SUBCOMMITTEE NO. 2

NATURAL RESOURCES, ENVIRONMENTAL PROTECTION, ENERGY, and TRANSPORTATION

Natural Resources

AB 32 and Cap and Trade Funding....2-1
Resources and Water Bonds....2-5
Parks Funding....2-9

Transportation

Transportation Finance....2-13
High-Speed Rail....2-20

AB 32 and Cap and Trade Funding

BACKGROUND:

The California Air Resources Board (ARB), along with 35 local air pollution control and air quality management districts, protects the state's air quality. The local air districts regulate stationary sources of pollution and prepare local implementation plans to achieve compliance with federal and state standards. The ARB is responsible primarily for the regulation of mobile sources of pollution, greenhouse gas emissions (GHG), and for the review of local district programs and plans.

AB 32 establishes greenhouse gas reduction levels. Assembly Bill 32, enacted in 2006, established the goal of reducing statewide GHG emissions in California to 1990 levels by 2020. It also charged the ARB with monitoring and regulating the state's sources of GHGs and identified a timeline by which ARB is to complete specified AB 32-related implementation actions. This included developing a scoping plan encompassing a set of measures that, taken together, would enable the state to achieve its 2020 GHG-reduction target. The scoping plan's measures include a combination of direct regulations and mandated requirements affecting energy efficiency and consumption, along with actions to provide price incentives for energy efficiency and GHG reductions.

Cap and Trade One of Many CO2 Emission Reduction Measures

The state's overall goal for GHG emission reductions is the 1990 level of 427 million metric tons of carbon dioxide equivalents (MMT). The Cap and Trade program sets a statewide limit on the sources of greenhouse gases (GHGs) responsible for 85 percent of California GHG emissions. Under the cap and trade system, the ARB sets a cap on the amount of emissions (pollution) will be allowed. After that, the ARB issues credits (license or permit to emit the pollutant), most of which are issued for free. The California Public Utilities Commission (CPUC) also will be issuing credits under this plan to the Investor Owned Utilities and has started a rulemaking proceeding for the expenditure of any proceeds. The number of credits issued establishes the level a given company may pollute. A certain amount of credits are held back to be sold. Finally, if a company pollutes under its cap, it may trade or sell its credits. If it needs to pollute over its cap, it must buy credits. Essentially, cap and trade programs establish a financial incentive for long-term investments by assessing a cost to emit a GHG. As shown in the following figure, the scoping plan estimates that cap and trade will create approximately 23 percent of the reductions needed to meet the state's reduction goals.

Scoping Plan's Greenhouse Gas (GHG) Emissions Reduction Measures

GHG Emissions in millions of metric tons of carbon dioxide equivalents.

Category of Measure [a]	2010 Analysis Target Reductions	Percent of total
Low carbon fuel standard	15	19%
High global warming potential gases [b]	6.5	8
Energy efficiency	12	15
Renewables portfolio standard (33 percent RPS) [b]	11.4	14
Pavley standards [c]	3.8	5
Other measures [b]	13.3	16
Cap-and-trade	18	23
Total	**80**	**100**

a) Source: Legislative Analyst's Office

b) Target excludes measures under this category which have not been updated for 2010 from 2008, and therefore does not reflect all measures contained in the 2008 Scoping Plan.

c) The Pavley standard refers to the state's fuel economy regulations, which are broken into two rules known as Pavley 1 and Pavley 2.

GOVERNOR'S PROPOSAL:

Governor's budget includes regulation and programs for GHG reductions. The Governor's budget includes funding for GHG reduction programs in multiple state agencies. Most of the programmatic activity is hosted at the ARB and state energy agencies including the California Public Utilities Commission. This is because ARB is charged with monitoring and regulating GHG emissions while CPUC and the Energy Commission (CEC) are charged with monitoring one of the largest sources of GHG emissions, the energy sector.

Annually, the Administration submits a cross-cut budget to help the Legislature evaluate its AB 32 activities, both compliance and direct regulation. In May 2011, the ARB submitted a required zero-based budget that detailed expenditures in each agency, complete with programmatic information and positions. A total of 181 positions and about $36 million are dedicated to AB 32 activities across state government in the budget. This does not include overlapping positions at the energy agencies that work on related programs. For example, the state has an existing law, the renewable portfolio standard (RPS), which mandates levels of renewable energy sources the state's energy sector may use. The goals of the RPS complement GHG reduction but the primary focus of this law is the reduction of traditional sources of pollution such as reduced dependence on coal-fired energy.

