TOTAL RECALL: IS THERE ADDITIONAL RISK FROM RECALLED VEHICLES IN YOUR PORTFOLIO?

BLACK BOOK WHITE PAPER

AUGUST 18, 2014
According to Bloomberg News, by the mid-way point this year, automakers had broken the record for number of recalls in a single year. By early July, 37.5 million vehicles had been recalled, shattering the previous record of 30.8 million set in 2004\(^1\).

Several manufacturers have had the spotlight on them in recent memory for a number of recall situations. Most recently, General Motors (GM) has had to recall roughly six million vehicles due to an issue with its ignition system. Toyota recalled approximately nine million vehicles between 2009-2010 for its unintended acceleration issue. Ford navigated through its own crisis in 2000 with its Explorer vehicles when a problem arose with the Bridgestone-Firestone tires in use. Bridgestone-Firestone recalled six-and-a-half million tires, and Ford offered to replace an additional thirteen million tires on its vehicles\(^2\).

While safety has understandably been the main concern with these and most vehicle recalls, how has vehicle retention fared following these situations? When a particular vehicle undergoes a recall, should auto lenders steer clear of the vehicles when determining their portfolio expansion strategies?

These are important questions lenders should ask, particularly in today’s ultra-competitive environment. A slowing pace of sales growth, rising supply and overall accelerating used-vehicle depreciation are placing more pressure on lenders to maintain profitable portfolio growth strategies. These factors, combined with an increase in subprime loan activity, have set the landscape for lenders in 2014.

A closer analysis through historical collateral data trends can prove valuable for lenders. By analyzing collateral data, we see that recalls do not necessarily spell trouble for vehicle retention in the short term or several months following the recall period. And while there are never any guarantees, particularly in a recall environment that affects millions, the strength of a manufacturer’s brand can play a significant role in mitigation. This report will take a close look at the relationship between vehicle recalls and vehicle depreciation trends.
Collateral Data And Lender Psychology

Auto lenders typically look at projected vehicle values twenty-four months out to determine if a certain car or truck represents a profitable candidate for portfolio expansion. However, when a vehicle recall is implemented, especially one that generates a plethora of national headlines, lenders may immediately question if that vehicle is right for their portfolio.

Because of its highly volatile environment, retention patterns are most vulnerable in the months immediately following a recall. Collateral data is critical in helping lenders identify any disruption in normal retention patterns, which can offer a trickle effect months and years down the road.

Collateral data trends are collected and analyzed in an expedited fashion today, compared with recalls of years past. This data is used to help lenders find profitable growth amidst a multitude of changing components that include supply levels, credit worthiness, originations and loan-to-value (LTV) levels, and interest rates.

Historical collateral data, combined with current-day values and residual forecasts, all team to help lenders set the right LTV. Collateral data is also a key element in loss forecasting, allowing lenders to determine expectations for future loss levels. With this data available, lenders can determine where they can be more aggressive with terms for higher portfolio growth opportunities while minimizing their risk environment.

Any negative impact to vehicle retention immediately following a recall, or even several months later, can affect a lender’s ability to identify certain vehicles that represent an opportunity for profitable portfolio expansion.

Following are four different examples of vehicle recalls and equipment replacements that have made headlines dating back to the year 2000. Each example will offer collateral data trends that show the recalls themselves did not offer a negative impact to typical vehicle retention patterns.

Recent Vehicle Recalls

1. August, 2000 Ford Explorer
   - Bridgestone-Firestone
2. December, 2009 Toyota
   - Unintended Acceleration
3. November, 2013 Ford Escape
   - Engine Issue
4. February, 2014 GM
   - Ignition
Recall: Toyota Unintended Acceleration  
Recall Date: December, 2009  
Models Impacted: 2008 & 2009 Toyota Camry

Figure A

Long known for dependable and affordable vehicles with a strong reputation in the marketplace, Toyota underwent a series of three related recalls toward the end of 2009 as a result of “unintended acceleration” from its gas pedals on specific vehicles. Roughly nine million cars were recalled during that period, including its popular Camry model. Toyota’s share of new-car sales dropped from 16.6% of all new cars sold to 15.8% by the end of 2010. Despite this loss of sales activity, the Camry continued to show retention value resilience even after the recall commenced.

According to Figure A, historical vehicle depreciation data show the 2008 Camry with a monthly depreciation rate of 3.0% at the end of February in 2010, just a few months into the recall and during a time when heavy public scrutiny fell at the hands of Toyota. This particular vehicle’s retention rate held firm, even outperforming its entire model-year segment, the Upper Mid-Size Cars (UMC), which showed an overall depreciation rate of 3.5% during the same period. As a result, auto lenders could leverage collateral data to see that the Camry remained a viable option for portfolio growth, despite the recall.

The 2009 Camry saw similar results against the model-year segment performance for depreciation. The 2009 Camry showed 3.6% depreciation at the end of February in 2010, whereas the rest of the 2009 Upper Mid-Size Cars showed a depreciation of 3.9%.

Especially in the case of Toyota, brand strength is important during and after a recall. According to a corporate reputation study of 150 leading brands, Toyota’s brand rebounded to #74 in 2012, up from #139 the year after its major recalls.
Recall: Ford Explorer Tire Recall
Recall Date: August, 2000
Models Impacted: Ford Explorer (with Bridgestone-Firestone equipment)

Figure B

During the summer of 2000, the Ford Explorer experienced an onslaught of negative PR when a series of fatal rollover accidents plagued its popular Explorer utility vehicle. Despite this crisis having more to do with tires than the vehicle brand itself, it was Ford’s logo splashed across television screens throughout the country during news reports.

