What should I know about the differences between leasing and buying a vehicle?

A lease is an agreement to use a vehicle for an agreed number of months and miles. You may lease a new or used vehicle.

You do not own a leased vehicle and you are required to return the vehicle after the lease ends unless you exercise a purchase option.

Below are some of the factors in buying and leasing to help you compare your choices.

Leasing a vehicle:

- Monthly payments may be lower than buying but the payments are going towards the depreciation of the vehicle during the lease term plus rent charges (like interest on a loan) and other fees.
- You may be responsible for early termination charges if you end the lease early. These fees can be very expensive. You will not be able to simply return the vehicle and stop making payments.
- At the end of your lease term, you can either turn the vehicle in and pay any end-of-lease fees or purchase the vehicle if your lease includes a purchase option.
- For most leases, the company or person leasing the vehicle to you assumes the risk of depreciation.
- Most leases include mileage restrictions of 10,000-15,000 miles per year. At the end of the lease, most leases also include fees for excessive mileage and wear and tear. The amount of excessive wear and tear is usually determined by the lessor.
- A typical lease is 2-4 years.

Buying a vehicle:

- Monthly payments may be higher than leasing, but part of each payment is going towards the purchase price of the vehicle.

- You might sell or trade-in the vehicle when you want to purchase a new one.
- You assume the risk of depreciation to your vehicle regarding what it will be worth when you decide to sell or trade it in.
- You can drive as many miles as you want. High mileage and excessive wear and tear will affect the vehicle's resale value.
- A typical auto loan term is 4 to 6 years.
- You own the vehicle and get to keep it at the end of the financing term.

If you decide to lease, you can and should negotiate the lease terms. You can compare different lease offers with the goal of negotiating terms such as the:

- Cost of the vehicle.
- Amount of any down payment or trade-in.
- Rent charge.
- Mileage limit, and
- Purchase option.

Just as an auto loan is complicated, so is an auto lease. With a standard lease most of the monthly payment is the amount the vehicle will depreciate over the lease term plus a rent charge. The steps involved in calculating the monthly lease payment are generally as follows:

You and the leasing company decide on the cost of the vehicle minus any trade-in, down payment, or rebate. *For example, $20,000.*

1. You decide on the lease term, typically 2-4 years. *For example, 3 years/36 months.*
2. The leasing company will determine what the vehicle will be worth at the end of the lease, known as the "residual value." *For example, $8,000 is the residual value.*
3. The amount of depreciation is calculated by subtracting the residual value. *For example, $20,000-$8,000=$12,000 of depreciation.*
4. The monthly payment will be calculated by adding the estimated amount of depreciation during your term plus the rent charge, taxes, and fees, and dividing that amount by the number of months in the lease term. *For example, $12,000 divided by 36 months equals $333.*

Note: If your lease includes a purchase option, you will want to consider how accurate the residual value estimate is because that residual value amount is often the purchase option price.

Tip: Some dealerships, known as "lease here pay here" dealerships, lease older used vehicles. These dealerships lease to consumers with poor or no credit that often need quick access to a vehicle. Common features of a lease may be weekly or bi-weekly payments, high rent charges, and no repair or maintenance coverage. If the vehicle breaks down, you may be responsible for repairs. Before leasing any vehicle, determine if you will be able to afford the payments into the future and if this is the right deal for you. You should also ask if the vehicle will be equipped with a starter interrupt device that will shut down the ignition if you miss a lease payment.

Plan to shop for your auto loan

Planning to shop for your loan can save money, time, and stress. Making decisions early gives you time to think about your alternatives, and helps you make the right choices.

Decisions to make at this step

- How much can I afford?
- How much can I pay as a down payment?
- Do I want or need a co-signer?
- How much is my trade-in worth?

