

STATE CAPITOL
P.O. BOX 942849
SACRAMENTO, CA 942849-0116

LEGISLATIVE OFFICE BUILDING
1020 "N" STREET, SUITE 112
SACRAMENTO, CA 95814
(916) 319-2093
FAX: (916) 319-2193

Assembly California Legislature



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OVERSIGHT HEARING

Review of the Draft 2018 Business Plan for the California High-Speed Rail Authority

Monday, April 2, 2018

Upon Adjournment of Bill Hearing ♦ 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 2018 Business Plan. The Authority is statutorily required to adopt and submit a final business plan to the Legislature on May 1st 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 March 9, 2018. With the release, the Authority continues their commitment to a northern oriented and expanded Initial Operating Segment (IOS) from the Silicon Valley to the Central Valley, the so-called "Valley to Valley" line. This northern orientation was first detailed in the 2016 Business Plan and at that time signaled a major shift in the project, from the previous south-oriented IOS from the City of Merced in the Central Valley through the Tehachapi Mountains to the San Fernando Valley in Los Angeles County.

Additionally, the draft plan reflects work directed by the Authority's Board of Directors in 2017 for a comprehensive review of the current Central Valley construction contracts and cost estimates for the Valley to Valley Line and full Phase I of the system. This new cost review was first unveiled in November 2017, when the Authority revealed that costs for the Central Valley segment had risen over \$2.8 billion from previous estimates, due primarily to right-of way acquisition delays and so-called third party agreements with freight railroads and utilities. The new cost estimates are reflected in the draft plan. The draft plan also introduces the concept of cost ranges, meaning the Authority is offering a range of estimates of potential costs for the various segments to reflect early design and the uncertainty about alignment and scope, risks and costs. The new projected total cost of Phase I, in the middle or base range, is \$77.3 billion with a completion date of 2033 as compared to \$64.2 billion with a completion date of 2029 in the 2016 Business Plan.

Finally, the draft plan continues the financing structure for the IOS proposed in the 2016 Business Plan, specifically the financing of future Cap and Trade proceeds dedicated to the Authority. For the first time, the 2016 Business Plan laid out a potential funding scheme that could get high-speed service up and running on the IOS. However, the scheme had many conditions and associated risks. The 2018 draft plan elaborates on these and details what would be needed, including potential actions by the Legislature, to make the financing successful. However, even with the financing of Cap and Trade revenues, the cost estimate ranges leave a potential funding shortfall for the IOS. To tackle this issue, the Authority proposes to build the IOS in stages with potential early high-speed or other rail service in two parallel corridors, the Central Valley and the San Francisco to Gilroy corridors.

Despite more accurate costs estimates, new executive leadership at the Authority, and real world construction experience, major questions remain about whether the Authority can accomplish the most important project priority – get high-speed rail up and running. The high-speed rail program is at a crossroads, with hard decisions on the very short horizon for legislators. The purpose of today’s hearing is to provide an opportunity for legislators and the public to gain a full understanding of the costs, funding sources and associated risks in completing the proposed IOS, the possible early service options in the Central Valley and Bay Area, and the ongoing investments in significant projects in the so-called “bookends” in the Bay Area and Southern California.

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 an eleven-member Board of Directors. The Governor appoints five members of the board, the Senate Rules Committee appoints two, and the Assembly Speaker appoints two. Additionally, the board includes two ex-officio, non-voting members, one member of the Assembly and one member of the Senate.

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.

At the time of the passage of Proposition 1A, estimates for the cost of the system varied. The analysis by the Legislative Analyst’s Office (LAO) that accompanied the ballot measure referenced a 2006 estimate from the Authority that the total cost to develop and construct the entire high-speed rail system would be about \$45 billion. However, the Authority’s 2008 Business Plan, released after the passage of Proposition 1A estimated the cost at \$33 billion, financed by a mix of bond funds, federal, local, and private funds.

