

AGENDA

**JOINT HEARING
ASSEMBLY BUDGET SUBCOMMITTEE NO. 3
ON CLIMATE CRISIS, RESOURCES, ENERGY, AND TRANSPORTATION
AND
ASSEMBLY TRANSPORTATION COMMITTEE**

**ASSEMBLYMEMBER STEVE BENNETT, CHAIR
ASSEMBLYMEMBER LAURA FRIEDMAN, CHAIR**

**WEDNESDAY, APRIL 12, 2023
9:30 A.M. – SWING SPACE, ROOM 1100**

INFORMATIONAL HEARING

California High-Speed Rail Authority's 2023 Project Update Report

- I. Welcome and Opening Remarks**
- II. California High-Speed Rail Authority's 2023 Project Update Report**
 - Helen Kerstein, Principal Fiscal and Policy Analyst, Legislative Analyst's Office
 - Louis S. Thompson, Chair, California High-Speed Rail Peer Review Group
 - Brian P. Kelly, Chief Executive Officer (CEO), California High-Speed Rail Authority and Brian Annis, Chief Financial Officer, California High-Speed Rail Authority
- III. Member Questions and Comments**
- IV. Public Comment**
- V. Closing Remarks**

Public Comment

The public may attend this hearing in person or participate by phone. This hearing can be viewed via live stream on the Assembly's website at <https://assembly.ca.gov/todaysevents>.

We encourage the public to provide written testimony before the hearing. Please send your written testimony to: BudgetSub3@asm.ca.gov. Please note that any written testimony submitted to the committee is considered public comment and may be read into the record or reprinted.

*A moderated telephone line will be available to assist with public participation. The public may provide comment by calling the following toll-free number: **877-692-8957 / Access Code: 185 01 100.***

2665 CALIFORNIA HIGH-SPEED RAIL AUTHORITY

ISSUE 1: CALIFORNIA HIGH-SPEED RAIL AUTHORITY’S 2023 PROJECT UPDATE REPORT

The California High-Speed Rail Authority’s (HSRA) 2023 Project Update Report (PUR) provides updates on cost, schedules, agreements, and milestones related to the 119-mile construction segment and the 171-mile Merced to Bakersfield early operating segment.

As feared, the update reflects that project costs have grown significantly due to high inflation, change orders, and changes to the project scope. As a result, HSRA may not have enough funding to complete the 119-mile segment that is intended to operate as a test track. Moreover, the project is dependent on the receipt of billions in federal grants and even with those additional funds HSRA likely will not have enough funding to complete the 171-mile operational segment from Merced to Bakersfield.

BACKGROUND

Introduction

The HSRA—an independent authority consisting of a nine-member board appointed by the Legislature and Governor—is responsible for planning and constructing an intercity high-speed train system that would link the state’s major population centers. State law requires HSRA to prepare a project update report every odd-numbered year that provides information about the planned high-speed rail system.

This paper summarizes the overall progress of the project, key aspects of the project update report, and considerations for the Legislature.

Project Background

Chapter 796 of 1996 (SB 1420, Kopp) established HSRA to plan and construct a high-speed rail system that would link the state’s major population centers. In November 2008, voters approved Proposition 1A, which authorized the state to sell \$10 billion in general obligation bonds to partially fund the system, as well as related projects. Proposition 1A also specified certain criteria and conditions that the system must ultimately achieve. For example, the measure requires that the system must be designed to be capable of specified travel times along certain routes, such as nonstop travel from San Francisco to Los Angeles within two hours and forty minutes. The measure also specifies that passenger rail service operated by HSRA, or pursuant to its authority, will not require an operating subsidy.

The Legislature took additional actions last year as part of the 2021-22 budget package and appropriated all of the remaining Proposition 1A bond funds—\$4.2 billion—for the project. The package included SB 198 (Committee on Budget and Fiscal Review), Chapter 71, Statutes of 2022 that specified the following:

- Legislative intent to (1) prioritize funding for planning and construction of the Merced-to-Bakersfield segment until the segment is completed, and (2) complete Phase 1 of the project, which extends from San Francisco to Anaheim.
- Prohibiting HSRA from entering into new commitments of Greenhouse Gas Reduction Funds (GGRF, also known as cap-and-trade funds) outside of the Merced-to-Bakersfield segment, except as specified. This prohibition is in effect until the Merced-to-Bakersfield segment is fully funded or through June 30, 2030, whichever occurs sooner.
- Limiting the use of the \$4.2 billion Proposition 1A appropriation to the Merced-to-Bakersfield segment. Additionally, the language conditions \$2.2 billion of the \$4.2 billion appropriation to be available only after submission of a specified report and notification to the Governor and Legislature.
- Establishing an independent HSRA Office of the Inspector General (OIG) with various authorities and responsibilities. (The budget also provides up to \$2 million in 2022-23 from the Public Transportation Account to the OIG.)
- Requiring HSRA to notify the chairpersons of the relevant committees of both houses of the Legislature before submitting a federal grant application and before releasing a request for proposals for certain contracts, such as for acquisition of trainsets.

