Appendix 3. Analysis of Potential Rail Development Funding Programs for Minnesota

Overview

Based on outreach with peer states, railroads, economic development agencies and some members of the freight community, several recommendations were assembled to enhance existing programs such as TED and MRSI in an effort to meet or increase demand for the programs and improve freight rail economic development. This analysis is also informed by a review of freight rail investment programs offered by the peer states as well as other states that have been identified by the research team or members of the freight community as worthy of further investigation. Following is a comparison of MRSI with the programs offered by various states across a number of parameters, such as eligibility, funding level, funding source and type of program (loan, grant, etc.). In addition to recommendations regarding enhancement to TED and MRSI programs, examples of other rail-related investment incentives are provided for consideration. Finally, the issue of rail program funding and how it has been addressed by other states is discussed.

Options to Enhance the Transportation Economic Development (TED) Program

TED is a competitive grant program established in 2010 as a collaborative effort between MnDOT and DEED. Legislation codifying the program was passed in the 2013 session in the Omnibus Transportation Finance bill, as Chapter 174.12.[38] Under the current funding, the program is primarily targeted at Trunk Highway construction projects.[39] There is a trend in other states to fund multimodal transportation programs to capitalize on the synergies among various modes of transportation and create an integrated, transportation network that can take advantage of the relative strengths of the different modes of transportation.[40] With an expanded source of funding, the TED program could become a more multimodal transportation program.

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[38] Minn. Stat. 174.12 Subd. 7.
https://www.revisor.mn.gov/bills/text.php?number=HF1444&version=5&session=ls88&session_year=2013&session_number=0 (accessed September 11, 2013). The statute directs the development of an objective project evaluation criteria methodology "to prioritize and select projects on the basis of (1) the extent to which the project provides measurable economic benefit; (2) consistency with relevant state and local transportation plans; (3) the availability and commitment of funding or in-kind assistance for the project from nonpublic sources; (4) the need for the project as part of the overall transportation system; (5) the extent to which completion of the project will improve the movement of people and freight; and (6) geographic balance. Minn. Stat. 174.12 Subd. 5.

[39] Since the program's inception, funding has come primarily from MnDOT trunk highway fund resources (bonds and cash) and DEED general obligation bonds, which have statutory and constitutional limitations restricting the types of projects that are eligible. See MINN. STAT. §161.20 Subd. 3 (2012). Alternative, flexible revenue sources would increase the scope of economic development projects that would qualify for the program. The statutory language of 174.12 provides for the establishment of two transportation economic development accounts for the program—one in the special revenue fund and another in the trunk highway fund; however, only trunk highway funds were appropriated.

[40] Many states have emphasized goals of improving a multimodal transportation system. For example, Florida's 2009 Rail Plan explains "Florida's future economic competitiveness and quality of life require meeting increasing

demands for moving people and goods in a sustainable manner… As Florida responds to this increased need for mobility, we must also meet rising business and household expectations for safety, security, efficiency, and reliability while preserving Florida's rich environment and livable communities. Furthermore, uncertainty in the future cost or availability of fossil fuels, as well as the growing awareness of the need to reduce greenhouse gas emissions, suggests a shift towards greater emphasis on rail transportation systems…. Clearly, no single mode of transportation will sufficiently serve the growing demand for the mobility of people and goods in Florida. Therefore, Florida must place a stronger emphasis on a multimodal interconnected system if the state is to be well positioned to compete globally in the 21st century." Cambridge Systematics et. al, *The Florida Rail System Plan: Policy Element,* p. 3-1 (March 2009) http://www.dot.state.fl.us/rail/PlanDevel/Documents/2009PolicyElementoftheRailSystemPlan-webfinal.pdf (accessed September 10, 2013). One key implementation strategy to meet Florida's goal regarding mobility and economic competitiveness is "continue to support expansion of the multimodal transportation system with rail playing a critical role." *Ibid*, p. 3-8.

Other states have implemented transportation economic development programs that are available to multiple modes of transportation. For example, the Kansas DOT's Economic Development Program provides $10 million annually in grants for "**[a]ny transportation project that can be shown to support job growth or capital investment in the State**. All modes are eligible, including road projects on and off the state-system, rail projects, airport improvements and public transit investments." Kansas Department of Transportation, *Economic Development Program*, (May 2011) http://www.ksdot.org/TWorks/EcoDevo/downloads/fact-sheet_ed_2011.pdf (accessed September 10, 2013) [emphasis in original].

