



National Railroad Passenger Corporation (“AMTRAK”): *Acela* Financing

On April 30, 1999, Arlene Friner, CFO of Amtrak, instructed her Treasury staff to review a leveraged lease proposal from the BNY Capital Funding LLC (“BNYCF”). Several weeks prior, Amtrak and its advisor, Babcock & Brown Financial Corporation, had invited financial institutions to submit lease-financing proposals for Amtrak’s planned purchase of locomotives and high-speed trainsets.¹ The equipment would be utilized on the *Acela* line, Amtrak’s new brand that was designed to differentiate Amtrak passenger trains and service in the Northeast corridor from the existing service.² *Acela*, scheduled to begin service in late 1999, promised to offer faster trip times and premium service (see **Exhibit 1**).

Arlene and her staff had gone over the proposals and agreed that BNYCF was among those that offered the best terms. Now she had to decide whether Amtrak should finance the equipment purchases using BNYCF’s leveraged lease proposal, or instead, borrow money and purchase the equipment on its own.

Company Background

In 1970 the United States Congress created The National Railroad Passenger Corporation (Amtrak) to ensure that “modern, efficient intercity passenger rail service would remain an integral part of the national transportation system.”³ The government mandated Amtrak to take over the rail passenger operations of private railroads. Since then, Amtrak became the primary provider of passenger rail service in the United States. Amtrak’s national network provided service to more than 20 million intercity passengers, and operated 516 stations in 44 states.

¹ A trainset consisted of one first class coach car, one bistro car, three coach cars, one end coach car and two power cars.

² Babcock and Brown memorandum, p.1

³ Executive Summary: 1999 Assessment of Amtrak’s Financial Needs Through 2002

Historically, Amtrak had received annual subsidies from the federal government. In 1997 however, Congress passed the Amtrak Reform and Accountability Act (ARAA), which stipulated that Amtrak eliminate its reliance on federal subsidies by 2002. After 2002, no federal funds could be used for Amtrak's operating expenses. This represented a formidable challenge, as Amtrak had never been profitable in its 30-year history. (See **Exhibits 2** and **3** for Amtrak's historical income statements and latest balance sheet.) Thus, to meet Congress' goal of operating self-sufficiency by 2002, Amtrak developed a radical new business plan, the centerpiece of which was a high-speed rail service that was projected to bring in net annual revenues of \$180 million by fiscal year 2002⁴.

Acela

In its Northeast corridor, which served routes from Virginia through Maine,⁵ Amtrak branded this new high-speed rail service "*Acela*":

"*Acela* is designed to be more than high-speed trains – it is a brand representing a new way of doing business. *Acela* was designed to bring high speed and high quality to Northeast Corridor passengers. The *Acela* service will offer faster trip times, comfortable amenities and highly personalized service. *Acela* is the latest and boldest step by Amtrak to change its rail service into a more customer-focused commercially driven, premium transportation service."⁶

The *Acela* trains, designed to operate as fast as 150 miles per hour (241.35 kilometers per hour), promised to reduce travel time significantly. For instance, the trip from Washington D.C. to Boston, which currently took 7 hours and 30 minutes, would take 5 hours and 50 minutes on the high-speed trains.⁷ The first high-speed trains, the *Acela Express*, were scheduled to begin service between New York City and Boston in late 1999, while the New York to Washington leg would be added within a year. The full high-speed service was expected to be in place by the fall of 2000.

The Equipment

To operate the *Acela* Regional Service as planned, Amtrak needed to purchase fifteen dual cab, high-horsepower electric locomotives, and twenty high-speed trainsets. Each trainset

⁴ Amtrak's fiscal year ends September 30.

⁵ Amtrak was organized along three Strategic Business Units (SBU's): Amtrak Northeast Corridor, Amtrak Intercity and Amtrak West. The Northeast Corridor included all the routes in the Northeast from Virginia to Maine; Amtrak West included the West Coast routes in California and the Pacific Northwest, and extended to Vancouver, BC. Amtrak Intercity is the remainder of the system across the middle of the country.

⁶ Babcock and Brown memorandum, p.3

⁷ Information provided by Mr. Raj Srinath, Senior Director, Corporate Finance, Amtrak.

consisted of one first class coach car, one bistro car, three coach cars, one end coach car and two power cars. The estimated total cost for all the equipment was around \$750 million:

	<u>No.</u>	<u>Cost</u>	<u>Aggregate Cost</u>
High-Speed Locomotives	15	\$ 7,161,300	\$ 107,419,500
Trainsets	20	\$ 32,129,050	\$ 642,581,000
Total			\$ 750,000,500

The trainsets and locomotives had estimated useful lives of 25 years, and residual values equivalent to approximately 15 percent of the original equipment cost. Amtrak used straight-line depreciation for accounting purposes, and seven-year MACRS⁸ for tax purposes. Amtrak was subject to the corporate income tax rate of 35 percent.

