



Lesson Nine: Cars and Loans

Financial Literacy Program



First Bank
make life better





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

- 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.

**NEVER BORROW MORE
THAN 20% OF YOUR
YEARLY 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.

**MONTHLY PAYMENTS
SHOULDN'T EXCEED 10% OF
YOUR MONTHLY NET INCOME**

● 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?

Consumer decision-making

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.

AS YOU SHOP:

- 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.

NEW-CAR DEALERS

provide quality used vehicles;
service department available;
higher prices than other sources

PRIVATE PARTIES

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

USED-CAR DEALERS

specialize in previously owned
vehicles; limited warranty (if any);
vehicles may be in poor condition

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

Sources of Cars

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

SHOPPING FOR A NEW CAR

- **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

SHOPPING FOR A CAR LOAN

variables include:

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

example of how loans can vary: Borrowing \$8,000 at different rates

APR	Length Of loan	Total monthly payment	Total finance charge	To be repaid
10.00%	36 months	\$258.14	\$1,293.04	\$9,293.04
	60 months	\$169.98	\$2,198.80	\$10,198.80
12.25%	36 months	\$266.67	\$1,600.12	\$9,600.12
	60 months	\$178.97	\$2,738.20	\$10,738.20
13.00%	36 months	\$269.55	\$1,703.80	\$9,703.80
	60 month	\$182.02	\$2,921.20	\$10,921.20

HOW TO CALCULATE THE TOTAL COST OF A LOAN

TO ESTIMATE THE TOTAL COST OF A LOAN:

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

- 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:

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

- Example:

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

THE TRUTH IN LENDING ACT

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

- **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

Types of auto insurance coverage

PERSONAL CHARACTERISTICS

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

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

GEOGRAPHIC LOCATION (OFTEN CLASSIFIED BY ZIP CODE)

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

VEHICLE CHARACTERISTICS

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

How insurance rates are set

REPOSSESSION

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

- 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

ADVANTAGES

- 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)

DISADVANTAGES

LEASING A MOTOR VEHICLE