Actions to take

Budget wisely

If you have a budget, you have a better chance of ending up with a loan you can afford and are able to pay on time. A budget also helps you think about ongoing costs such as vehicle maintenance and insurance. You want to be sure that there is room in your budget for both the loan and the other costs of ownership, such as:

- Additional costs at the time of purchase (taxes, title fees, and dealer fees)
- Ongoing costs throughout the time you own the vehicle (insurance, gas, annual registration fees, maintenance, and repairs).

TIP: Use the budget worksheet and information on making a budget to help you think through how much you can afford to borrow.

If you are having trouble coming up with a budget that works for you, think about ways that you can reduce the cost of your auto loan, such as:

- Saving for a larger down payment
- Buying a less expensive vehicle
- Getting fewer add-ons, features, or options
- Follow our guidance on how to check and improve your credit score

Check your credit report before you apply

The information in your credit report determines your credit scores. Your credit score(s) plays a large part in determining what kind of auto loan you can get, and how much interest you will pay for the loan. You can get a free copy of your credit report annually from each of the three nationwide credit reporting agencies at www.annualcreditreport.com. Check your credit report for errors and dispute any errors that you may find.

TIP: When you apply for a loan and the lender checks your credit, a credit score(s) is created for the lender. Depending on the credit scoring model used, generally any inquiries that took place within a short period of time, usually within a time span ranging from 14 to 45 days, will only count as one inquiry. So it's a good idea to do your loan comparison shopping within that short time span to minimize any impact on your credit score(s).

Decide if you want or need a co-signer

A co-signer is a person – such as a parent, family member, or friend – who is contractually obligated to pay back the loan just as you are. If your credit history is limited or needs improvement, and you have a low credit score (or no credit score), a co-signer with good or excellent credit could significantly lower your interest rate. That is because the lender will rely on the co-signer's credit history and score in deciding to make the loan.

If you are considering having a co-signer, you and the potential co-signer should think carefully about this decision. If you do not repay your loan, you and your co-signer will be responsible for repayment. The co-signer is responsible for the loan even though he or she has no right to possession of the vehicle. In addition, any late payments made on the loan would affect both your credit record and score(s) and your co-signer's credit record and score(s). Federal law generally prohibits a lender from requiring you to have a co-signer if you apply for a loan individually and you qualify under the lender's standards for creditworthiness for the loan.

Think about optional add-ons ahead of time

It's a good idea to think about add-ons ahead of time, so that you are prepared and know what you want on the day you finance your vehicle. These products and services are optional and negotiable. If you buy them, it can increase the total cost of your loan. Shopping around for any add-ons that you decide you want can save you money.

Some common add-ons are:

- Service contracts or extended warranties: These optional agreements provide protection for repair costs on certain mechanical and electrical components of the vehicle.
- Guaranteed Auto Protection (GAP) Insurance: In case of loss or destruction of the vehicle, optional GAP insurance can pay the difference between the value of the vehicle and the amount you owe on your loan.
- Credit Insurance: This is optional insurance that makes your auto loan payments in certain situations, such as death or injury, or loss of employment or property.
- Optional physical features for the vehicle, such as alarm systems, window tinting, tire and wheel protection, and other products.

Your own auto insurance company may offer GAP insurance, credit insurance, or similar products. If you want one or more of these products, check and see if you can get a better price. Lowering the amount, you need to borrow results in you paying less in interest over the life of your loan.

TIP: If you finance add-ons as part of your loan, the amount you borrow and pay will increase.

If trading in a vehicle, research its approximate value

Learn to explore loan choices

As soon as you know your budget, shop around. Banks, credit unions, and other lenders are common places to get pre-approved. Comparing offers will help you get the loan that's right for you.

Decisions to make at this step

- Where do I want to look for preapprovals or financing?
- How long do I want to be paying this auto loan?
- Should I make a down payment to reduce the loan's cost?
- Which lender can get me the best deal?

Actions to take

Learn more about sources of auto financing

While some consumers can pay cash for their new vehicle, most buyers use financing. Understanding your choices and the loan process will help you save money.

