



Minnesota Regional Transit
Board: Records.

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REGIONAL TRANSIT BOARD

Mears Park Centre
230 East 5th Street
St. Paul, Minnesota 55101
612/292-8789

Marginal Cost Guidelines for Submitting Bids as Part of Proposals to Operate Public Transit Service

NOTICE OF PUBLIC HEARING

The Regional Transit Board is holding a public hearing pursuant to Minnesota State Statute 473.392 to receive comments for establishing marginal cost guidelines for submitting bids as part of proposals to operate public transit service.

Interested parties are encouraged to attend this hearing and offer public comment. The hearing will be held Monday June 17 at 5:00 p.m. in the Mears Park Centre Board Chambers. (First Floor, 230 East Fifth St., St. Paul) Those wishing to present comments at the public hearings should contact the RTB at 292-8789, TDD 229-2715. Interpreters will be available.

Copies of the proposed guidelines are available from the RTB. Written comments will be received through Friday, June 21, 1991.

Michael J. Ehrlichmann
Chair

MINNESOTA VALLEY TRANSIT

15025 Glazier Avenue • Suite 213 • Apple Valley, MN 55124
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FACSIMILE COVER SHEET

DATE: June 19, 1991

TO: Mary Fitzgerald

FAX NUMBER: 229-2739

FROM: Audrey Swarf

FAX NUMBER: 431-2828 (431-4311 phone)

NUMBER OF PAGES TRANSMITTED (Including cover sheet) 3

Additional
Comments: Mary, call if you have any
questions. Sorry for the delay in getting
this to you.

COMMENTS TO THE RTB:
PUBLIC HEARING ON MARGINAL COST BIDS JUNE 17, 1991.

Mr. Chair and Board Members, my name is Sheila Klassen. I am Vice President of the Minnesota Valley Transit Authority (MVTA) which represents the cities of Apple Valley, Burnsville, Eagan, Prior Lake, Savage and my city, Rosemount.

Thank you for the opportunity to share some thoughts with you on the competitive bid process and the relationship between this process and the current program for funding regional capital equipment.

In March, 1990, the MVTA issued a request for proposals to provide our six cities with 21,000 annual revenue hours of service. Bids were only received from the public provider, MTC, and a private provider, Laidlaw.

At the time, the RTB was very supportive of our serious consideration to go with the private provider because we felt there were, and are, buses available through a federal funding source, UMPTA, and therefore, did not belong solely to the MTC.

Needless to say, buses are paramount to the provision of transit service and were a major component in the evaluation of proposals submitted by a private and public provider. However, since the availability of buses did not work out, our experience was that the public provider has a competitive edge over the private provider who must procure the equipment to provide the service.

MVTA's decision to award our contract to the MTC was based on the realization that we could not afford to pay for the cost of equipment necessary to provide the service through the selection of a private provider. Because MVTA is part of the Metropolitan Transit Taxing District, you must remember too, that our cities are also paying the Metropolitan Transit debt levy which is used to fund capital equipment (largely MTC buses) in the Metro area.

In 1991, we estimate MVTA's member cities will pay \$403,581 toward the metropolitan area debt service. Additionally, for 1991, MVTA is paying the MTC \$858,352 toward capital cost of the equipment they are using to provide MVTA service. Therefore, under the current system, MVTA is paying toward the cost of the equipment twice. MVTA pays the cost of the equipment in the metropolitan debt service levy and the cost of equipment included in the hourly cost we are paying the MTC. This is double taxation, a heavy burden for any taxpayer.

MVTA is essentially paying for both the metropolitan system and their own. This is on top of the 10% already being paid plus what is kept by the RTB of any unused 90% of our area's levy. It should not surprise any of us that we simply cannot afford to do this.

Competitive bidding is most favorable with solicitation for an "operations only" contract for service. Private sector participation and competition would increase if the private provider had the same opportunities to compete with the public provider. The cost of the equipment is the fundamental deterrent to awarding a contract to a private provider in this metropolitan area. The experience of all the opt-out contracts has been the same. The opt-out authority simply cannot afford service by the private provider when they must pay the cost of the public provider as well. For this reason, there is no competitive transit market in the Twin Cities metropolitan area. It seems the opt-outs are being penalized as well as the private providers.

