UNITED STATES DEPARTMENT OF TRANSPORTATION

Hearing on
the Railroad Rehabilitation and Improvement Financing Program

before the
Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee on Transportation and Infrastructure
U.S. House of Representatives

Written Statement of the
U.S. Department of Transportation

March 31, 2009

Statement of
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To
The Subcommittee on Railroads, Pipelines and Hazardous Materials
Committee on Transportation and Infrastructure
U.S. House of Representatives
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Chairwoman Brown, Mr. Shuster and members of the Subcommittee: I am pleased to have this opportunity to appear before you on behalf of Secretary of Transportation Ray LaHood to update you on the status of the Railroad Rehabilitation and Improvement Financing Program, also known as RRIF.

By way of introduction, I am Mark Yachmetz, Associate Administrator for Railroad Development of the Federal Railroad Administration (FRA.) The Office of Railroad Development which I have the honor to lead is responsible for FRA's investment programs including:

- Railroad Research and Development;
- Support to the Secretary of Transportation in his role as a member of Amtrak's Board of Directors;
- Analyses in support of development of intercity passenger rail policy;
- Operating and capital grants to Amtrak;
- Grants to States for rail line relocation, grants to the Alaska Railroad for capital improvements benefitting passenger service, grants to railroads for rehabilitation and repair resulting from natural disasters, and grants for high-priority rail-related projects designated by Congress.
- Implementation of FRA's responsibilities under the Passenger Rail Investment and Improvement Act of 2008;
- Implementation of FRA's responsibilities under the American Recovery and Reinvestment Act of 2009.; and
- FRA's credit program responsibilities under RRIF and Transportation Infrastructure Finance Innovation Act (TIFIA).

I joined the staff of the FRA in 1978 to work in the program providing credit-based financial assistance to the rail industry that was authorized by Title V of the Railroad Rehabilitation and Regulatory Reform Act of 1976. That program was the predecessor to RRIF, thus I have been involved to some degree with FRA's credit-based programs since just after their inception.

Touching on the highlights of the RRIF program since its creation in the Transportation Equity Act for the 21^{st} Century (TEA-21):

- FRA has made 22 loans totaling $786.72 million dollars. FRA has not yet guaranteed any loans. (A list of loan recipients is attached to this testimony.)
- Three of these loans, totaling $381 million dollars have been repaid in full.
- Payments on all other loans are current; there have been no defaults of RRIF loans.
- There are currently 3 complete applications being reviewed by FRA, with several additional draft applications in various stages of development.
- On March 30, 2009, the U.S. Department of Transportation published a notice in the Federal Register withdrawing a proposed rulemaking initiated in the prior administration that would have changed RRIF policies and procedures.

RRIF Program in Brief

The RRIF program was established by section 7203 of TEA-21 and amended by section 9003 of the Safe, Accountable, Flexible, and Efficient Transportation Equity Act: a Legacy for Users (SAFETEA-LU) and section 701(e) of the Rail Safety Improvement Act of 2008. Under this program the Federal Railroad Administrator is authorized to provide up to $35 billion in direct loans and loan guarantees. Of this amount, $7 billion is reserved for projects benefiting freight railroads other than Class I carriers.

<u>Applicants</u>

Entities eligible for this financial assistance are:

- State and local governments;
- Interstate compacts consented to by the Congress under section 410(a) of the Amtrak Reform and Accountability Act of 1997 (49 U.S.C. 24101);
- Government sponsored authorities and corporations;
- Railroads (which means a rail carrier subject to Part A of subtitle IV of Title 49 U.S.C. – specifically freight railroads, intercity passenger railroads and commuter railroads that operate on the general system of railways of the U.S. and are subject to FRA's safety jurisdiction)
- Joint ventures that include at least one railroad;
- Solely for the purpose of constructing a rail connection between a plant or facility and a second rail carrier, limited option rail freight shippers that own or operate a plant or other facility that is served by no more than a single railroad.

<u>Eligible purposes</u>

Loans or loan guarantees provided under RRIF can be used to:

- Acquire, improve, or rehabilitate intermodal or rail equipment or facilities, including track, components of track, bridges, yards, buildings and shops;
- Refinance outstanding debt incurred for the purposes described above; and
- Develop or establish new intermodal or railroad facilities.

