Leasing A Car

Background

Twenty-five percent of all new cars moved off dealers' lots are leased. The contract that defines this relationship between the consumers and the owner of these vehicles is complicated, subject to regulation, and often the site of misunderstanding and FRAUDULENT activity. Leasing cars allows people to drive cars they believe they could not afford to buy. It appears to give people access to a better class of cars, while another party remains in charge of the car's mechanical problems. For many people, leasing a car feels like renting an apartment; it's a way to live without the responsibilities of personal ownership. For some people perhaps leasing is a good idea; it is certainly a good idea for the owners of leased vehicles who profit generally at a rate of about three times the list price of their vehicles.

A car LEASE is a contract between the party who owns the car (LESSOR) and the one who will use the car (leasee). A contract signed between these parties governs the terms, those conditions under which the car may be used and the obligation of each party. Consumers sign their lease agreements with automobile dealers. Shortly thereafter, the dealers sell the leased vehicles to a leasing company. The leasing company may be, in fact, the car dealer, or it may be a finance company subsidiary to a car manufacturer, or an independent leasing company. This leasing entity now owns the vehicles and is thus the lessor. Besides profiting from the sale of the car, the dealer enjoys financial incentives from the leasing company and manufacturer rebates.

The leasee acquires no equity in the vehicle. During the lease period, in fact, the leasee pays the leasing company for the car's DEPRECIATION, that is the difference between the list price of the car new and the value it has once it has been driven for the leased period. For this reason, consumers are better off leasing vehicles that hold their value.

Federal Consumer Laws and Regulations

The Consumer Leasing Act (CLA) covers car leases of at least four months in duration in which the total amount of money a leasee owes does not exceed $25,000 for a vehicle limited to personal use. In 1998, regulations governing this act, referred to as Regulation M, were established by the Federal Reserve Board. Regulation M can be found in the **C**ODE OF**F**EDERAL **R**EGULATIONS (CFR), Title 12, Part 213.4. The

CFR is available in many law libraries and on the Internet. Leasing law specifies the disclosures which must be contained in the lease document. For example, dealers must reveal the monthly and total cost of the lease, additional fees, and potential mileage and early termination penalties. Enforcement of these disclosures is handled through the Federal Trade Commission.

Important Terms in Leasing Contracts and Negotiations

The lease contains terms which the consumer may not know but which are important to understand since they determine the nature of the contract the consumer is signing. The following are the important terms to know.

- Amortized Amounts: These consist of fees a lessor is required to collect, such as taxes and registration fees These expenses are paid off gradually as a part of each monthly payment. Expenses for insurance and maintenance, when provided by the dealer, are also amortized.
- Base Monthly Payment: This depreciation amount is the value the vehicle is calculated to lose each month, plus the amortized amounts and the interest leasees pay in financing charges over the lease term, divided by the number of months the vehicle is leased.
- Capitalized Cost: This is the total price of the car as agreed to by the lessor and the leasee over the life of the lease term, plus the registration fees, title fees, and taxes.
- Capitalized NET Cost: This is the amount the leasee will have paid for the car after all payments have been made. This is the same figure as the adjusted capitalized cost as it takes into account any DOWN PAYMENT made.
- Depreciation plus Amortized Amounts: The difference between the value of the car at the beginning of the lease and at the end of the lease is the car's depreciation. If the leasee does not exercise the option to purchase the vehicle, the lessor will charge the leasee a fee averaging between $250 and $400 to cover the expenses the lessor incurs in preparing the car for sale.
- Open-End Lease: When this lease is terminated, the leasee is liable for the difference between a lesser FAIR MARKET VALUE and a comparable residual value given to the value in the lease. The residual value will be considered unreasonable if it exceeds the fair MARKET VALUE by more than triple that amount.
- Close-End Lease: When this lease is terminated, the leasee is not responsible for paying the difference between the residual value given to the vehicle in the lease and a lesser fair market value.
- Lease Rate: This figure is that percentage of the monthly payment which is rental charge. Some dealers will disclose to a lessor what this amount is. As of 2002, no federal standard governs how this amount is calculated, and dealers are not required to disclose how they arrive at the amount. However, if a lease rate is used in an advertisement, there must also be a disclaimer that the lease rate may not be an accurate reflection of the total cost leasee will pay for their leases. This figure is frequently used to deceive customers into believing they are paying less interest in financing the lease than they actually are.
- Money Factor: This is a decimal number used to determine the proportion of the monthly payment that consists of a rental charge. This figure is similar to an interest charge and is not required to be disclosed under federal law.
- Reasonable Standard: The Consumer Leasing Act stipulates that penalties for early termination and late payments or ceasing to make payments must be reasonable according to the amount of harm actually experienced or anticipated by the lessor.

