2021. Market Perspectives & Trends

Buy Here-Pay Here Market Perspectives/ Trends

For 2021, the National Alliance of Buy Here-Pay Here Dealers and Subprime Analytics, with the approval and participation of NIADA, prepared this industry report from a database of dealers and operators nationwide.

The financial information included herein was prepared and contributed by SGC Certified Public Accountants. The financial information they used represents a composite of the best performing operators and not an average of the entire industry.

This information includes operating data on sales, collections and recoveries, and inventory management supplied by NCM and NIADA Dealer 20 Groups from composite averages.

This year we have again included industry perspectives on tax refunds from Tax Max, compliance and regulatory from NIADA, inventory from Manheim, consumer demands from NextGear Capital, and capital.

Also included are portfolio performance metrics compiled electronically by Subprime Analytics, which to date has analyzed approximately 2.7 million subprime installment contracts totaling $27.9 billion to identify loss rates, patterns and trends.

We've added an extensive What's Ahead section this year to address the market and other industry changes expected in 2022 and beyond.

In the aggregate, these statistics and the industry perspectives provide a comprehensive view of the financial and operating performance of the industry and important trend information.

In 2018, NIADA purchased the assets and operations of NABD and merged the two organizations. Subprime Analytics has contracted to provide analytical services, including periodic data, to NIADA to support important initiatives for the used car industry.

For further information, visit www.bhphinfo.com or www.niada.com. Industry reports for the past five years can be downloaded free of charge at www.subanalytics.com.

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2021 Tax Season for Independent Dealers

A Q&A with William Neylan, president and owner of Tax Max in Tampa, Fla.

When did tax filing season start and end in 2021 for subprime customers?

Due to the pandemic and last-minute tax law changes, the IRS didn't open filing until Feb. 12, 2021 – the latest opening in U.S. history.

Later that month, after the IRS had opened and processed some returns, Congress passed a law making the first $10,200 in unemployment benefits not taxable. That caused confusion, as some taxpayers had already filed while some had not.

Forms, software and the IRS were not ready to handle that change, forcing some filers to wait until the systems were ready to file.

As a result, the IRS extended the filing deadline (for the second year in a row) for one month, to May 15, 2021.

Which dealers fared best in 2021 and why?

I would say every dealer (franchise, retail and BHPH) won last year, as the IRS issued a stimulus check of $600 per person in each household on Jan. 5, 2021. In March, the IRS issued another stimulus check of $1,400 per person in the household.

Tax filings last year were late across the board because some consumers "just didn't need their tax refund." With tax season extended to May 15, consumers had ample time to file.

Consumers had money from multiple stimulus checks and unemployment checks, so tax refunds were last on the list. Some consumers (those without bank accounts) didn't want to file because they had no place to deposit the tax refund money.

All of that made 2021 an anomaly that should not be used as a basis for future planning.

Consumers could apply for a refund advance at the dealership, giving them access to their tax refund up to six to eight weeks before the IRS released it.

Some BHPH dealers also set up an irregular payment or a pickup payment and had the customer make a promise to pay a special payment in February 2022.

Those dealers received money down at the time of sale and an additional special tax payment on Feb. 28, 2022. That helped reduce the term of their contracts by up to 21 percent.

In 2021, dealers used the irregular payment program throughout the entire year.

What was the average refund in 2021?

The average refund was $5,211, a 15.5 percent increase over the 2020 average of $4,512.

The reasons for the increase included stimulus payments, which were sometimes added to tax returns; the earned income credit, which increased by 3 percent; and the child tax credit of $2,000 per child.

When did the IRS start and stop processing refunds in 2021 and what effect did COVID-19 have on the season?

Because of the PATH Act, tax refunds that had an earned income credit, the additional child tax credit or education credits could not be processed until after Feb. 15.

Because of the tax law changes and COVID, the IRS extended the tax filing deadline until May 15 instead of the usual April 15 deadline. As a result, the tax season extended longer than usual.

What impact did the PATH Act and COVID-19 have on 2021 refunds?

Taxpayers are becoming more aware of the PATH Act and consumer filing patterns are moving into February from January. Consumers who are hungry for refunds do have access to a refund advance, which they can get as early as Jan. 2.

With the pandemic continuing and stimulus checks and unemployment stimulus, taxpayers filed sporadically in 2021.

How did COVID change how dealers execute tax season?

Technology has changed dramatically because of COVID.

New methods that are touchless, paperless and faceless now exist. Because of staffing limitations, a new texting method lowers the time involved from 15 minutes to 1 minute per deal.

A dealer can now send customers a text to submit their tax documents online, allowing a tax professional to prepare their return. Refund advances are also available.

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How did 2021 tax refunds impact the selling season for independents last year?

Tax Max has a portfolio of more than 3,000 dealers, 75 percent of whom are independent. Those dealers had a successful tax season primarily because of the additional $2,000 in stimulus payments.

Some consumers put more money down and were able to buy more car with their money by filing for a refund advance.

Inventory was the main issue for many dealers in 2021, and some dealers chose to sit out tax season because vehicles were too expensive.

How would you characterize the financial ability of consumers when tax season ended on May 15, 2021 compared to the start of tax season on Jan. 1?

Consumers started 2021 in a strong financial position, which continued into the fall.

The government released the second stimulus payment in January 2021 and the last stimulus check in March. Unemployment payments continued and, depending on the state, ended sometime between June and December.

What can we learn from the 2021 tax refund season? What are the opportunities?

Dealers are being more effective with the ways they advertise and market their tax marketing program.

Dealers who used an effective tax marketing program had more sales during tax season while those who had no program at all thought "tax season doesn't exist anymore."

The tax season is alive for the dealers who have adapted to the changing times. More BHPH dealers are using irregular payments. ■

Legal and Government Affairs Summary

Commentary provided by Brett Scott, NIADA vice president of government affairs.

It takes a year to get acclimated to a new position, learn the issues and meet NIADA's members.

That box has now been checked.

Though 2021 began with uncertainty in Washington, with the Administration change and ongoing COVID developments, D.C. forged on and decisions were made in person and via Zoom.

Congress finalized the last COVID stimulus package, negotiations on a bipartisan infrastructure plan began and rumors were swirling about Sen. Richard Blumenthal (D-Conn.) introducing recall legislation into that bill.

NIADA engaged in partnerships with NADA, NAAA and Cox Automotive to join forces on Capitol Hill. Through persistent engagement, calls to action to NIADA members and open lines of communication with congressional staff, we were able to get the recall legislation withdrawn during Senate Commerce Committee markup and ensure that proposal would not advance.

The final infrastructure bill – which was signed into law in November – did not include safety recall language.

Senate and House Democrats worked on legislation called the Build Back Better plan, a massive spending plan totaling up to $3.5 trillion dollars.

The package included free college, free healthcare and other items of concern to our members. Among the troubling measures were the tax hikes proposed to pay for the bill, including increased taxes on S-corporations and LLCs.

NIADA, in coordination with the Small Business Legislation Council and the U.S. Chamber of Commerce, attended more than 80 meetings with Senate and House Democrats voicing our opposition to that provision.

As momentum for the BBB sputtered, Democrats pushed a new price tag of $2 trillion, which party leaders hoped would be low enough to get moderates such as Sens. Joe Manchin (D-W.Va.) and Kyrsten Sinema (D-Ariz.) on board.

NIADA expressed opposition for the new package as debate raged about what would be cut from the previous bill.

