Lenders Provide 100% Financing On Inflated Chicago Medallion Prices

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Disclosure: I am/we are short TAXI. **(More...)**

Summary

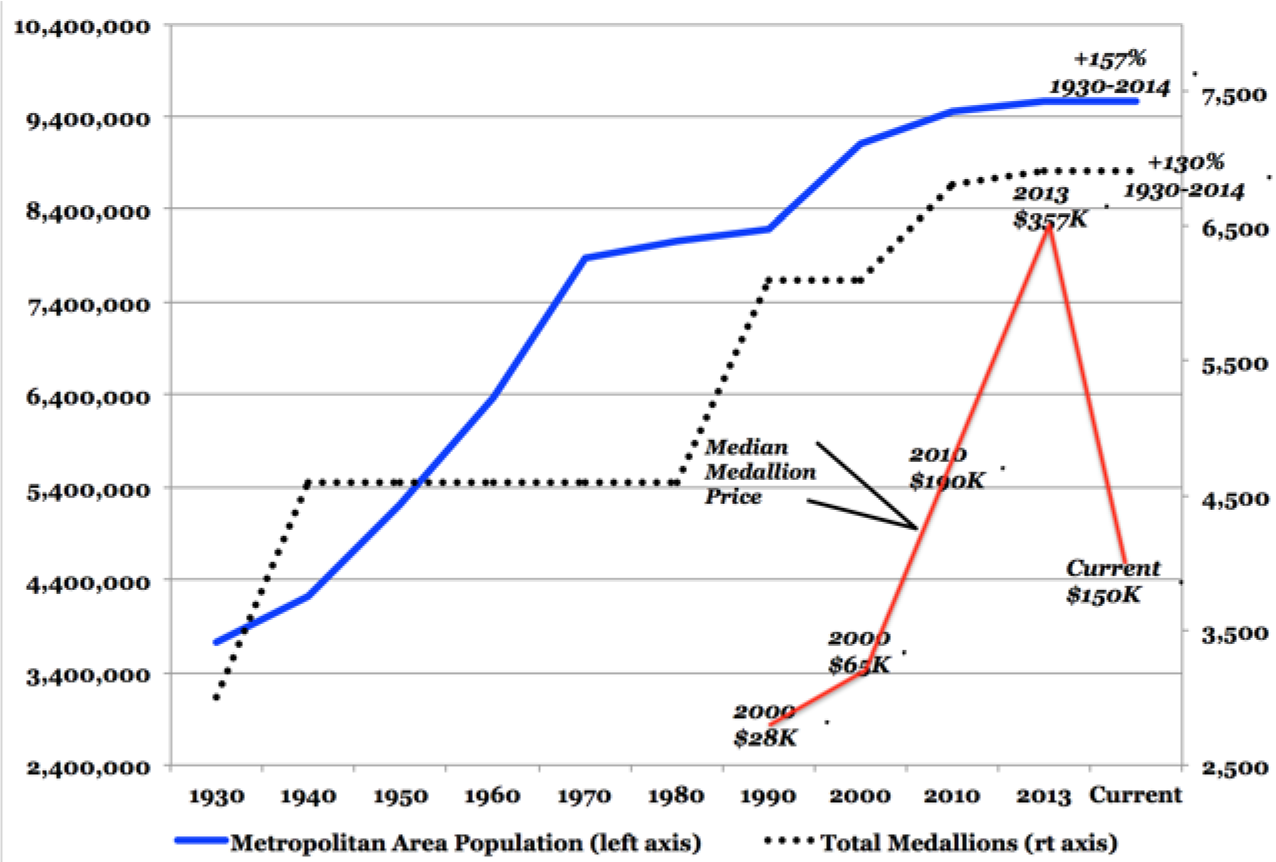
- Chicago medallion fleet owners enticed to buy at inflated values by 100% financing.
- Rational decisions for lenders and fleet buyers - but using non-arm's-length sales as fair value overstates assets and collateral.
- Earlier exposé published before cashless deals confirmed.

