

Driven

NADA MANAGEMENT SERIES

SL40



A DEALER GUIDE TO

The Trade Appraisal Process in a Transparent Market



NATIONAL
AUTOMOBILE
DEALERS
ASSOCIATION

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A DEALER GUIDE TO THE Trade Appraisal Process in a Transparent Market

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Trade Appraisal Process in a Transparent Market

I. INTRODUCTION

Almost every recurring activity in a dealership showroom is both measured and managed. That is, just about every activity—except the appraisal process.

Most dealerships can precisely cite the number of daily walk-ins, telephone, and Internet opportunities. They also know how many demo rides and walk-around presentations were performed each day as well as the number of sales made, the number of cars delivered, and their customer satisfaction results. When it comes to the number of vehicles appraised, the specific appraisers, and the daily, weekly, and monthly trade capture rates, however, the answers become increasingly vague. This, despite the fact that the appraisal process involves hundreds of thousands of dollars and directly influences the number of new and used vehicles sold. The lack of consistent process and measurement during the appraisal activity represents one of the greatest opportunities for dealers to improve the volume and the profitability of their variable departments.

The importance of sound and effective appraisal processes is magnified today by our ever more transparent and efficient marketplace. Consumers now have strong knowledge of the dealers' cost and competitive offerings, rendering the trade evaluation process one of the few remaining opportunities for dealers to gain a competitive advantage.

This guide examines the purpose and best practices of maintaining an efficient and effective trade evaluation process.

II. PURPOSE OF APPRAISALS

Trade evaluations serve two primary purposes. First, the trade-in represents a critical component of the purchase consideration of a new or used vehicle. Second, trade-ins represent an important source of acquiring used-vehicle inventory. Both of these purposes are of sufficient importance to warrant proper methods, monitoring, and management.

III. VALUATION METHODOLOGY

A. Historical Perspective

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.

B. 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.

C. Additional Considerations: Market Days' Supply

In addition to considering the *wholesale, loan, and retail* reference points, vehicle appraisers today need to consider the supply and demand dynamics of similar vehicles in the current market. The current used-car market is an efficient market and, as such, vehicles are subject to the rational economic principles that drive efficient markets. Specifically, if a particular trade-in vehicle has a high supply and low demand, then the appraiser should be extra careful not to overvalue the vehicle. Vehicles with high supply and low demand need to be priced very aggressively in order to ensure proper sale. Conversely, when appraising a vehicle with high demand and low supply, the vehicle does not need to be priced on the low end of the competitive spectrum. In such cases a modest overvaluation may not be a problem for rapid disposition and acceptable profit margin.

For example, if there are 10 identically equipped vehicles in the market, the appraiser should be prepared to price his vehicle such that it will rank as either the first, second, or third best-priced vehicle in the market relative to comparable cars. If the appraiser overpays for the vehicle, it will make it impossible for the dealership to meet this ranking goal and simultaneously achieve its margin objective, forcing the vehicle to be priced in the upper range of competitors (positions 7, 8, or 9). In such cases, the vehicle will likely not sell and will become aged.

These examples underscore a fundamental shift in the art of determining a trade-in vehicle's proper value. Previously, used-vehicle trade-in values largely drove the retail price, whereas today their retail price should rightfully, in part, drive the trade-in value.

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Vehicle Appraisals

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Step 2
Market Summary

Step 3
Appraisal Worksheet

Step 4
Vehicle Adjustment

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[APPRAISAL WORKSHEET](#)

STEP 2: Market Summary

NADA Used Vehicle Values Period: June 2009

	Rough Trade-In	Average Trade-In	Clean Trade-In	Clean Loan	Clean Retail
Base Price	\$11,425	\$13,300	\$14,875	\$13,400	\$17,700
Vehicle Options	\$1,050	\$1,050	\$1,050	\$1,050	\$1,175
Mileage Adjustments	-\$275	-\$275	-\$275	-\$275	-\$275
Adjusted Value	\$12,200	\$14,075	\$15,650	\$14,175	\$18,600

All NADA values are reprinted with permission of NADA Used Car Guide, NADASC.