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 percent 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. 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, a 2014-15 state budget trailer bill [SB 862 (Committee on Budget and Fiscal Review), Chapter 36, Statutes of 2014], continuously appropriated 25 percent of the revenues derived from the Cap and Trade program to the project. Additionally, in July 2017, the Legislature extended the state's Cap and Trade program through 2030, in AB 398 (Garcia), Chapter 135, Statutes of 2017. In the draft plan, the Authority estimates that this equates to roughly \$750 million annually.

Finally, in 2016, the Legislature passed and the Governor signed into law AB 1889 (Mullin) Chapter 744, Statutes of 2016, which defined the Proposition 1A terms "suitable and ready for high-speed train operation." As a requirement of Proposition 1A, prior to spending any

bond funds for construction, the Authority must demonstrate certain aspects of the project corridor or usable segment, including that it is suitable and ready for high-speed rail operation. AB 1889 defined that a segment is “suitable and ready” if the bond funds are used for capital projects that would enable high-speed trains to operate immediately or after additional planned investments are made on the corridor or usable segment and passenger train service providers will benefit from the project in the near-term. Additionally, the bill further declared the intent of the Legislature that early investments in the bookends and other parts of the system, as outlined in the appropriation in SB 1029, is consistent with Proposition 1A. As discussed in the funding section below, this point is currently being litigated.

2016 Business Plan

The 2016 Business Plan shifted the previously proposed South-oriented IOS to a Northern-oriented IOS, proposing the first high-speed line run from San Jose to North of Shafter in Kern County. The Authority estimated that the IOS would cost \$20.8 billion and be completed and in service by 2025. The Authority stipulated they could 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, through both pay-as-you-go and long term financing. Additionally, the plan detailed an extension of the IOS in the south to downtown Bakersfield and in the north to the Caltrain terminal at 4th and King Streets in San Francisco at an additional cost of \$2.9 billion, for which the Authority planned to pursue federal funds. Finally, the 2016 plan detailed early investments on the Burbank to Anaheim corridor totaling \$4 billion 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. Overall, Phase I of the project, San Francisco to Los Angeles/Anaheim, was estimated to cost \$64 billion and be completed by 2029.

Draft 2018 Business Plan

The Authority established three objectives in the draft 2018 Business Plan:

- Initiate high-speed rail into passenger service as soon as possible.
- Make strategic concurrent investments throughout the high-speed rail corridor that can be linked together over time.
- Position them to advance additional segments as funding becomes available.

As part of these objectives, the Authority has expanded the scope of the IOS from the 2016 Business Plan, extending it to 4th and King Streets in San Francisco and to Bakersfield. Additionally, the Authority details plans to potentially initiate interim service in the Central Valley and the San Francisco Peninsula while financing and constructing the connecting tunnels through the Pacheco Pass to complete the IOS.

The draft plan includes the Authority’s updated cost estimates and schedules for this expanded IOS (San Francisco 4th and King to Bakersfield), and the remainder of Phase I

(San Francisco to Los Angeles/Anaheim). Additionally, as mentioned, the Authority conducted a comprehensive cost review to better reflect and estimate costs of both existing construction in the Central Valley and the remaining IOS and Phase I, and is now showing cost estimates in a range from low, base, to high. Finally, the Authority updated the environmental review schedule on eight remaining project sections in Phase I to be completed by 2020.

Many of the project elements discussed in the draft 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, the potential to run early interim rail service, and the continued funding and construction of the bookend projects. 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

The Draft 2018 Business Plan details an implementation and delivery strategy for the IOS from San Francisco to Bakersfield, or the Silicon Valley to Central Valley (Valley to Valley) Line. The Authority expects the line to be completed by 2029. The IOS includes the current construction underway in the Central Valley from Madera to Shafter in Kern County. The IOS would extend south to end in Bakersfield, and would continue west to Gilroy over the Pacheco Pass, through Diridon Station in San Jose, and end at the 4th and King Streets station in San Francisco.

