Understanding Vehicle Financing

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With prices averaging more than $31,000 for a new vehicle and $17,000 for a used model from a dealership, you might consider financing or leasing your next vehicle. You have two financing options: direct lending or dealership financing.

In **direct lending**, you get a loan directly from a bank, finance company, or credit union. You agree to pay, over a period of time, the *amount financed*, plus a *finance charge*. Once you enter into a contract with a dealership to buy a vehicle, you use the loan from the direct lender to pay for the vehicle.

Direct lending may offer you:

- Comparisons. You have the chance to shop around and ask several lenders directly about their credit terms before you agree to buy a specific vehicle.
- Credit terms in advance. By getting financing before you buy the vehicle, you will know your rate and other terms when you are shopping.

In **dealership financing** – another common type of vehicle financing – you get financing through the dealership. You and a dealer enter into a contract where you buy a vehicle and agree to pay, over a period of time, the *amount financed* plus a *finance charge*. The dealer may retain the contract, but typically sells it to a bank, finance company or credit union – called an *assignee* – that services the account and collects your payments.

Dealership financing may offer you:

- Convenience. Dealers offer vehicles and financing in one location and may have extended hours, like evenings and weekends.
- Multiple financing options. The dealer's relationships with a variety of banks and finance companies may mean it can offer you a range of financing choices.
- Special programs. Dealers sometimes offer manufacturer-sponsored, low-rate or incentive programs to buyers. The programs may be limited to certain vehicles or may have special requirements, like a larger *down payment* or shorter contract length (36 or 48 months). These programs might require a strong credit rating; check to see if you qualify.

Remember: Shop around before you make a decision about buying or leasing. Consider offers from different dealers and several sources of financing, including banks, credit unions, and finance companies. Comparison shopping is the best way to find both the vehicle and the finance or lease terms that best suit your needs.

Before you buy or lease a vehicle

Consider Federal and State Laws

Review the federal and state laws that affect the vehicle financing and leasing process (see pages 13-14). These laws offer important information that can help you negotiate a better deal or better understand the process. They also give you certain rights.

Determine how Much You Can Afford

Before you finance or lease a vehicle, take a look at your financial situation to make sure you have enough income to cover your monthly living expenses. Then, if you want to finance a vehicle, know that the total amount you will pay will depend on several factors, including the price you negotiate for the vehicle, the *Annual Percentage Rate (APR)*, which may be negotiable, and the length of the credit contract.

Finance or lease a vehicle only when you can afford to take on a new obligation. Check the overall costs for the purchase or lease. Consider the monthly payment in finance or lease negotiations. You may want to use the "Monthly Spending Plan" worksheet on page 4 as a guide.

The only time to consider taking on additional debt is when you are spending less than you take home. The additional debt load should not cut into any amount you have committed to saving for emergencies and other top priorities or life goals. Saving for a down payment or trading in a vehicle can reduce the amount you need to finance and reduce your financing costs. In some cases, your trade-in vehicle will take care of the down payment on your new vehicle.

If you owe more on your vehicle than its market value, you have *negative equity* in your vehicle. This is a consideration if you plan to use your vehicle as a trade-in. The longer your new credit contract, the longer it will be before you have positive equity in the new vehicle – that is, before it is worth more than you owe. If you have negative equity, you may need to make a bigger down payment. Or the dealer may offer to include the negative equity in your new finance contract by increasing the amount financed to include the amount you still owe on your current vehicle. This will increase your monthly payments on the new contract in two ways: it adds to the amount financed and increases the finance charge. If you have negative equity in your vehicle, consider paying down the debt before you buy another vehicle. If you use the vehicle for a trade-in, ask how the negative equity affects your new credit obligation.

For more information, see *Auto Trade-ins and Negative Equity* (**www.consumer.ftc.gov/articles/0257-auto-trade-ins-and-negative-equity**), a publication from the Federal Trade Commission.