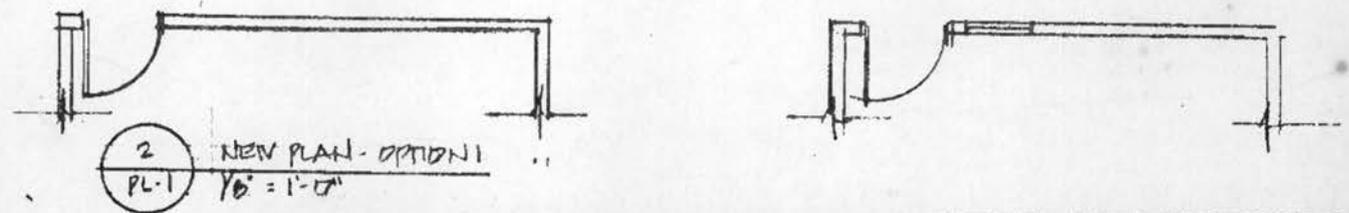
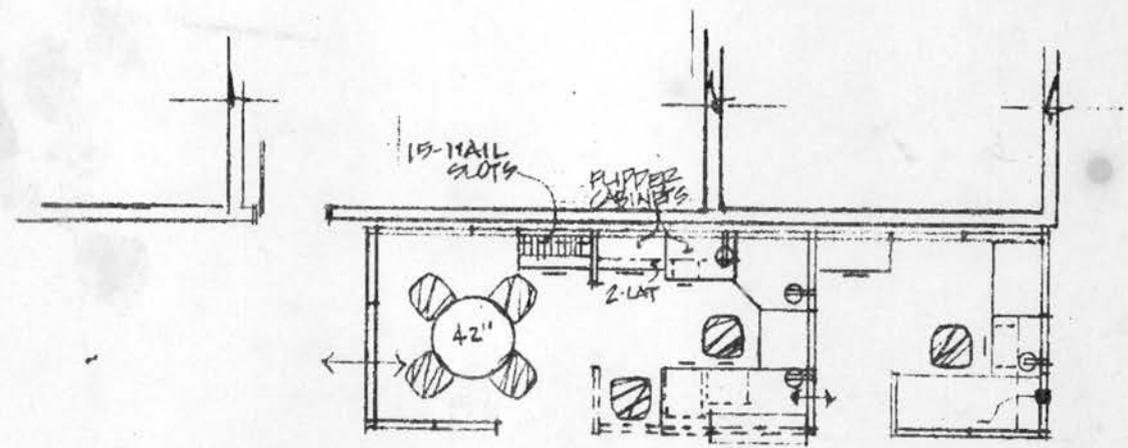
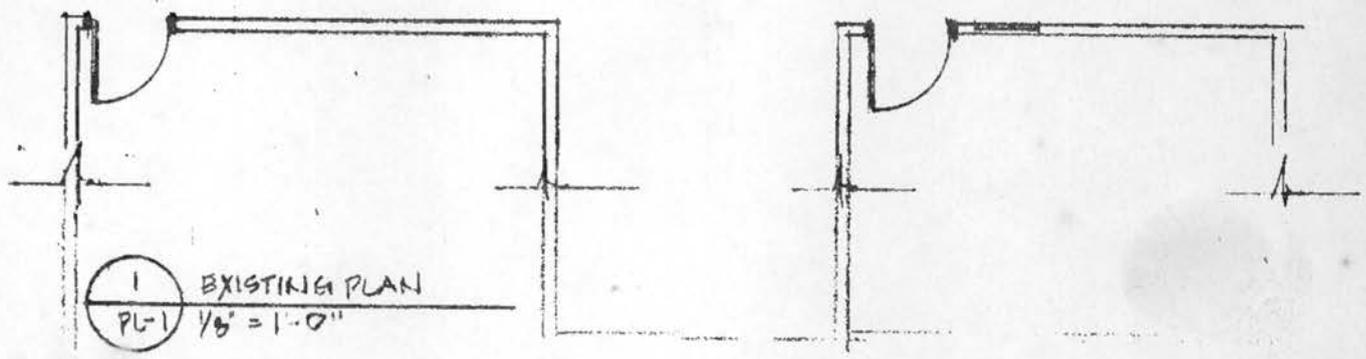
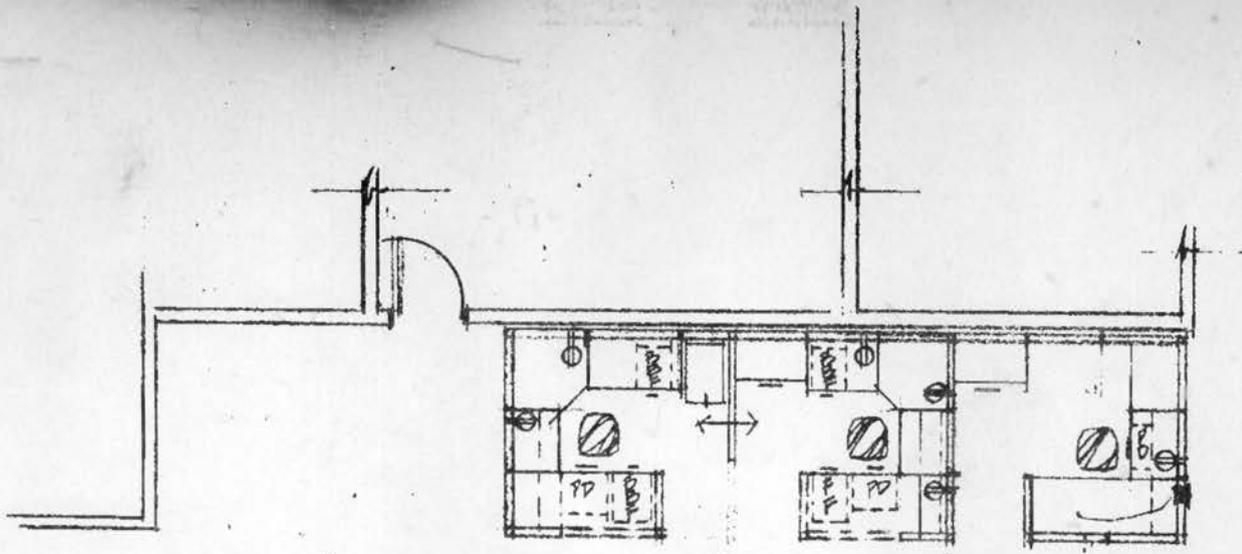
The RTB has the responsibility for setting policy directions for the transit service. Where is the policy that directs the competitive procurement of transit? Guidelines we are discussing today are simply the mechanism, the "How to manual" for procuring service. What we really need is policy direction. The policy should address issues such as: What is the purpose of competitive bidding? (We all participate in the acquisition of regional fleet buses). Why does the MTC have sole access to the fleet? Why is one public agency paying for the equipment used by another public agency? Why are we paying for equipment that is already funded through Federal and state monies?

With the increasing budget shortfall, we ask the RTB to provide incentives and work toward policies which would create a favorable environment toward competition. In the last five years, private participation in the competitive transit market has decreased to the point of almost nonexistence.

In 1986, Southwest Metro Transit competitively bid their service and received five proposals. In 1990, the MVTA received only two proposals for service that is three times larger than Southwest Metro.

In closing, taxing constraints and policy direction in the competitive transit environment need to be changed and developed. Public policy needs to support the use of private contracting in the transit market. Changes in the capitol funding environment would increase the private sector participation and the availability of transit service in the suburban market where contracting for service already exists.

Thank you for your time and consideration.



REGIONAL TRANSIT BOARD	5.23.91
MARY FITZGERALD'S AREA	1/8" = 1'-0"

EMERT DESIGN INC.
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 Programming
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REGIONAL TRANSIT BOARD
ROLL CALL AND ATTENDANCE SHEET

DATE: 6/17

BOARD OR COMMITTEE: Public Hearing on Marginal Costs

Member Name Present Vote Vote Vote Vote Vote Vote Vote Vote

ISSUE

Mike Ehrlichmann									
Doris Caranicas (P)									
John Finley (A&F)									
Ruth Franklin, Chair (P)									
Ed Kranz (A&F)									
Sandra Hilary (P)									
Terry O'Toole (P)									
Open (P)									
Norbert Theis (P)									
El Tinklenberg (Chair-P)									
Richard Wedell (A&F)									

same as board

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<u>David Ewald</u>	
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<u>Sheik Klassen MTA</u>	
<u>Diane Harbert</u>	

REGIONAL TRANSIT BOARD

Mears Park Centre
230 East Fifth Street, St. Paul, Minnesota 55101
612/292-8789

DATE: October 29, 1990
TO: Chair and Members of the Policy Committee
FROM: Edward Kouneski, Manager of Programs 
SUBJECT: Guidelines for the Justification of Marginal Costs in Awarding Transit Service Contracts

SUMMARY

This memorandum transmits the staff recommendation to approve the Deloitte & Touche guidelines for marginal cost justification that will be used to revise the RTB's *Standards, Procedures and Guidelines for Competitive Procurement of Transit Services*.

DISCUSSION

The regional Dispute Resolution Board recommended earlier this year that the RTB develop specific costing guidelines for contractors to follow in pricing proposals for transit service, for this could prevent future conflicts. The RTB in June 1990 amended the contract with its auditing firm, Deloitte & Touche, to perform this work.

RTB staff and the Deloitte & Touche consultants extensively involved MTC staff in the development of the costing guidelines. Furthermore, MTC staff reviewed the document with its commissioners at a meeting in July 1990, and the guidelines were accepted.

The Providers' Advisory Committee reviewed the consultant's work in progress on several occasions, and the final report was endorsed by PAC in August 1990.

Please note Deloitte & Touche project manager Bob McNulty will be present at the November 5 Policy Committee meeting to provide additional information and answer questions about the final report, which is attached for your review.

RECOMMENDATION

That the Regional Transit Board approve the guidelines for the justification of marginal costs in awarding contracts for public transit services, as represented in the attached report prepared by Deloitte & Touche.

