

FINANCIAL STRATEGIES FROM
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Leasing Your Car? Convenient But Rarely the Right Financial Move!

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I recently walked into an Acura dealership and a BMW dealership, two very common brands of luxury vehicles you see on the highways of our country, and I asked the manager what percentage of their vehicles are leased.

90% he said.

Oh my God. I knew I had to write this article.

I hope you find it useful as you contemplate future vehicle purchases.

Leasing a car is much different from buying or financing it. With financing, you're basically taking out a loan to pay for the car. You pay for the total value of the car, plus monthly interest and fees. At the end of the finance term, the car is yours¹.

With leasing, you don't get to keep the car at the end of the term and are essentially renting it, only paying for the amount of time you have the car. This is calculated as the value of the car when you first start leasing it minus the estimated worth of the car after your lease is up (plus interest, and a monthly leasing fee). So, let's say you take a two year lease out on a \$30,000 car, and in two years the car is estimated to be worth \$13,000. You're paying for the car's depreciation, or the \$17,000 loss of the car's worth while you were driving it².

This may make leasing seem like a good idea. You're only paying for the part of the car you want: the first few years, when the car is bright, shiny, and new. However, it's during this time a car's value depreciates the most: dropping a staggering 10% the second it's driven out of the parking lot³. In the first two years of a car's life, it will depreciate between 20 to 40%⁴. In short, it's true that you *are* paying for only part of the vehicle's life – it just happens to be the most expensive part.

Being able to afford monthly lease payments is not the same as being able to afford a car. At the end of a lease, you have paid numerous monthly payments to drive the

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¹ <http://auto.howstuffworks.com/buying-selling/car-financing.htm>

² <http://www.marketwatch.com/story/your-money-avoiding-auto-lease-horror-stories>

³ <http://livingstingy.blogspot.ca/2011/01/never-lease-car.html>

⁴ <http://www.investopedia.com/articles/pf/05/042105.asp>



car. What do you have to show for it? Either absolutely nothing, or your name added to the lease of a different car - and, with that, more monthly payments. At the end of a financing term, on the other hand, you have no more monthly payments, and a car that is your own asset.

It's also important to note that since you are effectively borrowing the car in a lease, you have very little freedom with it. You are not allowed to modify the car, or else warrant heavy fees upon its return⁵. You can also get charged a great deal for scratches, dents, or any other signs of deterioration

not associated with what the dealer deems normal "wear-and-tear"⁶. Finally, you are only allotted a set number of kilometers you may drive per year. This kilometer limit is often very low, about 20,000 km per year in most cases, and if the car goes over this limit, you're looking at heavy fees - \$0.15-0.20 per extra kilometer⁷. These charges add up very quickly, and can end up pushing the cost of a lease much higher than expected. Not only that, but there are significant fees to end a lease early: often equal or close to the cost of sticking it out with the car for the rest of the lease term⁸.

Leasing can seem very attractive as it puts within reach luxury cars that may be out of most people's price range to buy outright. In many cases, the monthly cost of leasing a luxury car can equal the cost of financing a less extravagant one⁹. Once again, it's important to note that while this may be tempting, at the end of the lease you'll say "goodbye" to the luxury car and "hello" to taking transit every day, or you'll have to roll over into a new lease and begin a cycle of never-ending monthly payments.

For many people, leasing can initiate a "paycheck to paycheck" lifestyle and a symptom of bad financial habits - in order to have a car, you must keep leasing, and keep paying monthly payments - leaving you with no financial freedom. It may seem enticing to have a new car every few years, but with this comes lease after lease, and monthly payments that will never end. With financing, however, there comes an end to these payments. The car is yours, and money can be spent on other things or saved for the future. If you are behind on your retirement saving or children's RESP, this should matter to you.

It's important to take a long-term outlook when considering the costs of financing versus leasing a car. On the short-term, leasing is definitely appealing. Monthly lease payments are, for the most part, lower than monthly finance payments, due to the fact that you are paying for the entire cost of the vehicle over a finance term so you can own it at the end¹⁰. This is what makes it seem so easy to roll into a lease, as monthly lease payments often seem that much more manageable. Don't be fooled.

