**Before the Committee on Commerce, Science and Transportation**

**United States Senate**

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# Assessment of Amtrak's Financial Performance and Requirements


**Statement of**

**The Honorable Kenneth M. Mead**

**Inspector General**

**U.S. Department of Transportation**

Mr. Chairman and Members of the Committee,

We appreciate the opportunity to testify on Amtrak's financial performance and requirements. Last winter when we testified on this subject, we stated that it would be possible for Amtrak to achieve operating self-sufficiency by 2003, but that delays in Acela Express would pose additional obstacles. Today, the picture is bleaker. Acela Express is still not in service and large holes exist in Amtrak's business plan that will need to be filled in order for Amtrak to achieve operating self-sufficiency. On the plus side, Acela Express stands to benefit if aviation delays continue to plague the Northeast. However, time is running short, as are Amtrak's available funds to invest in its equipment and infrastructure. Amtrak will face a $91 million minimum capital needs funding shortfall in 2001, or worse, if it does not hit its operating targets.

With 3 years to go in its Congressionally-set mandate, we still believe it is possible for Amtrak to reach operating self-sufficiency, but this will depend heavily upon Amtrak's ability to curb expense growth; in its 2001 business plan, fill the nearly three-quarters of a billion dollars in existing "undefined management actions"[1]; and secure sufficient capital funding to support Amtrak's projected ridership and revenue growth.

We have just issued a report–the 2000 Assessment of Amtrak's Financial Performance and Requirements[2]–that summarizes our findings from our most recent Congressionally mandated annual review of Amtrak. Today, we would like to discuss the main points in this report by presenting our views on Amtrak's financial status through the first 11 months of Fiscal Year 2000, the likelihood of Amtrak's reaching operating self-sufficiency by 2003, the impact of Acela delays, and Amtrak's capital funding needs. And as requested, I would also like to share some comments on the proposed bond bill, S. 1900, that is currently under consideration in the Senate.

[1] Placeholders in Amtrak's business plan that represent the difference between where Amtrak needs to be to achieve operating self-sufficiency and where it believes it will be based on the performance of already identified actions.

[2] Report No. CR-2000-121, September 19, 2000. 2000 Assessment of Amtrak's Financial Performance and Requirements, Office of Inspector General, U.S. Department of Transportation.

## AMTRAK'S RECENT FINANCIAL AND PERFORMANCE RESULTS

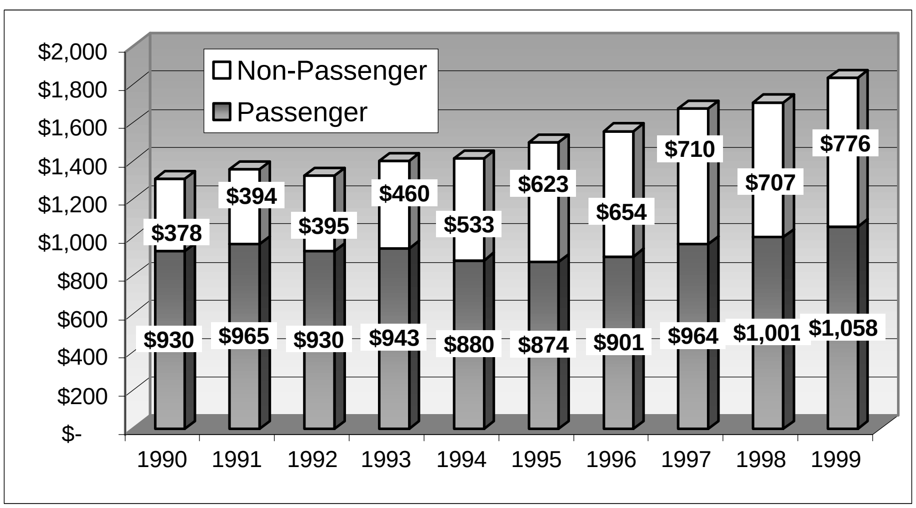
**Amtrak has shown financial improvement but greater efforts must concentrate on curtailing expense growth**. The good news is that Amtrak's revenue and ridership showed marked improvement in 1999 and through the first 11 months of 2000. The bad news is that expense growth has kept pace. If Amtrak is to reach operating self-sufficiency by 2003, it must aggressively pursue actions that curb the growth in expenses.

