



## Subprime Analytics

*Finding Solutions For The Sub-prime Market*

***"Learn From Your Losses"***

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# Controlling Your Credit Losses; The Key To BHPH Success!

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During the next several months, Buy Here, Pay Here dealers will be faced with escalating costs! Vehicles and money, two critical elements of the business, both will cost more! Market conditions do not allow dealers to pass these increased costs directly to subprime customers, so successful operators must find other ways to offset their effect to remain profitable. The most significant way to offset their impact in this inflationary environment is to control and reduce bad debts!

Although reducing losses seems logical, dealers must first identify their past mistakes through portfolio analysis in order to avoid the same mistakes in the future. Such analysis should focus on identifying the key underwriting “drivers” or factors which directly affect the collection performance of their customers. These “drivers” include sales price, mark-up, amount financed, vehicle cost and characteristics (mileage, age, etc.), payment amount, loan term, down payments and others. It is also necessary to correlate or combine the impact of these variables together in order to identify where underwriting mistakes are being made.

During the last few years, I have performed extensive computerized analysis on nearly one billion dollars of buy here, pay here portfolios originated around the nation and Canada. This analysis utilized my proprietary state-of-the-art data mining and extraction software called “Subprime Analytics” which electronically “mined” the aforementioned portfolio information from most of the dealer software management systems used throughout the industry.

At the recent (NABD) National Buy Here, Pay Here Conference in Las Vegas, I disclosed some of the results obtained from this analysis. Dealers can utilize these results as credit loss benchmarks to compare against their own collection statistics. In addition, dealers can improve their own results by analyzing their losses in order to

identify how loss deals differ from those loans which performed. The use of my electronic data extraction software facilitates a more comprehensive study and makes portfolio analysis affordable. However, such analysis can be done manually by using smaller sampling techniques to monitor performance.

In order for the portfolio analysis results to have validity, dealers must charge-off portfolio losses consistently. This requires them to establish a loss confirmation period which is usually a 60-120 day period where the collectibility of individual loans can be determined. During this confirmation period, if a loan is deemed uncollectible, it should be written-off. Despite writing loans off as bad debts, dealers often continue to pursue recovery through wage garnishments and other remedial collection techniques. Laws governing such recoveries vary by state, so dealers are limited by the applicable local rules and regulations.

Following are some of the highlights from my "Subprime Analytics" portfolio analysis study:

<b><u>Individual Deal Characteristics of Portfolios Surveyed</u></b>	
<b>Average Vehicle Sales Price</b>	<b><u>\$7,271</u></b>
<b>Average Vehicle Cost</b>	<b><u>\$3,620</u></b>
<b>Average Loan Principal Balance</b>	<b><u>\$6,905</u></b>
<b>Average Loan Term</b>	<b><u>30 months</u></b>
<b>Average Down Payment</b>	<b><u>\$752</u></b>
<b>Average Weekly Payment</b>	<b><u>\$68</u></b>
<b>Average Number of Weekly Payments</b>	<b><u>124</u></b>
<b>Total Loans Analyzed</b>	<b><u>Over 110,000!</u></b>
<b>Total Principal Analyzed</b>	<b><u>Over \$800 million</u></b>
<b><u>Portfolio Loss Statistics</u></b>	
<b>Average Gross Dollar Loss Rate</b>	<b><u>30.99 %</u></b>
<b>(% of Principal)</b>	
<b>Average Net Dollar Loss Rate</b>	<b><u>23.95 %</u></b>

<b>(After Recoveries)</b>	
<b>Average Default Rate of Loans Written Off</b>	<b><u>24.00 %</u></b>
<b>(% of Loans Underwritten)</b>	
<b>Average Gross Principal Dollar Loss Per</b>	<b><u>\$5,254</u></b>
<b>Default (Before Recoveries)</b>	
<b>Average Net Principal Dollar Loss Per</b>	<b><u>\$4,051</u></b>
<b>Default (After Recoveries)</b>	

The statistics above are evidence that success in the buy here, pay here industry is about managing portfolio risk prudently. If dealers are writing off 31 % of every dollar they originate and approximately one in every four deals default, controlling losses obviously affects profitability and cash flow.

Improving portfolio performance can be done in two ways:

- 1) Via trial and error (which usually costs millions of dollars) or;
- 2) Via portfolio analysis (which can save dealers millions)!

The answer is obvious; isn't it time to work smarter, not harder!

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