Lease vs Buy

It's a common dilemma: lease versus buy — to lease or buy a car — which is better? Everyone who has ever considered leasing has had this question cross their mind.

So what is the answer?

Lease versus buy?

The answer is – it depends. It's not possible to simply say that one is always better than the other because the answer depends on the specifics of each individual situation.

Leases and purchase loans are simply two different methods of automobile financing. One finances the use of a vehicle; the other finances the purchase of a vehicle. Each has its own benefits and drawbacks.

> *The statement in the previous paragraph "One finances the use of a vehicle" is often misunderstood. It implies that one finances only a portion of the vehicle if leasing when in fact you finance the same amount as with a purchase, the difference is that you pay back less.* (See **Lease Payments**) ~SCP~

When making a 'lease or buy' decision you must look not only at financial comparisons but also at your own personal priorities — what's important to you.

Is having a new vehicle every two to four years with no major repair risks more important than long-term cost? Or are long term cost savings more important than lower monthly payments? Is having some ownership in your vehicle more important than low up-front costs and no down payment? Is it important to you to pay off your vehicle and be debt-free for a while, even if it means higher monthly payments?

So we find out that making a lease-or-buy decision is not quite cut and dry. There are some things you need to consider. Let's take a look at some of these things.

> *An important consideration in evaluating the two options is whether one uses their vehicle for business. The tax deduction for business usage requires that one use their vehicle at least 50% of the time for business before any deduction can occur. ~SCP~*

First, it's important to understand that buying and leasing are fundamentally different, not just two versions of the same thing.

Buying and leasing are different

When you **buy**, you pay for the *entire cost* of a vehicle; regardless of how many miles you drive it. You typically make a down payment, pay sales taxes in cash or roll them into your loan, and pay an interest rate determined by your loan company, based on your credit history. You make your first payment a month after you sign your contract. Later, you may decide to sell (Retail Market) or trade (Wholesale Market) the vehicle for its depreciated resale value.

When you **lease**, you pay for only a *portion of a vehicle's cost*, which is the part that you "use up" during the time you're driving it. You have the option of not making a down payment, you pay sales tax only on your monthly payments (in most states), and you pay a financial rate, called *money factor*, that is similar to the interest on a loan. You may also be required to pay **fees** and possibly a refundable security deposit that you don't pay when you buy. You make your first payment at the time you sign your contract — for the month ahead. At lease-end, you may either return the vehicle, or purchase it for its depreciated resale value specified in the lease contract.

Fees

*The "fees" addressed in the previous paragraph are **Acquisition Fee**, **Disposition Fee**, and **Purchase Option Fee**. They are separate fees that can add hundreds of dollars to the cost of leasing. The Acquisition Fee however is of great value to the lessee and it's important to know what it includes.*

1) *GAP Insurance – Most leases (TMCC leases excepted) have automatic built-in gap coverage, while car loans do not unless purchased separately, if you can find somewhere to buy it. Thus, you're better protected with a lease. Gap coverage pays the difference or deficit between what you owe on your vehicle and what it is worth if your vehicle is stolen or destroyed in an accident.*
2) *Residual Value Insurance – The resale value of the vehicle is guaranteed in a closed end lease (excluding excess wear and tear and excess mileage). The lessor will buy insurance or self insure in order to guarantee the value. Acquisition Fees have gone up significantly over the years, so has the cost of insuring resale value. The average Acquisition fee today (4/10/10) is about $595.*
3) *CarFax – An adverse CarFax report can have a significant impact on a car's resale value. The residual value or resale value guaranteed in a closed end lease protects the lessee from the loss of value in the event of an accident that, after repair, still negatively impacts the value of the vehicle. ~SCP~*

Buy vs lease example

As an example, if you **lease** a $20,000 car that will have, say, an estimated resale value of $13,000 after 24 months, you pay for the $7000 difference (this is called *depreciation*), plus finance charges, plus possible fees.

When you **buy**, you pay the entire $20,000, plus finance charges, plus possible fees.

