Yo-Yo Financing: Don't Let a Car Dealer Pull a Switcharoo on Your Loan

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Imagine you're proudly driving around town in your new car when your cell phone rings. It's the dealer telling you there is a problem with your financing.

"Basically, they tell you that you've got credit [and a deal]. You drive the car home and then they call you back up and say, 'oh by the way, that credit didn't work. You need to bring your car back in. You need to sign new terms.' And the new terms are always worse," says Ira Rheingold, executive director of the National Association of Consumer Advocates.

The practice is called yo-yo financing.

How Common is Yo-Yo Financing?

Sadly, yo-yo financing is common with both new and used cars and usually ends with a higher interest rate and worse loan terms. Rheingold says women, African-Americans and Latinos are disproportionately victimized.

Yo-yo financing often happens with a spot delivery of the vehicle, meaning a customer leaves with a car while the dealer shops for financing.

"If you're in their car dealership and you leave without buying a car, the odds of them selling you a car are diminished greatly," Rheingold explains. "They want to make sure you buy that car while you're there in front of them. That's their incentive. They want to put you in a car and make a car deal."

The goal of spot delivery is to turn lookers into buyers. It often happens when people want to buy a car quickly, like on a weekend or at night when the banks are closed. When the banks open again, they review financing applications and either approve or deny them. Borrowers with shaky credit or other red flags often find themselves on the receiving end of a phone call from the dealer.

What Happens in Yo-Yo Financing?

During the initial negotiations, the dealer gives the impression the car is the buyer's to keep, without telling them the financing isn't locked in.

"You'll give them your name, you'll give them some basic information like your driver's license and they'll put that information through their automated systems they use and it gets sent off to a bunch of car finance companies," Rheingold says. "The dealer will have a basic idea of what they think you can be approved for, and they will offer those terms to you. They're making an educated guess that someone will buy the car loan they are making to you."

Even though a dealer's name may be on the documents, dealers usually sell loans to a finance company to service the loan. If the financing doesn't come through, the dealer may demand the buyer bring the car back — or threaten to repossess it or report it stolen.

"Even though they are telling you the deal is complete, they believe the deal is contingent on them getting approval to sell the loan they made to you. So you think it's complete, they think it's conditional," Rheingold says.

Avoiding Yo-Yo Financing

When buying a car, Rheingold recommends looking at the sale as two different negotiations. The first is the price of the car and the second is how you're paying for it.

"That's actually the way you're going to get the best deal," he says. Rheingold suggests researching car prices online so you know a target price and trying to get pre-approved for a loan from an independent lender before you go to the dealer.

This way, you won't have to use the dealer's financing.

"Then when you're going to the car dealer, what you're doing is simply haggling about the price of the car," Rheingold says. "Once you agree to a price, then the second transaction takes place. You say 'look, I have a car loan and if you can beat this loan, that's fine, otherwise I will get the loan from somewhere else.'"

It can be difficult to predict who may be a potential victim of yo-yo financing, but there are some warning signs to look out for.

- The sales contract has some fields blank.
- The interest rate is not clear.
- The word "conditional" is written somewhere in the contract.
- You are able to drive away in a car without any contract at all.
- There is no mention of where to make payments or when that first payment is due.

Reviewing the sales contract is important. If there is something you do not understand, ask questions. Also, verify that the loan rate and terms are final. If the dealer does not explain something to your satisfaction, walk away.

A deal being conditional isn't always as clear as missing information on a contract. Rheingold says it is sometimes hidden deep in a contract most buyers don't usually read, or it may not be spelled out at all. Don't feel pressured to sign something without reading it.

"It's what car dealers do to protect themselves, not you," Rheingold warns. "They want to make sure you walk off the lot believing you bought a car, but they want to protect themselves so if they can't sell the loan they offered you with terms they like, they can call you back and change the terms on you."

What to Do if You're a Victim of Yo-Yo Financing

If you think you've been lured into yo-yo financing, Rheingold suggests calling a lawyer or your local consumer protection agency. Sometimes you can rewind the deal and get your money back.

The practice of spot delivery is not legal in some states, so knowing your rights is also important. As a consumer advocate and attorney, Rheingold says he thinks even though many dealers don’t plan on changing the terms on customers, spot delivery is not innocent.

“I think it’s a deceptive practice and it’s not the way anyone should be doing business,” he says.

Tiffani Sherman is a Florida-based freelance reporter with more than 25 years of experience writing about finance, health, travel and other topics.