Taxi medallion lenders resurrect "no money down" financing, in apparent effort to support (inflate?) prices. In our June 1 report, *Medallion Financial & Credit Unions Behind Above-Market Chicago Taxi Medallion Sales*, we documented the facts surrounding five March medallion transfers at nearly twice the price brokers, owners and local attorneys say were and are readily available. We have subsequently learned that the two buyers of these five medallions received 100% financing, and more of the same is in the pipeline.

The emergence of Uber and other "ridesharing" companies has caused a great deal of pain for taxi drivers and taxi medallion owners unaccustomed to any competition for decades. The old guard taxi ecosystem has responded by seeking redress via the courts, legislatures and the media. One of the more fascinating and largely untold stories has been unfolding in Chicago.

Unlike New York and Boston, Chicago increased the number of taxis largely in line with metropolitan population growth over the years (see Chart). As such, the Chicago taxi industry had less capacity to absorb new for-hire vehicle supply than the other cities and was therefore more vulnerable to steeper and more immediate taxi medallion market share and price erosion. Taxi medallion prices dropped from peaks of $375,000 in April 2014 to street asking prices of$150,000 by January 2015.

Chicago Taxi Medallions Tracked Population



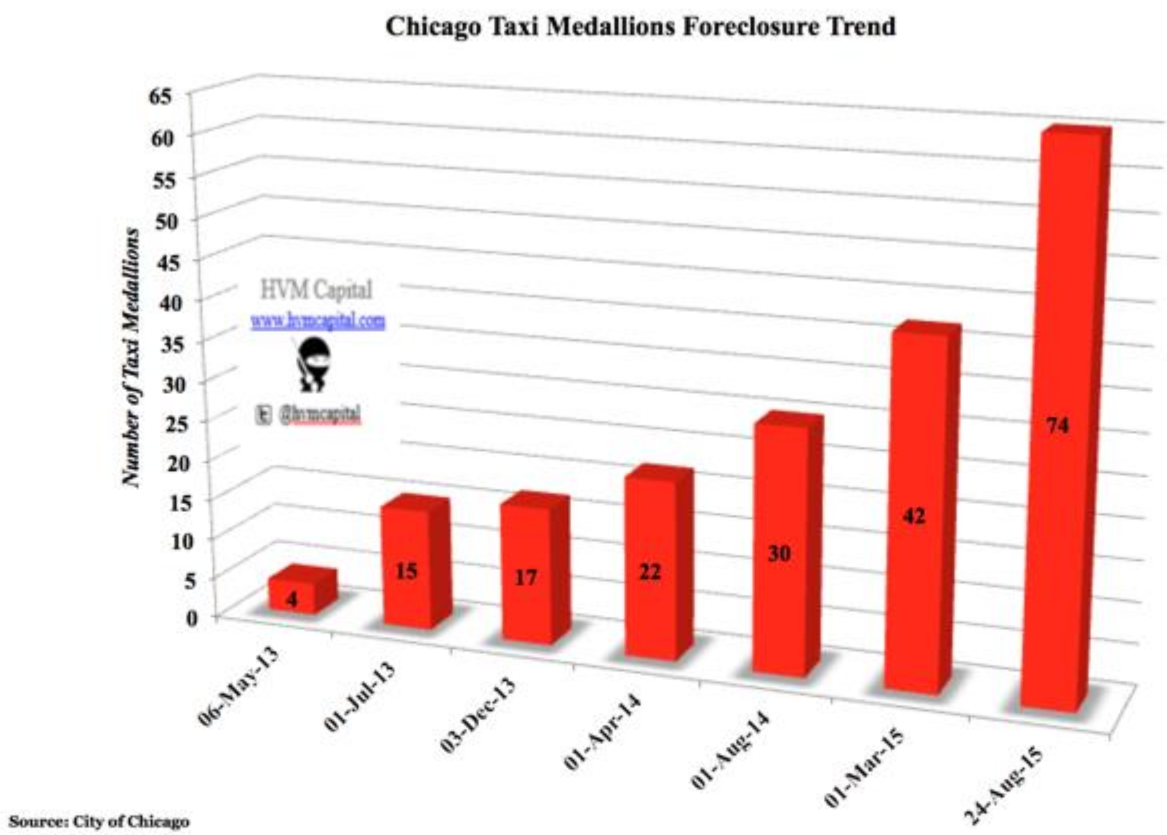
It was odd to observe a paucity of actual taxi medallion sales at the $150,000 street asking price (only 3 since January). Even more peculiar was the concurrent flurry of sales reported in the range of $235,000 to $290,000, despite no relief from the Uber effect.

