

# UNDERSTANDING VEHICLE FINANCING



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**W**ith prices averaging more than \$28,000 for a new vehicle and \$15,000 for a used vehicle, most consumers need financing or leasing to acquire a vehicle. In some cases, buyers use “direct lending:” they obtain a loan directly from a finance company, bank or credit union. In direct lending, a buyer agrees to pay the amount financed, plus an agreed-upon finance charge, over a period of time. Once a buyer and a vehicle dealership enter into a contract to purchase a vehicle, the buyer uses the loan proceeds from the direct lender to pay the dealership for the vehicle. Consumers also may arrange for a vehicle loan over the Internet.

A common type of vehicle financing is “dealership financing.” In this arrangement, a buyer and a dealership enter into a contract where the buyer agrees to pay the amount financed, plus an agreed-upon finance charge, over a period of time. The dealership may retain the contract, but usually sells it to an assignee (such as a bank, finance company or credit union), which services the account and collects the payments.

For the vehicle buyer, dealership financing offers:

1. *Convenience – Dealers offer buyers vehicles and financing in one place.*
2. *Multiple financing relationships – The dealership’s relationships with a variety of banks and finance companies mean it can usually offer buyers a range of financing options.*
3. *Special programs – From time to time, dealerships may offer manufacturer-sponsored, low-rate programs to buyers.*

This booklet explains dealership financing and can serve as a guide as you evaluate your own financial situation before you finance a new or used vehicle. It will also help you understand vehicle leasing.



## FEDERAL LAWS

Familiarize yourself with laws that authorize and regulate vehicle dealership financing and leasing.

**TRUTH IN LENDING ACT** – requires that, before you sign the agreement, creditors give you written disclosure of important terms of the credit agreement such as APR, total finance charges, monthly payment amount, payment due dates, total amount being financed, length of the credit agreement and any charges for late payment.

**CONSUMER LEASING ACT** – requires the leasing company (dealership, for example) to disclose certain information before a lease is signed, including: the amount due at lease signing or delivery; the number and amounts of monthly payments; all fees charged, including license fees and taxes; and the charges for default or late payments. For an automobile lease, the lessor must additionally disclose the annual mileage allowance and charges for excessive mileage; whether the lease can be terminated early; whether the leased automobile can be purchased 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.

**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 your 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.

**FAIR CREDIT REPORTING ACT** – Gives consumers many rights, including the right to one free credit report each year. It allows consumers to call one number to notify credit reporting agencies and credit card companies of identify theft. It also provides consumers with a process to dispute information in their credit file that they believe is inaccurate or incomplete.

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

Federal Trade Commission  
Washington, DC 20580  
Phone: (877) FTC-HELP (382-4357)  
Web site: [www.ftc.gov](http://www.ftc.gov)

Federal Reserve System  
Washington, DC 20551  
Phone: (202) 452-3693  
Web site: [www.federalreserve.gov](http://www.federalreserve.gov)

## STATE LAWS

Your state's laws may provide you with additional rights. For information on these laws, contact your state's consumer protection agency or Attorney General's office (Web site: [www.naag.org](http://www.naag.org)).





## WHAT ABOUT A CO-SIGNER?

You may be required by the creditor to have a co-signer sign the finance contract with you in order to make up for any deficiencies in your credit history. A co-signer assumes equal responsibility for the contract, and the account history will be reflected on the co-signer's credit history as well. For this reason, you should exercise caution if asked to co-sign for someone else. Since many co-signers are eventually asked to repay the obligation, be sure you can afford to do so before agreeing to be someone's co-signer.

## SHOULD I LEASE A VEHICLE?

If you are considering leasing, there are several things to keep in mind. The monthly payments on a lease are usually lower than monthly finance payments on the same vehicle because you are paying for the vehicle's expected depreciation during the lease term, plus a rent charge, taxes, and fees. But at the end of a lease, you must return the vehicle unless the lease lets you buy it and you agree to the purchase costs and terms. To be sure the lease terms fit your situation: Consider the beginning, middle and end of lease costs. Compare different lease offers and terms, including mileage limits, and also consider how long you may want to keep the 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, which is a typical provision in retail lease contracts. Keep in mind that in most cases, you will be responsible for an early termination charge if you end the lease early. That charge could be substantial.



