Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

April 30, 2009 Joint Committee on Finance Paper #773

Freight Rail Preservation Program (DOT -- Local Transportation Assistance)

[LFB 2009-11 Budget Summary: Page 623, #6]

CURRENT LAW

The Department of Transportation's freight rail preservation program provides grants or loans for the acquisition of railroad property or for the rehabilitation or construction of rail facilities on existing, publicly-owned rail lines. Eligible applicants include local governments, railroads, current or potential users of rail service, or rail transit commissions organized by local governments for the preservation of rail service. Applicants receiving a grant are required to pay at least 20% of the cost of an acquisition of railroad track or improvement project, but the Department may provide a loan to cover up to 15% of the total cost. No match is required for the acquisition of railroad property (exclusive of the railroad tracks and other improvements). Funding for rail property acquisitions and rail improvements is provided with transportation fund-supported, general obligation bonds.

GOVERNOR

Provide $60,000,000 in general obligation bond authority for the freight rail preservation program, an increase from $22,000,000 provided in the 2007-09 biennium.

DISCUSSION POINTS

1. Freight railroad companies generally invest a much higher percentage of their revenues in capital expenditures than other industries. Because of these high capital expenditures for track and equipment, railroads have generally concentrated their investments in the most profitable lines since federal deregulation of the industry in the late 1970s, oftentimes abandoning lower-traffic lines in the process. Although many abandoned lines have remained out of service,

regional and short-line railroads have assumed service on certain smaller networks of low-traffic lines that otherwise would have been abandoned. In some cases, these railroads ship commodities from origin to destination within their networks, but they also serve as localized collectors and distributors for larger, long-haul railroads (termed "Class I" railroads).

2. The freight rail preservation program (FRPP) was established to maintain rail service for shippers and customers who are dependent on the service, but who are located on low-traffic lines. Because these lines have relatively few shippers, the amount of revenue earned by the railroad may not be sufficient to support the cost of capital improvements to the line. By assuming responsibility for the ownership and improvement of these lines with the use of FRPP funds, the state can allow a short-line or regional railroad to continue to operate profitably.

3. FRPP funds may be used to either acquire abandoned track to preserve it for future service or rehabilitate track that is already owned by the state or by local rail transit commissions (multi-county entities established to preserve freight rail service). There are currently 538 miles of publicly-owned track in the state and two railroad companies that operate on this track. Wisconsin & Southern Railroad (WSOR) operates on a 700-mile network in the southern third of the state and northern Illinois, of which 519 miles are publicly-owned track in Wisconsin. The other 19 miles of track are in Washburn County and are currently used by Wisconsin Great Northern Railroad for excursion trains, although the railroad has also considered freight operations. In addition, the state has an equity interest (although not outright ownership) on a portion of the track operated by Escanaba & Lake Superior in northeast Wisconsin, and has made improvements on that track.

4. The state has authorized transportation fund-supported bonds for the freight rail preservation program since the 1993-95 budget. Prior to that time, the state made grants from a transportation fund appropriation to local rail transit commissions for rail acquisition and rehabilitation. The following table shows the amount of bonds authorized per biennium since 1993-95, including the amount proposed by the Governor for the 2009-11 biennium.

Biennium	Bond Authorization
1993-95	$10,000,000
1995-97	4,500,000
1997-99	4,500,000
1999-01	4,500,000
2001-03	4,500,000
2003-05	4,500,000
2005-07	12,000,000
2007-09	22,000,000
2009-11*	60,000,000

*Amount proposed in the bill.

5. In 2008-09, debt service on freight rail bonds will total approximately $3.5 million, accounting for 1.8% of total transportation fund-supported debt service.

6. Most FRPP grants that have been made over the past decade have been for acquisitions or rehabilitation of track on the WSOR network, making that railroad and its customers the primary direct beneficiaries of the program. Some of the most common commodities shipped by the railroad are grains and other agricultural products, aggregates for construction, lumber, coal, fertilizer, and ethanol. WSOR currently has 250 full-time employees and approximately 180 customers for inbound or outbound shipments. The railroad estimates that in 2008 its customers had over 21,000 employees. The railroad is currently in discussions with an additional eight potential customers that could begin using the railroad in the next 12 months.

7. Much of the rehabilitation work supported by FRPP grants on the WSOR network goes toward replacing tracks and bridges that, in some cases, are up to 80 years old. Those facilities are often not adequate to accommodate 286,000 pound rail cars, which is the current industry standard. On certain lines in its network, the deteriorating condition of the rails limits trains to a speed of 10 miles per hour. Improvements to the rails and bridges allow the railroad to haul heavier loads and operate at a faster speed, increasing transportation efficiency for shippers.

8. The proposed bond authorization in the bill would almost triple the amount provided in the 2007-09 biennium. Compared to the 2005-07 biennium, the proposed amount of bonding is five times larger. The Department of Transportation (DOT) included this level of bonding in its budget request, indicating that the additional bonding was needed to accelerate the replacement of the substandard rail infrastructure and, if necessary, acquire additional abandoned track.