Files obtained via FOIA requests and direct conversations with buyers involved as well as other industry insiders, confirmed that two buyers, each owners of taxi medallion fleets, purchased five medallions in March at an average price of $278,000 and received *100% financing* - zero out-of-pocket cash. These prices were subsequently used by public companies (Medallion Financial NASDAQ: TAXI and Signature Bank NYSE: SBNY) and credit unions (Melrose, Montauk, Progressive and LOMTO) as the basis for valuing Chicago medallions owned and used as collateral for large loan portfolios. Not only did lenders (and one seller) provide 100% financing on medallion sales at $270,000 and $290,000, they refused to lend on medallion sales at $150,000. It has also been learned another 14 cashless transfers of foreclosed medallions at $238,000 are pending, and may have closed in August. In the meantime, the only July medallion sale closed at $150,000 - all cash.

Cashless asset purchases at significantly higher prices than those readily available in the marketplace are obviously riskier to lenders than those in which the borrowing buyer has meaningful capital at risk and the lender has commensurately less at risk per unit of collateral. The logic motivating fleet buyers to agree to inflated purchase prices is that they given significant existing debt on dozens of medallions already owned, additional leverage does not change the personal financial risk profile. Such buyers are going bankrupt if Chicago medallion cash flows and prices continue to decline. As long as additional taxi medallions can generate enough cash flow to service the incremental debt, it is reasoned, the buyer has essentially received a free call option on the recovery of Chicago medallions. For the lenders offering 100% financing the calculus is simple. It is better to offer 100% financing on a handful of loans, at significantly inflated prices, to borrowers with decent credit, than finance transfers at half those prices and be forced to write down collateral values across entire medallion loan portfolios (or directly write down owned medallions, in the case of TAXI). This thinking is not irrational for either lenders or borrowers. However, lending more money into a declining asset class facing unfettered competition for the first time in industry history inherently assumes Chicago taxi medallion cash flows and values will recover. If that calculus is wrong, these lenders will have exacerbated losses. Efficacy of the double-down strategy will become clearer in time.

One thing is certain, these sales prices do not represent reasonable proxies for values that might be realized in arm's length transactions under conventional lending terms - fair-market-value. They should not, therefore, have been used for mark-to-market, LTV calculations or capital adequacy assessments. SBNY indicated it used $250,000 as the market value in Chicago for LTV purposes in the second quarter. No owner could hope to realize that price if forced to liquidate, unless willing to offer 100% financing. Taxi medallion cash flows andprices have been in material decline for the last year in NYC, the most protected city, and conditions in Chicago are even worse. Chicago medallions with "foreclosure" status currently stands at 74 compared to 30 one year ago - see Chart below.

Chart 1 Rising Stress for Chicago Medallions



Details on Cashless Medallion Sales in Chicago

We spoke again with Dimitri Manolitsis, the buyer of 3 Chicago taxi medallions in March at $270,000. As indicated in our June report, Montauk Financial extended financing to Manolitsis exactly equal to the par value of the loans upon which it had foreclosed, $645,000. The medallions involved were numbers 1326, 2880 and 3313. What was unclear in the Settlement Statement at the time, but we now know, is the balance of the purchase price,*as well as the transfer fees*, were also financed by Montauk, collateralized by second liens on four other medallions owned by the buyer that already had a $500,000 lien.

