North Carolina Should Require NC Railroad Company to Pay an Annual Dividend and Strengthen Reporting

Final Report to the Joint Legislative Program Evaluation Oversight Committee

Report Number 2012-10

October 17, 2012

Program Evaluation Division
North Carolina General Assembly
Legislative Office Building, Suite 100
300 North Salisbury Street
Raleigh, NC 27603-5925
919-301-1404
www.ncleg.net/PED

150 copies of this public document were printed at a cost of $104.70 or $0.70 per copy.

A limited number of copies are available for distribution through the Legislative Library:

Rooms 2126, 2226	Room 500
State Legislative Building	Legislative Office Building
Raleigh, NC 27601	Raleigh, NC 27603
919-733-7778	919-733-9390

The report is also available online at www.ncleg.net/PED.

NORTH CAROLINA GENERAL ASSEMBLY
Legislative Services Office
George R. Hall, Legislative Services Officer

Program Evaluation Division
300 N. Salisbury Street, Suite 100
Raleigh, NC 27603-5925
Tel. 919-301-1404 Fax 919-301-1406

John W. Turcotte
Director

October 17, 2012

Senator Fletcher L. Hartsell, Jr., Co-Chair, Joint Legislative Program Evaluation Oversight Committee
Representative Julia Howard, Chair, Joint Legislative Program Evaluation Oversight Committee

North Carolina General Assembly
Legislative Building
16 West Jones Street
Raleigh, NC 27601

Honorable Co-Chairs:

N.C. Session Law 2011-145, as amended, directed the Program Evaluation Division to conduct a comprehensive evaluation of the North Carolina Railroad Company, a discretely reported component of the State of North Carolina, of which the State is sole shareholder.

I am pleased to report that the North Carolina Railroad Company cooperated with us fully during this evaluation.

Sincerely,

John W. Turcotte
Director

PROGRAM EVALUATION DIVISION
NORTH CAROLINA GENERAL ASSEMBLY

October 2012 Report No. 2012-10

North Carolina Should Require NC Railroad Company to Pay an Annual Dividend and Strengthen Reporting

Summary

The General Assembly directed the Program Evaluation Division to evaluate the North Carolina Railroad Company (NCRR). The legislation required a review of the corporation's mission, economic development benefits, tangible and intangible value, and governance and required consideration of whether NCRR should be sold, transferred under the North Carolina Department of Transportation or another state agency, or maintain its corporate structure.

NCRR has benefitted from its unique relationship with the State of North Carolina, the corporation's sole shareholder, but the State has not profited financially from this relationship. NCRR's capital has increased by at least $196.3 million since 1998 when the State became the corporation's sole shareholder. As a result, NCRR is both profitable and solvent. However, the State has not profited from this relationship in the form of receiving direct financial benefits because dividends are required by state law to pay for NCRR capital improvements.

Selling NCRR or the railroad corridor may not be in the best interest of the State because these valuable rail assets and their long-term earnings potential would be lost. However, NCRR property not related to the railroad corridor could be transferred to the State as a dividend and sold to provide one-time revenue.

The State has limited mechanisms for oversight of NCRR. As a private corporation, NCRR has less stringent reporting requirements than publicly-traded corporations. NCRR has not fully met all reporting requirements since 2007 and lacks a comprehensive strategic plan and performance measurement system. Changing NCRR's corporate structure could strengthen the State's oversight but requires a lengthy and complicated process. Amending state law would improve the corporation's reporting to the State and require NCRR to make an annual dividend payment while maintaining its corporate structure.

To address these findings, the General Assembly should

- amend Chapter 124 of the General Statutes to strengthen reporting by NCRR;
- require NCRR to pay a one-time dividend of $15.5 million and, thereafter, require NCRR to pay an annual dividend equal to 25% of NCRR's annual income from its trackage rights agreement (estimated at $3.7 million annually) to the General Fund; and
- require NCRR to convey to the State 14 properties not directly related to the railroad corridor so these properties can be sold and the proceeds deposited into the General Fund.

Purpose and Scope

The General Assembly directed the Program Evaluation Division to conduct a comprehensive evaluation of the North Carolina Railroad Company (NCRR), a discretely reported component of the State of North Carolina, of which the State is the sole shareholder.[1] The legislation directed the evaluation to address, at a minimum, the following issues:

1. Whether the corporation is adhering to its stated corporate mission of maximizing the value of the corporation for the people of the State.
2. What economic development benefits have been provided by the corporation and for what costs.
3. An evaluation of the use of available cash by the corporation, including the purchase of real property used for investment purposes rather than paying dividends to the State.
4. The approximate value of the corporation's assets, based on a market valuation rather than historic or book value of assets.
5. The approximate value of the entire corporation as a going concern.
6. The effectiveness of the provisions of Chapter 124 of the General Statutes to allow the State to exercise its shareholder rights and to provide effective shareholder oversight of the corporation.
7. Whether the ownership of the corporation provides the State a reasonable return on its investment, attempting to consider both the tangible and intangible value provided by the corporation.
8. Whether the corporation should be sold, transferred under the jurisdiction of the Department of Transportation or another State agency, or maintain its corporate structure.
9. Whether the General Assembly should consider the possibility of repealing the corporate charter of the corporation by a special act, as allowed under Section 1 of Article VIII of the North Carolina Constitution.

The following data were collected to address these issues:

- 1999–2011 corporate financial data from financial, income, and cash flow statements, balance sheets, trial balances, dividend and property tax payments, and annual reports;
- a list of all property owned and leased by NCRR and accompanying geographic information system data;
- capital improvements projects completed and planned by NCRR and economic impact studies;
- interviews with and administrative queries completed by NCRR staff and Board of Directors;
- interviews with the Department of Transportation;
- interviews and focus groups with stakeholders from the 16 counties along the railroad corridor;
- interviews with and documents provided by eight other state and local government entities that own or operate railroads;
- administrative query completed by Norfolk Southern Corporation;
- physical inspection and observations of the railroad corridor; and
- review of North Carolina statutes.

[1] N.C. Sess. Law, 2011-145, Section 28.12A, as amended.

Background

The North Carolina Railroad Company (NCRR) is a 163-year-old corporation. In 1849, the General Assembly chartered NCRR with an initial State subscription of $2 million of stock in order to further develop North Carolina's economy. At the same time, the General Assembly authorized the purchase of up to $1 million of NCRR stock by private shareholders. NCRR was directed to construct, "as speedily as possible," a railroad between Goldsboro and Charlotte that would convey persons, goods, merchandise, and produce. The first train ran the entire length of the railroad in 1856, but not without an additional $1 million investment by the State in order to complete the railroad. At the time, the railroad was the State's largest corporation, longest railroad, and of critical importance for economic growth and modernization. Currently, NCRR owns a railroad corridor with 317 miles of track in 16 counties. Exhibit 1 illustrates the NCRR corridor. For almost 150 years after it was chartered, NCRR would continue to exist with a combination of majority state ownership along with minority private shareholders.

The State became the sole shareholder in 1998 to eliminate conflict between the State's interest and that of the private shareholders. The State proceeded with a buyout because of

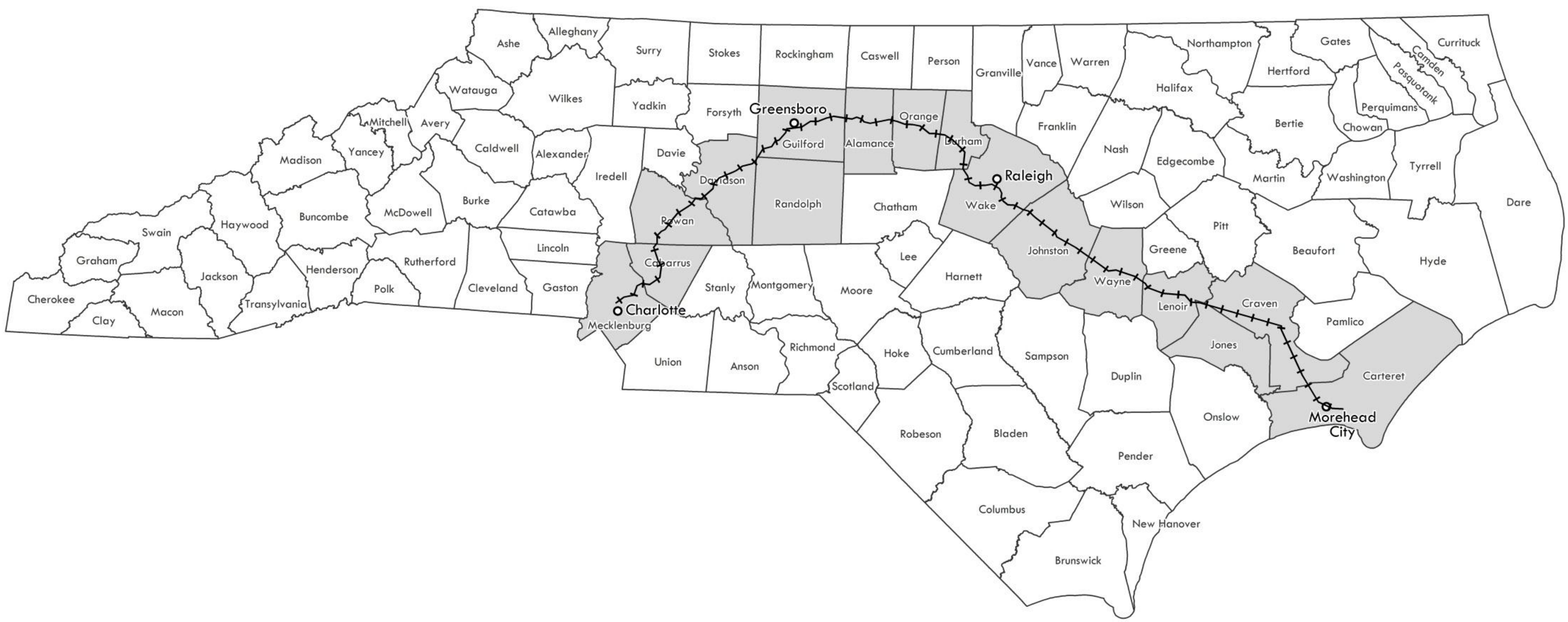
- the tension between the desire of minority shareholders for enhanced shareholder value and the needs of the State concerning economic development;
- the inequality of the bargaining position of NCRR and Norfolk Southern Corporation (Norfolk Southern) and the resulting difficulty of negotiating a lease that the minority shareholders would view as being in their interest; and
- the uncertainty created by shareholder lawsuits against NCRR and NCRR litigation with Norfolk Southern.

At the time of the buyout, the State owned approximately 75% of the shares of NCRR. The total cost to buy out the minority shareholders was $70.8 million.[2] Ten million dollars of the $70.8 million total was derived from previous dividends paid by NCRR to the State. The remaining $61 million was a debt to the State assumed by NCRR as a condition of the buyout. In 2000, the General Assembly allowed NCRR to invest in railroad capital improvements in lieu of repaying the debt and forgave the interest.

Exhibit 2 displays some of the important events in the history of NCRR.

[2] The State paid $70.8 million to purchase shares representing 25.06% of the total outstanding common stock.

Exhibit 1: The North Carolina Railroad Company Corridor



Source: Program Evaluation Division based on information from the North Carolina Railroad Company.

Exhibit 2: Timeline of Events in the History of the North Carolina Railroad Company

1849	The General Assembly incorporates the North Carolina Railroad Company (NCRR) with the State authorized to subscribe to $2 million in stock.
1852	The General Assembly incorporates the Atlantic and North Carolina Railroad. The Atlantic and North Carolina Railroad connects Morehead City to Goldsboro.
1854	NCRR runs short of funds and the General Assembly authorizes the purchase of an additional $1 million in stock.
1856	Construction of the North Carolina railroad, which runs from Goldsboro to Charlotte, is completed.
1871	NCRR leases the railroad line to the Richmond and Danville Railroad (later Southern Railway) for a period of 30 years.
1896	NCRR begins leasing railroad to Southern Railway (later Norfolk Southern) for a period of 99 years.
1968	NCRR signs an agreement with Southern Railway (later Norfolk Southern) to lease several parcels of land in downtown Charlotte for 99 years.
1989	The Atlantic and North Carolina Railroad are merged into NCRR, resulting in a single railroad from Morehead City to Charlotte.
1998	The State becomes the sole shareholder of NCRR by buying the remaining 25% of stock that is privately held for $71 million.
1999	NCRR signs an exclusive trackage rights agreement with Norfolk Southern to operate the NCRR line for 15 years, renewable for two additional 15-year periods.
2000	The General Assembly passes legislation forgiving $6.7 million in interest and allows NCRR to invest in capital improvements in lieu of repaying an additional $61 million in debt remaining from the state buyout.
2012	Norfolk Southern exercises its right to extend the trackage rights agreement through 2029.

