll deductions. (A similar exercise table was used on “Income” Section of the “Counting your Money” lesson.)

Exercise

Check the box by the answer that describes how often you get paid.

Step 1: Determine how often you get paid.

- Weekly (generally, every Friday)
- Bi-weekly (every two weeks, generally every other Friday)
- Semi-monthly, (twice a month, for example on the 15th and 30th of the month.)
- Monthly (once a month)

Step 2: Calculate your gross monthly income

Pay before taxes	How are you paid?	Multiply by:	Equal gross annual income	Divided by 12 equals gross monthly income
\$	Weekly	52	\$	\$
\$	Bi-weekly	26	\$	\$
\$	Monthly	12	\$	\$

Loan Application

What does it include?

When applying for a vehicle loan, it's essential to ensure you have all the relevant information on hand. For joint borrowers this information will be required for both (or all) signers at the time of application. The information needed varies depending on the lender, but in general it requires:

- Proof of income and employment details, usually pay stubs or a signed letter from your employer
- Proof of identity such as a photo identification card or other form of identification accepted by the lender
- Assets, your lender will want to know how much is in your bank accounts, any property and vehicles or other personal property you own, whether you rent or own your home or apartment
- Debts such as credit cards, mortgage loans, verifications of other loans held
- Details of the vehicle you are purchasing, generally dealer invoice, any registration papers, proof of insurance

Your lender will consider your debt repayment history as well as your credit history overall.

What is a Co-Borrower

If more than one person will be responsible for repaying the loan, the second person listed on the application is the co-borrower. When someone signs as a co-borrower on a loan, he/she assumes responsibility for the repayment of the debt. In certain occasions, you might need a co-borrower if you have not established credit at all or if you had some credit problems in the past.

A co-borrower's obligations are the same as those of the primary borrower. If the primary borrower does not repay the loan, the co-borrower accepts responsibility for repaying.

Using Pre-Approval as Leverage

You may use your loan pre-approval as leverage to negotiate at the car dealership. Sales people at the dealership earn their income by selling vehicles, options, and service products. They will want to sell you a vehicle especially if you have been pre-approved by a lender. You may visit the loan department at your bank, credit union or dealership prior to choosing your vehicle.

How to determine what I can afford

Financial experts recommend spending no more than 12% to 15% of your after tax monthly income for car payments. To calculate how much you can afford, multiply your monthly net pay (take home pay after taxes are deducted) times 15%. Your car payment should not exceed this general guideline. You can find a car payment calculator on the Internet, but remember that there is more to the cost of a car than just the car payment. You may want to consider the cost of insurance, parking and any repairs and add it to your total monthly car cost.

Shopping for the Right Financing

The lending market has evolved considerably in recent years. It is easy to get a loan these days because there is a lot competition and innovation in the lending process, still lenders will check your credit scores and history to base their decisions. Automated underwriting makes loan approval fast.

Loan Categories

Auto loans typically fall under two main categories: prime and sub-prime loans. Prime and sub-prime lenders differ in the type of loans they offer. Prime lenders offer “A” loans to those with credit scores of 650 or higher. Sub-prime lenders provide loans to everyone else. Sometimes though, financing companies offer both types of financing.

Some banks and credit unions make loans on the “sub-prime” area. Usually, specialty companies make sub-prime loans and they charge accordingly. On average, a sub-prime borrower pays at least 4 percentage points more. For example, if the average national auto loan rate is 9.04%, then a sub-prime borrower would pay 13.04%. On a typical four-year, \$18,000 loan, the payments would be about \$448 at 9.04% and \$483 at 13.04%.

Prime vs. Sub-prime
Compare the monthly payments between a four-year, \$18,000 loan at 9.04% vs. 13.04%
(a sub-prime rate)

Percentage rate:	9.04%	13.04%
Monthly payments:	\$448	\$483

Sub-prime loans have higher rates and fees since the risk is higher for lenders.