- **Revenue and Ridership results are positive**. The revenue growth that began in 1995 has brought Amtrak to the highest passenger revenue levels in its history and Amtrak expects that 2000 passenger revenues will exceed those of 1999. Passenger revenue grew by 5.7 percent in 1999 and in the first 11 months of 2000, was up 8.6 percent over the same period in 1999. Overall operating revenues increased in 1999 by 7.4 percent, and were 11.7 percent higher in the first 11 months of 2000 than they were for the same period in 1999. Non-passenger revenues showed a strong 9.7 percent growth in 1999 and in the first 11 months of 2000, were almost 16 percent better than the same period last year.[3] Ridership grew 2 percent over 1998 levels and in the first 9 months of 2000, was up by 3.5 percent.[4]

[3] Non-passenger revenues include mail and express, commuter, reimbursable, commercial development, non-transportation, state reimbursement, and other transportation revenues.
[4] Ridership and on-time performance results were only available through June 2000.

Overall operating revenues increased in 1999 by 7.4 percent, from $1,708 million to $1,834 million,[5] with non-passenger revenues showing a strong 9.7 percent growth, increasing from $707 million in 1998 to over $775 million in 1999. Non-passenger revenue constituted an increasing share of Amtrak's total revenues between 1990 and 1999. The overall increase in non-passenger revenue for the last 10 years has been 105 percent, going from $378 million in 1990 to almost $776 million in 1999. Non-passenger activities now account for over 42 percent of Amtrak's total operating revenues.

**Composition of Amtrak Revenues, 1990 Through 1999 ($ in millions)**

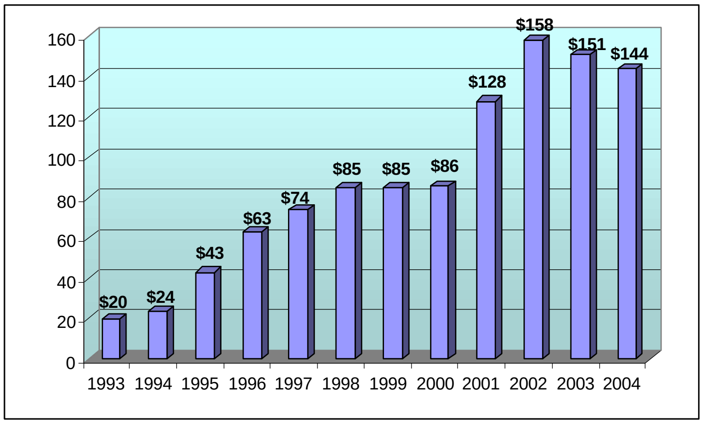



Source: Amtrak Financial Statements

[5] Amtrak's reported operating revenue in 1999 and 1998 included, as required by generally accepted accounting principles, $191 million and $542 million, respectively, of Federal payments received, including TRA funds, and $58 million in interest earnings on temporarily invested TRA funds. Because the TRA funds and the interest earnings will be spent on capital investment, they have been excluded from our reporting of operating revenue.

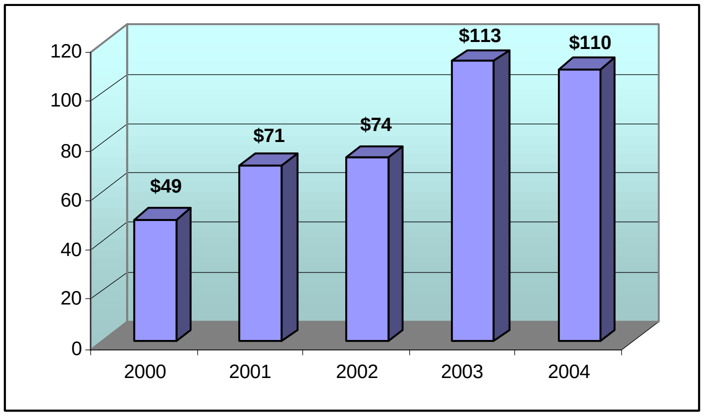
- Although revenue and ridership trends are positive, increases in labor costs, depreciation, and train operation expenses have fueled continued growth in operating expenses, increasing by 6.9 percent in 1999 and by 7.3 percent in the first 9 months of 2000. Additionally, Amtrak has funded most of its recent refleeting efforts through external financing, which caused interest expenses to grow rapidly in the 1990's. The interest costs on this financing are adding about $100 million more to cash losses *per year* between 2000 and 2004 than in the 5-year period before these programs. Principal payments on debt, which are considered capital costs, are also projected to grow steadily between 2000 and 2004.

