



The Siren Call, and Dangers, of the Zero-Percent Car Loan

By ANN CARRNS JULY 8, 2015

Car dealerships tend to offer zero-percent loans in the summer, and this season is no different. But while a no-interest loan may sound like a no-brainer, consumers should weigh whether it is really the best deal.

For starters, car shoppers should be aware that zero-percent offers come from the financing arms of the big auto manufacturers as a way to get potential buyers into dealerships. “It’s an incentive to get people in the door,” said Carroll Lachnit, a consumer advice editor with the auto website Edmunds.com.

The offers often peak in July and August as the dealerships prepare to bring in newer models, she said. In June, about 10 percent of the auto industry’s financed sales were zero-percent loans, the highest proportion this year, Ms. Lachnit said.

But the catch is that just a small proportion of consumers — no more than 10 percent, typically — qualify for the no-interest loans. The loans are usually available for new cars, rather than used vehicles, and are often aimed at well-qualified borrowers with strong credit — typically, a FICO score of 720 or above, although some automakers may accept lower scores, she said.

In addition, the low rates tend to be available only with shorter-term loans. Three years tends to be more common than five years or more, although there are exceptions. While you will pay less over all with a shorter-term loan, your monthly payment will generally will be higher than if the loan is stretched over a longer term.

If you do qualify, the loans can be a great deal, provided that borrowers do not focus so heavily on the great rate that they fail to negotiate the price of the vehicle.

“A big rule is to negotiate a great price upfront,” said Karl Brauer, a senior analyst at Kelley Blue Book. Also beware of pressure to buy costly add-ons, like service plans or tinted windows, that can increase the price, said Lisa Stifler, senior policy counsel with the Center for Responsible Lending.

You should also consider what kind of vehicle you really need, regardless of the interest rate. Special rates are usually available only on specific models. “Know what you want,” said Ms. Lachnit, rather than letting a low rate sway you into buying something else.

Shoppers should also be aware that the interest-free loan at the dealership might not be the lowest-cost option. That is because the offers usually come with an alternative, such as zero percent or \$1,000 cash back. It could be significantly cheaper to get a loan from an outside bank or credit union at a relatively low rate and take the rebate instead of choosing the interest-free loan.

Occasionally, offers may include zero percent financing and a cash-back rebate, but the rebate is typically even higher if you forgo the zero-percent rate.

Even if borrowers think they will qualify for the special financing, it is best to shop around and get preapproved by a bank or credit union before heading to the dealership. That way, borrowers will have a commitment to compare with the dealer’s offer, said Tara Baukus Mello, an auto expert with Bankrate. “I’m a big proponent of loans through credit unions,” she said, because they might offer competitive interest rates.

Having a loan offer in hand can also reduce stress and may help protect borrowers from potential problems like interest rate markups, in which dealers increase the interest rate on the loan and pocket the difference, Ms. Stifler said.

If borrowers don’t apply for outside financing, they should at least check their credit reports and, ideally, their credit scores, ahead of time. That way, if the dealer tells them they don’t qualify for the special rate, they can ask what credit score it

used, for comparison. Credit scores are often available free, for example, through some credit cards and student loan servicers; or a single credit-bureau FICO score can be bought from myfico.com for about \$20.

Here are some questions about car shopping:

■ *How can I compare whether it's better to take a zero-percent offer or a rebate?*

There are online calculators, like one at Bankrate.com, that can help you crunch the numbers and see which benefits you more.

■ *Will shopping for auto loans at multiple lenders hurt my credit score?*

Not if you confine your applications to a limited period, said Ethan Dornhelm, principal scientist with FICO. Its latest credit score model considers multiple car loan applications (as well as other applications for loans that involve rate shopping, like mortgages and student loans) made within 45 days as a single inquiry, Mr. Dornhelm said. Older versions of FICO software use a 14-day period, he said, but they are becoming less common. Even so, inquiries have less of an impact on your score than your on-time payment history and your overall use of available credit, he said.

■ *How can I find auto financing offers in my area?*

Offers and incentives typically change at the beginning of each month, so it is best to check what is available before going car shopping. If you know what brand of car you prefer, you can go to the manufacturer's website and search by ZIP code to see what is available in your area.