



Michael Sussman

Leveraging capital for the *entire* industry

At a time when more capital is being invested in North American railroads, it's as important as ever that capital flow throughout the entire system. After all, it is an interdependent network. While the major railroads emphasize high-volume lanes and trade corridors, a comprehensive growth mode for rail transportation must incorporate all regions and shipment sizes to realize a stable, lasting expansion.

Now that higher fuel prices have reconfigured the competitive economics of "road vs. rail," smaller railroads and shorter rail movements make more sense than ever. However, smaller railroads and other transportation providers are handicapped by private-sector funding options and government programs geared for the largest transactions. Understanding this phenomenon has led to breakthroughs in access to capital for them, but to solve this dilemma on an industry-wide level will require a fresh, coordinated effort.

My company has created a strategy for railroad "collateral and financial reengineering" that multiplies capital access and leverages limited public-sector dollars. This approach could be expanded to benefit the entire industry, resulting in a healthier branch line system of rural and urban rail service.

Public-sector support, used wisely, can attract private-sector financing and investment. One of our earliest clients, Progressive Rail, Inc., had been frustrated in its efforts to finance a transload facility in Lakeville, Minn. All the "railroad banks" turned them down, in spite of this company operating a successful industrial park in the state. Our collaborative solution integrated a state low-interest \$500,000 rail loan with three separate bank loans. The result: \$4.5 million of new capital for this ambitious rail developer.

We will continue to work with state officials to share best practices for using limited taxpayer resources to stimulate

private-sector rail development. It will take a new level of financial expertise, trust, and coordination. Local and state governments are often stymied when they invest in new private-sector rail facilities or the revitalization of their rail systems' neglected components. These states do not lack railroad entrepreneurs with the expertise and determination to take on new rail operations. But often these operators lack the capital to expand staff and facilities to market and grow the line.

Beginning in the early 1980s, the few national and regional banks still interested in rail finance refocused on the largest transactions, primarily for equipment rather than projects. By 1995, the minimum loan thresholds had increased to \$5 million. And most local lenders had lost touch with the contribution of railroads to their marketplace, retaining little knowledge about rail finance. Options were further limited by the 1997 termination of the USDOT Local Rail Freight Assistance small loan program. Also, the subsequently instituted Railroad Rehabilitation and Improvement Financing (RRIF) program lacked a simplified application process for smaller loans.

Interestingly, while often short on funding options, smaller railroads and rail shipper projects have a two-decade record of financial reliability and creditworthiness. As we point out in funding presentations to the private and public sectors, \$300 million of state and SBA loans for 300 small rail projects have been administered without a single default.

Short line railroad owners are brilliant at working with limited capital. But lately more of them own less of their rail lines, rolling stock, and property, preserving capital by leasing these business assets.

Not owning the underlying collateral and lacking the equity gain from asset appreciation, these operators have less access to the significant growth capital required for new facilities, equipment, and personnel.

Which should be easier to finance: a Caterpillar backhoe or a rebuilt locomotive? Based on its long useful life and market value, a locomotive should be, hands-down. It isn't, nor is it easy to finance many rail projects in comparison with riskier, less collateralized business ventures. Is this true for every rail opera-

tor? No. But understanding and remedying this limitation is key to strengthening branch lines as a vital element of a rail network within a sound transportation system.

Industries and markets grow as a function of overall capital flow to not only the largest operators, but also the numerous smaller and new-start operations.

It's illustrative that Google's dynamic growth has been built on its partnership with many smaller Internet enterprises.

The North American railroad industry as a lending marketplace has been misunderstood and underserved for decades. This is a multifaceted circumstance requiring a comprehensive, collaborative approach. The solutions are within our grasp if we work together with government and the private sector to meet the full range of growth funding needs and opportunities.

Michael Sussman is president of Strategic Rail Finance (www.strategicrail.com). He is also the founder of OnTrackAmerica (www.ontrackamerica.org), a nonprofit committed to the development of the North American rail system through improved collaboration and coordination. See p. 20 for further details.

As a lending marketplace, the railroad industry is misunderstood.
