VINING SPARKS

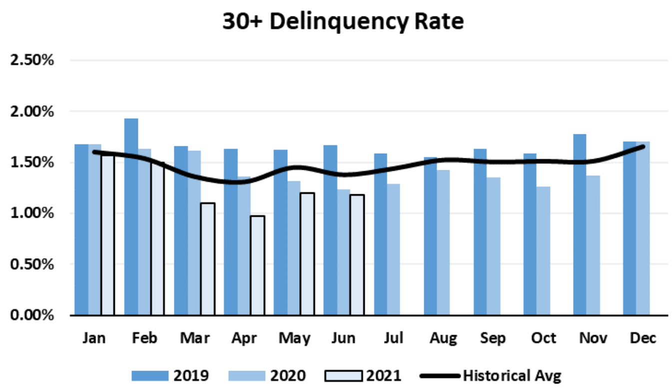
Loan Trading: Auto Market Analysis

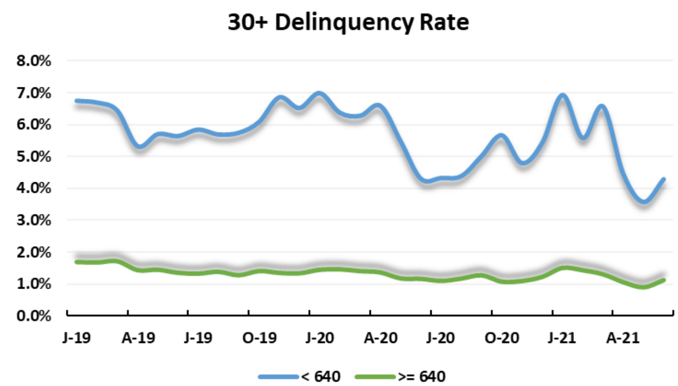
Key Takeaways: **August 13, 2021**

- **Delinquencies and defaults remain below pre-pandemic levels**
- **Prepayment speeds remain elevated**
- **Loss given default levels have improved, resulting in lower net charge offs**
- **Demand for loans has driven prices/yields beyond levels last seen in 2016**
- **Sellers are considering strategic sales, as opposed to liquidity/concentration driven sales**

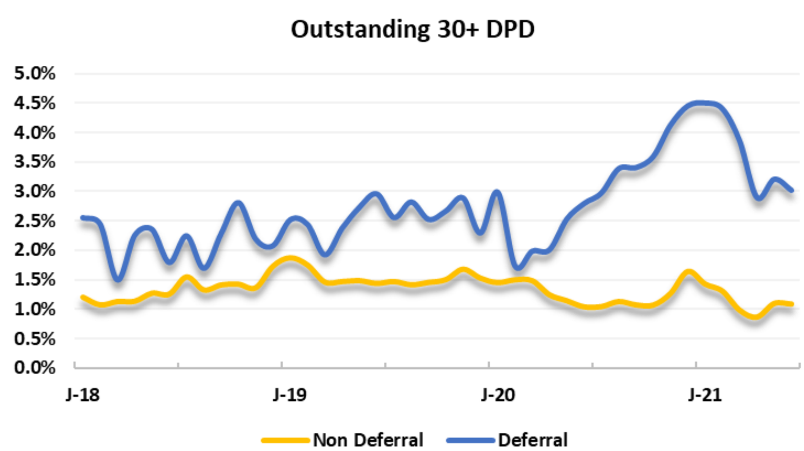
Delinquency and Defaults

Assistance programs began to go into effect in March 2020 which led to a decline in loans that are at least 30 days past due for the remainder of the year. In December of 2020, delinquencies increased to levels experienced in 2019, however delinquency levels in 2021 are less than the previous 2 years. Delinquencies for prime quality loans are continuing to remain near record lows. Nearly 95% of all the auto loans sold by Vining Sparks have credit scores of 640 or greater, and this emphasis on higher credit quality has helped to produce greater performance stability than the subprime and broader markets.