Even with the President voicing support for the new proposal, it was not favorably received by moderate Democrats.

At press time, momentum has stalled, but negotiations on some form of BBB package continue in 2022.

While large comprehensive bills grabbed the headlines, NIADA continued to monitor key congressional committees of jurisdiction.

The Senate Banking Committee held a hearing July 29 to discuss S.2508, the Veterans and Consumers Fair Credit Act, introduced by Sen. Jack Reed (D-R.I.), which would extend the financial provisions of the Military Lending Act to the general public.

Those provisions include an interest rate cap of 36 percent, which, American Financial Services Association president and CEO Bill Hempler said, would have a "disastrous effect" on credit-challenged consumers.

NIADA, together with AFSA and the Consumer Bankers Association, sent a letter to Congress opposing the bill. Currently, no action has been taken on that legislation.

In the House, H.R. 2668, the Consumer Protection and Recovery Act, passed 221-205 by voice vote.

That bill would grant the Federal Trade Commission authority to order businesses that violated the law to pay monetary relief to consumers without going through lengthy administrative and court proceedings.

The FTC had been using that practice for decades, but in April the Supreme Court ruled it was in violation of the language of the FTC Act.

H.R. 2668 moved on to the Senate, where it fizzled.

An executive order issued by President Biden sparked conversations around right to repair rules that would give consumers and independent auto service operations the same access to repair information, technology and equipment as OEMs and franchise dealerships.

The order, signed July 9, was aimed primarily at large technology companies, but it also addressed other general concerns, such as equipment manufacturers using proprietary repair tools, software and diagnostics to prevent third parties from performing repairs that force customers to pay higher prices when independent repair shops could perform them at a lower cost.

The order also encourages the FTC to issue rules against anticompetitive restrictions against using independent repair shops or doing DIY repairs.

NIADA maintains communications with Congress on that important issue.

NIADA was also in communication with state associations as state legislative sessions began.

In Illinois, harmful GPS/starter-interrupt legislation was introduced in early March that would have been detrimental to NIADA's dealer members.

NIADA, along with National Corporate Partners PassTime, Ituran, Spireon and Advantage GPS, retained a state lobbyist to engage the assemblyman who introduced the bill. Over the next few months, we were able to kill that legislation.

In New York, we worked on recall legislation with New York IADA and initiated discussions with state assembly members.

Similar to the engagement plan in Illinois, New York members had multiple meetings with the author of the bill and explained the detrimental impact it would have on small businesses. As a result, that specific legislation did not pass.

NIADA members in Michigan supported a bill giving car dealerships more flexibility in their hours of operation.

Previously, dealerships were required to be open for at least 30 hours a week for all 52 weeks of the year, making it difficult for small dealerships to accommodate emergencies, vacations, repairs and other necessary closures as employment shortages and the pandemic continued.

The new law allows vehicle dealerships to be open for less than the 30-hour minimum for up to four weeks each year. The bill, backed by NIADA, was signed into law by Gov. Gretchen Whitmer.

In the regulatory sphere, former FTC commissioner Rohit Chopra was nominated by President Biden as director of the Consumer Financial Protection Bureau.

During Chopra's confirmation, NIADA members engaged through the One Click Politics platform to express opposition to his appointment. Chopra was eventually confirmed in a close vote along party lines, and quickly focused on mortgage lending and big tech.

While converging on those, the CFPB announced two new debt collection rules, which went into effect Nov. 30.

The final rules, issued under the Fair Debt Collection Practices Act, included a rule focused on debt collection communications, clarifying the FDCPA's prohibitions on harassment and abuse, false or misleading representations and unfair practices by consumer debt collectors.

The second rule clarified disclosures collectors must provide to consumers at the beginning of collection communications, prohibiting them from suing or threatening to sue consumers on time-barred debt. It also spelled out the steps collectors must take to disclose the existence of a debt to consumers before reporting it to a reporting agency.

Chopra also singled out a few "buy now pay later" companies, including Affirm, Afterpay, Klarna, PayPal and Zip, that drew concerns over accumulating debt, regulatory arbitrage and data harvesting in a consumer credit market already changing with technology.

Independent dealer issues were not mentioned, but as used car prices increase and consumers purchase vehicles, auto finance lending will become a hot topic. In preparation, NIADA has gathered feedback from our members and reached out to the CFPB.

NIADA recommended quarterly calls with the bureau continue in 2022.

Chopra's position on the Federal Trade Commission was filled by the confirmation of Lina Khan on June 15. She was immediately named the FTC's chairwoman by President Biden.

While Khan was familiarizing herself with a multitude of issues, the FTC implemented a controversial update to the Safeguards Rule. The update requires non-banking financial institutions – which now include vehicle dealers – to develop, implement and maintain a comprehensive security system to keep their customers' information safe.

The changes define the specifics of a compliance information security program, including limiting access to customer information and new requirements for encryption and multifactor authentication.

The new rule also requires entities to designate a "qualified individual" to oversee the information security program and explain the administrative, technical and physical safeguards used to handle customers' secure information.

NIADA previously submitted comments opposing the revisions to the Safeguards Rule in 2020, citing the "enormous expense" for dealers to comply – up to $330,000 annually.

NIADA held a conference call with Khan's staff during the 2021 NIADA Convention and Expo. During that call, FTC staff wanted to explore dealership "add-ons" and the products dealers provide consumers.

NIADA suggested a walk-through to explain the process of purchasing a car, what is offered and the transparency of the process to consumers. FTC staff members expressed their appreciation for the opportunity to meet our members and requested continued communication.

In 2021, NIADA began Coffee With Congress, a series of virtual events that allow NIADA member dealers to engage with congressional offices and ask questions of their legislators.

NIADA held more than 10 Coffee With Congress events, including both Republicans and Democrats, covering issues from recalls to EV's to the CFPB and FTC, and politics in general.

While we can't guarantee the outcome of every issue coming out of Washington, we can promise NIADA will continue to fight each and every day to protect the interests of our members and independent dealers. ■

NIADA

Inventory

Commentary provided by Jonathan Smoke, Cox Automotive chief economist, and Kevin Chartier, vice president of Manheim Consulting.

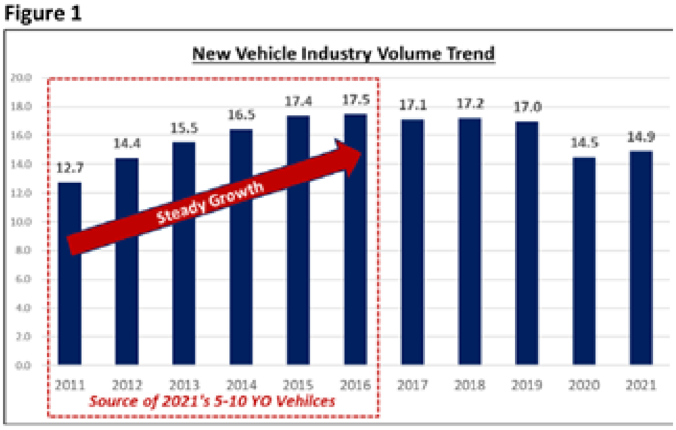
Supplies of 5-10 Year-Old Vehicles

Acute supply shortages were the main storyline for the auto industry in 2021.

COVID lockdowns, chip shortages and other supply chain challenges have combined to severely limit the number of new vehicles produced and sold over the past the past two years.