Banks, credit unions, and nonbank auto finance companies

You can get preapproved for your auto loan before selecting a vehicle. Check out banks, credit unions, and other lenders. You usually don't have to have an account with the bank or other lender to get a preapproval. Generally, you do need to be or become a member of a credit union to apply for an auto loan.

The preapproval will give you a loan quote with an interest rate, loan length, and maximum loan amount based on factors such as your creditworthiness, the terms of the loan, and the type of vehicle you have in mind. The rate you are offered may be negotiable. This quote allows you to compare different lenders' offers against each other, giving you a stronger hand in negotiations.

Lenders and dealers are not required to offer the best interest rates available. You may be able to save a lot of money over the life of the loan by negotiating the interest rate.

Dealer-arranged financing

With dealer-arranged financing, you obtain financing from a lender through a dealership. The dealer collects information from you and forwards that information to one or more prospective auto lenders. If the lender(s) agrees to finance your loan, they may authorize or quote a rate to the dealer, referred to as the "buy rate." The interest rate that you negotiate with the dealer may be higher than the "buy rate" because it may include an amount that compensates the dealer for handling the financing.

Dealers may have discretion to charge you more than the buy rate they receive from a lender, so you may be able to negotiate the interest rate the dealer quotes to you. Ask or negotiate for a loan with better terms. After the auto purchase is finalized, a dealer-arranged loan may then be sold to a lender who has already indicated a willingness to extend the credit. That lender may own your loan and collect the monthly payments or transfer those responsibilities and rights to other companies.

TIP: Because you have preapproved loan offers in your pocket, you can choose whether to stick with one of them or ask the dealer to match or beat your best preapproval. Choose the option that best fits your budget.

Buy Here Pay Here dealership financing

Some types of dealerships finance auto loans "in-house" to borrowers with no credit or poor credit. At Buy Here Pay Here dealerships, you might see signs with messages like "No Credit, No Problem!" The interest rate on these loans can be higher. You may want to consider if the cost of the loan outweighs the benefit of buying the vehicle. Even if you have poor or no credit, it may be worth seeing if there is a bank, credit union, other lender, or another dealer that is willing to make a loan to you.

Check current auto loan interest rates.

Start by researching rates and loan terms by contacting several banks, credit unions, or other lenders. You can also look online at many commercial sites that may give you an estimate of interest rates nationwide and by your ZIP code. Some commercial sites will link you to specific lenders and dealers for estimates, so you should be careful about entering your personal information.

Get preapproved for a loan.

Shopping ahead of time will get you ready for negotiating your auto loan and make the process less stressful. Getting preapproved by multiple lenders can mean that they may compete for your business. This puts you in a stronger negotiating position for whichever lender you choose. This can help you lower your total cost.

When you're heading over to a bank, credit union, or dealership make sure to gather all the information you'll need. Lenders will generally ask for this information in a loan application:

- Name
- Social Security Number or Individual Taxpayer Identification Number
- Date of birth
- Current and previous address(es) and length of stay
- Current and previous employer(s) and length of employment
- Occupation
- Sources of income
- Total gross monthly income
- Financial information on current credit accounts, including debts

In addition to giving, you more options and power in negotiations, a preapproval helps you stay within your budget and save time. Preapprovals allow you to compare interest rates without the time pressure you may feel once you are at the dealership. Then, at the dealership you can focus more attention on items like your trade-in or auto choice. Because you have preapproved loan offers in your pocket, you get to choose whether to stick with one of them or negotiate with the dealer for the best financing option.

Understand how loan shopping impacts your credit score(s)

Shopping for the best deal on an auto loan will generally have little to no impact on your credit score(s). The benefit of shopping will far outweigh any impact on your credit. In some cases, applying for multiple loans over a long period of time can lower your credit score. You can minimize any negative impact on your credit score by doing all your rate shopping in a short amount of time.

