How to sell a car you don’t own

Sometimes you’ve got to bail out on your car, even though you may owe more than it’s worth. Here’s how to do it.

By Liz Pulliam Weston

Selling a car you don't own free and clear can be a challenge if you try to do it yourself and an expensive mistake if you go through a dealership. But it's a situation many sellers face.

Plus, plenty of people get a nasty shock when they prepare to sell: They owe more on the vehicles than they're worth.

"People often don't realize they're 'upside down' on their car," said Steve Nolan, spokesman for Cars.com. "They don't realize how much the value of their car has dropped since they bought it." (You can research used-car values at MSN Autos and read more about how to use differing value guides here.)

This phenomenon has become a lot more common in recent years, said Philip Reed, consumer advice editor for auto information site Edmunds.com, for a number of reasons:Do you need
life insurance?
Get a quote.

New-car incentives are causing many vehicles to depreciate more quickly: the cheaper the new version, the less the old ones are worth.

Fewer consumers are making the 20% down payments that could help protect them against this drop-off in value.

The vast majority of buyers -- more than 80% -- opt for loans longer than four years. (The longer the loan, the longer you're likely to be upside down.)
As a result, more than one in four new-car buyers owes more on the vehicle they're trading in than it's worth, Edmunds.com figures show. The average amount of negative equity: nearly $3,900.

Bite the bullet if you can
Typically, the buyers roll that debt into their new loans, leaving them further upside-down on the new car -- and even more vulnerable if the vehicle should be stolen or totaled, since the amount they would receive from their insurers is far less than the loan.

"You could find yourself owing a lot of money," Reed said, "and having no car . . . to get to your job to pay for it."

So-called "GAP" insurance -- for “guaranteed auto protection” -- can help pay off an upside-down loan in these situations, but many drivers don't buy the coverage, Reed said. Besides, owing more money on a car than it's worth is a sign you've bought more vehicle than you can really afford.

"It's not a good thing for consumers to be doing," warned Reed, editor of the book “Strategies for Smart Car Buyers.” "It's a matter of being able to live within your means."

That's why most experts advise delaying a car sale until you own the vehicle.

"People say they need to sell, but what they're really saying is 'I want this new car,'" Reed said. ”Bite the bullet and pay it off . . . unless you're in a situation where you absolutely have to change cars, don't change cars."

Well, if you really must …
Of course, there are a few situations where you may feel pushed into selling a car you don't own:

You've got a real lemon. In most cases, it costs less to fix and maintain an older car than it would to buy a new one. But occasionally a car is so unreliable -- and so unfixable -- that it poses a danger to you or your family.

You're bursting at the seams. In a few instances -- like when you're driving a two-seater but expecting twins -- you really can't make do with your current car for a few more years.

You really, truly can't afford the payments. This one isn't the slam-dunk it might seem, however.
Selling the car might help you retire a good chunk of the debt, but you'll still need to figure out how to pay off the rest of the loan -- and find some way to get to work.

That's why most people in this situation would be better off refinancing their existing loans, Reed said. You may be able to get a better interest rate or a longer term to lower your monthly payments. Check with your lender, credit union or an online lender like Capital One or eLoan.

If you must sell, you've got two options: sell it yourself or go through a dealer.

Selling it yourself
A private sale is often the best choice, since you'll get a lot more for the car than if you trade it in at a dealership. (See “Make a bundle by selling your own car.”) But it can be a lot of work -- and kind of tricky to pull off.

You first need to:

Check with your state's Department of Motor Vehicles (DMV) to get all the required paperwork and procedures for transferring ownership of your car.

Check with your lender to find out its procedures on how to get the lien released on your vehicle.
A lien is a kind of legal wheel-lock that lenders put on financed vehicles. Until the lien is released, the vehicle can't be transferred to a new owner.

Most lenders will want you to pay off the loan in full before they release the lien, which is a problem if you need the buyer's money to pay off your debt. Your problem deepens if you need extra cash on top of the buyer's payment to retire the loan.
Meanwhile, your buyer understandably may be reluctant to hand you a wad of cash if you don't have the title in your possession.

You may be able to solve this quandary if you have a cooperative lender -- and amenable buyer -- by making the sale transaction in your lender's branch lobby. The buyer hands over the cash or certified check to the lender, you pony up any extra money due (see some options for finding the cash below)

and the lender releases the lien. (It's smart to call in advance so the lender has any necessary documents ready.)

