



NORTH CAROLINA
RAILROAD
C O M P A N Y



NORTH CAROLINA RAILROAD COMPANY

2012

ANNUAL REPORT

Building a better railroad



Contents

Chairman's Letter	3
2012 at a Glance	4
NCRR By the Numbers	9
Capital Improvements	11
Consolidated Financial Statements	17

OUR MISSION: TO MAXIMIZE THE VALUE OF THE NORTH CAROLINA RAILROAD COMPANY'S PROPERTIES FOR THE PEOPLE OF NORTH CAROLINA THROUGH PARTNERSHIPS THAT DRIVE ECONOMIC GROWTH, ENHANCE FREIGHT AND PASSENGER SERVICE, IMPROVE SAFETY AND RESPECT THE NATURAL ENVIRONMENT.



“The North Carolina Railroad is well positioned to serve business and industry throughout our state. As a local family owned and operated company, we value the relationship we have established with the Railroad over the years. Having access to the rail corridor has significantly influenced the direction our business model has taken. The staff and leadership are friendly, professional and accessible, and we appreciate having the opportunity to do business with them.”

The Daniel Family
Co-Owners
Bailey Feed Mill, Selma, N.C.

Chairman's Letter



John L. Atkins, III

In 1849 the visionary Governor John Motley Morehead described North Carolina as "an economic tree of life." Today, the railroad is on the same track, improving freight, moving people, and investing in our state by promoting commerce and helping to create jobs.

Looking back on 2012, we reflect on an important year in the life of the North Carolina Railroad Company. Last summer, Norfolk Southern renewed its track operating agreement with us for an additional 15 years. The NCRR uses revenues from this agreement to benefit our entire state through investments in rail upgrades such as bridges, double-tracking and sidings, and other upgrades for capacity, efficiency and safety.

In 2012, the NCRR also began focusing on the future.

Our management team spent the better part of the year assisting the North Carolina General Assembly's Program Evaluation Division with a comprehensive report on the railroad's history, its unique corporate structure, mission, and capital improvement plans.

Late in 2012, with the help of the Kenan Flagler Business School, the NCRR board and management team started a comprehensive strategic visioning exercise. This key effort will help us set priorities that will benefit North Carolina for years to come.

These priorities include meeting the needs of our state for economic development, and focusing on the Piedmont where double tracking is underway to help freight and passenger service capacity.

This work will help us maximize the railroad's assets for the good of the people of North Carolina.

The North Carolina Railroad is a self-sustaining company managed by a dedicated board of directors working closely with all of our partners to build a bright future for the rail industry and contribute to our state's economic growth.

The NCRR depends on a variety of partnerships to accomplish our goals and help drive our state's economy. We collaborate with Norfolk Southern, the NC Department of Transportation, transit authorities, chambers of commerce, local governments and North Carolina's economic development community.

As in the past and into the future, the NCRR, its management and its board of directors remain committed to improving the North Carolina Railroad to benefit our state.

JOHN L. ATKINS, III
CHAIRMAN OF THE NCRR BOARD OF DIRECTORS

2012 AT A GLANCE



A historic former railroad depot is now a mixed-use commercial establishment, filled with locally owned restaurants that bring an economic boost to the artsy warehouse district in downtown Raleigh.



↑ The NCRR is uniquely positioned to serve businesses and industries that transport products by rail. The family-owned Bailey Feed Mill in Selma, which saw growth in 2012, has long been one of the NCRR's most valuable partners. From left: Richard Wiley, NCRR; Albert Daniel, Bailey Feed Mill; Jennifer Daniel Boughman, Bailey Feed Mill; Al Daniel, Bailey Feed Mill; Scott Saylor, NCRR; Douglas Daniel, Bailey Feed Mill.

→ The NCRR completed improvements to the Trent River Railroad Bridge in New Bern. The \$1.8 million cost was split evenly between the North Carolina Railroad and Norfolk Southern. This project involved encasing corroding steel piles in concrete for stabilization.



↓ Norfolk Southern extended its trackage rights agreement with the North Carolina Railroad, ensuring that their long partnership will continue for years to come.



North Carolina Railroad Company

A Banner Year for the NCRR

2012 was a significant year for the North Carolina Railroad Company.

It was the year Norfolk Southern extended its track operating agreement with the NCRR for an additional 15 years.

And it was the year the NCRR made history when it leased three miles of its corridor in uptown Charlotte to the Charlotte Area Transit System to enable the CATS light rail service to reach the campus of the University of North Carolina at Charlotte.

The NCRR, in partnership with the University of North Carolina at Greensboro, broke ground on a pedestrian underpass connecting new student housing and a mixed use village with the university's main campus.

The NCRR also partnered with Norfolk Southern on improving bridges in Eastern North Carolina. This will enable trains to increase speed and efficiency.

In 2012, the NCRR participated in events promoting rail safety, economic development, and other activities of vital importance to the railroad and the people it serves.

To help the NCRR continue to serve the people of the state of North Carolina, the management and board kicked off a landmark strategic visioning program to set priorities and guide decision making in future years. Here are a few highlights of a banner year in the life of the North Carolina Railroad.



The North Carolina Railroad participated in a variety of safety awareness programs, with the N.C. Department of Transportation and Operation Lifesaver.



North Carolina Railroad started a innovative monumentation project, installing permanent markers along the rail corridor boundary for future corridor management, and engineering and planning purposes. The project stretches the entire 317-mile length of the NCRR.



The North Carolina Railroad participated in the Envision East Conference in Jones County. During the daylong event, participants focused on creative ways to bring economic development and jobs to Eastern North Carolina. NCRR board member Franklin Rouse (center).



The NCRR was a part of the North Carolina Main Street Association's 2012 Conference in Clayton.





The Board of Directors and management launched a comprehensive strategic planning initiative under the guidance of Dr. Paul Friga, with UNC Kenan Flagler Business School Executive Development Program. This exercise will chart the NCRR's mission to enhance business growth, facilitate passenger rail and help improve North Carolina's economy.



