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Bankers hopeful but bracing for more stress in taxi medallion space

By Maria Tor and Robb Soukup ***March 28, 2016***

As the taxi business struggles to stabilize amid the market disruption wrought by Uber and Lyft, bankers with exposure to the medallion lending business are warning of further potential stress for their borrowers.

Bankers have — not surprisingly — publicly backed the long-term prospects of their medallion borrowers and argued that they will make changes and find a new equilibrium level of market share that ensures their long-run survival. But various disclosures have revealed that many of those banks fear more stress and potential losses as Uber and its ilk continue to disrupt the city taxi market and strengthen their foothold.

"This is the portion of our loan portfolio that we keep the closest eye on, for obvious reasons," BankUnited Inc. COO Rajinder Singh said during the company's Jan. 21 fourth-quarter 2015 earnings conference call. The bank reported medallion loans totaling $212 million at the end of 2015, which was the second-highest total among banks with disclosed concentrations in the New York area. Singh added during the call that after a detailed review of its credits the company classified about $78 million of its portfolio as substandard, bringing the total of substandard classified medallion loans to $80 million; delinquencies were about $7.9 million in the portfolio.

BankUnited Chairman, President and CEO John Kanas said in an interview that the company had yet to see significant deterioration in the portfolio overall. "The performance of our loans have been quite good, actually. Out of $212 million we only have $2 million worth of loans that are past due," Kanas said. "So we're feeling like that portfolio will work its way out over the next few years as valuations of these medallions become more obvious," he added.

After a decline in medallion transactions some recent sales have pegged medallions in the New York area at about $700,000, a valuation that some believe reflects a normalized value, according to Kanas. "If that turns out to be true, our portfolio will perform quite well over time," he said. Most of the substandard classified loans were related to medallion valuation, but those borrowers have continued to pay as agreed, Kanas said.

In its Form 10-K disclosure, though, the bank warned that the risk of additional stress and potential classification extended to the rest of its medallion portfolio. "Taxi medallion loans currently rated 'pass' may be considered potential problem loans due to stressed conditions in the transportation-for-hire industry. If conditions in the industry deteriorate further, additional taxi medallion loans may be downgraded in the future," the company said. It said such loans totaled $131 million at the end of the year, which along with the $80 million already classified as substandard, represents essentially the entirety of its taxi medallion loan portfolio.

BankUnited has set aside reserves representing about 5% of that medallion portfolio, and Kanas said it was unlikely the bank would add more to those medallion-allocated reserves in 2016. "By putting that much in reserve, we think that's more than enough to cover any long-term losses we might have in that portfolio based on their performance to date," Kanas said.

Signature Bank, which has the largest medallion lending portfolio among New York-area banks at $815 million, has also grappled with stress in the medallion lending space since last year. The company said in its 10-K that taxi medallion loans represented the largest bucket within its commercial and industrial lending portfolio at 17.02% of its total C&I loans.

The company restructured a total of approximately $147 million of the portfolio during 2015, and it said that it anticipates "additional taxi medallion loans will need to be restructured in 2016." It also disclosed that "significant nonaccrual loans" among its medallion portfolio totaled $51.8 million. Those related to "44 taxi medallion relationships that comprised about 70 individual medallion loans," the company said.

Those problems have been particularly pronounced in the bank's Chicago medallion loans. Signature's Eric Howell, executive vice president of corporate and business development, said during a public appearance in February that the Chicago market was far less regulated — calling it the "Wild West" — and that the bank faced workout situations in that market. It had previously announced that it would restructure about $120 million of its medallion holdings in the Chicago area.

Changes in the New York market will play out differently, he argued. The taxi industry is highly regulated in New York, and those regulators are pushing through changes to help the industry cope better with the disruption. He said regulators in the city are "supportive of the medallions."