Such arrangements are *not* historically uncommon in this business, but monetizing equity on medallions has become almost impossible in the last 12 months as ride sharing competition has eliminated taxi exclusivity and eroded cash flows and values. Manolitsis suspects he would have had trouble taking out a second mortgage on those four medallions if the money was not part of financing new medallion purchases.

As previously reported, Medallion Financial (NASDAQ: TAXI), through its wholly-owned subsidiary Fresh Start Ventures, provided $370,000 of debt financing on the $580,000 purchase of medallions #4039 and #4051 to "Myrtos Corp." But we have now confirmed that the seller of those medallions, Michelle Corporation, owned by Floren Peremen, a long time TAXI client who had at least $7.5 million of outstanding NYC medallion loans on the Medallion Financial books at year-end, took back paper from Spero "Dimitri" Drake on the balance of the purchase prices. Drake put no cash into the purchases according to multiple sources who know him personally, but we could not confirm that Michelle Corp financed all of the purchase price balance because UCC files only confirm the loan itself, not the loan amount. Drake owns Top Cab Corporation, personally owns dozens of the 60+ affiliated vehicles and manages at least 11 of Medallion Financial's 159 owned medallions.

Why Buyers Agree to Inflated Prices

Manolitsis, a thoughtful businessman, believes medallions will one day recover, while acknowledging the risk he is taking, "Friends tell me I'm crazy." He indicated he is about to close on another 5 medallions out of foreclosure priced at $238,000, with Montauk Credit Union and LOMTO CU, again, providing 100% financing, including the transfer fees. This purchase is part of a larger sale facilitated by Montauk and LOMTO of 14 foreclosed medallions, under the same cashless terms to three separate buyers. The other two buyers, according to Manolitsis, are Blue Ribbon Association and Dimitri Drake.

According to Manolitsis, still an optimist that Chicago medallions will recover and already an owner of over 30 Chicago medallions, the terms of Option 1 below are more attractive than Option 2.

Option 1: $238,000 price per medallion

· Spend a grand total of $65,000 out of pocket to purchase 5 used vehicles ($13,000 per used vehicle),

· Incur $1.3 million of debt

· Own 5 medallions.

Option 2: $150,000 price per medallion

· Spend $59,000 out of pocket ($30,000 down, $16,000 transfer fee and $13,000 for a vehicle)

· Incur $120,000 of debt

· Own 1 medallion.

Manolitsis did not reveal his total debt on the 30 medallions he owns, but he indicated part of his thinking is that if he is wrong on the recovery of Chicago taxi medallions, the millions in medallion debt he already has will bankrupt him. Another $1.3 million of debt does not affect that outcome. If the recovery does materialize, all the equity accrues to him on 5 more medallions for which he only has $65,000 of personal capital at risk (the cost of 5 used vehicles). In the meantime, the taxi medallion cash flows remain adequate to service the debt.

Table 1 summarizes the somewhat complicated series of financings behind Manolitsis' recent medallion purchase activity. Approximately $2.8 million of debt is secured by 12 medallions, assuming the 5 at $238,000 close as planned, equal to $232,000 per medallion. Another cash transfer closed in July at $150,000 and according to Mohammad Kamran, an affiliation and medallion owner, lender and broker, others are still available at that price. The 3 sales since January were arguably the *only* arm's length transaction since January, though the actual clearing price might be somewhat higher if lenders were willing to finance at market prices. The implied LTV on these 12 medallions financed by Montauk and LOMTO is 160%.

Table 1 Summary of Debt Financing (note: 5X $238K pending)

Medallions	Price	Transfer fee	Vehicle Cost	Total Cost	Out-of-pocket Cash	Debt
3	$270,000	$16,000	$13,000	$897,000	$39,000	$858,000
4						$660,000 [1]
5	$238,000	$16,000	$13,000	$1,335,000	$65,000	$1,270,000
12					$104,000	$2,788,000
Per medallion					$8,667	$232,333

[1] Existing lien of $500K, and $213,000 of debt in second lien on the 4 medallions included in aggregate debt ($858K) to purchase 3 medallions.