✦ Last September, the North Carolina Railroad joined officials with the University of North Carolina at Greensboro to break ground on a pedestrian walkway, linking a new student housing village with the main campus through a passageway under the North Carolina Railroad corridor.

2012 AT A GLANCE

✦ Participants in the North Carolina Railroad-sponsored Commuter Rail Roundtable spent a day in Nashville, Tenn. with the Nashville Metro Transit Authority learning about the development of the Music City Star.



The Queen City shines behind the train station in uptown Charlotte. In 2012, the North Carolina Railroad signed a landmark agreement to lease three miles of its corridor to the Charlotte Area Transit System to extend the Blue Line light rail.



"The North Carolina Railroad Company plays a key role in the economic development of a vital corridor in Norfolk Southern's rail network. Our longstanding partnership with NCCR has helped the economy of North Carolina expand and helped our business grow. The NCCR team is highly professional and committed to advancing North Carolina's interests, and that's good for Norfolk Southern, too."

Charles W. "Wick" Moorman
Chairman, President & CEO
Norfolk Southern Corporation

NORTH CAROLINA RAILROAD COMPANY

By the Numbers

200

feet – The North Carolina Railroad corridor is uniformly 200 feet wide

317

miles – The North Carolina Railroad is 317 miles long

1

mile – the distance it takes a train to stop

24%

percent – the percentage of North Carolina's economy that is touched by the North Carolina Railroad

\$104
MILLION

dollars – The amount of money the North Carolina Railroad has committed toward capital projects through 2020

16

counties – the number of counties the North Carolina Railroad passes through

164

years – the North Carolina Railroad Company was chartered 164 years ago



“Our partnership with the North Carolina Railroad represents a significant investment in the future of public transit in Charlotte. The LYNX Blue Line Extension provides connectivity and sustainable choices for the Charlotte region, one of the fastest growing areas in the country.”

Carolyn Flowers
Chief Executive Officer
Charlotte Area Transit System

Capital Improvements

Completed 2012

Lenoir County: Rebuilt wooden bridge trestles over the Neuse River near Kinston to improve speed.

Partner: Norfolk Southern

Total Cost: \$3,310,808 | NCRR Investment: \$1,655,404 | Completed 2012

Craven County: Improved corroding steel pipe piles on the railroad bridge over the Trent River in New Bern for preservation.

Partner: Norfolk Southern

Total Cost: \$1,886,756 | NCRR Investment: \$943,378 | Completed 2012

Johnston/Wayne/Lenoir/Craven/Carteret Counties: Improved Eastern Grade Crossing protection on unsignalized or partially signalized grade crossings for 115 miles between CSX Junction in Selma and Morehead City to improve safety and speed. (Under Phase I, 23 crossings have been improved)

Partners: NCDOT (Federal Funds); Norfolk Southern

Total Cost: \$3,757,366 | NCRR Investment: \$913,040 | Completed 2012

Completed 2000 - 2011

Lenoir/Craven Counties: Replaced railroad trestles over creeks in Lenoir and Craven counties to address settling piers and weight requirements and to improve drainage and speed.

Partner: Norfolk Southern

Total Cost: \$3,007,616 | NCRR Investment: \$1,503,808 | Completed 2011

Craven/Carteret Counties: Welded joints in the 100-lb. rail between New Bern and Morehead City to improve longevity and speed.

Total Cost & NCRR Investment: \$300,510 | Completed 2010

Lenoir County: Constructed siding track and loading ramp to serve local industries and other users for economic development.

Total Cost & NCRR Investment: \$891,937 | Completed 2010

Lenoir County: Straightened a curve in the railroad in downtown Kinston to improve train speeds from 10 mph to 25 mph, to increase clearances for safety, and to reduce impacts to downtown traffic.

Total Cost & NCRR Investment: \$2,759,628 | Completed 2010

Alamance County: Constructed a pedestrian underpass at Elon University to help the campus expand, improve safety, and discourage pedestrian access to the rail corridor.

Partner: Elon University

Total Cost: \$2,500,000 | NCRR Investment: \$1,000,000 | Completed 2010

Completed projects 2000-2011 (continued)

Guilford County: Double Track High Point/Greensboro Segment: Added a second track for nine miles on one of the most congested areas of the NCRR to reduce delays associated with meeting and passing trains, and to add rail capacity and improve efficiency.

Partners: NCDOT (Federal Funds) & Norfolk Southern

Total Cost: \$27,963,685 | NCRR Investment: \$4,000,000 | Completed 2009

Wayne/Lenoir/Craven/Carteret Counties: Upgraded 90 lb rail, (dating back to 1924) with a higher grade continuous welded rail. Improved drainage in Dover and constructed a retaining wall to support the track and welded rail. This work improved reliability and drainage.

Total Cost & NCRR Investment: \$4,836,410 | Welding Completed 2007 / Drainage Completed 2009

Johnston County: Replaced a restricted bridge structure to eliminate speed restrictions, increase clearance on Old Hwy 70 in Clayton, and improve safety.

Total Cost & NCRR Investment: \$889,660 | Completed 2008

Wake/Johnston Counties: Constructed three passing tracks totaling 8 miles between Raleigh and Selma to improve passenger and freight train performance and service. Added Centralized Traffic Control for 31 miles to raise service to the same standard as service between Raleigh and Charlotte. The project included installing a new interlocking and revising the track layout to increase speed to and from the Raleigh rail yard, as well as improving the Cabarrus Street Yard. Project improved capacity, speed and efficiency.

Total Cost and NCRR Investment: \$20,882,331 | Completed 2008

Johnston/Alamance Counties: Repaired and renovated Neuse River Bridge in Johnston County and Webb Avenue bridge in Alamance County to improve clearances.