Taxi medallion lending disclosures at select US banks

Data as of Dec. 31, 2015, unless otherwise noted

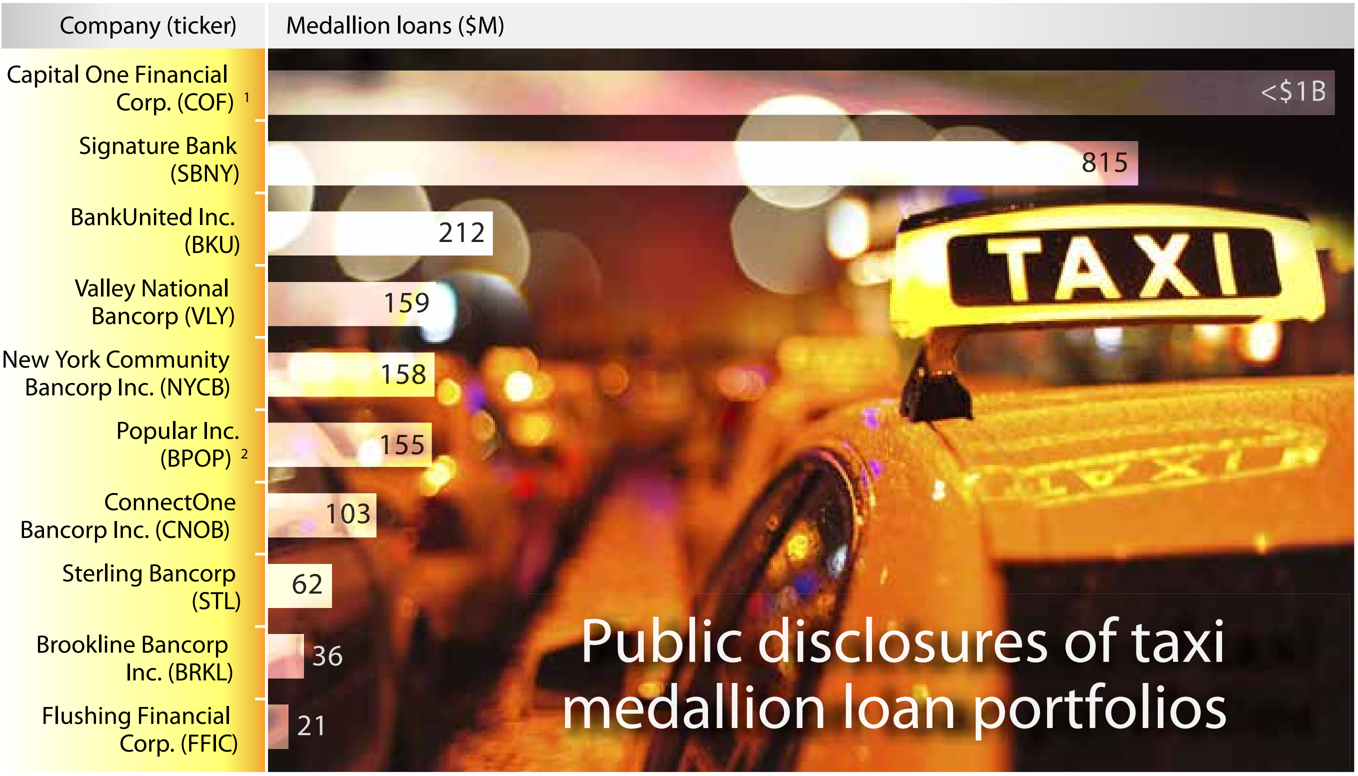
Company (ticker)	HQ city, state	Medallion cities	Medallion loans ($M)	Medallion loans As percentage of gross loans HFI (%)	Medallion reserves/ medallion loans (%)	Disclosed performance
Capital One Financial Corp. (COF)[1]	McLean, VA	NA	Less than $1 billion in loans	NA	NA	• Rising losses • Credit pressures • Adverse market conditions • Larger build in both allowance and reserve
Signature Bank (SBNY)	New York, NY	Mostly NYC; Chicago	815 (160 in Chicago)	3.4	3	• $147.4 million of restructured loans • $51.8 million nonaccruing • $4.0 million charge-offs in 2015
BankUnited Inc. (BKU)	Miami Lakes, FL	95% NYC	212	1.3	"A little under 5"	• $131 million may be considered potential problem loans • $80 million loans substandard • $7.9 million 30+day delinquent
Valley National Bancorp (VLY)	Wayne, NJ	NYC	159	1.0	NA	• Zero nonperforming loans
New York Community Bancorp Inc. (NYCB)	Westbury, NY	NYC	158	0.4	NA	• $1.8 million nonperforming • First charge-off historically of $30,000
Popular Inc. (BPOP)[2]	Hato Rey, PR	91-92% NYC, 5-6% Chicago, remainder elsewhere	155	0.7	NA	• Higher estimated credit losses
ConnectOne Bancorp Inc. (CNOB)	Englewood Cliffs, NJ	NYC	103	3.3	4.4	• $80.3 million were downgraded to substandard in 2015 • $78.5 million troubled debt restructurings • $3.3 million 30-60 day delinquent loans
Sterling Bancorp (STL)	Montebello, NY	91.7% NYC, remainder in Chicago and Newark	62	0.8	NA	• $24.0 million substandard
Brookline Bancorp Inc. (BRKL)	Boston, MA	Boston, Cambridge	36	0.7	12	• Established specific loss factor for taxi medallion loans
Flushing Financial Corp. (FFIC)	Uniondale, NY	NYC, Chicago	21	0.5	1.6	• $2.118 million substandard

