

**ASSESSMENT OF RAILROAD PROPERTY
LEASING PRACTICES IN
NORTH DAKOTA**

By

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Highlights

Railroad property holdings in non-railroad use are numerous in North Dakota. Many of these properties are leased to retail firms, warehousemen, manufacturing firms, agricultural product and supplies outlets, and others. Soo Line properties are leased primarily to agricultural concerns located along their operating right-of-way, while Burlington Northern leases constitute a wide range of business types throughout the state.

Rental prices of railroad property in 1982 were higher for BN holdings than for Soo Line, reflective of the metropolitan locations of BN property. Rental prices increased by approximately seven percent per year between 1977 and 1982. Few of these firms leasing railroad property shipped significant portions of their inbound or outbound freight by rail.

Most leases were for a one year term or were indefinite term leases, presumably renegotiated annually. These short term leases have reportedly contributed to firm managerial problems such as credit worthiness and inability to make long-term investment decisions due to uncertainty about lease terms in the future.

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Daniel L. Zink*

Introduction

Railroad land holdings in rural and urban areas of North Dakota are extensive, due in part to the vast amount of land granted to the Northern Pacific Railroad over a century ago. Much of this land is now owned by the Burlington Northern Railroad and is leased to various types of businesses throughout the state. Commercial and industrial firms located on railroad property have experienced considerable changes in the terms of their railroad land leases.

Locating a business on leased property has advantages and disadvantages. Initial outlays for property will be lower than if the site was purchased outright. Also, the tenant is not burdened with taxes, upkeep, etc., on the property (although these costs are likely to be implicit in the lease terms). However, leasing has inherent problems, as evidenced by complaints from current railroad land leaseholders. The lessee is at the mercy of the landowner concerning terms of the lease when the instrument is renewed, particularly if the lessee has built or made improvements on the property. Also, a great deal of uncertainty may exist if the tenant does not receive a long-term lease, thereby prohibiting him from making long-term decisions consistent with his economic planning horizon.

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North Dakota businessmen utilizing railroad property have expressed concern over the recent changes made in their renewed leases. Annual increases in the lease price of some tenants' sites have been substantial. Also, the time period covered by some leases has been shortened, leaving lessees uncertain about future changes in the terms of their lease. This uncertainty affects business decisions concerning future expansion of facilities or relocation of the firm.

Objectives

The primary objective of this study is to identify and assess problems currently associated with holders of leases of railroad property in North Dakota. Specific objectives are:

- 1) to identify holders of railroad leases by type of business, location and carrier;
- 2) to identify general lease policies of railroads serving North Dakota;
- 3) to evaluate changes in railroad land lease terms in North Dakota with regard to:
 - a. price
 - b. length of lease
 - c. escalation clauses
 - d. vacate notices; and
 - e. other lease related clauses
- 4) to identify problems resulting from various lease terms and agreements.

Procedure

Leaseholders of railroad property were identified via consultation with the Greater North Dakota Association and Local County Directors of Tax Equalization. A mail survey was conducted of those firms holding railroad leases in cities and rural areas. Railroad lease policies were identified by contacting Burlington Northern and Soo Line personnel.

The sample consisted of businesses leasing property from North Dakota railroads (Soo Line, Burlington Northern and former Northern Pacific and Great Northern property). Sites are leased by various types of businesses and are located in rural and urban areas and in various sizes of cities. An evaluation of each of these strata was made to identify unique lease problems and comparisons made among strata.

Number of lease sites in each selected county varies due to the amount of railroad trackage present, size of cities in the county and whether the BN or Soo Line (or both) serve county shippers. For example, the number of rented BN sites in Fargo alone was 101, while Mountrail County, served by both BN and Soo, had only 27 rented sites (Figure 1).

