

Railroad Right of Way Appraisal

by James D. Jennings

Techniques of railroad right-of-way appraisal used to determine net liquidation value under "forced sale" provisions of 49 U.S.C. 10905

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The appraisal of railroad rights-of-way has become an essential part of the regulatory process that governs railroad abandonments. Real estate appraisals are needed by the abandoning rail carriers, protesting shippers, local governments, and prospective shortline railroads to help the Interstate Commerce Commission (ICC) determine if cessation of carrier service is to be granted, and if granted, what amount of financial assistance is needed to preserve local rail service.

Used as an example throughout this article is a major Class 1 rail carrier (the railroad) that is attempting to abandon a segment of light traffic density rail line (the branchline). This railroad is assumed to be neither Conrail nor in bankruptcy as their abandonment procedures are different even though the appraisal methodologies would be the same.

Abandonment Procedures

No railroad may abandon service, salvage the rail and other materials, and dispose of the underlying real estate unless two conditions are met: (1) The ICC must find that the public convenience and necessity (PC&N)

permit abandonment and (2) no financially responsible party provides financial assistance, subsidy or purchase, under 49 U.S.C. 10905. The ICC will not grant an effective abandonment certificate unless these two conditions are met.

When a railroad files an abandonment application it must list revenues and expenses that are attributable to operating the branchline, along with its estimate of New Liquidation Value (NLV).

Although the ICC does consider the public interest in determining if PC&N permits abandonment, the most important factor appears to be whether the branch is operated at a profit by the railroad.¹ Before 1980, if a branchline had revenues of \$1,000,000 and expenses of \$800,000 then the resulting profit of \$200,000 per year would make it unlikely that the ICC would grant abandonment.

Since 1980, the ICC has determined that attributable revenues must not only cover the avoidable cost of operation but also the "opportunity cost" that the railroad forfeits by not being able to liquidate the branchline. Opportunity costs are determined by multiplying the NLV by an adequate rate of return. The NLV of the branchline is the value of the rail, other track materials, structures, and underlying real estate minus the cost of removing and disposing of these assets.

Now if a rate of return of 15.5% was applied to our sample branchline with an estimated NLV of \$2,000,000, then



the opportunity cost would be \$310,000 per year. This branchline which had previously shown a profit of \$200,000 would now show a loss of \$110,000 per year (\$1,000,000 - \$800,000 - \$310,000 = -\$110,000). It is now likely that the ICC would find that the PC&N should permit abandonment. In order to preserve local rail service the shippers or local government could offer to subsidize the railroad with a payment of \$110,000 per year or the branchline could be purchased for \$2,000,000 and operated as a shortline railroad.

When the ICC issues its initial decision that permits abandonment, it may or may not accept the railroad's estimate of NLV. If the protestants, usually the branchline shippers, were able to point out factual errors or flaws in the railroad's appraisal methodology the ICC may revise the initial estimate of NLV. However, in many abandonment proceedings this initial estimate of NLV will be virtually unchallenged.

An offerer who wants to purchase the branchline for a shortline operation (the shortline) must make an offer within ten days after the initial ICC decision is published in the *Federal Register*. There is then a thirty day period in which the railroad and shortline can negotiate a sale of the branch. At the end of this period, if no agreement is reached, the shortline can request the ICC to set the price and terms of the sale. The burden of proof is now on the shortline and it is important to understand that it must submit all of its appraisals and other value evidence

with this request. This request should also outline the exact sale area to be conveyed. The ICC then acts as a quasi-judicial condemnation tribunal and must set the price and terms of sale within sixty days of the request. This decision is binding on both parties except that the offerer may withdraw within ten days. Because of the short sixty day time period it is unlikely that the ICC will hold an oral hearing with cross examination of appraisal witnesses.