Different Types of Loans

Conventional Loans – The easiest way to get car financing is to go to a bank or finance company and take out a loan that is secured against the vehicle itself. Most loans from finance companies must be paid off over two to five years, although banks offer personal loans that can be repaid over a longer period.

Automotive loans are generally offered at a fixed interest rate, which simplifies budgeting for repayment. One of the biggest factors behind the record sales of new cars has been the low interest rate environment available in the market, and the ability of consumers to borrow against their equity in their homes to buy new cars. Financing companies offer other options such as different types of leasing for individuals and business owners. Ask your dealership for any innovative loan incentives that they might be offering at the time of purchase.

Finding the Right Lender

Before you begin working with a lender, shop around to find someone who has the experience and skills to help you find the best loan product. You may find a lender through referrals, newspapers, the telephone and the Internet. In comparing lenders you should analyze:

- Whether or not they have competitive interest rates
- The experience of other borrowers
- Whether or not they are reputable as a company



Shopping for a Vehicle Loan

Before you go to the dealership, your bank, or credit union, do some research on the Internet. The best way to find who has the best rates is to do your own comparison shopping. If you are looking for an auto loan online, remember to use primarily vehicle loan companies that will help you compare quotes and offers from more than one lender. This will help you get the lowest interest rate and best terms possible.

Also, make sure to fill out your application as accurately as possible in order for the lender to give you the most realistic offer they can.

While there are no instant solutions to find the best auto loan rates, on line sites do make it faster. A couple of hours securing your vehicle financing will both save you money and make the car buying process easier.

Comparing Loans

When obtaining financing to buy a car, there are two factors that influence the total price of the car (1) time and (2) interest rate. The following table shows rates of various lenders:

Lender	New Car Purchases			Used Car Purchases		
	APR	APR	APR	APR	APR	APR
	36 months	48 months	60 months	36 months	48 months	60 months
Lender 1	7.79%	7.59%	7.99%	8.49%	8.49%	9.49%
Lender 2	7.54%	7.65%	8.00%	8.69%	8.69%	9.69%
National Average	8.90%	9.07%	9.09%	9.86%	9.86%	9.89%

The calculations below illustrate the effect of time on total purchase price. Although these figures are calculated using the same interest rate, in the real world, often the longer the loan term, the higher the interest rate.

Suppose you plan to borrow \$20,000 to purchase a new car and you have already been qualified for a loan at 7.54%. The lender asks you if you want to pay the loan back over a three, four, or five year period. If you choose five years, your payments will be lower; however, you're going to pay more for the total price of your car than if you chose a three year repayment schedule. The cost of buying your car over time is noted in *italics*

- 3-year loan: \$622.49 monthly payment x 36 months = \$22,409.64 (*\$2,409.64*)
- 4-year loan: \$483.95 monthly payment x 48 months = \$23,229.60 (*\$3,229.60*)
- 5-year loan: \$401.14 monthly payment x 60 months = \$24,068.40 (*\$4,068.40*)

Doing research, comparing loan terms and finding a lower interest rate might seem like an overwhelming task to you now, but it can save you hundreds on the price of your car.

Worksheet: Shopping for a Car Loan

Name _____ Date: _____

Instructions

You have decided to buy a new car. Select the model that you like and find out how much it costs. Then, shop around for the best car terms.

When you have finished, look at your chart. Which loan will you take? What makes it more appealing? Which institutions offered the best rates, and why do you think they did so?

Amount of Loan \$ _____

Financial Institution				
	Bank 1	Bank 2	Bank 3	Bank 4
APR				
Length of Loan				
Monthly Payment				
Total Finance Charge				
Total to be Repaid				

Special Loan Programs

In an effort to keep up with competition and to offer better deals to consumers, finance companies offer a vast array of auto loan programs. There are programs for first time car buyers, programs for students, military personnel, and even green loan programs. Green loan programs offer special discount incentives to buyers of environmentally friendly vehicles. Credit unions and dealerships all have their own special programs to accommodate the buyer's needs. No matter how good a special program sounds to you, do your homework and compare interest rates and loan terms carefully.

