

ALLIANCE for CHILDREN'S RIGHTS

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Transition Age Youth Resource:
Buying or Leasing a Car: A Step-by-Step Guide for Young Adults

Buying a car can be an exciting milestone and a crucial step toward independence. It can also be one of the largest financial decisions you make as a young adult. Understanding the full cost of owning a car, determining what you can afford, and navigating the purchasing process will help you make a smart and sustainable choice. This guide will walk you through the key steps to buying a car and managing the responsibilities that come with it.

Step 1: Decide If You Really Need a Car

Consider whether owning a car is necessary based on your lifestyle and current transportation needs.

Things to consider:

- Transportation alternatives: Public transportation, biking, walking, or rideshares may meet your needs at a lower cost.
- Work and/or school location: How far do you travel daily, and at what times?
- Impact on your budget: A car includes ongoing costs beyond the purchase price (see Step 2).

Owning a car offers convenience, but it also requires long-term financial commitment and maintenance.

Step 2: Understand the True Cost of Owning or Leasing a Car and Whether You Can Afford One

The cost of a car is more than just the sticker price (the price the seller is asking for the car). Make sure you account for both one-time and ongoing expenses when you're

considering whether to buy a car:

Upfront costs can include:

- Down payment (the amount of money you put down against the price of the car),
- Independent Pre-Purchase Inspection cost (PPI is a car checkup you can do to make sure the car is in the condition the seller says it is to avoid surprise problems that can come with a used vehicle),
- Car loan origination or lease fees,
- Sales tax,
- Title and vehicle registration fees, and
- Extended warranty and service contracts.

Ongoing costs can include:

- Monthly car payment (if you're financing the car) or monthly lease payment,
- Insurance (required by law),
- Gas or charging costs,
- Maintenance and repairs (regular oil changes, replacing tires, brakes, windshield wipers, etc., and any other maintenance and repairs),
- Annual vehicle registration renewal fees (if you're buying a car), and
- Parking and tolls (if applicable).

Before shopping, review your budget to decide how much you can afford monthly without sacrificing essentials like rent, food, utilities, and savings, and other priorities like education or training. Determine how much you can afford for a down payment (see Step 5), how much you can afford for monthly car payments if you're financing part of the purchase price, or lease payments if you are leasing a car, monthly gas/charging and parking, plus annual vehicle registration renewal fees if you are buying a car, and maintenance and repairs.

Step 3: Decide Whether You'll Buy or Lease and Between a New or Used Car

Both new and used cars have advantages and disadvantages.

Buying a New Car:

- Come with warranties and fewer maintenance issues initially,
- More expensive upfront,
- Lose value (depreciate) quickly in the first few years of ownership.

Buying a Used Car:

- Lower purchase price,
- Slower depreciation,
- May have upfront repairs to make, and
- May require more maintenance, depending on age and condition.

Many young adults choose reliable used cars to reduce costs while meeting their transportation needs.

Research price:

- Compare prices across multiple websites and sellers,
- Check the value of the car using Kelley Blue Book or Edmunds,
- Look at the total price of the car, not just monthly payments (including cost of insurance, DMV registration, and fuel efficiency that impacts monthly gas costs),
- Compare similar cars (same year, mileage, condition),
- Compare dealership fees, and
- Set a budget (both down payment and monthly costs) before you start shopping.

If you choose to lease a car:

- You are paying for the right to use the car for a certain number of months and miles (for example, 36 months and no more than 10,000 miles a year).
- Monthly payments are usually lower than if you bought the car.
- Lease agreements specify whether you must pay for maintenance and repairs.
- Lease mileage limits are usually 15,000 or fewer miles a year.
- Monthly payments are based on depreciation (the amount of value the car loses while it is leased), interest, and taxes.
- There are often additional lease fees including:
- Acquisition Fee: A fee (typically $400-$900) charged to initiate the lease.
- Disposition Fee: A fee charged at the end of the lease to cover cleaning/reselling costs, usually waived if you lease another vehicle from the same brand.
- Excess Wear and Tear Fee: Charges for damages beyond reasonable, normal use (for example, dented panels, cracked glass).
- Early Termination Fee: Costs associated with breaking a lease contract before the term expires.