AB 32 Cross-Cut Budget [a]
(dollars in thousands)

Department	Fund Source	2011-12	2012-13	Total Positions
Secretary for Environmental Protection	AB 32 Cost of Implementation (COI) Fee	$1,821	$586	4
Department of General Services	Service Revolving Fund	416	416	5
Department of Housing and Community Development	AB 32 COI Fee	98	98	1
California Energy Commission	Energy Resources Program Account	590	590	5
Department of Resources Recycling and Recovery	AB 32 COI Fee	501	496	6
Department of Water Resources	State Water Project Funds/ AB 32 COI Fee	551	316	3
Air Resources Board (includes development of cap-and-trade regulations)	AB 32 COI Fee	32,932	32,932	155
State Water Resources Control Board	AB 32 COI Fee	535	555	2
Department of Public Health	AB 32 COI Fee	314	348	0
Subtotal AB 32 Cost of Implementation Fee		**$37,758**	**$36,337**	181
Unknown/Undetermined	Cap-and-Trade Revenues		Up to $1 billion	Unknown
California Public Utilities Commission	Cap-and-Trade Revenues		Unknown	Unknown

a) Does not include complementary programs such as RPS activities at the energy agencies.

Cap-and-Trade fee revenues are included in the budget. The ARB plans to begin auctioning GHG emission allowances as part of its market-based compliance measures in 2012. The ARB estimates that fee revenues from the first set of auctions will be $1 billion in the first year of the program which is included in the budget. These auction revenue estimates vary widely making specific budget expenditures uncertain. Actual revenues are not anticipated to be certified until late in 2012-13. A General Fund offset of $500 million is also included in the budget; however, there is no specific proposal for this expenditure. Rather than a detailed budget proposal, the budget provides general categories of spending from the proceeds of the auctions. These include:

- Clean and efficient energy
- Low-carbon transportation
- Natural resource protection

- Sustainable infrastructure development.

30-Day notification to the Legislature planned for expenditures. The budget provides that an expenditure plan for both the $500 million General Fund offset as well as the $1 billion will be jointly submitted by the Director of Finance and the Air Resources Board. The plan must include specific expenditure and will allow the Legislature not fewer than 30 days to review the plan before allocation of funding will begin.

ISSUES TO CONSIDER:

Planned emission reductions from Cap and Trade Program were adjusted downward. The role for cap-and-trade to fill the gap between the total target and the emission reductions planned from traditional command and control measures have been reduced. The 2008 Scoping Plan initially was expected to provide 34.4 MMT of carbon dioxide equivalent reductions. Revised expectations in 2010 now show a reduction of 18 MMT of emission reductions proposed from cap-and-trade. The majority of reductions will be from traditional command and control measures including to some extent existing programs in renewable energy investment and clean car standards. According to the Legislative Analyst's Office, these figures are still likely overstated because the board has not comprehensively scored the emission reductions planned to come from other complementary measures.

Cap and Trade Program is complex and subject to potential gaming of the system. Carbon markets are, by their very nature, complex. In general, the more complex the markets are, the more susceptible they become to manipulation and fraudulent activity. The cap and trade program as designed by ARB is particularly complex in that it has a multitude of design features that are intended to address various policy objectives. These policy objectives include the ARB's desire to reduce the potential for economic activity to leave the state as a result of the program implementation. In addition to this, there is no national or state oversight agency to monitor and regulate trading of compliance instruments on the spot market.

30-Day Notification means short review and little oversight of potentially $1 billion in new program spending and budget backfills. The Governor's proposal provides the Legislature with a 30-day notification to expend funds from the auction proceeds. The auction of carbon credits is highly speculative—with estimates ranging from $350 million to over $1 billion revenues in the first year. This notification would be the first time Legislators would see the Governor's detailed expenditure plan. There is no detail provided in the budget indicating specifically where funding would be directed from the proceeds, what types of grant or loan programs would be created, or what state programs would be offset. Legislative oversight of the funds related to fee nexus, GHG emission reduction achievement, and overall program selection would be extremely shortened under the Governor's plan.

Resources and Water Bonds

BACKGROUND:

$21.8 billion in resources bonds have been approved since 1996. These General Obligation bond funds represent the majority of non-State Water Project infrastructure investment in the Resources and Environmental Protection arena during this time period. Infrastructure spending covers a wide array of programs and projects including for:

- Water-related local assistance;
- Land and wildlife conservation;
- Parks and recreation;
- State flood control capital outlay; and,
- Forestry and fire protection.

Many resources programs and local infrastructure projects rely on state general obligation bond funds. For example, state conservancies rely nearly 95 percent on bond funds with some supplemental operating funding from either the General Fund or Environmental License Plate Fund. Bond funds have also been a major source of local assistance grant programs including for local parks, regional water supply, and regional conservation efforts. Over two-fifths of state spending on resources infrastructure of the last decade was for local assistance, with that amount funded almost entirely from general obligation bonds.

Natural Resources and Environmental Protection General Obligation Bonds
(dollars in millions)

Bond	Year	Allocation	Obligated Funds	Balance (July 2012)	Proposed [a)]
Proposition 204	1996	$870	$837	$32	$1
Proposition 12	2000	2,100	2,077	16	15
Proposition 13	2000	2,095	1,876	205	11
Proposition 40	2002	2,600	2,544	9	37.5
Proposition 50	2002	3,440	3,368	22	70
Proposition 1B	2006	1,200	892	26	n/a
Proposition 1E	2006	4,090	2,590	1,205	63
Proposition 84	2006	5,388	4,034	873	837
Total		**$21,783**	**$18,218**	**$2,388**	**$10,345**

a) Estimates pending adjustments in April with the release of the forthcoming Infrastructure Plan.

