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Assembly
California Legislature

ASSEMBLY TRANSPORTATION COMMITTEE
JIM FRAZIER, CHAIR

OVERSIGHT HEARING

Review of the Draft 2016 Business Plan for the California High-Speed Rail Authority

Monday, March 28, 2016
2:30 P.M. ♦ State Capitol, Room 4202

Background

Introduction and Purpose of Hearing

The purpose of today's hearing is to review the California High-Speed Rail Authority's (Authority's) recently released Draft 2016 Business Plan. The Authority is statutorily required to adopt and submit a business plan to the Legislature every two years. At least 60 days prior to the publication of the plan, the Authority is required to release a draft for legislative and public review and comment.

The draft plan was released on February 18, 2016. With that release, the Authority signaled a major shift in its proposed planning and construction of the high-speed rail system. Rather than pursue a south-oriented Initial Operating Segment (IOS) from the City of Merced in the Central Valley through the Tehachapi Mountains to the San Fernando Valley in Los Angeles County, the Authority is now proposing a north-oriented IOS, from the Central Valley to San Jose. Moreover, for the first time, the business plan presents a fiscally constrained funding plan that sets forth a clear vision of how to proceed to construct the IOS, an extension of the IOS to Bakersfield and to San Francisco, and corridor improvements between Burbank and Anaheim.

Despite a more definitive plan for an IOS and despite actual construction experience, clearer funding expectations, and a lower estimated budget, the road from construction to operation of high-speed rail service is far from guaranteed. Significant prerequisites must be met and the level of risk for the project remains high.

Today's hearing is not intended to be a comprehensive review of the high-speed rail project. Instead, the purpose of today's hearing is to provide an opportunity for legislators and the public to gain a full understanding of the costs, necessary preconditions, and associated risks in completing the newly proposed IOS, the extension to Bakersfield and to San Francisco, and the planned investments in the Burbank to Anaheim corridor.

Background

Development of high-speed rail in California began more than 20 years ago. SB 1420 (Kopp), Chapter 796, Statutes of 1996, created the Authority to direct development and implementation of intercity high-speed rail service that would be fully coordinated with other public transportation services. The Authority reports to the California State Transportation Agency and is governed by a nine-member Board of Directors. The Governor appoints five members of the board, the Senate Rules Committee appoints two, and the Assembly Speaker appoints two.

Assembly Bill 3034 (Galgiani), Chapter 267, Statutes of 2008, directed the Safe, Reliable High Speed Passenger Train Bond Act for the 21st Century (Proposition 1A) to be placed before the voters in the fall of 2008. California voters approved the initiative, which authorized $9.9 billion in general obligation bonds for two distinct purposes: $9 billion to develop and construct a high-speed rail system connecting San Francisco Transbay Terminal to Los Angeles Union Station and Anaheim; and $950 million for connecting intercity and commuter rail systems that would enhance those systems' capacity, safety, or connectivity to the high-speed rail system.

Proposition 1A prescribes specific route and design requirements for the high-speed rail system including that it must be electrified, be capable of sustaining speeds of no less than 200 miles per hour, and have the capacity to achieve travel times between San Francisco and Los Angeles of 2 hours and 40 minutes. Additionally, Proposition 1A requires a 50% match of all bond funds and lays out specific requirements the Authority must meet in order to access and spend the bond funds, including submission of detailed funding plans to the Legislature and Department of Finance. Furthermore, Proposition 1A requires high-speed rail to operate without government subsidies.

In July 2012, the Legislature approved SB 1029 (Committee on Budget and Fiscal Review), Chapter 152, Statutes of 2012, that appropriated nearly $8 billion in federal and state funds to begin the construction between Madera and Bakersfield. SB 1029 funded three components envisioned in the April 2012 revised business plan, as follows:

1) Initial Operating Segment: SB 1029 provided $5.8 billion to fund construction of the high- speed rail "backbone" in the Central Valley with approximately 130 miles of right-of-way and track bed from Madera to the northern outskirts of Bakersfield to be constructed. Of this amount, $3.2 billion was from federal grants and $2.6 billion was from Proposition 1A bonds.

2) Connectivity: SB 1029 appropriated $819 million of Proposition 1A bonds for "connectivity" projects on existing regional and inter-city rail systems throughout California to improve the connectivity to the future high-speed rail system.

