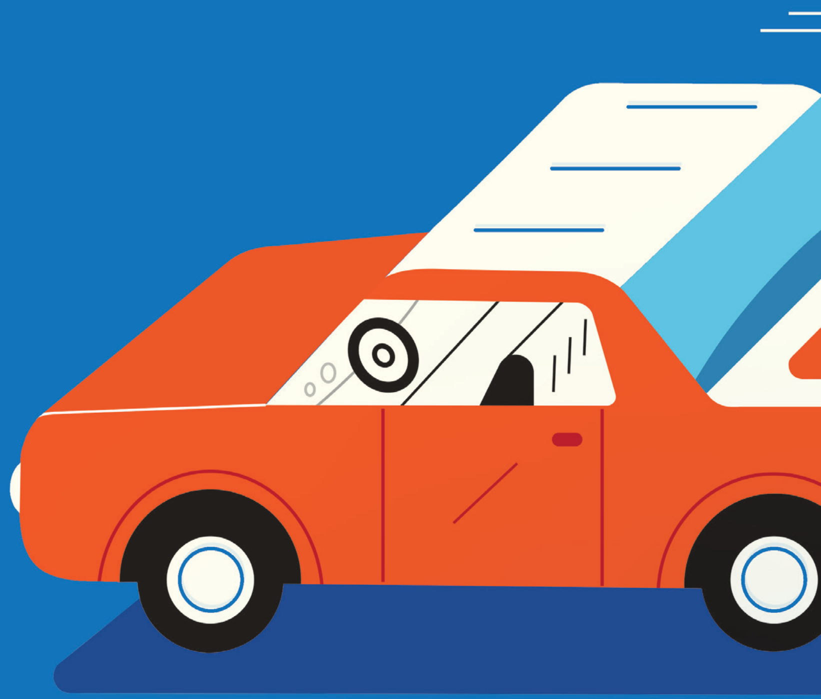
ROAD
REPORT

Stop Paying Too Much for Your Car Loan



Some borrowers, including those with great credit, are charged interest rates as high as 25 percent, a CR investigation has found. Here's what we learned, and how you can get a fair deal when you buy.

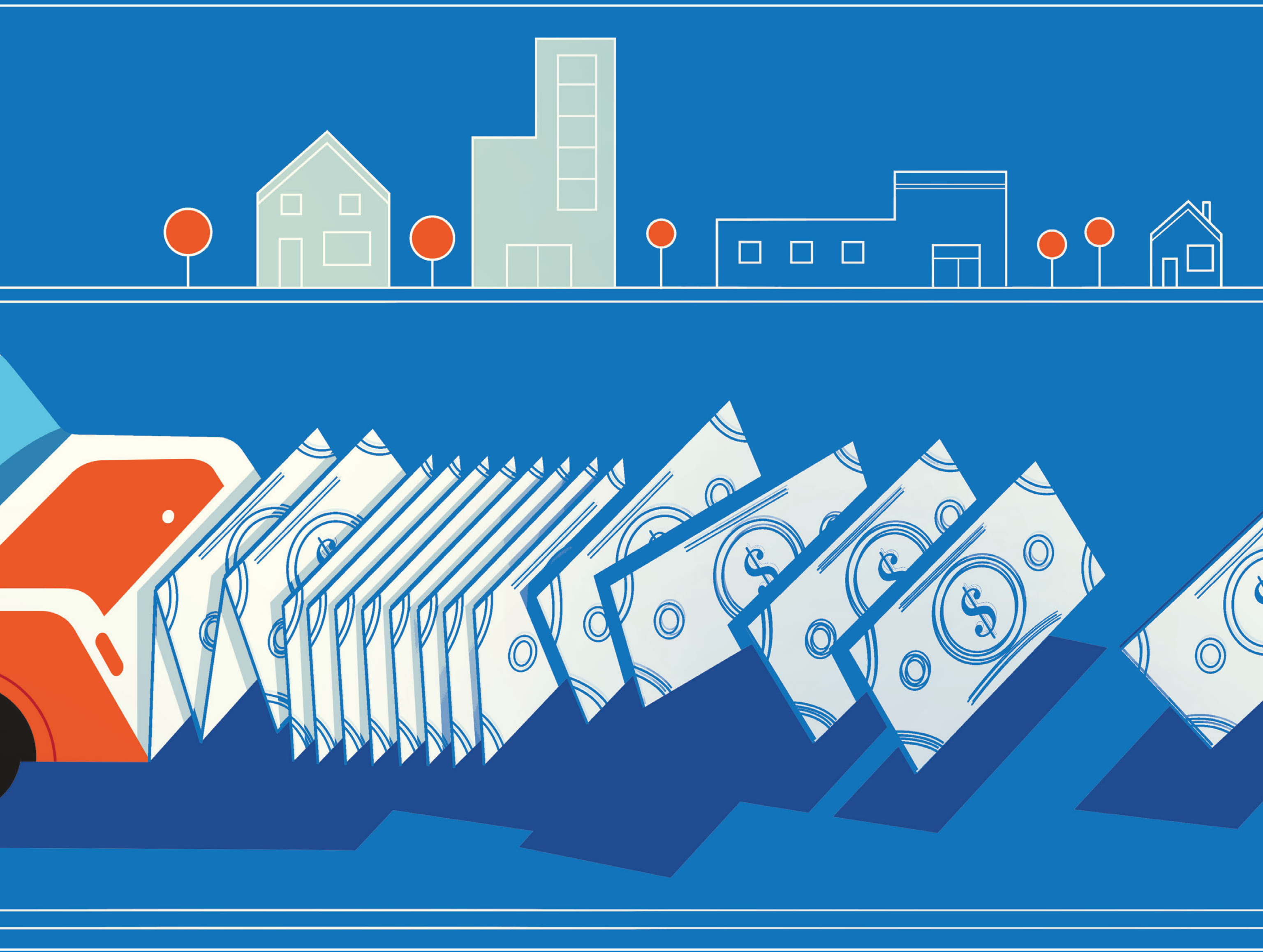
by RYAN FELTON
Illustrations by HARRY CAMPBELL

