
Office of Inspector General

Audit Report

***Pennsylvania Station
Redevelopment Project
Federal Railroad Administration***

*Report Number: RT-2000-081
Date Issued: April 19, 2000*





Memorandum

**U.S. Department of
Transportation**

Office of the Secretary
of Transportation

Office of Inspector General

Subject: ACTION: Review of the Pennsylvania Station
Redevelopment Project
RT-2000-081

Date: April 19, 2000

From: Alexis M. Stefani
Assistant Inspector General for Auditing

Reply to JA-1
Attn. of:

To: Federal Railroad Administrator

This report presents the results of our review of the Pennsylvania Station Redevelopment Project. The report is in response to a request by the Chairman of the House Subcommittee on Transportation and Related Agencies, Committee on Appropriations. Our objectives were to review the project's current cost, scope, and funding, as well as to determine whether Federal funds used for the project have been spent as specified in the funding legislation. In addition, we determined the status of required life safety improvements in the river tunnels leading into Pennsylvania Station. The scope of our review, the methodology used to achieve our objectives, prior audit coverage, and project coverage under the Government Performance and Results Act are discussed in Exhibit A.

BACKGROUND

Pennsylvania Station, at the center of Amtrak's Northeast Corridor, is the nation's most heavily used railroad station and is the terminal for Amtrak's routes from Washington and Boston to New York City. In addition to the 28,000 Amtrak passengers, more than one-half million Long Island Rail Road, New Jersey Transit Corporation, and subway commuters use Pennsylvania Station each day. In the early 1990s, deteriorating conditions at the station and projected growth in traffic prompted Amtrak to consider alternatives for expanding Pennsylvania Station. At that time, Amtrak also identified life safety improvements needed in the tunnels below the station. The station, located beneath the Madison Square Garden Arena, had no practical alternative for growth except to expand across the street to the underutilized Farley Post Office Building, situated above the railroad tracks and passenger platforms serving Pennsylvania Station (Figure 1).

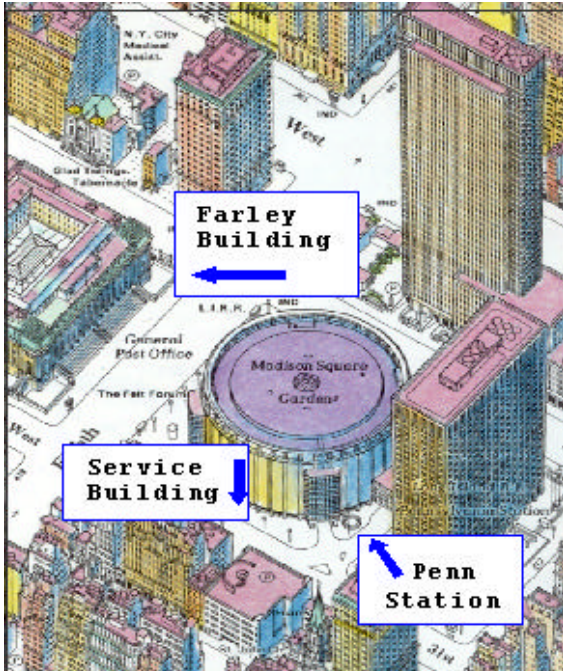


Figure 1: Map of Project Area
Source: Rand McNally

In 1992, Amtrak recommended that the Farley Building be redeveloped to include new Amtrak facilities, at an estimated cost of \$315 million. In February 1994, Congress appropriated the first Federal funds for the proposed redevelopment. In August 1994, the Federal Railroad Administrator, the Governor of New York, the Mayor of New York City, and the President of Amtrak, signed a memorandum of agreement for the project. Under the agreement, more than one-third of the U.S. Postal Service's Farley Building would be converted into a new railroad passenger station, and the existing Pennsylvania Station would be renovated to include additional retail services and support facilities. Amtrak would shift its operations to the Farley Building, while the Long Island Rail Road and the New Jersey Transit Corporation would continue to operate from Pennsylvania Station. As part of the project, Amtrak was also to undertake a major rehabilitation of its Service Building, across from Pennsylvania Station. Amtrak was to manage the project, which was to be completed by September 1999.

In 1995, the Pennsylvania Station Redevelopment Corporation (PSRC) was created as a subsidiary of the Urban Development Corporation, an agency of the State of New York. On March 10, 1997, Amtrak and PSRC split responsibility for the project.¹ Amtrak was to complete necessary improvements to the existing Pennsylvania Station and the Service Building, and PSRC was to develop the Farley Building and a subway passage connecting the building to Pennsylvania

¹ In January 2000, the President of PSRC resigned after managing the project for more than 3 years. PSRC is currently seeking a replacement for this critical position.

Station. PSRC discarded Amtrak's design to redevelop the Farley Building and hired a new architectural firm to provide a complete new design for the building. The redesigned Farley Building will provide significantly more retail space and a substantially rehabilitated Post Office area, in addition to expanded intermodal transportation facilities.