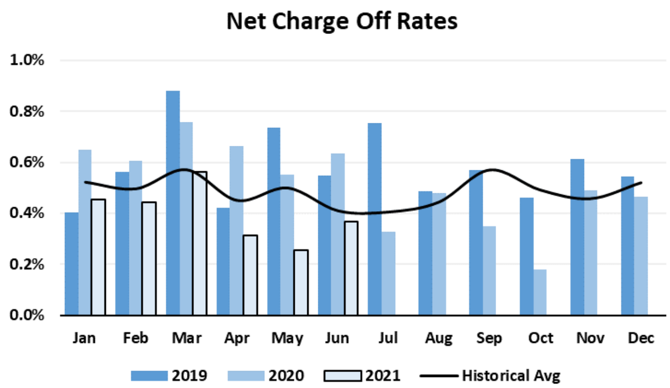


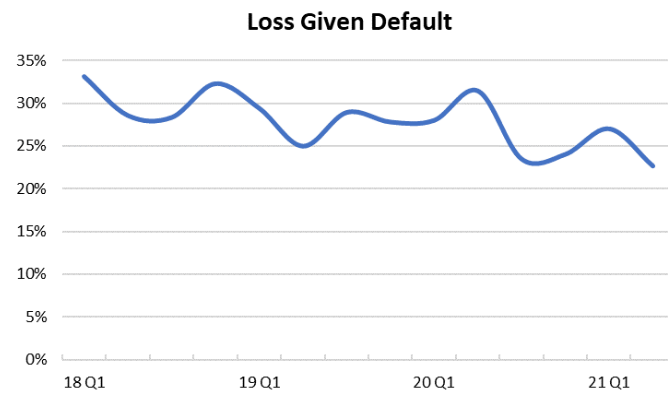


In the chart on the right, we compare delinquency levels between loans that entered deferment at some point during 2020 with loans that did not. Loans that utilized a deferment program had an average credit score of 701 compared to an average score of 736 for loans that did not defer. In May 2020, there was a drastic divergence in performance as 30 days past due occurances began to increase in loans that utilized deferment options, going from 2.0% in April to 4.5% in January. Over this same period, delinquency in loans that did not enter deferment continue to remain muted. Over the past few months, delinquency levels have returned back to prepandemic levels for defered loans. For reference, deferment levels for loans we monitor peaked around 6% in April 2020.



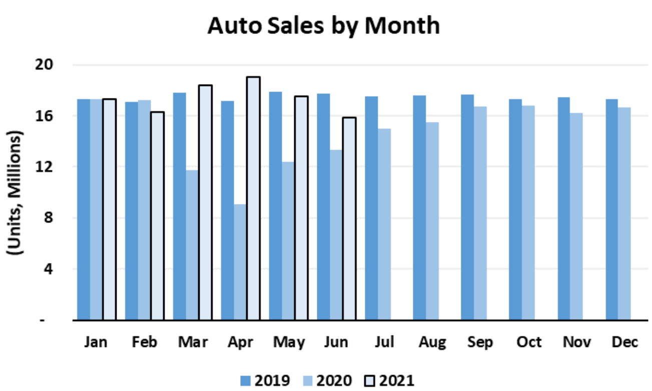
Net Charge Off levels were unseasonably high in April 2020 which is likely due to defaults in loans that were already delinquent before the pandemic and ineligible for payment assistance programs. Since last April, charge offs have continued to decline and remain well below pre-pandemic levels. Similar to delinquencies, net charge offs levels have remained relatively unchanged compared to 2019 for higher credit tiers. The chart on the right below demonstrates how loss given default levels have trended down over the last few years One factor helping to reduce loss given defaults and ultimately charge off levels is used auto values have increased at a record pace providing borrowers more equity and lenders additional value on recoveries. .

