



Washington State Transportation  
Commission

**Statewide Rail Capacity and System Needs Study**  
*Task 6 - National Funding Opportunities for Washington State  
Passenger and Freight Rail Programs*

Technical

**Memorandum**

*prepared for*

**Washington State Transportation Commission**

*prepared by*

**Cambridge Systematics, Inc.**

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September 2006

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# Task 6 – National Funding Opportunities for Washington State Passenger and Freight Rail Program

## ■ Summary

The purpose of the Washington State Transportation Commission (WTC) Rail Capacity and Needs Study Task 6 is to identify existing and emerging national funding opportunities for Washington State rail improvement projects. It also is to advise Washington State as to how it might position itself to take advantage of these opportunities, either alone or as part of a multi-state Pacific Northwest or West Coast consortium.

Advances towards a national rail policy and funding framework were more modest in Safe, Accountable, Flexible and Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) than many had hoped for. However, there is a growing recognition that multi-state coalitions and the Federal government will play a role in the future of the nation's rail system because the scale of the rail system is multi-state and national. There has been much recent emphasis in national transportation policy discussions of the need for a national rail policy to ensure that there is adequate investment to eliminate critical rail bottlenecks and add needed capacity. The emphasis has increased as states have considered the difficulties of accommodating more truck traffic on highways and as shippers and motor carriers face increased fuel and labor costs for trucking.

The emergence of public-private partnerships such as the Alameda Corridor in Southern California and the CREATE project in Chicago are also a signal of what the future might hold for freight rail programs. Multi-state coalitions such as those pioneered by the I-95 Corridor Coalition with its landmark Mid-Atlantic Rail Operations Study (MAROps) hold promise as models for how states and private freight railroads can work together in the future. The American Association of State Highway Officials (AASHTO) in its new Freight Bottom Line Report is attempting to define directions for national rail freight policy, recognizing the need for a balanced multimodal transportation system to meet the nation's goods movement needs. Recent funding increases proposed for Amtrak and the strong role that a number of states have taken in intercity passenger rail also suggest directions for future public funding of the passenger rail system.

Washington State can take an aggressive position in promoting an appropriate role for the public sector in the future of the private and public rail system. The WTC Rail Capacity and Needs Study recognizes the importance of an effective rail system to meeting the economic, environmental, and mobility needs of the State. By clearly defining when and

how the public sector should play a constructive role in partnership with the private sector to advance rail system goals, Washington State can be a leader in the national rail policy discussion. By examining emerging directions in this national discussion, the State can also position itself effectively to take advantage of emerging funding opportunities and offer itself as a model for the rest of the nation. As growth in trade and passenger travel put increasing pressure on the State's rail system, the necessity of protecting, maintaining, and growing the system will be viewed as a crucial aspect of the State's economic well-being. Therefore, the State must have a clear idea of how it can best support and leverage private rail investment to support its continued functioning and growth.

This technical memorandum provides the initial guidance to help ensure that the State is started on the right path to achieve these goals by identifying directions in national rail policy and funding opportunities that the State can support and in which it can participate.

Three main categories of funding sources were analyzed: existing Federal programs; state programs and multi-state/multi-partnership financial strategies; and bills under consideration/developing strategies at the national level. The findings are reported in three sections:

- **Section 1.0** of the technical memorandum reviews current Federal grants, loans, and tax credits used to support and leverage private sector investment in rail; some of which are already being utilized by Washington State.
- **Section 2.0** describes funding strategies undertaken by other states and multi-state/multi-partnership agreements to support rail investments.
- **Section 3.0** presents bills under consideration, innovative public private partnership examples, and examples of developing freight initiatives. Any of these may become sources of funding for future rail projects.

## ■ 1.0 Federal Rail Programs

Federal rail funding mechanisms of possible use to Washington State can be grouped into two categories: Federal grants and Federal financing tools (tax credits and loans). Another section including "other funding methods" (such as private activity bonds, public/private partnerships, and loans/tax credits), is included in a later section of this technical memorandum. The two types differ from each other, in that, grants are direct investments by the Federal government into the state transportation system that do not require repayment. Although they generally require a contribution from the state or other non-Federal source, grants usually cover a significant portion of the proposed project amount. Loans and tax credits, on the other hand, are examples of non-direct investment. Loans are funds that are borrowed from the Federal government by a state (or other non-Federal source). They must be repaid to the Federal government over a fixed timeframe. In the case of tax credits, no repayment is required, but the source of funding comes not

from a direct investment, but from an alleviation of tax responsibility. Of the three funding types, tax credits may provide the greatest flexibility for the private sector and the least control by the public sector over the types of projects that are advanced.

## 1.1 Federal Grants

### Federal Department of Transportation

Funding programs discussed in this section are examples of direct investment by the Federal government that often cover between 80 to 90 percent of total project costs, with the remaining 10 to 20 percent the responsibility of the state or another non-Federal agency. Washington State already uses some of these mechanisms to fund its projects and programs. However, it is worth noting that several of the programs are in the process of being updated or expanded, creating new opportunities for Washington State to consider. Table 1 provides a summary and overview of these grant sources.

**Table 1. Federal Grant Sources Summary**

Program	Code	Funding Use	Funding Allocation
Highway Railroad Grade Crossing program	FHWA Section 130	Improvement of highway-railroad crossings	Federal share is 90%
CMAQ	TEA-21	Projects that improve/mitigate congestion	Formula based
Capital Grant Program for Rail line Relocation and Improvement projects	Section 9002 SAFETEA-LU	Rail line relocation and improvement projects that foster economic development.	Federal share is 90%, not to exceed \$20 million
PNRS program	SAFETEA-LU Section 1301	Projects of national significance (rail, highway, or any project eligible under 23 USC)	Federal share is 80%
Freight Intermodal Distribution Pilot program	SAFETEA-LU Section 1306	Development of intermodal freight transportation	Up to \$1 million per project per year

<b>Program</b>	<b>Code</b>	<b>Funding Use</b>	<b>Funding Allocation</b>
New Starts program	SAFETEA-LU Section 5309	Fixed-guideway transit projects, including new systems and extensions to existing systems	Formula based
New Small Starts	SAFETEA-LU Section 1309	Transit capital investments less than \$75 million	Program will start operating in 2007 through 2009
Fixed-Guideway Modernization	SAFETEA-LU	Modernization and rehabilitation of fixed-guideway transit systems	Formula based
Economic Development Administration Funds	Public Works and Economic Development Act of 1965	Projects that promote job creation or retention in rural/industrial regions	Application and selection process
Community Facilities program		Community facilitates in rural regions	Application and selection process

The projects described in this section are continuations of existing programs or were newly created by the SAFETEA-LU legislation. There had been high hopes that Congress would take a bolder stance on funding flexibility as part of the reauthorization process and allow funding of rail projects from highway provisions as was done for transit; however, this did not happen. There were successes, including the new provisions for Transportation Infrastructure Finance and Innovation Act (TIFIA) loans that allow funding of freight projects. However, there continues to be a lack of diversity of funding sources for freight projects. Highway agencies, much of the trucking industry, and portions of the construction industry are opposed to opening the Highway Trust Fund for investments in non-highway projects, fearing that this will aggravate the short-fall in investments in highways. This continues to be an obstacle to a major national funding program for rail.

The issue of funding flexibility and a source of funding for a national rail infrastructure program will be discussed as part of the National Surface Transportation Policy and Revenue Study Commission's deliberations (The Commission was created by SAFETEA-LU). The WTC Rail Capacity and Needs Study can assist in this discussion by defining model policies and a policy process for public investment in the private rail system, and by defining appropriate roles in this process of state, multi-state, and Federal involvement. The National Surface Transportation Commission will continue meeting

and developing its recommendations through 2006, with an expected report and recommendations due to Congress in July 2007. (A technical corrections bill currently being debated by Congress may extend the Commission's report date by six months and provide more funding for the Coalition). This strategy for Washington State is discussed further in Section 3.0 of this memorandum.

Another disappointing aspect of the recent Federal reauthorization process was the degree to which promising new programs were subject to project earmarks and how little discretion the U.S. Department of Transportation was given in implementing these programs. This was particularly true of the National Corridor Infrastructure Improvement Program, the Projects of National and Regional Significance, and the Freight Intermodal Distribution Pilot Grant Program. Almost all funds in those programs were earmarked by Congress to specific projects. Nonetheless, the Federal Highway Administration (FHWA) is preparing regulations for these programs with the intent of influencing the character of the projects that were earmarked by Congress. While this might seem to be of little importance to Washington State, it may still be beneficial for the State to comment on the regulations and to meet with the FHWA staff to influence the regulations for these programs and their future directions. This could set the stage for a more favorable outcome in the next reauthorization (as well as ensure that any project earmarks received by Washington State can be implemented consistent with the State's rail policies).