**Growth in Interest Expenses, 1993 Through 2004 ($ in millions)**




Source: Amtrak 2000 Strategic Business Plan

**Projected Growth in Debt Principal 2000 Through 2004 ($ in millions)**




Source: Data provided by Amtrak in July 2000

This expense growth has kept Amtrak's cash loss from declining. Amtrak's cash loss in 1999 of $579 million was Amtrak's highest in 10 years. Although we project the cash loss in 2000 will be $521 million, the lowest since 1992, Amtrak must make significantly more progress each year if it is to reach its goal of operating self-sufficiency in 2003. Amtrak must reduce its cash loss to $266 million in 2003 to meet this goal, a required improvement of $255 million over 2000. Reducing the cash loss will depend heavily on limiting the growth in Amtrak's expenses over the next 3 years.

The ridership and passenger revenue growth has occurred in the face of little change in either Amtrak's Customer Satisfaction Index or its on-time performance. In 1999, the Index decreased to 83 from 85 in 1998, and has rebounded to 85 for the first 9 months of 2000. On-time performance was constant at 79 percent in 1998 and 1999, and has risen slightly to 80 percent for the first 9 months of 2000. Both on-time performance and customer satisfaction have been affected by the service problems experienced by the freight railroads over the last 3 years.

To further bolster ridership, passenger retention, and revenue, Amtrak instituted a Customer Service Guarantee on July 4, 2000. The guarantee provides passengers who are not satisfied with Amtrak's service, for any reason, with vouchers for future travel equal to the value of the trip on which they were dissatisfied. Amtrak's goal for the Customer Service Guarantee is that no more than 1 passenger in 1,000 (a 99.9 percent satisfaction rate) will request a voucher. The issuance rate for July was about 2.8 per 1,000 passengers (99.7) and the estimate for August is about 5 per 1,000 passengers (99.5).

## AMTRAK'S FUTURE FINANCIAL OUTLOOK

**Amtrak will need to take major corrective actions if it is to achieve operating self-sufficiency in 2003.** Despite positive trends in revenue and Amtrak's financial results being close to goals over the last 2 years, starting next year, the bar will be raised much higher. Amtrak's cash losses must drop by an average of $85 million per year to reach operating self-sufficiency in 2003.

Our assessment of Amtrak's business plan identified a number of elements that are unlikely to perform as Amtrak expects. *If no corrective action were taken to compensate for them,* Amtrak's cash loss would be about $1.4 billion more than it projects over the 5-year period, 2000 through 2004. Most critically, we project that in 2003, the year of operational self-sufficiency, Amtrak would still require $351 million more in operating assistance than it can fund with its Federal appropriation.

About 85 percent of the total $1.4 billion at risk of not being achieved is concentrated in three elements of the Plan: $737 million in undefined management actions, $304 million in Northeast Corridor passenger revenues, and $179 million in Mail and Express net revenues. I would like to say a few words about each of these areas.

- **Undefined Management Actions.** Amtrak's business plan projects operating self-sufficiency largely on the back of the $737 million in undefined management actions. In essence, these undefined actions represent the gap between the total cash loss improvements Amtrak needs and what it expects to get from actions it has already identified. If Amtrak's 2001 business plan does not fully define these management actions, we strongly doubt that Amtrak will be able to achieve its mandate by 2003. Actions of the magnitude necessary to fill these gaps do not translate into revenues or savings overnight.

- **Northeast Corridor Passenger Revenues.** We are concerned that Amtrak's projections for Acela Express ridership assume a higher-than-likely diversion of passengers from air and automobile, and an underestimation of ridership on the slightly slower, but significantly less expensive Acela Regional service. However, if Amtrak were to make some fare and service adjustments, and if aviation delays continue to plague the Northeast Corridor, we believe that a significant share of the benefits we have questioned would indeed be forthcoming.