Total Cost and NCRR Investment: \$78,236 | Completed 2008

Durham County: Replaced existing single track railroad bridge over Highway 54 in Research Triangle Park (RTP) with double track ready structure to improve capacity and permit NCDOT to upgrade and widen the highway.

Total Cost and NCRR Investment: \$5,460,726 | Completed 2006

Craven County: Replaced wooden bridge trestle over Batchelder Creek to improve capacity.

Total Cost and NCRR Investment: \$372,237 | Completed 2006

Lenoir County: Replaced jointed rail with continuous welded rail for a 17-mile segment near Kinston to improve efficiency and speed.

Total Cost and NCRR Investment: \$3,875,652 | Completed 2005

Lenoir County: Replaced the Neuse River Bridge in Kinston to increase the load to permit the transport of 286,000-lb railcars and allow for increased port traffic. Also replaced jointed rail with continuous welded rail for a 14-mile segment in Kinston. Projects improved efficiency and speed.

Total Cost and NCRR Investment: \$6,570,182 | Completed 2004

Durham County: Extended a passing siding and straightened a curve west of Durham for approximately one mile to improve efficiency and speed for passenger trains.

Partner: NCDOT (Federal Funds)

Total Cost: \$2,308,257 | NCRR Investment: \$22,912 | Completed 2003

Wayne/Lenoir/Craven/Carteret Counties: Upgraded track condition between Goldsboro and Morehead City including tie and rail replacement to improve speed and efficiency.

Total Cost and NCRR Investment: \$9,957,700 | Completed 2000

Committed Projects 2013- 2017

Wayne/Lenoir/Craven/Carteret Counties: The Bridge & Culvert Program improves two bridges in Goldsboro and Newport and two culverts in Kinston and Cove City. The bridge in Newport is wrapping up construction; the others are complete. Projects will improve drainage and train speed.

Partner: Norfolk Southern

Total Cost Estimate: \$4,677,700 | NCRR Investment: \$2,338,850 | Est. Completion: 2013

Guilford County: A pedestrian underpass at the University of North Carolina at Greensboro will improve safety, discourage pedestrian access to the rail corridor, and allow the campus to expand. The project will improve safety and facilitate economic development.

Partner: UNCG

Total Cost Estimate: \$9,000,000 | NCRR Investment: \$1,000,000 | Est. Completion: 2013

Rowan/Davidson Counties: Track improvements between Linwood Yard and the Yadkin River will improve the railroad alignment and provide capacity and safety improvements in Rowan and Davidson counties under new I-85 bridges.

Partner: NCDOT (Federal ARRA Funds)

Total Cost Estimate: \$4,444,659 | NCRR Investment: \$3,000,000 | Est. Completion: 2013

Lenoir County: Construction of a two mile passing siding near LaGrange on the eastern part of the NCRR. There currently are no passing sidings for 114 miles between Selma and Morehead City, and the new siding will improve capacity.

Total Cost and NCRR investment: \$4,070,000 | Est. Completion: 2013

Craven County: Replace bridge ties and draw span lift rails on the Trent River Bridge in New Bern to improve train speed.

Partner: Norfolk Southern

Total Cost: \$1,890,000 | NCRR Investment: \$945,000 | Est. Completion: 2013

Alamance County: Rehabilitate the Webb Avenue Bridge at Glen Raven by painting and cleaning concrete abutments and wing walls for preservation.

Partner: Norfolk Southern

Total Cost: \$920,000 | NCRR Investment: \$460,000 | Est. Completion: 2013

Committed projects 2013-2017 (continued)

Corridor wide: Survey/Monumentation Project to establish permanent rail corridor monuments for corridor management, engineering, and planning purposes. The project will also incorporate geodetic monuments in a statewide survey grid.

Total Cost and NCRR Investment: \$3,000,000 | Est. Completion: 2014

Johnston County: Improve capacity and operations in the Selma Yard by constructing a fourth track and reconfiguring track alignments.

Total Cost and NCRR Investment: \$3,470,000 | Est. Completion: 2014

Johnston/Wayne/Lenoir/Craven/Carteret Counties: Eastern Grade Crossing Improvements will complete eastern grade crossing upgrades on unsignalized or partially signalized grade crossings for 115 miles between Selma and Morehead City to improve safety and speed. (Under Phase II, the remaining crossings will be improved).

Partners: NCDOT (Federal Funds); Norfolk Southern

Total Cost: \$3,884,384 | NCRR Investment: \$1,314,160 | Est. Completion: 2014

Durham County: Construct a grade separation and a passing siding and straightening a curve near Hopson Road at Research Triangle Park in Durham County to improve safety and allow higher speeds for freight and passenger trains.

Partner: NCDOT (Federal ARRA Funds)

Total Cost: \$24,000,000 | NCRR investment: \$2,000,000 | Est. Completion: 2015

Davidson County to Mecklenburg County: Double track heavily used portion of the NCRR corridor with up to 50 freight trains and eight passenger trains daily. Second track will reduce congestion and delays, increase rail capacity, and improve safety. Costs include highway grade separations.

Partner: NCDOT (Federal ARRA Funds)

Total Cost: \$203,100,000

Individual sections and costs:

Thomasville to Lexington Double Track - 4.2 miles: \$42,000,000

Kannapolis to Salisbury Double Track – 10 miles: \$60,400,000

North Charlotte to Concord Double Track – 12.1 miles: \$100,700,000

NCRR Investment: \$31,000,000 | Est. Completion: 2017

Mecklenburg County: Grade Separation at Sugar Creek Road in Charlotte will eliminate a busy and dangerous at-grade railroad crossing by adding an overhead bridge at Sugar Creek Road, the NCRR's main freight and passenger line, and the busiest intersection on the railroad. The project will improve safety and increase track speed.

Partner: NCDOT (Federal TIGER Funds)

Total Cost: \$34,000,000 | NCRR Investment: \$10,000,000 | Est. Completion: 2017

* Committed projects are those under contract with a partner that does not include all of the NCRR proposed future projects.