### ***FHWA Section 130 – Highway Railroad Grade Crossing Program***

The FHWA Section 130 Highway Railroad Grade Crossing program provides grants for the improvement of highway-railroad grade crossings that enhance safety, and other projects including: separation or protection of grades at crossings; the reconstruction of existing railroad grade crossing structures; and the relocation of highways or rail lines to eliminate grade crossings.

Funds from the FHWA Section 130 Program can be used to further freight rail projects, provided that the projects improve safety at grade crossings. In general, Federal funding is available at a 90-percent share. For certain projects (including signing, pavement markings, active warning devices, and crossing closures), the Federal share may amount to 100 percent.

**Current funding level.** The funds for this program remained practically unchanged between 1987 and 2003, totaling around \$150 million annually. SAFETEA-LU increased Section 130 program funding to \$220 million per year for FY 2006 – FY 2009.

**Recommendation.** Washington State should support the continuation and expansion of the highway-crossing program. It should also apply for funding projects that advance the WTC Rail Study goals and program objectives such as improving access and mobility at the international ports.

### ***Congestion Mitigation and Air Quality (CMAQ) Program***

The Congestion Mitigation and Air Quality (CMAQ) program was created in 1991 by Intermodal Surface Transportation Efficiency Act (ISTEA) in order to provide innovative

funding for transportation projects that improve air quality, and help achieve compliance with national air quality standards set forth by the Clean Air Act. CMAQ funds are often used for freight and passenger projects; examples include: priority control systems for transit vehicles, intermodal facilities, rail track rehabilitation, and new rail sidings. CMAQ funds also can be used for construction activities that benefit private companies, if it can be shown that the project will improve air quality by removing trucks off of the road.

**Current funding level.** SAFETEA-LU provided \$8.6 billion for the CMAQ program for the FY 2006 – FY 2009 period. The funds are fully allocated to the individual states. Washington State will receive between \$26 million to \$29 million for FY 2004 – FY 2009.

**Recommendation.** Because CMAQ funding funds are allocated to states based on the population of local areas in the state that are in noncompliance, or seeking to maintain compliance, with national standards for ozone and carbon monoxide (CO), there is little that Washington State can do to increase its share. However, it can estimate its next CMAQ allotment and make plans for packaging funds with other sources to create the largest benefit to the freight rail system. Projects that will result in either maintaining or adding to the amount of freight diverted from truck to rail would be particularly well-suited for these funds.

### ***Capital Grant Program for Rail Line Relocation and Improvement Projects***

The Capital Grant Program for Rail Line Relocation and Improvement projects was created under Section 9002 of SAFETEA-LU to fund local rail-line relocation and improvement projects. States are eligible to receive grant funds from this program for the following types of rail projects:

- Rail line improvement projects serving the purpose of mitigating the impacts of rail traffic on safety, motor vehicle traffic flow, community quality of life, and/or economic development; and
- Rail line relocation projects involving a lateral or vertical relocation of any portion of the rail line.

**Current funding level.** Section 9002 of SAFETEA-LU authorizes, but does not appropriate, \$350 million per year for each of the FY 2006 to FY 2009 period. According to the grant allocation requirements slated under this program, at least 50 percent of the grant funds awarded under this program in a fiscal year must be provided as grant awards not exceeding \$20 million each. The state or non-Federal entity receiving the grant is required to pay at least 10 percent of the total cost of the project being funded by this grant program.

**Recommendation.** There is no funding allocation for FY 2006. However, Washington State should track the progress of this source to ensure that it has projects at the ready in the event that funds are appropriated in the FY 2007 to FY 2009 cycle. Several of the WTC Rail Study program policies include rail line relocations and safety projects that could be funded from this program.

### ***Projects of National and Regional Significance (PNRS) Program***

The Projects of National and Regional Significance (PNRS) program was created by Section 1301 of SAFETEA-LU to provide grant funds for high-cost projects of national or regional significance. Projects eligible for funding under this program include any surface transportation project authorized under 23 United States Code (USC) for assistance, including freight rail projects. In addition, projects must have a total eligible project cost greater than or equal to the minimum of \$500 million; or 75 percent of the total Federal highway funds apportioned to the state where the project is located (in the most recent fiscal year). Federal shares for this program are generally 80 percent of project total cost. Eligible project activities include development phase activities, right-of-way acquisition, construction, reconstruction, and rehabilitation, environmental mitigation, construction contingencies, equipment acquisition, and operational improvements.

**Current funding level.** Funds are allocated to projects based on a competitive evaluation process based on the ability of projects to satisfy criteria that include, but are not limited to, generating national economic benefits, reducing congestion, and improving transportation safety. SAFETEA-LU authorized \$1.602 billion for this program from FY 2006 to FY 2009.

**Recommendation.** Washington State received a \$220 million earmark under SAFETEA-LU for the Alaska Way viaduct and seawall replacement project, one of the largest to be distributed in FY 2005 to FY 2009. However, it should consider positioning several of the larger rail infrastructure projects for PNRS funding in the future. Appropriate projects would be major capital investments such as the crown-cutting of Stampede Pass to accommodate double-stack container trains. The Stampede Pass project would be eligible because it would facilitate movement and reduce rail costs between the Washington State's deep water ports and the eastern United State, generating national economic benefits as well as local Washington State benefits. However, it is unlikely that Congress will do anything to change existing earmarks in this program in an election year, so this will be a longer-term strategy.

### ***Freight Intermodal Distribution Pilot Grant Program***

The Freight Intermodal Distribution Pilot Grant program was created under Section 1306 of SAFETEA-LU to provide grant funds to states to facilitate and support the development of intermodal freight transportation initiatives at the state and local levels for congestion reduction and safety enhancements, and to provide capital funds to address freight distribution and infrastructure needs at intermodal freight facilities and inland ports. This is a pilot program, and Congress earmarked all the grant funds from this program, totaling \$30 million, to five states (Alaska, California, Georgia, North Carolina, and Oregon) for six projects, with each project receiving \$1 million for the 5 years from FY 2005 through FY 2009.

**Current funding level.** \$30 million, with all funds earmarked to six pilot projects.

**Recommendation.** Track the outcome of this project and position intermodal projects for future rounds of funding. An appropriate Washington State project might be developing

an intermodal freight center to support agricultural or industrial development strategies. Considering that SAFETEA-LU has already allocated this funding source through FY 2009, this will be a longer-term strategy.

### ***New Starts Program***

The New Starts program was continued under Section 5309 of SAFETEA-LU, which provides funds for new fixed-guideway transit projects including new systems and extensions to existing systems. Rail transit projects eligible for funding under New Starts include heavy-rail transit systems, light-rail transit (LRT) systems, automated guideway transit systems, and commuter rail. Projects eligible for New Starts funding are earmarked in the SAFETEA-LU authorization. Funds for project construction are generally provided after a detailed review of the project by the Federal government and a subsequent entry into a contingent funding commitment that is referred to as the Full Funding Grant Agreement (FFGA).

Section 1309 of SAFETEA-LU also created a new “Small Starts” (Capital Investment Grants Less Than \$75 million) program for smaller projects with a Federal New Starts share of less than \$75 million.

**Current funding level.** Congress earmarked \$6.578 billion in New Starts funding in SAFETEA-LU from FY 2006 through FY 2009. The new “Small Starts” program will be funded, starting FY 2007 to FY 2009, with a \$200 million takedown annually from the New Starts apportionments.

**Recommendation.** Although funds are already earmarked for the FY 2006 – 2009 cycle, Washington State can track the guidelines for selection of projects and position Washington State projects for consideration during the next funding cycle. Several of the proposed passenger rail programs would be ideally suited to be New Starts projects in the next funding cycle.

### ***Fixed-Guideway Modernization***

The Fixed-Guideway Modernization program, also referred to as the Rail Modernization program, remains unchanged under Section 5309 of SAFETEA-LU, and provides funds for the modernization and rehabilitation of fixed-guideway transit systems. All types of rail transit projects are eligible for funding from this program. Fixed-Guideway Modernization program is classified as a formula program for authorization in SAFETEA-LU; wherein, funds are apportioned to projects based on a formula contained in authorizing legislation.

**Current funding level.** SAFETEA-LU authorizes \$6.076 billion from FY 2006 to FY 2009 for this program. Although this entire funding source is currently earmarked for projects and, therefore, not available for new applicants, it is a potential funding source in the coming fiscal cycle.

**Recommendation.** The State should consider this source in the future to support and modernize any fixed-guideway transit systems that are currently under construction or planned.

## United States Department of Commerce

### *Economic Development Administration (EDA) Funds*

The U.S. Department of Commerce's Economic Development Administration (EDA) provides grants for economic development projects in economically distressed industrial sites. A critical objective of the program is to promote job creation and/or retention in the region. Eligible projects must be located within an EDA-designated redevelopment area or economic development center. Freight-related projects that are eligible for funding from this program include: industrial access roads, port development and expansion, and railroad spurs and sidings.

