Financing an Auto

Once a consumer decides to acquire an automobile, the next step is to decide how to pay for it. There are three methods of financing an auto:

- **Pay cash:** Using already accumulated funds.
- **Borrow the funds:** Taking out a loan and paying for the vehicle over time.
- **Lease:** Allows use of an auto for a specified period of time, in return for regular monthly payments.

The decision as to whether to pay cash, take out a loan, or lease a vehicle is usually made after considering a number of personal and financial issues.

Factors to Consider

The table below compares some of the factors to consider when considering how to finance an auto:

	Pay Cash	Borrow the Funds	Lease
Method of financing	Consumer uses cash to completely pay for the vehicle at the time of purchase.	Consumer borrows the funds to purchase the vehicle, and makes monthly payments to repay the loan.	Consumer obtains the right to use the vehicle for a specified period of time, in return for monthly payments.
Out-of-pocket costs	Entire purchase price.	Down payment and/or trade-in. Special offers may allow zero down.	Down payment and/or trade-in. Often less than for an auto loan. Special offers may allow zero down.
Monthly payments	None.	Payments cover repayment of loan amount, plus interest.	Payments cover estimated depreciation during the lease period, and other costs. Typically less than for an auto loan.
Vehicle ownership	Consumer is the owner.	Consumer is the owner, subject to a lien held by lender. Once loan is repaid, consumer takes title free and clear. Lender may repossess vehicle if payments not made as scheduled.	Leasing firm retains ownership. Consumer usually has the right to purchase the vehicle at the end of the lease.

	Pay Cash	Borrow the Funds	Lease
Excess mileage charges	None.	None.	Typical lease limits consumer to no more than 10,000 – 15,000 miles per year. Miles in excess of lease limits are subject to a per-mile charge.
Excess wear and tear	No additional charges. Excess wear and tear, or high mileage, can reduce a vehicle's resale value.	No additional charges. Excess wear and tear, or high mileage, can reduce a vehicle's resale value.	Additional charges for excess wear and tear usually apply.
Risk of future vehicle resale value	Risk remains with the consumer.	Risk remains with the consumer.	With a closed-end lease, risk of future vehicle resale value remains with leasing firm. With an open-end lease, consumer may be responsible for substantial additional charges.
Early disposal of vehicle	Consumer is free to sell vehicle at any time.	Consumer is free to sell vehicle at any time, subject to repayment of loan balance to lender. Early loan termination fees may apply.	Additional fees for early lease termination normally apply.
Tax issues	Deduction available for business use of vehicle.[1]	Deduction available for business use of vehicle.[1]	Deduction available for business use of vehicle. In certain situations, leasing may provide a larger deduction for business use than an owned vehicle.[1]
Lifestyle issues	Limits consumer to vehicle that he or she can currently afford. Consumer avoids additional debt burden.	Usually allows consumer to purchase more expensive vehicle than if full cash payment is required.	Consumer typically has use of more expensive vehicle than with other financing options. May also allow consumer to drive a new car more frequently. No equity at end of lease.

[1] Based on federal law. State law may vary.

Comparing the Dollar Costs

The following table provides a hypothetical comparison of the costs involved in the three options for financing an auto:

- **Pay cash:** Purchase price of $22,500, sales tax of $1,631, registration and fees of $350. Total purchase price of $24,481.
- **Borrow the funds:** Total purchase price of $24,481, less down payment of $2,250. Financed over a 48-month period at 4.0% annual interest.
- **Lease:** 48-month closed-end lease, with same costs and interest rate as under the “loan” option. $500 down payment and an assumed resale value at the end of the lease of $12,000.

	Pay Cash	Borrow the Funds	Lease
Up-front cash	$24,481	$2,250	$500
Monthly payment	0	502	437
Total payments over 48 months	0	24,096	20,976
Opportunity costs[1]	999	92	20
Total costs after 48 months	**25,480**	**26,438**	**21,496**
Value of vehicle after 48 months	(12,000)	(12,000)	0
Total	**$13,480**	**$14,438**	**$21,496**

[1] The amount of interest the “up-front cash” shown for each option would have earned over the 48 month period, at an assumed 1.0% annual after-tax rate of return.