North Carolina Railroad Company

NCRR Board of Directors and Management



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REAL ESTATE
REPRESENTATIVE

RICHARD WILEY

SENIOR CONSULTANT FOR
ECONOMIC DEVELOPMENT



“The North Carolina Railroad Company worked very closely with United Furniture Industries to make our expansion work well in Davidson County.

Today we have over 450 workers producing upholstered furniture in Davidson County. Without the close cooperation of the North Carolina Railroad, we would not have been able to recognize this opportunity.”

–Bob Cottam

United Furniture Industries, Lexington, N.C.

2012

FINANCIAL REPORT

Consolidated Financial Statements
Years Ended December 31, 2012 and 2011

North Carolina Railroad Company

TABLE OF CONTENTS

	<u>Page No.</u>
Independent Auditors' Report	21
Consolidated Financial Statements:	
Consolidated Balance Sheets.....	23
Consolidated Statements of Income	25
Consolidated Statements of Stockholder's Equity	26
Consolidated Statements of Cash Flows	27
Notes to Consolidated Financial Statements	28



Independent Auditors' Report

To the Directors and Stockholder
North Carolina Railroad Company
Raleigh, North Carolina

We have audited the accompanying consolidated financial statements of North Carolina Railroad Company and subsidiary, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of income, stockholder's equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.



Basis for Qualified Opinion

We did not obtain sufficient audit evidence supporting the capital contributions received from the State of North Carolina representing capital improvement projects of \$2,004,821 and \$2,666,693 during the years ended December 31, 2012 and 2011, respectively, nor did we obtain sufficient audit evidence supporting the capital contributions received in years prior to 2011. The total of these contributions of \$78,375,872 and \$76,371,051 are recorded in property and equipment and contributed capital in the consolidated balance sheets as of December 31, 2012 and 2011, respectively. The consolidated statements of income for the years ended December 31, 2012 and 2011 includes depreciation expense of \$6,646,852 and \$6,596,267, respectively related to these assets. We were also unable to satisfy ourselves as to the carrying value of this property and equipment, capital contributions, and related depreciation expense by other auditing procedures.

Qualified Opinion

In our opinion, except for the possible effects of the matter discussed in the Basis for Qualified Opinion paragraph, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of North Carolina Railroad Company and subsidiary as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Dixon Hughes Goodman LLP

Raleigh, North Carolina
May 22, 2013

North Carolina Railroad Company
Consolidated Balance Sheets
December 31, 2012 and 2011

	2012	2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,828,078	\$ 2,137,061
Accounts receivable	539,772	237,159
Prepaid expenses	38,879	38,874
Total current assets	<u>4,406,729</u>	<u>2,413,094</u>
Property and equipment		
Roadway and land	7,848,742	7,848,742
Tracks, signals and bridges	124,030,189	119,878,042
Land	4,613,555	4,611,755
Buildings and improvements	15,494,439	14,694,500
Equipment and furniture	1,445,773	1,163,802
Construction in progress	5,600,879	2,909,254
	159,033,577	151,106,095
Less accumulated depreciation	<u>71,776,697</u>	<u>60,468,309</u>
Property and equipment, net	<u>87,256,880</u>	<u>90,637,786</u>
Other assets		
Funded capital projects	72,220,616	65,188,435
Long-term receivable	1,724,567	2,645,378
Deposits	22,541	16,725
Total other assets	<u>73,967,724</u>	<u>67,850,538</u>
Total assets	<u>\$ 165,631,333</u>	<u>\$ 160,901,418</u>

North Carolina Railroad Company
Consolidated Balance Sheets (Continued)
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
LIABILITIES AND STOCKHOLDER'S EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 1,289,069	\$ 1,376,006
Total current liabilities	<u>1,289,069</u>	<u>1,376,006</u>
Long-term liabilities		
Security deposits	61,601	61,601
Deferred tax liability	<u>533,000</u>	<u>541,000</u>
Total long-term liabilities	<u>594,601</u>	<u>602,601</u>
Total liabilities	<u>1,883,670</u>	<u>1,978,607</u>
Commitments (Note 3)		
Stockholder's Equity		
Common stock, \$0.50 par value; 10,000,000 shares authorized; 317 shares issued and outstanding	159	159
Additional paid-in capital	199,370,772	197,365,951
Accumulated deficit	<u>(35,623,268)</u>	<u>(38,443,299)</u>
Total stockholder's equity	<u>163,747,663</u>	<u>158,922,811</u>
Total liabilities and stockholder's equity	<u>\$ 165,631,333</u>	<u>\$ 160,901,418</u>

See accompanying notes to consolidated financial statements.

North Carolina Railroad Company
Consolidated Statements of Income
For the Years Ended December 31, 2012 and 2011

	2012	2011
Income:		
Lease of roadway and land	\$ 14,311,367	\$ 14,133,845
Other lease income	1,991,638	2,351,383
Interest and dividend income	892,025	799,927
Other income	<u>1,094,302</u>	<u>3,417,907</u>
Total income	<u>18,289,332</u>	<u>20,703,062</u>
Expenses:		
Wages and benefits	1,499,003	1,421,327
Professional fees	512,003	289,194
Contracted services	354,313	306,833
Reporting and public relations	166,861	179,795
Insurance	131,003	137,791
Franchise and property taxes	435,680	416,678
Depreciation	11,308,388	11,232,243
Repairs and maintenance	158,412	205,997
Engineering, surveying and mapping	189,590	163,387
General and administrative	<u>662,309</u>	<u>610,052</u>
Total expenses	<u>15,417,562</u>	<u>14,963,297</u>
Income before income taxes	2,871,770	5,739,765
Income tax expense	<u>51,739</u>	<u>60,772</u>
Net income	<u>\$ 2,820,031</u>	<u>\$ 5,678,993</u>

See accompanying notes to consolidated financial statements.