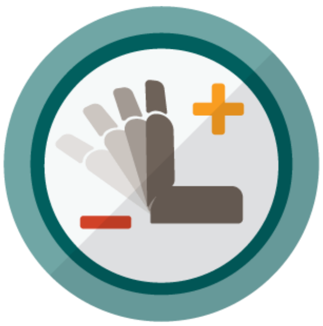
TIP: When you apply for a loan and the lender checks your credit, a credit score is created for the lender. Depending on the credit scoring model used, generally any credit inquiries that took place within a 14 to 45-day time span will only count as one inquiry. So, it's a good idea to do your loan comparison shopping within a short time to minimize any negative impact on your credit score.

Know your rights

A lender cannot discourage or deny your application for credit or offer different prices or other terms and conditions of the loan, based on your race, color, religion, national origin, sex, marital status, age, receipt of public assistance income, or good faith exercise of any right under the Consumer Credit Protection Act. You can submit a complaint with the CFPB online or by calling toll-free at 1-855-411-CFPB (2372) or with the Federal Trade Commission (FTC). You can also tell us about your experience without submitting a formal complaint.

Know what is negotiable

Did you know that you can negotiate the terms of your auto loan? Negotiating can save you hundreds or even thousands of dollars over the life of your loan.



Decisions to make at this step

- Can I get a better loan from a different lender?
- How long do I want this loan to last?
- Is what I'm being offered consistent with my research?
- Does this deal work for my budget?

Actions to take

Learn more about sources of auto financing

While some consumers can pay cash for their new vehicle, most buyers use financing. Understanding your choices and the loan process will help you save money.

Know what is negotiable

In addition to the price of the vehicle, there are the terms and costs of the auto loan that you may be able to negotiate or control. These items, taken together, will influence the amount of your monthly payment and the total loan cost. Later we'll give you tips on how to focus your negotiation to lower your total cost.

Negotiable loan terms and features

- Annual Percentage Rate (APR) and interest rate
- Length of loan
- Whether or not there will be a prepayment penalty
- Any additional fees associated with the loan

Optional "add-ons" that increase the amount you'll borrow

- Optional products for the loan or vehicle such as extended warranties, GAP insurance, and credit insurance.
- Optional physical features for the vehicle, such as alarm systems, window tinting, and tire and wheel protection.

Other things that affect the amount you'll borrow

- Trade-in amount (if you trade-in your vehicle)
- Amount of the down payment
- Fees charged by the dealer such as dealer preparation fees, origination fees, document fees, and delivery charges.

You cannot negotiate taxes or title and registration fees. These are set by your local or state government.

TIP: Your total loan cost starts with the amount financed. The amount financed is the amount of money you are borrowing. It includes the price of the vehicle, taxes, and other government fees, as well as any add-ons like extended warranties and optional credit insurance, minus your down payment and trade-in amount. The amount financed does not include the cost to borrow the money. That cost is known as the finance charge and includes interest and certain fees over the life of the loan. Your total loan cost is the amount financed plus the finance charge. By negotiating for better terms on your loan, you can reduce the total amount of money you pay over the life of the loan.

Negotiate to lower the total cost, not just the monthly payment

Many people think about a loan in terms of the monthly payment. Be careful here. If you reduce the monthly payment by taking out a longer loan, you may pay much more in interest. The total cost of the vehicle financing matters. By negotiating for better terms on your loan, you can reduce the total amount of money you pay overtime. For example:

- Getting a lower interest rate and APR means you will pay less to borrow money. The total cost of your loan will be lower.
- A shorter loan term (in which you make monthly payments for fewer months) will reduce your total loan cost. A longer loan can reduce your monthly payment, but you pay more interest over the life of the loan.
- A higher down payment, or a higher price for your trade-in, will reduce the total amount financed because you will have to borrow less money.
- Optional “add-on” products like extended warranties, GAP insurance, or credit insurance that are added into your loan amount will increase your total cost because you will be borrowing more money.

Some financial advisers recommend keeping the length of your auto loan to five years or less, reasoning that the longer the loan, the longer you will owe more than the vehicle is worth, which is called negative equity.

