
Office of Inspector General

Audit Report

PROCESS INEFFICIENCIES AND COSTS DISCOURAGE PARTICIPATION IN FRA'S RRIF PROGRAM

Federal Railroad Administration

Report Number: CR-2014-054

Date Issued: June 10, 2014





Memorandum

U.S. Department of
Transportation

Office of the Secretary
of Transportation
Office of Inspector General

Subject: **ACTION:** Process Inefficiencies and Costs
Discourage Participation in FRA's RRIF Program
Federal Railroad Administration
Report No. CR-2014-054

Date: June 10, 2014

From: Mitchell Behm 
Assistant Inspector General for
Surface Transportation Audits

Reply to
Attn. of: JA-30

To: Federal Railroad Administrator

The Railroad Rehabilitation and Improvement Financing (RRIF) program, established in 1998 and administered by the Federal Railroad Administration (FRA), provides loans and loan guarantees to railroads and other entities to finance rail infrastructure projects. To date, FRA has issued 33 RRIF loans totaling roughly \$1.7 billion—less than 5 percent of the program's authorized \$35 billion spending limit. Members of Congress have expressed concerns that the program's lengthy application process and the associated costs may be contributing to this low participation rate.

As a result of these concerns, we conducted this audit to (1) assess FRA's policies and procedures for evaluating and selecting RRIF applications; and (2) identify factors that affect applicants' decisions to apply for RRIF financing.

We conducted our audit between March 2013 and April 2014 in accordance with generally accepted Government auditing standards. In our work, we reviewed RRIF's authorizing statute,¹ associated regulations, and program guidance. We also met with FRA officials, and reviewed processing data for the 29 applications that the program received between January 1, 2010, and April 30, 2013. To identify factors that influenced applicants' decisions on whether to apply to RRIF, we randomly selected and interviewed 15 applicants and 7 prospective applicants. See Exhibits A, B, and C for additional information on our scope and methodology and a list of past, present, and prospective applicants.

¹ 45 USC §§ 822 *et seq*

RESULTS IN BRIEF

FRA's policies and procedures for evaluating RRIF applications and selecting RRIF loan recipients are not effective. Insufficient guidance on the program's eligibility criteria, application procedures and requirements has frequently led to incomplete applications, causing substantial delays. Of the 29 applications we reviewed, 9 are still pending. For the remaining 20, FRA took an average of 278 days working with applicants to complete their applications.² Ultimately, however, the Agency determined that only 6 of these applications were complete. Under RRIF's authorizing statute,³ FRA has 90 days to review and render decisions on completed applications. However, the Department of Transportation's (DOT) Credit Council⁴ and the Office of Management and Budget (OMB) must also review complete applications before the Administrator approves the loan and the loan terms are finalized. Because of these sequential reviews, FRA rendered decisions for only 2 of the 6 complete applications within the statutory 90 days. Furthermore, because the program does not use a risk based approach to review applications for loans under \$1 billion, processing times for low risk applications can be lengthy.

Insufficient guidance has discouraged some applicants and program costs have deterred others from applying for RRIF loans. Of the 15 applicants we spoke with, 3 stated that FRA took months to inform them that their applications were incomplete. Ultimately, one of these applicants withdrew their applications. Applicants also reported that FRA did not provide requested information about their applications' status, or explain the reasons for denials. Officials from passenger⁵ and Class I freight railroads informed us that they generally would not consider applying to the program because RRIF's unclear process and uncertain timeline outweighed the financial benefits of RRIF loans. Most of these officials noted that private financial markets gave them better control than the RRIF program over the planning, timing, and execution of their capital projects. Officials from some short-line railroad noted that payment of the required credit risk premium⁶ (CRP) prior to loan disbursement and the potential costs of hiring financial and legal consultants to assist with the application process deterred them from applying.

² Of the 20 applications, 4 applicants were ineligible and 12 withdrew.

³ The Transportation Equity Act for the 21st Century, P.L. No. 105-178.

⁴ The Council was established in 2004 to ensure the application of consistent credit policies and management practices across all DOT credit programs.

⁵ Includes the National Railroad Passenger Corporation (Amtrak), and other passenger railroads such as commuter and privately owned intercity rail lines.

⁶ A reimbursable cost required by the Credit Reform Act of 1990 that equals the net present value of expected losses due to default, delinquency, or prepayment—generally up to 5 percent of a loan amount.

We are making recommendations to FRA to improve the RRIF loan application process.

BACKGROUND

RRIF was established by the 1998 Transportation Equity Act for the 21st Century⁷ to promote the development of railroad infrastructure. The program targets freight and intercity passenger and commuter railroads, but State Governments, local Governments, and joint ventures that include at least one railroad may also be eligible. The program may finance up to 100 percent of a project for as long as 35 years at interest rates equal to the Federal Government's cost of borrowing. It allows borrowers to defer loan repayments for 6 years. Seven billion of RRIF's \$35 billion authorized spending limit is reserved for Class II and Class III freight railroads.⁸ Class I railroads are railroads with annual revenues over \$433.2 million. Class II railroads are regional short-line railroads with annual revenues between \$40 million and \$433.2 million. Class IIIs are local short-line railroads with annual revenues of less than \$40 million.

RRIF is one of four credit programs⁹ that DOT administers. All applications for loans, loan guarantees, and other financial assistance from these programs must be reviewed by the Department's Credit Council. The Council, chaired by the Deputy Secretary of Transportation, makes recommendations to loan programs' deciding officials on whether or not to finance applicants.

RRIF's authorizing statute requires FRA's Administrator¹⁰ to render a decision on each complete application within 90 days of receipt. As illustrated in figure 1, FRA has a two-phase process for RRIF applications. In the first phase, program staff work with applicants to determine their eligibility and complete their applications. The second phase—the application review phase—begins with FRA's acknowledgement that an application is complete and starts the 90-day statutory clock. It concludes with the FRA Administrator's decision on whether or not to issue a loan.