In Ohio, the Ohio Logistics and Distribution Stimulus Program provided loans of $100 million over three years. Ohio Department of Transportation, *2010-2011 Business Plan*, p. 23 http://www.dot.state.oh.us/policy/2010-2011BusinessPlan/Documents/ODOT2010-2011BusinessPlan-WEB.pdf (accessed September 11, 2013). "Eligible capital infrastructure projects include road, rail, air and port improvements that expand connectivity to logistics and/or intermodal centers, reduce checkpoints, and freight bottlenecks, and enhance the flow of freight and/or improve access to new markets for Ohio businesses." Ohio Department of Transportation and Ohio Rail Development Commission, *Chapter 11: Rail Funding and Finance Options*, Ohio Statewide Rail Plan Final Report, p. 11-2 (May 2010) http://www.dot.state.oh.us/Divisions/Rail/Programs/StatewideRailPlan/Documents/Ohio%20Statewide%20Rail%20Plan%20-%20Final%20Report%20Complete.pdf (accessed September 11, 2013).

*Connect*Oregon is a $382 million, multimodal transportation fund created to invest in "air, marine, rail, and public transit infrastructure improvements...providing grants and loans to non-highway transportation projects that promote economic development in Oregon… In creating the Multimodal Transportation Fund, the legislature found that local governments and businesses often lack sufficient capital and technical capacity (i.e. engineering, planning, labor and/ or equipment) to undertake multimodal transportation projects and that public financial assistance can help support these long-term economic growth and job creation projects." Oregon Department of Transportation Freight Planning Unit, *ConnectOregon Report*, p. 1-2 http://www.oregon.gov/ODOT/TD/TP/CO/ConnectOregonReport.pdf (accessed September 11, 2013). In 2013, the Oregon Legislature approved a fifth round of ConnectOregon fund in the amount of $42 million, which is in addition to the $340 million previously approved in four prior rounds of funding. See http://www.oregon.gov/ODOT/TD/TP/pages/connector.aspx (accessed September 11, 2013).

There is demonstrated demand and need for this type of program that cannot be met due to the nature of the current funding source. The most recent Governor's budget included a request for $20 million from general funds.[41] This would have opened the TED program to other projects in addition to Trunk Highway construction.[42] Ultimately, the Legislature approved $20 million for the biennium from Trunk Highway funds. In the interim period between the presentation of the Governor's budget and the Legislature's approval and under the assumption that the program may be available to non-Trunk Highway projects, MnDOT received applications for projects that ultimately were rejected because they did not qualify for the funds that were ultimately available for the program. Based on data provided by MnDOT, 25 applications were submitted in April 2013: seven from the Twin Cities metropolitan area and the other 18 from Greater Minnesota. Of the 25 projects requested funding in the amount of $74 million, five were selected for a total program funding of $16 million. Eleven of the 18 projects from Greater Minnesota (44 percent of all applicants statewide) had no Trunk Highway component and so ultimately they were ineligible for TED funding and not considered. For these 11 projects, the requested funds under the TED program were $23 million on projects with an estimated total cost of $41 million.

Assuming a source of additional funding could be secured, a portion of the TED funds could be available in the form of forgivable loans. Forgivable loans are available in other states.[43] Loan forgiveness is typically conditioned upon the achievement of pre-determined performance measures that are commensurate with the project size, scope, and public funding. The program participant can earn loan forgiveness by meeting specified performance measures—if the recipient is unable to meet the agreed upon measures, then loan forgiveness is not triggered. Examples of performance measures include achievement of job creation, retention and wage commitments, track improvement or upgrades goals, and increased carload traffic.

In addition, eligible applicants should demonstrate planning partnership engagement to help ensure early involvement of railroads and local interests. For example, requirements for railroads (short lines, Class I and Rail Authorities) might include participation with MnDOT in annual capital planning efforts and providing freight data for rail and highway planning purposes. Proposals should include letters expressing support for the project from railroads demonstrating an understanding of the nature, size, and scope of the project—it is essential that the railroads be engaged in any rail-related project proposal. Proposals with letters of support from public agencies such as port authorities, counties, and economic development agencies are helpful and should be given priority. In addition, under the current statute some priority is to be given to projects with a commitment of funding or in-kind assistance from

[41] Governor Dayton, *Budget for a Better Minnesota*, FY2014-14 Proposed Budget, pp. 11-12, & 20 http://www.mmb.state.mn.us/doc/budget/bud-op/op14/presentation.pdf (accessed September 11, 2013).

