VINING SPARKS
A Stifel Company

Loan Trading: Consumer Lending

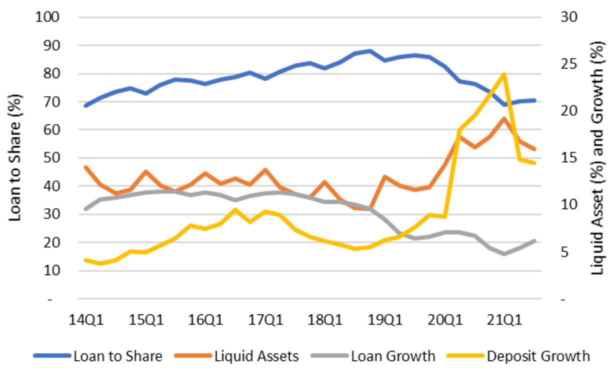
Key Takeaways: **January 4, 2022**

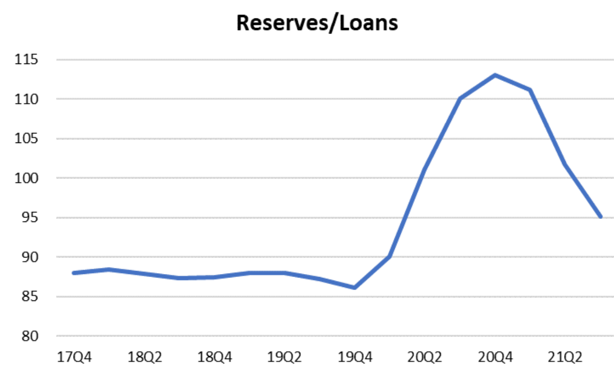
- **Credit union liquidity remains high, liquid asset ratios peaked in 1Q21**
- **Both new and used auto values increasing at record pace**
- **Supply chain and workforce challenges have limited new auto sales**
- **Spreads tightening for auto loans, and all types of Recreation Vehicles**

BALANCE SHEET SHIFTS

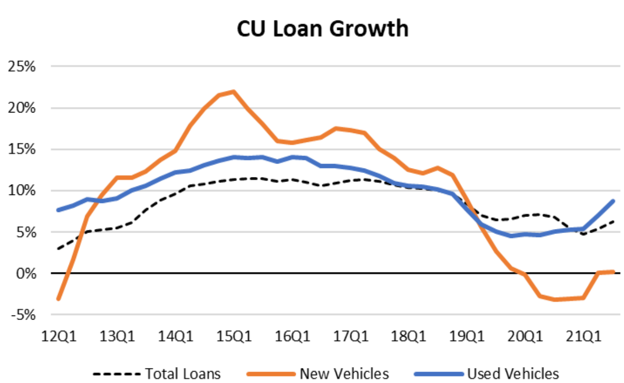
In 2020, credit unions saw a mass influx of deposits continuing through the first quarter of 2021. At the same time, credit unions saw loan growth stall out and decline leading to a 15 percentage point decline in loan to share ratios from the end of 2019 to the end of 2020. Levels have flattened out in 2021 but are still well below historic levels. It does appear that deposit growth is slowing down and that credit unions were able to put some of these new deposits to work, with liquidity levels beginning to decline over the last few quarters.

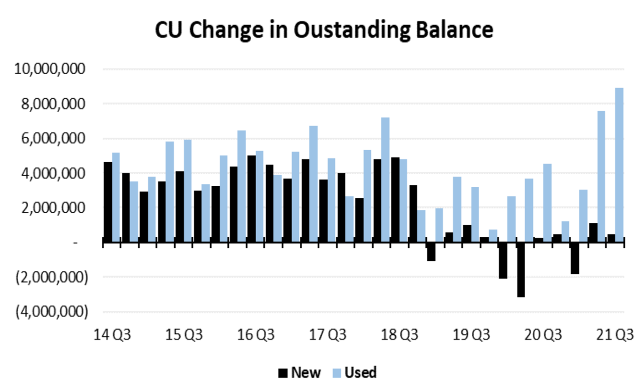
Credit unions have begun to unwind the loan reserves that were built up at the beginning of the pandemic, but they remain above pre-pandemic levels. This decline in reserve levels is a reaction to fears of a pandemic driven spike in defaults beginning to recede. As credit unions continue to reduce reserve levels, there will be added pressure to put liquidity to work due to the need for a new, more durable earnings driver.