Disclosures Required Under CLA and Regulation M

When dealers and consumers discuss a potential lease, dealers are required by law to disclose certain factors. Disclosures include a description of the vehicle, the amount due at signing or delivery, the payment schedule, and other charges payable by the leasee. These charges need to be itemized. Dealers need to disclose the total dollar amount of the payments. Also the dealer needs to reveal the leasee's responsibility for compensating the owner for the car's depreciation. The payment calculation must disclose the following figures and explain how they were determined: gross capitalized cost, capitalized cost reduction, adjusted capitalized cost.

In addition, dealers need to explain the rules governing termination and the formula used in calculating the penalties. Leasees need to be warned that early termination may result in a PENALTY of several thousand dollars, the earlier the termination, the larger the penalty. Excessive wear and tear needs to be defined, along with all other possible additional fees. Liability, the right of the leasee to get an independent APPRAISAL of damage and the vehicle's end value need to be explained. Responsibility for insuring the vehicle and for maintaining it need to be explained. Purchase options need to be spelled out as well.

Consumers need to know Regulation M does not cover all elements involved in the lease design. For example, it does not make clear that the leasee has the right to a written explanation of termination fees. Nor does Regulation M govern the fact that TAXATION can change over time. Tax rates may change and thus affect the costs leasees incur.

Additional Disclosures Required under Certain State Laws

At least 20 states have chosen to adopt their own disclosure laws on car leases in order to provide more protection to consumers. These states are: Arkansas, California, Colorado, Florida, Illinois, Hawaii, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Michigan, New Hampshire, New Jersey, New York, Oklahoma, Washington, West Virginia, and Wisconsin. Some laws are inconsistent with the CLA or Regulation M. Where these inconsistencies exist, state law is superseded by federal law. Moreover, some state laws give greater protection to the consumer. These laws require additional notices, warnings, disclosures regarding gap insurance and manufacturer warranties. Also, some newly enacted state laws have caused consumers confusion which is contrary to the intention of state reform.

California has enacted extensive reforms of leasing law. For example, the $25,000 maximum limit stipulated by the CLA and Regulation M does not apply to cars leased in California. Second, leasees are free to terminate at any time. Termination penalties are calculated according to a specified formula that sets a ceiling on the amount. Moreover, notice must be given at least ten days in advance by mail that a vehicle turned in by a leasee will be sold by the lessor. This disclosure allows those who terminated early to obtain an independent appraisal of the vehicle's worth. If the appraisal gives a value higher regarding the residual value, the leasee will owe less in termination fees.

Fraud and Overcharging

In the 1990s, numerous instances of FRAUD occurred in car leasing transactions. ABC's Prime Time reported on an undercover investigation which puts car dealers under surveillance with hidden cameras. Half of the ten dealers surveyed attempted to cheat the undercover investigators. These dealers used various means, such as secretly raising the purchase price or capitalized cost of the vehicle or by quoting low-ball interest rates. In Florida, a probe by the state attorney general uncovered illegal business practices in 23.000 leases which overcharged leasees on an average of $1,450. The terms of the leasing contract are complicated, and fast talking dealers can all too easily mislead unsuspecting customers.