TWO YEARS AGO a Maryland resident with sterling credit financed a 2018 Toyota Camry with a loan that had a 19 percent annual percentage rate (APR) and a monthly payment of about $823. By the time the loan is expected to be paid off, in late 2025, the borrower will have spent roughly $59,000—more than twice the car's value and about what you would pay for a high-end Tesla Model 3.

Another borrower who got stuck in a car loan with a sky-high APR suffered even more serious consequences. The man, an insurance account manager from Connecticut who earns about $80,000 per year, bought a used Toyota Tacoma pickup truck at a local dealership in early 2019. But the monthly payments on his loan—with a 17 percent APR—came to $900. Though he was able to make those payments for a while, by the spring of 2020 he had fallen behind. His truck was repossessed in June 2020.

These are just two stories out of many about the effects of what has become a widespread practice: auto lenders giving consumers expensive car loans, even to borrowers whose incomes and credit credentials ought to qualify them for far better rates.

Over the past decade, auto loan debt held by Americans has skyrocketed, surpassing $1.4 trillion—more than the gross domestic product of Australia. And Americans today with new-car loans are paying a lot more every month, roughly 25 percent



more than 10 years ago, on average.

To understand why this is happening, and to investigate the effect on consumers, Consumer Reports assembled and analyzed almost 858,000 loans, from 17 major lenders, that had been bundled into bonds sold to investors in 2019 and 2020.

Details about these loans, the vast majority of which were arranged through a dealership—the primary way Americans finance cars—are required by the Securities and Exchange Commission to be made public, including information about the terms of the loan and the borrower's finances. The data, while not nationally representative, provide a close-up look at what Americans can pay, or overpay, when they borrow money for a car.

Read on to see what we found.

WHAT ONE LOAN WILL END UP COSTING

A 2018 Toyota Camry loan in Maryland, from CR's data analysis

Borrowed

$34,943

AT 19% APR

Total Payment

$58,785

OVER 6 YEARS

Source: CR analysis of 857,904 loans obtained through the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system.

1

Similar consumers got very different loans.

THE COST OF BORROWING was all over the map and often not tethered to the borrower's credit score. Some borrowers with super-prime credit scores—720 or higher—were in loans with a 0 percent APR, while others with similar scores got loans with APRs of more than 25 percent. We found the same wide range of APRs when we looked at deep subprime borrowers, those with scores below 580.

And we found examples of loans with vastly different terms given to borrowers with almost identical finances—for the same car.

"Sadly, this is all too common," says Ian Ayres, a lawyer and economist at Yale University's School of Management and Yale Law School who has studied disparate pricing in auto lending. "I've seen a surprising number of consumers with excellent credit who are nonetheless written into subprime loans with high APRs."

A TALE OF TWO BORROWERS

2017 Chevrolet Trax

About $18K in financing

$60K to $66K annual incomes

Prime credit scores

California residents

4.9% APR	14.1% APR
TOTAL PAYMENTS	
$20,448	$27,540

2

Dealers and lenders appeared to charge what they could get away with.

