



Memorandum

To: Darrell Smith
Chair, PRIIA Section 305 NGEC Finance Subcommittee

To: Brent Thompson, Section 305 NGEC Finance Subcommittee Vice Chair

CC: Steven J. Hewitt
NGEC Support Services Manager

CC: Eric Curtit
Chair, PRIIA Section 305 NGEC Executive Board

From: David Ewing
NGEC Policy Advisor

RE: Update on the status of the Finance Subcommittee's Exploration of Options for Funding/Financing Passenger Rail Equipment

DATE: August 19, 2014

Summary Overview:

The Finance Subcommittee heard from four different speakers on specific aspects of intercity passenger rail funding and finance. Each speaker provided supplemental material. One of the sessions was expanded to include additional participants. As planned, material generated from the Finance Subcommittee conference calls that included speakers will provide input to the 305 NGEC Future Working Group's efforts. Individual Finance Subcommittee members have stated that the presentations have provided value to them.

None of the four speakers requested a fee. Additional speakers are proposed. Future speakers will focus on governance as well as funding/finance issues.

Preliminary conclusion:

Despite a fragmented approach to funding, several funding/finance tools exist or can be reimagined or strengthened to allow the intercity passenger rail fleet to survive and supporting institutions to be created and/or continued until a dedicated funding source is established.

Details:

Format: Potential speakers were nominated by the consultant. Once the Subcommittee agreed, the speakers were contacted and scheduled. Alternatively, Subcommittee members nominated speakers.

Upon consideration by AASHTO, FRA, and others, specific presentations were made available to a broader audience.

The speakers presented for 15 to 20 minutes, each one provided either a PowerPoint and/or print material. A question and answer period followed. The materials were posted on the AASHTO maintained NGECC website. Materials were also posted on the States for Passenger Rail Coalition website.

The presentation and Q & A were summarized by the NGECC Support Services Manager, distributed as part of the minutes, and once approved, they were posted on the AASHTO maintained NGECC website, thus providing an archival function.

Two Points of Departure:

A consensus exists among the broader intercity passenger rail community that the funding of the mode requires a dedicated source of financial resources, that these funds be captured in a trust fund that is administered at a national level. Such a fund, indexed for inflation, would provide contract authority for longer term capital projects such as equipment.

All three sectors of 305 NGECC have endorsed this concept: Amtrak, the Federal Railroad Administration and the states.

Second, while these presentations occurred during a period of legislative consideration of federal surface transportation policy, it is important to note that PRIIA 305 NGECC does not lobby. These presentations were meant to inform individuals and the group. At points in each of the presentations, the federal legislative policy process was encountered, speakers and questioners were careful to acknowledge that the policy process could take to take a possible action or a set of actions that would result in a change of circumstance.

In the absence of a dedicated source of funding, a fragmented financial approach has evolved.

Simply put, what are the financial tools at hand? What tools could developed or re-imagined? To answer these questions, the Subcommittee chose to listen to the experts in the field.

The Process to Date:

Date	Speaker	Topic
October 26, 2012	Darrell Smith, Amtrak	Amtrak Review of potential use of RRIF as a funding source
June 4, 2014	Larry Salsi, Salsi Consult	The Federal Tax Code: History and Opportunity
June 4, 2014	Jennifer Moczygemba, Hatch Mott McDonald	Transportation Development Credits
July 30, 2014	Allan Rutter, Texas A & M University	A Review of the Landscape: Governance

Highlights:

Topic: Amtrak Review of potential use of Railroad Rehabilitation & Improvement Financing (RRIF) as a funding source – Gordon Hutchison/Darrell Smith:

Background (from FRA website, <http://www.fra.dot.gov/rpd/freight/1770.shtml>)

Gordon Hutchinson reviewed Amtrak’s experience with RRIF.

RRIF was established by the Transportation Equity Act for the 21st Century (TEA-21) and amended by the Safe Accountable, Flexible and Efficient Transportation Equity Act: a Legacy for Users (SAFETEA-LU). Under this program the FRA Administrator is authorized to provide direct loans and loan guarantees up to \$35.0 billion. Up to \$7.0 billion is reserved for projects benefiting freight railroads other than Class I carriers.

Among other items, the funding may be used to: Acquire, improve, or rehabilitate intermodal or rail equipment.

