

Trend Analysis: Regional and Short Line Railroads

Trend Statement

A 2011 freight shipment cost comparison study by the United States Government Accountability Office¹ noted that freight service costs (which include public costs, such as congestion, pollution, accidents, and infrastructure maintenance) are not adequately paid for by the freight users of the highway system and therefore, these costs are not being passed on to consumers. This uneven distribution of costs distorts competition and forces more freight to travel by truck. Public policy continues to focus on safety and environmental stewardship rather than ensuring the short line railroad industry will continue to be able to provide an attractive alternative to trucking to serve businesses in California.

Background

Class II regional railroads are line-haul railroads operating at least 350 miles of railroad and/or having carrier operating revenue between \$40 million and the current Class I revenue threshold (\$398.7 million).² Class III short line railroads earn revenues less than \$40 million or are switching and terminal railroads that are either jointly owned by two railroads for the purpose of transferring cars between railroads or operate solely within a facility or group of facilities.

In California, there are 18 short line railroads and eight switching and terminal railroads operating on 823 miles of track (14 additional switching and terminal railroads add 910 miles of service)³. Regional and short line (Class II and III) railroads play a crucial first-and-last-mile role in the “door-to-door” collection and distribution of goods. They also provide rail service to shippers that must transport heavy, bulky, or hazardous commodities at cost-effective rates.

Freight System Implications

To shippers, the ability to use short line railroads means lower transportation costs, more flexible local service options, and a greatly expanded market reach for local products through their Class I railroad partners. In many cases, short line railroads provide the only connection for California customers, shippers, and manufactures to the national rail network. Without short line railroads, businesses would be forced into more expensive truck transloads that typically take place in large cities adding more trucks on an already congested metropolitan highway system. Even worse, these shippers might be forced to close or relocate, taking jobs and tax revenue with them. Although it is rare for a short line railroad to abandon service, these financially fragile railroads face four significant threats: failure or relocation of their primary customers, slow deterioration due to deferred infrastructure maintenance, the need to make significant infrastructure upgrades in order to handle the much heavier 286,000-pound rail cars being used on Class I railroads, and the effects of significant storms on their infrastructure, particularly bridges.

¹ Surface Freight Transportation: A Comparison of the Costs of Road, Rail, and Waterways Freight Shipments That Are Not Passed on to Consumers, GAO-11-134, Jan 26, 2011, <http://www.gao.gov/products/GAO-11-134>

² What are "SHORT LINE" and "REGIONAL" railroads? American Short Line and Regional Railroad Association, http://www.aslrra.org/about_aslrra/faqs/

³ Railroads in California FAQ, California Short Line Railroad Association, <http://www.cslra.org/faq-links.html>

Regional and short-line railroads can be profitable by taking advantage of lower labor cost structures and greater labor flexibility, lower profitability targets, and a “can do” attitude. As the Class I railroads have consolidated their services onto critical high-density, higher-profit corridors, and curtailed or eliminated their services in lower volume markets (such as short haul movements and bulk commodity markets) railroad entrepreneurs, often residents of the region, have purchased many branch lines and offered rail service to these less profitable markets.

Short lines have also been able to develop previously neglected real estate assets to attract new rail-served businesses. Their innovative ideas have allowed them to continue operating railroads that were previously deemed unprofitable by their higher cost, larger brethren. They have also become very good at capturing some truck freight back to rail using better cost and service agreements with these customers.

In California, short line railroads play an important role in moving commodities for the state’s \$37.5 billion agricultural industry. Inbound commodities moved by short line railroads include bulk food products (cattle, poultry feed, grain), and chemicals (fertilizer). They are also responsible for moving processed food, chemicals and manufacturer goods out of California. In addition, they handle many bulk commodities such as stone, sand, gravel, wood, paper, minerals, petroleum, and various metal products.⁴

A second freight implication stems from the state of good repair of the railroad lines and equipment. In many cases, these smaller railroads are operating over lines that they bought from Class I carriers that allowed the infrastructure to decline through deferred maintenance over many years before they were sold. It is not uncommon for light density lines owned by short line railroads to be impacted by a combination of modest traffic, unclear market outlook, and weak finances that provide insufficient resources to achieve a standard gauge railroad (SGR). These lines have poor tie and ballast conditions and have lighter weight rails than are needed to support safely the new, heavier, 286,000-pound railcar which is fast becoming the industry standard today. Accommodating the 286,000-pound rail cars would require heavier rail and significant bridge and infrastructure upgrade costs, putting a heavy burden on short line railroads. In many cases, the revenues generated by short line railroads are only enough to fund on-going maintenance. Additional resources are needed to make the necessary upgrades to remain competitive.