This is fundamentally why leasing offers significantly lower monthly payments than buying.

Lease payments are made up of two parts: a *depreciation charge* and a *finance charge*. The depreciation part of each monthly payment compensates the leasing company for the portion of the vehicle's value that is lost during your lease. The finance part is interest on the money the lease company has tied up in the car while you're driving it. In effect, you are borrowing the money that the lease company used to buy the car from the dealer. You repay part of that money in monthly payments, and repay the remainder when you either buy or return the vehicle at lease-end.

Loan payments also have two parts: a *principal charge* and a *finance charge*, similar to lease payments. The principal pays off the full vehicle purchase price, while the finance charge is loan interest.

However, since *all vehicles depreciate in value by the same amount regardless of whether they are leased or purchased*, part of the principal charge of each loan payment can be considered as a *depreciation charge*, just like with leasing — it's money you never get back, even if you sell the vehicle in the future. It's lost money for which you'll have nothing to show.

> *The previous paragraph is important to understand and misunderstood by most who believe that they drive too many miles to lease… "All vehicles depreciate in value by the same amount regardless of whether they are leased or purchased". ~SCP~*

The remainder of each loan principal payment goes toward *equity*. It's what remains of your car's original value at the end of the loan after depreciation has taken its toll. Equity is resale value. It's what you get back if you sell the vehicle. The longer you own and drive a vehicle, the less equity you have. At some point in time, after the wheels have fallen off and the engine is worn out, the only equity left is scrap value. You never get back the amount you've paid for your vehicle. In short, equity (defined for vehicles) is an illusion created by higher payments and fleeing in time.

> *This last paragraph is about the great illusion called "equity". Equity is almost always misinterpreted and exacerbated when used in conjunction with a loan. Those in the car business compound the problem by labeling the difference between the value of a used vehicle which is greater than the loan payoff as "equity". If the value was less than the payoff the difference is called deficit. If one paid cash for the vehicle however, in almost every case the difference between the cost of the vehicle (basis) and it's current value is deficit.*
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> *Equity, when referring to cars, is an illusion created by time and payments. In other words, one has paid down their loan quicker than the vehicle has depreciated. There is never real equity in an automobile when you consider basis. In this example the basis is $20,000 and only if the car someday is worth more than $20,000 would there be real equity and not just an illusion. ~SCP~*

Buy versus lease - savings account or no savings account

So, buying a car with a loan is essentially like putting money into a declining-value savings account — you never get out as much as you put in. A portion of every payment you make is lost to depreciation and finance charges. What you have "to show" for your investment when your loan is paid off is only the part that is left over after depreciation and interest. A terrible investment by any measure. But cars are not usually purchased as investments, are they?

Leasing, then, is similar to buying, but without the equity "savings account." You only pay for what you use and you don't put anything extra into "savings." It's true that you'll own nothing at the end of a lease; you'll have nothing "to show" for the money you've put into it. But... what you don't own is the *same part* of the car's original value — the depreciated part — that a buyer too doesn't own at the end of his loan. Again, a car's value depreciates the same amount whether it is leased or purchased. That money is gone forever, lease or buy.

> *The two previous paragraphs address a common misconception when one chooses to buy versus lease because one wants to something "to show" for their investment. In fact, if one uses a lease correctly (i.e. the money saved in the monthly payment is invested into an increasing-value investment) you will most certainly have something "to show" for choosing to lease. ~SCP~*

With leasing, you may have the option of putting your monthly payment savings into more productive investments, such as mutual funds or stocks that have the possibility of increasing in value. In fact, many experts encourage this practice as one of the benefits of leasing, though most people will typically find other uses for the money they save by leasing — such as paying the mortgage or buying groceries.

To summarize, leasing typically does not build equity, while buying does. The reason that a buyer has equity at the end of his loan is that he purchases that equity by making higher monthly payments. Part of each payment funds the equity. Leasing - lower payments, no equity. Buying - higher payments, partial equity.