Deloitte & Touche



3600 West 80th Street
Suite 100
Bloomington, MN 55431-1070

Telephone: (612) 893-0111

August 30, 1990

Mr. Gregory Andrews
Executive Director
Regional Transit Board
Mears Park Centre
230 East Fifth Street
St. Paul, Minnesota 55101

Dear Mr. Andrews:

The accompanying report presents our recommendations to the Regional Transit Board for guidelines for the identification of marginal costs in competitive bids for public transit services and for the justification of the use of marginal costs in awarding contracts for public transit services. An executive summary of these guidelines is presented below.

BACKGROUND

While the measurement of the total costs of an organization is subject to well established, generally accepted standard procedures and relatively precise, the determination of the actual costs of specific products or services provided by an organization is more difficult. It would be economically unfeasible to precisely measure the actual consumption of all of the resources consumed in the process of providing each unit of output and some of the costs are for resources which are associated with administering and maintaining the capacity to produce rather than the actual production.

As a consequence, the accounting process assigns many of an organization's costs to products or services using allocations based upon supportable assumptions, average cost rates or other accounting mechanisms which serve to provide reasonably accurate representations of the costs of each product or service. The keys to the validity of this process is consistency in the treatment and assignment of costs and that the sum of all of the costs assigned to products or services (cost objectives) equals the total costs of the organization. The inherent drawback of this process is that the costs assigned to a cost objective represent that cost objective's share of total costs under current conditions and not necessarily the costs that could be avoided if the organization stopped providing that cost objective or the costs that would be incurred if additional

units of it were produced. These costs are the marginal cost of the product or service.

While the marginal cost of a product or service represents the costs that will be incurred or avoided based upon the decision to produce or not produce a specific unit of a product or service, the sum of all marginal costs do not represent the total costs that will be incurred or avoided based upon substantial changes in the level of output. Marginal costs are only applicable within a narrow range of activity or output.

Since the validity of marginal cost estimates cannot be verified by comparing the aggregate of all marginal costs to the total costs of the organization, it is necessary to rely on the consistent application of defined procedures to provide reasonable assurance that the marginal cost estimates are representative of the actual costs that will be incurred or avoided as a result of an incremental change in the level of activity or output.

The sections that follow summarize our recommended procedures for determining marginal costs and the applicability of marginal cost bids to individual competitive contracts. The essence of these recommendations is that marginal cost estimates should be derived from fully allocated costs and fully allocated costs should include all costs relevant to the provision of public mass transit. The applicability of marginal cost proposals should be based upon the significance of the proposed services in relation to the prospective contractor's total capacity to provide such services.

TOTAL RELEVANT COSTS

To determine the fully allocated costs of a particular segment of transit services, it is necessary to define the total costs associated with the provision of mass transit services. A prospective contractor, such as MTC, may be providing services other than mass transit operations. Section II provides the criteria for identifying those costs which a prospective contractor may be incurring that are not associated with the provision of mass transit services and therefore should not be included in total costs for mass transit and allocated to segments. On the other hand, a prospective contractor may have access to resources which are paid for by other public agencies or governmental units and not by the prospective contractor. These costs, while not directly incurred by the prospective contractor, should be included in total costs and allocated accordingly. The objective of these procedures is to assure that all relevant costs are reflected in the fully allocated costs of a proposed segment.

FULLY ALLOCATED AND MARGINAL COSTS

In order to provide reasonable assurance that marginal cost estimates fairly represent the actual costs that will be incurred in conjunction with a proposed contract, we have recommended procedures which call for the development of marginal cost proposals as a subset of fully allocated costs. Procedures for the development of fully allocated costs were designed to allow for this approach in defining marginal costs. Section III presents the procedures and criteria for classifying and assigning all costs and for determining fully allocated and marginal costs. The classifications reflect the relationships of costs to the services to be provided under the proposed contract.

These procedures assure consistency in the treatment of costs and allow for the reconciliation of marginal costs to fully allocated costs and fully allocated costs to total costs.

JUSTIFICATION OF MARGINAL COSTS

The provision for the consideration of marginal cost proposals is derived from the objective of competitively awarded contracts - to reduce the amount of public funding for public transit services. In view of this, the use of marginal costs in awarding contracts is justified if the marginal costs truly represent all of the costs that will be incurred as a result of providing that segment of service. Unfortunately, this can only be determined retrospectively. Therefore, procedures which will provide a reasonable assurance of determining this are necessary.

Section IV presents the procedures for determining the applicability of marginal cost proposals to individual contracts. The procedures are predicated on the premise that changes in those costs which are not included in marginal costs generally correlate with changes in capacity. Based on this, it can be assumed that proposed contracts which will not require a meaningful (or material) change in capacity of a prospective contractor will meet the justification criteria. In order to quantify the criteria, Peak Vehicle Requirements and Vehicle Miles were selected as indicators of the capacity required under proposed contracts. The relationship of these two indicators to the Peak Vehicle Capacity and Total Vehicle Miles of the prospective contractor are used to determine the materiality (or significance) of the changes in capacity required.

Based upon analyses of MTC data, ranges for each of these indicators were established to determine the significance (or materiality) of the changes in capacity that would be required under prospective contracts, individually and in

Mr. Gregory Andrews

August 30, 1990

conjunction with all other marginal cost contracts. Contracts requiring changes below the ranges are clearly immaterial and the consideration of marginal costs is justified, contracts requiring changes above the range are clearly material and the consideration of marginal costs is not justified. Contracts requiring changes that are within the range require the consideration of all of the specific circumstances involved to make a determination of the materiality (and justification for marginal costs).

The Peak Vehicle Requirement range is 4% - 8% for individual contracts and 15% - 18% for cumulative marginal cost contracts. The ranges for Vehicle Miles are 5% - 10% and 15% - 20%. While the need to recognize the cumulative impact of marginal cost contracts is obvious, the potential inequity that could occur solely as a result of the timing of proposals should also be addressed. We recommend that a specific policy dealing with this issue be formulated by the Board.

* * * * *

Thank you for providing us with this opportunity to serve the Regional Transit Board. We would be pleased to discuss this report with any groups you deem appropriate.

Yours truly,

Deloitte + Touche

MARGINAL COSTS

Procedures for Determination and Justification in the Competitive Procurement of Mass Transit Services

Section I	- Full Allocation of Costs Policy	1
Section II	- Procedures for Determining Relevant Total Costs and Identifying Excludable Costs	2
Section III	- Procedures for the Classification and Assignment of Costs	4
Section IV	- Procedures for Determining the Applicability of Marginal Cost Proposals to Proposed Contracts	9



SECTION I

FULL ALLOCATION OF COSTS POLICY

In order to promote equal competition among both private and public bidders, all relevant costs shall be included in all cost proposals for transit services. This includes costs that are necessary to the overall operations of the prospective contractors, although a direct relationship to any particular cost objective cannot be shown. Costs that are estimated in a proposal must be consistent with the contractor's practices in accumulating and reporting those costs and the practices must be consistent with respect to the classification, assignment and allocation of costs.

