

# Empowering Ontario's Short Line Railways

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*Photo by Michael Berry*

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# Executive Summary

*It is recommended that the federal Minister of Transport and the Minister of Transportation of Ontario work in partnership to implement the reforms necessary to ensure the long-term viability of Ontario's short line railways by:*

- *Establishing a tax credit program to offset track and bridge rehabilitation costs;*
- *Modifying eligibility criteria for federal infrastructure programs to allow short lines to apply for funding directly, without a government sponsor;*
- *Creating a federal/provincial rail infrastructure program to meet capital investment needs through grants and low-cost, long-term financing; and*
- *Assisting in the establishment of a pooled short line insurance regime.*

Ontario's regional or short line railways play a critical role as "first and last mile" feeders to the continent-wide rail system. By lowering costs and providing a more locally-responsive service, they have revived several light-density lines slated for abandonment by Canadian Pacific (CP) and Canadian National (CN). Nationally, short lines originate one-fifth of all rail tonnage.

Short lines also produce many environmental benefits, including reductions in high-carbon fuel consumption and greenhouse gas emissions. As a result, the Ontario Climate Change Action Plan has recommended a study to determine the actions required to improve short line competitiveness.

However, with only marginal profitability, these short lines have struggled to overcome the deferred maintenance they inherited from CP and CN. Adding to the pressure are new safety requirements, a lack of access to federal funding for safety upgrades and a need to improve their infrastructure to handle the 130,000-kg cars now standard on the main line railways.

Due to light traffic and revenues, as well as large operating expenditures, Ontario's short lines are generally able to devote only 12 per cent of revenues for capital investment, which is less than half the amount required to meet the rail industry's required level of re-investment.

By comparison, the U.S. short line industry is far healthier and able to invest to a higher degree because of progressive federal and state policies that recognize the ongoing need for public investment to maintain a state of good repair and attract new, revenue-producing traffic.

The challenges facing Canada's short lines were addressed in the March 2016 report of the Canada Transportation Act (CTA) Review. A strong case was made for a new rail freight policy that fully recognizes the critical role played by short lines and a need for innovative Canadian policies and funding programs based on the successful U.S. models. Greater federal/provincial engagement on all rail freight policies and programs was also recommended.

The opportunity to enact the CTA Review's short line recommendations has been created by the new federal Transportation 2030 policy announced on November 3, 2016. It pledges \$10.1 billion to eliminate bottlenecks and build more robust trade corridors. The inclusion of short lines in this strategy is critical if they are to contribute fully to Canada's global competitiveness by providing them with the policies and funding they require to not just survive, but to thrive.

# The Impact of Ontario's Short Line Railways

Short line or regional railways play a highly-specialized role in the functioning of the economies of Canada and Ontario, particularly in rural regions. Operating on light-density lines that once belonged to the main line or Class I railways (Canadian Pacific and Canadian National), they provide cost-effective, self-supporting freight service on lines the major railways could no longer serve under their higher cost structure and less flexible labour agreements.

The establishment of these short lines – more than half within the last 25 years – has preserved service

to industries that cannot be served physically or economically by trucks for a variety of reasons. They are also competitive alternatives to high-cost, high-carbon highway transport.

Ontario is home to 12 regional or short line common carrier railways, which are defined as railways with annual operating revenues of less than \$250 million for two consecutive years.

## ONTARIO'S SHORT LINE AND REGIONAL RAILWAYS

RAILWAY	OWNERSHIP
Barrie-Collingwood	Municipal
Essex Terminal	Private
Goderich-Exeter	Private
Guelph Junction	Municipal
Huron Central	Private
Nipissing Central	Provincial
Ontario Northland	Provincial
Ontario Southland	Private
Orangeville-Brampton	Municipal
Ottawa Valley	Private
Southern Ontario	Private
Trillium	Private



**ROAD COST SAVERS:** Without the services provided by the Ontario Southland Railway and other short lines, thousands of carloads of freight would be transferred to local, regional and provincial roads. This would increase public costs as a result of the additional wear and tear resulting from truck haulage of this tonnage. Photo by Walter E. Pfefferle

These railways pay more than \$30 million in wages and more than \$7 million in federal and provincial taxes annually. They handle more than 150,000 carloads each year, serving industries with annual revenues of \$4 billion. Without the cost-effective and customer-driven service provided by short lines, some Ontario industries would not be viable.

It is estimated that Ontario's short lines allow for savings in transportation costs of as much as \$616 million annually and additional socio-economic benefits of up to \$559 million annually.

Short lines are also climate change fighters. If all short line freight traffic was shifted to trucks, an additional 73,114 tonnes of greenhouse gases would be emitted. Truck haulage would also lead to additional municipal and regional funding to compensate for the additional road wear.

These environmental benefits have been recognized in the Ontario Climate Change Action Plan, which recommends a study to determine the actions required to improve short line competitiveness and thereby assist in reducing Ontario's high-carbon fuel consumption and greenhouse gas emissions.