RESULTS IN BRIEF

The project's cost, scope, funding, and scheduled completion date have all changed considerably since PSRC took responsibility for redeveloping the Farley Building in 1997. The cost of the project is now estimated at \$768 million.² This is more than twice the original \$315 million estimate developed in 1992, but reflects a greatly expanded project scope and includes a number of items omitted in the earlier forecast.

Furthermore, the new project design is only 15 percent complete and the estimated cost of the project is still changing. Federal, state, and local governments have committed \$473 million of funding to the project. Of the \$473 million of committed funding, approximately \$66 million has been spent. We found that Federal funds used for the project have been spent as directed in the funding legislation. However, \$295 million in Federal and state loans are not yet secured.

To obtain the loans, PSRC must finalize its agreement with the Postal Service and its leases with the principal tenants—Amtrak and the Port Authority of New York and New Jersey. In addition, PSRC must demonstrate that the completed project will generate sufficient revenues to repay the loans. The project is now scheduled to be completed in 2005, about 6 years later than originally planned. PSRC plans to issue a more accurate cost estimate in May 2000, after the new design is 30 percent complete. *This would be an appropriate time for PSRC to establish a finance plan with cost containment strategies. Annual updates would provide information on actual costs and funds available in comparison to initial estimates.*

Life safety requirements in tunnels and areas beneath the existing Pennsylvania Station and Farley Building have been identified as a largely separate project to be completed by Amtrak, the Long Island Rail Road, and the New Jersey Transit Corporation. The life safety requirements, estimated to cost \$804 million, will be funded jointly by the three railroads to improve ventilation, lighting, evacuation capability, and communications in the tunnels.³ Since 1976, the railroads have spent or committed close to \$150 million for underground life safety, but

² This includes \$125 million for work in the Postal Service sections of the building, of which \$120 million will be funded by the Postal Service.

³ Estimates in 1997 dollars.

\$654 million of requirements will remain after Fiscal Year 2000. To ensure that these projects are completed in a timely manner, the FRA Administrator should work with the three railroads to identify the necessary funding sources.

FRA did not agree with our recommendation that an annual finance plan for the project should be submitted for its approval. According to FRA, the finance plan submitted with PSRC's loan application is sufficient. In our opinion, PSRC's finance plan is not sufficient as it does not include contingency plans for funding shortfalls or identify cost containment strategies. We are asking FRA to reconsider its position. FRA agreed with the recommendation to closely monitor PSRC's progress toward effectively implementing its cost containment strategies and achieving its project completion date. However, preparation of an annual finance plan to include cost containment strategies and realistic project milestones should be established first, and then used to closely monitor PSRC's progress. PSRC agreed with our recommendation to work with the railroads to identify the necessary funding for tunnel life-safety requirements.

FINDING AND RECOMMENDATIONS

Project Cost Estimate has Increased

In the 3 years since PSRC took responsibility for redeveloping the Farley Building, the scope of the project has greatly changed and the project is now estimated to cost \$768 million. This is much more than the \$315 million project envisioned in 1992, which was less ambitious and did not include a number of items that have increased the current cost estimate. In addition, the design for the current project is only 15 percent complete, and as the design progresses, project costs could rise further.

In 1992, Amtrak established the project cost estimate at \$315 million. In 1996, out of concern that the cost estimate was unrealistic, PSRC hired a cost consultant who found that Amtrak's estimate was too low, and that a more accurate estimate was \$455 million.⁴ In 1997, PSRC assumed full responsibility for redeveloping the Farley Building and decided to expand the project beyond Amtrak's requirements by rehabilitating Postal Service areas in the building and providing intermodal facilities. In 1998, PSRC hired a new architect to accomplish the redesign.

Table 1 on the following page identifies the major additions to the redesigned project that contributed to the current cost estimate of \$768 million.⁵

⁴ Preparation of a Project Budget for the New York Penn Station Redevelopment Project, O'Brien-Kreitzberg, Inc. (July 15, 1997).

⁵ The \$315 million and \$455 million project cost estimates did not provide sufficient information to fully identify all of the changes leading to the current \$768 million cost estimate.

Table 1. Growth of Farley Building Project Cost: 1992-2000

<ul style="list-style-type: none"> • Original Project Cost Estimate (1992) 	\$315 million
<ul style="list-style-type: none"> • Cost consultant hired in 1996 finds that Amtrak's original cost estimate, based on early design assumptions, was unrealistically low, and recommends revising cost upwards. 	\$140 million*
<ul style="list-style-type: none"> • The Postal Service is taking advantage of the redesign effort to rehabilitate its sections of the building. Approximately \$120 million of the increase is being funded by the Postal Service, and will provide numerous improvements to postal facilities, including a new communications system and restoration of the lobby. 	\$125 million
<ul style="list-style-type: none"> • Interest charges on the loans needed to fund the higher cost of the project. 	\$43 million
<ul style="list-style-type: none"> • Costs associated with hiring a new architect for the redesign. 	\$35 million
<ul style="list-style-type: none"> • Inflation expected from extending the project completion date from 1999 to 2005. 	\$35 million
<ul style="list-style-type: none"> • PSRC agreed to make an up-front, lump-sum payment to the Postal Service that will be part of PSRC's 99-year agreement for occupying project space at the Farley Building. 	\$20 million
<ul style="list-style-type: none"> • Addition of an intermodal hall. 	\$17 million
<ul style="list-style-type: none"> • Cost increase for a glazed roof structure (Figure 2), rising 186 feet above the first-floor level (\$28 million total cost). 	\$10 million
<ul style="list-style-type: none"> • Addition of an electronic media wall (Figure 3) to display commercial advertisements, national weather maps, and other information. 	\$10 million
<ul style="list-style-type: none"> • Additional increase since August 1999, when PSRC submitted a cost estimate to FRA as part of its application for a Federal loan. 	\$20 million
<ul style="list-style-type: none"> • Current Total Project Cost Estimate (2000) 	\$768 million
<p>*To avoid double counting, \$2 million of the \$140 million increase that was included in the other cost increases was not added to the \$768 million total. The \$768 million cost estimate includes about \$50 million in net planned cost-containment reductions.</p>	

