



Snapshots™

STARTING OUT: TRANSPORTATION

MANY YOUNG PEOPLE COMING OUT OF A FEW YEARS OF COLLEGE OR UNIVERSITY AND BEGINNING A NEW CAREER WILL BE EXCITED ABOUT THE PROSPECT OF A STEADY PAYCHECK AFTER LIVING ON WHAT HAS PROBABLY BEEN A TIGHT BUDGET.

One of the things you may be looking forward to buying is a car. Owning your own car can provide a great deal of freedom and personal satisfaction. However, even a modest vehicle takes a significant amount of money to buy and operate. It is important to step back and consider two related factors: is the car really necessary? and, is it affordable?

Alternatives to Car Ownership

While it is nice to own a car, depending on where you live and your business and personal situation, it may not really be necessary because of alternate sources of transportation. For those living and working in an urban environment, public transit, biking or even walking may be very viable alternatives. Given the nature of urban traffic, particularly in rush hours, taking public transit may actually be faster than driving your own vehicle.

Even if you live in a suburban area, making the commute into a city is often possible by public transit. The question you need to ask yourself, though, is whether the convenience of owning a car and using it to drive into the city—or even just to your commuter station—is worth the additional expense of car ownership and its related costs. Public transit has a cost, too, of course, which should be factored into your budget, but in most cases the cost of parking a vehicle in an urban area—not to mention fuel—will be much higher.

If you live and/or work in rural or outlying areas, or are unable to access a transit system, driving will probably be the only alternative and a car will be a necessity. Even in these situations, though, you can reduce costs by using strategies such as carpooling.

How Much Does a Car Cost?

Before considering the own/lease debate, we should look at the ongoing costs of vehicle ownership, which can be surprisingly high, regardless of the type of vehicle. When considering buying a car, it is very important that you incorporate reasonable estimates of these costs into your monthly budget to determine if you can afford it. Here are some of the main costs to consider:

- Lease or loan maintenance payments
- Insurance (this will be a reflection of your age, sex and driving record, and premiums can differ dramatically—a licensed broker should be approached)
- Gas
- Parking (rates can be very high in downtown areas)
- Maintenance (regular check-ups are recommended)
- Unforeseen expenses (auto repairs can be expensive, but they do happen and you should make an allowance for them)

Leasing or Owning an Automobile?

This is a debate that has been going on for many years and there really is no 'correct' answer. It depends on your particular situation, circumstances, and needs—as well as the details of a potential lease agreement. First, we should consider the nature of each arrangement:

Buying a Car

Since most of us do not have the financial means to buy a car outright, it is likely you will have to borrow money for a purchase. You can arrange a loan through a bank or through the vehicle dealer or manufacturer. During the term of the loan, the lender keeps ownership of the vehicle since it represents the collateral on their loan. Because cars are depreciating assets (their value decreases every year), there will always be a down payment required and you should expect to be able to put about 20% down. You will have to pay the loan off over the next 36 to 48 months, which will entail monthly payments of interest and principal. When the loan is paid off, you will own the vehicle and can then decide to keep it or sell it.

Leasing a Car

A lease is essentially a long-term rental contract. For certain up-front fees and monthly payments over two or three years, you are entitled to the use of a vehicle. During the lease term, you are responsible for all the usual costs of operation—the same as with a purchase. However, at the end of the lease term, the vehicle is returned to the leasing company. On a monthly financing level, leases will be less expensive than a purchase since the leasing company eventually gets the vehicle back with value, which they can then sell.

Leasing a car can initially appear to be more attractive than buying due to the lower monthly cost. Consider the following simplified example:

Vehicle cost = \$20,000

Term of financing = three years (36 months)

Interest rate = 6% per annum compounded and paid monthly

Down payment on purchase = \$4,000

Expected value of the car in three years = \$10,000

In this situation, the prospective buyer could get a loan to buy the vehicle, paying a monthly fee of \$475. The monthly lease cost, meanwhile, is approximately \$300. It might seem like a dramatic difference but mathematically, if the assumptions hold, the prospective buyer ends up in a roughly similar financial situation at the end of the three-year period. That's because if he was to take out a loan and pay \$175 more per month over three years, he would own an asset worth \$10,000 at the end of the term. If he chooses to take the lease, while his monthly payments are lower, at the end of the term, ownership of the vehicle remains with the leasing company.

In actual practice, the various features attached to leases and loans can make the decision seem quite complicated and there may be situations where one option is somewhat better than the other. As the example illustrates, though, the actual overall cost of the purchase or lease should not differ dramatically.

A very important aspect of the buy/lease decision is your own personal preferences and temperament. Some people don't want any kind of debt. Some might be willing to deal with higher debt payments provided they own the car once the debt is paid off. Others may not mind never actually owning the vehicle and are comfortable with making monthly payments for the foreseeable future. As a general rule of thumb, people who like to drive a new car on an ongoing basis will prefer a lease, whereas those who plan to keep their vehicle for more than six or seven years should probably purchase.

The following [Buy or Lease Calculator](#) can help decide how to pay for your automobile.

Watch this [video](#) from the Investor Education Fund for tips on how to save money when buying a car.

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