



## **Rail Finance and Development Corporation**

There is a lack of balance in our nation's transportation system due, in some measure, to the way government funds infrastructure. When Congress enacted TEA 21 and AIR 21 there was a significant and fundamental change in the way the federal government funds transportation. Now, 70 percent of all federal funding for transportation is guaranteed. As a result, only 30 percent of the federal funding allotted for transportation is discretionary and much of that is used for safety related programs, Amtrak, the administration of the Department of Transportation and a variety of independent agencies. There is no room in the traditional transportation appropriations process for addressing critical rail infrastructure needs with the remaining funds left over after the guarantees are honored.

While user fees pay for much of the guaranteed spending, other non-user fee sources are becoming increasingly significant. For example, according to a recent Brookings Institutions Series on Transportation Reform (April 2003), of all the federal, state and local funding for highways in 2001, 59 percent were from user fees and 41 percent came from non-user fee sources (property taxes, bonds, general fund and a variety of other sources). This report also points out that taxpayers are subsidizing the trucking industry because heavy trucks impose costs on the highway system that significantly exceed those of lighter vehicles like family cars. While we recognize the

complexity of imposing a user fee in a fair and equitable manner, we point this out only as a way of demonstrating the kind of imbalance in our transportation system that exists today and as an example of the competitive disadvantage for the railroad industry.

This, of course, has an impact on those of us in the railway supply industry. Recently, the domestic railway supply industry has been suffering through difficult times. According to RSI's American Railway Car Institute, new freight car deliveries have plummeted from near record high deliveries in the late 1990s to near record low deliveries last year. As recently as 1998, freight car builders delivered 75,685 new cars. Orders and deliveries have declined every year since. Last year the entire industry produced only 17,714 new freight cars. Despite an upturn in orders, this year's production may only reach into the 20,000 range.

During this same time span many freight car component suppliers have had to declare bankruptcy or have simply gone out of business. Because of this, the industry has had to shut down plants and lay off workers. Absent sustained growth in this important transportation sector we can continue to expect difficult times for new freight car builders and their component suppliers.

RSI believes that there are ways for Congress to put more balance into our transportation system in a way that will stimulate the economy without imposing a sales tax on rail rolling stock to help fund a railroad trust fund. Such a sales tax may be a disincentive to purchase freight cars thus prematurely ending the fragile recovery we are beginning to see in this sector. In addition, RSI opposes using the 4.3-cent deficit reduction fuel tax paid by railroads and redirecting this tax to create a railroad trust fund. While we believe there is an urgent need for Congress to develop a workable and

effective rail infrastructure funding mechanism, it makes little sense to alienate the stakeholders in the process. If the goal is to improve rail infrastructure, we need to do it in a way that gets all the stakeholders behind that effort.

Recognizing this we have developed a proposal that would address the needs of our nation's railroad infrastructure without generating opposition from those whom would benefit.

Earlier this year, RSI endorsed the creation of a private, non-profit, federally chartered Rail Finance and Development Corporation (RFDC) authorized to issue tax-credit bonds for capital investment in rail-related infrastructure not generally eligible for transportation trust fund expenditures under TEA 21. Our proposal was the subject of a feature article in the June 2003 issue of *Railway Age*.

Under our proposal this corporation would provide financial support for capital projects that:

- Develop higher speed intercity rail corridor passenger services, including infrastructure and equipment;
- Meet the backlog of capital needs on the Northeast Corridor (NEC) Infrastructure;
- Provide efficient rail access to ports;
- Support development of intermodal terminals, transloading facilities and rail access thereto;
- Facilitate high frequency rail access to airport terminals;
- Enhance capacity on the nation's rail freight network designed to enhance security, reduce congestion, improve air quality and improve efficiency;

- Support the capital needs of short line and regional railroads for infrastructure improvements to serve rural and smaller communities and accommodate 286,000-pound freight cars;
- Support relocation and/or consolidation of rail lines and facilities in urban areas.

### **Financing**

Modeled on existing federally chartered entities such as Fannie Mae, RFDC would be authorized to issue up to \$50 billion in federal tax credit bonds to states and public/private partnerships to finance eligible rail-related capital projects. Specific criteria to be included in the RFDC's authorizing legislation would govern project eligibility, selection, financing and repayment obligations.

RFDC would establish a principal sinking fund to secure payment of the principal at maturity. A 20/30 percent non-federal match (depending on what the current interest rates may be), contributed by state, localities or other project participants, would form the primary basis of the sinking fund for each bond issuance, supplemented by additional federal contributions as may be required.

### **Governance**

A Board of Directors appointed by the President of the United States would govern this corporation. The function and authority of this corporate entity would be subject to the oversight of the congressional committees of jurisdiction.

### **Transportation Finance Corporation**

This is a variation of the American Association of State Highway and Transportation Officials (AASHTO) approach that proposed to create a Transportation Finance Corporation. This concept is designed to help create more balance in both

transportation policy and funding by creating a RFDC to help finance those capital projects that are not currently covered by the guaranteed spending programs created by TEA 21 and AIR 21. The non-covered programs include passenger and freight railroads, short line railroads, ports, high-speed rail and MagLev projects. The creation of the RFDC would enhance the prospects of projects that do not have the benefit of guaranteed funding.

