

The Impact of Uber on the Taxi Lending Industry

How Lenders are Facing Credit Quality Deterioration as a Result of Their Exposure

Authors

Bob Durante

Senior Director,
Global Risk Services

Eduardo Alves

Associate Director,
Global Risk Services

Arnold Gevero

Associate Director,
Global Risk Services

As recent news coverage has widely noted, taxi drivers and medallion owners are not the only ones feeling the impact of new competition brought on by ride-sharing companies like Uber Technologies Inc. and Lyft Inc. These disruptive technologies are also affecting the myriad of lenders to taxi medallion holders, including financial institutions, which are not only seeing the value of the medallions they underwrote at all-time-high prices plummet but, simultaneously, and perhaps even more importantly, are also experiencing an increase in credit risk. Understanding how depreciating medallion prices are driving this risk and what this risk means, especially for creditworthiness, is an essential first step in developing effective rules, regulations and business tactics that can foster an environment conducive to the future stability of the midsized-bank and credit union lenders.

Even during the Great Recession, medallion prices edged higher mostly because the supply of medallions is restricted by the equivalent of regulated regional monopolies, with limited supply and minimal threat of competition. Consider that the number of taxi medallions in New York City (regulated by the NYC Taxi and Limousine Commission) grew by only 2.2% between 2007 and 2013¹, creating a market imbalance wherein the supply of taxicabs was constantly outpaced by demand. Other regional markets (e.g. San Francisco, Boston, and Chicago) followed similar dynamics, pushing the auction price of medallions sky-high.

During this pre-Uber, high-price period, buyers relied on short-term financing to afford the purchase of medallions. Financial institutions, notably midsized-banks and credit unions, perceived taxi medallion lending as a lucrative and low-risk investment option – open to financing as much as 90% of the value of the purchase. Interestingly, in 1998, the United States Senate passed legislation to limit credit unions' business-lending activities. However, exceptions to these lending activities were added, including taxi medallions, church construction and fishing boats.²

Today, however, medallion prices are falling because of a fundamental shift in the competitive and regulatory landscape caused by new entrants to the market, such as Uber and Lyft. These companies compete directly with taxicabs and eroded the profitability of each medallion. Lenders now face the challenge of seeing the value of the loan collateral, the medallion itself, plummet. For example, in Chicago, medallions are worth around \$240,000 in 2015, down from \$360,000 in 2013. Similarly, in New York City, the medallion value dropped from a high of \$1.3 million in 2013 to roughly \$750 thousand in 2015.

¹ New York City Taxi and Limousine Commission's 2013 Annual Report to the New York City Council, March 2014.

² United States Senate Report 105-193, Credit Union Membership Access Act, May 1998.

Consequently, lenders are reluctant to continue to refinance taxi medallion loans, deciding instead to demand final loan payments, leading to higher risk of defaults.

To assess the financial impact on banks and credit unions that focus on lending to the taxi medallion industry, we conducted an assessment of a select number of institutions' creditworthiness using S&P Capital IQ's Bank Scorecard. The Bank Scorecard, like the other 90 S&P Capital IQ scorecards, is designed and calibrated to align with the Standard & Poor's Rating Services criteria and ratings. Each Scorecard is dynamically split between qualitative and quantitative risk factors to fully capture counterparty credit risk. Lowercase nomenclature is used to express the output of the Bank Scorecard to differentiate it from the uppercase ratings issued by Standard & Poor's Ratings Services, which is analytically and editorially independent from S&P Capital IQ. For the purpose of this exercise, we initially held all qualitative factors constant, allowing only the quantitative factors to vary from 2011 (pre-Uber) to 2014 (post-Uber). This permitted a direct analysis of the banks' and credit unions' financial positions.

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Senior Director,
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Arnold Gevero

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Table 1

Institution Name	Institution Type	Total Assets Q3 2015 (\$MM)	Total Loans Q3 2015 (\$MM)	Change in Score from 2011 to 2014 (notches)
BankUnited, Inc.	Bank	22,537.7	15,482.2	-1
Lomto Federal Credit Union	Credit Union	271.5	245.0	-1
Melrose Credit Union	Credit Union	2,083.7	2,003.7	-1
Montauk Credit Union	Credit Union	179.5	166.2	-3
Signature Bank	Bank	31,920.5	22,830.7	0

Source: SNL Financial, December 4, 2015.

