11 Funding Alternatives

Implementation of the RMRA FRA Developed Option will require the state to develop a financing plan to fund the required capital costs. This plan will require a commitment from the state and the counties participating in the RMRA rail system with regard to institutional arrangements and funding process. Funding is available from a broad range of transportation programs, but will require a coordinated effort to identify all the relevant potential sources and pursue funding.

Many innovative financing concepts for transportation projects are available at state and local levels throughout the U.S. These projects include privatization or turnkey operations (i.e., design-build-operate projects), public-private partnerships, incorporating federal funds and federal credit enhancements in state and local projects, and establishing state infrastructure banks. In addition, bond issuance and leasing are options for increasing or leveraging funds to finance the required state contributions.

11.1 Federal Funding Programs

As of the time of preparing this report, there are a number of Federal programs that have been developed by the Federal Railroad Administration (FRA) over the last ten years to fund research, planning and corridor development. Many of these programs originated with the Intermodal Surface Transportation and Efficiency Act (ISTEA), and the Swift Rail Development Act. The ISTEA legislation was signed into law in June 1991, but has now been superseded by the "Passenger Rail Investment and Improvement Act of 2008". PRIAA provides grants of $1.9 billion for intercity rail and $1.5 billion for high-speed rail (i.e., trains that can reasonably be expected to reach speeds of 110 mph). Potential expenditures include "inquiring, constructing, improving or inspecting equipment, track and track structures."

11.1.1 Passenger Rail Investment and Improvement Act of 2008

High-Speed Rail Development ($1.5 Billion)[1] - From 2009 to 2013 $300 million will be made available each year for three years for the eleven existing authorized corridors, and will be available to Colorado if it achieves high-speed rail designation. Grants will cover 80 percent of project costs and need 20 percent local match. Funds are awarded competitively based on economic performance, ridership, and other social factors.

Intercity Passenger Rail Development ($1.9 Billion) - Each year (2009-2013) a state may apply for grants from the $380 million available. Grants can cover 80 percent of the capital costs of facilities and equipment necessary to provide new or improved passenger rail. Again, selection is

[1] This provision under Passenger Rail Investment and Improvement Act (PRIAA) is not to be confused with Intercity Passenger Rail Services grants under American Recovery and Reinvestment Act (ARRA), which have no similar speed restrictions.

competitive and based on economic performance, ridership and social factors. The grants are only available for speeds of 110 mph and up (i.e., not commuter rail), and recipients are subject to Buy America requirements.

11.1.2 American Recovery and Reinvestment Act: Capital Assistance for High Speed Rail Corridors and Intercity Passenger Rail Service (ARRA)

The Passenger Rail Investment and Improvement Act of 2008 has been supplemented by the American Recovery and Reinvestment Act (ARRA), which provides $8 billion in grants for passenger rail services capable of 110 mph for acquiring, constructing, improving or inspecting equipment, track, and track structures. The funds will be available through September 30, 2012. The funds will be distributed through three types of competitive grant programs:

1. High-Speed Rail (i.e., greater than 110 mph) grants for infrastructure and equipment to states, Amtrak, and public agencies
2. Intercity Passenger Rail Service - grants for rehabilitation of rolling stock and facilities to states, Amtrak, and public agencies
3. Congestion Relief - states and Amtrak can apply for grants to increase capacity and facilitate rail ridership.

Projects need to be included in state rail plans, and can achieve up to 100 percent grants (under track 2) for project costs (this includes EIS and preliminary engineering, but not train operating costs). Projects are subject to "Davis Bacon" wage rate and "Buy America" requirements.

11.2 Federal Credit Programs

The Transportation Equity Act for the 21st Century (TEA-21) created two credit programs to assist in funding passenger and high-speed rail projects. These programs include Rail Passenger Eligibility under the Transportation Infrastructure Finance and Innovation Act (TIFIA) and Railroad Rehabilitation and Improvement Financing (RRIF). The strategic goal under both programs is the use of credit rather than grants to help advance projects of national significance. As such, funding under the programs are loans and must be repaid.

11.2.1 Transportation Infrastructure Finance and Innovation Act

TIFIA provides federal assistance in the form of credit, rather than grants, to help fund major transportation investments of critical regional or national importance. The TIFIA credit program is designed to fill funding gaps and leverage substantial private co-investment by providing supplemental and subordinate capital in the form of long-term loans. A critical role for TIFIA loans is to pay for start-up costs, and ramp up losses for an otherwise "profitable" project.

