To buy or lease a vehicle essay

When purchasing a new vehicle, many consumers are faced with many choices of financing, and part for the decision that needs to be addressed is buying or leasing. In this paper we will look at the differences between buying and leasing a new automobile. Automobiles In America, cars have become a way of life, and most people could not live without one. They have also become the second largest financial commitment that most people will make, outside of buying a house, and for some people, there car will cost more then their house (Bauldings, 2004).

Lease Versus Buying Obviously in today's financial world there are numerous options to consider when making this financial decision.

Essentially the decision you want to make is based on what is the best way to finance this purchase that meets your particular needs. It is also important to differentiate between acquiring business or personal assets (Bauldings, 2004). In either case the fundamental issues are pay cash, finance at a bank or some other financial institution, and leasing.

The lease versus purchase decision involves the application of capital budgeting methods (CLA, 2005).

Now we need to determine the relevant cash flows and apply present value techniques. The four steps to do this include: after-tax cash outflows for each year under the lease alternative, after-tax cash outflows for each year under the purchase alternative, present value of cash outflows associated with the lease, and choose the alternative with the lowest present value of cash outflows from step three (Balance, 2005). Leasing.

There are two basic kinds of leases; With a closed-end lease, at the end of the lease term you simply return the vehicle; you do not owe any additional money unless the car or truck shows more-than-normal wear and tear, has been damaged, or has been driven more miles than are specified in the lease. An open-end lease generally offers lower monthly payments, but includes a specific value that the vehicle will be worth at the end of the lease period (this amount is called the “ estimated residual value”). If the vehicle is worth less at the end of the lease, you owe the difference (LeaseGuide, 2005).

Leasing Advantages. There are short-term cost advantages to leasing. The monthly payments on a leased car are usually far less than on a loan, even for a luxury model. The down payment usually works out to be less than what you would pay for a bought car as well. Because the typical lease is for three years, most repairs are covered by factory warranty (Balance, 2005).

Sales tax is cheaper too, as you only pay it on the financed portion. An attractive feature of leasing is the ability to drive a new car every few years.

You never have to go through the hassle of selling it; you just turn it in at the end of the term. Leasing Disadvantages. While the payments are often reasonable, you never gain equity in the car.

If you were to buy it at the end of your contract, it would cost you a lot more than if you had just bought it in the first place. Leases are restrictive. If you exceed the yearly mileage limit you will be assessed an extra charge. You must take good care of the car as well, as any nicks or dings will be considered “ wear and tear” and will cost you.

Comparing lease offers can be very confusing, making it hard to know if you got a good deal. And you will find it difficult to get out of your lease early if you want to – a problem if your driving needs or financial circumstances change (CLA, 2005). Interest Rate. Leasing is typically more expensive than conventional bank financing from an interest rate perspective – always ask what the rates are. Don't forget that you will end up paying GST and other sales taxes (if any) on interest since interest is built into the monthly leasing cost.

It is possible that this can add 0.

5% to the interest rate assuming that the GST is eligible for input tax credits or 1. 0% if not (e. g. buying personally). On the other hand, if you do not buy out the lease at the end you do not have to pay the GST and other sales taxes for the buyout amount (Bauldings, 2004). Often automobile dealerships will have 0% or some other reduced form of lease financing.

However, in most cases it is clear that you can negotiate a better price if you are willing to pay cash (i. e. borrow to purchase the auto).

You can safely bet that the lease price has an interest factor built in so consider negotiating to reduce the price and provide you own form of financing (Balance, 2005). Borrowing Powers.

Whenever you are borrowing consider the impact on future borrowing (Wachovia, 2005). Financial institutions do not take into account funding by leasing in the same way that conventional borrowing is. Borrowing via leasing will leave you with greater leverage for future transactions. This fact can be very important with companies of limited borrowing powers, especially if there are anticipated financial needs in the near future.

As a result you may be willing to pay a higher interest rate for this flexibility (TMV, 2005).

Cash Flows Leasing can provide better current cash flows with minimal down payments and a significant buyout price in three, four or five years. This fact means that the monthly payments can be significantly reduced compared to conventional financing which does not usually provide this option. Clearly interest rate is not the only important factor as to what is best for you. However, it can be a nuisance to rearrange financing for buyout purposes (Hawling, 2002). Timing

The company's year-end is December and the company is going to purchase a truck in March.

This is the point where income tax effects can definitely come into play. Consider the following: If the company purchases (via conventional bank financing) a truck for $20, 000 in March it is able to expense $3, 000 for the year (50% of the normal capital cost allowance rate of 30% multiplied by the cost). This rate of write-off for tax purposes is the same whether the vehicle was purchased in March, September or December. The lease rate for a $20, 000 truck could be $479 per month.

If purchased in March it would be possible to write-off 8 payments, or $3, 832, for tax purposes resulting in greater tax savings of the leasing option versus the purchase option. One can see that the above example could yield a much different result if the truck was going to be purchased in November (Bauldings, 2004). Ownership When you use conventional financing you have title to the piece of the equipment. When you lease, the lessor (seller) retains the title to the asset until you complete the buyout at the end of the lease..

. f you exercise the option (Wachovia, 2005). Later in a lease this fact can mean reduced borrowing powers since you cannot leverage the equity that you have. If there is good equity in your ownership of the asset, it should be taken into account in future borrowing, assuming you want to keep the asset.

If you do not want to keep the asset, then you let the leasing company have it back at the end of the lease (TMV, 2005). Buying Advantages When you buy a car, it’s yours. You can customize it and drive it as hard and far as you want, penalty-free.

Rather than having infinite payments, buying means you will eventually pay the car off, and if you want to sell it, you can do so at any time. (Hawling, 2002).

Buying Disadvantages Down payments on bought cars can be substantial. Monthly payments are usually higher than a leased car, and once your warranty expires, you will be responsible for the maintenance costs. When you want to sell it (or trade it in) you will have to go through the hassle of doing so. And, as an investment, new cars depreciate rather than appreciate (Balance, 2005). Decisions

When trying to decide if you should lease or buy a car, consider whether or not you plan to keep your car forever, drive large distances (road trips), or want to modify and customize the vehicle. If you think you would like to paint or stripe the car, install a different stereo, lift it, drop it, or customize the car in any way, then leasing may not be the best option for you (Wachovia, 2005).

Custom rims and tires also need to be considered; the may not fit on your next leased vehicle (CLA, 2005). Conclusion When purchasing a new vehicle, many consumers are faced with the decision of buying verse leasing.