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FINANCE & INSURANCE

New life for leasing

Rise in interest rates pushes consumers to lower-cost option

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More consumers will choose to lease vehicles as interest rates increase and manufacturers sweeten leasing incentives, auto industry experts say.

Lease financing accounted for 17.7 percent of vehicle purchases in the first nine months of this year, according to data tracked by industry researcher Edmunds.com. That's the first time since 2002 that the percentage has topped 15 percent.

Other factors driving more movement to leasing: sell-offs of 2006 inventories, banks moving into lease financing and rising interest rates.

"The percentages may not get back to 26 percent, but they will get to 20 percent within two years because affordability becomes an issue as interest rates move," says Paul Taylor, chief economist for the National Automobile Dealers Association in McLean, Va.

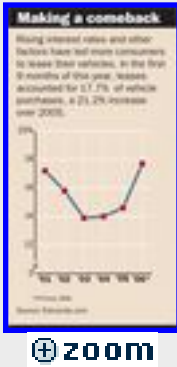
Leasing declined sharply early in the decade as used-car values fell and manufacturers focused more on 0 percent and other low-rate financing tools to lure buyers. But for many consumers, a low-interest, longer-term deal led to a loan balance higher than the value of the vehicle.

Some consumers have chosen to delay new-car purchases. Others have turned to lease deals, which offer lower payments and a chance to pay off the loans.

"Low interest rates over a long period sold cars for manufacturers," says Bob Tasca Jr., president of Tasca Automotive Group in Cranston, R.I. "It generates sales up front but costs them more in the long run" because it takes people off the market.

Other economic factors also affect leasing. On the financing side, slowing real estate markets are pushing lenders to look at leasing as an option to replace those loans, Taylor says. The strengthening stock market usually boosts luxury-car sales, which are typically leases. And as the labor market tightens, corporations that pulled out of leased cars will return.

Younger professionals



Demographically, younger professionals often choose leases because they can buy more expensive cars than they can with retail loans, Tasca says. "Younger people think different than older buyers," he says. "With older generations, if they can't pay for it, they don't buy it."

That said, leasing generally won't spike around the country. Detroit and the northeastern United States generally account for most lease deals, experts say.

At Tasca Automotive Group, lease deals represent about 60 to 70 percent of sales, Tasca says. The dealership sells Ford Motor Co. brands.

"Everybody likes low payments, and there's no resale-value risk," Tasca says. "A lot of people want the flexibility of driving two to three years and walking away."

At Armory Nissan in Albany, N.Y., about 50 percent of transactions are leases, says Joe Kramer, Armory Nissan vice president.

Manufacturers "have figured out and so have we: (Consumers) don't want to do 72 months at 0 percent," Kramer says. "They're getting people back in the door in 24 to 36 months. ... Once people go out on a 60- to 72-month or 84-month term, the chance of getting those people back is extremely low."

Car buyers who like the latest technology and styling typically choose lease options, Tasca says. He says most deals come with the option to buy at the end.

The launching of new vehicles increases leasing because residual values are the highest they'll ever be, says Kelly Mankin, vice president of Chrysler Brands Marketing for Chrysler Financial.

"To the extent we have more new vehicles and launches, we're more likely to rely on leasing more heavily in the marketing strategy," Mankin says. This year Chrysler launched 10 new models, he says.

Lenders getting smarter

Although experts say all signs point to an increase in lease deals, they say the financial side will be smarter this time. With retail loans, lenders only have to concentrate on credit risk, Mankin says. With leasing, lenders also take a risk on calculating residual values - how much the car will be worth at the end of the lease.

Leasing rates of 25 percent and higher were driven by an industry that didn't understand that manufacturers and financing companies owned the residual risk, Mankin says. "From 1999 to 2001, the industry took billions of dollars in losses for guessing wrong in residual values," he says.

Many banks got out of leasing about five years ago because they couldn't make a profit, says John Lindley, president of the Association of Consumer Vehicle Lessors.

"You don't know if you've made money until the lease is completely over and you've sold the vehicle," Lindley says.

Leasing also will help lenders get new deals by helping upside-down buyers - those whose car is worth

less than the balance of the loan - get into new cars, says Gil Van Over, president and founder of gvo3 & Associates, a consulting business near Chicago.

"A lot of consumers are upside-down but want to buy a car," Van Over says. "Leasing is the perfect tool to help those type of situations."

By being less strict on financing terms to encourage leasing, captives hope to build loyalty, says Armory Nissan's Kramer.

"Captives want to find a way to approve customers because they know we'll have a customer in the next three years," he says.

Unlike in the past, when only about 50 percent of people qualified for leases through captives, says NADA's Taylor, more people will be eligible for the deals.

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