BACKYARD FINANCE
FUNDING BACKYARD DREAMS

OFFERING FINANCING IN A HIGH-RATE ENVIRONMENT

April 2023

Showing your customers how funding can save them money.

On March 17, 2022, interest rates were just 0.25%. That day, the Fed started raising the federal funds rate from that low mark of 0.25% and over the next 12 months, they increased it a total of 10 times to the current rate today of 5.25%. Depending on the inflation rate, there could still be more to come in 2023. At 5.25%, the current rate is the highest it has been in the US for the last 16 years.

The current rate of 5.25% could be classified as the minimal wholesale cost of funds. Of course banks buy money a lot cheaper from depositors with the average savings account returning just 0.23% Annual Percentage Yield or APY, according to Bankrate's March 29 weekly survey of institutions. This begs the question of why our customers are currently seeing rates in the high teens or even over the 20% range. The simple answer is that the high cost of funds in this interest rate environment plus the risk margins that are being added to the loan.

The risk margin is high because the loans given under this platform are unsecured, so are seen as high-risk by the lender. This means the lending institution is really relying on the customer's integrity to pay back the loan. The threat of damaging their credit score is always a consideration, and the lender might seek to reclaim in the event of borrower defaulting.

We are currently seeing a very high offer rate of loans coming through the system. In order to secure the deal we want to give you some tips to overcome the high interest rate objection.

During the borrowing process, the customer enters their data into the portal and during the soft credit phase. The customer is either declined outright because of their credit score and/or a myriad of other factors or they are presented with offers from one or more lenders. The loan offers will vary by amount offered, term length, and of course the APR. It's great to have choices but consider which is the best loan for the borrower to select. Let’s look at the factors to consider.

First, eliminate the loans that are not high enough to cover the cost of your product or purchase. The second consideration is the loan repayment. If it is prohibitively high and it may cause the borrower to default, then those options are also best avoided. Every customer is different and has a different economic situation, so there is no blanket advice that is going to be the best for all customers. At the end of the day, the loan with the lowest interest rate is technically the cheapest money but if the amount and the term make the repayment unaffordable, then that is not the right loan to choose. In the offers where the loan amount is the same, the borrower should consider the loan with the lowest Annual Percentage Rate or APR and also the longest term as this gives the borrower the most flexibility in repaying the loan.

The reasoning is based on the fact that all these loans generally have **no penalties for early repayment**. This is where a diligent borrower can allow the system to work for them, even if the APR is quite high. The trick is to understand that interest is calculated on a daily balance and generally debited or charged to the loan at the end of the month. The goal with any loan under the circumstance is **paying as much as you can, as soon as you can**. The beauty of this feature is working out how to minimize interest, and the exercise becomes a pure mathematical one.

Let's use an actual example and show how you can easily reduce the effective interest rate with a few simple tricks.

If the borrower is offered a $10,000 loan over 60 months (5yrs) at an APR of 18%, the standard repayment for this loan is $253.93 each month for 60 months resulting in a total payback amount of $15,236.06 and the borrower incurs total interest of $5,236.06.

This means that 34.4% of the total amount repaid is the interest portion.

In contrast, the same loan of $10,000 with an APR of 18%, but in this case the customer is able to round the repayment up to $300 per month or an average of just $1.54 extra per day. Then the loan term is cut to 3.88 years and the total payback amount is reduced to $13,966.66.

This means that 28.4% of the total amount repaid is interest. And the borrower **saves $1,269.40**.

Let’s take it one step further. We advise that customers should always pay their loan in alignment with their cash flow. This means if the customer is paid bi-weekly then although the loan is contracted to be paid monthly there are potentially great benefits to paying the loan every two weeks. Remember the rule is to pay as much as you can as soon as you can.

In this example, we consider the same loan amount of $10,000 at an APR of 18%. But, this time the borrower pays the loan bi-weekly for the amount of $149.99. Then the loan is paid out in 3 years and 6 months resulting in a total payback of $13,438.57 resulting in savings of $1,797.49.

This means that 25.58% of the total amount is the interest portion and the borrower saves $1797.49

Using the this link
https://www.omnicalculator.com/finance/mortgage-extra-payments

You can have a conversation with your customers to show them the true cost of financing can be easily lowered by simply paying that little extra repayment. If their cash flow suits more frequently, this can have a profound effect on the amount of interest that they will end up paying and reduce their effective interest rate.

Another tactic is **lump sum payments**, with the wrap of tax season many consumers hopefully enjoy receiving a tax refund check. While it can be tempting to upgrade the television another five or ten inches, paying this money into an outstanding loan could also save you hundreds if not thousands of dollars in interest.

Final Thought:
When you discuss financing with a customer, we encourage you to find out how much money the customer is **short** which will identify how much is needed to finance their purchase. Another way of saying this, is how much money do you have to contribute and we can help you borrow the rest. We do this for two reasons: The first is that a lower amount is easier to get financed. If their purchase total is $8,000 and they can afford to pay upfront $3,000, then the financing need is only $5,000.

The second advantage is that the customer paying the large deposit, shows they are committed to purchasing with you.

If you would like to further discuss how to frame financing to your customer, please contact one of our team members at Backyard Finance. Your success is our success.

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