NEWS

News

Lenders ease throttle on car loans

Apr. 2, 2008 09:11 AM

By ELEANOR LAISE

The Wall Street Journal

The credit crunch, having knocked around the American home, is now rolling into the garage.

Even as the Federal Reserve slashes interest rates, it's getting tough for many consumers to find attractive terms on auto loans. Many lenders are making fewer loans and instituting stricter standards on loans they do approve, often requiring higher credit scores, making smaller loans and demanding bigger down payments. GMAC Financial Services tightened lending standards three times last year, and firms like AmeriCredit Corp. and Sovereign Bancorp Inc. have recently raised the minimum credit score required for borrowers to avoid an automatic rejection of their car-loan application.

Where you live can make a difference. Some lenders are applying especially tough standards for borrowers in states hard-hit by the housing crisis, such as California and Nevada.

While "subprime" borrowers with poor credit will bear the brunt of the shifting lending standards, even "prime" borrowers with good credit may be affected by some changes. And some consumers may not be able to get a car loan at all. This year through March 20, about 90 percent of auto-loan applications from prime borrowers were approved, down from 92.5 percent for the same period last year, according to CNW Research, which tracks consumer spending. Among subprime applications, 57 percent have been approved this year, down from 68 percent early last year. Loan applications for all types of borrowers are also being sent to a greater number of financial institutions before being approved, according to CNW.

When Michael Staggs, 36 years old, of Spring Hill, Fla., set out to buy a 2006 Dodge Dakota truck last month, he was looking for an auto loan with an interest rate below 10 percent and monthly payments between $250 and $300. But Mr. Staggs, an engineer for a telecom company who says his credit isn't bad, but not great, didn't get the terms he was banking on. He put down $1,500, and his $14,000, 72-month loan came with $298 monthly payments and a 13.5 percent rate. "That's a lot higher than I wanted," he says.

Borrowers hoping to get attractive terms on a car loan should do some spadework before heading to a dealership. First, get a copy of your credit report and have any errors corrected. Then, shop around local banks, credit unions and online for pre-approval on an auto loan. Having secured the best rate you can find, head to the car lot and ask the dealer to beat that rate. "You want an offer in your back pocket because that gives you maximum flexibility when you're weighing dealer offers," says Greg McBride, senior financial analyst at Bankrate.com.

Lenders are tightening standards as more cash-strapped consumers become delinquent on their auto loans. Delinquencies hit a 10-year high in January, according to Fitch Ratings, though they declined slightly in February. Also, many auto loans are bundled into securities to be sold, but the credit turmoil has caused investors to lose their appetite for these securities. That leaves lenders with less money to lend.

The changes come at a time when many consumers have fewer options for financing a car purchase. Many people with good credit in recent years have financed a car purchase by tapping their home equity, but that source of cash is also drying up as home values drop.

In addition, a growing number of consumers are "upside down" on their current auto loan, meaning they owe more on the loan than the vehicle is worth. Among people who traded in a vehicle in February, 27 percent were upside down on their loan, up from 24 percent in October according to Edmunds.com, an automotive Web site. On average, they owed nearly $4,400 more than their car's value, a record high.

Not all borrowers will see tougher terms. In some cases, lenders are "being more generous and creative for prime consumers because they want to attract (them)," says Jesse Toprak, executive director, industry analysis at Edmunds.com. The average rate on a prime five-year new car loan is now 7.2 percent, according to Bankrate.com, down from 7.7 percent before the Fed started cutting rates in September.

But some borrowers may find they can't get as large a loan as they'd like. Whereas lenders in recent years have made loans substantially exceeding the car's worth - a common practice in the era of easy credit - some are now keeping loan amounts closer to the vehicle's value.

AmeriCredit last year reduced this "loan-to-value" ratio that it allows for subprime loans. Jon Garcia, finance manager at a Toyota dealership in Janesville, Wis., says he's seeing subprime lenders supply only 85 percent to 90 percent of the car's book value, down from as much as 140 percent previously. The changes are preventing customers from buying the cars they want and have cut the dealership's sales to customers with blemished credit by about 10 percent, relative to last year, Mr. Garcia says.

Indeed, terms are getting especially tough for subprime borrowers. At GMAC, 12 percent of new loans booked in North America in 2006 and 2007 were nonprime, but that figure dropped to 9 percent in December. Capital One Financial Corp. has stopped originating loans for the riskiest segment of subprime borrowers, according to a recent presentation by Chief Executive Rich Fairbank. J.P. Morgan Chase & Co.'s Chase Auto Finance recently stopped originating subprime loans longer than 72 months. The firm also boosted by 10 points the credit score required of subprime customers borrowing more than 110 percent of the car's value. "We're trying to lend to people who will be able to pay us back," says Thomas Kelly, a Chase spokesman.

Even borrowers with good credit may find tougher loan terms if they live in areas where home prices are dropping. Chase Auto Finance has tightened lending standards across the country, but they're "even tighter in places with declining home values," Mr. Kelly says. Falling home values generally reduce borrowers' financial resources and may hurt their ability to make loan payments. Chase is requiring more collateral on longer-term loans in "high risk" states like Arizona, California and Nevada. Sovereign in January stopped originating auto loans in the Southwest and Southeast and now limits its auto lending to the Northeast. The Southwest and Southeast "were experiencing more challenges" and "the housing market was a big driver of those challenges," says Tom Nadeau, president of consumer lending at Sovereign.

In states that have been hard-hit by the housing crisis, auto-loan approval rates have dropped more dramatically than the nationwide rate. This year through March 20, 86 percent of California prime auto-loan applications were approved, down from 94 percent for the same period last year, while 84 percent of Florida prime auto-loan applications were approved, down from 90 percent a year earlier, according to CNW Research.