Date: June 16, 2009
2006 Cadillac CTS Sedan 4D 3.6L V6
VIN: 1g6dp577560147794
Mileage: 55,000

Vehicle History Report by

Market Reports ZIP Code: Radius: [GO](#)

Market Report		AutoTrader Listings	JD Power Transactions	MMR Transactions		
	Vehicle	Volume	Low Range	Average	High Range	
	Mileage Adjusted Price (\$5,000)	2006 Cadillac CTS Sedan 4D 3.6L V6		\$16,679	\$18,452	\$20,224
	Asking Price		(106)	\$17,769	\$19,542	\$21,314
	Mileage			52,329	34,804	17,278
	Mileage Adjusted Price (\$5,000)	2006 Cadillac CTS Sedan 4D 3.6L V6		\$16,467	\$18,515	\$20,562
	Retail Transactions		(29)	\$17,446	\$19,494	\$21,541
	Mileage			54,180	30,846	7,511
	Mileage Adjusted Price (\$5,000)	2006 CADILLAC CTS 4D SEDAN		\$11,450	\$13,300	\$15,100
	Auction Transactions		(70)	N/A	\$14,729	N/A
	Mileage			N/A	35,737	N/A
	Days Supply	2006 Cadillac CTS Base				
	Market Days Supply				71	
	Like Mine				69	

JD Power Retail data is based on transactions in the last 60 days.
N/A - Not Available
Insuf. Data - Insufficient Data - Please try expanding search radius

Source: NADA AppraisalPro

D. Additional Considerations: Packs

Another important consideration in appraising trade-in vehicles is the effect of packs. Packs or arbitrary amounts added to the acquisition cost of trade-in vehicles often misalign behavior and rational acquisition principles. Consider the case where an appraiser determines the proper value of a trade-in to be \$15,000. The appraiser knows that after the dealership's pack of \$800

plus the \$1,200 expected reconditioning cost, the front-line-ready unit cost will be \$17,000. The appraiser is also likely to be mindful of the fact that similar vehicles have recently sold for around \$18,000. Since the appraiser is frequently a sales manager, he is expected to produce per-vehicle retail profits of at least \$1,500. Subconsciously he realizes that the \$15,000 acquisition value may be too high to achieve the per-vehicle retail profit goal, and therefore

reduces the appraisal to \$14,500.

While this \$500 reduction seems rational from the appraiser's perspective, it may not be acceptable to the consumer who likely possesses equal knowledge of the vehicle's fair market value of \$15,000. Like the misalignment between new- and used-car managers previously outlined, the misalignment of financial objectives between the dealership and the customer as a result of the pack creates discord and inconsistent operating results.

In addition, it should be noted that charging the used-car department retail rates for reconditioning repairs is, in fact, another form of pack. This extra charge did not present a significant handicap to the vehicle's salability when the used-car marketplace was inefficient and lacked transparency. Today, however, the same retail reconditioning charges cause unit costs to be higher than necessary, subjecting the dealership to the same pack problem described above. Today's progressive used-car operations are charging reconditioning and repair expenses at the same rate that is extended to the best customers of the service department.

E. Additional Considerations: Age

Aged inventory is yet another condition that artificially influences trade-in valuations. Once again, because appraisers are often sales managers, they are held responsible for the used-vehicle's inventory age and turn rate. When appraisers/sales managers are burdened with many vehicles that are too old and owned for too much money, they naturally become tentative and unduly conservative with respect to appraising new vehicles. This condition is best addressed by having a firm age limit policy.

IV. CONSULTATIVE VALUATION PRESENTATION

In today's efficient and transparent marketplace, the best practice for evaluating a trade-in is to assume that the consumer has access to the same information as the appraiser. Although this may not actually be the case with all consumers, this operating assumption serves the general interest of the dealership because consumers place a high value on transparency and openness. This approach, however, challenges the traditional practice of attempting to acquire the trade-in vehicle for the least amount of money possible in order to make the deal. This practice needs to be challenged because, increasingly, continuing such practices will destroy the credibility of the dealership and/or sales representatives.

Dealerships that experience the best results are those that openly share the above described valuation methods and data points with the consumer. With full disclosure of the valuation data and methodology, the opportunity for differences is often reduced to matters of how much reconditioning is necessary.

A. Determining Proper Reconditioning Amounts

Many dealerships provide only cursory analysis of what is needed for reconditioning. Failure to adequately assess necessary reconditioning expenditures results in both lost sales and profits. The best practice for determining proper reconditioning expense is for a dealership appraiser to follow a thorough and prescribed checklist (see example next page). This process should be executed with the vehicle owner present. Properly performing a thorough review of the vehicle's physical and mechanical condition builds trust and understanding with the consumer.