- **Mail and Express.** In our opinion, the Mail and Express service is not likely to ramp up as quickly as Amtrak projects; however, by 2004, our projections come close to Amtrak's. Agreements with freight railroads for permission to operate trains with consists greater than 30 cars is essential to the growth of Mail and Express capacity. According to Amtrak, most of the freight railroads have expressed a willingness to enter into such negotiations.

The bottom line is that if our projected losses were to occur, the situation would be untenable for Amtrak. In 2001 and 2002, Amtrak would have to cover the greater losses through its Federal appropriation, leaving virtually no funds for capital investment. *Amtrak must take major corrective actions now.*

## ACELA DELAYS

**Acela Delays Will Impact Revenue but Delays are Understandable in New Technology Investments.** The delays in the introduction of Acela Express and Acela Regional service will reduce Amtrak's 2001 revenue below Amtrak's earlier projections. This will put additional pressure on Amtrak to reduce expenses and fortify its efforts to improve performance in both its passenger and non-passenger services, including Mail and Express. However, the approximately 1-year delay should not be surprising for a program of this nature. The testing and introduction schedules were ambitious, in part, because of the dire need for Amtrak to generate as much new revenue as quickly as possible in order to meet its self-sufficiency deadline.

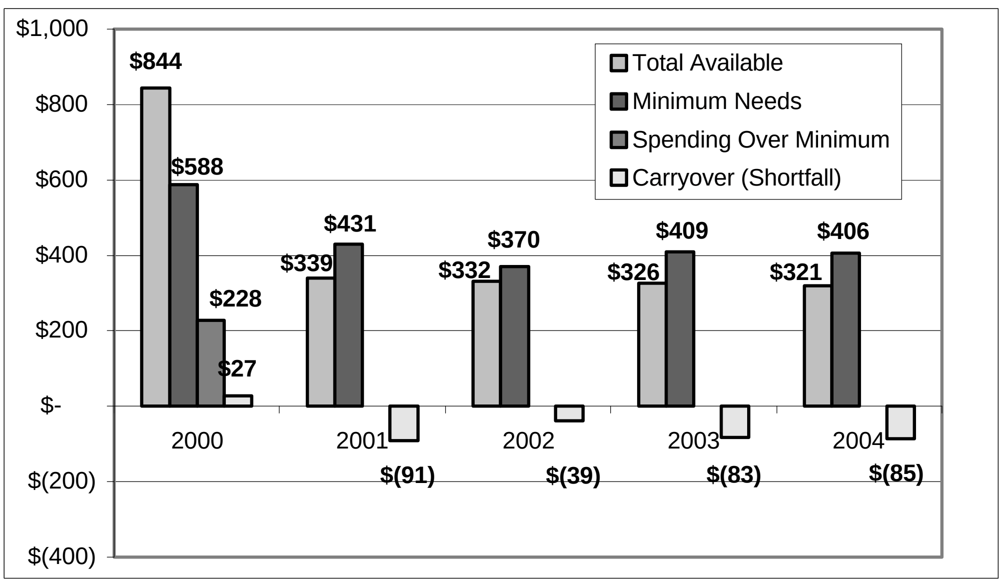
Amtrak's 2000 Strategic Business Plan incorporated the revenue and expense impacts of delays until July 2000, which was the anticipated start-up date when the Plan was issued in January. The revised plan for starting operations in October 2000 will result in some additional revenue loss in 2000 (which is reflected in our assessment) and in 2001. While delays of this magnitude will pose a financial challenge to Amtrak in 2001, if there are no further extended delays, the Acela service should be able to reach its full operating and revenue potential in 2003.

Although the Acela delays have affected Amtrak's revenue projections and path toward self-sufficiency, delays of this nature are not uncommon in programs of this complexity. In fact, in other industries projects with delays of this length might actually be considered ahead of schedule. The new trainsets represent a significant adaptation of existing high-speed designs to meet more stringent safety requirements in the United States and to compensate for the unique track configurations on the Northeast Corridor. Problems identified in testing and design modifications are normal consequences of such new technology development programs.