Evidence of the economic distress that the project is intended to alleviate is required of the grantees. The program provides grant assistance up to 50 percent of a project cost; however, it can provide up to 80 percent of cost for projects located in severely-depressed areas.

**Current funding level.** During the last quarter of 2005, the EDA announced 117 grants greater than \$100,000, totaling almost \$103 million. The total value of grants awarded under the program totaled over \$240 million.

**Recommendation.** This funding source could be used by Washington State for rail improvement projects such as industrial rail spurs and sidings in industrial areas that can be shown to support employment growth and contribute to economic development.

## U.S. Department of Agriculture

### *Community Facilities Program*

The U.S. Department of Agriculture Community Facilities program provides three types of funding for the construction, enlargement, extension, or improvement of community facilities in rural areas and towns with a population of 20,000 or less. The three programs are:

1. Direct Community Facility Loans,
2. Community Facility Loan Guarantees, and
3. Community Facility Grant Program.

Grant assistance is available for up to 75 percent of project cost. Rail-related community facilities eligible for funding from this program include rail spurs serving industrial parks, and other railroad infrastructure in the region such as yards, sidings, and mainline tracks.

**Current funding level.** The Community Facility Program amounts to \$297 million in direct loans, \$208 million in loan guarantees, and \$17 million in grants for FY 2007. The average loan, loan guarantee, and grant amounts are estimated to be \$442,000; \$860,000; and \$32,000, respectively.

**Recommendation.** This funding source could be used by Washington State for rail improvement projects in rural agricultural and industrial regions.

## 1.2 Federal Loans and Tax Credits

The funding programs described in this section include both loans and credit enhancement programs. In the case of loans, a project sponsor borrows funds directly from a state DOT or the Federal government under the condition that the funds will be repaid. Credit enhancement involves the state DOT or the Federal government making the funds available on a contingent, or standby, basis. An example of this is a Transportation Infrastructure Finance and Innovation Act (TIFIA) loan guarantee. This type of credit enhancement helps to reduce the risk to investors and, thus, allows the project sponsor to borrow at lower interest rates. Table 2 lists the loans and tax credit programs and their intended use.

**Table 2. Federal Loans and Tax Credits Summary**

<b>Program</b>	<b>Code</b>	<b>Projects Funded</b>	<b>Funding</b>
Railroad Rehabilitation and Investment Financing (RRIF) program	TEA-21 Section 7203	Acquisition, improvement, or rehabilitation of freight and passenger rail facilities, also refinance existing debt	Direct loans and loan guarantees to public and private entities
TIFIA	23 USC 181-189	Large surface transportation projects of national significance	Loans and guarantees, contingent Federal loans
State Infrastructure Banks (SIB)	National Highway System (NHS) Designation Act Section 350	Transportation projects	Subordinate loans, interest rate buydowns on third-party loans, loan guarantees, and line of credit
Railroad Track Maintenance Credit	Internal Revenue Code Section 45G	Track maintenance on any Class II or Class III track	Tax credit equal to 50% of the maintenance and rehabilitation expenditures
Private Activity Bonds	SAFETEA-LU Section 11143	Surface Transportation Projects	National capacity of liability \$15 billion

Several loan and credit programs that can be used to finance freight rail projects at the state level were created or changed substantially in SAFETEA-LU. These include:

- The Railroad Rehabilitation and Investment Financing Program (RRIF), which saw a tenfold increase in funding, from \$3.5 billion to \$35 billion.
- Transportation Infrastructure Finance and Innovation Act (TIFIA), which widened the definition of eligible projects to include freight rail projects; (previously, rail projects had not been eligible for TIFIA support). Eligible projects now include projects that improve/facilitate public or private freight rail facilities that provide benefits to highway users, intermodal freight transfer facilities, and Port terminals and port access.
- Private Activity Bonds (PABs) were established as a new source of funding in SAFETEA-LU. The Act amended the IRS code to allow use of PABs for highway and freight transfer facilities. PABs, otherwise known as tax-exempt facility bonds, are qualified bonds, which means that interest on the bonds is excluded (not subject to income reporting) for Federal income tax purposes in the gross income of recipients. With this qualified status and the resulting tax benefit to investors, exempt facility bonds can be offered at lower interest rates, reducing the cost of financing projects for the bond issuer.

These three actions helped to widen the pool of funding available to freight rail projects. They are explained in greater detail below.

### ***Railroad Rehabilitation and Investment Financing (RRIF) Program***

Section 9003 of SAFETEA-LU amended the RRIF program, which was created originally under Section 7203 of the 1998 Transportation Equity Act for the 21<sup>st</sup> Century (TEA-21). The RRIF program, administered by the Federal Railroad Administration (FRA), provides financial assistance in the form of direct loans and loan guarantees to eligible recipients for the following types of rail projects:

- Acquisition, improvement, or rehabilitation of freight (intermodal or carload) and passenger rail equipment and facilities, including tracks, yards, bridges, etc.;
- Refinancing of outstanding debt incurred in the acquisition, improvement, or rehabilitation of freight and passenger rail equipment and facilities; and
- Development of new freight and passenger rail facilities.

The RRIF program does not provide financial assistance for rail operating expenses. Recipients eligible for direct loans and/or loan guarantees from the program include public and private entities, railroads, joint ventures (including at least one railroad), limited-option freight shippers (e.g., shippers who own a plant or facility served by no more than a single railroad), and interstate compacts consented to by Congress under Section 410(a) of the Amtrak Reform and Accountability Act of 1997.

Thirteen loans, totaling \$517 million, have been issued since 2002. The smallest and largest loans approved were \$2.1 million for Mount Hood Railroad and \$233 million for the Dakota, Minnesota & Eastern Railroad.

Direct loans from the program can be used to finance 100 percent of the total project cost, while loan guarantees can be made for up to 80 percent of the cost of a loan, for terms up to 25 years. The program requires applicants to cover the subsidy costs through payment of a “credit risk premium” equal to a fraction of the loan amount calculated based on the financial viability of the applicant and the value of the collateral provided to secure the debt.

### ***Transportation Infrastructure Finance and Innovation Act (TIFIA)***

The Transportation Infrastructure Finance and Innovation Act (TIFIA) was created in 1998 by TEA-21. The strategic goal of this program is to leverage limited Federal resources and stimulate private capital investment by providing credit assistance (up to one-third of the project cost) for major transportation investments of national or regional significance. The program has a project cost threshold for eligibility, which is the lower of \$50 million, or 33 percent of a state’s annual Federal-aid apportionment for highway projects.

SAFETEA-LU expanded TIFIA eligibility to certain private rail projects. Eligibility for freight facilities includes the following:

- Public or private freight rail facilities providing benefits to highway users;
- Intermodal freight transfer facilities;
- Access to freight facilities and service improvements, including capital investments for Intelligent Transportation System (ITS); and
- Port terminals, but only when related to surface transportation infrastructure modifications to facilitate intermodal interchange, transfer, and access into and out of the port.

The TIFIA credit program offers three distinct types of financial assistance: secured (direct) Federal loans to project sponsors; loan guarantees by the Federal government to institutional investors; and standby lines of credit in the form of contingent Federal loans. Federal credit assistance from this program cannot exceed 33 percent of the total project cost.

SAFETEA-LU authorized \$122 million per year to pay the subsidy costs of supporting Federal credit under TIFIA. There is no limit on amount of credit assistance that can be provided to borrowers in a given fiscal year. Repayment of TIFIA loans must come from tolls, user fees, or other dedicated revenue sources. As of July 2006, TIFIA assistance amounted to \$3.2 billion, leveraging \$13.2 billion of investment in 14 transportation projects. Among these projects were:

- Reno Transportation Rail Access Corridor (ReTRAC), a 2.25-mile below-grade rail freight corridor, which received \$51 million; and
- Washington Metropolitan Area Transit Authority Capital Improvement Program, replacing vehicles and rehabilitating facilities and equipment, which received \$600 million.

Several Washington State passenger and freight rail projects are similar to the projects that received TIFIA funding in the FY 2006 to FY 2009 cycle. TIFIA is a promising funding source that should be targeted by Washington State during reauthorization of SAFETEA-LU.

### *State Infrastructure Banks (SIB)*

The State Infrastructure Bank (SIB) program was started as a pilot program that was authorized under Section 350 of the National Highway System Designation Act of 1995 (NHS Act). SIBs are revolving infrastructure investment funds which are established and administered by states and are eligible for capitalization with Federal-aid highway apportionments and state funds. The purpose of SIBs is to provide innovative and flexible financial assistance to states for rail, highway, and transit projects in the form of loans and credit enhancements. Washington State has established an SIB and has used it to finance three highway projects. The total of the loans to date is \$2.4 million.

