U.S. House of Representatives
Committee on Transportation and Infrastructure
Washington, DC 20515

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April 20, 2009

SUMMARY OF SUBJECT MATTER

TO: Members of the Subcommittee on Railroads, Pipelines, and Hazardous Materials

FROM: Subcommittee on Railroads, Pipelines, and Hazardous Materials Staff

SUBJECT: Hearing on the "Railroad Rehabilitation & Improvement Financing Program"

PURPOSE OF HEARING

On Wednesday, April 22, 2009, at 2:00 p.m., in room 2167 of the Rayburn House Office Building, the Subcommittee on Railroads, Pipelines, and Hazardous Materials is scheduled to meet to receive testimony on the Railroad Rehabilitation and Improvement Financing (RRIF) program. The hearing will highlight the importance of the RRIF program in helping States, railroads, and shippers finance development of railroad infrastructure; applicant experiences with the RRIF program; and ways of improving the RRIF program in the upcoming surface transportation authorization bill.

BACKGROUND

Adequate investment in passenger and freight railroad infrastructure is crucial to our nation's economic growth, our global competitiveness, and the quality of life in our communities. In 2007, the Passenger Rail Working Group for the National Surface Transportation Policy and Revenue Study Commission reported that the total capital cost estimate of re-establishing the national intercity passenger rail network between now and 2050 is approximately \$357.2 billion (or \$8.1 billion annually). Similarly, the Department of Transportation (DOT) estimates that freight rail transportation demand will increase 88 percent by 2035. Recent studies show that an investment of \$148 billion for rail infrastructure expansion over the next 28 years is required to meet the DOT's projected demand. Without this investment, 30 percent of rail miles in primary corridors will be operating above capacity by 2035, causing severe congestion that will affect every region of the country and potentially shift freight to an already heavily congested highway system.

Rail infrastructure projects are financed through a variety of means. The railroad industry typically funds projects through a combination of cash generated from operations, the sale or lease of various operating and non-operating properties, the issuance of long-term debt, and cash on hand. States finance rail infrastructure projects through Federal grants, direct tax revenues, by selling debt in the form of bonds, and, with the respect to grade crossing improvements or separations, highway user fees. However, the economic crisis has made rail infrastructure financing increasingly difficult as railroads ratchet down capital investment, states face increasing budget deficits, and banks restrict lending. For example, California faces a budget deficit of more than $41 billion. As a result, many infrastructure projects have been put on hold. In 2008, California voters approved a $9.95 billion bond measure to build a high-speed rail line running from Sacramento to San Diego. However, the California High Speed Rail Authority has halted work on the project due to the State's frozen infrastructure fund, and the bond market is so poor that the State is not selling bonds, which would generate money to build the system.

The RRIF program can help States, railroads, and shippers finance railroad infrastructure through low-interest government loans. Funding may be used to: (1) acquire, improve, or rehabilitate intermodal or rail equipment or facilities, including track, components of track, bridges, yards, buildings, and shops; (2) refinance outstanding debt incurred for acquisition, improvement, or rehabilitation of intermodal or rail equipment or facilities; and (3) develop or establish new intermodal or railroad facilities.

The Federal Railroad Administration (FRA) is required to give priority consideration to projects that: (1) enhance public safety; (2) enhance the environment; (3) promote economic development; (4) enable United States companies to be more competitive in international markets; (5) are endorsed by plans prepared under 23 U.S.C. 135 by the state or states in which they are located; (6) preserve or enhance rail or intermodal service to small communities or rural areas; (7) enhance service and capacity in the national rail system; or (8) would materially alleviate rail capacity problems which degrade the provision of service to shippers and would fulfill a need in the national transportation system.

Direct loans can fund up to 100 percent of a railroad project with repayment periods of up to 35 years and interest rates equal to the government's cost of borrowing.[1]

Since 2002, the FRA has executed 23 agreements with 19 railroads for a total of $778.62 million in loans. To date, no recipient of a RRIF loan or loan guarantee has defaulted on a loan or is delinquent in making payments. Additionally, three loans have been re-paid in full: a 2002 loan to Amtrak for $100 million, and two loans to the Dakota, Minnesota & Eastern (DM&E) Railroad worth a combined $281 million.

[1] The Rail Safety Improvement Act of 2008 (P.L. 110-432) increased the repayment period from 25 to 35 years.

