



Chapter 7. Consumer Durables: The Personal Auto



Chapter Objectives

- ❖ To recognize the importance of budgeting for consumer durables
- ❖ To understand the rules governing electronic transactions
- ❖ To describe the characteristics of warranties
- ❖ To obtain information on new and used car prices
- ❖ To know both the cost of owning and operating an automobile
- ❖ To evaluate the lease-buy decision
- ❖ To explain the complaint process for correcting auto defects
- ❖ To state your rights under lemon laws



Major Topics

- ❖ Definition of Consumer Durables
- ❖ Durable Purchases in General
 - ❑ Essential information gathering
 - ❑ The electronic marketplace
 - ❑ Warranty
- ❖ Selecting an Automobile
 - ❑ Transportation choices
 - ❑ The costs of owning & operating an automobile
 - ❑ The leasing alternative
 - ❑ Dealing with problems



Definition of Consumer Durables

- ❖ Goods that provide consumer benefits that extend over a period of at least one year
- ❖ The largest durables:
 - ❑ Automobile
 - ❑ House
 - ❑ Furniture
 - ❑ Appliances
- ❖ Durables are often expensive and require budgeting.



Durable Purchase in General: Essential Information Gathering

- ❖ Prices of various brands at different stores
- ❖ Available optional features
- ❖ Product service record and service availability
- ❖ Cost of operation and maintenance
- ❖ Warranty coverage



The Electronic Marketplace

- ❖ Information gathering made easy
 - ❑ Price comparison
 - ❑ Product features
 - ❑ Consumer reviews
- ❖ Electronic purchases
 - ❑ Mail Order Merchandise Rule
 - Applies to all electronic sales
 - The "30-day rule": Retailer must ship in 30 days or obtain your consent

⚙ On-line auctions

- ⚙ Types
 - "person-to-person"
 - "business-to-person"
- ⚙ Main source of Internet-related fraud complaints
- ⚙ Methods for handling payments
 - Financial intermediaries, ex. Pay Pal
 - Escrow intermediaries

Warranty (Guarantee)

- ⚙ The seller's assumption of responsibility for the quality, character, or suitability of goods sold.
- ⚙ Implied warranty - protection under the law when no express warranty is made
 - ⚙ Merchantability
 - ⚙ Fitness for purpose
- ⚙ if product is sold "As is" the seller has no responsibilities

⚙ Express warranty

- ⚙ Oral or written agreement concerning the character or performance of the good
- ⚙ Magnuson-Moss Warranty Act of 1975
 - Federal law regulating express warranties
 - written warranties may not reduce an implied warranty
- ⚙ Puffery
 - ⚙ persuasive sales talk praising the product
 - ⚙ not legally binding in most cases

⚙ Full warranty

- ⚙ consumer entitled to "full" remedy for specified time
- ⚙ no charge for labor, parts or associated transportation costs
- ⚙ includes lemon protection
- ⚙ Limited warranty
 - ⚙ all other warranties

Service Contracts (extended warranty)

- ⚙ Usually not worthwhile unless you are extremely risk averse.

Transportation Decision

- ⚙ Public transportation vs. private transportation
 - ⚙ Time cost
 - ⚙ Money cost
 - ⚙ Environment

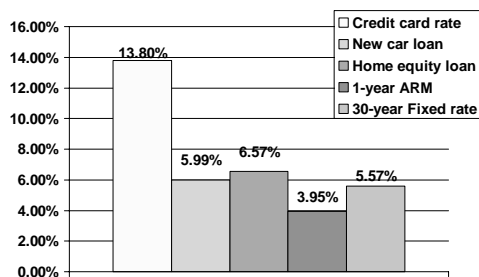
Selecting an Auto

- ⊕ New car
 - ⊞ Depreciation
 - Loses about 15-20% of previous year's value
 - ⊞ Dealership
- ⊕ Used car
 - ⊞ Risks
 - ⊞ Dealership or private seller

Purchasing Strategy of New Cars

- ⊕ Research the car(s) you want
 - ⊞ Read reviews, know the features you want
 - ⊞ Dealer sticker price - Monroney sticker price plus add-ons
 - ⊞ Know invoice price - price the manufacturer charges the retailer and dealer rebates
 - Edmunds: www.edmund.com
 - MSN Autos: <http://autos.msn.com>
- ⊕ Negotiate price from invoice up (not sticker down)
- ⊕ Don't get talked into features you don't want
- ⊕ Issue of trade-in: know the value of your trade-in
- ⊕ Issue of financing

Representative Loan Rates



Purchasing Strategy of Used Cars

- ⊕ Gather information
 - ⊞ Reasonable price
 - Kelley Blue Book: www.kbb.com
 - NADA: www.nada.com
 - ⊞ Reliability issue
 - Consumer Reports
<http://www.consumerreports.org/main/home.jsp>
- ⊕ Check mechanical problems
- ⊕ Check title problems
 - ⊞ CARFAX vehicle history report: www.carfax.com