[42] Scott Dibble, *Ominbus Transportation Fin/Pol Bill*, Consolidated Fiscal Note – 2013-2014 Session, p. 5 (May 15, 2013) http://www.mmb.state.mn.us/bis/fnts_leg/2013-14/S1173_1E.pdf (accessed September 11, 2013).

[43] As discussed above, the Kansas Economic Development Program is a grant program. Kansas Department of Transportation, *Economic Development Program*, (May 2011) http://www.ksdot.org/TWorks/EcoDevo/downloads/fact-sheet_ed_2011.pdf (accessed September 10, 2013). The Ohio Logistics and Distribution Stimulus Program was a forgivable loan program. Ohio Department of Transportation and Ohio Rail Development Commission, *Chapter 11: Rail Funding and Finance Options*," Ohio Statewide Rail Plan Final Report, p. 11-2 (May 2010) http://www.dot.state.oh.us/Divisions/Rail/Programs/StatewideRailPlan/Documents/Ohio%20Statewide%20Rail%20Plan%20-%20Final%20Report%20Complete.pdf (accessed September 11, 2013).

nonpublic sources. [44] Projects with higher private matching funds maximize private investment, increase private and local involvement early in the process, and advance the objective of private/public partnership. Examples might be projects with shippers who can provide matching funds or a per-car fee to offset a portion of the project cost could be given preference. Each interested party should have a financial contribution to the total project. Having stakeholders with monetary risk incentivizes a commitment to achieving a successful project outcome.

Expanding the funding to include non-Trunk Highway projects would provide opportunities to include projects similar to other states where funds have been spent productively on issues important to shippers and railroads, including rail access expansion, new or improved facilities and upgrades to existing tracks.[45] In addition, allowing expenditures of a portion of program funds for planning grants should be considered as has been the case in other states.[46]

Under the statute, one of the mandated bases for project evaluation is "the extent to which the project provides measurable economic benefit."[47] Many states include proposed performance measures and/or

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[44] Minn. Stat. 174.12 Subd. 5.

[45] Typical projects for Kansas Economic Development Program include access roads, turning lanes, and rail spurs. Kansas Department of Transportation, *Economic Development Program*, (May 2011) http://www.ksdot.org/TWorks/EcoDevo/downloads/fact-sheet_ed_2011.pdf (accessed September 10, 2013).

Ohio's Logistics and Distribution Stimulus Program helped "spur Ohio's logistics and distribution industry. [The program] created and retained more than 1,400 direct jobs with these investments, including projects advancing the National Gateway freight rail corridor, the Cleveland Port Authority, and the multi-modal Rickenbacker initiative in Columbus. [HB 554, 6/12/2008] The National Gateway, which will be centered around a world-class freight distribution hub in North Baltimore, is projected to create more than 50,000 jobs over a 30-year period, save Ohio $70 million in highway maintenance costs, and save companies across the state $350 million in logistics costs." http://www.tedstrickland.com/job-stimulus/ (accessed September 11, 2013).

In Oregon, railroads received 44 percent of funds in the first four rounds of ConnectOregon program funding. As explained in a mandated overview on the public benefits from the investments made by ConnectOregon, "unlike other modes of transportation, railroads are predominately owned and operated by private sector entities. Railroads play a significant role in the state's economic vitality by providing Oregon businesses with a cost effective means of transporting goods. … Railroads such as Union Pacific (UP) and Burlington Northern Santa Fe (BNSF) are national, publicly traded corporations that invest a sizeable amount of funds into their operations and infrastructure both nationally and within Oregon. These private investments along with *Connect*Oregon funds have the impact of removing trucks from Oregon roads, improving the efficiency of the highway system." Oregon Department of Transportation Freight Planning Unit, ConnectOregon Report, Note to Appendix 1, Table 3 http://www.oregon.gov/ODOT/TD/TP/CO/ConnectOregonReport.pdf (accessed September 11, 2013). Examples of approved projects included rail yard improvements, 286K railroad upgrades, reload facilities, rail freight siding projects. Oregon Department of Transportation Freight Planning Unit, *ConnectOregon Report*, Appendix 2 http://www.oregon.gov/ODOT/TD/TP/CO/ConnectOregonReport.pdf (accessed September 11, 2013).

