How to Lease a Car

The consumers' guide to leasing a car

What does leasing a car mean?

An auto lease is a long term rental agreement for a vehicle that is subject to specific terms and conditions. The lease terms are agreed upon by the customer and dealership and a third-party leasing company who actually takes ownership of the vehicle and then leases it to you.

The Capitalized Cost

Instead of negotiating an out-the-door price (which is the price of the vehicle plus all taxes and fees), you negotiate the capitalized cost (also referred to as the "cap cost") of the lease.
The cap cost is the amount that the leasing company is paying for the vehicle. This will include:

- The negotiated selling price
- Doc fee
- Miscellaneous fees
- Additional products

Some of these charges are negotiable. For example, you don't need nitrogen-inflated tires or security etching that you didn't ask for billed on your lease agreement«

Residual Value

The residual value is the vehicle's projected value at the end of the lease term. When you lease, you pay for the amount of depreciation that will occur over the course of the lease term.

For example, if the residual on a 36 month lease is .75 (or 75%), your lease will include payment that covers the 25% expected loss in value over the course of 36 months.

Key points

There are four parts to a lease:

1. The capitalized cost (which is the out-the-door price on a lease)
2. The residual value of the vehicle
3. The money factor
4. The state sales tax

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The residual value is disclosed on the lease as the amount that you can purchase the vehicle for at lease end. Residual values are not negotiable and they are set by the leasing company based on allotted annual miles to be driven.

The Money Factor

The money factor is set by the lender and can be marked up to the consumer, much like on a car loan.

With a car lease, dealers make money by marking up the money factor on a lease. The lender charges the dealer a money factor of say, .00125, and the dealer marks it up 50, 75 or even 100 basis points. The difference between the buy rate (what the lender charges the dealer) and the marked up rate (what you're quoted) is additional backend profit on the lease for the dealer.

You should always try to negotiate the money factor to the buy rate or as close to the buy rate as you can get!

Sales Tax

Taxes in most states are added to the total price of the lease. NY, NJ, MN, OH, and GA charge sales tax upfront on the total amount of the lease payments. VA, MD, and TX charge sales tax on the total selling price of the vehicle (the cap cost). In all other states, sales tax is simply factored into your monthly payment. Sales tax is not negotiable.

Who owns the car in a lease?

The leasing company owns the vehicle that you are leasing from them. In most cases that will either be that automaker's captive lender (for example, Hyundai Motor Finance) or an outside bank. The vehicle will be registered in both the leasing company's name and your name as the lessee. You will be responsible for registration renewals, maintenance and all insurance.

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Do car leases require a down payment?

No, but If you want to lower your monthly payment, consider making a down payment on your lease. In a car lease, the down payment is called a capitalized cost reduction, or cap cost reduction. These up front payments are optional, but they can help make leasing more affordable by lowering the monthly payments.

What happens at the end of my car lease?

These are your options at the end of a car lease:

- Return the car
- Buy the car
- Sell the car (if allowed)
- Move into a new lease

Pros and Cons to Leasing

Pros

- **Risk Mitigation** - When you lease, you transfer to the lender (bank) the risk of accelerated depreciation, diminished value due to damage/accident, and unexpected repair expense.§
- **Convenience** - Having the most modern platform, technology, and safety features. Plus, you will always be under the bumper-to-bumper warranty.
- **Flexibility** - No long-term commitment. You have options: turn-in, sell, transfer, buyout, or extend the lease if you need more time finding a replacement.
- **Financial** - In some cases, the net total ownership cost is less than financing a purchase.

Cons

- The car isn't yours. It is a long-term rental and other than the use of the vehicle you have nothing to show for the money that you have spent.
- Residuals are typically higher than the vehicle's fair market value at lease end which means if you buy out your lease at the end you will more than likely be paying too much.

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Cons (continued)

- Fees and costs. If your leased vehicle has a wear and tear beyond the limits set by the lending company (large scrapes, worn tires, broken windshield, etc.), you will be charged for repairs. Some lenders are known for billing excessive reconditioning fees.
- If you incorrectly estimate your mileage, you will overpay for depreciation.
- If you decide to turn in your lease, you will have to pay a disposition fee ($300 - $595) unless the lender offers to waive it.
- While most lease contracts include a GAP waiver, they require elevated liability coverages, increasing your insurance premiums.

What happens at the end of my car lease?

- For every $1000 in cap cost reduction on a 36-month lease, your monthly payment will be reduced about $27.
- The Money Factor and some of the Capitalized Cost **ARE** negotiable. Sales tax and residual values are not.
- You will be responsible for registration renewals, maintenance and all insurance.
- Leasing isn't for everyone, but it can be an affordable way to stay in a modern, new car.