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

John L. Mica
Chairman

James W. Coon II, Chief of Staff

Nick J. Rahall, II
Ranking Member

James H. Zoia, Democrat Chief of Staff

February 14, 2011

SUMMARY OF SUBJECT MATTER

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

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

SUBJECT: **Sitting on our Assets: Rehabilitating and Improving our Nation's Rail Infrastructure**

PURPOSE OF HEARING

The Subcommittee on Railroads, Pipelines, and Hazardous Materials is scheduled to meet on Thursday, February 17, 2011, at 10:00 a.m. in 2167 Rayburn House Office Building to receive testimony on the Railroad Rehabilitation & Improvement Financing ("RRIF") program. The hearing will highlight the importance of the RRIF program in helping railroads, States and authorities, and shippers finance the development of railroad infrastructure, which creates new jobs and economic benefits; applicant experiences with the RRIF program; and ways to improve the existing RRIF program and the Department of Transportation's management of the program in the upcoming surface transportation reauthorization bill.

BACKGROUND

Effective and well-maintained passenger and freight railroad infrastructure is crucial to our nation's economic growth and global competitiveness. The U.S. 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 properties, the issuance of long-term debt, and cash on hand. Over the past 20 years, America's freight railroads have invested more than $460 billion of their own financial resources to maintain and improve rail infrastructure and equipment, an average of $23 billion a year, representing more than 40 cents out of every rail revenue dollar. States and public entities typically finance rail infrastructure projects through federal grants, direct tax revenues, selling debt in the form of bonds, and, with respect to grade crossing improvements or separations, gasoline tax-funded federal highway funds.

Description of the RRIF Program

The RRIF program provides direct, low-interest federal loans and loan guarantees to finance the development of railroad infrastructure. The RRIF program allows up to a total of $35 billion in loan authority, with $7 billion set aside for projects benefiting Class II and III freight railroads, commonly referred to as regional and short line railroads. These are small or mid-sized railroad companies that operate within a region or over a relatively short distance, with an annual operating revenue of less than $401.4 million.

Railroads, rail freight shippers, and state and local governments and government-sponsored authorities are eligible to apply for RRIF loans. The program is authorized under section 502 of the Railroad Revitalization and Regulatory Reform Act of 1976. The current RRIF program was authorized by the Transportation Equity Act for the 21st Century (TEA-21) in 1998, and has been subsequently amended under the 2005 Safe, Accountable, Flexible and Efficient Transportation Equity Act: a Legacy for Users (SAFETEA-LU) and the Rail Safety Improvement Act of 2008 (RSIA).

Loans provided under the RRIF program 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 the purposes listed above; and (3) develop or establish new intermodal or railroad facilities. 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 cost of borrowing to the government.

RRIF loans have been used to repair and upgrade rail track and equipment, build new spur lines and add rail capacity, buy locomotives and rail cars (including passenger rail cars for Amtrak and commuter railroads), and other purposes. The Federal Railroad Administration (FRA) states they have had inquiries regarding using RRIF loans to help finance the installation of positive train control systems and high-speed rail projects. FRA conducts an average of three or four serious pre-application discussions each month with potential RRIF applicants, or 29 a year. The agency currently has 10 active loan applications under consideration. However, only an average of 3 loans are approved and executed by FRA each year.

RRIF Loan History

Since 2002, FRA has executed 28 agreements with 22 railroads and public entities for a total of $1.02 billion in loans. Three loans have been repaid in full: a 2002 loan to Amtrak for $100 million, and two loans to the Dakota, Minnesota & Eastern Railroad worth a combined $281 million. Current outstanding loans total only $430 million, although the authorized credit ceiling for the RRIF program is $35 billion. To date, no recipient of a RRIF loan or loan guarantee has defaulted on a loan or is delinquent in making payments.

The following railroads and public entities have received RRIF loans since the program was established in 1998. (Note: DOT did not finalize regulations for the RRIF program until four years after the program was created, so the first loans were not made until 2002.)

