State of New York
Office of the State Comptroller
Division of Management Audit

NEW YORK STATE DEPARTMENT OF TRANSPORTATION

STAFF STUDY: THE VIABILITY OF THE OAK POINT LINK AND HARLEM RIVER YARD PROJECTS

REPORT 95-D-43

H. Carl McCall

Comptroller

State of New York
Office of the State Comptroller

Division of Management Audit

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Mr. John B. Daly
Commissioner
NYS Department of Transportation
State Office Building Campus - Building #5
Albany, New York 12232

Dear Mr. Daly:

The following is our staff study of the viability of the Oak Point Link and the Harlem River Yard projects.

We did this study according to the State Comptroller's authority as set forth in Section 1, Article V of the State Constitution and Section 8, Article 2 of the State Finance Law. We list major contributors to this report in Appendix A.

Office of the State Comptroller
Division of Management Audit

February 5, 1997

Executive Summary

New York State Department Of Transportation Staff Study: The Viability Of The Oak Point Link And Harlem River Yard Projects

Scope of Study

In the early 1970s, the New York State Department of Transportation (DOT), the Port Authority of New York and New Jersey and the City of New York identified a series of capital improvements (that included raising rail clearances) to improve the rail freight network in the downstate region of New York. These activities comprised the Full Freight Access Program (Program). The Program's two most important elements were the Oak Point Link (Link) and the Harlem River Yard (Yard).

In the early 1980s, DOT awarded contracts for the construction of the Link and the development of the Yard. These contracts were terminated in 1987 before the projects were completed. In 1991, DOT leased the Yard to a private developer - Harlem River Yard Ventures, Inc. (Ventures) - and in 1992 awarded a new contract to complete the construction of the Link. According to DOT officials, about $200 million in public funds have been expended on the two projects. Further, about $80 million of additional public funding has been committed to the projects. Public officials expected the Link and the Yard to provide the necessary intermodal (transporting truck trailers and containers on rail cars) services to New York City and Long Island and to help coordinate the fragmented rail freight network in the region. Moreover, officials projected the Link and Yard to reduce total shipping costs in the region by $100 million per year, create more than 5,000 permanent jobs, reduce air pollution by decreasing truck traffic on the region's highways, and help avoid $500 million in public road improvement costs.

Our study addressed the following questions about DOT's Oak Point Link and Harlem River Yard projects:

- Are the Link and the Yard commercially viable catalysts for restoring the rail freight industry in the downstate region of New York?

- Does the agreement between Ventures and DOT for the lease of the Yard serve the best interest of the State's taxpayers?

Study Observations and Conclusions

We found that the Program has not been completed because the responsible public and private entities do not have a plan for a comprehensive, coordinated, and economically-competitive rail freight system in the downstate New York region. At the time of our review, according to DOT officials, DOT and its partners had spent $200 million on the Link and the Yard, the two flagship projects of the Program. However, neither project has been completed, and consequently, little economic benefit has been realized. The Link is expected to be completed soon, and construction of an intermodal facility at the Yard is also expected to begin shortly thereafter. Although additional public funds have been obligated or are being sought to complete these projects, there are conflicting views on the extent to which the Yard and

Link will be commercially viable and what public benefits will be realized when the Link and Yard are completed. In 1982, DOT projected that the completed Link and Yard would have a capacity of about 180,000 trailer-loads of freight per year, if the Yard was used exclusively as an intermodal facility. However, based on revised use assumptions in 1988, a consultant projected that 45,000 trailer-loads per year (only 25 percent of capacity) would actually use the Link and the down-sized intermodal facility at the Yard. There continues to be differing opinions and estimates regarding potential use for the Link and Yard. (See pp. 5-9)

Under the Program, bridge clearances over railroad tracks between Albany (Selkirk) and Tarrytown were raised to 19 feet 6 inches to allow boxcars and single-stacked intermodal trains to enter the downstate region by rail. However, clearances further south between Tarrytown and Highbridge Yard (just north of the Link) are only 17 feet 4 inches. Moreover, newer double-stacked and high-cubed-double-stacked trains, today's fastest growing and most economical mode of intermodal freight transportation, are unable to access the downstate region through the Link because they require higher clearances - between 20 feet 6 inches and 22 feet. DOT officials stated that when the Link was initially conceived in the 1970s, no one anticipated the trend towards double-stacking. Officials further state that clearances will be raised when each bridge is scheduled for major reconstruction, a process expected to take between 20 and 30 years and cost the State an estimated $300 million to $1.3 billion. Thus, near term future use of the Link and Yard will be limited. Therefore, it is essential that a comprehensive and coordinated rail freight plan for the downstate New York region be developed before investing additional millions of public dollars in the Link, Yard and any other related freight projects. (See pp. 9-12, 17-18)

There has been virtually no additional economic development activity at the Yard since the 99-year lease was signed in 1991. We question whether certain lease terms were in the best interest of the State. Although more than $213 million in public funds will be expended to construct the Link and develop the Yard, it appears that most economic benefits from the taxpayers' investment will effectively benefit the private lessee, who assumes little or no risk in this project. (See pp. 15-20)

We also concluded that DOT officials should determine if $10 million in Federal funding can be obtained to offset costs of the Link. Further, although the City of New York owes DOT $10.7 million (as of July, 1996) for construction costs incurred for the Link, DOT's actions to collect this debt had not been successful, at the time of our review. (See pp. 12-13)

Comments of Department Officials

We provided draft copies of this study to DOT officials for their review and formal comments. We have considered their comments in preparing this study. DOT officials stated that DOT has taken actions to bring the Link and Yard projects to fruition so that the anticipated benefits can be realized.

Contents

Introduction

Background

For the past 25 years, the Department of Transportation (DOT) has worked in partnership with the Port Authority of New York and New Jersey (Port Authority), and the City of New York (City) on several transportation and economic development projects, funded with the proceeds from bond sales. Together, they have committed more than $200 million, including the 1974 Rail Preservation, 1979 Energy Conservation and 1983 Rebuild New York Transportation Bond Issues, to improve the freight transportation system in the downstate region of New York.

In the 1970s, the New York State Legislature initiated the Full Freight Access Program (Program) to address the long-standing problems with transporting freight by rail through the City. Included in this program were the:

- improvement of clearances on existing rail lines by raising overhead bridges and lowering track;

- conversion of the Harlem River Yard (Yard) into an intermodal (transporting truck trailers and containers on rail cars) facility that would make it possible to move truck trailers or ship containers onto flat railroad cars (see Map Exhibit A);

- construction of the Oak Point Link (Link), a 1.9-mile freight-dedicated rail link that would remove freight trains from the "zig-zag" route that traverses busy passenger train lines in the Bronx (see Map Exhibit A); and

- diversion of freight from the highway to rail.

