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New Ways to Understand the Impact of Auto Finance on Low-Income Families

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Conventional analysis of auto finance tends to ignore the number of families affected and their demographics. It also tends to obscure the rate at which new car financings are originated in comparison to other consumer debt. While economists, policymakers, and others realize the overall role that auto finance plays in the United States' financial landscape, the scale of the impact of auto finance on those with low and moderate income, people of color, and younger people has received less attention. This report looks at existing data in new ways to better understand the true scale of auto finance for low- and moderate-income families.

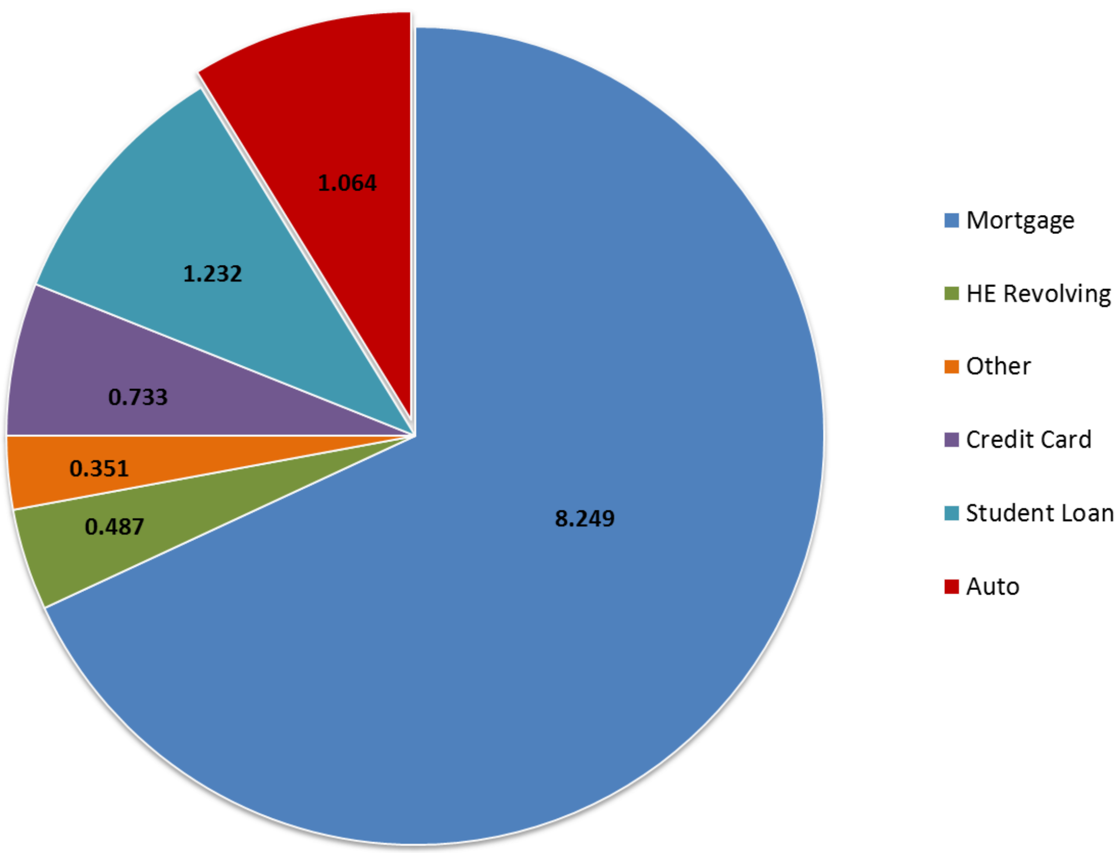
Most decision makers, when trying to understand the role of auto finance in the economy and the extent to which it affects households and particular populations, look at data regarding the total outstanding balance of auto finance. Often this debt is examined in comparison to other large and important consumer finance categories, typically mortgage loans, student loans, and credit card debt.

