



March 3, 2017

Jeff Morales
Chief Executive Officer
California High-Speed Rail Authority
770 L Street, Suite 620
Sacramento, CA 95814

Central Valley Segment Funding Plan

Dear Mr. Morales:

In 2008, California voters approved \$9.9 billion in bond funding for high-speed rail with the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century (Proposition 1A). Under Proposition 1A, as outlined in Streets and Highways Code Section 2704.08(d), the Director of Finance must review a funding plan for each corridor or segment to determine if "the plan is likely to be successfully implemented" prior to the Authority's expenditure of Prop 1A bonds for construction under that plan.

The High-Speed Rail Authority submitted a funding plan for the Central Valley segment of the system to the Department of Finance on January 3, 2017. Proposition 1A requires that an independent consultant prepare a report assessing each funding plan. Finance has received and reviewed the independent consultant's report on the Central Valley funding plan. Finance also received and reviewed comments by the Joint Legislative Budget Committee, other legislators, the Legislative Analyst's Office, the Legislature's California High-Speed Rail Peer Review Group, and the Community Coalition on High-Speed Rail. Finally, Finance received and reviewed the Authority's response to the Legislative Analyst's Office's analysis of the plan, which attached the independent consultant's supplemental report evaluating projections of revenue and operating profit/loss.

Requirements under the Funding Plan

Proposition 1A requires the Authority to submit a funding plan that specifies the usable segment, estimates segment construction costs, identifies funding sources, provides a report on projected ridership and operating revenue, describes changes since the preliminary 2011 funding plan, and outlines contract terms. These elements are reviewed below.

Usable Segment and Construction Costs

The Central Valley funding plan identifies the usable segment as from the Madera Amtrak station to Poplar Avenue in Shafter, including two high-speed rail stations at Fresno and Kings/Tulare. As for estimated construction costs, the plan indicates that this segment is estimated to cost \$7.8 billion. This amount includes \$6.7 billion for right-of-way acquisition, utility relocations and civil works construction and \$1.1 billion for electrification of the segment.

The Authority performs ongoing complex risk analyses to identify, manage and mitigate risks to the project. Specifically, the Authority models the various risks to determine their probability, analyzes the results of these models, and implements various risk mitigation strategies to manage the identified risks.

Under the terms of the federal grant agreements, the Authority submits quarterly funding plans for the Central Valley segment to the Federal Railroad Administration (FRA) for review and approval. The FRA reviews, assesses and approves the Authority's quarterly funding plans in the course of its duties as a grant manager of the federal funds in this plan. Additionally, in the process of managing the grant, the FRA performs routine reviews and analysis of the funding plans and other project information. The Authority manages the project and its associated risks by relying on contract terms, in-depth expenditures, and other information to ensure that the project stays on schedule and on budget. Recently an internal FRA risk update was released that included potentially different levels of cost risk for the Central Valley segment. This risk update was part of the FRA's ongoing high-level grant management process with the Authority that did not reflect the level and specificity covered by the quarterly funding plans. The Authority has not found the magnitude of cost or schedule risk as was indicated in the FRA risk update in its more detailed ongoing risk analyses. Further, the independent consultant's review of this plan indicated the cost estimates and contingencies in this plan are reasonable and found:

"the cost estimates for the Central Valley segment, including the allowances for contingency, to be adequate . . . and the funding to be sufficient to pay for those capital costs, even under a less favorable scenario than what the Authority assumes."

Funding Sources

The Plan for this segment identifies the amount, source, and estimated time of receipt for all construction funding. The plan indicates it will utilize \$3 billion in federal funds, \$2.6 billion in Proposition 1A bonds and \$2.2 billion of Cap and Trade auction proceeds to construct the segment.

As is the case with almost all major infrastructure projects, all of the intended funding is not yet in hand in the early stages of construction. However, the Legislature has already appropriated the full \$7.8 billion in funding. Consequently, there will be no delays in spending the funds once received. Upon the approval of this plan and the sale of state bonds, the Authority will have spent or have in hand more than two-thirds of the necessary funding.

