Assembly Transportation Committee
Informational Hearing

High-Speed Rail Authority: Revised 2012 Business Plan

Monday, April 30, 2012
State Capitol, Room 4202

Background:

The California High-Speed Rail Authority (Authority) is statutorily required to prepare, publish, adopt and submit to the Legislature a business plan by January 1, 2012, and every two years thereafter. At least 60 days prior to the publication of the plan, the Authority is required to release a draft business plan for legislative and public review and comment. The Authority released its draft business plan to the Legislature and the public on November 1, 2011.

That plan drew extensive criticisms and comments. As a result, the Authority delayed release and adoption of its revised business plan until earlier this month.

Purpose:

The purpose of this hearing is to provide an opportunity to better understand changes made to the business plan since it was published in draft in November 2011 and the effect of those changes on the project and its feasibility. Additionally, the hearing will provide an opportunity to discuss outstanding issues surrounding the project and the Administration's plans for its near-term implementation.

The Revised Business Plan: In Brief

The *Revised 2012 Business Plan* represents some significant re-tooling of the previous draft plan:

- Blended system: The revised business plan provides for "the integration of, or blending, of high-speed rail improvements with existing and upgraded rail systems." According to the Authority, "By leveraging new infrastructure and systems with existing and upgraded systems, taxpayers will benefit from greater cost efficiency and more effective use of state investments dollars."

- Bookends: The revised business plan proposes near-term investments in the "bookends," that is, the urban segments on either end of the route. Memorandums of understanding (MOUs) between the Authority and regional transit agencies in northern and southern California have been drawn and adopted in support of this effort. Specifically, the Authority intends to invest in electrification of the Caltrain commuter rail corridor in the San Francisco Bay Area and near-term improvements in Metrolink, southern California's commuter rail system. The Authority intends to fund these improvements from Proposition 1A bond funds for high-speed rail ($9 billion) and for connectivity to high-speed rail ($950 million).

- Lower cost estimates: The revised business plan estimates that the cost to complete a Phase 1 (San Francisco to Los Angeles) blended system is $68.4 billion. The draft business plan estimated the blended system would cost $78.2 billion. The difference between these two estimates is due to lower inflation rate assumptions and an accelerated schedule.

- Initial operating segment: The earlier draft business plan posed two alternatives for an initial operating segment—one from the Central Valley north to the San Francisco Bay Area and one from the Central Valley south into the San Fernando Valley. The revised business plan identifies the Bakersfield to Palmdale segment as the high-priority segment that should be completed initially.

- Increased utility for the Central Valley segment: The Authority intends to work with the California Department of Transportation, Amtrak, Altamont Commuter Express, BNSF Railway, and Union Pacific to develop a "Northern California Unified Service Concept" to connect the first section of the initial operating segment using the San Joaquin intercity rail service and the Altamont Commuter Express service.

- Cap-and-trade revenue: The revised business plan relies on cap-and-trade revenue from AB 32 (Nunez, Chapter 488, Statutes of 2006), the California Global Warming Solutions Act of 2006, as a funding backstop to complete the initial operating segment in the event federal funding is not forthcoming.

With these key changes, the revised business plan alleviated, to some extent, issues raised regarding the earlier draft plan. However, not all issues have been alleviated and some new ones have since arisen.

Legal Issues:

Throughout earlier discussions on the draft business plan, issues regarding the project's adherence to the requirements of Proposition 1A (the Safe, Reliable, High-Speed Passenger Train Bond Act of 2008) persisted, namely:

- Does the initial segment proposed for construction provide independent utility, as required?

- Does the high-speed rail system, as proposed, comport with mandated design characteristics (e.g., for speed and travel time)?

- Does the plan (or associated funding plan) appropriately identify sufficient funding sources to complete construction of at least the initial operating segment?

- Does the plan comply with the prohibition against the use of public subsidies?
- Are all environmental review requirements sufficiently addressed as required under Proposition 1A?

Again, the revised business plan does address these issues, at least to some extent; for example, according to the Authority:

- The revised business plan provides for increased utility of the initially constructed segment by tying the segment in with the existing San Joaquin intercity rail and the Altamont Commuter Express services.
- Development of a blended system, rather than a dedicated line, will not interfere with design requirements relative to speed or travel time so the pertinent design criteria remain achievable.
- The availability of cap-and-trade revenue fulfills the requirement that all funding sources needed to complete an initial operating segment are identified prior to committing funds.
- Re-tested ridership forecasts confirm that public subsidies will not be required for operation of the initial operating segment.

