

Tips for Smart Consumers

Car Leasing

A Message from Attorney General Bill Sorrell

Leasing a car has become increasingly popular as an alternative to buying and financing. Many car dealers heavily advertise and promote leases. Unfortunately, vehicle leasing can be very confusing and as a result has the potential for consumer abuse. In order to make a wise decision about leasing it is important that you understand the differences between buying and leasing, the pros and cons of leasing, the language of leasing and other important facts.

Leasing vs. Buying

One reason why leasing is so confusing is that while it may seem similar to buying and financing a car, it is a very different type of transaction. Some of the basic differences include the following:

- When you purchase and finance a car, you are the owner; the bank holds the title until you pay off the loan. In a lease, the dealer actually sells the car to the bank and you lease it from the bank.
- When you purchase and finance a car, you are paying the full price of the car; in other words, the sum of your down payment, trade-in and monthly payments equals the purchase price. In a lease, you are only paying for that portion of the value of the car that you are actually using.
- When you purchase and finance a car, you own it free and clear once you have made all your payments to the bank. In a lease, you return the car to the bank at the end of the lease term.

Pros and Cons of Leasing

Leasing has a number of advantages over buying:

- Lower monthly payments;
- Minimal or no down payment in many cases.
- No resale hassles; in most leases, if there is no excess damage or mileage, you walk away at the end of the lease (although in most leases you have the option to purchase the vehicle at the end of the lease).
- With most leases being two to four years in length, you will most likely be covered by a warranty during most if not all of the lease period.

But there are also disadvantages:

- Leasing is usually more expensive, because you are using the car in its first few years while it is depreciating the most.
- You build no equity in the vehicle. At the end of the lease you have no trade-in to apply as a down payment on your next vehicle.
- You will be charged up to 15 cents per mile for every mile over the number of miles--usually 12,000 to 15,000 per year--stated in your lease agreement. (You can negotiate a higher limit, but that will increase the cost of the lease.)
- You will be charged for "excess wear" at the end of the lease. This includes such damage as scratches and dents on the exterior and holes or tears in the upholstery
- If you turn the vehicle in before you have made all your payments, you may end up paying a substantial penalty. Leasing is *not* like renting a car.

Should you lease your next car or truck?

In general, leasing makes *most sense* for those consumers who:

- Don't have enough cash for a down payment;
- Need to keep their monthly payments to a minimum;
- Want to drive a new car every two to four years without the hassle of selling or trading a used car; or
- Can claim lease payments as an income-tax deduction for a business use of the vehicle.

Leasing makes the *least sense* for consumers who:

- Wish to build equity in their vehicle;
- Want to spend as little as possible on a car;
- Put high mileage on their cars; or
- Are not careful about maintaining the appearance of their cars.

The Language of Leasing

If you're considering leasing, you need to know the terms used in a lease transaction. They are very different from the terms used in a sale, which is one reason why leasing can be so confusing.

Capitalized cost is the price on which the lease is based. It is the price the bank or finance company pays the dealer, plus extras such as service contracts and insurance. You should be aware that this figure is negotiable, just as the price of a car you are buying is negotiable. The lower the capitalized cost, the lower your monthly payments and the lower the overall cost of the lease.

Capitalized cost reduction is the same as a down payment. It will also include any credit you may receive for a trade-in.

Adjusted capitalized cost is the capitalized cost minus the capitalized cost reduction (or--more simply--purchase price minus down payment or trade-in).

Residual Value is what the lease company projects the vehicle will be worth at the end of the lease. It is also the price you will pay if you choose to purchase the vehicle at lease end. The higher the residual value, the lower your monthly payments will be. As a general rule, cars that don't depreciate greatly in their first few years will have a higher residual value.

Money Factor (also known as the **lease rate**) is similar to the interest rate on a car loan. It is a source of confusion for consumers, because it appears as a much lower rate. To compare it to an interest rate, you have to multiply it by 2400 (for example, a money factor of .00310 is the same as an interest rate of 7.4%).

Gap insurance. If the vehicle you are leasing is stolen or totaled in an accident, there may be a "gap" between what your insurance company will pay and what you still owe. Gap insurance pays the difference for you.

How to get the best lease deal

If you plan to own a new car every two to four years, the cost of leasing and buying may be comparable—if you are savvy and patient. Here are some tips that may help you get the best deal possible:

Negotiate the purchase price. Once you have identified the vehicle you are interested in, find out the *dealer's cost* for that vehicle. The information is available from a number of sources, including your local library and various sites on the worldwide web. Whether you plan to purchase or lease, the dealer's cost should be the starting point of your negotiations--not the "sticker price" (also known as the *manufacturer's suggested retail price*) or the capitalized cost. If you start out negotiating the terms of a purchase and then switch to a lease, the dealer should use the price you negotiated as the basis for the lease as well. The deal should not revert back to the sticker price. Remember: the higher the initial price of the vehicle, the higher your monthly payments will be.

Consider the mileage allowance. Before committing to a lease, give serious thought to whether the mileage allowance is sufficient for the amount you drive. A penalty of up to 15 cents for each mile over the allowance can be expensive if you exceed it by several thousand miles. If you normally put a lot of miles on your car, leasing may not be the right option for you.

Ask what the "money factor" is. Dealers are not required by law to disclose this figure to you. However, it is an important piece of the picture, so you should ask what it is and determine if it is competitive. You may be able to negotiate a lower rate and thus bring down your monthly payment. If the dealer won't disclose the money factor to you, you probably don't want to lease your car there.

Read the contract carefully. Leasing is a complex transaction and should not be rushed into. Make sure that the contract is completely filled out and that you understand all the terms. Be certain that your down payment or trade-in is fully reflected in the capitalized cost reduction. Be sure that you understand what counts as "excess wear." If the salesperson won't let you take the contract home to read and evaluate it, take your business elsewhere.

Compare leasing and buying carefully. If you can negotiate a price close to dealer's cost and a competitive rate of interest (money factor), leasing may work for you. Otherwise, you are probably better off buying. In order to determine which alternative is best, you will need to compare what you will pay in total over the term of the lease versus what you will pay over the term of a loan. Even if leasing comes out only slightly ahead, you may still be better off buying because of charges for wear and excess mileage or because of the equity you gain from buying.

Where to go for help

For more detailed information about leasing, check back issues of *Consumer Reports* at your local library.

If you have a complaint about a lease transaction or other automobile problem, contact:

Consumer Assistance Program
Morrill Hall--UVM
Burlington, VT 05405-0106
Phone: 800-649-2424 (toll-free) or
802-656-1025 (Chittenden County)
Email: ConsumerComplaint@atg.state.vt.us