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Committee on Appropriations**

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Amtrak's Financial Outlook



**Statement of
The Honorable Kenneth M. Mead
Inspector General
U.S. Department of Transportation**

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify on Amtrak's financial outlook. Last October, we provided our views in testimony before the House Transportation and Infrastructure Subcommittee on Ground Transportation. Our overall assessment at that time was that with strong leadership, intense management, and favorable economic conditions, it would be possible, albeit difficult, for Amtrak to become operationally self-sufficient by 2003.

Five months into Fiscal Year (FY) 2000, we still believe that it is possible for Amtrak to achieve operating self-sufficiency, although the delays in Acela Express service will pose additional obstacles. Amtrak's success will require aggressive pursuit of projects such as the service improvements identified in its Market Based Network Analysis and implementing high-speed rail service between Boston and Washington that is not only fast, but reliable. A year from now, after high-speed rail has begun and other market based service changes have been implemented, we will be able to tell you with greater certainty whether Amtrak is likely to achieve its congressional mandate in 2003.

Today, we would like to present our views on Amtrak's Fiscal Year 1999 and first quarter 2000 financial results, the financial impact of delays in the high-speed rail program, the "yardstick" for measuring self-sufficiency, Amtrak's capital funding needs and spending plans, and the critical fire and life-safety needs in Penn Station-New York and the Hudson and East River tunnels.

- **Amtrak's Financial Results.** The financial results for FY 1999 show that Amtrak has made some progress, but still indicate the need for major improvement. Amtrak's audited 1999 operating loss of \$916 million, including depreciation, was \$56 million more than its 1998 loss and the largest in Amtrak's history.¹ Amtrak's test for self-sufficiency, however, pivots on its cash losses rather than its operating losses. In 1999, the cash loss was \$579 million, \$54 million higher than the 1998 cash loss and \$19 million worse than Amtrak projected for 1999.

On the positive side, Amtrak's systemwide passenger revenue grew by almost 6 percent in 1999, although this was short of Amtrak's goals by \$31 million, or about 3 percent. Systemwide ridership increased by 2 percent from 1998 levels, led by growth of better than 3 percent in both the Northeast Corridor

¹ Amtrak's reported operating loss for 1998 was \$930 million, which included the full amount of retroactive labor payments attributable to the years 1996 through 1998 (per newly settled labor agreements). After allocating these costs to the years in which they were incurred, the 1998 operating loss totals \$860 million.

and Amtrak West business units. Intercity ridership decreased by 1.6 percent, due in part to fare increases, reservation system glitches, and residual effects from the Bourbonnais accident last March. Nevertheless, all three business units posted increases in passenger revenues ranging from 2 to 11 percent.

In the first quarter of FY 2000, passenger revenue, while almost \$10 million better than the first quarter of FY 1999, was still more than \$9 million behind plan. Most significantly, Intercity passenger revenues fell \$11 million short of plan, and \$2 million worse than the same period last year. Intercity ridership also fell 7 percent short of plan and 4 percent below the same period last year. These shortfalls were partially offset by a strong 7 percent increase in passenger revenues in the Northeast Corridor, which came in \$2 million ahead of plan despite the delays in high-speed rail. Overall, Amtrak recorded an operating loss of \$240 million. While these results indicate progress in some areas, Amtrak will have to see much more improvement in the remaining three quarters if it is to remain on its glidepath.

Amtrak has been able to mitigate passenger revenue shortfalls in both 1999 and the first quarter of 2000 through means such as reimbursable work² and one-time sales of real estate, but these opportunities are limited. *Amtrak is clearly moving in the right direction, but the heavy lifting is still ahead.*

- **High-Speed Rail Delays.** Amtrak is currently projecting at least a 6-month delay in the start-up of Acela Express service. The delays were caused by suspension and oscillation problems in the wheel trucks discovered during testing on the high-speed trainsets and locomotives. Amtrak, the Federal Railroad Administration, and the manufacturer have made progress in resolving these issues; however, work continues on remaining issues that must be resolved before the trainsets can be operated at their designed speed of 150 miles per hour. The current delays and the associated lost passenger revenues are projected to be \$142 million this year. While this loss will make it more challenging for Amtrak to achieve its financial goals in 2000, it is too early to tell what impact it will have on Amtrak's self-sufficiency mandate.