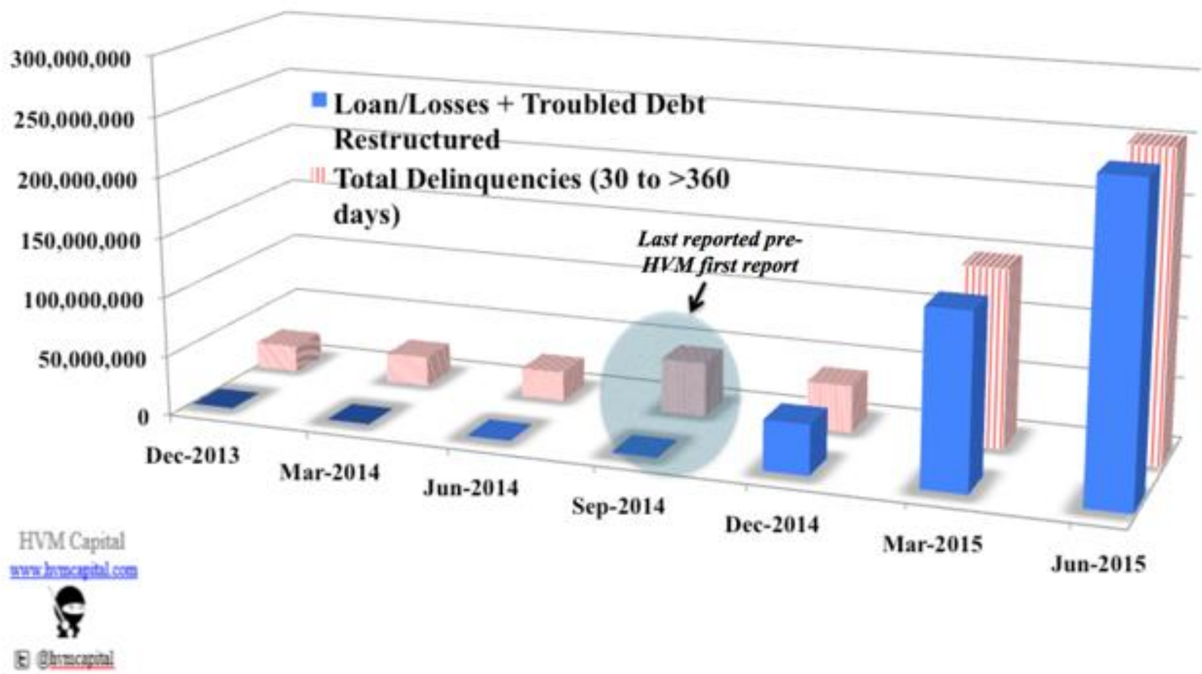
Source: Dimitri Manolitsis.

Chicago Market Remains Distressed

In addition to 74 Chicago taxi medallions currently in foreclosure status, Signature Bank (NYSE: SBNY) placed "two thirds" of its Chicago taxi medallion loan portfolio on "watch," restructured over 1/3 of the portfolio in June, and is in the process of restructuring almost another 1/3 in July. CEO Joseph DePaulo sought to downplay the risk of actual losses and justify putting more capital at risk through refinancing of troubled loans rather than foreclosing by saying, "… giving up a medallion is not just giving up an asset, but a livelihood." True enough. But the same was said early in the financial-crisis about houses not just being assets but family homes. We saw how that worked out, and houses have intrinsic value, while taxi medallions do not. When cash flow is inadequate to service debt, equity is negative and there are no other meaningful assets, foreclosure soon follows, no matter how motivated the debtor is to avoid it.