About 0% Loans vs Leasing

Below is a comparison of a typical lease compared to a 0% loan and a conventional loan. Does this mean leasing is always better? Not necessarily, because monthly payments are not the only factor that should influence your decision.

	Lease	**0% Loan**	**6% Loan**
Car Price	$23000	$23000	$23000
Down Payment	$1000	$1000	$1000
Interest Rate	6%	0%	6%
Residual	$11000	n/a	n/a
Months	36	36	36
Payment	**$388.06**	**$611.11**	**$669.28**

Leasing can be a little more complicated

Because leasing is somewhat more complicated; with residuals, money factors, etc.; it shouldn't be undertaken quite as casually as you might with a simple loan. There are more opportunities to misunderstand and make mistakes. Therefore, leasing requires that you be more careful and more informed.

Just a comment on lease-to-buy plans

Some folks lease with the intention of buying their vehicle at the end of the lease, or before the end of the lease. This is nearly **always more expensive** than simply buying outright. However, you may have a good reason for this tactic. Just be aware that it costs you more in the long term.

Lease or Buy? Which is Better?

So, is it better to lease, or to buy? As with any question of this type, there are always pros and cons, pluses and minuses, advantages and disadvantages.

Let's simplify the answers and summarize them here:

1. The short-term monthly cost of leasing is ALWAYS SIGNIFICANTLY LESS than the cost of buying.
For the same car, same price, same term, and same down payment, monthly lease payments will **always be 30%-60% lower** than loan payments. This is still true even when compared to 0% or low-interest loans.

2. The medium-term cost of leasing is ABOUT THE SAME as the cost of buying; assuming the buyer sells/trades his vehicle at loan-end and the leaser returns her vehicle at lease-end.
The overall cost of leasing compared to buying, over the same lease/loan term, is **approximately the same**, *assuming the buyer sells the vehicle at the end of the loan*. Comparisons sometimes show buying to cost a little less than leasing due to fewer fees, lower total finance costs, and the assumption that a purchased vehicle will return full market value if it is sold or traded at the end of the loan (often a bad assumption, especially if traded). However, when the benefits of wisely investing monthly lease savings are considered, the net cost of leasing can easily be less than buying.

3. The long-term cost of leasing is ALWAYS MORE than the cost of buying, assuming the buyer keeps his vehicle for years after loan-end.
If a *buyer keeps his car after the loan has been paid off and drives it for many more years*, the cost is spread over a longer term. It doesn't take rocket science to figure out that the cost of buying one car and driving it for ten years is less expensive than leasing or buying five different cars over the same period. Therefore, **leasing is always more expensive than long-term buying**. If long-term financial cost savings were the most important objective in acquiring a new car, it would always be best to buy the car and drive it for as long as it survives — or until the cost of maintenance and repairs begins to exceed the cost of replacing it. However, many automotive consumers have other objectives that reduce the importance of long-term cost savings.

So, which is better, lease or buy?

It depends on what's most important to you. All of us have different lifestyles and priorities — in cars and in finances. Car lease-versus-buy decisions must be made with your own lifestyle and priority attributes in mind. What's right for one person can be totally wrong for another.

LEASE - If you enjoy driving a new car every two or three years, want lower monthly payments, like having a car that has the latest safety features and is always under warranty, don't like trading and selling used cars, don't care about building ownership equity, have a stable predictable lifestyle, drive an average number of miles, properly maintain your cars, are willing to pay more over the long haul to get these benefits, and understand how leasing works, then you should **lease**.

BUY - If you don't mind higher monthly payments, prefer to build up trade-in or resale value (equity), like the idea of having ownership, like paying off your loan to be payment-free for a while, don't mind the unexpected cost of repairs after warranty has expired, prefer to drive your cars for years to spread out the cost, like to customize your cars, expect lifestyle changes in the near future, and don't like the risk of possible lease-end charges — then you should **buy**.

Excerpt from Lease Guide

In closing, it's imperative to evaluate both options. Many have heard about problems with leasing but usually don't know the specifics and as a result have determined that leasing is bad. In fact, only poorly written leases and poor advise are bad.