Direct loans can fund up to 100% of a railroad project with repayment periods of up to 35 years and interest rates equal to the cost of borrowing to the government.

Eligible borrowers include:

- Railroads
- State and local governments
- Government-sponsored authorities and corporations
- Joint ventures that include at least one railroad
- Limited option freight shippers who intend to construct a new rail connection

Project Priority

(*Federal Register*, Vol. 75, No. 188, September 29, 2010, Notices, pp 60165 - 60168)

FRA gives priority to projects that:

1. Enhance public safety.
2. Enhance the environment.
3. Promote economic development
4. Enable United States companies to be more competitive in international markets.
5. Are endorsed by the plans prepared under 23 U.S.C. 135 by the State or States in which they are located.
6. Preserve or enhance rail or intermodal service to small communities or rural areas.
7. Enhance service and capacity in the national rail system.
8. Materially alleviate rail capacity problems which degrade the provision of service to shippers and would fulfill a need in the national transportation system.

Recent Amtrak Experience

RRIF loan to fund 70 electric locomotives, spares and improvements:

- Arranged in June 2011
- \$563 million
- Credit risk premium of 4.424% paid on each drawdown
- Interest rate of 4.04%
- 4 year drawdown and 25 year repayment

Excellent result:

- Construction period – flexible
- Repayment period – flexible (long)
- Cost - competitive

Points to Consider Based on Amtrak's Experience:

- Borrower must clearly demonstrate ability to repay
- Terms and conditions are different than the financial marketplace
- Interest rate of Treasuries set higher than financial market
 - RRIF Loan interest rate – based on the time to final maturity (about 29 years)
 - Financial market interest rate – based on how long the full amount is effectively borrowed (about 20 years)
 - Penalty to borrow varies – perhaps 0.5% in this case

Gordon noted here that with the TIFIA loan program, if you meet all of the criteria, you will get the loan, whereas with the RRIF program, you must demonstrate the ability to pay, and they still do not have to grant the loan.

Discussion: The use of outside expertise

David Ewing asked if Amtrak had used outside consultants when applying for its RRIF loan. Gordon responded that they did use outside consultants, and explained that Amtrak had not purchased a large quantity of new equipment in a long time, so it did not have recent experience for this type of purchase. Therefore, there was great benefit to using outside consultants.

Vincent Brotski, Amtrak Legal, noted that Amtrak and FRA/DOT both used outside legal counsel as well.

Chad Edison, FRA, commented that he thought Gordon had provided a very good summary and explanation of RRIF and Amtrak's experience with it. He also noted that FRA had not only retained outside legal counsel, but also outside financial advisors as well.

Topic: Federal Tax Code and Passenger Rail Car Financing - Larry Salci, SalciConsult:

Mr. Salci's PowerPoint presentation is available at: <http://s4prc.org/advocacy-outreach>

The specific file:

[http://s4prc.org/sites/default/files/media/Leveraged Lease Transactions for Passenger Railcars and Equipment.pdf](http://s4prc.org/sites/default/files/media/Leveraged_Lease_Transactions_for_Passenger_Railcars_and_Equipment.pdf)

Larry provided the following presentation on the Federal Tax Code and Passenger Rail Car financing; he began by establishing three distinct types of leases:

- ☐ **True Lease** – A specific type of multi-year lease which does not pass ownership rights of the asset to the lessee. A true lease is an arrangement where the lessor (the person granting the lease) bears both the risks and rewards of ownership of the property.
- ☐ **Financial Lease** – Financial leases pass more of the aspects of ownership on to the lessee, such as maintenance and tax benefits from depreciation. Financial leases are often treated as loans (capitalized leases) by the IRS, whereas true leases are not.
- ☐ **Leveraged Lease** – A lease agreement that is partially financed by the lessor through a third-party financial institution. In a leveraged lease, the lending company holds the title to the leased asset, while the lessor creates the agreement with the lessee and collects the payment. The payments are then passed on to the lender.