## CAPITAL NEEDS

**Amtrak's capital outlook is grave.** In both our prior assessments, we projected that Amtrak would face serious capital shortfalls beginning in 2001. Our predictions have come true. In 2001, *assuming Amtrak's cash losses are no higher than it projects*, Amtrak will face a minimum needs capital funding shortfall of $91 million, and continued shortfalls through 2004 totaling $298 million.[6]

### Amtrak's Projected Minimum Capital Needs Funding Shortfall, 2000 Through 2004 ($ in millions)




Amtrak will be faced with some very difficult choices next year concerning how to best use its limited capital dollars. After covering its mandatory capital costs,

[6] Our definition of minimum needs includes only the capital investment necessary to maintain Amtrak's infrastructure and assets in a steady state *through 2003*. Thereafter, the condition of Amtrak's infrastructure and assets will begin to steadily decline.

Amtrak will have only $179 million left to invest in its capital program. Competing for these funds would be remaining minimum needs, key projects in progress – including many projects that support the self-sufficiency glidepath, and commitments to States for corridor development projects. Amtrak would need *at least* an additional $385 million in capital funding in 2001 if it were to cover all of these costs.

If our projections for cash losses in 2001 were to occur, Amtrak's capital position would be far more serious. Amtrak would need to use $310 million more than planned of its Federal appropriation to cover the losses, leaving only $29 million available for capital investment, which is not even enough to cover Amtrak's debt obligations in 2001. This outcome is not inevitable, but it underscores how critical it is for Amtrak to fill the gap in its business plan for undefined management actions.

**Growth-focused capital spending starves minimum needs and could ultimately undermine the benefits of key investments like high-speed rail.** Despite known minimum-needs shortfalls, Amtrak has pursued a growth-focused capital program. In our 1999 assessment, we recommended that Amtrak set aside funds to meet minimum needs in 2001 and 2002 by revising its spending plans for 2000.

Although Amtrak agreed with our predictions, its 2000 Plan provided for continued investment in projects outside of minimum needs. For example, Amtrak invested $25 million in planning efforts for the Midwest Regional Rail Initiative, $15 million in infrastructure improvements to support the future Las Vegas service, and $9 million for the refurbishment of Heritage diner cars. Amtrak's spending strategy reflects its belief that these projects are necessary to achieve the business plan goals and ultimately self-sufficiency by 2003. We agree that these projects are important to Amtrak's financial growth, but do not believe they should be funded at the expense of the minimum investments necessary to maintain the reliable operation of the railroad.

In addition to spending on non-minimum needs, Amtrak also *underspent* on certain minimum needs in 1999 and 2000 to support a higher level of growth-related capital spending. This is most true for projects that support the operational reliability of Amtrak's services. Projects in this category include replacing old tracks, resurfacing rails, and replacing worn out electric traction catenary wire and insulators. We estimate Amtrak's minimum operational reliability needs to be $135 million each year. Amtrak's annual spending on operational reliability projects in the past 3 years has averaged only $71 million.

If Amtrak continues to defer spending on operational reliability, service quality will suffer and its goals for revenue growth may not be met. In order for high-speed rail to be successful, Amtrak acknowledges that it must provide superior service and on-time performance. If it cannot maintain that level of service, ridership and revenue will begin to erode.

## FUNDING AMTRAK'S CAPITAL REQUIREMENTS

In February of this year, we testified before the Subcommittee on Surface Transportation and Merchant Marine on several Amtrak issues, including the question of capital funding for Amtrak beyond 2002. Although precluding use of Federal funds for most operating expenses after 2002, the Amtrak Reform and Accountability Act did not say whether Amtrak could count on receiving any long-term Federal subsidies for capital investment.

At that hearing, we stated that even if Amtrak meets its operating self-sufficiency mandate in 2003, it would not make it by much, clearly not enough to cover its minimum capital requirements. Our position then, as it is now, is that without significant capital funding to cover such costs as debt, safety improvements, infrastructure reinvestment, and equipment renewal, Amtrak will not be able to continue to operate the railroad. We do not see this situation changing—it will not be feasible in the foreseeable future for Amtrak to progress to a point where it can generate sufficient internal revenue to cover its capital costs.

