RESEARCH BRIEF

Auto Loans and Credit Unions: Trends, Challenges, and Projections

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15 MINUTE READ

Across the credit union system, auto loan growth has flattened in recent years. Consumer preferences, economic conditions, competition, and technology are shifting. What will these trends mean for credit union auto loan portfolios? How should your credit union prepare?

OVERVIEW

Whether to purchase a vehicle and how to finance it are key questions most people ask at some point in their lives. A significant portion of purchased vehicles are financed through loans or leases; in the third quarter of 2020, 82% of new vehicle purchases and 34% of used vehicle purchases were financed.[1] For credit unions, vehicle financing through auto loans not only makes up a significant fraction of loan portfolios but financing also helps credit unions improve members' transportation options, attract new members, and form lasting, meaningful member relationships.[2]

RESEARCH BRIEF

This brief reviews recent trends in auto lending and how COVID-19 has affected the market. From these data, we present short and long-term projections, and identify next steps credit unions can take to prepare for a future where auto loans and related services can continue to advance member well-being and diverse credit union loan portfolios.

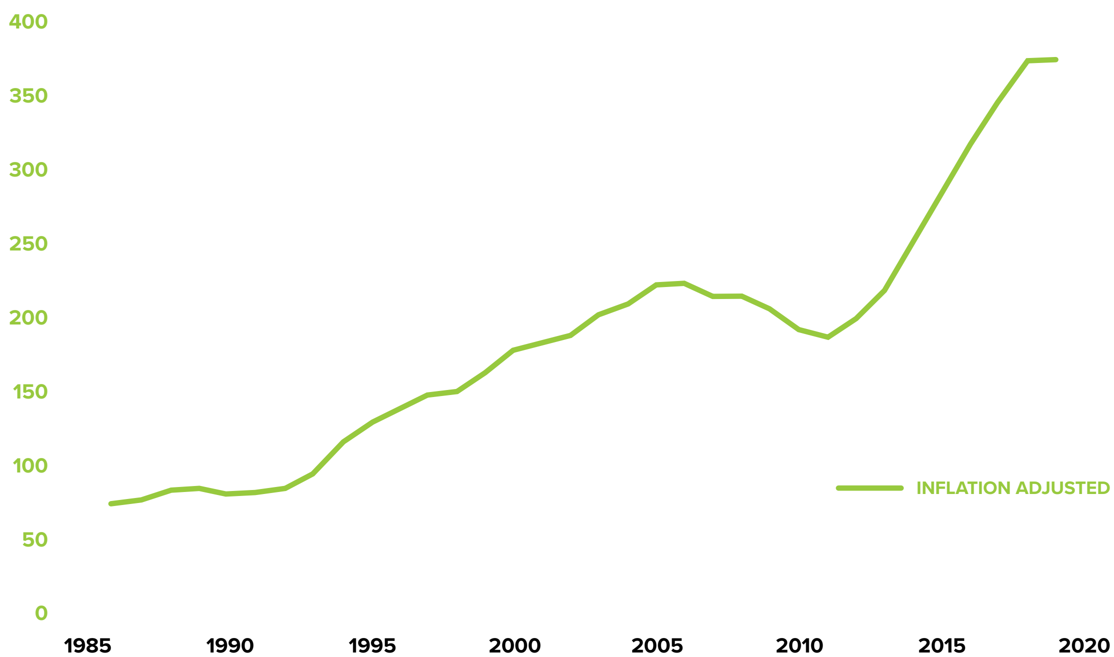
RECENT TRENDS

As of the third quarter of 2020, credit union auto loans totaled $343 billion (B): $143B in new auto and $200B in used auto loans. In total they made up 19.1% of total assets and 29.6% of total loans. In terms of nation-wide auto loans, credit union auto loans made up 25% of the $1.36 trillion US auto loan industry.[3] Credit unions reached a total of 7.6 million (M) members with new vehicle loans and 18.6M members for used vehicle loans, helping meet auto financing needs for a total of 26.2M people or roughly 10% of the US adult population.[4]

Overall, the long-term trend of growth in credit union auto loans has been strong and consistent with growth in US population, income per capita, and overall GDP, despite periodic deep recessions and crises. Figure 1 shows credit union auto loans grew from $74B to $375B between 1985 and 2019.

FIGURE 1

CREDIT UNION AUTO LOANS, $ BILLIONS



Note: Values adjusted for inflation in 2019 dollars.
Source: NCUA.