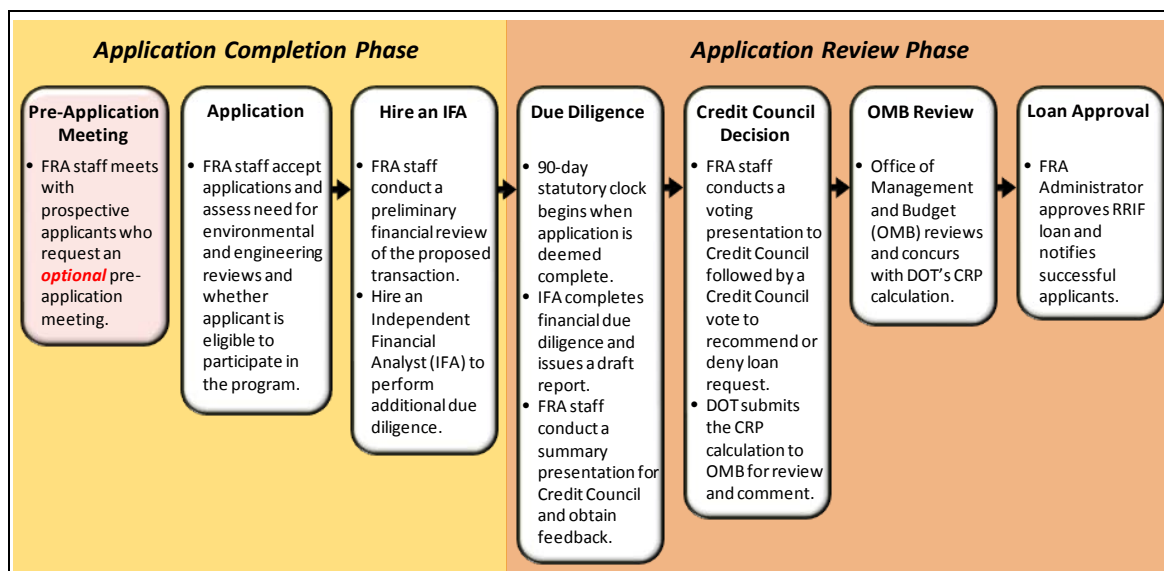
⁷ The program was amended in 2005 by the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (P.L. No. 109-59, known as SAFETEA-LU).

⁸ In 2011, DOT classified railroads based on their annual revenues.

⁹ The other three are the Transportation Infrastructure Finance and Innovation Act program; the Minority Business Resource Center Short-Term Lending program; and the Title XI Federal Ship Financing program.

¹⁰ The statute required the Secretary of Transportation to approve all RRIF loans, but authority was subsequently delegated to the FRA Administrator.

Figure 1. Overview of the RRIF Application Process



Source: OIG analysis

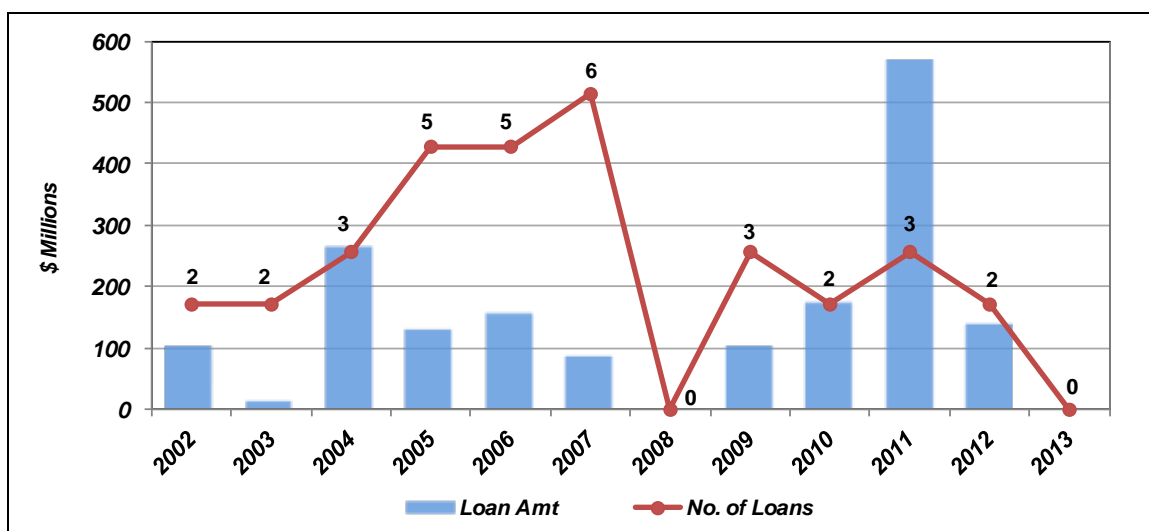
Applicants are responsible for a number of costs associated with the RRIF application process. There is a non-refundable application fee of up to one-half of 1 percent of the loan amount. This fee covers the expenses FRA incurs to retain independent financial analysts (IFA) and legal consultants to help it process applications. Applicants also incur costs for legal and financial consultants they may hire to help navigate the application, environmental¹¹ and engineering review processes. Furthermore, successful applicants must pay CRPs based on their financial viability and the value of their loan collateral. A CRP equals the net present value of expected losses due to default, delinquency, or prepayment, and generally ranges between 0 and 5 percent of the loan amount. Loan recipients must pay CRPs in advance of receiving loan proceeds and cannot finance them with loan proceeds. CRPs from applicants approved over a defined period—typically 1 year—are pooled together and returned to the borrowers after all associated loans are repaid minus any loan losses.

The loans that RRIF has issued to date range in size from \$53,000 to a privately owned local railroad to \$563 million to Amtrak. Nine of RRIF's 33 loans have been repaid in full and one borrower has defaulted.¹² As seen in figure 2, the number of issued loans has declined since 2007. Exhibit D provides further analysis of the 29 RRIF applications received between January 1, 2010 and April 30, 2013.

¹¹ All Federal transportation-related capital assistance requires environmental reviews in compliance with the National Environmental Policy Act (NEPA) of 1969 (42 USC § 4321 *et seq.*).

¹² As of April 30, 2014, Montreal Maine and Atlantic Railroad was in payment default and bankruptcy.