USED VEHICLE INSPECTION FORM

Salesperson:										Date:																																																	
Customer Name:										Email:																																																	
Address:										Phone:																																																	
VIN#:										<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td> <td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td><td style="width:20px;"></td> </tr> <tr> <td colspan="10"></td> <td colspan="2" style="text-align: center; font-size: small;">YEAR</td> <td colspan="8"></td> </tr> </table>																																								YEAR									
										YEAR																																																	

Year:		Make:		Model:			
Color:		Mileage:					
Vehicle Equipment ☐ Rear Defrost ☐ Luggage Rack ☐ Leather ☐ Air Conditioning ☐ Alloy Wheel ☐ Custom Wheel ☐ Tilt Wheel ☐ ABS Brakes ☐ Spare Tire ☐ Sunroof ☐ Extended Cab ☐ 7/8 Passenger ☐ Rear Air		Transmission/Engine ☐ Automatic ☐ Manual ☐ 4 Cylinders ☐ 6 Cylinders ☐ 8 Cylinders ☐ AWD ☐ 4WD ☐ Additional Equipment		Power Accessories ☐ Power Steering ☐ Power Locks ☐ Power Windows ☐ Power Seats ☐ Power Mirrors ☐ Keyless or Security ☐ Cruise Control			Entertainment ☐ DVD/TV ☐ CD ☐ Cassette ☐ CD Changer ☐ iPod Jack ☐ Bluetooth ☐ Navigation

CUSTOMER QUESTIONNAIRE		Preliminary Reconditioning Costs _____ Mechanical _____ Front Bumper _____ Rear Bumper _____ Glass _____ Tires _____ Front End _____ Rear End _____ Driver Side _____ Passenger Side _____ Interior _____ Lights/Bulbs _____ Other _____ LMA TOTAL
Yes or No ☐ Yes ☐ No Records of scheduled maintenance? ☐ Yes ☐ No Has the vehicle been smoked in? ☐ Yes ☐ No Does the transmission shift properly? ☐ Yes ☐ No Does the air conditioner blow cold? ☐ Yes ☐ No Extended Warranty? ☐ Yes ☐ No Are the books and manuals complete? ☐ Yes ☐ No Will any equipment be removed? If yes, what? _____ Vehicle Ownership & Maintenance How many original keys are missing? _____ When was the last major service? _____ When was the oil last changed? _____ Are you the original owner? _____ Has this vehicle ever been in an accident that required repairs over \$2,000? _____	On a scale 1-10 (1=Worst / 10=Best), please rate the following _____ Engine/Transmission _____ Brakes/Suspension _____ Electrical _____ Front/Rear Bumpers _____ Glass _____ Lights Tires _____ LF _____ RF _____ LR _____ RR Wheels _____ Front _____ Side _____ Rear _____ Hood _____ Roof _____ Other Interior _____ Seats _____ Carpet _____ Dash _____ Other	
Comments		

Appraiser's Signature:	Customer's Signature:
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B. Proper Appraisal Metrics and Measurement

In order to ensure that the appraisal process yields optimal results, there are several important metrics that need to be captured and reviewed. To this end, there are three parties involved in each appraisal: the consumer, the appraiser, and the salesperson. As stated above, each relevant party to the transaction should participate fully in the appraisal process. Recording the owner's identity, address, contact information, and vehicle description will serve an important purpose for follow-up, marketing, and future vehicle sourcing.

The number of trade opportunities should be tracked at the dealership as well as at the salesperson level. It is also essential to capture salespeople's success rate in capturing the trade (often referred to as look-to-book). Salespeople maintaining abnormally low percentages of trade evaluations may be encouraging consumers to dispose of their trades through alternate means outside the dealership. This practice sometimes occurs as a result of the salesperson's lack of confidence in the dealership's appraisal process. As a guide, approximately two-thirds of the sales opportunities for each

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APPRAISALS **REPORTS** **SETTINGS**

Vehicle Appraisals

Step 1: Vehicle Information | Step 2: Market Summary | **Step 3: Appraisal Worksheet** | Step 4: Vehicle Adjustment

STEP 3: Appraisal Worksheet **SAVE & CONTINUE**

Vehicle:
2006 Cadillac CTS Sedan 4D 3.6L V6
VIN: 1g6dp577560147794
Mileage: 55,000