The funding estimate for the Valley to Valley line is \$29.5 billion, for the middle or base range, and includes everything needed to construct the line and start revenue service, including rolling stock, maintenance facilities, stations, and all necessary rail systems. As the Authority continues to work to establish a full funding package for the Valley to Valley line, the "building blocks" of the funding package includes existing sources of Proposition 1A bonds, federal funds, continued Cap and Trade pay-as-you-go funding and Cap and Trade financing, as follows:

- \$2.31 billion in federal stimulus funds (appropriated in SB 1029);
- \$929 million in Federal Railroad Administration Fiscal Year 2010 construction grants (appropriated in SB 1029);
- \$2.60 billion in state Proposition 1A bonds for Central Valley construction (appropriated in SB 1029);
- \$333 million in state Proposition 1A bonds for planning (appropriated in SB 1029);
- \$4.16 billion in remaining Proposition 1A bonds that have not yet been appropriated;

- \$4.75 billion to \$5.42 billion in Cap and Trade proceeds, to be used on a pay-as-you go basis through 2023; and,
- \$3.90 billion to \$11.10 billion in financing proceeds using Cap and Trade funding from 2024 to 2050. (Assumes a low estimate for future annual cap and trade proceeds of \$500 million and a high of \$750 million).

This equals a total of available funding for the Valley to Valley line at a range of a low of \$19.00 billion to a high of \$26.86 billion. The estimated cost to complete the Valley to Valley line is a range of a low of \$25.13 billion to a high of \$36.84 billion with a base or middle range of \$29.53 billion. The Authority notes that these estimates present a gap or funding shortfall which would likely result in partial funding of the tunnels connecting the IOS through the Pacheco Pass. The cost of the connection from Gilroy to Madera in the Central Valley, which includes the tunnels, is estimated at \$12.64 billion.

As included in previous Business Plans, the Authority continues to pursue private financing and more federal funding, noting that other large infrastructure projects have historically enjoyed over 50 percent federal funding, while the high-speed rail project has received less than 20 percent federal investment. In fact, the draft plan includes reference to the Trump Administration Infrastructure plan currently being debated in Washington D.C. While the plan does not include specific funding grants for high-speed rail, it does propose the expansion of existing federal credit programs and private activity bonds, which the Authority believes could be pursued to help support the project.

The Authority acknowledges the potential funding gap for completing the IOS, so they have included an incremental plan to deliver the Valley to Valley line. Specifically, the Authority plans to:

- Complete the Central Valley civil works – completing construction of the current 119 mile Central Valley segment from Madera to Shafter by 2022.
- Add Central Valley track and systems – adding track and systems to prepare the Central Valley segment for possible early interim service and testing of high-speed trains.
- Expand Central Valley construction – extend the line from Shafter to Bakersfield and analyze the potential to utilize a completed segment in the Central Valley for early high-speed operations, including testing, or interim service for an existing Amtrak route.
- Expand the electrification of the Caltrain corridor – expand electrification south to Gilroy for potential enhanced service to Gilroy for Caltrain and express high-speed rail operation between San Francisco and Gilroy. However, the corridor is shared with Caltrain, Amtrak, and the Union Pacific, so the Authority is in discussions with all involved.
- Make additional capital investments from San Jose to San Francisco – limited capital investments to improve safety and prepare the segment for initial high-speed rail

operations.

- Advance Pacheco Pass and Merced project development work – complete geotechnical analysis, environmental review, design, and right-of-way acquisition prior to construction of the tunnels.
- Engage with partners to deliver the tunnels– engage with the federal government and public and private sector experts on tunnel design options.

