

Your Money: Auto Loan Contract

What is a loan?

"Loan" is a thing that is borrowed, such as money. "Contract" is written and signed agreement between two parties (such as you and dealership) enforceable by law. "Lender" gives money to "borrower," and borrower agrees to make "payments" to pay money plus "interest" by a future date, such as 36 months (3 years). Lender may be bank or car dealership that gives you a loan of money to buy a car. Loan payments are required every month by deadline date (for example, payments must be made before or on first day of each month. If you do not pay the loan payments on time, you are charged a late payment fee (penalty) of \$30 to \$50 extra.



What is loan interest?

Loan interest is extra money you pay back for right to use somebody else's money. If you buy car that costs \$5,000, you can: a) Pay \$5,000 cash. b) Get \$5,000 loan from bank or car dealership. c) Make cash down payment (such as \$700), then take out a loan on the balance of \$4,300. When bank or car dealership lends you money NOW so that you may drive the car NOW, you are required to make a payment every month to pay back loan and interest on the money you borrow. Loan interest (also called "finance charge") is a percent — for example, 4% to as much as 25% per year. If you borrow \$5,000 at 12% interest, you pay \$600 interest for first year of the loan (\$5,000 times .12).

What is APR?

Lenders are required to tell you APR (Annual Percentage Rate). APR is the real loan interest rate after all extra fees are added to the loan. Car loan is advertised at 8% on car dealer's website, but you will see 9% APR in the sales contract you must sign. The extra 1% is extra fees the car dealership adds to the loan to make the real (or APR) interest rate 9%. Laws require lenders to tell borrowers in writing: 1) Basic interest rate; 2) APR real interest rate. Then, your final and real interest cost is \$450 (\$5,000 times .09).

Costs of owning a car

Cost of a car loan is only one of the costs of owning a car. Other costs are: 1) Down payment; 2) Sales tax; 3) Car license; 4) Car insurance; 5) Maintenance/repairs; 6) Gas.



What loan interest will I need to pay for a car loan?

Lenders decide on a loan interest rate (2% to 18% or more) **for you** based on the following:

1) Credit Score — also called FICO (Fair Isaac Corporation): Your credit, or FICO score may be from 300 (lowest) to 850 (highest). Your FICO score is given to you by a company that keeps track of how well you pay your bills. Your FICO score is based on a) 35% payment history; b) 30% amount you owe; c) 15% length of credit history; d) 10% new credit recently; e) 10% type of credit used. If your credit score is high (good or over 700), bank or dealership will offer you a low loan interest rate, such as 4%. If your credit score is low (bad), the bank or dealership will offer you a high loan interest rate, such as 12%.



- 2) Job Stability:** If you are at same job for one year or more, interest rate dealership or bank offers is lower.
- 3) Debt-to-Income Ratio:** Monthly debt (bills) divided by your income. For example, if you earn \$3,000 each month and your bills (debts) are \$1,600 each month, your debt-to-income ratio is 53%. Most loans require that you have a debt-to-income ratio of 36% or less. That means for \$3,000 income each month, you need to have \$1,080 or less in bills (debts) to pay each month.
- 4) Size of Down Payment:** Interest rate is lower if you make a large down payment.
- 5) Age of Car:** Loan interest rate will be lower for newer car — and higher for older car.
- 6) Payment Method:** Loan interest rate may be lower if you allow the bank or dealership to take automatic payments from your checking or savings account rather than you mailing in a check each month



Example of Car Loan: You are buying \$6,000 sharp-looking pre-owned car from car dealership

APR	Length of Loan	Monthly Payments	Total Interest Paid	Loan End/Total You Pay Back
4%	60 months (5 years)	\$110.50	\$629.95	\$6,629.95
4%	36 months (3 years)	\$177.14	\$377.18	\$6,377.18
4%	12 months (1 year)	\$510.90	\$130.79	\$6,130.79
6%	60 months (5 years)	\$116.00	\$959.81	\$6,959.81
6%	36 months (3 years)	\$182.53	\$571.14	\$6,571.14
6%	12 months (1 year)	\$516.40	\$196.78	\$6,196.78
9%	60 months (5 years)	\$124.55	\$1,473.01	\$7,473.01
9%	36 months (3 years)	\$190.80	\$868.74	\$6,868.74
9%	12 months (1 year)	\$524.71	\$296.51	\$6,296.51

From: onlineloancalculator.org



QUICK CHECK:

1. a) What is a loan? b) What is a contract?
2. a) What does a lender do? b) What does the borrower agree to do? c) Give 2 examples of lenders that loan money to buy a car. d) What happens if you do not pay on time?
3. a) What is loan interest? b) What is loan interest also called?
4. If you borrow \$5,000 at 14%, how much interest will you pay the first year? (5000 x .14)
5. a) For what words are the initials APR used? b) What is APR? c) Why does car dealership advertise 8% car loan, but sales contract says APR car loan interest rate is 9%? d) What 2 things do laws require lenders tell borrowers?
6. List 6 costs of owning a car.
7. For what words are the initials FICO used?
8. What is lowest and highest FICO score?
9. List 5 things on which your FICO is based.
10. If your FICO score is low, what will the bank or car dealership offer you?
11. What happens to interest rate you are offered if you are at the same job for one year or more?
12. a) What is divided by income to get debt-to-income ratio? b) If you earn \$3,000 and bills are \$1,600 each month, what is debt-to-income ratio? c) What debt-to-income ratio do most loans require? d) If you earn \$3,000 monthly, how much do your bills need to be to have a debt-to-income ratio of 36%?
13. **YOU BUY: \$6,000 a car at 9% APR:**
What are monthly payments:
 a) For 3 year loan? b) For 5 year loan?
What is total interest paid:
 c) For 3 year loan? d) For 5 year loan?
What is total you pay back at loan end:
 e) After 3 years? f) After 5 years?
14. a) How much CASH must you save each month to save \$6,000 in 36 months? b) To save \$6,000 in 5 years? c) Would you rather save and pay cash for a car or make loan payments? d) Give a reason for your choice of cash or loan.