Assembly Transportation Committee
Oversight Hearing

High-Speed Rail Authority: Draft Business Plan and Funding Plan

Tuesday, November 29, 2011
State Capitol, Room 4202

Purpose:

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.

The Authority's draft business plan, along with its detailed funding plan for initial construction, represents the most definitive look ahead to date for California's high-speed rail program. As the Authority is set to embark on the largest public works project in California, it is appropriate that the Legislature pause and consider the following: Knowing what we now know about California's plans for high-speed rail:

- Is high-speed rail an appropriate solution to address California's anticipated transportation needs?
- If high-speed rail can appropriately meet future transportation needs, can we afford it?
- What will be the net fiscal impact of high-speed rail on the state in general and on transportation systems specifically?
- Does the draft business plan adequately reflect the most cost-effective approach to building a high-speed rail system?
- Does the approach reflected in the 2012 draft business plan comport with the requirements and limitations set forth in Proposition 1A?

This hearing will explore these issues.

Background:

Is high-speed rail an appropriate solution to address California's anticipated transportation needs?

According to the draft business plan, the case for investing in high-speed rail in California is tied to two key factors:

1) Continued growth will require major investments in expanded transportation systems; and,

2) High-speed rail can meet those demands more effectively and at lower costs than the alternatives.

The Authority asserts that providing expanded capacity equivalent to that which high-speed rail can provide would require:

- 2,300 new lane-miles of highway;

- 115 additional gates at California airports; and,

- 4 new airport runways.

The Authority anticipates that the cost for these alternatives would exceed $170 billion.

By way of comparison, the Transportation Finance Executive Working Group of the California Transportation Commission (CTC) just published a report entitled, "2011 Statewide Transportation System Needs Assessment" (Needs Assessment) in which it estimates that California's transportation expansion needs will exceed $195 billion over the next ten years. (These cost estimates were derived from adopted regional transportation plans that are fiscally constrained; meaning that the number and types of projects in the plans are limited to those for which revenues can be reasonably identified during the planning period.) The report takes into consideration needs across the full spectrum of transportation systems, including highways, local streets, freight rail, seaports, airports, bicycle, and pedestrian systems.

Clearly, California's future transportation needs will be huge and they will be costly. What is not clear, however, is how those needs should best be met.

According to the Authority, its draft business plan reflects all new, conservative ridership numbers that have undergone a thorough re-evaluation based on an international peer review of the ridership model and methodology. Additionally, the Authority reports having used a similar review and conservative methodology to develop its revised cost and revenue forecasts.

Still, questions about the Authority's projections abound.

While it is impossible to know how many passengers will actually use high-speed rail when it is completed, it is important that whatever numbers are developed have as high degree of certainty as possible. Decisions such as station locations (and related development activities nearby), frequency of trains, appropriate feeder systems, and revenue forecasts all rely heavily on ridership projections. For example, a recent *Los Angeles Times* article illustrates the dangers of banking on ridership numbers that later fail to materialize. According to the article, proponents of Spain's Ciudad Real Central Airport, which opened three years ago, predicted that several million passengers would use the airport annually, relieving traffic at Madrid's international hub. However, only 33,000 people used the new airport last year. Consequently, the regional government, that heavily subsidized the $1.5 billion airport, is considering closing it down.

<u>If high-speed rail can appropriately meet future transportation demand, can we afford it?</u>

In publicly discussing the draft business plan, members of the Authority have sought to answer this question with a separate question, "Can we afford NOT to pursue high-speed rail?" They argue that the cost of alternative solutions far outweighs the estimated cost of high-speed rail. Moreover, they argue, the alternative means of expansion (for example, highway expansion) would be contrary to important state policies such as AB 32, the Global Warming Solutions Act of 2006, and SB 375, the Sustainable Communities and Climate Protection Act of 2008.

In reality, building a high-speed rail system will not preclude the need to expand California's other transportations systems; hence, an either/or comparison doesn't apply. At best, high-speed rail will accommodate future growth needs in intercity passenger travel. It will not, for example, do much to address passenger travel within regions, to other states, or internationally and will have little or no direct benefits for freight movement.

There is no reason to assume that California can afford to pay for all of its transportation needs. Which of these needs should we pay for?

The draft business plan estimates that costs to fully fund Phase 1 of the high-speed rail system (San Francisco to Los Angeles/Anaheim) will be somewhere between $98 billion and $117 billion. The draft business plan does not include costs for the entire planned system (800 miles) as envisioned in the original ballot initiative. Currently, $6 billion is available ($3.316 billion in federal grants and $2.684 billion in state bond funding). Other identified and likely sources of funding for the high-speed rail system include the remainder of the state's $9 billion commitment ($6.316 billion), assuming matching funds can be found. Additionally, $950 million is available for regional and local rail systems and may be used to proceed with integrating high-speed rail with established regional or commuter rail in urban corridors (referred to as the "blended service" in the draft business plan).