Figure 2. RRIF Loans Issued to Date



Source: OIG analysis of FRA data

FRA'S RRIF APPLICATION PROCESS LACKS SUFFICIENT GUIDANCE AND IS NOT TIMELY

FRA does not have an effective process for evaluating and selecting RRIF applications. The Agency's guidance is not comprehensive, and as a result, applicants frequently submit incomplete applications. Consequently, FRA spends significant time obtaining information needed to complete applications. The Credit Council and OMB must also review complete applications, making it difficult for FRA to make a decision and finalize loan terms within the mandated 90 days. Furthermore, because FRA uses the same procedures to review applications for loans under a billion dollars, those for low risk loans may take longer to process than necessary.

FRA's Guidance Does Not Provide Sufficient Detail on Application Requirements

Because FRA's RRIF program guidance does not provide sufficient information on eligibility criteria, application requirements, and the application process, applicants have difficulties completing their applications. The guidance—available on the program's Web site—consists primarily of a reiteration of requirements from the program's authorizing statute and the application form, and is missing important information. For example, the guidance does not explain the level of financial detail that applicants must submit or fully describe the application evaluation process. It also does not include information on the requirement that all applicants for Federal loans comply with NEPA and the FRA's Buy America

policy (Buy America).¹³ Of the 29 applications we reviewed, 9 are still pending. FRA worked with the remaining 20 applicants for an average of 278 days helping them complete their applications.

Furthermore, FRA does not ensure that all aspects of the process are discussed at pre-application meetings. A pre-application meeting provides an opportunity for FRA to clarify program requirements for an applicant. However, the Agency has not made the meeting a required part of the application process and not all applicants have chosen to attend one. Furthermore, FRA has not developed guidance for applicants that attend these meetings, and RRIF program managers told us they did not have detailed materials to give attendees. As a result, the meetings do not seem to reduce the time that FRA takes to process applications. Of the 29 applications we reviewed, 15 applicants¹⁴ attended pre-application meetings, and FRA took an average of 384 days to process their applications.

FRA officials told us that they consider an application complete when its IFA confirms receipt of all information needed to determine the applicant's credit worthiness, and the required environmental and engineering reviews are near completion. However, as of December 31, 2013, FRA had determined that only 6 of the 29 applications received during our review period were complete and moved to the review phase. The Agency took an average of 219 days, and as many as 517, to obtain missing information and determine applications' completeness. FRA management stated that the program accepts all applications and often acts as a "sympathetic lender." For example, one applicant was found to be un-creditworthy and financially ineligible. Rather than deny the applicant at that point, however, FRA management took the time to reexamine the applicant, and took 183 days to reaffirm its original decision that the applicant was ineligible. In another instance, FRA allowed an applicant to make significant modifications to its application on three occasions and restarted the evaluation process each time. The Agency took 28 months to process the application and determine that it was eligible. Twelve of the 29 applicants withdrew their applications for a variety of reasons, including general discouragement with the process.

Inadequate guidance and ineffective pre-application meetings result in incomplete applications that require RRIF program staff to spend significant time dealing with ineligible applicants and obtaining missing information. During the course of the audit, FRA acknowledged that the application process is not streamlined and is taking steps to improve it. One initiative involves developing a checklist of program requirements to guide discussions with potential applicants.

¹³ FRA is not subject to the Buy America requirements in 49 USC § 5323, but applies them as a matter of policy.

¹⁴ Nine additional applicants attended pre-application meetings. However, this analysis does not include them because, as of December 31, 2013, their applications were still undergoing review.

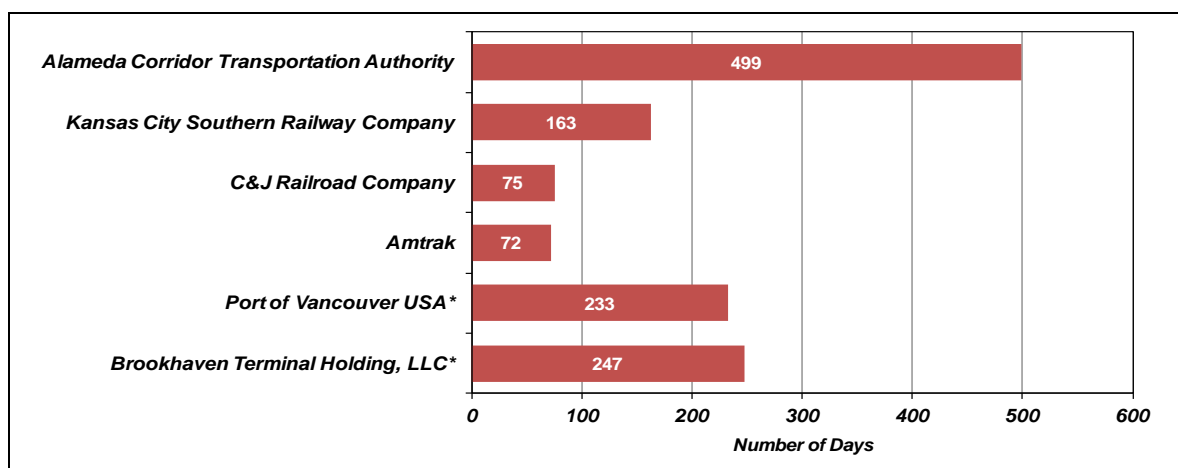
FRA Did Not Always Comply with RRIF's 90 Day Statutory Requirement

RRIF's authorizing statute requires FRA's Administrator to render a decision on a complete application within 90 days of receipt. However, before the Administrator can make a decision and the terms of the loan can be finalized, DOT requires that the application be reviewed by FRA and its IFA, the Credit Council, and OMB must review and concur with the CRP calculation. For the 6 applications that were submitted to the review phase, FRA's IFAs alone took an average of 57 days and as many as 105 to complete their reviews and issue their reports.

After an IFA's review, an application is usually presented to the Credit Council on at least two occasions—first for an informational presentation, and then for a Council vote on a recommendation to the Administrator. Because it typically meets monthly, the Council takes at least 30 days between the 2 presentations. The Council may also reschedule presentations because of members' schedule constraints or need more meetings to obtain additional information. Furthermore, OMB must concur with FRA's calculations of an applicant's CRP before the Administrator's final decision.