The \$20 million increase in the project cost estimate since August 1999 reflected cost modifications resulting from further refinement of the project design. Because the design for the Farley Building is still only about 15 percent complete and does not yet reflect detailed design work, it is possible that further cost increases or decreases could occur.

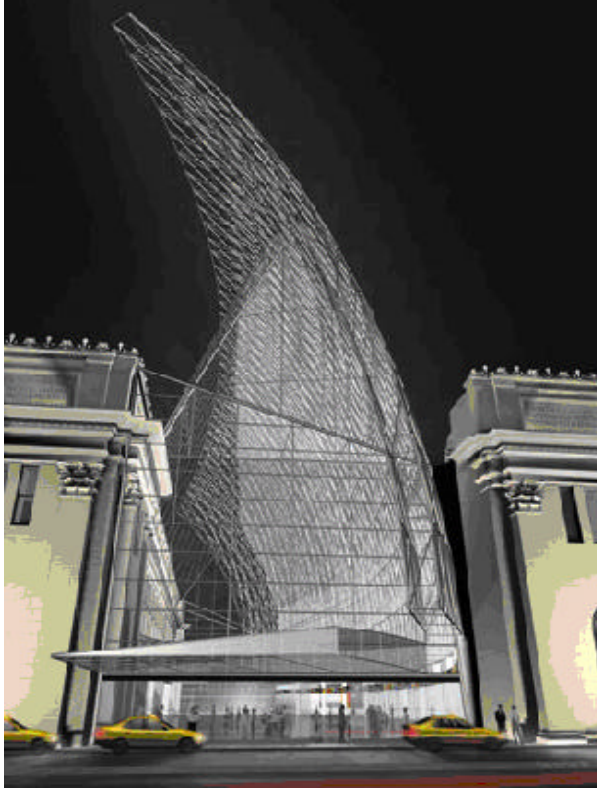


Figure 2: Glazed Roof Structure
Source: PSRC

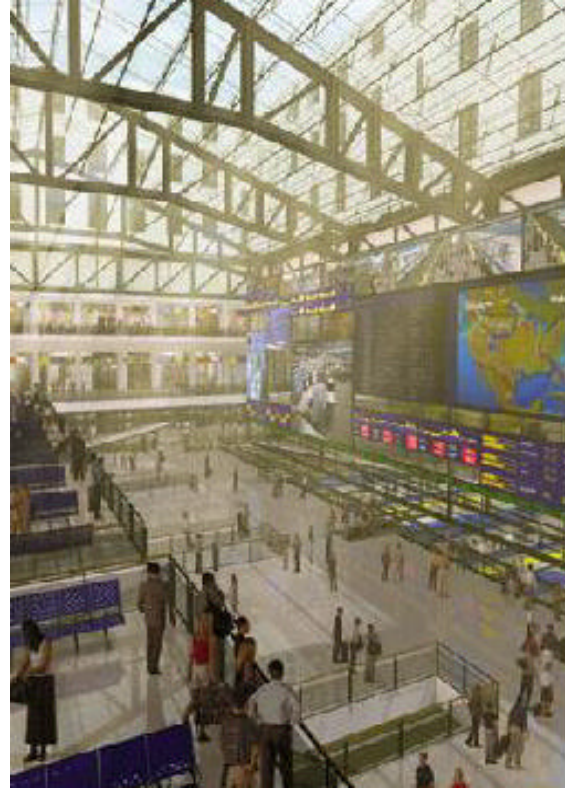


Figure 3: Electronic Media Wall
Source: PSRC

Loans Needed to Complete Funding

A total of \$768 million is needed to fund the project. Of that amount, \$295 million (38 percent) is to come from loans and bonds which are conditional on finalizing leases.

The project has secured \$473 million in commitments from Federal, state, and city agencies, as well as Amtrak and the Postal Service. The \$120 million committed by the Postal Service is conditional upon the approval of its Board. Of the \$473 million, approximately \$66 million has been spent. We found that Federal funds used for the project have been spent as directed in the funding legislation. Federal funds provided through the U.S. Department of Transportation, including a loan being made under the Transportation Infrastructure Finance and Innovation Act (TIFIA), will amount to \$324 million or 42 percent of the project's current estimated total cost. A summary of project funding is provided in Table 2.

