4-5: Finance a Purchase with a Loan

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Cast List
- Terri
- Darryl
- Nelson Yang, personal finance expert; (34-45/Asian)
- Other:
  - Fred
  - Janeen
  - Joe
  - Bonnie

Synopsis
- Terri explains that Darryl is a failed saver who had kept his checking and savings accounts at the same bank (in studio)
- They go to a branch of Lifetime Savings and Loan to meet with Mrs. Dunn, who explains various types of savings accounts

Location
- Studio
- A branch of Lifetime Savings and Loan

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A. How Consumer Loans Work
  a. Can be smart for larger purchases
    i. Build credit
    ii. Lower interest than credit card
  b. Don't forget that you are borrowing the money
    i. Total cost of product will be more because of interest
      1. Example, $20K car, 5 yr., actually costs…
    ii. Risk of repossession if can't make payments
  c. Down payment
  d. Principal – balance of loan paid off
  e. Interest
  f. Equal payments (basic amortization) gradually involve more principal as balance declines
B. Secured and Unsecured
  a. Larger loans secured by collateral, e.g. auto
    i. Creditor holds title until paid off
  b. Smaller loans may not require collateral
C. Choose the Best Deal for You
  a. Shop for best APR
  b. Make largest down payment you can
  c. Negotiate best price separately from financing
  d. Pay for tags, title, taxes separately (don't finance)
  e. Can get pre-approved
  f. Be wary of ads promising loans for those with bad credit/no credit
  g. Not required: service contracts, credit insurance, extended warranties
  h. If sell car early on, may owe lender more than car is worth
  i. Check if penalty for early repayment
D. Sources for Consumer Loans
  a. Dealers
  b. Banks
  c. Credit Unions, other sources
  d. Home equity
    i. To get money for other uses (house is collateral)
    ii. Amount of equity is value of property minus debt
    iii. Use for most things (car, college, home improvements)
    iv. Can be line of credit (like credit card, w/multiple withdrawals up to certain limit)
    v. Benefit-lower interest rates; may be tax deductible
    vi. If you can't make monthly payments, consider other options (e.g., governmental assistance)
    vii. Have three days to change mind after signing (Right to "rescind" or "right to cancel")
    viii. Shop for best rate
E. FTC.gov for Info on Buying Cars (new and used)

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	F. Rent to Own a. Payment plan where rent it long enough to own it b. If miss a payment, lose item and all paid c. Technically no interest, but more expensive than consumer installment loan

Theme music up

SFX: chatter of crowd in background, occasional shout or whoop

DARRYL: Welcome to the "Money Smart Podcast Network, with Darryl and Terri." Today we're joining you from the Dunmore Community Fair, where the State Consumer Advocacy Association is sponsoring free consumer financial advice.

Music fades

Terri, I'm thinking we didn't set up our equipment close enough to the food concessions – I'm smelling and seeing some fantastic things over there.

TERRI: Whoa – that was some big funnel cake that guy ran by with… it just missed my head!

DARRYL: Well, I don't suppose you'd let us pack our stuff and move closer to…*(audibly reacting to a withering look)* ….didn't think so. Well, I know where I'm headed right after this segment! But for now, audience members, we have with us personal finance expert and award-winning syndicated financial columnist, Nelson Yang. He's with us today to help folks with their questions on loans.

NELSON: It's great to be with you. Helping others handle their money well is one of my favorite things!

TERRI: Well, Nelson, in the last several podcasts, we've focused on helping people get out of debt and save money.

NELSON: That's great.

TERRI: Can you help our listeners understand when it's responsible to take out a loan – and when it's a bad idea?

NELSON: Sure! Well, when there's a large purchase you actually need, and you do your homework to make sure you can afford the payments, then a loan can be a good way to go.

TERRI: Like…a car?

NELSON: Great example. The average new or used car is too expensive for most people to buy outright.

DARRYL: That's for sure.

NELSON: Earlier I talked to a young man who was about to buy his first car with a credit card. *Big* mistake!

TERRI: Why is that a "big mistake"?

NELSON: Well, two reasons. First, I explained that a credit card will probably have a much higher interest rate than most auto loans.

TERRI: That certainly makes sense. No one wants to pay someone more than they have to. What's the second reason?

NELSON: Having a consumer loan is a good way to build your credit history.

DARRYL: Aren't there some down sides to loans?

NELSON: Of course. Look, a loan is a bad idea when you're taking on more debt than you should – or you're buying something you don't really need.

DARRYL: Even if you can afford the debt and you need the item, taking out a loan costs more than buying the item outright.

