

BUYING A VEHICLE



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OUR PURPOSE

The purpose of The USAA Educational Foundation is to lead and inspire actions that improve financial readiness for the military and local community.

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BEFORE THE FIRST TEST DRIVE



Buying a car can be an exciting experience! It's a major purchase. It's yours and it can give you a sense of absolute freedom!

But you need to stop and think before you get too carried away comparing the horsepower, sound systems, colors or even safety features.

It's good to get your facts and your priorities straight to help you make the best decision for your finances, lifestyle, and personal needs before you start shopping for any vehicle.

Buying a new vehicle can impact your finances for the next five to 10 years, so it's important to get it right.

PREPARING TO BUY

For most young service members, buying a vehicle is the first major financial decision they will make. The following points can help you get it right.

- » **Budget:** Even if you think you can afford to spend a large percentage of your pay on a vehicle, it's probably not a good idea, or it won't be at some point in the future. It's important to allow money for other things as well, some you might not even be thinking about right now. A budget worksheet is available to help with this on usaaef.org.
- » **Total Vehicle Costs:** To balance other financial goals, try to keep total transportation costs under 10% of your gross pay. To be fair, this can seem very difficult when you're first getting started, but spending less is typically better than spending more. See page 9 for more information.
- » **Credit Reports:** It's important that you review your credit report before applying for an auto loan. That way, you can correct any errors that could negatively affect you. It's also a good idea to check your credit score (even if you have to pay for it) so that you have a solid idea of what to expect when it's time to finance your purchase. You can obtain a free copy of your credit report at www.annualcreditreport.com.
- » **Down Payment:** Many first-time vehicle buyers will need either a cosigner or down payment since they have little credit history. Even if you can secure 100% financing, it's still a good idea to put money down to decrease your chances of being "upside down" with what you owe relative to the value of the vehicle. Plus, being able to set aside money each month for a down payment is good practice for making loan payments.
- » **Insurance:** It's a great idea to get a quote on auto insurance before you head out to the dealership.

- » **Financing:** There is power in knowing the interest rate and loan amount you can borrow from your bank or credit union before you step on the lot. If presented with 0% financing or cash back options, you can make an intelligent decision on which is better. You can also use this information as leverage to negotiate better financing terms with a dealership.
- » **Research:** There are plenty of online resources that review price, safety, reliability, and cost of ownership. Resale value is important to service members in case a PCS move forces you to sell before you want.





DECISIONS, DECISIONS...

As cliché as it sounds, life happens and your priorities can change overnight. The backdrop of an active duty military career also adds an extra element of uncertainty to the car-buying decision. A deployment, PCS, or extended assignment might make even owning a vehicle completely unnecessary.

So, how do you settle on the right type of vehicle?

Start by considering the following:

- » **Living Situation:** If you live on base do you even need a vehicle? Spending a lot of money on a vehicle you rarely use isn't the best financial move.
- » **Family Dynamics:** If you get married (or divorced) or have children, your vehicle needs could change.
- » **Financial Goals:** Money spent on vehicles cannot be used for other financial goals.
- » **Income Changes:** Your household income in the future could be less than it is today. Be careful not to commit too much of your current budget to transportation costs.

Consider these points before you go on the first test drive. Remember, if things can change overnight, consider how much can change in three to five years when your lease or auto loan is finished.

KEYS TO BUYING A VEHICLE

When it's time to buy a vehicle, many make the mistake of thinking it has to be new. But while new vehicles certainly have their benefits, those benefits can be expensive. Avoiding this extra cost is why used vehicles often make more financial sense for young people with tight budgets — especially young service members.

NEW VEHICLES MAY OFFER...

- » Lower loan rates
- » Full warranties (typically for the first 36 months or designated mileage, whichever comes first)
- » Latest safety features and technology
- » Less maintenance cost and clean vehicle history

USED VEHICLES COULD COME WITH...

- » Lower purchase price
- » Limited warranty if it's a certified pre-owned vehicle
- » Lower registration, licensing, and registration fees (based on price)
- » Unexpected maintenance and repair costs not covered under warranty



YOUR BUYING OPTIONS

ONLINE BUYING SERVICES

An online buying service matches you with dealerships offering the vehicle you want at a price you want to pay. While some services only provide contact information for a dealership, others provide a negotiated price and arrange for delivery.