This year's revenue loss will be mostly mitigated by operating expense savings, interest savings, and contractor penalties for late equipment delivery. The balance is expected to be offset by new leasing agreements valued at about \$44 million. The fact that the current delays will have a minimal effect on Amtrak's 2000 operating results should not detract from the critical significance of the high-speed rail program. High-speed rail is the cornerstone

² Maintenance work performed for commuter and freight railroads, and state and local agencies for which Amtrak is reimbursed.

of Amtrak's business plan, and its success is critical to Amtrak's ability to reach self-sufficiency. The offsetting savings, penalties, and leasing actions are sufficient in the short term, but *compensation* is no substitute for *implementation*. Amtrak should move as quickly as possible to begin service, but should not do so until it is certain that this service can be operated with consistent reliability.

On a final note, we are aware that there has been some discussion about whether Acela delays might necessitate an extension of Amtrak's glidepath by one year. Our view is that it is premature to make this call. In a year, we will be in a better position to judge the impact of the delays on Amtrak's timeframe for reaching self-sufficiency.

- **Amtrak's "Yardstick" for Self-Sufficiency Needs to Be Clearly Defined.** The Amtrak Reform and Accountability Act of 1997 (ARAA) precludes Amtrak from using Federal funds for operating expenses after 2002, except for excess contributions to the railroad retirement fund (RRTA). It is silent, however, on several key issues. We believe clarification is necessary so that Amtrak, the Congress, the Administration, and the Amtrak Reform Council (ARC) can all measure Amtrak's progress using the same set of standards.
 - ⌘ **Capital Funding After 2002.** While precluding use of Federal funds for most operating expenses, ARAA does not specifically indicate the Congress' intent to provide capital funds after 2002. If Amtrak makes its mandate in 2003, it will not make it by much; clearly not enough to cover its minimum capital requirements. Even with the currently projected Federal capital funding, Amtrak will fall \$244 million short of meeting its minimum capital needs in 2001 and 2002. Without funds to cover such costs as debt or mandatory safety improvements, Amtrak will not be able to continue to operate the railroad. It would be pointless for Amtrak to reach operating self-sufficiency in 2003, if the absence of capital funds in that year would effectively shut down the railroad.
 - ⌘ **Capital Depreciation.** The ARC's report stated its position that Generally Accepted Accounting Principles (GAAP) are both logically and legally the standards that should be used to measure Amtrak's operating self-sufficiency. Because capital depreciation expenses are operating expenses, a strict application of GAAP would require Amtrak to include depreciation, essentially the cost of replacing capital, in its calculation of operating self-sufficiency. This would require Amtrak to cover the costs of capital replacement from its fare box after 2002. Although we agree with the ARC that GAAP standards are the appropriate ones to use in examining Amtrak's finances (and we have always done so in our assessments), we

disagree that depreciation expenses should be included in the self-sufficiency calculation. Congress has historically funded replacement of capital assets through capital grants, not through the operating subsidies that ARAA seeks to end. In addition, requiring Amtrak to include depreciation in its calculation of operating self-sufficiency would effectively guarantee that Amtrak would not reach its mandate by 2003 and, in fact, would have guaranteed that result when the law was passed in 1997.

- ⌘ **Progressive Overhauls.** Progressive overhauls are limited equipment overhauls that are performed each year in lieu of a comprehensive, or “heavy” overhaul every 4 years. Amtrak believes that progressive overhauls increase equipment reliability, reduce out-of-service time on equipment, and save money.

The ARC report took the position that under ARAA, progressive overhauls, as an operating expense, could not be federally funded after 2002. We agree that progressive overhauls are operating expenses, but other considerations should come into play in deciding what overhaul program Amtrak should be able to use Federal funding for after 2002. Prohibiting the use of Federal funds for progressive overhauls would likely encourage Amtrak to scale back or even eliminate them completely. Amtrak would rely instead exclusively on heavy overhauls, which *can* be funded out of Federal funds after 2002. Because progressive overhauls keep equipment in a better average state of good repair and increase availability for service, eliminating them would likely lead to a reduction in service reliability, customer satisfaction, and critical passenger revenues.

It is important to note that this shift to an exclusive heavy overhaul program would *not* change the total amount of Federal funds being used by Amtrak for overhauls. Reductions in progressive overhaul expenditures (currently federally funded) would likely be offset, dollar for dollar, by increased expenditures for heavy overhauls (federally funded now *and* after 2002).

If capital funding is to be provided beyond 2002, allowing Amtrak to use Federal funds for both progressive and heavy overhauls would allow Amtrak to make responsible business decisions about the best way to keep the railroad’s capital assets in good working order. Discontinuing this practice would likely result in a less satisfactory overhaul program, dictated solely by the fact that Federal funds may be used for heavy overhauls after 2002, while progressive overhauls would need to be funded from the fare box.

