

## Zero-percent loans

Credit cards and vendor financing, whether dealer financing for cars or point-of-sale financing for other things, are at times advertised as “0% APR”.

**APR stands for ‘annual percentage rate’.** It’s the yearly cost of a loan to the borrower.

- Like an interest rate, the APR is expressed as a percentage.
- Unlike an interest rate, it also includes other upfront (one-off) and ongoing fees that are charged on some loans.
- APR ignores compounding – it’s not a completely reliable measure to assess costs of borrowing. For example, the APR quoted by credit card companies does not include the interest on interest you’d pay if you carried balances on your credit card.

**Zero-percent APR should mean it’s a free loan** – no interest and no fees. Low-APR means a cheaper loan than competitors offer.

**Why would anybody offer free financing?** As a promotion to get customers in the door or sell certain models quickly. A 0% or low-APR loan has a similar effect to a price reduction when certain items go on sale. It’s important to know how to compare different forms of promotion.

**Zero or low APR loans or loans with low monthly payments are not automatically the best options.** You need to carefully compare them over the life of the loan, and even better over the entire period you think you’ll be using the thing you’re buying.

Compare incentives on a car purchase		
In this case, a higher APR results in a higher monthly payment, but this is more than offset by a cash rebate upfront		
	0% APR	Cash rebate with 4% APR
Purchase price		\$32,000
Down payment		\$2,000
Rebate	\$0	\$2,000
APR	0%	4%
Payment	\$500/month for 60 months	\$516/month for 60 months
You paid by the end of term	\$32,000 [500*60 + 2,000 down payment]	\$30,960 [\$30,960 or 516*60 + 2,000 (down payment) -2,000 (rebate)]

*These are estimates – we don’t not account for the time value of money (the same payment of \$500 made today is worth more than when made 60 months into the future).*

**Zero-percent / low APR loans are often a teaser:**

- Not everybody qualifies – a very strong credit score is normally a requirement. Making a down payment may also help you qualify.
- It could be 0% only for an initial period of a few months, rather than for the entire term of the loan.
- It will be offered only on certain models or certain types of loans (and for cars, on new cars only).
- The vendor does not have to include in the calculation of the advertised APR all the fees that will actually be charged.