Statement from Laura McNichol, Watco in Favor of SB 326
House Taxation Committee
March 16, 2022

Good morning Chairman Smith and members of the Taxation Committee. Thank you for the opportunity to come before you today. I am Laura McNichol and I work for Watco. As you may know, Watco is a homegrown Kansas company providing best-in-class transportation services all across the country.

Our business started in railroad industrial switching and grew into railcar mechanical repair before quickly blossoming into owning and operating Class III short line railroads, including the three here in Kansas we run today. From there, we expanded into terminals and ports, as well as logistics. We consider ourselves a one-stop transportation services provider.

We are here today in support of Senate Bill 326 – the bill to create a short line railroad maintenance tax credit. This bill passed in the Senate on Monday, March 7 on a 29-7 vote.

This bill would create an incentive that, if passed, would drive greater infrastructure investment in Kansas's short line railroads. The proposed tax credit is a tool our short lines can use to keep up with the growth we've seen in recent years, as well as help us modernize our bridges and track – all in the service of our customers. You see, when we acquired these lines through the 1980s, 90s, and 2000s, they had already been put out to pasture by their previous owners. As the regulatory structure changed for the large Class I railroads beginning in 1980, they began shedding lines that were low density and unprofitable. Kansas was a state that sadly lost many of its rail miles to abandonment. According to a 2003 study prepared by the Kansas Department of Transportation (KDOT), Kansas lost more than 2,000 rail miles between the 80s and 90s.[1]

Between our two larger railroads here in the State of Kansas, the Kansas & Oklahoma Railroad (K&O) and the South Kansas and Oklahoma Railroad (SKOL), we average over 120,000 carloads a year. This is the equivalent of 480,000 trucks NOT on Kansas roadways, reducing pavement damage and providing competitive transportation options for farmers and shippers across the state. In 2021, the K&O hauled 25,000 carloads of wheat, totaling nearly 80 million bushels, which equates to just about 22 percent of Kansas total wheat production for the year. In 2019 and 2020, the percentages were 25.5 and 26 respectively. Needless to say, we are a critical link for Kansas grain growers.

In the 2003 study cited earlier researchers determined that "if the four short line railroads in the study area were abandoned, a large diversion of wheat shipments from rail to truck would occur and traffic would increase beyond the counties' capacity. **Transportation and handling costs of grain would increase by $0.056 per bushel, for a total income loss to Kansas farmers of $20.5 million.** The short line railroad system in the study area annually saves the state of Kansas $57.8 million in road damage costs."[2] Adjusted for inflation, farmers would see a $0.09 per bushel increase in transportation cost.

[1] https://www.ksdot.org/Assets/wwwksdotorg/bureaus/burRail/Rail/Documents/Impact2003.pdf
[2] https://www.ksdot.org/Assets/wwwksdotorg/bureaus/burRail/Rail/Documents/Impact2003.pdf (last visited 21Jan21)