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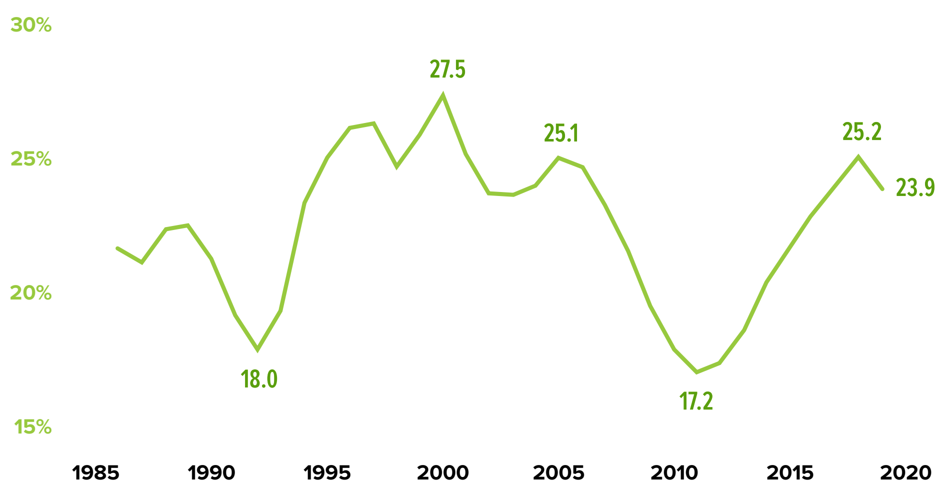
FIGURE 2

CREDIT UNION AUTO LOANS AS PERCENTAGE OF ALL CREDIT UNION LOANS



Source: NCUA.

Figure 3 shows credit union auto loan growth in recent decades, adjusted for inflation. Since the economy began to recover from the Great Recession, credit unions have experienced positive growth rates in auto loans since 2013. However, this rate has been slowing in recent years. The slowdown in credit union auto loan growth can be attributed to both the increased aggressiveness of banks for those loans and planned reductions by some credit unions as auto loans had become an overly large part of their portfolios.[5]

FIGURE 3

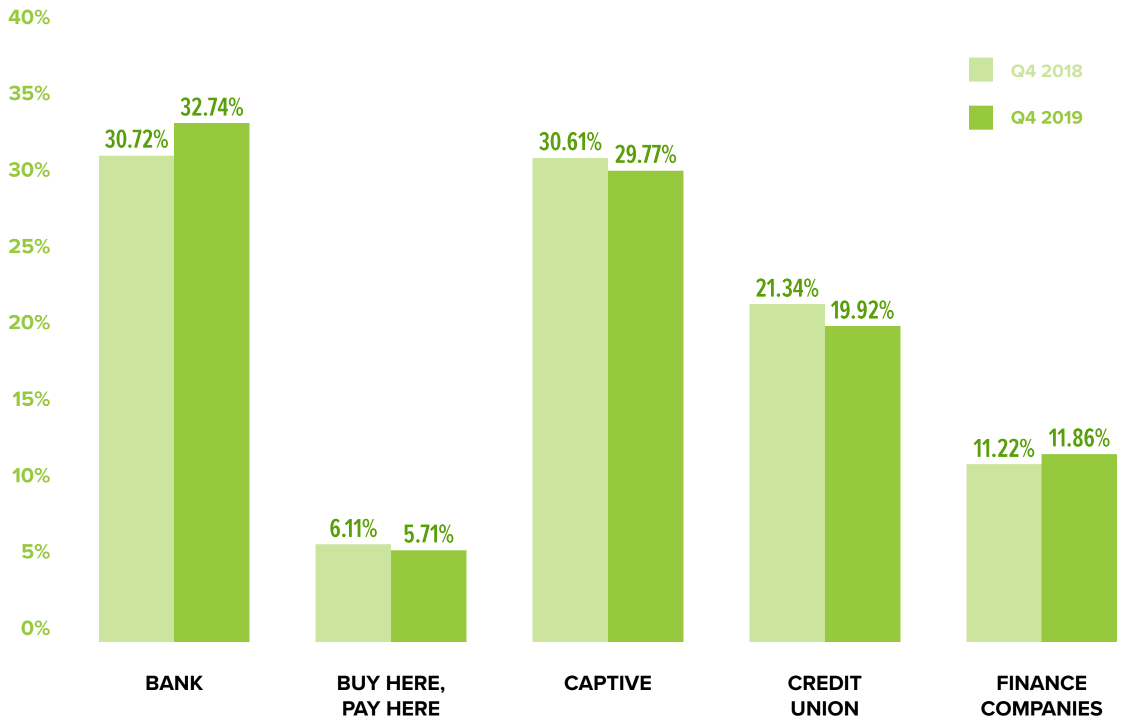
PERCENTAGE GROWTH IN CREDIT UNION AUTO LOANS

Note: Values adjusted for inflation.
Source: NCUA.