Financial assistance is available to public and private entities through the SIBs. The assistance includes below-market rate subordinate loans, interest rate buydowns on third-party loans, loan guarantees, and line of credit for the FY 2005 to FY 2009 time period. The following Federal transportation funds may be used to capitalize SIBs:

- **Highway account.** Up to 10 percent of the Federal-aid highway apportionments to the state for the NHS program, Surface Transportation Program (STP), Highway Bridge Program, and the Equity Bonus;
- **Transit account.** Up to 10 percent of the Federal funds for transit capital projects under Urbanized Area Formula Grants, Capital Investment Grants, and Formula Grants for other than Urbanized Areas; and
- **Rail account.** Federal funds for rail capital projects under Subtitle V (Rail Programs) of Title 49 USC.

A state setting up and using a SIB is obliged to match the Federal SIB capitalization funds on an 80 to 20 Federal/non-Federal basis. The exception is funds from the highway account, where a sliding-scale matching-provision applies.

### *Railroad Track Maintenance Credit*

The Railroad Track Maintenance Credit authorized under Section 45G of the Internal Revenue Code provides tax credits to qualified taxpayers for expenditures on railroad

track maintenance on railroad tracks owned or leased by a Class II or a Class III railroad. The amount of tax credit provided equals 50 percent of the qualified railroad track maintenance and rehabilitation expenditures. Qualified railroad track expenditures include all expenditures towards maintenance and rehabilitation of railroad track, including roadbed, bridges, and related track structures.

Eligible taxpayers qualifying for this credit include any Class II or Class III railroad, and any person transporting property on a Class II or a Class III railroad facility, or furnishing railroad-related property or services to a Class II or a Class III railroad on miles of track assigned to such person by the Class II or Class III railroad. The maximum credit allowed under this program is \$3,500 per mile of railroad track owned or leased by an eligible taxpayer, or railroad track assigned to the eligible taxpayer by a Class II or a Class III railroad that owns or leases the railroad track. This credit program, which was released in 2004, was for a 3-year period from December 31, 2004 to December 31, 2007. However, for eligible taxpayers not having enough taxable income to make full utilization of the credit, the credits can be carried forward for a 20-year period.

### ***Private Activity Bonds (Tax Exempt Bonds)***

Title XI Section 11143 of SAFETEA-LU amended Section 142(a) of the IRS Code to allow the issuance of tax-exempt private activity bonds for highway and freight transfer facilities. States and local governments are allowed to issue tax-exempt bonds to finance highway and freight transfer facility projects sponsored by the private sector. SAFETEA-LU includes a cap of \$15 billion on private activity bonds.

Passage of the private activity bond legislation reflects the Federal government's desire to increase private sector investment in United States transportation infrastructure. Providing private developers and operators with access to tax-exempt interest rates lowers the cost of capital significantly, enhancing investment prospects. Increasing the involvement of private investors in highway and freight projects also generates new sources of money, ideas, and efficiency.

Tax-exempt bond is an obligation issued by a state or local government, where the interest received by the investor is not taxable for Federal income tax purposes. Because of the exception of Federal income tax on the interest earned, these bonds have a lower cost of financing compared to taxable bonds. Section 11143 of SAFETEA-LU created a new type of exempt facility eligible to be financed with tax-exempt bonds, the qualified highway, or surface freight transfer facility. The new type of exempt facility bonds finance certain projects for surface transportation, projects for certain international bridges or tunnels, or facilities to transfer freight from truck to rail or rail to truck, provided the project or facility receives Federal assistance. In general, the law limits the total amount of such bonds to \$15 billion and directs the Secretary of Transportation to allocate this amount among qualified facilities.

Section 142(m) (1) defines “qualified highway or surface freight transfer facilities” as:

*(A) Any surface transportation project that receives Federal assistance under Title 23, United States Code (as in effect on August 10, 2005, the date of the enactment of Section 142(m)).*

*(B) Any project for an international bridge or tunnel for which an international entity authorized under Federal or state law is responsible and which receives Federal Assistance under Title 23, United States Code (as so in effect), or*

*(C) Any facility for the transfer of freight from truck to rail or rail to truck (including any temporary storage facilities directly related to such transfers) that receives Federal assistance under Title 23 or Title 49 as so in effect.*

## ■ 2.0 States and Multi-State/Multi-Government Rail Improvement Financing Strategies

This section reviews state and multi-state or multi-partnerships that have been formed to fund rail projects. Some of the states profiled below have created grant or loan programs to provide ongoing capital resources to support freight-related investments. The state programs are generally used to support smaller-scaled projects, while the multi-state state or multi-partnership strategies are used to support larger investments, typically projects spanning several states.

### 2.1 State Strategies

Programs discussed in this section could be pursued by Washington State to support smaller rail projects (e.g., geographically constrained or those under a million dollars). Of particular interest is the Texas Rural Rail Transportation District (RRTD) program. This program allowed the creation of special rail districts in rural communities and grants the districts the rights of a political subdivision of Texas state government. Washington State should consider a similar mechanism as part of its agricultural or industrial shortline preservation strategy. The RRTD program, as well as several other state and multi-state programs, are described in more detail below.

#### *Rural Rail Transportation Districts (RRTDs)*

RRTDs were established after the Staggers Act of 1980, which deregulated the railroad industry. They were established as a way to mitigate the impacts of rail abandonments on

rural areas in the state.<sup>1</sup> The Staggers Rail Act made it easier for the freight railroads to abandon lines that were not cost-effective to operate. In many cases, these abandonments were in rural areas. Envisioned as mechanisms to preserve rural transportation, trade, and economic competitiveness, RRTDs were granted the rights of a political subdivision of Texas State government. As such, RRTDs have the power to purchase, operate, and/or build new railroad and intermodal facilities, the right of eminent domain, and the ability to issue revenue bonds or grant anticipation notes.

Of particular significance is the authority given to RRTDs to issue bonds to assist in their efforts to preserve and promote rail infrastructure in rural areas. Although no RRTD has yet taken advantage of this mechanism, it should be noted that it exists in Texas state law. The primary functions of RRTDs, which can be established by a county or a group of counties in the state, pertain to acquisition of abandoned rail lines, rehabilitation of existing rail lines, and construction of new rail lines. In addition, RRTDs can also be used to develop rail services accessing industrial parks, intermodal facilities, and transload facilities.

Washington State could consider establishing similar rail districts, modeled after the Texas RRTDs, in areas where the viability of shortline rail roads or rail spurs is at risk and there are significant business or community benefits to be gained by sustaining rail service. RRTDs are also attractive because they encourage and require local businesses and community leaders to become involved directly with the project and the rail system planning goals of the State.

### ***Texas Capital Fund Infrastructure Development Program***

The Texas Capital Fund's Infrastructure Development Program, a program of the U.S. Department of Housing and Urban Development (HUD) and administered by the Texas Department of Agriculture, is designed to assist business expansion and retention in the State's rural counties and communities. Rail projects, such as construction of new railroad spurs are eligible, but the maximum funding ceiling is set at \$750,000 per project and the minimum award is \$50,000. Funding from this program may not exceed 50 percent of the total project cost, and there is a minimum equity contribution of 10 percent of the total project cost required of the business.

### ***Pennsylvania's Rail Freight Assistance Program (RFAP)***

Pennsylvania's RFAP is a competitive grant program offering grant funds for rail infrastructure maintenance and construction projects. The program's objectives are to preserve rail freight services in the state, where economically feasible; and to stimulate economic growth and development in the state through the promotion and expansion of freight rail services. Projects eligible for assistance from this program include

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<sup>1</sup> The Staggers Rail Act of 1980 made it easier for freight railroads to abandon lines that were not cost-effective to operate. In many cases, these abandonments were in rural areas.

maintenance and construction related to rail tracks, ties, turnouts, and other track materials (including ballast). The maximum funding available from this program for maintenance projects is \$750,000 or 75 percent of the total cost of the project, whichever is less; while for construction projects, it is the lesser of \$100,000 or 50 percent of the total cost of the project. Project applications to the Pennsylvania DOT are evaluated and ranked using the Federal Railroad Administration's (FRA) benefit-cost methodology to determine and allocate competitive grant funds among deserving projects. An explanation of this methodology can be found in Interim Report 2 of this study. Projects are required to maintain active rail operations for 5 years after implementation.

### ***Maine's Industrial Rail Access Program (IRAP)***

Maine's IRAP is a competitive grant program for rail projects aimed at promoting economic development and increased use of the rail transportation mode in the state. The types of rail projects eligible for funding include accelerated maintenance, rehabilitation, new siding improvements, right-of-way acquisition, and intermodal facility construction. The 2006 program has a total of \$900,000 in state funds to provide funding for a maximum of 50 percent of estimated project costs. In addition, the program has \$630,000 in No Interest Loan funds, which can be used to provide funding for 100 percent of estimated project costs. Similar to the RFAP, this program also utilizes the FRA benefit-cost methodology to evaluate project applications. A program such as this would work well with the WTC Rail Study policy to promote projects that support industries of all size within the State.

