Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

March 14, 2012

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Transportation: Section 13.10 Request for Passenger Rail Permanent Maintenance Facility Design Engineering -- Agenda Item V

REQUEST

The Department of Transportation (DOT) requests $2,500,000 in passenger rail development bonds to proceed with final design engineering on a permanent maintenance facility in Milwaukee for the state's passenger rail cars.

BACKGROUND

Permanent Rail Car Maintenance Facility

The state purchased two passenger car train sets in 2009 from Talgo, a Spanish train manufacturer. At the time of the purchase, the Department indicated that the cars would initially be used on Amtrak's Hiawatha service between Milwaukee and Chicago, but would eventually be used in a proposed expansion of that service to Madison and for other future service expansions. For the Madison extension, the state would purchase an additional two train sets and would build a maintenance facility in or near the City of Madison. Although the state was awarded a federal grant for the Madison expansion, the grant was later refused and the Department is not currently pursuing expansion. Consequently, the current plan is to use the car sets in place of Amtrak passenger cars on the existing Chicago to Milwaukee service and to build a maintenance facility for the cars near the downtown Milwaukee station. Amtrak would continue to supply the locomotives and would operate the service. A total of $68.9 million in passenger rail development bonds has been approved for the purchase of the rail cars ($48.5 million), as well as other costs related to construction management, purchase of maintenance equipment, and a temporary maintenance facility.

The train sets are now nearing completion, and are scheduled to be delivered to the state for initial testing in mid-March. Following testing, the cars would be ready for use on the Milwaukee to Chicago service, likely in late 2012. With the purchase, the state entered into a 20-year contract with Talgo for the maintenance of the cars. Under that agreement, the state is responsible for providing a facility for the maintenance and for making payments to Talgo for ongoing maintenance costs. [In anticipation of the completion of the Talgo cars, 2011 Act 32 provided $4,450,000 SEG in 2011-12 and $6,700,000 SEG in 2012-13 in the Department's passenger rail service appropriation for start-up maintenance costs.] Initially, the trains will be maintained at a temporary site in the City of Milwaukee, but this site, because of several logistical issues, cannot be used as a permanent maintenance facility.

In order to prepare for the construction of a permanent maintenance facility, the Department conducted an initial assessment of site options late last year, and submitted a request to the Joint Committee on Finance in December under s. 13.10 of the statutes for an additional $5,000,000 for final design engineering for the facility. At the December meeting, the Committee approved $2,500,000 of passenger rail development bonds to begin design engineering, but specified that any additional engineering or construction of the facility beyond that may not proceed until the Department submits a report to the Committee that: (a) provides a comparison of the estimated total cost of building a permanent maintenance facility in Milwaukee for the state's passenger rail cars with the total cost of any necessary improvements to Amtrak facilities in Illinois to accommodate maintenance at those facilities; (b) includes a discussion of potential differences in the annual costs of performing maintenance at the different facilities as well as any relevant non-fiscal considerations in choosing a site for the permanent maintenance facility; and (c) includes an analysis of the costs and savings of not proceeding with the construction of any permanent maintenance facility and maintaining current rail operations.

Following the December meeting, the Department conducted preliminary engineering to investigate in more detail various alternative sites for the permanent facility and develop more refined cost estimates. Although a final estimate is not yet available, the Department indicates that the final cost of the facility is expected to be between $55 million and $63 million, which includes final design, real estate acquisition, construction of an access road, railroad track work, signaling upgrades, hazardous materials mitigation, utility work, construction of the facility, construction management, and a 20% contingency.

The Department's current request for $2,500,000 would be to complete design engineering for the permanent maintenance facility, and is included in the total cost estimates cited above. Additional funding would need to be provided at a later date for the remaining construction cost.

Cost Comparison of Alternatives

With the request, the Department provided a comparison of the cost to support the Hiawatha service with current Amtrak equipment and the cost to use the Talgo cars on the Hiawatha line, including associated capital costs, amortized over a 20-year period. The

Department's analysis, however, did not include a detailed comparison of the cost to utilize Amtrak maintenance space in Chicago. In response to the Department's inquiry, Amtrak indicated that it would be unlikely that such an arrangement would be cost effective, due to space constraints and capacity limitations at the current Chicago facility. If the state chooses to pursue this alternative further, Amtrak indicated that additional funding would be needed to conduct an engineering study to identify capital requirements. The Department indicates in its request that such a study could cost between $2.0 million and $6.5 million, but that it did not include funding for such a study, after determining that utilizing Amtrak maintenance facilities would not be a viable option.

