Used Auto Price Trends & Impact

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2 Minute Read

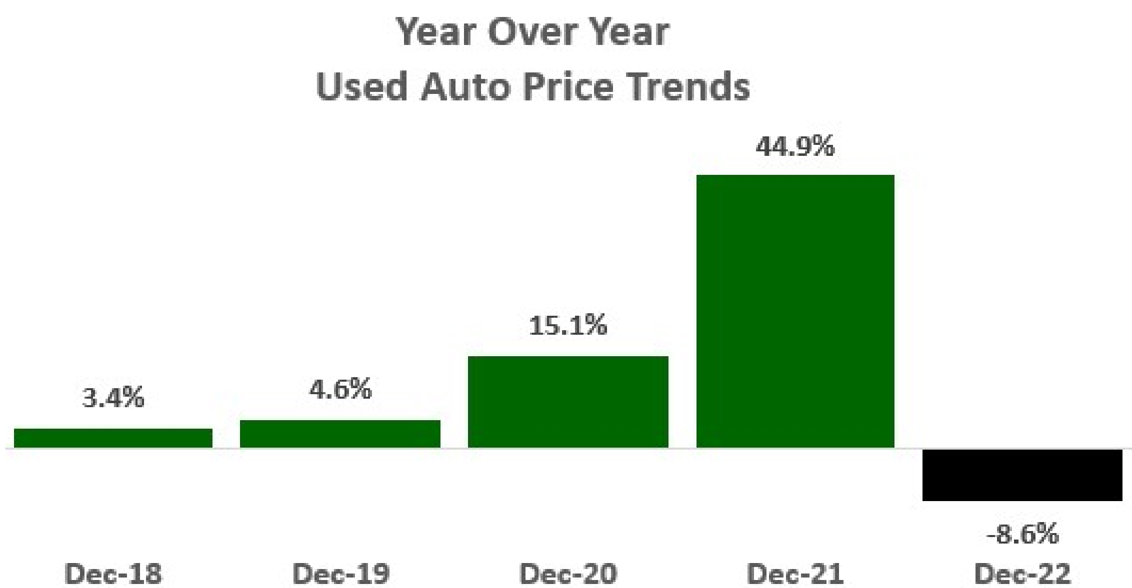
McQueen Financial Advisors

Many credit unions rely on auto loan lending as a primary source of growth. Across the industry, auto loans represent approximately 32% of total loans. About 65% of auto loans are made on used autos, and they amount to just over $305 billion. The dollar amount of auto lending has soared in recent years, and clients have recently started asking about concentration limits, used auto value trends and the potential impact of a rapidly changing marketplace.

"Dollar amount of auto lending has soared in recent years"

Used Auto Price Trends

Manheim is the nation's leading provider of wholesale vehicle auctions. Auto dealers, car rental agencies, manufacturers and financial institutions buy and sell bulk autos through over 100 nationwide auction sites. Each year, over 6 million autos are bought and sold through Manheim's network. Manheim's used auto index skyrocketed starting in mid 2020, then again in 2021. In 2022, the index dropped by nearly 9%, which is the largest decrease in at least 15 years. Falling used car prices are a legitimate concern which may accelerate over time.



The decrease in prices of used vehicles is likely a result of a combination of factors, including a decline in retail sales due to interest rate hikes and economic uncertainty, as well as an increase in the availability of new vehicles. As the supply of new vehicles rises, consumers have more options to choose from, which can lead to less demand for used vehicles. Additionally, as new vehicles become more available, automakers' financing arms may be able to offer better loan options, which can make it more affordable for consumers to purchase new cars. These factors can lead to a surplus of used vehicles on the market, which in turn can drive down prices. Recessionary fears could also be contributing to the decrease in prices as consumers may be more hesitant to make big purchases during economic downturns.

Impact on Borrowers
The increase in new vehicle availability is having a negative impact on the used car market. As inventory starts to build, it's producing momentum in new vehicle sales, but this is happening at the expense of used vehicle sales. Traditional new car buyers are the most affected by this shift. Over the past few years, many consumers purchased cars at the end of leases or purchased used cars because new models were unavailable. Now, the availability of new cars with better financing options makes it easier for them to purchase new cars. The natural choice for a typical new car buyer is to trade in what they have for a new car. Auto leasing will also rebound.

Impact on Lenders
As new cars start to fill dealer lots, attractive dealer financing options will follow. Auto company finance arms will be the largest beneficiary of new car lending growth. For traditional used car lenders, the likely outcome will be faster prepayments and fewer opportunities for used auto loan growth.

"Growth may be challenging"

For indirect lenders, faster prepay speeds will reduce overall program yields when loans are prepaid during the dealer reserve amortization period.

Some of our clients have expressed concern that lower car values will result in higher delinquency and charge offs. We have not seen much evidence of this yet, but it may be too early to tell.

Growth may be challenging. Some credit unions may consider maintaining low offering rates to maintain or grow their programs. However, growth at low rates is never a good idea.

We suggest the following
- Review used auto concentration risk limits.
- Consider reducing indirect dealer reserves to slow growth of low yielding programs.
- Internally discuss growth opportunities versus yield opportunities. There is nothing wrong with shrinking a program that no longer provides an adequate risk-reward.
- Ask us for our report on Indirect Lending Rates & Dealer Reserves.
- In the current rate environment, it is almost always a bad idea to borrow money for the sole purposes of growing loan programs.

Talk to your MFA Advisor about growth and funding strategies.