



Chautauqua, Cattaraugus, Allegany & Steuben Counties

Southern Tier Extension Railroad Authority

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John Margeson, Chairman**

History of STERA's Abatement Process

The Southern Tier Extension is a 145-mile long mainline railroad that connects Corry, Pennsylvania to Hornell, New York. It passes through Jamestown, Falconer, Randolph, Salamanca, Olean, Cuba, Friendship, Wellsville, and Alfred Station, and to the west, extends into Pennsylvania to Corry PA. Once a part of the Erie Lackawanna system, the Southern Tier Extension once was a 75 mile-per-hour mainline freight and passenger line. The economy of southwestern New York State was in large part developed because of its rail system, of which the line which now is the Southern Tier Extension was a primary part.

The Southern Tier West Regional Planning & Development Board (STW) has been working on issues surrounding the Southern Tier Extension railroad line since the mid 1980's. In the 1980's, Conrail, which owned all of the line between Corry PA and Hornell NY, pretty much did not use any of the line (i.e., it was "dormant"), with the exception of the segment from Jamestown to Olean, which by the mid-1990's, because of Conrail's attitude toward serving small volume customers on this line, served two customers (Agway and Monofrax in Falconer) totaling 75 carloads per year.

Conrail's negative attitude toward the line derived from the fact that it had a parallel east-west line in Pennsylvania that made the Southern Tier Extension line redundant. Conrail also did not like the fact that it paid over \$1 million in real estate taxes on the Southern Tier Extension line to local taxing jurisdictions in New York State (i.e., counties, cities, towns, villages, and school districts). In contrast, since Pennsylvania does not impose real estate taxes on railroad real estate, the Pennsylvania mainline was a lower overhead cost railroad line. (Note that there were no real estate taxes imposed on the western-most section of the Southern Tier Extension from the Pennsylvania line to Corry PA, because of this fact.) Accordingly, from Conrail's perspective, and especially since there were no high volume shippers along the Southern Tier Extension line, the Pennsylvania mainline was a preferable line compared to the Southern Tier Extension. Conrail had decided to formally abandon the line, ripping up the track and salvaging the steel.

However, Conrail had an obligation to provide service on the Southern Tier Extension through an agreement with NYS DOT known as the Southern Tier Agreement, but Conrail's pricing and maintenance practices effectively shut down completely the segments west of Jamestown and east of Olean. This was a strategy that Conrail employed to defeat its obligation to provide as-need service (i.e., prices were so high that no shipper wanted to ship, so maintenance obligations also were lowered).

However, the Southern Tier Agreement was to expire in 1998. In the years preceding the expiration, the four counties in New York and two in Pennsylvania (in which the Southern Tier Extension is located) were concerned that after the agreement expired, Conrail would formally abandon the line between Corry PA and Hornell NY and tear up the track. The counties felt that if the track were torn up, the line never could be re-installed and become a functioning railroad line again, because the limited traffic volume would not justify the costs of re-acquiring the real estate and restoring the rail line. The

counties saw the railroad line as an important economic asset, and were determined to save the rail line from its probable demise.

Accordingly, the counties embarked on a strategy to retain the railroad line. The strategies of the counties in PA and NY differed, but ultimately became complimentary. In New York the four counties agreed to designate STW as their lead agent in the process. NYS DOT then gave STW its rights under the Southern Tier Agreement to negotiate with Conrail and its successors.

STW began a multi-year strategy of negotiating the purchase of the line from Conrail. The initial strategy was to land bank the line once Conrail ceased operations on it in 1998, and wait until the line became economically viable to operate once again (e.g., as fuel prices escalated). A less-desirable fall-back strategy was to keep the parcels intact for use as trails. The negotiating process that was replete with many unanticipated turns and strategic re-starts. At one time, the four NYS counties proposed creating a non-profit corporation to acquire, own, and operate the line; however this process was brought to a halt in the mid-1990's when CSX and Norfolk Southern Corporation announced their proposed acquisition and division of Conrail's assets.

Subsequently, STW began negotiating directly with Norfolk Southern Corporation (NSC), which was the railroad that would acquire the Southern Tier Extension line in the CSX/NSC acquisition of Conrail's assets. During this period, STW became a formal party of record in the federal Surface Transportation Board's (STB's) review of the proposed acquisition of Conrail's assets by CSX and NSC. STW hired a Washington, D.C. attorney who practiced in front of the STB, and provided testimony and written commentary to the STB. In May 1998, weeks before the Southern Tier Agreement was to expire, STW, NSC, and the NYS DOT executed an agreement (the "1998 MOU") that provided a strategy for insuring that the line would continue to have service after NSC acquired it. In part, the 1998 MOU provided for the abatement and payment in lieu of taxes (PILOT) on the line.

