Funding Review of the Merced-to-Bakersfield Segment

New Federal Grants Will Not Likely Be Sufficient to Resolve a Fast-Approaching, Multi-Billion-Dollar Funding Gap

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OFFICE OF THE INSPECTOR GENERAL
CALIFORNIA HIGH-SPEED RAIL

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The Governor of California
President pro Tempore of the Senate
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State Capitol
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Dear Governor and Legislative Leaders:

The Office of the Inspector General, California High-Speed Rail initiated the following review of current and potential funding for the Merced-to-Bakersfield segment (M-B segment) of the California High-Speed Rail project because of the issue's importance to the project's immediate future. The California High-Speed Rail Authority (Authority) is facing a funding gap of roughly $6.5 billion for the M-B segment, which it intends to fill in large part with federal grant funds. However, based on the evidence we reviewed, we believe it is unlikely that the Authority will secure enough grant funding in time to keep the M-B segment on its current schedule. Although no one can precisely predict the outcomes of efforts to secure future federal grants, and although we would be pleased to see the Authority's federal fundraising goals fully realized, state lawmakers need the clearest and most realistic view of funding prospects that current information allows. Having analyzed that information, we conclude that even if it has additional success in obtaining federal grant funds, the Authority will still likely be facing a significant, fast-approaching funding gap for the M-B segment.

We are concerned that the Authority has not fully communicated the urgency of the funding situation, which it estimates will begin impacting the M-B segment schedule between January and June 2026. Without the necessary funding, delays to the schedule and to the subsequent benefits the M-B segment is intended to provide are highly likely. Extensive delays would also likely increase segment construction costs beyond current estimates. This review is therefore part of our statutory mandate to provide independent assessments of the project's funding situation as well as practical information about the challenges and opportunities involved therein. Given the urgent and likely sizeable funding need, we believe the Authority and policymakers—in order to avoid delays in the M-B segment schedule and additional risks to its cost—should work collaboratively to identify and analyze solutions, such as low-cost federal loans that could help meet near-term funding needs, but which may require legislative changes to the project's revenue sources. As indicated in its responses, the Authority has agreed to implement our recommendations and thereby provide policymakers with the information needed for critical upcoming decisions regarding the M-B segment of the project.

Introduction

In 2022, the Legislature and Governor directed the California High-Speed Rail Authority (Authority) to prioritize completing the 171-mile high-speed rail corridor in the Central Valley, connecting Merced to Bakersfield (M-B segment). Extending the rail line into downtown Merced and Bakersfield beyond the 119 miles currently under construction in the Central Valley is expected to improve access to other transportation services, including providing direct connections in Merced to conventional rail lines to the Bay Area and Sacramento. In addition to environmental benefits associated with anticipated traffic reductions, a finished M-B segment will demonstrate to state and federal stakeholders the Authority's ability to successfully undertake new and highly technical construction and operational tasks, such as designing and laying track and systems and ultimately running high-speed service. Thus, the completed segment will also serve as a steppingstone toward the broader high-speed system connecting San Francisco to Los Angeles. The Authority's current project schedule is for the M-B segment to begin operation between 2030 and 2033 at a total estimated cost of between $32 and $35 billion. However, as Table 1 shows, funding for approximately $8.8 billion of these costs has not been secured. Further, much of the needed funding must be secured within the next two years if the M-B segment is to be completed on schedule.

An estimated $2.3 billion of the $8.8 billion in total costs shown in Table 1 will be funded with future appropriations from California's Cap-and-Trade program revenues, 25 percent of which state law directs to the high-speed rail project. However, to complete the M-B segment the Authority will need to fill a sizeable remaining funding gap, which we estimate to be about $6.5 billion. Figure 1 shows the cost of the M-B segment as well as the segment's current funding and its estimated range of future Cap-and-Trade revenues through 2030, which is the last authorized year for the Cap-and-Trade program. Our analysis, discussed in more detail below, aligns with guidance from the federal government regarding cost estimates and therefore uses the higher end of the estimated cost range, $35.3 billion. With total funding of $28.8 billion, the Authority faces a funding gap of roughly $6.5 billion to complete the M-B segment. The ultimate funding gap could be less than or greater than this estimate depending on future actual costs and revenues.