Delving deeper into publicly available data allows for new insight into the prevalence of auto debt and the extent to which it weighs on vulnerable consumers, particularly low- and moderate-income families.

Conventional Analysis

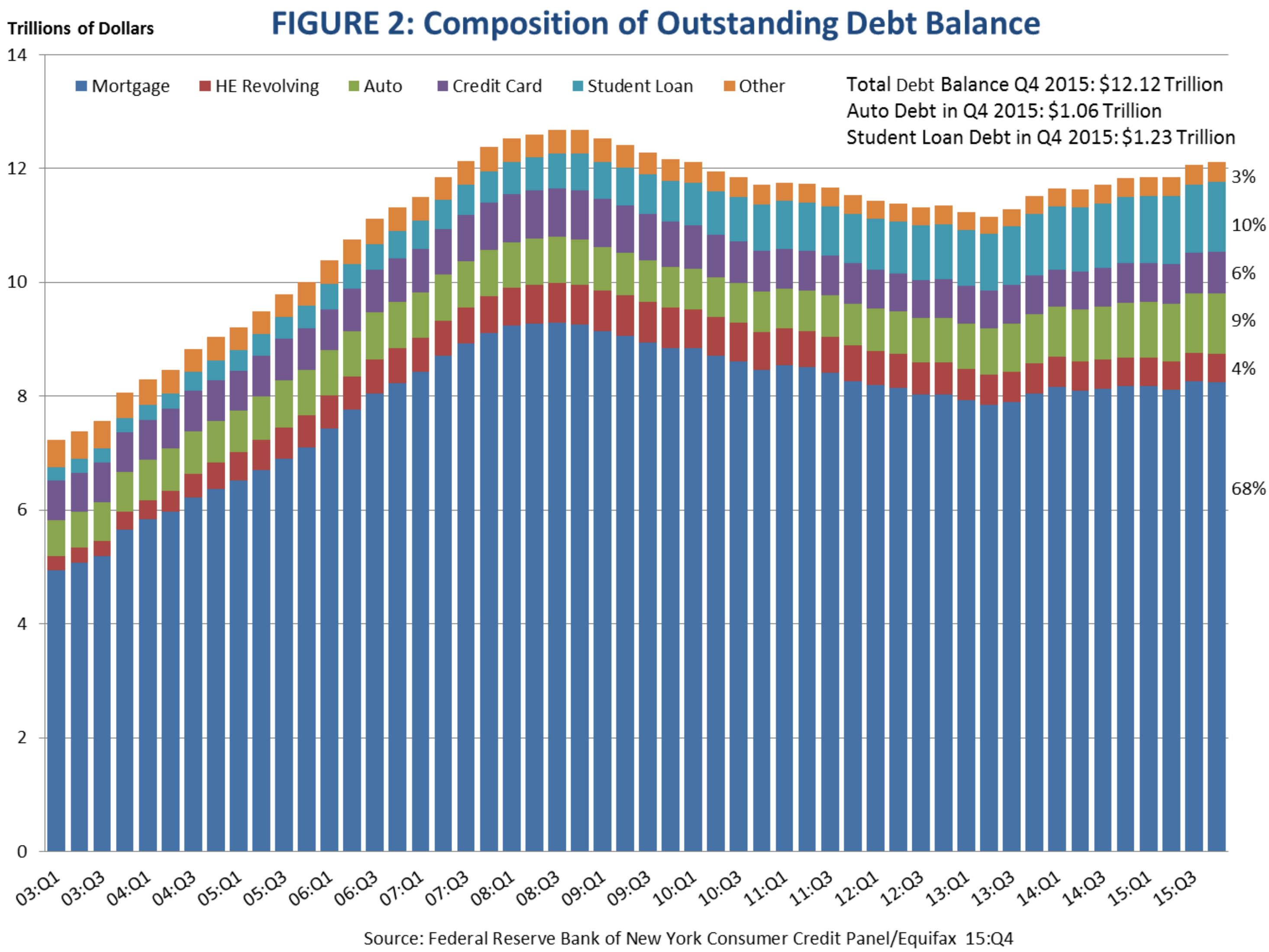
Data from the fourth quarter of 2015 shows that, by dollar volume, the vast majority of the consumer debt in the United States is mortgage debt. A small but significant portion of the total debt is comprised of student loans and auto finance. Total outstanding mortgages account for $8.24 trillion compared to $1.23 trillion for student loans and $1.06 trillion for autos (Figure 1).

