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Private financing of railway equipment

In the 20th century most procurement of rolling stock in the rail sector was by state owned operators or was state funded. This had three unwelcome consequences. It placed a strain on state budgets. It drained resources which could otherwise be allocated to rail infrastructure – rolling stock costs commonly account for between 25% and 30% of the overall costs of a new rail project and are a continuing liability in the rail network as rolling stock needs to be renewed. And then investment was often restricted depending on other public policy priorities rather than being driven by operating requirements. The result across the world has been, with a few exceptions, inefficient underinvestment, old rolling stock being used beyond its useful life, in turn restricting the environmental, development, economic and social benefits of the railways to the community.

Private operators have long looked to shareholders, banks and lessors for finance but the market is limited. Policy makers are now carefully looking again at using the private sector to carry the financing burden for state supported operators. There clearly is a public sector role in building roads but no one seriously suggests that the state should own the cars which run on them. With over \$50 billion invested in new rolling stock world-wide every year, central and local governments are now beginning to realise that this logic should also apply in the rail sector, thereby releasing valuable public resources.

Private finance of railway equipment is not new. In fact leasing of movables in its modern form began in the mid-nineteenth century in Britain, with the leasing of rolling stock to British mine owners by the Birmingham Wagon Company in March 1855. Today, the private sector can support investment in rolling stock in six specific ways:

1. Manufacturer/supplier “sales aid” credit where the manufacturer or supplier, as seller of the equipment, allows the operator to purchase the asset by paying in instalments. Until all the instalments are paid, the seller retains title in the equipment.

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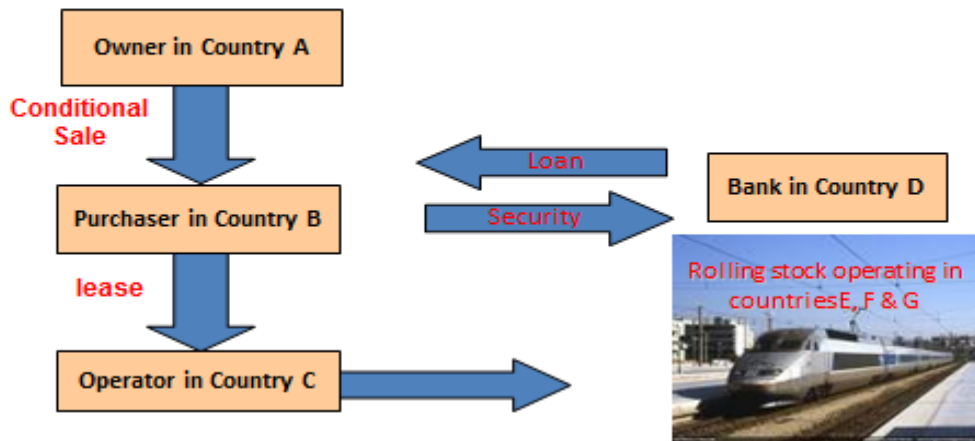


2. Bank finance where the bank lends money to an operator secured on the rolling stock. Title remains with the borrower but will pass to the lender if the borrower does not keep up with payments of interest or principal.
3. Capital market finance where the operator will raise debt directly on the capital markets, often in London or New York, through directly or indirectly (through a special purpose subsidiary) issuing commercial paper or bonds on the capital markets to be purchased by institutional (e.g. pension funds), corporate or other private investors.
4. Finance leasing where a bank, lessor or another financier leases the rolling stock for the (remaining) expected useful life of the rolling stock. The rent payments plus interest pay off the entire cost of the equipment. Title in the equipment remains with the lessor although there may be either a legal or moral agreement with the lessor to transfer title to the operator at the end of the lease at a nominal price.
5. Operating leasing where a bank, lessor, another financier or an operator leases the rolling stock for less than the (remaining) expected useful life of the rolling stock. The rent payments plus interest pay off less than the entire cost of the equipment. Title in the equipment remains with the lessor. At the end of the lease, either a new lease is granted by the lessor to the operator or moved and re-leased to another operator. For an extra charge, the lessor may also provide other facilities such as insuring and maintaining the equipment or providing crew (a so-called "wet lease").
6. Rental where an operator takes rolling stock on a short term basis paying a daily, weekly or monthly rent and where the arrangement can be terminated on short notice.

Moreover these different financing techniques are not mutually exclusive. The manufacturer providing sales aid support to its customer, or the specialist rolling stock leasing company leasing or renting equipment to an operator, may in turn obtain secured credit from a bank. The bank financing the operator may package and syndicate similar secured loans or securitise them on the capital markets.

The Luxembourg Rail Protocol will support all of these forms of finance by providing the creditor/lessor with much more security, registering creditor rights in an international registry, and granting clear priority and repossession rights to creditors all on a global basis. This is particularly important where creditors, debtors, operators and the rolling stock can all be in different jurisdictions with different domestic laws governing the recognition and enforcement of creditor rights – especially where they can compete, as shown below.

Securing the creditor



Accordingly the Luxembourg Protocol will increase the availability, and lower the cost, of private sector credit. In particular, by providing that a creditor in the future can rely more on the collateral of the rolling stock rather than the credit-worthiness of the borrower/lessee, it will facilitate more operating leases with many lessors prepared for the first time to take risks on the residual value of the financed equipment both during and at the end of the lease. This in turn will lower barriers to entry for many small but potentially effective current and new operators, promote increased procurement of more efficient rolling stock and more competition, for the benefit of governments, manufacturers, operators and the community as a whole.

For more information on the Luxembourg Protocol, see www.railworkinggroup.org