Arlene Friner had already been able to arrange financing for all the equipment save for six locomotives and seven trainsets, which totaled \$267.9 million in value. This was the amount (not \$750 million) for which she was considering the BNYCF leveraged lease proposal.

Financing Options

Three options were available for Amtrak to gain use of the equipment: 1) borrow money to fund the purchase; 2) lease the equipment from a financial institution such as BNYCF; 3) rely on federal sources for funding.

Borrow and Buy. A major bank had offered to underwrite a bond issuance for Amtrak with a 20-year term at 6.75 percent per annum. This arrangement would call for Amtrak to make semi-annual payments of \$12.303 million beginning in December 1999. The locomotives and trainsets would serve as collateral for the loan. A member of the Treasury staff suggested that one drawback to this alternative was that Amtrak had recently issued debt – as such, the public market might already be saturated with Amtrak paper.

Lease. BNYCF had proposed a leveraged lease⁹ structure for this transaction (see diagram on **Exhibit 4**). BNY Capital Funding LLC, a wholly owned subsidiary of The

⁸ MACRS stands for Modified Accelerated Cost Recovery System. See **Exhibit 6** for a 7-year MACRS schedule.

⁹ There are three common types of financial leases. Direct leases are those in which the lessor purchases the equipment or asset and rents this out to the lessee. In sale and leaseback arrangements, the lessee already owns the asset but sells it to a lessor and leases it back. Leveraged leases are those in which the lessor borrows money to fund part of the purchase of assets, pledging the lease contract as security for the loan.

Bank of New York, would act as lessor. It would provide the equity funds needed to finance the purchase. On the other hand, The Export Development Corporation (EDC) of Canada would be the sole lender and debt provider, agreeing to provide 80 percent of the required funds. The equity investor, BNY Capital Funding LLC, provided the remaining 20 percent, and would receive lease payments only after the debtor had been paid.

The equity and debt funds on closing would flow through Wilmington Trust, an independent third party to the transaction that acted as Owner Trustee. The rent payments on rental dates would also flow through Wilmington Trust, which would then distribute the payments to either EDC or BNY Capital Funding LLC.

Under the lease proposal Amtrak would need to make semi-annual payments according to the schedule provided in **Exhibit 5**. At the end of the lease term, Amtrak could buy the equipment from BNY Capital Funding LLC at the higher of terminal or fair market value.¹⁰ Amtrak also had an early buyout option in which it could acquire the equipment from BNY Capital Funding LLC in 2017 for \$126.6 million.

Rely on federal sources. Theoretically, Amtrak could use federal monies to fund the *Acela* equipment purchases. Although Congress had mandated that Amtrak could not use federal subsidies for operating expenses, it had agreed to continue funding Amtrak for capital appropriations. Purchase of the *Acela* equipment would be considered a capital asset acquisition and as such federal grant monies could be used. However, federal grants were considered by Arlene Friner and her staff to be a "premium and precious" commodity; thus Amtrak preferred to use the grant money to fund capital projects which could not be easily and cost-effectively financed, such as safety, right of way and infrastructure related projects, and major overhauls. On the other hand, *Acela* trainsets and other rolling stock could be very efficiently financed through the capital markets.

Conclusion

Arlene Friner needed to make a decision soon. The timely commencement of the *Acela* service was crucial to Amtrak's prospects for self-sufficiency. She needed to arrange financing immediately if the equipment were to be delivered on time.

¹⁰ Using historical data, the Treasury staff estimated that the standard deviation of the market value fluctuations of trainsets and locomotives was 25 percent. The 17-year risk-free rate currently stood at 5.78 percent. The Treasury staff also calculated Amtrak's WACC to be 11.8 percent.

Exhibit 1

Amtrak: *Acela* Financing

About *Acela*

Northeast Travel

Ride the **Acela**

New World-Class Service From Amtrak®.

AcelaSM A blend of "acceleration" and "excellence." AcelaSM (pronounced ah-CELL-ah) represents the Amtrak® commitment to excel. To make your journey the best it can be at every stage — from faster, more efficient reservation systems to striking new and renovated stations to premium on-board services. Acela ExpressSM is the name of the sleek new high-speed trains you'll see in the Northeast this year.

amtrak.com
30% off
Book online today!

1+1=3
On Acela Express

But Acela means more than fast trains. It stands for leading technology, superior comfort and modern amenities. With three levels of service — Express, Regional and Commuter — Acela offers an unparalleled standard of travel for every guest on every train. A standard that includes consistently professional, highly personalized service; new and refurbished trains with a contemporary interior design; convenient connections to a wide variety of destinations across the U.S. and thoughtful touches for your pleasure and comfort. Simply stated, Acela puts top priority on your time and provides a pleasant travel experience. It's Amtrak's commitment to the way you choose to travel.