Common Leasing Scams

There are a number of ways dealers can illegally increase the leasing fees they obtain for their vehicles. For example, they can use an undisclosed acquisition fee, concealed in the net capitalized cost of the car. This fee typically averages $450. Consumers should ask if the fee has been included in the cost of the vehicle and if it can be waived. Another way is for dealers to quote the money factor as an interest rate. Customers can be easily confused because both of these figures are quoted in decimal form. For example, a dealer may tell the customer that the interest rate is 2.6 percent. The use of a money factor of.00260 will be mistaken for the interest rate. When this money factor is used, the actual interest rate is 6.24 percent. If the customer is able to distinguish between these two figures and voices an objection, the dealer may say he said 6.2 instead of 2.6 percent.

Dealers may also "forget" to enter the value of the trade-in into the lease terms. Customers need to carefully examine the figures of the lease to make sure the value of their trade-in is listed. Then too dealers can secretly increase the cost of the vehicle. Customers need to insist the residual, money factor, applicable fees, taxes, and dealer incentives are fully disclosed. Then the customers can calculate the lease payment themselves. Moreover, termination penalty wording may be vague enough to allow some dealers to charge more than the leasee was expecting to pay. Finally, many customers may not know that so-called **L**EMON **L**AWS pertain to leased vehicles as well, and dealers may not offer that information.

Should People Lease or Purchase?

Leasing may be a good choice under certain circumstances. For example, if consumers use a vehicle in easy-wear situations only and for only the distance specified in the lease mileage terms. Also, it may pay to lease a car if the monthly payments for the lease are lower than those for a car loan to purchase that car. To calculate how to compare car loan payments with lease payments, follow these steps:

- Determine through negotiation the lowest possible price so that it is no more than $200 over the dealer invoice
- Add SALES TAX and other up front costs applicable to purchasing and to leasing
- Add the relevant figures in each case to arrive at the gross purchase price and the capitalized cost for the lease
- Subtract from each of these figures the trade-in value if applicable
- Subtract from each of these figures the amount of the down payment. Ideally, 20 percent of the figure calculated in the immediately preceding step should be put down for a purchase and nothing should be put down for a lease. This calculation gives the customer the net purchase price for buying and leasing
- Next add the respective FINANCE CHARGE for leasing and purchasing. For a lease this amount will be listed as a rent charge. This will give the total cost in purchasing and leasing
- Finally, divide each figure by the number of payments required

After the comparative costs have been determined, customers need to remember that if they buy their cars, they will have a vehicle to sell the next time they enter the car market as consumers.

Additional Resources

Buying and Leasing Cars on the Internet. Raisglid, Ron et. al. St. Martin's Press, 1998.

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Car Shopping Made Easy: Buying or Leasing, New or Used: How to Get the Car You Most Want at the Price You Want to Pay. Edgerton, Jerry, Warner Books, 2001.

Complete Idiot's Guide to Buying or Leasing a Car. Nerad, Jack, Macmillan Spectra, 1996.

Don't Get Taken Away Every Time: The Insider's Guide to Buying or Leasing Your New Car or Truck. Sutton, Remar, Penguin Books, 1997.

How to Buy or Lease a Car Without Getting Ripped Off. Lyle, Pique, Adams Media Corp., 1999.

Insider's Guide to Buying and Leasing. Wesley, John, Delmar-Thompson Learning, 2002.

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Leasing Lessons for Smart Shoppers. Eskeldson, Mark, Technews Pub., 1997.

Smart Wheels, Hot Deals: A Layperson's Guide to Buying, Leasing, and Insuring the Best Car for the Least Money. Silver Lake Publishing, 2001.

The Unofficial Guide to Buying or Leasing a Car. Howell, Donna, Macmillan 1998.

Organizations

American Council on Consumer Interests

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URL: http://www.consumerinterests.org
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Association of Consumer Vehicle Lessors

URL: http://www.acvl.com

Auto Leasing Hot Line Service

Phone: (800) 418-8450

Automotive Consumer Action Program

8400 Westpack Dr.
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