LIST OF APPROVED RRIF PROJECTS

ORGANIZATION	YEAR	AMOUNT
Iowa Interstate Railroad	2008	$31.0 million
Nashville and Eastern Railroad	2008	$4.6 million
Columbia Basin Railroad	2008	$3.0 million
Great Western Railway	2007	$4.0 million
Virginia Railway Express	2007	$72.5 million
R.J. Corman Railway	2007	$59 million
DM&E *	2007	$48 million
Iowa Northern Railroad	2006	$25.5 million
Wheeling & Lake Erie Railway	2006	$14 million
Iowa Interstate Railroad	2006	$9.35 million
Great Smoky Mountains Railroad	2005	$7.5 million
Riverport Railroad	2005	$5.5 million
The Montreal, Maine, & Atlantic Railway	2005	$34 million
Tex-Mex Railroad	2005	$50 million
Iowa Interstate Railroad	2005	$32.7 million
Stillwater Central Railroad	2004	$4.6 million
Wheeling & Lake Erie Railway	2004	$25 million
Arkansas & Missouri Railroad	2003	$11 million
Nashville and Western Railroad	2003	$2.3 million
DM&E*	2003	$233 million
Amtrak *	2002	$100 million
Mount Hood Railroad	2002	$2.07 million
Georgia and Florida Railroad	2009	$8.1 million
Total		**$786.72 million**

* *Indicates loan has been repaid in full.*

Steps in the RRIF loan application process

According to the FRA, there are nine major steps in the evolution of a RRIF loan:

- **Pre-application Meetings:** Potential RRIF applicants typically meet with the FRA in advance to review the requirements for an application and the likely costs and terms of financial assistance, including compliance with the National Environmental Policy Act, Section 4(f) of the Department of Transportation Act, and Section 106 of the National Historic Preservation Act; the FRA's analysis of the business case for the proposed financial assistance; and the documentation that will be required for that analysis.

- **Applications:** Parties interested in seeking financial assistance from the FRA submit an application addressing the requirements of an application, as laid out in the regulations implementing the RRIF program (49 CFR 260) and augmented by pre-application meetings.

FRA reviews the material submitted and identifies where additional material will be required to complete the application.

- **FRA Analysis:** The FRA initiates its analysis of applications once sufficient information has been submitted. The FRA undertakes an independent detailed review of the financial aspects of the proposed project including reviewing the railroad's past financial performance and the basis for estimating costs (both project and future operating and capital needs) and future revenues. Where appropriate, FRA reviews the project designs to assure that the project as proposed can reliably accommodate the volume of traffic needed for the railroad to achieve its revenue projections. As with all other Federal agencies, FRA's analysis also includes the reviews necessary to comply with NEPA and related environmental laws, regulations, and orders, including where necessary, the preparation of an environmental impact statement.

While FRA's staff possesses broad technical expertise, conducting the level of analysis required for thorough review of multiple concurrent applications requires access to greater resources, some of which are very specialized. The FRA has used two approaches to acquire the expertise necessary to supplement existing FRA staff in reviewing applications. Until SAFETEA-LU was enacted, the FRA required applicants to fund a "third party" contractor; that is, applicants paid for financial advisors who received technical direction from the FRA to undertake independent reviews of portions of the application. More recently, the FRA has used the opportunity provided in RRIF's modified statute to assess investigation charges of up to one-half of one percent of the proposed financial assistance to fund contractors working directly for the FRA to supplement FRA staff in the review of applications.

Upon completion of the analysis of the application by FRA staff and independent contractors where needed, FRA staff develops a draft recommendation as to how to proceed with the application, i.e., whether to recommend approval, rejection, or rejection with suggestions of how a proposal might be amended and improved, so that it could move forward at a later date. FRA staff also prepares a draft calculation of the required credit risk premium using methods approved by the OMB.

- **DOT Credit Council Review:** The proposed direct loan or loan guarantee is presented to the DOT Credit Council. This Council is composed of nine members including: the Assistant Secretary for Budget and Programs who serves as the chair; the Under Secretary for Policy; the General Counsel; the Assistant Secretary for Transportation Policy; the Federal Highway Administrator; the Federal Transit Administrator; the Federal Railroad Administrator; the Maritime Administrator; and the Director of the Office of Small and Disadvantaged Business Utilization. The DOT Credit Council reviews the proposed transaction and makes a recommendation to the FRA Administrator about the project's financial viability and consistency with departmental policies, including credit policies.

- **Administrator's Decision:** The FRA staff recommendations and the Credit Council recommendations are presented to the FRA Administrator. As provided for by SAFETEA-LU, the amount of time that elapses between the completion of an application and a decision by the Administrator is 90 days or less.

- **OMB Review:** At the time the DOT Credit Council recommendations are submitted to the FRA Administrator, the FRA's estimate of the required credit risk premium is submitted to the OMB for review and concurrence, as is required under the Federal Credit Reform Act. Per its Federal Credit Reform Act responsibility for determining subsidy costs, the OMB reviews and approves subsidy cost estimates for Federal credit programs.