The TIFIA credit program consists of three different types of financial assistance designed to address varying requirements throughout the project life cycle:

- *Secured loans* are direct federal loans to project sponsors offering flexible repayment terms. These provide combined construction and permanent financing of capital costs. The interest rate is "not less than" the yield on marketable Treasury securities of similar maturity on the execution date of the loan agreement.

- *Loan guarantees* ensure a federal government full-faith-and-credit guarantee to institutional investors making a loan to a project.
- *Standby lines of credit* represent secondary sources of funding in the form of contingent federal loans that may be drawn upon to supplement project resources (if needed) during the first ten years of project operations.

Projects eligible for federal financial assistance under surface transportation programs (Title 23 or Chapter 53 of Title 49) are eligible for the TIFIA program. In addition, projects of regional or national significance, such as inter-city passenger rail facilities and vehicles (including Amtrak and magnetic levitation systems), publicly-owned intermodal freight facilities on the National Highway system, border crossing infrastructure, and other large infrastructure projects, could also qualify under the TIFIA umbrella. The RMRA rail proposal is the type of project that would meet TIFIA eligibility requirements.

The U.S. Secretary of Transportation has developed criteria to guide the selection of TIFIA-candidate projects. These criteria include:

- The extent to which the project is nationally or regionally significant in terms of generating economic benefits, supporting international commerce, or otherwise enhancing the national transportation system.
- The creditworthiness of the project, including a determination by the Secretary that any project financing has appropriate security features (i.e., rate covenant) to ensure repayment.
- The extent to which the project will foster innovative public-private partnerships and attract private debt or equity investment.
- The likelihood that assistance would enable the project to proceed at an earlier date than the project would otherwise be able to proceed.
- The extent to which the project uses new technologies, including Intelligent Transportation Systems (ITS), that enhance the efficiency of the project.
- The amount of budget authority required to fund the federal credit instrument.
- The extent to which the project helps to maintain or protect the environment.
- The extent to which assistance would reduce the federal grant contribution to the project.

Investment funds may be provided by a corporation, joint venture, partnership, or governmental entity. The amount of federal credit assistance may not exceed 33 percent of total project costs. The Secretary must require each project applicant to provide a preliminary rating opinion letter from at least one rating agency indicating that the project's senior obligations have the potential to achieve an investment-grade rating.

The secured TIFIA loan must be payable, in whole or in part, from tolls, user fees, or other dedicated revenue sources; and include a rate covenant, coverage requirement, or similar security feature supporting the project obligations; and may have a lien on revenues. The Secretary establishes a repayment schedule for each secured loan based on the projected cash flow from project revenues and other repayment sources. Scheduled repayments of principal or interest shall begin not later than 5 years after the date of substantial completion of the project, and the final maturity date of the secured loan shall be no later than 35 years after the date of the substantial completion of the project.

11.2.2 Railroad Rehabilitation and Improvement Financing (RRIF)

The Railroad Rehabilitation and Improvement Financing Program (Section 7203 of TEA-21) is intended to make funding available through loans and loan guarantees for railroad capital improvements. The FRA is authorized to provide direct loans and loan guarantees up to $35 billion. Loans have been made in the range of $20 million to $250 million. The R2C2 project would qualify under RRIF.

The U.S. Secretary of Transportation is authorized to provide direct loans and loan guarantees to state and local governments, government sponsored authorities and corporations, railroads, and joint ventures that include at least one railroad. Funds are to be used to acquire, improve, develop or rehabilitate intermodal or rail equipment or facilities, including track, bridges, yards and shops. The Secretary is to prioritize those projects that enhance public safety and the environment, promote economic development, enable U.S. companies to be more competitive in international markets, are endorsed in state and local transportation plans, or preserve/enhance rail or intermodal service to small communities or rural areas.

The Secretary is allowed to accept a commitment from a non-federal source to fund, in whole or in part, the required credit risk premium. Credit risk premiums fund the costs associated with a potential default on the loan/loan guarantee. Private commitments can be used in lieu of or in combination with any appropriations of federal funds for this purpose. The Secretary (in consultation with the Congressional Budget Office) determines the amount required for credit risk premiums for each loan/loan guarantee on the basis of the circumstances of the applicant, including collateral offered, the proposed schedule for disbursing the funds, historical data on the repayment history of similar borrowers, and any other relevant factors.

The term of any loan may not exceed 25 years; the assistance must be justified by the present and probable future demand for rail services or intermodal facilities; the applicant must provide reasonable assurance that the facilities or equipment to be acquired, rehabilitated or established will be economically and efficiently utilized; and the obligation must be reasonably expected to be repaid, taking into account an appropriate combination of credit risk premiums and borrower collateral.