Two of the institutions that we assessed are banks and three are credit unions. With the exception of Signature Bank, all institutions faced a decline in overall credit quality, based purely on financial performance. In Signature Bank's case, we believe its larger size and smaller proportional exposure to taxi medallions has shielded the bank, thus far, from a drop in credit quality.

Standing out on the list is Montauk Credit Union, which suffered the biggest drop in credit quality, according to our Credit Assessment Scorecard analysis, with nearly 30% of its outstanding loans issued to the taxi medallion industry. By using the institution's 2011 quantitative financial results, the S&P Capital IQ Bank Scorecard revealed that Montauk Credit Union's risk score was 'bb-'. As indicated in Figure 1 below, each risk score maps to a historical default rate -- the 'bb-' risk score maps to a 1.21% 1-year global historical default rate.

Using the 2014 financial results and adjusting the Bank Scorecard qualitative risk factors, the risk score declined three notches (as seen in Table 1), changing from 'bb-' to 'b-'. The 'b-' risk score maps to 8.17% default rate -- a rate that is almost seven times greater. This steep

decline in credit quality was due to its weak business position, most notably its loan concentration and a sudden and significant decline in the bank’s liquidity position. Not surprisingly, throughout 2015, Montauk Credit Union’s credit quality continued to decline and was ultimately placed under conservatorship by the New York State Department of Financial Services in September 2015 because of “unsafe and unsound conditions”³, in what is largely viewed as a result of their over-exposure to the taxi medallion industry. As seen in Table 1, BankUnited, Inc., Lomto Federal Credit Union, and Melrose Credit Union have each already fallen 1 notch in their credit model risk scores, indicating the beginning of the decline in their credit quality, as well. Time will tell if they continue to follow in the footsteps of Montauk Credit Union.

