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Trends In Auto Loan Serving | No. 7

LOAN DELINQUENCY TRENDS

Don’t Panic, Prepare

It’s in the news, repossessions are on the rise. But what does that mean for your loan servicing operation: cause to panic or time to prepare?

Cox Automotive’s Deshaun Sheppard sits down with Chief Economist Jonathan Smoke to get right to the crux of it all. Here is the transcript from the short video where they discuss this trend and how Accelerated Title can make sure you are prepared to optimize payoff & title release.

DeShaun Sheppard: I’ve been getting a lot of questions around data and trends regarding loan defaults and repossessions and what it means for loan servicing. As many of you know, our chief economist Jonathan Smoke keeps a watchful eye on everything happening in our industry. Fine tuning his predictions based on latest events. It’s where I get all my information from. And 2023 is looking like another year where things can change quickly. So rather than paraphrase any of the content that he’s put in the market, I was able to grab 5 minutes with this very, very busy man to share what he sees directly with us. So, Jonathan, for all the people watching out there who may not know you, I shared my excitement with my wife this morning. You know, she said congratulations, but she didn’t exactly know who you are. So, I don’t think she understands my excitement. So, for anyone out there who doesn’t know who you or, if there’s someone brand new to the industry, would you mind just introducing yourself and let us know what you and your team do at Cox Automotive?

Jonathan Smoke: Sure, Deshaun. And thanks for having me on and the kind words, I’m sure your wife thinks you’re crazy to be excited to be interviewing an economist. But I head up our Economic and Industry Insights team, we are tasked with tracking the economy, the auto market, which includes the new and the uses markets and what we see with sales, supply, and pricing. We get into the weeds on retail and fleet demand. Of course, on the retail side, that means we’re heavy in the focus on consumer credit and everything going on in auto financing. And we also pay very close attention to both dealer and consumer sentiment to see how trends happening are impacting both consumers and dealers alike in that in the vehicle market. And of course, we try to leverage everything that we can access across Cox, which includes all our businesses and platforms. So, we’re leveraging data from Manheim, AutoTrader, Kelley, Blue Book, vAuto, xTime and Dealertrack, every single day. And ultimately, my job is to make sense of the economy and market trends to help our own businesses and our clients make the best decisions possible. Of course, it’s been an interesting couple of years to be tasked with that, and I think that this year is going to be another one of those years where paying attention to what’s going on and learning how to adjust to the market and economic circumstances are going to be critical to success.

Sheppard: Thank you, Jonathan. You definitely keep all of us informed here at Cox and we definitely appreciate you. Very happy that we were able to get this time with you today. So, let’s just get right to it. You recently published an article in response to what’s happening with loan defaults and repossessions. Let’s start there. What is the trend? We should all be aware of?

Smoke: Yes, we are seeing a return to normalcy, I would say, overall. But these days that return to normalcy is creating some, I would argue, misinterpreting or using statistics in a way that can be misleading, to try to create the view that the sky is falling, and bad times are ahead because we've really gone through some unprecedented times for the economy, the auto market and consumer credit. And 2021 was just an incredible year. That was a very strange base to be judging how things have been trending since. So, in 2021, we had record high vehicle values, used vehicles appreciated that year substantially, and that resulted in a change of behavior that we would have seen. But at the same time, we had consumers who had been spending less through the pandemic receiving trillions in stimulus and seeing loan accommodations and the like, that ultimately all added together to having the lowest loan defaults in history. And as a result, we also had record low repossessions. So, as we start to move away from that abnormal year last year, we started to see an increase in some normal things happening and that included delinquencies, auto loan defaults and repossessions. But of course, I don't want to dismiss some of the increase that we've had as purely a return to normalcy because last year wasn't normal either. We had a 40 year high in inflation. That inflation was negatively impacting all consumers, but especially putting stress on lower income and lower credit quality consumers. We have seen, I would argue, more than a deterioration in delinquencies in 30 and 60 day delinquencies. But beyond that, we really haven't seen those delinquencies turned in to what is a normal level of defaults and repossessions. And we're not expecting this year to produce even 2019 similar default rates or repossession rates because the loan pool is a higher quality loan pool. And, most loans still have more equity in them than they traditionally do. And as a result, we actually--if we avoid a recession--shouldn't see abnormal stress. But we are seeing increases simply because we're moving away from that very abnormal 2021.

Sheppard: Got it. So, from a lender operations perspective, it sounds like there will likely be an uptick in repossessions but bringing services back to former levels. So, where some lenders may have downsized or refocused staff away from this work, which is more complex and more time consuming in nature. We're dealing with repossessions here, how they scale back up to address the potential inflection of the strategic focus area for this year. And I say that because of a few other predictions you've shared. ASARE once again lower than the highs everyone enjoyed before the pandemic being one of them. And there's quite a few factors contributing to that assessment. Would you mind just diving into that a little bit?