Data to Be Obtained From Railroad

Because of these strict time limits it is necessary for the appraiser to begin work before the ICC issues its initial decision. At the earliest possible time copies, or the right of inspection, of all necessary real estate information should be obtained from the railroad. If this information is not voluntarily produced sufficient time must be allowed for its legal discovery. It will be of little help if the requested information for a 100-mile branchline is made available only a few days before the appraisal is due to be sent to the ICC.

The requested information should include: a full set of valuation maps for the branchline and also for previously abandoned lines in the general area; the complete sale, lease, and utility easement files for the branch and other abandoned lines; the original acquisition deeds (OAD) for the branch; all records, accounts, appraisals, working papers and other documents used by the carrier in preparing its estimate of NLV. Permission should be requested to enter upon railroad property and unless the branchline is of a short distance, arrangements should be made for an inspection trip by hi-rail car.

Valuation Maps

Congress in the Valuation Act of March 1, 1913 ordered the ICC to inventory and value all property of the nation's rail carriers. This massive appraisal took place over the next two decades and cost the ICC and the carriers over 100 million dollars apiece. Even though railroad economists in the first half of this century debated whether this effort was worth the price, there can be no doubt that one of the great legacies of this act was the creation of valuation maps. A sample Valuation Map has been provided as a guide to the reader. It should

be noted that longitudinal distances have been compressed by a factor of 3 in order to show on the sample map what is represented on a full size valuation map that could measure up to three feet by six feet. The Deed Index, which would normally appear on the valuation map itself, is shown in Table 1. Not all carriers have kept their valuation maps as up to date and complete as that of our sample map and the appraiser should be justifiably cautious in their use. (map next page)

Valuation Methodology

The ICC will set the sale price at the Constitutional Fair Market Value which in the case of branchlines purchase under 49 U.S.C. 10905 is always considered to be NLV as opposed to a going concern value. The railroad as owner of an unprofitable branchline is entitled to be put into the same position monetarily as if there was not a forced sale of the branchline and it was free to dismantle the rail line and sell what real estate it could on a piecemeal

basis over a number of years. NLV for all practical purposes is synonymous with "scrap value."

Only right-of-way which the railroad would have fee or marketable title after abandonment is to be valued. No enhancement or assemblage factor is to be used to represent value for continued rail use. The total right-of-way would be classified into individual segments based on land use, zoning, environmental regulations, and across-the-fence (ATF) values. An estimate of the total retail base prices for the segments is estimated. Retail price is expressed as a percentage of adjacent ATF values after adjustments have been made for the physical and economic characteristics of the parcels. Retail price is then discounted to net present value to reflect piecemeal sale of small parcels over a period of several years; the inherent selling, administrative, holding costs must also be deducted.

The two leading cases which have established the legal principles and appraisal procedures to be used in

