Rail Freight Leasing: The influence of current developments in Europe on vehicle leasing markets

Mr Wolf-Dietrich Geitz, founder, RAILISTICS GmbH Wiesbaden

More than ten years after the EU's first liberalisation rules on rail freight, progress has been made on a very different scale in different countries. Independent freight operators are active in the UK, as well as in Germany, The Netherlands and Scandinavia and are beginning to appear in Switzerland, Italy and Belgium. Outside the EU, development is accelerating in the candidate countries with the first operators in Poland and the Czech Republic using main lines across the country.

With all the drawbacks for liberalisation, the development of independent operators has advanced far enough to develop a certain demand on locomotives and wagons, lead by the German market. With the new entrants being in many cases industrial railways, operators or completely new entrants, all of them are dependent on concrete transport orders. In the increasingly flexible freight market, this means terms of 1 to 4 years, far away from the ideal world of passenger contracts for 10 or 15 years.

In the wagon business, the end of the traditional EUROP organization for international exchange of wagons might lead to more cost transparency for some of the state railways, but also creates a new challenge for the owners of wagons to use them effectively. Whether leasing companies are ready to fill this gap, still has to be proven.

GM provides the international diesel locomotive: often on lease the Class 66 might be the first foreign locomotive to run into Poland.

Experience with operate and finance leases since liberalisation

Without operate lease offers, liberalisation in Continental Europe could not have started. State railways did not provide locomotives to newcomers for obvious reasons, newcomers did not have the financial means to invest (or even to find a willing supplier in the first years), only the lucky few industrial railways had understanding, helpful owners with a well-filled pocket.

Classical finance leasing was a product which could easily be adapted to long-term contracts for passenger services, even with the disadvantages in Germany, the biggest market, as investment in new trains is supported by some authorities while leasing is not.

Nevertheless, finance leasing proved not to be the right thing for the freight business. With operate leasing having been virtually unknown to the continental railway industry, this market is developing only reluctantly. And as stated earlier, liberalisation could not have started without operate leasing, but faster development could have spurred opportunities in the new railway world in freight terms.

Reasons are widely spread, but easy to understand. Usually, new market opportunities draw the attention of potential suppliers. Here this was not the case, as the ideal new supplier did not exist. Finance companies in continental Europe were not used to offering operate leases. Obviously a new market lacks experience. This includes a lack of experience in calculating residual values for locomotives in an environment with more than one thousand different types of locomotives and few second hand deals, and therefore incomparable with standard definitions in the U.S. or the airplane markets.

Finance companies also did not have the experience in the transport market itself, the prime market if you see transport of the goods as a secondary market. Moreover, most new operators fail to fit into classical rating patterns and thus might not get any offers at all. This does not favour new operators in an environment where is it increasingly difficult to fund investments, even for long-term market actors. The author's observations of the wagon leasing market include more and more signs for the opening of an investment gap, even for those with a more than stable business basis.

Macki Bor Railway, a Chemtrans subsidiary, is one of the first open access operators in Poland.

Reluctance in the development of locomotive leasing offers have partly been off-set by the activities of the suppliers. Suppliers do not need to discuss expected maintenance and life-cycle costs, they know, or should know, them better than anyone else. They have helped to push the operate leasing market for freight locomotives outside UK to nearly 200 in the autumn of 2002, with a nice range from non-modified diesels of Russian origin to the most advanced three-phase electrics.

But, one can see that locomotive suppliers are not necessarily suppliers of innovative financial tools as they are not necessarily experts of the transport market. Consequently, rumours about the future (owners)

Other than locomotives freight wagons, with their unique international standards and an existing market for used equipment, are a standard operate lease product.

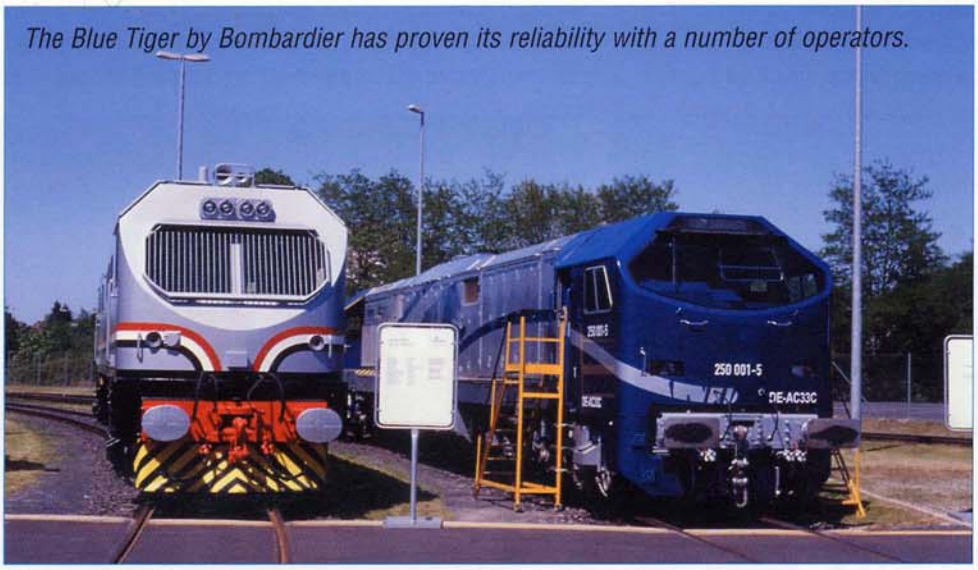
of those suppliers' locomotive pools have thrived throughout the market.