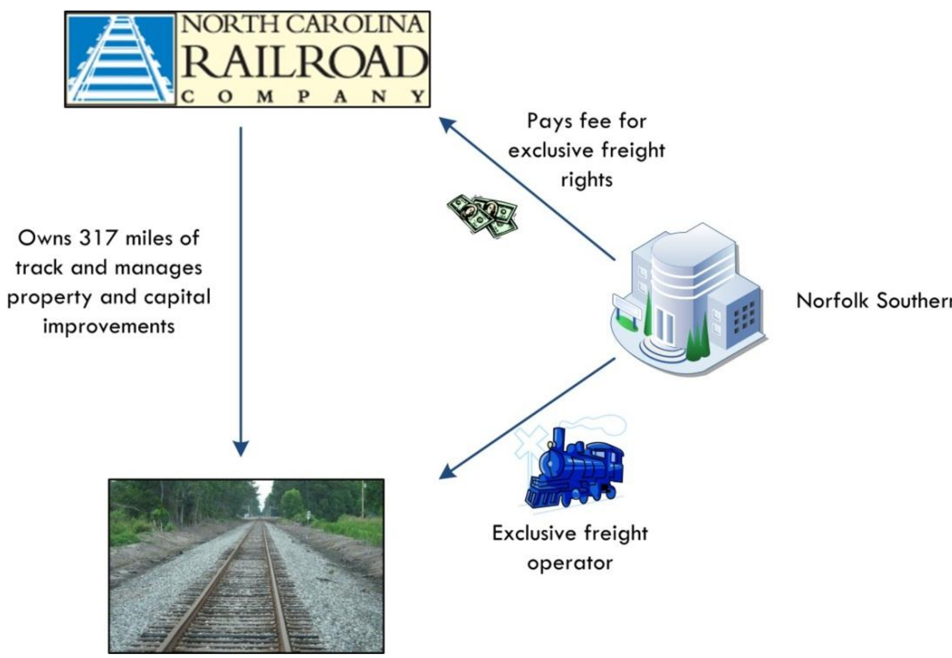
Source: Program Evaluation Division based on State law and North Carolina Railroad Company documents.

NCRR owns the railroad franchise and property, but Norfolk Southern is the exclusive freight operator. NCRR owns a railroad comprised of 317 miles of track, but it is not a freight or passenger operator. Norfolk Southern is the exclusive freight operator of the railroad and controls dispatching of trains. Since 1871, NCRR has had a longstanding relationship with Norfolk Southern and its predecessor, Southern Railway. At the end of 1994, NCRR's 99-year lease with Southern Railway expired. A trackage rights agreement was signed with Norfolk Southern in 1999 that grants Norfolk Southern exclusive freight rights over the entire railroad for 15 years with an option to renew for two additional 15-year terms. On July 27, 2012, Norfolk Southern exercised its option to extend the trackage rights agreement through 2029.[3]

Under the agreement, Norfolk Southern is responsible for maintaining the railroad to a standard based on the railroad's condition in 1999. Norfolk Southern pays an annual trackage rights fee that is calculated by multiplying the prior year's fee by a factor that is intended to adjust for inflation.[4] In 2011, NCRR received $14.1 million in trackage rights fees. Exhibit 3 depicts the relationship between NCRR and Norfolk Southern under the trackage rights agreement.

Exhibit 3

Structure of the Trackage Rights Agreement between North Carolina Railroad Company and Norfolk Southern



Source: Program Evaluation Division based on review of North Carolina Railroad Company documents.

[3] A final renewal option is available to Norfolk Southern to renew the agreement until the end of 2044.

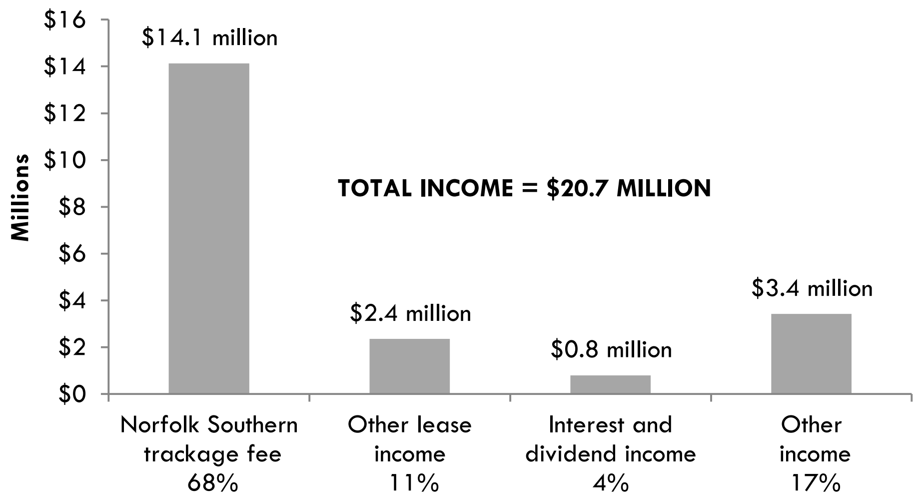
[4] The annual trackage rights fee is "calculated by multiplying the prior year's annual trackage rights fee by the factor obtained by dividing the Implicit Price Deflator for Gross Domestic Product ("IPD-GDP") for the calendar year preceding the prior calendar year by the IPD-GDP for the calendar year preceding that calendar year."

The trackage rights agreement altered the division of corridor management responsibilities between NCRR and Norfolk Southern from the prior lease. NCRR is now the primary administrator and manager of the corridor and adjoining properties that it owns, though Norfolk Southern has certain operational control rights and some uses of the corridor require Norfolk Southern's consent as operator. Income from corridor land licenses and other property leases with individuals, businesses, and local governments are paid to NCRR, whereas that income went to Norfolk Southern under the previous lease. Norfolk Southern was previously responsible for all improvements and maintenance, but the trackage rights agreement states that capital improvement and maintenance costs are to be borne by the party that requests the improvement or additional capacity. NCRR now has greater control over the corridor but now also has expenses for property management and capital improvements it requests.

NCRR's primary income source is payments from Norfolk Southern under the trackage rights agreement. The $14.1 million fee represents 68% of NCRR's total income in 2011. The corporation received additional income from utility agreements, land licenses, and the leasing of operating and non-operating properties (See Exhibit 4). NCRR's 2011 income is higher than usual because it includes a non-recurring adjustment of $2.6 million for unrecorded income from the assignment of tax credits to Norfolk Southern between 2009 and 2011. Over the past five years, NCRR's total income has averaged $17.5 million per year.

Exhibit 4

North Carolina Railroad Company Reported Total Income of $20.7 Million in Calendar Year 2011



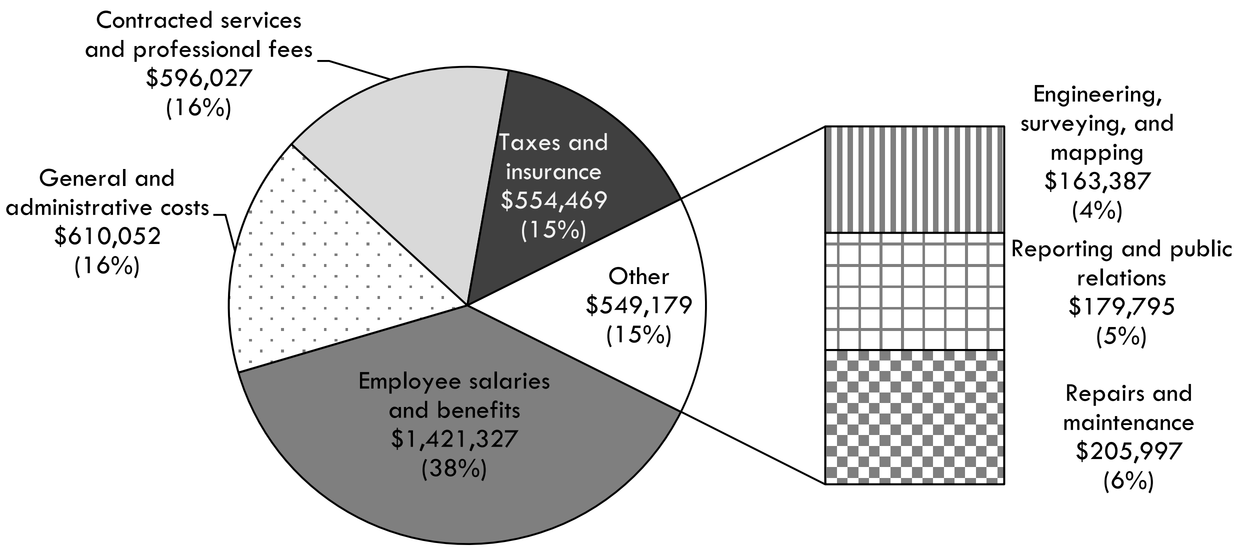
Note: Other income includes a non-recurring adjustment of $2.6 million for unrecorded income from assignment of tax credits to Norfolk Southern between 2009 and 2011. The North Carolina Railroad Company will receive three payments from Norfolk Southern for these tax credits between 2012 and 2014.

Source: Program Evaluation Division based on review of North Carolina Railroad Company financial documents.

NCRR operating expenses have grown mainly as a result of increased property management responsibilities under the 1999 trackage rights agreement. NCRR pays operating expenses from its corporate earnings and does not receive state appropriations. Exhibit 5 shows the total operating expenses of NCRR for 2011. Operating expenses increased from $1.4

million in 1998 to over $3.7 million in 2011. This increase was primarily due to growth in the number of employees, from 4 employees in 1998 to 13 employees in 2012. Six of the 13 employees have property management responsibility, and NCRR has two ongoing contracts for economic development and engineering consulting services. Under the previous lease arrangement, Norfolk Southern managed all operations and maintenance of the railroad corridor.

Exhibit 5: Operating Expenses for the North Carolina Railroad Company, Calendar Year 2011



Note: Depreciation expense was not included in the calculation of operating expenditures.

Source: Program Evaluation Division based on North Carolina Railroad Company financial statements.

The railroad corridor also supports passenger rail operations. Amtrak operates a number of routes that travel some portion of the North Carolina railroad line including the Piedmont, Carolinian, Crescent, and Silver Star routes. The two North Carolina Department of Transportation-sponsored routes are the Piedmont, which travels between Charlotte and Raleigh, and the Carolinian, which travels between Charlotte and New York City. Six daily trains currently serve the Piedmont and Carolinian routes, with trains stopping in 12 North Carolina cities. The Department of Transportation, with participation from NCRR, has made a substantial investment in track and signal improvements on the NCRR corridor. Since work began in 2001, the average Amtrak travel time between Raleigh and Charlotte has decreased by 35 minutes and ridership has grown by 54%. The railroad corridor will also be used for commuter rail transportation in the near future. The Charlotte Area Transit System (CATS) plans to begin operation of a 9-mile light rail extension in 2017. The light rail extension will utilize 2.7 miles of the NCRR corridor but will operate on a separate commuter rail track. CATS has a lease agreement with NCRR for 50 years, with an option available to renew the lease for an additional 50 years.[5]

[5] Under the lease agreement, CATS will pay NCRR a one-time payment of $11.8 million as rent for the first 50-year lease term.

The use of the NCRR corridor continues to evolve with events such as the light rail agreement with CATS and federal and state investment in the railroad corridor for passenger rail service. Norfolk Southern recently exercised its option to extend the trackage rights agreement until 2029. Because these events have taken place since the State became the sole shareholder of NCRR, this evaluation is timely in determining North Carolina's continued support and oversight of this corporation.

Findings

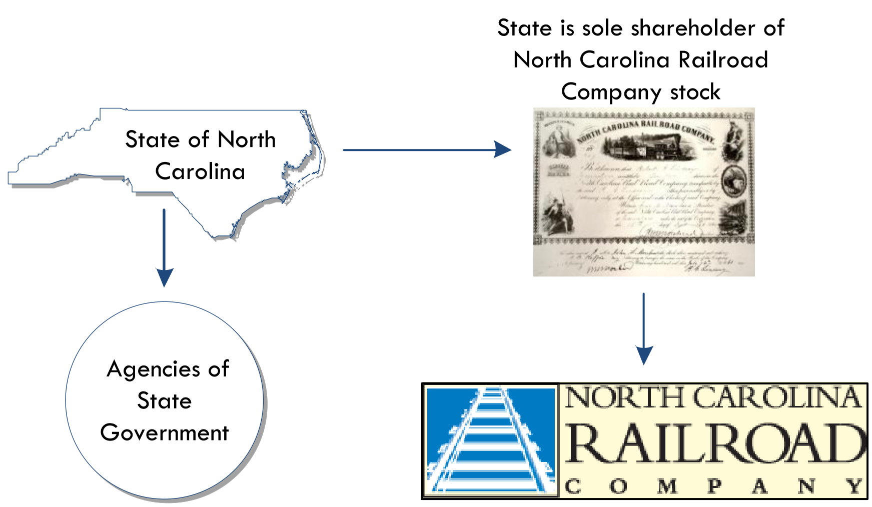
Finding 1. North Carolina Railroad Company's unique relationship with the State contributes to the company's financial health.

The State of North Carolina is the sole shareholder of the North Carolina Railroad Company (NCRR), but it remains a private corporation. With the 1998 buyout of private shareholders, the State became the sole shareholder of NCRR stock. Exhibit 6 shows the relationship between NCRR and the State. As a private corporation, NCRR files with the U.S. Internal Revenue Service as a C corporation and is subject to Chapter 55 of the General Statutes.[6] Because NCRR is not part of state government, several state laws do not apply to the corporation.