### ***Wisconsin Freight Railroad Infrastructure Improvement Program (FRIIP)***

Wisconsin's original rail assistance program was created in 1977 to help preserve freight rail service during an era when widespread railroad bankruptcies and line abandonments threatened the availability of rail service in Wisconsin. In 1992, the FRIIP loan program was added to the State's rail assistance program. FRIIP loans enable the State to encourage a broader array of improvements to the rail system, particularly on privately-owned lines. It also provides funding for other rail-related projects, such as loading and transloading facilities. The program provides 100 percent funding for the following types of rail projects:

- Industry rail access projects providing connection with the national railroad system;
- Rail improvements that enhance transportation efficiency, safety, and intermodal freight transportation;
- Rehabilitation of rail lines; and
- Rail projects promoting economic development.

Since 1992, Wisconsin has awarded \$79 million in FRIIP loans. Funds from repayment of prior loans are recycled into new loans, making the program largely self-sustaining.

**Wisconsin Freight Railroad Preservation Program (FRPP)**

In 1992, the original rail assistance grant program was replaced by the current FRPP program, which provides grants to local units of government, industries, and railroads for the purpose of preserving essential rail lines and rehabilitating them following purchase. The FRPP program provides grants covering up to 80 percent of the project cost for the following types of rail projects:

- Purchase of abandoned rail lines for continuation of freight rail service, or rail banking; and
- Rehabilitation of rail facilities like tracks and bridges on publicly-owned rail lines.

Since 1980, under both the original rail assistance program and FRPP, \$80 million in grants have been awarded for rail acquisition and rehabilitation projects. The 2005 to 2007 state budget provides \$6.5 million in bonding authority for the program.

**2.2 Multi-State/Multi-Partnership Financing Initiatives**

Several multi-state consortiums offer innovative case studies of approaches to finance large-scale rail infrastructure projects that span or benefit several states. A key objective of these initiatives is to engage both government and private support in funding the projects. The key initiatives are listed in Table 3.

**Table 3. Multi-State and Multi-Partner Financing Strategies**

<b>Multi-State Agreement</b>	<b>Proposed Financing Strategies</b>
Mid-Atlantic Rail Operations Study (MAROps)	<ul style="list-style-type: none"> <li>• Direct funding from railroad revenues</li> <li>• Direct funding from state and local appropriations</li> <li>• Federal rail programs, including the RRIF and TIFIA</li> <li>• Federal-aid grant programs, including CMAQ</li> <li>• Federal highway and rail safety programs</li> <li>• Federal tax credit bond programs</li> <li>• Toll or user charges to pay back loans, bonds, or SIB programs</li> <li>• Sale of freight assets for passenger-rail use</li> <li>• State-based approaches such as property tax relief to railroads in exchange for public-purpose improvements by railroads</li> </ul>

Multi-State Agreement	Proposed Financing Strategies
Midwest Region Rail Initiative (MWRRI)	<ul style="list-style-type: none"> <li>• Federal loans and grants, Grant Anticipation Notes, and TIFIA loans</li> <li>• State funding to purchase trainsets and to match Federal funding for infrastructure improvements</li> <li>• State general funds</li> <li>• Capital and revenue generated from system-related activities, such as joint development</li> </ul>
The Alameda Corridor	<ul style="list-style-type: none"> <li>• Revenue-backed bonds issued by CTA</li> <li>• U.S. DOT loan</li> <li>• Grants from the Ports of Los Angeles and Long Beach</li> <li>• Grant from the LA Metro</li> <li>• Grants from interest income and other Federal and state sources</li> </ul>
Shellpot Bridge Rehabilitation	<p>Public Private Partnership enacted that established the following funding package:</p> <ul style="list-style-type: none"> <li>• \$5 million in grants from Federal and State sources</li> <li>• \$9 million in loans from the State</li> <li>• Loan repayment through a sliding per-car user fee paid by the railroad to the State</li> </ul>

The following four case studies presented below show the diversity of funding sources and partners that can be employed to finance large transportation investments. In every case, the financial strategies are characterized by a mix of funding sources that include the use of Federal grants, Federal loans or tax credits, state aid, and the participation of the private sector. Multi-state coalitions, such as those pioneered by the I-95 Corridor Coalition in the landmark MAROps, hold promise as models for how states and private freight railroads may work together in the future.

### ***I-95 Corridor Coalition – Mid-Atlantic Rail Operations Study (MAROps)***

The Mid-Atlantic Rail Operations Study (MAROps) was a joint initiative of the I-95 Corridor Coalition, five member states (New Jersey, Pennsylvania, Delaware, Maryland and Virginia), and three railroads (Amtrak, CSX, and Norfolk Southern). The Federal Railroad Administration (FRA) and Federal Highway Administration (FHWA) participated as advisors. Over a two-year period, the MAROps participants crafted a 20-year, \$6.2 billion program of rail improvements aimed at improving north-south rail transportation for both passengers and freight in the Mid-Atlantic region and helping reduce truck traffic on the region's overburdened highway system. The study examined a number of national models for innovative, public-private financing of rail improvements and pointed to the following options as the most promising:

- Direct funding out of railroad revenues, state and local appropriations, and congressional earmarks, as available.
- Existing or pending Federal rail assistance programs, including the RRIF, a \$35 billion loan program, and TIFIA, which provides loans and loan guarantees for large projects. The recently proposed High-Speed Rail Infrastructure Improvement Act, which would authorize more than \$71 billion in tax-exempt state bond financing, loans, and loan guarantees, would expand these assistance programs.
- Federal-aid formula grant programs, such as CMAQ program, which has been used to fund transportation improvements that reduce congestion and engine emissions in regions that do not meet national air quality standards.
- Highway and rail safety programs, which can be used to eliminate dangerous highway-rail grade crossings or improve grade separations.
- Federal tax credit bond programs, which could be used to generate capital for investment in rail infrastructure projects.
- Toll or user charges on increased rail freight traffic and revenue, which can be used to repay loans, bonds, and SIB programs.
- Sale of freight assets for passenger-rail use.
- State-based approaches, where states could elect to provide property tax relief to the railroads in exchange for public-purpose improvements by the railroads.

The MAROps findings offer a good overview of the emerging methods to finance freight rail projects. They also offer a case study of how a multi-state partnership can work in a coordinated fashion to address regional freight rail needs. The I-95 Coalition has since extended the MAROps approach to include the New England states (Northeast Rail Operations Study (NEROps)) and the Southeast states (Southeast Rail Operations Study (SEROps)). It has also commissioned a second phase of work for MAROps, with the objective of developing specific institutional and funding approaches to implement the MAROps program.

### ***Midwest Regional Rail Initiative (MWRRI)***

The purpose of the Midwest Regional Rail Initiative (MWRRI) is to improve and expand the passenger rail system across nine Midwest states. The sponsors of MWRRI are the transportation agencies of Illinois, Indiana, Iowa, Michigan, Minnesota, Missouri, Nebraska, Ohio, and Wisconsin. The major plan includes the use of 3,000 miles of existing rail system providing rail rights-of-way to connect rural, small urban, and major metropolitan areas. The capital requirements are estimated around \$7.7 billion (in 2002 dollars) phased over a 10-year implementation period.

Giving the large capital investment required, the MWRRI has created an investment plan consisting of a mix of funding sources, including the following:

- Federal loans and grants. Federal support will be the major funding source of capital. It is expected that Federal funds from transportation and non-transportation programs will cover 80 percent of infrastructure costs. Among the Federal sources to be used are Federal Funding Agreements, Grant Anticipation Notes, and TIFIA loans. Some of the Midwest states are currently using Federal funds to implement components of the plan, such as railroad grade safety improvements.
- State funding in the form of State support to purchase trainsets and to match Federal funding for infrastructure improvements will be obtained.
- General funds.
- Capital and revenue generated from system-related activities, such as joint development proceeds.

Similar to MAROps, the MWRRI provides a good synopsis of the most innovative, emerging funding sources by which to fund regional passenger rail systems. It also offers a case study of how a multi-state partnership can work in a coordinated fashion to address regional passenger rail needs.

### *Alameda Corridor*

The Alameda Corridor is a 20-mile double-track rail corridor linking the Ports of Los Angeles and Long Beach to the transcontinental rail network in downtown Los Angeles. The corridor grade-separates freight trains from street traffic and passenger trains. The project was undertaken with the objectives of reducing port-related rail-traffic delays, achieving operational improvements and safety enhancements by elimination of at-grade crossings, mitigation of environmental impacts through more efficient operations, and economic development. The project involved consolidation of railroad traffic (90 miles of branch line tracks into one 20-mile corridor) and construction of grade separations (east-west street overpasses south of Route 91 and depressed rail trench from 25<sup>th</sup> street to Route 91) to separate freight trains with passenger trains and street traffic.