The Department's comparison of the state's Milwaukee to Chicago route costs using current Amtrak equipment and using Talgo equipment includes both the operating costs associated with running the line and maintaining the equipment, and the capital costs associated with the purchase of the equipment and, as applicable, the construction of maintenance facilities. In both cases, the Department has calculated an estimated, average yearly payment over the course of twenty years, while making various assumptions with regard to inflation and other potential future costs. A table showing the Department's estimates for both scenarios is shown in an attachment to this memorandum. The elements of the operating and capital costs for both alternatives are discussed below.

Operating Costs

Under the Department's analysis of the cost to maintain the Chicago to Milwaukee service utilizing current Amtrak equipment, it is assumed that the Department would store the Talgo equipment, either for future passenger rail service or until a buyer can be found. [Although the states of Oregon and Washington use Talgo equipment on regional train service in the Pacific Northwest, that service does not currently need additional equipment. No other state or train route utilizes compatible passenger car equipment at this time.] In addition to storage costs, the state would incur the cost to insure the property against damage, since the failure to provide regular maintenance on the cars would invalidate the warranties on the equipment. With respect to the operation of the route, it is assumed that the State would continue to contract with Amtrak, paying 75% of the operating cost of the service (net of ticket revenue) with Illinois continuing to pay the other 25%. However, the Department assumes that a recent agreement between Amtrak and various states regarding how the costs of state-supported service are calculated will result in an increase in the amount paid under the contract. Specifically, the agreement requires states to pay a capital charge based on the amount of Amtrak equipment used, something that was not previously part of the state's payment. It was assumed that the Amtrak operating cost contract would increase by 3% per year.

Under the Talgo equipment alternative, the state's contract with Amtrak would not include maintenance on passenger cars, since the maintenance would be done under a contract with Talgo (although Amtrak would continue to charge for maintenance of the locomotives). Consequently, although the state's contract with Amtrak would be less, the maintenance contract with Talgo would increase the overall operating cost. The Department indicates that under the terms of the Talgo maintenance contract, the passenger cars would be maintained on a more frequent basis than the Amtrak cars, resulting in a higher annual cost. For the purpose of the analysis, the Department assumed that the annual cost in the first two years, which is specified in the maintenance agreement, would be inflated by 3% over the remainder of the 20-year period. For the purposes of the comparison of scenarios, the resulting average, annual amount is used. In addition to maintenance costs, the state would incur costs associated with operation of the maintenance facility, separate from the maintenance contract, and liability insurance associated with the use of the equipment.

In summary, the Department estimates the average, annual operating cost for continuing to use Amtrak equipment on the Chicago to Milwaukee service at $8.5 million, while the cost of utilizing the Talgo equipment would be $13.6 million, or $5.1 million higher. It should be noted that the Department assumes the same ticket revenue for both scenarios. Any differences in ticket revenue resulting from the utilization of the Talgo equipment would change the relative cost of the scenarios. In addition, it is assumed that Illinois will continue to pay 25% of the contract with Amtrak, but would not pay for a share of Talgo maintenance costs. If the State of Illinois were to agree to pay a portion of these costs, the cost of the Talgo scenario would be reduced by that amount.

Capital Costs

In its comparison of the average, annual capital costs, the Department includes annual debt service on bonds issued for purchases that have already been made in both scenarios. That is, even though the Talgo passenger cars would not be used in the Amtrak equipment scenario, the state would still incur debt service costs associated with the purchase of those cars. In addition to the cost of the passenger cars, the state has also issued bonds for improvements to the temporary maintenance facility, for some maintenance equipment, and for some preliminary engineering on the permanent facility. Under the Talgo equipment scenario, the state would incur additional debt service associated with constructing the permanent maintenance facility and for completing the purchase of maintenance equipment. In total, the annual debt service costs associated with the Amtrak equipment scenario are estimated at $4.8 million, while the Talgo equipment scenario would be $9.8 million, or $5.0 million higher.

