

Realizing a Larger Piece of the Auto Lending Cherry Pie

The one thing you can count on when begging the question—what stops credit unions from getting a larger piece of the auto lending pie?—is that there's no simple answer. However, when you take a closer look, the answers become quite clear.

It's not difficult to find some advantages that credit unions have over other lenders in their market: For one, a built-in community of loyal borrowers. Secondly, competitive rates and terms. And, perhaps a willingness to buy marginal to sub-prime paper. All things considered, they offer advantages for many credit unions. Even with the advantages many credit unions still find it hard to increase market share past the initial growth from entering the indirect lending market.

Why? Because other outside factors impact the decision of which lender a dealer will choose to do business with. In most cases, it's at the point of sale that the dealer's finance and insurance manager makes this decision. Further, profitability and commitment are the driving forces behind which lenders receive the lion's share of loans from dealers.

In today's extremely competitive environment, dealers are forced to sell cars for a minimal profit in the hope to regain a modicum of profit in the back end, which consists of earning finance reserve as well as selling highly profitable products such as extended warranties, alarms, etc. In many cases these items can earn the dealer more profit than the sale of the vehicle.

Offering a competitive rate is crucial, but does not always translate into the best profit opportunity for the dealer. Auto dealers are willing to sell a higher rate to a car buyer when it means higher profits.

By way of explanation, finance reserve income is earned when the dealer sells the rate to a car buyer for higher than they buy it for. This is a critical part of the dealers' profit opportunity. Many credit unions pay dealers a flat fee for each loan funded by the credit union. In most cases, this flat fee is dwarfed to the finance reserve paid by other lenders. Therefore, when a credit union chooses not to offer the dealer finance reserve, they must understand that loan quality and volume will be affected. Additionally, there are guidelines and prepayment charge backs to dealers who earn finance reserve when a loan is

paid off prematurely.

Why does finance reserve affect the volume of quality loans a credit union receives? Consider that higher credit scores get offered lower rates. Therefore, starting at a lower rate provides an opportunity for the dealer to markup the rate while still offering a competitive rate to buyers.

It's a known fact that if a credit union doesn't offer dealer finance reserve, they are at a disadvantage. Is the credit union in a position to require a dealer to send them a guaranteed quantity of quality applications? Possibly, but you first need to understand why a dealer chooses to or is required to commit to a lender.

There are ample reasons, starting with working with lenders who commit to approving marginal credit to subprime paper. This can be a bank, credit union or captive lender such as GMAC, Chrysler Financial, etc.

"If you send a number of quality loan applications, we'll be flexible on a number of marginal to subprime loan applications." This statement suggests an arrangement not uncommon between a lender representative and dealer management. Dealers will commit to sending higher quality loan applications to lenders who consistently approve marginal to subprime loan applications. After all, marginal to subprime loans are traditionally higher profit transactions and provide dealers with a competitive edge over their peers. But, in order to keep the right mix of paper quality, it is important that the lender monitor this very closely.

Most auto dealers finance their inventory with the same lender that provides auto financing to consumers, whether captives, local banks, etc. Lenders that provide a dealer with floor plan assistance usually receive some level of commitment from the dealer regarding auto loan applications. This clearly takes a substantial piece of the lending pie away from all other lenders, including credit unions.

In addition to offering floor plan assistance to dealers, most manufacturers offer financing and leasing on the products they manufacture. For example, GMAC provides financing and leasing for most of the vehicles that GM sells. This financing consists of the low rate financing such as 0% that has swept the

nation since September 11, 2001. Many captives urge dealers to send a certain percent of business to them in addition to the low rate financing. Due to the nature of the relationship, a financial institution that floor plans a dealer's inventory, is more likely to approve a wider range of lower quality paper. In return, the dealership promises to submit higher quality loan applications in order to offset some of the potential losses associated with approving higher risk loans.

Leasing grew 21% in 2006 over 2005. Primarily reserved for better credit consumers, leasing provides a higher interest income to lenders. While it undoubtedly provides a greater opportunity for both market share and profitability growth to credit unions, it also provides the same opportunity to other lenders.

Past experience has caused many credit unions to turn away from exploring the



David Jacobson is founder and president of GrooveCar, Inc., a Long Island-based financial intermediary. He can be reached at David@groovecar.com or (631) 454-7500 extension 111.

opportunity leasing offers. Even though caution is always recommended, there are new lease products that can address the concerns that credit unions have.

In the final analysis, credit unions can find a healthy way to gain consistent market share in today's extremely competitive lending environment, but this requires understanding, planning and communicating on all fronts, which will facilitate the realization of securing a larger share of the proverbial auto lending cherry pie.

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