BENEFITS	SHORT LINE VS. INTER-MODAL SHIPPING (\$ MILLIONS)	SHORT LINE VS. ALL-TRUCK SHIPPING (\$ MILLIONS)
Transportation cost savings	\$265	\$ 616
Socio-economic benefits	\$126	\$ 559
Total benefits	\$391	\$1,175

Source: *Economic Benefits of Ontario Shortlines*, Canarail for the Railway Association of Canada, 2007

# The Challenges Facing Ontario's Short Lines

One of the key challenges for Ontario's short lines today is the need to upgrade their tracks to accommodate the North American main line standard of 130,000 kg. for loaded rail cars. This standard is employed by the Class I railways with which Ontario's short lines must connect and interchange cars moving to and from local shippers on their lines.

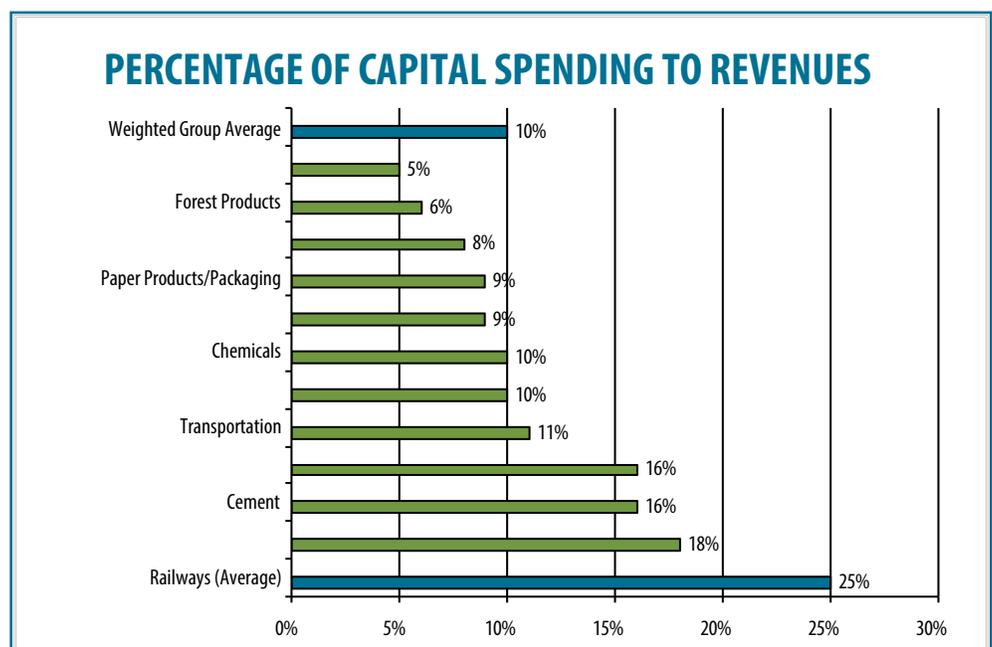
The light rails and bridges on these short lines are holdovers from the days when these lines were low-density components of the Class I rail systems. This results in weight restrictions that require cars to be loaded to less than their full limits, thus leading to the use of more cars than necessary and imposing operational and economic inefficiencies on the short lines and their shippers.

Ontario's short lines are currently at an economic disadvantage compared to other forms of transportation. Rail is one of the most capital intensive industries in Canada. On average, the

industry allocates 20 per cent of revenue to capital spending and renewal.

As opposed to trucking and other forms of transportation that enjoy considerable indirect support through access to publicly-funded infrastructure for non-compensatory user fees, Ontario's short line railways are fully responsible for their own financing and construction, maintenance, security and operations. They also pay taxes on their rights-of-way, which they must maintain through the profits they generate.

Due to light traffic and revenues, as well as large operating expenditures, Ontario's short lines have operating ratios of 92 per cent, leaving only 8 per cent of revenues for capital replacement and the generation of a return on investment. This is less than one-third of the 25 per cent required to ideally meet the entire rail industry's normal level of capital expenditures.



Source: Globe & Mail



Despite these high operating ratios, Ontario's short lines have invested heavily in restoring the deteriorated lines they purchased or leased from the Class I railways, which had deferred maintenance on these light-density lines for many years prior to their sale or lease.

Maintaining and improving this infrastructure is costly and many short lines are routinely facing costs of \$200,000 to more than \$5 million annually just to keep rolling. New ties can cost \$65 or more apiece. Replacing the light rail inherited in the takeover of these lines, which will not accommodate 130,000-kg freight cars, can easily cost half-a-million dollars per kilometre.

Simply maintaining the infrastructure for current operations – let alone capacity expansion to handle the heavier rolling stock – is beyond the financial capabilities of some short lines. One result is a reduction in their operating speeds. Lower speeds hinder overall performance and have subsequent effects on the whole supply chain, which has negative implications for rail-dependent industries and Canada's economic competitiveness.