<u>Priorities for Consideration</u>

When evaluating applications, FRA gives priority consideration to projects that:

- Enhance public safety;
- Enhance the environment;

- Promote economic development;
- Enable the United States to be more competitive in international markets;
- Are endorsed by the plans prepared under section 135 of title 23, United States Code, by the State or States in which they are located;
- Preserve or enhance rail or intermodal service to small communities or rural areas:
- Enhance service and capacity in the national system; or
- Would materially alleviate rail capacity problems which degrade the provision of service to shippers and would fulfill a need in the national transportation system.

Loan Terms

The maximum repayment period for direct loans or loan guarantees is 35 years or if collateral is pledged, the life of the asset whichever is less. The interest rate on direct loans is equal to the rate on Treasury securities of a similar term.

Fees

Applicants may be required to pay an investigation charge of up to one half of one percent of the principal amount of the direct loan or the portion of the loan to be guaranteed. These fees have been used only for the cost of independent financial advisors, including appraisers of collateral, related to the specific loan under consideration, and reflect actual expenses incurred for the review of the application. FRA's experience has been that investigation fees for loans ranging from $10 million to $100 million normally fall in the range of $30,000 to $60,000. For smaller proposed loans, where the cost of the consultant is greater than the maximum fee that can be charged, FRA absorbs the additional costs if the Agency's financial resources permit or undertakes the needed analysis using FRA staff.

Credit Risk Premium

The Federal Credit Reform Act of 1990, as amended, (FCRA) changed the budgetary measurement of the cost for direct loans and loan guarantees from the amount of cash flowing into or out of Treasury to the estimated long-term cost to the Government. This estimated long-term cost is referred to as the subsidy cost. FCRA requires that Federal agencies reserve this subsidy cost before entering into a new direct loans or loan guarantees. For the RRIF program, this subsidy cost can be paid for by or on behalf of applicants for credit assistance in the form of a credit risk premium.

Calculating the credit risk premium can be done in one of two ways. Where the applicant has received a recent credit rating from one or more nationally recognized rating agencies, that rating is used to estimate the credit risk. For applicants that have not received a credit rating, the credit risk is based upon an evaluation by FRA of the business risk based upon the applicant's industry outlook, market position and management financial policies; the financial risk based upon the applicant's past financial performance; the project risk; and the potential recovery in event of default, including the value of any collateral offered by the applicant. To date, the credit risk premiums charged by FRA have ranged between 0 and 6.16 -percent.

Collateral

Applicants are not required to offer collateral, but by offering collateral, an applicant may significantly enhance the strength of the RRIF credit and thus significantly reduce the required credit risk premium. As collateral, an applicant or any other party may offer anything of marketable value, not just assets related to the project under consideration. Indeed, collateral need not necessarily be related to the railroad or rail operations.

FRA is required to value collateral as a "going concern", based upon the premise that a business sold as a going concern has greater value than liquidating its component parts. The going concern valuation, however, is only relevant and thus only used when a whole business or a business unit is used as collateral. Other collateral such as a building is valued at its net liquidated value that is the value that could be received by selling the asset on the open market for its highest and best value.

The Application Process

Pre-Application

FRA encourages potential applicants to engage FRA in pre-application discussions. Such discussions help the applicant understand the application process, the issues that need to be addressed and the nature of the finance agreement that would result from a successful application. Some applicants have only one pre-application discussion. Other pre-application discussions can become quite extensive as the potential applicant refines description, scope and cost estimates of the proposed project. These differences in the length of the pre-application stage frequently reflect the wide differences in applicants. Some are public agencies or large corporations with in-house financial and engineering expertise, while others are smaller corporations that need outside help, and thus more time, in developing information necessary to support an application.

A RRIF application may be the first time an applicant has dealt with the Federal Government from a financial assistance perspective. Pre-application discussions thus also address certain requirements inherent in any Federal program, including the need for FRA to comply with National Environmental Policy Act of 1969 (NEPA) and its environmental review requirements. Because FRA does not have funds for this purpose, the financial burden of complying with NEPA falls on the applicant and NEPA clearance is a prerequisite to an application being complete. Fortunately, most RRIF projects to date have fallen under established categorical exclusions from NEPA review, have required nominal environmental reviews, or have involved projects for which NEPA documentation has been prepared for other purposes.