He then went on to discuss: **LILOs, SILOs and QTEs:**

- ▣ **LILO**- “lease-in, lease-out transaction
- ▣ **SILO** – “sale-in, lease-out transaction
- ▣ **QTE** – Qualified Technical Equipment (depreciated over 5 years-exempt from Pickle Rule)
- ▣ **SILOs and LILOs** are variations on financing transactions born of the storied history of **sale leaseback transactions.**
- ▣ **Defenders** of SILO and LILO transactions have argued that they are legitimate investments providing a vital source of funding to public transportation systems.
- ▣ **Critics**, such as then Senate Finance Committee ranking minority member Chuck Grassley, have denounced them as nothing more than, “good old fashioned tax fraud”.
- ▣ **Between 1984 and 2004**, before the Congressional “crackdown” on LILOs and SILOs there were **400 transactions claiming tax deductions of more than \$35 billion.**
- ▣ **Public Transit Agencies** – in their heyday, these transactions found many willing tax-exempt participants –**there were 99 transactions involving passenger railcars, locomotives, and QTE**

Tax-Driven Benefits of LILOs and SILOs:

- ▣ LILOs and SILOs are generally unattractive investments from a pretax perspective. Their primary financial benefit is derived by transferring unused or unusable tax benefits to an investor that is able to use them.
- ▣ LILOs and SILOs depend on the cooperation of a tax-indifferent party, usually a government agency or foreign entity not subject to U.S. income tax.
- ▣ A tax-indifferent party receives no U.S. tax benefit from depreciation or interest deductions attributable to its assets.
- ▣ In a SILO transaction, a taxable third party takes advantage of these unusable tax benefits by purchasing property from the tax-exempt entity and then immediately leasing the property back to the tax-exempt entity. The taxable party deducts depreciation on the assets it now claims to own. The investor also claims significant interest expense deductions because it acquired the property primarily with borrow funds.

Tax Driven Benefits of LILOs and SILOs:

- ▣ A LILO is similar to a SILO; however, instead of purchasing the property, the taxable party first leases the property from the tax-exempt entity and then immediately leases the property back to the tax-exempt entity. The taxable party claims deductions for “rent” (and interest expense for any related financing).
- ▣ In both SILOs and LILOs, the tax exempt entity continues to use, operate, and maintain the property during the lease term in the same manner as before.

- The tax-exempt entity receives a fee for participating, generally ranging from 4 to 8 percent of the transactions value. This fee represents a portion of the investor's tax benefits that are shared with the tax-exempt entity.

Larry then carefully distribute critical aspects of the tax finance as related to equipment, he summarized:

- In 1999 the IRS issued Rev. Ruling 99-14 that publicly announced that the LILO transaction was an abusive tax shelter, lacking economic substance and in 2002 added Rev. Ruling 2002-69 further adding that the circularity of cash flows and defeasance denied claimed interest and rent deductions.
- SILOs are sale-leaseback, but similar in form to a LILO, except the head lease is replaced with a sale to U.S. investor. But similar to LILOs payments are substantially defeased. Some SILO transactions have been found legal by the courts, especially where the profit motive for an investor is to be reasonably expected. The profit motive standard is measured by the expected pre-tax return. If less than the bank's cost of funds for its leasing business, the courts have ruled that SILO transactions were money losing propositions on a net present value basis.
- Question -What is the environment in Congress for transactions that reduce treasury tax collections during times of large federal budget deficits?

Discussion: Could a re-imagined tax finance program generate funds for a successor organization:

Eric Curtit asked if it would be possible to tighten the tax law to limit the scope for potential future use.

Mr. Salci noted that the time to do this would be during the re-authorization process. Talk to congressional staff to see if there is an appetite to "capture the depreciation" and narrow down the scope to show a public benefit. Whether it can get done all depends on the political environment and what the appetite of the financial institutions such as Wells Fargo and others is. After what has happened in the past they would be very hesitant unless the law is made very clear.

Eric commented that it would seem the approach needs to be to get it narrowed and made clear through the legislative process rather than through the courts or judicial system.

David Ewing asked "building on Eric's question" – is it feasible that with a narrowed and clearer scope, "a fee could be paid to a successor to the NGEC to fund that entity?"

Mr. Salci replied – that this could be a way to go, but, I would still depend on what Congress' appetite is.

David elaborated “it could provide money for funding the NGENC and funding a standardized fleet...this would feed the goal of standardization and economic development.” David added, and Larry agreed, this would need to be an “education and outreach” effort.