The inability of many short lines to commit the full funding from revenues that would allow them to decisively bring their infrastructure up to the new North American standards is jeopardizing their long-term viability and that of the industries they serve. Several short line-served Ontario industries have stated they would have to reconsider the location of their facilities if they were deprived of their rail service, which contributes to their cost competitiveness.

# Oxford County's Short Line: The Ontario Southland Railway

The Ontario Southland Railway (OSR), which serves Oxford, Norfolk, Elgin and Wellington counties, exemplifies the flexibility, resilience and untapped potential of short lines across the province and the nation.

Incorporated in 1992 by then-CP locomotive engineer Jeff Willsie, the OSR began operations in April 1994, contracting with Petro-Canada to switch empty and loaded tank cars between its Mississauga lubricants refinery and the CN Oakville Subdivision at Clarkson.

The next expansion occurred on January 1, 1998, when OSR began operating the 39-km Guelph Junction Railway (GJR), which was built by the City of Guelph in 1888 as a means of providing competitive rail service for local industries, which were then captive to the Grand Trunk Railway, which later became a component of the publicly-owned CN system.

The City of Guelph leased the GJR to CP for 99 years and it became part of a CP through route from Hamilton to Goderich. After CP abandoned its own Guelph-Goderich section of the line in December 1988, it provided contract operation of the municipally-owned segment from the connection with its Toronto-Windsor main line at Guelph Junction (west of Campbellville) to Guelph's Northwest Industrial Park. However, CP declined to renew the contract in 1997.

The OSR takeover of the service on the GJR was followed on February 26, 1998, by the start-up of its own lease and operation of the 28-km CP Tillsonburg Spur from its

connection with CP's St. Thomas Subdivision at Ingersoll to the end of track at Tillsonburg. This line serves:

- Future Transfer (agricultural logistics)
- Cedar Crest Wood Products (fibre board)
- Kissner Group (salt)
- Johnson Controls (toluene)
- International Beams (lumber products)
- Wellmaster (drilling pipe and supplies)

On December 15, 2009, OSR leased CP's 52-km St. Thomas Subdivision from its connection with the CP Montreal-Toronto-Detroit main line at Woodstock to St. Thomas. Customers include:

- Ontario Refrigerated Services (refrigerated warehousing)
- Auto Warehousing Company (GM CAMI and other automotive transfers)
- Agrium (fertilizer)
- Belmont Farm Supply (fertilizer)
- Sylvite (fertilizer and grain handling)
- Messenger Freight Services (auto parts for re-packaging)
- Factor Gas Liquids (fuel distribution)
- Putnam Propane (fuel distribution)

OSR also serves as the contract switching carrier for General Motors Canada's CAMI Assembly Plant at Ingersoll. OSR moves empty multi-level auto rack cars into this facility for loading and then conveys the loaded cars to the main line Class I railways for shipment throughout North America.

**FARM SUPPORT SYSTEM:**

*Agricultural supply firms such as Sylvite, at Putnam, Ontario, depend on the flexible and cost-effective service of short lines for access to bulk commodities such as fertilizer, which often can only be supplied efficiently through rail haulage.*

*Photo by Walter E. Pfefferle*



Additionally, OSR has built two servicing facilities to accommodate its own needs and perform additional work under contract for outside clients. The Guelph Junction Shop was built in 2000 to service equipment operating on the municipally-owned GJR.

The Salford Shop was constructed in 2005 to provide mechanical servicing facilities for the growing OSR operation and to handle contract work by and for other rail industry clients. It has been expanded three times and it now accommodates 18 locomotives, as well as providing offices and crew facilities.

In addition to meeting its own needs, the OSR Salford Shop is used by ZTR Control Systems to upgrade electronics and other locomotive sub-systems for Class I and regional railway clients in Canada and the U.S.

OSR operations in Oxford and Elgin counties and at Guelph are vital cogs in the economies of these areas. The combined operation now employs 80 workers, with a monthly payroll of more than \$80,000. Throughout its 18 years of operation in Oxford County, OSR has invested in its physical plant to maintain and improve its service. Ongoing tie replacement and flash butt welding the old 39-foot rail sections to eliminate joints have been two of the major programs undertaken. Sidings extensions and additions have also been undertaken to expand capacity.

Attesting to its credibility within the Class I rail industry and with shippers, OSR was brought in to rescue another short line that failed due to a serious infrastructure problem the operator couldn't afford to repair. Under a 1998 lease arrangement with CN, the St. Thomas & Eastern Railway (ST&E) was established by Trillium Railways, a Niagara Region short line, to take over CN's operation on its Cayuga Spur between St. Thomas and Delhi. This line once formed part of a CN main line route from Windsor to the Niagara Region.

However, the deterioration of a large bridge at Tillsonburg and other upgrading projects led to a need for capital investment beyond ST&E's financial capacity. This resulted

in the termination of the lease in December 2013, at which point CN announced its intention to abandon the entire line.