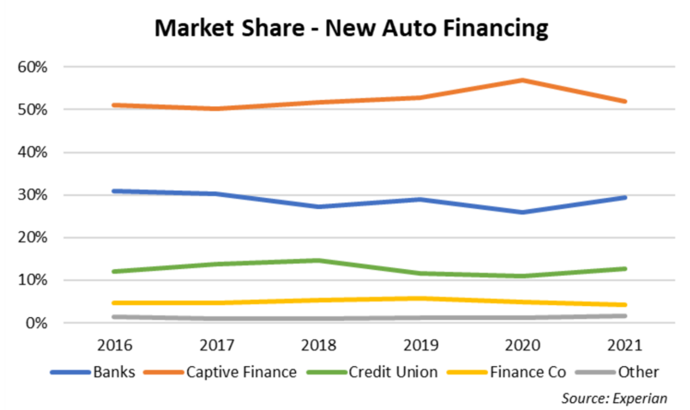


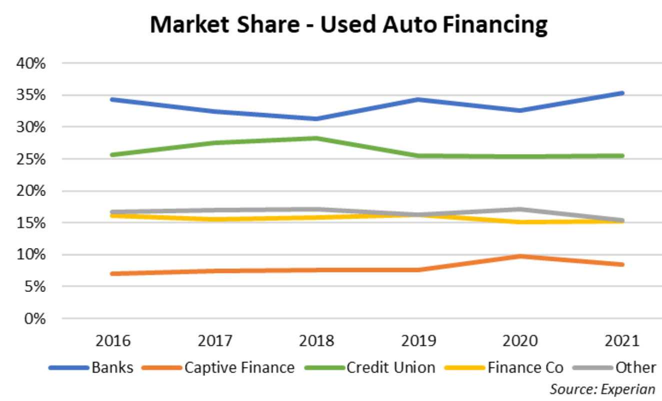
Credit unions benefitted greatly from the boom in auto sales between 2010 and 2018. Over the past few years, credit union loan originations plateaued, as more competition emerged from banks, finance companies and captives. Loan growth remained positive through 2020 and began to increase in 2021, but vehicle lending growth has trailed overall loan growth since 2019. New vehicle loans have significantly trailed used vehicle loans over the past 2 years. This is driven by both captives taking a larger market share as well as supply chain issues drastically reducing inventories. If production issues begin to ease next year, vehicles could be a good opportunity for loan portfolio growth.





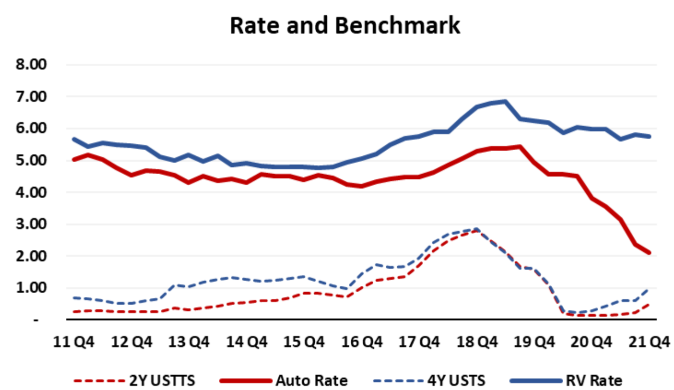
Captives gained a substantial increase in market share of new auto financing in 2020 at the expense of banks and credit unions. Banks and credit unions have been able to recapture some of this lost share of new auto financing from captives in 2021, but with new auto sales down it is a growing share of a shrinking pie. In 2021, Banks also increased their used auto market share to the highest level in years. Credit unions however have been flat since 2019, and several points behind their highwater mark of 28% in 2018.

