



**The steps to take  
to finance your car**



# **Buying a new car is very exciting, but there are a few things you should know to keep the experience from turning into a disappointment, whether from rushing into things, overlooking hidden fees or making the wrong choice.**

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# 1/ Financing your vehicle

Anyone who is of legal driving age may take out an auto loan. To take out a loan, having a good credit history is important. Building good credit is as easy as applying for a credit card or line of credit, using it regularly and paying off the balance.

# 2/ Your credit rating: a determining factor

Your credit rating score is critical for obtaining a loan. If you always pay off your debts on time and the level of debt you're carrying is reasonable, you have nothing to worry about.

Your rating can range from 300 to 900 points: the higher the number, the better your credit history.

## How do you get a good rating?

### Payment history

The most important factor is paying your debts on time. Any late payments 30 days or more past due are recorded in your credit report and hurt your score. The later the payment, the worse the damage. Avoid them at all costs.

### Financial stability

Doing business with the same financial institution for several years and having a history with them for your savings and credit accounts is considered proof of financial stability. The longer and more positive your history, the better your rating. With a better history, it's easier to provide financing for your vehicle because your repayment practices are already well known.

### Single inquiry

Every time a lender checks your credit report to issue a loan or credit card, a note is made on your report. Applying for credit too frequently may lower your rating. In fact, a recurring need for credit demonstrates financial instability.

Shop around, take as many test drives as you need to make the right decision, compare offers, etc. But remember to submit only one loan application when you are ready to buy.

### Number and variety of creditors

The more creditors you have, the higher your risk of debt. Try to keep your various types of credit to a minimum and don't have too many of the same kind (for example, multiple credit cards).

# 3/ A good credit rating isn't enough, you can have too much debt

## How do you figure out how much debt you have?

By calculating your debt ratio, which is a measurement that compares before-tax income and total debt. This information is especially useful when you are planning to apply for a loan from a financial institution or another lender. The decision to grant you a loan is based on your debt ratio. It provides **an indication about the condition of your finances and your ability to repay a loan.**

To calculate your debt ratio, add all of the payments that you regularly make (monthly rent or mortgage payments, home insurance, tax, auto or student loan payments, credit card payments, etc.) and divide the total by your gross monthly income.

A debt ratio of 30% is considered excellent, a ratio between 30% to 36% is considered good, while a ratio above 40% could make it hard for you to get approval for an auto loan, student loan or mortgage—and potentially make it difficult to pay off any such loans.



**Excellent**

Debt ratio under 30%



**Good**

Debt ratio between 30% and 36%



**Critical**

Debt ratio between 37% and 40%



**Excessive debt**

Debt ratio above 40%

Unlike your credit rating, which gives a picture of your credit history, your debt ratio takes current income into account.



## 4/ How to avoid taking on too much debt when buying a car?

To avoid excessive debt, it's better not to change vehicles before completely paying off your auto loan. Otherwise you may have to refinance your existing debt, which leads to "negative equity" or "balloon payments." Negative equity is the

difference between the balance due on your auto loan and its market value. If you owe more than your car is worth, you are in a negative equity situation.

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### For example:

Two years ago, Anne bought a car with a \$15,000 auto loan. At the time, she didn't realize she would soon need a more comfortable vehicle to transport her young twins. She went back to her dealer to buy a vehicle better suited to her new life and selected an SUV for \$35,000 with her husband.

She still owed \$10,000 on her initial loan but the market value of her car at the dealer was \$7,000. The dealer offered to buy back her car for \$7,000 and to finance the remainder of her initial loan with her new loan:

$$\mathbf{\$35\ 000 + \$10\ 000 - \$7\ 000 = \$38\ 000}$$

Anne's debt therefore went from \$10,000 to \$38,000, not counting the interest on the loan.

It's best to avoid this, because not only can it hurt your credit, in the end you'll wind up paying much more for your car than its actual value, since interest is spread out over such a long period of time.



## 5/ Auto or personal loan?

You have two options for financing your vehicle: a personal loan or an auto loan.