A recent example of this is reflected in the 2019 auto loan market, which is dominated by banks and captive finance companies or "captives," (the lending subsidiaries of car manufacturers including Toyota Financial Services, Ford Credit, Volkswagen Credit, etc.). Between 2018 and 2019, credit union auto loans were growing in volume, but portfolio management likely caused hesitancy in pursuing more auto loans. Figure 4 shows that between 2018 and 2019, auto loans for banks grew faster, leading to an increased share of the market from 30.72% to 32.74%. At the same time, market share for credit unions decreased slightly from 21.34% to 19.92%.

FIGURE 4

AUTO FINANCING (LOANS AND LEASES) MARKET SHARE BY LENDER TYPE

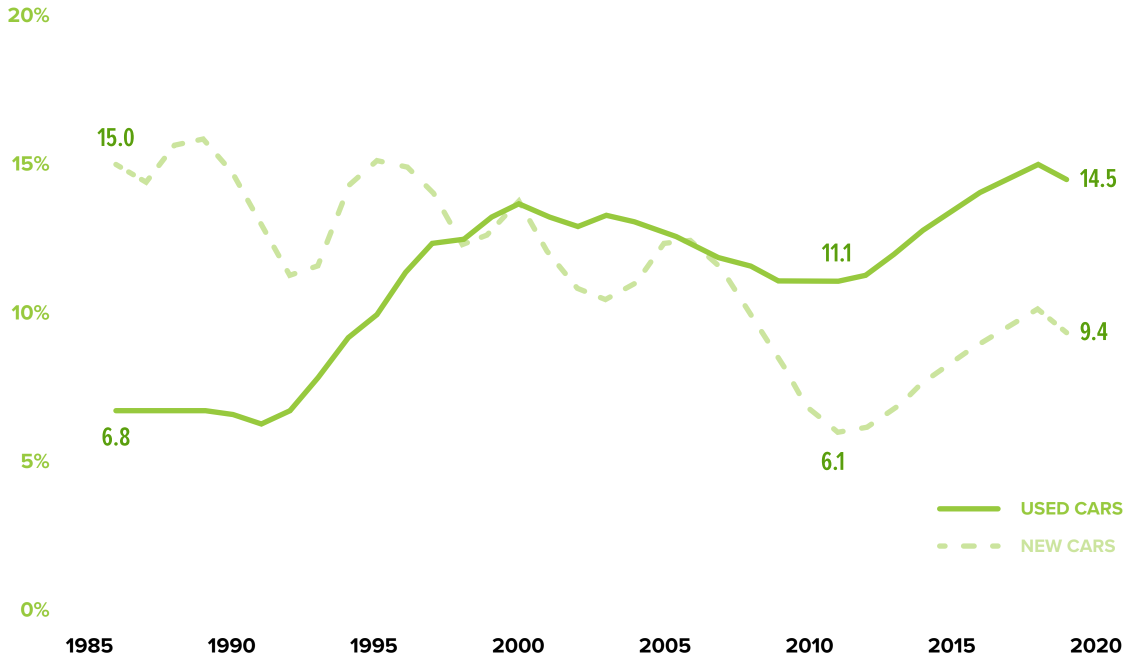


Source: Experian. 2019. State of the Automotive Finance Market, https://www.experian.com/content/dam/marketing/na/automotive/quarterly-webinars/credit-trends/2019-q4-state-of-the-automotive-finance-market.pdf

Recall the recent values for number of members served: credit unions served 7.6M members for new vehicle loans, and more than double this number for used vehicle loans (18.6M) by the third quarter of 2020. The volume of used auto loans was also greater than that of new vehicle loans (200B vs 143B). Figure 5 shows that since 2004, used car loans have made up a larger portion of credit union assets than new vehicle loans. Credit unions' increased market share of used vehicle loans may reflect a commitment to servicing lower-middle income individuals, families, and communities.

