Look Before You LEASE

It's not about what it costs to get behind the wheel; it's about achieving lowest cost of ownership.

By Duff McCutcheon

Leasing or financing – either option's gonna get you behind the wheel of a truck. How much you pay upfront, what you can write-off at tax time, and what happens at the end of the deal are all things to consider when mulling over which option's best for you.

There are differences between leasing and financing, but one thing remains constant: you and your accountant must examine the fine print before committing to anything. But that goes double for leases: double-check everything.

With a loan, all costs must be highlighted and pointed out to you beforehand. For example, you must be told what the interest rate is and the total cost of the interest will be over the life of the loan. Same goes for any other charges that are attached to your financing – document fees, administration fees, credit, life, or disability insurance – those must all be very clearly listed on a loan. Not so with leases.

Before committing to any lease, make sure you know what the lease interest rate is and have your accountant double-check it – we're told it's not rare that the quoted lease rate and the actual rate paid are as much as a point apart.

Also make sure you ask about late payment penalties, early payment penalties or interest charges, and whether you can team-drive the vehicle – something you can't do according to a lot of lease agreements.

Financing

You plunk down your down payment, arrange a loan via your bank, third-party lending institution, or OEM finance arm, and start making payments for what, God-willing, will eventually be your truck at the end of the finance term.

Your down payment – perhaps 10 to 15 percent of the truck's value – might be a little higher than the downstroke for a lease. However, the GST paid can be claimed immediately, interest on the loan is expensed, as is depreciation on the truck. If you know what you're doing, depreciation can be your best friend during a lean year.

The Canada Revenue Agency (CRA) allows for a 20-percent depreciation write-off for the first year of the truck, and 40 percent for years thereafter. You can defer these write-offs for a rainy day. Say the first couple of years of ownership are all gravy – major components are covered under warranty so you don't have to worry about downtime, and hopefully the freight gods are showering you with work so maybe you should hold off on maxing out your depreciation for hungrier times – maybe when the truck's starting to show its age and warranty coverage is but a memory.

Another big difference is what can happen at the end, if you want to trade your truck in before the lease or financing runs out. When you get a loan, you agree to pay a principal amount of money back to the finance company over a certain amount of time. If you want to pay that off early, then it's quite easy to figure out the principal balance remaining and you pay it. Usually there are no early-payout penalties.

"If you can manage money, buy the damn thing," says Andrew Galvin of Belleville, Ont.'s Transport Advisor, because depreciation is a major tax expense.

Leasing

There are basically two types of leases available to the owner-op: the capital lease and the operating lease. With the capital lease, you're making a flow of payments and at the end there's some kind of buyout. "Half the time you're definitely buying it out at the end, or you've got an option to buy out," says Scott Taylor, vice president of Waterloo, Ont.'s TFS Group.

With the operating lease, you don't own it at the end of the term – it's just a long-term rental. "And often with the operating lease they'll roll a full-maintenance package into the deal as well, where you're paying so much per mile for maintenance," says Taylor.

The maintenance packages have their pros and cons. Galvin urges his clients to stay clear of them because he says you can get routine maintenance done for cheaper rates at neighborhood shops rather than the dealerships you must go to under a maintenance package. Taylor, on the other hand, notes that if you sign up for one, "your costs are fixed so there are no big surprises. And most times, if there is any downtime, they'll give you another truck. Otherwise, with most OEM warranties you'll come away without a bill to pay, but you might be in the garage for five days. You've lost a week's worth of work in the deal."

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The downstroke for a lease can be a little less than what you'd be paying for a loan, but not always. "From what I've seen, the down payment is typically the same for both leasing and financing – usually around 10 percent down," says Taylor.

When it comes to taxes, normally with a lease, if the ownership is in the lessor's name for the term of the lease, then you, the lessee, can't capitalize the lease and claim depreciation on it, explains Galvin.

You can expense your down payment of course, but not all in one shot – it must be divided by the term of the lease. If the term of the lease is 48 months, and you put down $15,000, then you can claim $312 per month. Of course, you can expense the lease itself, plus the PST and GST costs.

The End Run

Got a surprise inheritance and want to pay off the rest of the lease in one fell swoop? That may not be an option, at least not without some kind of early payout penalty. With a lease, you've agreed to make a flow of payments, so if you want to pay it off early, "leasing companies are well within their rights to say, 'well, your monthly payments are X, and you've got 18 months left, so you owe 18X.' So obviously you're paying all the interest to the end, they may charge a penalty, and it's a lot more expensive to get out," says Taylor. "If you're refinancing and going through them again, then magically all those extra charges will be waived, but if you're not, you're pretty much guaranteed a pretty high payout figure that would be higher than a loan."

Make sure you know what's going to happen at the end.

"A lot of times people believe that they have the option to buy at the end, but don't realize that if they choose not to, then usually somewhere in the fine print they're guaranteeing that the finance company will be able to sell the unit to someone else for the buy-out figure you agreed to – and if they can't, you're paying the difference," says Taylor.

On the other hand, when you make that famous final payment, the truck is yours. You've now got some equity to work with. You can use that value to trade up to a new truck, invest it, or bury it in the back yard. With a lease, you just walk away empty handed after the truck is used up.

And as for either – leasing or financing – make sure you shop around. Try to get at least three different quotes before committing to anything. ★

In a nutshell...

Lease or buy? Either way, you don't have title, so ignore the semantics and focus on the true costs, starting with an amortization schedule that reveals the hidden interest cost built into the lease. (Get help to do this and confirm your calculations.)

Choose the lowest cost of ownership measured by the total amount spent to bring either finance option to a zero balance due. Talk to your banker about the limits that may be created on your ability to borrow for other assets (home, car, etc.) based on how you choose to finance your truck.

Do you need flexibility? If you have seasonal cash flow, a lender can build finance programs around it. Accelerated principal payout programs can balance a larger payment in the early part of the term where warranty coverage reduces operating expenses.

Aim for smaller payments in the latter part of the contract as your expenses climb and warranties expire. Above all, avoid loans that have a longer life than the truck you're choosing. What looks like a good deal now – a low monthly payment – may be a nightmare at the end of your term.