$11.1 billion water bond proposed for November 2012 ballot. In 2010, the Legislature approved the Safe, Clean, and Reliable Drinking Water Supply Act of 2012, an $11.1 billion bond measure mainly for state and local water projects. The bond originally was to appear on the November 2010 ballot; however the Legislature voted to postpone the measure until the November 6, 2012 ballot. The bond includes a mixture of local assistance and statewide water management projects. A portion of the bond is to be used for conservation projects largely unrelated to water supply or water quality.

Proposed Water Bond (in millions)

Category	Allocation
Drought Relief	455
Integrated Regional Water Management	1,400
Delta Sustainability (public benefits)	2,250
Statewide Water System Operational Improvement	3,000
Conservation and Watershed Protection	1,785
Groundwater Protection and Water Quality	1,000
Desalination and Water Recycling	1,000
Water Conservation	250
Total	**11,140**

GOVERNOR'S PROPOSAL:

Governor plans to release five-year infrastructure plan. The Governor proposes about $10.3 million in new bond appropriations in the budget. This is a significant increase from the previous year's budget proposal and reflects the varying amount of bond funds available for programs and projects. Because the Governor plans to submit his five-year infrastructure plan, the amounts reflected here are estimates and are likely to be adjusted in April. Much of the water-related funding available is for flood control capital outlay from Proposition 1E with lesser amounts available for integrated regional water management ($505 million), various water projects including those in the Bay-Delta ($205 million), safe drinking water ($140 million), and State Parks ($63 million).

A significant amount of bond funds have been appropriated by the Legislature that are in the process of being expended over the next several years. For the majority of these projects, bonds have not been sold on the market, meaning that we are not incurring debt service as yet. For at least $3 billion, however, bonds have been sold, the projects have yet to start, and the state is paying debt service for the projects.

ISSUES TO CONSIDER:

Debt-Service Ratio (DSR) Expected to Rise. Voters have authorized close to $20 billion in general obligation bonds for resources since 2000. Unlike bond measures issued in prior decades, recent bond measures have been larger (typically several billion dollars) and wider in scope (covering a broad array of resources issues). The large bond measures have increased state debt-service expenditures considerably. The current year budget included almost $1 billion from the General Fund to service resource-related general obligation bond debt. This amount reflects 46 percent of total General Fund expenditures in the resources area. In contrast, resources-related general obligation debt service represented eight percent of General Fund spending for resources programs in 2000-01. General Fund support for other priority programs is limited by the necessity to repay general obligation bond costs.

Debt service impacts cash management now more than ever. About one-third of the $10 billion in general obligation bond funds appropriated remain unspent. This is in part due to a change in the way the state issues bond debt. Up until recently, the Pooled Money Investment Board (PMIB) would approve interim loans (known as “AB 55 loans”) from the state’s pooled cash accounts to move capital outlay and similar grant-funded projects forward prior to the issuance of state bonds that would ultimately pay for the projects. However, since December 2008, the PMIB has essentially frozen AB 55 loan funding, in part due to the increasing needs of the General Fund to borrow from the pool due to the state’s cash flow and budget crises. This means that the cash to support bond appropriations must come from bond sales, meaning that the state is incurring debt-service costs earlier than it would when AB 55 loans were available.

Other options are available for some types of bond funded programs. General obligation bond funds are not required to be paid back by the General Fund. As an example, the State Water Project was passed as a General Obligation bond, with the full backing of the General Fund. However, nearly 96 percent of this bond issue has been paid back with fees paid by the users of the State Water Project, and further bonds necessary for the project have been similarly repaid by user fees. This allows the up-front need for capital to be issued while requiring only those who benefit from the project to incur the costs of the bond debt.

The Water Bond impacts the budget in a significant way. Debt service for resources bonds has increased annually from a low in 2001-02 of just under $200 million to over $700 million in 2009-10. The $11.1 billion water bond would add over $650 million in debt service over time to this figure resulting with no new revenue identified to pay for these programs and local assistance projects. Not all of this would occur within the first few years as the bond is scheduled to be issued over a longer time period.

Does the Water Bond address the most pressing needs of the state? The water bond was created to address multiple water needs from projects with statewide significance to local park conservation projects. There are many water-related infrastructure needs throughout the state, from local wastewater infrastructure to the state's levee system. As decisions are made in the Delta, projects will be necessary to execute the state's vision for future Delta water supply and reliability. The LAO has recommended that resources bond expenditures in the annual budget be well justified, reflect a clear programmatic need, be an appropriate funding source for the activity in question and reflect legislative priorities. They also recommend the use of the "Beneficiary Pays" funding principle for projects with direct benefits to project beneficiaries. All of these issues factor into questions about whether or not the current water bond addresses all of these issues or should it be modified to focus on only the highest pressing needs with a link to beneficiary pays where allowable.