FIGURE 5

CREDIT UNION AUTO LOANS: NEW VS. USED CARS AS A PERCENTAGE OF CREDIT UNION ASSETS



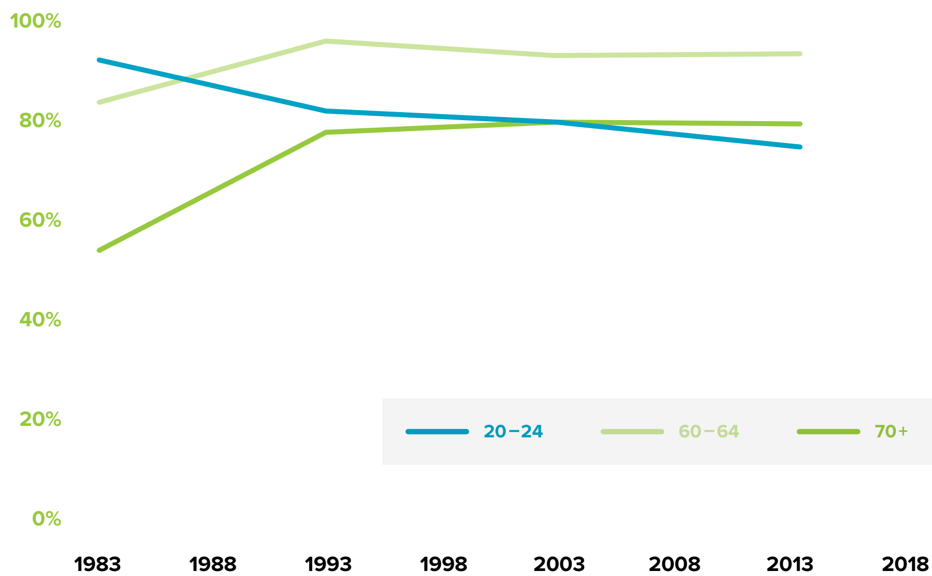
Source: NCUA.

CONSUMER PREFERENCES FOR DRIVING AND RIDE-SHARE SERVICES

In the last few decades, younger people have been moving away from purchasing vehicles. Some of this is due to changing attitudes surrounding car ownership. For many, particularly millennials and Gen Z, the idea of obtaining a driver's license at the age of 16 and getting behind the wheel of a sweet ride is no longer viewed as a rite of passage into adulthood. Driving is considered a chore or a hassle much like the effort and time required to maintain a personal vehicle.[6] Figure 6 shows the percentage of licensed drivers has been decreasing for the 20–24 age group in the past few decades as more and more young people are saying no to a driver's license and their personal vehicle. Younger people are putting off purchases and perhaps relying more on public transport and rideshares. Although it is difficult to make projections with precision, it is possible that people will decide to buy a car later in life, after moving to the suburbs or starting a family, and so on. Overall, this delay could mean fewer cars are purchased over the average person's lifetime.

FIGURE 6

PERCENTAGE OF LICENSED DRIVERS PER AGE GROUP



Source: Frank, Bill. 2016. "Americans Show Declining Interest in Driver's Licenses." Horsepower Online. www.horsepoweronline.com/2016/11/ americans-show-declining-interest-in-drivers-licenses/

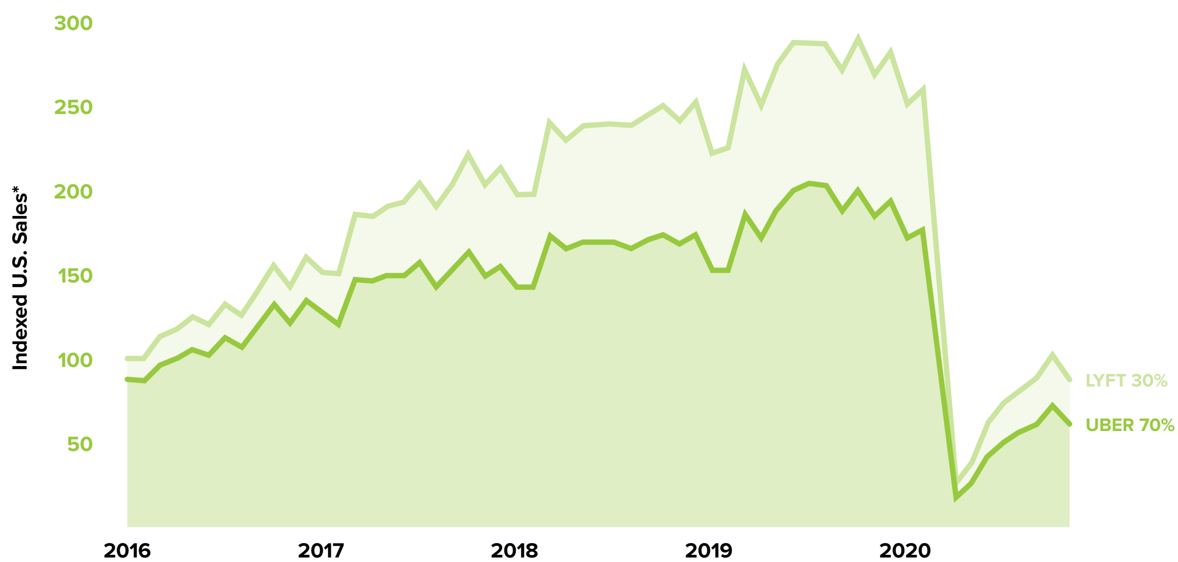
Overall, short-term trends do not point to an impending cliff for auto sales or auto loans. While there are no obvious signs of trouble in the data, credit unions need to be aware that technologies and consumer preferences can change quickly once a critical mass is reached for a market disruptor. Credit union leaders should be on the lookout for new ways to serve members and hedge against the possibility of sustained slow growth in auto loans.