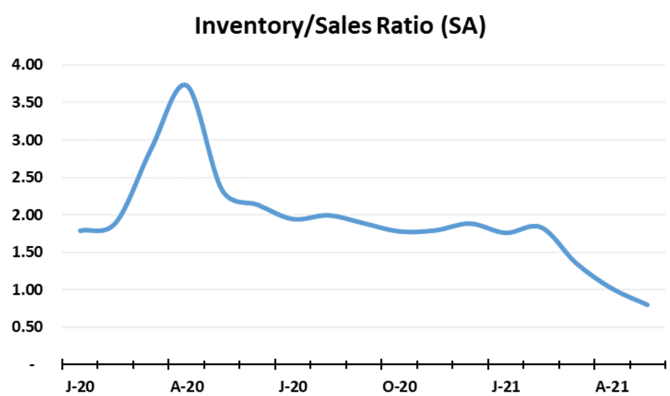




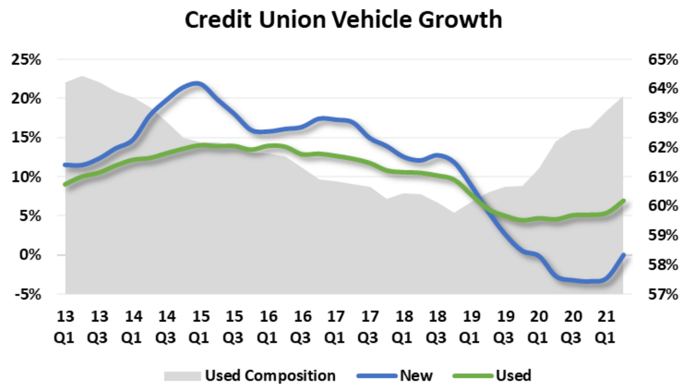
Auto Market

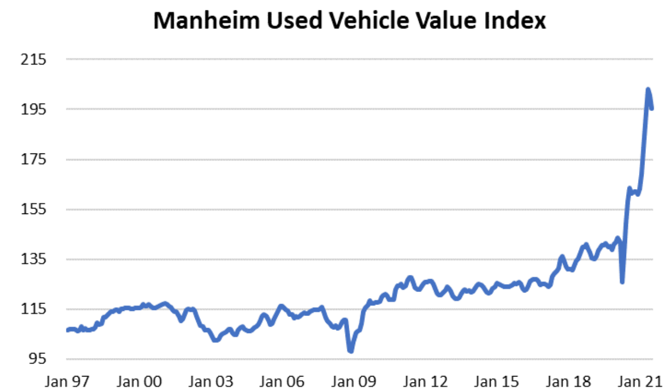
As a result of dealership closures in response to COVID-19 and more than 30 million Americans filing for unemployment, April 2020 experienced a 46% decline in YoY sales, the largest single month decline on record. Sales have since exhibited a V-shaped recovery and have returned to pre-pandemic levels. One interesting development over the last year is that dealers are facing inventory shortages due to global microchip shortages disrupting production for all manufacturers. These challenges are expected to remain for the next few quarters and this will continue to impact both new and used auto pricing.



