

**An Analysis Of
Local Transit Agencies' Proposals
To Claim High-Speed Rail Monies
For Their Capital Enhancements**

March 7th 2012

THE AUTHORS

Alain C. Enthoven – Marriner S. Eccles Professor of Public and Private Management (emeritus), GSB Stanford; President, Litton Medical Products; Economist, Rand Corporation; President's Award for Distinguished Federal Civilian Service; Fellow American Academy of Arts and Sciences; Founder, Jackson Hole Group (BA Economics, Stanford; Rhodes Scholar–Oxford; PhD Economics, MIT)

William C. Grindley – World Bank; Associate Division Director, SRI International; Founder and CEO, Pacific Strategies, ret. (B Architecture, Clemson; Master of City Planning, MIT)

William H. Warren – Officer, US Navy. Forty years of Silicon Valley finance, sales and consulting experience and management, including CEO of several start-ups, Director/Officer at IBM, ROLM, Centigram, and Memorex (BA Political Science, Stanford; MBA, Stanford)

PUBLICATIONS – All available at www.cc-hsr.org

Major Reports on High Speed Rail by the Authors:

- The Financial Risks of California's Proposed High Speed Rail Project (Oct 2010)
- A Financial Analysis Of The Proposed California High-Speed Rail Project (Jun 2011)
- Revisiting Issues In the October 2010 Financial Risks Report (Sep 2011)
- Twelve Misleading Statements on Finance and Economic Issues in the CHSRA's 2012 Draft Business Plan (January 2012)
- California High-Speed Rail Authority's 2012 Draft Business Plan – Assessment: Still Not Investment Grade (January 2012)

Briefing Papers:

- Dubious Ridership Forecasts (Oct 2010)
- Six Myths Surrounding California's High-Speed Rail Project (Jan 2011)
- Seven Deadly Facts For California's High-Speed Rail Authority (Jan 2011)
- A Train To Nowhere But Bankruptcy (Feb 2011)
- Big Trouble For California's \$66 Billion Train (Mar 2011)
- Will The Train Benefit California's Middle Class? (Apr 2011)

Brief Notes: Twenty-three one page, single subject papers on various aspects of financial issues related to the proposed high-speed rail system, Oct 2010 to present

The Authors appreciate the untold hours spent by many citizens groups and individuals that formed this analysis. However, any fault found in this report is solely the responsibility of the Authors.

Background and Conclusions

Background – Several California agencies and transit operators have raised the notion of using some of the high-speed rail’s legally obligated Federal grants and State Proposition 1A bond monies currently allocated to the California High-Speed Rail Authority (CHSRA) for their use. Such ideas can be found in:

a) A February 9th 2012 staff report from the Orange County Transportation Authority (OCTA) titled ‘MOU with CHSRA, SCRRA, SANDAG, and SCAG and its Member Agencies for the CHSR Project.’ OCTA’s idea is based on complementing what is called a ‘blended approach’ in the CHSRA’s November 2011 Draft 2012 Business Plan “ . . . to leverage existing infrastructure and benefit travelers through greater interconnectivity.”ⁱ

b) A February 14, 2012 presentation by Luis M. Zurinag to the TJPA Citizens Advisory Committee of the SAN FRANCISCO COUNTY TRANSPORTATION AUTHORITY called ‘Fast Start Proposal for DTX and Caltrain Electrification.’ⁱⁱ The author claims this would potentially save the in-progress SF Transbay Terminal investments and introduce high-speed rail to San Francisco and the Peninsula earlier than the forecasted 2034.

c) A Caltrain, staff-prepared presentation called ‘Draft Caltrain Modernization Program: Early Investment Proposal’, dated February 2012, which on page 3 says the transit agency would use “Funding from Proposition 1A and local match”

Three Key Questions – Without debating their merits or demerits, the agencies’ ideas to use monies presently dedicated to high-speed rail must meet three tests to prove their legality and feasibility:

1) Does their idea conform to what Californians approved in 2008 in Proposition 1A for using Prop1A bonds?