- The federal funds identified for this segment are assured through two grant contracts between the Authority and the Federal Railroad Administration. As of December 2016, the Authority had spent over \$2.2 billion of the \$3 billion in federal funds programmed for this segment.
- Proposition 1A funds are required to be used for the high-speed rail system, and the \$2.6 billion will be available for expenditure upon approval of the funding plan and sale of the bonds.
- A total of \$1.2 billion in Cap and Trade auction proceeds has been appropriated to the Authority as of December 31, 2016. The Authority has expended \$259 million of this amount—including \$154 million on the Central Valley segment—as of December 31, 2016. The Authority therefore has an additional \$941 million in Cap and Trade funds to allocate to the Central Valley segment. The Authority's 2016 Business Plan has estimated \$500 million in future receipts annually from Cap and Trade. As the Department of Finance noted in the 2017-18 Governor's Budget Summary, Cap and Trade auctions

have experienced significant volatility over the past year, at least partially due to perceived legal uncertainties about the program's future beyond 2020. To address this, the Governor has proposed urgency legislation to confirm authority for the program beyond 2020.

The civil works portion of the Central Valley segment will be completed at an estimated cost of \$6.7 billion. With the federal and Proposition 1A funds, the Authority's already existing \$941 million Cap and Trade allocation will be sufficient to cover the majority of civil works costs, so that the Authority would only need \$5 million in future Cap and Trade proceeds to complete the civil works portion of the project. The remaining \$1.1 billion in construction costs are related to electrification and associated improvements, which may be completed as funding becomes available. Regardless of the pace of future Cap and Trade auctions, therefore, it is reasonable to assume that the Authority will have the remaining \$1.1 billion in Cap and Trade funds by the time it is needed to complete electrification of the segment and associated improvements.

Ridership and Operating Revenue

The funding plan notes that the Authority could allow the Amtrak San Joaquin service to use this segment, which would reduce overall run times and improve the attractiveness of its service. The independent consultant concluded that this segment "could accommodate the San Joaquin service" and that this "will not result in any unreimbursed operating or maintenance cost to the Authority." The Authority's 2011 funding plan and 2016 Business Plan also indicated the Authority's rail service will not require a subsidy.

In response to requests for additional analysis, the independent consultant prepared a supplemental report evaluating the Authority's projections of revenue and operating profit/loss for the funding plan. This report confirms the Authority's conclusion that the planned level of service on the Valley to Valley line is likely to be sufficient to operate without a subsidy after an initial start-up period.

Changes from the 2011 Funding Plan

The Central Valley funding plan is consistent with the Authority's 2016 Business Plan. The Authority lists the changes since the 2011 funding plan, including the prioritization of the completion of the northern segment, the addition of Cap and Trade funding, updated construction costs, and the inclusion of electrification in this segment.

Contract Terms

The funding plan includes a summary of the terms and conditions for the federal funding grant and construction agreements for this segment, as well as an overview of the Authority's approach to future contracts for the delivery of rail infrastructure and train operations.

Risk Management

In the funding plan, the Authority discusses the risks associated with this segment in the plan and outlines the risk management program they will utilize to monitor and mitigate these risks. The independent consultant reviewed the plan, identified risks, and offered strategies to address these risks. Additionally, the consultant concluded that:

"the Authority has a well-developed risk management process that includes industry standard risk identification, quantification and assessment procedures for the work elements that are in construction and ready for procurement."

Conclusion

Any transportation infrastructure project of this magnitude involves major risks—including possible funding shortfalls, cost overruns, and engineering challenges. The risks associated with this project are no different. The voters of California, the Governor, and the Legislature weighed those risks and chose to proceed with the project given its vast potential to address California's future transportation demands, increase the supply of affordable housing accessible to the state's job centers, reduce transportation's impact on the environment and address climate change, and spur the economies of disadvantaged communities. The specific risks associated with successfully completing the Central Valley segment are more limited because the bulk of funding is nearly in hand, and much work has already been completed.

The Authority has indicated it will continue to monitor risks to the project overall and the segment identified in the plan in its biennial Business Plans and Project Update Reports. Additionally, Proposition 1A requires the Authority to promptly update the Administration and Legislature when events occur that could endanger the completion of the segment outlined in the plan and provide options to address these challenges.

The Department of Finance will continue to monitor the Authority's management of the risks in the construction segment outlined in the plan by various means, such as:

- Regular review of project costs and progress through monthly Authority Board meetings, Public Works Board meetings, and Quarterly Federal Funding Contribution Plans.
- Review and monitoring of funding through quarterly Cap and Trade auction results, biannual bond sales, and the annual budget development process.
- The Authority's ongoing risk management process which includes continuous updates of cost analysis models for review by the Authority Board's Finance and Audit Committee.

Consequently, after thorough review, I find that the Central Valley funding plan submitted by the Authority is likely to be successfully implemented as proposed. The Authority may therefore enter into commitments to expend bond funds and accept offered commitments from private parties in support of the Central Valley segment.

Sincerely,



MICHAEL COHEN
Director