The Authority is endeavoring to fill most of the M-B funding gap with federal grants. In 2021, Congress passed the federal Bipartisan Infrastructure Law (BIL), which—according to the Federal Transportation Administration—authorized up to $108 billion for public transportation projects. The Authority has since identified nine BIL-funded grant programs to target and, in recent years, has been awarded $3.3 billion in funding. Nearly all of this amount—roughly $3.1 billion—came from one grant program, the Federal-State Partnership for Intercity Passenger Rail-National (FSP-National). This $3.3 billion is included in the funding that Figure 1 shows. The Authority stated in its 2024 Business Plan that it will continue to pursue funding from the FSP-National program in future grant cycles and from other BIL programs or other ongoing federal funding sources as necessary.

Table 1. Major Elements of the M-B Segment Remain Unfunded and the Dates by Which to Fund the Most Significant Costs Are Fast Approaching

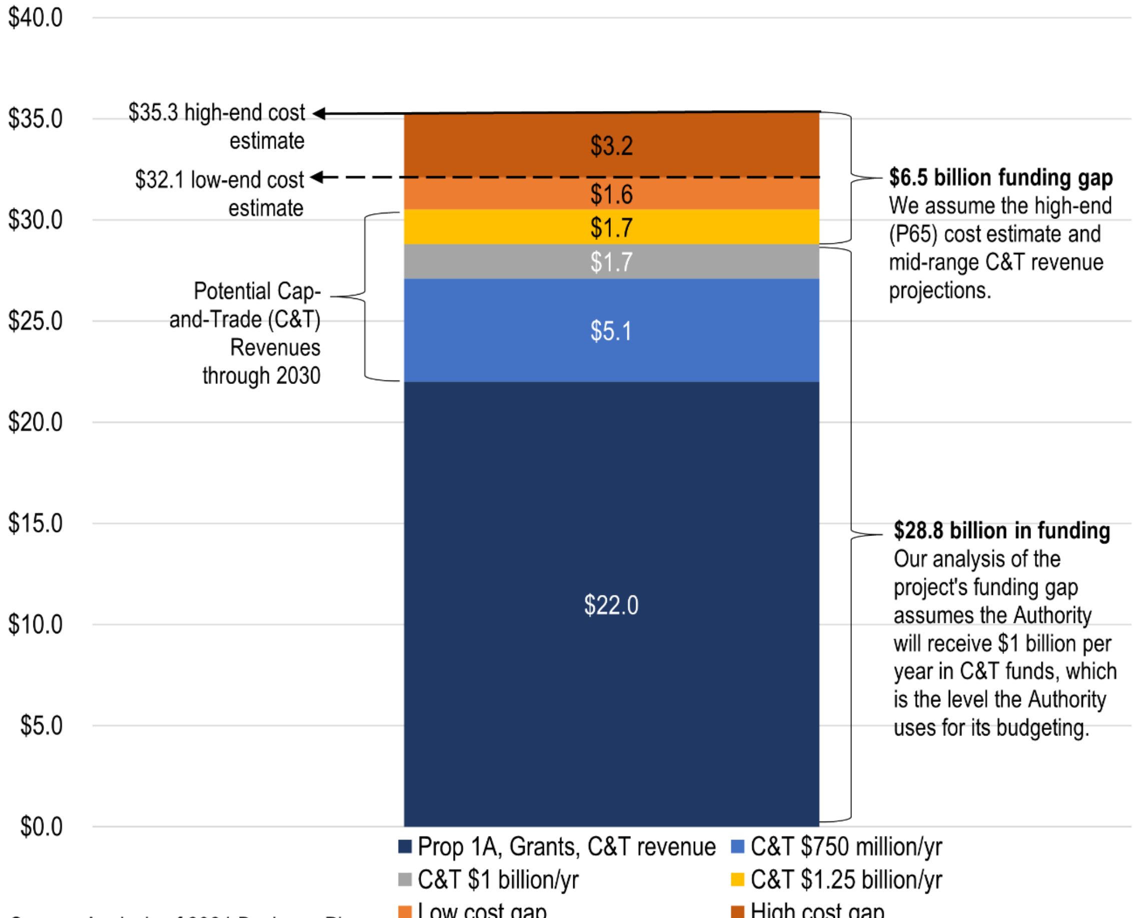
Unfunded Elements of the M-B Segment	Estimated Cost ($ in Billions)	Critical Dates by Which to Secure Funding
Merced Extension Construction 119-Mile Section Second Track	$3.7 $1.4	January – March 2026
Bakersfield Extension Construction[1]	$1.4	April – June 2026
Kings/Tulare Station Construction Merced Station Construction Bakersfield Station Construction	$0.3 $0.3 $0.4	July – September 2027
Merced Extension Track and Systems	$1.1	January – March 2029
Bakersfield Extension Track and Systems[1]	$0.2	October – December 2029
Total Cost	**$8.8**[2]	

Source: Analysis of Table 3.3 of the 2024 Business Plan.