If the lender has the title in its possession, it's given to you to sign over to the new owner. Otherwise, the lien-release document is sent to the DMV, along with the bill of sale and a release of liability (which you can usually download in advance from the DMV site). Once those have been sent to the DMV, a new title will be mailed to the new owner, typically within one to three weeks.

Another option, if your buyer will agree: Go with the buyer to the DMV and get a temporary operating permit for the car based on the bill of sale you both fill out. The buyer has to be a little more trusting here, since he or she is relying on your promise to get the lien released and the title transferred. (A hint: Use a certified check to pay off your loan, said Steve Schooff of Capital One Auto Finance. The lender doesn't have to wait as long to determine the check's good, which will speed up the process of getting your lien released.)

If your buyer isn't willing to close the deal without physical possession of the title and/or you're dealing with an out-of-state lender, you may need to arrange a temporary loan (part of which could become more long term if the buyer's payment won't completely cover your debt).

If you don't have the money you need in savings -- and we're guessing you don't -- here are some options:

Personal loan. If you have good credit, a sympathetic credit union or bank may be willing to offer you a personal loan so you can pay off your car. You're going to pay a relatively high interest rate, though, since unsecured loans like this usually have interest rates in the mid-teens.

Retirement plan loan. Borrowing from your 401(k) or other workplace retirement plan can mean getting a lower interest rate than you could win from a lender, particularly if you have troubled credit. But retirement plan loans are risky: If you lose your job, you typically have to repay the money in short order, or the balance of your loan becomes a withdrawal that triggers taxes and penalties. In addition, many plans only let you pay off your debt in one lump sum or in payments stretched over five years.

Home equity line of credit. If you have some equity in your house, you can establish a variable-rate line of credit and tap it for the money you need. The interest you pay is potentially tax-deductible, but the rate can soar; most lines of credit have caps around 18%. Also, you're putting your house at risk of foreclosure if you don't make the payments.

Credit cards. This is probably the worst of your options unless all you need is a very short-term loan. For one thing, you'd be making a cash advance, which usually triggers interest rates of 20% or higher. For another, you're vulnerable to even higher interest rates if you miss a payment or your credit-card issuer just decides to jack up the rate. Finally, you may risk maxing out your credit limit, which in itself could trigger astronomical rates.

Borrowing from friends or family. This could be the answer to your prayers -- or a great way to ruin a good relationship. Read “The right way to loan money to family members” for some guidance.
Or there’s the final option.

Trading it in

A trade is by far the easier choice, since the dealership handles all the paperwork. You also could score one of the new-car incentives that might help you erase or at least reduce your debt.

Let's say you're $2,000 underwater on your car. A $4,000 rebate could erase that debt and give you a small down payment on your replacement vehicle, Nolan said.

"There are so many incentives and cash-back rebates out there that you should be able to find one," he said.

The downsides: You'll get less for your old car than if you sold it yourself, and you may be vulnerable to some of the dealers' worst tricks: overcharging you for the new car or the new loan, or both. (The dealer knows you're either desperate or not very sophisticated financially if you're selling a car on which you still owe money.)

And worse, despite the big rebate on your new car, you're instantly underwater, because rebates aren't magic. A $20,000 car that carries a $4,000 rebate is realistically worth $16,000 -- and that value starts dropping the minute your new car becomes a used one. The damage will be even worse if you've rolled over old debt into the new loan.

And then the cycle starts all over again.

How to take control
Do your research so you can bargain hard for the vehicle (read "5 keys to driving a new-car bargain" if you're shopping for a new car, or "Before you kick the tires, hit the computer" if you're going to a used-car lot). Make sure you know what your credit scores are and what interest rates you should expect based on those scores.Liz Pulliam Weston's newsletter
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"Auto financing is almost entirely dependent on your credit rating," said Nolan, but dealerships aren't above overcharging consumers who don't know they could qualify for better terms. You can get an idea of what your credit will look like to lenders by taking this 10-question quiz.

If you do decide to sell when you're upside down on a loan, try to make it the last time you find yourself in such a situation. In the future:

Make at least a 20% down payment whenever you buy a car. You can save up the cash by keeping your current car for at least a year after it's paid off and depositing an amount equal to your old payment in a savings account each month.

Opt for a shorter loan. Don't finance a car for more than five years -- four years or less is even better.

Limit your payments. Your car payment shouldn't equal more than 20% of your take-home pay. If you have substantial credit card debt, keep the payment to 15% or less.
Liz Pulliam Weston's column appears every Monday and Thursday, exclusively on MSN Money. She also answers reader questions in the Your Money message board.