To help implement the Program, DOT, the City and the Port Authority committed significant sums of public funds for the construction of the Link and the Yard. These two projects were the flagship projects of the State's plan to revive the declining rail freight industry in the downstate region.

The Link and the Yard were expected to remedy the lack of intermodal services in the City and Long Island, reduce total shipping costs in the region by more than $100 million per year, create more than 5,000 permanent jobs, reduce air pollution by decreasing truck traffic on the region's highways, and avoid $500 million in road improvements. According to Department officials, at the time of our study, DOT, the Port Authority, and the City had committed $213 million in public funds to these two projects, as summarized in the following table:

(Amounts in Millions of Dollars)

SOURCE	LINK	YARD	TOTAL
New York State	$ 51.4	$21.0	$ 72.4
Port Authority	104.5	3.5	108.0
New York City	29.1	3.5	32.6
TOTAL	$185.0	$28.0	$213.0

In the early 1980s, DOT awarded contracts totaling approximately $70 million for construction of the Link. It also purchased the Yard for $9 million and spent an additional $11 million on preliminary track work. Both projects were expected to be completed by the end of 1987. However, design and construction problems resulted in just one-third of the Link being constructed by the end of 1987. Thus, DOT stopped the construction and terminated the construction contract. Development of the Yard, which is to be serviced by the Link, was also terminated because it was not considered commercially viable without the Link.

In 1988, DOT retained Temple, Barker and Stone (TBS), a consultant, to develop a plan to maximize private participation in the development of the Yard. TBS recommended that the Yard, which TBS said would attract just one-fourth of the Yard's annual capacity of 180,000 trailer-loads of freight (if used exclusively as an intermodal facility), be developed as a transportation and industrial park with a scaled-down intermodal facility. As such, DOT issued a request for proposal (RFP) in June 1989 for the financing, construction and overall management responsibility of the Yard. After a review of four competing proposals, DOT selected Harlem River Yard Ventures, Inc. (Ventures) to develop the Yard. Ventures is a joint project that includes the Galesi Group (that has a 95-percent interest), a developer and manager of industrial parks. Ventures also includes the Hunts Point Terminal Produce Cooperative (with a 5-percent interest), which is the City's largest distributor of both refrigerated and non-refrigerated foods. (Note: In 1994, another consultant study–called Transmode–concluded that the potential market for intermodal service through the Link exceeded the capacity of the Yard. Thus, over time, there have been conflicting opinions about the potential utility of the Link and Yard projects, when they are completed.)

A 99-year lease for the Yard was signed in September 1991 between the landlord (DOT) and the tenant, Ventures. The lease included a proposed land-use plan for a 25-acre intermodal facility; a bulk transfer facility; a newsprint de-inking, recycling, and production facility; general and refrigerated warehouses; and a solid waste transfer station at the Yard. According to the land-use plan, all components were expected to use rail service. In 1992, DOT awarded a contract to John Picone, Inc., to complete construction of the Link. In August 1994, the South Bronx Clean Air Coalition (Coalition) sued DOT in State Supreme Court to void the lease and the land-use plan. The court agreed with the Coalition and ruled that the "failure of the state to take a 'hard look' at and give 'reasoned consideration' to the lower-cost 1982 plan as a viable no-action option appears arbitrary and capricious in nature." However, in August 1995, the Appellate Court ruled that the Coalition's lawsuit was not filed timely and reversed the lower court's ruling.

Study Scope, Objectives and Methodology

We reviewed DOT's administration of the Link and the Yard projects for the period from April 1988 through September 30, 1996. Our objectives were to determine whether the Link and the Yard are commercially viable catalysts for restoring the rail freight industry in the downstate New York region, and to determine if the agreement between Ventures and DOT, for lease of the Yard, serves the best interest of the State.

To accomplish these objectives we reviewed relevant laws, rules and regulations. We interviewed current and former DOT officials, other knowledgeable parties and visited the Link and Yard field sites. We also interviewed officials from the New York State Department of Law, the Empire State Development Corporation, the Port Authority of New York and New Jersey, the City of New York Economic Development Corporation, the MTA's Long Island and Metro-North commuter railroads, the New York Cross Harbor Railroad Corporation, Conrail, and major trucking companies and intermodal corporations, as well as Ventures and its environmental and marketing consultants. We reviewed DOT's policies and procedures; the RFP, proposals, the lease agreement, and other documents related to the development of the Yard; and engineering, marketing, and other studies of the two projects.

Response of Department Officials

We provided draft copies of this study to DOT officials for their review and formal comment. We have considered their comments in preparing this study and have included them as Appendix B.

Within 90 days after final release of this study, we request the Commissioner of the Department of Transportation to report to the Governor, the State Comptroller, and the leaders of the Legislative and fiscal committees, advising what actions were taken by Department management in response to the observations made and issues raised in the study.

The Downstate Regional Freight Network

The mission of DOT's Office of Passenger and Freight Transportation is to provide State residents and businesses with a world-class system of passenger and freight transportation facilities and services, that meet current needs and stimulate economic vitality and improve the quality of life. However, the rail system in the downstate region is fragmented and uncoordinated. There has not been an effective regional approach to plan and coordinate rail freight programs in the downstate New York and northern New Jersey area. The fragmentation is caused, to a considerable degree, by the fact that there are many owners of rail facilities in the region. Each rail owner has different business interests and priorities.

For example, the Long Island Railroad and private railroads, such as Conrail, all own pieces of the downstate rail infrastructure. A customer who wants to transport goods by rail must negotiate with several of these entities, each of which may have different rates and service periods. We noted that a potential customer told us that his goods sat on a rail track for four days because the LIRR did not have the manpower to move them. According to this customer, the LIRR would not allow a connecting railroad, the Cross Harbor Railroad, to enter its service territory to do so. This lack of a coordinated system resulted in substandard service and increased costs to the customer, ultimately forcing him to transfer the shipping of a larger percentage of his products from rail to truck.