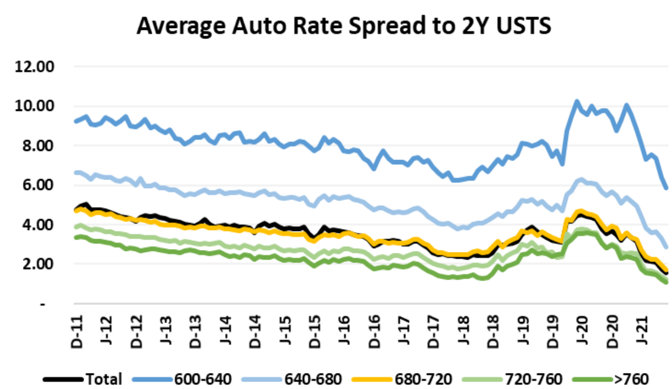




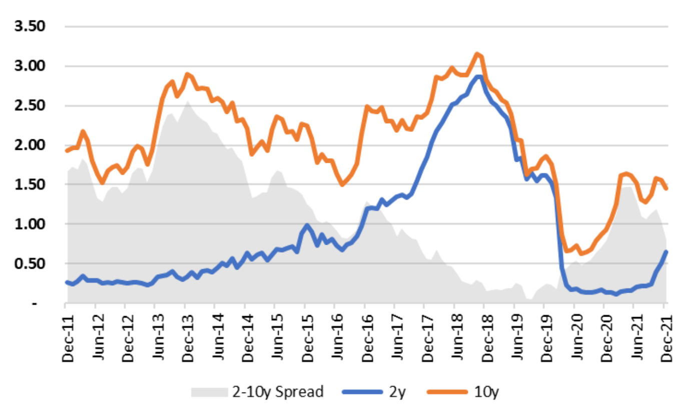
RATE ENVIRONMENT

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 tightened significantly for auto loans as benchmark yields increased and gross rates declined simultaneously. RV Loans have been able to maintain average rates during this period which has helped to maintain spreads. Average auto rates spread to the 2-Year Treasury was over 400bp in the middle of 2020, while they are currently averaging just over 155bps through November 2021.





Another important development has been the increase in spread between the 2-year and 10-year US Treasuries. After steadily declining between 2013 and 2019, the spread between these two benchmarks began to increase rapidly, going from 5bp in September 2019 to 100-150bp for most of 2021 – although it has declined in the 4th quarter. *This volatile spread will be important to monitor going forward, and it may be beneficial to have portfolio reviews done more frequently to stay abreast of market developments and get updated pricing.*

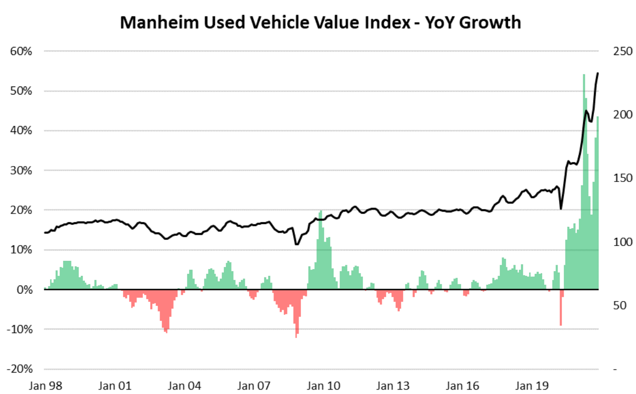


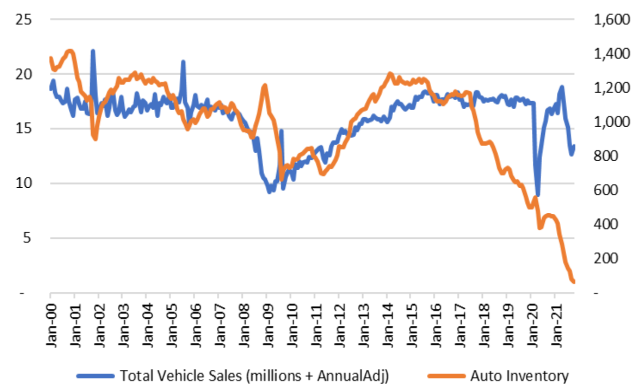
AUTO MARKET ENVIRONMENT

Supply chain constraints have posed serious challenges to dealer inventories as well as new production. As a result, new vehicle prices have increased substantially, which has spilled over into an increased demand for used cars. Between 2020 Q3 and 2021 Q3, new auto loan values increased 8.5% and used auto loan values increased 21%.