The growing acceptance and popularity of ride-share or ride-hailing services such as Uber and Lyft may also help some avoid purchasing their own vehicle. The convenience of obtaining a ride within minutes, minus the hassle of obtaining a driver's license, paying for car insurance, parking, and vehicle maintenance may continue to appeal to younger generations. While research on the causal impacts of ride-hailing services is limited, some researchers have found that options like Uber and Lyft can change consumer behavior, suggesting that the availability of ride-hailing apps in an area could reduce car ownership.[7]

Monthly sales data for Uber and Lyft (Figure 7) show usage of the services has been rapidly increasing since 2016.[8] Both ride-hailing services experienced a steep decline in early 2020, likely due to the economic shutdown, job losses, and work-from-home transitions, but data show sales are recovering, and it is unlikely that the COVID-19 pandemic will damage the rideshare industry over the long term.

FIGURE 7

RIDESHARE—MONTHLY SALES



**Notes: Indexed to rideshare Jan 2016 sales (=100); Some Uber Eats sales are indistinguishable from Uber rides sales, especially in May–Aug, 2019. Corporate spending and purchases made with Uber Cash are not included.*
Source: Yeo, Liyin. 2020. "Uber vs. Lyft: Who Tops in the Battle of U.S. Rideshare Companies." Second Measure, https://secondmeasure.com/datapoints/rideshare-industry-overview/

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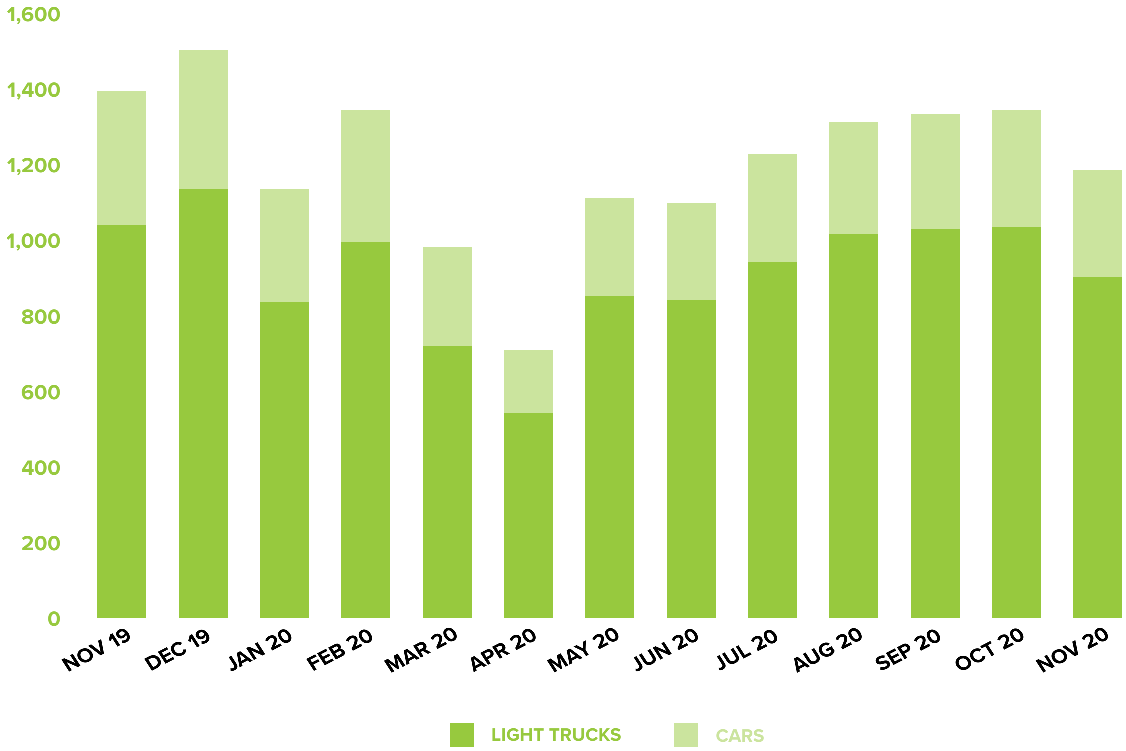
COVID-19 PANDEMIC

