



## Subprime Analytics

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# Collections Control Loan Losses - Limiting Losses Key to Profits

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**Las Vegas** – Controlling losses continues to be the top challenge facing buy-here, pay-here dealers, according to study from the National Alliance of Buy Here, Pay Here Dealers (NABD).

NABD founder Ken Shilson discussed collection issues during the group's recent conference here. "The better dealers have controlled their losses over the last five years," Shilson said. "That's been the key. They've reduced bad debt write-offs from about 21 percent of sales to about 16 percent of sales."

Starting in October 2003, the NABD has studied more than 56,000 subprime loans and nearly \$400 million of portfolios to identify loss rates and loss frequencies. The key drivers that result in credit losses causing default include: sales price, down payment amount, dealer mark-up, amount financed, vehicle cost and other vehicle characteristics, such as mileage, manufacturer, make, car vs. truck, ect. "We also think the payment amount is very important," Shilson said. Within the sales studies, the NABD discovered the average

"Approximately 30 percent of all principle that you book gets charged off, not to mention all the interest that you're losing. The second commandment is there are two ways to control losses, reducing the number of gross losses you have or increasing your recoveries through the vehicles themselves or garnishments. He said people often forget they can reduce losses by more than just vehicle recoveries.

"No. 3, you need to have prudent, consistent underwriting," Shilson said. This includes finding out why your dealership is having losses and focusing on how to address those issues specific to your dealership, he said. Shilson's fourth commandment is that one of the biggest factors that led to credit losses was dealer mark-up. "When dealers mark the car up more than \$3,750, their loss rates jumped up significantly, from 20 percent to about 27 percent," he said. When they went north of \$4,000, the loss rate almost doubled." Shilson said these losses occur because the mark-up leads to an extension of the term or payment, and the car doesn't

vehicle sale price was about \$7,600 and the average dealer cost was about \$3,500. The average principle loan balance was about \$6,900 and the average term was little more than 28 months, Shilson said. In these deals, the average down payment was about \$720, with an average weekly payment of \$70 and the average number of weekly payments was about 123. The average dollar loss, as a percentage of principal, was more than 29 percent. The losses ranged from a high of 45 percent to a low of 14 percent. “That means that 29 percent of every dollar that (dealers) booked, in principle, was written off, Shilson said. “The average net dollar loss after recovery, brought the loss rate down to a little more than 21 percent.” The default rate was 25 percent. “So one out of every four deals that was booked by these dealers went bad,” Shilson said. The average principle that dealers wrote off in these losses was \$5,200, and the average net loss after recovery was \$4,113.

Overall, losses hit their peak 11 months into the deal, Shilson said. “So if you can get past the first year, your chances of collecting your money increase dramatically”, he said. The highest frequency of charge-offs was in the fourth month and the highest loss month was February. “That would make me want to look very closely at all the tax deals that are out there’, Shilson said.

He said just getting a big down payment from a tax refund doesn’t necessarily mean a customer is going to pay off his contract. Shilson used the information he compiled to develop a list of “commandments” of credit losses. “No. 1, controlling your losses is the key to profitability to the buy here, pay here business”, he said.

make it to the end of the term.

Another Shilson commandment is that higher down payments do not ensure performance. “Just getting a big down payment doesn’t mean that a customer is going to pay, “ he said. “That really surprised me because I believed that if you got more than \$800, then your probability of not having a default went up significantly. “But we didn’t see that in our survey.”

Vehicle performance is essential. “More than 30 percent of the deals that were repossessed were cars that had more than 100,000 miles to begin with, “ Shilson said. Shilson pointed out loss rates of Hondas and Acuras were high, despite their reputation as good vehicles. Dealers pay more for them and they end up having to buy vehicles with 115,000 to 120,000 miles on them. “That car is not the same Honda or Acura that rolled off the showroom floor, “ he said. He said experimenting with the cheaper models like Hyundais or Kias may show they work better because a dealer could get a newer car for the same money. Vehicle cost is another important factor, Shilson said.

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