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BUDGET AND FISCAL REVIEW

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RESOURCES, ENVIRONMENTAL PROTECTION, ENERGY AND TRANSPORTATION

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S. Joseph Simitian, Chair

HIGH-SPEED RAIL

JOINT INFORMATIONAL HEARING OF THE

SENATE BUDGET SUBCOMMITTEE NO. 2 ON RESOURCES, ENVIRONMENTAL PROTECTION, ENERGY AND TRANSPORTATION

AND

SENATE SELECT COMMITTEE ON HIGH-SPEED RAIL

Senators S. Joseph Simitian and Alan Lowenthal, Chairs

Tuesday, March 13, 2012
Mountain View Center for the Performing Arts
500 Castro Street, Mountain View, CA 94041
7:00 PM

<u>Agenda</u>

7:00 p.m.	Brief Welcome: Senators Simitian, DeSaulnier, and Lowenthal
7:15 p.m.	Testimony from the High-speed Rail Authority: Dan Richard, Chairman, and Jim Hartnett, Board Member followed by questions from and discussion with Senators
8:00 p.m.	Testimony from the HSR Peer Review Group: Will Kempton, Chairman followed by questions from and discussion with Senators
8:30 p.m.	Testimony from the Legislative Analyst's Office: Farra Bracht & Brian Weatherford followed by questions from and discussion with Senators
9:00 p.m.	Comment (if any) by members of the Senate, followed by public comments (beginning with elected officials in attendance)

High-Speed Rail

Staff Report for the March 13, 2012, Joint Hearing

BACKGROUND:

History: The California High-Speed Rail Authority (HSRA or Authority) was created by Chapter 796, Statutes of 1996, to direct development and implementation of inter-city high-speed rail service that is fully coordinated with other public transportation services. In its first twelve years of existence, the Authority was a small entity with a staff of under 10 and during this period it spent a cumulative amount of about $60 million on program-level environmental studies and other analyses. In 2002, the Legislature enacted, and the Governor signed, AB 1856 (Costa) that would place before voters a bond proposition that would provide $10 billion in bond financing for high-speed rail. Subsequent legislation delayed the bond vote. In 2008, AB 3034 (Galgiani) modified the provisions of the bond act and it was placed before voters as Proposition 1A (Prop 1A) in November 2008. Voters approved Prop 1A, and the project received a further boost in 2009 when the federal American Recovery and Reinvestment Act (ARRA) allocated $8 billion nationally for high-speed and intercity rail. In the last five years, the staff of the Authority and its budget have grown as the Authority has worked to complete the project-level environmental documents and complete initial design work. From its creation, through 2011-12, the HSRA will have spent about $630 million from the following funding sources: Proposition 1A bond funds (about $400 million); federal funds (about $140 million); and various state special funds and bond funds (about $90 million).

High-Speed Rail - the Organization: The Authority is governed by a nine-member Board with five members appointed by the Governor, two members appointed by the Senate Committee on Rules, and two members appointed by the Speaker of the Assembly. Appointments are not subject to Senate confirmation. Members serve four-year terms and receive limited compensation – only $100 per day for performing Authority business, not to exceed $500 in a calendar month. The Board appoints an Executive Director who serves at the pleasure of the Board. The Executive Director and six other executive positions are defined in statute and exempt from civil service – these seven positions may be paid high salaries as determined necessary by the Board and the Department of Personnel Administration to attract persons of superior qualifications. The Authority has a total of 54 authorized staff positions, but has struggled to fill positions and about half of the positions are vacant. Among currently vacant positions are key positions such as the Risk Manager and the Chief Financial Officer. The authority contracts out most of its workload, and has approximately 600 contractors (full-time equivalents) working on the project. The engineering workload is performed by regional contractors, who are managed by both state staff and a statewide program management contractor. In addition to state staff, another contractor performs oversight of the program management contractor. Other contractors and subcontractors have been hired for specialty contracts such as communications and ridership forecasting.