A total of 376 surveys (27 percent of the population) was mailed to leaseholders in 22 counties, with 101 North Dakota grain elevators receiving a survey. A variety of cities was chosen as sites to survey, consisting of a mix of large and small populations, cities served by both BN and Soo Line, and main line and branch line stations. One hundred fourteen useable surveys were returned, and constituted the source of this analysis. Number of responses to each question varied, however, because some were not answered on particular questionnaires. Careful attention should be paid throughout the report to the size of the sample as certain responses and strata are analyzed. Due to the limited number of responses from some strata, sampling error may occur. A copy of the questionnaire is presented in the Appendix.

General Railroad Lease Policies

Soo Line¹

Soo Line properties are leased primarily to agricultural firms in North Dakota. Grain elevators, fertilizer distribution warehouses,

¹Based on personal conversations with Leasing Department personnel, Soo Line Railroad, Minneapolis, Minnesota, September 23, 1982.

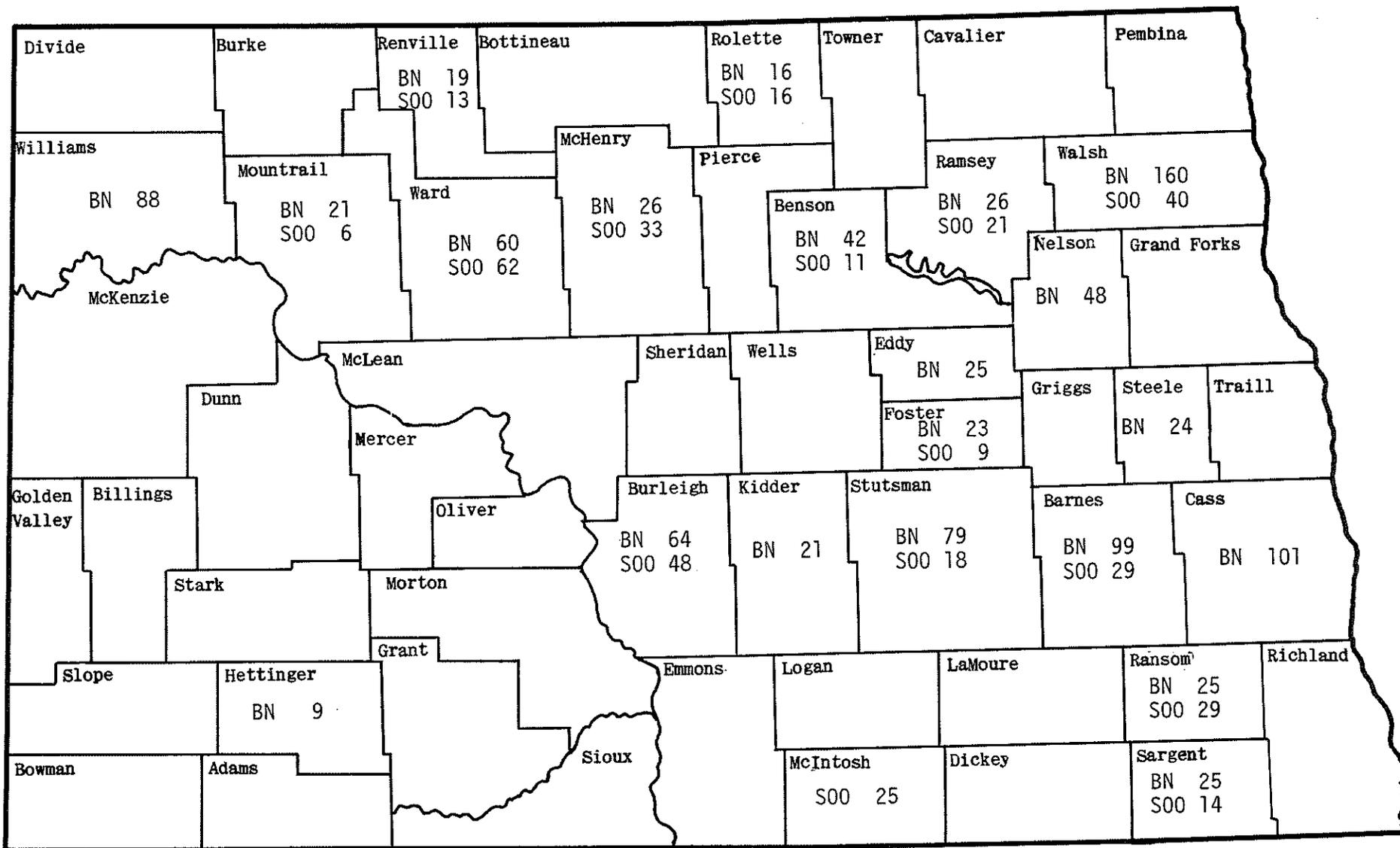


Figure 1. Number of Railroad Property Leased Sites, Selected Counties by Railroad, 1982^a

^a Numbers for Cass and Burleigh Counties represent numbers of leased sites only in Fargo and Bismarck, respectively.

local agricultural cooperatives, and other agricultural concerns comprise the majority of Soo Line leaseholders. Soo Line land holdings in North Dakota consist mainly of operating right-of-way and do not constitute extensive commercial property holdings. The Soo Line was not a land grant railroad.

According to Soo Line policy, rental rates reflect a fair return on leased property. Rental rates are usually assessed on a square foot basis, with a specified minimum, and are adjusted annually depending on the general inflation rate and/or changes in value. Normally, no separate charge is made for the siding or spur trackage serving leased sites; this charge is implicit in the property lease charge.

All track revisions or additional construction are normally the responsibility of the lessee. The Soo Line may assume ownership and maintenance responsibilities of the new track, or the lessee may retain ownership and be responsible for maintenance.

Burlington Northern²

Burlington Northern property holdings in North Dakota consist of industrial/commercial sites in rural and urban areas. Although 68 percent of North Dakota's grain elevators received service by the Burlington Northern in 1980,³ many types of firms other than elevators receive service from the BN and/or are situated on BN property. Burlington Northern trackage extends through many of the larger cities in North Dakota, therefore including many nonagricultural firms on its commercial

