



## Lesson Nine

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# Cars and Loans



# costs of owning and operating a motor vehicle

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## **ownership (fixed) costs:**

- Depreciation (based on purchase price)
- Interest on loan (if buying on credit)
- Insurance
- Registration fee, license, taxes

## **operating (variable) costs:**

- Gasoline
- Oil and other fluids
- Tires
- Maintenance and repairs
- Parking and tolls



# how much can you afford? (the 20-10 rule)

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## **never borrow more than 20% of your yearly net income**

- If you earn \$400 a month after taxes, then your net income in one year is:

$$12 \times \$400 = \$4,800$$

- Calculate 20% of your annual net income to find your safe debt load:

$$\$4,800 \times 20\% = \$960$$

- So, you should never have more than \$960 of debt outstanding.
- Note: Housing debt (i.e., mortgage payments) should not be counted as part of the 20%, but other debt should be included, such as car loans, student loans and credit cards.

## **monthly payments shouldn't exceed 10% of your monthly net income**

- If your take-home pay is \$400 a month

$$\$400 \times 10\% = \$40$$

- Your total monthly debt payments shouldn't total more than \$40 per month.
- Note: Housing payments (i.e., mortgage payments) should not be counted as part of the 10%, but other debt should be included, such as car loans, student loans and credit cards.



# consumer decision making

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## **deciding to spend your money:**

- Do I really need this item?
- Is it worth the time I spend making the money to buy it?
- Is there a better use for my money right now?

## **deciding on the right purchase:**

- What level of quality do I want (low, medium, or high)?
- What level of quality do I need?
- What types of services and repairs does the dealer offer?
- Should I wait until there is a sale on the type of car I want?
- Should I buy a new or a used car?
- If I buy a used car, should I buy it from a dealer or from a private party?
- Should I choose a car with a well-known name even if it costs more?
- Do I know anyone who owns the type of car I want?
- Are the warranty and the service contracts on the car comparable with warranties and service contracts on similar cars?
- What do consumer magazines say about the type of car I want?



# shopping for a used car

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## **before you begin shopping:**

- Decide how much you can afford to spend.
- Decide which car models and options interest you.
- Research the reliability of the model of car you want.
- Find out where the nearest repair facility is that works on the type of car you want.
- Find out whether parts are readily available for the type of car you want. Find recent prices in used-car “blue books” in the library, on the internet, in newspaper ads, consumer magazines, etc.
- Shop for financing.
- Factor in the costs of the loan and the cost of maintenance.
- Know how to read a “Buyer’s Guide” sticker.

## **as you shop:**

- Find out the reputation of the dealer.
- Find out what type of warranty comes with the car.
- Find out what type of service contract comes with the car.



## **sources of used cars**

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**new-car dealers** provide quality used vehicles; service department available; higher prices than other sources

**used-car dealers** specialize in previously owned vehicles; limited warranty (if any); vehicles may be in poor condition

**private parties** may be a good buy if vehicle was well maintained; few consumer protection regulations apply to private party sales

**other sources** such as auctions or sales by government agencies, auto rental companies, and on the internet; most of these vehicles have been driven many miles



# shopping for a new car

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## **before you begin shopping:**

- Decide which car model and specific options you want.
- Find out the invoice price and the true cost to the dealer of the model and options you want.
- Decide how much you are willing to pay the dealer above the invoice price.
- Make your offer to as many dealers as possible.
- Compare final sales prices with other dealers and buying services.
- Compare financing costs from various sources.
- If you already have a car, find out its value independent of the dealer's trade-in offer.
- Try to sell your old car yourself (dealers usually give better deals without a trade-in).
- Decide whether you need an optional service contract or credit insurance.



## **as-is (no warranty):**

- No expressed or implied warranty.
- If you buy a car and have problems with it, you must pay for any repairs yourself.
- Some states do not permit “as-is” sales on used cars.

## **implied warranties:**

- Warranty of merchantability—a product will do what it is designed to do.
- Warranty of fitness for a particular purpose—a product will do what the seller promises it will do.
- Always in effect unless the product is sold as-is or the seller says in writing that there is no warranty.

## **dealer warranties:**

- Offered and specifically written by the dealer.
- Terms and conditions can vary greatly.
- Useful to compare warranty terms on similar cars or negotiate warranty coverage.

## **unexpired manufacturer's warranties:**

- Manufacturer's warranty can sometimes be transferred to the new owner. There may be a fee for the transfer process.