The High-Speed Rail Project Route: The route for the high-speed rail project is generally described in statute and was included in Prop 1A. Phase I of the system would connect the San Francisco Transbay Terminal, through the Central Valley, to Los Angeles Union Station and Anaheim. Phase II of the project would include the corridors of Sacramento–Stockton–Fresno and San Diego–Riverside–Los Angeles. Specific alignments between the listed cities are the subject of the project-level environment process, which is in various stages of completion for different corridors.

The High-Speed Rail Project Cost: The cost to build "Phase I" (from San Francisco to Anaheim) was most recently estimated in the Draft 2012 Business Plan to cost $98 billion, with a higher-cost scenario of $118 billion if more environmental mitigation and infrastructure is required. Earlier studies, carried lower cost estimates. The 2010 Business Plan estimated the Phase I cost at $43 billion (like the Draft 2012 Business plan, in year-of-expenditure dollars). The 2008 Business Plan estimated the Phase I cost at $33 billion in 2008 dollars. None of the recent Business Plans have included cost estimates for Phase II segments.

Proposition 1A of 2008: As indicated above, the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century (Prop 1A) was approved by voters in 2008 and authorizes $9.950 billion in general obligation bonds for the project. Bonds must be appropriated by the Legislature for expenditure and the bond act lays out other requirements for reporting and expenditure of bond funds.

- Connectivity Funds: Of total Prop 1A bond funds, $950 million is set aside for capital improvements to intercity, urban, and commuter rail that provide direct connectivity to high-speed rail, or are part of the high-speed rail system or that provide capacity enhancements or safety improvements. Of this, $190 million is specifically directed to intercity rail administered by Caltrans. The remaining $760 million is allocated to urban and commuter rail by a formula based on rail miles, vehicle miles, and ridership. The California Transportation Commission (CTC) has approved a program of projects to receive the $760 million; however, both the current and prior administrations have been critical of the CTC's allocation plan. Governor Brown has indicated the projects "appear unrelated to the high-speed rail project or an integrated rail plan." Governor Schwarzenegger and Governor Brown have only approved Prop 1A connectivity funds for positive train control, which is a safety control system, and have vetoed funds appropriated by the Legislature for the other connectivity projects programmed by the CTC. The amount approved for positive train control is $136 million and it appears in Department of Transportation (Caltrans) budget.

- High-Speed Rail Funds: Of the total Prop 1A bond funds, $9.0 billion is set aside specifically for the high-speed rail project. Up to $450 million is available for general administration and up to $675 million is available for initial construction activities such as environmental studies and preliminary engineering – no match is required for this $1.1 billion. The remaining $8 billion is available for construction; however, a non-bond match of at least 50 percent is required for each corridor or segment. The bond act specifies certain characteristics for the design of the system, including electrified trains capable of sustaining speeds of no less than 200 miles per hour and capacity to achieve travel times between San Francisco and Los Angeles Union Station of 2 hours, 40 minutes.

- Requirements for Construction Expenditures: Prop 1A contains many requirements prior to the use of bond funds for construction expenditures.

    - HSRA report/certification #1: Before requesting an appropriation of bond funds for construction, the HSRA must identify a "usable segment" (a usable segment is defined in the bond act as a portion of a corridor that includes at least two stations) and among other requirements: (1) identify the sources of funds to complete the usable segment; (2) certify the segment can be completed as proposed; (3) certify one or more passenger service providers can begin using the tracks for passenger train service; (4) certify the segment can be used without an operating subsidy; and (5) certify it has completed all necessary project-level environmental clearances necessary to proceed to construction. *The plan was released November 3, 2011.*
    - Legislative appropriation: Bond funds must be appropriated by the Legislature before they can be expended.
    - HSRA report/certification #2. Prior to committing any bond funds for expenditure, the HSRA must submit to the Joint Legislative Budget Committee (JLBC) and Department of Finance (DOF) findings similar to report/certification #1 above, plus a report prepared by a financial services firm that finds the segment can be completed as proposed, would be suitable and ready for high-speed rail operation, and that upon completion, would be usable by a passenger service provider. The DOF shall review the submission and within 60 days, and after receiving any communication from the JLBC, determine if the plan can be successfully implemented.
    - Bond Committee finding: The High-Speed Passenger Train Finance Committee, composed of the Treasurer, the Director of Finance, the Controller, the Secretary of Business, Transportation and Housing, and the chairperson of the Authority, must determine if it is necessary or desirable to issue bonds to carry out the purpose of the bond act, before bonds are sold.