[1] Construction and track and systems costs for the Bakersfield extension are for remaining unfunded work not covered by the Authority's 2023 federal grant awards.

[2] Although the Authority has not yet secured funding for the total cost shown, the Authority's revenue estimates and program baseline budget indicate that about $2.3 billion will be available from future Cap-and-Trade appropriations to potentially cover some of these costs and thereby reduce unfunded costs to $6.5 billion.

Figure 1. The Cost of the M-B Segment Exceeds Current Funding Sources



Source: Analysis of 2024 Business Plan.

The Authority Must Secure Billions in Funding in the Next Two Years to Remain on Schedule

The availability of funding in the next two years will have a critical impact on the Authority's ability to complete the M-B segment by 2030 to 2033 as scheduled. In response to a recommendation we made during our review of its 2023 Project Update Report, the Authority has determined that to best ensure it can meet the latter end of that timeframe it must secure funding for certain elements of the segment in the near future—between January and June 2026. Specifically, the Authority reported in its 2024 Business Plan that it needs funding by that time for the second track on the 119-mile portion of the M-B segment that is currently under construction, as well as for building the extensions of the segment into Merced and Bakersfield that are currently being designed. We discuss how the Authority determined these dates later in this report.

Not only is the need for funding fast approaching, but the amounts for the most immediate needs are significant. The Authority's estimated total cost for constructing the currently unfunded second track and extensions is $6.5 billion, which also happens to be the overall funding gap for the M-B segment as described earlier. This numerical coincidence highlights the fact that the Authority faces the challenge of filling most of the funding gap within the next two years and with only limited known resources. Specifically, most of the future revenue the Authority estimates it will receive from Cap-and-Trade appropriations will not be available by June 2026. Therefore, identifying and securing sufficient new funding is critical to addressing the project's needs. Table 2 shows the dates by which the Authority must secure full funding for the cost of the currently unfunded elements of the M-B segment. It also presents the amount of grant funding we estimate the Authority may receive and the Cap-and-Trade revenues it may have available for the M-B segment. As the table demonstrates, even if the Authority receives awards from the federal grant programs to which it plans to apply, our analysis estimates that in fiscal year 2025-26 the Authority will still need more than $4 billion in additional funding, with additional funding needs being significantly less in subsequent fiscal years.

Insufficient funding for these elements of the segment would limit the Authority's ability to begin work on them. A remaining funding gap could also delay subsequent work that depends on the completion of those elements. For example, the Authority cannot install track and systems on the Merced and Bakersfield extensions until the infrastructure for those extensions is built. Given the amount of funding needed and the rapidly approaching deadlines the Authority has identified, the remaining funding gap poses a near-immediate threat to the project schedule and increases the likelihood that high-speed rail operations will not begin as currently scheduled.

Table 2. Insufficient Funding Poses an Immediate Threat to the M-B Segment Schedule

	Critical Timing to Secure Funding (July-to-June fiscal year)				
($ in Billions)	**2025-26**	**2026-27**	**2027-28**	**2028-29**	**2029-30**
Cost of Unfunded Elements of the M-B Segment[1]	$3.7 Merced extension		$0.3 Kings/Tulare station	$1.1 Merced track and systems	$0.2 Bakersfield track and systems
	$1.4 Second track		$0.3 Merced station		
	$1.4 Bakersfield extension		$0.4 Bakersfield station		
Cost Subtotal	*$6.5*	-	*$1.0*	*$1.1*	*$0.2*
Estimated Federal Grant Award Funding[2]	$1.9	$0.3	Not estimated[3]	Not estimated	Not estimated
Estimated Cap-and-Trade Revenue[4]	$0.5	$0.5	$0.5	$0.5	$0.3
Yearly Unfunded Cost (Surplus)	$4.1	($0.8)	$0.5	$0.6	($0.1)

Source: Analysis of Table 3.3 of the 2024 Business Plan, federal grant funding opportunities, and Cap-and-Trade funding.

[1] The Authority indicated in Table 3.3 of the 2024 Business Plan that the cost of these elements of work would be funded with federal grant awards matched by state dollars. Table 3.3 did not identify the source of the state funds, but the Authority receives revenue from Cap-and-Trade appropriations that it could use to fund a portion of the costs shown.
[2] These numbers represent our estimate of how much federal grant funding the Authority may receive from federal fiscal year funding opportunities in 2024, 2025, and 2026. We describe our methodology in the next section of the report.
[3] We did not estimate federal grant opportunities past federal fiscal year 2026 because the BIL's five-year authorization period currently ends in 2026.
[4] These numbers reflect a potential distribution of the amount of Cap-and-Trade revenue that may be available specifically for unfunded elements of the M-B segment, as opposed to other project costs. The amounts we present are consistent with the Authority's budget estimates and represent a subset of the total $1 billion in annual Cap-and-Trade revenue it expects to receive. Given a Cap-and-Trade program expiration date of December 31, 2030, the Authority could receive and/or commit some of the funding in fiscal year 2030-31 after the period shown.

