

## Accentuating the positive



**Toby Kolstad**

**A**round 2000 B.C., there lived a Trojan priestess named Cassandra, who was blessed with the gift of prophesy but cursed with a lack of credibility. She correctly predicted the Greeks' sack of Troy, but her countrymen did not heed her prophesy and disliked her for making it.

Since Cassandra, accentuating the positive has been Rule No. 1 for soothsayers, prophets and modern-day economic forecasters. This month, my aim is to do just that. With that in mind, let's explore the current state of affairs in the rail-car leasing business.

Railroad carloads have increased more than 4 percent during the past two years; slow train speeds, meanwhile, have forced railroads to add 2 percent more cars (or about 24,000) simply to handle 2003 traffic levels.

The result? Demand for almost all rail-car types is strong. In 2006, carload and intermodal traffic likely will continue to increase, and train speeds show no signs of reversing their three-year decline.

Moreover, supplies of most equipment types are tight — even with higher new-car production levels. A tight market coupled with high car prices have caused car lease rates to reach all-time highs.

### ASSET OWNERS RIDING HIGH

But no shipper or railroad would have been able to pay the higher rates if higher commodity prices and rail-shipment tariffs had not put more money in their pockets. We seem to be in a classic inflationary cycle in which higher prices lead to higher costs that, in turn, result in even higher prices.

As in past inflationary cycles, owners of assets — in this case, rail cars — do better than holders of cash. Long-time lessors of older cars are earning windfall profits; lessors of recently purchased cars also are faring well in this market.

There are car-type exceptions, of course. But even there, there's good news for some owners.

For box cars, the car-hire rates required to cover new lease rates finally have exceeded the hourly market rate cap set by the four major U.S. carriers. With paper and other box-car shipments flat or falling during the past year, the demand for new box cars

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hasn't been strong enough to force car users to negotiate a higher car-hire limit. With lessors offering full maintenance lease rates in the \$350 range, the longevity of the 1970s-built 70-ton fleet looks more secure every day. Offering lease rates around \$600, lessors who invested in the 110-ton cars built during the past decade also are doing better than they expected.

### DISSECTING DEMAND DRIVERS

The demand for grain covered hopper cars also softened in 2005 on the heels of a rapid recovery in 2004 from a multi-year slump. A drought in the Midwest and an increase in foreign competition kept grain exports and car demand at 2004 levels. The 1970s-built

100-ton fleet of cars is commanding lease rates of \$425, which hardly provides incentive for owners to scrap these old cars and replace them with new 110-ton cars. Because lease rates for the latter have risen to \$600, the high new-equipment cost has cooled demand. Meanwhile, the housing boom during the past few years has kept the demand for new centerbeam flat cars and the lease rates for same at record levels.

But full-service lease rates of around \$600 are not moving cars as quickly these days, suggesting that demand and supply are coming into balance. Carloads probably won't decrease in 2006, given that the repair and rebuilding of the U.S. Gulf Coast should offset any decreases in lumber demand elsewhere.

### COAL'S THE REAL STORY

But coal cars are the real leasing story. The market was red hot in 2005, with full maintenance lease rates for rotary aluminum gondola cars topping \$700 and lease rates for aluminum rapid discharge cars being quoted at up to 10 percent more than that. At third-quarter 2005's end, builders had backlogged orders for 21,000 new coal cars for lessors who'd hoped to cash in on those rates (or utilities that wanted to avoid them).

This year, coal production is expected to continue expanding at the 2 percent annual growth rate of the past two years due to high natural gas prices, which have caused some electric utilities to idle gas-fired plants.

Will the traffic increases cease? Will train speeds improve? Will higher interest rates tame inflation as they did in the 1980s? Will car orders and car lease rates crash as they did in 2001? As stated at the beginning of this column, no one wants to be a modern-day Cassandra, so I'll use P.C. language and simply say: "The future looks good for those who prepare for it." ■

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