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SENATE TRANSPORTATION COMMITTEE
& SENATE BUDGET SUB-COMMITTEE #2
JOINT INFORMATIONAL HEARING
High-Speed Rail Authority Project Update
MARCH 26, 2019
BACKGROUND PAPER

Introduction

The purpose of this hearing is to receive an update on the high-speed rail project. Hearing panelist will include members from the California High-Speed Rail Authority (HSRA), the Independent High-Speed Rail Peer Review Group (PRG), the State Auditor, Legislative Analyst's Office, and transportation agencies directly involved in delivering "bookend" projects. The intent of this hearing is to create a forum for project stakeholders to provide testimony on where the project stands today and for Legislators to ask stakeholders about HSRA ongoing organizational and funding challenges and where the project is heading.

Background

Brief history of HSRA

The HSRA was established in 1996 (SB 1420, Kopp, Chapter 796, Statutes of 1996) for purposes of planning and constructing a high-speed train system to connect the State's major population centers. However, until voters approved Proposition 1A in 2008, authorizing the State to sell up to $9.95 billion in general obligation bonds for the project, HSRA lacked a significant source of funding. Proposition 1A imposed specific requirements on the project as a condition of using the funds, including that it be capable of achieving specified operating speeds and travel times between certain cities.

Proposition 1A also limited funding to no more than 50% of the construction cost of any corridor or usable segment of the system and further required that the system operate without a public subsidy. Subsequently, the project received approximately $3.5 billion in federal funds, including $2.6 billion in federal stimulus funds which had to expended by September 30, 2017. Furthermore, in 2014, the Legislature authorized a portion of the State's annual cap-and-trade auction proceeds to be used for the project. Construction of the project was to begin in the Central Valley with a 130-mile segment, known as the Initial Construction Segment (ICS), running from Madera to Bakersfield. HSRA intended to construct the remainder of an Initial Operating Segment (IOS) in subsequent segments, though high-speed trains would not operate on the system until the entire IOS was complete. In July 2012, the Legislature appropriated $5.85 billion ($2.61 billion from Proposition 1A and $3.24 billion in federal funds) to complete the ICS. At the same time, the Legislature also appropriated $1.1 billion for investment in the "bookends" — the San Francisco Bay Area and Los Angeles Basin regions — including electrification of Caltrain between San Francisco and San Jose and various projects to improve the existing rail corridor between the San Fernando Valley and Los Angeles/Anaheim. These projects would provide near-term benefits to commuters and existing rail systems, while preparing these heavily-trafficked urban corridors for high-speed rail. HSRA originally planned to complete the ICS by 2017. However, due to litigation and other delays, groundbreaking for the ICS did not occur until January 6, 2015. HSRA now expects to complete the ICS by 2022. This segment of the project is being constructed using a series of design-build contracts.

HSRA Business Plan

Pursuant to State law, beginning in 2012 and every two years thereafter, HSRA is required to prepare and submit to the Legislature a business plan outlining key elements of the high-speed rail project. At minimum, the Business plan (plan) must include project development information, including a description of the type of service being developed, the timing and sequence of project phases and segments, and estimated capital costs. It must also include estimates and descriptions of the total anticipated federal, state, local, and other funds that HSRA intends to access to construct and operate the system, forecasts of financial scenarios based on projected ridership levels, and maintenance and operations costs. Additionally, it must identify all reasonably foreseeable risks to the project and outline HSRA's strategies for managing those risks.

HSRA has always planned to develop the project in phases, with Phase I connecting San Francisco to Anaheim over a distance of approximately 500 miles. A subsequent Phase II would extend the system to San Diego in the south and add a separate link to Sacramento in the north. When the HSRA adopted its 2012 Business Plan it outlined a framework for development of Phase I at a cost of approximately $68 billion, including an IOS that would connect the Central Valley with the Los Angeles Basin within 10 years.

The 2012 plan proposed to accelerate the benefits of high-speed rail through a "blended approach" which utilizes and upgrades existing rail infrastructure wherever possible, combined with increased early investment in the bookends. The purpose of this early investment was to enhance regional rail service in two major population centers while simultaneously paving the way for future high-speed rail service. At that time, the primary rationale for a southern-oriented IOS (as opposed to a northern connection to San Francisco) was that the densely populated Los Angeles Basin could provide the high levels of ridership needed to operate the system without a subsidy. The intent was to complete the northern connection to San Francisco once the IOS was operational and ridership levels could be demonstrated. However, the 2012 plan did not specifically identify funding for this portion of the project.