NEW-VEHICLE DEALERSHIPS

These are brand-specific dealerships. While their focus is on selling new vehicles, most also have a used-vehicle inventory. Many dealers also have an Internet sales department and a certified pre-owned vehicle program that may offer lower prices for select vehicles.

USED-VEHICLE DEALERSHIPS

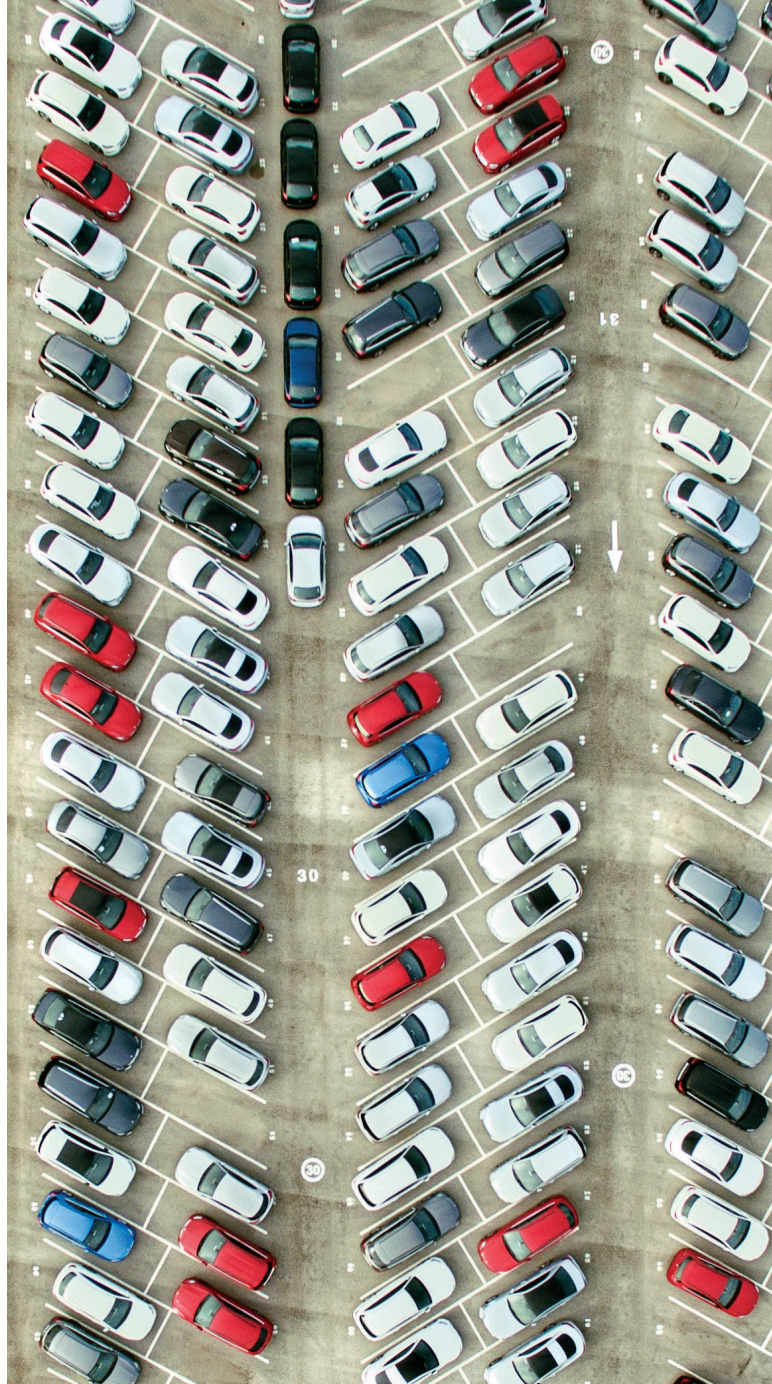
These facilities may offer vehicles that are priced below those you will find at new-vehicle dealerships — but many don't provide a warranty or any repair service. They may also have older vehicles in poor condition or that have been damaged and repaired to resell. Exercise caution. Know the reputation and any complaint history of the dealership. Go to the Better Business Bureau at bbb.org for ratings or complaints about any business.