Keep track of multiple factors while negotiating

When negotiating for your loan, make sure you keep track of all the factors that affect the total cost. If you are negotiating the interest rate, make sure that you also know the length of the loan and other terms. Comparing total loan cost will help you keep an eye on these multiple factors.

Ask the dealer or lender to tell you the price, trade-in value (if applicable), interest rate, term of the loan, and estimated monthly payments, and write these numbers down on the auto loan worksheet. It’s best to get these numbers early in the process, so you can better compare and negotiate.

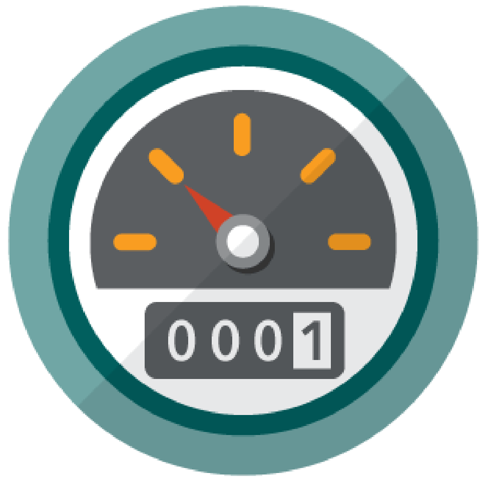
Just as the first price you are offered for the vehicle may not be the lowest price available to you, the first rate for a loan the lender or dealer offers you may not be the lowest rate you qualify for. If the lender or dealer agrees to a better loan feature (such as a lower APR or interest rate), check to make sure other factors, like the length of the loan or the amount financed, haven’t changed. A lower monthly payment doesn’t necessarily mean a lower interest rate; it might just mean that you are paying for a longer time.

TIP: In general, dealers and lenders are not required to offer the best rates available. When negotiating, ask if you can get a better rate or more favorable terms.

Understand how to close the deal

By now you've negotiated for your auto and chosen a loan and lender. But there's still a lot of paperwork to go over and sign. Before you drive off, make sure everything matches what you agreed to when negotiating.

Decisions to make at this step



- Does this loan work for my budget?
- Does this match what I agreed to?
- Am I comfortable with this deal?
- Did the lender sign all the paperwork?

Actions to take

Verify that you get what you agreed to

Once you have finalized the negotiations, review all the paperwork before signing the loan documents. The federal Truth in Lending Act (TILA) requires lenders to give you specific disclosures in writing about important terms before you are legally obligated under the loan. One purpose of TILA is to help consumers make apples-to-apples comparisons between loans. The important terms include:

- Annual Percentage Rate: the APR is the cost of credit expressed as a yearly rate in a percentage.
- Finance Charge: cost of credit expressed as a dollar amount (this is the total amount of interest and certain fees you will pay over the life of the loan if you make every payment when due).
- Amount Financed: the dollar amount of credit provided to you (this is normally the amount you are borrowing).
- Total of Payments: the sum of all the payments that you will have made at the end of the loan (this includes repayment of the principal amount of the loan plus all the finance charges).

The TILA disclosure will also include other important terms such as the number of payments, the monthly payment, late fees, whether the loan has a fixed or variable rate, and whether you can prepay your loan without a penalty.

Take the time to review the details of your auto loan and look over the paperwork. If there are things you don't understand, ask questions. You are signing a contract, and this is a major purchase, it is important that you understand what you are signing.

ANNUAL PERCENTAGE RATE The cost of your credit as a yearly rate	FINANCE CHARGE The dollar amount the credit will cost you	Amount Financed The amount of credit provided to you or on your behalf	Total of Payments The amount you will have paid after you have made all payments as scheduled	Total Sale Price The total cost of your purchase on credit, including your downpayment of
%	$	$	$	$

Finish the paperwork before you drive away

Before you drive off with your new vehicle, make sure that:

- You have a copy of all documents
- Both you and the dealer have signed
- All blanks are filled in

Some dealers will allow the customer to take possession of the new vehicle before the loan is approved by the lender. This practice, called "spot delivery," could put the deal that you thought you had at risk. Make sure that the financing is nailed down before you sign the contract and drive away with the vehicle.