TO UNDERSTAND why interest rates varied so much among borrowers with similar credit scores, CR statisticians considered numerous factors, including payment-to-income ratio, when the loan was issued, whether a co-borrower was present, the length of the loan, the amount of equity in the car, and whether the purchaser received financial incentives on the loan. None could fully explain the vast differences in costs.

So what's going on? Experts CR spoke with say dealers and lenders may be setting interest rates based not only on risk—standard loan underwriting practice—but also partly on what they think they can get borrowers to agree to. Studies show that many borrowers don't know they should, or even can, negotiate the terms of a loan or shop around for other offers.

> *"The financing you get has a lot more to do with how prepared for battle you are when you walk onto the showroom floor than your financial history."*

R.J. Cross Tax and budget advocate, U.S. PIRG

5

Many people were given loans they couldn't afford.

LENDING EXPERTS recommend that consumers spend no more than 10 percent of their income on car debt. That's because paying more than you can afford poses serious financial risks, including default.

But in our data, almost 25 percent of borrowers spent more than that on a car loan.

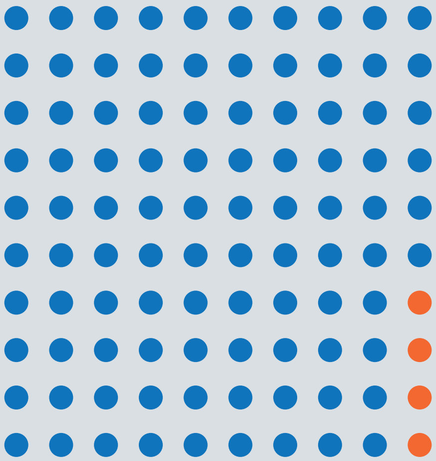
People with low credit scores, who tend to have lower incomes, appear to be particularly likely to spend more than 10 percent of their monthly income on car loans.

3 Some good-credit customers got pricey loans.

THE AVERAGE APRs for borrowers with credit scores of 660 or higher ranged from 3.73 percent to 5.94 percent. But in the data CR reviewed, almost 21,000 consumers in those credit tiers—about 3 percent of the entire group—paid exorbitant rates of 10 percent to about 25 percent for their car loans.

Over time, the cost of those high rates can be significant. A typical borrower among that group of people would spend $4,500 more over the life of the loan than if they paid average rates.

4 Income verification was rare.



96% OF BORROWERS DID NOT HAVE THEIR INCOME VERIFIED

WHEN FINANCING a home, lenders typically check a borrower's income and employment. But in the car loans CR reviewed, lenders verified income just 4 percent of the time and employment even less often.

Consumers such as Oklahoma resident Lana Ash learned the hard way about lax underwriting. In April 2020, she received a loan arranged by a dealer through the lender Santander Consumer USA.

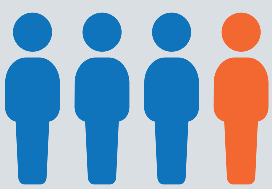
But when Ash received her first bill from Santander, she learned she owed $428 per month—about 20 percent more than she'd agreed to with the dealer. She discovered the dealer had overstated her income on her loan application, according to a lawsuit she later filed.

Santander ultimately repossessed her car in August 2020, her attorney says. (The lawsuit is pending. Santander declined to comment.)

Income verification could have prevented this. "I think they should take the steps to make sure the person can afford the payments," Ash says.

Of course, owning a car is not so much a choice as a requirement—to drive to a job, to a doctor, or to shop for food.

"Lower-income people spend a higher percentage of their budget on cars out of necessity," says John Van Alst, an attorney and expert on auto lending at the National Consumer Law Center, a consumer advocacy nonprofit.



1 IN 4 SPENT OVER 10% OF THEIR INCOME ON CAR LOANS

Experts say payments that high can be unaffordable

WHO'S SPENDING OVER 10% OF INCOME?

48% of borrowers with low credit scores UNDER 620

20% of borrowers with high credit scores 660 AND OVER

Source: CR analysis of 857,904 loans obtained through the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system.

6

Delinquencies and repossessions were common.

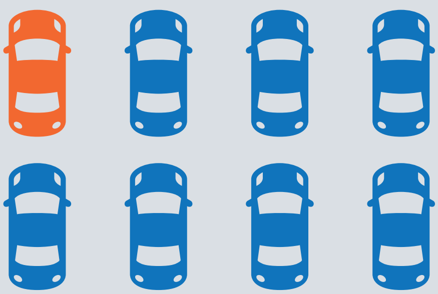
WITH SO MANY PEOPLE devoting so much of their monthly incomes to car loans, you'd expect a lot of late payments and forfeited cars. And there are.