USED-VEHICLE SUPERSTORES

Here you can find nearly new vehicles that have been inspected with good warranties from every major vehicle manufacturer. Prices may not allow for negotiation and may be higher than those at traditional used-vehicle dealerships. Any warranties may only be in effect for a very limited time, so ask questions and read any terms of sale.

PRIVATE SELLERS

When buying from a private seller there are often no guarantees, no paperwork or titling assistance, nor easy remedies for disputes. This doesn't mean you should avoid private sellers, you just need to be more cautious. Always get an inspection from your own mechanic and if possible, obtain a vehicle history report.



TIP: Don't limit your search for a vehicle to only those that are nearby. You might land a better deal if you are willing to drive a little farther.



LET'S MAKE A DEAL

Once you've narrowed your choices to a specific model or two, it's time to negotiate. Remember these tips.

- » Get pre-approved to buy a vehicle through your bank or credit union. This will give you strength in negotiating dealership financing rates.
- » Negotiate outside of the dealership. This is often more effective than at the dealership where inventory, emotions, and the sales environment can contribute to a poor financial decision.
- » Don't be drawn into a conversation with a salesperson about monthly payments. Focus instead on the base price you are willing to pay for the vehicle.
- » Know the value of any trade-in based on its condition before you go shopping. Then, negotiate the trade-in price as a separate transaction.
- » Research competitors' pricing and factory invoice pricing — the actual cost to the dealer for that vehicle — to give you an upper hand in the process.
- » Be prepared to walk away if the negotiations become uncomfortable.

HOW MUCH CAN I AFFORD?

Your total transportation costs should not exceed 10% of gross pay.



MORE THAN A CAR PAYMENT

A bank or credit union considers credit score, debt-to-income ratio, and ability to make a payment when determining how much it will lend. But you should do more. When you’re shopping for a vehicle, consider not only the payment, but also insurance, fuel, maintenance, and repairs. Frequent relocations are a reality

in the military and unfortunately the cost of insurance and fuel could vary greatly depending on where you are stationed. Simply put, a loan payment gets you on the road, but insurance, fuel, maintenance, and repairs keep you driving. Remember to budget for these costs accordingly.

HOW MUCH VEHICLE SHOULD I BUY?

AFFORDABLE PAYMENT

Angelina, a young service member, is shopping for a new vehicle. Her gross pay is \$3,750 per month. Knowing that it’s good to keep total transportation costs under 10% of gross pay, let’s see what monthly payment Angelina can afford.

| | |
|-------------------------------|-------|
| MONTHLY TRANSPORTATION BUDGET | \$375 |
| GAS, INSURANCE, MAINTENANCE | \$175 |
| AMOUNT LEFT FOR PAYMENT | \$200 |

AFFORDABLE LOAN

After accounting for gas, insurance, and maintenance costs, Angelina’s monthly budget leaves \$200 for a vehicle payment. By financing for five years with an interest rate of 3%, Angelina’s monthly payment will allow for an \$11,000 loan amount. Angelina has also saved a down payment of \$2,000 and should shop for vehicles priced around \$13,000.

| | |
|--------------|----------|
| LOAN AMOUNT | \$11,000 |
| DOWN PAYMENT | \$2,000 |
| TOTAL PRICE | \$13,000 |

THE COST OF FINANCING

When a financial institution lends you money to purchase a vehicle, each payment includes an expense or cost for borrowing. This cost to borrow is called interest.

There are two factors that will impact the amount of interest you pay during the life of a vehicle loan:

» **Interest Rate:** The percentage rate the lender charges you to borrow money. The higher the rate, the more interest you will have to pay. Interest rates are determined by a number of factors, with your credit profile being one of the most significant.

» **Loan Term:** The scheduled length of time for the loan. Longer loan terms mean more payments and more interest to pay. Also lenders typically charge higher interest rates on longer-term loans.