Bookend Projects

As previously described, the so-called bookend projects were defined and appropriated by SB 1029 in 2012. Specifically, the Legislature appropriated \$600 million in Proposition 1A bond funds to the Northern California project, the electrification of Caltrain. Additionally, the Authority committed some of their allocation of state Cap and Trade funds to the project for a total commitment of \$713 million. The Caltrain electrification project, which is scheduled to be completed by 2022, will electrify and upgrade Caltrain's commuter rail service between San Francisco and San Jose. Additionally, a component of the project is to install Positive Train Control (PTC) in the corridor, which is now required by federal law. The improvements will allow high-speed trains to utilize the corridor as part of the blended system. The total cost of the Caltrain project is estimated at \$1.98 billion.

In Southern California, two projects have been identified for funding from the \$500 million in Proposition 1A bond funds appropriated in SB 1029. Specifically, in early 2017, \$76 million was approved for the Rosecrans/Marquardt grade separation project. The Rosecrans/Marquardt grade separation is in Santa Fe Springs on the BNSF mainline tracks at the intersection of Rosecrans and Marquardt Avenues. The intersection is also on the Los Angeles/San Diego/San Luis Obispo (LOSSAN) corridor, which is utilized by Amtrak and Metrolink. The intersection sees more than 112 freight and passenger trains per day and has been rated by the California Public Utilities Commission (CPUC) as the most hazardous grade crossing in California. The total cost of the project is \$155.3 million.

The remainder of the Proposition 1A bonds funds for Southern California, \$423.3 million, is being dedicated to Los Angeles Union Station (LAUS) for the Link Union Station (Link US) project in downtown Los Angeles. The Link US project will extend up to 10 rail tracks at LAUS to the south of the station over U.S. Highway 101, including platforms and tracks for use by future high-speed rail. The project allows trains at LAUS to “run through” the station rather than head in and back out through a single entrance. The project is planned for two phases of construction with the cost of Phase A estimated at \$950.3 million (including Proposition 1A bond funds) and the cost of Phase B estimated at \$1.14 billion. The project is expected to be completed in 2027.

The original MOU entered into by the Authority, the SCAG and their regional transportation members committed the Authority to invest \$1 billion in projects in the SCAG region. Although the two projects detailed above fulfill \$500 million of that commitment with Proposition 1A bond funds, “other” state funds are not discussed in the draft plan.

How Certain is the Funding?

The Authority outlines an incremental plan and possible funding scheme for the IOS Valley to Valley line. The funding outlined by the Authority, however, is far from guaranteed and associated risks remain high. As detailed in the 2016 Business Plan, and continued in the draft plan, the Authority relies on long term financing of Cap-and Trade funds. The Authority outlines three steps the Legislature could take to make this financing a viable option, as described below.

Additionally, since the completion of the 2016 Business Plan, the Authority has moved to access the Proposition 1A bond funds appropriated for Central Valley construction that serve as matching funds for the federal stimulus funds. To utilize the remaining roughly \$4.1 billion of Proposition 1A bond funds for the Valley to Valley line, the Authority must meet some stringent requirements, as detailed below.

Cap and Trade Funds

Currently, 25 percent of Cap and Trade funds are continuously appropriated for the high-speed rail project. Following the Legislature's extension of Cap and Trade to 2030, the LAO released a report containing two revenue scenarios for future Cap and Trade auctions. Based on these projections, the Authority has assumed that annual receipts for the high-speed rail project will be \$750 million. This is up from \$500 million per year assumed in the 2016 Business Plan. The draft plan assumes both direct pay-as-you-go funding through 2023 and financing, by way of loans and/or bonds, with future Cap and Trade revenues through 2050. As Cap and Trade funding is not secure, there are numerous risks associated with relying on this source of funds.

Specifically, 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 the 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.

The Authority incorporated this feedback into the draft plan, highlighting three areas requiring legislative action that are necessary for financing:

- Non-impairment of appropriations to the Authority – meaning guaranteeing that the Cap and Trade flow of funds would not be restricted, halted, or redistributed. This could possibly require a vote of the people as this Legislature cannot bind the hands of future Legislatures. Additionally, this could be affected by Proposition 70 which is pending on the June 2018 ballot requiring a 2/3 vote of the Legislature in 2024 on all Cap and Trade expenditures.