That really has not been the case for the 5- to 10-year-old vehicle segment. Availability in that segment during 2021 was driven by what happened in the new vehicle market between 2011 and 2016.

Figure 1



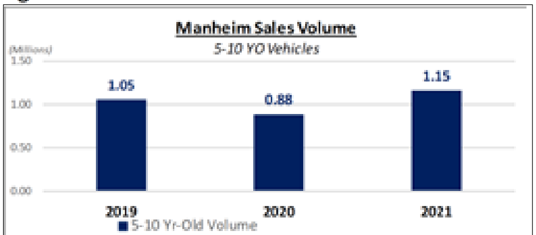
As shown in Figure 1, that was a period of steady growth, as the economy continued to recover from the Great Financial Crisis of 2008/2009.

The echo of that steady new vehicle sales growth was confirmed by the growth in volume of 5-10-year-old vehicles sold through Manheim in 2021 (Figure 2).

While the overall volume at Manheim was up only 5 percent vs. 2020 and down 13 percent from 2019, the volume in the 5-10-year-old age segment was up significantly in 2021 (31 percent over 2020 and 10 percent vs. 2019).

While the rest of the industry struggled with acute inventory shortages, the 5-10-year-old segment had continued growth in availability.

Figure 2



Manheim Volume Growth Rate Comparison

	vs. 2020	vs. 2019
5-10 YO Vehicles	**+31%**	**+10%**
Total Manheim Volume	+5%	(13%)

Pricing Trends

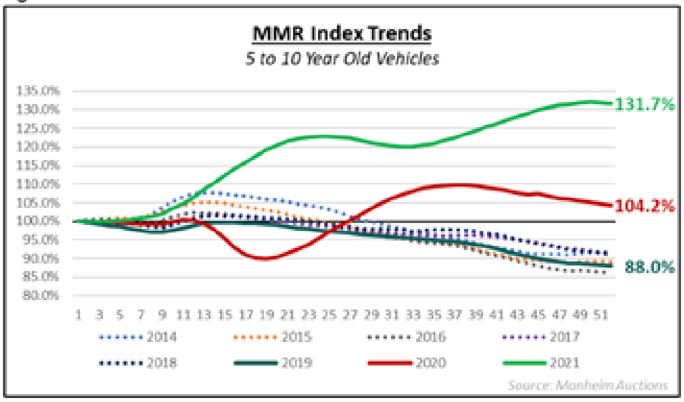
Although supplies of 5-10-year-old vehicles were up in 2021, the competition to acquire those vehicles was intense.

Excess demand from the new vehicle marketplace found its way into the near-new used market, driving prices for 2-3-year-old vehicles up more than 35 percent. That, in turn, forced many traditional buyers of near-new vehicles to dig deeper into the older used vehicle market to find what they needed.

That, along with increased demand from the government stimulus programs, touched off a waterfall of intense demand throughout the entire used vehicle market, driving prices significantly higher across the board.

Prices for 5-10-year-old vehicles rose by 32 percent between the beginning and end of 2021 (Figure 3). Looking back at 2019, prices fell by a very normal 12 percent. So to say a 32 percent increase was unprecedented is a major understatement.

Figure 3



Retail Sales

Retail sales of vehicles between five and 10 years old increased dramatically in 2021 – more than any other category – as supply and demand came together.

On the demand side, the global computer chip shortage forced automakers to cut production of new vehicles, causing tight inventories and pushing buyers into the used vehicle market.

Sales of nearly-new vehicles – those less than four years old – declined as lessees bought out their leased vehicles or the grounding dealer took them back. Sales of older vehicles – more than a decade old – held steady.

In 2021, the 5-10-year-old category overtook the under-4 segment in share of the overall market for the first time since 2015.

For independent dealers, the 5-10-year-old category surpassed the 11-plus-year-old group in 2020 in share, which hadn't happened since 2015.

Compact sport utility vehicles, which became the best-selling category for new vehicles mid-decade, drove much of the 2021 increase as their massive numbers started showing up in the 5-10-year-old category.

In 2021, compact SUVs represented the largest percentage increase of share for 5-10-year-old vehicles, rising to nearly 18 percent of the volume in 2021. That was up four percentage points from 2019.

Full-size cars dropped the most, down more than two percentage points to 6.9 percent of all vehicles sold, largely because there are fewer of them since automakers dropped them from their lines.

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Small cars still held the largest share at 21.9 percent, unchanged from 2019, but midsize cars slipped a percentage point to 20 percent. Share of midsize utilities also slipped by nearly 1 percentage point to 14.9 percent.

Other segments held roughly steady.

By automaker, Ford, Chevrolet, Toyota, Nissan and Honda, respectively, logged the most sales, as they did in 2019 in the same order.

Subsequently the Ford F-Series and Chevrolet Silverado pickup trucks topped the list of bestsellers. But some compact SUVs began to rise to the upper ranks of the list in 2021, led by the Ford Escape and Chevrolet Equinox.

Jeep models – the Wrangler, Cherokee and Renegade – had the biggest percentage-point increases from 2019 of any compact SUVs.

Data from the Federal Reserve Bank of New York indicate subprime auto loan originations grew 12 percent to $123.3 billion in 2021 – the largest year for subprime originations since 2014.

Credit Trends

Credit became more accessible in 2021 and growth in subprime contributed to record new loan originations measured in dollars.

Federal Reserve Bank of New York data indicate that subprime auto loan originations grew 12 percent to $123.3 billion in 2021 – the largest year for subprime originations since 2014.

However the subprime share of originations declined to 16.8 percent as all other credit tiers grew even more.

The strongest quarter for subprime lending was the second quarter of 2021, when the subprime share was 17.5 percent.

That quarter was the strongest for used vehicle sales in 2021. It was supported by two rounds of stimulus in the months prior, as well as tax refund season. It was also assisted by more supply and lower prices compared to later in the year.

Dealertrack auto loan data indicate that spring saw the largest share of subprime lending for independent dealers in March and April 2021, when the subprime share was 27.2 percent and 26.1 respectively.

Credit conditions for subprime remained favorable throughout 2021. The Dealertrack Credit Availability Index for dealer finance lenders reached its highest level in December.

That reflected that approval rates remained high as yield spreads narrowed, terms lengthened, negative equity grew and down payments declined as the year progressed, making credit more accessible.

The average rate on a loan in the dealer finance channel was the lowest of the year in December. ■

Manheim Cox Automotive

Meeting Shifting Consumer Demands

Commentary provided by Scott Maybee, NextGear Capital president.

Many of the advances today, including investments in technology, have offered clients the ability to work smarter and more efficiently.

There's no doubt technology will play an increasingly significant role for everyone in the automotive industry.

At our company, we're using it to accomplish two primary goals.

First, we want to offer innovative solutions that work for everyone. Second, we want to enhance the overall client experience and ensure working with NextGear Capital is simple and transparent.

To meet shifting consumer demands, we've invested in everything from our front-end account management system to our back-end software.

Technology offers solutions for your industry research, sourcing, digital retailing, floorplanning, consumer financing, logistics, marketing and any other facet of your business. It solves problems, provides insights, saves time, increases client satisfaction and eliminates hurdles.

Technology is shaping our future. Today, clients have new insights and transparency when it comes to their accounts and can easily request changes, making floorplanning easier than ever.