According to DOT officials, about $200 million has been spent on the Program, and DOT and its partners will spend significant additional sums on rail freight feasibility studies and the construction of specific downstate rail projects. However, these investments have not produced an efficient and coordinated rail freight system, because none of the three partners has developed a unified or comprehensive rail freight plan for the downstate region. As a result, significant sums of public dollars may have been wasted. Specifically, in 1980, the State spent $20 million to construct an intermodal facility (the 65th Street Yard) on the Brooklyn waterfront that has never been used. In addition, although the Port Authority has allocated $130 million to deepen the New York harbor, an official at the Port Authority's Red Hook Marine Terminal (the only operating shipping terminal on the Brooklyn waterfront) stated that the terminal's rails and its railcarbarge infrastructure have been abandoned. Thus, there is no intermodal service from this terminal.

Moreover, significant public outlays have been made for projects that could compete with the Yard. Specifically, the Port Authority has recently invested about $19.5 million in an ExpressRail on-dock intermodal terminal located at the Port Authority Marine Terminal in Elizabeth, New Jersey. ExpressRail, which has state-of-the-art container handling and tracking equipment and is capable of handling double-stack rail cars, links the port at Elizabeth with the nine other intermodal facilities in northern New Jersey as well as key inland markets in the Midwest, New England and Canada. The Port Authority also plans to spend more than $48 million to reopen a freight rail service between Howland Hook Marine Terminal on Staten Island and Conrail's freight lines in New Jersey. Furthermore, the Empire State Development Corporation has funded a study to determine the feasibility of building a rail freight tunnel to connect New Jersey to downstate New York. Although it would appear to be necessary for public officials to coordinate these projects with the Link and the Yard, no such formal coordination had taken place at the time of our review.

In contrast, the Southern California Association of Governments has undertaken efforts to better coordinate the freight rail systems to the ports in the Los Angeles and Long Beach region through the proposed Alameda Corridor project, according to a report recently issued by the U.S. General Accounting Office (GAO). This project involves consolidating 90 miles of rail track into a single 18-mile rail corridor to transport intermodal freight from the ports to distribution centers. This project is expected to ease traffic congestion and reduce air pollution by taking trucks off the road and eliminating delays at rail crossings. These issues also need to be addressed in the New York City metropolitan region. The GAO report suggested that regional (multi-state) intermodal freight planning efforts are necessary to effectively address intermodal freight movement issues.

According to DOT officials, they have not unilaterally developed a comprehensive rail freight plan for the metropolitan region because DOT would also have to accept sole responsibility to fund the associated capital projects of such a plan. Consequently, DOT officials held two seminars in mid-1996 with officials from the other affected transportation agencies, in which short- and long-term goals were prioritized. According to DOT officials, these goals will be used to develop a blueprint to address freight transportation issues in the region.

We believe that DOT, as the State's lead transportation agency, has the responsibility to bring together the Port Authority and the other entities (that fund and/or provide rail freight service in the downstate region) and to facilitate efforts to develop and implement a coordinated rail freight plan. This plan should result in a comprehensive, coordinated, unified, and economically competitive freight network. The goals should include increasing the movement of goods and reducing shipping costs within the region as well as increasing the opportunity for the Link and the Yard to become commercially viable. It should also significantly reduce truck-generated highway congestion, improve air quality, and improve the region's economy by generating and retaining jobs.

Issue To Be Considered

1. What actions need to be taken to develop a formal comprehensive long-term plan to produce a coordinated and economically viable rail freight network in the downstate region? Further, what leadership role should DOT take in facilitating the development of such a plan with the Port Authority and other rail freight entities?

The Oak Point Link

Our study determined that use of the Link will be limited in the foreseeable future, due to the changes in transportation technology that occurred over the past 20 years and delays in completing construction of the Link. In addition, we observed that the City has not paid about $10.7 million it owes the State for the City's share of the Link's costs. Also, we questioned whether the DOT has adequately pursued $10 million in Federal funding that may be available to offset State payments for the Link.

Completion and Utilization

Construction of the Link, which began in 1983 and was originally scheduled to be completed in 1987, had not been completed as of December 1996. DOT officials pointed out that problems with the competitive bid process, in addition to design flaws, construction delays, and escalating construction costs, resulted in termination of the original construction contract in late 1987, when about one-third of the Link had been constructed. They noted that the Link was subsequently redesigned, and that a new construction contract was awarded competitively in 1992, with a new completion date of February 1995.

According to DOT officials, the current construction effort has been monitored closely by DOT personnel and by inspection consultants hired by both the DOT and the City. However, construction delays continued to occur because of inclement weather. Except for installation of automated switching equipment, DOT officials expect the Link to be completed soon. This delay has prevented the public from receiving the proposed benefits from the construction of the Link, such as the estimated $100 million in annual savings from reduced shipping costs, 5,000 permanent jobs, and reductions in truck traffic and air pollution. Instead, through September 1996, the only jobs that were created are the jobs for the construction of the Link, four waste transfer employees, and seven security positions at the Yard. In addition, the estimated cost for construction of the Link has grown from $70 million in 1982 to approximately $185 million, a 164-percent increase.

A 1982 Environmental Impact Statement, prepared by DOT and the United States Coast Guard, projected a capacity of approximately 180,000 trailer-loads per year for the completed Link and Yard, if the Yard was used exclusively as an intermodal facility. In contrast, in 1988, the TBS consultants projected that just 45,000 trailers-loads per year would use the Link and the down-sized intermodal facility at the Yard. However, the 1994 Transmode Study, by another consultant, concluded that the potential market for intermodal service through the Link exceeded the capacity of the Yard. Thus, over time, there have been conflicting opinions about the potential utility of the Link and Yard projects, when they are completed. The Link, in the near future, will likely be underutilized for other reasons. For example, under the Program, bridge clearances over railroad tracks between Albany (Selkirk) and Tarrytown were raised to a height of 19 feet 6 inches to allow boxcars and single-stacked intermodal trains to enter the downstate region by rail. The higher clearances were intended to enable General Motors (in Tarrytown) to transport its commodities at a more economical rates by rail freight, and thereby continue to operate at that location. Nonetheless, General Motors closed its Tarrytown operations in mid-1996.

Moreover, clearances between Tarrytown and Highbridge Yard (just north of the Link) are only 17 feet 4 inches. Consequently, newer freight equipment such as double-stacked and high-cubed-double-stacked trains, the fastest growing and most economical mode of intermodal freight transportation, will be unable to access the downstate region because they require higher clearances - between 20 feet 6 inches and 22 feet. DOT officials stated that when the Link was initially conceived in the 1970s, no one anticipated the trend towards double stacking. Officials further state that clearances will be raised when each bridge is scheduled for major reconstruction, a process expected to take 20 to 30 years and to cost the State an estimated $300 million to $1.3 billion.