As a result of these sequential review steps, FRA made final decisions within the statutory 90 days for only 2 of the 6 applications we reviewed that progressed to the review phase. As seen in figure 3, FRA took as long as 499 days to process applications in the application approval phase. Two applicants withdrew before decisions were made on their applications; one spent 233 in the review phase before withdrawing and the other 247 days.

Figure 3: Total Time in the Application Review Phase for the Six Completed Applications



Source: OIG analysis of FRA data

* Applications were withdrawn prior to a final decision.

Furthermore, FRA has not established criteria for assessing the risk associated with applications for loans under \$1 billion, and uses the same review process for all applications—regardless of loan size, applicant creditworthiness, or project complexity. Loans applied for have ranged in size from \$56,000 to \$6.5 billion, and applicants have had varying degrees of creditworthiness. Furthermore, projects seeking RRIF funding range in complexity from straight forward locomotive purchases to railroad reconstruction and land development. However, because the program does not use a risk based approach to review applications, processing times for low risk applications can be lengthy.

PROCESS UNCERTAINTIES AND COSTS DETER APPLICANTS FROM USING THE RRIF PROGRAM

The lack of clear information on RRIF's process has frustrated some applicants while costs associated with the program have deterred others from applying. In many cases, FRA did not provide applicants with requested information about applications' status or the reasons for loan denials. Lastly, costs, including the CRP and those incurred to hire consultants, were burdensome for small railroads, and the program's unclear process and uncertain timing outweighed program benefits for large ones.

FRA Did Not Provide Sufficient Information on the RRIF Application Process

Applicants were unsure how the application process worked, and FRA did not provide the information they needed. For example, one applicant told us that FRA did not inform it that it had to comply with Buy America until late in the application process, and the engineering review required to ensure compliance with Buy America extended the process. Other applicants stated that they were not informed that their applications were incomplete when they first submitted them. For example, three applicants told us that they submitted what they thought were complete applications. However, one applicant noted that it did not hear from FRA for months regarding its application. When the applicant contacted the Agency, FRA stated that the application was not complete and the applicant needed to provide additional information. FRA asked the other two for additional information to complete their applications, but only after several months had elapsed. One of these two withdrew its application out of frustration. Two others we spoke to also withdrew their applications out of frustration with the application process.

Furthermore, FRA does not track applications and has not developed a process for maintaining regular communications with applicants. As a result, FRA could not

respond to applicants' inquiries about the status of their applications. For example, 9 of the 15 applicants we spoke with told us that RRIF program staff did not provide information on the status of their applications when they requested it. Two of these applicants stated that they withdrew their applications because of their general frustration with the process, and would not recommend the program to others unless FRA streamlines the application process.

FRA also did not always inform denied applicants of the reasons for the denials. Two of three Class III short-line applicants that were denied stated that FRA did not inform them of the reasons for the denials, and that they would not reapply to the program.

FRA also did not inform applicants about the role of DOT's Credit Council in the review and decision making processes. For example, 12 of the 15 applicants we spoke with informed us that throughout the application process, they were unaware of the Credit Council's role, the time the Council requires for review, and its review criteria.

Furthermore, 10 of the 15 applicants we spoke with informed us that planning their projects was difficult because of a lack of information on the process' timeline. Officials from all four Class I railroads stated that they understood the process and the time required to secure a loan in the private market. However, it was not clear to them how long RRIF approvals take. These railroads noted that this lack of information made it difficult to plan project financing because of the uncertainty about the availability of loan funds. Officials from one passenger railroad told us that they had to secure alternative financing—a bridge loan—because unexpected delays during its RRIF application created funding gaps.

The American Short Line Regional Railroad Association (ASLRRA) has advised its members not to apply to RRIF because of the program's difficult application process and uncertain timeframes. ASLRRA officials stated that before the association will recommend RRIF to its members, the program needs a streamlined application process and more complete program guidance.

RRIF's Program Costs Were Burdensome for Small Railroads, and Uncertain and Untimely Processes Outweighed Benefits for Large Ones

Short-line railroads found the CRPs as well as the costs they may have to incur to hire consultants for assistance with applications to be burdensome. For passenger and Class I freight railroads, the program's unclear process often outweighed the benefits.

Officials at two short-line railroads that were denied loans informed us that the requirements regarding the CRP—having to pay the entire cost upfront and not being able to finance it through loan proceeds—concerned them when they decided to apply. Officials at another railroad stated that the CRP requirements contributed to its decision to not apply. Furthermore, ASLRRRA officials informed us that the requirement to pay the CRP prior to loan disbursement deters Association members from applying. The CRP is similar to costs that railroads face in private market financing. However, private markets allow borrowers to finance these costs as parts of their loans.

Officials from short-line railroads also expressed concerns over the costs they may incur to hire financial and legal consultants to assist with the application process. According to officials at three of these railroads, the uncertain timeframes involved in completing applications made estimating these costs difficult. Officials at two other railroads informed us that they would not recommend RRIF to others because of these costs. Officials at another railroad stated that they withdrew their application because of these costs.

For passenger and Class 1 freight railroads, RRIF's uncertain timeframes offset the program's benefits, including competitive interest rates and access to long-term maturities. In a hypothetical comparison of the cost of borrowing \$100 million for a Class I freight railroad, we found that a RRIF loan could save more than \$23 million compared to a private market loan. See Exhibit E for our comparison of RRIF loans to private market loans. According to officials at three of four Class I freight carriers and two of seven passenger railroads, RRIF's uncertain timeframe would expose them to additional costs. For example, officials of one freight carrier informed us that RRIF's benefits were offset by the lack of certainty about the timing of loan fund disbursement. These officials noted that they would not consider applying for RRIF loans until changes were made to the program. Officials of another Class I freight railroad informed us that private markets offered certainty about loan proceed availability and that this certainty outweighed RRIF's benefits because of its importance for project planning.

CONCLUSION

Congress established RRIF to promote the availability of low cost funds for rail infrastructure development. However, FRA's administration of the program has limited participation in the program. Only a small part of the \$35 billion that the Congress authorized is being used to develop improved rail infrastructure. As a result, despite the overall favorable interest rate terms that the program provides, the improvements to the Nation's rail infrastructure that Congress envisioned in establishing this program are not occurring.