11.3 State and Local Financing

Federal funding under the grant programs described above usually requires a minimum local match of 20 percent at the state and local levels. In addition, several provisions are included in TEA-21 that provide greater flexibility to states and local governments in satisfying the non-federal matching requirements of a project.

11.3.1 Delayed or Tapered State/Local Match

TEA-21 permits grantees to defer payment of the state/local share of transit projects. The Secretary may allow the federal share to vary up to 100 percent on individual progress payments on a project, as long as the final contribution of federal funds does not exceed the maximum federal share authorized for the project. The states may wish to delay the application of their matching funding, particularly if they are trying to maximize the use of available state/local funds. This could occur because the funds are invested in a short-term security, for example, or otherwise encumbered. However, there may also be a situation where the grantee is seeking to arrange construction period financing or some other innovative financing mechanism, which could be facilitated through an uneven expenditure of Federal and matching funds.

The USDOT grant process is generally based on a level outflow for a specific project. For example, for every 20 percent expended by the state/locality, 80 percent in federal funds are expended. Little value can be added to such a cash stream through the assistance of private capital markets. However, if the federal dollars are expended first (e.g., for 100 percent of the design, engineering or environmental reviews), then the construction period can be financed with some private participation. In this instance, state/local funds can be “banked” or pledged as additional security for the construction period financing. This is all possible because there are no arbitrage concerns with state/local funds as there might be with the federal funds. The benefit of a delayed state/local match is that it may help assure the smooth progress of a major transit infrastructure project without any increase in federal outlays.

11.3.2 Credit for Acquired Land

TEA-21 expands the law relating to donated property to also allow the fair market value of land lawfully obtained by the state or local government to be applied to the non-federal share of project costs. If Colorado purchases right-of-way for the high-speed rail project, that purchase would count to the local match.

11.3.3 Using Federal Funds as Match

For transportation enhancement projects, the states may apply funds from other federal agencies to the non-federal share of the project. For example, Economic Development Funds, Highway or Transit funds, even grade crossing improvement grants from FRA could be used to match federal rail grant funds.

11.3.4 Local Funding

Financial support for the system may also come from a wide variety of local and regional sources, which at present typically contribute a share of certain costs of surface transportation projects (e.g., freeway interchanges). In the case of the Colorado corridors, endorsement of local funding for station construction or improvements (e.g., part of an urban renewal or downtown development program) can be justified given the economic benefits that will accrue to new development in station areas because of the high level of ridership in the I-70 and I-25 corridors.

Local communities frequently encourage businesses to enhance station facilities activities such as commercial offices, convenience stores, restaurants, cafes, and in the case of larger stations, even hotels. In addition, some communities have used their stations as transportation multimodal hubs with integrated bus and taxi operations. For these reasons, it is likely that funding for station facilities could be obtained from local communities. Given the character of high-speed rail stations, these developments by local government and the private sector could easily provide the total local match needed for Federal Funds.

11.4 Private Sector Contributions

Private sector contributions may also be used to partially fund public works projects and can be used as non-federal matching funds. Private developers may be willing to provide cash and in-kind contributions to support transportation improvements from which they expect to benefit. Businesses and individuals may have a strong interest in promoting certain types of development and may be willing to contribute money, property, or services to enhance the feasibility of the project. Special benefits may accrue to private contributors in the form of projects sited near property owned by the developer, the creation of access points between the developer's property and the project, zoning concessions, development rights, or public recognition.

11.4.1 Joint Development

Joint development involves adjoining facilities shared by the public and private developers, such as a station adjoining office or retail space. Developers may be granted development rights for stations in exchange for contributions toward funding a transportation project. Contributions could include one-time payments toward the rail project or annual payments that can be applied to project costs or operating costs. Project viability depends on real estate market conditions and the ability of the public agency to provide necessary inducements for development. Inducements may include land, favorable zoning changes, lower financing costs, or improved public access to the developer's property.

11.4.2 Freight Railroads

Freight railroads will be major recipients of benefits because of infrastructure investments in track, signaling and rights-of-way. As a result, they may experience substantial productivity gains within their operations and significantly lower track maintenance and renewal. Therefore, the freight railroads may contribute to the costs of implementing the Colorado High-Speed Rail project through such projects as R2C2, increasing the local match potential.