NELSON: Sure. To your point, let's say you have a twenty thousand dollar car loan, at six percent interest, for sixty months. Because of the interest, by the time you repay the loan, you're out nearly twenty-three thousand and two hundred dollars. Until you pay the loan in full, the car still belongs to the finance company. If you fall behind in your payments, the car could be repossessed, taken away from you – even after years of making payments.

DARRYL: I don't like that idea at all.

NELSON: But that's where the question, "Is it something I really need?" comes in. If you live in a suburb, and public transportation doesn't go where you need it to—

DARRYL: —and there isn't a single funnel cake stand for hundreds of miles…

TERRI: *(rushing in to "save" Nelson)* Can you break down how a typical loan works?

NELSON: *(laughing)* Sure. Let's say you've established a real need for the item you're borrowing money for. For our example, we'll say it's a car. We won't actually get into *why* we've determined it's needed—

DARRYL: —your loss.

TERRI: *(audible slap to the head)* Darryl!

NELSON: For most purchases, you'll be expected to make a down payment. The amount you'd put down would vary with the lender.

TERRI: Sometimes a larger down payment will get you better loan terms, right?

NELSON: Right. So, a car loan, like many consumer loans, is an installment loan – you pay a fixed amount each month, for a fixed term – two, three or five years, for example. Your monthly payment will include a payment for principal – which is paying off part of the loan balance – and it'll include an amount that covers interest on the loan. As far as your checkbook is concerned, you're paying the exact same dollar figure every month. But if you were to break down that sum of money into principal and interest, you'd see that you'll start out paying mostly interest, gradually paying more of the principal each month.

DARRYL: Fred Jenkins just stopped by, and he has a question… and what looks like fried pickles?!

FRED: They are indeed, Darryl, and they are *good*. Hey! They're also *mine* – paws off there, buddy!

TERRI: *(to herself/Darryl)* Sheesh! *(to Fred)* What can Nelson help you with, Fred?

FRED: Well, sir, my dentist has the annoying habit of yakking at me as he's working. He was talking about an insecure loan for something and I had no idea what he was talking about, nor could I ask him!

DARRYL: You'd think the borrower would be the insecure one…

NELSON: *(laughs)* Okay – I think he meant an *unsecured* loan. Fred, you may not know it by name, but most of us are familiar with secured loans. When you take out a loan for a car, a house, a boat… the item you're buying is used as what's called "collateral" to secure the loan. So if you stop making your payments, the lender can reclaim the item – to get the money back.

DARRYL: What's an ins – uh, an unsecured loan?

NELSON: An unsecured loan means there's no collateral to secure it. To get an unsecured loan, you have to have very good credit, and you'll usually pay a higher interest rate. Also, you typically can't get as large a loan amount.

FRED: Thanks. Mystery solved. …Get *away* from my pickles, man!

DARRYL: *(sighs)* Next in line to talk with Nelson is Janeen Harris. Janeen is shopping for a car, and she has a bunch of questions for you.

NELSON: Fire away, Janeen.

JANEEN: I'm starting to look at cars and loans. I was comparing interest rates, but my friend said I should be looking at APR, instead. What's the difference?

NELSON: The interest rate usually reflects just the cost of what you're buying. Say you need a car loan for twelve thousand dollars and the interest rate you get cited is five percent. But there might be application and processing fees that are added to the loan, so your interest rate actually applies to those costs as well. The APR – that stands for Annual Percentage Rate – the APR might be something more like five point zero five percent Because it takes everything into consideration, the APR is considered to be a more precise and fair way of comparing rates.

JANEEN: I'm really trying to save money. Besides getting the best rate, is there anything else I can do to get my payment down?

NELSON: Absolutely! First, plan to make the largest down payment you can afford. That will reduce the amount you borrow, which will lower your payments. It also might help you get a slightly better rate.

JANEEN: Ok.

NELSON: Also, don't let car dealers try to negotiate the price of the car and the financing together.

JANEEN: Oh?

NELSON: Bargain for the best car price you can, using online pricing for comparison, or working with a buying service if your bank or auto club offers one. Only after you get the best price on the car should you negotiate for financing. They're two separate items and you should negotiate the best deal you can *on each*.

JANEEN: Super – thank you!

NELSON: And one more tip – the price of the car won't include tags, title, and taxes. Don't let the dealer wrap those items into the loan – pay those separately.

DARRYL: Don't dealers always try to pile on a bunch of extras? They do when they see me coming.

NELSON: Darryl, that's true for many purchases – from computers and appliances to cars – you don't need and shouldn't pay for a service contract or extended warranty. Another trick is selling credit insurance – insurance to pay off the loan if anything happens to you. That just protects the lender – not you!

TERRI: Are there ways that loan shoppers *can* protect themselves?

