

Auto Financing Q&A

Q. I understand that my credit history will have an impact on what APR I can get. What other factors will affect my rate?

A. There are a number of variables that are used to determine the APR you are offered. Things like prevailing rates, the amount of your down payment, the amount you finance, the vehicle make and model, the length of the financing contract, special offers, and market conditions. Additionally, your APR could be affected by the credit history of any co-applicant you may have, such as your spouse. Depending on the financing company, a strong co-applicant may improve your ability to secure a lower APR.

The vehicle financing industry is highly competitive – you will find that it's not uncommon when shopping around for your financing that you can find different APR's even just down the street from each other. Shopping around, and negotiating your financing, will put you in a solid decision-making position.

You are right – creditworthiness is a vital component in your APR. Finance companies rely heavily on this information when determining their risk. If you have a history of not managing your finances well – or if you're new to the credit scene and have little or no credit history – you will be considered a riskier contract, and the rates you are offered will reflect that. Be sure to check your credit reports regularly. You can obtain a free copy of your credit report annually from each of the three major credit bureaus by visiting www.annualcreditreport.com. And be diligent in managing your finances wisely. This strategy will help you in financing any major purchase down the road at a competitive rate.

An interesting aside – you're not alone in your understanding of the importance of creditworthiness in auto financing. More people understand that creditworthiness impacts APR than know that Dick Cheney is the Vice President of the United States (78 percent versus 69 percent).

Q. I have a home equity line of credit, and the interest rates are currently low. Should I consider using this to buy my next car? It would mean a lot less money on a monthly basis out of my budget.

A. While the majority of Americans finance through the dealership, a finance company, bank or credit union, home equity loans seem to be gaining in popularity. But as in any other financing decision for such a major purchase, it is important for you to do your homework, run real comparisons, and determine whether this makes the most financial sense for you – not just on a monthly basis, but in the long term.

As *Washington Post* personal finance columnist Michelle Singletary reminds us in a recent column, financing a car with a home equity loan comes with risks consumers need understand. In her column, Singletary writes that "if you don't make extra payments or

pay the loan off early, you end up paying more in interest over the life of that loan than you would with an auto loan, erasing any savings on your taxes. Plus, because the car money is rolled up in a home mortgage, you could still be paying on a loan for a vehicle you've long since sold or traded in."

With that in mind, AWARE reminds consumers to consider some important points when deciding whether to use a home equity loan to finance a vehicle purchase:

Know the financing terms available to you – In such a highly competitive marketplace, it's important to check annual percentage rates and other financing terms from multiple sources. When considering a home equity loan, be sure to consider not only the financing rate, but also the length of the financing. The typical auto financing option is around five years, while a home equity loan can range from 10 to 30 years. So while a home equity loan can mean lower monthly payments, it also means paying more in interest over the length of the financing, unless you make enough extra payments along the way.

Consider the Tax Implications – Depending on the type of home equity loan, taxpayers may be allowed to take advantage of the mortgage interest tax break. The interest paid on the loan each year might be able to be taken as a deduction, lessening your taxable income and the amount of taxes you pay overall. But it's important to know that a tax benefit could be outweighed by the greater interest you may pay because of the longer term of a home equity loan. You should consult with a professional tax advisor to address your specific situation.

Don't forget Closing and Refinancing costs – Home equity loans carry processing fees. These fees can be higher than auto financing obtained from other sources, so it's important to ask about them and factor them in before making your final decision.

Understand the Risks – It's important to understand the risks of financing an automobile through a home equity loan. If you fail to meet financing obligations, for example because of a health catastrophe, on an automobile loan the worst case scenario is that your car will be repossessed. If you fail to meet it on a home equity loan you could lose your house.

For a good calculator to help you determine your true long term costs of financing your vehicle using different options, visit the [LearningSuite](#), and click on the "Auto Loan Calculator" in the "Calculators" section.