Five percent–or 1 in 20–were reported to be delinquent on their loan.

After 30 to 90 days, lenders generally start the process of repossessing cars. Consumers with low credit scores are more likely to be affected.

A 2020 survey of 28 nonprime* lenders, representing billions of dollars' worth of auto loans, reported that those lenders had a repossession rate of around 13 percent in 2019, or roughly 1 in 8 vehicles financed by them. Between 2017 and 2019, 1.6 million to 1.7 million cars were repossessed annually, industry estimates show.

1 IN 8 CARS OF NONPRIME BORROWERS IS REPOSSESSED



You're not helping somebody get a car if the odds are that they're going to lose it. That's not getting somebody a car. That's taking their money.

Kathleen Engel Consumer Reports board member and research professor at Suffolk University Law School

How to Shop for a Car Loan

Whether you're a paragon of virtue when it comes to your credit—or not—there are steps to take before borrowing for a car that will help you make sure that you are offered fair terms and that you don't borrow more than you can afford.

Review your credit report and score.

This is something you should do months in advance, says Jordan Takeyama, public relations manager at Experian, a credit reporting agency. Your report–which lists your bill payment history and debts–is used to calculate your credit score, which in turn is used to help determine the interest rate you might be charged on a loan. Generally, the better your score, the lower the interest rate because you are considered by lenders to be low-risk.

*Nonprime score defined as 650 and below on the FICO Score 9 credit-scoring model.
Source: 2020 Non-Prime Automotive Financing Survey, published by the National Automotive Finance Association and the American Financial Services Association.

To get a free credit report, go to annualcreditreport.com. To check your credit score, see whether your bank or credit card shows you a free version. Just knowing your score gives you a starting point so that you can manage your expectations.

Improve your score.

Sometimes improving a low score is as simple as correcting mistakes or discrepancies in your credit report. Most mistakes and disputes are addressed in 10 to 14 days, Takeyama says, and credit reporting agencies generally must complete investigations within 30 days.

Paying down existing debt and late bills can also give you a last-minute bump. As always, pay bills for credit cards, utilities, and goods promptly to avoid late fees and further damage to your credit score.

Set a loan budget and stick to it.

Dealer sales staff can be masters of the upsell. Consider your needs today and how they may evolve over the ownership period. Resist the urge to indulge in extras or to buy a bigger or fancier vehicle than you need, because you're likely to be paying on that depreciating asset for years to come.

Make the biggest down payment you can.

That shortens the loan, says Alain Nana-Sinkam, vice president of lending and insurance solutions at TrueCar, a CR partner that analyzes market trends. Putting down more money up front also means you'll be paying interest on a smaller amount of money, costing you less overall.

Don't focus on just the monthly cost.

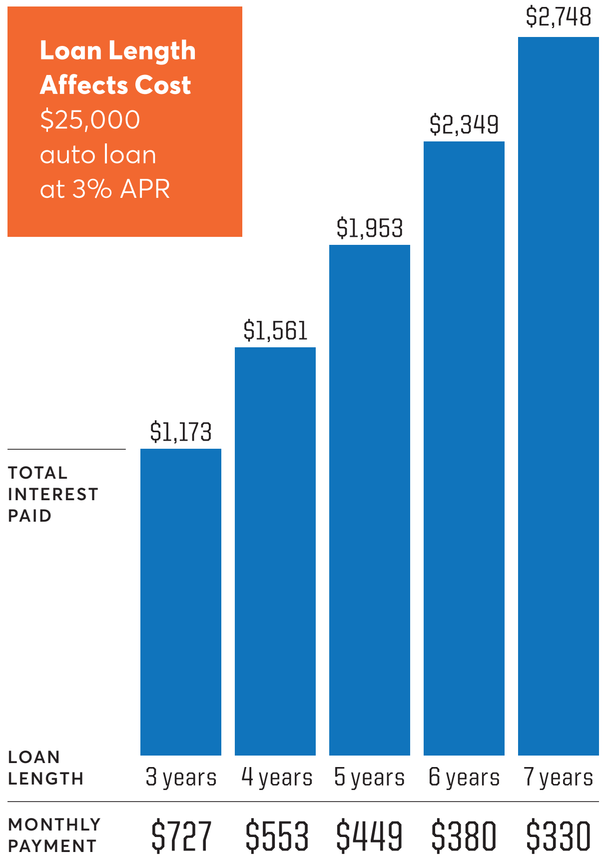
Dealers often try to sell you on a loan by emphasizing what you will have to pay each month. And that does matter, of course, for budgeting purposes. But to get low monthly payments, you probably will need an extended loan length, which can increase the overall cost. Another downside to long-term loans: They increase the chances that you will end up "underwater" or "upside down" on your loan, which is when you owe more on the car than it's worth. Of course, a monthly cost you can handle is important, too, so consider both factors when choosing a loan.