Behind the scenes, technological innovations are underpinning significant advances in how we do business and react to changing market and client needs. It's helping us be more nimble and opening doors to opportunities.

It's no different for independent dealers.

Technology offers solutions for your industry research, sourcing, digital retailing, floorplanning, consumer financing, logistics, marketing and any other facet of your business. It solves problems, provides insights, saves time, increases client satisfaction and eliminates hurdles.

And consumers expect it. A recent Cox Automotive study made it clear consumers are completing more car-buying steps online and the preference for online shopping is not expected to wane this year for both new and used vehicles. ■

NextGear Capital Cox Automotive

Capital Markets

Commentary provided by Ken Shilson, president of Subprime Analytics and past president of NABD, based on conversations with capital providers to the subprime auto industry.

Asset-Based Lines of Credit

If you like strong collateral performance, 2021 was a great year to be a lender in the Buy Here-Pay Here space.

Several macro effects greatly impacted Buy Here-Pay Here dealers in 2021.

Whether we're talking about vehicle values, parts and labor shortages, higher cash collection rates or competitive pressures, most Buy Here-Pay Here dealers performed exceptionally well in 2021 from a finance receivables standpoint.

During the first half of 2021, many dealers experienced higher cash collection rates, as consumers were spending stimulus dollars and inflation had yet to accelerate. Cash collection rates (total payments collected/average finance receivables balance) were strong in the first half of 2021 and slowly progressed downward in the second half.

Increased cash payments kept receivable recency rates healthy throughout the year. Similarly, cash liquidation rates (principal payments and auction proceeds/finance receivables liquidation) were higher in the first half of 2021 before moving downward to more normalized levels.

Heightened wholesale vehicle values offset gross charge-offs and reduced net loss rates, but also brought higher vehicle sales prices and customer loan payments.

The most challenging issues dealers faced in 2021 were accessing affordable inventory and converting that inventory into sales/finance receivables among increased competition from large Buy Here-Pay Here operators and indirect lenders.

For the most part, lenders' portfolios didn't see strong growth in 2021 as their dealer sales levels were lower compared to pre-COVID levels. The reduced sales levels were offset by lower repossession rates, keeping portfolios relatively flat.

With lower growth in dealer borrowings, some lenders moved their market focus by serving smaller dealers, while others offered lower interest rates with higher advance rates.

As 2021 came to an end, some banks re-entered the Buy Here-Pay Here market as they gained comfort in the strong collection performance.

Contract Acquisitions

The same effects that impacted secured lenders in Buy Here-Pay Here also affected bulk portfolio purchasers.

Because sales levels were lower across many small-to-medium-sized dealers, bulk portfolio purchase volume suffered in 2021.

While dealers struggled to have sufficient working capital to cover cash operating expenses, the smaller number of available contracts for sale resulted in a larger number of smaller transactions purchased for higher prices.

Many purchasers continued to serve dealers by purchasing seasoned loans while others expanded offerings to include purchasing unseasoned loans and developing continuous flow programs.

The flow programs essentially served as a point-of-sale substitute, allowing dealers to convert contracts into cash at or near the time of origination.

From a dealer's perspective, 2021 was a great year to sell contracts.

Many contract buyers raised prices in order to maintain or capture market share. As typical, contract buyers had strong collection performances and higher wholesale vehicle values, so prices edged up throughout 2021.

The most challenging issues dealers faced in 2021 were accessing affordable inventory and converting that inventory into sales/finance receivables among increased competition.

As with all economic cycles, pricing stabilized in the second half of 2021 as payment rates and projected wholesale values began to decline.

Subprime Auto Asset-Backed Securities Market

Auto loan originations, from a dollar perspective, for consumers with credit scores below 620 rallied 12.1 percent to $123.3 billion in 2021, as opposed to $109.9 billion in 2020 according to the New York Fed and Equifax.

That increase (from higher vehicle prices and loan amounts rather than increased units financed), was absorbed by the capital markets.

After a year-over-year decline in 2020, subprime auto asset-backed securities issuance rebounded in 2021 with 67 securitizations raising approximately $43.4 billion – the highest yearly issuance after the Great Recession.

That compares to 49 transactions for a total of $27.7 billion in 2020, according to data published by Finsight.

While some normalcy returned later in the year, consumer credit performance remained strong for most of 2021, resulting in rating agencies reversing most of the conservatism in their loss projections made in 2020.

Most issuers, therefore, experienced lower credit enhancement requirements, translating into higher advance rates and proceeds from issuances.

Investor demand showed resiliency in the aftermath of COVID volatility and remained robust for most of the year, as subprime auto asset-backed securities provided higher yields and more favorable value compared to other markets.

Strong investor appetite in the sector resulted in lower credit premiums through the summer, followed by higher rates later in the year. In the fourth quarter, more diverse credit tiering among different issuers occurred (which often resurfaces during a weaker market).

Beside higher credit premiums, yields were negatively impacted by higher interest rates as a result of inflationary pressures, but the cost of funds for issuers remained favorable given market compression and the record lows of late 2020 through mid-2021. ▪

NABD

Subprime Analytics

What's Ahead in 2022?

Commentary collectively provided by all the commentary contributors to this report.

Capital and vehicle inventory availability (at reasonable costs) will continue to constrain subprime used vehicle sales in 2022, while the continued availability and use of COVID-19 vaccinations work to end the pandemic.

Operators must anticipate it will take at least another 12 months for the return of any form of economic normalcy.

In the interim, inflation will increase operating costs and depress consumer cash flow, making collections more challenging in the absence of government stimulus payments.

In response to those and other challenges, prudent operators must overcome those obstacles with entrepreneurial skill and creativity.

At the time of this report, issues ranging from Russia/Ukraine, voting rights, China, supreme court nominations and decisions, Build Back Better, a potential government shutdown and the money needed to fund the infrastructure package are stealing the headlines.

It's also an election year, and the potential for Republicans to gain multiple seats in the House and Senate will influence what issues are targeted by the Administration and Democrats.

The regulatory world in 2022 looks similar to 2021. Both the CFPB and FTC will continue to focus on mortgage lending, big tech and how consumers navigate the pandemic.

More important, though, as used car prices soar and consumers take on more debt, it would not be surprising if the CFPB and FTC began focusing on this sector.

That means operators need to tune up their compliance management systems to avoid costly legal and regulatory pitfalls.

The 2022 tax season is getting back to pre-COVID patterns – with a few changes.

This tax season will last longer with more documentation needed, such as stimulus amounts, advanced child tax credits and other verification. More dealers will use irregular payments to extend tax benefits to future periods.

Rising inflation and interest rates, and tighter inventory supplies will threaten to erode future dealer profits. Future interest rate increases might cause some dealers to fix the rates on their lines of credit in order to limit their borrowing costs.

The next 24 months will bring two of the biggest accounting rule changes ever.

In 2022, the new leasing rules require companies to list property and equipment leases as debt.

In 2023, the new allowance for credit loss rules (CECL) will require dealers to record a reserve on the balance sheet equal to expected future losses on their entire portfolio.

Operators should work closely with their accounting and tax professionals to minimize the adverse impact of those changes on their bottom lines.

Inventory-related semiconductor production issues will persist in 2022, and vehicle production will be disrupted by the Russian-Ukrainian war.

The used vehicle market will continue to experience outsized demand – and elevated wholesale prices – throughout 2022.

Semiconductors aside, it's certain used vehicles will be in shorter supply for some years to come. Operators must be diligent in sourcing inventory and use the latest technology to aid their searches.