2) Does their idea meet the legal intent and strictures of the high-speed rail’s underlying legislation; i.e. AB3034?

3) Does their idea of using high-speed rail funds for public transit agencies’ capital development conform to the contractual-obligations between the DOT/FRA and the State of California?

Conclusions – Four primary conclusions emerge from analyzing the questions posed by the transit agencies idea to use high-speed rail funds for their capital enhancements. They are:

1. None of the existing DOT/FRA grants can be used by rail operating transit agencies without abrogating contracts between the State of California and the DOT/FRA.

1(a) Two times in the last ten months the DOT/FRA has stated that their portion of the high-speed rail funds can only be used in a specific section of California's Central Valley.

1(b) The transit agencies' benefactor in Washington is the Federal Transit Administration; that of high-speed rail being the Federal Railroad Administration. The two are separate and fiercely protect their funding.

2. None of the \$9Billion of Prop1A bonds allocated for high-speed rail can be used for commuter or local rail transit systems since no transit agency operates without a subsidy – and the 'no operating subsidy' clause is a key requirement of AB3034

3. Of the \$950Million approved for Prop1A bonds not strictly intended for high-speed rail construction, only \$760Million can be used for rail enhancement by transit agencies operating commuter or non-intercity rail services. The \$190Million balance is available only for intercity rail.

4. To gain access to the \$760Million, a public transit agency must find equal matching funds, most probably grants, from the Federal Transit Administration (FTA) and/or private capital sources.

4(a) The likelihood of private capital participation with transit agencies attempting to use part or all of the \$760Million is probably zero given the poor financial history of transit agencies.

4(b) The FTA's FY2013 budget does not contain much if any hope for using the FTA's funds as matching funds to gain access to the \$760Million in Prop1A bonds

The prospects seem very dim for California's transit agencies to enhance their rail transit operations using high-speed rail-dedicated Prop1A bonds and Federal-State contracted obligations.

In more general terms, public officials have a public trust to carry out what a law says – even more relevant in voter-approved initiatives. While legal opinions might find a way to accommodate 'repurposing' Prop 1A bonds or even Federal grants to fund local transit enhancement, that's a very slippery slope. What's next: taking school bonds to build stadiums or highway bonds for museums? Any of these may be important public projects, but it is not where or how voters were told their Prop1A tax dollars were to be spent. This type of action is really no different than a classic bait-and-switch. In these days of declining trust in public institutions and political leaders, to change the intent of Prop1A-AB3034 is definitely the wrong way to invest in local rail enhancements.

Discussion Of Question No. 1

Does their idea conform to what Californians approved in 2008 in Proposition 1A for using Prop1A bonds?

The thrust of 2008's Proposition 1A (Prop1A) was to bring California high-speed rail between at least Los Angeles and downtown San Francisco. Ballot descriptions also stated that other destinations would be served, and that the remainder of entire system of six major cities (San Diego, Los Angeles, San Jose, San Francisco, Oakland and Sacramento) would be built when funds became available. The only mention of costs was a 2006 estimate that forecast to build the entire six-city, 800-mile system would cost \$45Billion.ⁱⁱⁱ Nearly 53% of the voters approved issuing up to \$9.95Billion in General Obligation bonds to match other funds to build that system. The thought that the voters were committing to assist transit agencies enhance their capital plant was not central to what proponents claimed in their arguments for support of Prop1A.

Of the two ballot descriptions, using the State's Prop1A bond monies for local transit is only mentioned in the second.^{iv} Of the \$9.95Billion total approved by voters in 2008, only \$950Million is allocated for anything other than building high-speed rail. The final description that voters received clearly limits spending to capital improvements for rail systems, not rail operations:

"The remaining \$950 million in bond funds would be available to fund capital projects that improve other passenger rail systems in order to enhance these systems' capacity, or safety, or allow riders to connect to the high-speed train system. Of the \$950 million, \$190 million is designated to improve the state's intercity rail services. The remaining \$760 million would be used for other passenger rail services including urban and commuter rail."^v

AB3034 clearly sets aside that \$950Million for transit agencies' rail enhancements.^{vi} But one-fifth of that, \$190Million, is clearly for intercity rail as opposed to regional or commuter rail. There is no question whether the balance of \$760Million can be used by the transit agencies that operate regional or commuter rail commuter rail service.