HSRA's next business plan, presented and adopted in 2014, updated the project's cost estimates and revised HSRA's ridership and revenue forecasts, but did not significantly alter the construction plan. The 2014 plan continued to peg total costs of Phase 1 at $68 billion. It proposed a number of potential revenue sources to fund the project but did not definitively identify any new funds beyond the Proposition 1A and federal resources previously identified.

The 2016 and 2018 Business Plans

The 2016 Business Plan was the first provided by HSRA since construction had commenced on the ICS and the Legislature appropriated a portion of revenues from the cap-and-trade program to the project. It provided updated cost and schedule information informed by lessons learned through the work completed to date. In addition, it proposed significant changes to the construction plan and sequencing originally outlined in the 2012 Business Plan. Key elements of the 2016 plan included the following:

- Changed to northern orientation for IOS – now to travel from the central valley to San Francisco
- Full funding plan for northern IOS
- Updated cost and schedule estimates for Phase 1 (including projected savings)
- Expanded project scope in Burbank-to-Anaheim Corridor (using projected savings)
- Identified concepts for full funding of the total Phase 1

The subsequent 2018 Business Plan continued to focus on completing the northbound "Valley to Valley" section (see next page for description) with final completion to Los Angeles/Anaheim finished after trains are operating between Bakersfield and San Francisco. The 2018 plan further identified three primary categories that have led to project cost increases since the release of the 2016 Business Plan which included project contingency increases, inflation, and revised Central Valley Segment project costs. Lastly, in order for Valley to Valley to be completed, the plan called for more certainty in funding and providing a funding framework that allows HSRA the ability to securitize cap-and-trade dollars.

The 2018 plan built on the 2016 Business Plan by redefining the "Valley to Valley" line to now start from the 4th and King Caltrain station in San Francisco and end in downtown Bakersfield. In switching the IOS construction northbound, the 2016 Business Plan identified the new IOS to provide service between San Jose and a temporary station north of Bakersfield off Poplar Avenue near Shafter. The 2018 plan asserted that redefining the Valley to Valley line from San Francisco to Bakersfield will generate higher revenue due to stronger ridership potential than the previous line identified in the 2016 plan. The 2018 plan claimed that with increased ridership, the potential for higher revenue can provide another funding source to assist in completing Phase 1 into Southern California. Based on the 2018 plan, the 119 mile Central Valley segment (Madera to Poplar Ave.) is scheduled to be completed in 2022. The 2018 plan also diverged from the 2016 plan by proposing to continue construction south to Bakersfield and also expanding electrification of the Caltrain corridor south to Gilroy (the 2016 plan only identified electrification on the corridor from San Francisco to San Jose Diridon station). This approach will allow for dual operation of express service in both the Central Valley and Silicon Valley as early as 2027, leaving the connecting tunnel through the Pacheco Pass and construction of the Merced "Wye" to be carried out as future funding sources are identified.

Lastly, the 2018 plan provided updated project cost estimates for the high-speed rail project. In comparison to the 2016 Business Plan, both the project costs and project schedules had increased and timelines were extended. A notable change from the 2016 plan is that the 2018 plan now displayed the project costs for each segment in "ranges" to reflect uncertainties and various risks. The plan noted that as each segment continued to be developed through the completion of environmental planning and design, right-of-way acquisition, etc., over time, HSRA will be able to provide more accurate estimates of each project segment. Below is a table with the cost ranges and projected completion dates as identified in the 2018 plan.

Cost Range	Completion Date	Segment
\$63.2 - \$98.1 billion	2033	Phase 1 (S.F. to L.A./Anaheim)
\$25.1 - \$36.8 billion	2029	Silicon Valley to Central Valley Segment
\$10.1 - \$12.2 billion	2022	Central Valley Segment (119 miles)

The 2018 plan acknowledged that the identified Proposition 1A, Federal, and Cap-and-Trade funding will cover most of the Valley to Valley segment leaving only the Pacheco Pass tunnel and Merced "Wye" to require an additional funding source. In order to close the approximate $12 billion gap, the plan asserted that other revenue sources will need to be identified such as ridership concessions and/or future federal funds that can be used to complete both Valley to Valley and Phase 1 construction. Lastly, the 2018 plan suggested that future legislation will also be needed to allow HSRA to securitize Cap-and-Trade funding in order to ensure the HSRA is able to meet its project schedules.

