Infrastructure Financing Tools

New Infrastructure Policies Surfacing? Ideas for Improvements to the RRIF Loan Program

By Richard Sherman | The Seneca Group, LLC
February 2018

The ocean of U.S. public policy is frothing from battles over budgets, appropriations, and politically-charged programs. Beneath the flotsam and turmoil, the White House Infrastructure Plan lurks, pondering a trillion-dollar leap into the sunshine. Such a package has the potential to make changes in many existing infrastructure financing programs.

One mighty leviathan already residing within the depths is the $35 billion Railroad Rehabilitation and Improvement Financing (RRIF) Program. RRIF was created in 1998, but only $5.4 billion in loans have been made to date. RRIF has been criticized for having a costly, lengthy, uncertain, and generally painful application process. Its reputation became so fearsome that, rather than approach RRIF, railroads would forego projects, or attempt to obtain financing on substantially more expensive and less flexible terms.

The 2015 FAST Act made changes to help RRIF become a more viable financing option. This included creating a new agency within the U.S. Department of Transportation (DOT), the Build America Bureau. One objective of the Bureau was to professionalize the underwriting and management of RRIF, incorporating it into the centralized management of a suite of transportation infrastructure funding tools including TIFIA loans,

An Infrastructure Plan Embraces the U.S. Congress

private activity bonds, and certain grants. These changes have helped. It is very possible we shall see at least one or two interesting RRIF loans issued in 2018. *But more can be done to enable this tool to achieve its intended public policy objectives.*

Steps Forward

Based on our experience and input from stakeholders, we have compiled a list of changes to RRIF that could make it more attractive and effective.

1. Reduce RRIF transaction costs

There are several transaction costs associated with RRIF loan applications. Their scale can determine if RRIF is a viable financing source for a given borrower or project. The largest are often unknown until the end of a lengthy process. Congress could take steps to reduce these costs.

1.a Enable assistance for advisory fees associated with RRIF loan applications.

DOT charges fees to applicants to pay the cost of hiring legal and financial advisors to support the credit risk analysis process and credit agreement negotiations. These fees have exceeded $1 million for past loan applications. **Congress can dedicate financial resources to pay some or all the costs of advisory fees, ideally on an annual and continuing basis.** Approximately $2 million per year, made available until expended, would attract a meaningful number of applicants who otherwise wouldn't approach the Program. This concept is supported by two precedents. First, a one-time ~$2 million appropriation provided funds for RRIF for exactly this purpose for small railroad projects. This resource has been taken advantage of by eligible applicants in the past fiscal year. Second, $2 million is already programmed annually from DOT's TIFIA loan program budget to cover equivalent advisory fees, a resource called small project fee assistance.

1.b Enable a subsidy for RRIF loan credit risk premiums.

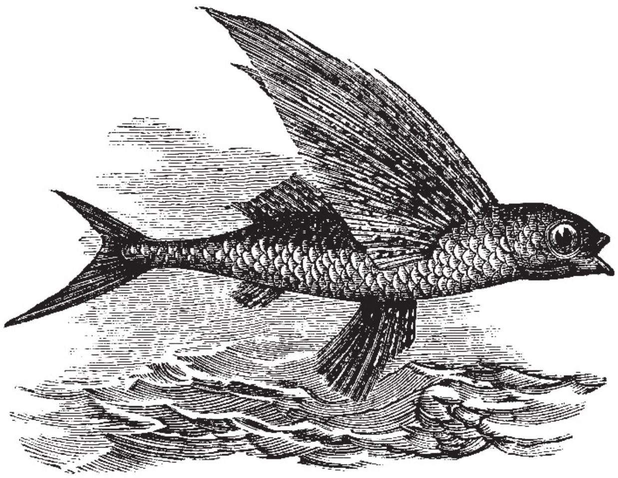
DOT charges a fee to borrowers to protect them against the risk of default on the loan: the credit risk premium, or CRP. Typical premiums have ranged up to six percent, with the highest to date over 18%. There is no cap on the CRP, and it is not known until the end of an expensive and lengthy loan application process. The uncertainty around the CRP discourages many potentially viable borrowers from approaching the program. **Congress can dedicate resources to pay some of the costs of RRIF credit risk premiums.** There are two precedents. Credit risk charges for TIFIA loans receive direct annual support through the Highway Trust Fund, with $275 million available in 2017, rising to $300 million by 2020. This TIFIA mechanism could be expanded to cover RRIF CRPs. Or, dedicated appropriations could be made. The second precedent is the eligibility of RRIF CRPs under the 2017 Positive Train Control Grant Funds Program. Offsetting the CRP costs could deliver a tremendous return on investment to the taxpayer. DOT estimates that, in the case of the similar TIFIA program, each dollar of credit risk charge support enables ten dollars in federal loan funds that further leverages another thirty dollars in non-federal investment in infrastructure.