North Carolina Railroad Company
Consolidated Statements of Stockholder's Equity
For the Years Ended December 31, 2012 and 2011

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Total Stockholder's Equity
Balance at January 1, 2011	\$ 159	\$ 194,699,258	\$ (44,122,292)	\$ 150,577,125
Capital contribution related to capital improvement projects	-	2,666,693	-	2,666,693
Net income	-	-	5,678,993	5,678,993
Balance at December 31, 2011	159	197,365,951	(38,443,299)	158,922,811
Capital contribution related to capital improvement projects	-	2,004,821	-	2,004,821
Net income	-	-	2,820,031	2,820,031
Balance at December 31, 2012	\$ 159	\$ 199,370,772	\$ (35,623,268)	\$ 163,747,663

See accompanying notes to consolidated financial statements.

North Carolina Railroad Company
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2012 and 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 2,820,031	\$ 5,678,993
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	11,308,388	11,232,243
Deferred income tax benefit	(8,000)	(9,000)
Interest earned by funded capital project investments	(800,440)	(449,468)
Changes in operating assets and liabilities:		
Accounts receivable	(302,613)	(25,968)
Long-term receivable	920,811	(2,645,378)
Prepaid expenses	(5)	1,285
Deposits	(5,816)	-
Accounts payable and accrued expenses	(1,048,517)	(1,104,982)
Security deposits	-	37,666
Net cash provided by operating activities	<u>12,883,839</u>	<u>12,715,391</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(4,961,081)	(1,485,683)
Transfer of unrestricted cash and cash equivalents to funded capital projects to fund board designations	(12,000,000)	(13,500,000)
Transfers of funded capital projects monies to cash and cash equivalents for capital expenditures	<u>5,768,259</u>	<u>2,400,596</u>
Net cash used in investing activities	<u>(11,192,822)</u>	<u>(12,585,087)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,691,017	130,304
Cash and cash equivalents at beginning of year	<u>2,137,061</u>	<u>2,006,757</u>
Cash and cash equivalents at end of year	\$ <u><u>3,828,078</u></u>	\$ <u><u>2,137,061</u></u>
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for income taxes	\$ <u><u>53,344</u></u>	\$ <u><u>60,525</u></u>
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Additions to property and equipment paid by the North Carolina Department of Transportation	\$ <u><u>2,004,821</u></u>	\$ <u><u>2,666,693</u></u>
Construction costs included in accounts payable and accrued expenses	\$ <u><u>961,580</u></u>	\$ <u><u>1,088,054</u></u>
Maturities of certificates of deposit transferred into funded capital projects	\$ <u><u>15,000,000</u></u>	\$ <u><u>5,000,000</u></u>
Purchase of certificates of deposit out of funded capital projects	\$ <u><u>15,000,000</u></u>	\$ <u><u>10,000,000</u></u>
Purchase of debt securities out of funded capital projects	\$ <u><u>15,000,000</u></u>	\$ <u><u>2,500,000</u></u>

See accompanying notes to consolidated financial statements.

North Carolina Railroad Company
Notes to Consolidated Financial Statements Years
Ended December 31, 2012 and 2011

Note 1 – Nature of Business and Significant Accounting Policies

Nature of Business

The North Carolina Railroad Company and subsidiary, a North Carolina company, (collectively referred to as the “Company”), owns approximately 317 miles of continuous railroad line extending from Charlotte, North Carolina to Morehead City, North Carolina. The Company’s railroad facilities are operated by Norfolk Southern Railway Company (“NSR”). The State of North Carolina is the sole owner of all the common stock of the Company.

North Carolina Railroad, Inc. (“NCRI”), a wholly owned subsidiary of the North Carolina Railroad Company (“NCRR”), was formed on December 15, 2006. NCRI conducts certain taxable activities, such as leasing of commercial real estate, while NCRR conducts all tax exempt activities, such as leasing of railroad facilities and corridor management.

A summary of the Company’s significant accounting policies follows.

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of NCRR and its wholly owned subsidiary, NCRI. All intercompany transaction and balances have been eliminated in consolidation.

Use of Estimates

In preparing its consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the consolidated balance sheet date and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents

For purposes of the consolidated statement of cash flows, the Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Cash equivalents include money market funds. Cash and cash equivalents that are restricted or designated by the Board of Directors for capital projects are reflected as funded capital projects in the accompanying consolidated balance sheets. See Note 3.

At times the Company places cash and cash equivalents and certificates of deposits with original maturities of three months or more with financial institutions in amounts that are in excess of Federal Deposit Insurance Company insurance limits. The Company has not experienced any losses in such accounts. The financial condition of financial institutions is periodically reassessed, and the Company believes the risk of any loss is minimal.

Accounts Receivable

Accounts receivable are uncollateralized obligations due under agreements. Management considers accounts receivable to be fully collectible, accordingly no allowance for doubtful accounts has been provided. If amounts become uncollectible, they are charged to operations in the period in which that determination is made.

An account receivable is considered to be past due if any portion of the receivable balance is outstanding for more than 30 days.

North Carolina Railroad Company
Notes to Consolidated Financial Statements Years
Ended December 31, 2012 and 2011

Note 1 – Nature of Business and Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. The Company computes depreciation using the straight-line method over the following estimated useful lives:

	Estimated Useful Lives (Years)
Buildings and building improvements	25
Bridges	25
Track and signals	10
Equipment and furniture	3 - 7

Values of the properties in the roadway and land account approximate 1916 valuations by the Interstate Commerce Commission. These properties represent fully depreciated roadway or land. The Company assesses long-lived assets for impairment whenever events or changes indicate that the carrying amount of the assets may not be recovered based on estimated future undiscounted cash flows. In the event such cash flows are not expected to be sufficient to recover the carrying value of the assets, the useful lives of the assets are revised or the assets are written down to their estimated fair values.