Table 1. Deed Index

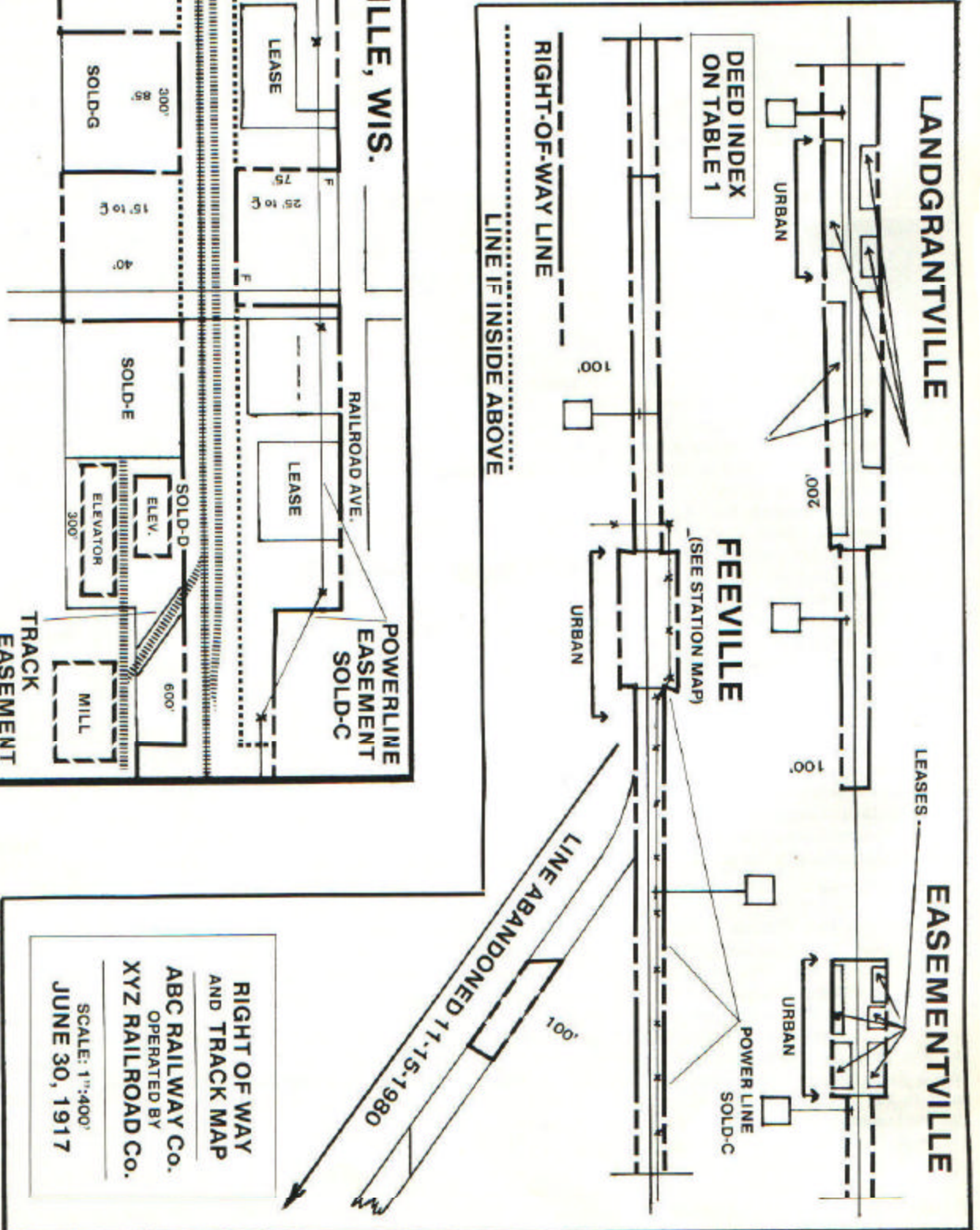
Original Acquisition Deeds (OAD)

No.	Grantor	Grantee	Instrument	Date	Book/ Page	Remarks	Area
1				1.30.1870		Land Grant Act of U.S. Congress	24.24 acres
2	J. Cook	ABC Ry. Co.	Warranty Deed	5.18.1871	25/123		6.06 acres
3			Ordinance	6.25.1871		Track in Street	
4	W. Hay	ABC Ry. Co.	Quitclaim Deed	2.10.1872	29/189		6.89 acres
5	G. Woods	ABC Ry. Co.	Easement	12.1.1871	27/239		6.06 acres
6			Adverse Poss.				6.06 acres
7	R. Small	ABC Ry. Co.	Quitclaim Deed	11.10.1871		Not Recorded	3.44 acres
8	P. Glynn	ABC Ry. Co.	Warranty Deed	6.8.1872	30/57		6.89 acres
9	E. Banks	ABC Ry. Co.	W.D. with Reversion	1.29.1872	29/45		12.12 acres
10	B. Bunn	MN&O RR Co.	Condemnation	12.19.1898	88/236		3.79 acres
	E. Hill	MN&O RR Co.	Quitclaim Deed	2.13.1899	89/38		6.06 acres