If possible, the goal should be to minimize your interest costs, not just your monthly payment. The obvious ways to do this are borrow less, negotiate a lower interest rate (if possible), and keep the length of the loan short. If you have already taken a vehicle loan, you can reduce the amount of interest you pay by making additional principal payments.

| | 3 Years | 5 Years | 7 Years |
|---------------------|----------|----------|----------|
| Loan Amount | \$25,000 | \$25,000 | \$25,000 |
| Interest Rate (APR) | 4% | 5% | 6% |
| Monthly Payment | \$738 | \$472 | \$365 |
| Total Paid | \$26,568 | \$28,320 | \$30,660 |

The longer you finance, the more it's going to cost you.
Here's how much interest you'll pay given each of these three scenarios.

| Total Interest | \$1,568 | \$3,320 | \$5,660 |
|----------------|---------|---------|---------|
|----------------|---------|---------|---------|

A TALE OF TWO CAR BUYERS



A TALE OF TWO CAR BUYERS

INTRODUCTION

In our tale of two car buyers, we meet Alex and Chace as they each purchase a new car. They are both active duty military, with identical pay grades, and each have been pre-approved for loans with the same interest rate, and neither plans to make a down payment.

The story begins on a dealership lot and then follows our buyers through the next five years of their lives. What happens when one of them purchases a fairly expensive dream car instead of something better suited for their financial situation? Let's find out.

THE CARS



HONDA CIVIC LX

PURCHASE PRICE: \$21,450*



HONDA CIVIC TYPE R

PURCHASE PRICE: \$36,395*

**These examples are for illustrative purposes only. Purchase price does not include taxes, title, license or dealer fees.*



PURCHASE PRICE: \$21,450

PAYMENT PER MONTH: \$385 for 5 Years

ESTIMATE PER MONTH: INSURANCE \$100, GAS: \$90

Alex: Alex likes both the Honda Civic LX and the Honda Civic Type R, so the salesperson urges him to explore payment options for each vehicle before making his final decision.

The Civic Type R is more expensive, but the finance officer explains Alex can lower his monthly payments by extending the loan for seven years. As tempting as this idea sounds, Alex doesn't want to finance any vehicle more than five years. He's heard that a car loses value as soon as it leaves the dealership. Alex has also heard you should keep your total transportation costs — payment, insurance, gas, maintenance, etc. — under 10% of your gross income. Both cars will cost him more than this, but he'd still like to keep his transportation costs down so he can save money for other goals.

Taking all of these factors into consideration, Alex decides to buy the Civic LX.



PURCHASE PRICE: \$36,395


PAYMENT PER MONTH: \$480 for 7 Years

ESTIMATE PER MONTH: INSURANCE \$175, GAS: \$150

Chace: After test driving both cars, Chace is excited and wants to get the paperwork going as quickly as possible on his dream car, the Honda Civic Type R.

The finance officer explains a five-year loan payment will be over \$650 per month. A disappointed Chace considers how he can make this purchase work. Maybe he cuts his contribution to his emergency fund or changes his cell phone plan? Before he can come up with an answer, the finance officer explains he can lower his payment to under \$500 by extending the loan to seven years. The idea of paying for seven years doesn't bother Chace because this is his dream car and he plans to keep it forever. Chace is sold!

The Bottom Line: The best way to balance multiple financial goals is to keep total transportation costs under 10% of gross income.



| |
|--------------------------|
| ESTIMATED VALUE: \$9,300 |
| BALANCE OWED: \$8,400 |
| EQUITY: \$900 |

Three years pass. Alex still thinks about the Honda Civic Type R but he’s enjoyed his Honda Civic LX and been able to save \$200 per month towards his house goal.

Today, Alex receives orders for an overseas PCS and unfortunately can’t take his car with him. Luckily, a good friend would like to buy his Honda Civic LX immediately. The two do some online research and agree the car is worth \$9,300. After three years of payments, Alex still owes \$8,400.

Though he’s sad to see his car go, he’s able to pay off the loan and keep \$900 for himself.