In addition, short line railroads primarily use older, pre-owned diesel locomotives, resulting in high locomotive maintenance or rehabilitation cost ratios and are not as fuel efficient as the newer or retrofitted Class I locomotive fleets. Older locomotives also produce more diesel emissions than the newer Class I fleet. This is a significant issue in California, since the California Air Resources Board has issued stricter diesel locomotive emissions standards, putting an additional burden on short line railroads.

⁴ Railroads and States – California, American Association of Railroads
<https://www.aar.org/keyissues/Pages/Railroads-And-States.aspx>

Planning Considerations

Because rail cars travelling over the short line railroads must also travel over the Class I rail system, the small railroads are subject to many of the same safety and operating regulations that require large investments of scarce capital resources. Yet short lines, being mostly independent and privately held, do not enjoy the same access to private-sector capital as the Class I railroads. Private sector loans with favorable rates are only available on short-term loans. Short line railroads need long-term loans to support track and structure upgrades that will enjoy useful lives of 20 to 30 years. Given the greater risk of longer term repayments, these loans carry a much higher interest rate. The cost to upgrade and repair a rail line is expensive, but necessary, to avoid safety-related speed reductions and derailments.

Some states have recognized the economic consequence of rail service loss and have provided below-market loan programs to support facility rehabilitation and locomotive retrofits to accomplish public energy and environmental goals. In a 2011 study titled “Rail Preservation Programs: A Survey of National Guidance and State Practices,”⁵ ten states were identified as having loan or grant programs to preserve rail corridors and assist short lines in making capital improvements. The purpose of these programs is to preserve rail corridors for future passenger and freight rail use and to ensure that businesses have the ability to ship by rail on a transportation system that is more fuel efficient and more environmentally friendly than trucks. These states recognize the importance of having a rail alternative to keep trucks off the highway.

In 2006, California voters passed the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006, approved by the voters as Proposition 1B. This bond program included funding for railroad infrastructure improvements along federally designated "Trade Corridors of National Significance" in California or along other corridors that have a high volume of freight movement. Unfortunately, this precluded most short line railroad projects because they did not have high volumes of freight movement.

The federal government also has a loan program to support railroad projects. The Federal Railroad Administration’s (FRA) Railroad Rehabilitation & Improvement Financing (RRIF) Program provides direct federal loans and loan guarantees to finance development of railroad infrastructure. Up to \$7.0 billion is reserved for projects benefiting freight railroads other than Class I carriers. The funding may be used to: acquire, improve, or rehabilitate intermodal or rail equipment or facilities, including track, components of track, bridges, yards, buildings and shops; refinance outstanding debt incurred for the purposes listed above; and develop or establish new intermodal or railroad facilities. Direct loans can fund up to 100 percent of a railroad project with repayment periods of up to 35 years and interest rates equal to the cost of borrowing from the government.⁶

⁵ Rail Preservation Programs: A Survey of National Guidance and State Practice, CTC and Associates, LLC, for Office of Goods Movement, Caltrans Division of Transportation Planning, http://www.dot.ca.gov/newtech/researchreports/preliminary_investigations/docs/rail_preservation_preliminary_investigation_6-21-11.pdf.

⁶ FRA RRIF fact sheet, <http://www.fra.dot.gov/eLib/Details/L04476>

California Freight Mobility Plan Regional and Short Line Railroads

During the past several years, short line railroads also have had access to federal tax credits available to offset track maintenance. However, these tax credits expired in December 2011. The Internal Revenue Code Short Line Tax Credit – 45G, which had been in effect since 2005, provided for a 50 percent tax credit incentive, capped at \$3,500 per mile, for small railroads that invested in rehabilitation of their infrastructure. The proposed Short Line Railroad Rehabilitation and Investment Act of 2013 (H.R 721) would extend and modify the tax credit; however, as of December 2013, Congress has not passed the bill.

Resources

Federal Surface Transportation Board (STB): www.stb.dot.gov

Federal Railroad Administration: www.fra.dot.gov

California Public Utilities Commission: www.cpuc.ca.gov

American Association of Railroads: www.aar.org

American Short Line Railroad Association: www.aslrra.org

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