Can we accelerate bonds to stimulate jobs? Most of the bond funding has been appropriated but much remains to be expended. Most of this funding is in the water arena, primarily flood and levee funding as well as some integrated regional water management local assistance funding. The administration has plans to expend the money and the Legislature may wish to be kept apprised of its efforts to move funding out the door quickly.

Parks Funding

BACKGROUND:

The Legislature approved two major reductions to the Department of Parks and Recreation in the 2011 budget. The first was a reduction of $11 million in the current year and a $22 million ongoing starting in this budget. To implement the reduction, the Legislature approved trailer bill language specifying criteria for reducing the state park system including how the administration can select parks for closure, partial, closure and reduced service. The Legislature also approved a reduction of $10 million to the Off-Highway Vehicle (OHV) program and a shift of the same amount from the Motor Vehicle Fuel account to the General Fund.

In May of 2011, the department submitted a list of 70 parks slated for closure to the Legislature and the public. Using the following criteria, parks were selected from all areas of the state:

- Relative significance (e.g., historic value, uniqueness)
- Rate of visitation
- Estimated net savings to each park unit
- Feasibility of closing the park
- Operating efficiencies to be gained
- Infrastructure deficiencies (such as septic repairs or costly building upgrades)
- Recent infrastructure investments and capital improvements
- Deed and grant restrictions
- Funding provided from non-General Fund sources (such as dedicated fees)

Shortly after the list of closures was released, the department produced its estimates of operating costs and capital improvement needs at the 70 parks slated for closure. The department does not budget on a park-by-park basis; therefore, it is difficult to determine the exact amount of money an individual park may save. This also makes it difficult for those who wish to take over the parks to determine how much funding is necessary to take over an individual park.

In the interim since the budget has passed, members of the public, local agencies, federal agencies, and non-profit organizations have made efforts to find other ways to fund parks on the closure list. For example, the National Parks System will charge two dollars more at Muir Woods to pay for continued operation of Samuel P. Taylor State Park which was slated for closure and to help support Mt. Tamalpais State Park which is not on the closure list. Mono Lake State Natural Reserve was also removed from the closure list because of efforts by local nonprofits to take over funding for the park through increased fees.

GOVERNOR'S PROPOSAL:

The Governor's proposal includes the final and ongoing $11 million General Fund reduction approved by the Legislature last year resulting in closure of *up to* 70 state parks effective July 1, 2012.

The budget proposes to shift $11 million from the base budget to a continuously appropriated fund to provide the department additional flexibility to implement new projects or programs that generate additional revenues. The department is also proposing to spend $4.3 million from this fund for revenue generating projects. This is tied closely to the department's efforts to provide incentives to individual park units while pursuing concessions, operating agreements, and other arrangements with public, nonprofit, and private entities to keep as many parks open as possible.

The budget also includes a ballot trigger reduction to eliminate all seasonal lifeguards and 20 percent of park rangers if the Governor's tax proposal is not approved in November. This will result in an additional $8.7 million ongoing reduction if fully implemented.

Major Sources of Funding (in thousands)

Funding Source	2011-12	2012-13	Comment
General Fund	$121,831	$112,015	Reflects General Fund reduction
State Parks and Recreation Fund	139,316	132,286	Reflects proposal to shift funds to non-budget act
Off Highway Vehicle Trust Fund	113,912	75,233	
Federal Trust Fund	28,116	16,175	
Bond Funds	688,774	28,308	Reflects reduction in one-time bond expenditures
All Other Funds	86,452	68,451	
Total	**$1,178,401**	**$432,468**	

ISSUES TO CONSIDER:

Funding shifts and funding increases mask a challenged budget environment. Over the past five years, the department has effectively shifted its main source of funding from the General Fund to the State Parks and Recreation Fund (SPRF). On paper, this means that the department's spending power has effectively remained the same between these two funding sources since 2008-09. In fact, with other sources of funding, the department's overall budget has grown from $367 million to $432 million. Even excluding one-time bond expenditures, the budget has grown about 18 percent in the past several years. Much of this growth can be attributed to other funding sources including increased reimbursements, increases in the Off-Highway Vehicle Trust Fund, and other dedicated funding sources for specific purposes.

State Parks and Recreation Funding 2008-09 to 2012-13
(dollars in thousands)

	2008-09	2009-10	2010-11	2011-12	2012-13
General Fund	$135,241	$120,720	$117,458	$121,831	$112,015
State Parks and Recreation Fund	111,596	118,080	114,339	139,316	132,286
Other Funds	94,679	127,286	130,313	228,480	159,859
Subtotal	**$341,516**	**$366,086**	**$362,110**	**$489,627**	**$404,160**
Bond Funds (One-Time)	26,192	40,542	116,243	688,774	28,308
Total (including bond funds)	**$367,708**	**$406,628**	**$478,353**	**$1,178,401**	**$432,468**

Parks infrastructure costs are increasing with an aging system. However, during the time of the budget increases, costs to run state parks have also increased. Many state parks are over 50 years old and have an aging infrastructure much like our state levees and wastewater infrastructures. Decades old septic systems designed for lower visitor usage are being put to the test and in many cases failing requiring more and more costly repairs to maintain. Additionally, as we increase fees for park visitors, those visitors expect amenities that are reflective of an increased cost to use the park. Even such basics as flushing toilets and garbage service have increased in cost.

