

14-CU-06 Taxi Medallion Lending

Summary

*Prepared by NASCUS Legislative & Regulatory Affairs Department
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NCUA issued LTCU 14-CU-06 to provide credit unions with the [Supervisory Letter](#) NCUA published for its field examiners regarding taxi medallion loan origination and loan participation. It also provides information about the taxi medallion industry in general, and discusses the typical structure of taxi medallion loans. Finally, NCUA identifies several of the risks posed by medallion lending, and explains unique aspects of the taxi medallion business model such as valuations, ownership structures, and sources of cash flow and income.

Taxi medallion are the physical licenses authorizing the operation of a taxi in many metropolitan areas nationwide. Taxi authorities generally govern two types of medallion ownership:

1) Individual Medallion - typically an individual medallion is a class of license in which an owner owns only a single taxi medallion. The owner is usually required to drive a taxi a specific number of shifts per year and may lease out any remaining shifts to other drivers.

2) Minifleet Medallion or Corporate Medallion - generally a class of license in which an owner typically holds two taxi medallions and does not drive the taxi. A minifleet medallion owner may lease a medallion, with or without a corresponding taxi, directly to a driver. However, the majority of minifleet medallion owners lease their medallions to a management company that in turn leases the medallion to a driver.

Often, a single owner will employ multiple business entities to purchase and hold multiple minifleet medallions, with each business entity holding a single minifleet medallion. As a result, it is common for principals in the medallion industry to hold multiple minifleet medallions through an intricate network of business entities. Further complicating the business model, minifleet owners frequently share ownership in the management company that leases their medallions, resulting in vertically integrated operations.

NCUA reminds its examiners that in addition to compliance with the principles contained in this guidance, taxi medallion loans are member business loans that must comply with the member business loan provisions of NCUA Part 723.

Interest Rates and Loan Terms can Inflate Medallion Value

NCUA notes that the market value of a taxi medallion continues to benefit from record low financing costs and liberal underwriting terms. However, NCUA cautions that while the low rates expands the potential pool of buyers (driving up the value of the medallion), in most cases the income potential of the medallions through lease rates remain unchanged as the lease rates are fixed by regulations.

Credit unions offering liberal loan terms may be exposed to elevated risk, requiring heightened due diligence, risk modeling, and mitigation strategies. Terms that may elevate risk include:

- Extended Amortization - may expose a loan to multiple economic and interest rate cycles, which could significantly impact the valuation of collateral if interest rates increase or when there is an adverse change in the market or industry conditions. NCUA notes that interest rates have an inverse relationship to the market value of taxi medallions. Rising interest rates often have a negative impact on medallion value.
- Interest-Only Payment Terms - exposes a loan to the same risks as extended amortization, however, the adverse impact to the credit union is greater because there is no reduction in principal.
- Unsupported Cash-Out Refinancing - occurs when an existing loan is refinanced with a new, larger loan, and the borrower receives the difference between the two loans as a cash disbursement. Cash-outs that do not support a valid and approved business need could mask problems a borrower or principal is experiencing, such as insufficient debt service ability or operational losses.

Exam Procedures for Taxi Medallion Loans

NCUA examiners are instructed to obtain from the credit union a copy of the governing taxi authority's revenue regulations, including fare and lease rates and medallion sales reports. NCUA considers this critical information for evaluating the credit union's cash flow analysis and risk assessment. In reviewing the taxi medallion portfolio, NCUA examiners will evaluate:

- Amount of current and future activity, in relation to capital and earnings
- Level of ALLL funding
- Reliability of financial reporting
- Past credit administration quality and performance

NCUA examiners will also evaluate the policies, procedures and overall management of taxi medallion loan programs. NCUA instructs its staff to verify the following practices with respect to the taxi medallion loan program:

- Has the loan authority been assigned to an individual or committee with commensurate knowledge and experience about the medallion business and medallion lending.
- Is the board ensuring that each loan's risk assessment is complete and accurate through sound policies, reporting, procedures and controls. The board, or a designee, should also be involved in the specific details of large loan relationships.
- Does the credit union maintain a loan review, risk assessment, and credit risk grading validation function separate from the lending function.
- Has the board established concentration limits relative to net worth.
- Does the credit union have the ability to recognize complex interconnected relationships among borrowers and minifleets.

NCUA cautions its examiners that interest-only taxi medallion loans are high risk and the credit union should only be granting such loans on a case-by-case basis.