It Is Unlikely That the Authority Will Receive All the Funding It Needs Through Federal Grants

Current funding availability and past trends in its grant applications strongly indicate that the Authority will not be able to use federal grants alone to cover critical M-B segment costs within the next two years as needed. The Authority's assessment of its prospects of receiving grant funding have been optimistic—perhaps overly so considering the size of the estimated $6.5 billion funding gap facing the program in fiscal year 2025-26. State law requires the Authority to report in its business plans on its level of confidence in receiving federal funding, among other potential funding sources. As part of our review of the 2024 Business Plan, we expressed our concern that the information the Authority provided in that plan could give stakeholders more comfort than was warranted about the prospect of receiving federal funding in time to keep the M-B segment on schedule. For instance, the business plan presented a table listing the federal grant programs the Authority was targeting and the amount Congress had appropriated for each, which was billions of dollars for most of the programs. However, the business plan did not specify the amount of funding that had already been awarded from those programs, effectively reducing the total available to future applicants—an issue we discuss in detail below.

Additionally, although the federal grant programs still had billions of dollars available to award at the time of the business plan, the number of applicants, caps on award sizes, and other factors generally limit the size of awards the Authority could realistically expect from upcoming funding opportunities. For example, the BIL appropriated $7.5 billion for the Rebuilding American Infrastructure with Sustainability and Equity (RAISE) grant program, but individual RAISE grants have been capped at $25 million for each of the past four funding cycles. Thus, appropriated amounts alone, such as those in the business plan, are not accurate indicators of how much the Authority might realistically receive from a specific grant program. Instead, those totals may present an overly optimistic outlook about overall funding prospects. In our published evaluation of the 2024 Business Plan, we reiterated the need for a realistic assessment of the size and timing of a funding gap that might threaten the M-B segment schedule.

During this review, we again asked the Authority about its federal funding strategy and shared our estimate that, as discussed in the previous section and shown in Table 2, the M-B segment could well be facing a significant shortfall in the next two years. In response, the Authority provided us an updated analysis of federal grant funding opportunities. This analysis indicates that it expects to receive about $4.7 billion, enough to cover the majority of the funding gap. However, although ideally the Authority will enjoy that level of funding success, the details of its analysis did not resolve our concerns and instead highlighted the following issues:

1. The Authority is likely overly optimistic about the total amount of available grant funding and thus overestimates the amount it will receive for individual awards.

2. The Authority's analysis assumes it will receive every grant for which it applies, which has not been the case historically.

We acknowledge that there is uncertainty regarding the amount of federal grant funding the Authority will ultimately receive. Even so, to determine the potential size of a funding gap the Authority may be facing at critical points in the M-B segment schedule, we evaluated evidence from recent years' grant activities and used that evidence to better assess the risk that the Authority's federal grant funding goals will not be fully realized. Taking that approach, and as Table 2 shows, we estimated that the Authority could potentially receive about $2.2 billion in grants from 2024 through 2026—an amount significantly less than the cost of portions of the M-B segment that need funding during that same timeframe.

Our review of congressional actions in recent years indicates that the Authority's estimate of the future amount of available grant funding is likely overly optimistic. The federal government has already awarded significant amounts of existing funding for key grant programs; the FSP-National program, for example, has already announced awards for the majority of the total $12 billion the Authority identified in the 2024 Business Plan. Therefore, the likelihood of large future awards depends in part on whether Congress will appropriate more funding to those programs in the coming two years. When analyzing its funding prospects for future years, the Authority generally assumed that Congress will appropriate the maximum additional funding allowable under the BIL for these grant programs in both fiscal years 2025 and 2026. However, this assumption is likely unrealistic because Congress has not taken such action to date. Instead, it has appropriated significantly smaller amounts and, in several cases, has not appropriated any additional funds. Therefore, to arrive at the estimates shown in Table 2, we used an average of the additional amounts Congress has appropriated for each program in previous years. Using these data resulted in a considerably lower amount of available future funding than the Authority assumed in its analysis.

