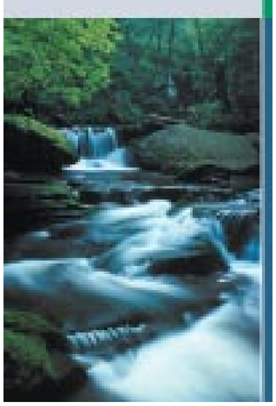
Should You Lease Your Next Vehicle?

Searching for that perfect car or truck is not such an easy task anymore. Every auto dealer has a special deal just for you — and that deal is not all that easy to understand. Before you go shopping for your next vehicle, think about whether you want to lease or buy and make sure you understand both options. What you are likely to find is that the decision comes down to what kind of person you are and what habits you have.



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Leasing vs. Buying a Car

How do I decide?

WHEN YOU SHOULD LEASE

If you drive less than 12,000 miles/year. Many auto leases require you to pay for each additional mile over a certain limit. That mileage limit is usually between 10,000 and 12,000 miles per year.

If you plan to keep your vehicle for 3 years or less. Many auto lessors offer leases with terms of 24 and 36 months, and this can be an attractive feature to people who don't usually keep their car that long before they trade it in for a new one.

If you want lower payments and/or lower down payments. Leases usually contain lower down payments and have lower payments compared with auto loans of similar terms. This is due to the fact that an auto loan usually amortizes a larger portion of the car's value over the repayment period of the loan.

If you prefer newer vehicles. Leasing a car may save you some money if you usually trade in your car to buy another every few years. Leasing might be something you should consider if you think having a car payment is just a fact of life and you plan to get a new car every few years.

If you keep your car well-maintained. A usual provision in an auto lease is that you agree to keep the car well-maintained and in good running order. If you are lousy at doing that, it will cost you at the end of the lease; the car will probably not be worth its residual value and you will be required to make up the difference.

WHEN YOU SHOULD BUY

If you drive more than 12,000 miles/year. If you drive more than the annual mileage limit required by the lease, you may want to compare the cost of buying the car to the estimated total leasing cost. If you drive a lot of miles over the mileage limit, you will probably be better off buying the auto.

If you plan to keep your vehicle for 3 years or more. If you usually keep a car or truck for a longer period of time than the lease term, compare the cost of buying the vehicle at the end of the lease to buying the auto now instead of leasing it. In many instances, if you plan to purchase the auto at the end of the lease, buying now can make more sense financially.

If you like the idea of owning your car. Auto leasing is most comparable to "renting" your car. If you don't like the idea of renting your car and it is important to you that your car is yours, then you are probably a good candidate for auto ownership.

If you like the idea of eventually paying off your car. Being debt free is always a good goal to have, and being without a car payment can be a reality if you buy instead of lease. Many leases do, however, contain purchase options to buy the car once the lease expires. By that time, though, you have already put a lot of money into a lease that could have been used to purchase the car in the first place.

If you like the customized look. If customizing your new car is what you had in mind, you definitely should consider buying. Changing the appearance of a leased vehicle alters the value and this may prove to be costly at the termination of the lease.

An Up-Close Look at Leasing

Before you can make an informed decision to lease a vehicle, you must know and understand the terms of the lease. Leasing contracts include some complicated language which we will define here in simpler terms.

When you lease a car, you will have a **negotiated vehicle price**, which is the total price at which you agree to lease the car. You will pay a down payment up front when you sign the lease agreement and take possession of the vehicle. The amount that you agree to "finance," (i.e. the negotiated vehicle price plus any options, minus the down payment) is the **Adjusted Capitalized Cost**, or the **Net Cap Cost**.

To determine how much the lease will cost you each month, you need to know a host of other terms, including the **residual value**, the **lease** or **rent charge**, the **money factor**, the **monthly lease rate** and the **monthly depreciation**.

The **Residual Value** is how much the auto will be worth at the end of your lease term. The **Lease Charge**, or **Rent Charge** is like the interest rate on a loan. The auto lessor charges you a monthly fee to lease the vehicle to you at the terms specified in the lease. The **Money Factor** is the lease or rent charge divided by 24.

All of the above terms are used to calculate the **Monthly Lease Rate**, which in turn, makes up part of your monthly lease payment. The monthly lease rate is the Net Cap Cost plus the Residual Value, multiplied by the Money Factor.

Example:

$18,000	(Net Cap Cost)
+ $11,000	(Residual Value)
= $29,000	
x .00333	(Money Factor-8% divided by 24)
= $ 96.57	(Monthly Lease Rate)

The **Monthly Depreciation** is also figured into your monthly lease payment. The monthly depreciation is the difference between the Net Cap Cost and Residual Value, divided by the term of the lease.