- **Despite Anticipated Capital Funding Shortfalls, Amtrak Continues to Provide for Projects Beyond Minimum Needs.** Our last assessment of Amtrak's financial needs found that projected Federal funding will fall short of meeting minimum capital needs in 2001 and 2002 by at least \$244 million.³ Still, Amtrak continues to pursue projects such as investment in the design of the planned California high-speed rail corridor and infrastructure improvements to support new Las Vegas service. Amtrak believes such projects are critical investments if it is to continue to improve financially. While we are sympathetic to Amtrak's position, it is necessary for Amtrak to first ensure that funds are available to meet legal obligations and to make the minimum investments necessary to continue the safe, reliable operation of the national rail system over the short term. If the Administration's proposed budget for 2001 is adopted, Amtrak would have sufficient funds to address minimum needs *and* invest in projects with long-term growth opportunities like new high-speed corridors.

Without additional funding, we projected last year that Amtrak's minimum needs in 2001 and 2002 of \$459 million and \$391 million, respectively, would exceed available funding by \$139 million and \$105 million, respectively. These estimates represent the annual minimum investment necessary in areas such as debt, infrastructure improvements, life-safety, and equipment overhauls. Every capital dollar spent on projects outside minimum needs adds another dollar to the existing minimum needs funding shortfall.

- **Fire and Life-Safety Needs in Penn Station-New York and the Six Hudson and East River Tunnels.** Amtrak has identified over \$12 billion in capital needs on the southend of the Northeast Corridor over the next 25 years. One of the most serious needs relates to \$654 million in unaddressed fire and life-safety needs in Penn Station and the six adjoining river tunnels. In addition to Amtrak, the Long Island Rail Road and New Jersey Transit use the station and tunnels. Although these railroads have already invested \$150 million in the project, the remaining problems (estimated at \$654 million in 1997 dollars) will not be fixed before 2014 under the current plan.

The plan's timing is long, in part, because of the difficulty of doing the construction without impairing the operations of the three railroads and, in part, because of assumed funding constraints. We have asked the three railroads to estimate how much the plan could be accelerated, especially the most serious needs for ventilation and evacuation, if its timing were only constrained by the pace of operations and not by a lack of funding. When this

³ Report No. CE-1999-116, July 21, 1999. *Report on the 1999 Assessment of Amtrak's Financial Needs Through Fiscal Year 2002*, Office of Inspector General, U.S. Department of Transportation.

accelerated plan is available, the three railroads, the Administration and Congress should explore ways to implement this new, accelerated plan.

Year End Results Show Some Progress, But the Heavy Lifting Is Still Ahead

Amtrak's financial results for FY 1999 show that Amtrak has made some progress, but still indicate the need for major improvement if Amtrak is to reach operating self-sufficiency by 2003. While Amtrak was able to accomplish most of its stated financial goals, Amtrak's audited FY 1999 operating loss of \$916 million, including depreciation, was \$56 million more than its 1998 loss and the largest in Amtrak's history.⁴ On the positive side, Amtrak's systemwide passenger revenues grew by almost 6 percent while systemwide ridership increased by 2 percent over 1998 levels.

FY 2000 is a critical year for Amtrak. Last October, we testified that Amtrak's operating loss in 1999 reflected, in part, investments in projects like the Market Based Network Analysis (MBNA) and Service Standards, which had high up-front costs such as training and research, but were expected to yield significant financial improvements in the years ahead. These and other "placeholders" accounted for over half of the \$692 million in projections we considered to be "at risk" in the 1999 Business Plan.⁵ This year, it is imperative that Amtrak begin to realize the payoffs of such investments -- the small steps made in 1998 and 1999 must now be replaced with large strides this year and next.

The first quarter of 2000 indicates that these strides are slow in coming. Overall passenger revenue, while almost \$10 million better than the first quarter of FY 1999, was still more than \$9 million behind plan. Both Amtrak West and Intercity fell short of their passenger revenue targets for this period, although

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⁵ Business Plan Actions projecting revenue growth or expense savings for which no concrete plans had been developed or linked to projected results.

Amtrak West's revenues exceeded results for the same period last year. Intercity, however, not only fell short of its passenger revenue targets by nearly \$11 million, its revenues were more than \$2 million shy of the same period last year. The good news is that, despite the delays in high-speed rail service, Northeast Corridor passenger revenues for the first quarter of FY 2000 were up a strong 7 percent, exceeding projections by over \$2 million.