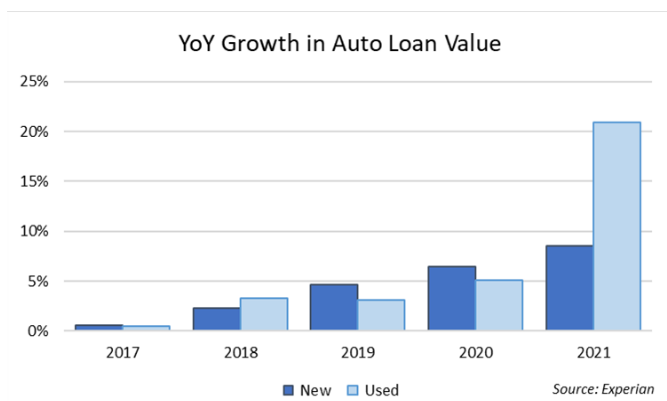
New auto supply remains one of the largest concerns facing dealers and consumers. Dealerships have been operating at significantly lower new auto inventories. This supply shortage has resulted in more used autos being sold in relation to new autos, and this increased demand for used autos has caused prices to increase at record levels. It will be interesting to see if these values decline when the new auto supply issues are worked out.

Inventory constraints are leading buyers to pay a premium to obtain new vehicles, and this has resulted in LTV going up for new vehicles. Used vehicles have also seen a decrease in LTV over this period. This is being driven by the rapid increase in value of used cars resulting in higher trade in values at purchase. According to Experian, new LTV's increased from 111.4% to 115.1% between 2020 Q3 and 2021 Q3, while used vehicles decreased from 124.2% to 110.8% over the same period. Loan to value ratios for new auto loans are now higher than that of used auto loans.

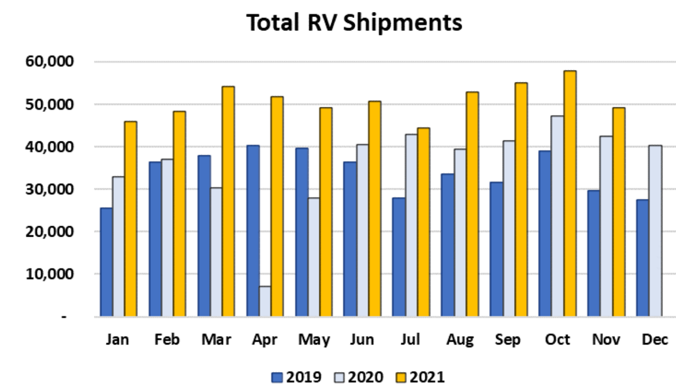


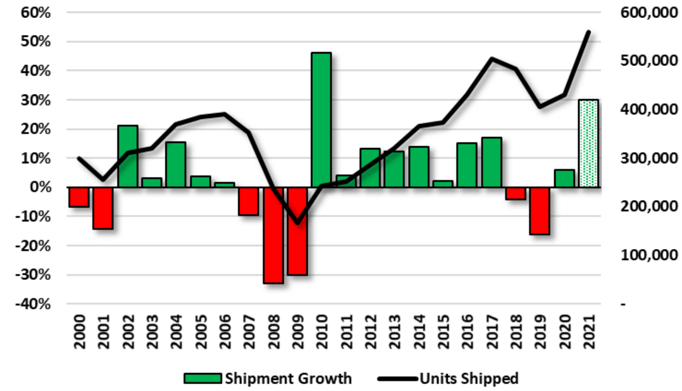


According to Experian, the average new loan amount is up 8.5% from the third quarter in 2020 to the same period in 2021 ($2,965), and the average used loan amount increased 20.9% ($4,500).



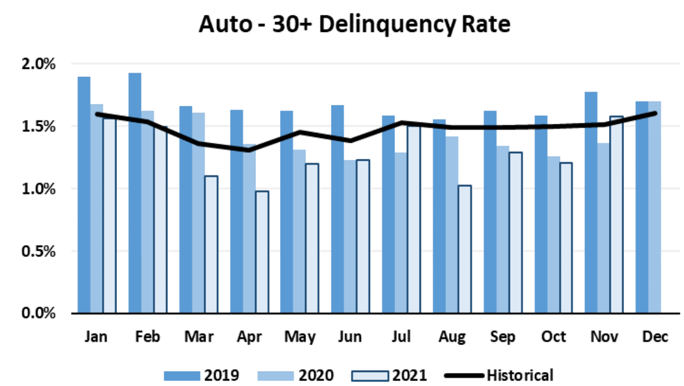
RV shipments have grown massively this year despite all of the supply chain and workforce challenges. With one month remaining in the year, 2021 has already set the record for the most RV shipments in a year according to the RV Industry Association who have been tracking shipments for over 40 years. The past 13 months have all set new records for shipments volumes for their respective months. The record for most shipments in any month was broken three separate times this year in March, September and finally October with nearly 60,000 shipments.