Step 4: Check and Understand Your Credit

If you do not have enough money saved to purchase the car outright, you may need to apply for and get credit to purchase a car or lease a car. Your credit history and credit score can significantly affect your ability to finance or lease a car and the interest rate you receive.

- Good credit: Lower interest rates and lower monthly payments.
- Little or no credit: Higher interest rates, or you may need a co-signer.
- Poor credit: Limited loan options and higher overall cost.

If possible, review your credit reports (see the Alliance TAY Toolkit Checking Your Credit Report and Addressing Identity Theft) before applying for a car loan so you know your credit score. Lower credit scores may make it difficult to get credit or may increase the amount of interest you are required to pay to borrow money to pay for a car.

Step 5: Save for a Down Payment

A down payment reduces the amount you need to borrow and can lower your monthly payment and interest costs.

- Aim for 10–20% of the car's price, if possible (for example, if you're buying a used car for $15,000, you would pay a down payment of $1,500 if you're putting down 10% and $3,000 if you're putting down 20%.
- Some loans may require no down payment but usually cost more over time as you finance the total amount of the car (meaning you're paying interest on a higher amount of money, which results in you paying more interest).

Saving in advance also shows lenders that you can manage money responsibly.

Step 6: Get Pre-Approved for a Loan or a Lease (Optional but Helpful)

Before going to a dealership, consider getting pre-approved for a car loan or a lease through:

- A bank,
- A credit union, or
- An online lender.

Benefits of pre-approval:

- You know how much you can afford,
- You can compare interest rates, and
- You have more negotiating power at the dealership.

Even if you plan to finance through a dealership, pre-approval gives you an important point of comparison. Note: Even if you receive a pre-approval for a monthly payment amount from a bank or other lender, always set your own budget to determine for yourself what you can afford.

Step 7: Research Cars and Shop Around

Take your time researching:

- Reliable makes and models,
- Safety ratings,
- Fuel efficiency, and
- Maintenance costs.

When shopping:

- Compare prices from multiple dealerships or private sellers,
- Ask for a vehicle history report for used cars,
- Test drive the car in different conditions (like freeway driving and street driving), and
- Have a trusted mechanic inspect a used car before buying, if possible.

There are multiple types of car dealers:

- Franchised dealerships (specific makes or brands like Toyota or Honda), which usually offer new and used cars in that make, and used cars in a variety of makes,
- Independent dealerships (variety of cars),
- Used car dealerships (variety of cars),
- Online dealerships (variety of cars), and
- Private sellers.

Not all car dealers are honest or have your best interests in mind. Be skeptical and do your research to understand the average cost of the car make and model you are interested in, if you have a specific car in mind, and the average interest rate for any loan you may need.

Don't feel pressured to buy the same day you test drive.

Step 8: Understand the Purchase/Lease Agreement and Financing Terms

Before signing anything, carefully review all documents.

Key terms to understand when buying a car:

- **Loan amount**: the amount of money you are borrowing to purchase the car.
- **Interest rate (expressed as Annual Percentage Rate or APR):** the cost of borrowing money is usually expressed as a percentage, which usually combines the interest rate and fees to show the yearly expense. The lower the percentage APR, the less you will pay to borrow the lender's money to purchase a car.
- **Length of loan (or term of loan)**: the length of time you have to pay off the loan, generally expressed in months. Longer terms mean smaller monthly payments but higher total cost.
- **Total cost of the loan**: the full amount of money you will repay to the lender, including the amount borrowed, interest, and fees.
- **Optional add-ons**: extended warranties, gap insurance.

Key terms to understand when leasing a car:

- **Acquisition Fee**: covers dealer expenses such as obtaining a credit report and verifying insurance coverage.
- **Adjusted (or Net) Capitalized Cost:** (total amount upon which the lease payments are based, including vehicle cost (minus any down payment) and any fees or other charges not paid up front).
- **Base Monthly Payment**: covers depreciation, any amortized amounts, and finance charges. Monthly sales/use taxes and other fees are added to determine the monthly payment.
- **Capitalized Cost Reduction**: the same as a down payment when purchasing something with a loan.
- **Closed-End Lease**: the consumer does not owe a difference if the actual value of the car at the end of the agreement is less than the residual value that was set at the beginning of the lease.
- **Depreciation**: charged to cover the vehicle's projected decline in value during the lease term.
- **Disposition Fee (aka Disposal Fee):** charged to defray the cost of preparing and selling the vehicle at the end of the lease.
- **Early Termination:** if you end the lease before the scheduled termination date, whether voluntarily or involuntarily, in most cases, you must pay an early termination charge.
- **Excess Mileage Charge:** usually 10 to 25 cents per mile, for mileage in excess of the maximum mileage specified in the lease agreement.
- **Excessive Wear-and-Tear Fee:** covers interior and exterior damage on a leased vehicle beyond what is considered normal.

