



Legislative Fiscal Bureau

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July 16, 2015

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Natural Resources: Stewardship Purchase of Railroad Rights-of-Way in Barron and Manitowoc Counties -- Agenda Item IV

REQUEST

On June 11, 2015, the Department of Natural Resources (DNR) requested approval under s. 23.0917(6m) of the statutes to purchase two parcels of railroad right-of-way from Wisconsin Central Limited (a subsidiary of Canadian National Railway Company) utilizing up to \$532,800 (including \$8,800 in miscellaneous costs) in 2014-15 funds from the Warren Knowles-Gaylord Nelson Stewardship program. The proposed purchase includes a parcel of approximately 71 acres totaling \$283,700 for the Devil's River State Trail in Manitowoc County, and a parcel of approximately 14 acres for \$249,100 for the Wild Rivers State Trail in Barron County. Notice of an objection to the proposed purchase was made on July 1, 2015.

BACKGROUND

Stewardship Program

Through the Warren Knowles-Gaylord Nelson Stewardship program, DNR acquires land and provides grants to local units of government and non-profit conservation organizations (NCOs) for land acquisition, easements, and nature-based outdoor recreational property development activities. The state generally issues 20-year tax exempt general obligation bonds to support the stewardship program. Beginning in fiscal year 2011-12, any bonding authority remaining unobligated at the end of a fiscal year may not be used in future fiscal years. Under current law, DNR may obligate not more than one-third of land acquisition funds for DNR fee title acquisition (outright purchase). In fiscal year 2014-15, \$20 million in stewardship bonding authority was available for Department acquisition, of which the Department could utilize up to \$6.66 million for acquisition of land in fee title.

Federal Rails-To-Trails Program

Under the National Trails System Act (Rails-to-Trails), 16 U.S.C. 1247(d), the federal government encourages states to establish trails as an interim use of railroad right-of-way that would otherwise be abandoned. The process, referred to as "railbanking", involves an agreement between a railroad company and a trail agency to use an out-of-service rail corridor as a trail until such time as the corridor might be reactivated for rail use. Under 49 U.S.C. 10903-4, rail carriers must notify the federal Surface Transportation Board (STB) of their intent to abandon any part of their railroad lines and discontinue operation on the lines, with some exceptions based on the scope of the abandonment. The STB may grant a notice of interim trail use for the land corridor if the railroad has notified the STB of their intent to seek an exemption to the abandonment proceedings for the corridor and if a state, political subdivision, or qualified private organization signs a statement of willingness to assume financial responsibility for a right-of-way that has been proposed for abandonment, provides a map of the right-of-way, acknowledges that use of the right-of-way is subject to the user's continuing to meet those obligations, acknowledges the possibility of future reactivation of rail service on the corridor, and certifies that the statement has been served to the rail carrier. In Wisconsin, the Wisconsin Department of Transportation (DOT), as the state rail agency, files a notice for interim trail use on behalf of DNR to acquire and use a right-of-way for recreational trail purposes and rail banking under the National Trails System Act. If the notice of interim trail use is approved, the railroad and DNR have 180 days from the STB approval to reach an agreement. If no agreement is reached, the railroad may abandon the line. However, additional 180 day extensions may be filed with and approved by the STB provided the parties show a good faith effort that they are continuing to work toward an agreement. Rail reversion (reactivation of a line) has occurred nine times, none in Wisconsin.

In the 1960s, Wisconsin acquired the Elroy-Sparta Trail and began acquiring other railroad right-of-ways and establishing recreational trails. The state currently owns approximately 1,200 miles of such trails statewide. Since the mid-1990s, the federal Rails-to-Trails law has been the primary vehicle for these acquisitions.