- **Financing Agreement:** Assuming that the Administrator decides to provide the requested financial assistance, the FRA notifies the applicant of the FRA's offer of financial assistance, and the terms under which it will be provided (the interest rate and amount of the credit risk premium). The FRA and the applicant then finalize the terms of the financing agreement and all other necessary legal documents, such as mortgages, to secure pledged collateral. Most of the terms of the agreement are standard and are available to the applicant well in advance of this point. In addition to the standard terms, there may be project specific terms, such as a commitment of improved cash flow from refinancing of an existing debt to a capital improvement program or requirements imposed on the applicant to assure the protection of environmentally sensitive sites.

- **Project Implementation:** Once the agreement is signed, funding is made available to implement the project and is provided only as needed. This helps the FRA assure that the project is undertaken in the most timely and cost effective manner possible. The FRA staff with specific expertise, such as track engineers, may monitor the progress of specific major project elements to assure they are being implemented as planned and are progressing on schedule.

- **Loan Servicing:** FRA staff monitors the repayment of the financial assistance and the continuing financial condition of applicants.

PRIOR LEGISLATIVE AND OVERSIGHT ACTIVITY

Section 7203 of the Transportation Equity Act for the 21st Century (TEA 21) (P.L. 105–178) established the RRIF program. This program revised and replaced the pre-existing railroad financing program established under Title V of the Railroad Revitalization and Regulatory Reform Act of 1976. TEA 21 limited the aggregate unpaid principal amounts of obligations under direct loans and loan guarantees to $3.5 billion at any one time. One billion dollars of this amount was reserved solely for projects primarily benefiting short-line and regional railroads. In addition, TEA 21 allowed the DOT to accept credit risk premiums from non-Federal sources to support loans and loan guarantees made under this section. In 2000, the FRA promulgated a rule implementing the RRIF program (65 FR 41838, July 6, 2000) found in 49 CFR Part 260 ("RRIF Rule").

The Administration's implementation of the RRIF program was problematic and protracted. Following enactment of TEA 21, the Administration announced in its Fiscal Year 2000 budget proposal that (1) RRIF loan applicants would be required to document two prior rejections by private sector lenders, making RRIF the "lender of last resort"; and (2) that RRIF loans would carry interest rates that were "comparable to the private sector." On April 15, 1999, Chairman Bud Shuster, Ranking Member James L. Oberstar, Subcommittee Chairman Thomas Petri, and

Subcommittee Ranking Member Nick Rahall wrote to DOT Secretary Rodney Slater and Acting Office of Management and Budget (OMB) Director Jacob J. Lew, pointing out that the proposed "lender of last resort" requirement for RRIF "has no basis in statute" and that the market interest rate proposal "is directly contrary to the language of the statute."

Further, the DOT issued proposed RRIF regulations in 1999 that included a requirement for one prior rejection by a private sector lender, but omitted the market-rate interest requirement (64 FR 27488). In 2000, the DOT and the OMB entered into a memorandum of understanding (with no public comment and no acknowledgment in the public rulemaking docket) entitled "RRIF Administrative Procedures." The memo contained these additional RRIF loan requirements: (1) no RRIF loan may be larger than 10 percent of the annual "cohort" or risk pool of loans; (2) no loan amount may exceed 6 percent of the remaining authorization limit after prior loans; and (3) the DOT would seek to obtain for all RRIF loans collateral value to cover "100 percent of the anticipated principal and accrued interest amount of the direct loan/loan guarantee."

In July 2000, the DOT issued final RRIF regulations that included the "lender of last resort" requirement (49 CFR Part 260, 65 FR 41838). The rule did not acknowledge the additional requirements contained in the DOT-OMB memorandum of understanding. However, at a July 25, 2000 House Railroad Subcommittee hearing, then-FRA Administrator Jolene Molitoris acknowledged the existence of the DOT-OMB memorandum and stated that for guaranteed (but not direct) loans, an OMB circular directed that the Federal guarantee would be limited to 80 percent of the total loan (Committee Print 106-104, "Short Line Rail Infrastructure Needs").

To correct the problems and encourage greater utilization of the RRIF program, Section 9003 of the Safe Accountable, Flexible and Efficient Transportation Equity Act: a Legacy for Users (SAFETEA-LU) further amended and expanded the RRIF program. It increased the total authorization level from $3.5 billion to $35 billion and increased the amount that is reserved for short line and regional railroad projects from $1 billion to $7 billion. The Act allowed rail shippers and commuter railroads, for the first time, to receive RRIF loans and loan guarantees, and expanded the priorities for eligible projects to include projects that would enhance service and alleviate rail capacity problems. It prohibited the Secretary from requiring an applicant for a direct loan or loan guarantee to provide collateral, and to seek financial assistance from another source before applying for a RRIF loan. SAFETEA-LU allowed the Secretary to defer payments on a loan for up to six years, and prohibited the Secretary from establishing any limit on the amount that could be used for one direct loan or loan guarantee. It also required the Secretary to publish within 30 days of enactment in the Federal Register and on the DOT website the substantive criteria and standards used by the Secretary to determine whether to approve or disapprove applications.