While it's unlikely there will be anything close to a repeat of 2021 in 2022, many of the dynamics that drove higher prices last year are still with us.

Demand at the top end of the market continues to outpace supply as persistent supply-chain challenges undermine new vehicle production. Until production recovers, expect some of the excess new vehicle demand to spill over into the used vehicle market, supporting higher than normal competition for used vehicle acquisitions across the age spectrum.

While used vehicle prices might correct a bit from the incredible highs reached last year (perhaps down 3 percent by year's end), expect most of the price gains to stick with us in 2022 and likely well into 2023.

Digging into data from Cox Automotive and looking at broader economic factors, it's apparent this year will continue to be measurably different than 2021.

Last year, vehicle appetite was strong thanks to low interest rates, longer terms, consumer cash on hand due to various government assistance programs and trades getting top dollar.

Demand is still high, thanks in part to the endurance of strong trade values and interest rates remaining low from a historical perspective. But government assistance has tightened and the Federal Reserve raised interest rates for the first time since 2019, with more rate hikes to come.

In addition, anyone in lending is likely already seeing defaults rising this year, as last year's lull was always going to be temporary.

Economic and inflation-related concerns are also very real.

Independent dealers who take the time to understand the factors impacting shifting consumer behaviors and who are future-focused and adaptable are thriving.

The hypercompetitive and rapidly evolving marketplace of today is no place to rely on the status quo or business as usual.

Sourcing and financing inventory successfully has always required a careful and strategic approach, and that's never been more true than today. Limited inventory and elevated pricing have reduced the amount of inventory purchased on speculation – a trend successful dealers will continue to follow.

Smarter acquisitions have been met by strong consumer demand, which has played into a boon for independents.

For dealers who work directly with consumers on financing, the fact average retail prices are up nearly 30 percent compared to last year and have far outpaced wages creates additional concern.

It will be important to focus on two key considerations:

- Know what type of inventory lenders prefer. That information can be found by reviewing the lender's vehicle criteria.
- Know what the retail consumer can actually afford. Try to think beyond the initial sale and consider the loan performance. The dealer-lender relationship is a true partnership and one that can provide benefits with proper care.

Staying on top of evolving consumer preferences, both in the type of vehicles they prefer and how they find and purchase those vehicles, will be your differentiator.

Analyzing every step of your business processes, looking at them through the lens of consumers and seeking out the partners and tools you need will help yield answers and solutions to your pressing questions and ensure you're prepared to achieve your goals in 2022 and beyond.

The aforementioned challenges offer opportunities for independents to regain lost market share and regrow their portfolios using prior profitability and cash flow in capitalizing on the market changes.

Dealer education plays an important role in finding solutions to all those challenges. This report is intended to help readers identify where they need to focus.

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WHAT'S AHEAD CONTRIBUTORS:

Financial Review/ Performance Data

Commentary and financial information provided by SGC Certified Public Accountants, Houston, Texas.

It was another record-breaking year in 2021 for dealers across the country.

Despite inventory shortages, dealers continued to post strong financial results.

Increasing consumer demand for used vehicles, higher hourly wages and government stimulus all helped to drive sales and reduce charge-offs. Lessons learned in 2020 paid dividends in 2021, as dealers relied heavily on technology and many used remote workers for collections and administrative positions.

Some dealers also sold portions of their portfolios to third-party finance companies as the contract market paid record prices.

The financial benchmarks for 2021 reflect all those trends.

For those who could afford to buy inventory, sales were up significantly over 2020. Dealers who could not afford inventory were constrained on sales. Cost of inventory and reconditioning costs increased as vehicle and parts prices spiraled upward.

The largest change in the benchmarks occurred with charge-offs, which declined 25 percent from 2020 levels. While the number of accounts charged off did not change dramatically, the higher inventory prices resulted in increased ACV recoveries, lowering net charge-offs.

There was also a significant decline in financing income collected. Many dealers lowered the interest rates charged to customers in an attempt to make vehicles more affordable. Additionally, dealers who sold off portions of their portfolio collected less interest income for the year.

Both of those factors resulted in the decline in financing income.

While operating expenses overall stayed fairly consistent compared to 2020, salary expenses declined, primarily related to dealers having unfilled job positions in a tight labor market.

Dealers reported higher turnover of employees during the year and finding and retaining good, experienced employees continues to be a significant challenge. ■

Ratio Comparisons: 2019-2021

(STATISTICS SUPPLIED BY SGC CERTIFIED PUBLIC ACCOUNTANTS)

NOTES TO FINANCIAL DATA

Financial information was prepared from the best performing dealers/operators in the SGC database of BHPH dealers nationwide.

The ratio and financial information has been verified for accuracy and comparability.

Financial results are combined (dealer and related finance affiliate), where applicable.

Intercompany activity has been eliminated from the financial information, where applicable.

COMBINED BUY HERE-PAY HERE BALANCE SHEET

	2021 AVERAGE BHPH BENCHMARK	2020 AVERAGE BHPH BENCHMARK	2019 AVERAGE BHPH BENCHMARK
(Year End Inventory X Days) / Cost Of Vehicle Sales	62.86 days	64.96 days	51.89 days
Cost Of Vehicle Sales / Average Inventory Dollars	6.34 x	5.79 x	7.42 x
Vehicle Sales / Average Inventory Dollars	9.55 x	9.00 x	11.77 x
Vehicle Sales / Total Assets	0.94 x	0.78 x	0.90 x
Total Assets / Total Liabilities	1.69 x	1.81 x	1.70 x
Allowance For Bad Debts / Finance Receivables*	21%	22%	23%
Total Debt / Total Assets	59%	56%	59%

* FINANCE RECEIVABLES IS PRINCIPAL BEFORE ALLOWANCE FOR DOUBTFUL ACCOUNTS
X = TIMES

COMBINED BUY HERE-PAY HERE INCOME STATEMENT

	2021 AVERAGE BHPH BENCHMARK	2020 AVERAGE BHPH BENCHMARK	2019 AVERAGE BHPH BENCHMARK
Bad Debts / Vehicle Sales	15%	19%	24%
Cost Of Vehicle Sales / Vehicle Sales	66%	64%	63%
Gross Profit*** / Vehicle Sales	36%	38%	31%
Operating Expense / Vehicle Sales	19%	21%	20%
Interest Expense / Financing Income	6%	10%	17%
Operating Income / Vehicle Sales	17%	17%	11%
Financing Income / Vehicle Sales	17%	21%	18%
Compensation** / Vehicle Sales	10.13%	11.38%	10.20%
Reconditioning Cost / Vehicle Sales	9.3%	8.7%	8.5%

**COMPENSATION EXCLUDES THOSE OF THE OWNERS
***GROSS PROFIT IS NET OF BAD DEBTS AND FINANCING INCOME

Cost of inventory and reconditioning costs increased as vehicle and parts prices spiraled upward. For those who could afford to buy inventory, sales were up significantly over 2020.