However, according to AB3034, to use that eight percent (\$760Million) of the Prop1A voter-approved funding, a requesting transit agency must match their request with at least equal amounts of Federal and/or private funds.^{vii}

In the later ballot description voters were able to see the formula for the California Transportation Commission (not the CHSRA) to share those funds, if and when the transit agencies demonstrate they have access to matching funds.^{viii} While seemingly complicated, essentially any of the state's transit agencies operating passenger rail systems can apply, further diluting the transit portion of the bond fund's impact. Even when matched equally with

Federal and/or private funds, the resultant \$1.52Billion may not purchase much construction or capital equipment. This is particularly true when divided among possible recipients.

Importantly, all the public transit agencies where high-speed rail will ultimately go qualify can apply to use the \$760Million. That's because the system as envisioned in 2008 was a 'one-shot' LA-to-SF construction project and therefore includes not only the present system's Phase 1 LA/Anaheim to San Francisco sections, including the Central Valley; but also those where voters were told the system they were paying for would go; namely Sacramento, San Diego and Oakland. Each of those cities has rail-based transit. Likewise, any city within the first tranche along the proposed route with any type of rail services could apply. The net effect, even if the \$1.52Billion were to be diluted among only three agencies, would be to render the sums available for enhancement far less than proponents might wish.

Discussion Of Question No. 2

Does their idea meet the legal intent and strictures of the high-speed rail's underlying legislation; i.e. AB3034?

AB3034 is the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century. The legislation, when approved two months later by voters under Prop1A, authorized the sale of \$9.95Billion of General Obligation bonds to plan and build a high-speed rail system connecting Los Angeles with downtown San Francisco.

Less than a tenth of those General Obligation bonds (\$950Million) were set aside for " . . . *other passenger rail lines to provide connectivity to the high-speed train system and for capacity enhancements and safety improvements to those lines.* . . ." ^{ix} Nowhere outside of that clearly circumscribed transit capital allocation is either the intent or purpose of AB3034 said to be for the funding of the transit agencies' capital enhancements. None is to be used for their operations.

As Question No.1 discusses, and Section 2704.095 (a) (1) of AB3034 confirms, only \$760Million can be used for commuter rail; the remainder is dedicated to intercity passenger rail.^x To the extent that the petitioning transit agencies make use of that \$760Million and match it with funds from Federal, private or local sources, they are within the prescriptions of AB3034.

However, Section 2704.095 (a) (1) of AB3034 also says portions of the \$760Million (of the \$950Million) can be used by commuter rail lines; ". . . *that are part of construction of the high-speed train system . . .*" But a key intent of AB3034 was that California's proposed high-speed train be profitable. While the CHSRA has contested the claim that the operator must repay the capital costs, the stricture to pay operating expenses is enshrined in Section 2704 .08 (2) (J) which prohibits an operating subsidy.^{xi} Every California High-Speed Rail Authority business plan has claimed profitable operations for the train.

It's easy to cite Section 2704 .08 (2) (J) to argue that a transit agency planning to enhance its capital plan intended to be part of the high-speed rail system (as do the three in this paper's Background) must prove its is profitable. But none of the California transit agencies proposing to use high-speed rail funds appear to break-even financially. For example, the fare-box revenue ratio of Caltrain, the SF Peninsula rail service, the amount taken in divided by the operating expenses is slightly higher than 40%. Taxpayers subsidize slightly less than 60¢ of every dollar spent on the regional rail service's operations and maintenance, while much if not most of their capital investments are gifts of the people of California and the United States.