Customer Information

First name: Mike
Last name: Anderson
Phone (H): 703-821-3214
Email: manderson@aol.com
Street Address: 8400 Westpark Drive
City / State / Zip: Mclean, VA 22102

Condition Assessment

Front Seats: Good | Rear Seats: Fair
Carpet: Rough | Transmission: Fair
Engine: Fair | Front Tires: Excellent
Rear Tires: Excellent | Wheels: Good

Vehicle Comments
Tires were recently replaced

Vehicle Options

• Bose Premium Stereo • Power Sunroof

Appraiser & Sales Consultant Information

Appraiser: Stu Zalud
Sales Consultant: John Beckman
Internal Comments: Timing belt needs to be changed

Other Features

☐ 4 Wheel Drive ☒ Air Conditioning
☐ All Wheel Drive ☐ Back-up Camera
☐ BEDLINER ☐ Chrome Wheels
☐ Climate Control ☐ Cooled Seats
☐ Cruise Control ☐ Diesel Engine
☐ Heated Seats ☒ Leather Seats
☐ Manual Transmission ☐ Navigation

Source: NADA AppraisalPro

salesperson should have a trade involved. To the extent that a salesperson's average falls below this threshold, notice should be taken to determine the reasons.

The salesperson's success rate in capturing the trade is also an important indicator as to the extent to which he is supporting and positively contributing to the appraisal process. If salespeople perceive that the dealership's appraisers are casual, reckless, or overly conservative, they will likely assume that all trade values are understated. It should be noted that the first sale of the appraisal amount is not between the salesperson and customer, but rather between the appraiser and the salesperson. Appraisers should take time

and care to convey their enthusiasm and commitment for acquiring the trade-in at a proper price. Once salespeople sense that commitment and have confidence in the dealership's trade-in appraisal practice, they will fully support the process.

A salesperson's trade-in capture rate is expected to be between 35 and 50 percent of all sales opportunities possessing trades. Performance above 50 percent may suggest that all opportunities possessing trade-ins are not being recorded. Performance below this threshold is an opportunity for improvement through training and closer supervision. You might want to use a report such as the one illustrated to help improve your salesperson's performance.

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  Home FAQs									
APPRAISALS REPORTS SETTINGS									
Clear Filter									
DATE	APPRAISER	CONSULTANT	CUSTOMER	VIN	VEHICLE	VALUE	STATUS	ACTION	
6/16/2009	Stu Zalud	John Beckman	Anderson, Mike	1G6DP577760124582	2006 Cadillac CTS Sedan 4D 3.6L V6	\$11,065	Completed	New	
6/16/2009	Stu Zalud	Jason McDonald	Bailey, Carson	1GNEK13TX5R166029	2005 Chevrolet Tahoe Utility 4D LS 4WD 5.3L V8	\$16,025	Completed	New	
6/16/2009	Stu Zalud	Trevor Kaiser	Glass, Jacob	1N4AL11D76N330237	2006 Nissan Altima Sedan 4D 2.5L I4	\$9,525	Sale	New	
6/16/2009	Stu Zalud	Dennis Freeman	Schultz, Randy	2GCEC19R1V1111365	1997 Chevrolet 1500 Extended Cab 2WD	\$1,780	No Sale	New	
6/16/2009	Mark Zot	Mary McIntyre	Forrester, Doug	4T1BF30K224528897	2002 Toyota Camry Sedan 4D LE 3.0L V6	\$8,100	In Progress	Edit	
6/16/2009	Mark Zot	Linda Ross	Baker, Jim	WDBNG70J1YA133048	2000 Mercedes Benz S Class Sedan 4D S430 4.3L V8	\$7,800	Completed	New	
6/16/2009	Mark Zot	Bill Opal	Murphy, Bill	JN8AZ08W04W310336	2004 Nissan Murano Utility 4D SL AWD 3.5L V6	\$10,000	Sale	New	
6/16/2009	John Beckman	Steve Appleton	Shah, Bob	STDZA23C34S129701	2004 Toyota Sienna Wagon 5D CE 3.3L V6	\$8,250	Sale	New	

Source: NADA AppraisalPro

For appraisers, there are three important metrics to be captured and managed. First, with multiple appraisers, it is important to understand the quantity of vehicles being appraised by each individual. This metric allows the dealership to track productivity as well as efficiency in capturing trades. Once the most efficient appraisers are identified, adjustments should be made to ensure that such individuals are on the front line of the process.

