ACCESS Education Systems

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Car Leasing vs. Buying Newsletter

There's no question that decisions about whether you should buy or lease a car can be overwhelming. One of your top priorities while working to reduce your debt and ultimately become debt free is learning how to distinguish between wants and needs.

In many instances, a new car would be classified as a want versus a need. On the other hand, if you must rely on dependable transportation to support your livelihood, driving a newer car could be more cost-effective than having to spend lots of money repairing the old clunker in the driveway.

Writing for Investopedia (www.investopedia.com), investment manager and financial planner Cathy Pareto says as new cars become increasingly expensive, more and more buyers will likely be forced to lease a vehicle instead of buying it. In fact, says Pareto, some experts predict that within 20 years, everyone will be leasing their cars. A car payment may become a fixed budgetary expense, much like your mortgage or utility bill.

This issue of Dollars & Sense presents objective information on leasing versus buying a car to help you make more informed decisions when you find yourself in need of an automobile. ■

Leasing is Different than Buying

To lease or to buy? That's the choice you face when mulling over makes and models and deciding which car deal best meets your needs. According to the Federal Trade Commission (www.ftc.gov), leasing a car is not the same as buying one. When you buy, you own the car. When you lease, you pay to drive someone else's vehicle. Leasing can involve lower monthly payments than a loan. However, at lease end, you will have no ownership or equity in the car.

As explained by the Federal Reserve Board (www.federalreserve.gov), you, the consumer, have a right to information under the federal Consumer Leasing Act about the costs and terms of a vehicle lease. The most common type of vehicle lease is a closed-end lease, which means you may return the vehicle at the end of the lease term, pay any end-of-lease costs, and walk away.

Perhaps the quickest way to present the differences between leasing and buying an automobile is through the following side-by-side comparison.

Consider Beginning, Middle, and End-of-Lease Costs

At the beginning of the lease, you may have to pay your first monthly payment; a refundable security deposit or your last monthly payment; other fees for licenses, registration, and title; a capitalized cost reduction (like

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Leasing is Different than Buying

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a down payment); an acquisition fee (also called a processing or assignment fee); freight or destination charges; and state or local taxes.

During the lease, you will have to pay your monthly payment; any additional taxes not included in the payment such as sales, use, and personal property taxes; insurance premiums; ongoing maintenance costs; and any fees for late payment. You'll also have to pay for safety and emissions inspections and any traffic tickets. If you end your lease early, you may have to pay substantial early termination charges.

At the end of the lease, if you don't buy the vehicle, you may have to pay a disposition fee and charges for excess miles and excessive wear.

You can compare different lease offers and negotiate some terms. Consider, for example:

- The agreed-upon value of the vehicle—a lower value can reduce your monthly payment
- Up-front payments, including the capitalized cost reduction
- The length of the lease
- The monthly lease payment
- Any end-of-lease fees and charges
- The mileage allowed and per-mile charges for excess miles
- The option to purchase either at lease-end or earlier
- Whether your lease includes "gap" coverage, which protects you if the vehicle is stolen or totaled in an accident.

Know Your Rights and Responsibilities

When you lease a vehicle, you have the right to:

- Use it for an agreed-upon number of months and miles
- Turn it in at lease-end, pay any end-of-lease fees and charges, and "walk away"
- Buy the vehicle if you have a purchase option
- Take advantage of any warranties, recalls, or other services that apply to the vehicle

You may be responsible for:

- Excess mileage charges when you return the vehicle. Your lease agreement will tell you how many miles you can drive before you must pay for extra miles and how much the per-mile charge will be.
- Excessive wear charges when you return the vehicle. The standards for excessive wear, such as for body damage or worn tires, are in your lease agreement.
- Substantial payments if you end the lease early. The earlier you end the lease, the greater these charges are likely to be. ■

A Heads Up on Leasing from Clark Howard

Clark Howard, personal finance guru and host of the radio program The Clark Howard Show, offers these additional insights and cautions with regard to car leasing:

- It's harder to compare prices on a lease, and the financing costs built into a lease are very high.
- Leasing may seem cheaper than buying, but you're mortgaging your future when you lease. After a few years of leasing a vehicle and making payments, you own nothing.
- Manufacturers and dealers like to use upfront fees to create ultra-low monthly payments that mask the actual cost of a lease.
- Before you turn in a leased car, have it detailed inside and out and make any needed repairs. Then find out what company is officially responsible for determining that the car is in acceptable condition.
- A four- or five-year lease is a recipe for disaster. Many customers end up married to a vehicle they hate or end up paying severe early termination penalties.
- If you lease for five years and your car is totaled in an accident, you could be responsible for a giant gap between the amount the insurance company will pay and the stated residual in the lease.