This proposal would place the RFDC within the jurisdiction of the Congressional authorizing committees that currently have oversight responsibility of these non-guaranteed programs (even though the legislation is in part a tax bill and would need to be enacted by the tax committees), providing the authorizing committees with the legislative authority to create the structure of the organization, establish guidelines for the allocation of the resources generated by the proceeds from the sale of the bonds and establish standards for projects eligible for funding with these proceeds. As previously mentioned, the authorizing committees already have a long list of rail needs that they have been unable to fund through the authorization process because no matter how much is authorized there is no room in transportation appropriations to fund these needs out of the 30 percent of funds left over after guaranteed spending programs are addressed.

### **Paying the Principal**

The idea of a RFDC removes some of the concerns expressed by states over accumulating more debt financing that arose when bonding authority was proposed to deal with Amtrak's needs. In this case there will be a separate, federally chartered corporate entity designed much like Fannie Mae, the successful Federal National Mortgage Association, which would sell the bonds and administer this program. The

RFDC would be set up as a federally chartered corporation governed by a Board of Directors appointed by the President of the United States. The RFDC could have the authority to sell up to \$50 billion in bonds. The Board would select a Chief Executive Officer and appropriate staff. There are a number of ways that can be devised to repay tax credit bond principal. As mentioned, AASHTO uses a sinking fund with a portion of the bond proceeds. The original Amtrak bonding proposal assumed states would contribute matching funds (30%) deposited into escrow accounts/sinking funds to secure principal repayment. The point here is that the sponsor/borrower would be responsible for principal repayment only—effectively providing zero percent borrowing. From the government’s prospective, this is cheaper than a grant over the short-term and from the borrowers perspective, much more cost-effective than conventional borrowing or credit instruments like RRIF.

Much of the costs associated with a proposal of this nature could be offset. The Center on Budget and Policy Priorities has indicated that the Senate passed tax provisions that were dropped from the recently enacted tax bill included measures to close abusive corporate tax shelters that could produce significant revenue enhancers and help cover losses associated with other tax measures. As *The Washington Post* has reported, the Senate Bill “included provision to crack down on abusive corporate tax shelters, combat some accounting scams such as those pursued by Enron Corp., prevent US companies from moving their headquarters to post office boxes in offshore tax havens such as Bermuda and limit grossly inflated deferred compensation plans for corporate executives.” The Senate provisions would have saved more than \$25 billion. *All* of these

provisions were dropped in conference and are available to help address the much needed rail infrastructure improvements we are concerned about.

### **Why We Need This Proposal**

Despite significant investments in highways and aviation, the American economy continues to lose billions of dollars each year as a result of traffic congestion. It has been estimated that aviation delays alone costs the U.S. economy about \$10 billion per year today and by 2015 it will be over \$30 billion per year. That is a total of more than \$150 billion over the next decade. The cost of congestion on highways is even more staggering. Creating a funding mechanism like the RFDC for non-guaranteed transportation programs that are designed to help reduce congestion on highways and at airports could substantially reduce the cost in delays to the U.S. economy, help stimulate job growth and help balance our transportation system.

The need for investment in the railroad industry to meet future mobility requirements for both goods and passengers is substantial. AASHTO recently projected in its Intercity Passenger Rail Transportation Bottom Line Report estimated higher-speed rail corridor investment needs of \$17 billion over the next six years, and \$42.9 billion over the next seven to twenty years for a total of \$59.9 billion. This sum is exclusive of capital requirements to continue long-distance intercity rail passenger rail service.

Freight rail needs are just as substantial, and experts are beginning to express concern over the industry's inability to meet its cost of capital. AASHTO's Freight Rail Bottom Line report cites specific needs the Class I freight railroads and the short line and regional railroads will require in capital investment to simply keep up with the freight rail's share of domestic freight tonnage over the next twenty years. AASHTO estimates

the following capital requirements: \$13.8 billion to assure rail safety, including funding for signal systems, grade separations, grade crossing elimination and track relocations for both freight and passenger systems); \$11.8 billion to improve short line tracks and bridges to handle 286,000 pound railcars, deferred maintenance and safety and speed improvements; \$4 to \$5 million annually for Class I infrastructure and repair; and \$3.5 billion annually for Class I infrastructure improvements, above and beyond repair and maintenance. AASHTO estimates total freight rail capital investment needs of \$175 billion to \$195 billion over twenty years, however the private rail industry will only be able to provide up to \$142 billion. The remainder (up to \$53 billion or \$2.6 billion annually) would require public investment.