HSRA Project Update Report

In July 2012, the California Legislature approved — and Governor Brown signed into law — SB 1029 (Committee on Budget and Fiscal Review, Chapter 152, Statutes of 2012) which appropriated almost $8 billion in federal and state funds to construct the first high-speed rail segments in the Central Valley and fund 15 bookend and connectivity projects throughout California. The bill also put into place extensive reporting requirements to ensure legislative oversight over the progress of the project. As a result, the Project Update Report is to be provided to the Legislature every two years starting 2013. The requirements of the project update report, include, but are not limited to, the following:

- A summary describing the overall progress of the project.
- The baseline budget for all project phase costs, by segment or contract, beginning with the California High-Speed Rail Program Revised 2012 Business Plan.
- The current and projected budget, by segment or contract, for all project phase costs.
- Expenditures to date, by segment or contract, for all project phase costs.
- A comparison of the current and projected work schedule and the baseline schedule contained in the California High-Speed Rail Program Revised 2012 Business Plan.
- A summary of milestones achieved during the prior year and milestones expected to be reached in the coming year.
- Any issues identified during the prior year and actions taken to address those issues.
- A thorough discussion of various risks to the project and steps taken to mitigate those risks.

2017 Project Update Report

On March 1, 2017 HSRA issued a new Project Update Report highlighting the progress made since 2015 in building the nation's first high-speed rail system and the nation's largest infrastructure project.

The report detailed how building high-speed rail is creating thousands of new jobs and economic benefits, especially for small and disadvantaged businesses. Achievements on this front include:

- Hundreds of workers building 119 miles of new transportation infrastructure at nine active construction sites that will bring passenger rail service to connect the Central Valley to the Silicon Valley by 2025
- Over 900 construction workers received well-paying jobs in the Central Valley, with many more coming across California
- 334 small businesses are engaged in the project right now, of which 102 are certified disadvantaged businesses and 39 are certified disabled veteran businesses

The 2017 report highlighted that from July 2006 to June 2016, HSRA invested $2.3 billion in constructing high-speed rail, of which 94 percent has gone to companies and people in California — investments that have involved more than 600 companies and generated up to $4.1 billion in economic activity, 52 percent of which occurred in disadvantaged communities. The report also outlined the various risks to project cost and schedules, and details how HSRA is using state of the art techniques to manage those risks and protect taxpayer dollars.

As for the release of the 2019 Project Update Report, HSRA has indicated that the release of the Project Update Report will not occur until May 1 of this year; failing to meet the March 1st statutory deadline. The new Administration and HSRA assert that additional time is required to revise the Project Update Report to reflect Governor Newsom's proposal to focus construction on first connecting Merced to Bakersfield.

New Administration: New Plans

On February 12th of this year, Governor Gavin Newsom issued the first State of the State Address under the Governor's new Administration. During the address, Governor Newsom stated that the current planned project is encountering significant time and financial constraints and that a focus on construction in the Central Valley is the most feasible option with HSRA's existing resources. The State of the State remarks left many perplexed as to what those comments actually meant. In the following days, numerous press articles reported that Governor Newsom's State of the State Address proposed to end the high-speed rail project, no longer connecting Los Angeles to San Francisco. The Governor's office and HSRA subsequently released statements conveying the Administration's commitment to completing the first phase of the project. At this point, while the Governor has announced a redirection of the Valley to Valley alignment, neither the Administration nor HSRA has provided any additional funding or project details. Rather, the Administration informed the Legislature that the 2019 Project Update Report will be delayed several months, indicating a May 2019 release date with funding and project details reflecting the Administration's new proposal.

Budget issues for the upcoming 2019-2020 fiscal year

Proposition 1A Administrative Cap Nearly Exhausted

Proposition 1A is the primary source of state funding for the project, and currently funds the majority of the project's administrative expenses. Proposition 1A caps administrative spending at 2.5 percent of total funding, or roughly \$225 million. As of December 2018, HSRA has spent roughly \$154 million of this \$225 million, leaving roughly \$71 million in remaining administrative funds. HSRA has indicated that their current budget spends roughly \$45 million on administrative costs per year. At this rate, HSRA will hit the Proposition 1A administrative cap near the end of the 2020-2021 fiscal year. At that point either the administrative cap must be raised or a new source of funding must be found to cover the project's administrative expenses.