ORGANIZATION	YEAR	AMOUNT
Denver Union Station Project Authority	2010	$155.0 million
Great Lakes Central Railroad	2010	$17.0 million
Georgia & Florida Railways	2009	$8.1 million
Permian Basin Railways, Inc	2009	$64.4 million
Iowa Interstate Railroad	2008	$31.0 million
Nashville and Eastern Railroad	2007	$4.0 million
Nashville and Eastern Railroad	2007	$0.6 million
Columbia Basin Railroad	2007	$3.0 million
Great Western Railway	2007	$4.0 million
Virginia Railway Express	2007	$72.5 million
R.J. Corman Railway	2007	$11.77 million
R.J. Corman Railway	2007	$47.13 million
Dakota, Minnesota & Eastern Railroad*	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
Dakota, Minnesota & Eastern Railroad*	2003	$233 million
Amtrak*	2002	$100 million
Mount Hood Railroad	2002	$2.07 million
Total Amount of Credit Approved		**$1.024 billion**
Total Disbursed		**$844 million**
Total Principal Outstanding as of 2/1/11		**$430 million**

** Indicates loan has been repaid in full.*

RRIF Loan Structure

The DOT has three major credit programs: the FRA's RRIF loans and loan guarantees; the Federal Highway Administration's Transportation Infrastructure Finance and Innovation Act (TIFIA) loans, loan guarantees and lines of credit; and the Maritime Administration's Title XI Loan Guarantee Program. Of these three programs, only RRIF does not require appropriations of a federal subsidy amount to cover potential credit losses. (For example, the TIFIA program receives $122 million a year to cover its credit subsidy. This amount can subsidize approximately $2 billion a year in credit assistance.)

The reason that RRIF does not require federal funds to cover the loan subsidy is that applicants must pay a credit risk premium that is held by the government for the life of the loan and is designed to equate to the government's risk of default. Additionally, applicants must secure their loans with collateral whose net liquidation value is at least 100 percent of the loan amount. The statute explicitly prohibits FRA from requiring applicants to provide collateral, but if an applicant does not provide collateral, the risk of default is assumed to be much greater, and the credit risk premium is significantly increased.

The credit risk premium is expressed as a percentage of the total loan amount. If the applicant can produce collateral equal to 120 percent of the loan amount and the independent financial analyst reviewing the loan for FRA returns a positive finding on ability to repay, the credit risk premium is usually one to two percent of the total loan amount. With collateral at 80 percent of the loan value, the credit risk premium rises as high as 15 to 20 percent of the loan amount, which can discourage a potential applicant from pursuing the loan.

Loan applicants are also responsible for paying the fee for independent financial analysts retained by FRA to review the applicant's past financial performance and revenue projections for loan repayment. This fee cannot exceed one-half of one percent of the total loan amount ($250,000 for a $50 million loan).

The interest rate for RRIF loans is set at the rate of Treasury bond interest for the equivalent term as the loan repayment period. For example, a loan approved on February 10, 2011 to be repaid over five years would require a 2.4 percent interest rate; a 30-year loan approved on the same day would require 4.75 percent. These are much more favorable interest rates than most small railroads would have access to in the private sector financial market (if they could get credit at all). Borrowers can structure repayment periods for as long as 35 years, which is the same loan period limit as under the TIFIA program. Additionally, repayment of the loan may be deferred as long as five full years after the loan has been disbursed. However, no RRIF loan recipient has been granted this deferred payment option.

The RRIF Application and Review Process

According to the FRA, it takes an average of 13 and a half months to process a RRIF loan application, from the time the application is submitted to the closing date of the loan. There is a statutory deadline for considering and approving or disapproving a RRIF loan of 90 days after a complete application has been submitted. The FRA has stated that they believe the most common factors in slowing down loan evaluations and decision-making are: (1) the National

Environmental Protection Act (NEPA) process; (2) changes in project scope requested by the loan applicant; (3) limited personnel and technical sophistication on the part of short line railroads, which leads to delays in returning requested information to the RRIF program office; and (4) complexity of some of the proposed loans.

There are three entities who participate in reviewing and ultimately approving or disapproving a RRIF loan application:

1. Federal Railroad Administration (usually working with a contracted independent financial advisor)

2. The DOT Credit Council. This Council is composed of 13 members including: **the Deputy Secretary who serves as the chair**; the Assistant Secretary for Budget and Programs and Chief Financial Officer; 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; the Director of the Office of Small and Disadvantaged Business Utilization; **the Chief of Staff, Deputy Chief of Staff, and Counselor to the Secretary** (these last three are at-large members appointed by the Secretary). Credit Council members that are listed in **bold** were added in December 2009 under a secretarial order expanding the Credit Council from 9 to 13 members and naming the Deputy Secretary as chair.

3. Office of Management and Budget (OMB)

These are the major steps in the evolution of a RRIF loan:

- **Preapplication Meetings:** Potential RRIF applicants meet with FRA in advance to review the requirements for an application and the likely costs and terms of financial assistance, including compliance with NEPA, Section 4(f) of the Department of Transportation Act, and Section 106 of the National Historic Preservation Act, 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 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 preapplication meetings. FRA reviews the material submitted and identifies where additional material will be required to complete the application. When FRA deems a loan application complete, the statutory 90-day period for approval or disapproval of the RRIF loan is begun.