The COVID-19 pandemic is changing how many consumers think, behave, and spend. Nationwide economic shutdowns, very large drops in demand and spending in many sectors, and firms dialing down production led to one of the sharpest increases in unemployment since the Great Depression. 22 million people lost their jobs in April. Schools, colleges, and workplaces were temporarily shut down and many have since adopted a work or learn-from-home approach. Consumer saving levels increased while consumer confidence plummeted. Vehicle sales unsurprisingly took a hit in March 2020. However, as shown in Figure 8, sales have been recovering since May. It is estimated that 14.5 million cars and light trucks were sold in 2020, a 15% decline from 2019, and the lowest level since 2012.[9] Recovery of vehicle sales points to projections that demand will hover around the inherent level of 16.5M units in the next few years (at least until 2023) and there is no reason to expect a significant decline in auto sales or auto loans in upcoming years.[10]

FIGURE 8

U.S. VEHICLE SALES BETWEEN NOVEMBER 2019 AND 2020, IN THOUSANDS OF UNITS

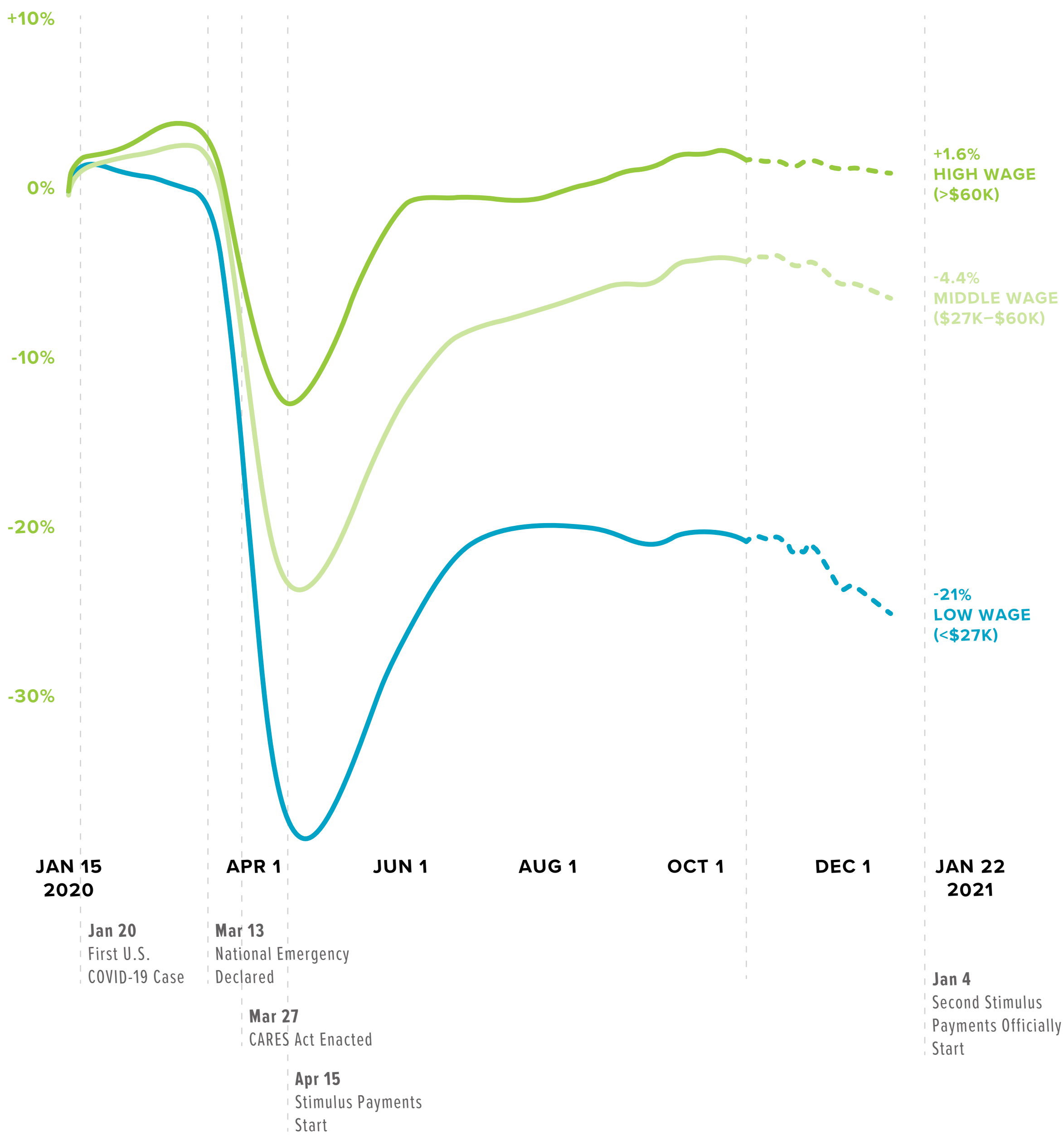


Source: BEA, St. Louis Fred. 2020 obtained from https://www.statista.com/statistics/204342/comparison-of-us-vehicle-production/

During the early months of the pandemic, the economy faced a supply shock with large scale factory shutdowns. As manufacturing has resumed, many consumers have more options to purchase accumulated inventories of new vehicles. However, larger inventories and pressures to lower prices are expected to benefit high wage earners who likely did not experience job losses and have experienced a quicker recovery since the onset of the pandemic. This group has lower expenses for dining, entertainment, and travel, greater savings, and climbing asset prices (in both housing and stock markets). Many are referring to the recovery from the COVID-19 recession as “K-shaped,” where the wealthier experience quicker recovery whereas those lower in the income and wealth distribution are left behind, more likely to be jobless.[11] As of December 2020, the economy had regained approximately half of the jobs lost during the early stages of the pandemic,[12] but monthly employment continues to decline for low wage earners (those earning less than $27,000 per year) and middle wage earners (those earning between $27,000 to $60,000 per year[13]) as shown in Figure 9. To reduce their exposure to the virus, many may prefer the safety of their own vehicle and may avoid taking flights or public transport wherever possible, but only those who can afford a vehicle amid these conditions can make this choice. As some wealthier individuals and households are moving to suburbs, an option that offers more free space and convenience while working from home, it is possible that preferences will shift away from concentrated urban living, public transport, and ride-share usage and toward using more personal vehicles.[14]

