# Leasing vs. Buying a New Car

## Comparing the two major finance choices

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The choice between buying and leasing a car is often a tough call. On the one hand, buying involves higher monthly costs, but you own an asset—your vehicle—in the end. On the other hand, a lease has lower monthly payments and lets you drive a vehicle that may be more

expensive than you could afford to buy, but you get into a cycle in which you never stop paying for the vehicle. With more people choosing a lease over a loan than they did just a few years ago, the boom in leasing isn't stopping anytime soon.



## In This Article



Buying a vehicle with a conventional car loan is pretty straightforward. You borrow money from a bank, a credit union, or another lending institution and make monthly payments for some number of years. A chunk of each payment is put toward paying interest on the loan, and the rest is used to pay down the principal. The

higher the interest rate, the higher the payment. As you repay the principal, you build equity until—by the end of the loan—the car is all yours. You can keep the car as long as you like and treat it as nicely—or poorly—as you want to. The only penalties for modification or abuse could be repair bills and a lower resale value down the road.

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As car prices remain high (more than $48,300 in July 2023), leasing a new vehicle remains an alternative. However, according to Experian, one of the credit reporting agencies, the percentage of all new vehicles that are leased was down in the third quarter of 2022 when compared with both 2020 and 2021.

With a lease, buyers make a monthly payment to drive a new car for a set term. That payment is often less than the monthly cost of financing a new vehicle, but buyers must return the car at the end of the lease term.

With many people working from home, the mileage restrictions on a lease might not be a factor for a lot of shoppers. Quite the opposite: They might find that they don't use the miles they have paid for.

The predictability of the payments and ownership costs (no expensive repairs when under warranty!) has its appeal. However, life can be unpredictable, and a lease has less flexibility than a purchase.

To find out whether leasing or buying is right for you, we take a look at the pros and cons.

## The Upside of Leasing

On the surface, leasing can be more appealing than buying. Monthly payments are usually lower because you're not paying back any principal. Instead, you're just borrowing and repaying the difference between the car's value when new and the car's residual–its expected value when the lease ends–plus finance charges. The major advantages of leasing include:

• You drive the car during its most trouble-free years.

• You're always driving a late-model vehicle that's usually covered by the manufacturer's new-car warranty.

• The lease may even include free oil changes and other scheduled maintenance.

• You can drive a higher-priced, better-equipped vehicle than you might otherwise be able to afford.

• Your vehicle will have the latest active safety features.

• You don't have to worry about fluctuations in the car's trade-in value or go through the hassle of selling it when it's time to move on.

• There could be significant tax advantages for business owners.

• At the end, you just drop off the car at the dealer.

# The Disadvantages of Leasing

As attractive as a lease may appear, there are a number of disadvantages:

• In the end, leasing usually costs you more than an equivalent loan because you're paying for the car during the time when it is most rapidly depreciating.

• If you lease one car after another, monthly payments go on forever. By contrast, the longer you keep a vehicle after the loan is paid off, the more value you get out of it. Over the long term, the cheapest way to drive is to buy a car and keep it until it's uneconomical to repair.

• Lease contracts specify a limited number of miles. If you go over that limit, you'll have to pay an excess mileage penalty. That can range from 10 cents to as much as 50 cents for every additional mile. So be sure to calculate how much you plan to drive. You don't get a credit for unused miles.

• If you don't maintain the vehicle in good condition, you'll have to pay excess wear-and-tear charges when you turn it in. So if your kids are apt to go wild with markers or you're a magnet for parking lot dents and dings, be prepared to pay extra.

• If you decide that you don't like the car or if you can't afford the payments, it might cost you. You will probably be stuck with thousands of dollars in early termination fees and penalties if you get out of a lease early–and they'll all be due at once. Those charges could equal the amount of the lease for its entire term.

• With a few exceptions, such as professional window tinting, you need to bring the car back in "as it left the showroom" condition, minus usual wear and tear, and configured like it was when you leased it.

