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Taxi Farebox Declines A Harder Hit To Medallion Owner Bottom Lines

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Disclosure: The author is short TAXI. **(More...)**

Summary

- NYC taxicab medallion borrowers have little cushion to absorb significant further market share losses.
- Some mini-fleet owners already losing cash and below water on medallion values.
- Owner operators pretax net near $15/hour after debt service – balloon payments could trigger defaults before cash flow might have suggested.

(Part II and companion report to Taxi Trips and Farebox Declines Accelerate Starting June 2014, available here)

In Part I of this series, *Taxi Trips and Farebox Declines Accelerate Starting June 2014*, we shared the facts around continuing negative trends in NYC taxi trips and meter revenue (farebox). New driver supply from Uber and other for-hire companies continues to usurp market share, as well as expand the market. Here in Part II, we will break down "average" taxi medallion economics as well as those for lease drivers who play such a critical role in supporting medallion ecosystem economics. Owing to high operating leverage, NYC taxi driver earnings are very sensitive to relatively small changes in farebox. Barring a sudden arrest in the market share and farebox decline trends, a significant increase in taxicab medallion loan non-performance is inevitable in the coming quarters for Medallion Financial (NASDAQ: TAXI), Signature Bank (NASDAQ: SBNY), Capital One Financial Corp. (NYSE: COF) and a slew of credit unions, including Melrose, Montauk, Progressive and Lomto. Some lease drivers and owner operators are driving and earning well above the averages discussed herein, while others are significantly lagging.

Lease Drivers

The TLC farebox data shows an average medallion generated gross meter revenue of $194,432 per year, or $533 per day for the last 12 months ending March 2015. This level of gross revenue equals around $266 per shift (2 shifts per day). Daily/shift lease fees currently average around $120 (after lease cuts in the fourth quarter of 2014), gasoline, tolls, MTA surcharges and other costs amount to another $20, leaving $126 per shift of net pretax income ($13.30 per hour).

Exhibit 1 Medallion Lease Driver Average Earnings

Avg. Daily Gross Farebox per Medallion per Shift (TTM ending March 2015)	$266
Shift Lease Fee (average day)	-120
Gasoline	-8
MTA Surcharge	-8
Tolls and other	-4
Net pretax Income	$126
Shifts Driven per Year	320
Total Net Annual Pretax Income	**$40,369**
per hour	$13.28

March 2015 versus March 2014 farebox dropped 9%. For a sense of earnings sensitivity, a 10% drop from the average of the last 12 months (we may already be about half way there as the March comparison is almost 4.5% worse than the average for the last 12 months ending in February) equates to $26 per shift, or a 21% decrease in income for the average driver, to $100 per shift ($10.50 per hour).

Fleet Owners

Mini-fleet or Corporate medallions represent 58% of all NYC medallions. Passive fleet owners are currently being paid $3,000 per month, per medallion, down from $3,400/$3,600 just months ago. Just to be clear, some fleet owners are not passive, like Gene Freidman. Freidman runs a company that manages his medallions along with medallions of passive fleet owners to whom Freidman pays something in the neighborhood of the $3,000 per month industry norm. The $3,000 per month received from a management company "agent" is essentially free cash flow for the passive owner who has no meaningful cost, excluding debt service, beyond annual regulatory fees and non-cash, tax-deductible depreciation on the medallion.

Management company/agents' revenue equals the sum of all driver lease payments received, around $75,000 per year, using an average daily lease rate of $120 (weekly shift leases are cheaper on a per day basis), times 2 daily shifts, times 320 days (accounting for vehicle maintenance down time and modest levels of idle shifts). From that gross revenue the costs of owning and running the management business are deducted including staff salaries, the real estate, insurance, vehicles and associated maintenance and depreciation, workers compensation and the $3,000 per month fees to other medallion owners for whom the garage manages. Management company margins are very thin, and many were actually losing money in the summer of 2014 before cutting lease fees paid to owners.

The TLC actually mandates that mini-fleet medallions be on the road at least two 9-hour shifts per day for 365 days - including holidays. The commission is contemplating repealing this rule because fleet owners have every incentive to meet it without a rule and it cannot be achieved consistently, especially in the era of ride share. Utilization rates for mini-fleet medallions are meaningfully higher than independent medallions, the latter not held to the same standard of double-shifts, 365 days per year. We met a NYC driver who is part of a three-man team that signs weekly leases and collectively drives that taxi 24 hours per day, 365 days per year. But the fleet owner is only paid for two shifts, not three, and the *value* of the medallion is driven by the *free cash flow*of $3,000 per month to the passive fleet owner.
Recall, fleet medallion prices peaked at $2.6 million ($1.3 million per medallion). The average fleet medallion price for the 200 auctioned in November 2013 was $2.3 million or $1.134 million per medallion. Using a 75% loan-to-value, 4% interest rate and 25-year amortization period, the monthly debt service payments equal $4,490. So, unlevered fleet medallion cash flow per year is

$36,000, and annual debt service is just shy of $54,000 (see Exhibit 2). Of course not all fleet owners purchased at these prices, but understanding this math helps explain why Citibank is seeking to foreclose on Gene Freidman's 89 medallions, New York Community Bank (NYSE: NYCB) isseeking to divest its medallion loan portfolio and Signature Bank reported its NYC taxi medallion debt service coverage dropped from 1.67 in Q4 to 1.30 in Q1, as reported during the respective earnings conference call Q&A sessions.