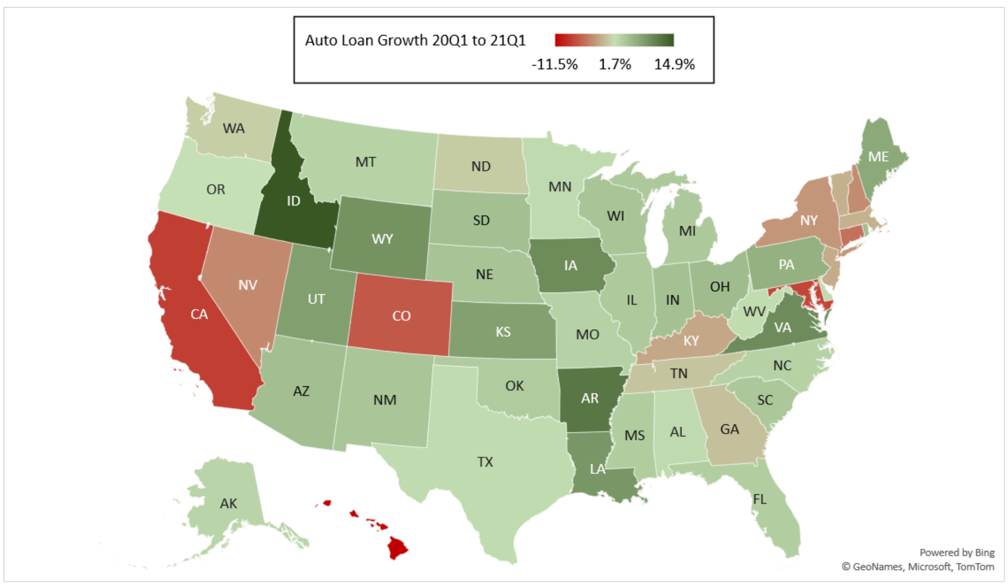


New auto supply remains one of the largest concerns facing dealers and consumers. Dealerships have been operating at significantly lower new auto inventories, with the most severe shortages in pickup trucks. This supply shortage has resulted in more used autos being sold in relation to new autos, and this increased demand for used autos has caused prices to increase at record levels. Used auto values increased nearly 50% from May 2020 to May 2021. Values have begun to decline the previous two months, but they still remain severely elevated compared to historical levels. It will be interesting to see if these values decline when the new auto supply issues are worked out.

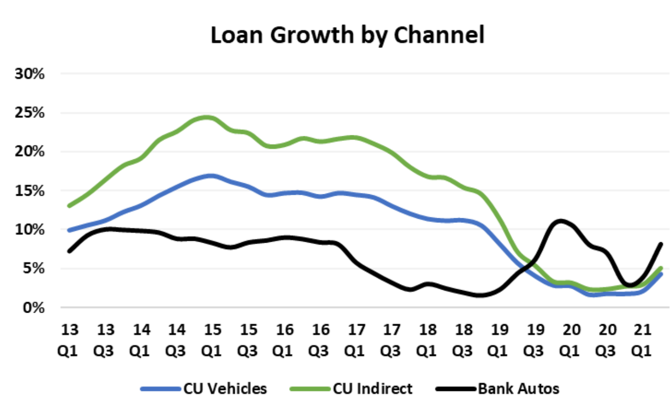


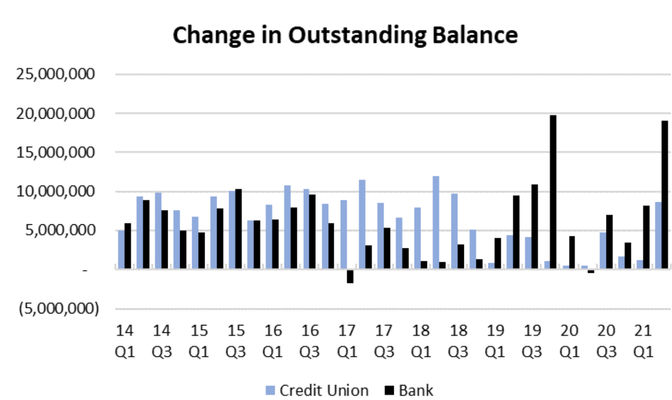


Impacts from shutdowns have varied greatly regionally, as will lending environments for at least the next few quarters. As you can see on the map below, states with the strictest lockdown restrictions such as California and New York experienced the greatest drop off in sales growth. Lenders that have been able to continue producing loans at profitable levels currently have an opportunity to achieve better sale pricing due to the continued supply/demand imbalance as well as continued low Treasuries yields.



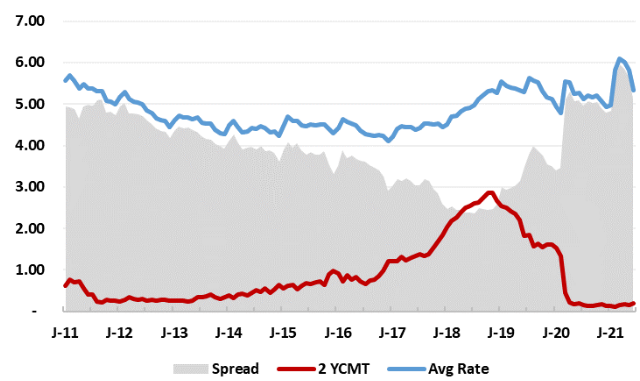
Credit unions benefitted greatly from the boom in auto sales between 2010 and 2018. Over the past few years, loan originations plateaued, as more competition emerged from banks, finance companies and captives. Bank auto lending was significantly slower in 2017 and 2018 but has been higher than credit union growth for over two years. There has been a substantial increase in market share over the past few months in new autos by captives. So far in 2021, volume has begun to ramp up for banks and credit unions, with banks posting some of the largest quarters on record.

