

To Buy or Lease Motor Vehicles?

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Helping your clients sort through the maze of options can make you a hero.

Getting a new vehicle can be one of the most emotional financial decisions there is. Status, lifestyle, self-indulgence all play a part in new-car emotions. We see ourselves cruising down the highway and parking it in the driveway for the neighbors to see. In fact, a new car may be one of the best new toys we give ourselves. We revel in the new-car smell and leather seats or sound system. We enjoy showing it off to friends and family.

Finding, researching and test-driving, are all part of the fun of getting a new motor vehicle. For most people, however, the fun ends when it comes time to negotiate a deal and decide how to pay for the car. Automobile shoppers generally feel a sense of dread when approached by a well-trained salesman at a dealership. It may feel a bit like a tough game of chess as we sort through the choices and financing the vehicle can seem like a trap.

Seasoned financial advisors will tell you it's not uncommon to receive client phone calls asking whether they should buy or lease a car. Helping your clients sort through the maze of options can make you a hero. With the proper guidance, your clients can move through the difficult decisions and refocus on the fun feelings that accompany getting a new vehicle.

KEY QUESTIONS TO ASK

If your clients are considering a lease, remind them to read the agreement carefully. They need to understand all its conditions and be prepared to meet them. They also need to be realistic about their driving habits.

Ask the following questions, all of which relate to the most common terms, and offer the accompanying advice. If your client answers yes to all of these questions, leasing a new vehicle is certainly an option. However, answering no to more than of two of these questions most likely means that your client should plan on purchasing their next car.

1. Do you plan on driving this car for less than the term of the lease? Getting tired of your car and turning it in before the lease ends will cost you money. Also, it never makes sense to enter into a lease that lasts longer than the warranty on the vehicle.
2. Is driving the perfect car more important to you than ownership of a car? Leasing a car means never owning a car. At the end of the lease term you may have the option of purchasing the car but it rarely makes financial sense to do so.

3. Do you drive less than 12,000 to 15,000 miles per year? Most vehicle leases set annual mileage limitations in this range. Fairly stiff per-mile charges will be assessed at the end of the lease for any overages; this can substantially add to the cost of the lease. However, this can be a negotiable condition and it might make sense to pay a bit more to increase the mileage limit in the beginning. It is important to understand your mileage needs.
4. Will you be content to make no changes or modifications to this vehicle in any way? The auto you lease is the auto the leasing company wants returned. Stiff penalties will be assessed for any changes or modifications made to the car. Get the options and features you want in the beginning.
5. Are you okay having a constant, ongoing lease payment? While your monthly lease payments will stop at the end of the lease term, you will need to decide if you want to keep the car or turn it in and lease or buy another car. Whichever you decide to do, you will likely have another monthly payment. Because the backend purchase price (called the residual value) is negotiated at the beginning of the lease, if you really love this make and model, you are usually better off turning in the car and looking for a similar used car where you can negotiate a new price.
6. Do you take really good care of your cars? Aside from what the leasing company terms "normal wear and tear," be aware that any damage to the vehicle will produce additional fees that must be paid at the end of the lease. When you own your own car you can choose whether or not you want to pay for cosmetic damage.
7. If you realize the car you've chosen isn't really right for you, are you willing to keep it, to term, anyway? You will be forced to either pay the return fees or live with a car you really don't like. Remember, you are not allowed to modify leased vehicles.
8. Will your lifestyle and family remain the same (without any changes such as a new child) in the next two to three years? You should anticipate any changes that will occur in your lifestyle or family during the term of your lease and purchase a vehicle that will meet the needs of those changes. While a two-door sports car may fit your lifestyle needs today, it may not be suitable transport for your new baby.
9. Will the car be primarily used for business? If the lease payments qualify as a business expense, this strengthens the case for leasing a vehicle.