Lease of Roadway and Land Revenue Recognition

Revenue received from property that is operated by NSR is reflected in the consolidated statements of income when earned in accordance with the Company's lease arrangements.

Other Lease Revenue Recognition

The Company leases certain property that is not operated by NSR. Revenue is reflected in the consolidated statements of income when earned. The Company also collects license fee revenue which is recognized when earned. The Company defers recognition of contingent rentals until the requirements are met.

Income Taxes

Pursuant to Section 11146 of the Safe, Accountable, Flexible, Efficient Transportation Equity Act of 2005 (the "Act"), a substantial portion of the Company's income is exempt from federal and state income taxes. The activities that generate income which is not exempt from federal and state income taxes pursuant to the Act are conducted in NCRI. NCRI is a taxable entity and the deferral method is used in accounting for income taxes, and deferred income tax assets and liabilities are determined based on differences between the financial reporting and income tax basis of assets and liabilities.

As part of the process of preparing the consolidated financial statements, the Company is required to estimate income taxes in each of the jurisdictions in which it operates. This process involves estimating the actual current income tax liability together with assessing temporary differences resulting from differing treatment of items for income tax and GAAP purposes. These differences result in deferred income tax assets and liabilities. The Company must then assess the likelihood that its deferred income tax assets will be recovered from future taxable income. To the extent that the Company believes that recovery is not more likely than not, it must establish a valuation allowance. Significant management judgment is required in determining the provision for income taxes, deferred income tax assets and liabilities, and any valuation allowance recorded against net deferred income tax assets.

North Carolina Railroad Company
Notes to Consolidated Financial Statements Years
Ended December 31, 2012 and 2011

Note 1 – Nature of Business and Significant Accounting Policies (continued)

Income Taxes (continued)

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more likely than not recognition threshold are measured as the largest amount of tax benefit that is more than 50% likely of being realized upon settlement with the applicable taxing authority. The portion of the benefit associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. The Company has determined that it does not have any material unrecognized tax benefits or obligations as of December 31, 2012 and 2011. With few exceptions, the Company is no longer subject to income tax examinations by the federal, state, or local tax authorities for years before 2009.

Investments in Debt Securities

Included in funded capital projects at December 31, 2012 and 2011 is \$20,094,049 and \$5,004,914, respectively, of investments in debt securities. The securities are classified as held to maturity and include net unamortized premiums of \$94,049 and \$4,913 as of December 31, 2012 and 2011, respectively. Held to maturity securities are reported at amortized cost. Premiums and discounts on investments in debt securities are amortized over the contractual lives of those securities. Amortization is computed on a straight-line basis, which approximates the effective interest method. Interest on debt securities is recognized in income as earned. Realized gains and losses, including losses from declines in value of specific securities determined by management to be other-than-temporary, if any, are included in income. Realized gains and losses are determined on the basis of the amortized cost of the securities redeemed. The debt securities held have contractual maturity dates through December 2015. The fair value of the debt securities was \$20,242,150 at December 31, 2012 and included net unrecognized holding losses of \$242,150. The fair value of the debt securities was \$4,944,103 at December 31, 2011 and included unrecognized holding gains of \$55,898.

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. The Company employs a systematic methodology that considers available evidence in evaluating potential impairment of its investments. In the event that the cost of an investment exceeds its fair value, the Company evaluates, among other factors, the magnitude and duration of the decline in fair value; the expected cash flows of the securities; the financial health of and business outlook for the issuer; and the Company's intent and ability to hold the investment. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded in investment income and a new cost basis in the investment is established.

Fair Value of Financial Instruments

The Company estimates that the fair value of all financial instruments approximates the carrying amounts, primarily because of the short term nature of these instruments, except for certificates of deposit and investments in debt securities that are held to maturity and reported at amortized cost.

North Carolina Railroad Company
Notes to Consolidated Financial Statements Years
Ended December 31, 2012 and 2011

Note 2 – Trackage Rights Agreement and Leases on Roadway and Land

Prior to 1999, substantially all of the Company's assets were leased to NSR or its predecessors, in two leases originally dating back to 1895 and 1939. The terms of the leases did not require either the Company or Norfolk Southern to renew the leases.

On August 10, 1999, the Board of Directors of the Company approved a Trackage Rights Agreement ("TRA") concurrent with NSR terminating the original leases. The TRA's term is 15 years with two 15-year renewal options by NSR (45 years) for a base annual rental of \$11,000,000 (minimum) beginning January 1, 2000, with annual adjustments based upon an inflation index and a 4.5% annual cap (arbitration of cap if it exceeds an average of 4.5% over any 7-year period). The TRA provides for transition of management of certain non-rail properties to the Company, maintenance of the Company's rail property, inspections, records sharing, and audit. The TRA was approved by the Surface Transportation Board on September 1, 1999.

The TRA grants exclusive freight trackage rights to NSR to conduct all freight operations over the NCRR railroad line. Under federal law the National Rail Passenger Corporation ("Amtrak") operates over NSR operated lines under agreements with NSR. NSR is obligated under the TRA to provide rail service to all industries on the NCRR line. NSR is obligated to maintain the NCRR line and any improvements made to the line by NSR for freight operations. Under the TRA, NSR does not have financial responsibility for passenger improvements made by the Company, North Carolina Department of Transportation (NCDOT), Amtrak, or other parties.

Approximately 38 parcels not used in railroad operations have been returned to the Company for separate (non-NSR) management. These noncorridor properties are managed by the Company after transition from NSR management. The TRA contains provisions for responsibility for environmental matters by NSR and the Company.

NSR is responsible for any taxes on its freight operations. A Policy Planning Committee comprised of NCRR and NSR representatives addresses all future planning issues, capital improvements, and any disputes that arise under the TRA. In the event of any disagreements, NCRR and NSR are subject to binding arbitration under the TRA.