11.5 Debt Financing

The use of debt financing provides the ability to advance project implementation by borrowing against projected future revenues. Several forms of debt financing are discussed on the following page.

11.5.1 Bond Issuance

The issuance of bonds and availability of up-front bond proceeds enables projects like the Colorado High-Speed Rail corridor to proceed in an uninterrupted fashion since project funding is secure. Additionally, the use of bond financing allows major capital projects, which are long-lived assets, to be paid for over their useful lives rather than by current users. Tax-exempt debt represents bonds issued by a public agency or authority and backed by a specified source of revenue. Taxable debt represents bonds issued under structures in which the project costs are not eligible under the Internal Revenue Code for funding by tax-exempt bonds. Taxable debt would be issued at an interest rate approximately 1.5 to 3.0 percentage points higher than tax-exempt debt, because the interest income from these bonds would be subject to federal, state, and local income taxes, which in turn affect investor returns. The basic structure of bonds is the same, whether tax-exempt or taxable.

11.5.2 Tax-Exempt Bonds

There are two major categories of tax-exempt bonds -- general obligation and revenue. The full faith and credit of the issuer with taxing power secures general obligation bonds. Revenue bonds are payable from specific revenue sources and do not permit bondholders to force taxation or legislative appropriation of funds not pledged for payment of debt service. Revenue bonds are non-recourse to the taxing power of the state in which the issuing authority is located. The only sources of repayment and security for bondholders are the specific revenues that are pledged under the bond indenture.

Under certain conditions (as defined in the Internal Revenue Code), state agencies and authorities would be able to issue tax-exempt "governmental use bonds" for a project. Exemption of the interest income on the bonds from federal taxes will lower the interest costs of the bonds, because investors can achieve the same effective return on tax-exempt bonds issued with a lower interest rate as they would achieve on taxable bonds at higher rates. For the bonds to obtain tax-exempt status, certain criteria must be met. Funded assets must be publicly owned. The operating contract must be a short-term contract that satisfies certain conditions, including termination rights by the public authority, and compensation cannot be based on a percentage of gross or net revenues. If a long-term operating contract is employed and the operating contract conditions discussed above are not met, tax-exempt governmental use bonds cannot be issued.

For different reasons (defined in the Internal Revenue Code), a second type of state-issued, federal tax-exempt bond, the "private activity bond," cannot be used for the 110-mph options. Under current law, these bonds may generally be used in private concessions for high-speed rail projects, except for the acquisition of rolling stock, for a system with operating speeds that meet a 150-mph minimum speed threshold. Thus, the Colorado High-Speed Rail corridor may qualify for “private activity bonds” for the higher speed (e.g., 220 mph) option, where its operating speeds are expected to meet or exceed the 150-mph requirements.

11.5.3 American Reconstruction and Rehabilitation Act (ARRA) Bonds

Under the ARRA the potential for bonds has been greatly expanded. Specific options include –

- Private Activity Bond (PAB's) - All PAB's issued in 2009 and 2010 will be exempted from the Alternative Minimum Tax (AMT).
- High-Speed Rail (PAB's) - ARRA allows purchases to deduct costs for buying and carrying Tax Exempt Bonds.
- Build America Bonds – In 2009 and 2010 Government Purpose bonds receive a cast subsidy or tax credit from the federal government equal to 35 percent of interest costs.
- Recovery Zone Bond – ARRA authorizes $10 billion in special BAB's in economically distressed/high unemployment areas. BAB's will receive a 45 percent interest subsidy.
- Qualified Energy Conservation Bonds (QECR) – QECR are 70 percent tax credit bonds with broad application to capital costs, research grants, emissions reduction projects. ARRA makes $3.2 billion available to states on population basis, with no more than 30 percent being used for PAB's.

11.5.4 Use of Proceeds and Source of Repayment

The revenues that are pledged to repay debt frequently include portions of a state's motor fuel taxes, motor vehicle registration fees, motor vehicle license or permit fees, and sometimes a portion of the state's sales tax. While net revenues from the operation of the proposed system could be pledged to repay the bonds, the interest rate for an untested entity such as the Colorado High-Speed Rail Authority would probably be substantially higher than those available to the individual states.

11.5.5 Establishment of New or Expanded Debt

States have constitutional or legislative restrictions on the issuance of debt. In addition, the enactment of a transportation bond program may require legislative action to establish the size of the program, identify existing or new revenue sources that will be pledged over a multi-year period to repay debt, and develop guidelines for the types of projects to be financed. The development of each new or expanded financing program must be tailored to meet specific legal, political and financial constraints. In this study, it has been assumed that each state will have (or will secure) the necessary bonding capability.