- **GAP (Guaranteed Auto Protection) Coverage:** makes up the difference if your car is stolen or destroyed and you owe more money on the lease than your insurance company will reimburse.
- **Gross Capitalized Cost:** the vehicle price on which the lease is based, which you may negotiate.
- **Lessee:** the party to whom the vehicle is leased, i.e., you. The lessee is required to make payments and meet any other obligations in the agreement.
- **Lessor:** a person or organization that leases, offers to lease, or arranges for the lease of a vehicle.
- **Mileage Allowance (or Limitation):** the fixed mileage limit for the lease term which you can negotiate, but you may have to pay an excess mileage charge. You can pay for extra miles up front, but you won't get your money back if you don't use them.
- **Money Factor (or Lease Factor):** a number, often given as a decimal, used by some lessors to determine the interest charge part of your monthly payment.
- **Purchase Option:** your right to buy the vehicle during or at the end of the lease.
- **Residual Value:** the vehicle's estimated projected value at the end of the lease. It's set at the beginning of the lease and used in calculating your base monthly payment. The residual value is deducted from the adjusted capitalized cost to determine the depreciation. The vehicle's actual value at the end of the term may be higher or lower.
- **Sales/Use Taxes:** taxes on the purchase of goods and certain services.
- **Security Deposit:** an amount that can be used by the lessor in case you default or at the end of the lease to offset any money you owe.

Ask questions if anything is unclear. Never sign paperwork you do not fully understand.

Step 9: Get Car Insurance Before Driving Away

Car insurance is required by law before you can drive your new car.

- Compare quotes from different insurance companies.
- Younger drivers often pay higher premiums (the annual total cost for insurance).
- Choosing a reliable, lower-cost car can reduce insurance costs.

Proof of insurance is required to finalize the purchase and register your car.

Step 10: Manage Your Car and Loan Responsibly

Once you own a car, responsible management is essential.

- **Make payments on time**: Late or missed payments can damage your credit, and you can be charged late fees. You may also pay more interest. If you fail to make payments, you may be contacted by a debt collector and/or your car could be repossessed (meaning the dealership could take the car). Late or missed payments can also have harmful consequences for the co-signer if you have a co-signer on the loan.
- **Maintain the car**: Regular maintenance prevents expensive repairs later.
- **Budget for repairs**: Unexpected costs happen (like flat tires or cracked windshields). Plan ahead for routine maintenance and unexpected repairs.
- **Avoid unnecessary upgrades**: Focus on reliability, not appearances.
- **Pay more when possible**: Paying extra toward the loan can reduce the interest you pay and shorten the loan term. Check to see if your loan has any pre-payment penalties before paying more.
- **Pay for your insurance on time**: Late or missed payments can result in cancellation of your car insurance. It is illegal to drive a car in California without insurance.
- **Pay your annual vehicle registration fees on time**: California vehicle registration fees are due annually on a specific date even though your license plates display only the month and year. Be sure to check your registration card for the actual expiration date. Late or missed payments can result in penalties assessed by the length of time the fees are late.
- **Pay parking tickets on time**: Not paying parking tickets in California on time leads to penalties including significantly increased fines, a hold on your vehicle registration, potential vehicle booting or impoundment (your car could be "booted" with a lock that would prevent you from driving or towed to an impoundment lot and you would have to pay the penalties and a booting/impoundment fee to get the car back), and collections actions.

How to Ask for Help If You Need Assistance Buying or Leasing a Car

Buying a car can feel overwhelming, especially if it's your first time. If you need help:

- Talk to your social worker, probation officer, or attorney,
- Ask supportive adults such as mentors, CASA, teachers, coaches, or school counselors,
- Reach out to trusted family members or financial counselors, and
- Ask questions at banks or credit unions about loans and budgeting.

Getting advice before making a major financial decision can help you avoid costly mistakes and set you up for long-term success.