The Bottom Line: Do not finance a vehicle more than five years.



| |
|---------------------------|
| ESTIMATED VALUE: \$18,500 |
| BALANCE OWED: \$21,300 |
| EQUITY: -\$2,800 |


After three blissful years, Chace also receives orders for an overseas PCS and will need to sell his car. Like Alex, Chace has a friend who is willing to buy his car. Even better, he’s willing to pay the \$21,300 Chace still owes on it.

But then to everyone’s surprise, the bank says it’s not willing to lend his friend that much because the car is only worth \$18,500. In other words, Chace owes \$2,800 more on the car than what it’s worth. This is called negative equity and it happens when a vehicle loses value faster than the loan is paid down.

Ultimately, Chace sells his car to his friend but has to come up with \$2,800 immediately to provide a clear title.

CHAPTER 3: THE TOTAL LOSS

A Tale of Two Car Buyers, continued




| |
|---------------------------------|
| ESTIMATED VALUE: \$9,300 |
| BALANCE OWED: \$8,400 |
| EQUITY: \$900 |

Three years pass. Instead of an overseas PCS, what if Alex's car was totaled in an accident?

Looking back at the PCS numbers, recall that Honda Civic LX is worth \$9,300 after three years. Let's assume this is the same valuation used by his auto insurance company.

Since Alex still owes a balance of \$8,400 on his loan, the insurance company will pay off this amount first.* The remaining \$900 will go to Alex to use for whatever he wants.



| |
|----------------------------------|
| ESTIMATED VALUE: \$18,500 |
| BALANCE OWED: \$21,300 |
| EQUITY: -\$2,800 |

Like Alex, instead of an overseas PCS, what if Chace's Honda Civic Type R was also totaled after three years?

Let's assume Chace's insurance company determines the car to be worth \$18,500 at the time of the accident. Since he still owes a balance of \$21,300, rather than getting money back like Alex does, Chace will actually be responsible to pay the difference of \$2,800 to satisfy his loan.

But it didn't have to end this way. If Chace had purchased GAP insurance when he bought the Honda Civic Type R (perhaps by not so hastily completing the financing paperwork at the dealership) he wouldn't be out \$2,800. GAP insurance pays the difference or the "gap" between the insured value of the vehicle and the balance owed. GAP insurance is typically inexpensive and should be seriously considered on longer loans or loans where there was no down payment.

The Bottom Line: Understand all the terms, conditions and options on your auto loan, like GAP insurance.

**Excluding deductibles.*

PROTECTING YOUR PURCHASE



Whether you purchase a vehicle using a loan, a lease, or cash, you must carry some kind of insurance. State laws require insurance to protect your vehicle, as well as yourself, in the event of theft or accidents.

VEHICLE INSURANCE

Virtually all states have established minimum liability coverage limits for passenger vehicles, and many also require uninsured motorist coverage. However, it's important to note state liability limits are generally not sufficient to protect you from individual liability for third-party medical costs, loss of income, and pain and suffering; especially if multiple individuals were injured in the accident. Carrying only state liability limits can put your future financial security at risk. You may be required to pay future wage garnishments to fulfill an obligation if your insurance limits are not sufficient at the time of the accident.

It's important to purchase adequate property damage liability limits to protect your assets in case you are found liable for a multi-vehicle accident. A multi-vehicle accident can easily exceed a \$50,000 loss. Most lenders also require "full coverage insurance" that includes comprehensive and collision coverages to repair or replace the vehicle if it is damaged or stolen. Ask your lender about their mandates and make sure all coverages are in effect before you take possession of the vehicle. Be sure to update your policy information at that time.

GAP INSURANCE

This insurance covers the difference between a vehicle's stated value in a finance contract and the amount an insurer would pay if the vehicle is damaged beyond repair or stolen before the end of the finance period. You can purchase GAP coverage from the dealer or lender. When considering GAP insurance, or any other add-on such as an extended warranty, be sure to shop around. Dealerships and auto insurance companies typically offer GAP coverage, but their costs and coverages can vary greatly.