- NCRR employees are not state employees under the State Personnel Act.[7]
- NCRR Board of Directors is not a covered board under the State Government Ethics Act.[8]
- NCRR is not subject to the State's public records law.[9]
- NCRR is not reviewed as a part of the state budget process because it does not receive state appropriations.

Exhibit 6

North Carolina Railroad Company is Not Part of State Government



Source: Program Evaluation Division based on North Carolina General Statutes.

[6] The U.S. Internal Revenue Service recognizes a C corporation as a taxpaying entity that is separate from its shareholders.
[7] N.C. Gen. Stat. § 126-1.1.
[8] N.C. Gen. Stat. § 138A-3.
[9] N.C. Gen. Stat. § 132-1.

The State of North Carolina has made $196.3 million in capital contributions to NCRR. These contributions have been made in three ways:

- **Conversion of $67.7 million of NCRR debt**. NCRR assumed a $61 million loan from the State Treasurer as part of the $70.8 million the corporation used to buy out private shareholders. In 2000, the General Assembly passed legislation that converted this debt and forgave $6.7 million in accrued interest in exchange for dividend payments to the North Carolina Department of Transportation (DOT) for capital improvements on the railroad corridor.[10] The State's conversion of debt and accrued interest amounts to a $67.7 million capital contribution to NCRR.
- **Return of $57.1 million in dividend payments for future capital improvements**. Under state law, dividends received from NCRR must be used for capital improvements as determined by the NCRR Board of Directors.[11] Between 1998 and 2006, NCRR paid $95 million in dividends to the State. DOT has returned $57.1 million to NCRR to fund future capital improvement projects.[12]
- **Funding $71.5 million in additional corridor improvements.** Since the buyout in 1998, DOT has paid for $71.5 million in capital improvements for tracks, signals, and bridges on NCRR's corridor (see Appendix A for a detailed list of completed capital improvement projects).

In addition, NCRR has received favorable income tax status because the State of North Carolina is the corporation's sole shareholder. Pursuant to the Safe, Accountable, Flexible, Efficient Transportation Equity Act of 2005, NCRR's income can qualify as exempt from federal and state income taxes if substantially all of its ownership, leasing, and operation of facilities, equipment, and other property is used "for railroad transportation and for economic development purposes for the benefit of its state and its citizens." This special status is afforded to NCRR, in part, because the State owns all of the outstanding stock of the corporation.[13] Prior to this act, NCRR had corporate tax status as a real estate investment trust (REIT). To qualify for REIT status, NCRR had to pay out at least 90% of its taxable income in dividends. After NCRR's income became tax exempt in 2005, it was no longer necessary for NCRR to pay dividends to the State.

Since the State of North Carolina became NCRR's sole shareholder, the corporation has been profitable and solvent. After the buyout of private shareholders in 1998, NCRR was in a weak financial position. NCRR's total debt of $63.9 million exceeded its total assets of $14 million, and the corporation had a net loss of $1.4 million. However, the State's forgiveness and conversion of the corporation's debt and other capital contributions have put NCRR in a stronger financial position. The Program Evaluation Division

[10] Session Law 2000-67, Section 7.2.(a)

[11] Session Law 2000-67, Section 7.2.(a).

[12] DOT received $95 million in dividends from NCRR, returning $57.1 million to the corporation and using the remaining $37.9 million to fund additional corridor improvements.

[13] Public Law 109-59, Section 11146, Tax Treatment of State Ownership of Railroad Real Estate Investment Trust.

used several indicators to determine the company's profitability and solvency.

- **Net profit margin is high.** Net profit margin is the profit per each revenue dollar earned after all expenses are deducted.[14] In 2011, NCRR's net profit margin was 27%. In addition, the corporation has made a profit every year since 1999.
- **Current ratio is greater than one.** The current ratio is a measure of the ability to pay for obligations currently due.[15] In 2011, NCRR's current ratio was about 2:1, meaning the corporation could pay for all of its financial obligations that were due and have half of its cash left over.
- **Debt-to-equity ratio is low.** This ratio is a measure of the percentage of assets owned by creditors and is also known as leverage.[16] In 2011, NCRR's debt-to-equity ratio was 1.2%, which means that for every $100 in NCRR assets, only $1.20 is owed to creditors. This favorable ratio means the corporation has substantial leverage when borrowing money.

NCRR has not paid dividends to the State since 2006. Instead, the Board of Directors has chosen to invest most of NCRR's income in capital improvements to the railroad.[17] Even if the corporation paid dividends, N.C. Gen. Stat. § 124-5.1 stipulates that dividends must be used by DOT for improvement of NCRR properties as recommended and approved by the NCRR board. This state law ensures NCRR's profits are continually reinvested by the corporation for capital improvements and cannot be used by the State of North Carolina for other purposes.

Between 2007 and 2011, NCRR invested an average of $12.8 million for capital improvements, spending $5.7 million and reserving $7.1 million for future capital improvement projects. As of December 31, 2011, NCRR has accumulated over $65.2 million for future capital improvement projects with $43.9 million restricted under construction contracts and agreements with DOT and $21.3 million that is board designated. Through 2017, NCRR has committed to 15 capital improvement projects with a total estimated cost of $437.2 million. NCRR's estimated share of these costs is $95.2 million. Appendix B shows NCRR's future capital improvement commitments.

In sum, NCRR has benefitted from having the State of North Carolina as the corporation's sole shareholder. The State's capital contributions have increased NCRR's total capital by $196.3 million since the buyout of private shareholders in 1998. In addition, NCRR qualifies for unique tax status because all of its stock is owned by the State. Whereas NCRR has benefitted from its unique relationship with the State, the corporation has not paid a dividend since 2006. Thus, the State is not profiting financially from being the sole shareholder of the corporation.

---

[14] Net profit margin is calculated by dividing net income by total revenue.
[15] Current ratio is current assets divided by current liabilities.
[16] Debt-to-equity ratio is total debt divided by total equity.
[17] NCRR's Board of Directors approves dividend payments to the State of North Carolina, the corporation's sole shareholder.

Finding 2. The North Carolina Railroad Company owns a railroad corridor and other assets, but determining the corporation's market value would require a professional business valuation.

North Carolina Railroad Company's (NCRR) primary asset is the 317-mile railroad corridor. In particular, the Charlotte to Greensboro segment of the corridor is the most heavily travelled. This segment hosts as many as 40 trains per day and is planned to be double-tracked by the end of 2016. The Greensboro to Charlotte segment is also an important part of the Norfolk Southern Corporation (Norfolk Southern) system. A major Norfolk Southern-owned classification yard, the Linwood Yard, is located along the segment. This segment is also part of Norfolk Southern's Crescent Corridor, a high-capacity intermodal route that spans 13 states from New Jersey to Louisiana.[18] From 1998 to 2011, intermodal business at the North Charlotte facility increased by 74%.

The NCRR corridor is 200 feet wide, which is wider than other railroad corridors in North Carolina. The wide corridor right-of-way provides ample clearance for freight and greater flexibility for future track expansion. Currently unused portions of the corridor also can be licensed for industrial spur tracks, parking, or other uses by adjacent landowners. The railroad corridor has encroachment issues; NCRR estimates approximately 21% of the corridor is encumbered by road or land occupations.

NCRR has additional assets of value besides the 317-mile corridor. For example, NCRR has

- long-term agreements such as the trackage rights agreement with Norfolk Southern and other long-term leases;
- various railroad spurs, including a spur that connects the North Carolina railroad line at Havelock with Marine Corps Air Station Cherry Point;
- a small, minority stake in the State University Railroad,[19] a Norfolk Southern-affiliated carrier that is under Norfolk Southern's control; and
- 62 other properties located outside of the 200-foot corridor.

Most of NCRR's 62 other properties are located immediately adjacent to the corridor. Appendix C provides a complete list of the 62 non-corridor properties, and Appendix D provides a list of properties purchased by NCRR. These properties have a variety of uses and characteristics. Some are still used in railroad operations by Norfolk Southern or Amtrak; others are reserved for future rail-based industrial development projects and marketed by NCRR for that purpose. However, a number of properties have no current railroad-related use and are either vacant or leased for rental income. NCRR has at times considered disposing of certain properties and reinvesting the proceeds in the company. However, NCRR has only sold five parcels properties over the past decade for a total of $279,250.

Charlotte and Morehead City both contain valuable groupings of properties. The Charlotte property is a series of downtown parcels with a combined property tax assessment value of $32.6 million. This property is under lease to Norfolk Southern through 2067 and is subleased by Norfolk Southern as

[18] For the purposes of this report, intermodal is defined as the coordinated transport of goods in containers or trailers by a combination of rail and another mode of transport such as truck or ship.

[19] The State University Railroad connects with the North Carolina railroad east of Hillsborough and terminates in Carrboro.

commercial real estate.[20] The Morehead City property consists of four parcels that were part of the former Atlantic Hotel, including downtown waterfront parcels, with a combined tax value of $3.5 million.

The value of railroad corridors varies widely and can depend on a number of factors. In valuing the NCRR corridor, an appraiser would have to consider a number of factors such as physical attributes of the corridor and the corridor's context and surroundings. Aspects of a corridor that can affect its value include

- length of the corridor;
- condition of track;
- presence and condition of signals and bridges;
- demand for corridor use for freight or other purposes;
- importance of the endpoints of the corridor;
- importance of other points along the corridor;
- availability of a substitute corridor;
- additional income generated by the corridor;
- encumbrance of the corridor by leases or trackage rights; and
- legal considerations.

A railroad corridor's value also depends on the conditions placed on the transaction and financing structure. For example, sales can contain conditions such as the retention of certain physical or legal rights of the seller, an obligation of the buyer to continue to serve freight customers on certain segments of the corridor, or an obligation of the buyer to permit certain passenger service uses. As a result of numerous factors, railroad corridors can vary widely in value in observed market transactions.

Two recent state purchases of corridors demonstrate the wide range of values in corridor transactions:

- The Florida Department of Transportation paid $432 million to purchase 62 miles of track in 2011 ($6.97 million per mile).
- The Michigan Department of Transportation paid $140 million for 136 miles of track in 2012 ($1.03 million per mile).

NCRR has not had a business valuation performed since 1997. Credit Suisse First Boston performed a business valuation of NCRR as part of the buyout of private shareholders. The resulting NCRR share purchase price implied an overall valuation in 1997 of $283 million. However, NCRR is worth more than that amount today. NCRR and the North Carolina Department of Transportation (DOT) have invested more than $134 million in improvements to the corridor since the buyout. These improvements include double-tracking of some sections, curve straightening projects, new sidings, new signals, and bridge repair and replacement. Beyond the value added by improvements to the corridor, the railroad industry as a whole has appreciated in value in the time period since the buyout.

The business value of NCRR can only be estimated with a professional business valuation. Other state and local governments interviewed for this evaluation reported the cost of railroad business valuations to be

[20] Norfolk Southern Corporation holds a separate 99-year lease on the Charlotte parcels that expires at the end of 2067.

approximately $1 million or more, though the price depends on the scope of the valuation. These governmental entities also noted that a business valuation was important to informing a strategy for sale of a railroad. For example, a business valuation could help inform whether certain segments of the railroad would bring more value if broken apart than if the entire railroad were sold as a whole. In addition, a business valuation could estimate the value of the railroad to the current freight operator, Norfolk Southern.

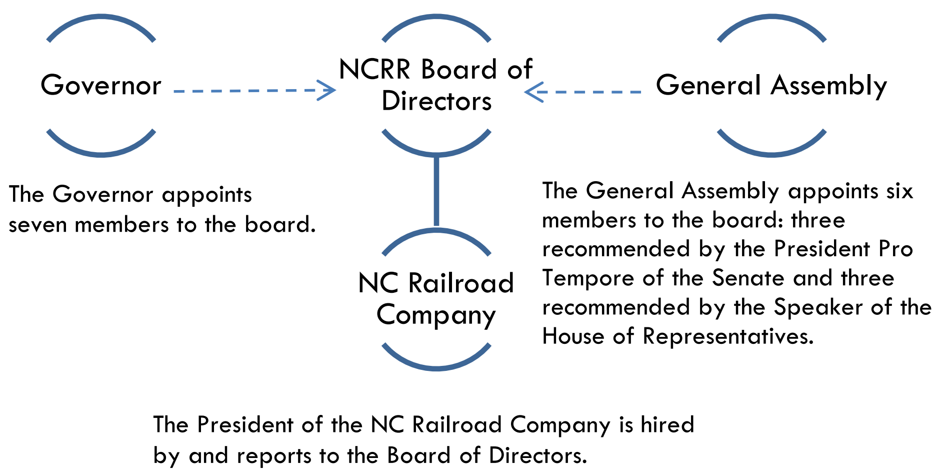
Business valuations are common in the sale or lease of railroads because they can help parties better understand the value of a railroad asset and are also useful negotiation tools. If the State were to sell NCRR, it would be important to first complete a business valuation in order to inform a negotiating strategy. Because railroad business valuations can become out-of-date quickly and are costly, the State should only consider contracting for a valuation if the North Carolina railroad is up for lease or sale.

Finding 3. The State of North Carolina currently has limited mechanisms for oversight of the North Carolina Railroad Company.

