

Auto Loan Basics

If you're in the market for a new car or truck, you're likely also shopping for an auto loan. Your auto loan will affect your monthly budget for the full term of the loan, so it's important to do your research and make an informed decision before finalizing it. Here's all you need to know about auto loans and how to choose the one that's best for you.

How do auto loans work?

Auto loans make it possible for consumers to purchase a new car without having all the cash on hand when buying. With a car loan from a financial institution or private lender, you'll receive the funds you need to purchase the vehicle in one lump sum, of which you'll pay a portion back each month, with interest, over the term of the loan.

Where do I apply for an auto loan?

There are two primary sources for auto loans:

- **Direct lenders.** This includes financial institutions like credit unions, banks, or online lenders. You'll likely have the opportunity to get pre-approved for a vehicle loan through these lenders, which can make your car shopping quick and easy.
- **Dealership financing.** This option enables you to purchase and finance your car in one location. Convenience aside, a dealership loan may be accompanied by a higher interest rate and enticing offers for upcharge add-ons and/or extra protection that may not be worth the price.

How high will my monthly payment be?

Your monthly payment amount will be determined by several key factors:

- **The loan amount.** The amount you borrow will be equal to the value of the car you're purchasing, or significantly less. A great minimizer of the overall cost is making a sizable down payment and/or trading in your old vehicle when buying a new car.
- **The annual percentage rate.** Usually referred to as the APR, this is the effective interest rate you pay on your loan. Your interest rate is determined by your credit score and other general creditworthiness or financial wellness factors.
- **The loan term.** The typical length of most auto loans is five years, but some lenders offer to stretch the term to seven years or even longer. A longer-term loan means paying less each month, but it also means paying more in overall interest throughout the life of the loan. A shorter-term loan also means you'll own the car fair and clear sooner.

How can I score the lowest interest rate on my auto loan?

The interest rate on your auto loan will directly affect your monthly payments throughout the loan term, so it's important to make every effort to score the lowest rate possible. Here's how:

- **Shop around.** Don't accept the first offer you receive for an auto loan. Get quotes from several lenders to find the one that offers the lowest interest rate.
- **Boost your credit score before applying for a loan.** In the months before you apply for an auto loan, take steps to boost your credit score, including paying all credit card bills on time, working to pay down outstanding balances, not opening new cards, and reviewing your credit report for fraud.
- **Borrow less than you qualify for.** While it's tempting to max out your eligibility, consider borrowing less than you qualify for when taking out an auto loan. A smaller loan amount generally means a lower interest rate as well.
- **Save up for a bigger down payment.** If you don't have a substantial down payment saved up, you may want to delay your auto loan application until you can save more, borrow less and qualify for a lower interest payment.

Shopping for a new car is exciting, and you may be itching to get behind the wheel of a newer vehicle. However, since your auto loan will directly impact your monthly budget for up to seven years, it's important to do your research carefully before finalizing your loan. We hope this guide on auto loans will help you make an informed decision about your loan.