

Transcript

Buying Vs. Leasing A Car

Let's say you're in the market for a new car, and you're trying to figure out how you want to pay for it.

The price of the car is \$17,700 and you have two options.

You could either buy the car, but you don't have \$17,700 sitting in your bank account. You have enough for a down payment of \$2,000 and so when you buy it, you would essentially have to take out a loan for the remainder of the car.

Your other option is to lease the car, essentially rent the car from the dealership.

And this other information is essentially the terms of either the loan or the lease.

So here, you put \$2,000 down.

You're able to borrow the money at a 4.22% interest rate.

The term is 3 years, which means if you pay the same monthly payment for the three years, at the end of those three years, you will own the car outright.

And then here we had the expected resale. There is no place where you can just look up the expected resale in three years but you could use how that same make or model – how that has performed in the past three years to get an estimate of what would it likely sell for in three years.

Now your other option is a lease. You could put \$2,000 down and to make a kind of an apples-to-apples comparison, we'll have it over the same three years. So this is essentially you're agreeing to lease it for these three years, paying \$159 a month, so it's a lower monthly payment. And at the end of the three years, you have a buy back option. If you want to keep the car, you can pay the dealer \$12,200 to keep it.

So let's think about two scenarios here. Let's say that the first scenario is the scenario where you want to keep it. And in that scenario, let's compare the buy option to the lease option.

When I say compare, let's just do a back of the envelop calculation, for if you want to buy it, what's the total amount of money that you'd have had to pay in order to keep the car after three years and the same exact question for the lease.

If you want to keep after three years, what is the total amount of money you would have had to pay and the amount of money that you would have to pay to keep it?

And I encourage you to pause the video right now and try to figure that out on your own before we work through it together.

Well I'm assuming you've had a go at it, so let's work through this.

So if you want to buy the car and keep it after three years, you're going to put down \$2,000. You're going to put down \$2,000,

Then you're going to have three years of payments at \$465 a month. So essentially 36 payments. So that's going to be \$465 times 36. \$465 a month times 36 months and then you don't have to pay anything after three years, you will own your car outright.

So this is essentially the total amount that you would have to put to keep the car outright.

So let's calculate that. So that's going to be, that's going to be \$2,000 plus \$465 a month, times 36 months, gets us to \$18,740.

So we have \$18,740. And if you're wondering why is this number higher than this number? Why is \$18,740 higher than \$17,700, it's because when you borrowed the money, you had to pay some interest.

So the total amount that you paid is higher and the difference between the two is the interest that you're paying.

Now let's think about the lease situation.

In the lease situation, you still had to put \$2,000 down. We do that in the lease color.

So you still had to put \$2,000 down. Then you had 3 years of payments at \$159 a month.

So you're going to have \$159 times 36 months, over 3 years. And then if you want to keep the car, remember, that's the scenario we're thinking about, you also have to pay the buy-back. You have to pay \$12,200. \$12,200 and so if we sum all of that together, we get \$2,000 plus \$159 times 36 plus \$12,200 is equal to \$19,924.

So when you look just, you know, just this back of the envelop calculation that we just did, what is the total amount of dollars that you had to pay over the three years, and I didn't do all the fancy present value and all the rest, there's other videos on that. This is really just kind of a back of the envelop calculation, it's pretty clear that you had to pay in aggregate less to buy.

Now there are some trade-offs here. The monthly payment was higher.

The monthly payment was higher, so you could only do this if you had \$465 a month in order to make this payment and there's also trade-offs here. If you decided to lease, this isn't the only thing that you have to deal with, there also tends to be limits on the mileage.

Often times they might say every mile above 12,000 miles a year is \$0.15 a mile or \$0.20 a mile. And so one, you have to worry about that and also you might have to pay even more than this \$19,924. But you might be thinking, okay Sal, well that's if I wanted to keep the car. But I like to always be driving a relatively new car and I might want to actually not keep the car after three years. So let's think about that scenario.

So let's look at that one. So let's give up car.

Give up the car.

So in the situation where you're buying it, if you want to give up the car, you're going to pay the \$18,740 – that's what you're going to pay and then you're going to get \$12,000 when you sell it. That's just our expected resale.

So minus, that's what you're going to get. And so you're net that you have to pay up, is going to be \$6,740 is the net you have to pay essentially for the ability to use that car over three years.

Now what's the scenario on the lease?

Well then you're going to have the \$2,000. \$2,000 and you're going to have the \$159 per month times 36 months and you won't have to pay the buy-back. You're just going to return the car.

So that's going to give us, \$2,000 plus \$159 times 36 gets us to \$7,724.

\$7,724.

So once again, even when you're going to give up the car, in terms of just the actual dollars that you had to pay out, it looks like you're doing better having bought the car. But once again, trade-offs, you had to put out more money every month. And of course on the lease side, it might be even larger than this number, if you go over the mileage limits.

So it depends on your context, but at least in these two scenarios, you're going to – it looks like the more economical thing to do. And there's other trade-offs. Sometimes there's tax advantages to leasing or business advantages or whatever else.

But just doing the simple calculation, the buying seems better, at least for these scenarios.