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The big push in leasing

You'll find lease deals everywhere you look, but you'll have to hunt for more than a low monthly payment.

Lease a 2005 Subaru Outback wagon for 48 months with no money down and pay just $278 a month! Lease a 2004 Chrysler Pacifica with $2,500 down over 39 months and pay only $258 a month!

You'll be seeing more offers like these as manufacturers and car dealers look for lures other than 0 percent financing to get you into a car. And the deals do look tempting. After all, if you bought the same Subaru or Chrysler, financing them over the same time period, your monthly payment could be twice as high. Shouldn't you jump at the chance to lease?

The answer is yes, if you don't mind paying plenty for a car you'll have to return or buy at the end of the lease. The ads don't always show you the true total cost of leasing, which typically includes fees at the front end, fees at the back end, and higher finance charges along the way. Worse, if a year into the deal you decide that leasing is not for you, you can't walk away without paying substantial costs.

"The cheaper way to drive a new car is to buy with a loan and keep it as long as the wheels stay on," says Albert Hearn of Leaseguide.com, a Web site that provides free leasing information. Not everybody wants to do that, however. If you decide to lease your next car, you should understand how leasing works, how much you'll pay, and what pitfalls you could encounter.

FEES COMING AND GOING

Many people who lease have wound up with lousy deals because they focus on the monthly payment without understanding how much the car itself costs. Indeed, many leases are based on the manufacturer's suggested retail price (MSRP) instead of a lower price the buyer negotiates. Also piled on top of the MSRP are extra charges for insurance coverage, extended warranties, delivery fees, and other items consumers will have to finance. Over the past decade, the Florida attorney general's office found that at times dealers failed to give lessees credit for trade-ins, down payments, rebates, and dealer coupons.

So here's the deal. When you lease a car, you are not paying for its full value, only its projected loss in value—its depreciation—while it's in your use, typically 24 to 48 months. Over three years, a $30,000 car might lose half its value. The remaining half is the residual value. Paying back only half a car's value, of course, will leave you with a smaller monthly payment.

But there are offsets. First is the mileage restriction. Most leases limit your use to 10,000 to 15,000 miles per year. (Passenger cars average 12,200 miles a year.) Then there is a raft of fees. One biggie: the "lease acquisition fee," usually about $600, levied by the automaker or finance company underwriting the lease. It isn't always broken out on the contract, and dealers may quietly jack up the fee and pocket the difference. You may also have to pay a security deposit, which typically equals one month's lease payment. It's refunded unless you default.

When you turn in the car at the end of the lease, you will encounter another set of fees: the "lease disposal fee," which runs about $395; and 15 to 30 cents per mile for exceeding the mileage limit in the lease agreement. (Drive fewer miles, and you've wasted your money for depreciation you didn't use.) Finally, there are charges for "excess wear and tear," which cover all but the smallest mechanical or cosmetic fixes.

THE MONEY FACTOR

Another significant cost is the lease finance charge. You might not think you'd pay a finance charge on a car you're just borrowing, but consider this: When you drive away in a $30,000 car, you're tying up someone's investment, just as if you took out a loan. So although you're not buying the car outright, you'll still be paying monthly finance charges.

Complicating the matter is the fact that the finance charge is not usually expressed

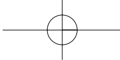
Lease vs. loan

Here's how leasing and buying a $30,000 vehicle might work out. The example assumes you'll put nothing down and pay a 6 percent sales tax. Numbers are rounded.

	Lease payments		Loan payments	
	Monthly	**Over 36 months**	**Monthly**	**Over 36 months**
Financed amount [1]	$433	$15,595	$883	$31,800
Finance charges: 5.7% [2]	108	3,898	80	2,872
Sales tax of 6%	33	1,170 [3]	Included	Included
Subtotal	**574**	**20,663**	**963**	**34,672**
Vehicle value the consumer retains after 36 months		0		15,000
Lease disposal fee	0	395		
Net investment earnings at 1.38% average statement savings rate 8-23-04 (15% income tax)		244		0
TOTAL COST		**$20,814**		**$19,672**

[1] Lease financed amount includes $595 lease acquisition fee. [2] Average interest paid monthly. [3] Sales tax would be hundreds more in states that apply tax to the total cost of the vehicle and not just the lease payment.

ILLUSTRATION BY BOB ECKSTEIN



as an interest rate but as a "money factor." To determine the equivalent interest rate, multiply by 2,400. The finance charges for lessees are generally higher than for buyers. Worse, dealers sometimes simply mark up the money factor.