² Based on personal conversations with Leasing Department Personnel, Burlington Northern Railroad, St. Paul, Minnesota, September 23, 1982.

³ Casavant, Ken and Gene C. Griffin, "Structure and Operating Characteristics of the North Dakota Grain Elevator Industry", UGPTI Report, 1982, forthcoming.

property sites. This higher track density, as well as extensive land holdings, account for the relatively large number of commercial sites owned by the Burlington Northern.

Applications for leasing railroad property are submitted to a Division Superintendent or Agent and approved by the Operating, Marketing and Industrial Development Departments within the Burlington Northern Railroad Company. The lease instrument is prepared and a property appraisal is performed to set the appropriate rent. The lessee has the option to have an independent appraiser evaluate the property if he feels it has been valued incorrectly.

The cost of leasing commercial or industrial property from the Burlington Northern is based on the appraised value of the property at each particular site. The rate of return desired by the BN is based on the level of the prime interest rate. Since 1970, the rate of return sought by the BN on leased property has varied from nine to 15 percent. The majority of Burlington Northern property leases are for an indefinite term and are cancelable in less than one year. Only a small portion of the leases are term leases, and usually cover a period of five years.

According to Burlington Northern policy, leases for siding or operating tracks are negotiated independent of agreements for rented commercial sites. The most common form of BN track lease is the "Superintendent's Track Lease", where the lessee is charged a fee to use the track for an entire month. If a private car is utilized, the lessee is exempt from track-related demurrage charges. The current rate for leasing track under a Superintendent's Track Lease is 15 dollars per 50 feet of track per month.

Another type of agreement, the "Standard Industrial Track Agreement", covers stub or spur trackage on or off the railroad right-of-way. The agreement can cover either railroad owned trackage or private siding. No fee is assessed for the Standard Industrial Track Agreement. However, the firm using the trackage is charged by the railroad for maintaining the track structure. If the track is off BN property and is privately owned, the BN maintains the track up to the property line. Other track is maintained by a private contractor. The length of the agreement is usually not stated; the agreement is in effect until cancelled. Presumably, either party can cancel the lease (effectually not renewing the lease) when the instrument is ended and/or renegotiated for renewal.