Including both operating and capital costs, the average, annual cost of the Amtrak equipment scenario is estimated at $13.4 million, while the annual cost associated with using the Talgo equipment would be $23.4 million, or $10.0 million higher. While the operating costs of the Hiawatha service are paid with a combination of transportation fund revenues and federal highway aid, the debt service associated with the capital expenditures is a general fund responsibility.

ANALYSIS

There are several factors for consideration in making a decision on the Department's request:

- At the time that the Talgo equipment was purchased in 2009, the Department indicated that it was sometimes difficult to ensure that Amtrak would supply enough passenger cars in good working condition for the Hiawatha route. Owning the Talgo equipment would allow the state, instead of Amtrak, to control the supply and condition of passenger cars. If the Department's request is not approved and the Talgo equipment is not used to replace Amtrak equipment, the availability and condition of Amtrak equipment may continue to be an issue.

- Also at the time of the purchase, the Department envisioned that the Talgo equipment could be used as part of the proposed Milwaukee to Madison extension and for possible future service extensions to the Twin Cities. Under such a scenario, the fixed costs associated with providing maintenance would have been spread over a larger number of passenger-miles than would be the case if the cars are only used on the Chicago to Milwaukee route. Consequently, limiting the use of the cars to the Chicago to Milwaukee route reduces their relative cost effectiveness.

- Similarly, at the time of purchase, the Department noted that other states in the Midwest and Amtrak had shown some interest in utilizing Talgo equipment. If this were to occur, the Wisconsin assembly facility and the maintenance facility would be more fully utilized, again lowering costs on a passenger-mile basis. However, it is now less likely that other states or Amtrak will purchase passenger cars from Talgo. Subsequent to the Wisconsin purchase, the U.S. Department of Transportation imposed more strict requirements for purchase of American-made equipment. Although these requirements may be waived under certain circumstances, the requirements disadvantage Talgo, because at this time its manufacturing facilities are in Spain.

- Even if the maintenance facility were to be more fully utilized, the maintenance standards included in the Talgo agreement may result in higher costs than would be the case if only Amtrak equipment were used. The maintenance payments in the Talgo agreement are based upon the assumption that each train set will be serviced every other day (not including routine cleaning, which would be performed daily). By contrast, Amtrak cars are typically maintained on an as-needed basis (other than overhauls or other major, scheduled work).

If the Department's request is approved, the Department would complete the process of selecting a site for the maintenance facility and proceed with the final engineering. The Department indicates that additional funding would be requested later in 2012 to begin construction. Upon approval of the current request, there would be $38,095,700 in remaining, authorized passenger rail development bonds. Since this remaining amount would be between $14.5 million and $22.5 million less than the estimated construction cost of the permanent facility, other sources of funding would be required. This could include an appropriation from the transportation fund or additional bonds, if the full Legislature authorized additional bonds.

If the Department's request is not approved, the Department would not be able to meet the contractual obligation to provide a permanent maintenance facility at this time. Although Act 32 provided funding for maintenance operating costs, and funding was approved for the temporary maintenance facility, the lack of a permanent facility may make even the short-term use of the Talgo equipment unfeasible.

Under the terms of DOT's maintenance agreement with Talgo, both parties acknowledge that the Department's authority to make any payment under the agreement is contingent upon the appropriation of funds by the Legislature. In the event that insufficient funds are provided, the agreement requires DOT to negotiate in good faith with Talgo for a reduction in the maintenance services provided, including an adjustment to the performance standards set forth in the agreement. In the event that no funds are provided for maintenance, the agreement can be terminated by either party.

In addition, if a permanent facility is not constructed, the Department's expenditures for preliminary engineering for the facility, which were made with bond proceeds, would have to be reimbursed with cash sources. Bond proceeds may be used for preliminary engineering for building projects as long as a physical asset is eventually built. In this case, however, since no building would be built, the use of bonding would be disallowed. Consequently, in the event that this request is rejected, the Department would need to reimburse the bond expenditures. One alternative, in this case, would be to direct the Department to make this reimbursement from the Department's existing SEG appropriation for passenger rail service to the extent that unencumbered funds are available in that appropriation. In the event that the Talgo maintenance contract is terminated, the passenger rail appropriation should have unencumbered funds that would have otherwise gone to that purpose.

