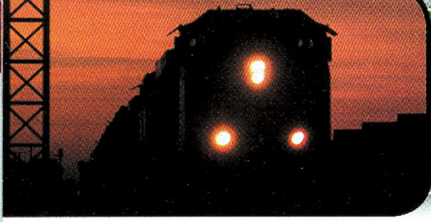
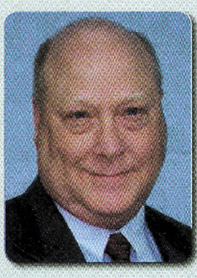


For most lessors, happier days are here again

Leasing appears to be leading the recovery in the rail-car industry, as idle freight cars return to service and the on-rental utilization rates for leasing companies increase. Although lease rates do not yet reflect the increased demand, most leasing companies should be singing that 1930s hit song, "Happy Days Are Here Again." Surplus rail cars will be a problem for a while yet; demand will not increase for all car types. But as progress is made in reducing the idled fleet both through retirements and traffic growth, utilization rates and profits for lessors will increase.

The 70-ton box cars built during the 1970s are being retired in record numbers, perhaps as many as 20,000 cars in 2010 alone. There are still thousands of old cars in the fleet from that period, and they are the ones that went into storage when traffic began to tumble two years ago. The 110-ton cars that were built during the past 20 years were kept in service at only slightly reduced lease rates. If carloads keep rising, demand for the latter should return lease rates back to levels that might justify new equipment, especially if the retirement of most non-grandfathered (for car-hire purposes) box cars opens the door for higher car-hire rates to be negotiated for this car type.

Scrapping old cars does not appear to be the solution for idle mill and covered coil gondola cars; the total fleet size remained about the same during 2010. Shipments of plate and coiled steel increased last year, but not nearly enough to reactivate all stored cars. Moreover, 2011 traffic levels probably won't prompt the reactivation of many more idled cars, so lease rates may stay low for this car type for a while.



Toby Kolstad

It will take a while before rail traffic reaches pre-recession levels and the lease market for rail cars returns to normal, but the trend lines are all positive.

RECOVERING AT VARYING RATES

Another fleet of old cars that owners would rather keep than scrap are the 100-ton covered hopper grain cars built during the 1970s. Although the newer 110-ton cars built during the past 20 years are more popular, the older cars are almost as good and cost a lot less to own. Lease rates for both car sets plummeted 50 percent during the recession; as much as 15 percent of the fleet became surplus. With grain exports increasing to almost pre-recession levels, all 110-ton cars are back in service and most 100-ton cars should follow this year. Savvy lessees who saw the demand change before lessors did snapped up most of the 110-ton cars at the old reduced lease rates, but lease rates for the 110-ton and 100-ton cars should return to normal levels in the near future.

The lease market for the coal car fleet is another matter. Most of the leased cars are relatively new and traffic seems to be topping out at a level below the fleet capacity. Moreover, the 10 gigawatts of new coal-fired, electric generating capacity that came online during 2009 and 2010 did not require as many additional coal cars as expected. Utility fleet managers apparently were able to supply the new plants with idle cars from their other plants.

Although the U.S. Energy Information Administration forecasts more new coal-fired plants to come online during the next few years, most industry observers expect only a marginal rise in coal traffic; therefore, only some of the thousands of idle coal cars will return to service.

Finally, chemical traffic continues to increase and utilization rates, both the railroad loads-per-year and leasing company cars-on-lease, are rising for tank cars. Lease rates are still lower than normal, but the lease market for this fleet should continue to improve.

POSITIVE TREND LINES

During the 1930s, the "Happy Days Are Here Again" lyrics were uplifting but hollow; the economy did not improve very much during The Great Depression. In 1939, railroad ton miles were only 74 percent of what they were in 1929. That is not the case today: The economy is improving and railroad traffic is growing. Ton miles in 2010 increased 11 percent year over year, even without the gains that would have been possible with normal coal traffic, and are only 6 percent below the 2006 peak level. It will take a while before rail traffic reaches pre-recession levels and the lease market for rail cars returns to normal, but the trend lines are all positive. PR

Toby Kolstad has been in the railroad industry for more than 30 years, with stints at the Illinois Central Gulf Railroad, Denver & Rio Grande Western Railroad, a car builder and lessor. Currently a consultant on rail-car matters and president of Rail Theory Forecasts L.L.C., he can be emailed at Tkolstad@aol.com.