Auto loans may be obtained directly from the dealer, who handles all the steps. It will generally have a lower interest rate because it's an installment sales contract (ISC) where the car serves as the guarantee for the loan amount.

Also, with an auto loan, repayment doesn't start until the owner takes possession of the vehicle, unlike personal loans where repayment starts as soon as the loan is taken out.

### **So, why choose a personal loan in this case?**

Personal loans are useful for buying a used vehicle from an individual.

To get a personal loan, you have to apply for it with your financial institution. If the application is accepted, the loan is granted and the amount is transferred to your account. The loan is activated as soon as it's approved and the repayment process is initiated at the same time.

A personal loan is also the best option if you are buying a vehicle for less than \$7,500 from a merchant or dealer. Auto loans are generally offered by dealers to finance purchases greater than \$7,500. So if you're purchasing an inexpensive car or a car from an individual, taking out a personal loan is recommended.

## Fixed or variable interest rate?

You are risk-averse and sensitive to rate fluctuations

### **Choose a fixed interest rate.**

- Guaranteed for the term of the loan.
- Predictable.
- Easy to manage.

You take risks and can tolerate a certain amount of rate fluctuation

### **Choose a variable interest rate.**

- Follows market fluctuations.
- Advantageous when stable or when rates decrease.
- Generally lower than the fixed rate in effect.
- If the rate goes down, your payment amount remains the same but the term of your loan could get shorter.
- Possible to convert your variable rate loan to a fixed rate loan without fees or penalties whenever it is convenient for you. The interest rate will be the fixed rate in effect when the conversion occurs.



# 6/ Practical negotiation glossary

## **Credit rating**

As we learned above, this is a confidence score given to you by a lender. The higher—and therefore more positive—the rating, the greater your chances of getting financing.

## **Interest rate**

Defined by the lender according to the type of vehicle, term of the loan and the borrower's level of risk. Interest is the lender's compensation in exchange for the money that is loaned.

## **Point of sale financing**

Dealers and merchants may offer three kinds of financing. The first, which is reserved for new vehicles, is offered by the manufacturer (low, subsidized rates or 0%). Next are loans offered by various financial institutions (competitive rates that are similar between institutions) and financing from lenders for second and third chance credit (higher rates).

## **Finance charges**

This is the real cost of a loan, including capital, interest, loan insurance (optional), administration fees, etc. This information must be clearly indicated on the financing agreement offered by the dealer or financial institution.

## **Installment**

The amount paid each month to repay the loan. It includes the repayment of a portion of the capital and interest.

## **Down payment**

An amount of money that you have and want to apply towards the purchase amount, thereby lowering the amount of financing required. Dealers will often offer you money to buy back your old car, which could also be considered a down payment.

## **Partial payment or deposit**

An amount paid by the purchaser to the seller as a promise to buy. Partial payments are sometimes non-refundable.

## **Legal warranty**

Protects the consumer against potential vehicle defects for a certain period of time or up to a certain number of kilometres, as long as the vehicle's owner uses it normally.

## **Extended warranty**

Optional warranty that extends the vehicle's legal warranty for an additional fee.



## 7/ 0% financing: is it worth it?

Many dealers offer financing with a 0% interest rate through a lender provided by the manufacturer (Mazda, Toyota, Ford, Chrysler, etc.) when you purchase a new car. This means that you don't pay any interest for the entire term of the loan. It may seem like a tempting offer, but be careful: you need to consider all of the conditions that go along with it.

### **Does your car dealership offer you a discount if you do not choose the 0% rate?**

If so, that means the price of the car is artificially inflated with 0% financing and the dealer is compensating for the lost loan fees by selling the car at a higher price. This increase is a sort of dressed-up interest rate.

## **The second thing to check: Would it be better to take out an auto loan with an interest rate to take advantage of the rebate?**

It all depends on the difference in total cost (principal and interest) between the two scenarios. It is important to understand that in one scenario, you're saving on interest and in the other, you're saving on the price of the vehicle and taxes because the rebate is usually applied to the pre-tax amount. This reduces the loan amount and the interest is also indirectly reduced. You should do the math for both scenarios. If the total cost for the scenario with the rebate and the interest is lower than the scenario with 0% financing, the rebate is the better option—even with the interest rate.