In a March 8 letter to the DOT Secretary, Talgo makes several points related to the issue of maintaining the Talgo-built trainsets. First, that the purchase price was based on the company's expectation that it would be providing twenty years of maintenance service. Second, that the warranty for the trains is predicated on Talgo providing the maintenance services. Third, that the maintenance agreement requires that DOT provide a permanent maintenance facility and that if this does not occur, Talgo can take steps to perform these services elsewhere, with DOT being obligated to reimburse Talgo for those costs. Finally, that under the contract, DOT agreed not to effect a termination of the contract for the purpose of replacing the trainsets with trainsets supplied by others.

Talgo notes that in the event of the failure to meet the terms of the maintenance agreement, the company would proceed under the dispute resolution terms of the agreement. Under that procedure, if informal negotiations fail to resolve the dispute, then a third-party expert is chosen to resolve the dispute. Under such a process, the third-party expert would consider the dispute upon written presentation from both parties.

While the outcome of any future dispute resolution process and any subsequent litigation is unknown, it may be a factor to be considered in addressing the Department's request. It should be noted, however, that the terms of the maintenance agreement are applicable to the Department's actions, not the actions of the Legislature or the Joint Committee on Finance. Consequently, the Department's failure to meet the obligations under the maintenance agreement because of the inability to construct a permanent maintenance facility would be due to insufficiency of funds provided by the Legislature, not because of the Department's failure to act in good faith under the terms of the agreement. Likewise, if the Department continues to contract with Amtrak for the Hiawatha service using Amtrak passenger cars, rather than utilize the Talgo trainsets, it would be because of the refusal of the Legislature to provide sufficient funds to allow the Department to have a viable means for maintaining the Talgo equipment.

If it is the Committee's intent to have the Department proceed with the utilization of the Talgo trainsets, but it is determined that the current maintenance agreement is not feasible given the limited use of the passenger cars in the Chicago to Milwaukee route, one alternative would be to direct the Department to attempt to renegotiate the maintenance contract to revise the terms so that maintenance costs are more similar to Amtrak maintenance costs. As noted above, the agreement includes provisions for the reduction in maintenance standards in the event of an insufficient appropriation, and such negotiation may result in a reduction in the agreement's performance standards. In addition, a reduction in the maintenance work could allow the Department more flexibility with regard to the selection of a site for the maintenance facility. The current agreement requires the Department to allow for at least eight hours for maintenance each night, a provision that requires the maintenance facility to be located relatively close to the downtown Amtrak station. A more flexible schedule could allow the facility to be sited further from the station, potentially reducing the amount of site-specific costs related to track work, real estate acquisition, and hazardous materials mitigation associated with the existing potential sites. However, even if renegotiation could produce savings in Talgo-related maintenance and related capital costs, the Talgo equipment scenario would still be higher than the Amtrak equipment scenario.

ALTERNATIVES

1. Approve the Department's request for the approval of $2,500,000 in passenger rail development bonding for final design engineering for a permanent maintenance facility for the State's passenger rail cars.

2. Deny the request.

3. Deny the request and direct the Department to reimburse any expenditures for the maintenance facility preliminary engineering that were made with bonds from the Department's SEG appropriation for passenger rail service, to the extent that unencumbered funds are available in that appropriation.

4. Deny the request for additional funding and direct the Department to attempt to renegotiate the maintenance agreement with Talgo to reduce ongoing maintenance costs and, if feasible, the cost of the permanent maintenance facility. Direct the Department, in any subsequent request for funding for maintenance-related services, to report to the Committee on the status of these negotiations.

Prepared by: Jon Dyck
Attachment

ATTACHMENT

Department of Transportation's Comparison of Operating and Capital Costs Associated with Two Train Car Equipment Scenarios, 20-Year Average, Annual Cost

	Amtrak Equipment Scenario	Talgo Equipment Scenario
Operating Costs		
Amtrak Contract	$7,803,600	$4,299,300
Talgo Maintenance	0	5,792,800
Storage Costs	739,400	0
Liability Insurance	0	1,475,000
Maintenance Facility Operations	0	1,750,000
Other Operating Costs	0	322,400
Operating Cost Subtotal	$8,543,000	$13,639,500
Capital Costs		
Train Sets	$4,212,600	$4,212,600
Maintenance Equipment and Temporary Facility	466,600	990,800
Permanent Maintenance Facility	163,600	4,577,000
Capital Cost Subtotal	$4,842,800	$9,780,400
Operating and Capital Total	$13,385,800	$23,419,900