NCUA examiners are also instructed to carefully review the debt service coverage ratios (DSCRs) with respect to taxi medallion loans. As noted above, 1.25X is the recommended threshold and any variances should be documented and justified by the credit union. Credit unions should:

- Base minimum DSCRs on traditional cash flow measures that reflect all influences on cash flow from operations, including any transfers of cash from the borrower to other entities
- Document rational for a DSCR less than 1.25X and demonstrates additional risk mitigation steps or factors

- Demonstrates additional risk mitigation factors for longer amortizations and interest only loans

Additionally, the credit union's underwriting and documentation should demonstrate an understanding of the following:

- Ownership of the borrowing entity
- Borrower's business type and structure
- Borrower's business operation and revenue generation
- The background, identity, and role of all principals
- History of the borrower and business entity
- Any potential interrelationships between separate taxi medallion borrowers

Borrower's Financials

NCUA instructs its examiners to pay particular attention to whether the quality of the financial information used in the financial analysis is commensurate with the level of risk and complexity of the borrower and principals' operations.

- For less complex loans, the tax return from the borrower and principal and personal financial statements are generally sufficient.
- For more complex borrowing relationships such as when there are multiple, integrated, businesses and medallions, credit union should require borrowers and principals to provide financial statements prepared in accordance with GAAP and subjected to a review engagement or audit by a CPA. In some cases, the complexity of the interconnectedness justifies enhanced due diligence. This would entail obtaining consolidated GAAP financial statements.

Credit unions should perform a global cash flow analysis for all borrowers and guarantors, including analysis of a global consolidation of the principal's activities for complex borrowers. The analysis should be included with the credit approval document. If a credit union relies on sources of repayment other than the borrowers operations, than the credit union must ensure that those sources are obligated to repay as co-borrowers or loan guarantors.

If the borrower is a new entity, without a financial history sufficient to establish cash flows to support the proposed debt, the credit union must validate financial projections prepared by the borrower. If the borrowing is for a new entity owned by principals that are already active in the taxi medallion business, the credit union should validate financial projections against the actual operational performance of similar business/taxi operations that are owned and operated by the principal.

Loan Documentation

In reviewing loan documentation, NCUA examiners will review the following:

- That loan documents establish a valid obligation, are properly executed, and that the security interest in the taxi medallion is perfected
- That licensing rights have been assigned to the credit union and that lien has been recorded in accordance with the appropriate local taxi authority and UCC requirements
- That loan documents incorporate the use of loan and financial covenants requiring the submission of financial information at least annually and providing the credit union the authority to otherwise monitor the financial condition of the borrower and guarantor

NCUA recommends, but does not require, credit unions obtain a legal opinion that the loan documentation creates an enforceable obligation, and the lien process achieves lien perfection, in the applicable jurisdiction.

Servicing Procedures and Risk Management Controls

NCUA examiners have also been instructed to evaluate credit unions' servicing procedures and risk management controls for taxi medallion loans. Credit unions should:

- Perform regular reviews, and risk modeling to test the overall taxi medallion loan portfolio's durability in the face of changes in market conditions, interest rates, and collateral values
- Take necessary precautions to limit exposure and/or adjust underwriting standards when premium market prices significantly exceed the value supported by the net operating income (NOI) the medallion generates
- Conduct periodic reviews and visits with the borrower, including a review of the operational and financial condition of the borrower and principal
- Conduct annual relationship reviews

Refinancing of Taxi Medallion Loans

Refinancing must be supported by a specific business purpose and benefit. NCUA instructs its examiners to ensure the credit union fully explains and justifies all cash-out refinancing. The proposed use of the funds should be outlined in detail in the credit approval document and tracked to confirm the funds were used for the approved and intended purpose.

Additional Guidance Relevant to Taxi Medallion Lending

NCUA references past guidance and encourages examiners to utilize those as well when scrutinizing a taxi medallion lending program. The additional guidance referenced are NCUA Supervisory Letter 13-0, [Evaluating Credit Union Requests for Waivers of Provisions in NCUA Rules and Regulations Part 723, MBLs](#); NCUA LTCU 13-CU-07, [Loan Participation Waivers](#); NCUA LTCU 10-CU-03, [Concentration Risk](#); NCUA Accounting Bulletin 06-01, [Interagency Policy Statement on the Allowance for Loan and Lease Losses](#).