To secure the use of some of the \$9Billion of the high-speed rail Prop1A funds, the agency must have access to at least an equivalent amount of federal, state, local or other funds, as the Prop1A high-speed rail funds can not exceed 50% of a project segment. Then the agency must submit a plan to the Legislature that represents at least three facts. First, that the funds are being used for high-speed rail; second, that the operation of the legally defined segment will not require a subsidy; and third, that all of the funds needed to complete that segment are identified, and committed. Measured in the short term, without high-speed rail trains running on the segment, the agency will fail the first and the second requirements. Measured in the longer term, the transit agency would fail the third requirement for funding, because they have no commitment to long term funding today: and may also not meet the second requirement.

Therefore it appears that access to the high-speed rail funds is probably not available under AB3034-Prop1A terms. It also appears that any Federal or private funds used to match part of the \$950Million could only be in the form of grants, as opposed to being loans which create additional debt obligations. None of the proposing agencies will be able to repay market rate debt obligations without increasing their required subsidy. The present non-recourse Federal or State grants donated to them do not require repayment.

Borrowing a mix of Federal, local, and State bond funds (at 6-6.5% interest over 30 years) to build or improve a local transit agency's capital plant without a proven ability to repay the lenders, would be highly risky (given transit agencies' financial history). Additionally, such additional debt would most probably be illegal vis-à-vis repaying market rate bonds issued under Prop1A-AB3034, as per the legislation's clear prohibition against subsidies, if this debt is used in conjunction with any of the \$9Billion of high-speed rail Prop1A funds.

Discussion Of Question No. 3

Does their idea of using high-speed rail funds for public transit agencies' capital development conform to the contractual obligations between the DOT/FRA and the State of California?

The CHSRA submitted proposals for, and was awarded American Recovery and Reinvestment Act (ARRA – aka Stimulus Funds) grants and other funds during 2010 to build the Initial Construction Section in the Central Valley. The Central Valley was probably selected because Article 2 of the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century, under the High-Speed Passenger Train Financing Program, says:

“. . . the authority [is] to give priority in selecting corridors for construction to those corridors that are expected to require the least amount of bond funds as a percentage of total cost of construction, among other considerations.”^{xii}

Subsequently the U.S. Department of Transportation/Federal Railroad Administration (DOT/FRA) and The State of California (represented by the CHSRA) signed several legally binding contracts for the planning and construction of the proposed high-speed rail project.

Attachment 3A of the FRA-CHSRA Grant Agreement of December 2010 is fairly clear about where the DOT/FRA funds will go and when: *“Pending completion of the environmental review, CHSRA would start construction of an initial Central Valley Section from Madera County to Bakersfield (Kern County), CA (hereinafter the “Project”).”^{xiii}* However, to drive home the point, the page following that says:

*“Because the Project is more expensive than any single funding source available, the Project scope is separated into two geographic sections that are integral and interdependent. In combination with each other, they will comprise and describe the entire initial Central Valley Project. **This Agreement covers final design and construction activities between Fresno and Bakersfield (Kern County) funded with \$2.23 billion in ARRA funds awarded through this Agreement.**”^{xiv}* (Emphasis added)

Two administrative reviews over the last ten months strengthened the contract's language. In May 2011, responding to a specific request to start the project somewhere other than the Central Valley, Roy Kienitz, then-US DOT Under Secretary for Policy, interpreted the terms of the contract: *“On the matter of the initial construction segment, we view the Central Valley as the logical place to begin building the core line to connect the San Francisco Bay area with the Los Angeles Basin.”^{xv}*

Under Secretary Kienitz's ruling was reinforced in early January 2012 in a letter from the Deputy Secretary of Transportation, John D. Porcari whose letter to then-CEO van Ark said:

"At the December 15, 2011 hearing . . . there were questions whether Federal funds awarded . . . could be reallocated to other projects in Southern California or the San Francisco Bay Area . . . As our Under Secretary for Policy stated in his letter to you dated May 25, 2011, the decision to begin the project in the Central Valley was and remains the correct one . . ." ^{xvi}

FRA funds have already been allocated to uses that will now not have any short-term high-speed rail applicability – and even questionable 'independent utility'. In January 2010 the FRA allocated \$0.4Billion to build the 'train box' under the San Francisco Transbay Terminal (SFTBT). This was part of the initial \$2.25B FRA grant; although at that time it would have had no benefit to the high-speed rail project until at least 2020. Currently it appears the SFTBT has no benefit to the project until 2034, if it ever does. Now there is less justification for that allocation since high-speed rail might only reach the SFTBT in twenty-two years.