In part because we estimated a lower amount of available funding, our analysis projects smaller potential grant awards compared to the Authority's analysis. Using our estimates of available funding for each individual grant program, we multiplied that dollar amount by the percentage of available funding the Authority either applied for or received from that program during prior grant cycles. For example, if Congress does not appropriate a greater amount of additional FSP-National funding than it has previously, on average, and if the Authority were to successfully secure the same proportion of available FSP-National grant funding as it did in 2023, we estimated that the Authority would receive about $857 million in additional funding from that program. For its part, the Authority's analysis indicates $2.5 billion in additional FSP-National funding. We acknowledge that the federal government could decide to award the Authority a larger share of the remaining funds from any program than it has in the past, but it could also award a lower relative amount.

Finally, the Authority's analysis also indicates it believes that it will receive every grant for which it has applied going forward. The Authority told us it has a high confidence level regarding its grant applications, although that confidence level is based on the current national political climate, which could change moving forward. In terms of receiving funding from the FSP-National program specifically, the Authority believes the Federal Railroad Administration (FRA) has demonstrated a commitment to the high-speed rail project. To support this assertion, the Authority noted that the FRA awarded a higher amount than the Authority had applied for in its 2023 FSP-National grant. However, since completing its analysis, the Authority has been notified that it did not receive a $236 million National Infrastructure Project Assistance grant for which it applied this year. We adjusted our estimate to account for this development, and although our estimate assumes the Authority will receive the other grants for which it is applying in 2024, such a rate of success is not guaranteed. Indeed, although we commend the Authority for taking an inclusive approach and applying under a wide range of programs, as Table 3 shows, it has not received all the grants for which it applied. The table also shows that the FSP-National grant was by far the most significant award the Authority has received in recent years. Awarded amounts from other grant programs have been much smaller in comparison, even cumulatively, and therefore are unlikely to suffice in the event the Authority does not receive another multi-billion-dollar award from the FSP-National program. Collectively, these facts further underscore the importance of identifying and preparing to secure alternative sources of funding now.

Neither our analysis nor the Authority's attempted to estimate potential grant awards after 2026. The BIL's current five-year authorization period ends in that year, making it additionally difficult to determine the potential amounts of grant funding that will be available thereafter. Congress could reauthorize the BIL with new funding, pass entirely new legislation aimed at funding rail infrastructure, or appropriate significant amounts for individual grant programs, but the likelihood of these actions is uncertain and not informed by any evidence we identified. Further, as we emphasize throughout this report, the majority of the funding needed to give the Authority the best chance of completing the M-B segment within its current schedule must arrive before the end of 2026.

Recommendation

To better inform state lawmakers and other stakeholders about funding-related risks to the M-B segment schedule, the Authority should strengthen its presentation of federal funding prospects in its 2025 Project Update Report and subsequent annual reports. The presentation should discuss the following information:

1. Current remaining funding for targeted grant programs;
2. Relevant limits on grant award sizes for the prospective programs;
3. The Authority's assumptions about the availability of additional future funding being approved by the federal government; and,
4. Based on the above, more detailed discussion of its prospects for receiving adequate grant funding, including a range of possible dollar amounts and timeframes.

To the extent the Authority has reason to believe that publishing certain information about specific grant programs or applications would hurt its prospects of receiving federal funding, it should nonetheless ensure its underlying analysis accounts for that information.

Authority's response

The Authority agrees with the recommendation to continue to refine information on program funding, including the size, status, outlook, and timing for federal grant awards. The 2025 Project Update Report will include further updates.

Table 3. The Authority's Recent Grant Applications Have Not All Been Successful

Grant Program	Year Applied	Applied ($ in millions)	Awarded ($ in millions)
Federal-State Partnership for Intercity Passenger Rail Grants-National (FSP-National)	2023	$2,825	**$3,074**
Multimodal Project Discretionary Grant Opportunity (MPDG)[1]	2021	$36	$0
	2022	$1,045	$0
	2023	$232	$0
	2024	$236	$0
Consolidated Rail Infrastructure and Safety Improvements (CRISI)	2021	$10	$0
	2022	$233	$202
Reconnecting Communities and Neighborhoods (RCP)	2023	$203	$0
Railroad Crossing Elimination (RCE)	2022	$67	$0
Grid Resilience and Innovation Partnerships (GRIP)	2023	$54	$0
	2024	$60	$0
Rebuilding American Infrastructure With Sustainability and Equity (RAISE)	2021	$25	$24
	2022	$25	$25
	2023	$25	$20
	2024	$16	$0
Wildlife Crossings Pilot Program (WCPP)	2023	$2	$0
Totals[2]		**$5,094**	**$3,345**

Received total requested funding
Received partial requested funding
Received no funding

Source: Analysis of grant applications, executed grant agreements, and other grant documentation. Amounts rounded.