It's over longer periods of time that the disadvantages of leasing really become clear.



⁵ <http://banking.about.com/od/loans/a/leasevsbuy.htm>

⁶ <http://www.federalreserve.gov/pubs/leasing/>

⁷ <http://auto.howstuffworks.com/buying-selling/buy-or-lease1.htm>

⁸ <http://www.consumerreports.org/cro/2012/12/buying-vs-leasing-basics/index.htm>

⁹ <http://livingstingy.blogspot.ca/2011/01/never-lease-car.html>

¹⁰ <http://www.leaseguide.com/lease03.htm>



If the owner of a financed car sells it at term end, the cost of leasing a car can reach and even surpass the cost of financing. Let's look at a cost comparison of leasing and financing a car valued at \$24,500 over six years.

A five-year finance term with a down-payment of \$5,000 and 3% interest rate would have a monthly payment of \$390, costing a total of \$28,830 out-of-pocket for the six years.

A lease that runs for three years would cost \$344 (and would therefore require a rollover into a new lease after the first three year term is up). Leasing the car would cost a total of \$24,500.

This is only a \$4,062 difference between financing and leasing a car for six years. However, at the end of the financing term the person owns the car, whereas at the end of the leasing term he or she does not. Adding in the \$11,000 the vehicle would be

worth at the end of the 6 years if the financee decided to sell it, the cost of leasing remains at \$24,768 while the total out of pocket cost for financing the car is \$17,830... a saving of \$6,938 to finance¹¹.

Looking even further into the future, if a driver keeps his car after the end of a finance term and drives it for many years, the total savings over leasing are even more profound. Over a decade, the cost of having a car can easily double or triple if leasing rather than buying.

When you consider owning a car for a long-term period of time, however, it's important to consider repair and maintenance costs that come with ownership. While you do have to cover these costs when leasing, you will only be keeping the car for the first few years of its life so the costs are often minimal. With financing, however, you own the car well past the "prime" of its life – meaning increased car maintenance costs. Many people argue that these repair costs associated with owning a car make leasing a more viable option and cancel out any increased costs¹². This is not true.

Let's look at an example of leasing versus financing a \$34,000 car over 10 years, taking into consideration any maintenance costs. The lease is a 36 month term, with \$0 down and 1.9% interest. The lessee pays about \$520 a month (assuming he starts a new lease at each term end over the ten years), coming to a total leasing cost of \$62,400 over the 10 years¹³.

The finance is a 60 month term, also with a \$0 down payment, and 0% financing. This costs the financee about \$567 a month over five years, or a total financing cost of \$34,000¹⁴.

At this point it looks like the financee is getting the better deal, paying \$28,400 less to own a car for ten years. Now let's add in repair costs of about \$14,500 over the 10 years (water pump and tensioner replacements and three brake pad and rotor replacements, as well as various parts and labour costs). Adding this into the total, financing the car instead of leasing it has saved about \$13,900 over the span of 10 year¹⁵.



¹¹ <http://www.edmunds.com/car-buying/compare-the-costs-buying-vs-leasing-vs-buying-a-used-car.html>

¹² <http://www.theglobeandmail.com/globe-investor/personal-finance/lease-or-buy-a-car-whats-the-better-option/article565403/>

¹³ <http://www.theglobeandmail.com/globe-investor/personal-finance/lease-or-buy-a-car-whats-the-better-option/article565403/>

¹⁴ <http://www.theglobeandmail.com/globe-investor/personal-finance/lease-or-buy-a-car-whats-the-better-option/article565403/>

¹⁵ <http://www.theglobeandmail.com/globe-investor/personal-finance/lease-or-buy-a-car-whats-the-better-option/article565403/>



Now let's compare the costs of buying outright, leasing, or financing a car over a short-term, medium-term, and long-term period of time. Let's say the car's value is \$40,295 (with taxes and fees included).