Land Changes

	Grantor	Grantee	Instrument	Date	Area	Sale Price	Unit Price
A	XYZ RR Co.	Al Farmer	Q.C.D.	6.14.1981	3.79 acres	\$500	\$132/acre
B	XYZ RR Co.	Ben Farmer	Q.C.D.	11.15.1982	3.03 acres	\$2,273	\$132/acre
C	XYZ RR Co.	Electric Co.	Q.C.D.	5.13.1984	90.91 acres	\$192,689	\$2119/acre
D	XYZ RR Co.	Grain Co.	Q.C.D.	8.1.1984	36,000 sq.ft.	\$36,000	\$1.00/sq.ft.
E	XYZ RR Co.	Chemical Co.	Q.C.D.	9.13.1979	30,600 sq.ft.	\$4,000	\$1.33/sq.ft.
F	XYZ RR Co.	Main St. Assoc.	Q.C.D.	3.10.1983	24,700 sq.ft.	\$6,120	\$25/sq.ft.
G	XYZ RR Co.	Coth Cob Inc.	Q.C.D.	4.25.1984	25,500 sq.ft.	\$7,650	\$30/sq.ft.

Sample Valuation Map



establishing NLV for nonrail use are *Lake Geneva Line*³ and the *CNJ Opinion*.⁴

Railroad Titles

It is necessary to do more than examine the generic name given to an original acquisition deed listed under "Instrument" on the Deed Index. The actual instrument must be interpreted for the title quality against current state title laws. One exception to this rule would be OAD No. 1, land grant right-of-way, which would be subject to current federal law.

After examining the actual OAD's for our sample branchline, it was determined that the railroad had originally obtained fee title to parcels No. 7, No. 8, No. 9 and No. 11 and therefore it would only be necessary to value the right-of-way east of milepost 18.

It should be noted that the railroad had not been able to sell any excess property (land within the right-of-way but not needed for transportation purposes) west of milepost 18 but that it did have ten sites under lease. The income from these leases should be included in branchline "attributable income" for determination of PC&N. The income from the three lease sites in Feeville would continue to accrue to the railroad after the end of rail service and, therefore, would be disregarded in the determination of PC&N.

Conveyance Area

Since the shortline is the party that is endeavoring to preserve local rail service, its determination of the conveyance area must be paramount to any sale area proposed by the railroad. The conveyance area must contain the full width of all land grant and other reversionary interest right-of-way. In fact, the full width of land grant right-of-way may never be alienated by the railroad; it can only be transferred to a successor rail carrier.⁵

All of the area west of milepost 18 of the sample branchline would be included in the conveyance area. All leases, easements, and licenses west of milepost 18 would be assigned to the shortline and any prepaid rentals prorated to the date of conveyance.

The income from leases on reversionary right-of-way should not be capitalized and factored into the NLV since this income would be lost to the railroad when rail service terminated.

This is consistent with the principle that value is what the owner lost, not what the taker gained. The principal of conveyance of the full width of reversionary interest right-of-way and assignment of leases is consistent with the public interest.⁶

In areas where the railroad has fee ownership, especially in sections with high urban land values, the shortline may choose the minimum conveyance width needed for its safe and efficient rail operations. It was determined for the sample branchline that a 40 foot wide conveyance width was needed for the mainline and a siding in the Feeville urban area.

Severance damages should not be awarded because the railroad has lost nothing more of value to its excess property than if the abandonment had simply been denied by the ICC.⁷

A Second Bite at the Apple?

The U. S. Supreme Court has recently ruled that after a railroad obtains an effective abandonment certificate the branchline would still be subject to state eminent domain powers and condemned for continued rail use.¹⁰ If a potential shortline purchaser had participated in the 49 U.S.C. 10905 valuation proceeding and did not agree with NLV as fixed by the ICC, could it obtain a lower NLV through state condemnation? The court stated that the ICC's determination of value may well have preclusive effect in a state condemnation, but the court also recognized that the short time limits for the ICC to determine NLV "may deprive the parties of the adequate opportunity to litigate" and thus allow "a second bite at the apple." (see page)

Interpretation of Railroad Sales

The railroad made several sales in recent years on the sample branchline which are listed as "land changes" on the Deed Index. These sales are analyzed below to illustrate right-of-way appraisal methods.