Fully allocated cost proposals shall be developed and presented in accordance with the procedures contained in Sections II and III, and shall be considered in evaluating proposals and awarding contracts. Under certain conditions, as specified in Section IV, marginal cost proposals may be considered in addition to fully allocated cost proposals in evaluating proposals and awarding contracts. Providers that receive deficit financing from the RTB shall submit separately to the RTB complete summaries of their fully allocated and marginal cost proposals for verification of the applicability of marginal cost proposals to the proposed contracts.

SECTION II

PROCEDURES FOR DETERMINING RELEVANT TOTAL COSTS AND IDENTIFYING EXCLUDABLE COSTS

GENERAL: All costs incurred in the delivery, support, management and administration of transit services shall be included by the prospective contractor in determining the relevant estimated costs of the proposed segment. The Full Allocation of Costs Policy requires that:

The full costs of equipment, facilities, materials and services shall be used, regardless of the source of funding for those resources. This includes contributions of such resources from any public agency or governmental unit.

No adjustments shall be made to reflect differences in form of ownership (public vs. private ownership). All costs incurred by the prospective contractor as a result of governmental requirements shall be included. Similarly, adjustments for exemptions from governmental requirements shall not be made.

All costs shall be accounted for using generally accepted accounting principles. Depreciation of capital assets shall be based on the depreciation guidelines presented in UMTA's "Fully Allocated Cost Analysis - Guidelines for Public Transit Providers".

EXCLUSIONS: Certain costs incurred by a prospective contractor, identified below, shall be excluded from the total costs of transit services for the purpose of determining the estimated costs of the proposed segment. Costs to be excluded for this purpose must meet one or more of the following conditions:

- A. The costs incurred to provide programs mandated by public policy on a region-wide basis which are:
 1. Assigned to the operator by the RTB or other governmental unit,
 2. Are funded separately and
 3. Are not necessary or beneficial to the operator's transit route operations.

Examples of such programs include the Metro Mobility Administration Center and the Minnesota Ride Share program.

- B. The costs of equipment, facilities, materials or services donated to the operator by private organizations or individuals.

C. The costs incurred by a prospective contractor to provide services which are region-wide, promote a furtherance of public policy and benefit all providers in the region. In determining the applicability of this condition, all of the following criteria must be met:

1. The service cannot be operator-specific or disproportionately benefit the provider of the service (i.e. the provider does not benefit to a greater extent than would be the case if another entity provided the same service).
2. The costs of the service must be discretely identifiable.
3. The service must be region-wide in terms of both delivery and applicability.
4. The service must promote a furtherance of public policy as defined by the RTB.

An example of costs that would be excluded under this condition is the cost of advertising which promotes the utilization of mass transit in general, without advocating or promoting a single provider of mass transit services.

SECTION III

PROCEDURES FOR THE CLASSIFICATION AND ASSIGNMENT OF COSTS

GENERAL: All relevant costs incurred by a prospective contractor, for the same purpose and in like circumstances, are either direct costs only or indirect costs only in relation to cost objectives. A cost that is assigned as a direct cost to a final cost objective cannot be assigned as an indirect cost to another final cost objective for the same purpose in like circumstances. Conversely, a cost that is assigned as an indirect cost to a final cost objective cannot be assigned as a direct cost to another final cost objective for the same purpose in like circumstances.

Direct costs are the costs of resources which can be exclusively associated with a single cost objective; indirect costs are the costs of resources which cannot be exclusively associated with a single cost objective. The variability of a cost is not a factor in determining the relationship of a cost to a cost objective, both direct and indirect costs can be either fixed or variable in nature. For example, the procurement of buses is a fixed cost in that this cost will remain constant over short-term fluctuations in the level of operations. However, if the buses can be associated exclusively with a specific cost objective, this cost is a direct cost of that cost objective.

FULLY ALLOCATED COSTS: The Full Allocation of Costs Policy requires that all relevant costs be included in the prospective contractor's cost proposal for transit services. All direct costs and an appropriately allocated portion of all indirect costs must be presented. The following guidelines will direct the application of this policy to specific proposals:

Cost Objective: The cost objective for the purpose of classifying costs is the proposed contract including all services called for under that contract. Like cost objectives may include segments of transit service not subject to competitive bid procurement.

Cost Classifications: Costs are to be classified in accordance with their relationship to the proposed contract as either direct or indirect costs as defined below.

- A. Direct Costs - Direct costs are to be assigned directly to the proposed contract. The use of standard or average unit costs for the purpose of estimating direct labor or material costs is acceptable if the standard or average unit costs are based upon actual costs and variances are appropriately accounted for. Direct costs are to be separately identified based on the materiality of the individual cost elements and the fixed/variable nature of the cost elements:

1. Variable Direct Costs - Variable direct costs are those direct costs which are incurred or avoided in a linear relationship with changes in the level or volume of service provided under the contract. Examples include:

Driver Wages and Fringe Benefits

Fuel Costs

Tires and Tubes

Other Consumable Materials Costs (such as oil, grease, driver log sheets, etc.)

2. Fixed Direct Costs - Fixed direct costs are those direct costs which are not incurred or avoided in a linear relationship with changes in the level or volume of service provided under the contract. Examples include:

Vehicle Depreciation Costs

Vehicle Equipment Depreciation Costs (such as radios, fareboxes, or other removable vehicle equipment)

Performance Bond Costs

Garage Facilities and Equipment Costs (if exclusively associated with the proposed contract), including Depreciation, Insurance, Property Taxes and Utilities Expenses

- B. Indirect Costs - Indirect costs are those costs which are for resources which are shared with other cost objectives. Indirect costs are allocated to the proposed contract in a logical manner which reflects the rate at which the costs are incurred in relation to the activities performed under the proposed contract. The allocation rates used must be based on forecasted actual costs or standard costs, which are consistently applied and reviewed annually. Indirect costs associated with the management and supervision of activities should be allocated using a base which is representative of the activities being managed or supervised. Other indirect costs should be allocated using a base which is representative of resource consumption.

Indirect costs are to be classified based upon the fixed or variable nature of the cost elements and the relationship of the costs to the proposed contract. They should be identified separately based upon the materiality of the individual cost elements. The following classifications should be used:

1. Support Costs - Support costs are those indirect costs which can be incurred or avoided in a linear relationship with changes in the level of activity or the consumption of direct cost resources under the proposed contract. Items identified below as support costs, should be classified as variable direct costs if the costs can be associated exclusively with the proposed contract. Similarly, if they cannot be incurred or avoided in a linear relationship with changes in the level of activity or the consumption of direct cost resources, they should be classified as overhead costs. Examples include:

Mechanics and Cleaners Wages and Fringe Benefits

Maintenance Materials and Supplies

Vehicle Parts

Contracted Maintenance Expenses

Spare Vehicle and Vehicle Equipment Depreciation Costs

Liability and Vehicle Insurance Expenses

Vehicle Interest Expense

Transit Supervision Wages and Fringe Benefits

Project Management and Contract Administration
Salaries, Wages and Fringe Benefits

2. Overhead Costs - Overhead costs are those indirect costs which are incurred or avoided as a result of material changes, as defined in Section IV, in the level of the total transit services provided by the prospective contractor, but not in a linear relationship with changes in the level of activity or the consumption of direct cost resources under the proposed contract. Examples include:

Garage Facilities and Equipment Costs (if not associated exclusively with the proposed contract), including Depreciation, Insurance, Property Taxes and Utilities Expenses

Transit Operations and Maintenance Management Salaries and Fringe Benefits

Operations and Maintenance Clerical Wages and Fringe Benefits

Operations and Revenue Accounting Wages and Fringe Benefits

Service/Route Planning Wages and Fringe Benefits

Operations and Maintenance Information Systems Expenses

3. General Expenses - General expenses are those indirect costs which are associated with the general management, administration, financing and marketing of the business entity or agency. These costs can be incurred or avoided as a result long-term material changes in the level of the business entity's or agency's activities or as a result of other factors unrelated to the level of transit services provided. Examples include:

Executive, Financial Accounting, Personnel Administration, Legal, Information Systems and Other Administrative Management Salaries and Fringe Benefits

Nonmanagement Administrative Salaries or Wages and Fringe Benefits associated with the above functions

General Facility and Equipment Costs (not classified elsewhere), including Depreciation, Insurance, Property Taxes and Utilities Expenses

Interest Expense (not classified elsewhere)

Advertising Expenses

Management Contract Fees

Professional and Technical Fees associated with General Management and Administration functions

Note: The examples of expenses for all of the classifications above are presented for general guidance. They are not intended to be predetermined required classifications of the expenses and they are not intended to be all inclusive.

MARGINAL COST: Marginal cost, or incremental cost, is the change in cost resulting from a change in the level of output or services provided. For the purpose of preparing and evaluating marginal cost proposals, marginal cost shall be defined as all costs that can be incurred or avoided as a result of the performance of the services called for under the proposed contract or by the termination of such performance. In order to assure consistency of interpretation, measurability and verification, the marginal cost proposal shall be derived from, and reconcilable to, the fully allocated cost proposal. Specifically, the procedures defined under FULLY ALLOCATED COSTS for the classification, assignment and presentation of costs are to be followed in marginal cost proposals. Guidelines for the determination of the applicability of specific costs to marginal cost proposals are as follows:

- A. Variable Direct Costs - All costs classified as variable direct costs are to be included in a marginal cost proposal.
- B. Fixed Direct Costs - All costs assigned to this classification are to be included in a marginal cost proposal.
- C. Support Costs - All costs assigned to this classification are to be included in a marginal cost proposal.
- D. Overhead Costs - All costs classified as overhead costs are to be excluded from a marginal cost proposal.
- E. General Expenses - All costs assigned to this classification are to be excluded from a marginal cost proposal.

SECTION IV

PROCEDURES FOR DETERMINING THE APPLICABILITY OF MARGINAL COST PROPOSALS TO PROPOSED CONTRACTS

GENERAL: In recognition of the fact that the fully allocated costs of a particular segment of service may not represent the actual costs which will be incurred or avoided as a result of providing or not providing that segment of service, the Full Allocation of Costs Policy allows for the additional consideration of marginal cost proposals when appropriate. It must also be recognized, however, that costs other than marginal costs are subject to change as a result of material changes in the level of total services provided, including the cumulative impact of incremental changes.

The provision for the consideration of marginal cost proposals is derived from the objective of competitively awarded contracts for public transit services - to reduce the amount of public funding required without increasing fares or reducing service levels. Given this objective and in view of the facts above, the consideration of marginal costs in evaluating and awarding contracts is justified if:

- A. The marginal costs are fairly representative of the actual costs that will be incurred as a result of providing a particular segment of service and
- B. The fully allocated costs of other like cost objectives will not increase as a result of providing that segment of service, alone or in conjunction with all other segments provided at marginal cost.

In view of the fact that actual determination of conformity with these conditions can only be accomplished retrospectively, the guidelines presented below should be used to determine the applicability of marginal cost proposals to specific proposed contracts. Conformity with these criteria provides a reasonable assurance that the conditions above will be met and shall be considered as meeting those conditions for the purpose of considering marginal costs in the evaluation and awarding of contracts for public transit services.

APPLICABILITY CRITERIA: The determination of the applicability of a marginal cost proposal to a proposed contract must take into consideration:

- The existing capacity of the prospective contractor for providing transit services,
- The changes in capacity that would be required to provide the services called for under the proposed contract and
- The cumulative impact on capacity of all transit services currently provided or proposed by the prospective contractor at marginal cost.

Generally, changes in overhead costs and general expenses - those cost classifications which are not included in marginal cost proposals - will correlate with changes in capacity. Therefore it can be assumed that proposed contracts which will not require material changes in capacity, alone or in conjunction with all other marginal cost contracts, will not result in increased overhead costs or general expenses and thus will meet the justification conditions above, except under special circumstances. The following procedures should be used to make that determination:

Capacity Measurement: The capacity for providing public transit services consists of the equipment, facilities and systems used in providing those services as well as the human resources necessary to manage and maintain those resources and to administer the organization. Precise measurement of capacity, and changes in capacity, would be a complex and costly task. However, key factors which represent the utilization of capacity and serve to drive capacity related costs can be used to reasonably estimate capacity and changes in capacity economically and effectively. Previous research has indicated that Vehicle Miles and Peak Vehicles Requirement are accurate indicators of capacity requirements and capacity related costs. These factors shall be used to measure existing capacity and the changes in capacity necessary to meet the requirements of the proposed contract and all other marginal cost contracts.

Material Changes in Capacity: In determining the materiality of a required change in capacity, the ratios of the incremental value to the base value for each of the above factors provide the quantified parameters to be used in the judgment of materiality. Ratios falling below the specified range shall be considered to be immaterial changes; ratios higher than the specified range shall be considered to be material changes. Ratios within the specified range will require the consideration of the particular circumstances of the proposed contract and the relative position of the ratio within the range to determine the materiality.

Particular circumstances to be considered include, but are not limited to, whether the prospective contractor is currently providing service to the area covered by the proposed contract and the facilities involved in servicing the vehicles to be used under the contract. If the prospective contractor is currently providing service to the area, then the incremental changes that will occur if the prospective contractor is awarded or not awarded the contract should be analyzed rather than the total values associated with the proposed contract. If the services called for under the proposed contract are such that servicing vehicles will be performed at more than one facility of the proposed contractor, the impact of the proposed contract on overhead costs and general expenses will be diluted.

Specific procedures for determining the materiality of changes in capacity are:

A. Changes in Capacity Required Under the Proposed Contract -

The Peak Vehicles Requirement ratio is calculated by dividing the Peak Vehicles Requirement of the segment to be provided under the proposed contract by the current total Peak Vehicles Capacity of the prospective contractor. The Peak Vehicles Capacity shall be approved by the RTB based upon the operational capacity of the prospective contractor's facilities less the prospective contractor's necessary spare vehicle ratio.

The Vehicle Miles ratio is calculated by dividing the Vehicle Miles required for the segment under the proposed contract by the current total Vehicle Miles of the prospective contractor.

The materiality limits, expressed as percentages, for changes in capacity required under the proposed contract are 4% - 8% for Peak Vehicles Requirement and 5% - 10% for Vehicle Miles.

B. Cumulative Changes in Capacity Resulting From All Marginal Cost Segments -

The Peak Vehicles Requirement ratio is calculated by dividing the sum of the Peak Vehicles Requirement for all marginal cost contracts provided or proposed by the current total Peak Vehicles Capacity of the prospective contractor (refer to Exhibit 1).