Smoke: Yeah, overall, you're absolutely right. We're not very bullish on the retail market in 2023. And, when you extrapolate that to loan originations, I would say we're even less bullish than we are about retail sales. And there are numerous factors driving that opinion. And now the new market is likely to see some volume growth in the year ahead. At the end of last year, we started to see improvements in deliveries and inventory for the first time in more than two years. So, the supply problem is starting to gradually improve. But most of the growth that's likely to happen in the new vehicle market this year is going to be in fleet and not in retail, because in retail we actually are now dealing with a demand problem principally caused by affordability because we've got a 20 year high in interest rates and we have record high prices, especially in the new vehicle market that come together to reduce demand or make it very difficult to see improving demand over what we've had the last couple of years. And then on top of that, credit is much tighter now than a year ago. And in many channels, we actually see that credit standards are tighter than they were back in 2019. So as a result, aspiring to go back to 2019 levels is challenging in that kind of environment because prices are much harder, credit is harder to get and interest rates are higher. We absolutely have higher rates and those rates are higher because of what the Fed has done, but also because of wider spreads with the perception that risk is likely to be higher rather than lower down the road. We're seeing consumers having to put down bigger down payments both in nominal terms and on a percentage basis in order to qualify. And that eliminates some. And overall, we're really seeing a big decline in sub-prime as those consumers are the consumers that find it difficult time to make the math work, to take today's prices, today's interest rates, and come up with an affordable payment. I would add on top of all of that, what is contributing to a more negative view for auto finance is we're seeing a big rise in cash buying as rates of move higher. We basically crossed the threshold last year that by the end of the year we're at close to 20-year highs in rates. But at the same time, you have consumers, particularly higher income consumers who saved up quite a bit of money by not spending as much through the pandemic and have the wherewithal to be able to pay cash for vehicles and especially new vehicles. So ironically, that even diminishes the number of sales that turn into a loan as well. So, it's a really tough environment to see volumes increase.

Sheppard: Most definitely. So, What I'm taking away from everything you just explained, Jonathan, is that originations will stay constricted and that means tighter competition for every finance opportunity, especially for those lenders whose sweet spot is prime or super prime and even some poaching of existing loan customers. So while lenders need a strategy for what I would call loan conquest and customer retention, there's still a reality that it won't be the booming business it had been so in my mind, part two of that business strategy should be how do I best predict vehicle values and depreciation to build and maintain a healthy portfolio in the first place? And where can I gain efficiencies to do things better, faster and save my organization from unnecessary expense?

Smoke: I totally agree. What we know for certain is the market isn't going to give you growth. So if you are focusing on growth or improve bottom lines. It's got to come from performance. And of course, that can come from multiple avenues. Like you mentioned, it can come from acquisitions and growing the business, taking share or it can be in gaining efficiencies. This is a great year to take an end to end look at how your business operates and making sure your focus on being as efficient and up to standard to the rest of the industry. And to that end, know, we are absolutely a great source of insights on vehicle values. Whether you're looking at the wholesale side with Manheim and Manheim Market Report values or Kelley Blue Book on the retail side, or what instant cash offers and trade-ins look like. And of course my team is a great source to check in with on credit availability trends, what's happening with sales and supply. Lots of variations that I think understanding what's happening can really guide where to focus your business on performance.

Sheppard: Absolutely. And speaking of all those efficiencies and doing things bigger, better, and faster, I just can't help it. Especially someone like me who has spent his entire career in optimizing long service operations. All roads lead back to Accelerated Title for me, where we provide dealers with access to real time payoff quotes from lenders, images of the titles for the vehicles that are being traded in. And not only that, they're also able to submit payment right then and there, which expedites the release of that title. You know, that's very important in today's climate with everything that we've discussed today, It's also a free upgrade and easy onboarding for our lenders who currently utilize our collateral management services. So we're talking eliminating those short pays and revenue leakage, unnecessary incoming phone calls and the process of processing paper checks, allowing these lenders to refocus their staff on the bigger gorilla in 2023, which we just discussed, which we can safely say would be consumer conquest and retention, while also finding ways to save as a way to offset the decline in originations. I think Accelerated Title just does a great job of providing a solution for, you know, something like vehicle trading. It's just another service to consider from Cox Automotive that can help lenders during this unpredictable time. So again, just wanted to thank you so much, Jonathan. My wife does think I'm crazy, dare I say I'm a fan, but I really appreciate your time here today and I appreciate all that you do for us here at Cox.

Smoke: Well, thanks for having me on.

Sheppard: Absolutely. Thank you, Jonathan.