The Alameda Corridor project, which is one of the largest design-build projects in the U.S., also serves as a model for applications of innovative financing techniques, involving contributions from private as well as Federal, state, and local sources. Total cost of the project was close to \$2.5 billion, which was funded through the following sources:

- Revenue-backed bonds issued by the Alameda Corridor Transportation Authority (ACTA) and consisting of:
  - Senior tax-exempt (\$494 million),
  - Senior taxable (\$500 million), and
  - Subordinate (\$167 million).
- U.S. DOT loan (\$400 million);
- Grants from the Ports of Los Angeles and Long Beach (\$394 million);
- Grant from the Los Angeles Metropolitan Transportation Authority (Metro) (\$347 million); and
- Grants from interest income and other Federal and state sources (\$160 million).

Debt service costs for the project are covered by user fees and container charges for the use of the system by the private railroads and the Ports. A key aspect of the project financing was the loan agreement between ACTA and the Federal government, which involved leveraging of Federal credit assistance. The Federal government incurred a cost close to \$59 million for the subsidy cost associated with making a \$400 million subordinate loan, which was covered through a Congressional appropriation. The Federal government's junior-lien status for the debt provided key assistance to ACTA for implementing the project. This Federal government action provided the model for the subsequently enacted TIFIA loan guarantee program.

### ***Shellpot Bridge Rehabilitation***

The public-private partnership between Norfolk Southern and the Delaware Department of Transportation (DelDOT) for the rehabilitation of the Shellpot Bridge in Wilmington, Delaware, is an interesting example of innovative partnership for financing rail infrastructure improvement projects. The Shellpot Bridge provided an important link in Conrail's operations in Delaware until 1995, when Conrail took the bridge out of its service route. At that time, the more than 100-year old bridge (built in 1888 by the Pennsylvania Railroad) needed to be rehabilitated at an estimated cost of \$10 million, which Conrail was not prepared to finance. The closing of the bridge affected operations at the Edgemoor yard, and led to degraded service into the Port of Wilmington.

Norfolk Southern (NS) acquired Conrail's assets in 1999, and NS' business strategy of increasing north-south train movements to access the lucrative northeastern market served to direct attention to re-establishing the role played by the Shellpot Bridge as a critical transportation link for rail service in the region. However, with the acquisition of Conrail, NS was cash-short and had limited credit available to make the investment. To make up for the funding shortfall, an innovative public-private partnership (PPP) was implemented for financing infrastructure improvements for the Shellpot Bridge, which was based on a part-grant/part-loan program. Total cost of the project was financed through \$5 million in grants and \$9 million in loans, provided by the State. The loans are

being repaid through a sliding per-car user fee paid by NS to the state, based on the traffic volume thresholds, such that the per car rate decreases with increasing traffic volume. Nathan Hayward III, at the time the DeIDOT Secretary and Chairman of the Board of the Diamond State Port Corporation stated that “this innovative formula for funding a major capital project has enabled us to complete the reconstruction endeavor for the Shellpot Bridge. This was truly an advantageous solution for both DeIDOT and Norfolk Southern.”

## ■ 3.0 Emerging Federal Initiatives

Several emerging passenger-and freight-funding mechanisms are worth noting because of their possible impact in shaping and developing of Federal rail policy and funding programs. The emerging mechanisms fit loosely into four categories: 1) Financing sources that use debt or tax credits to finance projects, such as the proposed legislation Freight Rail Infrastructure Capacity Expansion Act, as well as legislation which has never been realized such as the tax-credit bond financing; 2) dedicated revenue sources to support freight investments; 3) institutional arrangements that include public-private partnerships and tax-exempt corporations, and 4) ongoing studies, commissions, and bill proposals that will be issuing passenger-and freight-related recommendations that will guide and develop Federal passenger-and freight policy. These are summarized briefly below.

### 3.1 Financing Sources That Use Debt or Tax Credits to Finance Projects

#### *Freight Rail Infrastructure Capacity Expansion Act*

Senate Bill 3742, the Freight Rail Infrastructure Capacity Expansion Act, was proposed in July 2006. This bill aims to provide incentives for investments in capacity enhancing freight rail infrastructure through the provision of tax credits. The legislation calls for a 25 percent tax credit expansion for any taxpayer making capital expenditures for new freight rail infrastructure. Relevant capital expenditures include the following:

- Addition of mainline track capacity to existing right-of-way;
- Addition of new or extending sidings on existing right-of-way;
- Construction of new intermodal or transload facilities;
- Technology-based expansions, such as signaling of dark territories; and
- New locomotives that increase the horsepower capacity of a railroad’s fleet.

This tax incentive program is intended to generate private capital investment from the Class I railroads, as well as any company that makes qualified freight rail infrastructure expenditure for capacity expansion projects described above. For example, a shipper making capital expenditures for new rail spurs from the production plant to the mainline rail network, or a trucking company making expenditures for a new intermodal rail

terminal, would be eligible for the tax credits. Other key features of the proposed legislation include the following:

- **Tax Credit for Investment.** A 25 percent capacity expansion tax credit would be available to any taxpayer making capital expenditures for new freight rail infrastructure that increases rail system capacity.
- **Intermodal Tax Equity.** All freight rail infrastructure capital expenditures, except locomotives, would be eligible for 100 percent expensing, so that capital cost recovery of railroad infrastructure is ensured on the same basis as other competing freight transportation modes.
- **Alternative Minimum Tax (AMT).** The tax credit received due to the freight rail infrastructure investment would be creditable against the corporate AMT. Thus, the amounts expensed would not fall within the scope of the AMT.

### *Tax-Credit Bond Financing*

During the debate over SAFETEA-LU, tax-credit bond financing, which has been used by the Federal government to subsidize development of schools, was advanced as a way of subsidizing increased investment in transportation projects. Tax-credit bonds are a form of Federally-subsidized debt financing. In this scenario, the investor receives Federal tax credit against Federal income tax liability in lieu of interest payments on the loan. From the borrower's perspective, it provides a zero-interest-cost loan, as the borrower is only responsible for the repayment of the principal amount. Bondholders must report the tax credit as income, but after calculating their tax liability as if they had received that compensation in cash, they can subtract the amount of the credit from the tax due. Therefore, the Federal government bears virtually all of the cost of borrowing (in the form of forgone revenues).

Tax-credit bond financing is not currently an option since it was not included in SAFETEA-LU; However, the Rail Infrastructure Development and Expansion Act for the 21<sup>st</sup> Century (RIDE-21), Section 1631, approved by the Transportation and Infrastructure Committee on April 27, 2005, but not by the full Congress, would authorize Federal subsidies for high-speed rail projects. It would allow states to issue \$12 billion of tax-exempt bonds and an additional \$12 billion of tax-credit bonds to finance high-speed rail transportation projects. Both types of bonds would be exempt from the state private activity bond volume caps. Eligible projects would be required to apply prevailing wage rate standards. The DOT would be responsible for approving projects.

Tax-credit bond financing, in short, is an intriguing form of transportation infrastructure finance. It is suggested that the use, implementation of, and legislation supporting tax-credit bond financing is watched carefully by Washington State. As well as prove to be a viable source of finance in the future, this may offer an opportunity for the State to present itself as a "case study" for tax-credit bond financing at the regional or national level.

### **3.2 Dedicated Revenue Sources to Support Freight Investments**

#### ***ConnectOregon (Senate Bill 71)***

ConnectOregon is a legislatively-authorized lottery-bond-based initiative to invest in air, rail, marine, and transit infrastructure in Oregon. In 2005, Oregon's legislature authorized a \$100 million lottery-bond-backed initiative to fund transportation projects. The lottery bonds are issued by the Department of Administrative Services, and the proceeds are deposited into a Multimodal Transportation Fund. Key stakeholders include representatives and advisory groups from the eligible transportation modes, freight shippers and carriers, business organizations, municipalities, and the environmental community.

On July 20, 2006, the Oregon Transportation Commission made its final project selection decisions for the ConnectOregon program. Some 43 projects were approved, worth a total of \$99.5 million. Projects in all parts of the State are considered for funding. In fact, Senate Bill 71 requires that at least 15 percent of the funds be allocated in each of the five regions; regions are geographic groupings of counties that cover the entire State. The projects can be funded by a grant or a loan, as decided by the Oregon Transportation Commission. The Oregon DOT Rail Advisory committee provides recommendations for rail projects to be considered for grants and loans from this initiative.

### **3.3 Institutional Arrangements Including Public-Private Partnerships and Tax-Exempt Corporations**

The growth in public-private partnerships to address rail capacity needs, such as the Innovative Financing Plan under consideration in Southern California and the CREATE project in Chicago, Illinois, is also a signal of what the future might hold for freight rail programs.