1.c Enable assistance for fees levied on borrowers during the term of the loan.

DOT assesses an inflation-indexed loan servicing fee each year for the life of a RRIF loan. They can also charge a "project monitoring fee" to cover the cost of oversight during construction. **Congress can dedicate resources to help pay these administrative costs.** Such support would be helpful during project implementation, and any traffic and revenue ramp-up, periods when a borrower's cash flows will often be weakest across the life of the loan. This will support challenging projects such as P3s, or multi-modal endeavors, where more DOT oversight is needed during the construction.

1.d Provide resources to capitalize RRIF loan reserve fund mechanisms.

A common tool in project finance is a debt service reserve fund. The only allowed use of these funds is to be drawn upon if the borrower experiences any temporary difficulty in meeting debt service obligations. Such a fund protects both borrower and lender. **Congress can dedicate resources to capitalize reserve funds for RRIF loans.** A reserve



fund is usually a small fraction of the loan principal amount. Such funds can help reduce the credit risk charges associated with the loan, reducing the costs to the borrower, and enabling a larger infrastructure investment.

1.e Modify existing grant funding vehicles to support some of these concepts.

Beyond new appropriations, there are existing resources that could support the purposes identified above. **Congress can adjust existing grant programs to make their funds explicitly eligible for the purposes described above.** This concept has precedent. Funds awarded under the Positive Train Control Grant Program were eligible to pay the administrative costs of RRIF loans and credit risk premiums. Several DOT rail grant programs could be modified in this respect, including the Consolidated Rail Infrastructure and Safety Improvement, Federal-State Partnership for State of Good Repair, and Restoration and Enhancement grant programs. Other programs that already have common goals and eligibility with RRIF include the Economic Development Administration's Public Works Assistance grants, FHWA Surface Transportation Block grants, the Department of Agriculture Community Facilities grants, the Department of Interior’s Abandoned Mine Land grants, and grants made by the Department of Defense Office of Economic Adjustment. Expanding eligibility in this way would allow relatively small grant awards to leverage much larger RRIF loans.

2. Extend RRIF loan terms to match true railroad asset lifespans

Many of the investments that a RRIF loan can finance are very long lived. Major structures such as bridges and tunnels can have useful economic lives of over a century. From a borrower’s perspective, financing ideally matches the operational life of the asset being financed. **Congress can enable RRIF loans to be made for terms matching the lesser of 50 years or the expected economic life of the financed assets.** This would enable borrowers to amortize financing costs over a period closer to the true depreciable lifespan of the capital assets being built or improved. This could reduce the overall cost of the capital structure of a given project, improve the financial strength of the borrower, and reduce credit risk to the lender.

3. Facilitate earlier identification of credit risk premium ranges

The process for determination of the RRIF credit risk premium can lack transparency and the CRP is typically offered very late in an already long application process. This creates fundamental uncertainty for RRIF applicants who can incur significant costs before knowing if the loan will be affordable. **Congress can better enable DOT to explain the CRP methodology to applicants and present pro forma CRP ranges earlier in the process.** Staff can be empowered to discuss in more depth the factors driving the magnitude and range of the estimated CRP specific to an application for financing, including dynamics and weighting of model key input factors. This could enable more effective financial structuring decisions earlier in the process, so that a capital structure is assembled up front that meets the needs of both borrower and lender. Consideration of credit risk dynamics by senior DOT leadership for specific transactions can also begin earlier in the process. One possible step would be for the DOT Council on Credit and Finance to meet more frequently, every two weeks, rather than monthly.