Amtrak has been able to mitigate passenger revenue shortfalls in both 1999 and the first quarter of 2000 through means such as reimbursable work (\$8.6 million greater than plan) and one-time sales of real estate. Additionally, the Express business is growing, with revenues almost \$2 million better than the first quarter last year, and \$1 million better than planned. *Amtrak is clearly moving in the right direction, but the heavy lifting is still ahead.*

On a cautionary note, we are pleased to see Amtrak able to compensate for some of the shortfalls in passenger revenues, but we are concerned that such shortfalls are occurring at this magnitude, especially in Intercity. A chain is only as strong as its weakest link, and even if projects such as high-speed rail perform as well as projected, those revenues alone will not be enough for Amtrak to reach and sustain viability. Amtrak must work just as aggressively to maintain existing sources of revenue as it works to secure new sources – otherwise benefits related to improved operations will only serve to maintain the status quo. As service changes indicated in the MBNA are implemented, we expect to see a strengthening of all of Amtrak's revenues.

Amtrak Will Be Able to Mitigate FY 2000 Losses Related to Acela Delays

Because of delays in the delivery of the new Acela Express high-speed trainsets and the Acela Regional high-speed locomotives, full implementation of new Acela

Express and Regional services will be delayed about 6 months.⁶ The delays were caused by suspension and oscillation problems in the wheel trucks discovered during testing on the high-speed trainsets and locomotives. Amtrak, the Federal Railroad Administration, and the manufacturer have made progress in resolving these issues; however, work continues on remaining issues that must be resolved before the trainsets can be operated at their designed speed of 150 miles per hour. As a result of these delays, Amtrak will forgo an estimated \$142 million in expected gross revenue that would have been generated by these Acela services. While this loss will make it more challenging for Amtrak to achieve its financial goals in 2000, it is too early to tell what impact it will have on Amtrak's self-sufficiency mandate.

This year's loss will be mostly mitigated by expense savings, interest savings, and contractor penalties for late equipment delivery. By not operating these services, Amtrak will save operating expenses for propulsion power, maintenance costs, onboard labor and supplies, and financing costs. In addition, Amtrak's purchase contract for the trainsets and locomotives includes a provision for liquidated damages for forgone revenue in the event of a delivery delay. These savings total \$98 million of the gross revenue loss of \$142 million. We have reviewed Amtrak's calculations of these expected savings in operating expenses, financing costs, and liquidated damages and conclude that these savings appear reasonable.

Amtrak is in the process of negotiating lease agreements that it projects will generate sufficient revenue in FY 2000 to offset the remaining net revenue loss. We have reviewed the proposals and their related revenue projections, as well as the likelihood they will be achieved. It is our opinion that, if these lease agreements are successfully completed, Amtrak will achieve the \$44 million offset

⁶ Delivery of the last (20th) Express trainset will not occur until December 2000 rather than July 2000 and the last (15th) high-speed locomotive for Regional service will not be delivered until June 2000 rather than December 1999.

this fiscal year. However, if delays extend beyond those currently identified, additional mitigating plans would need to be developed or revenue losses could affect 2000 operating results. Unfortunately, had the delivery delay not occurred, these funds could have been used to mitigate other risks in Amtrak's business plan or to address many capital investment needs that it has throughout its system.

The fact that the current delays are likely to have a minimal impact on Amtrak's 2000 operating budget should not detract from the critical significance of the high-speed rail program. High-speed rail is the cornerstone of Amtrak's business plan, and its success is critical to Amtrak's ability to reach self-sufficiency. The offsetting savings, penalties, and leasing actions are sufficient in the short term, but *compensation* is no substitute for *implementation*. Amtrak should move as quickly as possible to begin service, but should not do so until it is certain that this service can be operated with consistent reliability.

On a final note, we are aware that there has been some discussion about whether Acela delays might necessitate an extension of Amtrak's glidepath by one year. Our view is that it is premature to make this call. In a year, we will be in a better position to judge the impact of the delays on Amtrak's timeframe for reaching self-sufficiency.

The "Yardstick" Used to Measure Operating Self-Sufficiency Needs Clarification

The Amtrak Reform and Accountability Act of 1997 (ARAA) precludes Amtrak from using Federal funds for operating expenses after 2002, except for the costs of excess contributions to the railroad retirement fund (RRTA). It is silent, however, on several key issues. We believe clarification is necessary so that Amtrak, the Congress, the Administration, and the Amtrak Reform Council (ARC) can all measure Amtrak's progress using the same set of standards.

