Subprime auto loans threaten new crisis

By J. Cooper
11 April 2017

On April 3, the *Detroit Free Press* reported the liquidation of Valley State Credit Union, a small community credit union serving state employees in Saginaw, Michigan. The collapse of the credit union highlights the growing problem of ballooning auto debt and subprime vehicle loans that are rattling the banking and finance markets. This growth of auto loan debt is also an indication that the auto sales surge of recent years is heading for a collapse, threatening further layoffs in the industry.

The Saginaw credit union was acquired by ELGA Credit Union of Burton. Valley State had been taken into conservatorship last August, as it became clear that delinquent used-vehicle loans had caused it to be "operating in an unsafe and unsound condition." In July 2015, delinquent vehicle loans between 30 and 59 days overdue at Valley State had mushroomed to $1.59 million from $57,222 the year prior.

Automotive industry analysts are expressing concern that the mushrooming of auto-related debt and the preponderance of subprime vehicle loans, fueled by investors looking for high yields, could be the next financial bubble. As of the fourth quarter of 2016, auto loan debt in the United States had reached $1.16 trillion—an increase of $93 billion over 2015—rivaling the enormous sums of student loan debt that now stands at $1.31 trillion.

Following the financial crash of 2008 and the subsequent recession, auto sales plummeted. But with the government bailout of Wall Street and interest rates near zero, by 2012 the banking industry saw their opportunity in the unregulated field of auto financing. The subprime mortgage debacle brought mortgage lending under federal regulation, but no one was looking at vehicle financing. Bankers seeking quick profits began offering products to less-qualified borrowers, much as they had done with mortgages prior to 2007. Sales of both new and used vehicles hit record numbers in 2016 for the seventh straight year. However, since the beginning of this year, sales are tumbling, heading for an annual decrease of more than 12 percent.

Additionally, auto leasing has reached record numbers, from 13.2 percent of the market in 2009, to 28 percent in 2015. While this has helped boost the sales and profits of the car manufacturers, those leased vehicles have begun flooding the used-car market, as most leases are between two and four years. The market glut is expected to drive down used car prices, cutting into new-car sales and corporate profits.

For both manufacturers as well as lenders, the future looks grim. According to the April 7 *Automotive News*, "With both bad loans and interest rates on the rise, financial institutions are becoming more selective in doling out credit for new-car purchases, adding to the pressure for automakers already up against the wall with sliding sales, swelling inventories and a used-car glut. 'We've been having a party for a few years and it was fun,' said Maryann Keller, an industry consultant in Stamford, Connecticut. 'Now lenders are getting back to basics.'"

Wall Street is concerned that what happened to Valley State Credit Union could spread throughout the banking industry. Delinquencies on car loans over 30 days were up in December by 14 percent over 2015. By the end of 2016, over 6 million borrowers were more than 90 days late with their vehicle payments, also a new record.

Auto loan delinquencies of 30 days or more reached $23.27 billion in the fourth quarter of 2016, or 3.8 percent of all auto loan debt. The seriously delinquent portion, those more than 90 days past due, reached $8.4 billion.

Predatory lending practices relating to auto loans are now coming under some scrutiny. Santander Bank, known as the largest packager of subprime auto loans, just agreed to a settlement of $26 million with the states of Massachusetts and Delaware for issuing “unfair and unaffordable” loans, knowing the borrowers would default. According to AP, Massachusetts Attorney General Maura Healey said, “These predatory practices are almost identical to what we saw in the mortgage industry a few years ago.”

Recognizing that millions of auto loans may default this year, lenders are now looking to cast a wider net for struggling borrowers. According to a recent *New York Times* article, the credit bureaus that provide the scores that determine a borrower’s interest rate and credit limits are now looking at “alternative” criteria, such as cell phone payments, to entice those who have no credit history, or have previously defaulted on loans, to become the new victims of the predatory banks.

Auto finance companies are alarmed about looming defaults, but not to the extent they were with the collapse of mortgages in 2007 and 2008. The vehicles of borrowers with low credit scores and higher risk are often fitted with GPS technology and “kill switches” that can be activated if a loan is even one day past due. There are more than 2 million of these devices on the roads. The practice of “ignition interruption” has now become so widespread that the Federal Trade Commission is investigating the abuse of these tracking devices relating to privacy violations.

Tightening credit, swelling inventories and the glut in the used-car market point to more plant closures and layoffs on the horizon. Ford has already threatened layoffs in both Michigan and Mexico, while General Motors has announced 4,600 permanent job cuts since December.

Sales for Detroit-based US automakers made a weak showing in March. Fiat Chrysler sales were down 5 percent while Ford showed a 7.2 percent decline. GM sales were up just 1.6 percent. Meanwhile, Nissan sales rose 3 percent while Toyota sales fell 2.1 percent. Overall auto sales increased at an adjusted annual rate of 16.63 billion, lower than projections of 17.3 billion.