On September 26, 2005, following the changes made to the RRIF program under SAFETEA-LU, the DOT published a Federal Register notice providing the criteria and standards used to determine whether to approve or disapprove an application submitted under section 502 of the Railroad Revitalization and Regulatory Reform Act of 1976, as follows:

- The statutory eligibility of the applicant and the project (49 CFR 260.3, definition of applicant and 49 CFR 260.5, eligible purposes); including the present and probable demand for rail services and a reasonable likelihood that the loan will be repaid on a timely basis (49

CFR part 260, Subpart B–FRA policies and procedures for Evaluating Applications for Financial Assistance).

- The extent to which the project will enhance safety (49 CFR 260.7(a)).
- The significance of the project on a local, regional, or national level in terms of generating economic benefits and improving the railroad transportation system (49 CFR 260.7(c)).
- The improvement to the environment that is expected to result directly or indirectly by the implementation of the project (49 CFR 260.7(b)).
- The improvement in service or capacity in the railroad transportation system or the reduction in service-or capacity-related problems that is expected to result directly or indirectly from the implementation of the project (45 U.S.C. 822(c)).

Although the FRA did not remove the lender of last resort requirement (49 CFR. 260.23(o)) from its published regulations to abrogate the DOT-OMB memorandum of understanding or make other changes in regulations conforming to the 2005 amendments to the RRIF statute, at a March 15, 2006 hearing before the House Subcommittee on Railroads, Pipelines, and Hazardous Materials, Joseph Pomponio, Chief of the Freight Program Division for FRA, testified that the regulation would be removed as the "statute takes precedence over the regulations" (Committee Print 109-56, "Implementation of the Recently Expanded Railroad Infrastructure Loan Program").

On June 9, 2008, the DOT published a Notice of Proposed Rulemaking (NPRM) on the RRIF program (73 FR 32515) that would have required applicants to meet new, additional criteria that were not authorized by law, including (1) requiring an equity contribution of between 20 and 30 percent depending on the amount of the direct loan or loan guarantee; (2) capping the cumulative outstanding balance of loans and loan guarantees to a single borrower at $500 million; and (3) requiring applicants to obtain a credit rating or assessment if the application for financial assistance is in excess of $250 million. In October 2008, Chairman Oberstar and Subcommittee Chairwoman Brown wrote to then-DOT Secretary Mary Peters urging her to suspend the rulemaking due to concerns that it would seriously undercut the RRIF program and further weaken the construction sector of the U.S. economy. According to the DOT, the purpose of the NPRM was to ensure the long-term sustainability of the program and reduce the risk of default for applicants and the Federal Government. However, no recipients of RRIF loans or loan guarantees that have been issued to date have defaulted on any loans or are delinquent in making payments. In addition, under current regulations, the government requires the payment of a credit risk premium, which is held by the government for the life of the loan and is designed to equal the government's risk of default. Various factors are taken into consideration when determining the amount of the credit risk premium, including the applicant's credit rating, if available; business risk; industry outlook; market position; management and financial policies; capital expenditures; operating efficiency; financial risk; profitability; liquidity; financial strength; size; level of capital expenditures; project risk; potential for improving revenues; profitability and cash flow; reliance on third parties; potential recovery in the event of default; the nature of the applicant's assets; and liquidation value of the collateral offered.

Further, the RRIF application process requires a thorough examination of the applicant's business and financial performance – past, present, and future. In fact, the statute prohibits the

Secretary from making a direct loan or loan guarantee unless the Secretary has made a finding in writing that, among other things, ensures that the obligation can reasonably be repaid, using an appropriate combination of credit risk premiums and collateral offered by the applicant to protect the Federal Government. In the decision not to approve the DM&E application for a $2.33 billion RRIF loan, then-FRA Administrator Joseph Boardman stated that the loan to DM&E would pose "too high a risk concerning whether the obligation can reasonably be repaid, using an appropriate combination of credit risk premiums and collateral offered by the applicant to protect the Federal Government."

In the letter, Chairman Oberstar and Chairwoman Brown stated: "Denial of the DM&E's application shows that the administration currently has the ability to protect the Federal Government from risky loans. There is no need to institute the new requirements of the NPRM, which could prevent loans which meet the statutory standard that 'the obligation can reasonably be repaid.'"

The proposed rule was not implemented prior to the end of the Bush administration.

WITNESSES

Mr. Ken Pippin
President
Carolina Southern Railroad

Mr. Patrick Simmons
Rail Director
North Carolina Department of Transportation

Gen. Richard F. Timmons
President and Treasurer
American Short Line and Regional Railroad Association

Mr. Mark Yachmetz
Associate Administrator for Railroad Development
Federal Railroad Administration
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Mr. Dale Zehner
Chief Executive Officer
Virginia Railway Express