Sale A

The sale of OAD No. 10, an easement, was made by the railroad for the nominal fee of \$500 to cover conveyance cost. The buyer was not only the owner of the servient estate but also the owner of farm land on both sides of the right-of-way. The farmer wanted to remove any cloud of title caused by the rem-

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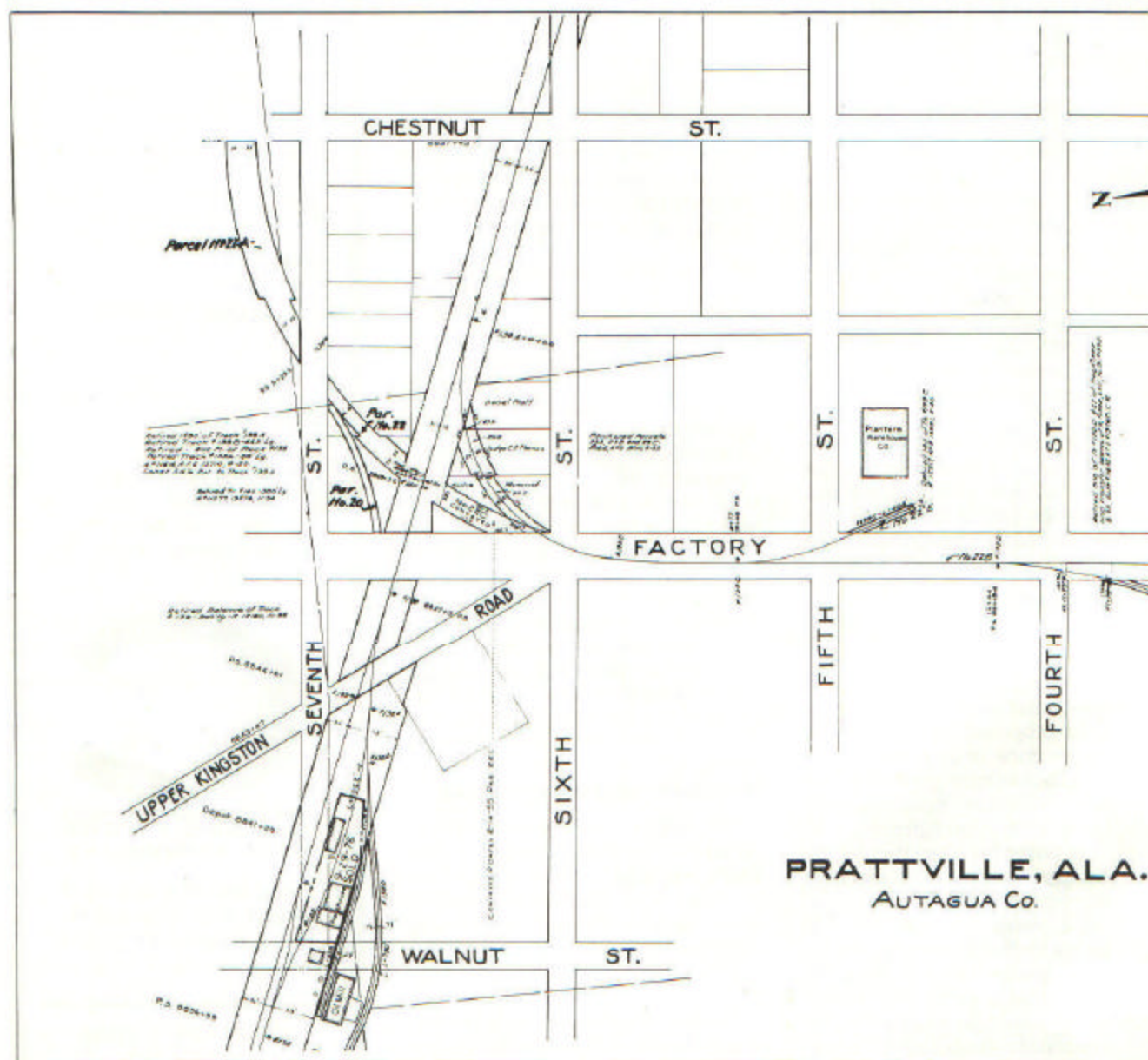
nant of the abandoned right-of-way. The railroad was able to end any possible responsibility for local taxation, fencing, weed control, and general liability.