Income Statement: 2019-2021

(STATISTICS SUPPLIED BY SGC CERTIFIED PUBLIC ACCOUNTANTS)

	2021 BEST DEALER BENCHMARK	2020 BEST DEALER BENCHMARK	2019 BEST DEALER BENCHMARK
Vehicle Sales	100%	100%	100%
Cost Of Vehicle Sales	-66%	-64%	-63%
Gross Profit BEFORE Bad Debts and Financing Income	**34%**	**36%**	**37%**
Bad Debts Expense	-15%	-19%	-24%
Financing Income	17%	21%	18%
Gross Profit	36%	38%	31%
Operating Expense	-19%	-21%	-20%
Operating Income	17%	17%	11%
Interest Expense	-1%	-2%	-3%
Income Before Income Taxes And Officers Compensation	**16%**	**15%**	**8%**

Cost of Goods Sold and Operating Expense Detail: 2019-2021

(STATISTICS SUPPLIED BY SGC CERTIFIED PUBLIC ACCOUNTANTS)

COST OF VEHICLE SALES

	2021 % OF VEHICLE SALES	2020 % OF VEHICLE SALES	2019 % OF VEHICLE SALES
Cost of vehicles	54.18%	52.51%	52.20%
Reconditioning costs	9.28%	8.65%	8.53%
Other	2.54%	2.84%	2.27%
Total cost of vehicle sales	**66.00%**	**64.00%**	**63.00%**

OPERATING EXPENSE

	2021 % OF VEHICLE SALES	2020 % OF VEHICLE SALES	2019 % OF VEHICLE SALES
Advertising	2.50%	2.24%	3.07%
Bank Charges	0.29%	0.33%	0.27%
Contributions	0.07%	0.03%	0.03%
Depreciation	0.25%	0.28%	0.30%
Dues and Subscriptions	0.20%	0.35%	0.20%
Insurance	0.47%	0.48%	0.34%
Legal and Accounting	0.32%	0.43%	0.58%
Outside Services	0.29%	0.40%	0.27%
Office Expense	0.68%	0.70%	0.70%
Rent	2.09%	2.08%	2.00%
Repairs and Maintenance	0.12%	0.26%	0.21%
Salaries (Non-Owners)	10.13%	11.38%	10.20%
Taxes - General	0.08%	0.32%	0.14%
Other Operating Expense	0.02%	0.14%	0.04%
Taxes - Payroll	0.76%	0.82%	0.84%
Utilities and Telephone	0.50%	0.54%	0.50%
Travel / Training	0.24%	0.22%	0.31%
Total Operating Expense	**19.00%**	**21.00%**	**20.00%**

Dealer Perspectives/ Operating Data

The following dealer operating information was provided by NIADA and NCM 20 Groups and represents composite averages from their group participants.

Methodology: The NIADA BHPH benchmarks are based on the 2021 results of more than 100 BHPH dealers from around the country. The benchmarks were derived from a cross-section of strong operators and include all sizes of dealerships, not just large ones.

These benchmarks represent the averages of the sample group. The mix of dealers included in the 2021 sample differs from those in years past, creating some comparability differences.

Inventory and reconditioning: Inventory availability was a consistent, major challenge in 2021. The ongoing COVID-19 pandemic, combined with a shortage of semiconductors, greatly curtailed new vehicle production and, thus, inventory availability.

The substantial loss in new vehicle inventory caused franchise dealers and consumers to turn to used vehicles to meet demand, with dealers reaching much further down the model year/age spectrum to acquire inventory than in years past.

To address inventory needs, BHPH dealers were forced to buy older vehicles that were frequently in poorer condition and with higher mileage, all at a far higher price point. The decline in condition meant dealers had to spend more on reconditioning last year, with costs rising by an average of 7 percent versus 2020.

Sales and marketing: Sales totals were essentially flat in 2021, due mostly to the inventory crunch. BHPH dealers could almost certainly have sold more units had inventory been more readily available.

While volume was flat, finance amounts and gross profits were up significantly versus 2020, illustrating the basic principles of supply and demand.

Collections and portfolio performance: Portfolio performance, as evidenced by collections and delinquencies, was outstanding in 2021. Pandemic-related stimulus and record tax refunds provided BHPH customers a large infusion of cash, which in turn improved recency and reduced delinquencies.

While charge-off amounts did rise, that was due in large part to higher ACVs. BHPH dealers remain diligent regarding collections activities given the cessation of pandemic stimulus, to prevent an increase in delinquencies.

Expenses: Expenses associated with inventory acquisition and reconditioning were substantially higher in 2021, as were personnel expenses.

Regarding the latter, technician compensation was up significantly, as competition for their services among dealers and independent repair shops intensified.

Inflationary pressure increased, as operational expenses – even down to fundamental items such as oil and other vehicle fluids – were up substantially. ■

NCM Commentary/ Data

Overview: Inventory acquisition and risk mitigation were the main focus in 2021.

Inventory costs increased dramatically from 2020, causing dealers to re-evaluate future growth plans based on capital needs and possibility of increased risk. Dealers having the most success with inventory acquisition took advantage of technology via online buying avenues to source vehicles.

Dealers having the most success with controlling risk saw a fairly significant increase in average payment that helped keep the increase in average term and average break-even times to a minimum.

> Unit sales were flat in 2021 for NCM's dealer clients, the result of a slight decrease from our large volume dealer clients (more than $10 million A/R). Small volume dealer clients (less than $10 million in A/R) showed a slight increase.

Sales: Unit sales were flat in 2021 for NCM's dealer clients, the result of a slight decrease from our large volume dealer clients (more than $10 million A/R). Small volume dealer clients (less than $10 million in A/R) showed a slight increase.

The dealers with the most significant volume increases operated in states that had fairly restrictive COVID policies in 2020. Lack of robust federal stimulus packages had an impact on volume for both small and large volume dealers.

Inventory: Average cost of vehicles for both large and small volume dealers increased significantly, with small volume dealers again experiencing the bulk of the increase.

The continued lack of available new inventory for franchise dealers again caused a significant increase in demand in used vehicles, pushing the average cost of vehicles in inventory up more than 20 percent by year's end. The increase in demand and subsequent price increases again caused a reduction in overall inventory carrying levels.

Reconditioning costs remained static across our dealer client base.

Collections: Delinquencies improved slightly for both large and small volume dealers. The number of accounts charged off dropped by 9 percent, with the average net loss decreasing by a substantial amount – mainly due to the increased value of used vehicles. ■

20 Group Dealer Operating Information: 2019-2021

(PREPARED BY NIADA AND NCM 20 GROUPS)

SALES

	2021 NIADA BENCHMARKS	2020 NIADA BENCHMARKS	2019 NIADA BENCHMARKS	2021 NCM BENCHMARKS	2020 NCM BENCHMARKS	2019 NCM BENCHMARKS
Average Units Sold Per Dealer (BHPH Deals Only)	1,084	1,080	684	521	571	579
Average Cash In Deal Per Vehicle Sold	$7,042	$6,403	$6,206	$6,894	$6,529	$6,192
Average ACV Per Vehicle Sold (Includes Recon)	$7,814	$6,364	$6,275	$7,444	$7,035	$6,596
Average Reconditioning Cost Per Vehicle Sold	$1,182	$1,100	$870	$1,165	$1,227	$1,171
Average Gross Profit Per Vehicle Sold	$6,981	$6,450	$6,029	$5,122	$5,035	$4,704
Average Cash Down Payment (Excluding Trades, deferred downs)	$1,192	$703	$735	$1,453	$1,267	$1,134
Average Amount Financed	$13,753	$12,206	$12,484	$12,975	$12,037	$11,824
Average Term Of Contract (In Weeks)	172	174	184	153	154	149

