

Auto leasing: Six dirty secrets Leasing can mean smaller monthly payments. But you can easily end up getting taken for a ride.

December 12, 2002: 12:03 PM EST

By Annelena Lobb, CNN/Money Staff Writer

NEW YORK (CNN/Money) - Auto leasing is a notoriously murky financial process. While there are some good deals out there, auto leasing is an area with more than its fair share of dirty secrets. The financial complexity of lease contracts makes customers easy prey for dishonest dealers and there are plenty of ways to go wrong even in a completely above-board transaction.

Before you can recognize the telltale signs of a bad lease, you first need to know exactly how leasing works.

Leasing basics

When you agree to lease, you may or may not hand over some money at the outset. Some people give a down payment, which lowers their subsequent monthly payments. And many leasing deals require a security deposit and other upfront fees.

Your monthly payments cover the cost of the car's depreciation over time. Between the time you drive the car off the dealer's lot and the time you bring it back at the end of the lease term, the car will have lost a certain amount of value. The underlying product you're paying for when you lease a car is the portion of that car's value that you've "used." You're also paying sales tax on each monthly payment, and interest charges, known in leasing jargon as the "money factor."

Several variables determine the exact amount of your monthly lease payment. First, there's the price of the car, which you should negotiate just as you would if you planned to buy it. (In fact, if you're planning to lease, it's a good idea to keep that to yourself until you've agreed on a price. Once the price negotiation is done, then tell the dealer you'd like to explore leasing the car at that price.) The price you agree on is called the cap cost, short for capitalized cost, of the car. Your net cap cost is your cap cost minus any factory-to-dealer incentives, the value of your trade-in, or rebates.

Now, back to depreciation. What you pay for depreciation depends on the "residual value" of the car, or what it's worth after the term of your lease. Some cars hold their value better than others. The cheapest cars to lease are those that lose the least value, usually cars that have a reputation for longevity. In other words, cars with high residual values.

A 36-month, 50 percent residual on a \$30,000 car means that its approximate depreciated value at the end of a 3-year lease will be \$15,000. Of course, since no one can perfectly predict the future, any specific car's residual value is an estimate.

When you lease, you pay the difference between residual value and net cap cost over the term of the lease, plus the money factor, sales tax, and any relevant fees.

It's estimated that as many as 85 percent of all automotive consumers never do any homework prior to visiting a dealer to buy or lease. But now that you have the basics in hand, let's take a look at a few loopholes and dirty tricks that can cost you money.

1. Is the dealer showing you a fair comparison between leasing and buying?

Experts say the number one reason people overpay to lease is because they focus solely on the monthly payment that's offered to them. Lease payments may be lower than loan payments, but that doesn't mean you're getting a better deal. You could be paying far more in interest and fees.

Furthermore, in order to encourage leasing over buying, dishonest dealers might compare a low lease payment with monthly loan payments over a shorter-than-average term, like four years, said Mark Eskeldson, editor of Carinfo.com and author of "What Car Dealers Don't Want You To Know." He added that the average consumer's car loan has a five-year term.

"Dealers will compare a four-year loan or even a three-year loan -- so the monthly loan payment will look much higher than the lease payment they're offering you," Eskeldson said.

2. Some dealers will say cap cost is non-negotiable to keep you paying sticker price. This is almost never the case. It always behooves you to score the lowest possible cap cost. The only instances in which you're not allowed to negotiate are if you're leasing a Saturn (they're only leased at full, "no haggle" price) or if you're getting a special lease, contingent on a specific price.

A buyer who goes in ready to haggle with the dealer might pay \$18,000 for a car with a sticker price of \$20,000. Someone who leases the same car at sticker price would end up with monthly payments about \$67 higher (on a 30-month lease) than if the lease were negotiated down to the \$18,000 sales price, according to Carinfo.com.

The key to haggling successfully is finding out the factory invoice price, according to Leaseguide.com. That's the price the dealer pays for the car. The difference between factory invoice and MSRP is his potential profit margin, and your bargaining range. You can use [CNN/Money's Car Finder](#) to find the factory invoice price for a car you're interested in.

3. Is the dealer offering the best possible rates? The interest you pay consists of the buy rate, or the rate set by the lender, plus any percentage points the dealer adds. So the buy rate might be seven percent, but the rate offered to you is ten percent. That's because most dealers are allowed to raise the buy rate and pocket some or all of the difference, Eskeldson said.

In order to get the best deal for which you qualify, check your credit before you even set foot in a dealership. Get a sense of the rates for which you'd be eligible. According to Eskeldson, a FICO score of 650 or above qualifies you for the best rates around.

Then, take a look at the money factor on the lease, said Joe Cashen, director of pricing strategy for CarsDirect.com. It's usually an obscure number with a decimal point, like .0035, Cashen said. But multiply it by 2,400, and you'll see what your APR is (for .0035, it would be 8.4 percent). Does it match the rates you'd qualify for with your FICO score, or are you being gouged?

4. No law requires APR disclosure on a lease. Again, if you don't know what rates you're eligible for on a lease, or how to calculate payments, you're a sitting duck, Eskeldson said. The law requires disclosure of the rates you'll get on an auto loan, but not on a lease.

"It's perfect for tricking someone into a horrible lease," he said. "Someone might say, we can get you on a lease with a lower APR, but with your credit, you could only get X percent on a loan." If you don't know any better, you might fall for it.

5. Some leases last longer than the accompanying auto warranty. Those aren't leases worth taking, Cashen said. When you take a lease, make sure your warranty lasts just as long.

Say you took a 48-month lease with a 36-month warranty. If something goes awry in your last year with the car, you're responsible for coughing up the entire cost of repairs on a car you don't own. A few months later, you still have to turn it back in to the dealership.

6. Certain fees may sometimes be waived. If you have great credit or are a repeat customer at a dealership, ask if your security deposit or bank acquisition fee often can be waived, Cashen said. Of course, it's highly unlikely someone will tell you that without prompting.

So ask. The worst they can do is say no. ■