Railway Corridor Valuation

Assessing the value of rail corridors that are no longer being used for rail transportation is difficult due to the unique shape of such corridors and the lack of comparable sales. There is not consensus over the best method to use for valuation, but one commonly used method of valuing unused rail corridors is an "across the fence" valuation technique, which estimates the selling price of the railway property if the railroad owned clear title and was selling to adjoining landowners. This method involves developing a value opinion based on comparison with abutting land including the consideration of adjustment factors such as market conditions, property rights conveyed, and location. However, it may also be difficult to establish a highest and best use of the corridor for the purposes of valuation. For a rail corridor that would potentially be abandoned, there are likely two feasible uses of the property, liquidation of the property and sale to the adjoining property owners, or conversion to a utility corridor or a recreational trail system. It is a typically practiced appraisal method to deeply discount the value of a railroad segment that is to be liquidated to reflect title issues, and the time and costs associated with selling many small parcels; whereas it is typical to

consider an enhancement or benefit to an already established corridor for a converted use. Further, railroad parcels may have existing improvements, such as bridges and culverts, which would be utilized for a recreational trail. These improvements are typically are not assigned value in a DNR appraisal, although a railroad company would typically argue these improvements have value. Also, the railroad removes the tracks and railroad ties for salvage prior to DNR acquisition.

In the case of a railroad corridor, the concept of plottage (the increment of value created when two or more sites are combined to produce greater utility) could be considered to positively affect the value. On the other hand, it is typical to recognize a discount for a single buyer purchasing multiple parcels. Further, the risk of reactivation of the line under the federal Rails-to-Trails program could be considered to have a negative effect on the value of the property.

ANALYSIS

Devil's River State Trail Parcel - Manitowoc County

One of the proposed parcels includes 70.93 acres in Manitowoc County, consisting of an inactive railroad corridor between the Town of Newton and the Village of Cleveland. Acquisition of the parcel would provide a 6.8 mile extension of the Devil's River State Trail. Although the segment is not contiguous to the existing 15 miles of developed trail, the parcel is within the existing trail project boundary. When completed, the trail is expected to extend from Green Bay through Manitowoc to Sheboygan. The purchase price is \$279,000 with an additional \$4,700 in estimated miscellaneous costs (appraisal costs, transfer fee, filing fee, and recording fee) for a total stewardship acquisition cost of \$283,700. DNR would acquire the parcel from Wisconsin Central Limited (WCL, a subsidiary of Canadian National Railway) using funds from the land acquisition subprogram of the stewardship program. WCL would convey a "quit claim" deed to DNR that, essentially, states whatever ownership interest the railroad has is transferred to the state. This type of deed does not guarantee DNR ownership in the parcels conveyed, but rather ensures the railroad has given up any ownership interest it held. If the land is acquired, DNR would also pay aids in lieu of property taxes on the land to the local governments, at an estimated cost of \$700 annually. Currently, railroads do not pay property taxes to any locality through which a line runs.

On July 13, 2012, the STB granted DOT's request (on behalf of DNR) for a notice of interim trail use for the corridor. Since then, the STB granted several extensions of time to negotiate an interim trail use/rail banking agreement, the most recent of which was issued on June 26, 2015, extending the negotiation period until January 4, 2016. In their request for the most recent extension, DOT noted that DNR and WCL have agreed upon a purchase price for the corridor for interim recreational trail purposes, subject to restoration for railroad purposes and, pending Joint Committee on Finance approval, anticipate a closing date of no later than November 1, 2015. Under the purchase agreement, if the line were reactivated, DNR would be due the fair market value for the corridor and any rail or trail-related capital improvements, fixtures, and equipment on the corridor.

The Devil's River State Trail is cooperatively managed through easements with Manitowoc County and Brown County. The terms of the easements state the trail shall be used for "bicycling,

hiking, snowmobiling or other mutually agreed upon compatible uses.” Currently, the trail is also open to cross-country skiing and snowshoeing but is not groomed. The proposed extension would be cooperatively managed through an agreement with Manitowoc County. Manitowoc and Brown counties plan to begin the master planning process for the trail once a determination is made on the proposed acquisition. Final allowed uses on the state trail will be determined by the public input process undertaken as part of the master planning process and determination of allowed use based on funding sources utilized for acquisition, development, and maintenance. Manitowoc County has indicated an interest in potentially adding equine use on the trail. The Department indicates that development costs for the trail segment are estimated at approximately \$50,000 per mile (or approximately \$340,000 total) and that the trail would not be paved but would be surfaced with crushed stone. These costs do not include infrastructure development costs such as converting existing bridges for recreational (hike, bike or snowmobile) use. DNR indicates there are five bridges on the segment and numerous culverts at waterway crossings. Estimated cost for decking and railings for the bridges is \$300,000. The county could seek state and federal grants to cover a portion of these costs.