Monthly Spending Plan

Consider all the costs involved, not just the monthly payment, for financing or leasing a vehicle. Knowing your monthly spending and saving commitments and habits will help make your budget more realistic.

1. Complete **Column 1** based on your current situation. Start with your monthly take-home pay. This is how much you have left after taxes and other deductions.

   Subtract the amount you need for all your saving goals and monthly expenses, including monthly credit payments and payments for housing and utilities.

   The remaining balance is the maximum you can afford to put toward the monthly payment for a vehicle and any new related expenses, like vehicle insurance.

2. Complete **Column 2** based on your new situation. This column will show your new vehicle payment and the adjustments you have made to accommodate your expenses and credit obligations. Adjust any expenses that might go up or down when you get a vehicle, such as maintenance and insurance expenses.

   The remaining balance in Column 2 will show you whether you can afford the new vehicle payment and the change in expenses.

	Current	Revised
Monthly Take-Home Pay	$__________	$__________
Saving	- $__________	- $__________
Monthly Expenses:		
Mortgage Payment/Rent	- $__________	- $__________
Utilities	- $__________	- $__________
Food	- $__________	- $__________
Transportation	- $__________	- $__________
Insurance (Home, Vehicle, Life)	- $__________	- $__________
Taxes	- $__________	- $__________
Clothing	- $__________	- $__________
Personal	- $__________	- $__________
Entertainment	- $__________	- $__________
Gifts & contributions	- $__________	- $__________
Education	- $__________	- $__________
Credit Card Payments	- $__________	- $__________
Vehicle Payment(s)	- $__________	- $__________
Miscellaneous	- $__________	- $__________
Remaining Balance	= $__________	= $__________

When you apply for financing

Most dealerships have a Finance and Insurance (F&I) Department that will tell you about its available financing options. The F&I Department manager will ask you to complete a credit application, which may include your:

- name;
- Social Security number;
- date of birth;
- current and previous address(es) and length of stay;
- current and previous employer(s) and length of employment;
- occupation;
- sources of income;
- total gross monthly income; and
- financial information on current credit accounts, including debt obligations.

Most dealerships will get a copy of your *credit report*, which has information about your current and past credit obligations, your payment record, and data from public records (for example, a bankruptcy filing from court documents). For each account, your credit report shows your account number, the type and terms of the account, the credit limit, the most recent balance and the most recent payment. The comments section describes the status of your account, including the creditor's summary of past due information and legal steps that may have been taken to collect on those obligations.

The dealership typically submits your credit application to one or more potential assignees, such as a bank, finance company or credit union, to determine their willingness to buy your contract from the dealer.

The finance companies or other potential assignees evaluate your credit application using automated techniques like *credit scoring*, where factors like your credit history, length of employment, income, and expenses may be weighted and scored.

The potential assignee will not deal directly with you when you finance through a dealer. It bases its evaluation on your credit report and *credit score*, the completed credit application, and the terms of the sale, such as the amount of the down payment. Each potential assignee decides whether it is willing to buy the contract, notifies the dealership of its decision and, if applicable, offers the dealership a *wholesale rate*, often called the *buy rate*, at which the assignee will buy the contract.

Your dealer may offer manufacturer incentives, such as reduced finance rates or cash back on certain models. You may see these specials advertised in your area and online. Make sure you ask your dealer if the model you are interested in has any special financing offers. Generally, these discounted rates are not negotiable, may be limited by a consumer's credit history, and/or are available only for certain makes, models, or model-year vehicles.

When no special financing offers are available, you usually can negotiate the APR and the terms for payment with the dealership, just as you would negotiate the price of the vehicle. The APR that you negotiate with the dealer usually is higher than the wholesale rate, because it includes an amount that compensates the dealer for handling the financing. Negotiation can take place before or after the dealership accepts and processes your credit application. Try to negotiate the lowest APR with the dealer, just as you would negotiate the best price for the vehicle.