- ⌘ **Capital Funding After 2002.** While precluding use of Federal funds for most operating expenses, ARAA does not specifically indicate the Congress' intent to provide capital funds after 2002. If Amtrak makes its mandate in 2003, it will not make it by much; clearly not enough to cover its minimum capital requirements. Even with the currently projected Federal capital funding, Amtrak will fall \$244 million short of meeting its minimum capital needs in 2001 and 2002. Without funds to cover such costs as debt or mandatory safety improvements, Amtrak will not be able to continue to operate the railroad. It would be pointless for Amtrak to reach operating self-sufficiency in 2003, if the absence of capital funds in that year would effectively shut down the railroad.
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Although we agree with the ARC that GAAP standards are the appropriate ones to use in examining Amtrak's finances (and we have always done so in our assessments), we disagree that depreciation expenses should be included in the self-sufficiency calculation. Congress has historically funded replacement of capital assets through capital grants, not through the operating subsidies that ARAA seeks to end. In addition, requiring Amtrak to include depreciation in its calculation of operating self-sufficiency would effectively guarantee that Amtrak would not reach its mandate by 2003 and, in fact, would have guaranteed that result when the law was passed in 1997.

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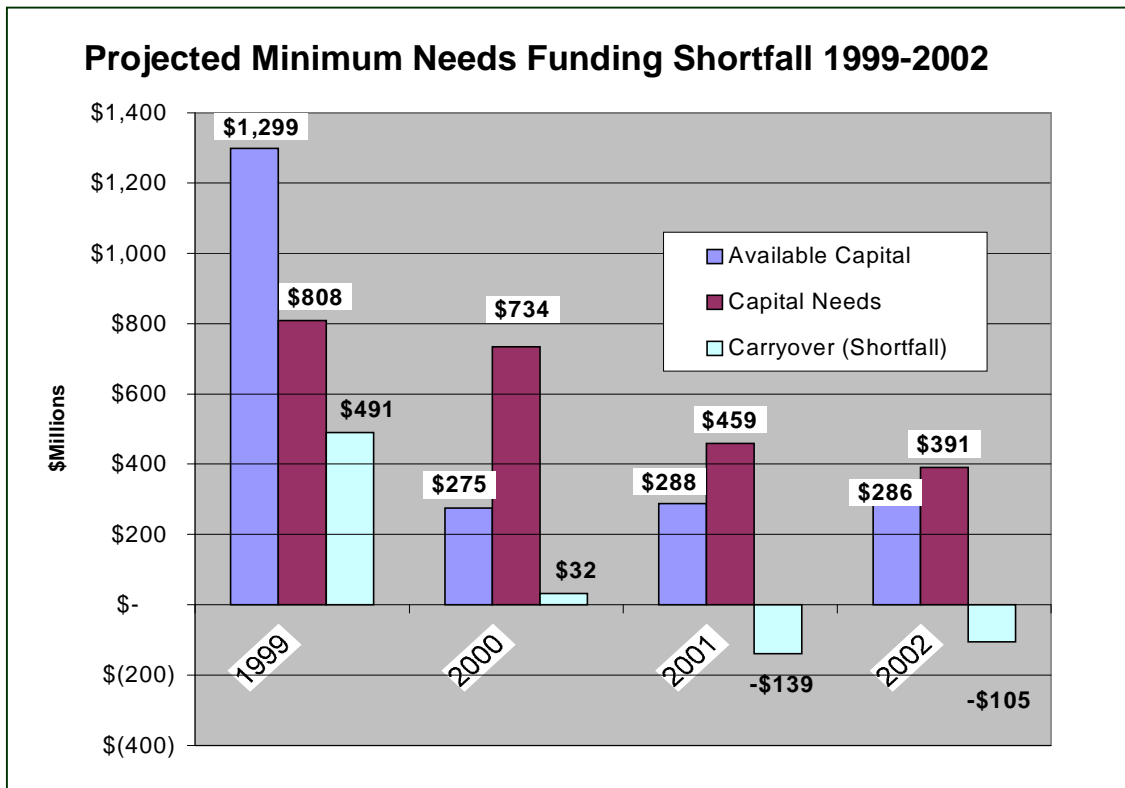
It is important to note that this shift to an exclusive heavy overhaul program would *not* change the total amount of Federal funds being used by Amtrak for overhauls. Reductions in progressive overhaul expenditures (currently federally funded) would likely be offset, dollar for dollar, by increased expenditures for heavy overhauls (federally funded now *and* after 2002).