This situation changed due to Siemens Canada's wind turbine manufacturing facility in Tillsonburg. The plant's initial customers were in Southwestern Ontario, allowing for the large turbine blades it produces to be moved by truck, although this is no easy task compared to rail haulage. However, the plant's current customers are outside Ontario and trucking these oversized loads long distances is not an option.

To capture these lucrative long-haul moves, CN invested \$640,000 to rehabilitate the bridge, installed 6,000 new ties and contracted with OSR to operate the line. OSR installed 3,800 ties and undertook considerable work at its own expense to re-open the line to Courtland.

Additional traffic may come from various new and existing shippers, including IGPC Ethanol's Aylmer plant, which is contemplating a doubling of its annual production of 200 million litres of fuel grade ethanol and 170,000 tonnes of distillers' grains. Traffic is also available at Delhi, but OSR cannot justify the expense of rehabilitating the line east of Courtland to capture it.

While the rehabilitation and reactivation of the Cayuga Spur is a success story for CN, OSR and the shippers, it is also a warning about the fragility of Ontario's short lines. Had this been wholly dependent on OSR investing its own capital in the full rehabilitation, it wouldn't have happened and Siemens Canada's competitive position might have been weakened. With only a marginal return on their current operations and an ongoing need for the maintenance of existing infrastructure, a project this large is beyond the capabilities of many short lines.

The OSR exemplifies the capabilities of a, locally-owned and well-managed short line. But it also underscores the fact that the full potential of short lines is not being realized in Canada.

# Needed: Canadian Public Policy and Investment Changes

The majority of Canada's short lines have been created in the last quarter-century as a result of broad multi-modal deregulatory policies first enacted by the Conservative government of Prime Minister Brian Mulroney and then expanded by the Liberal government of Prime Minister Jean Chretien. In terms of their rail components, these policies were said to be the Canadian equivalents of the three pieces of legislation that largely deregulated the U.S. rail industry:

- Regional Rail Reorganization (3R) Act of 1973;
- Railroad Revitalization and Regulatory Reform (4R) Act of 1976; and
- Staggers Rail Act of 1980.

These three pieces of legislation were designed to revive key components of the U.S. Northeast and Midwest rail system, many of which were bankrupt at the time the acts were passed. One contributor to the decline of what amounted to roughly one-quarter of the U.S. rail system had been excessive regulation, which had placed the railways at a competitive disadvantage vis-à-vis trucking and inland marine transportation, which benefitted enormously from the publicly-funded construction of the infrastructure on which they are dependent.

However, Canadian policy makers failed to grasp that deregulation was not the only driver of the U.S. rail industry's reorganization and revival. Coupled to the legislation was a considerable amount of public

funding to rehabilitate the portions of the system that would be retained after the abandonment of duplicate main lines and unprofitable light-density branches.

While U.S. deregulation made it easier for the Class I railways to abandon lines and for new short line operators to purchase them, it was federal and state assistance that made it possible for many of them to revive and improve service on lines that had suffered from years of deferred maintenance by the cash-strapped Class I railways.

This major point was missed in the formulation of federal deregulatory legislation in Canada. In point of fact, both the National Transportation Act (1987) and the Canada Transportation Act (1996) were as much about ending government investment in transportation facilities and services as they were about a reduction in regulatory constraints on carriers.

Similarly, the legislation enacted by some provinces to facilitate the establishment of new short lines under less burdensome provincial regulations was not backed by policies recognizing the need for investment. While the number of short lines nationwide has climbed from 12 in 1996 to more than 50 today, these railways have not thrived the way many of their U.S. counterparts have under the more realistic policies and programs that have been enacted there.

# Provincial Short Line Support

To their credit, the governments of Saskatchewan and Quebec have since adopted policies and funding programs that have been beneficial to the short lines within their boundaries.

Launched in 2008, the Saskatchewan Railway Sustainability Program (SRSP) has provided \$5.6 million in grants to provincially-regulated short lines, which operate about 2,000 km of former Class I branch lines. Several of these are locally owned by grain growers' cooperative committees. Based on a 50-50 funding match with the railway companies, this has resulted in more than \$11 million of repairs and capital improvements.

The SRSP is funded by the Saskatchewan Grain Car Corp., a Crown corporation that manages the Government of Saskatchewan's fleet of railway hopper cars, which are leased to producers and other shippers for the movement of western grain to domestic and export market positions.

As well, the Government of Saskatchewan provided interest-free loans to assist in the launch of some of these short lines to preserve a rail option for many farm communities. This has also benefitted provincial taxpayers, saving the cost of the road damage that would result from the abandonment of these lines and a diversion of the traffic to truck haulage.

As much as this public investment has been welcomed by the Saskatchewan short lines and their 74 online customers, it is still inadequate. The grants under the SRSP typically averaged only \$60,000 each, which is a minor amount in light of the infrastructure improvements required to get short lines up to a sustainable state of good repair and allow them to handle 139,000-kg rolling stock.