Further discussion took place following Allan Rutter’s presentation (see below):

What are the prospects of restoring the strategy of using safe harbor leasing for passenger rail equipment?

Allan noted that some form of structure for equipment leasing makes sense for public sector entities since they are being used in the private sector (freight and airlines). He added – “if it works for carrying grain, it should work for carrying people.”

Allan suggested that this should be considered in Reauthorization and recommended that the FRA talk about it with Treasury.

Topic: Transportation Development Credits Jennifer Moczygemba, Hatch Mott MacDonald:

Jennifer provided a summary report on the use of Transportation Development Credits -rather than cash – is seen as a potential remedy to lack of capital for equipment and other major intercity passenger rail projects.

Jennifer provided the following link as additional information for the Finance subcommittee members:

<http://ftp.dot.state.tx.us/pub/txdot-info/lgp/tech-memo-transportation-development-credits.pdf>

The general concept behind Transportation Development Credits (TDC) or toll credits is to leverage federal funds without using cash. States have issues with finding sources of revenue for non-highway activities because for the most part they cannot use the gas tax revenues for other modes. TDC’s are meant to provide the ability to flex those funds through toll credits.

Currently, however, while transit type projects can be eligible, intercity passenger rail or bus projects are excluded.

Because toll credits can give states access to federal funds without putting out actual cash, it can be a viable solution, but not for rail unless flexibility and eligibility changes are made.

Discussion: Allowing tolling of the existing interstate system and construction of new tolled facilities provides additional opportunities:

Larry Salci asked if the toll credits can be used only from revenue from existing toll roads or can it be used for interstate highways being converted to toll roads.

Jennifer referred Larry to the link (above) but responded in regard to converted interstates “probably not without an agreement with Federal Highways.”

David Ewing noted that the Obama Administration’s MAP-21 reauthorization proposal – Grow America allows for the ability to toll existing interstates to generate funds for repairs and maintenance. He asked “would this then give us a chance to utilize the funds as additional ‘soft match’?”

The response was that in identifying new tolling it would be necessary to define how the funds are structured. The money would need to be in excess of the O&M and road repairs.

Further discussion took part after Allan Rutter’s presentation: (see discussion following Mr. Rutter’s presentation summary below)

Topic: Send Lawyers, Trains and Money: Allan Rutter, Research Scientist Texas A&M Transportation Institute:

How’d They Do That?

Here’s How: Governance and Finance

- Look at examples of leading states
- Examine how states organize for passenger rail functions
- Detail how states finance capital and operating expenses

How “Leading” States Were Identified

- Look at examples of leading states
- Examine how states organize for passenger rail functions
- Detail how states finance capital and operating expenses

Leading States List

Categories	States
VDRPT Model, Corridor Support, Track 2	California, Illinois, North Carolina, Ohio, Washington
VDRPT Model, Corridor Support	Michigan, New York, Pennsylvania

Corridor Support, Track 2	Maine, Wisconsin*
VDRPT Model, Track 2	Florida*
Corridor Support	Indiana, Missouri, Oklahoma, Oregon, Texas, Vermont, Virginia

- Original Track 2 recipients

What Do I Mean by “Governance”?

The organizational, institutional, and transactional structures and relationships by which passenger rail services are planned, administered and operated.

Passenger Rail Functions

- Planning/Programming: State Rail Plan, feasibility studies, corridor prioritization, environmental clearance
- Design/Construction: PS&E, ROW, operational modeling, equipment procurement, infrastructure improvements
- Operation/Maintenance: train operations, infrastructure & equipment maintenance, P3 for operations/maintenance
- Financing: federal capital funding, state/local contributions for capital and operating, freight railroad infrastructure cost sharing (if any)

Functional Permutations

Function	Governance Options
Planning/Programming	Local/regional bodies, rail advisory groups, DOT rail divisions, independent rail agencies
Design and Construction	Local/regional bodies, DOT rail divisions, freight railroads, Amtrak, independent rail agencies, private contractors

Operations and Maintenance	Local/regional bodies, DOT rail divisions, freight railroads, Amtrak, independent rail agencies, private contractors
Financing	Local/regional bodies, DOT rail divisions, freight railroads, Amtrak, independent rail agencies, federal agencies, state agencies

NGEC Equipment Committee Scenarios

- Examined equipment procurement, maintenance, ownership and governance
- Four scenarios involving levels of state autonomy, private involvement, regional and national authority
- Scenarios for other functions could be useful

What's in Your Wallet?