Application and Review

FRA's website includes the RRIF application form. Once the applicant submits a draft application, it is assigned to a staff analyst for review. Once the staff analyst is comfortable that the application is complete or nearly complete, an estimate of the investigation charge is provided the applicant. Upon receipt of these funds, FRA retains its independent financial advisor (IFA) from among a group of advisors FRA has under contract. The IFA's first task is a final review of the draft application and development of any additional materials needed to make it final. Frequently, the IFA identifies additional documents needed to support detailed financial data or supporting information for traffic and revenue projections.

Normally within 30 days of the initial filing the staff analyst, based upon her or his review and recommendations of the IFA, sends a letter to the applicant explaining the information needed to complete the application. Upon the receipt of this information from the applicant and completion of any NEPA-related documentation, the application is deemed complete. FRA sends a letter to the applicant to this effect. This initiates the statutory 90 day period for review of the application.

FRA's exercise of due diligence involving the review of the financials of the proposed project and applicant is relatively intense, with substantial work occurring over a brief period of time. In cases where applicants do not have a credit rating from one of the national rating agencies, the analyst supported by the IFA analyzes all relevant aspects of the proposed transaction. This analysis includes such activities as interviewing existing and potential shippers and independently developing projections of traffic, revenues and expenses, leading to the development of pro-forma financial statements.

During this period, FRA's staff engineers review the engineering aspects of the proposed project to develop an independent assessment of the reasonableness of cost estimates and the ability of the proposed improvements to accomplish the intended purpose. When infrastructure is involved, this includes a site inspection. The Office of Railroad Development also consults with appropriate regional officials of FRA's Office of Safety to identify any specific concerns that they might have identified in their periodic inspections of the railroad. FRA also consults with other modes of the Department if the applicant or proposed project might interface with their programs (e.g. Federal Transit Administration for commuter rail projects.)

Upon the completion of the review of the application by FRA staff supported by the IFA, a recommendation is made to FRA's Administrator by the Associate Administrator for Railroad Development for action on the application. Those the Administrator decides to advance are presented to the U.S. Department of Transportation's Credit Council (the Credit Council.) Alternatively, the Administrator may choose to deny the application at this point.

The Credit Council is an organization created by the U.S. Department of Transportation to ensure the application of consistent credit policies and management practices across all the Department's credit programs. The members of Credit Council are the Assistant Secretary for Budget and Programs/Chief Financial Officer (chair), the Under Secretary of Transportation for Policy, General Counsel, the Assistant Secretary for Transportation Policy, the Federal Railroad Administrator, the Federal Highway Administrator, the Federal Transit Administrator, the Maritime Administrator and the Director of the Small and Disadvantaged Business Utilization. The Credit Council will provide to the Federal Railroad Administrator a recommendation regarding the financial viability of a proposed project and the merits of the requested credit assistance and its consistency with Department credit policies.

After considering the recommendation of the Credit Council, the Administrator then decides whether or not to approve the loan. If the loan is approved, FRA's calculation of the credit risk premium is submitted to the Office of Management and Budget (OMB) for concurrence. While FRA develops estimates of the credit risk premium using its model, in accordance with the FCRA, OMB must agree to the final calculation of the subsidy cost and thus the credit risk premium.

Finalizing the Assistance

Once the final credit risk premium is calculated, the applicant is informed and a term sheet is sent to the borrower. The term sheet includes all of the basic information on the loan including repayment period, interest rate and credit risk premium.

Upon acceptance of the terms, closing documents are prepared and signed, the credit risk premium is paid and funds disbursed as needed. FRA then monitors implementation of the project and repayment of loans. FRA also monitors the overall financial condition of borrowers to identify any issues that could impact repayment of the loan.

Conclusion

I appreciate the opportunity to provide the Subcommittee with an update on the RRIF program. I am available to answer any questions that you might have on FRA's implementation of this program.

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