Example:

$18,000	(Net Cap Cost)
- $11,000	(Residual Value)
= $ 7,000	
/ 36 months	(Term)
= $194.44	(Monthly Depreciation)

Accordingly, your **Monthly Payment** will be the Monthly Lease Rate plus the Monthly Depreciation.

Example:

$ 96.57	(Monthly Lease Rate)
+ $194.44	(Monthly Depreciation)
= $291.01	(Lease Payment)

The last few terms that you may encounter when leasing a vehicle are:

Your lease may contain a provision for a Security Deposit, which may be refundable if specified in the lease terms. This deposit is similar to a Security Deposit that a landlord would hold for a residence. If any damage occurs to the property that is specified in the lease, the lessor would be entitled to part or all of the Security Deposit.

An **Acquisition Fee** covers the administrative costs of the lessor, such as the cost of obtaining a credit report, verifying insurance coverage and processing the application and lease agreement.

If you understand and know the terms discussed above, you will be able to make an informed decision about whether you want to lease or buy a car.

An Up-Close Look at Buying

One of the most important things about buying a new car is understanding your financing options. There is a huge variety of financing options out there — there's your auto dealer's financing package, as well as those of your local bank, credit union and finance company. No matter whose financing package you take, you need to understand what kind of deal you are really getting how much you are really paying and how much the vehicle is really worth.

The Loan-to-Value ratio is what most lenders use to determine how much to lend you. If your new car is valued at $20,000, a lender may insist that you have a loan-to-value ratio of 80 percent, or $16,000. You would have to make a $4,000 down payment and the lender would agree to finance the rest.

One of the pitfalls of buying is that your car loses value the minute you drive it from the dealership. The value that your car loses over time is called "depreciation." Different types of cars depreciate at different rates. A car that has a record of lasting longer than other cars on the road will probably have a slower depreciation rate and be worth more at any given time than a car with a reputation of being a "clunker."

The other big issue when buying a car is your interest rate, which varies widely among different lenders. Shop around and get the best rate before you agree to buy a vehicle so that you can make an informed decision, rather than being at the auto dealer's mercy to accept its financing package.

The Argument for Leasing

In general, leasing is a good option for people who have little money in their pockets and/or can only make small monthly payments on a car, and for people who find that they buy a new car every three years or so.

Lower down payment

Leases traditionally require less money down than purchasing a vehicle. If you are looking for a car with little or no money in your pocket, you could take advantage of some leases that advertise little or no money down.

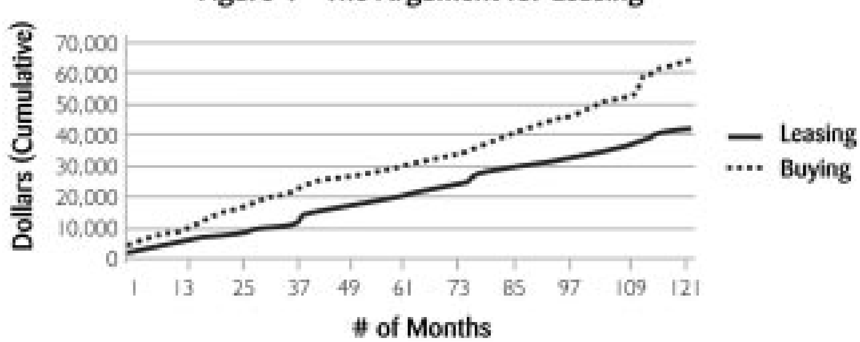
Lower monthly payments

Monthly lease payments are usually lower than monthly loan payments for the same term.

If you buy a car every three years

Leasing is a great option for people who find that they buy a new car every three years or so. For example, as *Figure 1* (below) illustrates if you lease a car valued at $20,000 and obtain a new 36-month lease whenever the previous lease expires, you end up spending $42,320 over a 10-year period. If you choose to buy the same vehicle every three years, using the old vehicle as a trade-in, getting financing for 36 months each time and putting down a 20

Figure 1 - The Argument for Leasing



percent down payment, you would spend $64,512 over the same period. In this example, if you buy the car you would spend 52 percent more than if you were to lease the car. It should be noted that these values are estimates comparable to today's market. Accordingly, if you find that you buy a new car every three years or so, leasing may be a better option for you.

If you don't need the advantages of a car lease, for instance, the lower down payment, lower monthly payments, and if you don't buy a new car every three years, then it is a better financial decision to buy a vehicle.