#### ***Innovative Financing Plan (Under Consideration for Application to the Inland Empire Rail Expansion and Grade Separation Project)***

An innovative funding mechanism for new rail investment, where costs of the project are shared between public and private entities based on expected benefits, is the integrated use of tax exempt bond financing, state and Federal loan guarantees, grants, and contributions from the railroads. With the expansion under SAFETEA-LU of the eligibility of private rail projects with public benefits to be eligible for tax-exempt bond financing, this innovative financing method can reduce the financing costs for the railroads, while realizing benefits in terms of increased rail system capacity. In addition, the use of loan guarantees can provide security for the bonds and produce low-interest rates for debt service. The rail investment can use state grants to fund specific elements of a project providing public benefits, for example, grade separations for safety improvement. The realization of interest savings for the railroads due to public assistance

in terms of tax exempt bonds and loan guarantees also enables the railroads to use excess savings to make contributions for funding additional public improvements.

The various elements of this integrated rail funding scheme are:

- **Tax Exempt Bonds.** The type of tax exempt bonds issued for financing the capital costs of the project will depend on the primary final use of the new rail construction. For new rail lines for private use – for example, freight rail service by a Class I railroad – private activity bonds will be issued by a joint powers authority (JPA), enabled by the eligibility of private projects providing public benefits to be financed by tax-exempt bonds. The railroads achieve two benefits from tax-exempt bonds issued by a JPA:
  - Reduced financing costs for the project compared to financing through taxable corporate debt available to the railroads.
  - Elimination of railroad indebtedness for the debt service, since the bonds are issued by the JPA. The debt service costs incurred by the railroad are determined entirely based on the relative railroad usage of the new rail system. A typical mechanism for repayment of debt service is through user fees paid by the railroads based on their usage of the system (e.g., a per container charge for intermodal rail service).

For new rail lines for public use – for example, a commuter rail service – tax-exempt governmental bonds are issued for the financing of the project. Tax-exempt bond financing for this type of project offers lower financing costs for the member jurisdictions of the commuter rail service. The debt service costs can be repaid through lease payments made by the member jurisdictions based on the projected usage of the system by commuter rail.

- **State and Federal Loan Guarantees.** An innovative add-on to tax-exempt debt financing, which can be applied to rail investment projects, is the use of state and Federal loan guarantees. Loan guarantees are contingent liabilities under which the state or Federal government will repay the lender the loan amount (to the extent of a guarantee) in the event of a default by the borrower in paying the debt service costs. In case of a new rail investment, the user fees from a private railroad can be insufficient to repay the debt service costs of private activity bonds if the freight rail service projections on the new rail system are not met in the future. Thus, state and Federal loan guarantees can secure the bonds and reduce the interest rates, reducing the risks involved for the lender. Federal loan guarantees through the TIFIA program under SAFETEA-LU can be used to fund private rail facilities providing public benefits.
- **State and Federal Grants.** Grants from state and Federal grant programs are an important source of funding for rail projects that generate specific public benefits. For example, the State of California “Governor’s Strategic Growth Plan” has the potential to provide up to \$3.1 billion of grant funding for the Inland Empire Rail Expansion and Grade Separation project, if approved by voters in November 2006. Grade

separation improvements associated with the project can be funded through the Federal Section 130 Highway-Railroad Grade Crossing Program.

- **Private Railroad Contributions.** Public-Private Partnerships (PPPs) for funding rail investments is a relatively new concept. The development of innovative funding mechanisms like tax-exempt and tax-credit bonds have generated financing concepts where PPPs can be particularly viable. In a rail investment financing scenario with private activity bonds, the private railroad using the system increases service levels at lower financing costs, compared to a traditional financing with corporate debt. The savings incurred by the railroad with tax-exempt bond financing, with public financing assistance, can thus be used to make additional investments in the rail system, resulting in public benefits.

### *Revenue-Sharing Arrangements/Leases*

Public ports use leases as a form of joint development. When a public port enters into a contractual lease arrangement, it is transferring the future services rendered by a fixed asset (e.g., a container crane or other terminal facility) to a private organization, while retaining the title to that fixed asset. There are three lease types, each of which varies in terms of the amount of risk that is assumed by the port and the incentives it creates for the lessee. However, all three lease types provide two important features for ports. First, long-term lease relationships provide a secure cash flow base upon which to issue bonds to finance new facilities and assure a steady base revenue base for the port. And second, a long-term lease relationship allows for specifying appropriate risk sharing between the public and private sector.

Other lease transactions include sale/lease-back arrangements, in which assets are sold and then leased back by the seller. An example of such transaction is the Southern Tier Rail Rehabilitation project, in which Norfolk Southern transferred the rail line title to a rail authority for 10 years, and then leased the rail line from the rail authority. The purpose of this transaction was to allow for tax abatement on the rail line over the lease period.

An arrangement such as this might be appropriate for a number of projects/programs for the port and international trade user groups.

### *Chicago Regional Environmental and Transportation Efficiency Project (CREATE)*

CREATE is a public private partnership (PPP) among the State of Illinois, City of Chicago, Metra, and the railroad industry (Burlington Northern Santa Fe Railway, Canadian Pacific Railway, CN, CSX Transportation, Norfolk Southern Corporation, and Union Pacific Railroad) to create five rail corridors, including one primarily for passenger trains; 25 new grade separations to eliminate many commuter delays; and the opening for commercial development of a key corridor in downtown Chicago.

The goals of this program are to:

- Reduce rail and motorist congestion,
- Improve passenger rail service,
- Enhance public safety,
- Promote economic development,
- Create jobs,
- Improve air quality, and
- Reduce noise from idling or slow-moving trains

The total cost of the project is estimated at \$1.5 billion. The financial contributions of both the private and the public sector were determined based on the economic benefits that each partner would receive from the projects. An analysis of public and private benefits indicated that the project would generate about \$4 billion in benefits, with 95 percent of those benefits being public and 5 percent private. The railroads committed to funding a roughly proportional amount of the project cost as their derived benefit, which in this case equals \$212 million. In reality, this is closer to 14 percent of the project costs. The public sector is expected to provide the remaining \$1.3 billion, including \$20 million from METRA with the remainder coming from local, state, and Federal contributions. The allocations are summarized below in Table 4.

Washington State may choose to employ a similar methodology to estimate benefits received by each user group and distribute project responsibility accordingly.

**Table 4. CREATE Benefits and Proposed Funding Allocations**

<b>Funding/Finance Source</b>	<b>Amount</b>	<b>Percent of Project Cost</b>
<i>Benefits</i>		
Public Benefits	\$3.9 billion	95%
Private Benefits	\$212 million	5%
<i>Funding Sources</i>		
Private Railroads	\$212 million	14%
METRA	\$20 million	1%
Federal Surface Transportation Reauthorization	TBD	
City and State Contributions	TBD	

***Reno ReTRAC Rail Access Corridor***

The Reno ReTRAC project offers another example of an innovative funding package to finance a large capital investment. As is the case of the CREATE project, the ReTRAC project funding package may offer some suggestions for Washington State to consider for certain projects. The ReTRAC corridor involves the building of a 2.3-mile subsurface rail corridor through the downtown region of Reno, Nevada. The goals of this project include:

- Enhancing the mobility of the Nevada warehousing core in and near Reno;
- Minimizing impacts from pedestrian conflicts;
- Minimizing emergency vehicle delay;
- Minimizing train-related congestion;
- Reducing air emissions caused by delay and idling vehicles; and
- Improving the aesthetics and continuity of the Reno Downtown region.

The major project sponsors of the Reno ReTRAC include Federal and state transportation agencies, the City of Reno, the Union Pacific Railroad, and gaming-related businesses in downtown Reno. The funding program for the project is shown in Table 5 below. This project is currently under construction.

**Table 5. Reno ReTRAC Funding Allocations**

<b>Funding/Finance Source</b>	<b>Amount</b>	<b>Percent of Project Cost</b>
Sales Tax	\$120 million	45%
Railroad ROW and Lease	\$87 million	33%
Special Assessment District Fees	\$21 million	8%
Federal and State Transportation Funds	\$21 million	8%
1% Room Tax	\$13 million	5%
Interest Income	\$2 million	1%
<b>Total</b>	<b>\$264 million</b>	<b>100%</b>

### 3.4 Other Emerging Rail Finance Issues

#### *National Surface Transportation Policy and Revenue Study Commission*

The National Surface Transportation Policy and Revenue Study Commission was created by Section 1909 of SAFETEA-LU. The Commission was created because Congress declared, “that it is in the national interest to preserve and enhance the surface transportation system to meet the needs of the United States for the 21<sup>st</sup> century.”

The Commission is comprised of 12 members, representing Federal, state and local governments, metropolitan planning organizations, transportation-related industries, and public interest organizations. The goal of the Commission is to examine the condition and future needs of the nation’s surface transportation system, and to establish short and long-term alternatives to replace or supplement the fuel tax as the principal revenue source to support the Highway Trust Fund over the next 30 years. The Commission has been active in its research and outreach agenda during 2006 and 2007. It is expected to provide a final report with recommendations to Congress by July 2007.<sup>2</sup> Washington State should be involving itself in the Commission’s progress. Doing so will ensure that the State is knowledgeable of new development and freight priorities at the national level. In addition, the involvement will allow Washington to track developing pilot programs, positioning it to take advantage of any suitable passenger or freight rail pilot programs.