Table 2. Project Funding (millions)			
Source	Funding	Spent	Status
Federal			
• Federal Railroad Administration (FRA) grants for existing Pennsylvania Station (pre-PSRC)	\$68.2	\$60.9*	Committed
• FRA grants for Farley Building and additional appropriations	116.1	0.5	Committed
State			
• Congestion Mitigation and Air Quality	64.0	0	Committed
• New York State Department of Transportation	40.0	2.9	Committed
• New York State Metropolitan Transportation Authority	35.0	0	Committed
City			
• New York Economic Development Corporation	25.0	.3	Committed
Other			
• U.S. Postal Service	119.6	1.1	Conditional on Board Approval
• Amtrak	5.4	.3	Committed
Loans			
• U.S. Department of Transportation – TIFIA Loan	140.0	0	Conditional on Leases
• New York State Bond Issue	155.0	0	Conditional on Leases
Total Funding	\$768.3	\$66.0	

*Spent primarily for life safety improvements in the existing Pennsylvania Station.
Sources: As listed above, as of December 1999.

PSRC has applied for, but not yet secured, \$295 million of Federal and state loans needed to complete the project. The loans consist of a U.S. Department of Transportation TIFIA loan for \$140 million and the proceeds from a New York State bond issue for \$155 million. The bonds, however, will not be issued without an investment grade rating.

Neither the TIFIA loan nor the investment grade rating for the bonds will be provided until PSRC signs the final agreement with the Postal Service and finalizes leases with the expected principal tenants of the project—Amtrak and the Port Authority. In addition, the loans require PSRC to demonstrate that the anticipated revenue from the project will be sufficient to repay the loans. To do so, PSRC must finalize leases with Amtrak and the Port Authority, as well as identify potential retail tenants.

Final Agreement and Leases Not Signed

The final agreement and leases with the project's principal stakeholders have not yet been signed. The Vice President of Facilities for the Postal Service stated that he would not seek approval from the Postal Service Board of Governors for a final agreement with PSRC until project design is at least 30 percent complete, which he believes would provide a more accurate cost estimate. According to FRA, this design stage was reached in April 2000, and the updated cost estimate is expected in May 2000. Postal Service funds for the project would be provided after the Postal Service signs the final agreement.

Amtrak has not signed a lease with PSRC, and has no immediate need to move to the Farley Building. Amtrak passengers account for only 5 percent of the 557,000 commuter, subway, and train passengers using Pennsylvania Station each day. Furthermore, Amtrak has nearly finished renovating its facilities at the existing Pennsylvania Station. The renovation, which began prior to the establishment of PSRC, was part of a series of station improvements initiated in preparation for the start-up of Amtrak's new Acela high-speed rail service.

The renovation included \$74 million for improved access and pedestrian flow within Pennsylvania Station and for life safety improvements. This life safety work includes asbestos abatement, compliance with Americans with Disabilities Act requirements, closed-circuit television and public address systems, structural repairs, and installation of smoke and fire-stopping material between platforms and station levels.

While the Postal Service and Amtrak are likely to sign with PSRC some time after the design becomes at least 30-percent complete, it is less certain whether the Port Authority will lease space from PSRC. The Port Authority's Executive Director has submitted a nonbinding letter of interest to PSRC, but has not presented a formal proposal for consideration to the Port Authority's Board of Commissioners. Neither the Executive Director nor the Board has established a date for Board consideration of such a proposal.

Project Revenue is Uncertain

To obtain its loans, PSRC must demonstrate that the completed project will generate sufficient revenue to repay the loans. PSRC anticipated \$8.3 million annually from a lease with the Port Authority, about 25 percent of the expected \$32.7 million annual project revenue. If the Port Authority leases project space, it would be to serve airline passengers using rail links that would connect the redeveloped Farley Building to John F. Kennedy (JFK) and Newark International

Airports. However, community groups have sued to block construction of the JFK AirTrain project connection, and neither the JFK nor the Newark rail link will provide direct service to the Farley Building. A previous attempt to provide “Train to the Plane” service to JFK airport that required passenger transfers ended in failure. As neither of these rail links has been established, or is likely to be established in the near term, PSRC’s expectation that the Port Authority will become a tenant in the near future is optimistic.

PSRC plans to obtain about \$5 million a year from renting project space to retail establishments and to airlines to sell plane tickets. However, partially because the rail link airport connections have not been established, no airlines have committed to renting space at the Farley Building, and PSRC has not been successful in identifying future tenants for the retail space the project will make available. In January 2000, PSRC adopted a plan to use a developer for the retail space to be developed by the project. According to the president of the Union Station Redevelopment Project in Washington, DC, use of a developer at Union Station was an important factor in overcoming earlier problems in redeveloping that facility, as retail leases are not usually committed before the start of construction. PSRC’s use of a developer might overcome the obstacles it has encountered thus far in identifying potential future tenants.