RECOMMENDATIONS

To shorten the review process and increase responsiveness to applicant concerns, we recommend that FRA:

1. Develop comprehensive guidance for applicants that details the information needed to submit complete applications.
2. Make pre-application meetings mandatory and provide clear program guidance and related materials to applicants in advance of the meetings.
3. Develop a tool to track the progress of applications and establish a process for timely communication with applicants about the status of their applications.
4. Provide timely information to applicants on the reasons for denials
5. Work with the Credit Council to streamline the application review process and develop a risk based approach for reviewing applications.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

We provided FRA a copy of our report on April 17, 2014, and received its response—including in full in the appendix—on May 28, 2014. In its response, FRA fully concurred with all five recommendations and provided acceptable planned actions and target dates for completion. We consider these recommendations resolved but open pending completion of the planned actions.

We appreciate the courtesies and cooperation of the Federal Railroad Administration representatives during this audit. If you have any questions concerning this report, please call me at (202) 366-5630, or Jay Borwankar, Project Manager, at (202) 493-0970.

#

cc: FRA Audit Liaison, ROA-3
DOT Audit Liaison, M-1

EXHIBIT A. SCOPE AND METHODOLOGY

We conducted our work from March 2013 through April 2014, in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To assess whether FRA has an effective process for evaluating and selecting RRIF applications, we identified the program's evaluation criteria by reviewing RRIF's authorizing legislation, associated regulations and program guidance documents. Additionally, we interviewed RRIF and FRA officials and reviewed documents to identify—(a) the process used to accept and review RRIF applications; (b) the critical activities ingrained in the application process; and, c) the impact of parties external to FRA on the application process. We also obtained application processing data for each of the 29 applications received between January 1, 2010 and April 30, 2013 to identify the time taken to review those applications and assess the impact of various internal and external entities RRIF's application processing time. We selected 5 of the 29 applications based on their unusual circumstances or lengthy processing times, and reviewed FRA's use of its application process and documentation protocols. Finally, we interviewed a representative of Credit Council to obtain the Council's perspectives on the RRIF application process and the Council's impact on the processing of RRIF applications.

To identify factors that influenced applicants' decisions to apply for RRIF financing, we interviewed a random sample of 22 officials. The sample included 4 successful applicants, 9 applicants whose applications were denied, withdrawn or pending as of December 31, 2013, and 9 prospective applicants. The 13 past and present applicants were selected from the 29 applications that were reviewed as a part of this audit. The 9 prospective applicants were selected from a universe of 643 RRIF eligible entities including inter-city passenger rail carriers, commuter rail carriers and Class I, II and III freight railroads and included 2 applicants that were misclassified because they had previously applied for a RRIF loan prior to January 1, 2010. We also interviewed officials from key stakeholders groups such as the Association of American Railroads, the American Short Line and Regional Railroad Association to get their perspectives on the RRIF program. Exhibits B and C provide more detailed information regarding the applications that met the OIG's scope criteria and the railroads included in OIG's outreach efforts. In general, our survey topics covered awareness of the RRIF and other DOT credit programs, including RRIF application timelines, costs and potential benefits. We

also inquired about the potential applicants' decision to apply for a RRIF loan as well as the potential applicant's perspective of the RRIF program.

EXHIBIT B. RRIF APPLICATIONS INCLUDED IN OIG REVIEW

The following RRIF applications were received by FRA between January 1, 2010 and April 30, 2013:

Passenger and Commuter Railroads:

1. National Railroad Passenger Corporation (Amtrak)
2. New York Metropolitan Transportation Authority
3. Desert Xpress Enterprise LLC (XpressWest)
4. All Aboard Florida (West Palm Beach to Miami)
5. All Aboard Florida (Orlando Extension)

Class I Freight Railroads:

6. Kansas City Southern Railway Company

Short-line (Class II and III) Freight Railroads:

7. Great Lakes Central Railroad Inc.
8. C&J Railroad Company
9. Carolina Southern Railroad Company
10. St. Mary's Railway West LLC (SMW)
11. Livonia, Avon and Lakeville Railroad Corporation
12. Permian Basin Railways Inc.
13. Eastern Maine Railway Company (1)
14. Eastern Maine Railway Company (2)
15. Sierra Northern Railway
16. Maryland and Delaware Railroad Company
17. Heber Valley Historic Railroad Authority
18. Northern Louisiana and Arkansas Railroad Inc.
19. Northwestern Pacific Railroad Company (NWP)

Other Railroad Related Entities:

20. Alameda Corridor Transportation Authority
21. GNP Railway Inc.
22. Lake Providence Port Commission
23. Port of Vancouver USA
24. Southwest Mississippi Regional Railroad Authority
25. Economic Development Corporation of Snyder Texas
26. Dyersburg Elevator Company, Inc.

27. Northeast Texas Rural Rail Transportation District (NETEX)
28. Brookhaven Terminal Holding, LLC
29. Rocky Mountain Railcar and Repair Inc.

EXHIBIT C. OIG'S SAMPLE OF PAST, PRESENT AND PROSPECTIVE RRIF APPLICANTS

OIG conducted conference calls with each of these past, present and prospective RRIF applicants:

Past and Present Applicants:

1. Alameda Corridor Transportation Authority
2. National Railroad Passenger Corporation (Amtrak)
3. C&J Railroad Company
4. Kansas City Southern Railway Company
5. Desert Xpress Enterprise LLC (XpressWest)
6. New York Metropolitan Transportation Authority
7. All Aboard Florida
8. Maryland & Delaware Railroad Company
9. North Louisiana and Arkansas Railroad Inc.
10. Port of Vancouver USA
11. St. Mary's Railway West, LLC (SMW)
12. Livonia, Avon and Lakeville Railroad Corporation
13. Carolina Southern Railroad Company