3) Bookends: SB 1029 also appropriated $1.1 billion of Proposition 1A funds for improvements in the Los Angeles Basin and in the San Francisco Peninsula, referred to as the "bookends." These funds were for near-term improvements to these existing rail

segments that will facilitate the eventual use of the segment for high-speed rail and also improve service for existing riders.

Of this amount, $500 million was dedicated to fund projects in the Los Angeles Basin as reflected in the 2012 Memorandum of Understanding (MOU) signed with the Southern California Association of Governments (SCAG) and its regional transportation members, and $600 million for electrification of the Caltrain system in the San Francisco Bay Area.

Furthermore, the 2014-15 state budget [SB 862 (Committee on Budget and Fiscal Review), Chapter 36, Statutes of 2014], continuously appropriated 25% of the revenues derived from the cap and trade program to the project. This equates to roughly $500 million annually.

Draft 2016 Business Plan

With the release of the Draft 2016 Business Plan, the Authority set forth its updated proposal to build the IOS. It also updated its plans, cost estimates, and schedule for the remainder of Phase I (San Francisco to Los Angeles/Anaheim by 2029) and eventually Phase II (Sacramento and San Diego). Additionally, the Authority announced its intentions to accelerate environmental review on eight remaining project sections with the aim to have all projects environmentally cleared by 2017 in case any new revenue becomes available for the project.

Many of the project elements discussed in the business plan, such as where funding will come from to build out the rest of Phase I, are still unknown. These elements are important and worthy of consideration, but will not likely require direct legislative involvement in the near future. Other aspects, however, are much more tangible and immediate, such as the Authority's plan to build the IOS north, the extension to Bakersfield and to San Francisco, and projects in the Burbank-Anaheim corridor. These elements will require direct legislative action in the near term; consequently, the remainder of the discussion will focus on these elements.

Initial Operation Section North

The Draft 2016 Business Plan refocuses the high-speed rail project on completing an IOS from San Jose to north of Shafter, dubbed the Silicon Valley to Central Valley line. The Authority expects construction to be completed by 2024 and service to be started on the line in 2025. The IOS includes the current construction underway in the Central Valley from Madera to Wasco in Kern County. The IOS would continue to Gilroy and end at Diridon Station in San Jose.

The funding estimate for the Silicon Valley to Central Valley line is $20.8 billion and includes everything needed to construct the line and start revenue service, including rolling stock, maintenance facilities, stations, and all necessary rail systems. The Authority stipulates they can build the Silicon Valley to Central Valley line with existing revenue and existing sources of Proposition 1A bonds, federal funds, and continued cap and trade funding, as follows:

- $2.60 billion in state Proposition 1A bonds (appropriated in SB 1029);
- $3.16 billion in federal stimulus and Federal Railroad Administration grants (also appropriated in SB 1029);
- $338 million planning funds (from a mix of federal funds and Proposition 1A provided for in SB 1029);
- $4.16 billion in remaining Proposition 1A bonds that have not yet been appropriated;
- $5.34 billion in cap and trade proceeds, to be used on a pay-as-you go basis through 2024; and,
- $5.23 billion in financing proceeds using cap and trade funding for 25 years, from 2025 to 2050.

Bakersfield to San Francisco Extension

To boost the ridership potential on the IOS, the Authority has committed to seeking an additional $2.9 billion in federal funding to extend the IOS south to downtown Bakersfield and north to the Caltrain terminal at 4th and King Streets in San Francisco. The Authority notes that transportation projects of this magnitude traditionally rely on the federal government for at least 50% of the funding. Federal participation in this project, however, is roughly 25% of the amount already appropriated, which represents only about 5% of the amount needed to build the IOS and the extension. The Authority reasons then, that expecting greater federal participation is reasonable and justified.

The $2.9 billion in estimated costs is in addition to the $600 million in Proposition 1A bonds that the Authority committed to provide to electrify Caltrain.

Burbank to Anaheim Corridor

The Authority commits to advancing projects in the Burbank to Anaheim corridor to prepare for the integration with the high-speed rail system. Overall, the Authority is committing to pursue $4 billion in early investments in the corridor through a combination of federal, state, and local funds, including funds previously committed for Southern California as a part of the SB 1029 appropriation for "bookend" projects.

It is not clear how the Authority's plans in this area reconcile with the pre-existing MOU that the Authority entered into with SCAG and its regional transportation members. The MOU called for the Authority to invest $1 billion in projects to be prioritized jointly by signatories to the MOU. It is also not clear how the Authority expects to contribute to the corridor, beyond the $500 million included in SB 1029, although the business plan lists numerous possible funding sources, including:

- Cap and trade proceeds not committed to building the IOS.