Looming Deadlines

The high-speed rail project received significant federal investment in 2010 and 2011. Overall, the project received roughly \$3.5 billion in federal funds (\$2.5 billion from ARRA funds and \$929 million in additional federal grants). As of July 31, 2018, HSRA had expended the entirety of the ARRA grant and none of the additional federal funds.

Under the original terms of the ARRA and additional grants, HSRA needed to complete the first useable section of the project by 2017. This includes: all relevant environmental clearances, completion of the three construction projects currently underway, the related State Route 99 Realignment, and 119 miles of track work necessary to allow train service once the three construction projects are completed. This date was later extended to December 2022. Failure to do so could result in the state having to repay \$3.5 billion to the federal government. An extension of this deadline would require an act of Congress.

Following this extension, HSRA is now required to provide the necessary state match for these funds between July 1, 2017 and December 31, 2022. As of December 2018, HSRA had provided \$477 million in state match, which is less than 20 percent of the required total. HSRA's straight-line liability schedule indicates that HSRA should have matched \$604.1 million by this point. This suggests that HSRA has been spending more slowly than anticipated, and will have to make up lost time later in the construction process.

This is consistent with the rest of HSRA's spending patterns. In order to complete currently-budgeted work within planned schedules, HSRA currently needs to spend roughly $150 million per month. Current expenditures, however, are far short of this. HSRA spent just $75 million in November 2018, and $89.5 million in December 2018. Similar to the state match liability issue, any underspending now will eventually need to be made up later in the construction process. Further delays, for example resulting from further ROW issues or delayed environmental clearances, will only exacerbate this problem. As it stands, finishing the projects by the December 2022 deadline will require HSRA to work twice as fast over the next four years as it has since it began construction in 2013. Failure to do so will result in further project delays, and the likelihood that the state will have to repay the $3.5 billion in federal funds granted to the project.

Conclusion:

The High Speed Rail project is the largest infrastructure project ever constructed in the United States. With the final project cost hovering around $77 billion and the geological complexities throughout the state, the project will inevitably encounter challenges. Up to this point, the HSRA has managed through the challenges that have arisen and the project continues to move forward.

However, the project continues to be plagued with issues. Primarily, questions around spending and establishing a sufficient ongoing revenue stream for the project continue to be raised. Funding issues have been exacerbated by a recent action by the Federal Railroad Administration (FRA) to de-obligate $928 million appropriated to HSRA in fiscal year 2009-10. HSRA issued a response to the de-obligation stating no contract violations have occurred and requested FRA to work in good-faith to resolve any potential cooperative agreement issues. Although HSRA had not planned to expend these funds until after its ARRA/state match requirements had be fulfilled, the federal government threatening to de-obligate these funds adds another complication to HSRA's funding constraints that will more than likely result in litigation.

Additionally, project delays have been widely reported by the press and stakeholders. Specifically, the challenge to meet federal deadlines and completion timelines as specified in the 2018 Business Plan continue to be raised. While HSRA asserts these deadlines will be achieved, a variety of entities including the State Auditor and Peer Review Group have indicated successfully meeting construction deadlines will be very difficult.

On the other hand, while the abovementioned challenges do in fact exists, the project's socio-economic benefits cannot be ignored. To date, the project has created over 2,600 well-paying skilled labor jobs in the Central Valley. HSRA currently implements a successful small business program where now over 480 small businesses have benefited from the project, including 159 disadvantage business enterprises and 53 disabled veteran business enterprises. Furthermore, 115 of the participating small business are located in disadvantaged communities. To date, the three construction packages have resulted in $254 million paid to small businesses. Ultimately, this translates into approximately between $6.8 to 7.6 billion in economic output in the Central Valley since construction has commenced. Lastly, HSRA commitment to sustainability and making environmental improvements in the Central Valley is noticeable. HSRA has completed over 1,100 acres of agriculture conservation, including 554 acres of unique farmland, preserved more than 2,000 acres of natural habitat, and awarded grants to California Urban Forests Council (CAUFC) and Tree Fresno to plant over 550 trees in Fresno and Los Angeles.

At this hearing, the committee will have the opportunity to receive an update on the project's progress from various stakeholders and at the same time, inquire about the project's next steps and financial stability.