[1] The MPDG combines three grant programs into one notice of funding opportunity: (1) the National Infrastructure Project Assistance program (Mega), the Nationally Significant Multimodal Freight and Highway Projects program (INFRA), and the Rural Surface Transportation Grant program. In 2021, prior to the BIL passage, the Authority applied only to the INFRA program. In 2022, the Authority submitted a combined application to all three programs. In 2023 and 2024, the Authority applied only to the Mega program.

[2] In 2023, the Authority received a $500,000 Corridor Identification grant. We did not include this grant in the table because of its relatively small amount.

The Authority Has Not Fully Communicated the Urgency of the Funding Situation

Despite the uncertainty of federal grant funding, the Authority has not sufficiently conveyed the extent to which additional sources of funds might be necessary in the near term to keep the M-B segment on schedule. Instead, in its 2024 Business Plan the Authority expressed that its level of confidence for continued federal grant awards remained high (though it also stated its belief that upcoming federal election results will likely have an impact on funding). In addition to stating the Authority would continue to seek $4.7 billion in additional funding from the FSP-National program and other BIL-funded programs, the business plan stated that anything not achieved through the BIL would be pursued through other ongoing federal funding. Although the business plan included a statement recommending that the Legislature address the stabilization of state funding in the 2025-26 session, that statement was focused on the expiration of the Cap-and-Trade program and did not attempt to quantify the amount of new funds state lawmakers and other stakeholders may need to identify.

The Authority also did not report in the 2024 Business Plan when it would need funding to complete the M-B segment by the target date of 2030. We previously recommended that the Authority identify and provide state lawmakers with funding timelines to meet the planned M-B schedule, and we emphasized in our assessment of the business plan that such a presentation should include dates relevant to both the 2030 and 2033 ends of its current schedule envelope. Instead of identifying specific dates to meet the 2030 target, however, the Authority simply asserted that obtaining all funding immediately was optimal, leaving unclear whether state lawmakers had a window of opportunity to facilitate the completion of the segment by 2030.

The Authority did present reasonable dates by which to secure funding and complete the segment by 2033, but it has not provided lawmakers with the latest possible dates for doing so. As part of this review, we determined that the critical funding dates the Authority identified in Table 3.3 of the 2024 Business Plan included time for schedule risk—that is, additional time beyond the current baseline schedule's estimates of how long each segment element will take to complete. This additional time, referred to as *contingency*, resulted in the Authority's critical dates being roughly one to two years sooner than the official project schedule indicates would be the latest possible funding deadlines for a 2033 completion. The use of a schedule contingency is an accepted industry best practice and allows the Authority to encounter some delays and stay within a target range of completion dates. Therefore, it may be reasonable that the Authority would want to secure funding no later than the dates it published. However, for all the above reasons, those dates do not technically represent the full range of time the Legislature has to consider identifying potential funding solutions for the M-B segment to be complete by 2033.

The longer it takes to identify and secure funding, the greater the risk of delays that could push the completion of the segment past 2033. According to the "building-block" project management approach that the Authority described in the 2024 Business Plan, work on remaining elements of the

M-B segment will not begin until funding for a given element is in place. As we described above, it is likely that any delays to the construction of the extensions due to insufficient funding would have a ripple effect on subsequent track and systems work and would jeopardize the goal to initiate high-speed rail operations as currently scheduled.

Schedule delays would likely also increase costs. First, all else equal, delays on individual elements of the segment would almost certainly result in higher costs for those elements because of inflation over time. Second, delays could require additional work and therefore increase other, non-construction costs. For example, the Authority explained that schedule delays lead to additional costs for maintaining and securing vacant properties and Authority assets during construction and that the longer the project takes, the longer the Authority will also need to contract for other ongoing program delivery support and related consulting services. The Authority's total cost estimates for the M-B segment should technically account for construction-related inflationary cost increases caused by delays up to the end of the schedule envelope in 2033 because those estimates are intended to generally account for risks to the segment's construction, including a certain amount of delays. However, costs from such delays would leave less margin for covering other potential risks, such as the cost of change orders that may be required if conditions encountered during construction vary from those reflected in the segment's designs. Further, by logical extension, inflation costs resulting from construction delays past 2033 would not be accounted for in the Authority's current cost estimates and could therefore increase the size of the funding gap.