Key Aspects of the 2023 Project Update Report

This background paper focuses on the 171-mile Merced to Bakersfield segment. This is because this is the part of the project the Legislature, last year, directed HSRA to focus on finishing completing because it has made the greatest investment there and has better odds of possibly completing a portion of rail there. Funding to complete a high-speed rail line from Northern to Southern California as envisioned by Proposition 1A has not been identified.

Cost Estimates Have Grown Significantly Since 2022 Business Plan. Compared to the 2022 Business Plan, the updated estimate to complete the 171-mile segment between Merced and Bakersfield has increased by between \$6.4 billion and \$9.5 billion for a total cost estimate of between \$29.8 and \$35.3 billion. HSRA has not updated construction costs for the project outside of the Central Valley.

The cost increases are largely due to high inflation, expanded project scope and more complete project definition, updated project schedules that extend construction by two years, and increased contingencies.

Ridership Estimates Down. The ridership estimates in the PUR assume for the Merced to Bakersfield corridor hourly bi-directional service for 18 hours per day, seven days a week. In California and across the nation, ridership on public transit is down. This trend is also impacting HSR and as a result its ridership estimates reflect this trend and HSRA

has flattened its ridership projection by 25 percent (2030 forecast) for both the Merced to Bakersfield section and for Phase I.

Need for Additional Funding. HSRA plans to submit multiple federal grant applications over the next five years with a total award target of around \$8 billion. Even with this additional funding there is still likely to be a funding gap of billions of dollars for HSRA to complete the Merced to Bakersfield segment. In addition, connections to Bay Area and Southern California would remain unfunded. The PUR stresses that this project needs stabilized, long-term, funding in order to complete the vision of high-speed rail from Northern to Southern California.

LAO COMMENTS

The LAO provides some key near-term questions for the Legislature to keep in mind:

- *Is the Legislature Still Committed to Merced to Bakersfield?* Chapter 71 expressed the Legislature’s intent to focus on the Merced-to-Bakersfield segment. This approach was based on the information available at that time that suggested that the project had roughly sufficient funds to complete that segment. The Legislature may want to consider the extent to which the updated information in the 2023 PUR—such as the emergence of the multibillion dollar funding gap—affects its intent.
- *What Funding Does the Legislature Want to Use to Fill the Merced-to-Bakersfield Gap?* To the extent the Legislature is still committed to completing the Merced-to-Bakersfield segment, it will likely need to identify billions of dollars of additional funding within the next few years to fill the funding gap. While the Legislature does not need to identify its specific funding plan immediately, at least beginning to formulate its preferred funding approach soon would allow it more time to fully evaluate and weigh the difficult trade-offs associated with each option. Some factors the Legislature will want to consider include:
 - Financial Approach: The Legislature could use cash to pay up front or borrow, such as by seeking voter approval for another general obligation bond, issuing revenue bonds, or pursuing federal financing programs.
 - Fund Source: Examples of potential fund sources for up-front cash or debt service payments include the General Fund, additional GGRF, or truck weight fees (which currently offset General Fund costs associated with repaying transportation-related general obligation bonds). All of these sources come with trade-offs, given other legislative priorities and uses of the funds—particularly in light of the current and forecasted out-year budget problems.
 - Existing or New Revenues: The Legislature could use existing revenues (such as by reducing spending in other areas) or raise new revenues (such as by increasing an existing tax or establishing a new tax).