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### **For example:**

The \$15,000 car that Anne chose costs \$17,247 including taxes and comes with 0% financing for 60 months, which comes out to a monthly payment of \$287.

During her conversation with the dealer, Anne realizes that if she opts for financing other than that offered by the manufacturer, she will get a \$2,500 rebate. To compare, she factors in a 5% financing rate from a financial institution and figures out that her \$15,000 vehicle minus the \$2,500 rebate comes out to \$14,372 including taxes. Using the same 60-month term, her monthly payment equals \$271. At the end of the five years, Anne will have paid a total of \$16,274 with interest for her car, in other words \$973 less than with the 0% financing offer.

Note that this is just an example. If the rebate had not been as high, it would have been better to choose 0% financing. Be sure to do the math to compare each scenario, because what's important is the final price you pay.

Use our [calculator](#) to compare your scenarios.

# 8/ Cost, looking beyond sticker price

Buying a car has a cost: the price and the financing. You will also need to factor in a variety of fees.

Here are some of the main expenses vehicle owners have:

- Gas: Cost varies depending on the vehicle, the number of kilometres driven and the price at the pump
- Regular maintenance: Again, the cost varies depending on the vehicle and the number of kilometres you drive. Proper car maintenance will extend the life of your car, optimize fuel consumption and reduce emissions.
- Repairs: You can't always predict when your car will need repairs, but you can expect that they will be needed somewhat regularly over the life of your car. Doing repairs quickly is important for extending the life of your vehicle.
- Auto insurance: Its cost, which must be paid every year, depends on the type of vehicle and the driver's experience, age, place of residence, coverage selection, etc. It is possible—and recommended—to request quotes from insurers before you buy a car.
- Loan insurance: Covers the repayment of a loan in the event of death or disability. This coverage offers valuable protection in the event you become disabled and cannot pay your loan and ensures that your debt will not be passed on to your heirs.
- Tires: Good tires can reduce your risk of an accident and your car's fuel consumption. In Quebec, winter tires are required between December 15 and March 15. Depending on how they're used, tires must be replaced every two, three or four years.
- Driver's license: Must be renewed annually and its cost varies depending on the number of demerit points on your driving record.
- Registration: Your car registration must be renewed annually. The cost varies according to the owner's place of residence, the type of vehicle and how it's used.
- Other: Accessories, windshield wipers, maintenance products, car washes, parking, etc.

# 9/ Helpful questions for picking the right vehicle for you

## 1. What do you want to do with your vehicle?

The question may seem simple, but it is essential for figuring out what you need and choosing the right car.

- Are you planning on driving it more in the city or in the country?
- Are you single or do you have a family?
- Will you be driving long distances or only making short trips?
- Will it be your family's primary or secondary car?
- What main features are you looking for?

Defining your specific needs helps you zero in on a vehicle category so you can compare each model more effectively—and you'll be less likely to let a clever salesperson talk you into features you don't actually need.

## 2. New or used?

Buying a new vehicle often means buying peace of mind. New vehicles are sold with a warranty that covers the major issues that could come up during the first five years. They do, however, cost more and their value drops quickly. They say that vehicles lose more than 20% of their value the moment they leave the lot.

Buying a used vehicle is riskier because you never fully know the vehicle's history. The most depreciation occurs in the first three years, so it's a good idea to purchase a three-year-old vehicle if it's in good condition.



## 10/ **Final step: signing the agreement**

When you've made your choice and you're ready to commit to buying, it's time to sign the agreement. Reread it one last time to make sure that it faithfully adheres to the terms you negotiated. Before you sign, it is important to check the information on the agreement, such as your name, address, the loan amount, interest rate, etc. Payment terms and conditions may be subsequently modified by the financial institution, but it's more difficult to change the borrower's name.

You now have all of the information you need to be smart about financing your next vehicle according to your financial resources and needs.

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