



Learn How Car Loan Works

Description

Purchasing a new or used car may be one of the most significant expenditures you make in your life. However, with all of the moving pieces that come with a car loan, determining how to pay for your ride can send you into a tailspin.



According to a Consumer Financial Protection Bureau blog post published in 2018, the average price of a new automobile is roughly \$35,000, so you'll almost certainly need to take out a car loan.

But, before you go out and buy your new set of wheels, it's a good idea to conduct some research on auto loans. This post will look at the most popular forms of automobile loans, auto loan lenders, crucial phrases to understand, and how to prepare to apply.

What exactly is a car loan?

When you don't have the cash to buy a new automobile outright, a car loan can help you do so – whether the vehicle is new or used. When you obtain an auto loan, you borrow money from a lender to purchase an automobile. You promise to repay the cash plus any fees and interest accrued over a specified period.

Important concepts to understand

Before we get into the specifics of how vehicle loans work, let's take a moment to familiarize ourselves with some of the most popular terminologies you may come across while you research loan choices.

Annual percentage rate (APR) – The annual percentage rate (APR) is the amount you'll pay to borrow money, including interest and fees, expressed as a yearly percentage. The greater the APR, the more you will owe in exchange for the loan.

- **Down payment** – This is an upfront payment made toward purchasing the car. It might be cash, the value of a trade-in vehicle, or both. The down payment reduces the total amount you need to finance, resulting in reduced monthly payments.
- **Loan period** – Also known as loan duration, this is the amount of time you have to repay your loan. Keep in mind that the longer your loan period, the more interest you're going to pay.
- **Monthly payment** – The amount you owe each month is your monthly payment. It comprises principal, interest, and any extra costs that may apply.
- **The principal** is borrowed with fewer fees, penalties, interest, and other expenditures.
- **Total cost** — Total cost refers to the total loan amount, or total principal and interest, that you will pay during the life of your auto loan.

What is the procedure for obtaining a car loan?

Loan payments are made to the lender every month on a car loan. Your monthly payment will be determined by the loan amount, the loan period, and the amount of interest you must pay throughout the life of the loan.

Your loan contract specifies the loan's principal and interest rate, as well as any optional add-ons.

Longer-term loans can reduce your monthly costs, such as 60-month or 72-month loans. However, keep in mind that if you have a longer loan term, you may pay more in interest throughout the life of the loan. You can even end yourself paying more than the automobile is worth, putting you in default on your loan.

Let's look at two potential loan conditions for a \$20,000 loan with a 3.75 percent interest rate. Keep in mind that this computation excludes any relevant sales tax.

Though the longer loan term decreases your monthly out-of-pocket expenditures, if you choose to repay the loan in five years rather than three, you'll wind up paying \$788 more in interest over the life

of the loan.

Loans that are most commonly used.

A car loan can be used to buy a new or used automobile. You can also apply for a loan to purchase a lease or refinance an existing loan. New-vehicle loans may have lower interest rates than used-car loans and may come with special incentives.

Where should I apply for a car loan?

When it comes to auto financing, it's a good idea to shop around for the best offer possible. You can examine conditions from several lenders, such as banks, credit unions, and other financial organizations, to determine whether their offers are better than your dealer's.

Who gives out vehicle loans?

In general, there are two ways to borrow money to buy a car: direct lending and dealer finance.

- Lending without intermediaries — Banks, credit unions, and other financial institutions, such as online lenders, are examples of direct lenders. Borrowing from one of these lenders allows you to comparison shop for the best loan conditions for you, and you may be able to get preapproved for a specific loan before you browse. When you're ready to buy, you'll utilize this loan to cover the cost of the vehicle.
- Dealership financing – This option, handled by your dealer's finance department, allows you to shop for your vehicle and auto loan in the same location. Dealers typically have links with numerous lenders, allowing you to compare conditions and maybe qualify for a manufacturer-sponsored low rate or incentive programs. However, be wary of "buy here, pay here" dealerships that provide high-interest in-house vehicle loans to buyers with poor credit.

If you don't want to take out a standard auto loan or don't qualify for one, consider asking a family member for assistance or waiting until you've saved enough money. You could also consider an alternative loan, such as a personal loan from a peer-to-peer lender.

Requirements for obtaining a car loan

To get a car loan, you'll usually need to fill out a loan application that includes details about your financial condition. To make the procedure run as smoothly as possible, you'll generally need the following information on hand:

- Number of Social Security
- Current and previous addresses
- Information on current and previous employment
- Total income and sources of income

Details on any other debts you may have

The approval procedure generally includes a credit check and may begin with a prequalification. This may result in a soft draw of your credit, which means it will not affect your credit ratings. If you are preapproved and proceed with a full application, the lender will normally run a hard inquiry on your credit, which might result in a drop in your credit ratings. Even though you have been prequalified, your loan conditions and approval may alter when you complete a full application. However, as long as you complete all of your loan comparison shopping in a short period, there will be little effect on your credit.

Can someone else take over a car loan if something goes wrong?

The quick answer is: most likely not in an official position, although it's worth verifying with your lender. If your lender authorizes it, the individual assuming the loan will most likely have to go through the loan application process, including a credit check. That means they'll probably wind up with a new loan rather than taking over your old one.

What's the point of all this extra paperwork? First, the lender wants to ensure that whoever accepts the loan will pay it back. Also, keep in mind that if your lender enables you to do this, the car is no longer yours.

Perhaps you might persuade a generous family member or friend to cover the payments temporarily until you can repay them. However, keep in mind that late payments may result in the repossession of your vehicle. And most importantly, the loan would still be in your name, which means the default would be yours as well.

If you've fallen behind, here are some alternatives to defaulting on your payments.

- Speak with your lender. You may be able to request an extension on your due date, as well as a payment extension or deferral.
- See if you can come up with a payment plan.
- Refinance the loan at a reduced interest rate if possible.

Steps to follow

Before applying for an auto loan, it's a good idea to check your credit score and monthly budget to see if you can afford a monthly car payment. If your credit isn't fantastic, you might want to apply with a co-signer or look into lenders who work with low-credit consumers.

Consider how much you can afford for a down payment and whether you want to trade-in a vehicle to assist reduce the total cost of the loan. And, if you're thinking about getting service contracts, credit insurance, or extended warranties, look into how they'll affect the total cost of your loan.

If you decide to take out a loan, make sure all of the documentation is correctly signed before driving away in your new automobile and make sure you make all of your payments on schedule.

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