Dealers who promote rebates, discounts or special prices must clearly explain what is required to qualify for these incentives. For example, these offers may involve being a recent college graduate or a member of the military, or they may involve reductions for only specific vehicles. Check to see if you qualify for any available rebates, discounts or offers as they can reduce your price and, therefore, the amount you finance or that is part of your lease.

Most consumers who apply for credit will get a free credit score disclosure notice. This notice includes a credit score, the source of that score, and information about where your score falls with respect to other consumers.

Ask questions about the terms of the contract before you sign. For example, ask whether the terms of the contract are final and have been fully approved before you sign and leave the dealership with the vehicle. If the dealer says they are still working on the approval, be aware that the deal is not yet final. Consider waiting to sign the contract and keeping your current vehicle until the financing has been fully approved. Or check other financing sources before you sign and before you leave your car at the dealership.

Should I lease a vehicle?

When you lease a vehicle, you have the right to use it for an agreed number of months and miles. At lease end, you may return the vehicle, pay any end-of-lease fees and charges, and "walk away." You may buy the vehicle for the additional agreed-upon price if you have a purchase option, a typical provision in lease agreements. If you end the lease early, in most cases you will be responsible for an early termination charge that could be substantial.

The monthly payments on a lease usually are lower than monthly finance payments on the same vehicle because you are paying for the vehicle's expected depreciation during the lease period, plus a rent charge, taxes, and fees. But at the end of a lease, you must return the vehicle unless the lease agreement lets you buy it and you agree to the purchase costs and terms.

To determine if leasing fits your situation:

- Consider the beginning, middle and end of lease costs.
- Compare different lease offers and terms, including mileage limits.
- Consider how long you may want to keep the vehicle.

The mileage limit in most standard leases is based on a certain number of miles you can drive, typically 15,000 or fewer per year. You can negotiate a higher mileage limit, but that normally increases the monthly payment because the vehicle depreciates more during the life of the lease. If you go beyond the mileage limit in the lease agreement, you probably will have to pay an additional charge when you return the vehicle.

When you lease, you are responsible for excess wear and damage and any missing equipment. You also must service the vehicle according to the manufacturer's recommendations and maintain insurance that meets the leasing company's standards.

For more information, see *Keys to Vehicle Leasing* (**www.federalreserve.gov/pubs/leasing**), a publication of the Federal Reserve Board.

What about a co-signer?

A creditor may require that you have a co-signer on the finance contract to make up for any deficiencies in your credit history. As a co-signer, you assume equal responsibility for the contract. The account payment history will appear on both the borrower's and co-signer's credit reports. For this reason, use caution if you are asked to co-sign for someone. Co-signers are legally obligated to repay the contract, so make sure you know the terms of the contract and can afford to take on the payments before you agree to co-sign for someone.

For more information, see *Co-signing a Loan* (**http://www.consumer.ftc.gov/articles/0215-co-signing-loan**), a publication from the Federal Trade Commission.

Get a copy of your credit report

It is a good idea to check your credit report before you make any major purchase. You can get a free copy of your report from each of the three nationwide reporting agencies every 12 months. To order, visit **www.annualcreditreport.com**, call 1-877-322-8228, or complete the Annual Credit Report Request form at **www.annualcreditreport.com** and mail it to Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281.

If you are denied credit or you experience another adverse action based on information in your credit report, you may be able to get additional copies of your report for free. Usually, you will get your credit score as part of a credit score disclosure notice after you apply for financing.

If you want a copy of your credit report, but have already received your free copy, you can buy your report for a small fee. Contact any of the three nationwide credit reporting agencies:

- Equifax Credit Information Services: 1-800-685-1111; **www.equifax.com**
- Experian: 1-888-397-3742; **www.experian.com**
- TransUnion Corporation: 1-800-916-8800; **www.transunion.com**

For more information about credit reports:

- *Free Credit Reports* (**www.consumer.ftc.gov/articles/0155-free-credit-reports**)
- *Disputing Errors on Credit Reports* (**www.consumer.ftc.gov/articles/0151-disputing-errors-credit-reports**)
- *How Credit Scores Affect the Price of Credit and Insurance* (**www.consumer.ftc.gov/articles/0152-how-credit-scores-affect-price-credit-and-insurance**)

Know the terms

Before signing any documents, whether at a dealership, bank, finance company or credit union, understand the following terms because financing has a language of its own.