If you buy and keep a vehicle, you would eventually pay off your car loan. You could save those extra funds that you were paying monthly on the car loan for emergencies, a child's education, your retirement or even to pay for your next car in cash.

The advantages of buying are illustrated in *Figure 2* (below). In the graph, we show three consumers. One buys a car valued at $20,000 with 36-month financing at 8.5 percent. Once this consumer pays off his loan, he deposits the monthly car payment amount into a mutual fund that follows the Standard & Poor's 500 index (which has averaged approximately 15 percent over the last 10 years).

The second consumer leases the same car for 36 months. He pays a $1,000 down payment, with $850 due in acquisition and title fees. This consumer then exercises a purchase option on the lease for 36 months. When he pays off the loan, he also deposits the same amount as the first consumer into the same mutual fund.

The third consumer leases a new vehicle every three years without exercising any option to purchase. All leases have the same terms as described for the second consumer, and all three cars have the same value.

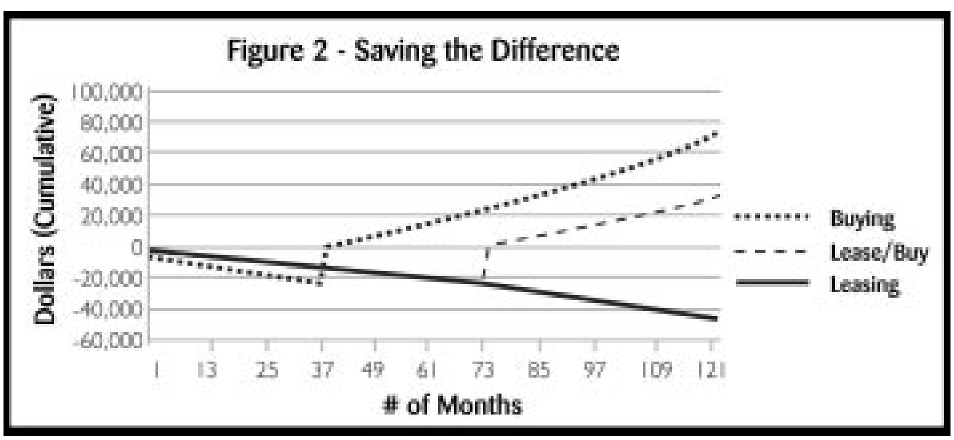
In this example, the first consumer (the buyer) amasses $74,300 over a 10-year period. The second consumer (who leased, and then bought) saves $34,940 over the same period. The third consumer (who continued leasing) spends a total of $42,320 in this amount of time.

Shopping for the Best Deal

Whether you decide to lease or buy a vehicle, be smart while looking. Here are some tips on how to get the best deal.

Shop 'til you drop

Shop around before negotiating so that you know (1) what price other car dealers want for the same vehicle (use pricing guides or services to see the invoice prices for the vehicle — don't just look at the retail sticker on the car); and (2) what financing terms are available for leases or auto loans. You don't have to sign a lease, loan or purchase agreement on your first visit. Don't let a



salesperson pressure you if you aren't ready to make a final decision.

Ask the dealer to explain anything that you don't understand. Also, don't fill out a lease application until you are ready to sign the final documents. Each application you complete may generate an inquiry on your credit report. Many lenders and lessors view too many credit inquiries as a negative factor when evaluating your credit profile.

Don't fill out a lease application until you are ready to sign the final documents.

Negotiate the best price

The price you negotiate on any vehicle is the starting point in determining the cost of leasing or buying your car. Have a maximum price that you want to spend for a car. Don't let the dealer talk you into a price that doesn't fit into your spending plan.

Tell the dealer whether you intend to lease or buy

This can save you lots of time.

Get the proper value for your trade-in

If you are trading in your current vehicle, get an estimate of its value from a used car dealer, financial institution or Kelley Blue Book at kbb.com before visiting the auto dealer.

If you decide to lease, ask about gap insurance

Gap insurance is insurance that will protect you against any "gap" in coverage between the value of the vehicle when you return it and the residual value as stated in the contract. This coverage may also provide provisions regarding theft or accidents. This is especially useful coverage in open-end leases (leases where you can be held liable for any difference in value). In closed-end leases, you may still be liable for this difference. Read the lease agreement carefully to find out exactly what your liability would be upon lease termination.

Know your early termination options in a lease agreement

Find out when you are allowed to terminate your lease, if at all, and how much it will cost you. This simple question can stop future headaches if, for some reason, you need to get out of your lease agreement.