Sources of funding for the remainder of the needed revenues are uncertain. The Authority anticipates that a number of potential federal grant and debt financing programs might be available to build out at least to the first initial operating segment when private financing might be expected to become available.

In recognition that future funding sources are unknown, the draft business plan envisions building out the system in phases, "…adding lateral segments and later service-level upgrades. This can be done so that each segment has independent value and so that funding confidence can be achieved before each such segment is commenced." Furthermore, the Authority expects to mitigate the risk of funding delays by "providing decision points for state policy-makers to determine how and when the next steps should proceed while leaving a fully operational system and generating economic benefits at each step." The draft business plan also declares that under the draft business plan, an operating subsidy will not be required.

The Needs Assessment predicts that California's overall transportation needs (including expansion and preservation) will exceed $536 billion over the next ten years alone (well before the first high-speed rail initial operating section is likely to become operational). This figure does not include costs to build or operate high-speed rail. The Needs Assessment also predicts that the total estimated revenue from all sources (excluding high-speed rail) during the ten-year study period is $242 billion, reflecting a shortfall of nearly $300 billion over ten years.

<u>What will be the net fiscal impact of high-speed rail on the state in general and on transportation systems specifically?</u>

The draft business plan describes an economic analysis that shows that the benefits of the high-speed rail system far outweigh the costs of building, operating, and maintaining it. The Authority cites as an example of these economic benefits the potential to provide 100,000 jobs to the Central Valley as a result of the first construction work. The Authority anticipates that nearly one million jobs could be generated eventually. Other anticipated benefits include reduced traffic congestion and a reduction in hours lost as a result of congestion.

Probably the greatest significant fiscal impact to the state that is anticipated in the draft business plan is the ability of the high-speed rail program to attract billions of dollars in private investments. With the state's contribution limited to $9 billion, the Authority projects the remainder of the $98 billion to $117 billion needed to complete Phase 1 will come from federal, private, and local sources. Furthermore, the Authority asserts the high-speed rail system will be profitable and that revenue from the service will more than cover operating and maintenance costs, even possibly providing capital for future expansion of the system.

Although the state's contribution to high-speed rail is limited to the initial bond authorization, state costs to service those bonds is significantly higher than the $9 billion principal. The Legislative Analyst's analysis of Proposition 1A (the Safe, Reliable, High-Speed Passenger Train Bond Act of 2008) estimated that the full costs of the bonds is likely to be $19.4 billion, resulting in an average repayment for principal and interest of about $647 million per year. These costs will be borne by the General Fund. The cost to the General Fund for servicing these bonds to date has been minimal but will start to mount soon if the Authority's request to fund the initial construction segment is granted and construction begins next year.

Regarding the impacts to other transportations systems in the state, some have raised concerns that high-speed rail will divert funds from more traditional transportation systems. For example, the draft business plan references federal grant and financing programs as potential sources of funding but these same competitive programs, such as the Transportation Infrastructure Finance and Innovation Act (TIFIA) and the Transportation Investment Generating Economic Recovery (TIGER) programs, fund other transportation systems as well. Consequently, adding high-speed rail to these programs will undoubtedly intensify the competition for funds.

<u>Does the draft business plan adequately reflect the most cost-effective approach to building a high-speed rail system</u>?

The Authority asserts that the phased implementation approach, beginning in the Central Valley, reflects the wisest course of action, federal requirements and spending deadlines notwithstanding. It believes that constructing the "spine" of the statewide high-speed rail system first, then extending it north or south to larger population centers when funding is available makes good, sound business sense. The Authority also asserts that starting the initial construction segment in the Central Valley is the cost-effective way to use initial funding.

Others have criticized the Authority's plans to begin construction of the high-speed rail system in the Central Valley. For example, the Legislative Analyst's Office (LAO), in its May 2011 report entitled, "High-Speed Rail is at a Critical Juncture," asserts that alternative segments could provide more benefit to the state, particularly if the statewide high-speed rail system envisioned by Proposition 1A is never fully completed. Furthermore, the California High-Speed Rail Peer Review Group, in its July 1, 2011, letter to the Senate states: "…starting in the Central Valley offers a chance to construct high-speed demonstration track and appears to have less environmental opposition, but would yield an asset of very little value if the project cannot be funded beyond this segment alone."

<u>Does the approach reflected in the 2012 draft business plan comport with the requirements and limitations set forth in Proposition 1A</u>?

