

ATAE Newsletter Article
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Trends in Trade Appraisal: Then and Now

In the past, the prevailing wisdom was to acquire the trade-in vehicle for the least possible amount of money in order to facilitate the sale of the new vehicle and to maximize the profit opportunity of the trade-in vehicle. This mentality frequently created tension between the new- and used-car departments. Conservative used-car managers undervalued trade-ins such that sales were missed while aggressive new-car managers overvalued vehicles causing negative equity to build up in the used-vehicle inventory. Both of these tendencies created discord within the dealership as well as inconsistent and inefficient operating results.

The common notion of a “proper valuation” was generally defined as the vehicle’s actual cash value (ACV). In other words, it was the objective of the dealership to acquire a vehicle for an amount equivalent to that which it could be disposed of in the wholesale market. This approach can be referred to as the *wholesale valuation method*.

Dealers historically relied on numerous third-party publications as well as their own past experience for determining this wholesale value. Auction results were also used as a reference point for the wholesale valuation method.

In some parts of the United States, particularly the West Coast, dealers often determined trade-in values working backwards from amounts that banks would likely finance. In the past decade of credit-driven markets, this *loan value* approach rivaled the *wholesale method* for valuing a vehicle. It is safe to say that most dealerships today rely on the *wholesale method* and/or the *retail* loan methods when valuing a trade-in vehicle.

Emerging Trend

Today, the used-car market is both efficient and transparent. This means that dealers and consumers have relatively equal access to information concerning vehicle values and selection alternatives. In this environment, a vehicle’s proper trade-in value is also affected by how much it can be sold for in the retail market. In other words, if a vehicle’s likely retail price is \$15,000 and the dealership wishes to make \$2,000 profit and plans to spend \$800 on reconditioning, then the vehicle’s value to the dealer is approximately \$12,200. Because the wholesale and retail markets do not move in perfect alignment, there are inevitable instances where a vehicle’s value will differ substantially according to the valuation method used—*wholesale, loan, or retail*.

For example, consider a case where a vehicle’s *wholesale* value based on third-party guidebooks and auction results is \$14,500, but its value using the *retail* method described above is \$13,800. In such cases, a dealership using the *wholesale* valuation method alone may acquire a vehicle for an amount that is too much for the retail market to bear after adding profit and reconditioning costs. This is why the best practice for determining a vehicle’s value must take into consideration the *wholesale, loan, and retail* data points. If the trade vehicle in question is earmarked for the wholesale market, then the *loan* and *retail* valuation methods are not relevant.

This article is excerpted from *A Dealer Guide to the Trade Appraisal Process in a Transparent Market* (SL40). You may order the guide online at www.nada.org/mecatalog or by calling NADA at 800-252-NADA, ext. 2.