[46] Iowa's Railroad Revolving Loan and Grant Program makes a portion of the program's funds available for planning and designing rail port facilities. "Eligible projects include planning and development studies that collect information and create databases that enable a community, county or region to make fact-based decision concerning the location, design or funding requirements for a rail port facility. The end result of a planning study should help decision makers evaluate rail development options that support industrial and business progress, and economic growth in the community or region." *Railroad Revolving Loan and Grant Program Guidelines*, p. 6 (March 2012) http://www.iowadot.gov/iowarail/assistance/documents/RRLGProgramGuidelines.pdf (accessed September 11, 2013).

Virginia's Rail Enhancement Fund allocates a minimum of 90 percent of program funds for capital improvement, however "up to 10 percent to of the Fund in any fiscal year may be spent on planning and environmental evaluation leading to capital project improvements." Virginia Department of Rail and Public Transportation, *Rail Enhancement Fund—Application Procedures*, p. 6 (January 2013) https://olga.drpt.virginia.gov/documents/forms/REF%20FY2014%20App%20Procedures%20Document%20010913.pdf (accessed September 11, 2013)

[47] Minn. Stat. 174.12 Subd. 5.

a benefit-cost analysis as part of the project application to demonstrate the public benefits associated with the public expenditures of taxpayer dollars.[48] This type of analysis allows for a fair and consistent point of comparison across projects. Minnesota may want to consider an abbreviated set of performance measures for projects that are smaller in size and scope since there is a smaller investment of public funds (thereby minimizing applicant time and expenses and not increasing the overall cost of smaller, yet worthwhile, projects).[49]

Options for Updating the Minnesota Rail Service Improvement (MRSI) Program

The Minnesota Rail Service Improvement Act is codified in Sections 222.46 to 222.54 of the Minnesota Statutes. According to the Minnesota State Transportation Improvement Program (STIP) 2013-2016, MRSI "established in 1976, helps prevent the loss of rail service on lines potentially subject to abandonment by railroads."[50] There are five programs under MRSI: Rail Purchase Assistance Program, Rail Line Rehabilitation Program, Capital Improvement Loan Program, Loan Guarantees, and State Rail Bank Program.[51] Per the STIP estimated funding summary, the only program with anticipated funding during the period from 2013 to 2016 is the Capital Improvement Loan Program.[52] The Capital Improvement Loan Program is a revolving loan fund program. The following analysis will focus primarily on potential enhancements to the Capital Improvement Loan Program.

Several enhancements to the Capital Improvement Loan Program could provide for increased interest in the program and greater demand for project funding. As discussed below, proposed enhancements include: an increase in funding cap, offering grants or forgivable loans, and increasing flexibility in repayment terms.

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[48] Some states require a benefit-cost ratio in excess of 1 in order for the project to even be considered, while other states incorporate the benefit-cost test as one consideration in the assessment process. If creating a benefit-cost test is a threshold requirement, it will be particularly important to specify the test and the evaluation criteria so the applicant can be sure that outlays of time and resources to complete the application will result in an application that will be fully considered. In addition, requiring a benefit-cost ratio greater than one before a project can even be considered, may mean projects worthy for other reasons would never be considered. In addition, Minnesota may want to consider an abbreviated or simplified test for smaller projects or if the project is time-sensitive (for example, in order to attract a new business and new jobs to an area or to prevent a business from shuttering). Washington State employs a limited methodology for evaluating smaller revenue projects and a more rigorous test for larger budget projects.

[49] This idea is similar to the existing Minnesota Job Skills Partnership Program where grant requests under threshold amount of $50,000 have an abbreviate application as compared to larger grant requests that have a more extensive application. See Minnesota Department of Employment and Economic Development, *Partnership Pathways Short Form Application Instructions*, (June 2008) http://www.positivelyminnesota.com/Programs_Services/Minnesota_Job_Skills_Partnership_(MJSP)/Word/Partnership-Pathways_Short_Application_Instructions_Forms.doc (accessed September 12, 2013).

[50] State of Minnesota, *2013-2016 State Transportation Improvement Program (STIP)*, p. B-1(1) (September 2012) http://www.dot.state.mn.us/planning/program/pdf/STIP/2013-2016_STIP_11-14_revised.pdf (accessed on September 11, 2013).