Two appraisals were conducted for the property. The Department commissioned a private appraisal for the property, which was completed in August, 2012, and the Department's review appraiser conducted an additional appraisal which was completed in March, 2015. Both appraisals utilized an "across the fence" valuation technique, to estimate the selling price of the railway property if the railroad owned clear title and was selling to adjoining landowners.

The first (private) appraisal valued the property at \$142,000 primarily based on the value of the property upon liquidation (abandonment). The figure was developed from sales data and then discounted to reflect the cost to reclaim the railroad grade and return it to its across-the-fence use. The appraiser noted that the property consists of a long, narrow, railroad corridor that is approximately 6.8 miles long and up to 100 feet wide, with numerous road crossings. The grade runs over flat to gently rolling terrain and the zoning is a combination of residential or commercial, reflecting the "across-the-fence" neighboring uses. The grade tends to be rural with most use of an agricultural nature, with some residential and commercial uses in the towns of Cleveland and Newton. The appraiser concluded that the highest and best use of the property was the across-the-fence uses of agriculture, residential, and commercial, but noted that use as a recreational trail would be consistent with these adjacent land uses. The appraisal utilized 19 sales (including thirteen agricultural sales, three rural land sales with a residential focus, one commercial sale, and two residential sales in an urban setting) with prices ranging from 7¢ to \$1.82 per square foot. No particular sale was considered most comparable. The appraiser chose a value of 12¢ per square foot, which was on the lower end of the value range, noting that over 90% of the railroad grade is rural, and that the more urban areas had limited potential use value due to nearby development. This resulted in a value of approximately \$355,500 for the property. The appraiser then discounted the property by 60% to arrive at an estimate of \$142,000 for the value as an abandoned, or liquidated, railroad corridor. The appraisal notes that the size, length, and mixed-use character of the grade location contributed to the discount.

The second (DNR in-house) appraisal valued the property at \$279,000 based on DNR obtaining the property under the federal Rails-to-Trails provisions and converting it to a

recreational trail. Based on adjacent land use types, for the purposes of the valuation, the corridor was considered to have approximately 39 acres of lands adjoining agricultural lands, 25 acres adjoining wooded recreational lands and seven acres within the Village of Cleveland. For consistency, all sales were broken down to a square foot basis. The valuation of the agricultural lands was based on six sales that ranged in value from 7¢ to 12¢ per square foot. The appraiser concluded that no adjustment was required for terms, motivation and time but that shape and utility (what the property could be used for) both affected the value, and arrived at a value per square foot of 8¢, for a total of \$135,500 for the 39 acres adjoining agricultural land. The wooded recreational lands valuation was based on four sales that ranged in value from 7¢ to 11¢ per square foot. Again, no adjustment was made for terms, motivation and time, but an adjustment was made for shape and utility, to derive a value of 7¢ per square foot, for a total of \$76,300 for the 25 acres adjoining wooded recreational lands. The value of lands within the Village of Cleveland was based on three sales that ranged in value from 22¢ to 68¢ per square foot, which included both residential and commercial sales. Again no adjustment was made for terms, motivation or time, but an adjustment for shape and utility was used to derive a value of 22¢ per square foot, for a total value of \$67,600 for the seven acres within the Village of Cleveland. The appraiser concluded that the total across-the-fence land value was \$279,000.