A few ways to help reduce the need for GAP insurance include:

- » Making a large down payment
- » Avoiding financing negative equity from your trade-in
- » Keeping your auto loan short, preferably to five years or less

EXTENDED WARRANTIES

These warranties augment a manufacturer's warranty, which is typically three to four years or up to a certain number of miles, on the entire vehicle or on individual parts and systems. You may opt for an extended warranty on items that are not covered for very long by the original warranty or if you keep the vehicle beyond the terms of the original plan. Talk to your financial institution about any extended warranties offered or research other options.

UNDERSTANDING A LEASE

MOTOR VEHICLE LEASE AGREEMENT

LESSEE

Name:

Address:

LEASE TERM:

This Motor Vehicle Lease Agreement

uses the words "Lessor," "your" and

"I" refer to each party herein.

The vehicle you are leasing under

DESCRIPTION OF VEHICLE

☐ New

☐ Used

The vehicle is being

FEDERAL

Amount

Signing

term

ADVANTAGES OF LEASING

The two principal benefits of leasing a vehicle are:

- » Lower monthly payments
- » Fewer repair costs

Leasing a vehicle has its perks. You enjoy lower monthly payments, potentially no down payment, and you may be able to drive a more expensive vehicle than buying. Generally speaking, monthly lease payments are lower than payments for buying a vehicle. This is because with leasing you are not paying for the entire vehicle; you are primarily paying for depreciation, which is the vehicle's expected drop in value during the lease.

You also should have fewer repair costs since most leases span one to three years and a factory warranty is likely to cover most of the cost of anything that goes wrong.

DISADVANTAGES OF LEASING

The two principal disadvantages of leasing are:

- » Lack of ownership
- » Potentially more expensive in the long run

When you are leasing a vehicle you do not own it. There are restrictions on the number of miles, wear and tear, and customization you can make to the vehicle. Most leases will impose a charge per mile over the allotted mileage limit.

When your lease is up, you can either purchase, trade, or return the vehicle. In any scenario, you will probably be looking at another cycle of payments to keep you on the road. For this reason, a lease could be more expensive over the long term.

BREAKING DOWN A LEASE PAYMENT

Although a number of factors go into a lease contract, often the biggest reason people decide to lease is a lower monthly payment. A majority of your monthly payment covers the cost of depreciation while you have the vehicle. Common terms found in a lease contract include:

CAPITALIZED COST

This is the agreed upon sales price of the vehicle plus any add-on fees or taxes that will be financed. It might also include the balance of a previous loan from your trade-in. The sales price of a leased vehicle is no different than buying so you need to negotiate the best deal possible.

DEPRECIATION

Depreciation is the amount by which the vehicle loses value during the lease.

RESIDUAL VALUE


This is the value of the vehicle at the end of the lease. For three-year leases the residual is typically 45 - 60% of the MSRP.

MONEY FACTOR

Money factor, or lease rate, determines how much you will pay in finance charges each month during your lease. To convert the money factor to an equivalent annual percentage rate (APR) multiply by 2400. For example, a money factor of .00125 would equal 3% APR.

The example to the right is for illustrative purposes. Finance charges, taxes, and fees can vary greatly by state and dealer.

| Value | |
|---------------------------------------------------------------------------------------------------|-------------------|
| MSRP Manufacturer's Suggested Retail Price | \$26,000 |
| NEGOTIATED SAVINGS Negotiate sales price as low as possible | <u>– \$2,000</u> |
| CAPITALIZED COST | \$24,000 |
| RESIDUAL VALUE Based on a percentage of MSRP Typically 45 - 60% for a 36-month lease | <u>– \$14,000</u> |
| DEPRECIATION Expected drop in value during the lease | \$10,000 |



| Payment | |
|-----------------------------------------------------------------------------------------------------------------------|------------------|
| DEPRECIATION Expected drop in value during the lease | \$10,000 |
| VARIOUS COSTS AND FEES | <u>+ \$1,700</u> |
| TOTAL | \$11,700 |
| 36-MONTH LEASE | <u>÷ 36</u> |
| MONTHLY PAYMENT Total depreciation, finance fee, sales tax, and other fees divided by number of payments | \$325 |

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