- Fixing America's Surface Transportation (FAST) Act Section 1116, which allocates formula funds for a National Highway Freight Program, of which California is expected to get $600 million over the next 5 years. Highway-rail grade crossings are an eligible use.

- FAST Act Section 1105, which created the new Nationally Significant Freight and Highway Program (FASTLane), a nationally competitive grant program with $4.5 billion over the next 5 years and for which highway-rail grade crossings are an eligible use.

- Transit and Intercity Rail Capital Program which receives 10% of cap and trade proceeds, estimated at $200 million per year, for statewide rail modernization.

<u>How certain is the funding?</u>

The Authority suggests that the Draft 2016 Business Plan illustrates how it can successfully get high-speed rail service running in California with existing revenues. The funding outlined by the Authority, however, is far from guaranteed and associated risks remain high, as discussed below:

Cap and Trade Funds

Currently, 25% of cap and trade funds are continuously appropriated for the high-speed rail project. Historically, this has equated to about $500 million annually. The business plan assumes both direct pay-as-you-go funding through 2024 and financing, by way of loans and/or bonds financed with future cap and trade revenues through 2050. Risks associated with relying on this source of funds include the following:

1) <u>Cap and trade financing is not secure:</u> In June 2015, the Authority issued a "Request for Expressions of Interest (EOI) for the delivery of an Initial Operating Segment" to get input from potential private sector partners. The EOI posed questions about the roles potential partners might be willing to play in the construction, financing, and operation of the project. In January 2016, the California High-Speed Rail Peer Review Group (PRG), whose statutorily directed purpose is to independently review work of the Authority, outlined the private sector responses in a letter to the Legislature. Overall, the PRG noted that there is strong private sector interest in the project; however, there are financial and investment risks the private sector will not be willing to take because the existing funding sources face varying degrees of uncertainty.

Of particular note related to the use of cap and trade funds for financing, the PRG reported that respondents to the EOI expressed the following concerns regarding cap and trade funds for this project:

- The legal foundation of the overall program is arguably not established beyond 2020;

- The Authority's future share could be changed by the Governor and the Legislature in the face of stiff competition from other potential claimants; and,

- Estimates of future cap and trade total income are uncertain.

As a result of these concerns, the PRG advised the Legislature that cap and trade income cannot be effectively securitized as it is currently constituted. To remedy this, the Legislature will need to do the following, at a minimum:

- Authorize continuation of cap and trade program, at least through 2050.

- Appropriate a fixed dollar amount for high-speed rail, rather than a percentage.

2) State needs to pledge its full faith and credit: The PRG also advised the Legislature that responses to the EOI also indicate that potential private sector investors question the ability of the Authority to make or to fulfill major investment commitments, such as availability payments, without access to the backing of the State. The PRG suggests that this is important because there are no other currently available significant federal or state grant programs. Consequently, were the state to pledge its full faith and credit it would have to be against existing funding sources.

Proposition 1A Bonds

The Authority plans to use all of the bond proceeds from Proposition 1A to construct the Silicon Valley to Central Valley line. The use of the funds, however, is conditioned on some very specific requirements, many which could be challenging to meet, including:

1) Funding Plan (c): Pursuant to Proposition 1A, the Authority must submit a "detailed funding plan for the corridor or usable segment," referred to as a Funding Plan (c), to the Administration and the Legislature prior to a request for an appropriation. Funding Plan (c) is to include the following:

   - A description of the corridor;

   - A description of any lease or franchise agreements;

   - Estimated full cost for construction of the corridor;

- The sources of all funds for the corridor;
- The projected ridership and operating revenue estimate on the corridor;
- Possible risks for the corridor;
- A certification by the Authority that construction of the corridor can be completed as proposed in the plan and that the corridor would be sustainable and ready for high-speed train operations;
- An identification of one or more passenger rail service providers that can begin using the tracks or stations for passenger rail service;
- A certification by the Authority that any service in the corridor will not require an operating subsidy; and,
- A commitment that the Authority has completed all project level environmental clearances.

The Authority submitted a Funding Plan (c) to the Legislature preceding the 2012 appropriation and was sued in a case that challenged the merits of the plan. The lower court found that the plan did not meet the requirements set forth in Proposition 1A. However, the appellate court found that the purpose of the funding plan was to inform the Legislature and if the Legislature acts on the plan, the plan is presumed to have been sufficient.