State law requires the Authority's business plan to identify the following:

- The type of service the authority anticipates it will develop, such as local, express, commuter, regional, or interregional;

- A description of the primary benefits the system will provide;

- A forecast of the anticipated patronage, operating and maintenance costs, and capital costs for the system;

- An estimate and description of the total anticipated federal, state, local, and other funds the authority intends to access to fund the construction and operation of the system; and,

- The proposed chronology for the construction of the eligible corridors of the statewide high-speed train system.

Additionally, the business plan is to include a discussion of all reasonably foreseeable risks the project may encounter, including, but not limited to, risks associated with the project’s finances, patronage, right-of-way acquisition, environmental clearances, construction, equipment, and technology, and other risks associated with the project’s development.

Similar to the requirements to submit a business plan, existing law (as set forth in the ballot initiative) also requires the Authority, no later than 90 days prior to submitting their initial request for appropriation of bond proceeds for each corridor (or usable segment thereof) to have approved a detailed funding plan for that corridor or usable segment thereof. The funding plan is to include, identify, or certify the following:

- A description of the expected terms and conditions associated with any lease agreement or franchise agreement proposed to be entered into by the authority and any other party for the construction or operation of passenger train service along the corridor or usable segment thereof.

- The estimated full cost of constructing the corridor or usable segment thereof, including an estimate of cost escalation during construction and appropriate reserves for contingencies.

- The sources of all funds to be invested in the corridor, or usable segment thereof, and the anticipated time of receipt of those funds based on expected commitments, authorizations, agreements, allocations, or other means.

- The projected ridership and operating revenue estimate based on projected high-speed passenger train operations on the corridor or usable segment.

- All known or foreseeable risks associated with the construction and operation of high-speed passenger train service along the corridor or usable segment thereof and the process and actions the authority will undertake to manage those risks.

- Construction of the corridor or usable segment thereof can be completed as proposed in the plan.

- The corridor or usable segment thereof would be suitable and ready for high-speed train operation.

- One or more passenger service providers can begin using the tracks or stations for passenger train service.

- The planned passenger service by the authority in the corridor or usable segment thereof will not require a local, state, or federal operating subsidy.

- The authority has completed all necessary project level environmental clearances necessary to proceed to construction.

Finally, Proposition 1A also requires, prior to the Authority committing any bond proceeds for construction or right-of-way acquisition to once again report to the Legislature and others a detailed plan that revisits the assumptions set forth in the initial detailed funding plan, making particular note of:

- Any material changes to earlier assumptions;

- A description of terms and conditions associated with contracts for construction or operation of passenger train service; and,

- A report, prepared by a financial services firm, financial consulting firm or other consultants, independent of any parties (other than the authority) involved in funding or constructing the high-speed train system, indicating the following:

    - Construction of the corridor or usable segment thereof can be completed as proposed in the detailed funding plan;

    - If so completed, the corridor or usable segment thereof would be suitable and ready for high-speed train operation;

    - Upon completion, one or more passenger service providers can begin using the tracks or stations for passenger train service; and,

    - The planned passenger train service will not require operating subsidy.

Reference to these provisions of Proposition 1A are reflected in ballot arguments in support of the initiative that declared, "Taxpayers interests would be protected by public oversight and detailed independent review of financing plans." Those arguments also asserted that matching private and federal funding would be identified before state bond funds are spent.

In the draft business plan and detailed funding plan, the Authority proposes to begin construction of a $6 billion, 130-mile initial construction segment between north of Fresno to north of Bakersfield. As envisioned in the draft business plan, the segment will not be immediately operational but will provide an opportunity, should additional funding become available, to complete an initial operating segment either north or south of the initial constructions segment, thereby bringing high-speed rail to California. The draft business plan provides that operational independence of the initial construction segment can be achieved with the diversion of parallel existing intercity rail service should the need arise. Funding for the diversion has already been set aside.

The Authority has initially requested funds for construction and right-of-way acquisition for the initial construction segment. This project alone does not include stations, trains, or electrification and, therefore, arguably does not meet the requirements of Proposition 1A. The Authority asserts, however, that the project does lay the groundwork for future work that will meet the statutory requirements eventually and that, thus, the requirements will be met.

Setting aside questions as to whether the planned initial construction segment reasonably meets the test of independent utility, other questions have been raised as to whether the Authority has secured the required project level clearances that the proposition requires before construction proceeds.

Ultimately, the courts may be asked to decide whether the draft business plan and the detailed funding plan approved by the High-Speed Rail Authority last month meet the requirements and limitations of Proposition 1A. In fact, such a lawsuit may have already been filed. Last month, Kings County and two of its residents filed a lawsuit against the Authority stating that plans for starting in the Central Valley violate provisions of Proposition 1A.

Summary:

High-speed rail is indeed at a critical juncture. For all the questions posed in this background paper, hundreds of others could, and perhaps should, be asked. Today's hearing is not intended necessarily to provide satiating answers to these tough questions, just food for thought.