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Automobile Leasing Versus Installment Loan Credit: A Comparative Analysis

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Poster Presentation 18

AUTOMOBILE LEASING VERSUS INSTALLMENT LOAN CREDIT: A COMPARATIVE ANALYSIS

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In the United States, the percentage of new cars and trucks that are leased has increased from 10% in 1986 to 30% in 1995. Reinforced by increased advertising, media attention, and popular magazine articles, this tremendous surge in leasing is expected to continue. In fact, automobile market analysts predict that leasing will account for 40% of all car sales by 1998. Using an economic model of consumer choice focusing on preferences and relative prices, this paper aims to determine the factors which may lead consumers to lease a vehicle as opposed to purchasing a vehicle on traditional installment loan credit. Preference factors including liquidity, risk, and automobile use patterns are addressed. One reason consumers choose leasing over traditional installment loan credit is affordability; leasing usually requires a lower down payment and lower monthly payments. A financial analysis combines the components of a set of lease contract conditions and installment loan conditions to calculate a lease "hurdle rate" which allows for the comparison of relative prices for a given vehicle. The lease "hurdle rate" considers the initial cash savings and periodic cash savings realized in leasing as well as the residual value of the vehicle and the term of the contract. From the "hurdle rate" and investment market conditions, consumers can determine which financing option is more advantageous: leasing or purchasing on installment loan credit. In addition, factors such as tax laws, inflation, and disclosure laws are evaluated with respect to their contributions to the long-term increase in leasing.