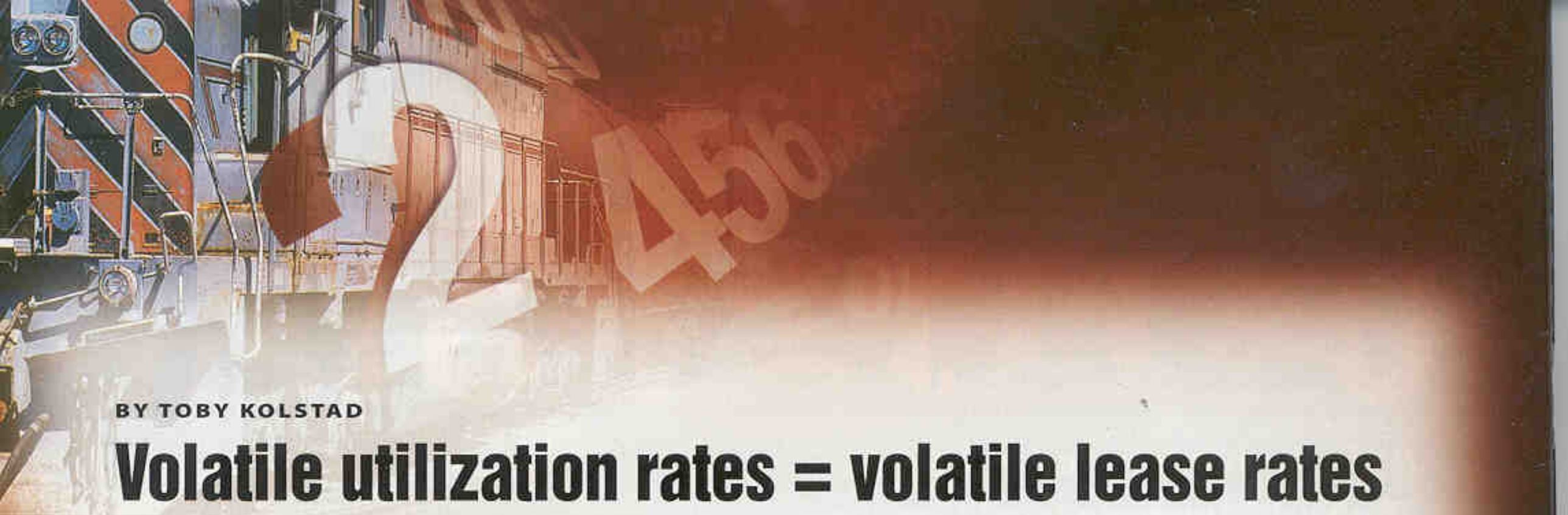


BY TOBY KOLSTAD

Volatile utilization rates = volatile lease rates

In the early 1980s, the interchange of electronic car movement and billing information made it possible for railroads to create car scheduling, automated car directive and car order systems. "Car management" became an industry buzz term, and railroads established departments headed by executives bearing titles denoting the new focus on improving rail car performance and reducing equipment costs.

For asset-management-minded rail executives, the high ratio of empty car miles to loaded car miles was too costly; and, given the low utilization rate of the various freight car fleets — as measured by the number of originated loads per year per car — they couldn't justify the acquisition cost of new cars.

A MISPLACED FOCUS

Within a few years, however, railroad execs realized that the day-to-day car management activities were not significantly reducing empty car miles or improving utilization rates, and that the gains achieved were being negated by other developments such as service cuts and traffic declines. The "car management" fad faded away, and managers moved on to other matters such as car hire deprescription.

Twenty years later, the empty return ratio and utilization rates aren't much better than what they were in 1980, but 682,707 new cars have been added to the national fleet since 1987 — and at prices that were almost double the amounts paid for the cars that were replaced.

In hindsight, the car management departments' focus was misplaced. Day-to-day activities don't determine the empty mileage ratio or fleet utilization rate; the month-to-month setting of freight rates and the year-to-year car repair and acquisition programs do.

Also, railroads stopped buying their own cars and started relying on outside parties to do it just when the car management trend was picking up steam.

FLEET FACTS

All of this would only be a historical footnote if the need to better control fleet utilization were not as important to today's non-railroad car owners as it was to 1980s railroads. For railroads, the main objective was to decrease ownership costs. Private car owners want to stabilize the utilization rates. The volatility in the utilization rates increases the volatility of lease rates, which depresses car values.

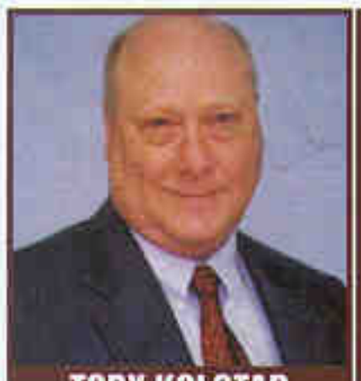
One of the three car fleets with the most constant utilization rates is the intermodal fleet, with a year-to-year variance (defined as the standard deviation divided by the mean of the sample) of only 5 percent. TTX Corp. owns more than 80 percent of this fleet; the company's total revenue is directly related to the day-to-day car utilization.

It might be argued, then, that a relatively constant utilization rate is only possible when the fleet is controlled by a single owner. However, the tank car fleet has an annual variance of only 4 percent, and there are many tank car owners, including shippers and leasing companies.

The same is true for the plastic pellet covered hopper fleet, which has an even lower annual utilization variance. Clearly, one owner is not required for a constant utilization rate. But one factor that all three fleets share is that the demand for new cars is controlled by private, non-railroad interests concerned about the utilization rates of their equipment.

A review of the other car fleets shows a similar correlation between utilization rate variance and the source of the new-car demand. After the aforementioned three car types, the next best managed fleet — at least as far as utilization rates are concerned — is the coal gon fleet. Many are owned or leased by utility companies, but railroads do have large fleets and play a significant role in determining the total fleet size.

The other car fleets — including box cars, small and large cube covered hopper cars, mill gondola cars, open top hopper cars, and non-intermodal flat cars — line up (in that order) for variance in utilization rates, with the highest rates measuring close to 20 percent.



TOBY KOLSTAD

Increasing the fleet utilization rate is not a high priority for railroads, which no longer need to minimize capital outlays for their own fleets.

VOLATILE VIEW

Increasing the fleet utilization rate is not a high priority for railroads, which no longer need to minimize capital outlays for their own fleets. Railroaders still lease cars, so they are not totally indifferent to the utilization rates of the various fleets. But it would be interesting to know if any railroader had noticed that as lease rate volatility increased, the average lease rate declined. PR

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