



Total Cost Of Ownership

When buying a car, your lifestyle and personal needs are very important considerations in order to feel good about your choice of automobile, and since you will typically drive the car from 3-5 years, it is very important to satisfy those emotional criteria. But feeling good about the car is not the end of the story, as there is also a financial side to your decision or might we say rational side.

Yes, both the initial cost of the car and/or the affordability of monthly payments play a key role in the decision, but there is one additional quantitative analysis that should be made – what is the total cost of ownership over the period of time you plan to keep the car? In essence, the less expensive car and monthly payment may not be the lowest cost to you over time.

As an analogy, say you were looking at two similar pair of shoes (we do this a lot) and one is more expensive than the other, but otherwise the same in style. But, if one pair needs repair after several outings while the other just lasts and lasts, what is the real cost of the shoes each time they are worn?

Here are the cost variables in descending order of financial impact:

- **Cost of the car less the expected depreciation** equals the residual value or in theory the trade in amount. A good barometer is summed up in the phrase, “past is prologue” as some brands and models hold their value better than others and this is well documented. Last year my son-in-law purchased a large SUV, and actually paid a significantly higher price for an 8-passenger Toyota Highlander vs. a similar equipped domestic brand, as the estimated trade in value after 5 years will more than make up for the initial price difference. Not all comparisons will be this great in price so other factors need to be considered.
- **Fuel cost** is the second biggest cost and becomes even more important if you are planning on driving the car more than the normal 15,000 miles per year for 5 years. The following example uses \$3.50 for a gallon of gas and 15,000 miles per year at two different mileage rates.

$$\frac{75,000 \text{ miles}}{22 \text{ miles/gal}} = 3,409 \text{ gallons}$$

$$\frac{75,000 \text{ miles}}{24 \text{ miles/gal}} = 3,125 \text{ gallons}$$

$$3,409 \text{ gallons} \times \$3.50/\text{gal} = \$11,913$$

$$3,125 \text{ gallons} \times \$3.50/\text{gal} = \$10,938$$

This also shows what only a 2-mile per gallon difference in mileage can save over five years, and it's almost a thousand dollars – at least several pair of shoes!

$$3,409 - 3,125 = 284 \text{ gallons @ } \$3.50 = \$994 \text{ savings or } \$16.57/\text{month}$$

For comparison use the manufacturers fuel rating, even though your own driving circumstances and habits will frequently not equate to these ratings, the difference will still show up.

- **Repairs and maintenance** depend greatly on the quality of the vehicle plus the warranty and can be a significant cost difference particularly over a 5-year time frame. As we all know, certain brands have a reputation for quality and reliability and a realistic assessment of the likelihood of the car needing more repairs and maintenance should be part of your calculation even though this is more of a guess than the fuel mileage comparison. Consumer reports and other websites can be a good source of information regarding this cost issue.
- **Interest** – Consider not only on the total amount borrowed, but also the interest rate. Some dealers have lower financing rates or special deals to be aware of. On the other hand, if you have arranged your own financing, then the rate will be the same, and the only difference in cost is the interest rate on the difference in price.
- **Insurance** is a significant cost and likely will be the same for cars of similar type, but check first. Some insurance will cost less depending on safety features, horsepower, etc. Call your agent and ask what features of the car boost or decrease insurance rates.
- **State fees** can also be a surprisingly high cost, as for an example, here in Arizona the license fees are pegged at the value of the car and can be quite high vs. in Ohio where the license fee does not vary based on the value of the car and is low.
- **Other miscellaneous costs** should be included for a complete total cost of ownership analysis. For example, my business partner lived 20 years in Chicago, and paid \$150/ month for garage fees before moving to Arizona – maybe that’s one reason, besides the weather, that he moved. Here in Arizona we have lots of dust (not including our now famous dust storms) and frequent car washes are needed.

Here are some interesting facts from a recent visit to Consumer Reports website:

- Over the first five years of owning a mid-size SUV, such as the Lexus ES, the median ownership cost is about \$9,100/year vs. about \$5,800 to own a smaller car such as the Mini Cooper. Even a small SUV, such as the Toyota RAV4, costs \$7,800 to own per year.
- Keeping a car eight years rather than five can reduce the above referenced median cost to \$7,800/year due to lower depreciation and paying off the loan.
- Hybrids are popular choices, but not necessarily for the fuel savings, as it takes six or seven years to make up for the added purchase price assuming you drive the normal 15,000 miles per year.

We will continually keep you up to date on the total cost of ownership issues and other important information with our FREE newsletter entitled “News, Views and Deals”.



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