Since the bond act is approved by voters, the Legislature must follow the scheme and design of the bond measure, meaning the Legislature cannot redirect high-speed rail bonds to build highways or school facilities. Other statutory changes to the program may be permitted it they further the purpose of constructing a high-speed trail system in California.

Debt Service on Proposition 1A Bonds: The debt service on Proposition 1A bonds is an obligation of the State's General Fund, but current law directs transportation special funds to the General Fund as partial or full reimbursement for these costs. In the fiscal analysis for Prop 1A in 2008, the Department of Finance and the Legislative Analyst's Office (LAO) jointly estimated average annual debt costs at $647 million (over about 30 years, once all $10 billion Prop 1A bonds are sold). In a recent fiscal analysis for a currently proposed initiative to repeal Prop 1A, the Department of Finance and LAO jointly estimated average annual debt costs at $709 million for the remaining $9.4 billion in Prop 1A bonds. The LAO indicates the debt service estimates have increased in cost because most bonds are now anticipated to be taxable instead of tax exempt. With this more recent estimate and including bonds already appropriated, total average annual debt service might be about $770 million. However, it is not an absolute certainty future

Prop 1A bond sales will be taxable – federal direction may make future bond sales eligible for tax exempt status, and reduce costs to the State.

- Transportation Special Funds for Prop 1A Bonds: Pursuant to 2011 legislation (AB 105), about $950 million per year in truck weight fees is available to reimburse the General Fund for debt service on transportation-related bonds. Truck weight fees can reimburse up to the following amounts for each bond: Prop 1A (100 percent); Prop 1B - Highway Safety and Traffic Reduction (80 percent); Prop 116 – Clean Air and Transportation Improvements (28 percent); Prop 108 – Passenger Rail and Clean Air (28 percent); and Prop 192 – Seismic Retrofit (100 percent). Where the reimbursable amount is less than 100 percent, it is due to the bond funds being used for bus purchases and other purposes that are not constitutionally allowable for truck weight fees – generally truck weight fee revenue is allowable for highways, roads, and fixed-guideway rail investments. In 2011-12, and probably through 2013-14, annual truck weight fees are expected to exceed debt service for applicable bonds. When truck weight fees exceed debt costs, those revenues have been transferred to the General Fund as pre-funding for out-year bond costs. Under the Governor's plan, about $1.3 billion would be set aside as pre-funding in this manner through June 2013. The use of transportation special funds for bond debt was a component of the "fuel tax swap" package that recognized the approximately $1 billion in extra transportation revenue from higher gasoline prices and made that revenue eligible for transportation bond debt. Gasoline prices had been in a range of $1.50 to $2.00 per gallon in the first half of the last decade, but have averaged more in the $2.50 to $3.50 range since.
- Multi-year Debt Service Plan: In 2011-12, and likely through 2013-14, annual truck weight fee revenue will exceed eligible debt service from the five transportation bonds, including Prop 1A. In 2014-15 and for a period of years to approximately 2017-18, the annual truck weight fee revenue plus the truck fee revenues set aside in 2010-11 through 2013-14, will likely fully fund eligible debt service on the five transportation bonds – again including Prop 1A bonds. However, in approximately 2018-19 and for a long period thereafter, transportation special funds will likely be insufficient to fully cover eligible bond expenditures on the five bonds, and additional General Fund expenses will be incurred. So in the next period through approximately 2017-18, high-speed rail bonds will likely not put new pressure on the State General Fund – instead they will be funded with the extra transportation revenue that has come with higher gasoline prices. In a period starting in approximately 2018-19, Prop 1A and the other 4 transportation bonds will again start to place increasing pressure on the State's General Fund.