Future requirements for lessors and lessees

Each partner needs to gain more knowledge about the other - to understand their point of view and help to develop fruitful co-operation. Lessors have to gain more understanding of the market environment -and will be rewarded with a fast-growing and profitable business. Their customers have to accept that lessors need full transparency in the new railway world and need detailed explanation - much more than customers think is required, or maybe want to explain.

Meeting future customers' requirements

As shown, the ideal operate lease supplier situation has still not been reached. In particular, the gap between primary and secondary market knowledge and technical knowledge has hindered all of the players in reaping the full potential benefits of this market. Only a fair evaluation of each business in its chosen



The Blue Tiger by Bombardier has proven its reliability with a number of operators.

equipment environment, along with contract terms for transport, transport costs and prices for intermodal and intramodal competition, as well as the business background of the customer, will provide a basis for negotiations. In my opinion, the liberalised railways in the European freight market will never see one supplier with all that combined knowledge.

Just following up on individual core business, for example gaining residual value experience in the case of lessors, or life-cycle-costs in the case of manufacturers, will be a challenge for all involved. All partners will have to depart from traditional practice, and will have to open up to each other for external knowledge. A complete picture cannot be gained from inside the market alone. All involved will have to improve co-operation and competition.

Ways to build up knowledge in value evaluation: A focus on Eastern Europe

Eastern European railways in recent years have experienced a unique combination of loss in volume but retention of high market shares; political neglect but at times rising importance for economy and society; investment backlogs yet some of the most experienced railway staff in the world.

Take Poland as an example: Even after 10 years of financial drawbacks and complete neglect by some governments, its railway business is still one of the three big markets in Europe, with liberalisation now beginning. It is worth looking at it from two sides of the leasing world:

One obviously is its pure market size with all areas of PKP, and a fast growing number of independent operators, needing innovative ways to finance their equipment. Careful market observation, a complete knowledge of the industry and full understanding of the transport market backgrounds, all within a rapidly changing environment, is not an easy task to fulfill for the finance business. But potential rewards look promising: the size of the market and the chance to gain the experience necessary for all European markets.

The second development should draw the industry's attention even more. While the industrial railways of Poland provide the basis for successful new operators, the traditional production complexes also have access to thousands of now privately owned wagons, and they are beginning to realise the value of that. Some wagon leasing companies have already come into existence, and others are likely to follow. And if they follow their outsourced mother companies, logistics companies like Chemtrans, they won't stop their expansion at the border, thus becoming new competitors to the traditional wagon leasers and providing new opportunities for the operators.

So far, only GATX with DEC has taken these opportunities in full, but it will be interesting to see how this pioneering activity bears fruit, especially in the more traditional western markets.

Possible participation in increasing rail's competitiveness

Funding investment is essential in all industries, and is even more so in the fixed-cost business of railways. Fair and innovative operate lease offers help to develop the market and are an important drive towards new independent operators as well as to traditional ones when they have to act in a competitive environment.

Other side effects may not be high in the balance sheets, but are not to be neglected in the competition with road.

Examples show that corridor use of locomotives and wagons is sometimes much more efficient than network use today. Wagon ownership and locomotive companies' leasing pools, together with intelligent wagon management and information systems with operation interfaces might lead to efficient combining of the advantages of road and rail.

Maintenance of wagons today is not always possible according to kilometers travelled but often according to time intervals. Pools with GPS systems might change that. International purchase of standardised locomotive types by international leasing companies can lead to a grade of standardisation both railways and the suppliers are far from realising now. Easier planning of short-term transport contracts with reasonable rates based on fair operate lease offers can increase rail's competitiveness.

No system, other than rail has so many unrealised areas of potential improvement. The combination of a liberalised railway system with the finance industry acting as an integrator and standardiser without limiting competition in the freight market could see realisation of those improvements while building a new market for itself at the same time■

Wolf-Dietrich Geitz is a founder and a senior with RAILISTICS GmbH, Wiesbaden. After studying Railway Engineering at RWTH Aachen he successfully lead several consulting projects regarding rail services, rail operation and infrastructure. He is known as an expert in Eastern Europe and as an expert in IT and finance for the railway business.

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