Cost of Owning and Operating an Automobile

- ⊕ Cost of Ownership
 - ⊞ insurance
 - ⊞ license, registration & taxes
 - ⊞ depreciation
 - ⊞ finance charges
 - ⊞ Other: snow tires, rented garage, etc.
- ⊕ Cost of Operations
 - ⊞ gasoline & oil
 - ⊞ maintenance & tires
 - ⊞ Other: parking lot fees, toll charges

The Leasing Alternative

Regulated by the Consumer Leasing Act of 1977

- ⊕ The Closed-End Lease
 - ⊞ you are not responsible for the value of the car at the end of the lease
- ⊕ Open-End Lease
 - ⊞ total cost is unknown until the end of the lease
 - ⊞ residual value of the car determines end of lease payment

The Leasing Alternative

- The Federal Reserve Bank has established common disclosure requirements on consumer leases
 - ▣ Keys to leasing terms
 - <http://www.federalreserve.gov/pubs/leasing/glossary.htm>
 - ▣ Sample leasing form
 - <http://www.federalreserve.gov/pubs/leasing/formce/default.htm>

The Lease/Buy Comparison

- Examine all costs that are relevant to the leasing decision and compare those with all costs relevant to the purchase decisions
- Relevant costs include
 - ▣ Up-front sales costs
 - ▣ Financing costs
 - ▣ The implicit (opportunity) cost of your own funds
 - ▣ Depreciation and return charges

Lease/Buy Comparison

Relevant Explicit Initial Costs

Leasing		Buying	
Capitalized Cost Reduction	\$3,500	Down payment and trade-in	\$5,000
First monthly payment	257		
Refundable security deposit	350		
Title fees	75	Title fees	75
Registration fees	60	Registration fees	60
Sales Taxes	0	Sales tax	1,075
Total explicit initial cost	\$4,242	Total explicit initial cost	\$6,210

Lease/Buy Comparison

Relevant Explicit Continuing Costs

Leasing		Buying	
Months	47	APR	8.5%
Base monthly payment	\$ 244.69	Months	48
Monthly sales/use tax	\$12.25	Initial amount financed	\$ 17,300.00
Total monthly payment	\$ 256.94	Monthly loan payment	\$426.42
		Months	48
Total continuing explicit costs	\$12,076.18	Total continuing explicit costs	\$20,467.95

Lease/Buy Comparison

Relevant Explicit Final Costs

Excessive mileage charge	\$0	Loan payoff	\$0
Excessive wear and tear	0	Estimated residual value	-12,350
Adjustment for overestimated residual value	0	Sales costs	400
Security deposit	-350		
Disposition fee	400		
Miscellaneous items	0		
Total explicit final costs	\$50	Total explicit final costs	(\$11,950)

Lease/Buy Comparison

Relevant Explicit Costs

Leasing		Buying	
Initial Expenses	\$4,242	Initial Expenses	\$6,210
Monthly Expenses	12,076	Monthly Expenses	20,468
Final Expenses	50	Final Expenses	(11,950)
Total explicit costs	\$16,368	Total explicit costs	\$14,728

Lease/Buy Comparison

Adjusting the cost of buying for implicit cost

Total explicit cost of purchasing			\$14,727.95
After-tax interest rate	6%		
Excess upfront cost of buying	\$1,968.06		
Lost interest income		\$ 532.34	
Excess monthly payment	\$169.48		
Lost interest income		1,033.43	
Total lost interest income			\$ 1,565.77
Total relevant cost of buying			\$16,293.72

Dealing with Problems

Lemon Laws:

- General information: <http://www.defect.com/>
- Utah Lemon laws: http://www.le.state.ut.us/~code/TITLE13/13_14.htm

Mediation

- attempt to have the parties to the dispute reach their own agreement

Arbitration

- an impartial third party suggests a binding or nonbinding remedy
- Arbitration Programs
 - BBB Autoline: <http://www.dr.bbb.org/autoline/index.asp>
 - Autocap: Automotive Consumer Action Program

Assignment for Chapter 7

- Go to the "New or Used Car? Calculator at the Yahoo Finance Center at <http://loan.yahoo.com/a/autocalc.html>. This calculator lets you compare the annual cost of depreciation and finance costs on a new car versus those on an old one. Go to the Average Cost Per Year (\$) link. Pick a particular loan rate, find out what the average cost per year on a \$20,000 new car versus a 3-year old used car.
- Suppose you are shopping for a new car. Pick a model, and use either the Internet or newspaper to find out a purchasing and financing deal, and then a leasing deal on the same car. Do a comparison to see which one is a better financial deal given your situation.