- *Does the Legislature Agree With the Elements Included in Merced to Bakersfield?* One way to help modestly decrease the size of the funding gap could be to reduce the scope of the project elements included in the Merced-to-Bakersfield segment. Most of the proposed elements—such as two tracks, basic stations, and a combined station at Merced—are important to the functioning of basic, reliable service. However, the Legislature could consider whether certain elements are less critical and could be removed. For example, the 2023 PUR adds \$230 million in costs—\$101 million of which are in Merced to Bakersfield—for a newly proposed solar and battery storage system. Given the funding gap, the Legislature could consider whether it deems this added scope to be critical to the project
- *Does the Legislature Agree With HSRA’s Planned Actions Beyond Merced to Bakersfield?* HSRA indicates that it plans to take various actions related to segments of Phase I beyond Merced to Bakersfield. This includes pursuing federal grants for the design of other segments in Northern and Southern California, such as the grants it intends to submit by April 21, 2023. Additionally, starting in 2025, HSRA indicates it plans to start undertaking activities beyond Merced to Bakersfield, such as right-of-way acquisitions, utility relocations, and agreements with third parties. The Legislature may want to consider whether it is comfortable with HSRA undertaking these activities, particularly in light of the funding gap that has emerged for the Merced-to-Bakersfield segment and the growing funding gap for Phase I. If not, the Legislature could consider strengthening the current statutory limitations to clarify its intentions.
- *Does the Legislature Have Sufficient Information to Inform Its Decisions?* To the extent the Legislature feels it would benefit from additional information and analysis—such as to justify the project’s business case given revised ridership estimates, to gain more confidence in the project’s cost estimates, to better understand which project elements could be removed or modified to reduce costs, or to assess the available funding options—it could consider funding an appropriate third party to develop such information. The Legislature could also consider requesting the IG, once appointed, conduct particular analyses.
- *How Can the Legislature Promote the Effectiveness of the IG in Providing Project Oversight?* The IG has the potential to play a critical role in project oversight, such as by conducting independent, self-initiated audits. Taking legislative steps to ensure the effectiveness of the IG will be important. This could include selecting strong, independent candidates for the position, properly resourcing the new office, and establishing a robust working relationship with the ultimate appointee.

STAFF COMMENTS

Key Considerations for Legislators

The HSR project continues to face many challenges with the key issue continuing to be the lack of adequate funding to complete a meaningful segment that could be used for

passenger travel. The issues below are important for the Legislature to consider as it envisions this project's future.

Funding May Be Inadequate to Complete the 119-mile Test Track. The PUR estimates the cost of the 119-mile segment to be roughly \$20 billion including a second track as required by the Legislature and trainsets to test on the track. HSRA estimates it has \$23.5 to \$25.2 billion in funding for the project. If inflation and project costs remain as projected by HSRA this would be enough to fund the 119-mile segment. However, based on past performance that is highly unlikely. Cost estimates have generally greatly exceeded HSRA's estimates in the past.

The Legislature's independent High-Speed Rail Peer Review Group (PRG) found that "Project costs have risen year after year, and they continue to rise with no clear end in sight." The PRG found that the current contract values for the construction package in the Central Valley and for State Road 99 are 97 percent greater than the original award values, up from an 86 percent increase a year ago. In addition, the PRG finds that the "impact of inflation has been and will continue to be significant." Given that the high rate of inflation is continuing, it is very possible that HSRA has underestimated the growth rate of future inflation. HSRA's PUR used inflation rates of 5.31 percent in 2024, 3.61 percent in 2025; 3.24 percent in 2026; and a rate of 2 percent for 2027-2030. These rates may be overly optimistic in light of the current experience.

Multibillion Dollar Funding Gap for Completion of Merced to Bakersfield. The PUR estimates the cost to complete Merced to Bakersfield to be between \$30 billion and \$35 billion and are likely to be greater give past project cost increases. As mentioned above, currently HSRA estimates the total funding available for the project to be a high of \$25 billion. This leaves a gap of between \$5 billion to \$8 billion that it is anticipating will be filled by federal funding awards it receives.

There is a significant risk that HSRA will not receive the anticipated \$8 billion in federal funds. To receive this amount would assume that California is receiving a much greater share of federal funding than it has historically received from pots of funding that are available nationwide. Moreover, in May 2022, HSRA applied for \$1.3 billion from the fiscal year 2022 federal MEGA (also known as the National Infrastructure Project Assistance program) grant program to fund work in the Central Valley on the 119-mile segment. The funding would have been used to double-track the 119 miles and purchase new, clean, electric train sets capable of speeds in excess of 200 miles per hour. U.S. Department of Transportation rejected the grant request for the bullet train, saying the proposal was not cost effective.

"*The Dilemma*" as highlighted by the PRG, "that the project now poses is that, given the expected cost increases, delays and demand decreases for the Merced to Bakersfield segment, there are few who would argue that completing this section, by itself, at a cost of up to \$35 billion, can be justified. Rather, it would make sense only in the context of a commitment to building the complete Phase 1 system. At the same time, completing the full Phase 1 systems poses a growing financial challenge for the State because the gap

is already large, and costs have been increasing faster than identifiable potential financing while forecast ridership has fallen.”