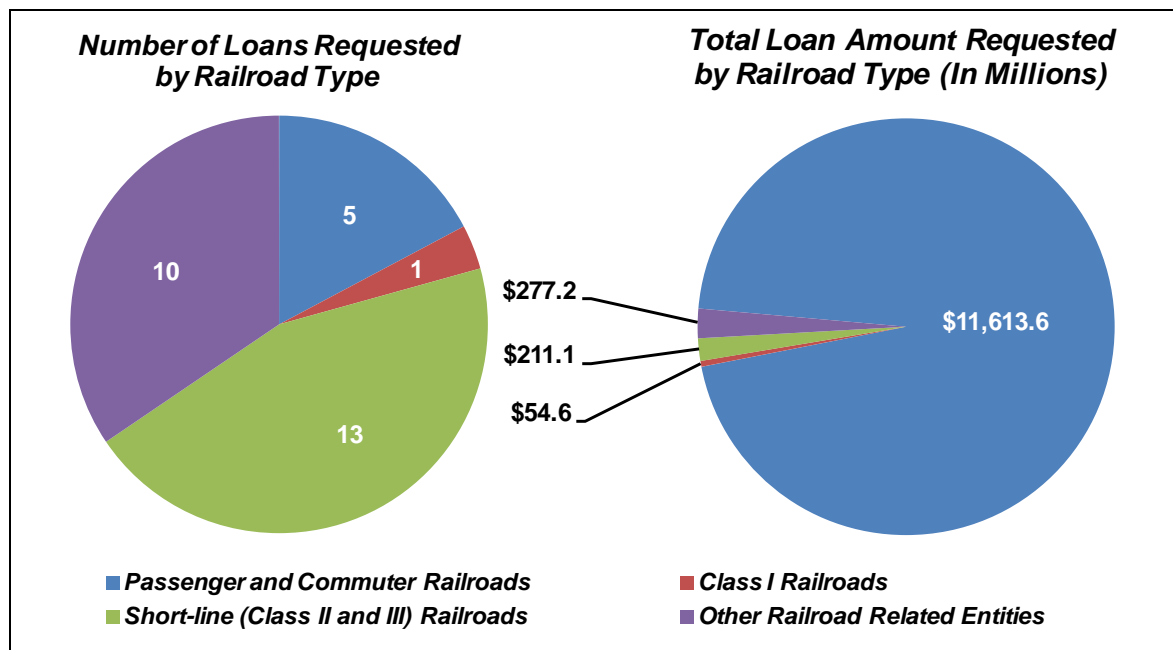
Prospective Applicants:

1. BNSF Railway
2. Union Pacific Railroad
3. Norfolk Southern Railway
4. Montana Rail Link
5. Winchester and Western Railroad
6. D&I Railroad
7. Trinity Railway Express (TRE)
8. Northstar Commuter Rail (NSCR)
9. Northern New England Passenger Rail Authority (NNEPRA)

EXHIBIT D. OIG'S ANALYSIS OF SAMPLE RRIF APPLICATIONS

OIG obtained and reviewed application processing data for the 29 applications received between January 1, 2010 and April 30, 2013. As seen in Figure 4, short-line railroads submitted the highest number of applications (13), while passenger and commuter railroads requested the most amount of funding (\$11.6 billion).

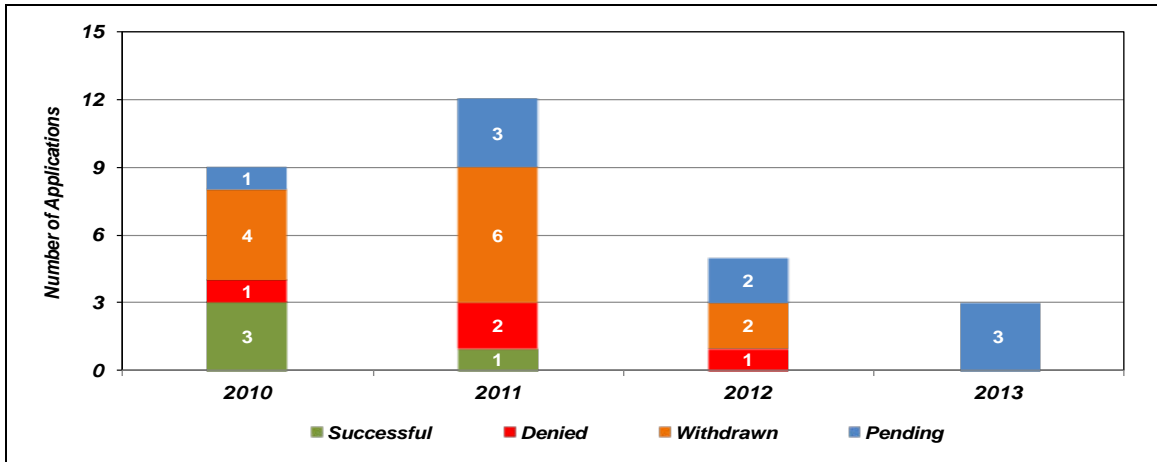
Figure 4. RRIF Applications Received Between January 1, 2010 and April 30, 2013