Exhibit 2 Passive Fleet Owner Cash Flows and Debt Service

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Annual Lease Payments ($3,000/month)	$36,000
Annual Debt Service:	
Medallion Purchase Price	$1,134,000
Loan at 75% LTV	$850,500
Assumed Interest Rate	4.0%
Amortization	25 years
Annual Debt Service:	$53,880
Total Net Pretax Owner/Operator Income:	**$17,880**
Debt Service Coverage	0.67

Independent Medallion Owner/Operators

Independent medallion owners, in contrast, cannot lease their medallions to a second driver unless they personally log 900 hours per year. The TLC reported in its 2014 Fact Book "True single-shifters are a rarity today, as only around 10% of all medallions operate for one daily shift on a consistent basis." It seems reasonable to infer "… 10% of *all* medallions …" means 10% of all outstanding medallions rather than 10% of independent medallions. If so, approximately 23% of all independent medallions are "consistently" being driven for a single shift. On a weighted average basis, then, independent medallions operate at a lower utilization rate and therefore lower average farebox per year (this point does not apply to average daily farebox per *shift*), and the difference is likely substantial. Importantly, as discussed above, the bigger the differential between average annual farebox between mini-fleet and independent medallions, the sooner widespread medallion loan defaults will occur in the event the downward trend in trips and farebox for the industry continues.

Exhibit 3 shows the average economics for an independent owner/operator, in which income from a second driver is calculated by multiplying 77% (to reflect in the average that 23% of independent medallions are consistently single shift) by the average shift lease fee by 365 days per year (obviously a generous assumption given the utilization differential versus fleet medallions discussed).

Using an owner who purchased or refinanced a medallion at a price/value of $900,000, a LTV of 75% and 4% interest rate suggests annual debt service of almost $43,000. Total annual operating costs are almost $30,000. Gross annual revenue is based on the same $266 per shift farebox reported by the TLC for the last 12 months. The estimated $46,500 of annual income equates to $15.30 per hour driven of net pretax income. Owner/Operators under this scenario have to drive 272 shifts just to cover their costs, with additional shifts and net income from a second driver representing pure profit. Average debt service coverage under this scenario is 2.09.

A 10% farebox decline equals $8,500 per year or 18% of the net pretax income total, before accounting for how lease income is affected by a decline of that magnitude - a substantial hit.

Exhibit 3 Independent Medallion Owner/Operator Average Earnings

Avg. Daily Gross Farebox per Medallion per Shift (TTM ending March 2015)	$266
Total Shifts Driven by Owner/Operator	320
Gross Annual Revenue from Driving (at $266/shift)	$85,258
Net Pretax Income from Second Driver [1]	$33,726
Total Gross Income to Owner/Operator	$118,984
Annual Fixed Operating Costs:	
Vehicle depreciation	$6,500
Insurance	$9,000
Medallion license renewal (per year)	$825
Annual Fixed Operating Costs Subtotal	$16,325
Added Fixed Expenses if Also Lease:	
Workers Comp.	$2,500
Supplemental Insurance	$2,400
Variable Expenses:	
Vehicle maintenance	$3,640
Gasoline	$2,613
MTA Surcharge	$2,205
Total Operating Costs:	$29,683
Pre-Debt Service (Operating) Net Pretax Income	$89,300
Annual Debt Service:	
Medallion Purchase Price	$900,000
Loan at 75% LTV	$675,000
Assumed Interest Rate	4.0%
Amortization	25 years
Annual Debt Service:	$42,756
Total Annual Net Pretax Owner/Operator Income:	$46,544
per hour	$15.31
Shifts to Breakeven (annual costs/$266)	272
Debt Service Coverage	2.09

[1] 77% of Owner/Operators lease to second driver, assumed 365 shifts at average shift rate of $120.

Conclusion

Signature Bank indicated its debt service coverage ratio for NYC medallion loans was 1.30X in the first quarter, down from 1.67X reported for the fourth quarter. If a NYC medallion loan portfolio was split evenly between independent and mini-fleet borrowers, the averages reflected in Exhibits 2 and 3 would yield a portfolio debt service coverage ratio of exactly 1.30. Regardless of the precise breakdown, 1.30X debt service coverage is a small cushion when a driver also has to pay all living expenses and the cash flows are still falling. The first-ever permanent and worsening supply shock is taking a toll on the cash flows of medallion owners who have historically been able to refinance against consistently rising asset values to meet cash flow shortfalls. That historical dynamic yielded an industry with extremely low rates of default - an asset class with a risk profile resembling US government bonds. Now that competition is allowed in these markets and cash flow and medallion values are falling, the refinance option is disappearing. The facts continue to support our thesis that continued dilution of taxi medallion cash flows will eventually lead to a combination of negative free cash flow (taxi drivers earning less than a competitive wage) and negative equity - forcing widespread medallion loan defaults.