Wild Rivers State Trail Parcel - Barron County

The second parcel includes an 0.8 mile inactive railroad corridor in the City of Rice Lake in Barron County. Acquisition of the parcel would extend the Wild Rivers State Trail south from the existing trail and provide connections to local trails (including county ATV trails). The parcel is within existing project boundaries. The existing Wild Rivers State Trail includes 104 miles through Douglas, Washburn, and Barron counties. North of Rice Lake, the trail connects to the 74-mile Tuscobia State (ATV) Trail. The purchase price is \$245,000 with an additional \$4,100 in estimated miscellaneous costs (appraisal costs, transfer fee, filing fee, and recording fee) for a total stewardship acquisition cost of \$249,100. DNR would acquire the parcel from Wisconsin Central Limited using funds from the land acquisition subprogram of the stewardship program. WCL would convey a "quit claim" deed to DNR that provides whatever ownership interest the railroad has is transferred to the state. Annual aids in lieu of property taxes on the parcel would be estimated at approximately \$200.

On March 27, 2014, the STB granted DOT's request (on behalf of DNR) for a notice of interim trail use for the corridor. The most recent STB extension expires September 18, 2015. As with the other proposed purchase, under the purchase agreement, if the line were reactivated, DNR would be due the fair market value for the corridor and any rail or trail-related capital improvements, fixtures, and equipment on the corridor.

The Wild Rivers State Trail is cooperatively managed through easements with Barron, Douglas, and Washburn County. DNR indicates that Barron County would enter into a cooperative agreement with the Department to develop, maintain, and operate the proposed extension. Uses on the extension would be consistent with current trail uses, primarily ATV and snowmobile use, but also allowing walking, mountain bicycling, and horseback riding. In particular, the Department notes that snowmobile routes through Rice Lake would be improved by moving snowmobiles from

routes on city streets onto the new trail extension. As the primary trail use is motorized recreational vehicles, DNR indicates the development costs for the trail segment would be less than for the Devil's River State Trail (where bicycling is the primary use), at approximately \$25,000 per mile (or approximately \$20,000 total for the segment) and that the trail would not be paved but would be surfaced with crushed stone. The county could seek state or federal grants to cover a portion of development costs. There are no bridges or major culverts that would require additional development costs on the segment.

Three appraisals were conducted for the parcel. The Department commissioned an appraisal for the property, which was completed in December, 2014, Canadian National (Wisconsin Central Limited's parent company) commissioned an appraisal for the property which was completed in June, 2014 and the Department's review appraiser conducted an additional appraisal which was completed in March, 2015. All three appraisals utilized the "across the fence" valuation technique, to estimate the selling price of the railway property if the railroad owned clear title and was selling to adjoining landowners. However, the first appraisal (commissioned by DNR) is primarily based on the value of the property upon liquidation (abandonment) whereas the appraisal commissioned by Canadian National and the appraisal conducted by DNR's review appraiser valued the parcel based on DNR obtaining the property under the federal Rails-to-Trails provisions and converting it to a recreational trail. The three appraisals conducted for the property described it as three different acreages, 12 acres, 13.29 acres, and 14.45 acres. The Department indicates that, based on geographic information system (GIS) mapping, the correct number of acres for the proposed purchase is 14.45, rather than the 13.29 acres mistakenly indicated in the DNR request.

TABLE 1

Barron County Parcel Appraisals

	<u>Value</u>	<u>Based on</u>
Appraisal #1 (commissioned by DNR)	\$136,000	Liquidation (abandonment)
Appraisal # 2 (commissioned by Canadian National)	248,000	Conversion to Recreational Trail
Appraisal #3 (DNR-in-house appraisal)	245,000	Conversion to Recreational Trail