In July 1998, the STB approved the acquisition and division of Conrail's assets by CSX and NSC. The Southern Tier Extension line was to be transferred from Conrail to Norfolk Southern. The STB decision formally incorporated the May 1998 MOU agreement into its decision as the STB's approved strategy for the Southern Tier Extension line.

In the summer of 2000, at the request of the four New York counties, the NYS Legislature created the Chautauqua, Cattaraugus, Allegany, and Steuben Southern Tier Extension Railroad Authority (STERA) as a local public authority. STERA was an essential element of implementing the 1998 MOU to return the entire Southern Tier Extension railroad line to local and mainline through service, inasmuch as the NYS Legislature gave STERA the legal authority to provide the abatement and PILOT.

In late 2000, on behalf of STERA, STW began negotiating a revision of the May 1998 agreement that would explicitly make STERA a party to the May 1998 agreement, provide for the redress for certain other tax abatement issues, and address certain specific service commitment obligations by NSC. This agreement was executed in January 2001.

In February 2001, STERA executed an agreement with Norfolk Southern Corporation under which Norfolk Southern Corporation transferred title to the Southern Tier Extension real estate and improvements between Corry PA and Hornell NY to STERA for a period of years, after which the title was to revert back to Norfolk Southern Corporation. The agreement also provided that Norfolk Southern Corporation was to lease the Southern Tier Extension line from STERA during the period of years that

STERA owns the line. STERA exercised its statutory power to abate real estate property taxes that would otherwise be owed on the portion of the Southern Tier Extension line located in New York State (as noted above, Pennsylvania does not tax railroad real estate). This abatement structure was designed to provide a low cost operating environment that would encourage the return of rail service to the entire 145 miles of the line between Corry PA and Hornell NY.

In March 2001, STERA approved the long-term (30-year) sub-lease by Norfolk Southern Corporation of the Southern Tier Extension line to the Western New York and Pennsylvania Railroad Company (WNYP). Under the terms of this sub-lease, WNYP operates the Southern Tier Extension line. WNYP also since has acquired outright ownership of the connecting section of line from Corry PA to Meadville PA. WNYP's Southern Tier Extension trains now connect with Class 1 service (Norfolk Southern) at Meadville PA and Hornell NY. WNYP is the operator and operates trains and provides service to freight shippers from Corry PA to Hornell NY; NSC has retained operating rights on the line and has operated overhead (coal) trains on the line; NSC does not provide service to local freight shippers from Corry PA to Hornell NY.

Decades of deferred maintenance by the prior owner Conrail had left the line needing extensive rehabilitation in order to bring it up to a safe and economical operating condition. STERA, STW, and WNYP have been working on an ongoing basis since 2001 to secure low-cost state and federal funding for the rehabilitation of the Southern Tier Extension line. The first phases of an ongoing multi-year rehabilitation work program began in August 2002, and have continued ever since when grant funds and WNYP matching funds are available for this purpose. STERA, STW, and WNYP expect this rehabilitation, upgrade, and maintenance effort to continue over a number of years.

As of the fall of 2003, however, STERA and WNYP had sufficiently rehabilitated the line so that commercially viable local service was re-established over the entire 145 miles of the line between Corry PA and Hornell NY, with functioning interchange connections to Norfolk Southern at Meadville PA and Hornell NY. (The section from Olean to Hornell had been totally out of service for years.)

STW completed a study in 2009 that documented the feasibility, selected the most appropriate site, and prepared preliminary engineering for a freight transload facility IN Olean NY. Based on this study and the recommendation of WNYP, STERA has decided to construct (on a phased basis and pending state and federal funding) a freight transload facility in Olean NY, which could lead to container service as traffic volume grows.

In December 2006, STERA was approached by Norfolk Southern Corporation and WNYP, who indicated that Norfolk Southern intended to lease the portion of the Buffalo Line that is north of Machias Junction to the Buffalo & Pittsburgh railroad company. Additionally, NSC and WNYP indicated that Norfolk Southern intended to lease the portion of the Buffalo Line that is between the Pennsylvania State Line and Driftwood PA to WNYP. NSC and WNYP also indicated to STERA that it no longer intended to operate the portion of the Buffalo Line that is between Machias Junction and the Pennsylvania State Line, and probably would formally abandon it. NSC and WNYP proposed that STERA, NSC and WNYP enter into an arrangement on the portion of the Buffalo Line that is between Machias Junction and the Pennsylvania State Line that would be similar to the arrangement between the parties on the Southern Tier Extension. That is, NSC would deed the specified portion of the Buffalo Line to STERA for a period of years, and STERA would lease it back to NSC, which would then sub-lease it to WNYP as operator, retaining trackage rights. STERA would provide a real estate property tax abatement on the line during the period of years, with a graduated PILOT in the last three years of operation that escalated to the full

tax level at the end of the period. NSC was to provide a one-time negotiated payment in 2007 to ease the first year transition to full tax abatement for the affected New York State taxing jurisdictions.