Most states are facing the prospect of large budget deficits. Nationally, it is now estimated that state deficits for the coming fiscal year will be \$80 billion. There is little prospect that states will have the resources to undertake transportation infrastructure projects like high-speed rail in this environment without a federal partner. In fact, Florida's Governor Jeb Bush is seeking a special election to overturn the state-approved initiative to build a high-speed train across the state. States are now looking to the federal government for assistance for critical infrastructure needs that provide a public good. The concept of a RFDC provides a reasonable and cost effective alternative to traditional grants or revenue sharing for states. It also encourages the type of public/private partnerships that are essential if we are to meet the needs of those surface transportation projects that are not covered by the guarantees provided in TEA 21 and AIR 21.

Most of the Class I freight railroads admit that their internal cash flow is not sufficient to meet its massive ongoing capital investment needs. Maintaining the status quo for the freight railroads according to some officials will result in one of two things: the industry will be forced to shrink OR the federal government will be forced to take over the railroad infrastructure at a very high cost. In an environment where a significant amount of government support pays for the transportation infrastructure of their competition, railroads cannot afford to continue to only use private funds to finance their infrastructure needs, especially for projects that provide a public good. Financial markets require railroads to only make infrastructure investments where there is a reasonable rate of return and discourage investments where the primary benefit is for the public good (fuel conservation, air quality, congestion relief, safety and security). A concept like the RFDC proposal would result in a source of capital assistance for rail projects that have a public benefit and **would not** depend on the fuel tax revenues as a source of funding. In addition, it has the potential of helping the federal government avoid a huge bailout in the future if the Class I railroads continue to have constraints on how much they can devote to infrastructure spending. Also, infrastructure investments in rail projects that result in a public good and help attain public policy goals like cleaner air, less congestion on highways, creation of jobs and a stimulus to the economy, is good public policy.

Ports have been clamoring for more efficient on dock railroad freight access to their facilities that would assist them in avoiding the high cost and congestion of shipping goods by truck in and out of ports. In testimony before Congress recently, the American Association of Port Authorities indicated that some forecasts show that imports and exports will increase eightfold by 2040. This kind of growth would mean about 10,000

more trucks a day just along the I-95 corridor. That is a truck about every 270 yards between Miami and Boston. This funding mechanism would set in place a way for ports to shift more of their connecting traffic to rail and help avoid that kind of highway congestion. In addition, it could help address much needed security measures at our ports by using the RFDC to fund demonstration projects on new security technology in connection with the rail infrastructure improvements.

The short line railroads have a significant infrastructure problem. They cannot afford the cost of capital to upgrade their tracks to handle heavy freight cars to serve shippers along their lines. There is no federal program in place to assist them primarily because there are no funds in the transportation appropriations process available. If these low-density lines, which play such an important part in connecting rural areas to the national rail freight network, cannot get some assistance for their infrastructure needs they may eventually face abandonment.

There are many deserving high-speed rail projects that are on the shelf due to lack of funding. States will not be able to carry this burden alone. They need a federal partner. Every industrialized nation in the world has made significant investments in high-speed rail, leaving the United States far behind in the development and implementation of this technology. And, it is this technology that can do the most to alleviate congestion on highways and at airports.

Finally, Amtrak has significant infrastructure costs in the NEC that will require much more support from the federal government than they have been able to provide in the past. Currently, Amtrak is asking Congress for \$1.8 billion in federal funding for Fiscal Year

(FY) 2004, much of which is for infrastructure costs in the NEC. This level of funding will be very difficult to obtain through the appropriations process. Creating a RFDC would relieve Amtrak of the burden of finding all its infrastructure needs for the NEC in the appropriations process and allow the NEC states to play a larger role by seeking funds from the RFDC for capital projects in the Northeast Corridor. The RFDC could provide resources for the NEC infrastructure leaving Amtrak to depend on the appropriations process for its operating subsidy.

### **Conclusion**

- The appropriations process has become a less dependable source of funding for rail infrastructure since the enactment of guaranteed spending laws;
- There is an enormous need for rail passenger and freight infrastructure capital that may not have a high rate of return on the investment but would address such public policy issues as security, congestion relief, safety and security;
- Amtrak may not be able to obtain the \$1.8 billion in FY 2004 it needs to operate the national system and invest in its infrastructure out of the annual appropriations process;
- Increasing the fuel tax or using the revenues from fuel taxes paid by railroads to cover rail infrastructure costs does not appear to be a realistic alternative;
- There is a growing interest among policy makers to use the tax code, especially tax credit bonds, as a funding source for transportation infrastructure when funding is not available through the appropriations process;
- There is a strong public policy argument to provide a more equitable policy among all transportation modes by creating a funding mechanism for those modes

of surface transportation (railroads) that are not protected by guaranteed spending programs;

- States are facing large deficits and will be unable to address critical infrastructure needs and are unable to assume any additional debt;
- The United States has fallen behind the rest of the industrialized world in preserving and improving its rail infrastructure; and
- The idea of a Railroad Finance and Development Corporation financed by tax-credit bonds for non-covered transportation programs has the potential of creating a coalition of all those who benefit from the proceeds to get this done in a way that is good for them and good for the country. Unlike proposals that would use the proceeds from federal diesel fuel taxes, taxes on rail equipment, commuter ticket taxes, etc., this concept would not divide the transportation community—it would unite it.