FIGURE 9

PERCENTAGE CHANGE IN EMPLOYMENT BY WAGE LEVELS, JANUARY TO DECEMBER 2020



Note: Change in employment rates (not seasonally adjusted), indexed to January 4–31, 2020. This series is based on payroll data from Paychex and Intuit, worker-level data on employment and earnings from Earnin, and timesheet data from Kronos. The dotted line in the low-wage series is a prediction of employment rates based on Kronos data.

Source: Opportunity Insights. 2020. Economic Tracker: Percent Change in Employment, https://tracktherecovery.org/

Perhaps the most prominent way that COVID-19 has shifted consumer preferences is via rapid digital transition—school districts have adopted online learning without much warning or choice, medical professionals are offering more tele-health appointments, and remote work is becoming more common. Many firms are eliminating or reducing their physical presence in favor of a more digital one. Many credit unions are re-thinking the branch structure post-pandemic and are closing some branches and cancelling construction plans for new ones. Credit union executives are considering offering more ITMs, kiosks, and other self-service digital channels that members have adapted to using during the pandemic. Contactless processes for member identity verification are also expected to continue to grow in popularity.[15]

Mike Long, SVP of Platform Strategy at Origence works in new consumer loan origination and account systems. He says, “Members now expect services that are digital, no-contact, and efficient.” At the onset of the pandemic, Long was EVP at UW Credit Union. “During that initially confusing time, credit unions struggled to meet member needs to accommodate service delivery while adhering to safety regulations. At UWCU, we were closing branches and offering whatever we could to members online. It was not an easy transition.

Over time, Long explains, consumers are not only more trusting of digital solutions but now expect a full digital experience, whether it’s an account, auto loan, or mortgage. In fact, many consumers want a safe, online, no- or limited-contact process for purchasing vehicles. “One need look no further than Carvana to see how this works,” says Long.

