Lease Financing

For auto-consumers, crunching the numbers is one of the most difficult and confusing aspects of leasing.
Take the finance charge on a lease for instance. Most people just don’t understand how this is calculated on capitalised cost AND residual value instead of just the capitalised cost. For most, it seems plainly obvious, just as is the case when purchasing, that a charge should be levied on the capitalised cost of the vehicle.

Well, no quite! When you lease a car, you’re only using the car over a specified period of time with the option of buying the car. The residual value represents the “loan balance” at the end of the lease. If you add it to the capitalized cost and divide by two, you’ll get the average capitalized cost outstanding over the lease term. Let us suppose you’re leasing a car with a capitalized cost of $25,000 and a residual value of $15,000. You average balance over the lease term, irrespective of how long it is, is $20,000 – the sum of the two divided by two -.
Using this sum works because the money factor is the annual interest rate devided by 24, rather than 12. Continuing with our example and assuming an interest rate of 6% APR:
$30,000 X (6 per cent / 24) = $75
(Capitalized cost + residual value) X (interest rate / 24) = Monthly finance charge
This finance charge is added to the depreciation charge to calculate the monthly payments on your lease.

(Word count: 248)

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