- How do leading states fund passenger rail?
- Look at two types of financing mechanisms—revenues (how money is raised) and funds (how revenues are aggregated or leveraged)

Revenue and Funding Options

Revenues		Funds
Sales and Use Taxes	Lottery Proceeds	General Funds
Sales Tax on Motor Fuels	Tax Increment Financing	General Obligation Bonds
Motor Fuels Taxes	Property Taxes	Revenue Bonds
Motor Vehicle Sales Taxes	Public-Private Partnerships	Flexible Transportation Funds
Motor Vehicle Registration Taxes	Freight Railroad Fees	Dedicated Rail Funding
Rental Car Taxes	Rail Passenger Charges	Local Transportation Funds

Funds
General Funds
General Obligation Bonds
Revenue Bonds
Flexible Transportation Funds
Dedicated Rail Funding
Local Transportation Funds

Revenue Examples

Revenue	States That Use Revenues for Passenger Rail
Sales and Use Taxes	California, Florida, Indiana, Michigan, New York, North Carolina, Pennsylvania, Texas, Virginia
Sales Tax on Motor Fuels	California, Illinois, Indiana, Michigan, New York, Virginia
Motor Fuels Taxes	California, Florida, Michigan, North Carolina, Oklahoma, Virginia
Motor Vehicle Sales Taxes	Michigan, North Carolina, Washington
Motor Vehicle Registration Taxes	Florida, Michigan, North Carolina

Rental Car Taxes	Florida, Maine, Virginia, Washington
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Revenue Examples

Revenue	States That Use Revenues for Passenger Rail
Lottery Proceeds	Oregon (for freight rail)
Tax Increment Financing	Illinois, North Carolina, Ohio, Texas, Virginia
Property Taxes	Florida
Public-Private Partnerships	Illinois, Vermont, Virginia
Freight Railroad Fees	California (project), Maine, Missouri (project), Oklahoma
Rail Passenger Charges	NA

Note: Passenger Rail use also includes transit

Rail Passenger Charges are additional to fares

Funds Examples

Revenue	States That Use Funds for Passenger Rail
General Funds	California, Illinois, Indiana, Missouri, New York, Oklahoma, Vermont, Wisconsin
General Obligation Bonds	California, Illinois, Maine, New York, Ohio, Wisconsin

Revenue Bonds	Texas, Virginia
Flexible Transportation Funds	California, Florida, Michigan, North Carolina, Oklahoma, Pennsylvania, Vermont, Washington
Dedicated Rail Funding	Florida, Maine, Michigan, Oklahoma, Oregon, Virginia
Local Transportation Funds	California, Florida, North Carolina, Vermont, Virginia

Note: Passenger Rail use also includes transit

Don't Cash That Check Just Yet

- Some revenues and funds are constitutionally off-limits to passenger rail
- Revenue/funds need to be raise enough \$ to make them worth the political effort to create
- Not all funding sources have a good match to passenger rail functions (not a deal-killer)

Possible Lessons for NGEC

- States might have more flexibility in contracting for services/equipment from a non-profit than via compacts/pooled funds
- Cities and transit agencies employ variety of O&M contracting mechanisms worth study
- Consider revenues on a corridor level within states, even if through regional body
- States might consider reallocating state rail property taxes (if any)

Thanks for the invitation and for paying attention

Allan was asked about TDC; he noted that TDC's are more flexible than other funding uses and could make sense in a more global sense. The key would be to expand eligibility.

Allan added that there are two hurdles to overcome – People need to get used to tolling something new or an existing facility – and they need to get used to having the revenues used beyond the toll road or facility where the revenue is being generated.

A listener asked-Michigan has used toll credits on transit projects with FTA match. Has anyone done it for FRA or TIGER?

David Ewing responded “you are not able to do it”.

Tim Hoeffner mentioned New Market Tax Credits as a possibility. The US Treasury gives credits for investment in economically stressed areas. The money must go for infrastructure. Michigan is using this. However, it is not traditionally used for transportation projects – usually housing or other public infrastructure.