Additional Products or Services – Products or services that the dealer may offer in a sale, financing, or lease. Examples include *extended service contracts, credit insurance*, and *guaranteed auto protection*. These products and services are optional. Get the costs and terms of any additional products and services in your contract, and sign only for the specific products you want.

Amount Financed – The dollar amount of the credit provided to you.

Annual Percentage Rate (APR) – The cost of credit expressed as a yearly rate. You may be able to negotiate this figure.

> **Factors that influence your APR –** Your credit history, current finance rates, dealers' compensation, competition, market conditions, and special offers are among the factors that affect your APR. Try to negotiate the lowest APR just as you negotiate the price of the vehicle.

Assignee – The bank, finance company or credit union that buys the contract from the dealer.

Credit Insurance – Optional insurance that pays the scheduled unpaid balance if you die or the scheduled monthly payments if you become disabled. The cost of optional credit insurance must be disclosed in writing. If you decide you want it, you must agree to it and sign for it.

Credit Report – A document that includes information on where you live, how you pay your bills, and whether you have been sued, or have filed for bankruptcy. Nationwide consumer reporting companies sell the information in your report to creditors, insurers, employers, and other businesses that use it to evaluate your applications for credit, insurance, employment, or renting a home.

Credit Score – A number that reflects the credit risk you present based on information in your credit file. The better your history of credit, the higher your score. Your credit score may be used to help decide the rate and other terms you are offered.

Down Payment – The initial amount you pay to reduce the amount you finance.

Extended Service Contract – Optional protection on specified mechanical and electrical components of the vehicle that may be available for purchase. It supplements any warranty coverage provided with the vehicle.

Finance Charge – The cost of credit expressed as a dollar amount. You may be able to negotiate this figure.

Fixed Rate Financing – Financing where the finance rate stays the same over the life of the contract.

Guaranteed Auto Protection (GAP) – Optional protection that pays the difference between the amount you owe on your vehicle and the amount you would get from your insurance company if the vehicle is stolen or destroyed before you have paid off your credit obligation.

Monthly Payment Amount – The dollar amount due each month on the loan, finance contract, or lease agreement.

Negative Equity – The amount owed on a vehicle above its market value. For example, if your credit payoff is $18,000 and your vehicle's market value is $15,000, you have negative equity of $3,000.

Negotiated Price of the Vehicle – The purchase price of the vehicle agreed on by the buyer and the seller. The price should reflect any rebates, discounts, or special offers that you can get at the dealership if you meet certain qualifications, which should be clearly disclosed.

Repossession – If you do not make timely payments on a vehicle, your creditor may have the right to repossess it without going to court or warning you.

Total of Payments – As disclosed on a loan or finance contract, the total amount you will have paid after you have made all the payments as scheduled. For a lease, this is the amount you will have paid by the end of the lease.

Variable Rate Financing – Financing where the finance rate varies and the amount you must pay changes over the life of the contract. This is not typical in vehicle finance transactions.

Wholesale Rate (Buy Rate) – The finance rate at which an assignee buys a retail installment sale contract from a dealer.

Shop for the Best Deal when Financing a vehicle

When you finance a vehicle, shop around, review, and compare the financing terms offered by more than one creditor. You are shopping for two products: the financing and the vehicle. Negotiate the terms and consider several offers. Take the time to know and understand the terms, conditions, and costs to finance a vehicle before you sign a contract. If you sign a contract, get a copy of the signed papers before you leave the dealer or other creditor. Make sure you understand whether the deal is final before you leave in your new vehicle.