Track leases for grain unit trains are handled in a manner similar to the Superintendent's Track Lease. The grain shipper is charged on a "days per month used" basis. For example, if the agreement calls for usage of the track for five days per month, the elevator is charged 5/30 of the normal Superintendent's Track Lease rate, or \$2.50 per 50 feet of track per month. Leasing of track by unit grain train shippers is currently under review by the Burlington Northern and may be subject to change in the future.

Track leases for unit grain train handling are temporary in nature and may be cancelled on 10 days notice by Burlington Northern. The Burlington Northern prefers each unit train shipper to build or purchase track of sufficient capacity to accommodate their grain loading operations.

Lease Characteristics by Location

Lease characteristics were identified and sorted by the location of the lease site relative to the city. None of the respondents stated their leased site was located in a rural area (Table 1).

TABLE 1. SELECTED LEASE CHARACTERISTICS BY LOCATION RELATIVE TO CITY, NORTH DAKOTA, 1982

Lease Site Location	Average Length Of Lease ^a (years)	Percent of Leases With 30 Day Vacate Notice	Lease Price	
			1982 (cents/sq. ft.)	1977 (cents/sq. ft.)
Within City	3.6 (n=70) ^b	68 (n=92)	30.67 (n=97)	22.92 (n=92)
Outskirts of City	1.8 (n=5)	14 (n=7)	29.91 (n=6)	17.79 (n=6)
Rural Area	---	---	---	---

^a In computing average length of lease, indefinite term leases were deleted from the sample. The term of the lease would, in fact, resemble the one year term lease.

^b n = Number of observations.

The average length of leases within the city was 3.6 years, and ranged from 30 days to 30 years. The average length of leases for sites on the outskirts of the city was 1.8 years, ranging from one to five years. Twenty of the respondents within the city and three on the outskirts indicated they had an indefinite term lease, presumably renegotiated on an annual basis. If these indefinite term leases are presumed identical in length to the one year term leases, the average length of leases would be much lower.

Sixty-eight percent of the respondents whose site was located within the city indicated their lease had a 30 day notice to vacate clause,

while 14 percent of the leases for sites located on the outskirts of the city had a 30 day notice to vacate clause. It should be noted that few of the respondents were located on the outskirts of the city. This small sample may lead to sampling error.

The 1982 average lease price for sites located within the city was 30.67 cents per square foot. This compares to an annual price of 22.92 cents in 1977, or an average increase of approximately 6.8 percent per year. Similarly, the 1982 average lease price for sites located on the outskirts was 29.91 cents per square foot, increasing from 17.79 cents in 1977, or an average annual increase of 13.6 percent per year. According to subjective comments made by respondents, increases in lease rental prices had occurred in the more recent portion of that five year period.

Lease Characteristics by Type of Business

Fifty-six of the 98 leases identified had a term of one year, while an additional 23 leases were of an indefinite term (Table 2). Only 19 of the 99 leases identified were specified as having a fixed term of greater than one year, and only seven for greater than 10 years.

The average annual price for leased property in 1982 ranged from 2.01 cents per square foot for grain elevator firms to 48.9 cents per square foot for retail sales firms (Table 3). The highest lease price in 1977 was 36.98 cents per square foot, also for retail sales sites. Price increases were most dramatic for grain elevators, which rose by an annual average of 35.1 percent over the five year period. The average annual increase for all categories of firms was 6.9 percent. The average proportion of leases having a 30 day vacate notice clause was 65 percent.

TABLE 2. LENGTH OF RAILROAD PROPERTY LEASE IN YEARS BY TYPE OF BUSINESS, NORTH DAKOTA, 1982.