Second, the success rate of capturing trades is an important indicator as to the proficiency of the appraiser. Like the salesperson, an appraiser is expected to capture at least two-thirds of the trade-in opportunities. Finally, it is not enough to track the number of trade-ins captured without also tracking each appraiser's aggressiveness with respect to the amount he is willing to pay.

For example, appraiser A could be capturing 100 percent of the trade-in opportunities by significantly overvaluing each vehicle. Appraiser B, who might appear less efficient in capturing trades, may be valuing vehicles appropriately. Appraiser C may be capturing few vehicles notwithstanding the fact that he is valuing vehicles properly. Each one of these scenarios demonstrates unique problems and opportunities for improvement that would not be identifiable without comparing the capture success rate and the degree of monetary aggressiveness of each appraiser.

Today there is appraisal technology that tracks and records these metrics. Such tools also create more standardized appraisal process workflows to support the integrity of the process and make information capture and retrieval uniform and efficient.

V. TIMELINESS OF APPRAISAL ACTIVITY

Although many phases of the sales process should be conducted with speed and efficiency, it is to your advantage to allocate sufficient time to the appraisal portion of the process. Taking ample time with the customer in the trade-in evaluation process demonstrates care and concern in ensuring the consumer receives the best possible valuation. Fast appraisals subliminally signal carelessness and under-evaluation in the mind of consumer.

Once the trade-in is captured, however, speed of disposition is of the utmost importance. It is recommended that all captured trades be segmented and identified in two categories. The first category includes captured vehicles where the transaction is not yet complete. The second category is for finalized transactions.

You should conduct a thorough review of each appraisal in both categories within 24 hours. If it is determined that the vehicle was incorrectly appraised, then an appropriate adjustment can and should be made at that time. An excess amount may be charged back to the original deal and/or charged off to a special account. In either event, it is recommended that freshly captured trade-in vehicles be put into inventory at a proper appraised value.

Next, a prompt determination should be made as to whether the captured vehicle will be retailed or wholesaled. If the vehicle is determined to be wholesale, the vehicle should be identified appropriately and arrangements should be made immediately.

For those vehicles intended for retail disposition, a reconditioning estimate should be written for each vehicle. Take care to compare the estimate made at the time of appraisal with that made upon review. The appraiser responsible for the initial estimate should participate in the reconditioning estimate; if he cannot participate, advise him of any discrepancies.

Adjustments and repair orders for vehicles in the first category should be held until the transactions are completed. Those vehicles in the latter category should be promptly reconditioned for sale. It is recommended that the reconditioning process take no more than 48 working hours, assuming no unexpected repairs. It is also recommended that you list such vehicles on the Internet within 12 hours of their capture and decision for retail. You may post finished photographs at the conclusion of the reconditioning process. Pricing, however, need not wait for completion of reconditioning.

VI. CONCLUSION

For most dealerships, the trade-in appraisal process continues to lag behind the more progressive transparent approach of pricing and selling vehicles. Yet as used-car operations become ever more an integral part of the dealership's viability, the trade-in acquisition process becomes a more critical component for success.

This new approach begins with the recognition that the trade-in appraisal process warrants proper time, attention, measurement, and management. Dealership personnel need to take the time to understand the multiple methods of determining a vehicle's proper value. Attempts to acquire the trade-in vehicle for less than its proper value should be abandoned in favor of an aggressive policy of acquiring vehicles for an appropriate amount.

The time has come for dealers to apply a consultative and transparent approach to valuing the trade-in vehicle, thereby completing the entire sales process in a manner that is likely to be most successful and pleasing for dealership personnel and customers alike. Many dealers are embracing this new approach in their sales process as evidenced by their increasing willingness to price vehicles at or near their transaction point.

The successful capture of a trade-in serves the dual function of properly facilitating a present sales transaction as well as a prospective one. In addition, the dealership's service department will enjoy a consistent revenue stream from each and every acquired vehicle. In a very real sense, the trade-in vehicle is a golden thread that is woven through the new, used, and service departments.

As the Internet infuses more and more information into the car-buying process, traditional techniques of appraising and negotiating need to be replaced by new, market-driven processes.

ACKNOWLEDGMENTS

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Examples shown are from NADA AppraisalPROSM, available exclusively to members of NADA and NIADA. For more information on NADA AppraisalPRO, please call Yvonne Porter, Account Executive, NADA Used Car Guide, at 800.248.6232 extension 4724.





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