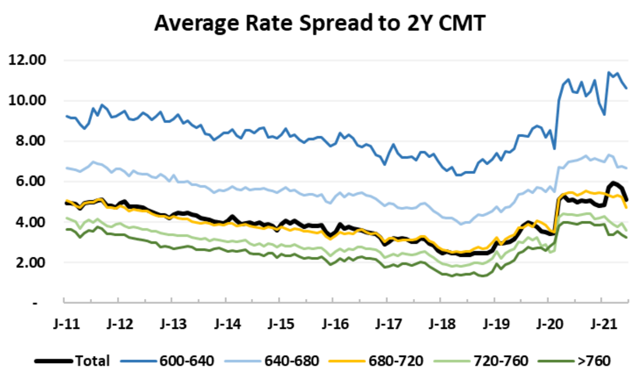




Rate Environment
The chart on the left below shows the weighted average coupon for auto loans reviewed by Vining Sparks and the 2-year Treasury rate during the same timeframe. Between 2016 and 2018, Treasury rates increased significantly while the average rate for auto originations plateaued. By the end of 2018, coupons began to increase at an accelerated pace despite Treasuries falling. This spread widening, combined with declining market interest rates, has provided auto loan sellers with premium pricing levels near all-time highs.

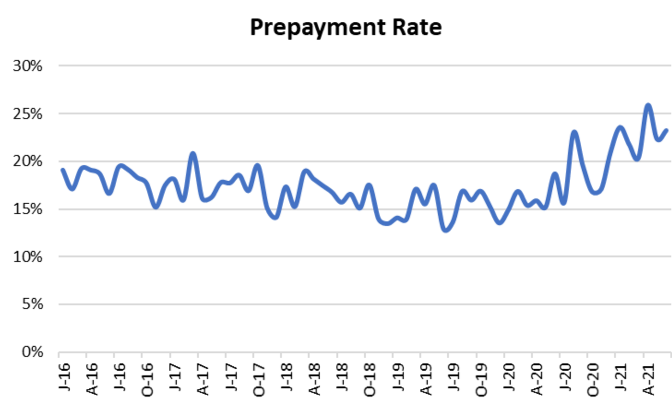
The Federal Reserve has signaled they expect to maintain interest rates near zero throughout 2021. As markets across the country continue to reopen and volume begins to recover, competition among lenders may create pressure to lower rates and ease terms. Maintaining rate setting discipline will be as important as ever. The chart on the right below shows that spreads have increased for all levels of credit ratings, but loans with the lowest credit have experienced the largest spread increase as lenders seek to protect themselves during uncertain economic times.





It should be noted that the charts above represent the weighted average coupon in auto portfolios reviewed by Vining Sparks. The 2020 increase in rate contradicts what is being reported by some organizations that monitor a broader market. Kelly blue book reported that in 2020 the average 60-month interest rate on a new car loan declined from 4.60% to 4.22%, and the average 48-month used car loan rate fell from 5.30% to 4.88%. None of the loans we review are 0% APR which made up 26% of new car purchases in April 2020 compared to 5% in March, according to Edmunds.

Prepayments
Aside from seasonal influences, historical auto prepayment levels have been fairly stable in the 15 – 20% range. Prepayment rates began to increase in June of 2020, until hitting 26% in April of this year, the highest single month in 5 years. The increase in prepayment speeds could be caused by a variety of factors including borrowers capitalizing on the increase in used auto values by trading in for a new auto, or possibly borrowers spending stimulus checks and travel/entertainment savings to reduce their debt levels. We will continue to monitor prepayment activity to see if prepayment speeds return to average historical levels, or if speeds remain elevated for an extended period of time.



In summary, auto loans continue to be a large part of our customers' loan portfolios and a participation class that remains in favor. It is important to stay abreast of market changes in rates and potential credit concerns that may be creeping in that could impact production and performance. We would welcome the opportunity to assist you in evaluating your portfolio for areas of opportunity or provide additional color on this dynamic market. Take advantage of our complimentary detailed analysis on your loan portfolio to give you a better understanding of how your portfolio composition has developed over time, how your portfolio compares to others in the market, and the current market value of your loans. We would be happy to work with you to develop potential strategies for consideration. Please contact your Account Rep or Vining Sparks Loan Trading to discuss in more detail.

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