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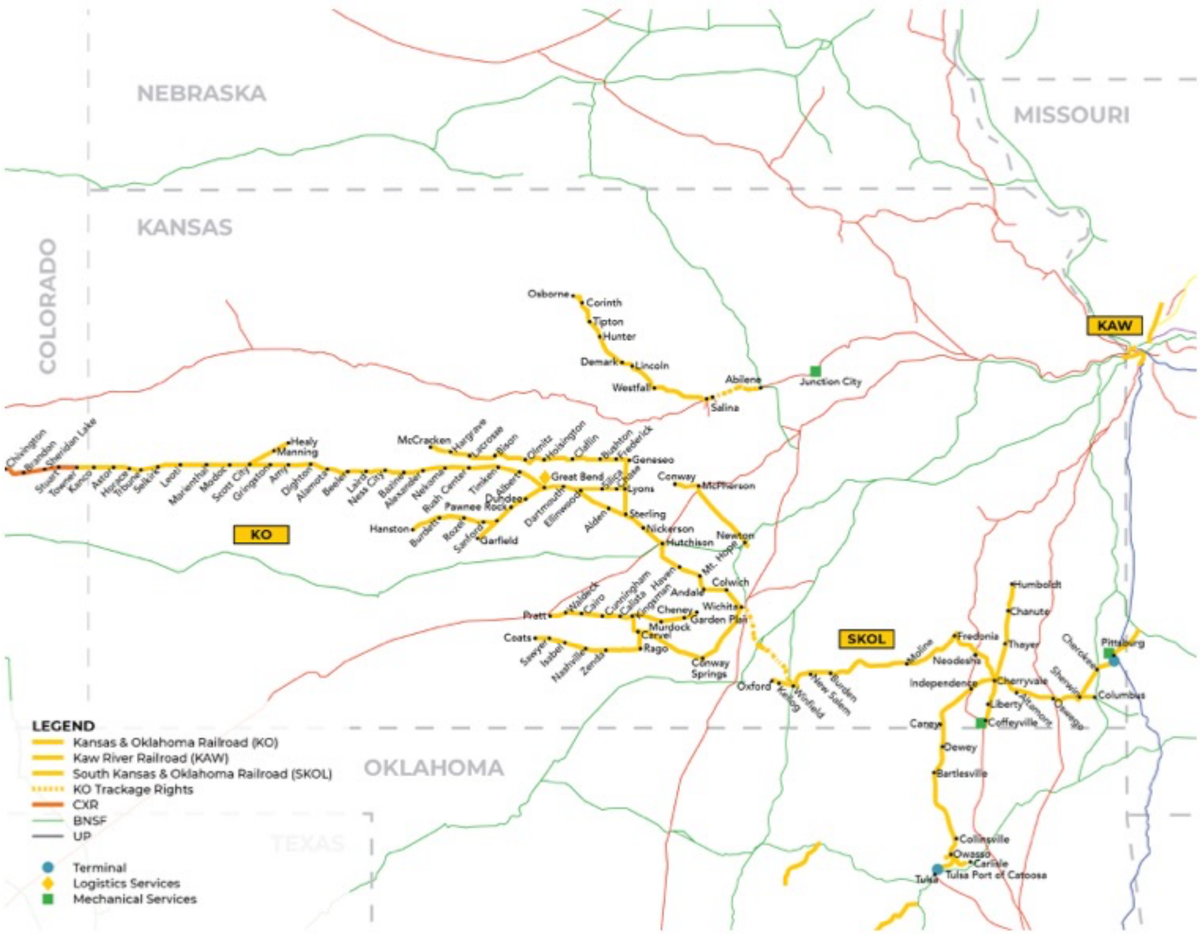
When the K&O was purchased by Watco in 2001, the lines that make up the K&O were in a state of disrepair. Railroads have the among the highest cost of capital of any industry (12.28% in 2018[3]). Crossties, ballast and rail are expensive. However, these assets will last for generations. A railroad crosstie can last 25 years and a bridge more than 100 years and the same goes for the rail itself. Yet, short line railroads here in Kansas and across the nation continue to claw their way out of the underinvestment of their previous owners. This is where the tax credit provides it value.



In 2022, Watco will spend over $5 million in track maintenance capital expenditures on the K&O and the SKOL railroads. Another $20.5 million will be spent on the SKOL as material purchasing and construction begins on a federal Consolidated Rail Infrastructure and Safety Improvement (CRISI) project in partnership with KDOT that will allow for roughly half of the SKOL to get to 286k capacity. Hauling railcars weighing 286,000 lbs is the industry standard. The necessary upgrades and investments are more than we can do on our own.

According to the most recent state rail plan, "Class III railroads purchased trackage from lower volume Class I railroad lines that primarily serve first- and last-line-mile customer operations. These lines have often been the victim of deferred maintenance resulting in slower operating speeds. As

[3] Surface Transportation Board Decision (last visited 20Jan21)

the industry has accepted heavier rail cars as the standard, Class III railroads have struggled to keep up with the costs to upgrade their track to accommodate these heavier loads. As a result, 30 percent of the Class III rail lines remain non-286,000 pound segments."[4]

Today, we cannot handle a unit train nor can we handle 286k railcars west of Great Bend on the K&O. On the SKOL, only a quarter of its 433 miles are 286k capable. The CRISI will change that for almost half those miles, but another 200 miles of track upgrades are needed to finish this railroad. And, that project must get underway to meet the needs of Bartlett Grain's big expansion of a new soybean processing facility in Henderson County.

We have seen year-over-year growth in carloads in the last three years, which is a testament, in part, to the investments being made in these lines to safely handle the freight shipped by our customers and **most importantly, to keep them connected to the national freight rail network.**

There is still more work to be done. And tools like the tax credit proposed in Senate Bill 326 will help us get there. This bill is modeled off similar short line tax credits in Oklahoma, Arkansas, Georgia, Kentucky, Alabama, Florida and Oregon. These tax credits are all modeled after a federal 45G short line tax credit valued at $3,500 per mile. Qualifying expenditures used to generate the federal credit are firewalled off from qualifying expenditures used for the proposed Kansas state short line credit. Therefore, taxpayers get more than twice the amount of infrastructure investment before a short line can generate the credit.

We appreciate your consideration of Senate Bill 326. We believe the tax credit will perform as it is designed. We respectfully ask for you to vote in favor of this innovative infrastructure tool. Thank you for allowing me to share our thoughts today. I am happy to answer any questions you may have.

[4] https://www.ksdot.org/Assets/wwwksdotorg/bureaus/burRail/Rail/Documents/KDOTPublicCommentRailPlan.pdf (last visited 14Jan22) page 4-5