The finance charges on a $30,000 leased car over a three-year period might be around $3,898, or about $1,027 higher than with a three-year loan, even if the annual interest rate for both was 5.7 percent. The extra lease costs would be partially offset by lower sales taxes. (Most states charge sales tax on lease payments instead of on the entire value of the automobile, as they do on a loan.)

OTHER ROADS TO A LOWER PAYMENT

So a lease isn't the cheapest way to go. But what are you to do if you can't afford loan payments for that shiny new ride?

One option is a car loan with a longer term. As a general rule, loans are less costly than leases of the same duration and interest rate. And a long-term loan, say over 60 months, is likely to cost much less than leasing twice over the same period, assuming you'll keep the vehicle for the entire length of the loan. If your plan, however, is to sell or trade in the vehicle early on a long-term loan, you could pay more than if you'd simply leased to start with.

You might also consider purchasing a reliable, well-maintained used car. After all, it's new to you. Many cars operate well even when they are a decade old.

WHAT TO DO

If you decide to lease, make sure you understand the deal before signing anything. Here's how to avoid overpaying.

▶ **Learn more.** Before stepping into a dealership, visit *www.leaseguide.com* and *www.leasetips.com,* and read the Federal Reserve's consumer leasing guide at *www.federalreserve.gov/pubs/leasing.*

▶ **Negotiate the car price.** Before even whispering the word "lease" at a dealership, haggle as if you were buying. Only after you've settled on a price should you announce that you want to lease. Price information is available from the CR New Car Price Service at *www.ConsumerReports.org* and at other car Web sites.

▶ **Buy extra miles up front.** If you know you'll drive more than the agreement allows, ask for more miles to be included in the lease. The extra cost won't be as high as an excess-mileage penalty. Some finance companies will give you a refund on miles purchased in advance that were not used.

▶ **Study the agreement.** Pay particular attention to restrictions, penalties, and end-of-lease procedures. Verify that everything is exactly as you negotiated. Examine the capitalized cost, which is the sum of the negotiated vehicle price and any fees, minus the value of any trade-in and down payment. If it's higher than you expect, don't sign until you find out why.

▶ **Check the calculations.** Before signing, write down the lease specifics and verify the numbers using a lease calculator, such as the free one at *www.bankrate.com.* You'll need to jot down the capitalized cost, term, residual value, and money factor. Remember to multiply it by 2,400. **$**

tax savers

How and when to take a home-office tax write-off

Almost everyone has a computer, a desk, and a file cabinet at home—but not everyone qualifies for a home-office deduction. How do you know whether your office fits the Internal Revenue Service definition of a home office? Size doesn't count in this case. The space doesn't have to fill a room; a corner of your den equipped with a laptop can qualify. What does matter is how you use the area, and how often. Here are the rules for home-office write-offs.

▶ **You must use the space exclusively for work.** If your kids use your home-office computer to do homework, or if you use the space to pay personal bills and track investments, you lose the deduction.

Tax tip: To make sure you can prove your time in your home office means business, keep a log of the hours you use the office and what tasks you perform.

▶ **You must do most of your work from home.** If you only occasionally take work home, you won't qualify for a deduction. Even if you work at home most days, however, you can't claim the tax break unless your employer specifically requires you to have a home office.

Tax tip: Have your boss give you a letter stating that as a condition of your employment you have an office at home.

▶ **You must deduct only the space you use.** Calculate the percentage of your apartment, condo, or house that you use for business. If your rooms are all about the same size, you can divide the number of rooms used for business by the total number of rooms in your home. For example, if you use one room in an eight-room apartment as a home office, one-eighth of the rent is deductible. Or you can divide the area used for business by the total area of your house. If the office takes up 10 percent of the total, you can deduct 10 percent of your mortgage payments, interest, and property taxes.

Tax tip: You can also deduct the same percentage of utility, insurance, and home-maintenance costs.

▶ **You may also claim depreciation.** To calculate depreciation, divide the square footage of the office by the square footage of the entire house. Apply that percentage to the fair-market value of the property or the adjusted basis (what you paid plus improvements and minus any depreciation), whichever is less. You must depreciate that amount over 39 years. An IRS table prescribes the percentage, around 2.6 percent for all but years 1 and 39. If you use 10 percent of a $300,000 house for business, your annual depreciation would be roughly $780. Your total home-office write-off in each year, however, may not exceed your business earnings for that year.

Tax tip: When you sell the house, all the allowable depreciation will be subject to a capital-gains tax. **$**