A lease of certain properties in Charlotte, North Carolina to NSR (the 1968 Lease) expires on December 31, 2067, and provides for an annual rental of \$81,319 through December 2018. The 1968 lease provides that beginning on January 1, 2019, the annual rental for the remaining term of the 1968 Lease is 6% of the appraised value of the property on that date. Under the terms of the 1968 Lease, all taxes connected with the property, except income taxes, are paid by the lessee. The 1968 Lease was not affected by the TRA.

Pursuant to agreements signed in each year since 2008, NCRR has assigned to NSR all of the NCRR lines that constitute eligible railroad tracks solely for purposes of allowing NSR to qualify as an eligible taxpayer with respect to such track and to claim tax credits under section 45G(a) for qualified railroad track maintenance expenditures it pays or incurs during each year under agreement with respect to such track. In exchange, NSR agrees to pay to NCRR fifty percent of the tax credits NSR claims. Payment of the amount owed under the agreement is not due until the amount of the allowable credit is not subject to further appeal, review or modification through proceedings or otherwise. As such, prior to the year ended December 31, 2011, the Company has deferred recognition of tax credit revenue as payment was uncertain.

North Carolina Railroad Company
Notes to Consolidated Financial Statements Years
Ended December 31, 2012 and 2011

Note 2 – Trackage Rights Agreement and Leases on Roadway and Land (continued)

In 2012, the Company received \$1,844,926, including \$147,426 in accumulated interest at 4%, from NSR representing repayment of the Company's fifty percent share of the 2009 and 2010 tax credit claimed by NSR, which is included in other income and interest income, respectively, in the consolidated statement of income. In 2011, the Company received its first payment under these agreements for \$941,412, including \$87,412 in accumulated interest at 4%, from NSR representing repayment of the Company's fifty percent share of the 2008 tax credit claimed by NSR. In addition, as the Company has sufficient evidence that payment will occur, the Company recorded a long-term receivable of \$1,724,567, representing \$1,697,500 of total tax credit revenue that the Company is due for tax years 2011 and 2012 from NSR, plus accumulated interest of \$27,067, as of December 31, 2012.

Note 3 – Capital Commitments

Capital Improvement Agreement

On March 20, 2002, the Company entered into a Capital Improvement Agreement (the "Capital Agreement") with NSR in order to establish an understanding between the parties about desired capital improvements as well as a means to fund individual projects pursuant to the TRA. The Capital Agreement calls for certain identified capital improvements to be made to the Company's railroad line (the "Projects"). As of December 31, 2012, the Company's share of the Projects totals approximately \$103 million and is scheduled for completion between 2013 and 2018.

The Capital Agreement calls for the execution of individual project agreements as appropriate and contains certain provisions with regard to construction responsibilities and cost allocation. The Capital Agreement provides for the funding of a capital program escrow account with an initial deposit of \$500,000 by the Company and additional deposits of obligated Company capital improvement funds held pursuant to N.C. General Statute 124-5.1 to fund capital improvements as recommended and approved by the Company's Board of Directors.

Capital Account Funds Agreement

On June 21, 2002, the Company and the NCDOT entered into a Capital Account Funds Agreement (the "CAFA") pursuant to N.C.G.S. 124-5.1. NCDOT has various capital improvement projects in progress under the CAFA as of December 31, 2012 and management expects to record a capital contribution and related asset as the improvements are completed in future periods.

ARRA/PRIIA High-Speed Passenger Rail Projects

In 2011, the State of North Carolina was selected to receive certain federal grant awards through the American Recovery and Reinvestment Act of 2009 ("ARRA") and the Passenger Rail Investment Act of 2008 ("PRIIA") for the capital funding of certain high speed intercity passenger rail projects, under which NCDOT is the grantee of the awards. On December 15, 2011, the Company, the NCDOT, and NSR entered into an Agreement on Principles ("AOP"), which outlined certain terms for capital improvements within and along the NCRRC corridor operated by NSR (Note 2). On March 21, 2011, the Company, NCDOT, NSR and Amtrak entered into a Definitive Service Outcomes Agreement ("DSOA"), clarifying the individual parties' responsibilities and further detailing the projects to be funded by the grants to NCDOT. On March 21, 2011, the Company and the NCDOT entered into a Railroad Corridor Property Acquisition Agreement ("RCPA") regarding rail corridor property, including acquisition of additional railroad corridor property needed in connection with certain projects funded by the grants to NCDOT. As a result of these agreements, management expects to record a capital contribution and related assets for a portion of the improvements that will be made by NCDOT as the improvements are completed in future periods, in addition to the commitment of funds made by the Company described below.

North Carolina Railroad Company
Notes to Consolidated Financial Statements Years
Ended December 31, 2012 and 2011

Note 3 – Capital Commitments (continued)

Under the AOP, DSOA, and RCPA, the Company has committed up to a total of \$31,000,000 of capital investment toward certain projects in order to assist in completion of certain track capacity improvement projects and engineering. Out of its \$31,000,000 commitment, the AOP and DSOA also provide that the Company reserve up to \$10,000,000 for a Capital Reserve Fund, which is designated by the Company for the purpose of making further capacity improvements to the NCRR line in the future in order to improve passenger and freight train reliability caused by identified unacceptable train delays. Investments by the Company under these agreements are to be applied against and reduce the Company's commitment under the agreements. The Company also has committed use of the Company's rail corridor lands for such capacity and other related improvement projects. As of December 31, 2012, the Company has designated approximately \$30,000,000 as restricted under construction contracts in funded capital projects on the consolidated balance sheet.

Board Designated Funds

The Board of Directors passed resolutions during 2012 and 2011 to designate \$12,000,000 and \$13,500,000, respectively, of unrestricted cash for use on capital improvement projects.