Allan Rutter provided a tour de force of existing funding/financing sources as well as institutional challenges, he concluded:

- Some revenues and funds are constitutionally off-limits to passenger rail
- Revenue/funds need to be raise enough \$ to make them worth the political effort to create
- Not all funding sources have a good match to passenger rail functions (not a deal-killer)

He suggested several possible “lessons” for the NGEC:

- States might have more flexibility in contracting for services/equipment from a non-profit than via compacts/pooled funds
- Cities and transit agencies employ variety of O&M contracting mechanisms worth study
- Consider revenues on a corridor level within states, even if through regional body
- States might consider reallocating state rail property taxes (if any)

Discussion: A rich array of topics

Tax Incremental Financing: - Are states using this?

This tool has been mostly used in transit oriented efforts – mostly at the station level or for certain kinds of equipment. **Allan will provide (through Steve Hewitt)** individual examples of the use of this tool. Although primarily used for transit – Alan believes it could be used for passenger rail as well.

Are there topics that have not yet been explored by us (NGEC) or that could be considered?

Allan Rutter responded: As other committees are considering approval of 3rd party’s - across state lines – the NGEC should look into financial consideration of such approaches, a pooled approach to train operations. States, however, would need to see if they can legally use funds for these kinds of things. He cautioned that “you should be aware of the financial implications of these kinds of considerations.”

Do you see a funding mechanism that we (NGEC) should stay away from? Is it worth it?

Allan commented – It is important that you develop good relationships with your comptroller. That body will know how the money will come about. As you think about things make sure you

create those internal relationships to get an outside perspective on assessing a potential revenue stream. Is it stable enough to bond against – is it enough for what I want to do?

He added that in considering bonding – you must factor in the transactional costs.

Eric Curtit, Missouri DOT, noted that there was a program proposed which would have taken 2% of general revenue growth and dedicated it to transportation. Unfortunately, this proposal failed to get approval.

Allan Rutter commented that local tax increments can work – such as a local sales tax – beginning with a baseline. Statewide Texas created a state “rainy day fund”. The first few years there was little revenue acquired, but in the last five years or so there are tens of millions of dollars generated (mostly due to fracking). The legislature is now looking to reallocate \$1.5 billion annually to transportation – multi-modal. The trick to this sort of program in perpetuity is either it grows beyond expectations or it is not steady enough to plan for it.

Use of Passenger Facility Charges for passenger rail – is this doable?

Allan was unsure if a supplemental charge could be applied in this manner for passenger rail.

Eric Curtit noted that Missouri is doing it now. It’s \$5 a head – and is similar to what airlines do – the passengers never see it. It’s almost like telling Amtrak to raise the fare \$5.

Allan asked – what are the applications of this surcharge?

Eric responded – “state revenue”.

Allan commented the advantage of such a PFC type charge is that you could finance against it.

Darrell Smith noted that the Amtrak pricing revenue management group would be good to hear from on this topic.

Eric Curtit agreed to get more information on the particulars of Missouri’s program and get it out through Steve Hewitt. (It will go to Kevin Brubaker as well as the Finance subcommittee and Allan Rutter)

Next Steps:

Allan Rutter’s presentation stimulated a rich set of questions. One line of conversation centered on the link between finance and multistate/ multiagency governance. More specifically:

For Passenger Rail – how about the use of Joint Powers Authority – such as that is being used in California?

Allan responded that consideration must be made of the overall cost of administering – organizationally. The structure makes sense – but it needs to be very clear about how the relationships happen. Personalities and the capabilities of the people who are running these things are critical. David Kutrosky in California is a prime positive example.

Allan also noted that a joint power authority with money is a lot easier than one without money.

Subsequently Tim Hoeffner recommended a speaker from WMATA- the Washington Metropolitan Area Transportation Authority. The group wholeheartedly agreed that that this multi-state group might provide sights. Chair Darrell Smith volunteered to explore possible speakers.

The identification of the powerful, direct link between governance, especially multi-state, multi-agency governance, and the funding/financing of a modern intercity passenger rail fleet is another critical finding. The prospect of identifying specific lessons learned from WMATA and sister agencies could be a critical product for use by the Future’s committee. The methodology-speaker-strategic presentation-q and a-would appear to have been successful. Part of the success is related to speakers and their substantial level of effort, should the Executive Committee so decide, a note of thanks to the four presenters would be in order.