The Vehicle Miles ratio is calculated by dividing the sum of the Vehicle Miles for all marginal cost contracts provided or proposed by the current total Vehicle Miles of the prospective contractor.

The materiality limits, expressed as percentages, for cumulative changes in capacity resulting from all marginal cost segments are 15% - 18% for Peak Vehicles Requirement and 15% - 20% for Vehicle Miles.

C. In the event that the ratio for one factor is within or greater than the specified range and the ratio for the other factor is below the specified range, the judgment of materiality shall be based upon consideration of the particular circumstances and the relative values of the two factors, with the greater weight assigned to the Peak Vehicles Requirement ratio.

Determination of Applicability: A marginal cost proposal shall be considered applicable to a proposed contract and consideration of marginal costs in awarding the contract shall be considered justified, except under special circumstances, if:

- A. The change in capacity required under the proposed contract is not a material change, as defined above, and
- B. The cumulative change in capacity resulting from all marginal cost segments is not a material change, as defined above.

In the event that the first condition (Condition A. above) is met but the second condition (Condition B. above) is not met, the determination of the justification for the consideration of a marginal cost proposal will be made by the RTB taking into consideration all factors involved, in recognition of the potential inequity that could occur solely as a result of the timing of proposals. (D&T Note: Specific policies to guide this determination should be formulated by the Board.)

Special Circumstances: Special circumstances may occur which warrant a deviation from the determination of the applicability of marginal cost proposals to proposed contracts based on the criteria above. While all specific circumstances warranting deviation cannot be anticipated, the following principle shall be used to determine if such deviation is warranted:

Proposed contract terms or conditions which would result in a substantial reallocation of resources by the prospective contractor to the detriment of other like cost objectives shall be considered overriding factors precluding the consideration of marginal costs in awarding the contract, regardless of changes in capacity.

Proposed contracts which would require the prospective contractor to build or lease an additional servicing facility shall be regarded as requiring material changes in capacity, regardless of the ratios calculated above.

EXHIBIT 1

To calculate the cumulative changes in capacity for the Peak Vehicles Requirement resulting from all marginal cost segments, the framework would be as follows:

$$PVR_{CC} = \frac{PVR_p + PVR_{mt}}{PVC_{ct}}$$

where,

PVR_{CC}	Cumulative Changes in Capacity Peak Vehicles Requirement
PVR_p	Proposed Contract Peak Vehicles Requirement
PVR_{mt}	Sum of All Other Marginal Cost Contracts Peak Vehicles Requirement
PVC_{ct}	Current Total Peak Vehicles Capacity
PVR_{m1}	Current Marginal Cost Contract #1 Peak Vehicles Requirement
PVR_{m2}	Current Marginal Cost Contract #2 Peak Vehicles Requirement

If a prospective contractor is currently providing transit service for three contracts that were awarded at marginal cost and one of the contracts is up for renewal; given that total Peak Vehicles Capacity equals 850, and the Peak Vehicles Requirements is 30 for the renewal contract, 20 for Marginal Cost Contract #1 and 25 for Marginal Cost Contract #2, then the cumulative changes in capacity calculation would be as follows:

$$PVR_{CC} = \frac{PVR_p + PVR_{m1} + PVR_{m2}}{PVC_{ct}}$$

therefore,

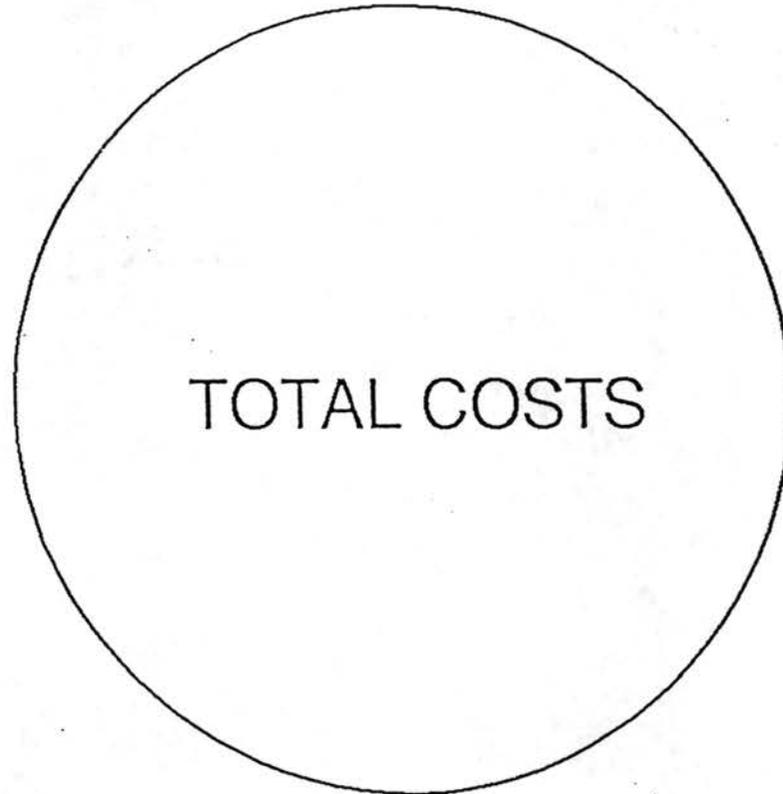
$$PVR_{CC} = \frac{30 + 20 + 25}{850} = 8.8\%$$

FULL ALLOCATION OF COST POLICY

"In order to promote equal competition among bidders, all direct and indirect costs associated with providing the service shall be included in the prospective contractor's proposed price for the service...