This sale should not, obviously, be used as a comparable sale for rural right-of-way held in fee, but it does

raise the question of whether the railroad could charge the farmer some price above its nominal conveyance cost for a quitclaim deed, and if so, should such "hold-up" prices be factored in for determination of NLV. Could the railroad, for example, hold out for 50% of fee value before giving a

quitclaim deed for its easement right-of-way? In at least one midwestern state it appears that such an attempt could make the railroad liable for fraud.⁵

It is clear, however, from the *Lake Geneva Line* case that easement right-of-way must be valued at zero and the



CNU Opinion stated that no compensation is warranted for "hold up" price in determining NLV.

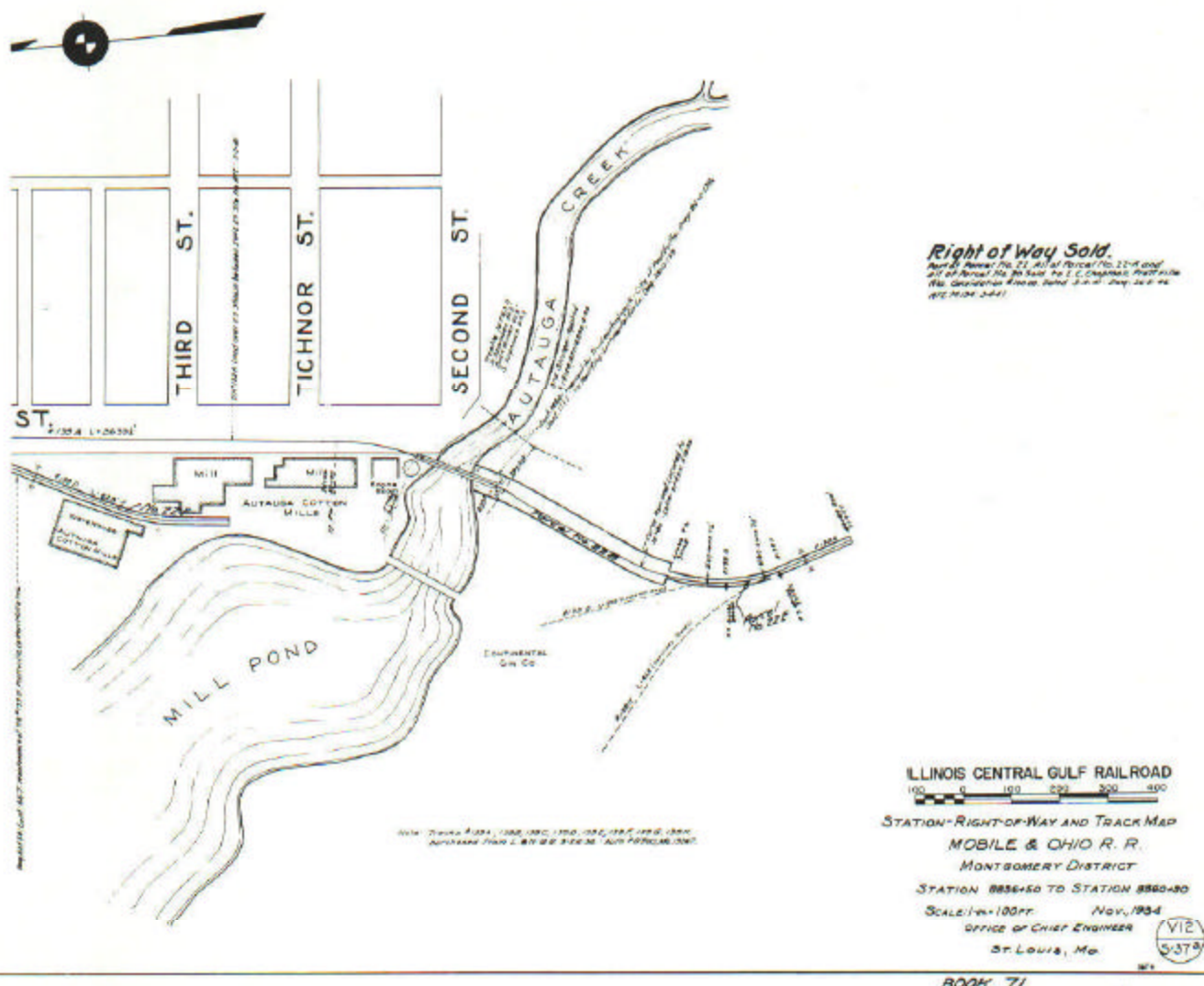
Sale B

The southeastern half of OAD No. 11, fee ownership, was sold two years after

the line was abandoned for a retail price of \$750 per acre. This transaction is considered to be representative of the average rural right-of-way sale. The average ATF value of farmland at the end of 1980 was \$1,000 per acre. This sale would indicate that rural right of way would sell for 75% of ATF value. If

average farmland now sells for \$1,250 per acre it then would be expected that the retail base value for OAD No. 7 and No. 9 would be 75% of ATF value or \$938 per acre. The retail base price would then be reduced for average time to sell, two years, and other related sale and administrative costs. (cont. next pg.)

66



Sale C

The railroad granted a permanent longitudinal easement for an existing 138 KV electric transmission line that occupies 90.91 acres in a 30 foot width for a distance of 25 miles. The occupancy is 90% in rural areas, 81.82 acres, and 10% in urban areas, 9.09 acres, and the price was based on 80% of ATF values.