When the Link and Yard become operable, Conrail will decouple the double-stacked cars at Selkirk and route them into the downstate region in a single-stacked mode. DOT officials indicated that this plan would meet the objectives of the Program and would also decrease the number of trucks on the Hudson River crossings and the region's highways because freight consigned to the downstate region would use the Yard instead of Conrail's intermodal terminals in New Jersey.

We would note, however, that there is considerable competition for the markets the Link and Yard would seek to capture. According to Conrail officials, Conrail has invested $110 million in facilities in Pennsylvania and Massachusetts that can accommodate double-stacked freight trains. In addition, Conrail's facilities in New Jersey, where the major freight-forwarders are already established, can not only accommodate double-stacked trains, but currently operate at less than full capacity. Moreover, shippers continue to stress low shipping costs and dependable timely delivery.

Furthermore, at the time of our study, Conrail (which provides long-haul rail service to the City) had no agreements with DOT to use the Link. Conrail officials told us they had tried, but had been unsuccessful in reaching an agreement. DOT officials stated that no agreement had yet been reached because of recurring delays in the Link construction. They added that Conrail had contacted them recently to discuss use of the Link, but no agreement had been reached. DOT officials said they expect such an agreement would be reached before the Link is completed. (Note: In responding to the draft study, DOT officials indicated that they held discussions with Conrail regarding an agreement to operate on and maintain the Link. Pursuant to these discussions, an agreement was being drafted.)

It is also important to note that no other new customers have agreed to use the Link. Conrail officials told us that major shippers, freight forwarders, and intermodal corporations that use Conrail's services were surveyed to determine whether they would be interested in using a direct rail service to the Bronx. However, none of the companies that were contacted expressed a strong interest in doing so. Instead, company officials said that they were satisfied with the services provided at Conrail's intermodal facilities in New Jersey, although they would be interested in a facility on Long Island. Moreover, Conrail officials told us that they plan to use the Link only for the single in-bound/out-bound freight train that currently operates daily between the Selkirk and Oak Point classification yards. Conrail officials further stated that the use of the Link for this train would provide their current customers with the financial and other benefits of using the newer and larger conventional boxcars that the Link could accommodate.

As the five-percent partner in Ventures, the Hunts Point Terminal Produce Cooperative is the largest potential customer in the downstate region with a projected intermodal demand of 30,000 trailer loads per year. The Cooperative's chairman stated that produce currently consigned to the Cooperative is trucked in from California and from Conrail's intermodal facilities in New Jersey. He further stated that he would not commit to using the Link to deliver produce unless Conrail officials could guarantee the same five-day delivery to the Bronx that they currently provide between California and Conrail's intermodal facilities in northern New Jersey. Conrail officials told us they could not commit to a five-day delivery to the Bronx based on what they know today. They stated that they could provide such service to the New Jersey facilities because they are not constrained by the downstate New York's freight system infrastructure and passenger service schedules. DOT officials also stated that discussions have been on-going between representatives from Conrail and the Cooperative.

When the Yard is developed and the Link is completed, DOT officials expect the Cooperative to use rail to transport produce to the Yard on a test basis. They further indicated that the use of rail to transport produce to the yard would be extended if the test proved to be a success. However, the commercial viability of this project remains uncertain, particularly when one of the venture's two partners (who depends heavily on rail freight) is unwilling to commit to use the Link significantly. Further, since Conrail controls the rail freight business in this region, it is important for all parties to determine Conrail's willingness to actively support the Link and the Yard.

DOT officials acknowledged the current lack of commitment by companies to use the Link. However, officials also advised us that, although there now are no other firms (besides Conrail) committed to using the Link, there is potential for increased use of the Link in the future. Specifically, they noted that the Fresh Kills landfill, in downstate New York, is nearing its capacity. Thus, the Link could provide an economical mode to transport municipal and other forms of solid waste from NYC to other localities.

New York City's Liability to the State

New York State, the Port Authority, and the City are required by law to pay for the Link. To complete the project, Section 1 of Chapter 54 of the Laws of 1992 appropriated $82.3 million to DOT as an advance from the State's Capital Projects Fund (Fund). This law required the Port Authority and the City to pay the Fund for their shares of the project's costs. In August 1992, the New York City Economic Development Corporation (Corporation) and the State agreed that the State would advance project funding and that the Corporation, as the funding administrator for the City, would reimburse the State an amount not to exceed $15.6 million (the City's share of construction costs incurred after January 1, 1992). However, although monthly invoices have been submitted to the Corporation, the City has not yet reimbursed the State for more than $10.7 million in billable expenses incurred as of July 1996.

An official of the Corporation told us that the City's Corporation Counsel has refused to approve the release of reimbursement checks until he has received and reviewed the deed covenants for the parcels of land that were purchased to construct the Link. DOT officials stated that DOT's only obligation is to inform City representatives that the covenants were filed, which they have done. In addition, although DOT is not obligated to provide copies of the filing receipts and the covenants to the City, DOT officials state that have done so. They further stated that the covenants are easily accessible by City representatives, since they are on file in the Office of the Bronx County Clerk.

DOT officials identified three possible solutions to collect this debt. DOT can sue the City, deduct the amount from the State's appropriations to the City, or work out a settlement with the City. However, at the time of our study, DOT officials had not elected to implement any of the possible solutions. Rather, they informally requested the assistance of the State Comptroller's Office in collecting this debt. The inability to obtain reimbursement could preclude the State from funding $10.7 million in other programs. (Note: On January 3, 1997, officials from the City's Corporation Counsel, DOT, and the State Comptroller's Office met to discuss this matter. Based on this meeting, the parties agreed that relatively minor actions were required for the Corporation Counsel to approve DOT's claims and that payment could be made in the near future.)

Funding from the Intermodal Surface Transportation Efficiency Act

In 1991, the United States Congress, under the Intermodal Surface Transportation Efficiency Act (ISTEA) authorized several billion dollars for nationwide transportation improvements to maintain and protect United States pre-eminence as an effective competitor in the global market. Specifically, the Act authorized $150 million to be appropriated for the Oak Point Link. However, DOT officials did not apply for these funds - because the Link was already fully funded by the State, City, and the Port Authority, according to a DOT official. Another DOT official stated that acceptance of federal funds would have required DOT to comply with the more stringent federal environmental standards, which could have resulted in considerable delays in constructing the Link. In 1995, $140 million of the $150 million was redirected to other New York State transportation projects, predominantly in the New York City region.