HSRA Recently Applied for Federal Grants to Advance Work Outside the Central Valley. Last year, the Legislature expressed its intent that the HSRA prioritize the use of available funding available to complete the Merced to Bakersfield segment. SB 198 prohibits HSRA from entering into new funding commitments for activities outside the Merced to Bakersfield segment except in certain circumstances and state cap and trade revenue expenditures for these “additional activities” are capped at \$500 million. In March 2023, HSRA applied for a \$193.6 million federal grant to advance configuration design (a minimum of 30-percent design) of the San Jose to Merced segment and the Bakersfield to Palmdale segment, for a total project cost of \$242 million.

Cap-and-Trade Revenues End in 2030. The Global Warming Solutions Act of 2006, AB 32 (Nuñez), Chapter 488, Statutes of 2006 and subsequent companion legislation SB 32 (Pavley), Chapter 249, Statutes of 2016, requires California to reduce statewide GHG emissions to 40 percent below the 1990 level by 2030. The state’s Cap-and-Trade Program is a key element of California’s climate plan. It sets a statewide limit on sources responsible for 85 percent of California’s greenhouse gas emissions, and establishes a price signal needed to drive long-term investment in cleaner fuels and more efficient use of energy. The program is designed to provide covered entities the flexibility to seek out and implement the lowest cost options to reduce emissions.

The state has historically committed 25 percent of annual Cap-and-Trade auction receipts to the HSR project totaling \$5.5 billion through December 2022 and it is estimated that future revenues could be as much as \$7.7 billion. In several reports and business plans, HSRA has discussed extending cap-and-trade to provide additional revenue for the project. Alternatively, given the uncertainty surrounding the state having enough funding to complete an operational segment from Merced to Bakersfield, after HSRA has more information securing additional federal funding (as early as later this year), it may want to consider if continuing to appropriate 25 percent of cap and trade revenues makes sense. The urgency of the climate crisis continues to make it a high priority for the state to ensure that the use of limited cap-and-trade funds targets activities that are likely to be the most cost-effective at reducing GHG emissions.

Provide Additional Funding or Develop Alternative Uses? The Legislature has faced many and continued difficult choices regarding the high-speed rail project and each time the urgency increases somewhat because the date for when there is no longer any state for federal funding available for the project gets closer. There is a real risk the state could be left with a stranded asset in the Central Valley. The Legislature has options to mitigate that reality. It could increase revenue to provide additional funding for the project. Alternatively, it may be a good time to consider alternative uses for a segment of rail in the Central Valley, at least, until a time in the future when more money might be available to complete a project from Northern to Southern California. The Legislature also may wait for the Inspector General to complete an independent analysis of the 2023 PUR.

Update on the Independent Inspector General. As mentioned above, the 2022 Budget Act established a new independent HSRA Office of the Inspector General (IG) to provide additional, stable, long-term independent oversight of the HSRA project. Specifically the IG is tasked with:

- Commencing with the 2023 PUR conducting independent fiscal estimates and reviews of HSRA's plans and estimates for project advancement and make findings of the reasonableness of those plans and estimates.
- Commencing with the 2023 PUR, monitoring progress towards meeting the milestones toward the implementation of the successful completion of the Merced to Bakersfield segment of the project.
- Conducting audits related to the delivery of the project.
- Identifying best practices in the delivery of capital project and recommend policies to enable the HSRA to adopt these practices when practicable.
- Recommending policies promoting efficiency in the administration of programs and operations as part of any audit findings.
- Reviewing the HSRA's process for considering proposed and executed change orders and to make recommendations to ensure the process is appropriate for determining the merit and reasonableness of change orders.
- Reviewing HSRA's contracts and contracting practices to determine whether they are executed consistent with state and federal laws and providing the state with valued services at reasonable cost.
- Reviewing proposed agreements to ensure they are in the best interest of the state, the HSRA's statutory mission, and state priorities.

This winter, the Joint Legislative Audit Committee (JLAC) conducted a comprehensive search for qualified candidates. The committee received a sufficient number of qualified applicants to move forward and initial interviews will begin in April. JLAC will use the interviews to identify three qualified candidates whose names will be submitted to the Governor. From this list, the Governor will appoint the HSRA Inspector General to a four year term. The 2022 Budget Act included \$1 million in start-up funding for the office, but it is anticipated that as more staff are hired there will be a need for additional ongoing annual funding to support the office's operations.

This item is presented for information only.