Federal Funding Awards: Federal funds have been awarded from 2009 American Recovery and Reinvestment Act (ARRA) funds and from Federal Fiscal Year 2010 Funds (FFY 2010). In addition to the original grant awards to California, the state has also received funds returned from other states and redistributed. In applying for competitive federal grants, California proposed differing levels of state matching funds. Early grant applications proposed state fund matches of 50 percent (i.e., the state funds 50 percent and the federal government funds 50 percent of project costs), and later grant applications proposed state fund matches of 20 percent. The weighted-average match for all grants is 43 percent state funding and 57 percent federal funding. The federal government awarded the grants contingent on the State fulfilling those match requirements. Included in the ARRA grant to California was $400 million received for the Transbay Terminal in San Francisco. The Transbay Terminal is the northern terminus of Phase I of the HSRA project, but that grant was directly awarded and not included in the state budget for the Authority.

Summary of Federal Grants for High-Speed Rail
(Dollars in Millions)

Federal Award	Date of Award	California HSRA	SF Transbay Terminal	Required State Match (weighted ave.)
ARRA	January 2010	$1,850	$400	50%
FFY 2010	October 2010	715	0	30%
Redistributed ARRA	December 2010	616	0	50%
Redistributed ARRA	May 2011	86	0	20%
Redistributed FFY 2010	May 2011	214	0	20%
Total ARRA		**$2,552**	**$400**	49%
Total FFY 2010		**$929**	**0**	28%
GRAND TOTAL		**$3,480**	**$400**	43%

Federal Deadlines: The ARRA legislation (Public Law 111-5, February 17, 2009) specifies that funds remain "available" through September 30, 2012, and projects must comply with the requirements of subchapter IV of chapter 31 of title 40, that requires full expenditure by the fifth fiscal year after the period of availability – so funds must be fully expended and reimbursed by September 30, 2017. Through grant agreements with the Federal Railroad Administration (FRA), all ARRA funds awarded to California have been obligated, and therefore, have already fully met the September 30, 2012, deadline. The FFY 2010 funds have a deadline of December 2018 for expenditure and reimbursement. The agreements with the FRA specify other "milestones" for the project, for example the milestone for the design-build contractor request-for-proposal (RFP) is December 2011, and the milestone for award of the design-build contract is August 2012. In signing the grant agreement, the HSRA has agreed to meet all the specified milestones, although generally the federal government continues to work with its project partners and amends cooperative agreements as needed for scheduling adjustments.

Federal Funding Restrictions: The federal grant agreement directs funding to construction in the "Initial Central Valley Section" with the exception of about $195 million which is available for preliminary engineering and design on all Phase I segments. Questions have been raised about the ability to move federal funds to other segments of the project, and the federal response is currently "no." A letter dated January 2, 2012, from Deputy Secretary of Transportation John D. Porcari, states the federal government's position that since "no other project could satisfy the statutory deadline, the Federal Railroad Administration cannot re-allocate the Recovery Act and fiscal Year 2010 funds committed to the Central Valley Project to other projects in California."

The Draft 2012 Business Plan and the Funding Plan: The HSRA released its Draft 2012 Business Plan (Draft Plan) on November 1, 2011, and released its Funding Plan on November 3,

2011. The plans included the new Phase I cost estimates of $98 billion, and also described the phased and blended construction approach which has the following components:

- Step 1 – Initial Construction Segment: Start construction in the Central Valley on a 130 mile segment running from north of Fresno to just north of Bakersfield. This segment would include two station locations of Fresno and a Kings/Tulare regional station. The Draft Plan calls this the "Initial Construction Segment (ICS)" a term which is not used in Prop 1A. This segment has available funding of $6 billion ($3.3 billion federal and $2.7 billion Prop 1A bonds). The Draft Plan indicates this segment would not initially be used for high-speed rail operations, but could be used to improve existing Amtrak service pending completion of further segments for high-speed rail.
- Step 2 – Initial Operating Segment: Complete a segment either south or north of the Central Valley segment that would connect to either San Jose or the San Fernando Valley. The cost of either segment is in the $26 billion range. The funding for this segment would be federal support of $21 billion (either grants of a tax-exempt bond program) and $5 billion Prop 1A bonds. When completed and combined with the Central Valley segment, the HSRA believes the systems would be ready to attract a high-speed rail operator who would be able to establish high-speed rail service and maintain the system without an operating subsidy.
- Step 3 – Bay to Basin Segment: Complete a segment either north or south (depending on the decision in Step 2) that would result in a line running from San Jose to the San Fernando Valley – this is described as the "Bay to Basin" segment, and would cost in the range of $22 billion. The Draft Plan indicates funding would come primarily from federal funds with a local or other match, some operating profits from the completed segment, and in one scenario some private capital investment.
- Step 4 – Phase I Blended: Implement blended operations with existing commuter rail operators and reduced infrastructure investment to connect to the Phase I endpoints of San Francisco and Anaheim. This would cost $24 billion with funding primarily federal with a local or other match.
- Step 5 – Phase I Completed: Fully build-out the Phase I segment with more infrastructure investment on the bookend segments of San Francisco to San Jose and San Fernando Valley to Anaheim. This would cost $20 billion with funding primarily federal with a local or other match.