Data compiled March 9, 2016.
Analysis based on most recent public disclosures by select U.S.-based banks and thrifts. Taxi medallion loan information comes from conference calls, Form 10-Ks, Form 10-Qs or annual reports.
Gross loans held for investment based on GAAP data if available; otherwise, regulatory data was used.
[1] Taxi medallion loans reported as of Sept. 30, 2015. Disclosure provided in Capital One's third-quarter 2015 earnings call, held Oct. 22, 2015.
[2] Taxi medallion loans reported on a fair value basis. The unpaid principal balance is $248.6 million.
HQ = headquarters; HFI = held for investment; NA = not available
Source: SNL Financial, a part of S&P Global Market Intelligence

"We see, really, values leveling off, their cash flows leveling off. Could we see further declines? Yes, but we're not seeing a fall from the cliff," Howell added at the time.

Others have also argued that they still see the taxi medallion business model as one with a viable future in New York. In a Jan. 11 note, Keefe Bruyette & Woods Inc. analyst Collyn Gilbert summed up a call that included Medallion Financial Corp. President Andrew Murstein; ConnectOne Bancorp Inc. Chairman and CEO Frank Sorrentino; and Matthew Daus, the former Chairman of the NYC Taxi and Limousine Commission. "Perhaps not surprisingly the tone of the call was positively biased as it related to the outlook for the taxi industry," Gilbert wrote, though she said the participants were "mindful" of the near- and long-term challenges facing the industry.

Gilbert added that the "massive transition" in the taxi transportation meant additional financial stress "could be on the horizon," though the taxi industry and its backers believe



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Source: SNL Financial, a part of S&P Global Market Intelligence
Credit: Cat Weeks

that "operationally, the environment is on a path of improvement."

Kanas also pointed to the fact that more than 95% of BankUnited's medallion loans are in the New York market as a reason for optimism. He said that rule changes at Uber and other moves by taxi regulators in the city have already helped to pull some drivers from Uber back into the ranks of yellow-cab drivers. "A lot of the fleet owners are feeling better these days about the long-term prospects of the industry," he said.

Despite those hopes, the near-term pressure on the taxi industry is unlikely to abate soon, according to Uber and tech analyst Jan Dawson of Jackdaw Research. He said the New York transportation market has always been competitive and rich with options, and Uber and Lyft will increasingly replace taxi rides in many situations where they had previously been the primary, or only, option — during a city downpour, for example. "Uber and Lyft have come in and shaved away ... the scenarios under which cabs are the best fit," Dawson said.

The intense competition for market share will continue as long as Uber follows its traditional strategy in the early part of its entrance into new markets. It wins market share by undercutting its traditional competitors' prices — and any market stabilization is likely to occur only when Uber shifts into its next typical strategy phase and begins lifting its own prices.

"At some point Uber has to raise prices to be profitable in these different markets, so a lot depends on the timing of those moves and how aggressive Uber is in trying to drive market-share gains," Dawson said