Unfortunately, for all the legal issues potentially alleviated with the revised business plan, new concerns have emerged. Of particular note are concerns regarding the questionable legality of using cap-and-trade revenues to fund construction of the project.

The cap-and-trade program, authorized under AB 32, is a market-based mechanism developed to reduce the state's greenhouse gas emissions. Billions of dollars are expected to be raised as a result of this program and the Administration has identified these funds as a potential source of funding for high-speed rail should federal funding not materialize. The Authority has identified federal funding needs of $42 billion and Congress is on the verge of providing $0 (beyond the $3.5 billion already granted). Consequently, the likelihood of needing to depend on cap-and-trade revenue is high.

Questions have been raised regarding the legality of using cap-and-trade revenue to fund high-speed rail. For example, according to the Legislative Analyst's Office, the use of these funds may not be legally viable under AB 32 or under existing restrictions that generally govern fees (versus taxes). While the Administration asserts that its legal counsel believes the use of cap-and-trade funds is legal, ambiguity and doubt persists. If funding high-speed rail is found to be an illegal use of cap-and-trade dollars, the project will lose its only identified, realistic source for long-term funding. Furthermore, the Authority will potentially fall short of complying with provisions of Proposition 1A that require certain assurances (such as a secure funding source) before bond proceeds can legally be committed.

Further questions also remain regarding:

- The legality of using a portion of Proposition 1A bond dollars, authorized for high-speed rail, to fund improvements identified in MOUs between the Authority and regional transit agencies on what will be shared facilities, not dedicated high-speed rail facilities as required by Proposition 1A.

- The suggestion that the Administration may propose changes related to the California Environmental Quality Act (CEQA) process for the high-speed rail project. The Administration is reportedly considering statutory remedies to facilitate the CEQA review process.

It is unclear when and how these questions will be resolved.

Funding Issues:

The use of cap-and-trade revenue is, to some extent, the cornerstone of the Authority's funding plan as it now stands. Previous analyses by the High-Speed Rail Peer Review Group, the Legislative Analyst's Office, the State Auditor, and others were highly critical of the Authority's overall funding plan, condemning it for relying too heavily on improbable federal funding and, as a result, putting the state at great financial risk. The High-Speed Rail Peer Review Group, for example, identified uncertainty about future federal funds as a fundamental flaw in the Authority's draft business plan. This assertion was echoed in the State Auditor's report dated January 24, 2012, that the Authority's funding situation had become "increasingly risky."

The cap-and-trade program is anticipated to generate billions of dollars. To the extent the funds can, indeed, be used (if needed) as the Authority asserts, then many of the earlier criticisms regarding the project's financial risks to the state may be resolved.

Other concerns regarding the project's fiscal viability focused on the Authority's ridership projections. For example, the State Auditor's report also noted that the success of the Authority's program hinges largely on the accuracy of its ridership projections, which are fundamental to its revenue projections and to private investors' interest in the program. To this point, the Authority's revised business plan reflects revised, re-tested, and re-reviewed ridership projections that, according to the Authority, provide reassurance that the project can easily meet and exceed its future operating and maintenance costs.

Budget Issues:

For the first time, the Governor's proposed budget this year includes budget requests for capital construction of the high-speed rail project. Although the Legislature's response to the Administration's budget requests is not directly within the purview of this committee, it will have profound, lasting impacts on the project and the state and, therefore, should be well understood.

The Administration's specific request for appropriations includes the following:

- $5.8 billion for construction and planning of the initial section of the Central Valley segment.

($3.2 billion from federal funding)
($2.6 billion from Proposition 1A high-speed rail bonds)

- $252.5 million for design and right of way acquisition

- $819 million of Proposition 1A connectivity bonds for early investments in the bookends.

Budget sub-committees of both houses are currently deliberating the Governor's budget request for high-speed rail, including related issues such as:

- Is it prudent to appropriate the entire $5.8 billion this year versus appropriating just the amount needed for the budget year.

- Should funding also be appropriated at this time for the two bookend MOUs?

- Is the Authority's request for staffing, and its efforts to date to hire staff, sufficient to ensure the project receives proper oversight?

- Should funding for bookend investments be tied to funding for construction of the initial Central Valley segment?

How and when these issues will be resolved is--much like the outstanding legal issues—uncertain.

<u>Summary</u>:

Not all of these issues will be resolved in today's hearing. Perhaps, however, a better understanding of the remaining hurdles will lead to their eventual clearing and ultimately assist the Legislature in making appropriate decisions on this very complex project.