The updated schedule in the Draft Plan indicates completion of the Initial Construction Segment in the Central Valley in 2018, with completion of the Initial Operating Segment and implementation of high-speed rail service in 2022. Bay to Basin service would begin in 2027, with full Phase I build out in 2034.

Peer Review of the Funding Plan: State law establishes a Peer Review Group to, among other duties, review the Financing Plan and prepare its independent judgment as to the feasibility and reasonableness of the plans, appropriateness of assumptions, analyses, and estimates, and any other observations or evaluations it deems necessary. The Peer Review Group provided its report on the Funding Plan in a January 3, 2012, letter to the Legislature. The report discusses a number of ways the Draft 2012 Business Plan and Funding Plan can be improved and concludes *pending review of the Final 2012 Business Plan and absent a clearer picture of where future funding is going to come from, the Peer Review Group cannot at this time recommend the*

Legislature approve the appropriation of bond proceeds for this project. Below are some of the key observations made in the Peer Review Group report:

- The phased and blended approach to construction is a good approach, but the decision should be made now whether the first Initial Operating Segment should be to the north and San Jose or to the south and the San Fernando Valley.
- The completion of the Central Valley Segment by itself may provide little independent utility if the Initial Operating Segment is not completed. Investments on the end segments (San Francisco to San Jose and Los Angeles to Anaheim) would have greater independent utility and benefit from the management experience of CalTrain and Metrolink.
- Completion of the initial operating high-speed rail segment (either San Jose to Bakersfield or Merced to the San Fernando Valley) requires an additional $24 billion to $30 billion beyond the initial $6 billion currently in hand, and the assumption that the federal government will provide these billions of additional dollars in the future is risky. The reports states: *The fact that the Funding Plan fails to identify any long term funding commitments is a fundamental flaw in the program…. The legislature could, of course, rectify this by enacting a dedicated fuel tax or some other form of added user charge that would not aggravate the existing State budget deficit. Lacking this, the project as it is currently planned is not financially "feasible."*
- The HSRA continues to suffer from lack of staff in numbers and experience and this deficiency creates risks that the HSRA can complete the Central Valley segment as scheduled.
- The business model lacks specificity on the role of a private operator and fiscal structure of a concession agreement. Additionally, a private operator should be brought in during the design-build process.
- The ridership forecast would benefit from external and public review and the revenue estimate would improve if a risk-based cost-loaded construction schedule were included.

Current Activity:

The HSRA continues project-level environmental work and initial design work on all segments. The Authority is also engaged in preliminary right-of-way work on the Central Valley Segment. The HSRA has begun the procurement process for future selection of design-build contractors – no contract award is expected until early 2012-13. The Draft 2012 Business Plan is being revised to incorporate some of the input received, and a Final 2012 Business Plan is expected in late March. If funding is approved by the Legislature, the Authority indicates it would be able in 2012-13 to proceed to purchase right-of-way for the project and proceed to construction.