A leading e-commerce platform for buying and selling used cars, Carvana offers consumers over 28,000 choices and the option to buy a car completely online and have it delivered to their doorstep. The experience can not only make buyers feel safer during the ongoing pandemic but also comes with convenient services such as a 7-day trial period.[16] Other dealerships have experienced a growing trend toward digital car purchasing which caters to consumers’ desire for safety and convenience. Dealers’ use of digital retail solutions, such as appointment scheduling, at-home delivery, and pickup have increased during the pandemic.[17] The percentage of dealers offering home delivery increased from 45% in March to 67% in April 2020. Over 30% of shoppers also want dealerships to offer at-home test driving, home delivery, and online financing options.[18]

The pandemic has accelerated a wider and deeper consumer transition to digital commerce and financial services, and this trend is expected to continue beyond the pandemic. Credit unions should plan for greater expectations from members to deliver digital-first auto loans and related services in coming months, and end-to-end digital offerings are likely to become table stakes across the market. Credit unions should develop internal capabilities and/or partner with trusted partners to enhance their digital lending services.

Despite the short-term disruption of COVID-19, we expect auto loans to remain a significant component of credit union loan portfolios over the medium term and for the foreseeable future.

INCREASING ELECTRIFICATION OF THE AUTO MARKET

Recent years have seen an increase in sales of electric vehicles (EVs). However, even as more consumers adopt new models of battery electric vehicles (BEVs) and plug-in hybrids (PHEVs), total EV sales are expected to make up only 4% of new vehicles in 2021.[19] Significant electrification of the auto market requires large investment in charging infrastructure, which remains some years into the future. Nonetheless, if consumer preferences start to shift strongly toward EVs sooner than expected (President Biden's goals for adopting clean energy and plans to invest in EV production and charging infrastructure could speed up this transition), credit unions can offer services to members that would support the transition to EV usage.[20] Many credit unions offer and advertise EV loans, along with resource guides that help members decide whether they want an EV.[21] Other examples of add-ons to EV lending include infrastructure loans for home charging systems or even home solar energy systems.

OVERALL TRENDS

Despite the short-term disruption of COVID-19, we expect auto loans to remain a significant component of credit union loan portfolios over the medium term and for the foreseeable future. We also project that credit union auto loan growth will slowly return to the long-term average of 6% (4% adjusted for inflation). However, longer term projections are particularly clouded as auto demand could fall substantially, and unexpectedly, as future generations shift away from auto ownership in favor of public transportation and ridesharing. Credit unions will continue to shift their loan portfolios to accommodate member demand, and future demand may offer a diminished focus on car ownership.

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CREDIT UNION IMPLICATIONS

Given these recent trends and patterns in the auto loan industry, here are some steps credit unions can take to prepare themselves.

1. **Speed up your digital transition to online auto loans.** Develop loan origination systems that are streamlined and online from start to finish. If your credit union does not have internal capacity, move your transition along with support from trusted system providers.

2. If your auto loan portfolio needs to grow, consider how your credit union can better **compete with captives and banks** for auto loans. Common options include offering your members longer terms and competitive rates, better advertising of your loan offerings, and deepening relationships with auto dealers. Make an effort to reach out to members of underserved communities who may be overlooked by competitors and who may often offer safer credit profiles than is usually assumed by standard credit scoring models. Pay close attention to members hit particularly hard by the pandemic. In addition, develop analytics capabilities to provide targeted loan offerings to members likely to be preparing for a car purchase.

3. **Adopt member-friendly non-interest income** that builds upon traditional auto loan offerings such as auto insurance, Guaranteed Asset Protection (GAP), and Mechanical Repair Coverage (MRC). Other offerings include auto insurance for leased cars and drivers working for ride-hailing firms. Partner with trusted system providers to offer these services if your credit union does not have the internal capacity.

4. **Offer Lease Alternative Loans,** also known as vehicle alternative loans or lease-like loans, which provide the flexibility of a leased vehicle experience with better terms for members. Members keep the vehicle title, enjoy shorter payment terms, and lower payments.

5. **Increase alternative lending offerings** for RVs, motorcycles, boats, and ATVs.

6. Begin preparing for the **growing adoption of electric vehicles (EVs) and the eventual adoption of autonomous vehicles.** Offer home equity loans to help members install home EV charging systems. Refer to Filene's research on "Consumer Insights on Autonomous Vehicles as an Impending Market Disruption" for more on how your credit union can prepare for the autonomous vehicle market.

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END NOTES

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[21] *See, for example,* **Alliant Credit Union, Navy Federal Credit Union, or Clean Energy Credit Union.**