To: Chairman Smedberg and the VRE Operations Board
From: Doug Allen
Date: October 20, 2017
Re: Proposed RRIF Loan Refinancing

Summary:
In 2007, VRE entered into a Railroad Rehabilitation and Improvement Financing (RRIF) agreement with the Federal Railroad Administration (FRA) for the purchase of 60 Gallery railcars. The original amount borrowed was $69.0 million over 25 years at an interest rate of 4.74%. The principal currently outstanding is $52.9 million. Interest rates are now lower than when VRE entered into the original loan, and a refinancing offers the potential for savings.

This item will provide the Operations Board with information on the RRIF loan, the refinancing alternatives considered for reducing debt service costs, and the preferred alternative for moving forward, which is refinancing through the Virginia Resources Authority. Staff anticipates bringing an action item to the Operations Board in November requesting approval and referral of the proposed parameters for the refinancing to the Commissions and the individual jurisdictions, in accordance with the Master Agreement.

Background:
The RRIF program was established by the Transportation Equity Act for the 21st Century (TEA-21), which authorized the FRA to provide direct loans and loan guarantees to finance the development of railroad infrastructure. Eligible RRIF borrowers include railroads, state and local governments, government-sponsored authorities and corporations, and certain freight shippers.

VRE entered into a RRIF financing agreement with FRA in October 2007 for the purchase of new Gallery railcars. Between FY 2008 and FY 2012, 60 new railcars were purchased and delivered to VRE – 35 to replace older railcars and 25 to provide expanded capacity. The total cost of the new cars was $114.0 million, of which $69.0 million was borrowed through the RRIF program and $45.0 million was funded through a combination of state and federal...
grants, proceeds from the sale of other railcars to the Maryland Transit Administration, and interest earnings.

As of April 2017, the management of the RRIF program has been transferred from FRA to the newly created Build America Bureau (BAB) within the U.S. Department of Transportation. This change has no impact on the terms of VRE's RRIF loan.

**Current Debt Service:**

VRE's annual debt service on the RRIF loan is $4.78 million, payable in equal quarterly installments. The total principal amount outstanding (following a payment on September 15, 2017) is $52.9 million, and the final payment is due in March 2033. Of the total annual payment amount, $4.67 million is grant funded, and $110,000 is paid solely with local funds. The current grant funding is 80% federal, 16% state, and 4% local, with the federal funding coming from a combination of 5307 Urbanized Area and 5337 State of Good Repair formula grants.

The RRIF loan bears an interest rate of 4.74%, equal to the 30-year Treasury rate as of the execution date. Pursuant to the terms of the Security Agreement, the loan is secured by VRE's gross revenues (subordinate to the then-outstanding revenue bonds) as well as security interest in the railcars themselves as collateral. The gross revenue pledge was given to the Series 1998 Bonds.

**Refinancing Alternatives:**

In the spring of 2017, VRE's financial advisor PFM reviewed a range of alternatives for refinancing the RRIF loan at a lower interest rate, including:

- Refunding with a direct bank loan
- Refunding with publicly offered bonds through the Virginia Pooled Financing Program (VPFP) of the Virginia Resources Authority (VRA)
- Refunding with publicly offered VRE bonds
- Requesting modification of the existing RRIF loan

The preferred alternative, given the various advantages and disadvantages of each approach, is refunding through VRA. The size and remaining term (just under 16 years) of the RRIF loan make it relatively unattractive for refunding via a direct placement with a bank. Offering VRE bonds directly would require credit agency review for establishment of an inaugural credit rating, significant disclosures, and a longer and costlier timeline for issuance. A request to the BAB to modify the terms of the original RRIF loan is likely to be time-consuming and have an uncertain outcome. Prior inquiries to lower the interest rate on the RRIF loan have been unsuccessful and are not allowed under RRIF policy.

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1 As part of the original purchase of the railcars, approximately $1.5 million of RRIF loan proceeds were used as a match to federal funds. Federal funds cannot also be used to pay the debt service on that portion of the RRIF loan, so this $110,000 of debt service is “segregated” from the remaining railcar debt service and is completely funded by local subsidy.
Refinancing Through VRA:

VRA was created by the General Assembly in 1984 to provide an additional source of funding for local infrastructure projects. VRA initially focused on financing for water and wastewater projects but has expanded to cover transportation, public safety, solid waste, and many other areas. Since its inception, VRA has financed investments across the Commonwealth exceeding $7 billion.

VRA’s VPFP offers a number of advantages to VRE. A public credit rating is not required to access the “AAA/AA” interest rates of the pooled program, and the lower cost of issuance is spread across the participants in the pool. VRA offers loan terms of up to 30 years and can custom-tailor the loan structure to meet the borrower’s needs. VRA also requires relatively limited disclosures, as compared to what a direct issuance by VRE would entail.

One area of uncertainty at this time is whether a debt service reserve fund (DSRF) would be required by VRA to secure VRE’s payment obligation to VRA. The potential savings from a refinancing are worth pursuing even if a DSRF is required, but the savings will be higher if not. Savings will also depend on analysis by VRE’s bond counsel as to the tax status of the loan (i.e., tax-exempt or taxable). VRE staff, in conjunction with PFM and the bond counsel, will seek resolution of this issue in discussions with VRA.

Based on an analysis by PFM assuming current market conditions as of September 22, the projected total debt service savings from a refinancing through VRA is $4.5 million ($295,000 per year) if a DSRF is required. At a discount rate of 3.5%, the present value of those savings is $3.2 million. If a DSRF is not required, then the total savings increases to $10.0 million ($656,000 per year), and the present value increases to $7.5 million. Actual savings will be subject to change depending on actual market conditions at the time of the bond issuance.

Next Steps:

VRA issues bonds at least twice a year, in the fall and the spring. The next available issuance is spring of 2018, and the application deadline is in early February 2018. Following a borrower’s application, VRA undertakes due diligence and credit analysis, and the proposed loan is then reviewed for approval by VRA’s credit committee. VRA expects to price the spring 2018 transaction in early May 2018 and close in late May. A borrower must provide an authorizing resolution or ordinance from its governing body before entering into the VPFP financing agreement. PFM is exploring options with VRA to potentially accelerate the bond issue given current favorable conditions.

Under Section III-A-(2) of the Master Agreement, the Commissions are authorized to “utilize responsible debt financing to the extent that such is financially advantageous to the commuter rail project [i.e., VRE]...” However, the “unanimous consent of all parties” to the Master Agreement is required before the Commissions may issue a debt related to VRE.
Therefore, VRE will seek approval from the Commissions and from all the individual jurisdictions for the proposed refinancing of the RRIF loan through VRA’s VPFP program.

A detailed schedule for bringing these authorization requests to the jurisdictions will be developed following further conversations with VRA and jurisdiction staff. The tentative schedule of approvals is as follows:

- Operations Board – November
- Commissions – December
- Jurisdictions – before the end January