4. Facilitate pairing of the Private Activity Bonds program with RRIF loans

Private activity bonds (PABs) are tax-exempt bonds issued by a local or state unit of government, to provide financing benefits for investment projects that are developed with a minimum amount of private participation. U.S. DOT's PABs are eligible for commuter and high-speed rail facilities and privately developed and operated freight transfer facility projects. The program has been successful: $6.6 billion in PABs have been issued, another $4.3 billion have been allocated. PABs paired with RRIF can facilitate local government participation in rail projects, including a range of innovative financing structures. **Congress can make a minor change in the PAB statute, allowing allocations for projects that have entered the RRIF application process as authorized under Title 45.** This eliminates the current dependency on an obligation of funding under Titles 23 or 49.

5. Provide an interest rate subsidy mechanism for RRIF loans

The RRIF program offers financing at interest rates calculated based on those of equivalent term Treasury debt securities, plus approximately a basis point. The estimated risk to the lender is charged to the borrower separately as the credit risk premium. **Congress can reduce the cost of borrowing for recipients of RRIF loan funds by subsidizing a portion of the interest rate.** Subsidies on federal loan interest rates have precedent in other programs, such as student loans. By reducing the interest cost, the long-term cash flow and overall debt capacity of the borrower is improved, credit risk can be reduced, and the overall capital structure can be optimized.

6. Enable an interest rate buy down feature for RRIF

TIFIA features a mechanism called an interest rate buy down intended to help borrowers manage interest rate risk. Interest rates can rise by a material amount between the time of application and execution of a loan agreement. **Congress can enable applicants to "buy down" this differential in interest rates.** For TIFIA this buy down is up to 150 basis points. This can provide greater transaction cost certainty, potentially increasing capacity to borrow, and reducing credit risk. This mechanism does not exist for RRIF. Given the scale and lengthy term possible with RRIF loans, and the lengthy application time frame, Congress can consider an even higher buydown rate, as well as making such a buy down eligible for direct support.

7. Enable a line of credit mechanism for RRIF

TIFIA is authorized to provide lines of credit to borrowers, RRIF is not. **Congress can add a line of credit capability to RRIF, providing flexibility in terms of the suite of credit products offered.** This could be particularly useful as a tool for smaller borrowers and complex public-private partnerships. This change aligns with a strategic objective of DOT, to better harmonize the TIFIA and RRIF programs.

8. Align creditworthiness evaluation procedures with those of other DOT funding programs

Project sponsors who access multiple federal financing programs may be asked to develop multiple forecasts and models to satisfy different agencies. **Determination of creditworthiness of**

demand-associated revenues can be made more consistent with other DOT funding programs. Specifically, for rail transit projects, the RRIF credit risk analysis should explicitly recognize FTA guidance on the use of the Capital Investment Grant travel forecasting methodology and rating agency evaluations of ridership studies. This measure would reduce application costs and improve the certainty of availability and timing of RRIF loans secured by pledges of passenger demand-based revenue streams.

9. Ensure that RRIF loans are counted towards local matching funds

The FTA's Capital Investment Grant program requires that proposed New Starts projects be supported by an acceptable degree of local financial commitment. **Congress can affirm that any proportion of a RRIF loan secured with repayment by non-federal sources shall be counted as part of the Local Financial Commitment for other federal programs, such as New Starts.** Because a RRIF loan will be repaid in full by non-federal funds, there should not be any confusion among policymakers that RRIF counts as an eligible local contribution to a project under other federal programs.

10. Implement an express framework for RRIF applications meeting certain criteria

DOT has begun to develop a framework for applications by borrowers that meet certain entity and project criteria. This framework is intended to filter applications that meet clear standards for risk and readiness. The concept proposes placing advisors "on-call" to work on qualifying applications through existing contracting mechanisms, reducing procurement delays. If successful, this framework could reduce application uncertainty and speed up the process for these borrowers. **The Build America Bureau can finalize and pilot this 'RRIF Express' framework in 2018.**

Allegory of the Coming Infrastructure Plan Debate in Congress

It is our hope that these ideas generate discussion among members of the transportation finance policy community, leading to consensus, support, and action. We have developed draft statutory language for some of the concepts that we are able to share. We are pleased to discuss with interested parties the ways in which different types of infrastructure investments could benefit from each of these proposed measures.

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