

Frequently Asked Questions about Taxi Medallion Lending Supervisory Guidance

In April 2014, NCUA issued a Letter to Credit Unions (14-CU-06) [Taxi Medallion Lending](#), which enclosed new guidance to examiners evaluating credit unions engaged in taxi medallion lending. Credit unions were also encouraged to review the supervisory guidance, which outlines certain sound practices for providing these types of member business loans.

Below, we have provided answers to a set of frequently asked questions that are intended to clarify the guidance provided in that supervisory letter.

Does NCUA Supervisory Letter (14-04) [Taxi Medallion Lending](#) (April 1, 2014) impose new requirements (in addition to the requirements outlined in [NCUA Rules and Regulations Part 723 – Member Business Loans](#)) on credit unions who engage in this type of lending?

No. Section 723(6)(g) of NCUA Rules and Regulations requires the credit union to analyze and document the ability of the borrower to repay the loan consistent with appropriate underwriting and due diligence standards. Supervisory Letter 14-04 simply provides examiners with guidance for how to assess whether or not a credit union has met the requirement of §723(6)(g).

In the case of taxi medallion lending, borrowers can range from simple operating structures consisting of a single operator to complex, interdependent entities owning multiple medallions with a complex income structure where the borrower is dependent on lease payments from similarly owned entities. NCUA determined that additional guidance that speaks to the unique characteristics of taxi medallion lending would be useful to examiners. Thus, the guidance we issued provides examiners with information that can help them evaluate and understand the unique risks and methods for evaluating the risks of borrowing relationships found in the taxi medallion industry.

That said, the risk-assessment concepts discussed in the letter are not unique to the taxi medallion industry; they are common in all commercial lending. These practices can be—and are—employed by many commercial lenders to evaluate the financial condition of a borrower with interdependent entities and the borrower's ability to generate a reliable source of repayment.

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What is the “speculative” (or market) premium that is mentioned in the guidance?

A taxi medallion is an income-producing asset. Income-producing assets are generally valued by determining the asset’s net operating income (NOI), which is calculated as the gross revenues generated by the asset, minus any operating expenses before depreciation and interest. The NOI is the basis for determining the economic value of the asset, that is, the value of the asset based on its ability to generate income.

However, the value of a taxi medallion is also influenced by the number of medallions made available by the local taxi authority. A limited supply of taxi medallions in a given market can raise the value of the medallions in that market above the economic value relative to a given level of demand. Simply put, the speculative value is the difference between the economic value of a medallion and the price the market is willing to pay for that medallion.

Examiners should understand that the portion of the value that is identified as the speculative premium is less stable than the economic value supported by the ability of the medallion to generate income. Any change in the market (e.g., increased competition, reduced supply of drivers or other market changes) will have a more pronounced impact on medallion values.

In addition, because the speculative portion of the price is not supported by the taxi medallion’s NOI, repayment of the speculative portion will have to be from another source (such as, the borrower’s liquidity or other earnings of the principal).

As communicated in the guidance to examiners, credit unions that perform proper credit analysis (that is, analysis that identifies sources of repayment and the reliability of those sources) should be able to withstand the impact of fluctuations in the value of taxi medallions. When the repayment relies on sources other than a borrower’s own operations, examiners should determine whether those repayment sources have been identified by the credit union and are committed to the loan repayment via guarantees or additional pledged collateral.

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Taxi medallions have no physical depreciation, so why do medallion loans need to be amortized?

Taxi medallions, like all assets, are subject to economic changes (e.g., increased competition and other influences on demand) that can impact value. As such, prudent risk mitigation practice requires an appropriate amortization of principal in order to withstand any adverse economic changes that could influence demand. If the amortization period is too long the principal reduction may be insufficient to keep pace with changes in the collateral value due to economic, market or industry changes. This could result in insufficient collateral protection and decrease the ability to refinance the loan.

In guidance to examiners, NCUA suggests 25 years as the maximum prudent amortization period. However, that assumes a stable market and economy. In practice, amortization periods should be based on current and anticipated market conditions. The amortization period should be shortened when market influences could adversely affect the medallion industry and medallion values.

What is a consolidated financial statement? Why is it necessary for taxi medallion lending?

A consolidated financial statement, prepared in accordance with generally accepted accounting principles (GAAP), presents the combined financial statements of interdependent separate legal entities and is the most accurate source of information to determine a complex borrower's financial condition and ability to repay. Reviewing the consolidated financial statements of a borrower can help a lender identify a borrower's source(s) of repayment and determine the reliability of that source (or sources); this is an important element of prudent risk assessment in all commercial lending. Whenever a commercial borrower relationship has a complex structure that includes interrelated activity, consolidated financial statements in accordance with GAAP prepared by the borrower's accountant is recommended.