Dealer Incentives

Automakers periodically offer an option to get a rebate or low interest rate when you buy a car. To decide which option makes sense for you, simply compare the savings you'll get with a lower interest rate to the size of the rebate and the rebate's impact on the total cost of your vehicle.

Making Your Decision

Car buying used to mean spending your Saturdays or Sundays visiting different dealerships looking at cars and reading stickers on windows. But, the Internet has changed forever the way to shop for a car. It gives you the best of both worlds: the ability to research and comparison shop at your leisure, in the privacy of your own home, and put you in touch with qualified dealers who can answer questions and arrange that test drive.

90% of buying a car is research. So making your decision after sound research is the best way to ensure that you're happy with your new purchase.

Review

Things To Keep In Mind When You're Shopping For Your New Car:

- Consider all of your car needs, from who will be riding in it to what kind of driving you'll be doing. How often you use it and for what purposes, how long you want to keep your car, etc.
- Decide how much money you can spend.
- Research various makes and models to determine which are the safest, most reliable, and gets the best gas mileage. Consider how much you can spend on maintenance and operating costs.
- Narrow your choices to several cars. Try to avoid having your heart set on one car - it may reduce your bargaining power and there are many makes and models that you might not consider until you get behind the wheel.
- Comparison shop. The Internet allows you to readily see what vehicles compete with each other and how they differ.
- Once you've decided on a car, consider questions about financing, insurance, service contracts, trade-ins, etc.
- Always take the car out for a long test-drive, on low speed roads as well as the highway before purchasing it. Notice noise levels, driver and passenger comfort, braking and acceleration, turning radius, how easily it is to parallel park, etc.
- Read and understand the purchase contract thoroughly before signing.

Working with a Lender

After you have selected the loan and lender, you can begin the application process. During this process you will meet with the lender to fill out a loan application. You can apply for the loan before or after you find the car you want to buy. However, you'll need to know how much money to borrow when you submit your application. Having a lender look at your income and debt prior to the purchase will give you a good idea of how much you can borrow.

Gathering Your Records

Before meeting with a lender, call and ask what documentation (papers) you need with your loan application. As we have mentioned throughout the lessons, a lender has to have proof that you have a good credit record, a steady income and monthly expenses that you are able to pay. Use the "Loan Documentation Checklist" on the next page to help you gather your records and papers.

Loan Documentation Checklist

General Documents	Bank Activity
<input type="checkbox"/> Social Security card and driver's license or other picture ID	<input type="checkbox"/> Most recent savings account statements <input type="checkbox"/> Most recent checking account statements <input type="checkbox"/> Most recent statements for stocks and bonds balances
Income	Current Debt
<input type="checkbox"/> The name, address, phone number and fax number of your employers for the past two years <input type="checkbox"/> Most recent two month's pay stubs	<input type="checkbox"/> For each creditor (bank, credit card or person) with whom you have an outstanding debt: name, address, account number, balance, monthly payment
All Other Income	Explain Bad Payment History
<input type="checkbox"/> Child Support payments <input type="checkbox"/> Pension payments <input type="checkbox"/> Seasonal employment income <input type="checkbox"/> Government assistance <input type="checkbox"/> Social Security benefits	<input type="checkbox"/> Bankruptcy discharge papers*
History of Good Payment	
<input type="checkbox"/> Letters from landlords* <input type="checkbox"/> Receipts of rental payment*	

*These items are for unusual circumstances and will be requested to you by the lender if needed.