Only a portion of Proposition 1A bonds have been appropriated to date. The Legislature will be asked to appropriate the remaining $4 billion in Proposition 1A bonds, presumably in the next few years. At that time, the Authority will need to submit a subsequent Funding Plan (c) that may, or may not be litigated (although it seems likely that any subsequent litigation would be as unsuccessful as the earlier complaint).

2) Funding Plan (d): Prior to spending bond proceeds, the Authority must again submit detailed funding plan, referred to as Funding Plan (d), to the Department of Finance and the Legislature. Funding Plan (d) must include similar requirements of Funding Plan (c), with an additional report to be completed by an independent financial services firm confirming the contents on the plan and that the corridor can be completed and will operate without a subsidy. The funding plan must then be reviewed by the Director of Finance and the Joint Legislative Budget Committee and the Department of Finance has 60 days to approve the plan.

   The Authority has awarded a contract in November 2015 for independent financial services to provide an independent review of the funding plan. Whether or not the firm will find that the system can operate without a subsidy is uncertain. Furthermore, based on experiences with Funding Plan (c), it is likely the merits of Funding Plan (d) will be litigated. If there is litigation, the Authority's ability to use the bond proceeds will likely be delayed until the lawsuit is resolved. It is unclear what impacts those potential delays will have on the project schedule or other funding plans.

Additionally, any delays in selling bonds will likely result in delays in constructing "bookend" projects.

Federal Stimulus and Already Appropriated Funds

As mentioned previously, the Authority has received roughly $3.2 billion in federal grants to build the Central Valley section of the IOS. Of this amount, federal stimulus funds, amounting to $2.6 billion, must be committed by September 30, 2017, as required by statute. According to a recent report by the Legislative Analyst's Office, less than $700 million of these funds have been spent to date. This deadline to expend is statutorily set by Congress and is not likely be amended.

Federal Grants or Loans

The Authority anticipates applying for federal grants and loans from various existing programs to fulfill both the construction of the IOS and the Burbank to Anaheim improvements. The business plan lists possible options for this financing the IOS as federal programs like the Transportation Infrastructure Finance and Innovation Act (TIFIA) administered by the Federal Highway Administration, the Railroad Rehabilitation and Improvement Financing (RRIF) administered by the Federal Railroad Administration, or revenue bonds. Additionally, as mentioned above, numerous federal programs such as FAST Act freight funding or Transportation Investment Generating Economic Recovery (TIGER) grants could help fund the Burbank to Anaheim improvements.

The state or local agencies would have to apply to the federal government for the various grants and loan programs, and grant awards are not guaranteed. Furthermore, high-speed rail projects will most likely be competing with other transportation priorities around the state, such as major freight projects.

State Transit and Intercity Rail Programs

Similar to competition for limited federal grants, the Authority's commitment to pursue $4 billion in additional investments in the Burbank to Anaheim corridor could significantly increase competition for already over-subscribed state programs that support transit and intercity rail, such as Transit and Intercity Rail Capital Program that is funded with cap and trade revenue.

Conclusion

Unquestionably, the Authority's task - to build a high-speed passenger rail system - is a daunting one. The sheer size the program combined with uncertain funding, rigidly prescribed design criteria, constant legal threats, weighty environmental concerns, and difficult engineering challenges seemingly jeopardize accomplishment of the task at every turn.

Nonetheless, the Authority has, indeed, made progress in implementing the project. As detailed in the business plan, the Authority has, to date, more than 100 miles of construction-related activities underway with almost $3 billion in contracts that came in lower than estimates; more than 200 construction craft laborers have been dispatched to work on the Construction Package 1; over 170 people have graduated from a Pre-Apprenticeship Training Program established by the Fresno Workforce Investment Board; and over 260 small businesses are working on the project statewide.

In its Draft 2016 Business Plan, the Authority lays out its recommended course of action that reflects the greatest opportunity for success. Success will, at a minimum, require the full support of the Governor's Administration, the full support of the Legislature, and some luck.

At today's hearing, representatives of the Administration and the Authority will discuss the details of the draft business plan. A consultant with the Legislative Analyst's Office will discuss that office's findings and recommendations regarding the draft plan, as will the chairman of the high-speed rail Peer Review Group. Next, the committee will hear from the Authority's regional partners who will discuss the implications of the draft business plan on their regions and to the existing MOUs. Finally, members will have an opportunity to hear from the public regarding the draft business plan.