Type of Business	Length of Lease (years)						Total
	1	2-5	6-10	11-20	More Than 20	Indefinite Term	
	----- number of leases -----						
Grain Elevator	8	0	0	0	0	2	10
Retail Sales	30	5	1	2	3	9	50
Warehouse	12	3	1	0	0	6	22
Other ^a	<u>6</u>	<u>2</u>	<u>0</u>	<u>2</u>	<u>0</u>	<u>6</u>	<u>16</u>
Total	56	10	2	4	3	23	98

^aIncludes manufacturing firms, farm land, service firms, wholesalers, construction contractors and miscellaneous.

^bIncludes one lease of term 30 days.

TABLE 3. SELECTED LEASE CHARACTERISTICS BY TYPE OF BUSINESS, NORTH DAKOTA, 1982.

Type of Business	Percent With 30 Day Vacate Notice	Annual Price Per Square Foot (1982) (cents)	Annual Price Per Square Foot (1977) (cents)	Average Annual Percent Change In Lease Price
Grain Elevator	36 (n=11)	2.01 (n=12)	0.73 (n=11)	35.1
Retail Sales	67 (n=45)	48.90 (n=46)	36.98 (n=45)	6.4
Warehouse	58 (n=19)	13.60 (n=25)	7.40 (n=24)	16.8
Other	79 (n=24)	26.12 (n=20)	20.29 (n=18)	5.7
All Firms	65 (n=99)	30.45 (n=103)	22.60 (n=98)	6.9

Most firms responding to the survey indicated they had spur track or siding on which they could ship by rail (Table 4). Seventy-eight firms, or 64 percent, indicated they could ship by rail if so desired. However, on the average, firms shipped only 12 percent of their inbound freight and 10 percent of their outbound freight by rail.

TABLE 4. SELECTED LEASE CHARACTERISTICS BY TYPE OF BUSINESS, NORTH DAKOTA, 1982

Type of Business	Spur Track Available		Percent of Freight Hauled by Rail	
	Yes	No	Inbound	Outbound
Grain Elevator	13	1	0	31
Retail Sales	27	28	11	3
Warehouse	22	5	15	8
Other	16	10	16	14
Total	78	44		

Nine firms indicated they had experienced difficulty obtaining credit due to the terms of their lease (Table 5). However, 96 firms, or 91 percent, indicated that their lease had not caused borrowing problems. The lease terms identified as causing problems with borrowing were 30 day vacate notice and length of the lease.

TABLE 5. SELECTED LEASE CHARACTERISTICS BY TYPE OF BUSINESS, NORTH DAKOTA, 1982

Type of Business	Difficulty Obtaining Credit Due to Lease Terms		Creditor Objected to:			
	Yes	No	Price	Vacate Notice	Length	Other
Grain Elevator	0	14	-	-	-	-
Retail Sales	4	45	-	-	2	-
Warehouse	4	15	-	2	1	1
Other	<u>1</u>	<u>22</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	9	96	0	2	3	1

Lease Characteristics by Railroad

Characteristics of lease terms also were categorized by leasing railroad. The 1982 average rental price was approximately 33 cents per square foot for Burlington Northern property and 18 cents per square foot for Soo Line property (Table 6). The average annual price five years previously was about 27 cents per square foot for Burlington Northern property and six cents for Soo Line property. Average annual increases over the five year period were five and 36 percent for BN and Soo Line property, respectively.

Lease prices by location (relative to the lease sites' proximity to the city) also varied between railroads. The average 1982 lease price for BN property located within the city was 35.21 cents per square foot while Soo Line property within the city rented for 17.94 cents per square

TABLE 6. AVERAGE LEASED SITE RENTAL PRICES BY RAILROAD, NORTH DAKOTA, 1982 and 1977.