Nonetheless, DOT had not yet applied for the remaining $10 million of ISTEA funding at the time of our review. According to DOT officials, they had formally pursued the ISTEA funds. However, officials did not provide us with any documentation of their actions, as we requested.

In their response to the draft study, DOT officials said that Congress never authorized the expenditure of the remaining $10 million of the ISTEA appropriation, in spite of repeated attempts by DOT officials to obtain such authorization. Officials also said that DOT will continue its efforts to secure these funds.

Issues To Be Considered

2. Should clearances on the rail lines between Selkirk and the downstate region be increased, and the significant corresponding costs incurred, so that modern rail freight equipment such as double-stacked and high-cube double-stacked trains can access the downstate region?

3. What steps need to be taken by DOT to ensure that an agreement with Conrail for the use of the Link is completed?

4. What steps are being taken by DOT to collect the City's share of the Link's construction costs?

5. What actions should DOT take to determine the availability of ISTEA funding and to apply for such funding, if available?

The Harlem River Yard

Intermodal shipping, the movement of truck trailer and shipping containers on railroad flatcars, is the most efficient and economical type of freight transportation. It is rapidly becoming the predominant method of shipping general commodity freight by rail. However, there has never been a modern intermodal facility on the east side of the Hudson River, although there are ten such facilities in northern New Jersey. Consequently, freight is either trucked directly into the downstate region or is shipped to the intermodal facilities in northern New Jersey, then trucked into the City and its suburbs. According to DOT studies, this has increased: costs for consumer goods; traffic congestion and air pollution; and the wear and tear on bridges and streets in the region.

In August 1991, the Galesi Group, acting through Harlem River Yard Ventures, Inc., signed a 99-year lease agreement with DOT to develop a state-of-the-art transportation and industrial park at the 96-acre Harlem River Yard. Twenty-five of the 96 acres were reserved for an intermodal rail terminal that will be connected to the Link. Ventures has occupied the Yard since September 1991.

Development At The Yard

In 1989, the City's Deputy Commissioner of Ports and Trade warned that "Harlem River Yard may be lost as a transportation facility if it is not developed quickly." Furthermore, the lease agreement states that construction of intermodal facilities at the Yard will begin 12 months after the execution of the lease. However, as of September 1996 (more than five years after the lease was signed), development at the Yard had not yet begun. No intermodal terminals, warehouses, de-inking plants, or waste transfer stations have been built in the Yard. In June 1996, USA Waste, a sub-tenant to Ventures, began a small waste trans-shipment operation at the Yard. Ventures officials claimed that the permitting process and the lawsuit filed by the South Bronx Clean Air Coalition in October 1994 discouraged potential investors and delayed construction at the Yard. However, between the signing of the lease in September 1991 and the initiation of the lawsuit in August 1994, Ventures did not begin any development at the Yard.

DOT officials advised us that there was no reason for Ventures to delay construction of the intermodal facilities at the Yard. They told us that the lawsuit did not block the construction of the intermodal facility, and that the permit process had been completed and the lawsuit resolved since December 1995. However, they also advised us that Ventures plans to begin demolishing vacant structures at the Yard in the fall of 1996, to clear the site for construction of the intermodal terminal. Construction is expected to be completed by mid-1997. This delay in constructing the intermodal terminal means that the Link, which is expected to be completed soon, may not be fully usable for intermodal purposes until the terminal is completed.

Lease Terms

It is standard commercial real estate industry practice for a landlord or the landlord's representative to prepare proposed lease agreements. This ensures that the lease terms benefit and protect the rights of the landlord. According to DOT officials, however, the tenant (Ventures) prepared the proposed lease agreement for the development of the Yard because the DOT had little experience with arrangements for commercial development. DOT officials believed it was prudent to let Ventures state its requirements and then have DOT and Ventures representatives negotiate the final lease terms.

The proposed lease agreement was reviewed by an investment and corporate real estate consultant who was paid $43,000 by DOT. State officials and the consultant recommended changes to the proposed lease because they believed that it excessively favored Ventures. In addition, the consultant noted there were few precedents in the transportation industry for a transaction in which a private developer provides infrastructure improvements in return for a profit opportunity. As a result, some terms in the proposed lease were modified to protect the interest of the landlord. However, we concluded that the signed agreement still favored Ventures, thus placing the State at a considerable disadvantage, as follows:

Lease term equates to a transfer of ownership.

The term of the lease agreement between DOT and Ventures is for a period of 99 years. DOT officials stated that they agreed to the 99-year term because Ventures needed a lease period of that length to secure financing for the project's components. The consultants who reviewed the draft lease disagreed, stating that although a long-term lease is desirable, the period does not need to be so long. They said a term of 50 years should have been adequate to secure financing. In addition, DOT's other consultant, TBS, indicated that a 10- to 30-year lease term would be adequate.

However, DOT did not follow the consultants' advice. Moreover, both a major real estate developer and the Deputy Commissioner for the City's Department of Ports and Trade concluded that a 99-year lease was equivalent to a transfer of ownership. Also, a former DOT official, who assisted in negotiating the lease agreement, recently acknowledged that he now regrets agreeing to a 99-year lease, noting that it places DOT at a disadvantage. In addition, a representative from the Port Authority, which leases more than 2,200 acres to developers for industrial and intermodal development, stated that none of the Authority's lease agreements exceeds 40 years. In agreeing to such a long lease, DOT essentially transferred ownership to Ventures - for no consideration - of a major tract of real estate for which it paid $9 million in 1982. DOT had invested another $11 million for rail improvements on the property, which was subsequently appraised in 1990 at $24.5 million.

Public funds will be expended in developing the Yard.

In 1990, former Governor Cuomo stated that "The final and key element of this modernization program is the development of the Yard as a major intermodal terminal ... DOT has completed a plan to privatize the development of the yard." The RFP for the development of the Yard also stated that it is DOT's objective to have the private sector invest in and develop the Yard. DOT's representative told us that Ventures was selected because the firm had the experience and proposed to invest $90 million, the estimated cost of developing the Yard at that time. However, such private development of the Yard has not yet materialized. In a December 1989 letter to DOT, the Galesi Group made the following revision to its proposal: "The Developer has used conventional financing for purposes of its proposal. Although our proposal is not contingent upon alternative financing sources, we would of course pursue the possibility of using funds available in the 1983 Transportation Bond Act ...and any other federal, state or local funds." Thus, we believe that prior to approving the lease, DOT officials were aware that public funds may be sought to develop the Yard.