Get preapproval from your bank.

Before you set foot in a dealership—either physically or virtually—contact your bank or credit union and get preapproved for a loan. The dealer may be able to offer a better deal on financing, but having a loan secured ahead of time gives you a strong starting point for negotiations.

If your credit isn't great, check out deals from car manufacturers.

Some automakers, including Chrysler, Hyundai, Kia, Mitsubishi, and Nissan, offer financing for subprime borrowers, although it is usually focused on entry-level and economy cars.



Consider buying a used vehicle.

Used vehicles that are just a few years old are unusually expensive right now, but you can still save money by buying an older model. Although interest rates tend to be higher on loans for used cars, lowering the amount you're borrowing can result in significant savings.

Report suspected discrimination.

A recent academic study found that Black and Hispanic borrowers were 1.5 percentage points less likely to be approved for a loan and that they paid interest rates that were 0.7 percentage points higher, even when their creditworthiness was the same. Loans offered by dealers are called indirect loans because the dealer arranges financing through a third-party company. But the dealer doesn't have to tell the borrower about all loan offers that lenders send. To make a profit, dealers mark up the loan they choose to share. The study suggests that loans to minority borrowers were marked up more. If you suspect discriminatory lending, file a complaint with the Consumer Financial Protection Bureau or the Federal Trade Commission.

Ways to Make Auto Loans Fairer

Here are some changes that could make it easier for you to find a good deal on a car loan.

CR'S INVESTIGATION into auto lending raises serious questions about how the system can be unfair to consumers.

For one thing, we found that some consumers who are similar in terms of their income, credit score, and even the type of car they are buying can be offered loans with wildly different terms.

We examined about 858,000 car loans and found that the problem does not affect just people with poor credit scores. Some with excellent credit—the ones you'd think would get the best terms—are offered very expensive loans, CR found.

Experts have no shortage of ideas for ways to make the system more equitable. Here are four key changes they'd like to see.

1

You should be able to easily compare loans.

Most people let the dealership handle the loan paperwork, rather than going directly to a bank or credit union. Dealers typically shop around at various lenders to fund the loan—perhaps as many as nine, according to a 2020 study published by the National Bureau of Economic Research.

But "the loan selected by the dealer is not necessarily the loan that is best for the consumer," says Ryan Kelly, acting auto finance program manager at the Consumer Financial Protection Bureau. "Consumers often do not realize that auto dealers are not required to select the cheapest loan," and instead may present one that provides the most profit for them.

A requirement that dealers put loans up for bid and then tell borrowers about all the offers could correct this, says Ian Ayres, a lawyer and economist at Yale University's School of Management and Yale Law School, who has studied disparate pricing in auto lending.

Chuck Bell, programs director at CR, agrees. "Consumers would be much better served by a financing model where they can choose the best of competing loan offers. We also believe dealers should be required to disclose all the loan offers they currently receive to consumers because it's blatantly unfair to conceal that information," Bell says.

2

You should be warned when offered a 'high cost' loan.

That's a protection provided to people shopping for home mortgages—but not to those seeking auto loans. Home buyers offered a mortgage with an annual percentage rate that is 6.5 percentage points higher than the average rate for people with good credit must be alerted that their loan is considered "high cost." Presented with that info, consumers may choose to shop around for a better loan.

A similar model could work for car loans, Ayres says. It could "help protect car buyers if dealerships had to warn them when they were likely paying too much for their loan."

3

You should be able to 'cool off' before accepting a loan.

A three-day waiting period between when a car dealer offers a loan and you accept it could help in several ways, according to an article by Adam Levitin, a Georgetown University law professor.

For one, it might help borrowers to avoid discretionary add-ons, such as vehicle service contracts or supplemental gap insurance, which dealers often try to load into loans. And it might motivate a borrower to shop around for a loan through a bank or credit union.

4

More data should be available.

Mortgage lenders must release certain information about the loans they make, including the race and income (but not the names) of their borrowers. That helps researchers, and the public, better understand problems such as discrimination in the housing market.

Auto lenders are under no such obligation. "That makes it far harder to understand, and fix, the inequities we know exist in the car lending world," says CR's Bell.