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Repossession Trends Reflect Economy, Hint at Road Ahead

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When repossessions and liquidations of machine tools rose steadily from the third quarter of 2007 through 2008, Nassau Asset Management took notice. We track equipment repossession trends through our internal activity, which includes collecting, repossessing, and remarketing assets for banks and lessors.

We have been tracking these activities and reporting on them in our NasTrac Quarterly Index (NQI) since 2000 and by analyzing these historic trends we have found that machine tool repossessions are a good indicator of the state of the economy.

Lessors called upon Nassau more frequently in recent months to repossess machine tools from failing or defunct manufacturing companies. We have now reached the point where the level of activity is providing us with what we feel is an accurate indicator of the true state of the economy.

Repossession trends offer a snapshot of current industry conditions when evaluated against other data. They also hint at predictors for the quarters ahead.

Everyone hopes 2009 marks the start of an economic turnaround. That is the intent of the American Recovery and Reinvestment Act, signed into law by President Obama on Feb. 17. In terms of helping businesses acquire or lease equipment, however, the stimulus package is a mixed bag. The Equipment Leasing and Finance Association [ELFA] reported that the act includes some favorable measures, including the extension of bonus depreciation for 2009 and a significant nod to renewable energy. But it fell short of a temporary investment tax credit that would have reduced the net cost of acquiring productive depreciable assets.

We also see mixed messages about efforts to loosen the credit squeeze. Federal Reserve Chair Ben Bernanke reported in Feb. 10 testimony before the House Financial Services Committee that programs created to encourage bank-to-bank lending are starting to show progress. Still, any significant changes for businesses won't be felt until later this year because of the current credit backlog.

Meanwhile, what can 2008 equipment repossession trends tell us about what may lie ahead? The following insights are based on Nassau's repossession and orderly liquidation activity, as well as a review of other factors in the leasing markets and governmental and regulatory activity. Given Nassau's present activity and other marketplace trends, we predict current trends will continue through at least mid-to-late 2010.

Repossession Trends

Manufacturing

A rise in repossessions and liquidations does not always signal a faltering economy. But past history has shown us that the economy is at its worst when we see a spike in machine tool repossessions.

Nassau's repossessions and liquidations of machine tools rose by more than 150 percent in 2008, according to our internal records. We researched similar trends regarding machine tools in the past and believe the hike was the direct result of a significant economic recession. In fact, the last major increase in machine tool repossessions occurred during the severe economic downturn following 9/11.

Several factors could influence future repossessions and liquidations in the manufacturing sector. If a major manufacturer such as GM or Chrysler filed for chapter 11 bankruptcy protection, it would produce a worldwide problem with a shockwave rippling through the many niche businesses that supply the automakers. A global accumulation of used machine tool equipment inventory would have a dramatic effect on residual values and prices of used equipment.

The recent drop in the demand for steel also could spell trouble. Numerous published reports in recent months indicate a noticeable decrease in activity.

There are flickers of hope. The U.S. is making progress toward controlling structural costs, such as labor, regulation, and taxes, according to a recent report by the National Association of Manufacturers (NAM), the Manufacturing Institute, and the Manufacturers Alliance/MAPI. Eventually, the manufacturing and construction sectors also could receive a boost from infrastructure projects outlined in the stimulus package.

Construction

Construction equipment repossessions in 2008 increased by 11 percent compared with 2007. This is not a dramatic hike, but is a sign of continuing struggles in the industry. We believe this is the beginning of a considerable spike in repossessions of construction equipment that will be reflected in future quarterly index reports.

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The U.S. construction industry lost 111,000 jobs in January and a recent report by the federal government shows new home construction has dropped to the lowest levels since at least 1959. In a review of 33 U.S. homebuilders with at least \$10 million in revenue, more than 30 percent were in financial distress and in danger of filing for bankruptcy, according to an analysis by Grant Thornton Corporate Advisory and Restructuring Services.

Nonresidential and public works construction also is feeling the pain. McGraw-Hill Construction is predicting a 7.4 percent drop in construction starts in 2009, following declines of 12.4 percent in 2008 and 8 percent in 2007.

Infrastructure projects that are part of the stimulus act may provide a bit of relief. That said, some experts are predicting hard times for the construction industry through 2010. Jim Haughey, chief economist for Reed Construction Data in Georgia, said in a recent Webinar that he believes the U.S. economy will bottom out in late summer or early fall and won't rebound until the end of 2010.

Transportation

Truck repossessions and liquidations dropped by 25 percent in 2008 from a high in 2007, but the numbers were still significant. They represented a 50 percent increase compared with 2006.

The slow economy has created a high level of inventory, which may increase even more given current constraints on credit. There also are other negative indicators. Statistics measuring month-to-month changes in the output of services by "for-hire" transportation companies -- The U.S. Department of Transportation's Transportation Services Index (TSI) -- declined 1.2 percent during the first 11 months of 2008. Freight TSI, which is based on month-to-month changes in the output of services provided by "for-hire" rail, trucking, inland waterway, pipeline and air freight firms, was 107.6 in November 2008 -- the lowest since January 2004. What's more, the trucking industry lost nearly 25,000 jobs in January, the highest monthly loss ever except during a national strike in 1994, according to data from the Department of Labor.

It is also difficult to predict how the market will react to the new emission standards for trucks in 2010. This standard will require urea tanks to be standard equipment for most new diesel trucks, buses and cars. These tanks will scrub nitrogen oxide (NOx) from diesel exhaust fluid (DEF).

Other Sectors

Nassau's repossessions and liquidations of medical equipment in 2008 increased by approximately 50 percent over 2007. However, Nassau has found that, in general, the healthcare industry is less affected by economic fluctuations than other sectors. Most likely, the spike in medical repossessions can be attributed to equipment for treatments not reimbursed by insurance, including equipment from cosmetic and aesthetics practices that are seeing a downturn in demand for certain procedures.

The Road Ahead

Based on our present activity and other marketplace trends, Nassau is anticipating similar economic conditions through mid-to-late 2010. Those conditions will be challenging, but not crippling. For example, we continue to sell assets without resistance and our collectors are still successfully bringing in dollars for our clients.

We do believe that a combination of government action and a rebound in credit will eventually fuel significant improvements in the nation's economy.

In the interim, however, some weaker companies will not be able to survive, especially in sectors reliant on American automakers for their existence. It will also be important to see if U.S. exports decrease because of a rising dollar.

Clearly, one of the most crucial factors to watch is the credit market, where government action along with a renewed sense of confidence among lenders is required to provide the economy with a needed boost.

While waiting for that to start, businesses need to apply sound operating practices, increase their flexibility and responsiveness in terms of obtaining and using assets, and have a firm understanding of all options available to them as they move forward.

Author Bio

Edward Castagna is president of Nassau Asset and has more than 18 years experience in all areas of asset management. His specialty is his expertise in remarketing strategies and liquidations. Castagna has helped liquidate the assets of thousands of distressed companies since joining the firm in 1991. He is particularly knowledgeable about using an alternative to auctions, known as orderly liquidations, to maximize return on liquidated assets. Reach him at 800-462-7728 or ecastagna@nassetcom.

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