The legal and administrative case that the high-speed rail funds cannot be transferred for use by transit agencies is underscored by another, bureaucratic, impediment. Federal funding for transit agencies comes from the Federal Transit Administration (FTA) not the Federal Railroad Administration (FRA), which funds the California high-speed rail project. While the FRA and FTA are part of the same Department, their goals and constituencies are distinct from each other, the budgets separate, and their 'turf protection' is even fiercer in an era of budget discipline.

It's also unclear what the transit agencies mean by any access to 'other sources' referred to in the Southern California proposal that says: *"The MOU calls for the CHSRA to provide \$1 billion in un-allocated Proposition 1A funds and other sources by 2020 for these candidate projects."* or the San Francisco group's statement: *"Analyze potential alternative funding sources including private investment."* ^{xvii} Private capital's appetite for risk in passenger rail is shown in their abandonment of those investments forty years ago, as well as their three-year absence from any commitment to the high-speed rail project since Prop1A, or for urban transit projects.

Do the agencies expect the FTA to provide the 'other sources' to match the \$760Million that Prop1A provides them? They need to look no further than the President's FY2013 request for the FTA to realize the paucity of that assumption. Of the roughly \$390Million for three urban areas of the CHSRA's Phase 1 project, \$300Million is for projects that are pending or already in construction. ^{xviii} Most of the remainder is for two projects in Los Angeles, with another \$10Million allocated for a Fresno transit project. While the State of California may be another source, depending on the FTA for matching funds doesn't seem to be a good option.

Reference Notes

ⁱ See: Staff Report of the ORANGE COUNTY TRANSPORTATION AUTHORITY called MOU with CHSRA, SCRRA, SANDAG, and SCAG and its Member Agencies for the CHSR Project, dated February 9th 2012 with a transmittal cover by Will Kempton, Executive Director. [Note that Mr. Kempton also holds the position of Chairman of the statutorily created Peer Review Group for the California high-speed rail project.]

ⁱⁱ See: A February 14, 2012 presentation by Luis M. Zurinag to the TJPA Citizens Advisory Committee of the SAN FRANCISCO COUNTY TRANSPORTATION AUTHORITY called 'Fast Start Proposal for DTX and Caltrain Electrification.'

ⁱⁱⁱ See page 5 of <http://www.voterguide.sos.ca.gov/past/2008/general/pdf-guide/suppl-complete-guide.pdf>

^{iv} The first issued Official Voter Information Guide of August 28, 2008, says: "*Routes linking downtown stations in SAN DIEGO, LOS ANGELES, FRESNO, SAN JOSE, SAN FRANCISCO, and SACRAMENTO, with stops in communities in between.*" See:

<http://www.voterguide.sos.ca.gov/past/2008/general/argu-rebut/argu-rebutt1a.htm>. Issued on 18 September 2008, the second, fifteen page ballot description can be found at:

<http://www.voterguide.sos.ca.gov/past/2008/general/pdf-guide/suppl-complete-guide.pdf>

^v See page 5 of: <http://www.voterguide.sos.ca.gov/past/2008/general/pdf-guide/suppl-complete-guide.pdf>

^{vi} This is articulated in Section 2704.095. (a) (1) which says: "*Net proceeds received from the sale of nine hundred fifty million dollars (\$950,000,000) principal amount of bonds authorized by this chapter shall be allocated to eligible recipients for capital improvements to intercity and commuter rail lines and urban rail systems that provide direct connectivity to the high-speed train system and its facilities, or that are part of the construction of the high-speed train system as that system is described in subdivision (b) of Section 2704.04, or that provide capacity enhancements and safety improvements.*" and again in (d) which says "*Funds allocated pursuant to this section shall be used to pay or reimburse the costs of projects to provide or improve connectivity with the high-speed train system or for the rehabilitation or modernization of, or safety improvements to, tracks utilized for public passenger rail service, signals, structures, facilities, and rolling stock.*"

