The residual value of leasing

If you are in the market to lease a vehicle, you will hear the term "residual value" recur like a leitmotif. A residual value does not only affect your monthly payments, but is equally used by leasing companies to determine any penalties should you break your lease early and how much to pay if you decided to buy the vehicle at the end of your lease.

Let us first start by looking at the meaning of residual value. The term "residual value", refers to the value of something after it has been used for some time. In leasing lingo, it refers to the depreciation of the vehicle's value over the life of its lease.
So how does it exactly affect your monthly payments? When you lease a car, you pay for the car's value that you use over the lease length. Suppose you leased an $18,000 car for 2 years: the leasing company needs to estimate the value of this car in two years time in order to know how much of the car you will be using during your lease term. That's where the "residual value" comes into the equation. If the residual value is estimated to be $13,000 at the end of your lease, then your monthly payments will be calculated on the $5,000 you will use over 24 months, giving an average monthly payment of $208.3 (plus interest, tax and fees). How about if the car is expected to lose half its value over the same period? In this scenario, you will be using $9,000 over the same period, leaving you with a higher monthly payment of $375 (plus interest, tax and fees).
As you can see, residual values are a key factor in determining how much money to pay on your lease and the higher the residual value, the lower your monthly fees. This works in reverse if you build a bond with your car and decide to purchase it at the end of your lease. If we stick with the same example above, the lower monthly payments in the second scenario come at the cost of paying substantially more to buy your car at the end of the lease.

So, since the residual value is so important, how do I know which one is best for me? Well, it all depends whether you want to purchase the car at the end of your lease. If you don't want to make a large down payment and you want low monthly payments, then a car that holds with a higher residual value is a good deal. If you are thinking of purchasing the car at lease-end, then you need to balance low-monthly payments with a moderate residual value.

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