One state park costing the state millions per year. As an example of increased costs, one state park, the Empire Mine State Park has cost the state $31 million over the past five years due to toxic runoff from the mining operation conducted there over 50 years ago. The park was a gold mine for 100 years before it closed in 1956. The state acquired the property in Grass Valley, California with more than 850 acres of forested land, mine buildings, and historic properties in 1975. The state park was the subject of a series of lawsuits and cleanup and abatement orders related to the park’s 367 miles of abandoned and flooded mine shafts and toxic legacy from gold mining. The rulings required the state to clean up toxic runoff from the gold mining legacy. The state has been in negotiations with the former owner over the cleanup since the orders were issued; however according to the latest budget proposal, mediation has stalled while cleanup is still required.

Empire Mine State Park Funding 2007-08 to 2012-13
(dollars in thousands)

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
General Fund, Bond Funds and Special Funds	$3,868	$1,368	$5,765	$4,070	$11,595	$4,594
Total (all funds)						**$31,260**

How can the state maintain its current park system? The greatest question for legislators is what kind of state park system can the state maintain over the long term. Acquisitions over time whether through ballot approved bond measures or donations from individuals or groups have led the state to own and manage more property than can appropriately be budgeted for. Unexpected expenses such as the Empire Mine example and an increasingly aging system have backlogged multiple millions in deferred maintenance issues. Continued increases in fees may be possible but this also comes with the risk of lower attendance numbers and reduced public access to state parks. This makes the prospect of partnering with other entities for revenue generation or simply taking over parks a costly endeavor for the entity taking over.

The administration proposed closure of 70 state parks in part or in full. The likelihood of all of those parks closing is slim given the efforts outside entities to take over certain parks. The Legislature should consider the following in the budget year:

- Are funds at the department being spent on the highest priority areas?
- What parks remain on the closure list and is there anything the Legislature can do to provide tools to the department to continue to reduce this list?
- Are there other ways to fund the department or to allocate funding within priority areas of the department?
- Are there parks that should close regardless of a funding sponsor in order to limit state liability and future costs?
- What is the department doing to increase revenues at state parks—and why is it that the National Park System and local nonprofits are able to increase fees to save parks when our state park system is unable to do so?
- Why can't we introduce entry fees rather than parking fees at all state parks?
- Is it time to change the way we budget for the parks system in general to allow for innovation locally while maintaining a robust statewide system?

Transportation Finance

BACKGROUND:

Transportation finance in California has seen many changes over the past five years as both the federal government and state have modified financing and programs to respond to the economic downturn and budget shortfalls. For transportation, the news has not been all negative – the federal American Recovery and Reinvestment Act (ARRA) provided significant one-time money to the state for economic stimulus. The slow economy has also produced bid savings for transportation projects – with this savings being redirected to fund additional projects. Tight budget times have not escaped transportation finance; however, as loans have been made from transportation special funds to the General Fund to address budget shortfalls, and bond sales have been delayed. This section provides a summary of the various sources of transportation funding and indicates the extent to which one-time funding has been expended, and what loans are still outstanding. The funding described in this section supports state highways, local roads, mass transit, and vehicle safety and regulation. High-speed rail funding is excluded from this section and is covered in another section of this overview.

Overview of Transportation Funding for California

Transportation in California is funded from multiple sources at the federal, state, and local level. Among State departments receiving this revenue are the Department of Transportation (Caltrans), the California Highway Patrol (CHP), and the Department of Motor Vehicles (DMV).

Major Sources of Transportation Funding (in billions)

Funding Source	Annual Amount	Comment
Local revenues	$11.0	About $11 billion annually from locally-imposed revenues such as add-on sales tax, property tax, developer fees, and transit fares. Some reimburses Caltrans for locally-supported work on the highway system.
Federal revenues	4.0	Primarily from the federal gas tax of 18.4 cents per gallon. Allocated to both the State and local governments.
State gasoline & diesel excise tax	5.5	Allocated to the State and local governments from the 35.7 cent state gasoline excise tax and 13 cent diesel excise tax.
Fees on cars and drivers	2.9	Primarily from vehicle registration and driver licenses. Supports the operations of the DMV, CHP and Air Resources Board.
Truck weight fees	0.9	Revenue primarily supports debt service and interest on transportation-related general obligation bonds.
Diesel sales tax	0.6	Primarily supports local transit operators.
GO bonds	3.0	State general obligation bonds, primarily Proposition 1B.
Total	**$28.0**	

Transportation Funding Need in California

The numbers in the prior table are from publications of the Legislative Analyst and Department of Finance, but they also are consistent with a recent publication of the California Transportation Commission (CTC). The CTC published a report in October 2011 entitled, *Statewide Transportation System Needs Assessment*. The CTC report excludes revenues from fees on cars and drivers, and reflects the one-time nature of general obligation bonds, but overall forecasts annual transportation revenues averaging $24 billion over the next decade. The CTC's analysis indicates the cumulative amount of $243 billion over the next decade is less than half of the $536 billion needed to appropriately maintain and invest in the transportation system. Note, the CTC's numbers do not include funding for high-speed rail.

