Cooperative Extension Service
C/T/A/H/R
College of Tropical Agriculture & Human Resources
University of Hawaii at Manoa

*Financial Connections*
Nov. 1999
FC-42

# Planning Auto Loans Lessens Financial Strain

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**How to handle recurring auto loans**

For many households, auto loans are a necessary part of life. Few of us have the discipline to save up for their next auto purchase. Moreover, such purchases come every so many years. For a two- car family, one auto loan may be stacked on top of another auto loan, making budgeting difficult. Here is a method of planning that may help you handle your auto needs better over the long haul.

Frequently, people decide how much they will spend for a vehicle based on the highest loan amount and longest repayment period they can obtain. In doing so, they often borrow too much for too long, and the payments for one auto loan overlap the payments for a subsequent auto loan. To avoid this problem, it is essential that buyers coordinate the timing of their auto purchases and loans and base their maximum loan amount in keeping with the repayment period needed to prevent overlapping loans and loan payments.

**Choices for a two-vehicle household**

In order for a two-vehicle household to avoid overlapping loan payments, the loan repayment period must be half of the vehicle replacement period. For example, a loan repayment period of 60 months, or 5 years, would require a vehicle replacement cycle of 10 years or longer. This may be too long for many people's tastes. It would mean that, although one of the two vehicles would be replaced every 5 years, the vehicle being replaced would have to be 10 years old or older. A loan repayment period of 48 months, or 4 years, however, would enable a replacement cycle of only 8 years, and a repayment period of 36 months, or 3 years, would enable a replacement cycle of 6 years. A shorter repayment period enables either more frequent vehicle replacement or non-loan years during which the previous loan payments could be put into savings for a future down payment.

**Effect of repayment period on loan payments**

As an example, the loan payments for a $10, 000 loan at 10% APR vary as follows in accordance with different repayment periods. The monthly payments for a 48-month loan would be around $254, while the payments for a 36-month loan would be about $323. A 48-month loan period with payments of $254 per month will require you to keep your vehicles for 8 years or longer to avoid overlapping loan payments. If you can afford $323 per month, then you can replace your vehicles every 6 years. Or perhaps you could keep to the 8-year cycle but use the one extra payment-free year in every 4-year period to save for your next down payment.

Many people choose 5-year loan periods because it enables them to borrow more money without increasing the payment. The problem is that doing this extends the replacement period needed to avoid overlapping loans. It also increases the amount of money going to interest. With respect to the $10,000 at 10% APR, the amount going toward interest would be $2,748 for a 5-year loan, $2,174 for a 4-year loan, and $1,616 for a 3-year loan. In other words, in comparison to the 5-year loan, the 4-year loan saves $574 in interest and the 3-year loan saves $1,132 in interest.

**Implications for single-vehicle households**

Single-vehicle households can use the same type of planning to coordinate their auto financing with the replacement cycle for their vehicles. It is still advantageous to select the shortest loan period and longest replacement period that one finds agreeable. A 6-year replacement cycle and a 4-year loan period provides 2 years out of every 6 when the former loan payments can be saved toward the next down payment. If the $254 monthly payment in the example above is placed in a 3% saving account over 2 years, it could provide $6,265 for the following down payment. In an 8-year cycle, it would provide $12,918. Similarly, if saved during non-loan years, the $323 3-year loan payment would provide $12,139 in a 6-year replacement cycle and $20,860 in an 8-year cycle.

Planning your auto purchases over the long term in a way that enables you to stagger your loans, save on interest, and even set money aside for your next down payment can help you avoid straining your budget and stressing yourself.

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