A reduction in retail base value must be made for OAD No. 9 from \$938 to \$713 per acre because of this power line. This deduction was made by reducing the unencumbered retail base value by the stated cost of the occupancy. $(\$938 - (\$1250 \times .30 \times .80 \times .75)) = \713 . An alternative method would be to do a market study of abandoned lines and compare the retail prices of those lines with and without permanent easements.

Sale D

In 1954 the Grain Company leased this site for \$250 per year and constructed two large grain elevators. The standard railroad lease gave the lessor the right to cancel on thirty days notice. Thirty years ago it was the policy of the railroad not to sell any of its right-of-way, but to lease sites at nominal rents to shippers. In recent years it has been the policy of the railroad to receive maximum rental income and dispose of excess right-of-way.⁹ In early 1984, the Grain Company was given the choice of renewing its lease, still with the thirty day cancellation clause, for a yearly rental of \$7,200 or purchasing this site for \$36,000. The sale price was three times the retail price for vacant right-of-way in Feeville.

The deed provided for a twenty foot wide track easement. This is an example of how the railroad is able to sell excess right-of-way and yet retain spur lines for rail service to offline industry.

Sale E

A previous tenant used this site to store leaky drums of chemical waste. The railroad, fearing that the EPA would hold it responsible, decided to sell to Chemical Co. even though the price was one half of what normal Feeville retail values were in 1979.

Sale F

This vacant parcel has the best location in Feeville and would set the upper limit on retail base value. A unit price of \$.40 per square foot for usable area was obtained by deducting the 2,250 square feet located in Main Street and 80% of the 9,000 square foot powerline easement.