COLLECTIONS / RECOVERIES

	2021 NIADA BENCHMARKS	2020 NIADA BENCHMARKS	2019 NIADA BENCHMARKS	2021 NCM BENCHMARKS	2020 NCM BENCHMARKS	2019 NCM BENCHMARKS
Average Weekly Payment Amount	$103	$98	$96	$97	$95	$91
Percentage Of Accounts Past Due	15.0%	20.4%	18.3%	14.4%	18.5%	17.2%
Average # Of Past Due Accounts Per Collector	68	86	69	112	81	95
Average Net Loss Per Charge Off	$5,817	$5,130	$6,646	$5,352	$5,665	$4,991
Average portfolio delinquency						
Current	85.00%	79.50%	81.70%	85.60%	81.50%	82.80%
1-15 days	9.50%	11.10%	9.80%	9.30%	12.80%	10.40%
16-29 days	2.70%	4.30%	3.50%	2.80%	3.60%	3.30%
30-59 days	1.70%	3.20%	2.70%	1.10%	1.20%	1.70%
60-89 days	0.60%	1.40%	1.00%	0.30%	0.30%	0.80%
90+ days	0.50%	0.50%	1.30%	0.90%	0.60%	1.00%
TOTAL	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**

INVENTORY MANAGEMENT

	2021 NIADA BENCHMARKS	2020 NIADA BENCHMARKS	2019 NIADA BENCHMARKS	2021 NCM BENCHMARKS	2020 NCM BENCHMARKS	2019 NCM BENCHMARKS
Vehicle Days Supply (Units)	67	65	61	57	69	76
Average inventory aging						
0-30 days	46.00%	46.30%	45.50%	46.60%	44.20%	38.90%
31-60 days	23.00%	26.30%	22.70%	25.60%	22.70%	23.20%
61-90 days	12.00%	12.90%	16.70%	10.00%	10.30%	13.30%
91+ days	19.00%	14.50%	15.10%	17.80%	22.80%	24.60%
TOTAL	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**

Portfolio Performance/ Metrics

Commentary provided by Subprime Analytics, Houston, Texas. The loss metrics data and the graphs that follow were compiled using four-year averages (2018-2021) representing the average term of the contracts analyzed.

The portfolio performance metric for the industry in 2021 is not apparent when viewing the four-year metric averages.

Though the pandemic threatened to have an adverse impact on the subprime auto finance industry in 2021, government stimulus and additional unemployment payments again benefitted collection performance by providing subprime customers with the additional liquidity to make their payments.

However, vehicle sales were constrained by the significant capital needed to fund the higher cost of vehicle inventory.

The following metrics and trends isolate the more important changes that occurred in 2021.

Average **amounts financed** were greater as dealers' sales prices were increased in an attempt to offset the spiraling cost of the vehicles. Amounts financed in 2021 increased by an average of 4.5 percent over the prior year.

Average **cash in deal** per unit sold increased by 16 percent as the average vehicle cost of inventory was considerably more expensive (also a 16 percent increase from 2020), as a result of supply shortages and heightened competition for Buy Here-Pay Here inventory. ACV averages in 2021 increased approximately $1,400 per unit over 2020 cost.

Operators tightened **underwriting** standards and increased average down payments by approximately 17 percent to preserve capital and to offset higher vehicle costs. Collections benefitted from government stimulus and additional unemployment payments, which stabilized default rates.

Average **gross dollar charge-offs** (before recoveries) increased due to the higher ACV of the vehicles collateralizing defaults, while net charge-offs (after recoveries) benefitted from a significant increase in the value of recoveries from repossessions.

Average **customer repayments** increased to more than $100 per weekly equivalent in 2021, reducing the need to extend the average contract term at origination despite the larger amounts financed.

Capital provided under lines of credit was limited by constrained dealer vehicle sales and their related installment contracts, which collateralize those loans. In response, dealers focused on maximizing collections, reducing operating expenses and maximizing internal cash flow.

Prudent operators also used the additional cash flow to reduce outstanding debt.

Those factors improved liquidity and profitability despite the constrained sales volumes. Given the spiraling cost of inventory, inflation and constrained sales, dealers offset margin compression with operating efficiencies and tighter underwriting. ■

Subprime Analytics

Loss Metrics: 2019-2020

BHPH LOSS DATA COMPILED BY SUBPRIME ANALYTICS AFTER ELECTRONICALLY ANALYZING APPROXIMATELY 2,733,000 CONTRACTS, AGGREGATING APPROXIMATELY $27.9 BILLION TO IDENTIFY LOSS RATES AND TRENDS.

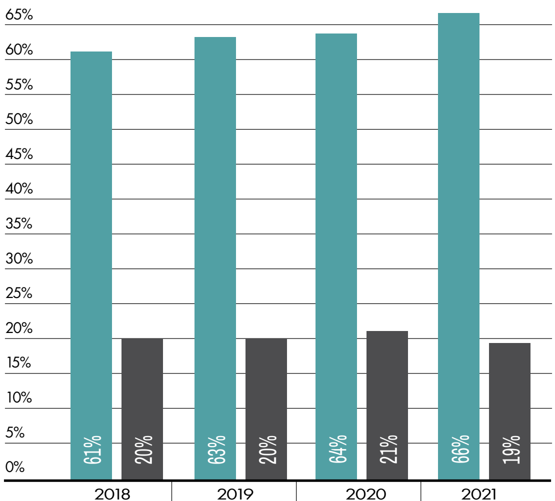
	2021	2020	2019
LOSS METRICS	BHPH BENCHMARKS	BHPH BENCHMARKS	BHPH BENCHMARKS
Average Gross Dollar Loss (Before Recoveries)	$8,877	$8,628	$8,510
Average Net Dollar Loss (After Recoveries)	$6,365	$6,228	$6,484
Average Default Rate (% Of Loans Written Off)	36.04%	36.77%	37.49%
Average Gross Dollar Loss/Liquidation Rate (% Of Principal)	37.44%	39.84%	41.74%
Average Net Dollar Loss/Liquidation Rate (% Of Principal)	26.85%	28.76%	31.81%
Average Recovery (% Of Deficiency Recovered)	28.30%	27.82%	23.81%
Highest Cumulative Default (Month After Origination)	24th Month	22nd Month	21st Month
Highest Frequency Of Default (Month After Origination)	8th Month	5th Month	4th Month
Worst Periodic Loss Month After Origination	February	February	February

TBD

COSTS/EXPENSES 2018-2021

NOTE: PERCENTAGES ARE EXPRESSED AS A PERCENTAGE OF VEHICLE SALES.