The TIFIA loan agreement was to be executed no later than the end of February 2000. Because PSRC has not obtained the leases necessary to secure the TIFIA loan, it requested an extension on February 27, 2000, according to FRA. The request for an extension is currently under consideration by the FRA Administrator.

Project Schedule has been Delayed Repeatedly

Since 1994, when the Federal Railroad Administration, New York State, New York City, and Amtrak signed the memorandum of agreement to construct the project, the scheduled completion date has been delayed repeatedly, as highlighted below. The project’s current schedule has a completion date of 2005 – about 6 years past the original schedule.

- In 1994, Amtrak established the project’s original completion date of September 1999.
- In 1998, PSRC revised the completion date to December 2002, because of its redesign of the Farley Building.
- In August 1999, the completion date was delayed to December 2003, reflecting the status of the project as of the TIFIA application.

- In November 1999, the completion date was postponed to April 2005, based on the architect's revised project schedule.

The project's current completion date could be delayed even further because the Postal Service and Amtrak have not yet approved the project design, or agreed on the sequence of work to be performed. The sequence of work is especially important to the Postal Service, which needs assurance that the redevelopment will not interfere with its mail operations. Furthermore, the project's completion date could be pushed back past April 2005 if the loans are not received in time to award contracts so that construction can begin by October 2000, as planned.

Project Needs Finance Plan

Although PSRC prepared certain cost, funding, and scheduling information as part of the project's TIFIA application, PSRC has not been required to establish a comprehensive finance plan. Requiring such a plan would benefit project management and oversight throughout the project's life. The new design is only 15 percent complete, and the cost estimate has increased about \$20 million from the estimate PSRC presented to the Department in August 1999, when it applied for the TIFIA loan. As the design work progresses and actual contractor bids are received, costs could change. A comprehensive finance plan with cost-containment strategies will be helpful in mitigating and addressing any unanticipated cost increases.

PSRC's current cost estimate of \$768 million is the same amount as the funds currently budgeted for the project. The cost estimate includes about \$50 million in net planned cost-containment reductions (\$75 million in decreases and \$25 million in increases). The largest reduction is \$17 million from decreasing the size of the roof structure. In addition, the Farley Building will need less exterior restoration than originally estimated, for a savings of \$13 million. Other savings come primarily from using more efficient construction methods, such as reducing the need for temporary work platforms. Because PSRC does not have any excess funds available beyond the contingencies included in its current budget, it has no room to accommodate any additional project costs.

Under the Transportation Equity Act for the 21st Century (TEA-21), sponsors of federally-funded projects of \$1 billion or more are required to submit annual finance plans containing specific information to the Department. Given the project's cost history, the funding difficulties encountered, and the repeated delays in the project's scheduled completion date, PSRC should be required to prepare a finance plan.

In April 2000, when the new design is expected to be 30 percent complete, PSRC plans to issue a more accurate cost estimate. That would be an appropriate time for PSRC to establish a finance plan, similar to the type of annual finance plan required by TEA-21. The finance plan should include the cost estimate, the project schedule, the funding sources, a cash flow analysis, and any other factors of importance. The finance plan for the project should also establish cost containment strategies. Annual updates would provide information on actual cost and funds available in comparison to the initial estimates and would highlight to management any significant cost or funding changes and the implications for completing the project.

Underground Life Safety Improvements Being Addressed Separately

Amtrak, the Long Island Rail Road, and the New Jersey Transit Corporation have identified as a largely separate project, \$804 million in fire and life-safety improvements needed in six tunnels beneath the Hudson and East Rivers and areas beneath the existing Pennsylvania Station and Farley Building. The six tunnels that need improvements were built around 1910 and were not designed for the current volume of traffic. In 1998, Amtrak officials warned Congress that, due to the age of the infrastructure and the size of the traveling population, the potential for an accident exists at Pennsylvania Station, unless improvements are made.

While most of the costs for the underground life safety improvements will be borne by the three railroads, costs related to additional ventilation needs resulting from operations in the Farley Building will likely be partially borne by PSRC. An analysis of the additional costs for ventilation is in progress, and when complete, allocation of the costs will be negotiated between Amtrak and PSRC.

The three railroads have spent or committed nearly \$150 million through FY 2000 to address the underground life safety improvements, but an estimated \$654 million of improvements are still needed for fire and smoke control systems, ventilation, communications, and access shafts in the tunnels. To stay current on meeting these improvements and monitoring progress, the three organizations formed a Fire and Life Safety Committee and Task Force, which meets regularly to review progress and set work priorities. Based on our discussions with Amtrak's Acting and former Chief Engineers for Fire and Life Safety, some of the most critical life safety improvements, particularly tunnel ventilation improvements, are being addressed first and should be finished close to the time the Farley Building redevelopment project is completed in 2005. The remaining underground life safety work is planned to be completed by 2014.