Many taxi medallion operations, particularly minifleet (or "corporate") medallion operators, reflect this complex structure. A minifleet medallion owner typically holds two taxi medallions and does not drive the taxi. A minifleet medallion owner may lease a medallion

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directly to a driver or to a management company which then leases medallions and vehicles to drivers. Most minifleet medallion owners purchase a medallion through a separate business entity. A common practice in the taxi industry is for a buyer to acquire multiple minifleet medallions by establishing a separate business entity for each pair of medallions. As a result, it is common for principals in the medallion industry to hold multiple minifleet medallions leased to entities that have common ownership through an intricate network of business entities.

The relationships between the principal's multiple business entities can become complex, making them difficult to analyze and requiring an enhanced level of expertise and analysis. Consolidated financial statements can help a credit union evaluate the management company's ability to make lease payments and to meet lease payments of all associated minifleets. Consolidated financial statements will eliminate inter-entity revenue and expenses, which will provide a clearer picture of the revenues, expenses, and funds available to service the debt of the associated minifleet entities.

Are consolidated financial statements necessary for all corporate and individual medallion owners?

NCUA guidance directs examiners to ensure that, as part of a complete global cash flow analysis, credit unions require corporate medallion owners and principals to submit a ***consolidated*** financial statement along with ***consolidating*** financial statements prepared by a licensed independent accountant (CPA) in accordance with GAAP. For an independent operator, generally a tax return for the borrower and principal, along with the personal financial statement of the principal, should be sufficient for the risk analysis. A credit union's lending policy should establish the required reporting based on the relative risk associated with the borrowing relationship and the ability of the credit union to perform a comprehensive and accurate risk assessment.

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Are taxi medallion borrowers required to have a 1.25X debt service coverage ratio (DSCR)?

No. As stated in the guidance, 1.25X is the recommended DSCR to qualify a borrower for a taxi medallion loan. A DSCR is established to ensure there is sufficient cash flow from operations so that a borrower can continue to make debt repayments in the event of an adverse change in business operations.

A DSCR of 1.25X is a generally accepted, prudent underwriting standard. As with all commercial loans, credit unions should tailor the acceptable DSCR for each taxi medallion borrower based on the financial merits of the borrower and current and prospective market conditions. For example, a borrower producing high-quality financial information with positive operating trends would warrant a lower DSCR, while a borrower experiencing negative trends or poor quality financial reporting would warrant a higher DSCR.

What do you mean by “all influences on cash flow” when evaluating the borrower’s ability to service debt?

NCUA guidance directs examiners to confirm that a credit union bases its minimum DSCR 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, shareholders, owners or principals, and unfunded capital expenditures.

In commercial lending, cash flows are a borrower’s primary source of funds available to make debt payments. All influences on the operational cash flow should be factored into the borrower’s ability to meet debt service requirements. In addition to operating expenses, the DSCR should consider and include unfunded and maintenance capital expenditures, dividends to shareholders, loans to principals and any other balance sheet change that is funded by the operating cash flow.

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Global cash flow is a difficult concept and sometimes specific to the borrower. Why and when should a credit union perform a global cash flow analysis and what should be included in that analysis?

Global cash flow analysis is used to evaluate the cash flows of a group of entities that are tied to one or more loans, and it can be useful in evaluating the value of a personal guarantee by the principal(s). In order for such a guarantee to be effective, the principal(s) must have sufficient financial resources or net worth at risk.¹ Global cash flow analysis helps determine the value of any personal guarantee.

Global analysis can be very straightforward, if the credit union has the requisite expertise, by combining financial statements from the principals' related entities when there is no inter-entity activity; it can be complex when there is inter-entity activity that would require a comprehensive understanding of the interaction between the related parties. In these more complex situations, a consolidated financial statement of the principals' operations, prepared in accordance with GAAP by a CPA, may be necessary to fully understand the financial capacity of the overall operation.

Why does NCUA issue supervisory letters?

Supervisory letters are used to communicate guidance and official agency examination policy to NCUA field staff. Supervisory letters are intended to provide a framework for more consistent application of staff judgment with respect to conclusions about a credit union's financial and operational condition and related CAMEL and risk ratings. These letters also provide a consistent approach for evaluating the adequacy of a credit union's relevant risk management processes. Generally, supervisory letters are shared with the credit union system and the public as an attachment to a Letter to Credit Unions.

Each supervisory letter focuses on a specific topic; the letter explains the topic and any related regulatory and statutory requirements. It may also require field staff to include

¹ See NCUA Supervisory Letter (13-01) [Evaluating Credit Union Requests for Waivers of Provisions in NCUA Rules and Regulations Part 723, Member Business Loans \(MBLs\)](#) (February 2013).

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certain procedures in an examination and provide instructions to help field staff implement those procedures.

Criteria detailed in a supervisory letter are not strict requirements for credit unions, unless they are already required by law or regulation. Rather, the criteria are to be used by field staff to evaluate a credit union's condition based on the preponderance of relevant factors.