Despite a summer’s worth of negative PR, the Explorer, like other brands in this report, saw little impact to its sales performance. In fact, Ford sold 40,157 Explorers during August 2000, when the tire recall began, compared with 39,000 in August the previous year.\(^5\)

Peter Kitzmiller, then-President of the Maryland New Car and Truck Dealers Association, was quoted in the *Baltimore Sun* saying the incidents were not impacting sales. “The five Ford dealers on our board say that so far their sales have not felt the impact of the Firestone problem,” he said.

Ultimately, Bridgestone-Firestone recalled six-and-a-half-million tires, and Ford replaced an additional thirteen million tires on its Explorer vehicles.

While sales held steady, how did retention values hold up on Explorer vehicles? According to Figure B, a three-year-old Explorer depreciated 2.7% in the three months following August 2000, but a three-year-old Explorer depreciated 6.3% in the same period a year earlier. A two-year-old Explorer depreciated 2.3% in the three months following August 2000, but the same-age Explorer depreciated 4.8% during a year earlier. The Explorer did experience larger depreciation beginning in July of 2000, but that was a result of seven additional lower-value trim levels causing the model average to decline. This average rebounded later that year in November, when an additional three higher-value trims were added. The value of trim levels added to a model of any manufacturer can have a noticeable impact on depreciation patterns.
Recall: GM Ignition
Recall Date: February, 2014
Models Impacted: 2005 & 2006 Chevy Cobalt

Even the actual vehicles affected by the recall model year can avoid an interruption in retention patterns. In early February, GM announced a major recall affecting several of its brands from model years 2005 – 2007. The Chevrolet Cobalt, a popular small car from the manufacturer, was front and center on this list. The automaker said in early 2014 that it needed to replace the key and ignition system on 2.6 million vehicles. The faulty ignition could shut off the engine and disable critical systems such as power steering and air bags. A few months later, GM announced an expansion of the recall to include an additional 2.4 million vehicles.

Figure C shows that the Chevrolet Cobalt, model years 2005 and 2006, actually increased in value several months following the recall. The 2005 Cobalt increased in value by 1.4% between January and June, while the 2006 Cobalt increased 1.1% during the same time.

The GM recall represents the most recent example of a widespread vehicle recall with major press coverage. Despite all of this attention, lenders are moving forward with GM vehicles in their portfolios. As published in the June 18th issue of Credit Union Times magazine: “I really don’t see this [GM recall] as a significant factor impacting credit unions,’ said Dave Colby, chief economist at CUNA Mutual Group. ‘Consumers will continue to look for monthly payments, MPG and vehicles that fit their needs.”

The magazine also stated that the most recent data from CUNA Economics and Statistics showed a 16.3% year-over-year growth in new vehicle loan portfolios as of this past April.
Ford recalled approximately 140,000 of its 2013 Escape utility vehicles because of a problem with its 1.6-liter EcoBoost 4-cylindar engine that has caused several fires. According to Figure D, the 2013 Ford Escape declined in value by 3.0% in May of this year. However, the same-aged version of the Escape declined 2.8% the same time a year earlier. The data shows that the Escape had downward depreciation in June 2014. However, this is part of seasonal patterns, not as a result of the recall. The Escape showed similar depreciation during June of the previous year.
Summary

Since the recession, auto manufacturers have embraced an era of increased transparency leading to more vehicle recalls. So far in 2014, approximately 37.5 million vehicles have been recalled. These recalls have touched virtually every manufacturer, with a spotlight shining more on certain brands. Recalls due to safety issues are not new, though, and over the past few decades there have been recalls that have impacted hundreds of thousands of vehicles. Vehicle sales from the majority of these recalls has not been affected, even from incidents in recent memory generating negative press.

The psychology of a vehicle recall, particularly one garnering national headlines, has the propensity to keep auto lenders from expanding their portfolios with the vehicle in question. However, historical collateral data trends have shown that recalls typically do not adversely impact normal retention patterns of a vehicle, immediately after the recall is initiated as well as into the future. Collateral data is a key element in identifying these trends for lenders, and can help detect particular vehicles that offer opportunities for increased risk. Historical, current and forecasted vehicle value data offers the right amount of insight for loan originations, LTV levels and where to be more aggressive within the portfolio.

Black Book collateral data is made possible through access to vehicle insight that is timely, independent and accurate. Black Book’s suite of data includes wholesale, trade-in and retail values that are updated on a daily basis. Black Book offers the industry’s most innovative portfolio management technology, which lets lenders evaluate different vehicle options to see how each would impact a portfolio in real time. Black Book’s data can also help with loss forecasting, which include historical trending and depreciation curves to measure the impending risk of downward or upward movement in specific vehicles and vehicle segments.

Collateral data from Black Book is made available with detailed analytics provided in a variety of file formats, online portals, and on desktop or mobile platforms. For more information, please visit BlackBookAuto.com/Lender-Solutions or call 855-371-7532.

Appendix

2. “The 8 Most Infamous CarRecalls In History”; FOXBusiness.com; August 20, 2010
4. “Toyota: FromRecalls To Relevance”; Forbes; March 27, 2012
5. “FordSUV Selling Despite TireRecall”; Baltimore Sun; September 9, 2000
7. “CU Loan Portfolios Won’t Be Hit By GMRecalls”; CUTimes.com; June 13, 2014
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