At 150 MPH, This is Not Your Ordinary Train Trip.

If your life is on the fast track, **Acela ExpressSM** is Amtrak's top-of-the-line ride to business or pleasure in the Northeast. The new 150-mph Acela Express trains will replace Metroliner[®] this year. These trains are designed to offer state-of-the-art equipment and premium service to travelers who expect nothing but the best. We're even improving our station locations — we've added a new Route 128 station near Boston and updated Penn Station in New York.

Reserved First class and Business class seating accommodate your busy agenda with comfort, upscale business amenities and polished professional service.

Plush seats with foot-rests and adjustable head cushions invite you to relax and recharge. Listen to music, enjoy a gourmet-to-go snack or sandwich. When there's work to do, you have an electrical outlet at your seat, adjustable lighting and a large tray table for your laptop. You can hold a meeting at one of our 32 conference tables located throughout the train. Or take a break in the bistro-like atmosphere of the Cafe car, where there's beer on tap and news on the TV screen. Aboard Acela Express, it's all about how you use your time.

Source: <http://amtrak.com/savings/acela.html>. Note: Image has been modified to fit page.

Exhibit 2

Amtrak: Acela FinancingIncome statement
(In millions of dollars)

	Fiscal Year Ending September 30				
	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>
Revenues					
Passenger related and other	\$ 1,152	1,177	1,213	1,341	1,392
Commuter	184	213	234	242	260
Reimbursable	77	107	108	91	91
Federal payments	-	-	-	-	542
Total revenues	\$ 1,413	1,497	1,555	1,674	2,285
Expenses					
Salaries, wages and benefits	\$ 1,330	1,241	1,236	1,299	1,448
Train operations	358	321	321	365	356
Facility and office related	153	172	181	187	190
Maintenance of way goods and services	45	73	59	46	52
Advertising and sales	91	90	109	98	102
Interest	185	144	149	160	181
Depreciation and amortization	245	230	238	242	294
Other	83	34	25	39	15
One time charges/(gains)	(244)	-	-	-	-
Total expenses	2,246	2,305	2,318	2,436	2,638
Operating income/(loss)	\$ (833)	(808)	(763)	(762)	(353)
Exclude federal payments and related interest					577
Operating loss restated	\$ (833)	\$ (808)	\$ (763)	\$ (762)	\$ (930)
Federal Grants:					
Federal operating grant	\$ 352	392	285	223	202
Excess railroad retirement taxes	150	150	120	142	142
Federal capital - interest	-	-	-	42	-
Federal capital - progressive overhaul & other	-	-	36	37	82
Total federal grants	\$ 502	542	441	444	426
Net loss	\$ (331)	(266)	(322)	(318)	(504)

Source: Amtrak annual report.

Exhibit 3

Amtrak: *Acela* FinancingBalance Sheet
(In millions of dollars)