Transportation Fuel Swap

Legislation enacted in 2010 and 2011 modified the tax rates on various transportation fuels to provide more flexibility in the expenditure of those funds. Overall, the changes are revenue neutral and an annual rate adjustment mechanism is included in statute to ensure the revenue neutrality is maintained over time. The fuel swap was originally enacted in 2010, but was reenacted in 2011 to conform to new constitutional requirements added by Proposition 22 and Proposition 26 on the November 2010 ballot. The 2011 legislation was AB 105, and was approved on the Senate floor with a vote of 39 – 0. The fuel swap legislation had the following effects.

- New tax rates: The intent of the legislation was to maintain the current-law amount of revenue, and neither increase or decrease taxes paid. Since the sales tax is applied to a price and the excise taxes are applied to quantity, or gallons, an annual adjustment is made by the Board of Equalization to the excise tax rates to maintain revenue neutrality over time. The fuel tax swap included four main tax adjustments, and the excise rates reflected are the initial base rates, subject to annual adjustment. The changes were as follows:
  - Exempted gasoline from the State's then 6.0 percent sales tax on July 1, 2010.
  - Increased the excise tax on gasoline by 17.3 cents per gallon, to a total of 35.3 cents per gallon, on July 1, 2010.
  - Increased the sales tax applied to diesel fuel by 1.87 percent on July 1, 2011.
  - Decreased the excise tax on diesel by 5.0 cents per gallon, to 13.0 cents per gallon on July 1, 2011.
- General Fund benefit from the fuel swap: General Fund support for transportation increased over the past decade as Proposition 42 of 2002 directed a portion of the State's gasoline sales tax from general purposes to transportation, and the Legislature placed before voters, and they approved major new general obligation bonds for transportation (the $19.9 billion Proposition 1B of 2006, and the $10 billion Proposition 1A of 2008). As the General Fund costs for transportation increased, the state's budget deteriorated and budget cuts were needed. Concurrent with General Fund difficulties, fuel prices increased from the $1.50 to $2.00 range per gallon in the first part of the decade to a $2.50 to $3.50 range per gallon in the latter half of the decade. This price increase brought increased revenues of $1 billion plus to transportation in addition to the new General Fund support of GO bonds and Proposition 42. Given the overall budget situation, the fuel swap sought to use some of the new revenue from $3.00 per-gallon gasoline to fund transportation-related GO bond debt as a General Fund budget solution. Due to constitutional restriction in Proposition 22 of 2010,

truck weight fee revenue of about $900 million per year is directed to GO bond debt instead of fuel excise revenues, but the overall effect is similar for transportation programs and General Fund relief.

The biggest benefit for flexibility was that in decreasing the sales tax on gasoline and increasing the excise tax on gasoline, that revenue could be more broadly used for both highway and transit capitol, instead of just transit operations and transit capital. The flexibility was significant in creating the situation where baseline funding programs could continue while at the same time allowing some of the new revenue to benefit the General Fund through GO bond payment.

- Transportation benefit from the fuel swap: The fuel swap received bipartisan support and was generally supported by transportation interests for the following reasons:
    - The fuel swap maintained the "Proposition 42" level of funding for highways and local roads. This equates to funding in the range of $1.0 billion to $1.1 billion per year.
    - The fuel swap increased funding for transit operators relative to what current law would have provided under Proposition 22 of 2010. The swap was structured to provide base State funding for transit operations of about $350 million per year. However, with higher diesel sales tax revenues, the funding amount in 2012-13 is expected to be closer to $420 million.
    - The fuel swap's direction of about $900 million in truck weight fee revenue to GO bond debt supported the ability of the General Fund to appropriate GO bond proceeds and move forward with the transportation projects funded by Proposition 1B and Proposition 1A.

Repayment of Past Transportation Loans.
Over the past decade, about $5.4 billion in transportation funds have been loaned to the General Fund. Of that amount, about $2.6 billion has been repaid and an additional $218 million is proposed for repayment in 2012-13. Proposition 22 of 2010 amended the constitution to prohibit future loans to the General Fund from the revenue derived from taxes on transportation fuels. This constitutional change will stabilize transportation funding in the future, as multiple loans have occurred over the past decade. Proposition 22 does not prohibit loans to the General Fund from taxes and fees paid on vehicles and the fuel swap enacted last year does direct truck weight fee revenue to some new transportation loans to the General Fund. The weight fee loans are directed to bond debt in future years when bond debt exceeds annual weight fee revenue. Outstanding transportation loans can be placed in three broad categories as indicated in the bullets below and on the table on the following page:

- Loans to be repaid by the General Fund that will support new projects. While there was once about $3.1 billion in loans in this category, loan repayments were accelerated in the relatively-good budget year of 2006-07 and about $800 million remains outstanding. The governor's framework to pay off the "wall of debt" would result in these loans being fully repaid by the end of 2015-16.