9. Despite the proposed increase, the Department indicates that project applications for 2009-10 funding, plus the cost for several anticipated acquisitions, would exceed the amount of available funds for that year ($30 million if the proposed bonding is divided equally between years). WSOR has requested $26.3 million for rehabilitation of existing track, an additional $13.4 million for reestablishing rail service on a line from Plymouth to Sheboygan, and $3.0 million to $4.0 million for the acquisition of track near Janesville to complete a connection between different parts of its network. In addition, the Department is in negotiations to acquire other branch lines from Class I railroads, including about 50 miles in Chippewa and Barron counties, at least some of which may occur in 2009-10.

10. When fully issued, the annual debt service payments on the proposed freight rail bonds would be about $4.8 million annually. Due to the time elapsed between when projects are approved for funding and the time that bonds are actually issued, the full, annualized debt service on the proposed bonds would not be paid during the biennium. The Department of Administration's overall general obligation debt service estimates are based on the assumption that the new freight rail bonds would not be issued during the biennium or would be issued late enough that no debt service payments would be incurred during the biennium. [The bill reflects an increase in debt service on freight rail bonds of $134,800 in 2009-10 and $335,300 in 2010-11, but this increase is attributable to the issuance of existing, unused bonds.] However, in submitting its biennial budget request, DOT typically assumes that one-half of the bonds programmed in each year (equal to one-quarter of the biennial total) would be issued in the year for which grants are made and the remaining one-half would be issued in the following year. Under this assumption, debt service

payments would be incurred on the new bonds during the 2009-11 biennium, and, therefore, the debt service estimate reflected in the bill may be too low. The bill could be amended to reflect the Department's bond issuance assumption, and DOA's assumed interest rates and bond issuance structure, which would result in a debt service increase, relative to the bill, of $225,000 SEG in 2009-10 and $1,757,800 SEG in 2010-11. [Alternative #1]

11. The transportation fund, which is the source of debt service payments on freight rail bonds, includes revenue from the ad valorem tax on railroad property. Although there is no direct tie between the amount of revenue generated by any particular tax or fee in the transportation fund and the amount that is spent for the programs most closely related to that source, there may be some expectation that there should be a balance between particular revenues and their related expenditures. During the 2009-11 biennium, it is estimated that ad valorem tax payments on railroads will total $21.5 million in 2009-10 and $22.8 million in 2010-11, which is considerably more than the total debt service payments on both the existing bonds and the additional bonds proposed under the bill, even with the reestimates discussed above. Most of the tax is paid by the Class I railroads that operate in the state (Canadian National, Canadian Pacific, Burlington Northern, and Union Pacific), which do not directly benefit from freight rail preservation program projects. However, since one of the functions of WSOR's and other regional railroad's service is to deliver cars to the Class I railroads for long-haul shipment, the Class I railroads may indirectly benefit from the program.

12. With the proposed increase in bonding for freight rail preservation, Wisconsin would have one of the most aggressive programs of its kind in the country. Many states do not provide any assistance for freight rail service, while others that do provide assistance provide only low-interest or no-interest loans, instead of grants. A few states, including New York, Pennsylvania, and Oregon, have similar, bond-funded programs for making grants, although freight rail improvements are generally only one possible use of the bonds authorized in these states. New York, for instance, has two programs, one of which provides $20 million annually for either passenger or freight rail improvement projects, while the other provides $27 million annually for either freight rail or harbor improvement projects.

13. DOT subjects all proposed freight rail rehabilitation projects to an evaluation process that includes a benefit-cost analysis. The Department indicates that the anticipated benefits for funded rail rehabilitation projects are generally higher than the estimated costs. However, this analysis, along with other program scoring criteria, are used principally to rank applications against each other, rather than to assess the total benefits against other possible uses of transportation funding. It is possible, therefore, that the use of the same amount of funding on other transportation purposes, such as for highway, transit, or airport improvements, could have higher total benefits, but the Department's process for assessing individual projects is not designed to assess this possibility.

14. The Department is in the process of developing a multi-modal transportation plan to establish transportation policy guidelines for the next 20 years. In its draft plan, which was published in November, 2008, the Department notes the importance of an integrated freight system, including a reliable regional railroad system. It advocates increased investments to improve the

publicly-owned rail system to comply with current industry standards and to acquire abandoned track, to maintain or reestablish rail service where economically feasible. However, the draft plan points out that the cost to upgrade track and bridges and, where appropriate, to acquire additional track, will be high. WSOR has proposed a 12-year plan for upgrading existing track at an approximate cost of $21.3 million per year, and, in addition, has proposed reestablishing rail service in parts of Sheboygan, Green, Lafayette, and Iowa counties at a total cost of $60.0 million. In other parts of the state, a proposal to acquire and rehabilitate track in Chippewa and Barron counties could exceed $30.0 million.