• You're still on the hook for expendable items such as tires, which can be more expensive to replace on a better-equipped vehicle with premium wheels.

• You may have to pay a fee when you turn in the vehicle at the end of the lease.

## An Alternative to Long Car Loans

Some car buyers opt for longer-term car loans of six to eight years to get a lower monthly payment. But long loans can be risky, and these buyers might find leasing to be a better option.

Longer loans make it easy to get "upside down"—when you owe more than the vehicle is worth—and stay that way for a long time. If you need to get rid of the car early on or if it's destroyed or stolen, the trade-in, resale, or insurance value is likely to be less than you still owe.

Buying a car with a loan isn't the way to go if you want to drive a new car every couple of years. Taking out long-term loans and trading in early will leave you paying so much in finance charges compared with principal that you'd be better off leasing. If you can't pay off the difference on an upside-down loan, you can often roll the amount you still owe into a new loan. But

then you end up financing both the new car and the remainder of your old car.

If your goal is to have low monthly payments and drive a new vehicle every few years with little hassle, then leasing may be worth the additional cost. Be sure, however, that you can live with all the limitations on mileage, wear and tear, and the like.

## Difficult Comparison Between Car Loans and Leases

It's difficult to make a fair head-to-head comparison between, say, a six-year loan and the standard three-year lease. At the point the lease ends, the bank borrower still has three years of payments to go, but the lessee has to look for another car—or perhaps take the lease's buyout offer.

A lease can also be subsidized, or "subvented." The automaker either takes money off the top with an extra rebate just for lease deals, or it can raise the residual, or both.

An automaker may also kick in extra rebates on a lease deal—rebates not available to a loan customer. In addition, the "money factor" (interest rate) on a lease may be different from the interest rate offered on a loan, making an apples-to-apples comparison almost impossible.

In general, two back-to-back three-year leases will cost thousands more than buying a car (with a loan or with cash) and owning it over that same six-year period. And

the savings increase for car buyers if they continue to hold on to the car, say, for three more years (for nine years total), even factoring in expected maintenance and repairs.

If a lease's limitations put you off, consider buying a less expensive new car or a well-maintained used car, such as a certified pre-owned vehicle from a franchised dealer, or getting a longer loan term. Whether you get your new car with cash, a loan, or a lease, you can save by choosing one that holds its value well, stays reliable, and gets good fuel economy.

For savings up front and over the long haul, buy used. And pay cash.

## For EVs, Leasing Could Be a Better Deal

If you're considering an electric car, the math changes a bit. That's because you might qualify for a $7,500 tax credit only if you lease rather than buy. In addition, leasing may offer some stability in an EV market that is changing rapidly and unpredictably.

Leases can qualify for a full $7,500 federal tax credit without meeting any of the restrictive federal requirements that purchasers must comply with on where an electric car was made, how much it costs, or a buyer's income level.

In addition to tax savings, there are other benefits. If an automaker drops the price of a new EV by thousands of dollars overnight—as Ford did this summer on the F-150

Lightning–you won't take the hit if your leased vehicle is suddenly worth less than it was the day before. And because you lease for only a few years, you won't be stuck with a car that has outdated battery technology or charging standards, as these are still rapidly evolving.

**Learn more in CR's guide to EVs and leasing.**

## Don't Forget to Negotiate

Many people assume that the monthly payment printed in a leasing ad is etched in stone. But that figure may be based on the manufacturer's suggested retail price, which can be negotiated downward just as if you were buying the vehicle.

Be aware, though, that the best lease deals are available only to those with superb credit, and that they may only be cheap because the automaker is trying to clear the decks of slow-selling cars.

## How Car Loans and Leases Differ

Below are some of the major differences between buying and leasing.

| | Buying | Leasing |
|---|---|---|
| **Ownership** | You own the vehicle and get to keep it | You don't own the vehicle. You get to use it but |