If Amtrak is to continue operating a national rail passenger network, Amtrak will require significant long-term capital funding—in amounts well above the annual operating subsidy of which it is supposed to be largely free in 2003. At that point, the central questions would not be <u>whether</u> Amtrak would receive a capital subsidy, but rather (1) what the funding vehicle would be (direct appropriations, contract authority, tax subsidy, etc.), (2) in what amounts, and (3) for what purposes. Another question is when these decisions should be made—now, before Amtrak shows whether it will meet the requirements of the Amtrak Reform and Accountability Act, or in 2003, at the end of the 5-year glidepath.

**S. 1900.** Clearly, it is the Congress' role to determine the need, the amount, and the vehicle for providing Federal capital support. However, at your request, we have several observations on S. 1900, the High Speed Rail Investment Act.

In addition to Amtrak funding policy, S. 1900 is a question of tax policy. Under the current version of the bill, the legislation, if enacted, would enable Amtrak to sell $10 billion in high-speed rail bonds over the next 10 years. Interest payments would be made by taxpayers in the form of a tax credit to bondholders and repayment of principal would be secured by a 20 percent matching contribution by the States that would be placed in escrow. The House version (H.R. 3700) would limit to 30 percent the amount of total funding that could go to any one corridor and would make the bonding authority available to any intercity passenger railroad, not just Amtrak.

These proposals are clearly attractive to Amtrak. S. 1900 would address part of the difficulty in securing additional appropriated funds for Amtrak capital investment. However, Amtrak’s capital needs extend well beyond high-speed corridors and because S. 1900 is limited to high-speed corridors, Amtrak will continue to need annual appropriations. These appropriations will be necessary to cover capital costs such as repayment of debt, information technology projects, environmental remediation, and approximately $200 million each year in overhauls and rolling stock improvements.

Until Amtrak develops a detailed, 5-year capital program, the annual requirements can not be estimated with precision. We recommended that Amtrak develop such a plan in our recent Amtrak financial assessment. However, even if S. 1900 or some version of the bill is passed, Amtrak is still likely to need *more* per year than the current Amtrak capital funding of $521 million.

**Federal oversight requirements.** As introduced, S. 1900 lacked sufficient Federal oversight of Amtrak’s spending of the bond proceeds. Essentially, the tax credit vehicle bypasses the oversight that would otherwise be in place through the annual appropriation process.

Costs of developing high-speed corridors are significant and $1 billion each year will not be sufficient for Amtrak to meaningfully invest in every corridor seeking a piece of the pie. Amtrak will need to make choices on where and how much to invest in each project. If funds are sprinkled around the country in amounts sufficient to get projects underway but insufficient to complete them, the likely result would be that few of the routes would make positive contributions to Amtrak's achieving or maintaining operating self-sufficiency.

The intent of S. 1900 is to provide Amtrak a vehicle to make investments that will not only help it maintain self-sufficiency, but potentially begin generating internal funds for capital investment. Federal oversight will be critical to ensure that Amtrak's investments meet those criteria. Without such oversight, passage of this or any similar bill would be tantamount to writing Amtrak a blank check. We have been advised that adequate oversight provisions have or will be included in the bill language; however, we have not seen the provisions of the marked-up bill and cannot comment on their adequacy.

**S. 1900 and Amtrak's Glidepath.** Finally, we have questions about how a 10-year authorization for high-speed rail bonds would interface with the provisions of the Amtrak Reform and Accountability Act, which requires Amtrak to reach operating self-sufficiency in 2003. Our most recent report finds that without major corrective action to curtail expense growth and fill unspecified revenue increases and expense savings totaling more than $700 million, Amtrak will not achieve this mandate. Although S. 1900 will not change how we measure operating self-sufficiency, it also will not fill this gap. If Congress decides that S. 1900 is an appropriate vehicle for addressing Amtrak's capital requirements in the northeast and other high speed corridors, we believe continuation of any such authority be made contingent on Amtrak meeting its operating self-sufficiency mandate as prescribed by law.

This concludes our statement. I would be pleased to answer any questions.