STERA felt that the long-term existence of the Buffalo Line was at jeopardy because of the lack of local freight volume on the Buffalo Line and the high costs of operation of the line for the Class I NSC. Further, STERA was convinced that WNYP operations and overall system load would be improved by integrating the Buffalo Line into WNYP operations. STERA approved this arrangement in February 2007, and the real estate transaction was filed in February 2007.

At the same time, STERA decided to extend the real estate tax abatement on the Southern Tier Extension. In STERA's judgment, the abatement was necessary to insure the viability of the line and maintain the region's investment in it since 2001. STERA felt that several factors, including the extensive historical deferred maintenance of the line and the removal of certain rail assets by CONRAIL, the deterioration of the line with the passage of time and the use of new heavier coal cars, and the inability to obtain public rehabilitation funding per the originally envisioned schedule, had caused progress toward complete rehabilitation of the line and viability of WNYP operations to be inadequate to date, and that the line's viability would be in jeopardy without the cost-stabilizing abatement.

Accordingly, simultaneously with the February 2007 approval of the Buffalo Line transaction, the STERA Board's approval of an extension of the 1998 MOU abatement term resulted in the matching of the terms lengths of the Buffalo Line agreement and the Southern Tier Extension line agreement. In fact, the Buffalo Line transaction arrangement was incorporated into the revised 1998 MOU by an agreement amending the 1998 MOU, which now expires in March 2016, with graduated PILOT payments on both lines due in years 2014, 2015, and 2016. All of the other terms of the May 1998 agreement continue with this extension.

WNYP then went in front of the Surface Transportation Board to obtain regulatory approval for the Buffalo Line proposal, which was granted in August 2007. On August 4, 2007, WNYP became operator of the Buffalo Line between Machias Junction and Driftwood PA. As a consequence of this development, WNYP has created an operations center in the Olean yard (located in Olean NY and Allegany NY), moving operations personnel from the facility in Falconer NY. WNYP has since built an engine house in the Olean yard for locomotive repair and maintenance work. WNYP's trains now additionally connect with Class 1 service (Norfolk Southern) at Driftwood PA and Machias Junction NY. There is significant customer traffic on the Pennsylvania portion of the Buffalo Line.

The mission of the Southern Tier Extension Railroad Authority is to fulfill the intent of the New York State Legislature in creating it, which was "to preserve and enhance the system of railroads serving Chautauqua, Cattaraugus, Allegany and Steuben counties in New York state and Warren and Erie counties in the Commonwealth of Pennsylvania, so as to insure a healthy economy for these counties." In other words, STERA's plan is to invigorate the southwestern New York and northwestern Pennsylvania economy by re-invigorating its railroad system. With respect to the Southern Tier Extension Line and Buffalo Line, STERA's success in this regard will be a function of the financial viability of railroad operations on the Southern Tier Extension Line and Buffalo Line, and hence a function of the financial viability of the operator WNYP.

Moving forward, STERA and Southern Tier West are working in partnership with WNYP and the other railroad operators to improve access to rail service by potential rail shippers in the region. Initiatives include rail sidings, intermodal access, and other economic development activities along the lines.

Summary of Specifics of Current STERA Abatement

There is a 100% real estate property tax abatement for 10 years (2007 – 2016) on the property included in the transfer to STERA on the Southern Tier Extension line and the Buffalo line that are in NYS. (There is no property tax on railroad property in Pennsylvania.)

This abatement is offset by PILOTS that are to be paid by NSC to STERA as follows:

- \$165,000 in year 2007 (transition PILOT fee)
- 33% of real estate property tax due in 2014
- 66% of real estate property tax due in 2015
- 100% of real estate property tax due in 2016

The transition fee in 2007 was 50% of the \$330,000 due collectively to all of the Buffalo Line taxing jurisdictions in 2007, which was paid pro rata amongst the various Buffalo Line taxing jurisdictions.

These 2007, 2014, 2015, and 2016 PILOTS will be distributed by STERA to the taxing jurisdictions on both the Southern Tier Line and the Buffalo Line in a pro rata fashion.

To reiterate for purposes of clarity, this abatement / PILOT schedule covers both the north-south line and the east-west line for the years 2007 to 2016 inclusive, except that there is no transition payment on the east-west line in 2007. The transition fee in 2007 is distributed exclusively to the north-south line taxing jurisdictions.

The property on both the Southern Tier Line and the Buffalo Line currently is scheduled to be back on tax rolls in 2017.

NSC also pays an annual abatement fee of \$40,000 to STERA from 2007 to 2016. This fee is not a PILOT; it is used for STERA corporate operations and is not distributed to taxing jurisdictions.