Railroad	1982 Lease Price ----- cents per sq. ft. -----	1977 Lease Price ----- cents per sq. ft. -----	Average Annual Price Change -- percent --
BN	33.44 (n=75)	27.19 (n=71)	5.5
S00	17.94 (n=22)	6.42 (n=21)	35.9
BN and S00	38.78 (n=6)	25.02 (n=6)	11.0

foot (Table 7). However, this price differential exists at least partially because BN trackage runs through larger cities in North Dakota, such as Grand Forks and Fargo, than does the Soo Line. Higher property values in these metropolitan areas would be reflected in their higher rental prices. Lease prices were lower for property located on the outskirts of the city. Average BN lease price was 2.18 cents per square foot; no respondents indicated their Soo Line leased property site was located on the outskirts of the city. No respondents (both BN and Soo) indicated their lease site was located in a rural area.

TABLE 7. AVERAGE 1982 PROPERTY LEASE PRICES, BY RAILROAD AND PROXIMITY TO CITY, NORTH DAKOTA.

Railroad	Within City ----- cents per square foot -----	Outskirts of City ----- cents per square foot -----	Rural -----
BN	35.21 (n=71)	2.18 (n=4)	-
S00	17.94 (n=22)	-	-
BN and S00	20.00 (n=4)	76.35 (n=2)	-

The length of the leases in years varied considerably, from 30 days to 30 years (Table 8). Most leases were written either as indefinite term or for one year. Fifty-seven of 70 BN leases, or 81 percent, ran for either one year or were for an indefinite term. Fifteen of 20 Soo Line leases (75 percent) were either one year or indefinite term leases.

TABLE 8. NUMBER OF LEASES BY LENGTH OF LEASE IN YEARS AND RAILROAD, NORTH DAKOTA, 1982.

Railroad	Length of Lease (Years)					Indefinite	Average ^a
	1	2-5	6-10	11-20	More Than 20		
	number of leases						
BN (n=70)	40	7	0	3	3	17	3.7
S00 (n=20)	13	3	1	1	0	2	2.7
BN and S00 (n=8)	3	0	1	0	0	4	3.3

^aIn computing average length of lease, indefinite term leases were deleted from the sample. The term of these leases would, in fact, resemble the one year term leases.

Sixty-three percent of respondents leasing BN property indicated that their lease had a 30 day vacate notice clause, while 75 percent of respondents leasing Soo Line property stated their lease had a similar clause (Table 9). The average size of the actual leased site was slightly larger for BN property (35,345 sq. ft.) compared to the leased Soo Line sites (26,919 sq. ft.).

Fifty-nine percent of the lessees of the BN property indicated they had spur track or siding available to ship by rail, while 71 percent of Soo Line lessees stated they had access to rail siding (Table 10). However, only 11 percent of BN lessees' inbound freight was shipped by rail, and 12 percent of Soo lessees' freight was railed in. Seven

percent of BN lessees' outbound freight was shipped by rail, while 13 percent of Soo lessees' outbound freight was shipped by rail.

TABLE 9. PERCENT OF LEASES WITH 30 DAY NOTICES TO VACATE AND AVERAGE SIZE OF LEASE SITE, BY RAILROAD, NORTH DAKOTA, 1982.

Railroad	Percent With 30 Day Vacate Notice	Average Size of Leased Site
		--- sq. ft. ---
BN	63 (n = 71)	35,345 (n = 81)
S00	75 (n = 20)	26,919 (n = 23)
BN and S00	50 (n = 8)	27,230 (n = 6)

TABLE 10. PROPORTION OF LESSEES WITH SIDING AVAILABLE, AND PROPORTION OF FREIGHT SHIPPED BY RAIL, BY RAILROAD, NORTH DAKOTA, 1982.

Railroad	Lessee with Siding Available	Freight Shipped by Rail	
		Inbound	Outbound
		percent	
BN	59	11	7
S00	71	12	13
BN and S00	100	31	10

Half of all respondents indicated they would rather have a lease price based on some county or city assessed value of their property, rather than valued by the owning railroad. Eight and nine percent of BN and Soo lessees, respectively, indicated they had difficulty obtaining credit in the past due to the lease terms (Table 11). The lease terms objected to by creditors were 30 day vacate notice and length of the lease. Thirty percent of BN lessees said they had delayed capital improvements on their building due to the terms of their lease. Forty-five percent of Soo Line lessees indicated a hesitance in capital expenditure due to unfavorable lease terms.