Another important consideration is the mileage limit – most standard leases are calculated based on a specified number of miles you can drive, typically 15,000 or fewer per year. You can negotiate a higher mileage limit, but you will normally have an increased monthly payment since the vehicle's depreciation will be greater during your lease term. If you exceed the mileage limit set in the lease agreement, you'll probably have to pay additional charges when you return the vehicle.

When you lease, you are also responsible for excess wear and damage, and missing equipment. You must also service the vehicle in accordance with the manufacturer's recommendations.

Finally, you will have to maintain insurance that meets the leasing company's standards. Be sure to find out the cost of this insurance.

"Keys to Vehicle Leasing," a publication of the Federal Reserve Board, contains more information about leasing. You can request a copy from:

Publications Services  
Board of Governors of the Federal  
Reserve System  
Mail Stop 127  
Washington, DC 20551

This brochure is also available on the Web at:

[www.federalreserve.gov/pubs/leasing](http://www.federalreserve.gov/pubs/leasing)

## DETERMINING HOW MUCH YOU CAN AFFORD

Before financing or leasing a vehicle, make sure you have enough income to cover your current monthly living expenses. Then, finance new purchases only when you can afford to take on a new monthly payment. The "Monthly Spending Plan" is a tool to help determine an affordable payment for you.

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

# VEHICLE FINANCING WORKSHEET

## MONTHLY SPENDING PLAN

1. Complete Column 1 based on your current situation. Start with your monthly take-home pay. This is the amount you have left after taxes and other deductions have been made.

Subtract the amount you need for savings and monthly expenses, including monthly creditor payments.

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

2. Complete Column 2 based on your new situation. This column will show your new vehicle payment and adjustments you've made to expenses and credit obligations. Be sure to adjust any expenses, like vehicle maintenance and insurance expenses, which might go up or down when you get a new vehicle.

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

	REVISED [1]	CURRENT [2]
<b>MONTHLY INCOME &amp; SAVINGS</b>		
Monthly Take-Home Pay	\$ _____	\$ _____
Savings	-\$ _____	-\$ _____
<b>MONTHLY EXPENSES:</b>		
Mortgage Payment/Rent	-\$ _____	-\$ _____
Utilities	-\$ _____	-\$ _____
Food	-\$ _____	-\$ _____
Transportation	-\$ _____	-\$ _____
Insurance (Home, Vehicle, Life)	-\$ _____	-\$ _____
Taxes	-\$ _____	-\$ _____
Clothing	-\$ _____	-\$ _____
Personal	-\$ _____	-\$ _____
Entertainment	-\$ _____	-\$ _____
Gifts & Contributions	-\$ _____	-\$ _____
Education	-\$ _____	-\$ _____
Credit Card Payments	-\$ _____	-\$ _____
Other Creditor Payments	-\$ _____	-\$ _____
Vehicle Payments	-\$ _____	-\$ _____
Miscellaneous	-\$ _____	-\$ _____
<b>REMAINING BALANCE:</b>	= \$ _____	= \$ _____

# WORKSHEET

## SHOP FOR THE BEST DEAL WHEN FINANCING A VEHICLE

Take the time to know and understand all of the terms, conditions and costs to finance a vehicle before you sign the contract. Review and compare the financing terms offered by more than one creditor.

	<u>CREDITOR 1</u>	<u>CREDITOR 2</u>	<u>CREDITOR 3</u>
Negotiated Price of Vehicle	\$ _____	\$ _____	\$ _____
Down Payment	\$ _____	\$ _____	\$ _____
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	\$ _____	\$ _____	\$ _____

\*Any 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.

### SAMPLE COMPARISON

This example will help you compare the difference in the monthly payment amount and the total payment amount for a 3-year and a 5-year credit transaction. Generally, longer terms mean lower monthly payments and higher finance charges. Make sure you have enough income available to make the monthly payment by reviewing your monthly spending plan. You'll also need to factor in the cost of car insurance, which may vary depending upon the type of vehicle.

