Money Lab

Choosing a car-financing option

We help you compare cash rebates, low-interest loans, and leasing offers.

Suppose you're looking for the lowest-cost financing deal on a new car and have a choice of several manufacturer incentives, including a cash rebate, low-rate loans, and a lease. Figuring out which option is best can be a complicated calculation.

You might need to calculate the total costs of the deals yourself or trust a dealer to provide them for you. But often the salesperson will try to focus your attention on the monthly payment instead. While that might seem like an easy way to compare deals, it's actually a surefire way to pay too much. The issue is further complicated if the terms of your financing choices are different. For example, a lease might be for 39 months, while the closest loan terms might be for 36 or 48 months. Often lease and loan offers with different terms have comparable payments, but the car's total cost varies widely.

So you need to arm yourself with the necessary tools to evaluate auto-financing deals. To help, we crunched the numbers on dozens of recent offers. We searched automaker websites for deals that included a choice of at least two manufacturer incentives, such as a cash-back rebate and low-interest financing, or low-interest financing and subsidized leasing. Then we calculated the total cost of each choice using a "negotiated" price based on the "great price" estimate for each vehicle provided by the free website TrueCar.com.

We found that the cash rebate is often the lowest-cost option if you can finance at below-average rates, which are likely to be found at a local banks, credit unions, or online lenders.

Side-by-side comparison

After reviewing dozens of deals, we developed a typical selection of finance offers: manufacturer financing of 1.9 percent; a cash rebate of $1,000 and a loan at 2.99 percent (the best lender rate we could find); and a $226-a-month lease with a $1,000 cash rebate. We calculated the total cost of a vehicle with a negotiated price of $26,256 under each offer. The term on each deal was 36 months, with a $2,700 down payment and 6 percent sales tax. The lowest-cost option was taking the cash rebate and borrowing the rest from an outside lender. The lease was the most expensive option once we factored in the vehicles's remaining value. Unlike a lessee, a buyer would own the car after 36 months.

	Lease*	Manufacturer financing	Cash rebate
36-month cost	$11,236	$28,574	$27,960
Vehicle value at end of financing term	0	18,551	18,551
Net cost	$11,236	$10,023	$ 9,409

*Includes a $595 lease acquisition fee and a $395 disposition fee.

HOW THE DEALS STACK UP

To understand why taking the rebate is often the best choice, you need to look at why the other options typically cost more.

► **Leasing.** In reality, leasing is just another form of financing. Whether you finance a $26,000 car with a lease or a loan, you'll be borrowing $26,000, assuming no down payment. And you'll pay interest on that amount, minus whatever you pay back.

When you take out a loan, you pay back the entire vehicle cost. But with a lease, you pay back only the projected loss in the vehicle's value over the lease term, the so-called depreciation. That results in a much lower monthly payment, which is the reason leasing appears attractive. But it also leaves a larger amount that's not paid back and is therefore subject to a finance charge every month. And though leasing means less out of pocket, it's more expensive overall because you won't own the vehicle after the lease is over, as you would with a car bought with a loan. That will probably be the case even after taking into account the sales-tax benefit that comes with a lease in most states and the net interest you'd earn by investing the monthly difference between the lease and loan payments.

Also, leases tend to have higher interest rates than equivalent loans. In our analysis of typical financing options on a vehicle with a negotiated price of $26,256 (see box at left), the lease rate was 4.5 percent, while the lowest loan rate we found was 2.99 percent. There is also a $595 lease acquisition fee and, when you return the vehicle, a $395 disposition fee.

► **Low-interest financing.** For this option, the question is whether the savings from the manufacturer's extra-low interest rate more than offsets the amount you'd lose by giving up the cash back. That can be the case if you take the cash and finance the car elsewhere at just an average rate. But if you shop carefully for a rate, as we did, you might get the best of both worlds: the cash and a competitive rate that, while not as low as what the manufacturer is offering, provides significant net savings over what you'd otherwise pay.