FIGURE 1: Total Debt Balance Q4 2015 in Trillions of Dollars



Source: Federal Reserve Bank of New York Consumer Credit Panel/Equifax 15:Q4

The dynamic movement of these aggregate outstanding balances over time is also often monitored. Consequently, the increasing significance of auto and student loan debt on overall debt is regularly reported. (Figure 2).

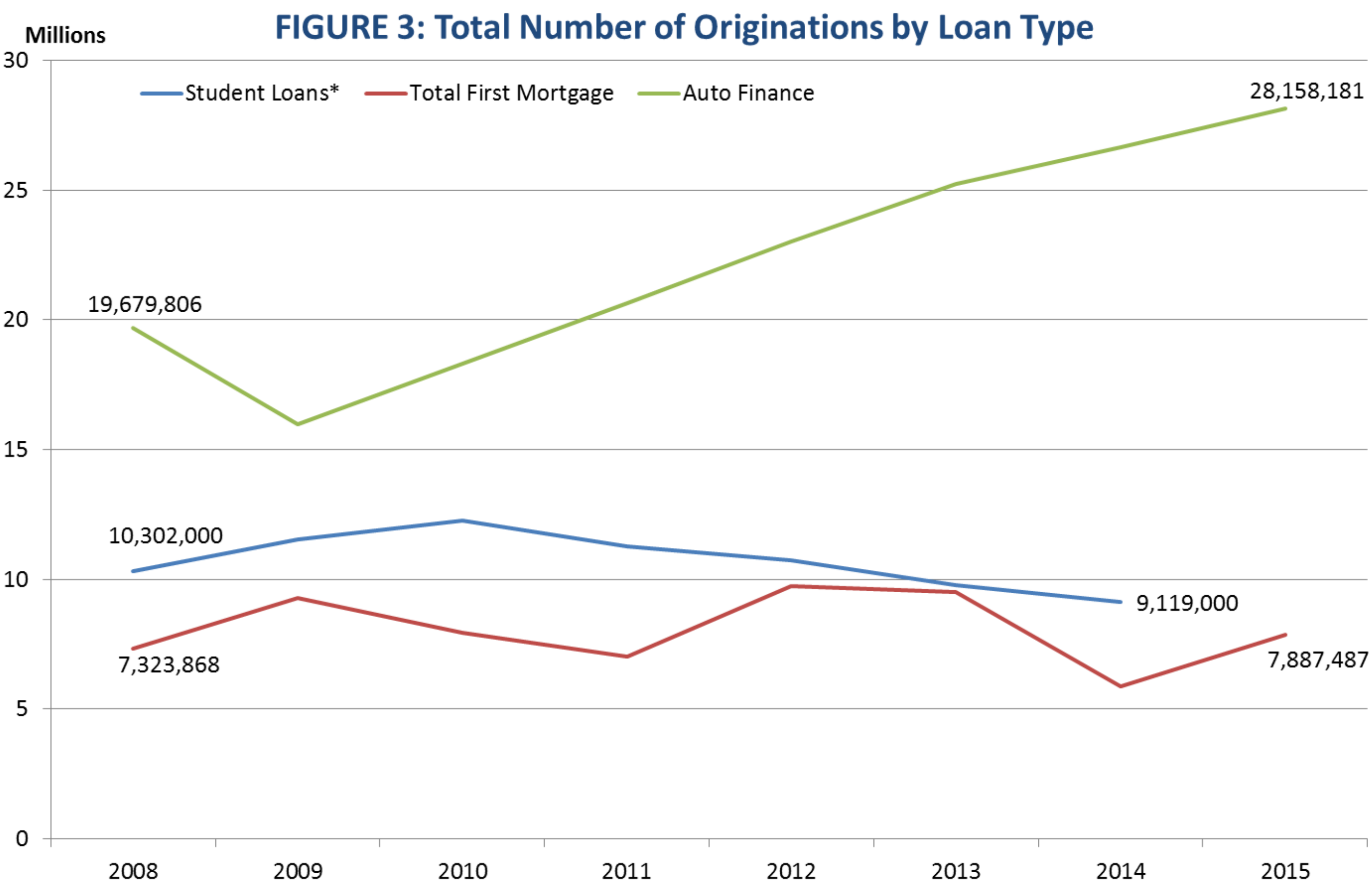


Deeper Analysis Including the Number of Families Affected and Their Economic Condition

While understanding the scale by dollar volume and the change in outstanding debt for these categories over time is helpful, there is much more to learn. Unfortunately, this is the point at which analysis often stops. These broad analyses paint an incomplete picture, ignoring both the number of consumers and new financing transactions represented by this data. Consequently, interested parties, especially industry actors and policymakers working towards the economic success of low- and moderate-income families, must look deeper.

From a perspective of family economic success, understanding the number of consumers affected by auto financing is critical. A large amount of total debt in one category owed by a smaller number of families may overshadow a smaller outstanding total debt owed by a much larger number of families. The extent of origination of new debt is also important to understand because origination is typically the point at which many abuses occur. While consumers will pay for these abuses over the life of the loan, each new financing event represents an opportunity—a time when consumers may either be saddled with new abuses or avoid unnecessary costs.