11.5.6 Structuring Considerations

Tax-exempt bonds can be structured as long-term, fixed-rate debt where the interest rate is established at the time of sale. Potential investors and the rating agencies carefully evaluate the credit strength of a bond issue. The key credit factor is the expected strength and stability of the pledged revenues.

11.5.7 Grant Anticipation Notes

Grant Anticipation Notes (GANs), or similar instruments, offer states an additional mechanism to raise up-front capital on the basis of receiving future federal funds. The term GAN refers to a debt financing instrument that permits its issuer to pledge future USDOT FRA funds to repay investors.

GANs are generally short term, usually less than one year to maturity but sometimes as long as two to three years to maturity, and intended only to meet short-term financial needs.

When the GAN is issued, the main form of security backing this debt financing instrument is the state's obligation of future federal aid apportionments based on a Letter of Intent or a Full Funding Agreement from the USDOT FRA. Short-term GANs are defined as notes backed by future obligations of a currently authorized Full Funding Agreement. Therefore, assuming that a state issued the GAN in the second year of a five-year authorization period, the term of the notes (or at least that portion backed by federal funds) could not exceed four years.

Federal tax law presently prohibits tax-exempt bonds from being directly or indirectly guaranteed by the federal government (i.e., Full Funding Agreement). Therefore, to enhance the credit rating of the issuance, additional security for the GANs is often required. Because of the shorter maturity and the additional security pledged, GANs usually are issued at a rate that is approximately one percent less than that for general obligation bonds. Accordingly, they could be a potential source of funding during the construction period, when the amount of funds received from federal grants does not meet the capital requirements of the construction program.

11.5.8 Leasing

There are two potential funding mechanisms for financing rolling stock and possibly maintenance facilities. One option is off-shore or cross-border leasing and the other is the issuance of Certificates of Participation (COPs). There must be a separation of federal and state interest in the equipment or facility in order to use cross-border leases or COPs to leverage additional funds, or when using short-term lending or debt subordination where arbitrage issues could be involved. For example, the portion of a fleet or facility without federal interest could be financed and the proceeds used to earn interest or act as a credit enhancement on a bond issue supporting a major investment, thus generating savings for the state. Any legislative package proposed for the Colorado High-Speed Rail Authority should include the powers necessary to enter into such leases.

11.5.9 Off-Shore or Cross-Border Leasing

Off-shore or cross-border leasing is a mechanism by which the state purchases rolling stock, such as railcars, then simultaneously sells them to a non-U.S. investor who would be allowed to take investment tax credits or tax depreciation write-offs on the value of the equipment. The investor in turn leases them back to the state, and the tax benefits are shared with the state through reduced leased costs. The foreign investor pays the state an up-front consideration usually ranging from five to ten percent of the cost or value of the vehicles. The balance of the proceeds is deposited in a trust account to prepay the lease payments. Cross-border leasing is an ideal market for railcars because of their long life and “resalebility.” The market has a proven advantage; however, it is volatile with uncertainties as to the availability and amount of savings. At a given point in time there may be more demand than supply.

11.5.10 Certificates of Participation

Certificates of Participation (COPs) are methods of issuing debt, similar to bonding, secured by the value of the vehicles and/or facilities of the project. The investors become the technical owners of the vehicles/facilities and "lease" them back to the state. The lease payments become the service on the debt and, at the end of the lease period, the debt is retired and ownership reverts back to the state or issuing agency. COPs represent an interest in the payments the issuer has promised to make, but which are subject to annual appropriation by the issuer's governing body. The issuer must actually appropriate the funds each year; therefore, there is an element of risk not present in bonds. Although COPs can be insured, the interest rate is usually higher because of the increased risk.

11.6 Funding Summary

Many states are exploring opportunities to involve the private sector more completely in the implementation of high-speed rail projects. At this time, it is assumed that the state will create a public-private partnership to fund its portion of the capital costs while using one or a combination of the project funding alternatives discussed above. It is expected that the most likely funding mechanisms will include:

- Federal Financial Assistance and grants
- Cash flow management (TIFIA, GANs)
- Cost reduction techniques (cross-border leases, COPs)
- Private sector and public-private partnerships for station development and train operation

The current objective of most High-Speed Rail initiatives and bills in Congress is 80 percent federal participation with a 20 percent local match. It is anticipated that during the proposed Program Development phase, a consensus on how to generate the local match by a public-private partnership can be achieved.