It is estimated that Saskatchewan's 14 provincially-regulated short lines now have in excess of \$30 million of shovel-ready capital projects that would remove 104,000 truckloads from provincial highways and local roads annually. This would save 51 million litres of fuel and create approximately 500 direct and indirect jobs over a three-year period. The short lines do not have the revenue and capital investment capacity to fund these projects on their own.

Even larger than the Saskatchewan program was a funding plan undertaken by Quebec between 2007 and 2014, which totalled \$100 million and included \$30 million from the federal Canada Strategic Infrastructure Fund. These grants went to projects that upgraded track and bridges, improved safety and efficiency, reduced greenhouse gas emissions and built new trans-loading facilities to transfer commodities from rail to truck and vice versa. The Quebec grants were substantial, ranging from \$850,000 to as much as \$30 million.

Although this program has ended, Quebec is assisting in the restoration of the deteriorated Gaspé Railway, a former CN line stretching 325 km from Matapédia to Gaspé. It has gone through a series of embargoes since 2011, eventually halting all freight service on the line's eastern end and suspending VIA Rail Canada passenger service over the entire route in 2013. Quebec has assumed ownership of the railway from the four regional county municipalities that previously owned it and is working to bring the western end up to a state of good repair. The future of the eastern half of the line remains uncertain.

A similar situation has occurred on Vancouver Island and others are beginning to arise.

# Rail Passenger Consequences

The Gaspé situation underscores a problem that is having serious consequences for Canadian rail passenger service. In addition to the suspended Matapédia-Gaspé route, VIA operates three other services in whole or in part over short line railways. These are:

- Toronto-London North Main Line service on the CN line that is leased to the Goderich-Exeter Railway (GEXR) between Kitchener and London;
- Winnipeg-Churchill service on the Hudson Bay Railway (HBRY) between The Pas, Thompson and Churchill; and
- Vancouver-Courtenay service on the not-for-profit Island Corridor Foundation's former CP/Esquimalt & Nanaimo (E&N) line, which is operated and maintained under contract by the Southern Railway of Vancouver Island.

Due to severe track and bridge deterioration on these short lines, VIA is now facing serious problems. Like the Gaspé route, VIA's Vancouver Island service has been suspended due to infrastructure deterioration since March 2011.



Photo by Braden Furtney

VIA's Summary of the 2016-2020 Corporate Plan noted: "The short line railways generally do not have the financial capacity to invest in infrastructure in order to maintain higher than freight train speeds. This limits the speed at which passenger trains can travel and leads to rail infrastructure deterioration. Further signs of the deterioration trend emerged as operational issues were faced in 2014 in Northern Manitoba (HBRY-owned infrastructure) and even in South West Ontario (GEXR-operated infrastructure), leading to service cancellations and suspensions or slow orders."

The only way the suspended VIA services will return and the others can be stabilized is through public funding for the rehabilitation of the short line trackage they require. As previously noted, the Government of Quebec is attempting to resolve the situation over a portion of the Gaspé route, but not the entire line. For Vancouver Island, a limited amount of federal and provincial funding to return the E&N line to operable condition has been promised, but not yet delivered. As for the GEXR's Kitchener-London line and the HBRY's line from The Pas to Thompson and Churchill, no action or public funding have yet been discussed.

Without public investment in the short line infrastructure required by VIA, the future of these passenger services is in jeopardy.



Photo ©Walter E. Pfefferle

## Short Lines at a Crossroads

Other than the longer-term commitments by Saskatchewan and Quebec, public investment in short lines has been slight and it has generally arrived only under crisis conditions. In Ontario, it was only a last-minute rescue agreement in late 2010 involving the provincial and federal governments that saved the 305-km Sudbury-Sault Ste. Marie Huron Central Railway (HCR) from abandonment. The fact that this issue swirled for four years before it was resolved was very disconcerting for HCR-dependent companies, including large employers such as the Domtar paper mill at Espanola and Essar Steel Algoma at the Soo.

The HCR indicated it was having trouble dealing with the deferred maintenance on the line in 2006 and requested government assistance to restore the line to a state of good repair. Track conditions had deteriorated to the point that numerous slow orders reduced much of the line's maximum permissible speed to 16 km/hour. This not only lengthened the scheduled running times, it also drove up operating costs by requiring more crew hours to complete the train runs.

A \$15.9-million stop gap plan in 2009 was funded largely by Essar, Domtar and the City of Sault Ste. Marie. The federal and provincials governments, through FedNor and the Northern Ontario Heritage Fund Corporation, contributed \$1.5 million each. An additional investment package of \$33.3 million was finally agreed upon in late

2010, with the federal and provincial governments each contributing \$15 million and the balance provided by HCR's parent company, Genesee & Wyoming, Inc.