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Feature	Leasing a Vehicle	Buying and Financing
Down payment	None or small	Usually required; the more that's paid up front, the smaller the monthly payment
Monthly payments	Continuous, usually less than for buying	End when the loan is paid off
Vehicle modification	Not allowed	You can do what you want, when you want
Mileage limits	Usually 12,000 to 15,000 miles/year	Unlimited
Wear and tear	If in excess of contract limits, penalties due at end of lease	No limits
Early termination	Fees and penalties apply	There usually are no prepayment penalties
End of term	Lease again, or purchase the currently leased vehicle; payments continue	Payments stop
Ownership	None	Ownership equity builds with each payment; vehicle is owned at the end of the financing period

NEGOTIATING THE BEST PRICE

One of the most commonly used selling points for leases is that, because of the smaller payments, you might be able to get into a car that you might not otherwise be able to afford. What a great sales tool. Talk about pushing emotional financial buttons. Unfortunately, this is often the only thing clients consider when entering into a lease. As a trusted advisor, you can help your clients realize that there's a lot more to this decision than how much the monthly payment is going to be.

Remind your clients that, when they are in the showroom, absolutely no talk of how the vehicle will be paid for should enter into the conversation until after the price is negotiated. There's a common misconception that leased vehicles are always priced at MSRP. Nothing is farther from the truth. The dealership sells cars and acts only as an agent for the leasing company. Once the lease contract is signed, the dealership sells the car to the leasing company. Therefore, your client should negotiate the best possible deal for the car, all the while sidestepping constant questions from the salesperson about how the care will be financed. Only when there is a firm price should buying or leasing be discussed. A lower price for the car will lead to lower lease payments.

This requires that your client do a little research on car prices before they start negotiating. Have them check Web sites such as www.Cars.com, www.Edmunds.com, www.CarTrackers.com and www.KBB.com (Kelly Blue Book) to look up vehicle prices with specific options.

Because new cars with the same options can be found at multiple dealerships, it pays to shop around for the best lease deals. Credit Unions often offer superior leasing rates when compared with dealerships. When comparing multiple lease offers, it pays to understand the basic language of leasing a vehicle. This will simplify making apples-to-apples comparisons. You can find leasing glossaries at www.Edmunds.com and www.LeaseGuide.com.

OTHER CONSIDERATIONS

While loan payments are made up of principal and interest, lease payments are made up of a depreciation charge, sales tax (where applicable) and a finance charge. The depreciation charge returns to the leasing company the lost value of a vehicle during the lease and the finance charge is comparable to the interest on a loan. The lease finance charge is defined as the money factor. To calculate the money factor into a more easily understood interest rate, multiply the finance charge by 24. If the money factor is not close to their interest rate on a comparable new car, it is a point of negotiation and should be written into the lease contract.

Money Factor Table				
Money Factor	x	24	=	Interest Rate
.002084	x	24	=	5%
.002292	x	24	=	5.5%
.0025	x	24	=	6%
.002709	x	24	=	6.5%
.002917	x	24	=	7%
.003125	x	24	=	7.5%
.003334	x	24	=	8%
.003542	x	24	=	8.5%
.00375	x	24	=	9%
.003959	x	24	=	9.5%
.004167	x	24	=	10%

Another main consideration your clients should be aware of when entering into a lease is Gap Insurance. In the event of an accident that totals a car, this insurance closes the gap

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between what an insurance company is willing to pay for the vehicle and what the residual value (as stated in the lease contract) actually is. For example, after an accident your client receives \$20,000 from the insurance company, but the residual value for the vehicle is \$24,000. Without gap insurance your client would need to pay \$4000 out-of-pocket.

One important item to have your clients negotiate into their lease: Terms for returning a vehicle that turns out to be a lemon. Because “lemon laws” vary from state to state, a leased vehicle may not be covered. It is important for clients to be proactive in this area.

Finally, the federal tax break on hybrid gas-electric models changes from a tax deduction to a tax credit January 1, 2006. The tax credit, which can range from \$2,000 to \$3,000, has complex rules which address not only which make and model you buy but when you buy it and how many other hybrids the dealer has sold. Clients subject to AMT do not qualify. With gasoline prices high and environmental concerns on the rise, purchasing a hybrid may be an attractive option for those who qualify

Leasing is considerably more complex than purchasing the vehicle. The contracts need to be scrutinized carefully. In addition, your client’s lifestyle, personality and financial situation need to be assessed to determine if leasing or buying is a better deal. All of this, plus doing a basic dollars-to-dollars comparison on the total cost of leasing or buying – including the insurance costs, which are often higher for leased vehicles – should be undertaken before making a final decision on whether to lease or buy the vehicle.

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