Reviewing the number of new originations rather than just the outstanding debt in dollars provides insight into how often new credit transactions occur and an approximation of how many families are affected in a given period (Figure 3). For example, in 2014 (the most recent year for which student loan data is available) there were almost three times as many families originating auto finance as borrowers originating student loans, and more than three times the number of auto finance originations as mortgage originations.



Source: Federal Reserve Bank of New York Consumer Credit Panel 15:Q4; Equifax U.S. Consumer Trends, February 11, 2016; Federal Reserve Bank of New York, Student Loan Borrowing and Repayment Trends, 2015 (student loan data through 2014)

* The student loan data represents the number of borrowers originating student loans during a given year.

Further analysis provides even more insight regarding the importance of auto finance on families of color and low-and moderate-income families. Data showing auto originations by race is not available and data by family income is not publicly available. However, there is data for both mortgage and auto finance by consumer credit score. Because credit scores have a strong correlation with race[1] and a correlation with income, in addition to correlations with educational attainment and other characteristics,[2] this data can help us understand the demographics of families who finance car purchases. This data should be of particular interest to policymakers and advocates, since those with low credit scores may be more vulnerable to abusive practices. Consumers with Experian credit scores classified as Prime (the best credit score) make up the largest individual cohort of those financing cars. Yet, collectively, consumers with lower credit scores, labeled as Nonprime, Subprime, and Deep Sub Prime, represent about 30% of open auto finance (Figure 4).