Amtrak's 2000 capital plan provides \$30 million for life-safety needs, but because all capital spending is subject to Amtrak's annual capital approval process, funding commitments beyond the current year are uncertain. Amtrak is facing two competing pressures that will make its ability to fund life-safety needs even more difficult. The \$2.2 billion in Taxpayer Relief Act funds will be largely depleted by 2001, meaning that all of Amtrak's capital needs will have to be financed from its general capital appropriation. We have projected that available capital funds will not be sufficient for Amtrak to even meet its minimum needs beginning in that year. At the same time, Amtrak is planning to begin implementation of service changes indicated by its Market Based Network Analysis. These changes will require capital investments to refurbish existing equipment and upgrade track and stations. A tighter capital budget compounded with greater capital demands will make it more difficult for life-safety projects to compete for needed funding.

RECOMMENDATIONS

We recommend that the Federal Railroad Administrator:

1. Require PSRC to submit for FRA approval a comprehensive annual finance plan for the project. The plan should establish cost-containment strategies and realistic project milestones, identify how PSRC will secure sufficient committed funding to meet expected costs, and provide contingency plans to resolve any funding shortfalls.
2. Closely monitor PSRC's progress toward effectively implementing its cost containment strategies and achieving its project completion date.
3. Work with Amtrak, the Long Island Rail Road, and the New Jersey Transit Corporation to identify the necessary funding for tunnel life-safety requirements to ensure that these needs are met in a timely manner.

MANAGEMENT COMMENTS

On April 14, 2000, FRA provided its response to our draft report (see appendix). FRA noted that nearly all of the cost growth we cite relates to changes in scope of the project from the original baseline. FRA does not believe that our report should characterize the changes as cost growth. FRA said that the projected revenue improvements resulting from these additions are expected to fully offset the investments. FRA also contends that the increases related to financing costs should be excluded. Furthermore, FRA indicates that the \$125 million in improvements to the space occupied by the Postal Service will be funded fully by the Postal Service and therefore should be considered separately from the remainder of the project.

FRA's position on each of our recommendations is summarized as follows.

1. Require a comprehensive annual finance plan. FRA believes it is incorrect to state that the project has not established a comprehensive finance plan. According to FRA, the TIFIA requirements already in place are equal to or even more stringent than the TEA-21 requirements, and the TIFIA agreements allow the Department to withhold committed funds if the project does not have sufficient funds to complete the planned work. Additionally, FRA does not believe the project should be subject to the type of comprehensive plan called for by TEA-21 for projects greater than \$1 billion because the cost of the project is significantly below that threshold, particularly if completed work and the Postal Service work are factored in.
2. Cost containment strategies and achieving the project completion date. FRA agreed to accomplish this recommendation through the TIFIA oversight process, independent cost estimating process, and oversight of the PSRC Board of Directors.
3. Identify necessary funding for tunnel life-safety requirements. FRA agreed to support this recommendation because upgrading the rail passenger tunnels that provide access to Pennsylvania Station is vital to the long-term future of rail passenger service in the Northeast.

OFFICE OF INSPECTOR GENERAL RESPONSE

Our report is clear that the majority of cost growth relates to changes in the project's scope. We do not agree with FRA's assertion that financing charges should be excluded from project cost. These expenses are appropriate inclusions in the total project cost, and PSRC properly included interest on financing as part of the estimated project cost in its TIFIA application. Our report also noted that the costs for the Postal Service improvements will be funded by the Postal Service.

With respect to our recommendations:

1. Require a comprehensive annual finance plan. We do not agree with FRA that the current financial documents prepared for the TIFIA application are equal to or more stringent than TEA-21 requirements for a comprehensive finance plan. The TIFIA requirements do not require contingency plans to resolve funding shortfalls, or identify cost containment strategies. A comprehensive finance plan is crucial to the Department's monitoring of the project, especially because the project does not currently have sufficient funds to complete planned work, a situation under which the TIFIA agreements allow the Department to withhold committed funds. The requirement to prepare a finance plan under TEA-21 generally applies to projects reasonably expected to cost at least \$1 billion, but Congress has directed that less-costly projects experiencing difficulties, such as this one, be required to prepare a finance plan. Given the project's cost history, the funding difficulties encountered, and the delays in the completion schedule, PSRC should be required to prepare a finance plan using the TEA-21 requirements.
2. Cost containment strategies and achieving the project completion date. Although FRA agreed with this recommendation, a comprehensive annual finance plan, as discussed above, should be prepared as the basis to effectively establishing and achieving cost containment strategies and a realistic completion date.
3. Identify necessary funding for tunnel life-safety requirements. FRA agreed to support this recommendation, but did not provide either specific actions to be taken to accomplish the recommendation or a timetable for completion of such actions.

ACTION REQUIRED

In accordance with Department of Transportation Order 8000.1C, we would appreciate receiving your written comments within 30 days of the date of this report. Please reconsider your position on Recommendation 1, and provide the specific action you intend to take as well as target dates for all the recommendations in this report. If you do not concur, please provide your rationale. Furthermore, you may provide alternate courses of action that you believe would resolve the issues presented in the report.

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Exhibit A. Scope And Methodology

We performed fieldwork at the New York City offices of PSRC, Amtrak, the Postal Service, and the Urban Development Corporation; and at FRA Headquarters and Union Station in Washington, DC. We also visited PSRC's architectural firm, the Farley Building, the existing Pennsylvania Station, and the tunnels below the station. In addition, we contacted the Port Authority of New York and New Jersey, Standard & Poor's, N.Y. State Department of Transportation, and representatives from airline offices. We met with life safety officials from Amtrak, the Long Island Rail Road, and the New Jersey Transit Corporation.