If capital funding is to be provided beyond 2002, allowing Amtrak to use Federal funds for both progressive and heavy overhauls would allow Amtrak to make responsible business decisions about the best way to keep the railroad’s capital assets in good working order. Discontinuing this practice would likely result in a less satisfactory overhaul program, dictated

solely by the fact that Federal funds may be used for heavy overhauls after 2002, while progressive overhauls would need to be funded from the fare box.

Despite Anticipated Capital Funding Shortfalls, Amtrak Continues to Provide for Projects Beyond Minimum Needs

In our 1999 assessment, we estimated that projected Federal funding in 2001 and 2002 would fall short of meeting Amtrak’s minimum capital needs by approximately \$244 million. The figure below illustrates the timing of this shortfall.



Despite our recommendation that Amtrak identify funding for all of its known minimum needs before investing in developmental, yet non-critical needs, Amtrak’s 2000 capital plan continues to provide funds for such projects.

The following are two examples of non-minimum needs spending.

- ⌘ California is considering spending \$20 to \$34 billion to build a very high-speed rail network that will not be completed before 2017. Amtrak is spending \$5 million in 2000, and plans to spend another \$20 million between 2001 and 2004 to finance a series of studies and projects related to this corridor. The State is investing an additional \$180 million. Amtrak believes this investment will ensure Amtrak's position in the planning and eventual provision of this high-speed service.
- ⌘ Amtrak is investing \$14 million in infrastructure improvements necessary to support a new Las Vegas service. The total project cost is \$28 million, and Amtrak is hoping that the \$14 million balance will be funded with a separate Federal appropriation. Amtrak is projecting \$1.35 million in net revenues by 2004 from this service. When the same project was proposed last year, our analysis indicated that expenses were likely to exceed revenues, in which case we concluded Amtrak would most likely make the decision to not offer the service, and restated the projected net revenues to zero.

Amtrak believes these projects are critical to its ability to generate future revenues and cost savings. In fact, revenues like those projected from the Las Vegas service are some of the building blocks in Amtrak's plan for reaching self-sufficiency. While we are sympathetic to Amtrak's position, it is necessary for Amtrak to ensure that funds are available for the minimum required investment in areas such as life-safety and refueling. This will not be possible in 2001 and 2002 if Amtrak continues spending on non-minimum needs. If the Administration's proposed budget for 2001 is adopted, Amtrak would have sufficient funds to address minimum needs *and* invest in projects with long-term growth opportunities like new high-speed corridors. In the meantime, while such funding remains uncertain,

we recommend that Amtrak take the more prudent course of delaying investment in such projects until all minimum needs are met and/or additional funding becomes available.

Critical Life-safety Needs in New York's Penn Station and River Tunnels

On a final note, we are very concerned with longstanding fire and life-safety needs in Penn Station and the six Hudson and East river tunnels connecting Penn Station to Queens and New Jersey. The Penn Station fire and life-safety project began in 1976, and more than \$106 million has been spent on these needs between 1976 and 1999. Even though an additional \$43 million will be spent by Amtrak, the Long Island Rail Road and New Jersey Transit in FY 2000, funding has not been secured for some of the more critical projects such as lighting improvements, benchwall repairs, evacuation stairs, and tunnel ventilation. The price tag for these projects after 2000 is \$654 million.

The current plan for addressing all needs anticipates completion by 2014. This is partly a function of constraints caused by the number of trains running through the tunnels and station each day. There are limits to how quickly the life-safety investments can be made without widespread disruptions for commuters and intercity passengers. But the prolonged schedule is also a function of constrained funding. Amtrak and the commuter railroads have identified several projects, including those that address critical ventilation and evacuation needs, which could be accelerated if funding were not a constraint. Such acceleration could be facilitated by a joint effort among the railroads, the Administration, and the Congress.

Mr. Chairman, Amtrak's ability to successfully implement its Northeast Corridor high-speed rail program and service improvements indicated by the Market Based

Network Analysis will play a crucial role in determining whether Amtrak's efforts will be sufficient to sustain progress along its remaining glidepath to operating self-sufficiency. During this period, it is important that all parties reach agreement on what "self-sufficiency" means. I can assure you we will continue to look closely at Amtrak's progress along its glidepath, and keep you and your staff fully informed. We expect to have our assessment report on Amtrak's 2000 Strategic Business Plan available early this summer.

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