June 30, 1939.

Chairman Eccles

Lauchlin Currie

Leasing of Railroad Equipment.

Attached is a copy of a memorandum on the leasing of railroad equipment, which I left with Secretary Morgenthau, and which he said he would send to the President.

LBC:em

COPY June 29, 1939.

# LEASING OF RAILROAD EQUIPMENT

## 1. The urgent need for new railroad equipment.

The number of freight cars owned by railroads is at the lowest point since 1907. Of the existing supply, some 45 percent is over twenty years of age. Over 70 percent of the steam locomotives are twenty years of age or older, and only 3 percent are under ten years of age. Any marked recovery in business and railroad traffic would run into a bottleneck in this field which would precipitate advance buying, duplication of orders, and inventory speculation in general. The railroads are currently retiring about 100,000 freight cars a year and around 1,000 locomotives. Repair costs are excessively high not only because of the age of the rolling stock but also because of the antiquated and run-down condition of the railroads' machine shop equipment. In the interests of recovery, efficiency and economy, as well as of national defense, our railroad transportation system should be modernized and its carrying capacity increased.

## 2. Why railroads are not buying new equipment.

The railroads today have adequate equipment in physical terms to care for current levels of traffic. There would, however, be very substantial savings from the substitution of modern equipment for old, high-repair cost equipment. These savings are not being realized because of the straightened financial condition of the roads and because of the very understandable reluctance of the managements and directors to increase further at this time the fixed debt of the roads, or to deplete their cash resources.

## 3. How the deadlock may be broken.

Certain roads, in order to achieve the economies of new equipment while avoiding the incurrence of debt, have entered into leasing arrangements with the equipment makers. The equipment makers, however, are in no position to grant favorable terms or maturities for such leases in any sizeable volume. It is proposed, therefore, that the government, through the RFC, should undertake to purchase equipment upon the specifications of the roads, and lease the equipment on favorable terms and for varying periods to meet the varying necessities of different roads.

The powers to let contracts and to lease will not supplant, but rather will supplement, the present loaning powers of the RFC. They will provide the government with financial instruments of the utmost flexibility to meet the varying requirements of the strong, weak, and bankrupt roads. With the addition of these powers the railroad in need of equipment may purchase it directly or through the RFC; may assume full title immediately or only upon the completion of the lease; may lease for long or short terms on either an irrevocable or revocable basis. Moreover, these new powers will provide a means not hitherto available for the rehabilitation of older equipment, for the modernization of the machine equipment of railroad shops, and the scrappage of obsolete equipment will be facilitated. Finally, through the pooling of orders and the stimulation of a large-scale program, substantial economies in the making of equipment will arise and it is expected that a part of these economies will be passed along to the railroads in either lower purchase prices or leasing rates than are now available to any one road.

4. Three illustrations of how the leasing arrangement might work.

a. At one extreme might be the straight hire-purchase arrangement whereby a road may enter into a contract with the RFC to lease a certain amount of equipment of certain specifications, title to revert to the lessee upon completion of lease.

b. At the other extreme, it is possible that the lease may be granted for a term as short as three to five years, renewable yearly thereafter, at current short-term rates of interest, until the original cost to the government is repaid, whereupon title will revert to the lessee. This might be called a revocable acquisition lease. Under such an arrangement the railroad would forfeit its equity rights upon failure to renew the lease. Special provision might also have to be made to ensure that the equipment was maintained in good repair.

c. A railroad short of cash may have a substantial block of equipment in need of major repairs. It cannot, however, pledge such equipment as security for a new loan. In such circumstances, under the proposed new powers, the RFC may contract to purchase the equipment, have the repairs carried out, and lease this equipment to the road.

5. Advantages to the roads.

The chief advantages to the railroads of a leasing arrangement are as follows:

a. They need not incur a fixed debt.

b. They need not put up 20 percent of the initial cost, as is the customary practice now, and cash resources can be released for urgently-needed expenditures on the way and structures.

c. Annual charges will be lower because of the economies of large-scale purchasing, because of greater standardization, because of the low interest rates on government-guaranteed obligations, and because of tax savings.

d. They can rehabilitate older equipment and modernize machine shops without incurring debt or depleting their cash resources.

6. <u>Protection of the Government's interest.</u>

The Government's interest could be protected in the following ways:

a. Any reductions in prices consequent upon large orders would provide protection for the Government's investment.

b. Specifications of roads for equipment they will lease must be approved by the RFC.

c. The minimum term of lease will be sufficiently long for the lessee to acquire at least a significant equity right, which it will sacrifice on failure to renew the lease and which will pass to a new lessee.

d. In the case of the shorter-term leases, a special charge could be made for the purpose of accumulating a fund available for the financing of major repairs.