Furthermore, a senior vice president of Ventures provided us with a financial statement which indicated that Ventures' equity investment in the Yard as of December 1995 was $7 million. In contrast, DOT and its two partners have so far spent $200 million in public funds on the Link and the Yard. They have also committed $7 million in additional public funds for site clearance, construction of an intermodal terminal and other infrastructure improvements at the Yard. The Empire State Development Corporation has provided an additional $1.1 million in public funds for design and other costs. The Empire State Development Corporation has also approved the future issue of $75 million in tax-exempt bonds to finance the construction of a waste paper recycling plant at the Yard. It is anticipated that additional funding will be needed, because the plant is expected to cost more than $75 million. In addition, on November 15, 1994, the New York City Economic Development Corporation submitted an application for $3.1 million in ISTEA Congestion Mitigation - Air Quality funds for Ventures.

Although the RFP and other internal documents generated by DOT indicate that the intent was to have the Yard developed with private funds, the lease did not contain any covenants mandating the exclusive use of private funds for the development of the Yard or provisions for renegotiating the lease if public funds were used. Instead, the lease states:

> "The Tenant shall be solely responsible for any and all design and construction work of any kind, at any time, to be done in, on or to the Leased Premises. The Tenant shall do any and all construction work in, on or to the Leased Premises at its sole cost and expenses, except for the costs and expenses for . . . Remedial Action or Environmental Damage Mitigation, without specific contribution from the Landlord or the State of New York."

DOT officials stated that they were aware that the Galesi Group generally did not use its own funds to finance its projects. Thus, they could have negotiated a provision in the lease precluding the developer from requesting or receiving public funds from any source. This was not done, according to DOT officials, because they believed it would have put an unnecessary limitation on Ventures. DOT officials told us that public funds obtained from sources other than DOT are considered private funds, and thus are available for use by Ventures. Our study indicates that Ventures is using public funds instead of private funds, to finance the development of the Yard. In addition, Ventures' role has changed from that of developer/investor/risk taker to that of a real estate broker. For example, Bronx Community Paper Company has an agreement with Ventures to construct a paper recycling plant at the Yard. At the time of our study, Paper Company officials were negotiating with the State and the City to obtain funds to build the plant.

Prescribed revenues to the State

According to the RFP, DOT intended to receive a reasonable return from the development and operation of the Yard. As consideration for leasing the Yard, Ventures agreed to pay DOT six percent of gross rental revenues, effective October 1, 1991. In the sixth year of the lease, DOT's consideration will increase to the greater of $400,000 or six percent of gross annual rental revenues and will continue to increase incrementally thereafter. DOT's consultants and attorneys who reviewed the lease disagreed with this rate of return. They indicated that it was below the market rate of return for the property and was atypical for such arrangements. They further indicated that six percent of Ventures' gross rental revenues would equate to a 75/25 share, in Ventures' favor, of the average net operating income. They recommended that the terms be changed to 10 to 13 percent of Ventures' gross rental revenues. At 10 percent, DOT would obtain the typical 50/50 share of net operating income, which was the industry standard.

Ventures' financial statement, which was included with its initial proposal, estimated that the DOT's six percent share of gross rental revenues would equate to approximately $1.1 million per year, averaged over a ten-year period. Officials from the City Comptroller's Office claimed at the time that this was still $2.3 million below the market rent for a 96-acre South Bronx industrial site. Subsequently, Ventures amended the DOT's proposed return to approximately $524,000, averaged over the same 10-year period. However, even though Ventures has occupied the Yard for nearly five years, the expected financial returns to the DOT have not yet materialized. Ventures officials told us that the undeveloped Yard has generated only $972,000 in gross rental revenues for the 57-month period from September 18, 1991 through June 30, 1996. DOT's share ($58,000) of these revenues has been credited against the amount that Ventures paid for an environmental remediation study. In contrast, during the 40-month period from June 1988 through September 1991, before the lease was signed, DOT earned about $1 million in rent from similar tenants at the undeveloped Yard.

Ventures officials stated that they restructured the proposed return to DOT because the market and expected conditions at the Yard had changed. DOT officials stated that they never intended to maximize the State's return on the Yard; developing an intermodal facility in the Bronx was their primary goal. Officials said they feared that the State would find other uses for the Yard, and the possibility of its use as an intermodal facility would have been lost forever, if an agreement had not been signed quickly with Ventures. Yet, the lease sets aside just 25 of the 96 acres at the Yard for use as an intermodal facility. Meanwhile, Ventures' role has changed from investor/developer (with a substantial risk in the development of the Yard) to a real estate broker with no risk, because a significant portion of the costs for site preparation and the construction of the intermodal terminal will be publicly funded.

Nonetheless, Ventures has not reduced its 94-percent share of gross rental revenues to reflect its diminished role, its reduced level of financial exposure and the increased reliance on public funds. In addition, since the State owns the Yard and has leased it to Ventures for 99 years, it will not be subject to real property taxes. Although many leases (for economic development programs) between public and private parties provide for payments in lieu of taxes to the appropriate governmental entity, this lease does not. As a result, officials from the City Comptroller's Office told us that the City will lose about $2 million annually in projected property tax revenues. Consequently, we believe that senior public managers and elected leaders should very carefully assess such arrangements if they are proposed in the future.

Environmental Issues

The RFP for the Yard stated that the developer/operator will accept the premises "as is." Ventures subsequently funded an environmental remediation study of the Yard, with the understanding that the cost of the $358,000 study would be credited against DOT's share of gross rental revenues. Ventures then negotiated a provision to the lease that shifted the responsibility for remediation of any environmental damage at the Yard to DOT. DOT officials stated that they accepted responsibility for the environmental remediation because Federal regulations required them to do so, and because Ventures threatened to withdraw its proposal if they did not.

A consultant hired by DOT estimated that remediation would cost between $11.2 million and $17.4 million, depending on the type of development at the Yard. DOT officials now state that Ventures' experienced environmental attorneys have proposed a settlement to the New York State Department of Environmental Conservation that will limit the remediation to less than $1.5 million. However, the lease agreement states that the cost of the remediation will be credited against DOT's share of gross rental revenues which have been estimated by DOT officials to be approximately $48.8 million over the 99-year term of the lease agreement. Thus, not only will the State be required to pay for the cleanup, but Ventures will be doing the work. Unless DOT accepts responsibility for monitoring operations at the Yard and reviewing Ventures' records, the State will have inadequate control over the cost of the remediation, which could be several millions of dollars.