The State's primary method for overseeing the North Carolina Railroad Company (NCRR) is through the appointment of its board. The NCRR Board of Directors is responsible for governance and oversight of the corporation's activities. NCRR has 13 directors appointed by the Governor and General Assembly. Exhibit 7 shows the current governance structure of NCRR. Director terms are for four years and are staggered so that terms do not end concurrently. The chair of the board is selected by the directors. Board responsibilities include setting company policy, evaluating the performance of the NCRR president, selecting and retaining an outside auditor, and approving all lease agreements.

Exhibit 7

North Carolina Railroad Company Governance Structure



Source: Program Evaluation Division based on North Carolina Railroad Company documents and N.C. Gen. Stat. § 124-6.

The Program Evaluation Division reviewed board meeting minutes in order to analyze the frequency of meetings and attendance between 2009 and 2011. The NCRR board held meetings on average six times per year over the three-year period with an 85% average attendance rate at meetings.

The Board of Directors has three subcommittees, as well as an executive committee that reviews board meeting agendas.

- The audit, budget, and personnel committee is responsible for oversight of quarterly/annual audit tax planning and for recommending cash management policies, personnel policies, and budget matters.
- The strategic planning and policy committee makes recommendations on long-range strategic planning and capital budgeting and serves as the Norfolk Southern Corporation (Norfolk Southern) liaison.
- The economic development committee recommends corridor management policy and directives, makes policy recommendations for new partnerships, and recommends guidelines for new industry site direction and development.

Additional mechanisms of oversight of NCRR are limited. Because NCRR is solely owned by the State of North Carolina but is not a state governmental entity, it is exempt from both federal publicly traded corporate requirements and certain state government oversight mechanisms. NCRR is no longer considered a publicly traded company because the State is the sole shareholder. Thus, NCRR is not subject to federal Securities and Exchange Commission regulations or disclosure requirements for publicly-traded companies, such as the filing of a 10-K annual report.[21] NCRR also is not a state agency and does not receive oversight through the appropriations process because NCRR is profitable and does not require an appropriation for its operating expenses. In addition, state policies such as North Carolina Executive Order 3, which requires state departments to develop a strategic planning process and measure progress toward annual and long-term goals, do not apply to NCRR because it is a private corporation.

NCRR has annual statutory reporting requirements to the Joint Legislative Commission on Governmental Operations. N.C. Gen. Stat. § 124-3(a) requires the president or chief officer of NCRR to generally report

- information about the number of shares, ownership of shares, par value of shares, and any sales of shares;
- information about debt and the purpose for which it was incurred;
- audited financial statements;
- amount of bonded debt and for what purpose it was contracted;
- amount of other debt and how it was incurred;
- leases, acquisitions, or sales of property since the last report; and
- lawsuits pending concerning bonded debt or in which title to any part of the railroad is concerned.

In addition to the annual reporting requirements, N.C. Gen. Stat. § 124-3(b) requires NCRR to provide additional information and data upon request of the Governor and the General Assembly. NCRR has provided information to legislative committees when requested.

[21] Form 10-K is an annual report that provides a comprehensive overview of a company's business and financial condition and includes audited financial statements. The Securities and Exchange Commission requires publicly-traded companies to file form 10-K.

Since 2007, NCRR has not fully met all reporting requirements to the General Assembly. NCRR met its reporting requirements prior to 2007 by submitting an annual report along with an addendum that addressed those items not covered in the annual report. Since 2007, NCRR has produced an annual report but has failed to submit an addendum to the Joint Legislative Committee on Governmental Operations. Because NCRR has not submitted necessary addendums, it has failed to address certain statutory requirements including reporting on leases, acquisitions, or sales of real property or lawsuits pending.

As shown in Exhibit 8, NCRR has less stringent reporting requirements in comparison to what is required of most publicly traded corporations in their annual 10-K filing. Whereas not all 10-K requirements would be applicable to NCRR, many of the requirements would provide the State with more information for oversight of NCRR (see Exhibit 8).

NCRR does not have a comprehensive strategic plan with measurable goals and objectives, which means the General Assembly cannot effectively judge NCRR's performance and hold the corporation accountable. Strategic planning has become a generally accepted best practice for the operation of successful public and private sector organizations. The federal government requires all agencies to complete strategic plans as part of the Government Performance and Review Act, and North Carolina Executive Order 3 requires all state agencies to conduct strategic planning and performance management. Within the private sector, strategic planning is common, though the process can vary according to type of industry and organizational culture.

Whereas NCRR does not have a formal strategic plan, the company does have a strategic planning and policy committee of the board, which meets six times a year for capital planning and discusses strategic planning once a year. NCRR officials contend this committee conducts strategic thinking on behalf of the company. NCRR also has a mission that was developed by the board and included input from stakeholders. The NCRR corporate mission is "to maximize the value of the North Carolina Railroad Company's properties for the people of North Carolina through partnerships that drive economic growth, enhance freight and passenger service, improve safety and respect the natural environment." NCRR management states the revised mission reflects the importance of "putting the railroad to the highest and best use for the citizens of the State." NCRR contends this maximization occurs when the 317-mile corridor is fully utilized for freight and passenger service.

Exhibit 8: Statutory Reporting Requirements for North Carolina Railroad Company Are Minimal as Compared to Federal Reporting Requirements for Publicly Traded Corporations

Reporting Requirements	Form 10-K Requirements	G.S. § 124-3 Requirements
Business. Description of company's business, subsidiaries, and markets in which it operates.	✓	
Risk. Information about risks that apply to the company.	✓	
Properties. Information about the company's materially important physical properties.	✓	✓
Legal Proceedings. Information about significant pending lawsuits or other legal proceedings, other than ordinary litigation.	✓	✓
Management's Discussion and Analysis of Financial Condition and Results of Operation. The company's perspective on the business results of the past financial year.	✓	
Quantitative and Qualitative Disclosures about Market Risk. Information about the company's exposure to market risk, such as interest rate risk or commodity price risk.	✓	
Financial Statements and Supplementary Data. The company's audited financial statements.	✓	✓
Changes in and Disagreements with Accountants on Accounting and Financial Disclosure. If there has been a change in accountants, the company must discuss any disagreements it had with those accountants.	✓	
Controls and Procedures. Information about the company's disclosure controls and its internal control over financial reporting.	✓	
Directors, Executive Officers, and Corporate Governance. Information about the background and experience of the company's directors and executive officers, the company's code of ethics, and certain qualifications for directors.	✓	
Executive Compensation. Disclosure about the company's compensation policies and how much compensation was paid to the top executive officers of the company in the past year.	✓	
Certain Relationships and Related Transactions and Director Independence. Information about relationships and transactions between the company and its directors, officers, and their family members.	✓	
Principal Accountant Fees and Services. Disclosure of the fees paid to an accounting firm during the year.	✓	

Note: G.S. stands for North Carolina General Statutes. North Carolina Railroad Company is required to provide a summary of all leases, sales, or acquisitions of real property to which the company has been a party since the last report.

Source: Program Evaluation Division based on N.C. Gen. Stat. §124-3(a) and U.S. Securities and Exchange Commission 10-K requirements.

Further evaluation of NCRR's adherence to its corporate mission was not possible because NCRR does not have specific goals tied to its mission. Such goals are a critical component of a strategic plan. A strategic planning process should be comprehensive, and the end result should include clear goals for an organization that managers can use to direct resources and make business decisions. Exhibit 9 details certain deficiencies in NCRR's strategic planning process and documents.

Exhibit 9

North Carolina Railroad Company's Strategic Plan Lacks Several Critical Features

Critical Aspects of the Strategic Planning Process	
Identifying and engaging critical stakeholders	●
Identifying an organization's mission and vision	●
Scanning the internal and external environment for an organization's strengths, weaknesses, opportunities, and challenges (commonly referred to as a SWOC analysis)	○
Comparing threats and opportunities to an organization's ability to meet challenges and seize opportunities (commonly referred to as a GAP analysis)	○
Identifying strategic issues based on SWOC and GAP analyses and formulating strategies for addressing these issues	○
Implementing strategies	○
Critical Elements of Strategic Plan Documents	
A mission statement that describes the purpose of an organization	●
A vision statement that expresses the aspiration of an organization or what the organization looks and acts like when it is fulfilling its mandate	●
Strategic goals that address the strategic issues facing an organization	○

● = Fully implemented ○ = Not implemented

Source: Program Evaluation Division based on review of North Carolina Railroad Company strategic plan and review of board meeting minutes.

Lack of a formalized performance management system means NCRR cannot measure, monitor, and report to the General Assembly on its progress toward achieving goals. Strategic planning links management to operational activities by connecting the goals identified in the strategic plan to the operational objectives measured by a performance management system. Developing and implementing a formalized performance management system involves

- setting operational objectives;
- monitoring progress towards achieving objectives; and
- taking remedial action when performance falls short.

Strong operational objectives identify what an organization wants, how much an organization wants, when an organization wants it, and how an organization is going to get it. These objectives guide each business unit's operational activities.

Successful performance management systems improve the upward and downward flows of information. Development and implementation of a formalized performance management system would allow NCRR to more easily and clearly report its activities and the result of those activities to the General Assembly, thus enhancing NCRR's accountability. A formalized system would allow NCRR to monitor the results of its activities, providing feedback about what is or is not working. However, NCRR should first develop a strategic plan that would inform a performance management system.

In sum, the State has limited mechanisms for overseeing the activities of NCRR. Since 2007, NCRR has not provided all of the information necessary to meet the corporation's statutory reporting requirements to the General Assembly. In addition, NCRR has not developed a comprehensive strategic plan to carry out its mission and does not have a performance monitoring system to report on progress toward achieving goals. Stronger oversight of NCRR is needed to evaluate corporate performance and ensure that corporate decisions are in the best interest of the State.

Finding 4. Changing the corporate status of the North Carolina Railroad Company has legal and financial implications.

The legislation requiring the comprehensive evaluation of the North Carolina Railroad Company (NCRR) directed the Program Evaluation Division to address whether NCRR should be

- transferred to the Department of Transportation (DOT), or
- transferred to another agency in state government.

The Program Evaluation Division reviewed how other states and local governments own and manage railroad assets to identify options for bringing NCRR under state government.

State ownership of railroad assets is not unique to North Carolina. Some states own no rail assets, while others own many miles of active rail lines. For example, Oklahoma owns 869 miles of track that is leased primarily to short-line carriers. States can own railroad lines that are used for freight service, passenger service, or in some cases, a combination of both. Rail lines that are used for freight service are often served by regional or short-line carriers; others are served by a Class I railroad company. Within the southeast region, five states own active rail lines. As shown in Exhibit 10, the ownership, operation, and use of railroads vary widely among these states.

Exhibit 10

Five Southeastern States Own Rail Assets

State	Miles of Active Track Owned	Ownership Entity	Use of Track
Alabama	75	Alabama State Port Authority	Freight
Florida	143	Florida Department of Transportation	Passenger, Freight
Georgia	440	Georgia Department of Transportation	Freight
	136	Georgia State Properties Commission	Freight
North Carolina	**317**	**North Carolina Railroad Company**	**Passenger, Freight**
West Virginia	185	West Virginia Rail Authority	Freight, Excursion

Note: Two separate state entities own rail assets in Georgia.

Source: Program Evaluation Division based on interviews with other states.

Unlike North Carolina, other southeastern states own and manage their rail assets under a state government entity. The ownership structure and operation of railroad assets varies amongst southeastern states; their railroads are either under a transportation department, authority, or property commission. A primary difference between North Carolina and other states that own rail assets is North Carolina owns a railroad company (NCRR) that operates outside of state government, instead of directly owning the assets. One other state, Alaska, also has a railroad company, but it uses a different structure. The Alaska Railroad Corporation is a quasi-public corporation and is an instrument of the state within the Alaska Department of Commerce, Community, and Economic Development.[22] The corporation is legally independent of and separate from the state, but its Board of Directors is appointed by the governor and includes state agency commissioners. This structure is similar to the North Carolina Housing Finance Agency, which was established as a quasi-public corporation by the General Assembly in 1969.

Owning rail assets can provide revenue for government entities, particularly if the assets are integral to a Class I carrier's rail network. The Program Evaluation Division identified two government entities that have exclusive freight leases with Class I carriers.

- **City of Cincinnati.** Railroad is leased to Norfolk Southern Corporation (Norfolk Southern), and lease revenue is used for city infrastructure improvements and railroad operating expenses.
- **Georgia State Properties Commission.** Railroad is leased to CSX and lease revenue goes to Georgia's General Fund.

NCRR receives income from its trackage rights agreement with Norfolk Southern, but the NCRR Board of Directors decides how the income is utilized including whether to give the State a dividend. Income from the trackage rights agreement has been used for capital improvements and operating expenses for NCRR.

Based on examples in other states and within North Carolina state government, the Program Evaluation Division identified two potential options for changing the structure of state ownership of NCRR. In accordance with the legislation requiring this evaluation, the Program Evaluation Division considered options to transfer the corporation to DOT or to another state agency.