GOVERNOR'S PROPOSAL:

The Governor presents only a placeholder budget for HSRA at this time. The January budget includes $15.9 million for state operations and no funding for capital outlay. The budget indicates no funding was included for capital outlay because the Department of Finance is still reviewing the Authority's Funding Plan and the 90-day review period was not concluded as the budget was finalized. The $15.9 million is primarily funded from Prop 1A bond funds and would provide $11.6 million for staff and administration and $4.3 million for external administration-related contracts. It is anticipated that the Administration will submit a budget request for capital funding after release of the Final Business Plan.

ISSUES TO CONSIDER:

Coming Soon – the Final 2012 Business Plan: By design, draft plans are released to solicit input which can be considered and included in final plans, and signs are the HSRA is adopting this approach. The Final 2012 Business Plan will hopefully respond to some of the issues raised by the Peer Review Group and others. However, it seems unlikely the Authority will be able to address all concerns. One of the biggest issues is federal funding, and it is seems unlikely the federal government will, in the short term, establish an ongoing funding stream for high-speed rail. Absent federal funds, additional state funding could be considered, but that would likely have to come from new revenues instead of more bonds. In a television interview, the Governor mentioned that "Cap and Trade" revenues associated with AB 32 implementation might be a funding source. After its release, the Final 2012 Business Plan will be the primary document for evaluation of the 2012-13 capital funding request.

Alternatives and Options: Since the Authority is unlikely to produce a final plan that includes funding commitments from the federal government beyond the funds already secured, the Legislature will likely have to take action in an environment of risk and uncertainty for the program. Given these risks, the following are some approaches to consider:

- <u>Proceed with the Central Valley segment</u>: The benefits here are federal support for this segment, environmental documents closer to final approval than with other segments, and some limited independent utility for Amtrak. Additionally, this investment would produce a 130 mile segment capable of running high-speed rail trains. The risks are that if no further investment is made to establish a track of sufficient length to support non-subsidized high-speed service, the benefit-to-cost ratio for this investment is lower than what might be achievable with other rail investments in the state. To mitigate this risk, the state could either try to expand the independent utility of this Central Valley investment, or identify other state funds to complete at least an initial operable segment.
- <u>Proceed to improve the Phase I rail corridors without completing a high-speed rail segment</u>: The benefits here are much greater independent utility for the investments made if no additional funds are identified to complete the high-speed rail system. Investments could include the electrification of CalTrain and Metrolink and perhaps some new grade separations or passing tracks. A traditional rail connector from Bakersfield to Palmdale could be explored with a possibility of a later upgrade for high-speed rail. The risk with these approaches is possible loss of federal funds, and the need to find other matching funds for Prop 1A bonds. In some cases, local funds may be available to match state bond funds. While this approach reduces risk, it would not produce a high-speed rail segment and therefore likely delay completion of an initial operating high-speed rail segment - assuming funds are later found to complete such a segment.
- <u>Delay or Suspend the Project</u>: The benefit here is that bond funds are not expended and the state's future debt-service is reduced. It is possible actions of the federal government in the future could provide funding certainty and therefore allow the Legislature to consider

resuming the project in an environment of less risk. Federal funding of $3.3 billion would be at risk in the case of a delay and presumably lost with an indefinite suspension. Should the state decide to resume at a later time, it would likely incur higher costs due to inflation and due to a recovered economy with a less favorable bond and construction market.

The options above are not necessarily mutually exclusive – some Prop 1A bonds funds (connectivity funds, or base high-speed rail funds) could be directed to other segments of the system while still beginning construction in the Central Valley. A short delay could provide additional time for alternatives to be further developed, and may not result in the loss of federal funds.

Information Received in Advance of the Final Business Plan: The Final Business Plan is expected to be released prior to the scheduled Authority Board meeting on April 5, 2012. However, Authority staff have been negotiating Memorandums of Understanding (MOU) with the Southern California Association of Government (SCAG) and with the Metropolitan Transportation Commission (MTC) in the San Francisco Bay Area. Information on these MOUs has appeared on the local government websites. The information suggests early investment in the Caltrain and Metrolink corridors of $1.3 billion and $2.0 billion respectively, with half of the funding from high-speed rail bonds. This early investment would provide shorter-term benefits for existing commuter rail service and make initial infrastructure investments for blended operation with high-speed rail.