The involvement of the City of Sault Ste. Marie in the initial HCR retention project highlights the fact that municipal governments have proportionately done more to assist their short lines than the two upper levels of government.

A prime example is the previously-discussed GJR, which has a considerable impact on Guelph's industrial sector and has succeeded in expanding its traffic base. While it generates a net operating profit, that income has been continuously reinvested in the property to deal with deferred maintenance and bring the line up to the 130,000-kg main line standard.

The situation is not as rosy on Ontario's other two municipally-owned short lines. The first to be created was the Barrie-Collingwood Railway (BCRY), which began operating the former CN Meaford Subdivision and five related spurs in 1998. The 50-km line was purchased jointly by the two municipal governments, with the City of Barrie acquiring the local spurs and the eastern 12 km of track to a connection with CP's main line at Utopia, near Angus. The Town of Collingwood purchased the remaining portion west to serve a number of local industries. Cando Rail Services was contracted to operate the BCRY for the two municipalities.

However, the erosion of Collingwood's industrial sector and the loss of some rail shippers resulted in the town's segment of the line being mothballed in 2011. It is currently being used to store surplus freight cars and is at least earning revenue from that short-term deal.

Not only is the future of Collingwood's portion of the line uncertain, but the City of Barrie is also questioning its ongoing financial commitment to the BCRY. While the four major shippers have said BCRY service is vital, municipal politicians have called for a strategy to reduce the city's support, which is now approaching \$1 million annually. Among the suggestions is a request to the Government of Ontario to eliminate property taxes paid by short lines.

Similar questions are also being asked regarding Ontario's other municipally-owned short line, the Orangeville-Brampton Railway (OBRY). Launched in September 2000, when CP transferred ownership of the remaining 55-km portion of its Owen Sound Subdivision to the Orangeville Rail Development Corporation, it is a partnership between the Town of Orangeville and five local shippers. Like the BCRY, the OBRY is operated under contract by Cando Rail Services.

In addition to maintaining a connection to the continental rail system through the interchange with CP at Streetsville, OBRY also supports the Credit Valley Explorer tourist train. Launched in 2005 with restored 1950s rolling stock, it operates from a new Orangeville station down through the scenic Forks of the Credit and the villages of Cheltenham and Inglewood.

Despite its positive impact on the industrial and tourism sectors of Orangeville, OBRY's freight and passenger operations have cost the town and its partners approximately \$8 million since its inception in 2000. The five shippers have also contributed significantly by paying a per-car surcharge in addition to the freight rates they pay to CP for the total line haul, which includes a small division for OBRY.

While both Orangeville and Barrie remain supportive of their short lines, they're facing some tough choices regarding the funding. Both have pointed to the boost the short lines give their local economies and the maintenance costs they save by keeping heavy freight traffic off their publicly-funded roads. However, like privately-owned

short lines, the municipally-owned railways are now facing additional costs that are being imposed on them, particularly by new federal regulations, with no sign of assistance from the upper levels of government.

While short lines were eligible for grants from the federal Building Canada Fund between 2007 and 2012, only two railways received any assistance. None have received assistance under the New Building Canada Fund, which came into effect in 2014.

Although short line projects are eligible for assistance under the federal Community Improvement Fund and the Provincial-Territorial Infrastructure Component, municipal or provincial governments must sponsor the applications and select railways for infrastructure upgrades. The problem is that municipalities and provincial governments have been more inclined to seek funding for government-owned assets such as roads and highways. Not a single short line has received any funding under these programs.

Since 2014, new federal regulatory measures have increased minimum liability coverage requirements that will substantially raise some short lines' insurance premiums. As well, revised federal railway safety management system regulations may require some companies to hire additional staff, which will stretch their budgets even further.

A serious problem today is the imposition of new federal grade crossings regulations, which will require tens of thousands of dollars of upgrading for each crossing. When Minister of Transport Marc Garneau announced the \$55-million Rail Safety Investment Program on October 12, 2016, he highlighted the use of this funding for mandated crossing improvements. However, the funds are only available to federally-regulated railways, making most short lines ineligible.

While an easy response might be that the short lines should simply pass their additional costs along to shippers, this is not possible. In most cases, they have existing rate agreements with their Class 1 partners, who set the end-to-end rates for the shipments, so that isn't even an option. More to the point, rate increases would make their services less competitive, or even prohibitive, and have a consequent impact on the competitiveness of their customers.

# Proven American Solutions

As with so many aspects of Canada's transportation system, the model for reform exists in the U.S., which went through many of the problems now being experienced here. The most important conclusion reached in the U.S. was that improvements to the transportation system, regardless of mode, would not occur without progressive policies that recognize the ongoing need for public investment to maintain a state of good repair and attract new, revenue-producing traffic.

Since the time of the collapse of the bulk of the Northeastern U.S. rail system in the 1970s, there have been federal and state programs to foster the retention and improvement of rail service. State governments have increasingly participated in this shift from a purely market-driven approach to railroading to one recognizing the need for public policy considerations.