First of all, paying upfront for a car is undoubtedly the cheapest option. Not only is the car yours from the start to do anything you want with, but paying upfront also removes any interest costs or associated fees that come with leasing and financing¹⁶. The price above is what the car dealership would like you to pay; however, the majority of cars are sold for less than this. Acura.ca gives a cash payment price of \$38,295 if paid outright, including taxes and additional fees¹⁷. Well, that was easy.

Now let's look at leasing versus financing. For this same car, worth \$40,295, person A takes out a 48 month lease. Person B finances the car for 60 months, and puts a down payment of \$5,000. Upfront fees for the lessee are \$756.10 once leasing fees are calculated in, while the financee pays an even \$5,000 upfront (no initial financing fees). For the lessee, the annual interest rate is 1.9%, and for the financee it is 2.9%. The lessee will have lower monthly payments over his term - \$610.95 to lease the car, and \$729.13 to finance it¹⁸.

Overall, the total value of the car the lessee will have to pay over the 48 months is \$23,804.50. With his monthly payments, interest, and additional fees to lease it added, the total cost of leasing the car over the 48 months is \$31,472.78 - for a car he will never own. This is without taking into account the discussed "wear-and-tear" damage and extra kilometer fees¹⁹.

The financee, on the other hand (since he is buying the car), will cover the full cost of the car over the 60 months, minus his down payment: \$40,678.50. With his \$5,000 down payment, interest, and additional fees added, the total cost of the car will come to \$51,817.10²⁰. While this is a far cry from paying \$38,295 for the car outright, he does get to keep the car at end of term.

In the end, the lessee, \$30,000 poorer and no car to show for it, now has a few choices: he can either begin to pay for the \$16,490.50 residual value of the car by starting a financing term (which, with interest and fees added, will end up costing him more than just financing the car from the beginning), or he can roll into a new lease. Either choice means more monthly payments²¹.

The financee however has a car that cost him \$51,000 and could last him more than a decade, with no monthly payments. He can either keep the car that will last him many more years, or can sell it for the \$16,490.50 residual value... meaning the out of pocket cost to finance would be \$35,326.60 - only a \$3,853.82 difference from leasing the car.

Let's look at the associated costs if the financee decides to keep his car for 12 years, while the lessee renews three separate leases during this term. The financee has paid \$51,817.10 for the car. Let's add in about \$17,000 for car repairs and maintenance over the 12 years to bring the total cost of owning the car for 12 years to \$68,817.10. That's it²²



¹⁶ <http://www.cars.com/go/advice/Story.jsp?section=fin&subject=loan-quick-start&sto>

¹⁷ <http://www.acura.ca/lease-and-finance/payment-calculator>

¹⁸ <http://www.acura.ca/lease-and-finance/payment-calculator>

¹⁹ <http://www.acura.ca/lease-and-finance/payment-calculator>

²⁰ <http://www.acura.ca/lease-and-finance/payment-calculator>

²¹ <http://www.consumerreports.org/cro/2012/12/buying-vs-leasing-basics/index.htm>

²² <http://www.theglobeandmail.com/globe-investor/personal-finance/lease-or-buy-a-car-whats-the-better-option/article565403/>

If the lessee, on the other hand, has rolled into a new lease each time his previous one expired, he will be looking at three 48 month leasing terms over the period of twelve years. This will cost him a whopping \$94,418.34. Choosing to finance the car and keep it resulted in total savings of \$25,601.24 over the twelve years.

In the end, the lessee has no car and the financier has a car he can sell (at least for parts) and put toward the down payment of a new auto finance term. It's pretty easy to see which scenario would be better for long term saving.

How Kurt Rosentreter & Our Wealth Management Team Can Help

Decisions about major purchases such as vehicles and real estate should be made in the context of your overall financial plan. Your financial plan starts with your goals (short term and long term), an examination of your resources and debts, priorities and consideration of all of the areas of your finances (retirement, career, debts, children's education, investments, tax planning, estate goals) and more. Most Canadians cannot afford to lease a \$70,000 BMW, Volvo or Audi SUV. We can look at your entire financial plan and help you make the best financial decisions for your family.

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