Our review included evaluation of PSRC's management controls over the project. We reviewed PSRC and Amtrak reports and documents pertaining to the project, including PSRC's TIFIA application; Standard & Poor's credit assessment; and project milestone charts. We also evaluated cost, economic impact, and budget reports and analyses, and tested supporting documents for key information. In addition, we reviewed funding legislation, architectural and engineering plans and reports; and FRA's August 1999 Environmental Assessment.

Based on lack of significant findings in the areas of projected traffic growth, the development of commercial space and anticipated retail revenue, and Amtrak's role in the planning, development, and funding of the project, it was decided to focus the report on project costs, funding, scheduling, and underground life safety requirements. To obtain information on these issues and identify community concerns, we interviewed management officials and attended New York State's public hearing on the project in December 1999. The OIG engineer advisor provided technical assistance for our review by evaluating project design and schedule documents. In addition, we compared supporting project documents used to obtain Federal funds already spent against funding legislation requirements to ensure the funds were used appropriately.

We performed our fieldwork in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States, focusing on activities since 1996, when we last reviewed the project. The 1996 review concluded that a determination was needed as to whether the project represented the best use of scarce financial resources. We recommended that (1) thorough consideration be given to viable alternatives to the project; (2) needed life safety improvements at Pennsylvania Station be accomplished; (3) a finance plan be prepared to identify funding for the project; and (4) binding commitments be secured to provide the required financial support. We also recommended that until these actions were

completed, all Federal funds for Pennsylvania Station be used for safety-related work.

In response to our recommendations, FRA obtained a revised project cost estimate. In addition, Amtrak established and began work on a life safety improvement project at Pennsylvania Station. However, a finance plan for the project was not prepared and binding commitments were not secured for all required financial support. FRA did require that the Federal funds for the existing Pennsylvania Station be used for safety-related work.

Our review was conducted from August 1999 through March 2000. The Department of Transportation's Performance Plans for Fiscal Years 1999 and 2000 under the Government Performance and Results Act did not include goals related to the project.

Exhibit B. Major Contributors To This Report

THE FOLLOWING STAFF CONTRIBUTED TO THIS REPORT.

Name	Title
Michael E. Goldstein	Program Director
Jeffrey Ong	Project Manager
Daniel Schultz	Team Leader
Rodolfo Perez	OIG Engineer Advisor
Doral Hill	Auditor
Timothy Keane	Auditor
Vera Tam	Auditor

U.S. Department
of Transportation**Federal Railroad
Administration**

Memorandum

Date: **APR 14 2000**

Reply to Attn. of:

Subject: Draft Report on the Review of the
Pennsylvania Station Redevelopment
Project, FRA Project No. 99R-3004-R000

From: Jolene M. Molitoris
Administrator

To: Alexis M. Stefani
Assistant Inspector General for Auditing

Thank you for providing us with the opportunity to review the Office of the Inspector General's (OIG) "Draft Report on the Review of the Pennsylvania Station Redevelopment Project, Federal Railroad Administration, Project No. 99R-3004-R000."

I would like to provide you with comments developed by Federal Railroad Administration (FRA) staff through review of the Draft Report. As discussed with your staff, FRA shared a copy of the Draft Report with the Office of the Secretary (OST), the Pennsylvania Station Redevelopment Corporation (PSRC) and Amtrak, and to some extent the concerns of these three entities are incorporated into these comments.

FRA is pleased that the OIG review has confirmed that the Federal funds appropriated for the project have been spent as directed in the funding legislation. While other rail-related projects in the New York area are also in need of funding (i.e., the rail tunnels), the appropriated funds were provided by the Federal Railroad Administration as directed by the Congress.

Report Findings

The Draft Report notes that PSRC retained a well-known engineering firm, O'Brien-Kreitzberg, Inc. (OK), to prepare a full-scale professional cost estimate for the project. This was recognition that there was little in the way of detailed estimates supporting the initial project cost estimate. The firm found that the original project would actually cost approximately \$455 million. The OK study, jointly funded by Amtrak and the City and State of New York, was a responsible effort to put the project on a business-like footing and provides the baseline for cost comparison purposes.

The Draft Report mentions on several occasions that the cost of the project has increased from \$315 million to \$455 million to \$768 million. The difference between the 1996 OK cost estimate of \$455 million and the \$768 million cost cited in the Draft Report is almost entirely attributable to differences in how the project is defined. In fact, the cost of building the new transportation terminal, which is the central purpose of the project, has actually shown relatively little increase in cost, although it has been dramatically improved by increasing the amount of retail and by addressing environmental issues and adding passenger service facilities. As mentioned in the Draft Report, the project “reflects a greatly expanded scope” including an expanded west end concourse with a new commuter level concourse, an intermodal ticketing hall, improved loading facilities for the United States Postal Service (USPS), increased retail area, and the addition of passenger handling facilities for airport access.