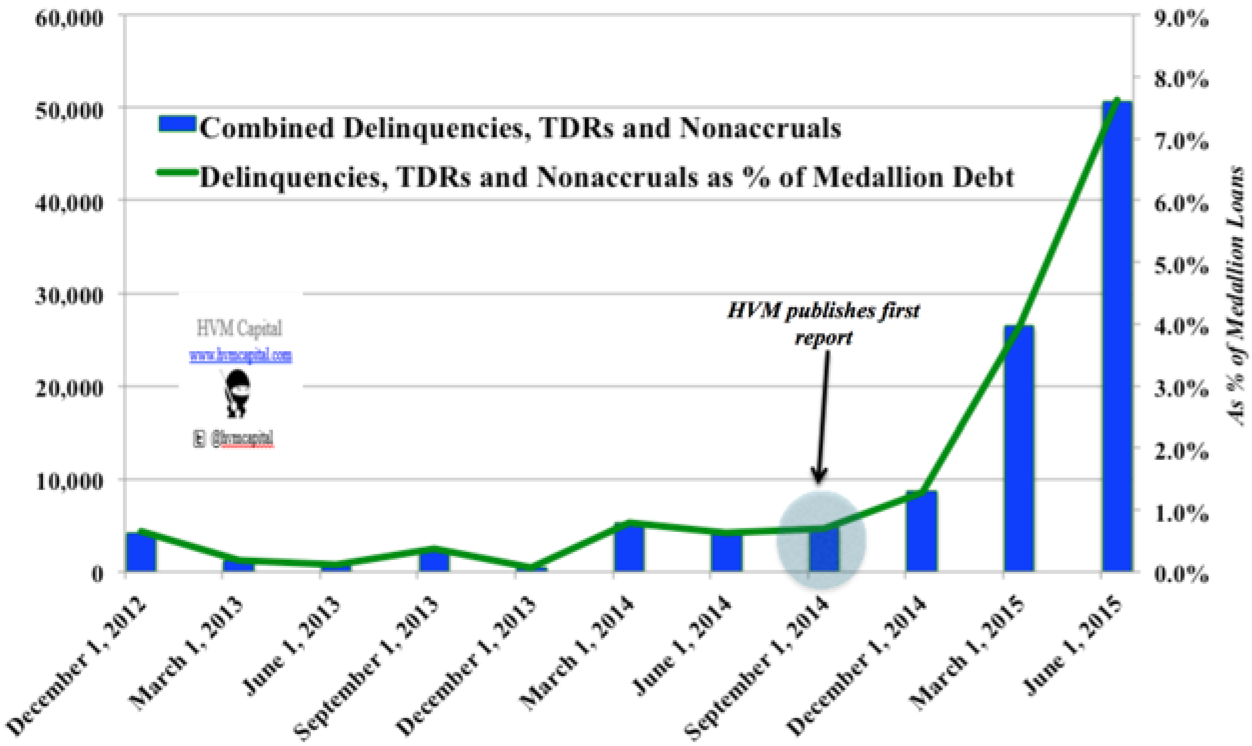
From second quarter Call Reports obtained from the NCUA for Melrose, Montauk, LOMTO and Progressive credit unions, the Chart below shows a staggering sequential increase from the first quarter in delinquencies to $251 million from $144 million (only $43 million in third quarter 2014) and loan losses plus troubled debt restructured to $228 million from $137 million (only $1 million in third quarter 2014). These are national figures, but Chicago is significantly worse than New York. Medallion Financial's 10Q also showed continued rapid deterioration in medallion loan performance metrics (see Chart 3) during the second quarter.

Chart 2 Credit Union Medallion Debt Stress Rising



Aggregate totals for Montauk, Melrose, Progressive and Lomto credit unions.
Source: NCUA

Chart 3 Medallion Financial Medallion Debt Stress Rising



Source: Medallion Financial Corp. SEC filings and Medallion Bank FDIC Call Reports.
Note: Medallion Bank "Loan Loss Provisions" and parent "Nonaccruals" not included becasue neither broken out for medallion loans.

Conclusion

The five March 2015 transfers published in Chicago were not arms length and did not reflect a "price that would be received to sell an asset … in an orderly transaction between market participants at the measurement date." By using these prices in the first and second quarters as the basis for calculating LTV ratios, Medallion Financial and Signature Bank understated the rising risk levels associated with their respective medallion loan portfolios. Medallion Financial's use of these transactions for purposes of marking-to-market owned Chicago medallions actually resulted in overstatement of net asset values by over $0.60 per share, in our opinion.