Family Economics & Financial Education

Shopping for an Automobile Loan

Purchasing an

Most people cannot afford to pay cash to purchase an automobile and will have to take out a loan. An **automobile loan** is borrowed money to purchase an automobile. The terms of the loan will vary depending on the source of the loan. Since an automobile is often a consumer's second most expensive purchase, after a home, it is important to understand the variables present in a loan agreement.

Truth in Lending Act

The **Truth in Lending Act** of 1968 is part of the Consumer Protection Act. It applies to all credit transactions including mortgages, automobiles, credit cards, loans, etc. It requires clear disclosure of key terms and all costs in lending agreements. This allows consumers to easily compare credit offers.

Lenders must disclose:

- The interest rate expressed as the APR;
- The total finance charge.

Loan Variables

- ⇒ **Negotiated Price**—The price being paid for the automobile agreed upon by the seller and buyer.
- ⇒ **Down Payment**—The amount of money paid on the automobile at time of purchase, usually required.
- ⇒ **Trade-In**—The amount of money received for trading in an automobile. This amount is subtracted from the negotiated price of the automobile.
- ⇒ **Loan Amount**—The amount of the loan for the automobile after subtracting the down payment and/or trade-in price from the negotiated price of the automobile before adding interest and fees.
- ⇒ **Annual Percentage Rate (APR)**—Measure of the cost of credit on a yearly basis expressed as a percentage.
- ⇒ **Time Period**—The amount of time the loan will be repaid, usually expressed in months.
- ⇒ **Total Cost of the Loan**—The total of the principal loan amount, interest paid, and other fees.
- ⇒ **Total Purchasing Cost of Automobile**—The total of the down payment, trade-in, and total loan amount.

◊ Rules of Thumb for Loan Variables ◊

The larger the down payment and/or trade-in, the lower the principal.
The longer time period of the loan, the smaller the payments. However, more interest is paid.
The higher the APR, the more interest is paid and the larger total loan amount.

Where to Get Loans

Lenders offer automobile loans to consumers. A **lender** is a large financial institution who offers loans to consumers. **Lender options** include auto dealers, commercial banks, savings and loans, credit unions, online lenders, life insurance policies, and auto insurance companies. Credit unions traditionally offer low APRs on auto loans. However, auto dealer financing might not be the best deal even though it may be the easiest.

> Every variable of a loan needs to be compared to determine the best option for the consumer.

Loans for Young Adults

A **cosigner** is a person who guarantees a loan for the original borrower. The cosigner becomes responsible for the debt if the original borrower defaults. A cosigner may be required if the consumer applying for a loan does not have a credit history or their credit rating is poor. The loan may be awarded with a cosigner because he/she has a good credit rating.

A **credit rating** is an evaluation of a person's credit history. It rates the person's creditworthiness based on many characteristics including repayment patterns, prior credit usage, credit history, and length of employment. For young adults, parents usually cosign the loan. Young adults usually do not receive individual loans because they have not had a chance to build a good credit rating.

Calculating the Cost

Financial Calculator:

Students must have prior knowledge of financial calculators to calculate the loan costs.

Payments per year = P/Y, Principal loan amount = PV, APR = I/Y, Time period = N

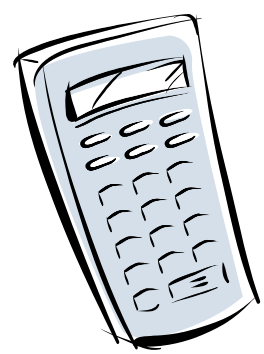
Enter P/Y, PV, I/Y, N into calculator to compute monthly payment (PMT).

(The calculator will perform the correct equation.)

Monthly payment * Number of payments = Total loan amount

Total loan amount - Principal loan amount = Interest paid

Total loan amount + Down payment = Total purchasing cost



Estimation with Standard Calculator:

This method is quick and easy, but is just an estimation tool because it does not account for compounding interest. It can be used if a financial calculator is not available.

Principal loan amount * APR * Time period = Interest paid

Interest paid + Principal loan amount = Total loan amount

Total loan amount / Number of payments = Monthly payment

Automobile Loan Calculator Web sites

If a financial calculator is not available, many Web sites offer loan calculators:

Bank Rate: http://www.bankrate.com/brm/calculators/autos.asp

Loan Calculators: http://www.loan-calculators.com/

Yahoo! Auto Loan Center: http://loan.yahoo.com/a/autocalc.html

Edmunds Car Buying Guide: http://www.edmunds.com/

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