The first appraisal valued the property at \$136,000. The appraiser noted that the property consists of a long, narrow, railroad corridor that is approximately 0.8 miles in length. The grade runs over flat to gently rolling terrain and the zoning is a combination of commercial-industrial and residential, reflecting the "across-the-fence" neighboring uses. The neighborhood surrounding the grade is more commercial/industrial than residential. The appraiser concluded that the highest and best use of the property was all neighboring uses, but noted that construction could be limited by a high voltage power transmission line located along the grade. The appraisal utilized 12 sales (11 in Rice Lake and 1 in the City of Rhinelander), including six commercial sales, and six residential sales. The six commercial sales included three sales of former railroad land, two of which occurred in Rice Lake, and one sale which took place in Rhinelander, which was included because it was a sale of former railroad property within a municipality of similar size to Rice Lake. The three

former railroad sales were considered the most comparable, with sale prices ranging from 38¢ to 75¢ per square foot. The appraiser chose a value of 40¢ per square foot. This resulted in a value of approximately \$210,000 for the property. The appraiser then discounted the property by 35% to arrive at a final value estimate of \$136,000 for a liquidated parcel. The discount took into account size, shape, environmental issues, marketability, and limits on the title. The appraisal notes that while the parcel is narrow, it is relatively short, with no known environmental issues, and that therefore a modest discount (35%) was appropriate.

The second (Canadian National) appraisal valued the property at \$248,000, assuming the property would be utilized as a recreational trail under the National Trails System Act. The appraisal divided the property into four parcels for the purposes of valuation based on the valuation maps provided by Canadian National to reflect the abutting land uses, topography and the individual parcel's alternate highest and best use (the neighboring uses). The appraisal utilized six comparable sales ranging in price from 33¢ to 50¢ per square foot. The appraiser chose a value for each of the four parcels based on adjoining land use and adjusted for concerns such as access and shape (each of the four parcels was discounted by 20% due to either access or shape). This resulted in a value of \$190,700 for the property. The appraiser then adjusted the price by a plottage (or assemblage) factor to reflect the increased value of purchasing the parcels as a corridor, rather than as individual parcels. The appraisal noted that plottage factors from 1.0 to 4.0 times the across-the-fence value are commonly seen and cited several examples of sales of transportation corridors through densely developed commercial and industrial areas for continued use as a corridor (for either transportation or utility transmission). As the subject property is a short corridor through a medium density industrial environment that is to be used as a recreational corridor, the appraiser concluded that a plottage factor of 1.30 is appropriate, for a final valuation of \$248,000.

The third appraisal, conducted by the Department's review appraiser, valued the property at \$245,000, assuming the property was obtained by DNR for use as a recreational corridor under the federal Rails-to-Trails provisions. The appraiser noted that the property transects a developed industrial area of the city. The industrial lots on the west side of the track are larger acreage with larger scale industrial companies and the lots on the east side of the track are smaller size. Three sales were chosen to reflect adjacent land uses, with prices of 31¢ per square foot, 49¢, and 59¢. With adjustments for the location and shape of the property, the appraiser determined a value of 40¢ per square foot, for a purchase price of \$245,000. The DNR appraiser discussed whether the concept of plottage should be applied to increase the value of the property and concluded that any plottage enhancement would be offset by the discount for a single buyer purchasing multiple parcels, the risk of reactivation of rail service (although the appraiser noted that the Department would receive fair market value for the property if the line were reactivated), and the fact that the Department was acquiring a quit claim deed rather than a warranty deed.

CONSIDERATIONS

In both cases, appraisers differed as to whether to value the property as an abandoned railroad or as an intact recreational trail corridor. The Department's review appraiser concluded that the maximally productive use of each property would be as a continued corridor, and in this case, a recreational trail corridor. As a result, no discount was applied. However, some would argue that

the Department should not pay a premium for land that would otherwise likely be abandoned and sold piecemeal primarily to abutting landowners. As noted, appraisal of railroad corridors is complex, and there is a lack of consensus on the appropriate method for appraisal as well as the extent to which various factors should be considered, such as discounts for buying multiple parcels, plottage enhancements, or ownership complications.

The Committee could approve the purchase based on DNR's estimated value as a recreational trail corridor [Alternative 1]. Another option would be to recognize some discount to a property that has entered the federal abandonment process, but not as low as the abandonment, or liquidation, value. For example, applying a discount of 25% would result in a purchase price of \$209,300 for the Manitowoc County parcel and \$183,800 for the Barron County parcel. This would result in a total combined price of \$401,900, including \$8,800 in miscellaneous costs [Alternative 2].