- Loans to be repaid by the General Fund that will then fund transportation-related debt service. A total of $932 million is outstanding in this category and will be repaid as needed when eligible bond debt exceeds annual weight fee revenue – this is expected to occur beginning in 2014-15.

- Loans to be repaid from select tribal gaming compacts. Annual revenue of about $100 million will again be directed to this loan repayment beginning in 2016-17 – until then, it is being deposited in the General fund.

Outstanding Transportation Loans (dollars in million)

Transportation Loans to the General Fund (in millions)	Loan Amount	Amount repaid through 2011-12	Repayment in Proposed Budget (2012-13)	Outstanding amount (after 2012-13)	Comment
Group 1: Loans repaid from General Fund to transportation special funds to support new projects					
Propositions 42 loans from 2003-04 and 2004-05	$2,167	$1,832	$83	$252	Constitutionally due $83 million per year.
State Highway Account from 2008-09 and 2009-10	335	200	135	0	Statutorily due by 2013
Highway User Tax Acct from 2010-11	328	0	0	328	Statutorily due by 2021
Vehicle Registration Fees from 2010-11	180	0	0	180	No statutory due date
Various funds from 2008-09	60	23	0	37	Statutorily due by 2013 & 2021
Total	**$3,070**	**$2,055**	**$218**	**$797**	
Group 2: Loans repaid from General Fund and directed to bond debt service (weight fee revenue)					
Weight Fee loans from 2010-11 and 2011-12	$932	$0	$0	$932	Statutorily due by 2021
Total	**$932**	**$0**	**$0**	**$932**	
Group 3: Loans repaid from tribal gaming funds for various uses					
Traffic Congestion Relief Fund loans (from 2001-02 & 2002-03) related to Weight fees	$102	$0	$0	$102	For bond costs. Statutorily repaid in 2016-17 and 2017-18
Traffic Congestion Relief Fund loans (from 2001-02 & 2002-03)	$1,281	$534	$0	$747	For new projects. Statutorily repaid in 2017-18 and after.
Total	**$1,383**	**$534**	**$0**	**$849**	
GRAND TOTAL	**$5,385**	**$2,589**	**$218**	**$2,578**	

Federal ARRA funds.
The federal American Recovery and Reinvestment Act (ARRA) provided highway and road funding for California of $2.6 billion. Legislation in 2009 (AB x3 20, Bass), appropriated and allocated these funds with $1.6 billion directed to regional and local transportation agencies and $1.0 billion directed to Caltrans. Federal funds are received on a reimbursement basis. According to Caltrans, all the ARRA funds have been awarded to projects, and approximately $2.0 billion of the $2.6 billion has been expended and reimbursed from federal funds. While not all ARRA reimbursements have been received, the 2012-13 budget does not include any ARRA expenditures as those funds were fully allocated to projects in prior budgets.

Proposition 1B Bonds.
Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006 (Prop 1B): Prop 1B provides for a general obligation bond issue not to exceed $19.925 billion. The 2012-13 budget reflects $3.0 billion in Prop 1B expenditures for Caltrans, the Air Resources Board, and the Emergency Management Agency, but the Governor's Budget Summary indicates that number may be increased with a revised budget request this spring. The table below summarizes Prop 1B funds by program. "Allocated" means awarded to a project and cleared to begin expenditures and "Liquidated" means bond cash expended from state accounts.

Proposition 1B Bonds (dollars in millions)

Proposition 1B Category	Total 1B Amount	Total Allocated	Total Liquidated	Budget
Corridor Mobility Improvement Account (CMIA)	$4,500	$2,855	$1,009	Caltrans
Transit	3,600	1,349	1,146	State Trans Assistance
State Transportation Improvement Program (STIP)	2,000	1,584	1,199	Caltrans
Local Streets & Roads	2,000	1,961	1,961	Shared Revenues
Trade Infrastructure	2,000	817	46	Caltrans
State Highway Operations and Preservation Program (SHOPP)	750	504	325	Caltrans
State/Local Partnership	1,000	435	54	Caltrans
Grade Separations	250	160	38	Caltrans
State Route 99 Improvements	1,000	447	80	Caltrans
School Bus Retrofit	200	196	195	Air Resources Board
Local Bridge Seismic Retrofit	125	38	17	Caltrans
Intercity Rail	400	166	54	Caltrans
Transit Security	1,000	503	289	CalEMA
Trade Infrastructure Air Quality	1,000	447	358	Air Resources Board
Port Security	100	97	37	CalEMA
Total	**$19,925**	**$11,559**	**$6,808**	

GOVERNOR'S PROPOSAL:

This year's Governor's Budget does not include any significant new changes to transportation finance – in a sense, it represents the "new normal" for transportation funding. The combination of Proposition 22 from 2010 and last year's modified fuel tax swap legislation has added stability to transportation funding as most transportation funds – with the exception of vehicle fees – are constitutionally restricted, and cannot be loaned to the General Fund or used to repay bond debt. The other reality is that one-time funds are being expended, and for this reason funding for transportation may shrink instead of grow over the next five years.