- **FRA's Analysis:** FRA initiates its analysis of applications once sufficient information has been submitted, and, after an initial review by the DOT Credit Council, recommends the hiring of an independent financial advisor (IFA) and identifies any issues that need to be addressed in the review of an application. FRA works with the IFA to undertake a detailed review of the financial aspects of the proposed project including reviewing the applicant'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. 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. At some point during FRA's analysis process, the agency briefs the DOT Credit Council a second time, to update the Council on the ongoing review and analysis of the application.

Upon completion of the analysis of the application by FRA staff and the IFA, 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.

- **Final DOT Credit Council Review**: The proposed loan is presented for a third time to the DOT Credit Council. 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.

- **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, 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, OMB reviews and approves subsidy cost estimates for Federal credit programs.

- **Financing Agreement:** Assuming that the Administrator decides to provide the requested financial assistance, FRA notifies the applicant of 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). FRA and the applicant then finalize the terms of the financing agreement and all other necessary legal documents.

- **Project Implementation:** Once the agreement is signed, funding is made available to implement the project and is provided only as needed. This helps FRA assure that the project is undertaken in the most timely and cost effective manner possible. 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.

Recent Changes to RRIF Policy at DOT

On September 29, 2010, the FRA published a notice in the Federal Register regarding the consideration and processing of applications for RRIF loans. This notice was published not to reflect recent changes in law (the only amendment to the RRIF program in the 2008 Rail Safety Improvement Act was to change the maximum loan repayment term from 25 years to 35 years), but to "clarify" DOT's management of the program.

Two important changes were set out in the Federal Register notice regarding FRA's priorities in considering RRIF loan applications. First, FRA stated that, in addition to determining the financial soundness of a loan application, the agency will also perform a cost-benefit analysis to examine the public benefits derived from the loan relative to the amount of financial assistance requested. Layering on an additional analysis of the costs and benefits of a proposed RRIF loan is superfluous, given that the underlying law specifically lays out loan eligibilities and priorities, and that the financial risk to the government is so thoroughly mitigated by the credit risk premium, collateral requirement, and close scrutiny and analysis of the financial viability of the loan by FRA, the IFA, DOT Credit Council, and OMB.

Second, the notice made it clear that loans requested for the purpose of refinancing debt will not be looked upon as favorably as loans requested for direct capital improvements, and that loans requested for refinancing will be required to "demonstrate significantly more than minimal public benefit from the transaction. Circumstances .... where a public agency is acquiring a rail property for direct public benefit (e.g. use for public transportation) are more favorably considered."

These changes, as well as other priorities set forth in the guidance, go beyond the letter of the law and, in some cases, are contrary to Congressional intent. The RRIF statute is specific. "The Secretary ***shall*** provide direct loans and loan guarantees" (45 USC 822(a), emphasis added) and loans "shall be used to (A) acquire, improve, or rehabilitate intermodal or rail equipment or facilities, including track, components of track, bridges, yards, buildings, and shops; (B) refinance outstanding debt incurred for the purposes described in subparagraph (A); or (C) develop or establish new intermodal or railroad facilities." (45 USC 822(b))

Section 822(c) of title 45, United States Code lays out the priorities that FRA must consider when evaluating RRIF loan applications. Priority is to be given 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) materially alleviate rail capacity problems which degrade the provision of service to shippers and would fulfill a need in the national transportation system. These priorities in the law are not ranked from highest to lowest, nor do they replace the statutory eligibilities in section 822(b). However, the September 29th guidance ranks some priorities more highly than others, reorganizes, and clarifies these priorities. Some of the clarifications in the FRA guidance actually replace clear Congressional intent with Administrative policy direction that can have the overall impact of decreasing participation in the RRIF loan program.

On October 15, 2010, Representatives Mica and Shuster wrote to DOT Secretary LaHood objecting to the RRIF policy notice. The letter notes the slow and cumbersome RRIF loan consideration and approval process, and questions why the DOT Credit Council has to review loans at three separate points during consideration of the loan application. The letter describes the RRIF program as "woefully undersubscribed" and advises FRA to "focus on making loans for any eligible purpose when the borrower is able to provide appropriate financial documentation."

INVITED WITNESSES

The Honorable John D. Porcari
Deputy Secretary
U.S. Department of Transportation

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

William A. Callison
President
Wheeling & Lake Erie Railway

John Fenton
Chief Executive Officer
Metrolink

Michael Sussman
President
Strategic Rail Finance

Thomas P. Loftus, Jr.
Chairman, Public Private Investment & Project Financing Council
American High Speed Rail Alliance
Principal, The Seneca Group LLC