A third option is to approve the sale at the abandonment, or liquidation, value estimated by DNR's private appraiser. This would include a purchase price of \$142,000 for the Manitowoc County parcel and \$136,000 for the Barron County parcel. The Department could utilize up to \$286,800 in stewardship funds for the acquisition, including \$8,800 in miscellaneous costs [Alternative 3]. If a lower amount is approved [Alternative 2 or 3] DNR would need to reopen negotiations with WCL to determine if the railroad would accept a price below the current purchase agreement.

TABLE 2

Alternatives

<u>Alternative</u>	<u>Manitowoc County</u>	<u>Barron County</u>	<u>Miscellaneous Costs</u>	<u>Total</u>
1 Request	\$279,000	\$245,000	\$8,800	\$532,800
2 Intermediate	209,300	183,800	8,800	401,900
3 Abandonment	142,000	136,000	8,800	286,800

Another alternative could be to defer the request at this time, and direct the Department to continue negotiating with the railroad company and to submit any modified request to the Committee under a 14-day passive review procedure [Alternative 4]. Any such renegotiations would likely also delay any potential purchase to fiscal year 2015-16.

If the state does not purchase the property, DOT would have to notify the STB. If any locality would like to then claim the land for interim trail use, they could file a late request for such use with the STB, provided the railroad was willing to negotiate. If the railroad company is not willing to negotiate or the STB turns down the late request, the land would likely be abandoned. After abandonment, lands the railroad does not own outright may revert to the landowner of the abutting property. [Railroads originally acquired corridors primarily through federal or state land grants, outright purchase of the land, or by purchasing an easement or other limited right to use the corridor for railway purposes.] DNR indicates that some portion of the lands may be subject to

ownership claims by adjacent landowners. Based on preliminary information it appears perhaps two of approximately 40 parcels on the Manitowoc County right-of-way could, potentially, have title issues. Under the purchase agreement, the railroad company is required to provide DNR with copies of all deeds, title evidence or reports, surveys or valuation maps that the railroad has in its possession. DNR may also purchase a preliminary title report or commitment from a title insurance company, which DNR indicates they plan to do in this case. The agreement specifies that if the title report or commitment shows exceptions (ownership complications) other than those provided for in the National Trails System Act, and the railroad is unwilling to address these issues or DNR is unwilling to accept the quit claim deed subject to them, either party may terminate the agreement (by serving written notice to the other party).

Under abandonment, the first right of acquisition would go to DOT under state law. DNR could request the right of acquisition from DOT to acquire the land the railroad owns outright for recreational purposes. Since it is not DNR practice to obtain trail land through condemnation, DNR could then attempt to obtain any land the railroad does not own in the abandoned railroad line in a piecemeal fashion from property owners willing to sell. This process would be more time-consuming, might not result in an intact corridor for the foreseeable future, and, potentially, could be more costly than obtaining the land by purchase in a single block for interim trail use.

ALTERNATIVES

1. Approve the Department's request to obligate up to \$532,800 in 2014-15 stewardship program land acquisition funds for the purchase of two parcels of railroad right-of-way from Wisconsin Central Limited (a subsidiary of Canadian National Railway Company), including a parcel of approximately 71 acres totaling \$283,700 for the Devil's River State Trail in Manitowoc County, and a parcel of approximately 14 acres for \$249,100 for the Wild Rivers State Trail in Barron County.

2. Approve the Department's request, but specify that DNR may obligate no more than \$401,900 from the stewardship program (to reflect a discount of 25% from the across the fence value) for the two acquisitions.

3. Approve the Department's request, but specify that DNR may obligate no more than \$286,800 from the stewardship program (to reflect the estimated value of the parcels upon abandonment and liquidation) for the acquisition.

4. Do not approve the request. Rather, direct the Department to continue negotiating with the railroad company, and require DNR to submit any modified agreement to the Joint Committee on Finance under a 14-day passive review procedure.

5. Deny the request.

Prepared by: Erin Probst