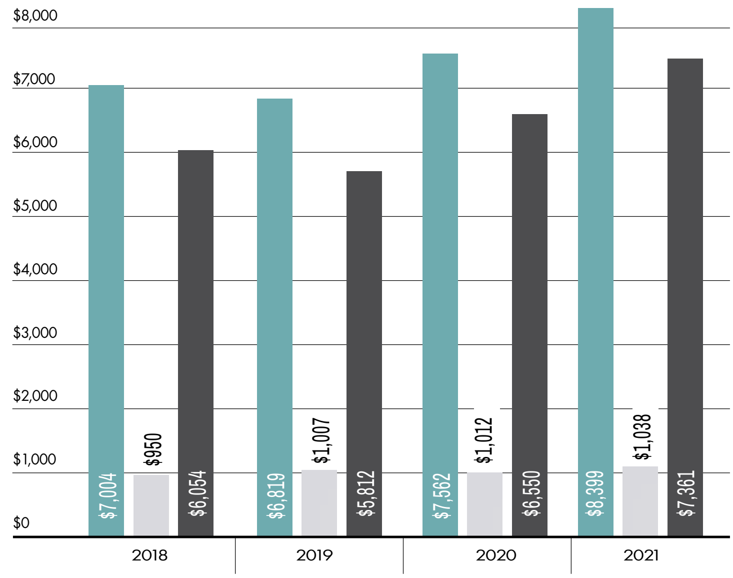
● COST OF VEHICLES ● OPERATING EXPENSES



SOURCE: SGC CERTIFIED PUBLIC ACCOUNTANTS

AVERAGE VEHICLE COST, DOWN PAYMENT, CASH IN DEAL 2018-2021

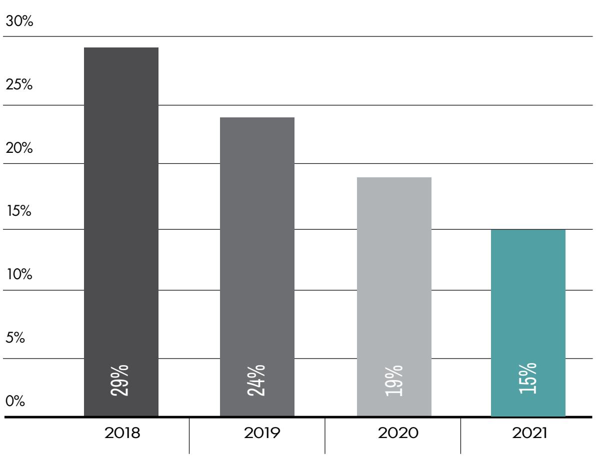
● AVERAGE VEHICLE COST ● DOWN PAYMENT ● CASH IN DEAL



SOURCE: SUBPRIME ANALYTICS

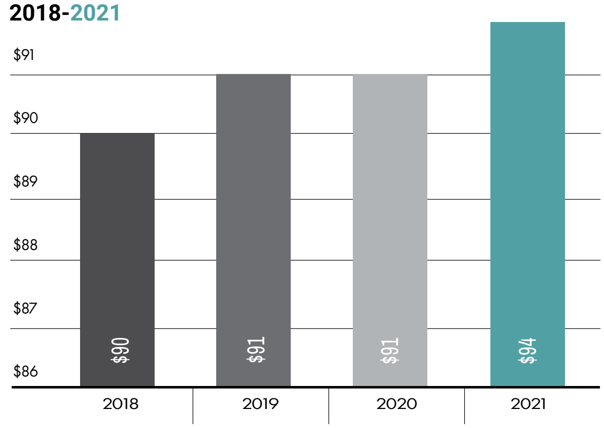
BAD DEBTS 2018-2021

NOTE: PERCENTAGES ARE EXPRESSED AS A PERCENTAGE OF VEHICLE SALES.



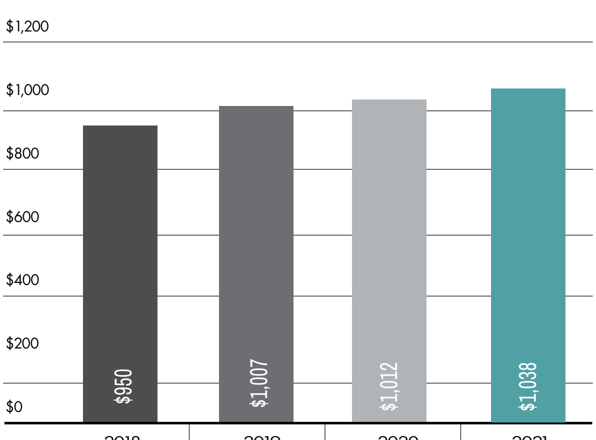
SOURCE: SGC CERTIFIED PUBLIC ACCOUNTANTS

AVERAGE WEEKLY PAYMENT AMOUNT 2018-2021



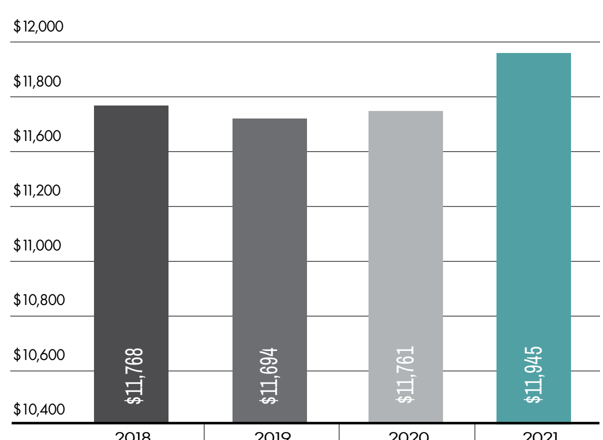
SOURCE: SUBPRIME ANALYTICS

AVERAGE CUSTOMER DOWN PAYMENT 2018-2021 (EXCLUDING TRADES)



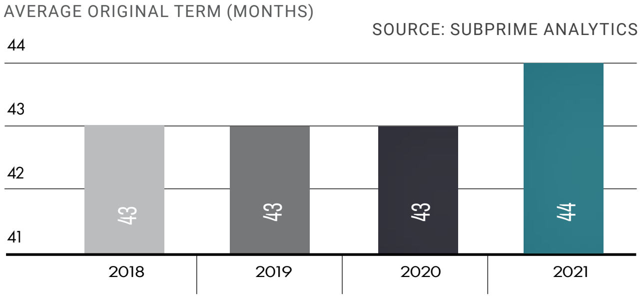
SOURCE: SUBPRIME ANALYTICS

AVERAGE AMOUNT FINANCED 2018-2021 (EXCLUDING ADD-ONS)

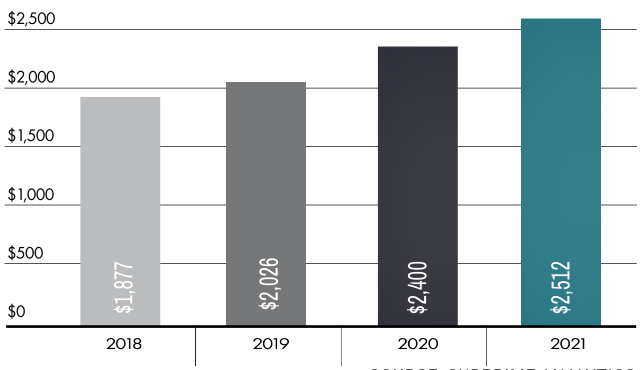


SOURCE: SUBPRIME ANALYTICS

AVERAGE ORIGINAL TERM 2018-2021



AVERAGE RECOVERY DOLLARS PER CHARGE OFF 2018-2021



SOURCE: SUBPRIME ANALYTICS

OUR SPECIAL THANKS TO ALL OF THE FOLLOWING CONTRIBUTORS FOR THEIR PERSPECTIVES AND DATA.

Their collective information provides a comprehensive view of the financial and operating performance of the BHPH industry and important trend information for 2021.

NABD · ncm ASSOCIATES · NIADA · NIADA 20 DEALER 20 GROUPS · SGC Certified Public Accountants · Subprime Analytics · TAX MAX · Manheim · NEXTGEAR CAPITAL · COX AUTOMOTIVE