15. Given the ongoing and potential new demands for funding for freight rail rehabilitation and track acquisition, the Department's draft plan notes that a more detailed, multi-modal study of the state's freight system is needed. Specifically, the draft plan says that "the state may need to re-evaluate its role given the large financial commitment needed to keep the system competitive for forecast traffic." However, the bill would almost triple the size of the program without having such an assessment. Without such a framework, it may be difficult for the Legislature to assess how the bill's proposed increase in bonding fits within the long-range strategy for the program. For instance, the Legislature provided an increase from $12.0 million bonds in the 2005-07 biennium to $22.0 million in 2007-09 biennium, perhaps with the understanding that the increase, if maintained, would provide sufficient funding to make needed improvements to the rail system. But the Legislature is now being asked to approve an additional increase to $60.0 million in the 2009-11 biennium, without a clear indication of how this increase fits within an overall policy framework. That is, does the approval of this level of funding signal the Legislature's approval to eventually proceed with reestablishing rail service from Monroe to Shullsburg and Mineral Point, as proposed by WSOR, or the acquisition and improvement of rail lines between Chippewa Falls and Rice Lake?

16. If the Committee decides that additional scrutiny of the freight rail rehabilitation program is needed, the bill could be amended to require DOT to present a report to the Committee by January 1, 2010, that provides an assessment of potential freight rail improvements and track acquisitions over at least the next 10 years. The provision could require the Department to provide the following in its report: (a) at least three scenarios for freight rail improvements and acquisitions, with different levels of annual expenditures; (b) an assessment of the benefits and costs of the improvements under each scenario; (c) a discussion of the potential benefits of each scenario in relation to other potential uses of transportation fund resources; and (d) an assessment of whether some proposed freight rail improvements on state lines could have sufficiently high benefits to induce the railroad to fund a higher percentage of the cost. [Alternative #2]

17. Either instead of, or in addition to, requiring the Department to present a report on the program, the Committee could decide to reduce the level of bonds in the bill. One alternative, for instance, would be to provide $22,000,000 in freight rail bonds, which is the same amount provided in the 2007-09 biennium. [Alternative #3] At this level, additional debt service increases would be $82,500 SEG in 2009-10 and $644,500 SEG in 2010-11, which would be a reduction from the reestimate of debt service under the bill of $142,500 SEG in 2009-10 and $1,113,300 SEG in 2010-11. Alternatively, the Committee could provide $44,000,000, or double the amount

provided in 2007-09. [Alternative #4] Debt service on this amount would be $165,000 SEG in 2009-10 and $1,289,000 SEG in 2010-11, a reduction from the reestimate of $60,000 SEG in 2009-10 and $468,800 SEG in 2010-11. If either of these reduction alternatives is adopted in addition to the freight rail report alternative described in the previous point, the Legislature could decide to provide additional bonds for the program for 2010-11 if it is determined that the report provides a sound justification for an increase.

ALTERNATIVES

1. Approve the Governor's recommendation to provide $60,000,000 in general obligation bond authority for the freight rail preservation program. Increase funding by $225,000 SEG in 2009-10 and $1,757,800 SEG in 2010-11 to reflect a reestimate of debt service on these bonds.

ALT 1	**Change to Bill** Funding
SEG	$1,982,800

2. Modify the bill to require the Department to present a report by January 1, 2010, that provides an assessment of potential freight rail improvements and acquisitions over at least the next 10 years. Specify that the Department's report must provide the following: (a) at least three scenarios for freight rail improvements and acquisitions, with different levels of annual expenditures; (b) an assessment of the benefits and costs of the improvements under each scenario; (c) a discussion of the potential benefits of each scenario in relation to other potential uses of transportation fund resources; and (d) an assessment of whether some proposed freight rail improvements on state lines could have sufficiently high benefits to induce the railroad to fund a higher percentage of the cost. [This alternative could be adopted in addition to Alternatives #1, #3, or #4.]

3. Modify the Governor's recommendation by providing $22,000,000 in bonds for the freight rail rehabilitation program, a reduction of $38,000,000 from the amounts in the bill. Increase funding by $82,500 SEG in 2009-10 and $644,500 SEG in 2010-11 to reflect an estimate of debt service on these bonds.

ALT 3	**Change to Bill** Funding
BR	- $38,000,000
SEG	727,000
Total	- $37,273,000

4. Modify the Governor's recommendation by providing $44,000,000 in bonds for the freight rail rehabilitation program, a reduction of $16,000,000 from the amounts in the bill. Increase

funding by $165,000 SEG in 2009-10 and $1,289,000 SEG in 2010-11 to reflect an estimate of debt service on these bonds.

ALT 4	**Change to Bill** Funding
BR	- $16,000,000
SEG	1,454,000
Total	- $14,546,000

5. Delete provision.

ALT 5	**Change to Bill** Funding
BR	- $60,000,000

Prepared by: Jon Dyck