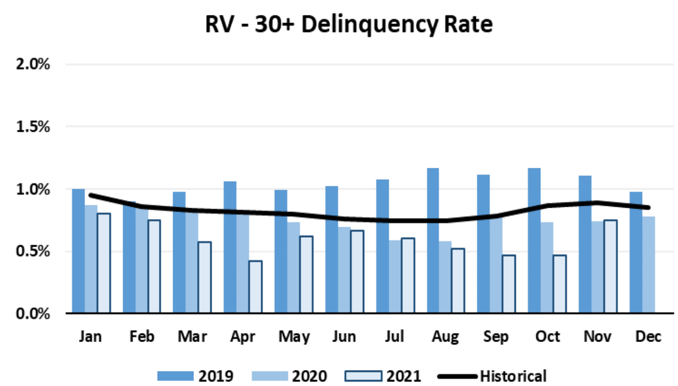




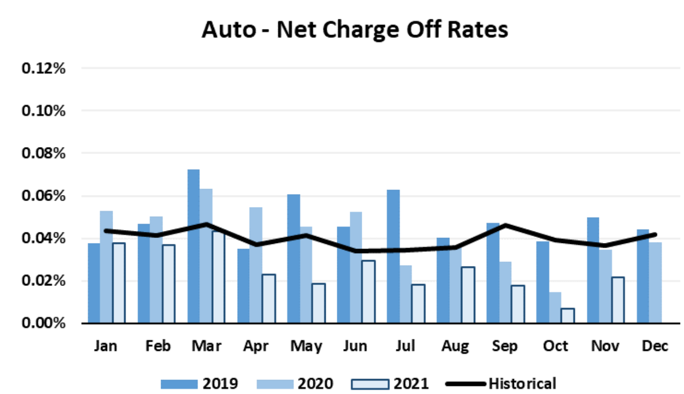
AUTO AND RV PERFORMANCE

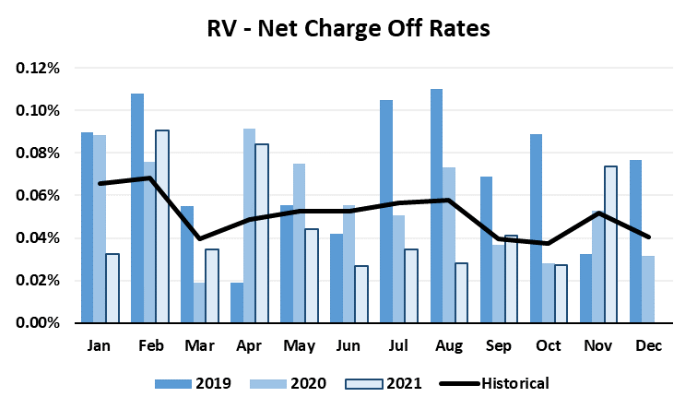
Delinquencies remain well below historical levels for both autos and RV's sold and monitored by Vining Sparks. Delinquency levels are typically the highest during winter months due to seasonal influences, so it will be important to monitor for any developing trends through the next few months.



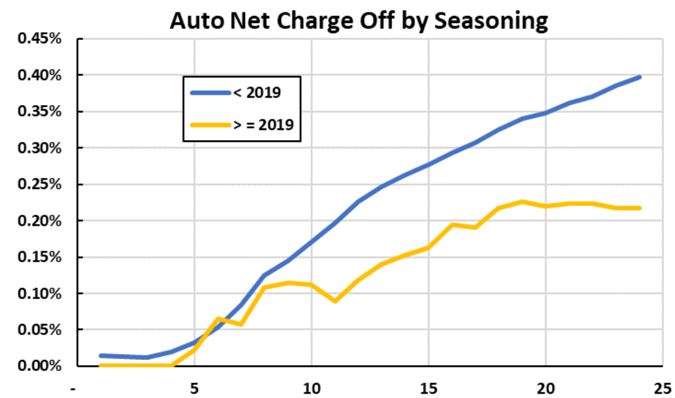


Net charge off levels have been well below both historical and 2020 levels for auto loans. RV loans have been a little more volatile, but charge off levels have been around or below 2020 levels most of the months this year.