Q. I recently graduated from college and am finally earning a paycheck (and spending most of it) every two weeks. One of my New Years resolutions is to buy a car before the end of next year and I know I need to start thinking about budgeting for it. Is there an easy way to do this, and to tell whether or not I'm ready? I'm new at this and I'm not sure where to begin.

A. With a little planning you'll be well on your way to achieving your goal. You may be new to the process, but you're not alone. A survey conducted by AWARE earlier this year

found that more than half (51 percent) of Americans plan to purchase or lease a vehicle in the next three years, and that 80 percent intend to create a budget before their next vehicle purchase.

Creating a budget gives you a chance to assess where you're spending that hard-earned paycheck and how much you can devote towards that new or used vehicle. Start first by developing a monthly budget to get a better sense of where you stand. You can download a pretty comprehensive budget, in either a monthly- or daily-tracking format, [here](#). These easy-to-use Excel spreadsheets will give you a very real picture of your true budget by taking all income and expenses into consideration – from rent or mortgage payments to credit card debt to that morning latte.

It's always hard to get started, but you've got the right attitude by thinking about it early. Developing a budget now will not only serve you well in realizing your goal of purchasing a vehicle this coming year, but it will also help you develop fiscal discipline and sound money habits that will make a major impact on all of your financial goals in the future.

Q. I just decided I can afford to buy a new car, and now, of course, I want it YESTERDAY. I went to my local dealership, and they were talking to me about my credit history and how that could impact my financing costs. I know I should take a look at my credit report before making a financing decision, but don't know where to begin. Does it take a long time? How much does it cost? How can I do it quickly? Should I even bother?

A. Your dealer was right -- credit history is one of the most important factors in determining the financing rate you'll be offered, so it's in your best interest to familiarize yourself with your credit reports, and give yourself a chance to correct any errors to help you improve your score.

You are entitled to three free credit reports each year – one from each of the three national credit reporting companies. The fastest and most secure way to obtain these reports is through the Web site www.annualcreditreport.com, a site recommended by the Federal Trade Commission and sponsored by all three credit reporting companies. If you don't have Internet access, call 1-877-322-8228.

These free reports will not include your score, but you'll have an opportunity to purchase that separately. In most cases, you will be able to view your credit report(s) instantly after answering a series of security questions.

Don't request all three reports at the same time. It's wise to space out your requests over the span of a year so you can see ongoing changes to your credit record and check if there are persistent problems.

After receiving your report(s), check them to make sure they are accurate, complete and up-to-date before you apply for any financing. Correcting errors – or taking other steps to

improve your overall credit score (such as improving your payment history) – will all take time. You do seem like you want your new car right away – but in this case, it might pay to be a bit patient and get your credit file in order.

Q. My son is a rising senior in college. This fall, he started a new internship away from campus. It's a well-paid job for a college student and I'm proud that he's finding his way in the working world. But it's a long bus ride and he's been thinking about buying his first car. I've always taught my children to be self sufficient, but I also want to be there for him. He'll probably need to finance the car. Is it a good idea for me to co-sign the loan?

A. Co-signing automobile financing with your son can serve as a terrific "teachable moment" to engrain in him the importance of building excellent credit, which will serve him well throughout his life. Help your son learn the common terms associated with financing, such as down payment, fixed- and variable-rate financing, and on- and off-site financing. And make sure he shops around.

When he's ready, and if you do decide to co-sign, I suggest drawing up a contract with your son that stipulates rules he must follow in order to have you help him with financing. I would suggest setting a total maximum budget for this purchase; stipulating how much per month he is required to pay for the car; and how much he is required to save to repair the car and pay for insurance.

By co-signing for the financing, you will, most likely, help him get a lower financing rate given your higher earnings, credit history and other factors that determine risk. Moreover, if he makes timely payments, you will help him improve his credit record, putting him in a better position to secure more competitive financing on his own in the future. But it is important to remember that as a co-signer, your credit will be affected if he doesn't make payments in a timely fashion. The bottom line: you are assuming joint responsibility for this loan. For it to be a positive experience, you must communicate very clearly with your son, in writing, about every aspect of this automobile purchase.