Source: OIG analysis of FRA data

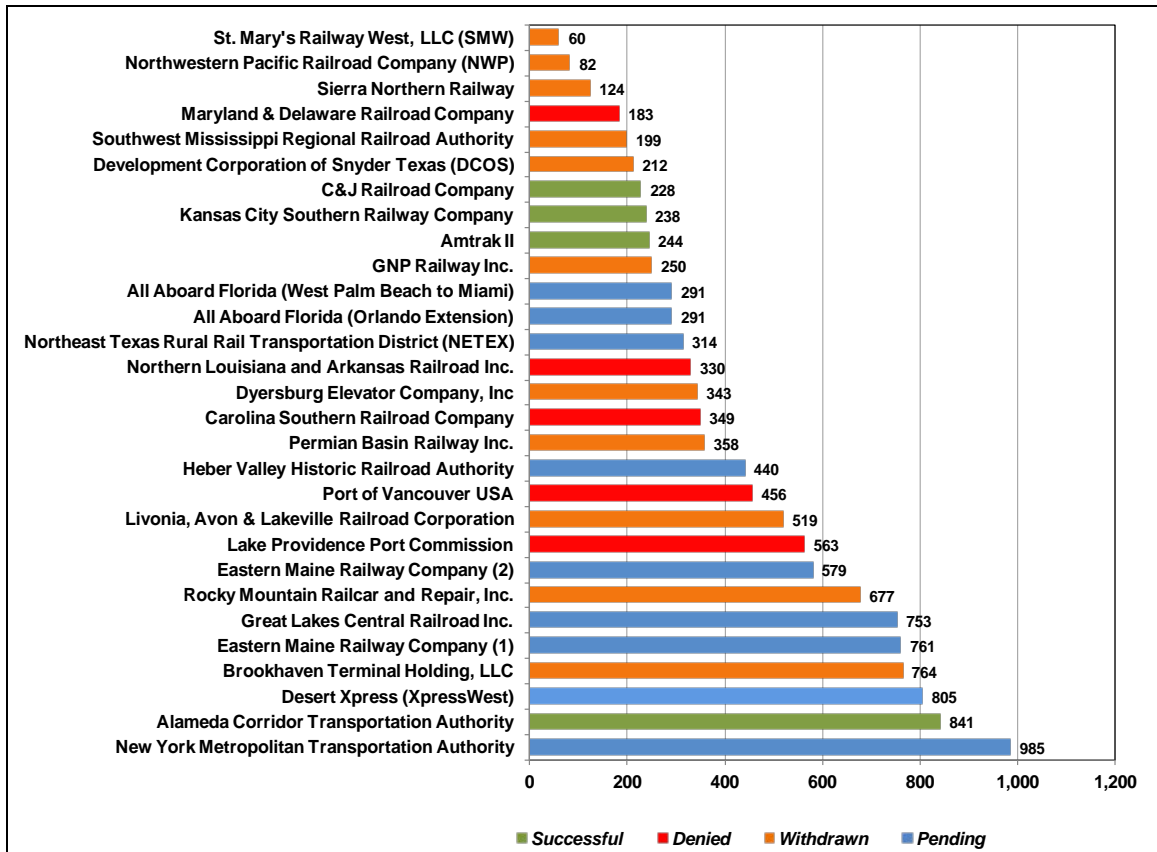
Furthermore, as seen in Figure 5, as of December 31, 2013, 4 of the 29 applicants received RRIF loans and 9 applicants were undergoing review. Four applications were denied and 12 had been withdrawn. Figure 6 presents the processing time for the 29 applications.

Figure 5. Status of RRIF Applications Received Between January 1, 2010 and April 30, 2013



Source: OIG analysis of FRA data

Figure 6. Processing Times and Outcomes for RRIF Applications Received Between January 1, 2010 and April 30, 2013



Source: OIG analysis of FRA data

Note: Processing time for pending applications is calculated from application date to December 31, 2013.

Exhibit D. OIG's Analysis of Sample RRIF Applications

EXHIBIT E. COMPARISON OF RRIF AND PRIVATE MARKET LOAN COSTS

We compared the cost of borrowing \$100 million from the private market to the cost of obtaining a \$100 million secured RRIF loan. For the private market we assumed a 30-year unsecured bond issuance for an investment grade Class I freight railroad. For the RRIF loan, we assumed a 30 year loan at the rate for a 30 year treasury note. Table 1 summarizes the result of our analysis.

Table 1. Hypothetical Comparison of an Investment-Grade Bond Issuance to a RRIF Loan

<i>Type of Debt Instrument</i>	<i>Unsecured Bond Issuance</i>	<i>RRIF Loan</i>
Face/Loan Amount	\$100,000,000	\$100,000,000
Coupon/Loan Rate	4.40% ^a	2.92% ^b
Term (Years)	30	30
Underwriters Fee (@ 0.875%) ^a	\$875,000	N/A
Investigation Fee (@ 0.5%)	N/A	\$500,000
Credit Risk Premium (@ 2%) ^c	N/A	\$2,000,000
Subtotal Fees and Upfront Costs	\$875,000	\$2,500,000
Present Value (PV) Interest Cost ^d	\$66,490,499	\$41,467,563
Total PV of Fees and Costs	\$67,365,499	\$43,967,563

Source: OIG Analysis

^a Coupon rate and underwriters fee assumptions based on Surface Transportation Board's 2012 Cost of Capital Data.

^b Interest rate based on the average of 2012 30-year Treasury Note.

^c We assume the RRIF loan is disbursed as a lump sum requiring the applicant to pay the credit risk premium upfront and that it will not be returned to the borrower.

^d Interest cost represents the present value of interest paid over the life of the debt instrument utilizing a discount rate of 1.8 percent based on the average of 2012 10-Year T-Bill

Comparing total fees and upfront costs for the two debt vehicles, the difference is significant. As illustrated in table 1, the RRIF application fee of up to one-half of one percent of the loan amount is a non-refundable and covers the expenses FRA incurs to retain independent financial analysts and legal assistance. Bond issuance fees are primarily composed of the underwriter's fee, which for our example is 0.875 percent of the amount but can vary based on the creditworthiness of the borrower. This fee is paid from bond issuance proceeds.

Because RRIF's interest rates are the same for all applicants—regardless of creditworthiness—RRIF borrowers must pay a CRP to offset the differences in

creditworthiness among applicants. CRPs have generally ranged between zero and five percent of the loan amount and must be paid prior to loan disbursement. Private markets assess the risk associated with a bond offering and charge a higher interest rate as well as higher upfront costs that can be paid from loan proceeds for higher risk loans. The primary difference in these approaches is that the CRP is an upfront cost while a bond issuance amortizes the cost over the life of the loan. While a RRIF loan may be cheaper than a bond issuance, the structure of the CRP may present a cash flow challenge to a RRIF borrower.

In our hypothetical scenario, the bond issuance fees are \$1.6 million less than the RRIF loan, however, the RRIF loan charges less interest than the bond issuance. We utilized a bond interest rate of 4.4 percent paid semiannually and a RRIF interest rate of 2.92 percent based on the average 30-year Treasury note for 2012. As shown in Table 1, these rates yielded on a present value basis approximately \$66 million versus \$41 million in interest costs for the bond and RRIF loan respectively. Consequently, the savings for the RRIF loan was approximately \$25 million. Taking into account fees, upfront costs and interest paid, the RRIF loan costs \$23.4 million less than the bond issuance in this scenario. Even if we assume a higher CRP estimate of five percent, the savings generated by borrowing under the RRIF loan is still favorable, by approximately \$20.4 million on a \$100 million loan.