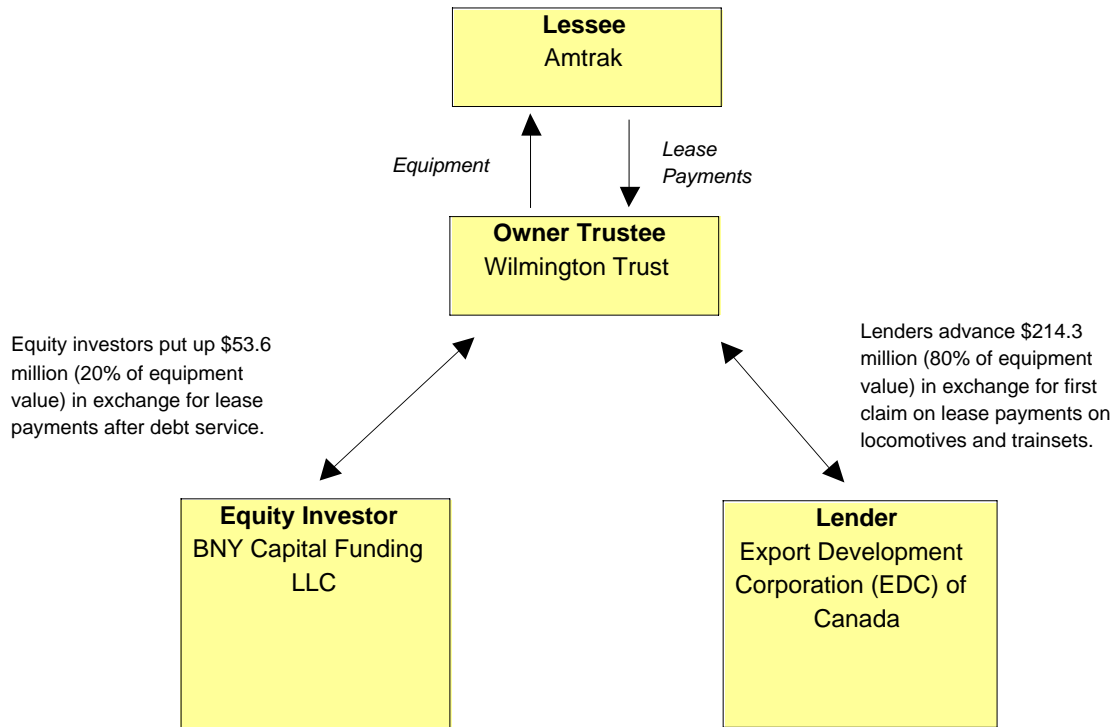
	FY Ending
	<u>Sept. 30, 1998</u>
ASSETS	
Current assets	
Cash and equivalents	\$ 274.7
Temporary cash investments	409.7
Accounts receivable, net	88.7
Materials and supplies	91.6
Other current assets	3.4
Total current assets	<u>868.1</u>
Property and equipment	9,456.4
Less accumulated depreciation	<u>(3,106.9)</u>
Net PPE	6,349.5
Other assets and deferred charges	87.6
Total assets	<u>\$ 7,305.3</u>
LIABILITIES AND CAPITALIZATION	
Current liabilities	
Accounts payable	\$ 270.8
Accrued expenses and other current liabilities	186.7
Deferred ticket revenue	61.4
Current maturities of long term debt and capital lease obligations	<u>102.2</u>
Total current liabilities	<u>621.1</u>
Long-term debt and capital lease obligations	
Capital lease obligations	1,213.1
Equipment and other debt	<u>322.5</u>
	1,535.6
Other liabilities and deferred credit	
Deferred federal payments	457.0
Casualty reserves	136.2
Postretirement employee benefits obligation	118.4
Environmental reserve	35.4
Advances from railroads and commuter agencies	20.6
Other	<u>1.5</u>
	769.1
Total liabilities	<u>2,925.8</u>
Capitalization	
Preferred stock	10,939.7
Common stock	93.9
Other paid-in capital	6,471.3
Accumulated comprehensive loss	<u>(13,125.4)</u>
	<u>4,379.5</u>
Total liabilities and capitalization	<u>\$ 7,305.3</u>

Source: Amtrak annual report

Exhibit 4

Amtrak: *Acela* Financing

BNY Capital Funding LLC's Proposed Leveraged Lease Structure



Note: Diagram based on illustration in "Principles of Corporate Finance" by Richard Brealey and Stewart Myers, 5th Edition, p. 755

Exhibit 5

Amtrak: Financing Acela

BNY Capital Funding LLC's Proposed Lease Payment Schedule
(In dollars)

<u>Date Due</u>		<u>Amount</u>
1999	June	\$ -
	Dec.	200,102
2000	June	3,761,228
	Dec.	7,965,652
2001	June	10,022,594
	Dec.	10,316,948
2002	June	8,617,634
	Dec.	10,360,645
2003	June	9,828,570
	Dec.	10,367,985
2004	June	8,607,823
	Dec.	10,418,573
2005	June	9,683,063
	Dec.	10,435,186
2006	June	8,580,151
	Dec.	11,599,993
2007	June	7,338,339
	Dec.	11,468,211
2008	June	9,475,208
	Dec.	15,792,709
2009	June	7,765,741
	Dec.	20,224,322
2010	June	5,067,035
	Dec.	15,872,556
2011	June	4,121,823
	Dec.	22,807,129
2012	June	3,336,587
	Dec.	23,645,133
2013	June	2,662,913
	Dec.	24,055,367
2014	June	1,957,919
	Dec.	20,017,608
2015	June	6,067,613
	Dec.	6,287,652
2016	June	12,292,315
	Dec.	21,394,788
2017	June	6,551,924
	Dec.	18,107,167
2018	June	8,612,133
	Dec.	13,469,295
2019	June	8,864,543
	Dec.	6,654,238
2020	June	2,035,748
	Dec.	1

Exhibit 6

Amtrak: Financing Acela

7-Year MACRS Depreciation Schedule¹¹

(figures in percent of depreciable investment)

<u>Year</u>	<u>% Depreciated</u>
1	14.29
2	24.49
3	17.49
4	12.49
5	8.93
6	8.93
7	8.93
8	4.45

¹¹ Because of the half-year convention, seven-year MACRS involves eight years of depreciation expenses.