The \$768 million project described in the Draft Report includes a number of items outside the scope of the 1996 estimate. The \$125 million in USPS improvements is being totally funded by USPS, and is unrelated to the cost of the transportation terminal. Rather, it improves the portions of the facility that USPS will continue to occupy after the transportation terminal opens.

The Draft Report is correct that PSRC’s decision to borrow approximately \$295 million, rather than relying exclusively on grants, has caused a \$43 million increase in the project’s budget, to account for interest costs. PSRC notes that there never was a realistic chance that the project could obtain \$455 million in grants from government sources as has been repeatedly demonstrated in recent appropriations. By borrowing through the USDOT’s Transportation Infrastructure Finance and Innovation Act (TIFIA) program, PSRC is obtaining \$140 million in funds for construction at a subsidy cost of roughly \$20 million to the federal government. Further, because the loans will be repaid by revenues from retail to be developed and operated by a private sector developer, this financing strategy will help bring market discipline to this large public works project.

Several of the other items included in the Draft Report’s Table 1 were added specifically to increase the private sector retail component of the project. The construction costs associated with creating this additional retail will be more than offset by the additional revenues it will generate. Increasing the amount of retail space (today’s design has approximately twice the 48,000 square feet Amtrak planned at the time of the OK cost estimate) will make the project more attractive to the private sector teams who will ultimately construct and operate the station. Specifically, the construction cost of the entire intermodal hall, which the Draft Report estimates at an extra \$27 million, is projected by PSRC to be offset by revenues from airlines and other private sector entities who will rent space in that portion of the station. The same is true of the electronic media wall, which makes use of technology and advertising strategies only developed in recent years. This facility, which is projected to cost \$10 million to build, is expected to generate roughly \$4 million in net revenues per year by PSRC’s estimate, which is much more than enough to support debt service from additional borrowing. Finally, the \$20 million cost increase listed as the last item in Table 1 of the Draft Report involves moving certain mechanical systems off the second floor of the Farley Building in order to increase the size of the future

conference facility, retail or other revenue generating space on that level. Seventy-five percent of additional construction expense is estimated by PSRC to be offset by revenues. This change will also open the door to future development of the second floor for commercial purposes.

Report Recommendations

The Draft Report's first recommendation states that the FRA Administrator should require PSRC to submit for FRA approval a comprehensive annual finance plan for the project, as soon as the project reaches 30 percent design in April 2000. The TIFIA application included a finance plan that contained all the elements mentioned on the top of page 11 of the Draft Report as needed in such a plan. FRA believes that it is incorrect to state that PSRC has not established one. Clearly, PSRC needs to refine/update that plan with revised cost estimates (based on additional design), revised revenue estimates (based on a feasibility study), a revised schedule, and other factors. Such revisions realistically would be completed later in the summer or fall of this year when more refined information is available as a result of the feasibility study revenue projections, more progress is made on the financial participation of the other funding partners, and PSRC has a better idea of the developer's approach. However, FRA does not believe that the project should be subject to the TEA-21 "mega-project" provisions for projects with costs greater than \$1 billion. The project is significantly under the TEA-21 "mega-project" threshold, particularly when the USPS and already completed Penn Station improvements are factored in. The current TIFIA requirements are essentially equal to or even more stringent than the "mega-project" requirements. This is especially true with regard to the TIFIA requirements related to the market acceptable finance plan and various credit monitoring and project reporting. Finally, the TIFIA agreements allow the Department to withhold committed funds in the event that the project does not have sufficient funds to complete the planned work.

The second recommendation states that the FRA Administrator closely monitor PSRC's progress toward effectively implementing its cost containment strategies and achieving its project completion date. FRA believes that this recommendation has merit and that it will be accomplished through several mechanisms including as part of the TIFIA oversight process discussed earlier, through the independent cost estimating process, and through the oversight of the PSRC Board of Directors.

Two independent cost estimating firms have been working on the design in order to ensure that the cost estimates are up-to-date with the design work. The project has conducted several value engineering exercises to reduce the cost of the project. The contract with Skidmore, Owings and Merrill (SOM) requires that the final design satisfy specific cost maximums consistent with the overall budget. If independent cost estimating firms conclude that the design does not satisfy this requirement, the SOM team will be required to do a re-design, at their own cost and expense.

The three entities comprising the PSRC Board of Directors--the City of New York, the State of New York, and the Department of Transportation/FRA--have a strong incentive and responsibility to ensure that the project is monitored closely. Both the Deputy Secretary and I

are Board members along with representatives of the Mayor and Governor of New York. FRA staff sit on a funding partners committee that meets every three weeks. FRA believes the mechanisms for appropriate monitoring already exist.

The third recommendation states that the FRA Administrator work with Amtrak, the Long Island Rail Road, and the New Jersey Transit Corporation to identify the necessary funding for tunnel life-safety requirements to ensure that these needs are met in a timely manner. Upgrading the rail passenger tunnels accessing New York Penn Station is vital to the long-term future of all rail passenger service in the Northeast, and the FRA supports this recommendation.