The Company has designated the following amounts (invested in cash, certificates of deposit or debt securities) for capital improvement projects as follows:

	2012	2011
Restricted under construction contracts	\$ 41,707,044	\$ 40,381,874
Restricted under the CAFA	113	3,391,712
Restricted for other capital improvements	145,282	144,469
Board designated funds	30,368,177	21,270,380
Funded capital projects	<u>\$ 72,220,616</u>	<u>\$ 65,188,435</u>

Note 4 – Employee Benefit Plan

The Company sponsored a SEP-IRA Plan covering substantially all employees. Employees who earn greater than \$400 in wages during the year were eligible to receive the contribution. The employer contribution percentage was approved annually by the Board and contributions were made to employee accounts in January and July. There were no employer contributions for the year ended December 31, 2012 and employer contributions for the year ended December 31, 2011 were \$147,456. The Company incurred no plan administrative expenses during 2012 or 2011. During 2012, the SEP-IRA Plan was terminated and replaced with a 401(k) Plan.

The Company established a Safe Harbor 401(k) Plan effective January 1, 2012 to provide retirement benefits for its employees. All full-time employees who meet certain eligibility requirements are qualified to participate in the 401(k) Plan. Participants may make pre-tax deferrals up to 90% of their compensation subject to Internal Revenue Service limitations. Participants are fully vested in their contributions plus actual earnings thereon and any rollovers into their accounts. The Company contributes 3% of the compensation of all eligible active participants. In addition, the Company may elect each plan year whether to make a discretionary employer contribution on behalf of eligible active participants. Employer contributions for the year ended December 31, 2012 were \$72,959. The Company incurred expenses of \$38,021 for the year ended December 31, 2012 related to the 401(k) Plan. No employer contributions were made and no expenses were incurred for the year ended December 31, 2011.

North Carolina Railroad Company
Notes to Consolidated Financial Statements Years
Ended December 31, 2012 and 2011

Note 5 – Future Minimum Lease Revenue

The Company derives income from leased commercial space and other property under non-cancellable operating leases. Of the non-cancellable leases, one lease, described in Note 2, comprises 88% of the lease income. Rental income received from this lease during 2012 and 2011 was approximately \$14.3 million and \$14.1 million, respectively. The remaining non-cancellable leases are related to the rental of commercial space. Future minimum rentals, excluding renewal periods, on the non-cancellable operating leases are as follows for the years ending December 31:

	Amount
2013	\$ 14,743,282
2014	14,702,011
2015	543,460
2016	395,305
2017	352,401
Thereafter	4,366,146
	<u>\$ 35,102,605</u>

Minimum lease payments do not include contingent rentals that may be received under certain leases. The Company's policy is to defer recognition of such contingent rentals until the requirements are met. Contingent rental income earned during the years ended December 31, 2012 and 2011 totaled \$30,487 and \$141,073, respectively.

City of Charlotte Lease Agreement

The Company and the City of Charlotte ("Charlotte") entered into an agreement ("Lease Agreement") dated May 3, 2011, whereby Charlotte leased a segment of the North Carolina Railroad corridor, approximately 2.7 miles in length parallel to the Company's main line railroad tracks and facilities, for the purpose of extension of Charlotte's LYNX Blue Line light rail transit system. The Lease Agreement provides for a total lease fee in the amount of Eleven Million Seven Hundred Sixty Thousand (\$11,760,000) as rent for the fifty (50) year lease term. The Lease Agreement provides for a one time rent payment to be paid to the Company within one year after the approval of full funding grant agreements by the United States Federal Transit Administration and the State of North Carolina, but in any event, no later than January 1, 2017. The Lease Agreement provides that Charlotte is responsible for all construction, operations, maintenance, taxes, assessments and costs related to Charlotte's use of the segment.

Coincident with the execution of the Lease Agreement, Charlotte entered into a Construction and Reimbursement Agreement and an Operations Agreement with NSR related to Charlotte's use of the segment and the compatibility thereof with NSR's operation and maintenance of the Company's rail line.

The Lease Agreement provides that design and construction is to be provided by Charlotte at its expense, subject to the approval of the Company. The Lease Agreement is subject to early termination, in which event a portion of the lease fee may be refundable. The Lease Agreement contains one renewal term at a rate agreed upon by the parties, or in the absence of agreement, based upon an appraised value.

North Carolina Railroad Company
Notes to Consolidated Financial Statements Years
Ended December 31, 2012 and 2011

Note 6 - Income Taxes

The Company's income before income taxes for the years ended December 31, 2012 and 2011 is as follows:

	2012	2011
Income before income taxes:		
Nontaxable entity	\$ 2,710,115	\$ 5,561,581
Taxable entity	161,655	178,184
Income before income taxes	<u>\$ 2,871,770</u>	<u>\$ 5,739,765</u>

The difference between the federal income tax computed by the statutory federal income tax rate of 34% and NCRI's income tax expense as reflected in the consolidated financial statements is as follows:

	2012	2011
Income tax at statutory federal income tax rates	\$ 54,963	\$ 60,583
Increase attributable to:		
State income tax, net of federal income tax benefit	7,264	8,114
Impact of graduated tax rates	(10,488)	(7,925)
	<u>\$ 51,739</u>	<u>\$ 60,772</u>

The Company's taxable subsidiary, NC Railroad Inc. has a deferred income tax liability at December 31, 2012 and 2011 as follows:

	2012	2011
Noncurrent deferred tax liability, property and equipment	<u>\$ 533,000</u>	<u>\$ 541,000</u>

The Company's total tax expense for 2012 and 2011 is summarized as follows:

	2012	2011
Current income tax expense	\$ 59,739	\$ 69,772
Deferred income tax benefit	(8,000)	(9,000)
Total income tax expense	<u>\$ 51,739</u>	<u>\$ 60,772</u>

Note 7 – Subsequent Event

The Company has evaluated subsequent events through May 22, 2013, which is the date the financial statements were available to be issued.



NCRR Corridor Map



- North Carolina Railroad Company**
(Operated by Norfolk Southern)
- Norfolk Southern**
- CSX Transportation**
- Various Short Lines**

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