HOW THE PANDEMIC HAS CREATED A ROLLER-COASTER USED CAR MARKET

(05Aug2020) … The pandemic that has ravaged the US economy to basically a near halt has also made for a surprisingly turnaround in the used-vehicle business - a part of auto retailing that franchised dealers and the credit union industry have increasingly relied on. Once the industry's "bread-and-butter," vehicle loans have dropped to 34% of total credit union loans with used vehicle loans accounting for 61% of that total.

Retail used-vehicle sales and wholesale auction volumes have plunged while vehicle values dropped significantly in the span of only a few weeks, leaving dealers wrestling with trade-ins and stock inventories. A recent Automotive News survey reports dealers "had seen the biggest opportunity for profit growth being in their used-vehicle departments." Previously, dealers had been eager to buy consumers' vehicles to build their inventories so they could capitalize on that hot market.

Until recently, dealers had started to approach trade-ins with caution, given collapsing retail demand and dropping wholesale prices. JD Powers reported that wholesale auction volume was down 83% from the pre-virus average. Retail used-vehicle sales have tumbled 63% compared to the same period in 2019. Moreover, fleet sales had suffered greatly, as business and rental car company demand has cratered. Industry experts expect companies will unload 1.5 million cars from their US fleets by the end of the year. Hertz recently announced they are about to put over 200,000 vehicles on the market as part of its bankruptcy deal.

But after hitting a multiyear trough in April, falling about 9% year-over-year, used-vehicle prices appearing to have risen again - even hitting a new high in June and another in July. Prices rose mostly due to the greater mix of available SUVs and pickups while the prices of used three-year-old midsize and combat cars declined 1% to 2%. Now, we believe prices are expected to be on par with pre-virus levels by the end of the year.

A survey conducted by Edmunds, found that people are making larger down payments and are taking on less negative equity in their loans. The average down payment grew to $3,167 - the first time since 2007 that figure surpassed $3,000. The number of vehicle sales that included trade-ins with negative equity landed at 26.3 percent, the lowest level so far this year. Edmunds also found the share of used vehicle purchases that were accompanied by a trade-in dropped to the lowest point since February 2009 - possibly an indication that more first-time buyers are shopping for cars than before.

Carmakers continue to offer deferred payment programs - some as long as 180 days - and a few have returned to 0% financing offers to their most qualified buyers. Although average A-paper loan rates at credit unions have dropped from 3.62% to 3.26%, some credit unions, especially larger institutions ($500M+), have dropped their 5-year rates as low as 1.99% as they are facing historically high levels of monthly principal run-off in their loan portfolios while facing declines in member demand. This has impeded their ability to originate enough new loans to cover that run-off - significantly diluting their revenue streams.

Digital retailing models are becoming key game changers, bringing quite a zing to the used car space - often referred to as the "brick & click" market. This has demanded a strategic adjustment to the used-vehicle market requiring retailers to identify specific targeted customer segments and the need to develop a growing array of available sales and financing options.

We estimate that the number of used vehicles three years old or less will increase from what was 51% of the total in 2017 to about 60% in 2022. A key part of this shift will likely result from the greater supply of off-lease vehicles, many of which fall into the category of newer certified pre-owned vehicles. This growth projection should be sizable enough to stabilize values and prices for a few quarters and with slightly higher market rates and stronger demand later this year and going into 2021, should be favorable to the credit union industry in 2020 and 2021.

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