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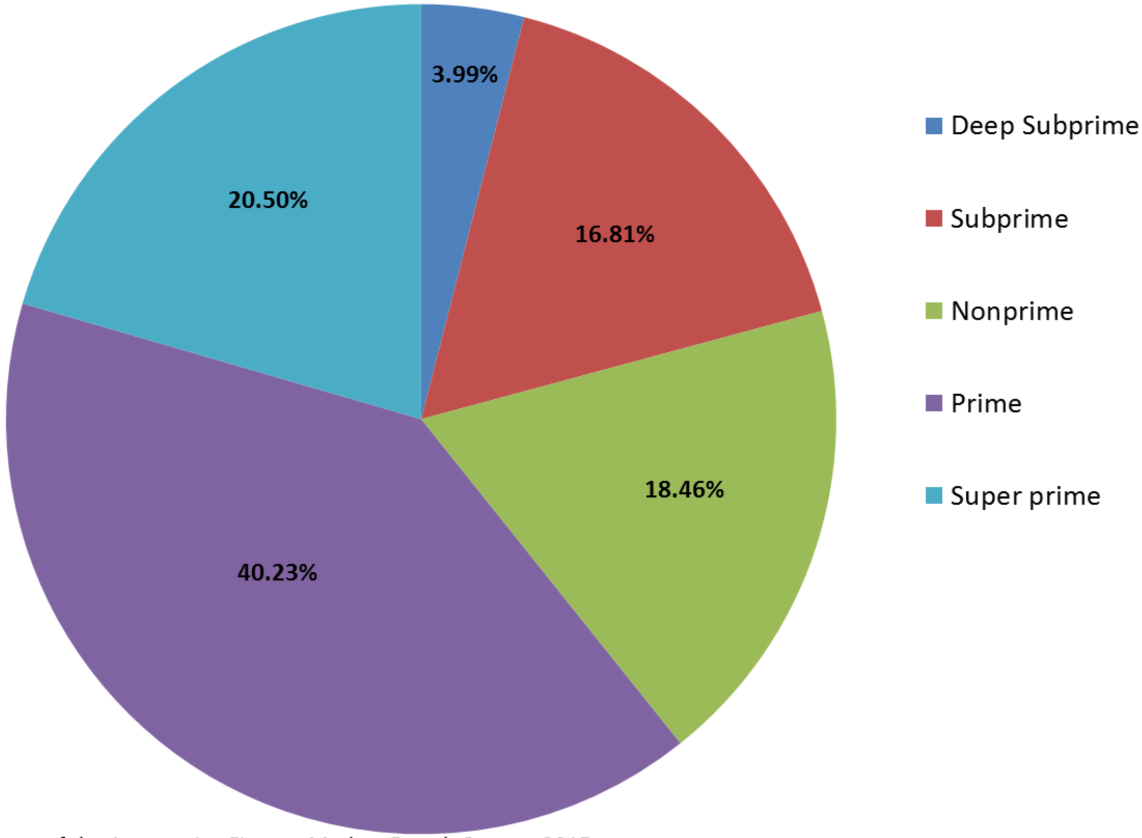
[1] See National Consumer Law Center, **Past Imperfect: How Credit Scores and Other Analytics "Bake In" and Perpetuate Past Discrimination** (May 2016) available at: http://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf.

[2] See Newman, Anna E. & Newman, Joseph A., The Demographic Impact on Credit Scores: Evidence From Statistical Methods and Geographic Information Systems (GIS) Mapping, Journal of Modern Accounting and Auditing, November 2013, Vol. 9, No. 11, 1497-1506