## **service contracts (also called "extended warranties")**

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### **before deciding to buy a service contract, find out:**

- The cost
- Which repairs the contract covers
- Whether the warranty already covers the same repairs
- Whether the vehicle is likely to need repairs and, if so, the potential cost of repairs
- Whether there is a deductible and, if so, what it is
- Whether repairs and service can be performed at locations other than at the dealership
- Whether the contract covers incidental expenses such as towing
- Whether there is a cancellation or refund policy and, if so, the cost
- Whether the dealer or company offering the service is reputable
- Whether you can purchase the service contract later



# shopping for a car loan

## variables include:

- Annual Percentage Rate (APR)
- Length of the loan
- Monthly payments
- Total finance charge
- Total to be repaid

**e.g.**

## example of how loans can vary:

- Borrowing \$8,000 at different rates

<b>APR</b>	<b>Length of loan</b>	<b>Total monthly payment</b>	<b>Total finance charge</b>	<b>To be repaid</b>
<b>10.00%</b>	36 months	\$258.14	\$1,292.94	\$9,292.94
	60 months	\$169.98	\$2,198.52	\$10,198.52
<b>12.25%</b>	36 months	\$266.67	\$1,600.15	\$9,600.15
	60 months	\$178.97	\$2,738.03	\$10,738.03
<b>13.00%</b>	36 months	\$269.55	\$1,703.87	\$9,703.87
	60 months	\$182.02	\$2,921.58	\$10,921.58



# how to calculate the total cost of a loan

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## to estimate the total cost of a loan:

- Amount of the loan x APR x number of years\*

**e.g.**

**example:**

$$\$10,000 \times 0.10 \times 5 \text{ years} = \$5,000$$

$$\$5,000 + \$10,000 = \$15,000$$

## to estimate the amount of monthly payments:

**e.g.**

- Total to be paid divided by number of months of the loan\*

**example:**

$$\$15,000 / 60 = \$250 \text{ per month}$$

\*These formulas produce estimates that are slightly higher than your actual costs and payments, because they do not account for the reduction of interest payments as you repay the loan.



# the truth-in-lending act

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## **the truth-in-lending act requires lender to inform borrower of:**

- Amount financed
- What charges are included in amount financed
- Total finance charge, in dollars
- Annual Percentage Rate (APR)
- Payment schedule
- Total amount of payments
- Total sales price
- Prepayment penalty, if any
- Late payment penalty, if any
- Security interest
- Insurance charges



# types of auto insurance coverage

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## **liability (40-50% of premium)**

- Bodily injury coverage
- Property-damage coverage (e.g., to another person's car)

## **collision (up to 30% of premium)**

- Pays for the physical damage to your car as a result of an accident
- Limited by deductible

## **comprehensive (about 12% of premium)**

- Pays for damage caused by vandalism, hailstorms, floods, theft, etc.

## **medical**

- Covers medical payments for driver and passengers injured in accident

## **uninsured motorist**

- Reimburses you for bodily injury in accidents caused by uninsured drivers

## **towing and labor**

## **rental reimbursement**

- Pays a specific amount per day to rent a car while yours is being fixed



# how insurance rates are set

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## **personal characteristics**

- Age
- Sex
- Marital status
- Personal habits (e.g., smoking)
- Type and frequency of vehicle use (e.g., commuting)

## **geographic location (often classified by zip code)**

- “Rural” usually lowers rates, “urban” usually raises rates

## **driving record**

- Accident with death, bodily injury, or property damage in excess of \$400 may trigger surcharge on premium for 3 years
- Number and kind of moving violations (and total of associated points)
- Number of years insured with the company

## **vehicle characteristics**

- Damage, repair, and theft record of type and model of car
- Age of car



## **rights of creditor**

- Can seize car as soon as you default
- Can't commit a breach of the peace, e.g., use physical force or threats of force
- Can keep car or resell it
- May not keep or sell any personal property in car (not including improvements such as a stereo or luggage rack)

## **your rights**

- May buy back car by paying the full amount owed on it plus repossession expenses

## **your legal responsibilities**

- Must pay the “deficiency balance”—the amount of debt remaining even after your creditor has sold your car



# leasing a motor vehicle

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## **advantages**

- Smaller initial outlay than down payment when buying on credit
- Monthly lease payments may be less than monthly finance payments
- Lease agreement provides detailed records for business purposes
- Oftentimes, all service charges related to maintenance are included in lease, so there is no additional outlay of money for regular maintenance

## **disadvantages**

- No ownership interest in the vehicle
- Must meet requirements similar to applying for credit
- Additional costs occur (such as for extra mileage, certain repairs, ending lease early)

## **discussion of leasing vs. buying**

- You must decide which option makes the most sense for your situation.
- Do you have cash available for a down payment?
- How much of a monthly payment can you afford?
- How long do you plan to keep the car?