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For U.S. automotive dealers, the pain of the 2008 financial crisis is far from over

By Jonathan Michaels

There are certain moments in a nation's history that define generations and forge the creed by which we live. The scars left by the Great Depression are still clearly visible. Those present in the 1960s can likely recall where they were when they learned that President John F. Kennedy had been shot. The current generation is left with the hurt of Sept. 11, and more recently, the financial meltdown that threatened to collapse a nation.

This week marks the third anniversary of the extraordinary relief that was required to stall, or at least slow, the 2008 global financial crisis that was born out of Wall Street greed. As our economy splintered and century-old companies failed, the elected few worked through the triage to prevent the collapse of it all. The solution was the Emergency Economic Stabilization Act of 2008, a sweeping bill that was signed into law by President George W. Bush on Oct. 3, 2008 and which established the \$700 billion "Troubled Asset Relief Program" — a program that enabled the administration to dole out billions of dollars to teetering companies with the stroke of a pen.

To say that the legislation was of epic proportions is to only state the obvious. Students of history will likely look at these acts in the same way we reflect back on the Great Depression, by asking: How could such a thing have ever happened? And, while the initial shock of the calamity has subsided, our economy still sputters through the recovery, as if to tell us that the wounds are much deeper than we wanted to believe.

Any optimism has been quelled by the harsh reality that things are just not looking better, despite the passage of time. Standard & Poor's downgraded the United States' AAA debt-rating for the first time in the agency's 70-year history, putting our country's default risk below that of Australia, Denmark and Finland; and Economist magazine puts the risk of the U.S. moving backwards into another recession at 1 in 2.

Through this, U.S. automakers have been bludgeoned by shakeups, bankruptcies and sell-offs, and have lost market-share that was decades in the making. Chrysler executives are now eating pasta and General Motors is eating crow, while Henry Ford's kingdom has been whittled down to a fraction of the goliath it once was. To see just how bad it is, consider that in 2006 U.S. vehicle sales were at 17 million units, with many industry experts predicting that the magical 20 million



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Associated Press

A cyclist passes the Glendale Star Chrysler Jeep dealership in 2009, with signs saying it will stay in business selling used cars, and its service center will remain open.

unit mark would soon be surpassed. Yet, by 2010 U.S. sales had retreated to 11 million units — the same number of vehicles sold in 1968, when our population was just a tick over 200 million.

While new vehicle sales have plummeted, there is an untold story about the collateral impact this creates. One of the major supply chains for used vehicle inventory is lease returns, and the 2008 slowdown is now beginning to have a heavy impact. As automotive research firm R.L. Polk & Co. noted, between June and November

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2008 new car leases fell 58 percent, creating an industry-wide shortage of late-model used vehicles. The result? Used car prices are about to drastically increase.

If this sounds bad, the problem will be exacerbated as consumers begin to realize that their leased vehicles have a residual value that is far less than the price of a comparable vehicle. The natural result of this will be that more consumers will purchase their cars at the expiration of their lease, further shortening the supply of available inventory.

Just how bad can it get? Manheim Auctions, the world's largest wholesale auction provider, has been tracking used vehicle prices since 1995, and notes that used vehicle prices have already begun to soar. Using 1995 as a baseline with a score of

100, Manheim maintains a used car price index that measures prices month-over-month, adjusted for the time value of money. In May 2011, the index hit a record-high 127.8, meaning that — as of May — the cost of buying used was approaching the cost of buying new. As we get deeper into 2011, this outlook promises to worsen.

While this spells trouble for consumers, it is particularly worrisome for automotive dealers, who are already struggling to remain viable with sunken new car sales. And, what's bad for dealers is bad for the economy, as new car dealers make up 7 percent of California's retail economy and provide for \$5.3 billion in annual payroll. This does not take into consideration the thousands of independent automotive dealers who depend exclusively on used car sales for their business, and who will be greatly impacted by the lack of supply.

Kelly Blue Book and Edmunds.com have been reacting to the shortage by steadily adjusting their used car pricing guides up, with Edmunds noting that nearly 70 used cars models are nearing the price of new. As Edmunds.com analyst Joe Spina stated, "I don't expect any dramatic decreases in used prices for at least 18 months." Other industry analysts are less optimistic, such as the National Automotive Dealers Association who opines that it could be as late as 2017 before used car prices return to their prior levels.

For an industry that sells some 30 million used cars each year, higher transaction prices will have a chilling effect on the growth of our economy. Given the size of the sector, and the direct impact it has on jobs, finance and state tax revenue, this is a problem that will impact us all.