Buying vs leasing a car

Cost Benefit Analysis

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Introduction

It is incredibly difficult to watch television without being bombarded by car advertisements that lead to daydreaming about driving a new vehicle. The exciting need for speed, the thrilling lust for luxury, and exciting new adventures are just waiting to be grasped down at the nearest auto dealership. Deciding whether to buy or lease that new vehicle can be a tough decision. Each method has its plusses and minuses, but with a little research of credible sources, the choice becomes much simpler.

Benefits of Buying a Car Instead of Leasing

There's no feeling quite like buying a new car, and the pride of ownership is unmistakable. One benefit of buying a car rather than leasing one is that when the loan is paid off, the vehicle becomes a tangible asset for the owner. The car, now paid off, can be sold for profit, leveraged as equity as a trade-in, or even given to a loved one as a gift. The purchase of this asset also means that there are no further monthly car payments to make. This allows the owner to budget the funds previously allocated to those payments and direct those funds toward some other endeavor. Essentially, once a car is paid off, it's providing a new revenue stream for the owner.

Another benefit of buying a car instead of leasing is that there are no restrictions on the amount of miles you can drive each year (U. S. News). The owner of a car has the freedom to drive where they want for as long as they want without the fear of a mileage fee hanging over their head. This kind of freedom allows the owner to make decisions about where they live or work without concern about the long commute. It also opens up the possibilities for long, leisurely, scenic rides or even driving to vacation spots across the country.

In the long-term, buying a car is cheaper than leasing. In a Consumer Reports study, the purchase of a Toyota RAV4 (MSRP $20, 987) from a dealer saved the buyer $4, 823 versus back-to-back leases of the same vehicle. The purchase of the same vehicle from the manufacturer was even more lucrative for the purchaser, as seen in the table below, with a savings of $5, 568 (Consumer Reports).

2012 Toyota RAV4 (mfr.)–MSRP: $21, 712

	First lease	Subsequent leases	Total lease cost		Loan	Months owned after loan
Lease terms, (2x) 36-mos.	36-mo.	36-mo.		Loan terms	60-mo.	12
Advertised monthly lease payment	$189			Prevailing loan rate	2. 9%	

Actual monthly lease pmt. (with tax)	$205	$341	$19, 655	Upfront/down pmt.	$2, 210
Cap cost reduction (with tax)	$2, 395	$0	$2, 395	Loan pmt.	$382
Other fees	$650	$1, 000	$1, 650	Maintenance/ repairs (est.)	
Maintenance/repairs (est.)	$666	$666	$1, 332	Resale value/equity	
Total lease cost			$25, 032	Total loan cost	
				Loan savings	

Costs of Buying a Car Instead of Leasing

The short-term costs of purchasing a car are higher than leasing. When you purchase a new car through financing, your loan represents payments for both the principal and interest. This financing also includes the transaction fees and taxes over the full life of the loan. This means that in the short-term your monthly car payments will be higher than if you had leased the car. It is also a common practice for dealers to require a significant down payment, which further adds to the short-term costs.

With each day that goes by, a car deteriorates and depreciates. Like most machines, the longer that a car is in service the more likely it is to need costly repairs that run outside of normal maintenance. While new car maintenance during the first three years is usually limited to basic maintenance like oil changes and tire rotations, the later years typically see costly out of pocket repairs for things like brakes and transmissions.

The depreciation gets even worse if the car is involved in a major accident. Unlike a leased vehicle, which can just be turned in for a new one, a purchased car is an owned asset that the purchaser retains regardless of the altered resale value of the vehicle. This may put the owner into the unenviable position of having negative equity (owing more on the car than it is worth).

Benefits of Leasing a Car Instead of Buying

In the short-term, a monthly lease payment is lower than a monthly car loan payment for the same vehicle. One of the reasons for that is that you are only paying taxes on the monthly payments instead of paying the full cost taxes up front as part of a loan. Given that it is typically easier to qualify for a lease than a loan, a lower monthly payment provides the opportunity to " buy up" and lease an even nicer car. When leasing a car you are only paying for the best years of the vehicle, which maximizes your short-term investment. Leases do not require money down, further saving short-term costs. There are even potential tax benefits. People who own a business and use the leased vehicle only for business purposes can claim it as a tax deduction (DMV).