	Creditor 1	Creditor 2	Creditor 3
Negotiated Price of Vehicle	$__________	$__________	$__________
Down Payment	$__________	$__________	$__________
Trade-In Allowance (If trading in your Vehicle, this may involve negative equity)	$__________	$__________	$__________
Extended Service Contract (Optional)*	$__________	$__________	$__________
Credit Insurance (Optional)*	$__________	$__________	$__________
Guaranteed Auto Protection (Optional)*	$__________	$__________	$__________
Other Optional* Products __________	$__________	$__________	$__________
Amount Financed	$__________	$__________	$__________
Annual Percentage Rate (APR)	__________%	__________%	__________%
Finance Charge	$__________	$__________	$__________
Length of Contract in Months	__________	__________	__________
Number of Payments	__________	__________	__________
Monthly Payment Amount	$__________	$__________	$__________

** Items that are optional are not required for the purchase. If you do not want these items, tell the dealer and do not sign for them. Be sure they are not included in the monthly payments or elsewhere on a contract that you sign.*

Sample Comparison

Consider the total costs of financing the vehicle, not just the monthly payment. It is important to compare different payment plans for both the monthly payment and *total of payments* required, for example, for a 36-month/3-year and a 60-month/5-year credit purchase. In general, longer contract lengths mean lower monthly payments, higher total finance charges, and higher overall costs. Be sure you will have enough income available to make the monthly payment throughout the life of the loan or finance contract. You also will need to account for the cost of insurance, which may vary depending on the type of vehicle you buy, among other factors.

Term	3 Years – 36 months	5 Years – 60 Months
Purchase Price	$31,000	$31,000
Down Payment (20%)	$6,200	$6,200
Amount Financed	$24,800	$24,800
Contract Rate (APR)	5.00%	5.00%
Finance Charge	$1,958	$3,280
Monthly Payment Amount	$743	$468
Total of Payments	$26,758	$28,080

Note: All dollars have been rounded for this illustration. The numbers in this sample are for example purposes only. Actual finance terms may be different and will depend on many factors, including your creditworthiness.

Remember

Before Visiting Any Dealership:

- Identify your transportation needs.
- Figure out your financial situation and budget. Using the worksheets in this booklet, determine how much you can afford to finance and spend for a vehicle. Remember that a longer-term finance contract may mean smaller monthly payments than a shorter-term finance contract (if all other terms are the same), but you will pay more money over time.
- Get and read a copy of your credit report. Errors or accurate negative information can affect your ability to get credit. Generally, you will be able to get a lower rate if you have paid your credit obligations when they are due. You have a right to dispute inaccurate information in the report, and you should do that before you apply for vehicle financing or a lease.
- Check auto buying guides, newspaper ads, and other publications and websites to find out the price range and other information for the vehicle you are interested in. Visit dealer websites. Some list their inventory online, by location.
- Find out the cost of insurance from your insurer in advance, so you can factor in that amount.
- Determine the market value of your current vehicle before you negotiate the purchase of a new vehicle and find out the net outstanding balance on your credit contract. If your vehicle's value is less than the amount you owe (negative equity), consider paying down the debt.
- Compare APRs and financing terms from several sources, such as banks, credit unions, finance companies, and dealerships. Shop for information about current offers online. You may find restrictions on the most attractive rates or terms from any credit source.
- Know the difference between buying and leasing a vehicle.

At the Dealership:

- Stay within your price range.
- Try to negotiate both your purchase price and your finance or lease terms.
- Determine whether an offer meets your budget and transportation needs.
- Understand the value and cost of any optional products or services offered to you, such as an extended service contract, credit insurance, or guaranteed auto protection. Make sure the payments or other terms quoted do not include these products unless you want them. If you do not want these products, do not sign for them.
- Read the entire contract carefully and ask questions about the terms of the contract before you sign. If you are using dealership financing or leasing, ask if the terms are final. Once you sign the contract, you are legally obligated.

After Signing:

- Be sure you have a copy of the credit contract or lease agreement, with all signatures and terms filled in, before you leave the dealership. Do not agree to have the papers mailed or provided to you later because the documents may get misplaced or lost.