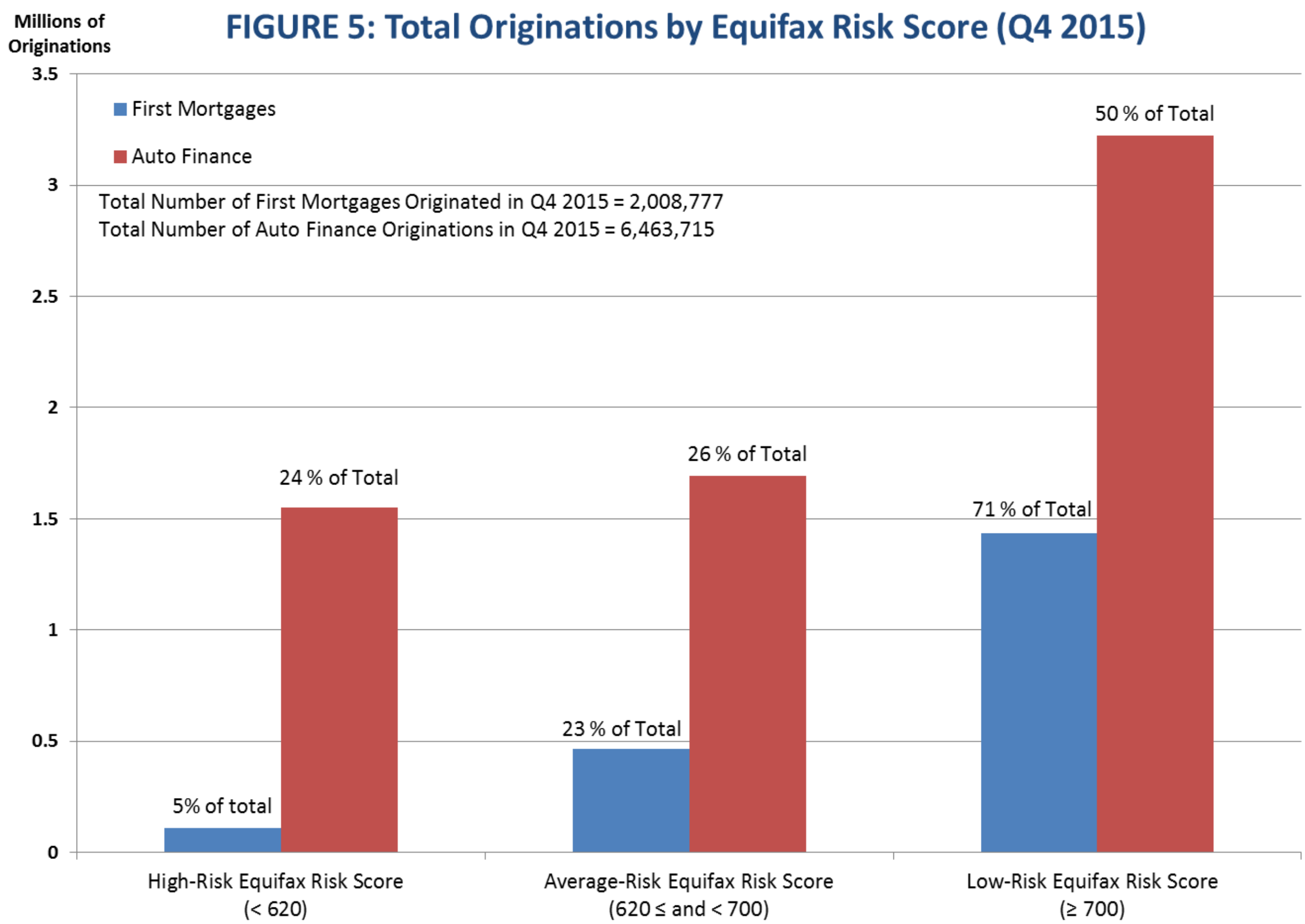
FIGURE 4: Percentage of Open Auto Finance by Experian VantageScore® 3.0 Q4 2015



Source: Experian, State of the Automotive Finance Market, Fourth Quarter 2015

Credit score categories are based on the following Experian VantageScore® 3.0 ranges:
Super Prime = 781-850; Prime = 661-780; Nonprime = 601-660; Subprime = 501-600; Deep Subprime = 300-500

Comparing mortgage and auto originations, those with "High-Risk" Equifax scores originated nearly 25% of auto finance transactions, but just 5% of mortgage transactions. There were about 2 million (2,008,777) total mortgage originations in that period and nearly 6.5 million (6,463,715) auto originations. This means that of struggling consumers with "High-Risk" scores, more than 1.5 million (1,551,292), bought and financed a car while just 100,439 financed a house (Figure 5).



Source: Equifax, U.S. Consumer Trends, February 11, 2016

Conclusion

Digging deeper into available data helps policymakers and advocates to better understand the true impact of auto finance, and government policy, on low- to moderate-income families. Moving away from the idea of dollars of debt outstanding to an appreciation of the huge number of struggling families that finance a car purchase puts into sharp focus the importance of policies that create and foster a fair and transparent market for auto finance.

For more information, contact John Van Alst (jvanalst@nclc.org) *or* Yael Shavit (yshavit@nclc.org).