TABLE 11. CREDIT AND CAPITAL INVESTMENT PROBLEMS RELATED TO LEASE TERMS, BY RAILROAD, NORTH DAKOTA, 1982.

Railroad	Percent of Respondents Indicating Credit Worthiness Problem Related to Lease Terms	Portion of Lease Lender Objected to				Percent Delaying Capital Improvements Due to Lease Terms
		Price	Notice	Length	Other	
		---- number of leases ----				
BN	8	0	1	2	1	30
S00	9	0	1	1	0	45
BN and S00	14	0	0	1	0	57

Summary and Conclusions

Railroad property leases in North Dakota are numerous, particularly within the larger cities in the state. These properties are leased to a variety of firm types, including retail sales, warehouses, manufacturing firms, service firms, and others. Approximately half of the firms responding to the survey were involved in retail sales.

Most leases were indefinite term or one year terms--few were written for longer than one year. Also, about sixty-five percent of the leases had a 30 day vacate clause. The cost of leasing railroad property has increased by an overall average of 6.9 percent per year since 1977.⁴ Many of the firms had a spur track or siding available to ship by rail, but relatively few shipped large proportions of their inbound or outbound freight by rail.

Some leaseholders in North Dakota have reported experiencing complications obtaining credit due to unfavorable terms in their lease. However,

⁴To truly assess the "reasonableness" of railroad lease price increases, a comparison of similar non-railroad property price increases would be necessary. However, the Consumer Price Index for all consumer items suggests that the price of railroad leases in North Dakota has increased less than prices paid for all consumer goods over the five year period.

incidence of this occurrence was quite limited according to survey respondents. In some cases, lenders objected to the notice to vacate, and/or the length of the lease term.

Lease characteristics did not appear to differ significantly between railroads. Although the price of leased property was higher for Burlington Northern sites, this may only be reflective of property values in larger North Dakota cities as opposed to smaller ones.

North Dakota railroad property leaseholders are generally unsure of the future of their leased property due to the short-term nature of most leases. Since leases are written for only a one year period or indefinite term, many lessees are in a quandry as to capital improvements on the property and entering into long-term arrangements with creditors and other institutions. These short-term leases lead to instability and insecurity in terms of a firm's long-term economic planning horizon. A specified longer term on a property lease would allow decision-makers to make long-term economic and financial decisions consistent with the long-term objectives of the firm.

There are few alternatives to leasing the railroad property for many firms. Sunk investment costs prohibit relocation of the firm. Also, outright purchase of the property is difficult due to the owning railroad's policy of leasing rather than selling the commercial sites.

Appendix

SURVEY OF NORTH DAKOTA RAILROAD LEASEHOLDERS

C O N F I D E N T I A L

1. Name of company _____
2. City _____
3. Type of business (grain elevator, retail sales, manufacturing, warehouse, etc.)

4. Which railroad do you lease from? BN _____ Soo _____
5. Are you located within the city, on the outskirts of the city, or in a rural area? _____
6. What is the length of your present lease in years? _____ years
7. Does your lease have a 30 day notice to vacate? yes _____ no _____
8. What is the approximate size of your leased property?
(square feet or acres) _____
9. What is the annual price per square foot or per acre? \$ _____
What was the approximate annual price five years ago? \$ _____
10. What is the approximate value of your building if you were to offer it for sale today? \$ _____
12. Do you have a spur track which allows you to ship on the railroad? yes _____ no _____
Are you charged for leasing this trackage separately from your leased property? yes _____ no _____ If yes, what is the lease price of the track? \$ _____
13. If your property has a parking lot, are you required to pay the same price for parking lot space as for the property occupied by the building? yes _____ no _____
14. What percent of your freight is hauled by rail? Inbound _____ %
Outbound _____ %

(over)