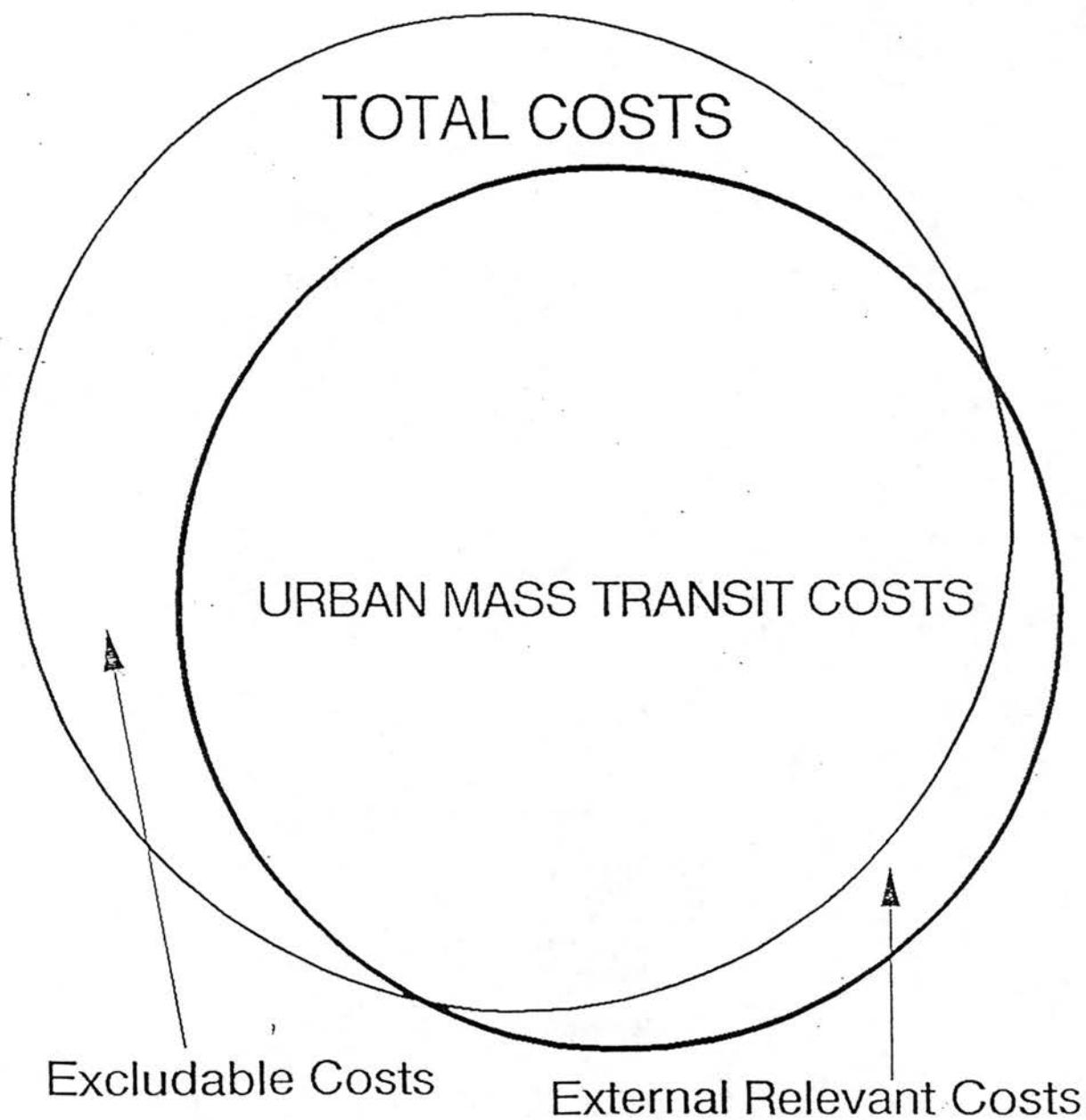
...Other costs, such as MTC marginal costs, can also be taken into consideration **when properly justified."**