Leasing vs. Buying Comparison

	LEASING	BUYING
Ownership	You do not own the vehicle. You get to use it but must return it at the end of the lease unless you choose to buy it.	You own the vehicle and get to keep it at the end of the financing term.
Up-front Cost	Up-front costs may include the first month's payment, a refundable security deposit, a capitalized cost reduction (like a down payment), taxes, registration and other fees, and other charges.	Up-front costs include the cash price or a down payment, taxes, registration and other fees, and other charges.
Monthly Payments	Monthly lease payments are usually lower than monthly loan payments because you are paying only for the vehicle's depreciation during the lease term, plus rent charges (like interest), taxes, and fees.	Monthly loan payments are usually higher than monthly lease payments because you are paying for the entire purchase price of the vehicle, plus interest and other finance charges, taxes, and fees.
Early Termination	You are responsible for any early termination charges if you end the lease early.	You are responsible for any pay-off amount if you end the loan early.
Vehicle Return	You may return the vehicle at lease-end, pay any end-of-lease costs, and “walk away.”	You may have to sell or trade the vehicle when you decide you want a different vehicle.
Future Value	The lessor has the risk of the future market value of the vehicle.	You have the risk of the vehicle’s market value when you trade or sell it.
Mileage	Most leases limit the number of miles you may drive (often 12,000-15,000 per year). You can negotiate a higher mileage limit and pay a higher monthly payment. You will likely have to pay charges for exceeding those limits if you return the vehicle.	You may drive as many miles as you want, but higher mileage will lower the vehicle’s trade-in or resale value.
Excessive Wear	Most leases limit wear to the vehicle during the lease term. You will likely have to pay extra charges for exceeding those limits if you return the vehicle.	There are no limits or charges for excessive wear to the vehicle, but excessive wear will lower the vehicle's trade-in or resale value.
End of Term	At the end of the lease (typically 2-4 years), you may have a new payment either to finance the purchase of the existing vehicle or to lease another vehicle.	At the end of the loan term (typically 4-6 years), you have no further loan payments.

Look Before You Lease

Many car dealers and other lessors offer vehicle leases. Before you decide whether to lease or buy, the Federal Trade Commission (FTC) reminds you: don't be dazzled by so-called deals. Ask questions, nail down the details, read the fine print, and shop around.

If you're thinking of leasing, the FTC offers these shopping tips:

1. Shop as if you're buying a car. Negotiate all the lease terms, including the price of the vehicle. Lowering the lease price will help reduce your monthly payments. Get all the terms in writing.

2. Learn the language of leasing:

- In a closed-end lease, you return the car at the end of the lease and "walk away," but you're still usually responsible for certain end-of-lease charges, such as excess mileage, wear and tear, and disposition.
- In an open-end lease, you pay the difference between the value stated in your contract and the lessor's appraised value at the end of the lease.
- Lease inception fees are payments you must make when the lease starts, and may include a down payment, security deposit, acquisition fee, first month's payment, taxes and title fees. Ask for a list of all charges due at lease inception. You may be able to negotiate some or all of the terms.
- The capitalized cost is the price of the car for leasing purposes plus taxes and extra charges like service contracts and registration fees.
- The capitalized cost reduction is similar to a down payment. If you're trading in a car, make sure the dealer applies the trade-in value to the price your lease is based on. The trade-in credit may reduce your down payment or monthly payments.

3. Ask whether extra charges will be assessed for excessive mileage, wear and tear, disposition and early termination, and find out the amount of these charges. Most leases allow you to drive 12,000 to 15,000 miles a year; if you put on more miles, expect a charge of 10 to 25 cents for each additional mile. You may think the ding in the door or coffee stains on the upholstery are normal wear and tear; to the lessor, it may be significant damage. Check out penalties for an early return; expect to pay a substantial charge if you give the car up before the end of your lease.

4. Make sure the manufacturer's warranty covers the entire lease term and the number of miles you're likely to drive.

5. Consider "gap insurance" to cover the difference (sometimes thousands of dollars) between what you owe on the lease and what the car is worth if it's stolen or totaled in an accident.

6. Before you sign the deal, take a copy of the contract home and review it carefully away from any dealer pressure. Be alert for any charges that were not disclosed at the dealership, like conveyance, disposition, and preparation fees. ■

Food for Thought from a Blogger

The following Web log or "blog" entry in response to the Kiplinger.com February 2008 article "Five Myths on Leasing a Car" by Mark Solheim offers some sound advice for anyone working hard to climb out—and stay out—of debt:

Posted February 18, 2008

Cars lose significant value over short periods of time. They are consumable items, not investments (there are few exceptions like a '67 Shelby). I only drive my car to get from point A to point B. The fact I get there is what is important. I own three old, cheap cars. When the engine of my 1998 Contour with 187,000+ miles blew, it did not matter. I started driving the F150 and my wife still drives the Accord (both have over 200,000 miles). I then splurged and bought a 2000 Taurus for a couple thousand dollars with my emergency fund which will be replenished in four months. I do not worry about big repair bills because I can wait and shop around and pay for them in cash and usually negotiate a discount. Living a patient, debt free life is definitely easier and a wiser solution.

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If you know of someone who would benefit from this information, please pass it along.