Leasing a car allows someone to drive a new vehicle every 2-3 years. This is a very important benefit, because it allows the leaser to take advantage of the latest safety features and technology advances. That's an especially critical differentiation when deciding whether to purchase or lease a vehicle in its technical infancy (cars powered by methods other than gasoline).

There is a substantial " peace of mind" factor when leasing a car. The new car warranty usually outlasts the lease, meaning that repairs are covered for the duration of the driver's time with the car. If you find that you no longer like the vehicle, and have met minimum standards, you can turn in a leased car at any time without penalties. On the flip side, if you fall in love with the car, there is an option to purchase it when the lease expires. Unlike buying, leasing protects the consumer from excessive depreciation or other unforeseen changes in market value (Edmunds).

Costs of Leasing a Car Instead of Buying

There are a number of additional costs involved with leasing. The Acquisition Fee (also known as a Bank Fee) is a charge by the leasing company to initiate the lease. The Acquisition Fee can be anywhere from $250 all the way up to $1, 000 for luxury vehicles. The Disposition Fee (typically between $200 and $450) is the fee for the leasing company to take the car back, clean it, and prepare it for auction. There are also Documentation, Tag, Title, Registration, and License Fees. The Documentation Fee alone can be anywhere from $50 to $695. There are also " Wear and Tear" fees, which are a concern for people transporting pets or small children in the leased vehicle. In most states you only have to pay Sales Taxes on a portion of the car (since that's all you're purchasing), but some states (TX, IL, VA) charge tax based on the full price. This may cost up to $1000 more than other states (mpgxsvcd). Insurance costs are usually higher for leased vehicles. Insurance for a leased car, such as the Accord EX, would be approximately $150 extra each year (Edmunds).

Leases are poor choices for people who drive long distances due to mileage restrictions. Leasing limits a person to the number of miles they can drive the vehicle per year (usually 10, 000-12, 000 miles). After that, each mile typically costs 15 cents (Edmunds) and 20 to 25 cents for luxury cars (Investopedia). So, if you go over your limit by 4, 000 miles, you can expect to pay about $800 at the end of the lease (Investopedia).

One of the biggest drawbacks to leasing a car is that dealers use tricky terminology and confusing rates to lure consumers into agreeing to an inflated lease price. " Money Factor" (MF) is essentially the interest rate. This interest rate is presented in the form of a tiny decimal number to make it look less serious than it is. A money factor value of 0. 00163 equates to a 3. 912% interest rate (multiplying the MF by 2400 gives you the interest rate). If the MF was lowered by 0. 0002 for a $50, 000 car, that would mean a savings of $500 (1%). Another consideration is the residual value of the car. That's the guess of what the car will be worth at the end of the lease (as a percentage of the MSRP) (Edmunds). There are different types of leases as well. " Open ended" (also known as a " finance lease") leases put all of the risk on the consumer to pay the difference between the residual value and the actual market value at the end of the lease. " Close end" (also known as a “ walkaway lease”) leasing has a fixed residual value, with all of the financial risk absorbed by the leasing company (neweraleasing).

Opportunity Cost

Buyers experience opportunity costs in the short term. Due to the higher monthly payment and “ money down”, buyers have less money to pursue opportunities during the term of their loan than leasers do. But when you lease, you essentially have a car payment for the indefinite future. So when the buyer has paid off their car they will have a new influx of capital to pursue opportunities, while the leaser continues to make monthly payments.

Decision and Conclusion

Individuals base their decision on whether to buy or lease a car on a variety of factors. Leasing has many short-term benefits that cannot be overlooked. Not only is it a great feeling to drive a new car every couple of years at a lower monthly payment than buying, but by driving a newer car the leaser has access to the latest automobile technology and safety features. But leasers essentially have car payments forever and have intense mileage restrictions that limit their individual flexibility. Buying a car presents the owner with a finite number of payments on the purchase of a tangible asset, allowing the user to benefit from future growth when the loan is paid. The buyer also keeps the retained value (equity). Therefore, buying is the right choice if your intention is to keep the car for a long period of time.

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