If you don't have the financing nailed down, the dealer may ask you to come back in and agree to a higher interest rate, add a co-signer, or make some other change different from what you thought was agreed. You don't have to agree to a second deal. If this happens and you don't want to agree to a second deal, you will have to return the vehicle and the dealer will have to unwind the deal and give you back your trade-in and down payment. In some cases, you may want to seek legal assistance and file a complaint with your state attorney general or consumer protection office.

TIP: Walk away if you are not comfortable with any aspects of the loan or the process; you can always leave without completing the deal. Take time to think it over and come back another time. No one can make you accept financing or a vehicle that you are not satisfied with.

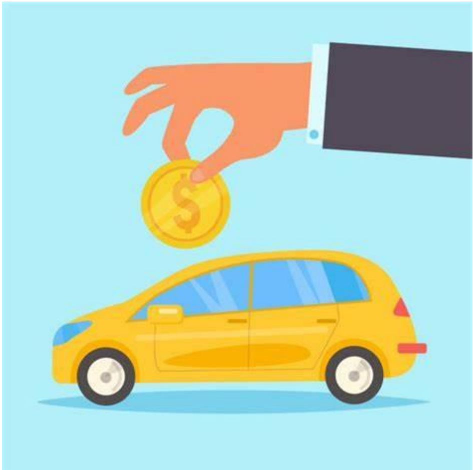
Pay attention to the details after you drive away

After you take out a loan, you should receive an introductory message from the lender that provided the financing. This communication will include important information related to your loan such as where to send your payments and payment due dates. Make sure to make your monthly payments on time to avoid the cost of late fees and the possible repossession of your vehicle, as well as negative entries on your credit report.

Due to the unique challenges of military life, special auto loan and lease protections were established and may be available to you if you are a servicemember currently on active duty. For more information, you can check out our page of information for servicemembers or read servicemember-specific auto financing questions and answers at Ask CFPB.

How should I decide how much I can afford to borrow for an auto loan?

Figuring out how much you can afford to borrow before you sign on the dotted line is a great way to stay in control of your finances. It can be very helpful to break the process down into several steps.



For example:

1. Assess your financial situation by creating a monthly budget.

- First, add up all your fixed expenses (these include rent/mortgage, utilities, phone, and other recurring monthly bills, amounts you set aside for each month for savings, child support payments, insurance premiums, and payments on any existing loans including outstanding credit card debt).
- Second, add up your estimated additional expenses – for food, gas, entertainment, emergencies, and unexpected expenses, and whatever else is not a set monthly expense.
- Third, if you didn't have a vehicle before, don't forget you'll also have to pay for insurance, maintenance, and registration. Shop around for auto insurance before you shop for a vehicle, to get a sense of how that will affect your budget. If you are going from a used vehicle to a new vehicle, your insurance rates may be higher.
- Fourth, if you will be trading in a vehicle but still owe money on it, be sure to find out how much you owe on that loan. If what you owe is more than the trade-in or private sale amount, you will need to account for how you will pay that amount. Your loan amount, monthly payment, and total interest cost will be higher if this old debt is rolled into the loan for your new vehicle.
- Now, subtract all expenses from your take-home pay and any other income you receive on a regular monthly basis.
- Your auto loan payment should be less than the amount you have left.

2. Review your credit.

One of the first things you should do before applying for an auto loan is review your credit report at all the largest consumer reporting agencies – Equifax, TransUnion, and Experian.

Review your credit report and dispute any errors that you find. A negative error on your credit report could affect the interest rate you get for an auto loan and cost you hundreds or thousands of dollars.

Any negative information on your credit report (such as late payments, delinquencies, court judgments and settlements, or bankruptcy filings) will influence your ability to obtain a loan or to obtain one at a low interest rate.

