First Trust ECONOMIC RESEARCH REPORT

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Government Taxi Bubble Causes Credit Union Failure

Since the financial crisis, we have been inundated with the idea that the private sector is to blame for the misery that has befallen the American public. Countless politicians have appeared on TV or hit the campaign trail and the message is always the same; greed caused the great recession and the only solution is to trust the government more. Very seldom do we hear that government might have helped cause the housing bubble and the bank failures that resulted.

Now, a similar scenario is now playing out in New York City, albeit on a smaller scale, and there is no denying the influence the government has had in creating it.

Montauk Credit Union was seized by the New York State Department of Financial Services this past Friday. This marked the first time the relatively new regulatory body, which was founded in Oct 2011, or any state regulator for that matter, has seized a credit union. The reason for the seizure? As of June, Montauk had around $19.3 Million in loans at least 30 days past due, more than twice the $9.5 Million in delinquency six months earlier according to Reuters. This, paired with the fact that it had only $18 Million in capital and another $6 Million in reserves to absorb losses, made it necessary for the state to "come to the rescue" according to Crain's New York.

So what kind of arcane, risky financial engineering got Montauk into this mess? None, actually. In fact, it specialized in loans to taxi-medallion owners.

Since 1937, when the taxi medallion system was signed into law and the government protected taxi cartel was created in New York, the number of taxis on the road has been restricted. This, paired with growing demand for rides over the years, made medallions a very good investment. Owners of medallions would use these appreciating assets as collateral for larger and larger loans to acquire rivals and update fleets. And with the consistently rising medallion values as a fallback, it looked like a win for lenders as well. Sound familiar?

Enter the entrepreneur. The rise of ridesharing companies - like Uber and Lyft - has taken a big bite out of the taxi business, causing an ever increasing number of defaults on these loans as revenues plummet and medallions are foreclosed on. The problem is medallions aren't worth as much without the government-created monopoly. According to Crain's New York, after peaking in price at $1.1 Million each in 2013, only two have sold in all of 2015, drawing $700,000 each. The market for medallions seems to have frozen and been largely replaced with foreclosure auctions as banks and credit unions try to salvage what they can.

This situation is only going to get worse for Montauk and peers, who have reportedly made $2.5 Billion of loans secured by 5,331 medallions according to Reuters. On September 9th, the New York State Supreme Court ruled against a lawsuit brought by the lenders to ban ridesharing services in New York City, dealing a potent blow to the taxi cartel. Reportedly, Montauk is not the only institution in trouble. Believe it or not, with 1/3rd of its $167 Million loan portfolio in medallion loans, it is in better shape than some of its peers.

The bottom line is that the government helped create this bubble when it established the medallion system in 1937, and now it is seizing the institutions that failed as a result of those policies. Don't mistake us, we fully support the innovation companies like Uber have brought to city streets and we are happy to see the taxi cartel go, but keep your nonsense filters on high alert for when this is inevitably blamed solely on the greed of the private sector.