[51] State of Minnesota, *2013-2016 State Transportation Improvement Program (STIP)*, p. B-1(1) (September 2012) http://www.dot.state.mn.us/planning/program/pdf/STIP/2013-2016_STIP_11-14_revised.pdf (accessed on September 11, 2013). The Loan Guarantee program is codified at Minn. Stat. 222.55 to 222.62. The State Rail Banking Program is codified at Minn. Stat. 222.63.

[52] State of Minnesota, *2013-2016 State Transportation Improvement Program (STIP)*, Figure B-3 (September 2012) http://www.dot.state.mn.us/planning/program/pdf/STIP/2013-2016_STIP_11-14_revised.pdf (accessed on September 11, 2013).

The maximum loan amount of $200,000 for the Capital Improvement Loan Program is inadequate and should be increased. Increasing the cap would bring the program more in line with other states. Funding levels vary across the states, but comparable loan program limits are in the millions of dollars.[53] The $200,000 cap is substantially too low given the nature and overall cost of rail infrastructure projects—particularly in light of the peer states' "think big" strategy.

Potential grants or forgivable loans could be considered if additional funding can be secured.[54] Many states have similar programs with a grant or forgivable loan element as discussed above. Grants programs in other states typically have a larger match requirement to maximize the state funds value. As discussed above, loan forgiveness permits the public to guarantee the benefits as promised for providing the funds. In contrast to a grant program, if the applicant is unable to meet the promised performance measures, then loan repayment is required to return to funds to the public.

Flexibility on the length of the loan and the terms of repayment would also be beneficial. Longer loan terms and loan deferment may make repayment easier and default less likely. In cases where it is expected to takes time for the project to generate a return on the investment, an extended loan period (with smaller monthly payments) or a deferment period allows time for the project to reap economic benefits making it easier for the recipient to repay the loan funds. In addition, less frequent payments—such as quarterly or annual payments—may decrease program administrative costs.

As discussed above with regard to the TED program, having a portion of funds available for planning purposes can be beneficial. The MRSI legislation allows the use of loans for planning purposes;[55] however, state bonds require an asset that can be put under lien, so the source of the program funding would be critical to realizing the potential benefits from planning.

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[53] North Dakota is similar to Minnesota in that its program is funded from revolving loan proceeds; its program application indicates that the loan program has a $1 million dollar cap. North Dakota Department of Transportation, *Local Rail Freight Assistance Program Application Instructions*, p. 10 www.dot.nd.gov/divisions/planning/docs/**LRFA**-APP-PART-I-II(3).doc (accessed September 11, 2013). However, the North Dakota Rail Plan indicates that the last four projects were funded at levels between $1.5 and $2.5 million. Upper Great Plains Transportation Institute, *North Dakota State Rail Plan*, p. 168 (December 2007). http://www.dot.nd.gov/divisions/planning/docs/railplan.pdf (accessed September 11, 2013).

Wisconsin's Freight Railroad Infrastructure Improvement Program project limit is $3 million. "Freight Railroad Infrastructure Improvement Program Part I—Application Instructions," p. 3 (2014).http://www.dot.wisconsin.gov/localgov/docs/friip.pdf (accessed September 12, 2013).

Iowa's Railroad Revolving Loan & Grant Program funding cap is tied directly to the number of new jobs that would be created and retained jobs--$6,000 per job for grants and $12,000 per job for loans. *Railroad Revolving Loan and Grant Program Guidelines*, p. 2 (March 2012) http://www.iowadot.gov/iowarail/assistance/documents/RRLGProgramGuidelines.pdf (accessed September 12, 2013).

[54] Forgivable loans and grants are not sustainable under the current revolving loan funding mechanism.

[55] Minn. Stat. 222.50 Subd. 7(a)(8).

In addition to these changes to the Capital Improvement Loan Program, the benefits of and need for a loan guarantee program have been raised during the study.[56] While the enabling legislation for a loan guarantee program is in place in Minnesota, the default reserve that is necessary to guarantee a loan has not been funded. The law requires that MnDOT set aside an amount equal to the loan if a guarantee is made. Appropriating funds for this program would meet a stated desire for this type of program and increase the efficacy and usefulness of MRSI.

[56] Minnesota's Loan Guarantee Program has been called out as an example of a tool that can be used for freight and passenger rail financing. CTC & Associates LLC, *Rail Preservation Programs: A Survey of National Guidance and State Practices*, p. 74 (June 21, 2011) http://www.dot.ca.gov/newtech/researchreports/preliminary_investigations/docs/rail_preservation_preliminary_investigation_6-21-11.pdf (accessed September 11, 2013).