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Could auto repos be next economic wave? Experts don't think so

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Consumers are taking advantage of the Cash for Clunkers program and stimulating some economic growth, but some worry the bubble will burst if buyers can't make the payments.



With the Cash for Clunkers program quickly reaching \$1.5 billion in vouchers last week and being declared "wildly successful" by the federal government, experts say the program is great for the short term.

But will all those new cars stay on the street? Or will a new, bigger wave of repossessions hit, as foreclosures did in the housing market?

That's unlikely, they said.

"Cash for Clunkers is stimulating production, which is helping not only to re-employ some autoworkers but also to prevent the bankruptcies of suppliers currently hanging on by their

fingernails," said Diane Swonk, chief economist and senior managing partner at Mesirow Financial in Chicago.

As a result, the auto industry will add 2 percent of growth in the third quarter, she said.

"This seems like a good tradeoff on risks. (I'd) rather stimulate production, which could help reignite employment than have to pay significantly more in unemployment," Swonk said. "Can you imagine how weak retail sales would have been today and the collateral damage in layoffs and balance sheets if Cash for Clunkers weren't in place?"

Recovery experts believe that the ratio of repossessions of new vehicles could go up proportionately with the increase in purchases. It's unlikely it will lead to anything worse for a variety of reasons.

One includes more-stringent laws today for getting loans. Also, auto loans are not comparable to the various types of home loans that were offered a few years ago. The lending instruments are completely different, said Van Conway, president of Detroit-based Conway MacKenzie Inc., a repossession and turnaround firm with offices in Chicago.

"This isn't anything like the housing industry," said Conway. "A few years ago, people paid too much for their homes and they were overleveraged."

Now, people are buying cars and trucks under the Clunkers program that include up to \$4,500 from the federal government and even more discounts from the automakers. Since the volume of new vehicles was low, and even with the current spike in sales, repos likely will be proportionately the same, Conway said.

"The more cars you sell, the more repossessions anyway," Conway said. "It's the conditions of the economy and the consumer that leads to repossessions, not the incentives."

The federal CARS program last week reported about 359,000 vehicles had been sold nationwide. Among the brands purchased most often under the program were Fords, including its Focus.

Detroit-based Ford Motor Credit Co. would not speculate on whether their surge in sales could lead to more repossessions in the future. But Ford has had higher repo rates anyway, due to the recession and higher unemployment, said Ford spokeswoman Margaret Mellott.

Ford's credit arm repossessed about 81,000 vehicles in 2008, compared to about 74,000 in 2007, even before the Clunkers program started.

Ford Motor Credit uses proprietary scoring models, in addition to FICO scores, to determine whether to extend credit, said Mellott,

"Our models provide us with greater predictive capability than FICO alone, and they enable us to do business with customers across the credit spectrum. This has not changed," said Mellott. "A customer who would have qualified for credit a year ago and who this year may have bought a car, whether or not it was through the CARS program, would qualify today, too, unless the customer's personal financial situation changed."

Irving, Texas,-based American Recovery Association, which includes recovery professionals worldwide, said it could take six months after the Clunkers program to see if the program has had any impact on the economy, said association spokeswoman Allison Bonlander.

"It's too soon to tell if this will have a big impact on the recovery market," Bonlander said. "In a down economy, most lenders will wait a longer period of time before putting a recovery plan into action."

The lending programs are stronger today than they were a few years ago. It's actually harder for consumers to get loans now, said David Klein, senior vice president/financial consultant for RBC Wealth Management in Vernon Hills.

"So we're hoping not to see too many repos," Klein said. "But for the short term, this program has had a very positive effect."