

# Leasing a Car



Don't!

A vehicle is a depreciating asset. By definition, you will not accumulate wealth spending your hard-earned money on a vehicle. As soon as you drive a car off the dealer's lot, it's worth less. The average vehicle depreciates—at least—20% in the first year, and about 10% per year for the next 4 years. The car you drive to work every day will eventually be worth zero = nothing, zilch, naught.

I want to make 3 points for you to remember:

- (1) Your goal is to spend as little as possible on your car, to minimize your losses.

Say you lease a new car for the standard period of 3 years. A security deposit may or may not be required. To entice you (would a dealer really do that?), the lease payment is often less than the comparable payment on a 5- or 6-year note. Depending on the state, you pay some or even all of the sales tax. Directly or indirectly, you pay the Personal Property Tax. You also pay the insurance and maintenance expenses. Since you are essentially borrowing the money to buy the vehicle, there is also a finance charge, called the fee factor. And, of course, don't forget that the dealer must make a profit.

The residual value of the vehicle at the end of the lease is defined when you sign the contract. It is rarely negotiable. As a rule of thumb, it is about 50% of the initial value of the car. At this time, you have the option to buy the vehicle at that price or walk away. If you walk, (1) you have no wheels, (2) there are "disposition fees" for the dealer to take the car back into their inventory, and (3) you usually just lease another vehicle. If you drive more than so many miles, usually about 15,000 per year, you are charged an average of 30 to 45 cents per mile, and if you abused the vehicle or did not adequately maintain it, there can be penalties.

By repeatedly leasing, you constantly expose yourself to the time of the greatest depreciation. Ex: If you lease a \$30,000 car that is worth \$15,000 after 3 years, and do this 3 times, at the end of 9 years, (1) you have paid some or all of the sales tax on 3 vehicles, (2) you have paid the dealer a

profit each time, (3) you have paid continuous finance charges, compound interest in reverse, working against you, and (4) you have nothing to show for it. Considered from another perspective, you have squandered the equivalent of the down-payment on a starter home. To make a medical analogy, you are repeatedly exposing yourself to the first-dose phenomenon of a drug.

If you lease a car so you can drive a bigger, flashier, hotter set of wheels than you can otherwise afford, you can stop reading now and save yourself the time. Not to disappoint you, but the people you hope to impress are more impressed by how careful you are with your money, and your charitable donations, than the car you drive.

- (2) The car you can "afford" is the car you can buy with cash. If all you can swing is a \$7,000, 6-year-old clunker, then that's the car for you. The greatest value can be a quality, low-mileage, 2 to 4-year-old vehicle, because you avoid the period of rapid depreciation.<sup>1</sup>
- (3) Please don't lease a car. It's just one more contrivance of post-WW II life in America that allows (encourages) people to live beyond their means.

Voltaire called the lottery "a tax on stupidity." I wonder what he would think of leasing a car.

## Disclosures

The authors have no conflicts of interest to disclose.

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