In the U.S., three types of assistance have helped to boost the effectiveness of short lines. These are direct grants, low- or no-cost loans and tax credits for track maintenance.

Current federal initiatives that are assisting U.S. short lines include:

- The American Recovery and Reinvestment Act of 2009, which has provided supplemental and discretionary grants for all modes through the Transportation Investment Generating Economic Recovery (TIGER) Program;

- The Fostering Advancements in Shipping and Transportation for the Long-Term Achievement of National Efficiencies (FASTLANE) Program, which provides dedicated, discretionary funding of \$4.5 billion for fiscal years 2016 through 2020 for projects that address critical freight issues under the Fixing America's Surface Transportation Act (FAST Act) of 2015; and

- Section 130 of the FAST Act, which funds up to 90 per cent of the cost of grade crossing improvement and grade separation projects.

Federal loans and loan guarantees have been provided to a wide variety of passenger and freight projects since 2002 under the USDOT's Railroad Rehabilitation and Investment Program. Up to \$7 billion is reserved for projects benefitting freight railroads other than Class I carriers. Direct loans can fund up to 100 per cent of a project with repayment periods of up to 35 years and interest rates equal to the cost of borrowing to the government.

Equally valuable and more consistent has been the Railroad Track Maintenance (45G) Tax Credit, which was implemented under the American Jobs Creation Act of 2004 to provide short lines and regional railways a 50-cent tax credit for each dollar spent on track rehabilitation and maintenance up to \$2,100 per km of track owned or leased. Because it offers an automatic and predictable tax credit, it has enabled long-range capital investment planning.



*Through a combination of its own internally-generated capital funding, investment tax credits and grants from the federal, state and local governments, the Reading & Northern Railroad acquired and rehabilitated nearly 500 km of track in Eastern Pennsylvania. Without this short line rail service, many of the industries in this economically-challenged region would be unsustainable.*

Thanks in large measure to the 45G Tax Credit, U.S. short lines have reinvested 25 to 33 per cent of their revenues since 2005 in infrastructure improvements, including during the difficult years of 2008 to 2010. Extension of the 45G Tax Credit has passed the Congress five times and is expected to become permanent with the passage of the Building Rail Access for Customers and the Economy (BRACE) Act. The legislation has been endorsed by 572 shippers, the 550 operating and supply industry members of the American Short Line and Regional Railroad Association, and the American Association of State Highway and Transportation Officials. The BRACE Act has enjoyed strong bi-partisan support in both houses of the Congress.

At the state level, more than half have programs of their own that provide financial support for a wide array of rail projects, including many specific to their short lines. Several states have multiple programs, some of which allow for shippers to make applications for grants to assist their short line service providers and to build sidings that will provide them with rail access.

Some states that are heavily reliant on agriculture and resource industries have gone beyond grant and loan programs to take ownership of critical rail mileage for continued or future use.

A prime example is Washington State, which has 22 short lines operating on approximately 2,200 km of track, of which nearly a quarter is state owned. Washington State has also "rail banked" several former Class I rights-of-way

and contracted with private operators to re-establish operations on a cluster of lines in eastern Washington that it purchased between 2004 and 2007 to prevent their abandonment.

Washington's hands-on involvement in rail freight has also included programs to provide equipment the railways and their shippers couldn't afford on their own. To help alleviate a national shortage of grain cars in the early 1990s, the state accessed federal funds to purchase 29 used grain cars to carry wheat and barley from loading facilities in eastern Washington to export facilities in western Washington and Oregon. Known as the Washington Grain Train, the program now has a fleet of 118 cars (100 owned by the state and 18 by the Port of Walla Walla) that are used cooperatively by shippers, the state's two Class I railways and its short lines.

State programs such as those in Washington are increasingly being synchronized with those of the federal government through the development by the U.S. Department of Transportation (USDOT) of a National Freight System Plan, which is now at the draft stage. As of December 4, 2017, each state that applies for grants under a federal/state formula funding program must have developed its own state freight plan. To assist, the USDOT has established a set of guidelines for the states, which includes the establishment of freight advisory committees representing a cross-section of public and private sector stakeholders.

# Canada Transportation Act Review Recommendations

In their report to Minister of Transport Marc Garneau, the members of the Canada Transportation Act (CTA) Review acknowledged the need to assist Canada's short lines under programs similar to those employed in the U.S. In terms of financial assistance, the CTA Review recommended:

- Modifying eligibility criteria for federal infrastructure programs to allow short line railways to apply for funding directly, without a government sponsor; and
- Creating a federal/provincial short line infrastructure program to meet capital investment needs through grants and low-cost, long-term financing.

To encourage greater private investments in both short lines and Class I railways, the CTA Review called for changes to the Income Tax Act. One simple step would be a reduction in the Canada Revenue Agency's railway asset categories from six to three:

- Motive power and rolling stock;
- Track, ballast, bridges and other fixed physical assets; and
- Rail traffic control equipment and technologies to reduce rail's environment impact.