	<b>3 YEARS (36 MONTHS)</b>	<b>5 YEARS (60 MONTHS)</b>
Amount Financed	\$ 20,000	\$ 20,000
Contract Rate (APR)	8.00%	8.00%
Finance Charges	\$ 2,562	\$ 4,332
Monthly Payment Amount	\$ 627	\$ 406
Total of Payments	\$ 22,562	\$ 24,332
Down Payment	10%	10%

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 credit worthiness.

## KNOW THE TERMS OF FINANCING BEFORE YOU SIGN

### NEGOTIATED PRICE OF THE VEHICLE –

The purchase price of the vehicle agreed upon by the buyer and the dealer.

### DOWN PAYMENT –

An initial amount paid to reduce the amount financed.

### EXTENDED SERVICE CONTRACT –

Optional protection on specified mechanical and electrical components of the vehicle available for purchase to supplement any warranty coverage provided with the new or used vehicle.

### CREDIT INSURANCE –

Optional insurance that pays the scheduled unpaid balance if you die or scheduled monthly payments if you become disabled. As with most contract terms, the cost of optional credit insurance must be disclosed in writing, and, if you want it, you must agree to it and sign for it.

### GUARANTEED AUTO PROTECTION (GAP) –

Optional protection that pays the difference between the amount you owe on your vehicle and the amount you receive from your insurance company if the vehicle is stolen or destroyed before you have satisfied your credit obligation.

### AMOUNT FINANCED –

The dollar amount of the credit that is provided to you.

### ANNUAL PERCENTAGE RATE OR “APR” –

The cost of credit expressed as a percentage.

### FINANCE CHARGE –

The total dollar amount you pay to use credit.

### FIXED RATE FINANCING –

The finance rate remains the same over the life of the contract.

### VARIABLE RATE FINANCING –

The finance rate varies and the amount you must pay changes over the life of the contract.

### MONTHLY PAYMENT AMOUNT –

The dollar amount due each month to repay the credit agreement.

### ASSIGNEE –

The bank, finance company or credit union that purchases the contract from the dealer.

## GETTING A COPY OF YOUR CREDIT REPORT

It's a good idea to check your credit report, which you can do every twelve months for free. To request a copy of your report, call 1-877-322-8228 or visit [www.annualcreditreport.com](http://www.annualcreditreport.com). In some situations, such as when you are denied credit, you may be able to obtain additional copies for free. In other situations, if you would like to obtain a credit report more often than once a year, you can do so for a small fee by contacting any of the three major credit reporting agencies listed below.

Experian  
P.O. Box 2104  
Allen, TX 75013  
Phone: (888) 397-3742  
Web site: [www.experian.com](http://www.experian.com)

Equifax Credit Information Services  
P. O. Box 740241  
Atlanta, GA 30374-0241  
Phone: (800) 685-1111  
Web site: [www.equifax.com](http://www.equifax.com)

TransUnion Corporation  
P. O. Box 1000  
Chester, PA 19022  
Phone: (800) 916-8800  
Web site: [www.transunion.com](http://www.transunion.com)

For more information about obtaining your credit report, visit [www.ftc.gov/bcp/online/pubs/credit/fcrasummary.pdf](http://www.ftc.gov/bcp/online/pubs/credit/fcrasummary.pdf).



**REMEMBER...  
BEFORE VISITING THE  
DEALERSHIP:**

- ✓ Evaluate your financial situation and determine how much you can afford to pay each month. A longer-term finance contract may mean smaller monthly payments than a shorter-term finance contract (if all other terms are the same) – but will result in more money paid over time on your contract.
- ✓ Determine the price range of the vehicle you're thinking of buying. Check newspaper ads, the Internet, and other publications.
- ✓ Understand the value and cost of optional credit insurance if you agree to purchase.
- ✓ Know the difference between buying and leasing a vehicle.
- ✓ Be aware that your credit history may affect the finance rate you are able to negotiate. Generally, you'll be able to get a lower rate if you've paid your monthly credit obligations on time.
- ✓ Compare annual percentage rates and financing terms from multiple finance sources such as a bank, finance company and credit union. This information may also be available from the finance sources' and vehicle manufacturers' Web sites.