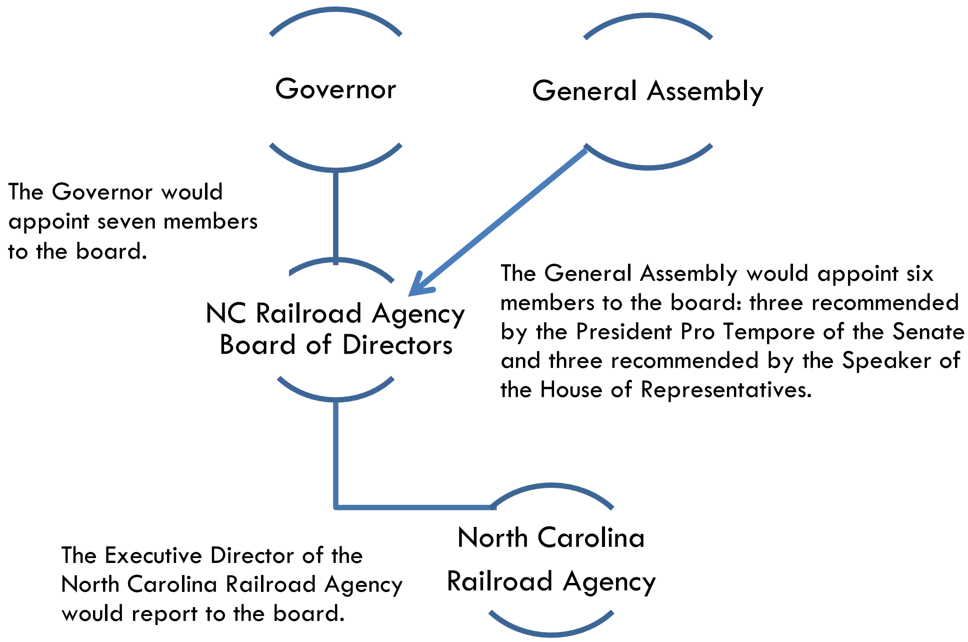
- **Establish the North Carolina Railroad Agency as a quasi-public corporation.** This option uses the Alaska Railroad Corporation and North Carolina Housing Finance Agency as models. The North Carolina Railroad Agency would be constituted as a public agency and an instrumentality of the State for the performances of essential public functions. The public purpose of the Railroad Agency would be to maintain a railroad corridor and manage the trackage rights agreement with a railroad company. The executive director of the Railroad Agency would report to a board of directors appointed by

[22] The term "quasi-public corporation" means a corporation owned by the public with a close relationship to state government, not to be confused with a "public corporation" as used by the financial markets to designate a corporation with publicly traded stock.

the Governor and the General Assembly (see Exhibit 11 for the governance structure). The Railroad Agency would not need state appropriations if the General Assembly directs the agency to use the revenue from the trackage rights agreement and other leases for railroad operating expenditures and capital improvements. The General Assembly could also direct that some of the railroad revenue be used for other purposes. Staff for the Railroad Agency would be state employees exempt from the State Personnel Act.

Exhibit 11

Governance Structure for the Quasi-Public Corporation Option



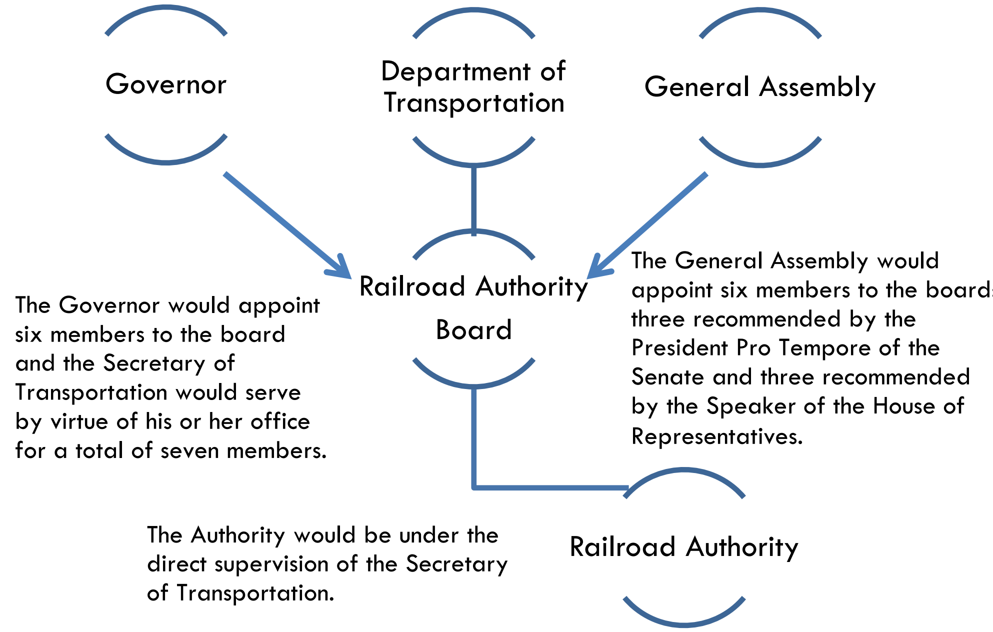
Source: Program Evaluation Division based on the governance structure for the North Carolina Housing Finance Agency.

- **Establish a state railroad authority under DOT.** This option uses the North Carolina State Ports Authority as a model. The North Carolina Railroad Authority would be under the direct supervision of the Secretary of Transportation with a separate board appointed by the Governor and the General Assembly (see Exhibit 12 for the governance structure).[23] The Secretary of Transportation would serve on the board by virtue of his or her office. The purpose of the Railroad Authority would be to maintain the railroad corridor and manage the trackage rights agreement with a railroad company. The Railroad Authority would not need state appropriations if the General Assembly directs the Railroad Authority to use the revenue from the trackage rights agreement and other leases for railroad operating expenditures and capital improvements. The General Assembly could also direct that some of the railroad revenue be used for other purposes. Staff for the Railroad Authority would be state employees exempt from the State Personnel Act.

[23] NCRR should not be placed within DOT's Rail Division because the division's regulatory responsibility for rail safety creates a conflict of interest.

Exhibit 12

Governance Structure for the Railroad Authority Option



Source: Program Evaluation Division based on the governance structure for the North Carolina State Ports Authority.

Transforming NCRR into a state government entity provides direct state oversight of the railroad assets and revenue but limits NCRR's autonomy and corporate flexibility. Under both options, the State of North Carolina has control of the railroad assets, and the General Assembly could direct the use of revenue from the trackage rights agreement. Establishing a Railroad Agency as a quasi-public corporation maintains most of the corporate flexibility that NCRR currently has and allows for some autonomy because it has a separate board and is not directly supervised by a state agency secretary. If the State of North Carolina was establishing a railroad corporation in this century to benefit the State's economy, the current North Carolina Constitution would require a quasi-public corporation instead of a private corporation. Establishing a Railroad Authority under the direct supervision of the Secretary of Transportation limits the autonomy of the railroad operations the most.

Transferring NCRR to a state government entity would be a lengthy and complicated process that requires the repeal of the corporation's charter and dissolution of the corporation, which would involve winding up the corporation's business and liquidation of corporate assets. To begin the process of transferring the railroad assets to the State, the General Assembly would first have to enact legislation to revoke NCRR's corporate charter and establish the state government entity that would manage the railroad assets after they are transferred to state government.

Revoking NCRR's corporate charter would require a special act as allowed under Section 1 of Article VIII of the North Carolina Constitution. The revocation of NCRR's corporate charter would prompt dissolution of the corporation under Article 14 of Chapter 55 of the General Statutes. The dissolution process would not happen immediately. The NCRR Board of Directors as representatives of the State of North Carolina, the sole shareholder of the corporation, would have to then vote to dissolve the corporation and articles of dissolution would then have to be filed with the Secretary of State. The articles of dissolution would need to specify the State of North Carolina is the successor entity to which the remaining assets of the corporation are transferred subject to its liabilities. The dissolved NCRR would continue its corporate existence, but it could only conduct business related to wrapping up and liquidating its business and affairs, including

- collecting its assets;
- disposing of its properties that will not be distributed in kind to its shareholders;
- discharging or making provision for discharging its liabilities;
- distributing its remaining property among its shareholders according to their interests; and
- doing every other act necessary to wrap up and liquidate its business and affairs.

The railroad assets would not devolve to the State until NCRR's dissolution is completed.

Enacting legislation to establish the state government entity to receive the railroad assets allows the State to prepare for the transfer of assets after the dissolution of NCRR is final. To ease the transition, the General Assembly could consider appointing NCRR board members to serve initially as the board of directors for the state railroad entity. Because the transfer of the railroad assets would not occur until the dissolved NCRR finishes wrapping up its business affairs, a transition plan and implementation timeline would be needed to guide the transformation of the dissolved NCRR into a state entity.

Changing the corporate status of NCRR has several legal and financial implications. These implications do not affect the feasibility of transferring the railroad assets to state government, but the General Assembly should consider these issues if it decides to change the structure of state ownership of NCRR.

- **Repealing or changing Chapter 124 of the General Statutes.** Chapter 124 of the General Statutes provides for control of state interest in railroads, canals, and other internal improvements. If the General Assembly decides to revoke the NCRR charter and bring the railroad under state government, it should consider repealing or changing Chapter 124 of the General Statutes to eliminate mention of a state-owned railroad company.

- **Transfer of NCRR land.** When land was transferred to NCRR for the railroad corridor in the 1850s, the original transfer documents specified the land could only be used for railroad-related purposes. If the General Assembly decides to revoke the NCRR charter and bring the railroad under state government, state law needs to restrict the use of railroad corridor property to railroad-related purposes, as required by the original transfers of land to the railroad.

- **Liability.** The State, as a shareholder receiving assets in dissolution, would likely be responsible for any liabilities of NCRR that existed at the time of dissolution, up to the value of the assets received from the dissolution. This liability would continue for up to five years after the dissolution notice is published, and the Tort Claims Act's cap on awards against the State may not apply. If NCRR becomes part of

DOT, claims arising after the dissolution would be covered by the Tort Claims Act, subjecting claims to the review of the Industrial Commission and the statutory cap on awards. If NCRR is a quasi-public corporation like the North Carolina Housing Finance Agency, its liabilities would be its own and the Tort Claims Act would not apply.

- **Labor law.** Federal law regulates retirement and collective bargaining for railroad employees. Railroad employees are subject to the federal railroad retirement laws, which operate in lieu of Social Security, as well as federal unemployment and disability laws for railroad workers. Railroad employees also are able to collectively bargain under the federal Railway Labor Act, which would preempt state law on collective bargaining. Federal law may also, in some instances, allow strikes by the railroad employees. The General Assembly needs to consider how these labor protection issues could affect other state employees if railroad employees become state employees.

- **Trackage rights agreement with Norfolk Southern.** The trackage rights agreement does not require NCRR to obtain approval to assign the agreement to another party if the assignment is affected by a merger, consolidation or corporate reorganization, or other transaction where substantially all rail assets and liabilities are brought under control of another party. Revoking the corporate charter of NCRR and dissolving the corporation appears to fall under the other transaction definition and, therefore, should not affect the trackage rights agreement with Norfolk Southern. The General Assembly may want to make it clear in the legislation establishing the state entity to manage the railroad assets that it is the intent of the State to adhere to the trackage rights agreement.

- **Taxes.** If the General Assembly decides to revoke the NCRR charter and bring the railroad under state government, the railroad property becomes a state-owned asset and would be exempt from the state railroad franchise tax and local property taxes.[24] The State would lose $226,205 in annual railroad franchise tax revenue. Local governments would lose an estimated $1.7 million in annual property taxes from Norfolk Southern and $192,427 in annual property taxes from NCRR. See Appendix E for estimated property taxes paid to local governments along the NCRR corridor.

Exhibit 13 summarizes the legal and financial implications for changing the structure of state ownership of NCRR and compares them to maintaining the status quo for the corporation.

[24] The General Assembly could require the state entity managing the railroad to continue paying the state railroad franchise tax to the General Fund.

Exhibit 13

Legal and Financial Implications for Transferring the North Carolina Railroad Company to State Government

Legal and Financial Implications	Maintain Corporation	Quasi-Public Railroad Agency	Railroad Authority under DOT
General Assembly revokes charter		✓	✓
Dissolution of NCRR		✓	✓
General Assembly establishes state railroad entity		✓	✓
Repeal/change Chapter 124 of General Statutes		✓	✓
Restrict railroad corridor property to railroad-related purposes	✓	✓	✓
State liability			✓
NCRR employees become state employees		✓	✓
State and local governments lose tax revenue		✓	✓

Note: DOT stands for the North Carolina Department of Transportation.

Source: Program Evaluation Division based on document review, interviews with North Carolina Railroad Company and Department of Transportation, and N.C. Gen. Stat. Chapter 124.

Changing the corporate status of NCRR is feasible, but the General Assembly would need to consider whether moving NCRR under state government is in the best interest of the State. Transforming NCRR into a state government entity requires a lengthy and complicated process that involves revoking the corporate charter, the dissolution of NCRR, and the establishment of a state entity to receive the railroad assets. The General Assembly would need to decide whether gaining direct State control of the railroad assets and revenue warrant the effort necessary to transform NCRR into a state government entity. Maintaining NCRR's corporate status is another possibility, but making no changes means that the State of North Carolina's limited oversight of NCRR continues and the NCRR Board of Directors controls corporate income even if dividends are paid to DOT.

The General Assembly could change existing state law to improve oversight of NCRR without revoking its corporate charter and dissolution. Amendments to Chapter 124 of the General Statutes could bolster State oversight of NCRR by improving reporting requirements, requiring strategic planning and performance measurement, strengthening NCRR's partnership with DOT, and mandating that NCRR pay the State an annual dividend that is not controlled by the NCRR Board of Directors. These statutory changes would not require a complicated process or extended timeframe for implementation but would result in improved communication between NCRR and the State of North Carolina.