^{vii} See AB3034, Section (3)(f)(a) which says; "*(f) In order to be eligible for funding under this section, an eligible recipient under paragraph (3) of subdivision (a) shall provide matching funds in an amount not less than the total amount allocated to the recipient under this section.*"

^{viii} See pg. 12: <http://www.voterguide.sos.ca.gov/past/2008/general/pdf-guide/suppl-complete-guide.pdf> : Sections 2704.095 (3) and (4)

^{ix} See: AB 3034 Assembly Bill – CHAPTERED found at http://www.leginfo.ca.gov/pub/07-08/bill/asm/ab_3001-3050/ab_3034_bill_20080826_chaptered.html

^x AB3034, Section 2704.08 (2) (D) says: "the planned passenger train service to be provided by the authority, or pursuant to its authority, will not require operating subsidy"

^{xi} One AB3034 defining phrase that demands the operator repay capital costs is Article 2 of the High-Speed Passenger Train Financing Program 2704.04. 2 (b) (5) which says: "*Revenues of the authority, generated by operations of the high-speed train system **above and beyond operating and maintenance costs and financing obligations, including, but not limited to, support of revenue bonds**, as determined by the authority, shall be used for construction, expansion, improvement, replacement, and rehabilitation of the high-speed train system.*" Operating costs cannot be subsidized as per Section 2704 .08 (2) (J) which says: "(J) The planned passenger service by the authority in the corridor or usable segment thereof will not require a local, state, or federal operating subsidy.

^{xii} See AB3034 Section 2704 08 (2)(K)(f) found on page 11 of the second of the official ballot descriptions. See: <http://www.voterguide.sos.ca.gov/past/2008/general/pdf-guide/suppl-complete-guide.pdf>

^{xiii} While there were other, similar DOT/FRA contracts with the CHSRA, this one was covers more than two thirds of the contractually obligated funds and their use. See: Attachment 3A, Statement

of Work (December 2010) called the Initial Central Valley Section: Fresno to Bakersfield (Kern County) of the California High-Speed Train Program. For the specific reference, see page 48 of the 'thumbnails' in a PDF file described as [FRA Grant/Cooperative Agreement for ARRA Funding \(\\$2.27B - FR-HSR-0009-10-01-01\)](#) 12/22/2010 and found at <http://www.cahighspeedrail.ca.gov/funding.aspx>

^{xiv} Ibid. See page 49 of the 'thumbnails'

^{xv} See: page 2 of a letter dated May 25 2011 to then-CHSRA CEO Roelof van Ark from the Under Secretary for Policy of the U.S Department of Transportation, Roy Kienitz.

^{xvi} See: January 3 2012 letter from the Deputy Secretary of Transportation, John D. Porcari, to then-CHSRA CEO Roelof van Ark.

^{xvii} The Southern California reference is found on page 3 in the Staff Report of the ORANGE COUNTY TRANSPORTATION AUTHORITY called [MOU with CHSRA, SCRRA, SANDAG, and SCAG and its Member Agencies for the CHSR Project](#), dated February 9th 2012 with a transmittal cover by Will Kempton, Executive Director. The San Francisco quote is from page 21 of A February 14, 2012 presentation by Luis M. Zurinag to the TJPA Citizens Advisory Committee of the SAN FRANCISCO COUNTY TRANSPORTATION AUTHORITY called 'Fast Start Proposal for DTX and Caltrain Electrification.'

^{xviii} See: U.S. Department of Transportation: Budget Highlights; Fiscal Year 2013, pages 29-32. Found at

<http://www.google.com/search?q=us%20department%20of%20transportation%20budget%20highlights%20fiscal%20year%202013&ie=utf-8&oe=utf-8&aq=t&rls=org.mozilla:en-US:official&client=firefox-a&source=hp&channel=np>