The goals of the Commission include the following:

- Conduct a study of the current condition and future needs of the surface transportation system;
- Assess short-term sources of Highway Trust Fund revenues;
- Research long-term alternatives to replace or supplement the fuel tax as the principal revenue source to support the Highway Trust Fund, including new or alternate sources of revenue;
- Identify revenue sources to fund the needs of the surface transportation system over at least the 30-year period beginning on the date of enactment of this Act, including new or alternate sources of revenue;
- Develop a conceptual plan, with alternative approaches, to ensure that the surface transportation system will continue to serve the needs of the United States, including specific recommendations regarding design and operational standards, Federal policies, and legislative changes; and

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<sup>2</sup> As part of a technical corrections bill now under consideration, Congress may extend the life of the Commission and its reporting date, and provide additional funding.

- Consult with the Secretary of the Treasury in conducting the study to ensure that the views of the Secretary concerning essential attributes of Highway Trust Fund revenue.

### ***Senate Bill 1516: The Passenger Rail Investment and Improvement Act of 2006***

The available funding and planning process for intercity passenger rail may change considerably with the decision of the Senate Bill 1516, the Amtrak reauthorization bill. This bill proposes to shift a full one-third of Federal Amtrak spending onto the states. This flexibility will allow the states to determine what type of intercity passenger rail service they would like to maintain. States will not be tied to the national rail system, but can use the funds to finance whatever service they feel is best for the state. Many proponents of the bill say that this will reduce spending on rail service in regions that do not see sufficient ridership to maintain it. Opponents of the bill see this as a means to cease intercity passenger rail service and to hasten the demise of Amtrak. Specifically, Senate Bill 1516 proposes the following:

- Reducing Amtrak operating grants from \$580 million in 2006 to \$455 million in 2011;
- Increasing Amtrak capital grants from \$813 million in 2006 to \$1,231 million in 2011; and
- Increasing Amtrak state grants as a percentage of capital grants from 3 percent in 2006 to 33 percent in 2011.

In addition, Senate Bill 1516 includes the provision that “The Secretary may not approve a grant for a project under this section unless the Secretary finds that the project is part of a State Rail Plan.” Therefore, this bill also introduces a requirement to have a State Rail Plan in place prior to any investment into the passenger or freight rail system. Senate Bill 1516 dictates the content of the State Rail Plan to include the following:

- Inventory of the overall rail transportation system;
- Review of all rail lines within the state;
- Statement of the state’s passenger rail service objectives, including a statement of minimum service levels;
- General analysis of rail’s transportation, economic, and environmental impacts in the state, including congestion mitigation, trade and economic development, air quality, land use, energy use, and community impacts;
- A long-range rail investment program for current and future freight and passenger rail infrastructure;
- A statement of public financing issues; and
- A performance evaluation of passenger rail service in operation in the state, including improvements and strategies to achieve those improvements.

Therefore, the Senate Bill 1516 necessitates the need to produce a fairly sophisticated and involved State Rail Plan prior to an investment into the passenger or freight rail system.

Though WSDOT already creates an involved passenger rail plan on a regular basis, this provision would create the need for WSDOT to begin an involved freight rail investment plan every 5 years. This is a development that is worth monitoring because of the impact on WSDOT. In addition, the State may want to ensure that its existing passenger rail plan is well-positioned to act as the new delegation body to an additional one-third Amtrak funding share that may be allotted to it, should Senate Bill 1516 be passed into law.

### ***AASHTO Intercity Passenger Rail Transportation Report***

The American Association of Highway Transportation Officials (AASHTO) in 2002 commissioned a report to address the public benefits and investments needs of the nation's intercity passenger rail system. One of the priority items in the AASHTO 2002 Action Agenda was to call for legislation ensuring that the nation's travelers will have efficient and dependable intercity passenger rail service. This report suggested that such legislation do the following:

- Establish a solid basis for passenger rail service partnerships between the states and the Federal government;
- Ensure the level of federal involvement necessary for financing and system integrity;
- Provide a stable system for funding rail passenger operating costs; and
- Create a dedicated, sustainable source of funding for intercity rail passenger infrastructure improvements.

The report provided a factual foundation to support good decision making at the Federal level for all of the above issues. During the course of its fact finding, the report documents the fact that though the states are willing and committed partners to providing quality, intercity passenger rail programs, they cannot do it alone. The report also found that a key factor in providing efficient passenger rail service will be the availability of adequate, predictable funding. Similar to its investments into other critical transportation systems (most notably the highway system), the Federal government must be a strong financial partner with states in the provision of future intercity rail passenger service.

### ***AASHTO Freight Bottom Line Report***

The American Association of Highway Transportation Officials (AASHTO) has commissioned a five-part study of the nation's freight system, the Freight Bottom Line Report. The study will look at freight demand and logistics; highway freight; rail freight; and water freight. The final part of the study will summarize policy recommendations for consideration by AASHTO. The suggestions and emerging themes identified by this report will be of interest to Washington State freight planners. The report is to be completed toward the end of 2006.

The Freight Bottom Line Report is an extension of AASHTO's 2003 Freight-Rail Bottom Line Report, which found that the rail industry was stable, productive, and competitive, with enough business and profit to operate but not to replenish its infrastructure quickly or grow rapidly. The report found that market forces would continue to pressure the rail industry to streamline and downsize, to maximize revenues, and to minimize capital costs.

The report estimated that the total cost to keep the national freight system running was \$175 billion to \$195 billion over 20 years. It anticipated that the railroads would be able to provide the majority of the funding needed (up to \$142 billion) from revenue and borrowing, but the remainder (up to \$53 billion, or \$2.65 billion annually) would have to come from other sources, including but not limited to loans, tax credits, sale of assets, and other forms of public-sector participation.

The 2006 Freight Bottom Line will review overall freight transportation and rail freight needs, and suggest policies and funding approaches to ensure the most efficient use of transportation investment dollars.

## ■ Conclusions

The purpose of this Technical Memorandum<sup>6</sup> was to identify national funding opportunities for Washington State rail improvement projects. Traditional methods to finance state freight and passenger rail projects include a variety of Federal grant and loan programs coupled with private investment dollars. Many of these programs were increased or adjusted as part of the SAFETEA-LU, and will continue to be important funding sources for Washington State to pursue. Three loan and credit programs were dramatically enhanced by SAFETEA-LU, all of which should prove to be important for funding future passenger and freight rail projects in the coming years:

- The Railroad Rehabilitation and Investment Financing Program (RRIF) saw a tenfold increase in funding, from \$3.5 billion to \$35 billion.
- The definition of eligible projects for the Transportation Infrastructure Finance and Innovation Act (TIFIA) was widened to include freight rail projects (which were previously not eligible for TIFIA funds). The new eligibility includes projects that improve/facilitate: public or private freight rail facilities providing benefits to highway users, or intermodal freight transfer facilities, or Port terminals and port access.
- Private Activity Bonds were established as a new source of funding. SAFETEA-LU amended the IRS code to allow PABs for highway and freight transfer facilities. PABs, (otherwise known as tax-exempt facility bonds), are qualified and thus their interest is excluded for Federal income tax purposes in the gross income of recipients. With this qualified status and the accompanying tax benefit to investors, exempt facility bonds

can be offered at a lower interest rate, thus providing the issuer with considerable financing cost savings.

Case studies of several different states also offer pertinent examples of using innovative funding arrangements to fund passenger and freight rail system improvements. Some samples could be transferable to Washington State and help support the policy statements developed through the course of the WTC Rail Study. An example of this would be the Texas Rural Rail Transportation District (RRTD) program. This program created special rail districts in rural communities; the districts were granted the rights of a political subdivision of Texas State government. As such, RRTDs have the power to purchase, operate, and/or build new railroad and intermodal facilities, the right of eminent domain, and the ability to issue revenue bonds or grant anticipation notes. This example, as well as several others within this Technical Memorandum, may provide Washington State with ideas of specific mechanisms to advance its rail program.

Finally, there are a number of emerging sources and mechanisms of interest to Washington State. Among these are the proposed Freight Rail Infrastructure Capacity Expansion Act, which would use debt or tax credits to finance projects; proposals for dedicated revenue sources to support freight investments; new initiatives to encourage public-private partnerships and tax-exempt corporations; and the reports to be issued by the National Surface Transportation Commission, which will guide and develop Federal freight policy. On the passenger side, the Amtrak reauthorization bill, if approved, will considerably change the role and planning process for the State's intercity passenger rail system.

By tracking these developing themes and continuing to research innovative finance mechanisms, WTC and the Washington State DOT will be better positioned to take advantage of Federal rail funding sources, either as a single state or as part of a multi-state Pacific Northwest or West Coast consortium.