Sale G

The sale of this vacant parcel because of its poor location would set the lower limit of retail base price, \$.30 per square foot.

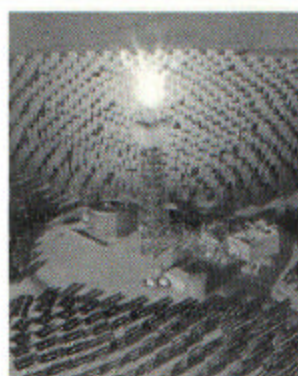
The best estimate of retail base price for the 72,000 square foot (1,800' x 40') parcel to be conveyed to the shortline in Feeville would be \$25,200 (\$.35 per square foot).

From this retail base price of \$25,200 would be deducted the usual time, administrative, selling, and holding costs. These costs could be expected to normally run between 25% and 40% of the base price, therefore the NLV of Feeville urban right-of-way conveyed to the shortline would be between \$18,900 and \$15,120.

FOOTNOTES

1. For a full description of ICC abandonment procedures, see: *Contesting the Burlington Northern's Proposed Rail Line Abandonment: Advocacy on Behalf of the Shipper in the Staggers Rail Act Era*, 58 North Dakota Law Review 239, (1982).
2. United States Railway Association, *Final System Plan, Volume 1*, Washington, D.C., 1975, pp. 239-41.
3. AB-1 (Sub-No. 70F), *Chicago & Northwestern Transportation Co. - Abandonment Between Ringwood, IL and Geneva, WI (Lake Geneva Line)*, 363 ICC 956 (1981); *Chicago & Northwestern Transportation Co. v. U.S.*, 678 F.2d 665 (1982).
4. *Central Railroad of New Jersey Opinion* (CNU Opinion), 571 F. Supp. 1269, 1278-1302, (Sp.Cl. 1983).
5. *Northern Pacific Ry Co. v. Townsend*, 190 U.S. 267 (1903).
6. *Marthens v. B&O Railroad Co.*, W.Va., 289 S.E.2d 706, 711-2 (1982).
7. Interstate Commerce Commission, AB-18 (Sub-No.33F), *C&O Ry Co. - Abandonment Comm.*, Nov. 24, 1981, p. 7.
8. *Haack v. Burlington Northern, Inc.*, Iowa App., 309 N.W.2d 147, J. Anthony DeRungs, *Reversion of Railroad Right-of-Way in South Dakota After "Haack v. Burlington Northern, Inc."*, 28 South Dakota Law Review 196 (1982).
9. Jerry Perkins, "Iowa Law Voided, So the Rock Squeezes Country Elevators Again," *Des Moines Sunday Register*, October 23, 1983, pp. 1F, 3F.
10. *Hayfield Northern RR Co. v. Chicago & Northwestern Transportation Co.*, U.S., No. 82-1579 (June 12, 1984).

THE COVER



This issue's cover photo shows Solar One, a 10-megawatt solar energy generating power plant. Solar One went into full-time commercial production in August 1984 after two years of extensive field testing (see RIGHT OF WAY - August 1982). Solar One is a joint effort of DOE, Southern California Edison Company, and the Los Angeles Department of Water and Power. Edison is now able to generate electricity from nine different sources, more than any utility in the world. The photo was provided by Edison.

Magnetic Power Plant Unveiled in Israel

An Israeli scientist has developed a unique power plant that can generate electricity from any heat source and reduce conventional fuel use by one-third, according to a UPI wire story.

Herman Branover, a professor of magnetohydrodynamics at Ben Gurion University, has unveiled a mini-plant that employs highly conductive liquid metal flowing between two poles of a magnet to generate electricity at low temperatures.

The prototype can produce 1 kW of electricity by using steam to heat and propel liquefied mercury. Branover plans to demonstrate a 10 kW semi-industrial plant in June as a prelude to a commercial-scale model capable of producing 1,000 kW or more.

Canadian Electrical Association, June, 1984.