EXHIBIT E. MAJOR CONTRIBUTORS TO THIS REPORT

Name	Title
Yana Hudson	Program Director
Jaydeep Borwankar	Project Manager
James Lonergan	Senior Financial Analyst
Kevin Sanders	Senior Financial Analyst
Deborah Kloppenburg	Senior Auditor
Tom Denomme	Project Consultant
Susan Neill	Writer/Editor
Megha Joshipura	Statistician

APPENDIX. AGENCY COMMENTS



U.S. Department
of Transportation

Federal Railroad Administration

MEMORANDUM

INFORMATION: Management Response to Office of

Subject: Inspector General Draft Report on the Railroad
Rehabilitation and Improvement Financing Program

Date: May 28, 2014

From: Joseph Szabo 
Federal Railroad Administrator

To: Mitchell L. Behm
Assistant Inspector General for Surface Transportation Audits

Reply to the
Attn of: ROA-03

The Federal Railroad Administration's (FRA) implementation of the Railroad Rehabilitation and Improvement Financing (RRIF) program has successfully supported nearly three dozen borrowers and obligated over \$1.7 billion in loans that in many cases were critical to the success of short line railroads. Both prior to, and throughout the Office of Inspector General's (OIG) audit, FRA has implemented numerous program enhancements that improve the quality of applications and streamline the review time for most applicants. As a result, FRA has implemented actions to satisfy OIG's first four recommendations.

FRA will continue to implement best practices to improve its administration of the RRIF program, as it recognizes the inherent challenges in RRIF's authorizing statute, Federal policies, and the population of potential applicants. For example, RRIF is appropriate for a relatively small population of potential borrowers, compared to other Federal credit programs or commercial lending and private capital markets. Moreover, FRA has no discretion to subsidize the required credit risk premium for potential borrowers. In addition, the applicants are in part responsible for application quality, responsiveness to requests for further information, and prompt payment of processing fees associated with the application. Some applicants further lengthen the process by changing their project proposals during the application evaluation process or fail to provide sufficient financial information for the Government's due diligence. Finally, FRA requires recommendations from the Credit Council and concurrence from the Office of Management and Budget on the credit risk premium calculation to close a loan. FRA will continue to improve the quality of applications and looks forward to implementing OIG's fifth recommendation to streamline the application process and explore refinements of the current risk based approach.

OIG Recommendations and FRA Responses

Recommendation 1: Develop comprehensive guidance for applicants that details the information needed to submit complete applications.

Response: Concur – FRA developed, and added to its public website, documentation that supplements previously available guidance to potential RRIF applicants. These materials include both program information (Fact Sheet and Information Presentation) and application documents (Application Process – Quick Guide, Draft Application Checklist, Final Application Checklist, and Application Form). By June 6, 2014, FRA will also add a detailed program guide to the public website. At that time, FRA will have satisfied this recommendation and requests that OIG then consider it closed.

Recommendation 2: Make pre-application meetings mandatory and provide clear program guidance and related materials to applicants in advance of the meetings.

Response: Concur – Formal pre-application meetings are an important step in the process and are now mandatory. The requirement for such meetings is documented in the RRIF materials referenced above. For example, step 1 in the Application Process – Quick Guide states, in part, “[FRA] offers Information Sessions to help potential applicants fully understand the RRIF program, including the objectives, requirements and process. Sessions are required for all new applicants and are highly recommended for returning applicants.” Consequently, FRA has satisfied this recommendation and requests that OIG consider it closed.

Recommendation 3: Develop a tool to track the progress of applications and establish a process for timely communication with applicants about the status of their applications.

Response: Concur – To improve its tracking of each step in the application process, FRA developed and deployed a tracking tool. FRA team members utilize this tool currently to track every step of the application process, including documentation of all formal communications from initial stages of information gathering to the final decision on loans accepted for review.

In addition, FRA’s standard operating procedures for processing applications include requirements related to communication with applicants. The procedures require FRA staff to work with applicants to establish a schedule for the review process and notify applicants regarding the completion of steps and upcoming milestones. Staff is also required to notify applicants of any issues impeding an application’s progress.

FRA demonstrated the tracking tool to OIG and, by June 15, 2014, will provide OIG a copy of the standard operating procedures, thereby fulfilling this recommendation. Thus, we request that OIG close this recommendation after receiving the standard operating procedures.

Appendix. Agency Comments

Recommendation 4: Provide timely information to applicants on the reasons for denials.

Response: Concur – FRA strengthened its pre-application meeting procedures to ensure that potential applicants understand, prior to drafting an application, whether they are likely to be denied. FRA procedures also direct staff to offer unsuccessful applicants the opportunity to discuss reasons for the denial. In addition, FRA documents the reasons for the denial in a letter to the denied applicant. By June 15, 2014, FRA will provide OIG a recently executed example of this procedure and FRA’s standard operating procedures that detail these measures, after which, we request that OIG consider this recommendation closed.

Recommendation 5: Work with the Credit Council to streamline the application review process and develop a risk based approach for reviewing applications.

Response: Concur – FRA will consult with the Office of the Assistant Secretary for Budget and Programs (Assistant Secretary) on how best to develop and submit streamlining proposals for Credit Council (Council) consideration. Moreover, FRA will seek the Assistant Secretary’s input on how best to work with the Council to identify refinements to the current risk-based approach that are both feasible and unlikely to increase the Government’s exposure to potential losses. (A risk-based approach is currently in place regarding applications for \$1 billion or more.)

FRA will begin working immediately on process improvements with the Assistant Secretary and Council members. Therefore, we request that OIG close this recommendation within 90 days of OIG’s final report issuance date after FRA demonstrates its efforts to work with the Credit Council.

We appreciate this opportunity to offer additional perspective on the OIG draft report. We also appreciate the courtesies of the OIG staff in conducting this review. Please contact Rosalyn G. Millman, Planning and Performance Officer, at 202.384.6193, or Corey Hill, Director of the Office of Program Delivery, at 202.493.0296, with any questions or requests for additional assistance.