In our comparison of sample deals, if you took the rebate and financed the car at an average new-car loan rate of 4.8 percent, your total cost would be about $84 more than if you'd opted for the 1.9 percent financing offer. (The lease option was more expensive either way.) But if you financed at 2.99 percent instead, the cash-back option would save more than $600 in total cost over the manufacturer's financing.

In another example, in the box at right, the recent $3,000 cash back/2.99 percent financing combination for a Chevrolet Avalanche was the lowest-cost option, even when compared with a six-year loan, the maximum term under the manufacturer's 0 percent financing offer. (We don't recommend loans longer than 48 months because of the extended time it will take to build equity in the vehicle. That can be a serious problem if you need to trade it in early or if the car is stolen or destroyed and the amount you owe exceeds its current value.)

That doesn't mean you won't find instances in which low-interest financing or even a lease deal is the lowest-cost option. That can happen if an automaker is particularly aggressive with any of its offers. In recent promotions for the Chrysler Town & Country minivan, for example, the lowest-cost deal turned out to be the lease. Chrysler offered lessees $2,750 cash and a near-zero lease financing rate. In comparison, purchasers got only $750 cash or 0 percent financing. And Hyundai recently offered buyers of its Santa Fe SUV both 2.9 percent financing and $1,500 cash. Those who took the cash alone and financed elsewhere, probably at a higher rate, got only $1,000.

So it pays to check offers carefully. Still, the only way to know for sure if you've got the best deal is to compare the numbers.

Can you beat 0 percent?

Yes, if the cash incentive is high enough. We compared two deals—0 percent financing for six years and a cash rebate of $3,000—offered in March on a 2011 Chevrolet Avalanche, at a negotiated price of $30,645. Both examples assume a $3,000 down payment and 6 percent sales tax.

Taking the cash-back option would save you $521.

Net vehicle cost with 72-month loan options

	Deal 1	Deal 2
The deal	0% financing	$3,000 cash rebate and 2.99% financing
Total cost	$32,484	$31,963

DOING THE MATH

Once you've negotiated the vehicle price, the dealer can provide you with the total cost of each option. Or you can calculate it yourself by multiplying the payments by the number of months. Then add any pre- or post-deal costs not included in the financing, such as a down payment.

Don't forget to include state sales tax. When you buy, the tax is typically on the entire amount, minus any trade-in. With a lease, it's usually on the down payment and the monthly lease payment. But a few states have different rules, especially on whether tax is applied before or after the rebate is deducted.

If you want to calculate the total cost yourself, use an online calculator. We recommend the loan calculator at LeaseGuide.com *(www.leaseguide.com/carloancalculator.htm)*. We're not impressed with the lease calculators we've seen. The one at LeaseGuide.com works well for confirming the monthly lease payment, but its total-cost calculation might be misleading, for example, if there's a lease rebate or up-front sales tax.

Once you know the total cost of each option, you can see the best deal. If you're comparing the total cost of a lease with that of a loan, first deduct the lease residual value from the total cost of the loan. That takes into account the projected remaining value of the vehicle, which you'd own, giving you the net cost of the loan options. (Verify with the dealer that the lease residual is the actual projected value of the car at the end of the lease and that it hasn't been adjusted to cut the monthly payment.)

Comparing a short-term lease with a longer-term loan is especially tricky. To put the two options on equivalent footing, assume that you'd either lease again for the remaining term of the loan or buy the car at the end of the lease and finance it for the same period. Then calculate the total cost. When we tried, leasing was more expensive in both cases.

Finally, keep in mind that any cost comparison you do is valid only if you keep the vehicle for the duration of the lease or loan. If you expect to trade it in early, say, during the second year of a six-year loan, leasing from the outset might cost you less. $

Watch out for this dealer trick

Before negotiating the vehicle price in a lease deal (as you should), find out what terms govern the offer, including the lease interest rate, vehicle residual value, down payment, and manufacturer contributions. After negotiating, ask the dealer to recalculate the payments using the revised price and those very same terms. (You can verify the payment using the online calculator at *www.leaseguide.com/calc.htm.)* Otherwise, the dealer can quietly change the terms to offset the savings from your price negotiations. If he or she won't tell you the offer terms, go elsewhere.