Finding 5. Selling the North Carolina Railroad Company may not be in the best interest of North Carolina, but some non-corridor properties could be sold.

The legislation requiring this evaluation of the North Carolina Railroad Company (NCRR) directed the Program Evaluation Division to identify tangible and intangible benefits provided by the corporation. Through interviews and focus groups with stakeholders, the Program Evaluation Division has identified several benefits of the State being the sole shareholder of NCRR. Exhibit 14 summarizes these benefits.

Exhibit 14: Benefits of the North Carolina Railroad Company

Tax Revenue	• Pays state railroad franchise taxes • Pays property taxes to local governments and requires Norfolk Southern to pay property taxes as a part of the trackage rights agreement
Capital Investment	• Increases the value of the railroad assets through capital investment • Includes $63 million on railroad capital improvements from 2002 to 2012 and $83 million committed for capital improvements through 2017
Passenger Rail	• Supports passenger rail service within and through North Carolina • Ensures Amtrak has priority over freight services under the trackage rights agreement with Norfolk Southern • Contributes to passenger rail capital improvements that improve travel times • Leases a section of the rail corridor to Charlotte Area Transit System for commuter rail service
Property Management	• Protects the corridor's right-of-way by correcting encroachments • Has improved GIS mapping of the railroad property • Provides information to local governments along the railroad corridor to assist in property plotting and preventing future encroachments
Economic Development	• Assists local and regional economic developers with site location and infrastructure modifications to support new and expanding businesses along the rail corridor • Maintains rail service in eastern North Carolina for the Port of Morehead City, military bases, and other customers along that section of the railroad corridor • Stimulates economic development by renovating and rehabilitating several historic properties in Burlington, New Bern, and Raleigh • Owns property along the railroad corridor suitable for future rail-related economic development

Source: Program Evaluation Division based on document review and interviews with the North Carolina Railroad Company, Department of Transportation, and focus groups with other stakeholders.

The Program Evaluation Division found that government entities owning rail assets cited similar benefits. Eight government entities that own active railroad lines in other states identified economic development, passenger rail development, and revenue as benefits of state ownership. These other government entities also cited several reasons for maintaining ownership of rail assets:

- the railroad provides recurring revenue;
- the railroad right-of-way may be needed for future passenger or commuter rail;
- the railroad was vital to the state port; and
- the expectation that rail assets values would continue to appreciate.

Purchasing railroad right-of-way for commuter and passenger rail can be expensive for states that do not already own rail assets. Florida paid CSX

$732 million in two separate transactions to buy 143 miles of railroad right-of-way in the Orlando and Miami areas for commuter rail services. Under this purchase agreement, CSX retained exclusive perpetual freight rights to use both rail lines.

Selling NCRR or the railroad corridor may not be in the State's best interest because the sale may eliminate or negatively affect benefits provided by NCRR. Based on current information available to the Program Evaluation Division, NCRR should not be sold. As shown in this finding, the State has received tangible and intangible benefits from being the sole shareholder of NCRR even though the State has not profited financially. The sale of NCRR or the railroad corridor could have the following effects:

- loss of the income stream from the trackage rights agreement that has been used for railroad capital improvements and economic development;
- loss of the valuable railroad corridor property that cannot be easily replaced;
- loss of economic development opportunities based on rail freight access for prospective and existing business in North Carolina;
- risk of cessation of Class I rail freight services to the Port of Morehead City or any routes deemed to have losses or inadequate profit margins for the new or future operator;
- negative impact to passenger rail services including the North Carolina Department of Transportation's (DOT) implementation of the passenger rail grant, DOT's maintenance and operating costs for passenger rail improvements, and Amtrak agreements; and
- loss of opportunities for using the railroad corridor for commuter rail service in urban areas along the railroad corridor.

Uncertainty about the value of NCRR and the price the State would receive from selling the corporation does not allow for a comparison of the potential one-time revenue to the benefits from continued state ownership of NCRR.

Selling NCRR property that is not directly related to the railroad corridor could provide one-time revenue for the State. Selling these properties would not affect railroad operations and could provide one-time revenue. As discussed in Finding 2, NCRR owns the railroad corridor and 62 parcels outside of the railroad corridor. The Program Evaluation Division reviewed information for all NCRR property and applied the following criteria to identify parcels that should **not** be sold:

- railroad corridor system property;
- property that buffers the railroad corridor;
- land reserved for industrial rail development;
- property that would be difficult to dispose of due to parcel shape or accessibility issues that render it unsalable;
- property related to passenger rail services (e.g., the Amtrak facility in Burlington); and
- property used for NCRR operations (i.e., corporate headquarters).

The Program Evaluation Division identified 18 parcels that did not meet these criteria and therefore could be sold. As shown in Exhibit 15, these parcels have a tax value of $44.5 million and 11 parcels generate income for NCRR. The most valuable parcels are located in Charlotte, Durham, Morehead City, and Raleigh.

Exhibit 15: North Carolina Railroad Company Could Sell Fourteen Non-Corridor Properties

	Property Description	County (City)	Property Has Tenant (Yes/No)	Year Acquired	Total Tax Value	Annual Income
	Retain Property with Annual Income Above $100,000					
1	Raleigh Warehouse Redevelopment Property	Wake (Raleigh)	Yes	1850s	$ 3,502,435	$ 320,472
2	Hillsborough Road and LaSalle Street	Durham (Durham)	Yes	2000	1,297,590	241,164
3	Former Depot in Durham	Durham (Durham)	Yes	1850s	1,038,107	102,420
					$ 5,838,132	**$ 664,056**
	Retain Property with Future Income Above $100,000					
1	Charlotte Downtown Property	Mecklenburg (Charlotte)	Yes	1850s	$ 32,643,200	$ 81,319
					$ 32,643,200	**$ 81,319**
	Sell Property with Annual Income Below $100,000					
1	Waterfront and Riparian Rights	Carteret (Morehead City)	Yes	1902	$ 1,011,884	$ 32,721
2	Bridges Street Lot	Carteret (Morehead City)	Yes	1903	1,148,121	27,700
3	Station and Former Industrial Property	Carteret (Morehead City)	Yes	1902	1,047,956	27,243
4	Hillsborough Former Depot	Orange (Hillsborough)	Yes	1850s	278,040	4,244
5	Wye Property	Carteret (Morehead City)	Yes	1887	994,500	3,000
6	4th Street Lot	Carteret (Morehead City)	Yes	1903	249,420	2,700
7	Wye Property Extension	Carteret (Morehead City)	Yes	1887	278,472	700
8	Burke Street Lot	Alamance (Gibsonville)	No	2005	38,793	0
9	Clarks Lot	Craven (Clarks)	No	1911	8,000	0
10	Morrisville Former Depot	Wake (Morrisville)	No	1850s	3,006	0
11	N. Craven Street	Craven (New Bern)	No	1899	915,390	0
12	Newport Lot	Carteret (Morehead City)	No	1903	50,440	0
13	Tiffany and Bright Streets	Lenoir (Kinston)	No	1901	31,025	0
14	Waynesboro Lot	Wayne (Goldsboro)	No	1850s	1,130	0
					$ 6,056,177	**$ 98,308**
	Totals for all Non-Corridor Property				**$ 44,537,509**	**$ 843,683**

Note: In 2006, the North Carolina Railroad Company reviewed non-operating real estate and recommended selling 15 properties, donating the Waynesville Lot to Waynesville Historic Park, and retaining the Hillsborough Road & LaSalle Street in Durham and the Raleigh Warehouse Redevelopment Property for income. The N. Craven Street parcel may be sold in 2012 or early 2013.

Source: Program Evaluation Division based on North Carolina Railroad Company property lists.

Because 11 of the 18 parcels generated $843,683 in annual income for NCRR in 2011, the Program Evaluation Division reviewed these parcels further to determine whether they should be retained by NCRR because they provide significant income to the corporation or have the potential to produce more income in the future. Three parcels should be retained by NCRR because they generated $664,056 or 79% of the total income:

- Raleigh Warehouse Redevelopment;
- Hillsborough and LaSalle Street in Durham; and
- Former Depot in Durham.

In addition, the Charlotte Downtown properties have the potential to generate increased future income for NCRR. Currently, these parcels only provide $81,319 per year, but the lease income will increase to 6% of the appraised market value in 2019. Although the appraised market value of the properties is unknown, the tax value is $32.6 million. Allowing NCRR to retain the Charlotte Downtown properties provides an opportunity for NCRR and the State to reevaluate whether to sell these properties or retain them for income. The increased income the properties will generate in 2019 also will make them more attractive to a potential buyer.

The remaining 14 parcels could be sold because they generate limited or no income for NCRR. The NCRR Board of Directors could convey the property to the State as a dividend. The property could then be sold or used by the State. The General Assembly would need to designate how the proceeds from the sale of these properties would be allocated because state law requires railroad dividends to be used for capital improvements for the railroad.

In sum, NCRR's unique relationship with the State of North Carolina has contributed to its financial health, but the State has not profited from this relationship by receiving a direct financial benefit. State law requires any dividends go back to the corporation for capital improvements for the railroad. Under the current governance structure, the State has limited mechanisms for oversight of NCRR beyond appointing its Board of Directors and receiving reports. Whereas changing the corporate status of NCRR is feasible, transforming NCRR into a quasi-public corporation or a railroad agency under DOT would require a lengthy and complicated process. Selling NCRR or the railroad corridor is not in the best interest of the State, but NCRR property not related to the railroad corridor could be conveyed to the State as a dividend and sold to provide one-time revenue. In lieu of changing NCRR's status as a private corporation, changes in state law can improve oversight and require the corporation to pay an annual dividend.

Recommendations

Recommendation 1. The General Assembly should amend Chapter 124 of the General Statutes to strengthen the North Carolina Railroad Company's reporting requirements including requiring strategic planning and performance measurement and enhancing its partnership with the Department of Transportation.

The General Assembly should maintain the North Carolina Railroad Company's (NCRR) corporate status and amend existing state law to improve

NCRR's reporting requirements. The General Assembly should amend Chapter 124 of the General Statutes to make the following changes.

- **Strengthen reporting requirements.** Currently, NCRR has less stringent reporting requirements as compared to the annual 10-K filings required of most publicly-traded corporations. The General Assembly should require NCRR to report on an annual basis information that is similar to what is provided in a publicly traded company's annual 10-K as required pursuant to Section 13 or 15(d) of the federal Securities Exchange Act of 1934.
- **Require strategic planning.** NCRR does not have a strategic plan. The General Assembly should direct NCRR to prepare and maintain an up-to-date comprehensive strategic plan that includes a mission statement describing the purpose of the company and clear goals that address the strategic issues facing the company. The NCRR Board of Directors can use the strategic plan to direct resources and make business decisions, and the plan will provide the General Assembly with information that will improve oversight of the corporation. NCRR should be directed to submit the up-to-date strategic plan to the General Assembly annually beginning in 2014.
- **Require performance measurement.** NCRR does not have a performance management system to measure and monitor its progress towards achieving goals. The General Assembly should require NCRR to develop and implement a formalized performance management system based on its strategic plan that sets operational objectives, monitors progress towards achieving objectives, and takes action when performance falls short. Developing and implementing a performance management system will allow NCRR to more clearly report to the General Assembly on the results of its activities based on the strategic plan.
- **Adjust board appointments.** To enhance NCRR's partnership with the Department of Transportation, the General Assembly should require that two of the Governor's appointees to the NCRR Board of Directors also be appointed to the Board of Transportation.

Recommendation 2. The General Assembly should require the North Carolina Railroad Company to pay a one-time dividend of $15.5 million to the General Fund from its reserve for future capital improvements no later than June 30, 2013.

Since the State of North Carolina became NCRR's sole shareholder in 1998, the corporation has been profitable and solvent. However, the State has not received a direct financial benefit from owning NCRR. All dividends paid by NCRR were used to pay for capital improvements for the railroad as required by state law, and the NCRR Board of Directors opted to invest in capital improvements in lieu of making dividend payments. NCRR has accumulated over $65.2 million in a reserve for future capital improvements that is under the control of NCRR Board of Directors.

The State of North Carolina should profit from its contributions to the financial health of NCRR since 1998 and receive a direct financial benefit from this unique relationship. To this end, the General Assembly should require NCRR to pay a one-time dividend of $15.5 million to North Carolina's General Fund from its reserve for future capital improvements no later than June 30, 2013. This proposed one-time dividend would still allow NCRR to maintain and improve railroad assets based on its committed capital improvement projects through 2017, assuming partners continue to participate in funding these projects.

Recommendation 3. The General Assembly should modify Chapter 124 of the General Statutes to require the North Carolina Railroad Company to pay an annual dividend to the General Fund that is equal to 25% of its income from its trackage rights agreement beginning January 15, 2014.

The North Carolina Railroad Company (NCRR) is not required to pay dividends to the State of North Carolina. The NCRR Board of Directors decides whether to pay a dividend, and Chapter 124 of the General Statutes specifies that any dividends received by the State shall be used by the Department of Transportation for the improvement of NCRR properties as recommended and approved by the NCRR Board of Directors. Because of this statute, the State has received no direct financial benefit as the sole shareholder of NCRR. Recommendation 2 proposes a one-time dividend that will allow the State to profit financially from its past contributions to NCRR's financial health.