**WHEN VISITING THE  
DEALERSHIP:**

- ✓ Stay within the price range that you can afford.
- ✓ Negotiate your finance or lease arrangements and terms.
- ✓ Consider carefully whether the transaction is best for your budget and transportation needs.
- ✓ Understand the value and cost of optional products such as an extended service contract, credit insurance or guaranteed auto protection, if you agree to purchase. If you don't want these products, don't sign for them.
- ✓ Read the contract carefully before you sign. You are obligated once you have signed a contract.

**AFTER COMPLETING THE  
VEHICLE PURCHASE  
OR LEASE**

- ✓ Be aware that if you financed the vehicle, the assignee (bank, finance company or credit union that purchases the contract) holds a lien on the vehicle's title (and in some cases the actual title) until you have paid the contract in full.
- ✓ Make your payments on time. Late or missed payments incur late fees, appear on your credit report and impact your ability to get credit in the future.

**IF YOU ENCOUNTER  
FINANCIAL DIFFICULTY:**

- ✓ Talk to your creditors if you experience difficulties making your monthly payments. Explain your situation and the reason your payment will be late. Work out a repayment schedule with your creditors and, if necessary, seek the services of a reputable non-profit credit counseling agency.
- ✓ Know your obligations. Repossession can occur if you fail to make timely payments. Creditor or assignee may take 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 the credit agreement. This second option is more common. If the vehicle is sold for less than what is owed, you may be responsible for the difference.
- ✓ Be aware that the law in some states allows the creditor or assignee to repossess your vehicle without going to court.



## **BEFORE YOU ARRIVE AT A DEALERSHIP**

Do some research:

- Determine how much you can afford to finance and spend on a monthly payment by using the "Monthly Spending Plan" worksheet in this booklet.
- Get a copy of your credit report so you are aware of what creditors will see. Errors or accurate negative information can impact your ability to get credit and/or your finance rate.
- Identify your transportation needs.
- Check auto buying guides, the Internet and other sources to find out the price range and other information for the vehicle you want to buy.
- Compare current finance rates being offered by contacting various banks, credit unions or other lenders. Compare bank quotes and dealer quotes; there may be restrictions on the most attractive rates or terms from any credit source.

## **WHAT HAPPENS WHEN YOU APPLY FOR FINANCING**

Most dealerships have a Finance and Insurance (F&I) Department, which provides one-stop shopping for financing. The F&I Department manager will ask you to complete a credit application. Information on this application may include: your name; Social Security number; date of birth; current and previous addresses and length of stay; current and previous employers and length of employment; occupation; sources of income; total gross monthly income; and financial information on existing credit accounts.

The dealership will obtain a copy of your credit report, which contains information about current and past credit obligations, your payment record and data from public records (for example, a bankruptcy filing obtained from court documents). For each account, the 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 current status of your account, including the creditor's summary of past due information and any legal steps that may have been taken to collect.

Dealers typically sell your contract to an assignee, such as a bank, finance company or credit union. The dealership submits your credit application to one or more of these potential assignees to determine their willingness to purchase your contract from the dealer.

These finance companies or other potential assignees will usually evaluate your credit application using automated techniques such as credit scoring, where a variety of factors, like your credit history, length of employment, income and expenses may be weighted and scored.

Since the bank, finance company or credit union does not deal directly with the prospective vehicle purchaser, it bases its evaluation upon what appears on the individual's credit report and score, the completed credit application, and the terms of the sale, such as the amount of the down payment. Each finance company or other 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 at which the assignee will buy the contract, often called the "buy rate."

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

When there are no special financing offers available, you can negotiate the annual percentage rate (APR) and the terms for payment with the dealership, just as you negotiate the price of the vehicle. The APR that you negotiate with the dealer is usually higher than the wholesale rate described earlier. This negotiation can occur before or after the dealership accepts and processes your credit application.

## **WHAT INFLUENCES YOUR APR**

Your credit history, current finance rates, competition, market conditions and special offers are among the factors that influence your APR.



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