- Extension of the Cap and Trade program through 2050.
- Minimum Guarantee – the state would have to provide a credit enhancement through a minimum guarantee or floor of Cap and Trade funds to be received by the Authority, which would likely entail a first call on Cap and Trade funds, a set amount of Cap and Trade funds, and a pledge of the state to fulfill the commitment from other state funds if Cap and Trade revenue does not keep pace.

Proposition 1A Bonds

The Authority plans to use all of the bond proceeds from Proposition 1A, other than planning funds, to construct the Valley to Valley line. The use of the funds, however, is conditioned on some very specific requirements, many of 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 \$4.16 billion in Proposition 1A bonds, presumably in the very near future. 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 a 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 in 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.

To that end, in January 2017, the Authority submitted a Funding Plan (d) to the Department of Finance and the Joint Legislative Budget Committee for the Central Valley segment and the Caltrain electrification project. In June 2017, the Authority also submitted a Funding Plan (d) for the Rosecrans/Marquardt rail grade separation project.

Following the submission of the funding plans for the Central Valley and Caltrain, a lawsuit was immediately filed to block the issuance of the bonds citing that the funding plans did not meet the standards in Proposition 1A and challenging the constitutionality of AB 1889 (Mullin). Although the court denied a request for a temporary restraining order to stop the sale of Proposition 1A bonds, the court case is still pending.

It is reasonable to presume that the submission and possible approval of any future funding plans, including for the remaining Proposition 1A funds for Valley to Valley and the L.A. Union Station bookend project could be litigated as well.

Federal Loans, Grants or Financing

As previously discussed, the Authority anticipates possible additional federal funding for the Valley to Valley Line and Phase I in the form of direct funding or financing. Specifically, the draft plan mentions the current Trump Administration infrastructure proposal, which includes an expansion of some existing federal loan programs, including the Transportation Infrastructure Finance and Innovation Act (TIFIA) administered by the Federal Highway

Administration, the Railroad Rehabilitation and Improvement Financing (RRIF) program administered by the Federal Railroad Administration, or private activity bonds.

Although Congress and the Administration are currently debating the plan, it is unclear if any infrastructure package will be approved. Additionally, there is currently no funding in the proposed plan for direct grants to high-speed rail projects. If the Authority did apply and compete for federal credit and financing programs, it would require a funding stream as detailed above.

Conclusion

Unquestionably, the Authority's task - to build a high-speed passenger rail system - is a daunting one. The sheer size of 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.

The Authority has, indeed, made progress in implementing the project. As detailed in the draft plan, the Authority has, since the 2016 Business Plan, advanced construction on 119 miles in the Central Valley, with a dozen construction sites and three major structures already complete; infused billions of dollars into the state's economy stimulating \$5 billion in economic activity; put hundreds of businesses and thousands of people to work, including 1,699 craft laborers working on Central Valley construction; and has new leadership and organizational improvements in place.

However, even with the continued progress on the project, the draft plan makes it clear that the Authority does not have funding necessary to complete the IOS and get high-speed rail service up and running. Action must be taken by the Legislature in the near term. The Legislature and the Administration must either commit to funding the project, and all the decisions that entails, or begin discussions on a plan to maximize the various assets and work that has been accomplished.

At today's hearing, representatives of the Authority will discuss the details of the draft plan. The LAO will discuss its findings and recommendations regarding the draft plan, as will the members of the High-Speed Rail PRG. Next, the committee will hear from the Authority's regional partners who will discuss the implications of the draft plan on their regions and the ongoing project activities funded by the bookend MOUs. Finally, members will have an opportunity to hear from the public regarding the draft plan.