The Authority will almost certainly need additional funding in the next two years and could need legislative action to secure it, but the Authority cannot effectively advocate for a solution to a problem it has not fully defined. Without specific information from the Authority about when it needs to fund various elements of work to complete the segment by 2030, the Legislature cannot effectively consider a funding plan that would support that more aggressive end of the schedule goal. Similarly, without context about the schedule contingency that is currently included in the Authority's critical dates to meet 2033, the Legislature cannot consider the full range of time during which funding decisions could keep the segment within the established schedule envelope.

Although identifying funding solutions for the project in the next two years is a responsibility that goes beyond the Authority itself, the Authority does need to provide the Legislature an accurate assessment of its funding needs. The ability of lawmakers and other stakeholders to address the funding situation depends on more complete information from the Authority, which decisionmakers could consider alongside other various priorities and budgetary considerations facing the State. Providing an up-to-date, accurate assessment is also important because the timing and amount of needed funding that the Authority identified in the 2024 Business Plan could change as a result of multiple factors facing the project. These factors include the outcomes of the Authority's current and planned federal grant applications; updates to the project schedule that the Authority has said it will publish in the upcoming 2025 Project Update Report; and changes that the Authority may make to its cost estimates as it continues to move ahead with elements of the M-B segment, including the designs of the Merced and Bakersfield extensions. Therefore, although the 2024 Business Plan represented progress implementing our recommendation to improve the specificity of its funding plan, the Authority has a responsibility to provide lawmakers with more complete information about its funding needs.

Recommendation

To ensure that state lawmakers have complete and accurate information about the amount of needed funding and the timing by which state funding decisions could enable the M-B segment to stay on schedule, in the 2025 Project Update Report the Authority should update its funding plan with information about when and how much funding it would need to meet the earliest and latest dates for completing the M-B segment according to the most current schedule envelope. To the extent the Authority includes dates that account for its schedule contingency, it should disclose and explain those considerations.

Authority's response

The Authority agrees with the recommendation to improve the 2025 Project Update Report with information about when and how much funding it would need to meet the earliest and latest dates for completing the M-B segment.

The Authority Should Determine the Feasibility of Federal Loan Programs as Part of a Broader Funding Strategy

For the reasons we have described, it is unlikely that the Authority's federal grant strategy alone will result in enough revenue to keep the M-B segment on schedule. The Authority has previously identified an option that could help finance remaining project costs—low-interest federal loans. However, the Authority told us it cannot pursue those loans until the Legislature makes changes to the project's revenue stream. Even so, we conclude that the Authority has not yet gathered sufficient information to determine the feasibility of pursuing loans—information that the Legislature may need as part of considering alternative funding options.

In its 2022 and 2024 business plans, the Authority identified two federal loan programs that could benefit the project. In doing so, it noted that loans would allow future revenue to fund near-term capital investments. Such financing could therefore help the Authority maintain its construction schedule. For example, in the event of a persistent funding gap, loans could supplement other revenues, including grants, to fund elements of the M-B segment on time instead of delaying work until sufficient funds from Cap-and-Trade appropriations accumulate or new federal funding opportunities arise in later years. However, the Authority told us it cannot currently pursue federal loans because the project's revenue is not sufficient to ensure future repayment. According to the Authority, to make loans possible the State would need to establish a permanent and reliable project revenue stream with certain other characteristics, such as a minimum funding guarantee, that would demonstrate the Authority's creditworthiness to federal lenders. The 2024 Business Plan suggested that one possible approach to stabilizing state funding would be to extend the Cap-and-Trade program through 2050 and exchange a portion of the project's funding from that program with other state funding. It further recommended that the Legislature address the stabilization of state funding in its 2025-26 session.

Despite that recommendation, the Authority has not yet obtained sufficient information regarding the feasibility of federal loan programs should the Legislature wish to consider changing the project's current funding structure. In 2022, the Authority described its intention to develop a new funding strategy, informed in part by its evaluation of new and existing federal funding and financing programs. The Authority told us that it had conversations with federal lenders to learn more about federal loan program requirements but paused further analysis of this option because, based on those initial discussions, it understood that federal loan financing was not economically viable due to risks associated with existing Cap-and-Trade funding, and because loan financing was more expensive than the pay-as-you-go approach it has thus far used on the project. Instead, the Authority indicated that it has focused its efforts on the development of federal grant applications, which it believed would be more promising and would not result in unnecessary interest costs being diverted from the project.

