crain
Automotive News
APRIL 23, 2007

Subprime auto market steers clear of peril

Lenders are likely to avoid mortgage industry problems

Jim Henry
autonews@crain.com

Subprime auto lenders have not caught the financial flu that has afflicted the subprime mortgage sector.

Luckily for automotive lenders, auto financing and home financing differ enough to keep the malady from becoming contagious.

The main threat to subprime auto lending could be that subprime mortgage lenders are getting bad press for "predatory lending," a practice of charging some borrowers higher prices for products and higher interest rates on loans. That could scare investors and attract the attention of regulators.

But the differences between auto lenders and mortgage lenders appear to be greater than their similarities.

Mortgage lenders got into trouble when rising interest rates made adjustable-rate mortgages unaffordable for cash-strapped homeowners. Automotive lenders don't make adjustable-rate car loans, so the impact of higher interest rates was muted.

Another obvious difference is that cars cost less than houses. Thus, a car loan poses a smaller financial burden on the borrower.

"They are very different businesses," said Brenda Hines, vice president of global communications for Ford Motor Credit Co. "It does not necessarily follow that the mortgage business translates into problems with autos," she said.

Advantage: Autos

Why subprime auto loans are faring better than subprime mortages

- There are no adjustable-rate auto loans.
- Subprime auto lending has been through a couple of rounds of consolidation. Survivors tend to be more careful and more diversified.
- Credit losses are down for some prominent subprime specialists, based on the performance of loans the lenders packaged and resold to investors.

Playing safe

In part, most automotive lenders have avoided trouble because they have been more conservative than subprime mortgage lenders.

A decade ago, several publicly traded subprime automotive lenders were forced into bankruptcy when their securitized loans failed to perform as expected and investors demanded repayment.

Ford Credit and GMAC took steps to avoid trouble.

Five years ago, Ford Credit closed its subprime subsidiary, Fairlane Credit LLC in Colorado Springs, Colo. In 2005, Ford Credit also sold another subprime subsidiary, Triad Financial Corp. of Huntington Beach, Calif.

Meanwhile, GMAC's subprime automotive subsidiary, Nuvell Financial Services LLC in Little Rock, Ark., has limited its subprime car loans.

Subprime loans are a small part of GMAC's auto lending business, said Barbara Stokel, executive vice president of GMAC's North American Operations.

GMAC is more likely than other lenders to keep auto loans on its own books, as opposed to reselling them. That policy forces GMAC to be more cautious, because it would have to eat any loan defaults.

"We evaluate all aspects of the loan because we know the minute it's on our books, it's going to be with us until that contract is eventually paid off," Stokel said.

Selling IOUs

Other lenders often sell their subprime loans to investors. The subprime lender gets a cash payment that can be used to finance more loans. And the investor receives payments plus interest over time, with an ironclad guarantee that he will be paid.

To back up that guarantee, the lender sets money aside to make good losses on loans that don't get repaid.

If subprime auto loans fail to perform as expected, that would signal danger for the sector. But losses on securitized subprime loans actually are declining, according to the credit rating agency Standard & Poor's.

In the third quarter of 2006 — the most recent period for which data are available — those lenders experienced average loan losses of about 4.2 percent. That's down from 5.3 percent in 2005, Standard & Poors said.

Although loan losses appear to be moderate, consolidation continues in the subprime automotive sector. Survivors are buying out smaller rivals and in some cases are diversifying their portfolios to include less-risky auto loans.

AmeriCredit Corp. of Fort Worth, Texas, an early specialist in subprime auto lending, now calls itself a full-spectrum lender. It makes loans to near-prime customers and customers with good credit.

As part of its new strategy, AmeriCredit acquired prime lending specialist Bay View Acceptance Corp. of Covina, Calif., in 2006 and near-prime lender Long Beach Acceptance Corp. of Paramus, N.J., in January.

Strong demand

One thing for sure is that the economy is generating strong demand for used cars. In turn, that props up demand for subprime loans, says Ford dealer George Gorno, co-owner of Gorno Ford in Woodhaven, Mich.

Gorno's dealership does little subprime business, but its used-car sales are picking up as the auto industry sheds employees. "It's a bigger piece of financing right now," Gorno says.

"The buyers start out looking at new (vehicles) but end up buying used. They were new-car customers three or four years ago, but now their credit is a little dinged up. Before, their second or third car would've been new," he said. "Now, they're getting rid of the third one, and the second one is used." AN