- Know that if you financed the vehicle, the finance source has a *lien* on the vehicle's title (and in some cases holds the actual title) until you have paid the contract in full.

- Make your payments on time. Late or missed payments can have serious consequences; late fees, repossession, and negative entries on your credit report can make it more difficult to get credit in the future.

If You Experience Financial Problems:

- Contact your creditor as soon as you realize you will be late with a payment. Many creditors work with consumers they believe will be able to pay soon, even if slightly late. You may be able to negotiate a delay in your payment or a revised schedule of payments. If you can reach an agreement to change your original contract, get it in writing to avoid questions later.

- Know your obligations. If you are late with your vehicle payments or, in some states, if you do not have the required auto insurance, your vehicle could be repossessed. The creditor or assignee may repossess the vehicle in full satisfaction of the credit agreement or may sell the vehicle and apply the proceeds from the sale to the outstanding balance on your credit agreement. If the vehicle is sold for less than what you owe, you may be responsible for the difference.

- Know that the law in some states allows the creditor or assignee to repossess your vehicle without going to court.

Federal laws

Some federal and state laws affect the vehicle financing and leasing process. They offer important information that can help you negotiate a better deal, better understand the process, and give you certain rights.

Consumer Leasing Act – requires the leasing company, or *lessor* (a dealership, for example), to disclose certain information before a lease is signed. That includes the amount due at lease signing or delivery; the number and amounts of monthly payments; all fees charged, including license fees and taxes; the charges for default or late payments; whether the lease can be ended early; whether the leased vehicle can be bought at the end of the lease; the price to buy at the end of the lease; and any extra payments that may be required at the end of the lease. The lessor also must disclose the annual mileage allowance and charges for excessive mileage.

Credit Practices Rule – requires creditors to provide a written notice to potential co-signers about their liability if the other person fails to pay; prohibits late charges in some situations; and prohibits creditors from using certain contract provisions that the government has found to be unfair to consumers.

Equal Credit Opportunity Act – prohibits discrimination related to credit because of gender, race, color, marital status, religion, national origin or age. It also prohibits discrimination related to credit based on the fact that you are receiving public assistance or that you have exercised your rights under the federal Consumer Credit Protection Act. It requires certain creditors to provide consumers with information if the creditor denies them financing or takes other adverse action.

Fair Credit Reporting Act – gives consumers many rights, including the right to one free credit report each year from each of the three nationwide consumer reporting agencies. It allows consumers to call one number to notify credit reporting agencies of identity theft. It also provides a process for consumers to dispute information in their credit reports that they believe is inaccurate or incomplete. It requires creditors to give consumers their credit reports and credit scores if a creditor used a credit score in denying them credit or taking other adverse action against them; and it requires creditors to provide consumers with their credit scores and related information in certain other circumstances.

Risk-Based Pricing Rule – gives most consumers information about their credit scores when they apply for financing. Most creditors comply with the rule by providing consumers who apply for vehicle financing with a Credit Score Disclosure Notice. This notice contains a consumer's credit score and additional information to put the score in context (for example, it indicates how the credit score compares to the credit scores of other consumers).

Truth in Lending Act – requires that, before you sign the agreement, creditors give you written disclosure of important terms of the credit agreement, like the annual percentage rate (APR), finance charge, monthly payment amount, payment due dates, amount financed, length of the credit agreement, and any charges for late payment.

For more information on federal credit regulations and your rights, contact:

Federal Trade Commission
Washington, DC 20580
877-FTC-HELP (382-4357)
www.ftc.gov

Federal Reserve System
Washington, DC 20551
888-851-1920
www.federalreserve.gov

Consumer Financial Protection Bureau
Washington, DC 20220
855-411-2372
www.consumerfinance.gov

State laws

Your state's laws may provide you with additional rights. For more information, contact your local consumer protection agency (www.consumeraction.gov) or Attorney General's office (www.naag.org).

Notes

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