If you follow these rules, you and your son are likely to have a positive experience that will serve as a life-long lesson about the importance -- and reward -- of building good credit.

Q. Three years ago I bought a new car when my credit was less than perfect. Since then, I've worked hard to clean up my credit and ensure that all my bills are paid on time. Recently, I heard I could refinance my car loan without penalty. Is this true? And since I've improved my credit, do you think I'll be able to get a better annual percentage rate?

A. Congratulations on getting your credit report cleaned up. Having a strong credit history is hard work, but the rewards that come with it, namely opportunities for more competitive rates, are worth it.

Yes, you can refinance your auto loan and typically there are no penalties to do so. Refinancing might be your best option, but it will depend on a number of factors, such as the remaining balance of your existing loan, the difference between your old finance rate and the new finance rate, the term of your new financing, and finally how much you improved your credit score.

You should check your original contract for any conditions surrounding refinancing and get an updated copy of your credit report before deciding to refinance. Your credit report will show you what creditors see, and give you a chance to correct any errors that may be on your report. You can get a free credit report from each of the three major credit bureaus once a year by visiting www.annualcreditreport.com.

Next, shop around for financing. Check annual percentage rates and other refinancing terms from the many sources available. Once you understand the terms available to you, you will be able to determine whether or not refinancing makes sense for you.

Q. Why is it that I got offered a different rate than my neighbor did for the exact same car from the exact same dealership?

A. There are a lot of factors that go into the Annual Percentage Rate (APR) you're offered, from the length of the financing to the amount of your down payment. In addition, financing rates can change over time: if you signed your contract a few months after your neighbor did, that can make a big difference.

Keep in mind that your financing rate is negotiable, but one of the biggest factors that will determine the APR you're offered is your credit score. Your credit score is based on things like the length of your credit history, how often you've paid bills late, how maxed out you are on your credit cards and other negative entries such as bankruptcies. It will serve you well to check your credit report before beginning your vehicle shopping process. You'll be able to see what your creditors will see, dispute any questionable entries and correct any errors you may find. And in the meantime, always try to pay your bills on time – this is the single most important thing you can do to improve your credit score over time. Bottom line – the better your credit score, the better position you'll be in to negotiate a good finance rate.

Q. I just graduated from college and got my first job. The old car I bought from my uncle is on its last legs, and I need a "grown up" car that will get me to and from work. I want to be sensible, but I know me – I'm going to walk into a dealership and fall in love with a car I can't afford and get in over my head. Any tips to help me make the best decision?

A. Information is power – it will give you power to negotiate, and power over yourself to make the best decision using cold, hard facts instead of your heart.

Get yourself a folder to store all of your financing information. The first thing to do is create a budget to determine how much you can afford to pay on a monthly basis. Take

into account your take home pay, and all of your new living expenses. BE REALISTIC. And remember, those expenses may vary depending on the car you select – for example, your clunker is probably costing you a fortune in repairs and gas mileage, but a new car will cost you more in monthly payments, insurance and in some states, taxes. A budget will show you in black and white what you can – and can't – afford.

Next, get a copy of your credit report. This will show you what creditors will see, and give you a chance to correct any errors before shopping. You can get a free credit report from each of the three major credit bureaus once a year by visiting www.annualcreditreport.com. Keep in mind that those with higher credit scores generally get offered better financing deals – that's true of all forms of credit, such as mortgages, credit cards and vehicle financing.

The next thing to add to your financing folder is quotes from various sources, such as your bank, credit union and the dealership. Compare the rates and other financing terms you're offered, and negotiate the best deal for you. Now don't drag your feet on this – applying for credit from several sources over a drawn-out period of time will generally lower your credit score. Credit scoring software can recognize if you're shopping around for a single financing option, such as a mortgage. But it's a good idea to make sure that any creditors pull inquires as closely together as possible.

Even though you're officially out of school, you still need to do your homework. This preparation will make you a more confident and successful shopper... and leave your heart to negotiate more important things in life.

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