To ensure the State continues to benefit financially from being the sole shareholder of NCRR, the General Assembly should modify Chapter 124 of the General Statutes to require NCRR to pay an annual dividend to the State's General Fund beginning January 15, 2014. The annual dividend should be equal to 25% of NCRR's income from its trackage rights agreement paid during the previous calendar year. Income from the trackage rights agreement is guaranteed through 2029, and Norfolk Southern Corporation has the option to extend the agreement through 2044. The first payment in 2014 would be calculated using NCRR's income from the trackage rights agreement for Calendar Year 2013. The estimated dividend payment from NCRR should be at least $3.7 million annually.[25] This proposed dividend would leave NCRR with sufficient income to pay operating expenses and continue to maintain and improve railroad assets based on its committed capital improvement projects through 2017, assuming partners continue to participate in funding these projects.[26]

[25] The estimated annual dividend of $3.7 million was calculated using the 2011 trackage rights agreement fee of $14.1 million.

[26] Based on income estimates provided by NCRR, the corporation's estimated income after paying the annual dividend to the State should be at least $14.1 million annually.

Recommendation 4. The General Assembly should require the North Carolina Railroad Company to convey to the State of North Carolina 14 parcels not directly related to the railroad corridor as a dividend and direct the Department of Administration to sell them with the proceeds deposited into the General Fund.

As discussed in Finding 5, the Program Evaluation Division identified 14 properties not directly related to the railroad corridor that could be sold because they do not generate significant income for the North Carolina Railroad Company (NCRR) or have the potential to generate more income in the future.

The General Assembly should require NCRR to convey to the State the 14 properties not directly related to the railroad corridor as a dividend. The General Assembly should authorize the Department of Administration to recoup expenses associated with selling the properties from the proceeds and specify that the remaining proceeds from selling the railroad properties be deposited in the General Fund.

Appendices

Appendix A: Completed Capital Improvement Projects for the North Carolina Railroad Company, 2000–2012

Appendix B: Future Capital Improvement Commitments for the North Carolina Railroad Company

Appendix C: Non-Corridor Properties Owned by the North Carolina Railroad Company

Appendix D: Property Purchased by the North Carolina Railroad Company, 2000–2012

Appendix E: Estimated Property Taxes Paid to Local Governments along the North Carolina Railroad Company Corridor

Agency Response

A draft of this report was submitted to the North Carolina Railroad Company. Their response is provided following the appendices.

Program Evaluation Division Contact and Acknowledgments

For more information on this report, please contact the lead evaluator, Jim Horne, at jim.horne@ncleg.net.

Staff members who made key contributions to this report include Michelle Beck, Jeff Grimes, Carol Shaw, and Pamela L. Taylor. Bill Drafting Division staff member Ryan Blackledge also contributed to this report. John W. Turcotte is the director of the Program Evaluation Division.

Appendix A: Completed Capital Improvement Projects for the North Carolina Railroad Company, 2000–2012

Project Description	Year	NCRR	DOT	DOT Source	Total
Goldsboro-Morehead City Track	2000	$ 0	$ 9,957,775	NCRR	$ 9,957,775
McLeansville Siding	2002	0	932,936	Federal/State	932,936
Raleigh-Selma Track	2002	0	2,591,756	NCRR/State	2,591,756
Mebane Siding	2003	0	898,310	Federal/State	898,310
West Durham Funston Curve	2003	23,912	2,284,345	State	2,308,257
Welded Rail Replacement between Mileposts 15.4-29.0/Neuse River Bridge Replacement at Milepost 27.9	2004	6,570,182	0		6,570,182
Cary-Greensboro Traffic Control	2004	0	10,763,276	Federal/State	10,763,276
East Durham (Durham and Southern Junction)	2004	0	1,289,557	State	1,289,557
Greensboro Elm Junction Track	2005	0	1,144,082	State	1,144,082
Burlington Company Shops Station Renovation	2004	3,000,000	0		3,000,000
Greensboro-Charlotte Super Elevation	2005	0	2,851,371	State	2,851,371
Hwy 54 Bridge	2005	5,460,726	0		5,460,726
Rail and Turnouts between Mileposts 37.5-54.5	2005	3,875,652	0		3,875,652
Bridge at Milepost 50.7	2006	372,237	0		372,237
Welded Rail Replacement Goldsboro-Morehead City (15.5 miles)/Dover Drainage Improvement	2007	4,836,410	0		4,836,410
East Durham Yard Siding	2007	0	6,262,473	Federal/State	6,262,473
Equilateral Turnouts-Greensboro to Charlotte	2007	0	2,430,550	State	2,430,550
Three Passing Sidings/Signals/Yard Improvements-Cabarrus St/Boylan	2007 2009	20,882,331	0		20,882,331
Bridge at Milepost 95.2	2008	889,611	0		889,611
Bridges/Bridge Replacements	2009	1,503,599	0		1,503,599
Bridge Improvements at Mileposts 19.01 and 106.5	2009	78,237	0		78,237

Project Description	Year	NCRR	DOT	DOT Source	Total
Cox-Hoskins 2nd Main Track	2009	4,000,000	16,975,367	Federal/State	20,975,367
Raleigh-Selma 79 MPH Speed	2009	0	1,232,524	State	1,232,524
Crossing Improvements	2009 2010	795,713	1,803,710	State	2,599,423
Cox-Hoskins 2nd Main Track, Additional Costs	2010	0	7,208,628	State	7,208,628
Raleigh-Selma 79 MPH Speed, Additional Costs	2010	0	175,765	State	175,765
Elon Pedestrian Underpass	2010	1,000,000	0		1,000,000[1]
Kinston Team Track (Spirit)	2010	891,937	0		891,937
Kinston Track Realignment	2010	2,739,002	0		2,739,002
Track Welding between Mileposts 59.5-94.3	2010	300,510	0		300,510
NCRR Projects Paid by DOT	2011	0	2,666,693	State	2,666,693
Bridges at Mileposts 27.8 and 27.9	2012	4,000,000	0		4,000,000[2]
Trent River Bridge	2012	1,500,000	0		1,500,000[3]
Total		**$62,720,059**	**$71,469,118**		**$134,189,177**

Note: NCRR stands for the North Carolina Railroad Company. DOT stands for the North Carolina Department of Transportation.

Source: Program Evaluation Division based on information provided by the North Carolina Railroad Company.

[1] Elon matched and paid $1.5 million of the total cost of $2.5 million.
[2] Norfolk Southern matched and paid 50% of the total cost of $8 million.
[3] Norfolk Southern matched and paid 50% of the total cost of $3 million.

Appendix B: Future Capital Improvement Commitments for the North Carolina Railroad Company

Description	Total Estimated Cost	NCRR Cost	Estimated Completion Date
Double Track Thomasville to Charlotte	$235,255,128	$31,000,000	2017
Raleigh East - Second Main Track[1]	60,800,000	10,000,000	2016
Double Track - Morrisville to Cary	41,000,000	19,000,000	2016
Sugar Creek Road Grade Separation	34,000,000	10,000,000	TBD
New Bern Sidings[2]	25,300,000	8,000,000	2015
Neuse River Bridge 27.8 and 27.9	8,000,000	250,000	2012
Pedestrian Underpass at UNC-Greensboro	8,000,000	1,140,000	2014
Eastern Grade Crossing Improvements[3]	6,000,000	1,300,000	2013
Bridge and Culvert Program	4,670,000	2,400,000	2013
Rail work - I-85 Bridge - Yadkin River	4,444,659	3,000,000	2014
Passing Siding at LaGrange	4,070,000	4,070,000	2014
Monumentation Project[4]	2,500,000	2,500,000	2013
Trent River Bridge	1,890,000	750,000	2013
Selma Storage Track[5]	1,300,000	750,000	2014
Walker Street Bridge	TBD	1,000,000	2018
Total	**$437,229,787**	**$95,160,000**	

Note: NCRR stands for the North Carolina Railroad Company.

Source: Program Evaluation Division based on data provided by the North Carolina Railroad Company.

[1] An estimated cost for Raleigh East – Second Main Track was not available when the 2011 Annual Report was prepared.
[2] New Bern Sidings Project has been approved by the NCRR Board of Directors, but it was not finalized when the 2011 Annual Report was prepared.
[3] Eastern Grade Crossing Improvements are shown in the 2011 Annual Report as year-to-date amounts.
[4] The Monumentation Project is not shown in the 2011 Annual Report because it is not a tangible improvement to the railroad corridor like a new bridge or track.
[5] Selma Storage Track is pending approval approved by the NCRR Board of Directors.

Appendix C: Non-Corridor Properties Owned by the North Carolina Railroad Company

Property Description	County	Leased?	Year Acquired	Who Pays Property Tax?
Burke Street Lot	Alamance	No	2005	NCRR
Graham Former Station Lot	Alamance	No	1850s	Norfolk Southern
Holt Street Lot	Alamance	No	2005	NCRR
Burlington Engine House Lot	Burlington	Yes	1850s	NCRR
East 1st Street Property	Cabarrus	No	1916	Norfolk Southern
Harrisburg Former Depot Site	Cabarrus	No	1850s	Norfolk Southern
Harrisburg Industrial Park	Cabarrus	No	2000	NCRR
Kannapolis Former Station	Cabarrus	No	1850s	Norfolk Southern
Rock River Rd. Property (slope)	Cabarrus	No	1909	Norfolk Southern
4th Street Lot	Carteret	Yes	1903	NCRR
Bridges St. Lot	Carteret	Yes	1903	NCRR
Newport Lot	Carteret	No	1903	NCRR
Station and Former Industrial Lot	Carteret	Yes	1902	NCRR
Waterfront and Riparian Rights	Carteret	Yes	1902	NCRR
Wye Property Extension	Carteret	Yes	1887	NCRR
Wye Property	Carteret	Yes	1887	NCRR
Clarks Lot	Craven	No	1911	NCRR
N. Craven St. Lot	Craven	No	1899	NCRR
N. Craven Street (SW)	Craven	No	2000	Norfolk Southern
National Avenue Property	Craven	No	1850s	Norfolk Southern
Queen Street Property	Craven	Yes	1850s	Norfolk Southern
S. Front St. and Hancock St. Lot	Craven	No	1880	NCRR
Albertson Rd. Track Relocation	Davidson	No	1907	Norfolk Southern
Davidson Wide Area in Corridor (slope)	Davidson	No	1850s	Norfolk Southern
I-85 Track Relocation	Davidson	No	1906	Norfolk Southern
Lexington Depot	Davidson	Yes	1850s	Norfolk Southern
Lexington Heights Track Relocation	Davidson	No	1906	Norfolk Southern
Thomasville Former Freight Depot Parcel	Davidson	No	1850s	Norfolk Southern

Property Description	County	Leased?	Year Acquired	Who Pays Property Tax?
Upper Lake Rd. Track Relocation	Davidson	No	1906	Norfolk Southern
Durham Former Depot	Durham	Yes	1850s	NCRR
Hillsborough Rd. and LaSalle St.	Durham	Yes	2000	NCRR
Hopson Rd. Curve and Bridge Property	Durham	No	2004	Norfolk Southern
Greensboro Downtown Property	Guilford	No	1850s	Norfolk Southern
Greensboro Former Depot Lot	Guilford	No	1850s	Norfolk Southern
Guilford College Rd. Track Relocation	Guilford	No	1906	Norfolk Southern
High Point Depot	Guilford	Yes	1850s	Norfolk Southern
Hilltop Rd. Track Relocation	Guilford	No	1906	Norfolk Southern
McLeansville Former Depot Lot	Guilford	No	1850s	Norfolk Southern
W. Market Center Dr. Track Relocation	Guilford	No	1906	Norfolk Southern
West Ward Ave. Track Relocation	Guilford	No	1906	Norfolk Southern
Clayton Hwy 42	Johnston	No	1979	NCRR
Garner Track Relocation	Johnston	No	1985	Norfolk Southern
Pine Level Property	Johnston	No	2006	Norfolk Southern
Selma Downtown/Station	Johnston	Yes	1867	Norfolk Southern
Neuse Lot	Lenoir	No	1850s	Norfolk Southern
Tiffany St. and Bright St. Property	Lenoir	No	1901	NCRR
Union Station Lot	Lenoir	No	1916	NCRR
Charlotte Downtown Property	Mecklenburg	Yes	1850s	NCRR
Hillsborough Former Depot Lot	Orange	Yes	1850s	NCRR
Asbury Lot	Wake	No	1850s	Norfolk Southern
Garner Hwy 70 Property	Wake	No	2006	Norfolk Southern
Morrisville Former Depot	Wake	No	1850s	NCRR
NCRR Office Building	Wake	No	2000	NCRR
Raleigh Amtrak Station	Wake	No	1868	Norfolk Southern
Raleigh Warehouse Redevelopment Property	Wake	Yes	1850s	NCRR
N. Center and Beech St. (NE)	Wayne	No	1850s	Norfolk Southern
N. Center between Beech and E. Vine (west)	Wayne	Yes	1850s	Norfolk Southern

Property Description	County	Leased?	Year Acquired	Who Pays Property Tax?
N. Center between Beech St. and W. Holly St	Wayne	No	1850s	Norfolk Southern
Rosewood Property	Wayne	No	1977	NCRR
W. Holly Street and N. Center (NW)	Wayne	Yes	1850s	Norfolk Southern
W. Vine and N. Center St. (SW)	Wayne	No	1850s	Norfolk Southern
Waynesboro Lot	Wayne	No	1850s	NCRR

Note: NCRR stands for the North Carolina Railroad Company.