DOT Oversight of Operations at the Yard

As the landlord and lead agency for operations at the Yard, DOT is responsible for monitoring the operations at the Yard, reviewing and verifying financial records relevant to those operations, and ensuring that Ventures abides by the terms of the lease agreement. We found that this monitoring responsibility is not being carried out adequately. DOT officials were not always aware of the status of negotiations between Ventures and potential subtenants. They have not enforced the benchmarks contained in the lease; nor have they verified financial documents submitted in support of rental revenues and Ventures' claimed expenses for the development of the Yard. For example, Ventures claimed that $972,000 in gross rental revenues had been collected during the period September 18, 1991 through June 30, 1996. However, this was never verified, although the lease agreement provides DOT with the authority to audit Ventures' rental records annually to verify that the State is receiving its fair share of the income stream.

Furthermore, Ventures claims to have expended approximately $7 million on the Yard as of December 31, 1995. However, this amount has also never been verified even though Ventures' expenditures will be considered in determining equity distribution if the Yard is sold or the lease is reassigned. DOT officials acknowledged that they have not been closely monitoring the activities at or related to the Yard. They stated that they do not have enough staff to provide effective monitoring, and thus do not want to be burdened with either day-to-day monitoring or close involvement with development at the Yard. They said they intended to simply rely on Ventures to abide by the articles of the lease agreement. Thus, we believe that DOT has not adequately performed its oversight responsibility, and therefore, Ventures has not complied with the lease terms and has yet to begin development of the Yard. Subsequent to presenting our preliminary findings to DOT officials, they advised us that they would take steps to improve DOT's oversight of activities at the Yard. This would include the assignment of a representative from DOT's NYC office to ensure that Ventures complies with the terms of the lease agreement.

The lease agreement also requires Ventures to set up a marketing fund of $100,000 to promote rail transportation at the Yard. This fund, which is to be replenished during the term of the lease and used for marketing and related promotional activities, is to be managed jointly by Ventures and DOT. To date, this fund has not been set up. DOT officials claimed that the Yard is not yet developed, and that it is Ventures' responsibility (not DOT's) to market the Link and the intermodal operation at the Yard. Thus, DOT has not insisted that the fund be set up or that the two projects be marketed effectively. As a result, there is only one signed agreement from potential customers to use the Link or the intermodal facilities to be developed at the Yard. However, our survey of major trucking companies and intermodal carriers indicated that many of them were unaware of the existence of either the Link or the Yard.

DOT officials now indicate that they will meet with representatives from Ventures to ensure that the fund is established.

Control of Use of the Yard and the Link

The intent of the Program was to promote the use of rail transportation, thereby reducing the level of air pollution and the number of truck trips into the region. In addition, Ventures' proposal for Congestion Mitigation - Air Quality funds indicated that the intermodal facility at the Yard will also decrease the number of truck trips in the region. However, Ventures has curtailed the access of Waste Management, Inc. (a solid waste recycling and transfer facility abutting the Yard) to a sidetrack that interchanges with the tracks in the Yard. Waste Management officials stated that until 1993 (almost two years after the signing of the lease agreement between DOT and Ventures), they used this sidetrack for daily shipments of more than 1,000 tons of sludge and recycled waste.

However, in May 1995, Ventures informed Conrail that Waste Management's sidetrack was illegal and that Conrail could no longer use the tracks in the Yard to service it. Ventures then summarily removed certain track switches and blocked the tracks with truck trailers. As a result, Waste Management officials told us that they now use an additional 40 trucks instead of 10 rail cars to ship recycled waste from their facility. At the same time, Ventures has allowed USA Waste, a competitor of Waste Management, to establish a small waste transfer operation at the Yard. Since the lease grants Ventures exclusive rights to the Yard, its tracks (and thus the Link), Ventures' action establishes a monopoly that could impede the achievement of the objectives of both DOT and the Program to increase rail use and decrease truck traffic on the region's roadways.

In addition, with Ventures denying Waste Management, Inc. access to the rail facilities, the potential is to increase the cost of waste collection for the citizens and businesses in New York City. It is also not in keeping with the intent of servicing the public interest and reducing truck trips in the region.

Renegotiating the Lease

In a May 1996 meeting, we asked DOT officials if they would consider renegotiating the lease agreement. They declined and stated that they negotiated the best lease possible, given the fact that DOT did not have the funds to develop the Yard. DOT officials also stated that the lease was approved by the Offices of the Attorney General and the State Comptroller. However, a letter dated April 9, 1991 from DOT's attorney to the Attorney General and the Comptroller, seeking approval of the lease, stated that the Yard would be developed by the private sector. This letter could have been somewhat misleading, since DOT officials were aware that the Galesi Group intended to seek public funds to develop the Yard. However, an official from the Department of Law cautions that renegotiating the lease agreement could lead to further litigation by the South Bronx Clean Air Coalition.

Issues To Be Considered

6. With more than $200 million in public funds already spent or committed for the development of the Link and the Yard, how can DOT, senior public managers, and elected officials closely evaluate proposals to use additional public funds for these two projects, to ensure that such funding does not primarily benefit a private developer?

7. Have adequate plans been developed to ensure that public funds spent to dredge the New York Harbor and to reopen the Howland Hook Terminal will complement public investment in the downstate rail freight system?

8. What actions should be taken by DOT if economic development of the Yard does not occur, as prescribed by the lease agreement? Should such actions include:

   ! renegotiation of specific lease terms, such as the 99-year lease term and DOT's share of gross rental revenues?

   ! providing Ventures with a notice of default for non-compliance with the lease agreement and develop the Yard themselves?

9. Would increased oversight of operations at the Yard ensure that DOT is receiving its fair share of revenues and that Ventures' expenditures are not overstated?

10. What action is DOT taking to ensure that the marketing fund is established, used, and monitored?

11. Why has the conflict between Waste Management Inc. and Ventures not been resolved? Is the effect of denying Waste Management, Inc. access to rail facilities to increase waste collection costs in New York City? Would resolution ensure that the objectives of the Program are achieved?