Even so, with the significant funding gap threatening to delay the M-B segment schedule, the Authority agrees that it is time to further evaluate the feasibility of federal loans. To do so, the Authority will need to gather and analyze additional information to determine the specific requirements, costs, and benefits of participating in the federal loan programs referenced in the business plans. For example, the Authority had previously identified potential interest rates between 4 and 6 percent based on market conditions it reviewed; however, the Authority had not determined that these are the likely interest rates it would experience under the federal loan programs. In fact, our review of interest rates published within the last two years for one of the federal loan programs in question found that the lower 4 percent rate appeared more realistic. Perhaps most significantly, the Authority has not determined the amount of revenue that would be required to participate in the loan programs, in part because it has not determined a likely loan amount. As a result, it also has not determined whether a Cap-and-Trade extension through 2050 would provide sufficient revenue for purposes of repaying likely loan amounts. Instead, it based the 2050 timeline in the business plan on a target year for state climate goals.

Attempting to answer these questions through further consultation with federal lenders would increase certainty and allow the Authority to demonstrate whether the types of revenue changes outlined in the business plan are necessary and would be sufficient to make participation in federal loan programs feasible. Furthermore, the Authority now has information it can use to consult with federal lenders about particular financing scenarios. Specifically, the Authority has identified the dates by which it believes it needs to fund the remaining unfunded elements of the M-B segment, and our office has estimated the size of the funding gap that may remain when those dates arrive. Consulting with federal lenders now could help answer questions about the timing, cost, and revenue needs of incorporating federal loans into the funding strategy for the M-B segment—all of which may be prerequisites for well-informed legislative decisions about changes to the project's current funding. The results of such a consultation could provide the Legislature with a realistic assessment of whether and how federal loan programs could help close the increasingly urgent M-B segment funding gap.

Recommendations

To determine whether federal loan programs could be effective in helping close the M-B segment funding gap, the Authority should obtain consultations with federal lenders for the federal loan programs identified in the business plan. Those consultations should consider a range of potential loan amounts based on the unfunded M-B segment costs that could remain depending on the outcomes of the Authority's federal grant applications.

To provide state lawmakers with better information about the feasibility of loans, the Authority should report to the Legislature in the 2025 Project Update Report the results of its consultations, including the anticipated timeframe and interest costs for potential loan amounts and the project benefits, such as schedule milestones, such loans could help secure. As part of that report, the Authority should describe any changes to the project's current state funding that lenders indicate would be necessary to qualify.

Authority's response

The Authority agrees to have continued conversations at the federal level to determine what minimum future revenue steam requirements would be needed for entrance into the Railroad Rehabilitation and Improvement Financing and Transportation Infrastructure Finance and Innovation Act federal loan programs and will discuss potential financing for a range of possible loan amounts based on unfunded M-B segment costs.

The Authority agrees with the recommendation to improve the 2025 Project Update Report with consultation results that help state lawmakers better understand the feasibility of federal loans.

Appendix

Scope and Methodology

The objective of this review was to assess federal and state funding options and their likelihood of filling the remaining funding gap for the M-B segment in time to keep the project on schedule. We performed the review during the period of July through October 2024. The three review objectives were as follows:

1) Evaluate the Authority's efforts to obtain federal grants and the likelihood that federal grants will be received in time and in sufficient quantity to stay on schedule;

2) Determine the likelihood and timing of the Authority's need for state funds to complete the M-B segment on schedule and the impact—in time and cost—of any unresolved funding gap, and;

3) Describe alternative strategies that the Legislature could consider should funding not be secured for the M-B segment as currently planned.

We performed the following to address the objectives:

1. Reviewed the Authority's cost and funding estimates to identify the amount of the M-B funding gap.
2. Identified and reviewed the Authority's applications for federal grants from 2019 through September 2024.
3. Reviewed information about the Authority's target grant programs, including funding opportunity amounts, award cycles, and limits on award sizes.
4. Using the above information, estimated the amount the Authority may receive from its target federal grant programs through 2026.
5. Reviewed the analysis the Authority performed to determine the critical dates to secure funding.
6. Using the information above and the Authority's information about additional funding that could be available from future Cap-and-Trade appropriations, identified the amount and timing of the Authority's likely need for additional state funds to keep the M-B segment on schedule.
7. Interviewed Authority personnel about the potential cost and schedule impacts of an unresolved funding gap.
8. Conducted interviews and reviewed documentation to identify the extent of the Authority's efforts to determine the feasibility of participating in federal loan programs described in the Authority's business plans.
9. Reviewed the basis of assumptions in the financing scenario in the 2024 Business Plan to determine whether the assumptions appeared realistic for federal loan programs.

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The Office of the Inspector General receives and investigates complaints or information from any person concerning the existence of an activity related to the high-speed rail project constituting:

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- Gross waste of funds.
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