Source: Program Evaluation Division based on data provided by the North Carolina Railroad Company.

Appendix D: Property Purchased by the North Carolina Railroad Company, 2000–2012

Property Description	County	Nearest Town	Purchase Price	Reason for Purchase	Year Acquired
Harrisburg Industrial Park	Cabarrus	Harrisburg	$ 400,000	Future economic development or station property (1033 exchange)	2000
Hillsborough Rd. and LaSalle St.	Durham	Durham	1,700,000	Income generation	2000
N. Craven St. (SW)	Craven	New Bern	28,000	Buyout to improve value of main parcel (1033 exchange]	2000
NCRR Office Building	Wake	Raleigh	1,900,000	NCRR office	2000
Burlington Train Station Lots	Alamance	Burlington	440,000	Parking for passenger rail station	2002–2003
Hopson Rd. Curve and Bridge Property	Durham	Morrisville	2,023,977	Land for main curve and new bridge	2004–2006
Burke St. Lot	Alamance	Gibsonville	0	Property exchange with Gibsonville	2005
Holt St. Lot	Alamance	Mebane	22,000	Reserved for future rail access to industrial park	2005
Garner Hwy 70 Property	Wake	Garner	11,500	Track drainage	2006
Pine Level Property 1	Johnston	Pine Level	7,000	Allow closure of railroad crossing	2007
Pine Level Property 2	Johnston	Pine Level	4,000	Siding and signal project	2009
N. John St. Storage Building	Wayne	Goldsboro	25,000	NCRR already owned the property; buyout of structure that was on property under a license agreement since 1953 with Southern Railway	2005
Kinston Track Relocation	Lenoir	Kinston	60,738	Kinston track realignment - Heath Property	2008
			15,271	Kinston track realignment - Queen St. United Methodist Church Property	2008
			10,101	Kinston track realignment - Pressly Easement	2009
Total Expenditures			**$ 6,647,587**		

Note: NCRR stands for the North Carolina Railroad Company.

Source: Program Evaluation Division based on data provided by the North Carolina Railroad Company.

Appendix E: Estimated Property Taxes Paid to Local Governments along the North Carolina Railroad Company Corridor

County	2012 Estimated Property Taxes
Alamance	$ 60,345
Cabarrus	128,918
Carteret	19,550
Craven	43,318
Davidson	263,253
Durham	58,103
Guilford	339,938
Johnston	89,374
Jones	4,386
Lenoir	31,815
Mecklenburg	262,407
Orange	56,566
Randolph	3,291
Rowan	157,534
Wake	93,513
Wayne	46,543
Total Property Taxes	**$1,658,855**

Note: Estimated taxes include all taxation jurisdictions: county, municipal, and special districts.

Source: Program Evaluation Division based on estimates provided by the Department of Revenue.

NORTH CAROLINA RAILROAD COMPANY

October 9, 2012

Mr. John W. Turcotte
Director
Program Evaluation Division
300 N. Salisbury St. Suite 100
Raleigh, NC 27604

Dear Mr. Turcotte,

On behalf of our Board of Directors, we appreciate the opportunity to offer our observations and comments on the Study of the North Carolina Railroad Company (Company) and its mission by the Program Evaluation Division.

The original purpose of the creation of the North Carolina Railroad Company 163 years ago was economic development. The working model adopted at that time was a public-private partnership in a business corporation, which model and corporate mission continue today. NCRR is able to achieve its mission through strong partnerships and relationships with other economic development and transportation organizations across the state.

As with the UNC System, our mountains and coastline, our state's intellectual capital, and many other of our state's treasures, the NCRR is a unique asset which gives North Carolina a competitive advantage in pursuing economic prosperity.

We appreciate the thorough and detailed study by the Program Evaluation Division staff of the Company and its operations to understand the NCRR's unique corporate status, flexibility, and capital structure. With respect to the report, we offer the following observations and comments:

1. Sale or Retention of the Company

We take no exception to the study and evaluation in the report with regard to the Company's intrinsic and financial value to the state if retained, and the advantages and disadvantages of a sale. This is a matter for our state's leadership, through the General Assembly and Governor, to decide. We view our mission - to continue to increase the value of the Company to the people of the state - as the core objective, both in economic development and financial terms, whether the Company is retained or sold.

2. Sale or Disposition of Non-Railroad or Economic Development Properties

The sale or transfer of 13 of the 14 non-corridor properties (all of the parcels listed as "Annual Revenue below $100,000," except the Orange County land) recommended in the report

2809 Highwoods Blvd., Suite 100, Raleigh, North Carolina 27604-1000
919 - 954 - 7601 phone / 919 - 954 - 7099 fax

that are no longer used for the Company's economic development or rail purposes can be achieved and remain consistent with NCRR's mission. We would suggest, however, that the current uses of the properties and current real estate market, unfavorable to sellers, be taken into account as to the timing of any sales or other dispositions in order to maximize the proceeds of sale or other benefits. With regard to proceeds of any sales, please note Item 6(b) regarding potential uses of NCRR working capital.

3. Retention of Corporate Structure

Railroad franchises and corridors are unique assets, and have substantial value as a platform for economic development and growth. NCRR does not receive any state appropriations, and substantial property taxes are paid on NCRR assets to the cities and counties through which the line passes. Therefore, we agree with the conclusions in the report that the Company should continue as the Chapter 55 business corporation with the inherent flexibility that this status affords the state as shareholder. This flexibility helps NCRR achieve its economic development mission. The continuation of this structure also offers the advantage of maintaining a single entity, at no cost to the state, if in the future a sale of the Company were deemed necessary by the General Assembly.

4. Economic Development Value

Over the review period 2007-2012, the Company has been engaged in 31 economic development projects. The N. C. Department of Commerce - Business and Industrial Division indicates that, on average, approximately 5% of their assigned projects statewide indicate rail service or access as a selection criterion, with 2011 having a total of 11 total rail projects assigned. Currently, NCRR is actively involved in 10 economic development projects statewide. A typical cross-section of rail project sectors includes agricultural, chemical, manufacturing, distribution, containers/merchandise, and bulk commodities.

NCRR values the opportunity to engage appropriately with local, regional and statewide economic development organizations in support of their efforts to expand existing industries and attract additional employment opportunities for our state. The 2007 economic impact study by the Research Triangle Institute concluded that the NCRR's rail line touches 24% of our state's economy, and saves North Carolina businesses $198 million annually in transportation costs. The Company is providing substantial economic development capital to help create jobs for infrastructure in the state at no taxpayer expense and contributes to the ad valorem tax base.

5. N. C. Gen. Stat. Section 124-5.1

The scope of capital investments listed in N. C. Gen. Stat. § 124-5.1 has served as a guide to the Company for large capital investment decisions. The Company has partnered with many organizations in making such infrastructure investments, including the North Carolina Department of Transportation Rail and Highway Divisions, Norfolk Southern Railway, universities which lie along the rail line, and municipalities.

If the General Assembly determines that NCRR should evaluate devoting the Company's working capital to a broader range of capital or other investments, it would be helpful to NCRR's Board and management if N. C. Gen. Stat. § 124-5.1 were amended to clarify that it is the intent of the General Assembly that such other investments, if any, are encouraged.

6. Dividends and Distributions to the State of North Carolina

The PED evaluation recommends that NCRR make a substantial one-time distribution of $15.5 million and annual distributions of approximately $3.7 million to the state, and directed to the General Fund.

(a) A key objective of the Company is to enhance the asset by adding double track, signals, replacing aging or weight restricted bridges, straightening curves, etc. If Recommendation #2 in the PED Report were adopted, NCRR may have to defer several capital projects which are currently less than 100% funded, including future double tracking between Raleigh and Garner and between Cary and Morrisville, the relocation of storage tracks out of downtown New Bern, or forego other projects if partner contributions to the projects cannot be obtained. A required distribution of a substantial part of the Company's available capital could delay such projects and preclude additional (new) capital projects if required capital outlays exceed available NCRR income. The scope and timing for the double track projects will be determined by ongoing analyses in 2012-13 of whether the NCRR can absorb additional trains on the line without adding the infrastructure capacity, and at what rate freight and passenger traffic continues to grow.

(b) While not currently a budgeted capital item, over the past few years NCRR has been evaluating whether, over the long term, it might partner in investing in a large industrial property (mega-site) to attract a new rail served manufacturer such as an automobile assembly plant. North Carolina is currently the only southeastern U. S. state without a major assembly plant. Reduction of NCRR working capital would likely preclude availability of capital for such an investment if such investment is warranted, unless such capital were otherwise set aside by the General Assembly from future NCRR dividends or other sources.

(c) If the General Assembly were to decide to require a NCRR dividend or distribution to the state, a designation of use of such dividends or distributions for economic development purposes (non-taxpayer dollars), instead of the General Fund, could permit the funds to be used for purposes aligned with the Company's mission.

We recognize that the foregoing are far reaching capital investment and revenue policy decisions, and we offer these comments only as information. We appreciate the General Assembly's attention to this topic and look forward to receiving further direction in this regard.

7. Strategic Plan and Vision

Following the $71 million acquisition of shares by the State in 1998 and renegotiation of the Norfolk Southern Trackage Rights Agreement in 1999, the NCRR Board of Directors and management engaged in two significant strategic planning processes (2008 and 2011), and two Mission Statement processes (2001 and 2010).

These four mission and strategy efforts, led by the NCRR Board, resulted in the capital investment program, adopted by the NCRR Board in 2000-2001, and now maintained and followed by the Company's management. We believe that NCRR does have very clearly defined goals – notably the efficient planning and execution of the capital investment program, developing and implementing effective strategies for the protection of the corridor, and vigorous engagement in economic development.

As examples, in the early years of the development of NCRR's capital program, it became apparent that the rail line east of Raleigh was in need of major bridge and track upgrades, and the line to the west was in need of additional track capacity associated with NCDOT's pursuit of additional passenger trains as well as expected increases in freight growth. $10 million of the capital investments in eastern North Carolina were expressly authorized by the Legislature in connection with the 1999 Norfolk Southern Agreement.

NCRR's business strategy for the period 2001-2012 has been simple and straightforward – upgrade the line to the east, and add line capacity to the west, leveraging federal funds to the maximum extent possible, in order to create value for economic development, increase value to the shareholder, and support the rapid growth in the state's population. Federal funds for freight projects are typically very limited. Federal funds for passenger projects have been, until very recently, more plentiful. This approach resulted in a strategy with the North Carolina Department of Transportation and Norfolk Southern for well over $600 million of rail investments along NCRR in between 2001 and 2017.

It is noteworthy that during this period, rail business in eastern North Carolina has increased substantially. In the 1980's and 1990's, rail traffic was declining and the line was deteriorating. The recent increase is due to a number of factors - marketing and investment by Norfolk Southern, NCRR, and economic developers, availability of rail served industrial sites in the region, and increased capital investment.

As the PED report notes, at the end of July 2012, Norfolk Southern gave notice of renewal of the entire line for the next 15 year term beginning in 2014, providing for the continuation of rental and maintenance under the same terms and conditions set forth in the 1999 Agreement. At the September 2012 meeting of the NCRR Board of Directors, the Board appointed a special ad hoc committee of directors to address future Strategic Visioning. This Board level emphasis on developing key directives for the next phase of NCRR's business and strategic plan will support the outcomes of the PED study process and any related Legislative recommendations.

8. Board Structure/Governance

The report includes a recommendation to "adjust board appointments" to include two interlocking directors with the Department of Transportation. While there is precedent for such dual roles in the discretion of the appointive bodies, we believe this is a policy issue that has advantages and disadvantages to be weighed by the General Assembly. We also offer that if interlocking Board positions are pursued, then close consideration be given with respect to the N. C. Department of Commerce and the state Economic Development Board.

9. Reporting and Accountability

Each year, NCRR has furnished annual reports, financial information, property information, and other information as called upon by the General Assembly and staff for purposes of reporting, meetings, and presentations/updates. These reports have provided timely, regular information. To the extent that the General Assembly would like greater detail in these reports, this information will be provided. (Updating NCRR's reporting requirements does not necessarily require legislation because NCRR is a Chapter 55 corporation managed by a 13-member Board of Directors. The Board of Directors will adopt reporting and other policies which conform to the wishes and needs of the General Assembly.)

With regard to the annual one-page addenda which were apparently omitted for years 2007-2010, these reports have been prepared and submitted to the PED staff. We apologize for this oversight. However, we do wish to note that every year NCRR has provided annual reports, including audited financial statements, to General Assembly committees and staff. These reports include NCRR's capital investments, capital improvements, cost information, discussion of material transactions, and other information.

In conclusion, we appreciate the opportunity to comment on this report and look forward to the discussion and recommendations of the PED Oversight Committee as it deliberates on the North Carolina Railroad as a key asset to our state and its economic future. We are available to the Committee and PED staff at any time to provide more information or to answer questions as they arise.

Sincerely,

John L. Atkins, III
Chairman

Scott M. Saylor
President