How to Get the Best Car Loan

Tips for Getting a Car Loan That Fits Your Budget

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The Balance

For a successful auto purchase, you'll need to choose a suitable car, negotiate a good price, and, perhaps most importantly, fund the purchase in the most affordable way. Unless you have a substantial amount of savings and can pay for a car in cash, you'll probably need to borrow money.

A car loan helps you buy a car that costs more than you can afford with cash. You'll generally pay off your vehicle over time by making monthly payments.[1] If you borrow wisely, you'll enjoy two key benefits:

1. You'll spend less (perhaps hundreds or thousands of dollars less) on your vehicle.[2]
2. You'll have the flexibility to change vehicles and fund other goals within a few short years.

Proper planning can improve your chances of getting a car and car loan that fit your budget.

Set a Budget

Before you start looking at cars, determine how much you can afford to spend.[1] Salespeople may make the case to you that a car is affordable through options like a long-term loan when it is not actually within your budget. To determine whether you can actually make payments on the car and how you want to handle car loan payments, you must first understand common loan terms:

- Down payment: This is a payment you make upfront when purchasing your car. In general, the larger your down payment, the smaller your loan and the lower your resulting monthly payments; experts recommend putting down at least 20% of the purchase price to secure favorable car loan terms.[3] It may be uncomfortable to write a large check, but you'll enjoy more flexibility, less interest cost, and lower monthly payment obligation for many months to come when you do so. In addition, if you plan to trade in your current vehicle, the trade-in credit may cover the down payment.
- Monthly payments: These are regular payments you make for a specified number of years. Keep the dollar amount of payments at a comfortable level to account for unanticipated events that could affect your income. Your income could decrease, or you might face unexpected expenses in the coming years. In general, your monthly car payment should be no more than your monthly income less your living expenses, the costs of ownership (insurance, registration, and maintenance), and any debt you might need to roll over from an old car loan into the new loan.[2]

- Loan term: This represents the period of time over which you will repay the loan. While a longer term like 72 or 84 months may result in lower monthly payments, it can increase interest costs and total costs over the life of the loan. If you can afford it, a short-term loan (36 or 48 months, for example) is preferable because it reduces your interest and total loan costs.
- APR: The annual percentage rate (APR) is the annualized interest rate you will pay on the loan, usually expressed as a percentage.[4] The lower the APR, the lower your interest costs.

A small down payment or long loan term can result in an upside-down loan, which is when you owe more on the vehicle than it is worth.

Review Your Credit

Your credit factors in your history of borrowing from other lenders and indicates whether you borrowed in the past and if you repaid those loans on time.[5] It's important to review your credit reports before you apply for auto loan loans or visit a dealership because it can affect whether you will be approved for a loan and at what interest rate. With a good credit score, you'll generally get a lower interest rate, which means you'll pay less for your vehicle both in terms of total interest costs and monthly payments.[2]

Under federal law, all U.S. consumers are entitled to a free credit report every year from each of the three credit bureaus, so exercise your rights.[6] You can obtain credit reports from AnnualCreditReport.com. Read through them carefully, and if you spot errors, contact the relevant bureau to get them removed and ensure that your credit appears as favorable as possible.[7]

Shop Around for Lenders

Consulting with multiple lenders of different types before you step onto a car lot will give you a sense of the car loan options available to you.

- Auto dealerships: This is a convenient lending option because you will enter into a financial agreement with the dealership and can skip a separate visit to a lender. Many offer multiple financing options and incentive programs to sweeten the deal.[1]
- Direct lenders: You can also secure financing directly from a bank, credit union, or online lender. In many cases, these lenders can offer a better deal on financing than a dealership. These lenders can often give you preapproval on a loan amount and interest rate, which can increase your bargaining power at a dealership.[8]

Recognize Sales Tactics That Can Cost You

Make smarter decisions about your loan by sidestepping approaches that a dealership may use to entice you to get a car loan from them:

- Monthly payment misdirection: It's tempting to look at the monthly payment when deciding how much you can afford to spend on a car, and some auto dealers use this as

a selling tactic. While affordable monthly payments are important, focus on the total cost of the car, which amounts to the purchase price plus interest on the loan and any fees or penalties.[1]
- Small down payment offers: A dealership may suggest that you make a smaller down payment on a car loan to make payments more manageable, but this means that you will need to borrow more money.[2] Make sure you're buying a car that you can realistically afford so that you don't have to take out a loan that can hurt you financially.
- Frivolous car features: Lenders may entice you with features relating to roominess, comfort, or maneuverability, such as higher car seats.[9] With a budget in mind, you can forgo features you don't need and can't afford.

Skip Unnecessary Insurance

Lenders may offer to include [different types of insurance]() with your loan. If you're after the best deal on a car loan, you're often better off buying it on your own or skipping it if you have comparable coverage.
- Liability insurance: In general, it's better to purchase your own liability insurance, as you'll pay less than what you would pay if your lender were to roll the insurance costs into your loan.[10]
- Credit insurance: If a lender asks whether you have life or disability insurance, it's usually because they want to sell you credit insurance. This optional type of insurance will cover your loan payments and protect your property if you become injured or ill, lose a job, or pass away. But it's a low-value add-on and seldom a good idea because it can be cheaper and more practical to get individual life and disability policies or obtain them through your employer.[11] [12]
- Collision insurance: Your lender may require you to get collision insurance, which covers the cost of car repairs when you are at fault.[13] If you don't get it, they can repossess the vehicle if you stop making payments. As with liability insurance, you can buy this insurance on your own, and often for a lower price.

If you need any of these common types of auto insurance, compare offers from several different sources, including an individual insurance agent who is not affiliated with your lender.

Avoid Prepayment Penalties

Life is unpredictable, which means you may need to pay off your auto loan quickly. Some lenders impose what is known as a prepayment penalty if you pay off a loan before the end of the loan term.[14] [2]

To avoid incurring this penalty, read the fine print of your auto loan contract before signing and ensure that it grants you the flexibility to accelerate payments, make extra payments, or pay off the loan in its entirety without penalties.

Since old-fashioned prepayment penalties have been outlawed in some states, lenders may disguise early payoff fees as rebates in loan contracts. For example, some states permit the use of the "rule of 78," which allows lenders to collect a disproportionate share of the loan amount in interest and fees if you pay off a loan in the early months of the financing term.

The Bottom Line

Arming yourself with the proper knowledge prior to car loan shopping and reading the fine print before you sign off on the dotted line can increase the chances of getting a great deal on a car loan. When you enter a dealership, be realistic about your means to avoid being seduced by seemingly good deals on shiny new cars that you cannot afford. With the right preparation, you can purchase a car that fits your budget and lifestyle.

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