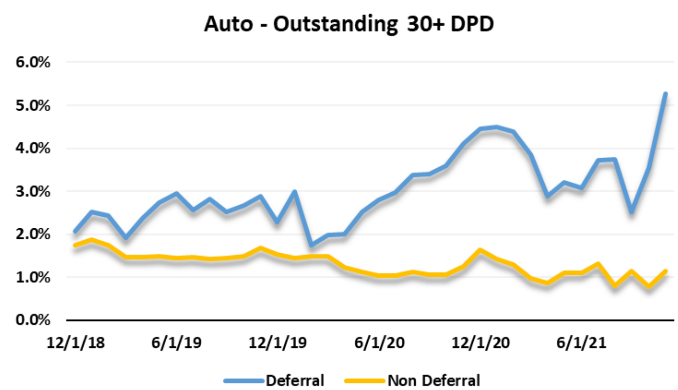




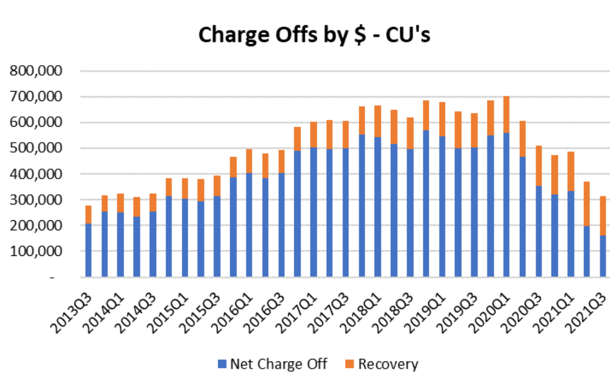
Assistance programs began to go into effect in March 2020, which led to a decline in delinquent loans and ultimately a decline in net charge off rates. In the chart on the right, we compared the net charge off rate by seasoning between loans originated before and after 2019. Newly originated loans have been charging off at around half the level of loans originated before 2019. This performance divergence has become more magnified as seasoning increases. Going forward, it will be interesting to see if net charge off levels remain historically low, or if this is a ripple effect from delayed delinquencies and assistance programs implemented during the height of economic shutdowns.

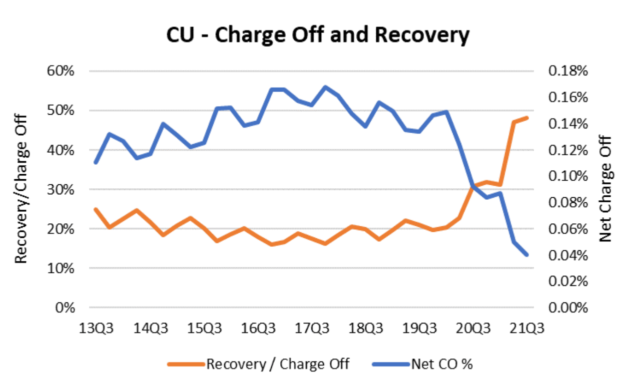


The chart on the right compares delinquency levels for loans that did and did not utilize deferment programs at some point during 2020. Delinquency levels began to diverge in performance beginning in April 2020 as lenders began to roll out payment assistance programs. Delinquencies ramped up significantly for the remainder of 2020 in loans that utilized deferments, and then began to decline back to historical levels through the first few quarters of 2021. During this same period delinquencies continue to remain at historically low levels for loans that did not use these assistance programs. The past two months have seen a sudden spike in delinquencies for previously deferred loans. Delinquencies are typically the highest during winter months, so we will monitor if this trend continues into the spring or if this increase is due primarily to seasonal effects or the elimination of stimulus programs. It is important to remember that deferment levels peaked at 6% in April, so the vast majority of loans sold by Vining Sparks do not fall into this category. This focus on higher credit tiers has resulted in the overall delinquency levels for all outstanding auto loans to decrease to record low levels.



Credit unions are experiencing the two-fold benefit of declining charge offs and larger recovery amounts. This has resulted in the lowest loss levels experienced in credit union auto portfolios in over a decade. One factor helping to reduce loss given defaults and ultimately charge off levels is a record increase in used auto values providing borrowers more equity and lenders additional value on recoveries. It will be interesting to see if used vehicle values continue their rapid accent or even remain elevated, and how long delinquency levels are able to remain at historically low levels.





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 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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