CONTRACTOR COSTS
PER FINANCIAL STATEMENTS

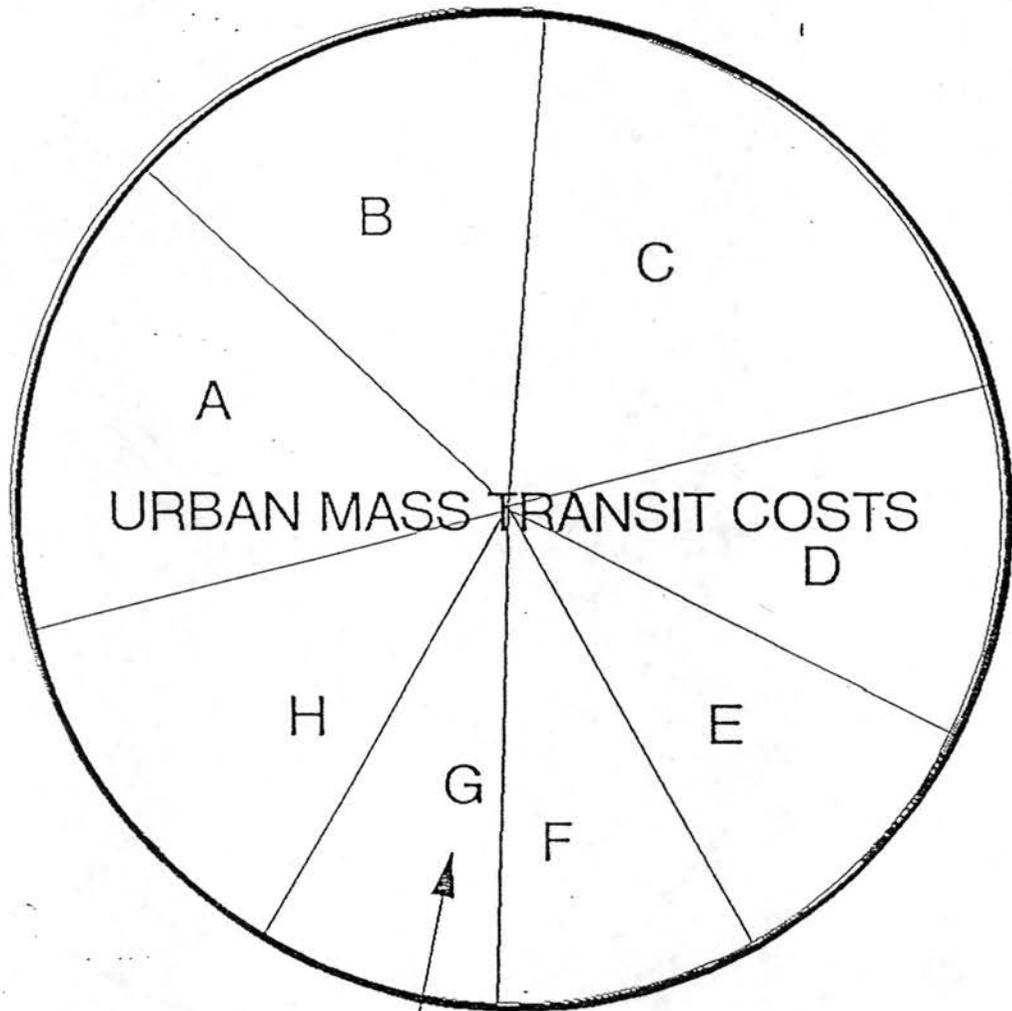


OPERATING COSTS
FACILITIES COSTS
ADMINISTRATIVE COSTS
MARKETING COSTS
FINANCING COSTS
MANAGEMENT COSTS

TOTAL RELEVANT COSTS

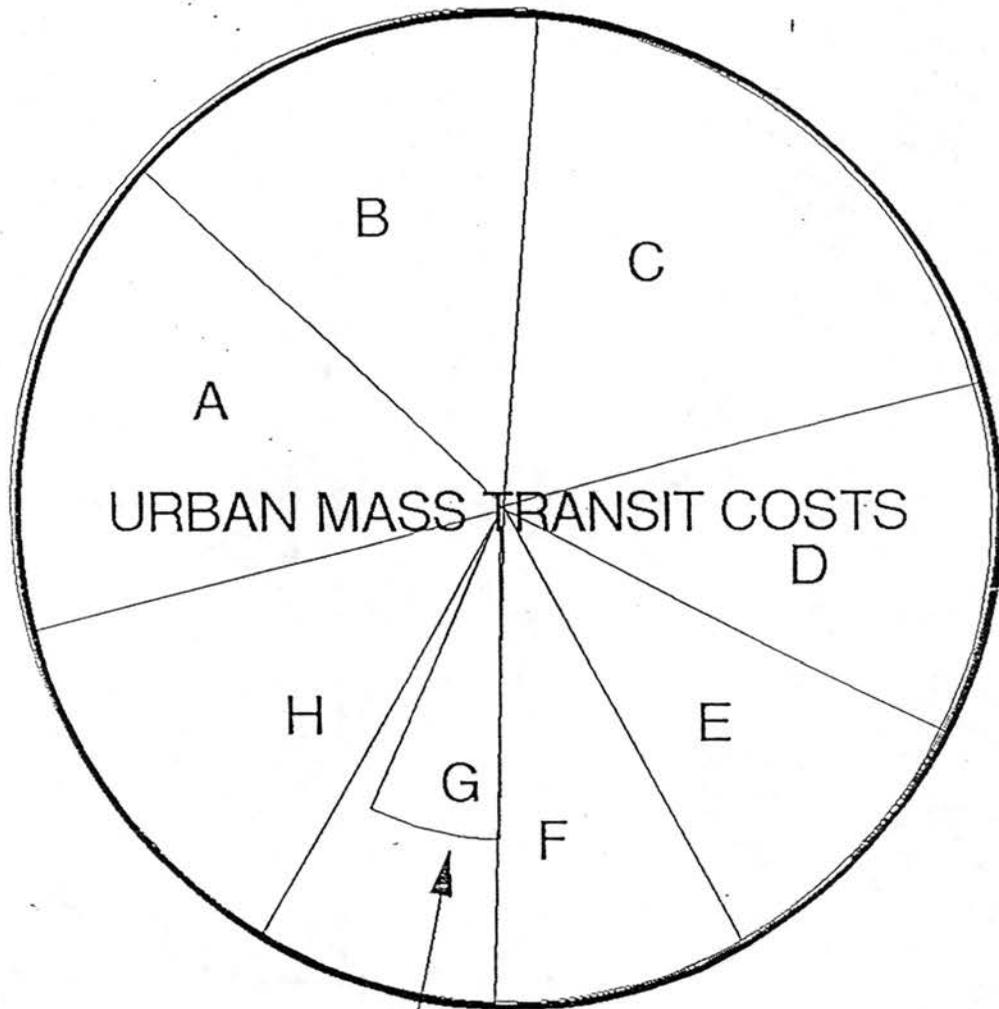


FULLY ALLOCATED COSTS



Costs Assigned to Cost Objective G

MARGINAL COSTS



Costs Assigned to Cost Objective G

FULLY ALLOCATED COST

- Direct Costs + an Allocated Portion of all Indirect Costs Under Current Conditions
- Increases or Decreases in Level of Utilization of Capacity will Inversely Change Fully Allocated Costs of Existing Cost Objectives

MARGINAL COST

- Costs that are Incurred or Avoided as a Result of Changes in Level of Output or Services Provided
- Changes in Level of Utilization of Capacity will not Change Marginal Cost of Existing Cost Objectives

FULLY ALLOCATED COSTS

GENERAL EXPENSES

Driven by long-term changes in organizational size, complexity or other factors unrelated to the level of transit services provided.

OVERHEAD COSTS

Driven by material changes in the level of total transit services provided.

SUPPORT COSTS

Driven in a linear, but not direct, relationship with changes in the level of activity.

VARIABLE & FIXED DIRECT COSTS

Incurred as a direct result of the specific services provided.

MARGINAL COSTS

GENERAL EXPENSES

OVERHEAD COSTS

SUPPORT COSTS

Driven in a linear, but not direct, relationship with changes in the level of activity.

VARIABLE & FIXED DIRECT COSTS

Incurred as a direct result of the specific services provided.

JUSTIFICATION FOR MARGINAL COST PROPOSALS

OBJECTIVE: Least Cost to the Taxpayer

PRINCIPLES: Consideration of Marginal Cost
Proposals is justified if:

- Marginal Costs Fairly Represent the Actual Costs that will be Incurred as a Result of Providing the Segment of Service
- The Fully Allocated Costs of Other Segments Will Not Increase as a Result of Providing that Segment of Service at Marginal Cost

JUSTIFICATION FOR MARGINAL COST PROPOSALS

The Justification Principles can be Assumed to have been Met if the Proposed Contract Will Not Require a Material Change in Capacity.

Peak Vehicles Requirement and Vehicle Miles are Effective Indicators of Capacity Requirements.

MATERIALITY LIMITS

PROPOSED CONTRACT:

Peak Vehicles Requirement	4% - 8%
Vehicle Miles	5% - 10%

CUMULATIVE IMPACT:

Peak Vehicles Requirement	15% - 18%
Vehicle Miles	15% - 20%

If Below Range - Marginal Costs Justified

If Above Range - Marginal Costs Not Justified

If Within Range or Split - Contract Specifics
Must Be Considered

MATERIALITY LIMITS AS APPLIED TO MTC

Peak Vehicles Requirement

4% - 8% = 37 - 73 Peak Vehicles

15% - 18% = 136 - 163 Peak Vehicles

Vehicle Miles

5% - 10% = 1,380,000 - 2,760,000 Miles

15% - 20% = 4,141,000 - 5,521,000 Miles

MTC MARGINAL COST CONTRACTS

Segment	Peak Vehicles		- % of PVC -	
	1990	1991	1990	1991
Fully Allocated	798	756	88.1%	83.4%
SW Metro	9	9	1.0%	1.0%
MAC Shuttle	3	3	0.3%	0.3%
Plymouth	9	9	1.0%	1.0%
Western Suburban	11	11	1.2%	1.2%
Maple Grove	8	8	0.9%	0.9%
MN Valley		45		5.0%
Total MTC Operated	838	841	92.5%	92.8%
Cumulative Contracts	40	85	4.4%	9.4%
Facility Capacity	1034			
Spares Ratio	14.1% Peak Vehicle Capacity			906

MTC MARGINAL COST CONTRACTS

Segment	Vehicle Miles		% of Total	
	1990	1991	1990	1991
	(thousands)			
Fully Allocated	26,695	25,825	96.7%	93.1%
SW Metro	240	240	0.9%	0.9%
MAC Shuttle	135	135	0.5%	0.5%
Plymouth	153	153	0.6%	0.6%
Western Suburban	230	230	0.8%	0.8%
Maple Grove	154	154	0.6%	0.6%
MN Valley		1,014		3.7%
Total MTC Operated	27,608	27,752	100.0%	100.0%
Cumulative Contracts	913	1,927	3.3%	6.9%

ILLUSTRATIVE EXAMPLES

Segment	Peak Vehicles		Vehicle Miles	
	1990	%	1990 (000's)	%
Fully Allocated	798	88.1%	26,695	96.7%
Existing Contracts	40	4.4%	913	3.3%
Total MTC Operated	838	92.5%	27,608	100.0%
Peak Vehicle Capacity	906	100.0%		
MN Valley - Base	45	5.0%	1,014	3.7%
MN Valley - Expanded	52	5.7%	1,174	4.3%
U of M Express	39	4.3%	954	3.5%
U of M Intercampus	40	4.4%	697	2.5%
U of M Combined	79	8.7%	1,611	5.8%