**BENEFICIAL CO-PRODUCTION:**

*In addition to serving its own mechanical maintenance needs, the OSR Salford Shop is used by ZTR Control Systems, which upgrades locomotive electronics and other systems for Class I and regional railway clients across North America. Photo by Walter E. Pfefferle*

Under this proposed reduction in tax categories, the capital cost allowance for motive power and rolling stock would be permanently increased to levels comparable to those in the U.S.

As well, other tax incentives would be offered for five years and, based on their success in stimulating private investment, could be made permanent. Among these would be an increased capital cost allowance for assets required by railways and their customers to develop multi-modal and trans-loading facilities, including storage, warehousing and track.

While these tax revisions outlined above would apply to all railways, large and small, the CTA Review's

recommendations included two applicable to short lines only. The first would be a tax credit, similar to the U.S. 45G program, to offset track and bridge rehabilitation costs. The other would establish a pooled insurance regime for both federally- and provincially-regulated short lines.

The CTA Review also called on both the federal and provincial governments to engage and work closer in resolving the challenges now facing Canada's entire rail freight industry. The cooperative development of a national freight system plan, similar to the one that now exists in draft form in the U.S., was also among the CTA Review's recommendations.



*With operating and support staff living in the communities they serve, short lines can respond quicker to customer needs than Class I railways. They also pay taxes and purchase a wide range of supplies and services locally, as do their employees. Photo by Walter E. Pfefferle*

# Maximizing Ontario's Short Line Potential

The positive economic, social and environmental impact of short lines has been substantial and well documented, especially in the U.S. There, shifts in public policy have led to policies and a steady stream of funds and tax incentives that have resulted in short lines re-investing more than twice the percentage of revenues than their Canadian counterparts can justify.

As the CTA Review concluded, short lines could play a larger role as robust and more fully integrated components of Canada's multi-modal freight system. This is unlikely to occur without supportive public policies and financial assistance.

A major consideration is the fact such investments bolster the competitive position not just of the short lines, but also the industries and the communities they serve. These investments also increase the role of the short lines as key feeders to the continent-wide Class I railway system and actually decrease public spending on transportation by diverting truckload traffic, which reduces road maintenance costs.

Ontario's short lines are surviving, but they are not thriving. The new federally-mandated requirements for various safety-related investments are putting more financial pressure on an industry that is already re-investing its own revenues to a higher degree than the other modes of transportation. The need to match the 130,000-kg standards of the Class I railways puts more pressure on the industry.

Policy makers need to consider the actions of those jurisdictions with which Ontario's industrial and agricultural sectors compete. Access to efficient, low-cost rail service can be a critical factor in private-sector decision involved in the expansion or establishment of production and processing facilities. Also of concern is the question of the permanence of this rail access.

Ontario's privately- and municipally-owned short lines are at a critical junction. They play a significant role within our multi-modal freight transportation system and have demonstrated their willingness to invest their own funds to do so. Their ability to go further is constrained by their marginal profitability and limited financial capacity.



Future growth will be almost entirely dependent on the adoption of new policies and funding mechanisms by the provincial and federal governments. Without such an approach, Canada's short line railways will simply be unable to realize their full potential. The failure of the St. Thomas & Eastern Railway in 2011 should serve as a warning.

However, the opportunity to change this situation is now at hand. On November 3, 2016, Minister of Transport Marc Garneau unveiled a new federal strategy: Transportation 2030. It includes a pledge to invest of \$10.1 billion in infrastructure "to help eliminate bottlenecks and build more robust trade corridors." A consultation process involving all stakeholders has been promised.

To empower Ontario's short lines, the case must now be made for policy and funding changes that will emulate those that have allowed the U.S. to tap the full potential of its short lines.

Based on the CTA Review, the Ontario Climate Change Action Plan and the objectives of Transportation 2030, it is recommended that the Minister of Transport and the Minister of Transportation of Ontario work in partnership to implement the necessary reforms to ensure the long-term viability of Ontario's short lines by:

- Establishing a tax credit program to offset track and bridge rehabilitation costs;
- Modifying eligibility criteria for federal infrastructure programs to allow short line railways to apply for funding directly, without a government sponsor;
- Creating a federal/provincial rail infrastructure program to meet capital investment needs through grants and low-cost, long-term financing; and
- Assisting in the establishment of a pooled short line insurance regime.

In conjunction with Ontario's short lines, the many shippers and local jurisdictions that benefit from these rail services must now advance this case at the federal and provincial levels.

***A RAIL-FED DISTRIBUTION NETWORK:*** *PDI Bulk depends on its short line service for the cost-effective delivery of the polymers it distributes to industries in and around Guelph. Without this connection to the main line railways, PDI would be forced to relocate its trans-load facility, depriving the city of the economic activity, employment and taxes it generates.*

*Photo by David Graham (www.railfan.ca)*



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