Department of Transportation
Oak Point Link and Harlem River Yard
Map of Rail Lines in New York City Region

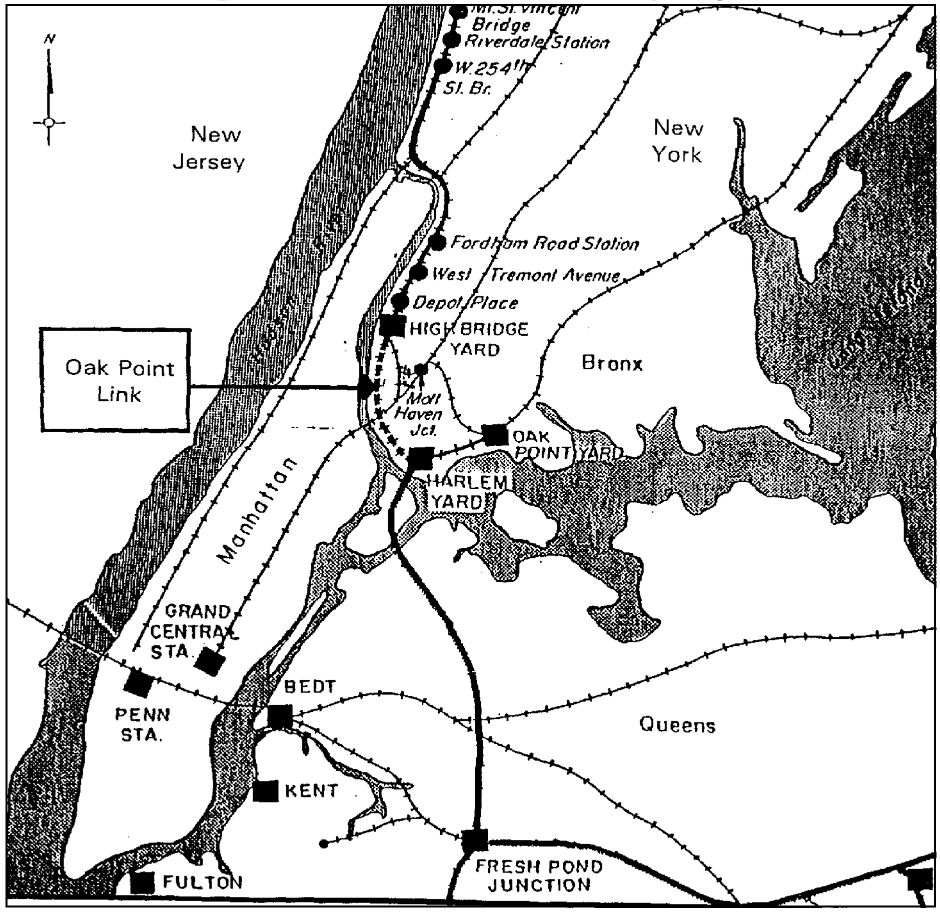

Exhibit A

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December 9, 1996

Mr. David Hancox
Director of State Audits
Office of State Comptroller
A.E. Smith State Office Building
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RE: Response to Oak Point Link/Harlem River Yard Report

Dear Mr. Hancox:

Thank you for allowing the Department of Transportation an opportunity to respond to your Draft Staff Study on the Viability of the Oak Point Link and Harlem River Yard projects (Report 95-D-43). As you know, while the Harlem River Yard project was funded by the Department of Transportation, funding for the Oak Point Link was provided jointly by the Port Authority (65%), the City of New York (19%) and the Department (16%).

The Department does not dispute that these two projects have faced difficulties over their duration in terms of increased costs and construction delays. However, the Department is committed to completing both the Link and the development of the Yard and utilizing them to every extent possible to enhance the region's and the state's economy.

As you may be aware, under Commissioner Daly's leadership, the Department has formed a new division, the Freight and Economic Development Division, to help promote rail as an important part of the state's transportation system. Last summer, the Division held two separate freight seminars in order to discuss with the business community and shippers how rail access can be improved in New York State. While these projects analyzed in the audit are not the full answer, the Department plans to utilize them as it continues its efforts to utilize transportation improvements to help promote economic development in New York State.

The Oak Point Link and the Harlem River Yard are rail transportation projects which have the potential to provide long term benefits to New York City and Long Island. The Department has begun the process of working with Conrail and Harlem River Yard Ventures to help maintain rail as a competitively priced transportation option for businesses in the New York Metropolitan area. The Department will also work closely with the Ventures Group to insure that the facilities to be constructed on state property are properly built and adequately maintained.

After years of delay, the Department has taken actions to bring the project to its fruition so that the Oak Point Link's anticipated benefits can be realized, including reducing congestion on Metro North Rail Road's primary commuter lines in the Bronx, and allowing modern, full-height rail cars into the Metropolitan area for the first time in many years. The Department is negotiating with Conrail which is committed to move its existing freight traffic from Metro North Rail Road tracks to the Link and will add service that currently terminates in New Jersey.

The Department has had discussions with Conrail regarding an agreement to operate on and maintain the Link. This agreement is now being drafted. The Department sees many potential markets for freight movements using the Link and the Yard, including the transport of foodstuffs to Hunts Point Terminal Market and the movement of solid waste and recycled materials out of the Yard.

As the Oak Point Link project draws to its conclusion, construction activities in the Harlem River Yard are commencing. Conrail already has an operating agreement with the Harlem River Yard Ventures group to serve rail customers within the Yard.

The Department believes that Conrail's operation in the Yard, combined with aggressive marketing by Harlem River Yard Ventures, has the potential to lure customers from the New Jersey freight terminals to the Harlem River Yard facility.

You should also be aware that the Department is pursuing and will continue to work to secure payment from the New York City Economic Development Corporation, which has agreed that it owes the Department funds for the project. However, disputes continue with their legal staff over the deed covenants. The recent assistance provided by your Office to obtain reimbursement from the City is greatly appreciated.

Regarding the $10 million ISTEA appropriation, it should be noted that the expenditure of federal funds under this appropriation was never authorized by Congress. The Department's repeated attempts over the past several years to have these funds authorized for the Oak Point Link project met with no success. The Department will continue its efforts to secure these funds.

In summary, the Department recognizes that these projects have been plagued by excessive delays and escalating costs. However, despite the past problems, the Department is committed to utilizing these projects to help improve rail access to the New York City Metropolitan area.

It is requested that the final report include the Department's comments.

Sincerely,

John F. Guinan

John F. Guinan
Assistant Commissioner, Passenger & Freight Transportation

cc: John Cape, Division of Budget
Deirdre Taylor, Division of Budget