Only lease for a term that is within the manufacturer's warranty period

This will save you from paying for repairs to a leased vehicle after the manufacturer's warranty expires. When you lease make sure that you are protected by the manufacturer's warranty. If the warranty has not been assigned to you, you may be responsible for the cost of repairs.

Consider leasing a vehicle that has a high residual value

The higher the residual value, the lower the cost of the lease may be. However, any purchase options contained in the lease will probably have a higher price tag. Vehicles that last longer are the most likely candidates for having higher residual values.

When Your Lease Is Over

Once the term of your lease has expired, you have a choice to make. Here are the options that are usually available:

Return the car to the dealer

If you don't plan to lease another car or want to negotiate with another dealer, you can simply return the vehicle to the dealer. There may be charges at lease-end, like a termination fee, excessive mileage charges or charges for excessive wear and tear.

Purchase the vehicle

The lease may contain a provision to purchase the vehicle at lease-end, with the purchase price usually being set at the residual value. If you have taken good care of the car, it may be worth more than the residual value, making this option a good deal for you. If the car is in bad shape, compare the cost of turning in the car to buying the vehicle.

Negotiate a new deal with the dealer

If the car is worth more than the residual value, use the equity in the car to negotiate a lease on another car. You always have the option to lease another car, but you may not always have the extra value, greater than the residual value. Use this to your advantage if you find yourself fortunate enough to be in this position.

Sell the car and pay off the residual value

If the lease has an option to purchase, as many leases do, and if the car is in good condition, then you could exercise the option to purchase first and then sell the car yourself. This could work in your favor if the car has held its value well and the residual value is less than the amount you could sell it for.

Lease Payments

Everybody has good intentions when entering a lease agreement, but financial hardships can befall even those with the best intentions. If you can no longer afford to make your lease payments due to such a hardship, consider the following:

Ask the auto lessor for the options under your lease for early termination

It is usually wise to be up front and honest with your auto lessor and to let him know about your hardship. The lessor may be able to offer you other options that will help you.

Ask the auto lessor if you can sell the car to pay off the lease

If the car is in good condition, you may be able to advertise the vehicle at a price that would pay the termination costs of the lease. Ask your lessor how much the termination cost would be, and make sure you ask the lessor if this option is available *before* you sell the car.

Ask the auto lessor about a substitution of the leased vehicle

If you just can't afford the auto you have leased but are able and willing to lease a car of a lesser value, ask the auto lessor about substituting the auto you have for another auto that will produce a lower lease payment. In some instances, your auto lessor may be willing to do this only if you terminate your current lease and apply for another one.

Ask the auto lessor what the total cost would be to return the car before the lease termination date

Obviously, there will be some kind of charge associated with this. However, these charges may be less than trying to make your remaining lease payments.

Ask the auto lessor about an extension of the lease or deferment of the lease payment

The auto lessor may be willing to renegotiate the lease over a longer period of time to lower your payment amount. In a few cases, your auto lessor may agree to defer your lease payment; this would depend entirely on your situation and the willingness of the lessor to work with you.

Find out if your lease is assumable

If your auto lease contains an assumption clause, you may be able to find someone who would be willing to assume, or take over, the payments on your auto lease.

If you decide to lease

If leasing looks like the right decision for you, make sure you know your rights regarding auto leasing in your state. Check with your state's consumer affairs office to find out exactly where you stand.

Before you lease or buy

However you decide to get behind the wheel of your next vehicle, the most important thing you need to consider is whether you can truly afford it. It may feel great to drive out of the showroom in a fancy new car or truck, but you're not going to look quite so fancy if a few months down the road the repo man comes looking for you.

Take a good, hard look at your monthly spending plan. (If you don't have a spending plan, you definitely shouldn't be looking to buy or lease a new vehicle at all.) What can you comfortably afford to pay each month for an auto? The key word here being "comfortably." Just because you get a new car, doesn't mean the rest of your life goes on hold. All those other expenses are still going to come up and you have to make sure you can afford your new pride and joy as well as pay the rent or mortgage, buy groceries, clothes etc. And don't forget the insurance. Auto insurance can easily run into hundreds of dollars every month.

If you do your sums and it looks like you'd be coming up short every month with a new vehicle payment, don't make the mistake of trying to stretch your spending plan to make the car fit in. You'll regret it sooner than you think. Instead, consider a good, used vehicle for now and try and put away a little every month towards your dream machine. That way, when you do get into the driving seat, you'll be certain that nothing can spoil your enjoyment further down the road.

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