Applying for the Loan

You have finally made your decision on the vehicle that you need, the amount that you can and the best loan for you. Now is time to apply for the loan and if approved, sign on the dotted line. Normally, when you apply for a loan, you (and any co-borrowers) will meet in person for about an hour with your loan officer. It is likely that you will:

- Discuss in detail the terms of the loan
- Complete and sign a written application form
- Give the lender copies of the documents you gathered
- Sign permission letters for the lender to send verifications of employment and deposits
- Discuss any issues that the lender should know about
- Discuss any questions that you will have about the loan and its terms

Approval and Rejection

If the lender delivers good news to you, when your loan is approved, you should be prepared to read over your loan documents. Take as much time to make sure you understand the terms of the loan. Loan quotes are generally estimates; however, the final product should look pretty close to the initial lender's offer. It is very difficult to change incorrect information once the loan documents have been signed, so ask questions about anything that does not look right. Check to make sure that your name and address are correct and that the interest rate and monthly payments are what you agreed to pay.

If the lender delivers bad news to you, and your loan is rejected, do not despair. Ask the reasons why your loan was not approved, get a copy of the credit report used, and work to fix and improve your credit so that next time you can buy the item that you want. Shy away from accepting loans with extremely high interest. Sometimes, it pays to wait and get a better deal in the long run.

Your Rights as a Consumer

You have the right to have your loan application reviewed fairly. Federal laws, in particular the Equal Credit Opportunity Act, do not allow loan applicants to be discriminated against, or treated differently, because of their race, religion, race, national origin, sex or marital status, or because they receive public assistance.

There are also state laws that apply to the purchase of a vehicle such as the “Lemon Law”, which provide remedies to consumers for vehicles that repeatedly fail to meet certain standards of quality and performance. Lemon laws vary by state and may not cover leased vehicles.

The Federal Trade Commission works for the consumer to prevent fraudulent, deceptive and unfair business practices in the marketplace and to provide information to help consumers spot, stop, and avoid them. To file a complaint or to get free information on consumer issues, visit www.ftc.gov or call toll-free, 1-877-FTC-HELP (1-877-382-4357); TTY: 1-866-653-4261.

Always Communicate with Your Lender

Once you start the application process, one of the most important things to do is to maintain continuous communication with your lender. Your lender should be able and available to answer any questions or concerns in a reasonable amount of time. If a lender does not answer your phone calls or e-mails promptly, this may be sign of trying to tend to too many customers at once or just being plain careless. Not a good sign of someone you want to handle your business.

Section Review

Choose the best answer by placing a check mark on the box:

1. A loan application can be done before you choose your vehicle
 - True
 - False
2. The lender will consider the following to approve my loan:
 - monthly debt
 - income
 - past credit
 - all of the above
3. The 4 C's or credit are:
 - capital, capacity, character, and collateral
 - consistency, capital, capacity, and collateral
 - capital, consultancy, collateral, and credit
 - consistency, capacity, collateral, and character
4. A guideline for your monthly car payment should be 25-30% of your income.
 - True
 - False
5. The Federal Trade Commission protects consumer rights and provides educational resources
 - True
 - False
6. The Equal Credit Opportunity Act protects
 - the lender
 - the buyer
 - the credit card companies
 - none of the above
7. If your credit is denied by a lender, you have the right to
 - ask the lender for the reasons
 - get a copy of the credit report used
 - re-apply if the denial was due to an error
 - all of the above
8. A lender might require the following at the time of application
 - Picture ID
 - School grades
 - Letters from friends
 - none of the above
9. Someone that shares payment responsibility on a loan is known as:
 - Lender
 - Co-borrower
 - Dealer
 - Salesperson
10. An example of a dealer incentive might be a lower interest rate
 - True
 - False



Additional Learning Resources

Federal Trade Commission

1-877-FTC-HELP (1-877-382-4357)

TTY: 1-866-653-4261

Web Sites and Contact Information

- **Federal Trade Commission (FTC)** – Provides free online consumer information, and resources for auto leasing, purchasing and financing.
Web site: www.ftc.gov/bcp/menu-auto.htm
- **National Association of Auto Dealers (NADA)** – Provides auto financing resources for consumers.
Web site: www.nada.org
- **Kelley Blue Book** – Provides consumers with car pricing and values for new and used cars, and resources for auto financing.
Web site: www.kbb.com