NELSON: Sure, Terri. First, check with your own bank or credit union, and get some recommendations from family and friends. You might find the best deal with a merchant or car dealer – but shop around, take your time, and don't let anyone pressure you. You can get pre-approved for a loan, and then choose your car or purchase without any pressure.

DARRYL: Ok.

NELSON: Think through big-ticket purchases carefully. If you decide to sell a car early, you might end up owing the lender more than you get. And check the terms of the loan agreement and make sure there's no penalty for early repayment, if you happen to want to go that way.

TERRI: Anything else?

NELSON: Yes! Be very wary of lenders who promise loans with no credit checks, or who offer loans for people with bad credit or no credit. These are sometimes scams, with lenders charging extremely high interest rates.

TERRI: Can you recommend a resource for people looking to buy a car? It's such a big purchase….

NELSON: Yes! In fact I was just about to suggest that any audience members who might be buying a car should check out the U.S. Federal Trade Commission website. They have great information on buying a car, whether new or used. Go to www.consumer.ftc.gov. Click on *Money and Credit* and then *Buying and Owning a Car*.

TERRI: I also saw that the Consumer Financial Protection Bureau has some great information. The website is www.consumerfinance.gov/askcfpg/.

DARRYL: Next we have…Joe Shock! I love your name, Joe! Joe has a question about using home equity to buy a car.

NELSON: Welcome Joe. What's the question?

JOE: So, I see a home equity loan has a lower rate than my bank's car loans. Is it a good idea or not to go that way?

NELSON: It can be a good way to finance a car, Joe. But let me go through a few things first. For audience members who don't know, equity is the value of your home minus the mortgage and any other loans you have against it. If your credit is good enough, and your equity is high enough, then your bank, credit union, or other mortgage lender may be able to give you a home equity loan with a low rate.

I always advise people to use home equity loans only for purchases that have some long-term value. Things like a car, college expenses, or home improvements.

JOE: So a good car has long-term value, right? Well, the loan I was looking at had a variable interest rate – that seems a little scary.

NELSON: For the audience, let me explain a variable rate loan. After a set period, such as a year, the loan's interest rate can go up or down, depending on the current interest rates. After the next term, it could change again. So you could find your monthly payment going up quite a bit if interest rates rise. But you can also get a fixed-term loan for a specific amount, or a home equity line of credit, which lets you take multiple withdrawals up to the approved limit. That's useful for things like home improvements, so you can borrow only what you need.

JOE: What are the pros and cons of using a home equity loan?

NELSON: Great question! There are several potential benefits. As you found, a home equity loan might have a lower interest rate. Depending on your personal situation, the loan interest might be tax deductible, giving you some additional savings.

JOE: Ok.

NELSON: A home equity loan also gives you three days to reconsider a signed credit agreement and cancel the deal without penalty. Your "right to rescind" or "right to cancel" is guaranteed by the Truth In Lending Act. You can rescind for any reason, but only if you're using your principal residence as collateral – not a vacation or second home.

JOE: If I could afford a second home, I wouldn't need a car loan!

NELSON: I hear you! And that brings up another good point. Always be aware that you're securing the loan with your house – so if you get behind on payments, it could put your home at risk of foreclosure. As with any loan, shop for the best rate and terms. Does that help, Joe?

JOE: Yes, sir.

TERRI: I think we have time for one last question…

DARRYL: Yeah – I'm ready to tackle the next person who walks by with a pulled pork sandwich.

TERRI: Patience, grasshopper. I'm sorry, Bonnie. We have Bonnie Jones. Go ahead with your question, hon.

BONNIE: Yes, well, my boyfriend thinks it's a great deal to get a widescreen TV from a rental place and pay by the week.

NELSON: Is this a rent to own deal?

BONNIE: Yeah, I think that's it.

NELSON: The rental fee sounds small when you think about the weekly amount – but when you add it up over time, I think you'll find that the total is *way* more than the cost of the television – often double or more.

BONNIE: Ouch!

NELSON: That's usually a lot more than what you'd pay with a regular loan. Also, you don't own that TV until you make the very last payment. There are a lot of complaints about people missing a payment close to the end of the agreement – and getting their merchandise repossessed. My recommendation? Look at other loan options – or save for it if it's not an essential purchase.

BONNIE: Okay – I'm going to make him figure out what that TV really costs! Thanks!

Theme music up

TERRI: That's a smart idea. Well, we'd like to thank personal finance expert Nelson Yang for his help. We're out of time – but please join us for the next installment of the "Money Smart Podcast Network, with Terri and—" wh…? I can't believe Darryl didn't even stick around for the end of the show!

NELSON: Apparently you and I were both too busy to see the turkey drumstick cart go by.

SFX and music fades