Transportation Revenue: The revenue available for transportation purposes in 2012-13 is similar to that available in 2011-12. These revenues support about $15.3 billion in transportation expenditures in the proposed 2012-13 budget. The only new transportation revenue proposal from the Governor is to reduce vehicle registration fees by $5 for vehicle owners that pay by mail or the internet. This proposal would reduce ongoing transportation revenues by about $100 million annually according to the Administration.

Transportation Loans: The Governor proposes to repay $218 million in outstanding transportation loans from the General Fund to transportation special funds in 2012-13. Repayment of $83 million is constitutionally required and related to "Proposition 42" loans in 2003-04 and 2004-05. Repayment of $135 million is statutorily required, and while the repayment could be deferred, the Administration indicates repayment is necessary to maintain the solvency of the State Highway Account. Finally, the Administration proposes to again set aside truck weight fee revenue not needed for debt service as a loan to the General Fund – as was done with the 2011-12 budget. This weight fee revenue of $350 million would be repaid in future years when needed to pay transportation-related bond debt service.

Proposition 1B Bonds: The budget reflects a placeholder funding level for Proposition 1B expenditures in 2012-13, with the final budget request to follow later this spring. Across budget areas, the total Prop 1B expenditures for 2012-13 are currently reflected at about $3 billion.

ISSUES TO CONSIDER:

Transportation Funding in the "Fuel Tax Swap" World.
The proposed budget continues the benefits for various transportation areas that were part of the fuel tax swap. The tax swap is expected to provide about $700 million in excise tax revenue to each of state highways and local roads, which more than offsets for the revenue lost from Proposition 42 sales tax revenues. Transit agencies are expected to receive $420 million from the diesel sales tax, which exceeds the $350 million originally estimated at the time the fuel tax swap was enacted. The issue for the Legislature to consider is a proposed General Fund solution of $350 million by adopting statutory change that would repeat the 2011-12 budget action of loaning some truck weight fees to the General Fund. Under current law, $635 million of truck weight fees is already directed to 2012-13 bond debt, and this proposal would set aside the

remaining $350 million in 2011-12 and 2012-13 weight fee revenue as a reserve in the General Fund for future bond debt.

Transportation Loans.
As indicated in the background section, the Governor's budget proposes General Fund repayment of $218 million in transportation loans in 2012-13, with $83 million of that amount required by the Constitution. The Governor proposes to delay loan repayment in other areas of the budget totaling $630 million in General Fund budget solution – these loans were previously planned for repayment in 2012-13. The Legislature should consider the Governor's transportation loan repayment proposals in the context of other special fund loans and in the context of the overall budget. The Legislature can consider options to either accelerate or defer transportation loan repayment. Caltrans and the Department of Finance should report at budget hearings on the status of fund balances and the expenditures that would be supported with loan repayment.

One-Time Transportation Funding / Proposition 1B Bond Funds.
Federal ARRA funds for transportation are fully allocated to projects and the majority of project expenditures have occurred and reimbursement has been received from the federal government. The majority of Prop 1B bond funds have been allocated to projects, but some projects have not yet started construction and only about $6.8 billion of the $19.9 billion in bond proceeds have been expended. The Department of Finance indicates that as of December 2011, Caltrans had about $2 billion in bond cash – this amount is higher than the Administration targeted last year. The Administration should report at budget hearings on the status of Proposition 1B projects and bond proceeds, and what it has done to accelerate projects and job creation. The Administration should also report on bond expenditures going forward, planned bond sales in 2012, and how bond cash is being managed to minimize General Fund costs.

Fee Reduction for Vehicle Registration.
The Governor proposes to reduce annual vehicle registration fees by $5 for individuals that pay by mail or on the internet. This would reduce the base fee from $69 to $64. The fee reduction is estimated to reduce visits to Department of Motor Vehicle (DMV) offices and to result in efficiencies totaling about $700,000 and the elimination of 25 positions. The resulting revenue loss would be $75 million in 2012-13 and $100 million in 2013-14 and ongoing. In reviewing this proposal, the Legislature should consider the long-term solvency of the Motor Vehicle Account and the performance standard and service delivery at the DMV and California Highway Patrol – both of which are supported by this revenue. It should also be noted that vehicle registration revenue is eligible for expenditures on infrastructure purposes such as highway maintenance. The Administration should report at budget hearings on its analysis of unmet transportation funding needs and alternatively the benefits from a $5 fee decrease for select motorists.

High-Speed Rail

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 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.

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 furds. 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 February or early 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.

Budget Hearings: High-speed rail implemented in other countries does appear to provide unique benefits as part of a multi-modal integrated system of transportation. But even if an ongoing funding stream was identified for California high-speed rail, this would still remain a high-risk, high-cost project for other reasons. Budget hearings later this spring will provide a forum to examine the Final 2012 Business Plan and receive public testimony on this project.