Authors

Bob Durante

Senior Director,
Global Risk Services

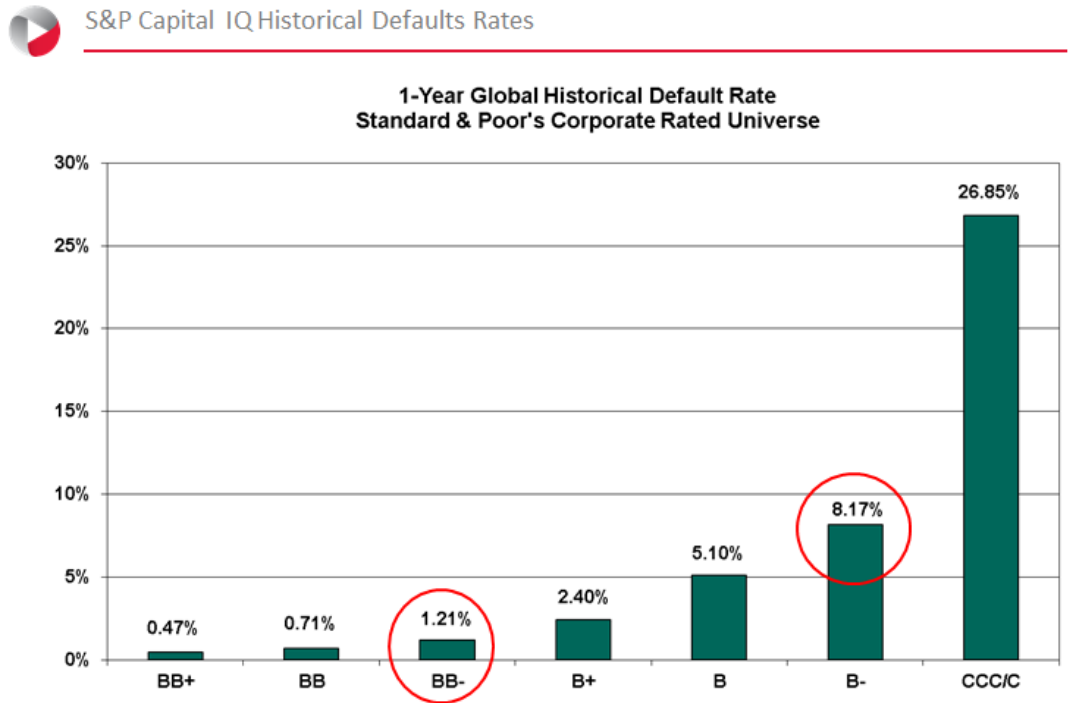
Eduardo Alves

Associate Director,
Global Risk Services

Arnold Gevero

Associate Director,
Global Risk Services

Figure 1



Source: S&P Capital IQ CreditPro, March 2015

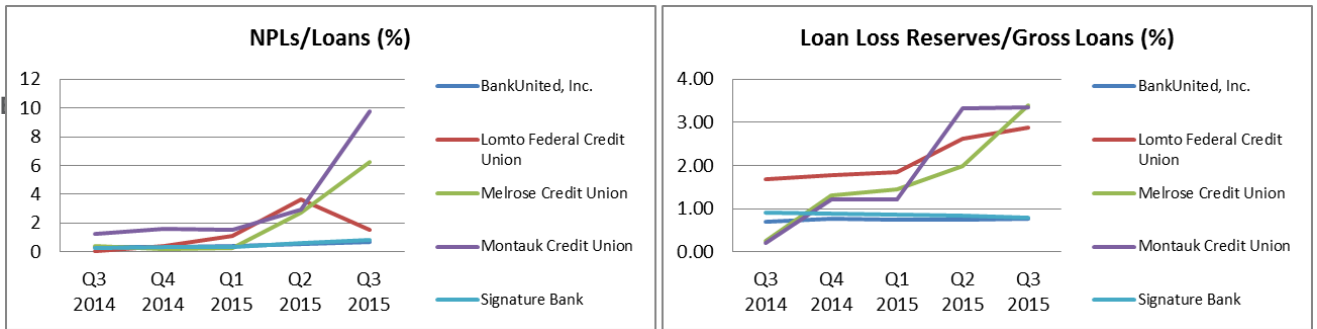
The risk of systemic foreclosures in the medallion industry continues to apply pressure on these institutions. Given the overwhelming loan concentration to the taxi industry and without a recovery in the value of the medallion, we expect the credit quality of these institutions to weaken further.

The decline in medallion values only began in 2013, thus its impact is not fully reflected in the capital or liquidity ratios of exposed institutions. However, increases in loan loss reserves

³ New York Department of Financial Services Press Release, “NYDFS Takes Possession of Montauk Credit Union, Appoints NCUS as Conservator”, September 2015.

are a reliable early-warning sign. Figure 2 indicates that Nonperforming Loans (NPL)-to-Total Loans and Loan Loss Reserves-to-Gross Loans for credit unions are trending upwards, sometimes drastically (e.g. Montauk's NPL). Both Signature Bank and Montauk Credit Union have not experienced the same effect largely due to the smaller size of their medallion exposure as a percentage of total loans.

Figure 2



Source: SNL Financial, December 4, 2015.

In S&P Capital IQ's past analyses, bank credit quality could deteriorate quickly in certain situations. What is apparent is that financial institutions with large exposures to the taxi medallion industry must take appropriate steps to measure and mitigate this increasing credit risk. Ride-sharing companies look set to become long-term competitors of the taxicab industry, thus medallion prices are poised to continue to decline until a more competitive equilibrium. Industry fundamentals are dynamic and should be reassessed on an ongoing basis. A safe investment today is not a guarantee of safe returns tomorrow, so the importance of diversification is as apparent as always.

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CONTACT US

Americas
+1 212 438 8701

Europe, Middle East
and Africa
+44 (0)20 7176 1233

Asia Pacific
+852 2533 3535
+61 2 9255 9886

www.spcapitaliq.com