TIP: Most accurate negative information on your credit report must be removed after seven years and bankruptcy information after ten years. If you find a negative item on your report that should have been removed, you should dispute the error on your credit report.

3. Save for a down payment.

It's important to know how much of a down payment you can afford before you call around for loan quotes or go to a dealer. This will help you decide the size of the loan you can afford. Remember the more you put on a down payment, the less you will need to borrow.

4. Research loan options and consider getting prequalified or preapproved for a loan.

It's a good idea to shop around for a loan before heading to a dealer. You may want to consider getting prequalified or preapproved for an auto loan from a bank, credit union, or other lender before visiting an auto dealer.

Shopping for the best deal on an auto loan will generally have little to no impact on your credit score(s). The benefit of shopping will far outweigh any impact on your credit. In some cases, applying for multiple loans over a long period of time can lower your credit score(s). Depending on the credit scoring model used, generally any requests or inquiries by these lenders for your credit score(s) that took place within a time span ranging from 14 days to 45 days will only count as a single inquiry.

This means shopping around for an auto loan during that time span will count the same as applying for just one loan. You can minimize any negative impact on your credit score by doing all your rate shopping in a short amount of time.

When you are offered different loans, **compare all the loan terms**. You will look at:

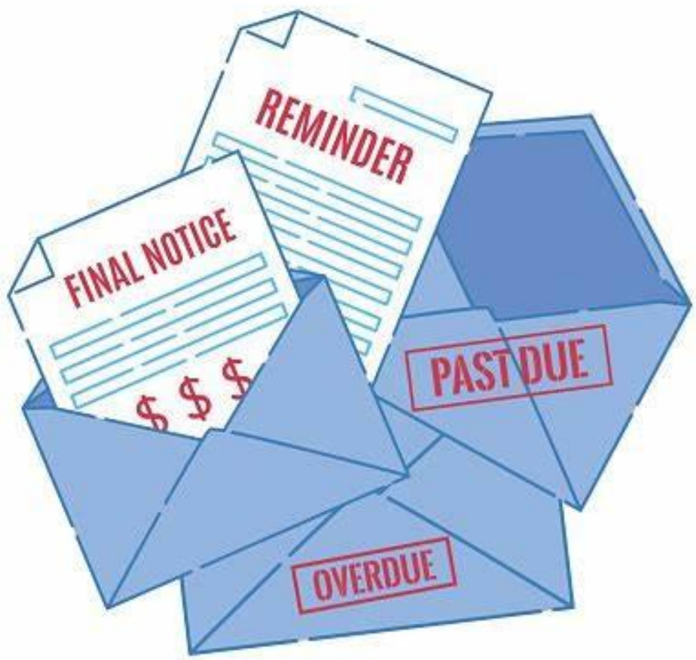
- The amount you will borrow.
- The interest rate and the Annual Percentage Rate (APR).
- The length or term of the loan (number of months).
- The monthly payment (and whether you'll be able to make that payment given your budget)

A higher interest rate or a longer loan term will result in additional interest costs for your loan.

Tip: Don't forget to read the fine print of any loan contract before you sign. Check to see if your loan has a "prepayment penalty," which means that you will have to pay a penalty if you pay off your loan before the end of the loan term. Even if you're not planning to pay off your loan before the end of the term, you may want to avoid loans that have a prepayment penalty in case your situation changes. Check the amount you are borrowing to be sure it is the amount you expected. Check that you are getting the amount of credit you agreed on for your trade-in.

What should I do if I have problems making my auto loan payments?

If you are having problems making payments, contact your lender or loan servicer and ask what options are available to you.



You can try to work out a payment plan. If you do, confirm any payment plan in writing. Also, be sure to ask about any negative impact that a workout plan might have on your credit report. If you are told there will not be any negative impact if you select one of the options you are offered, ask for confirmation in writing. If you have trouble making your auto loan payment, the sooner you contact the lender the better chance you have of working out an arrangement that gives you time to get back on track.