ON THE CHSRA'S ESTIMATED OPERATING EXPENSES
Brief Note #12 – June 27th 2011

From the authors of *The Financial Risks Of California's Proposed High-Speed Rail Project* and six Briefing Papers. Available at http://www.cc-hsr.org/

Finding: Realistic operating margins depend on realistic operating expenses.[1]

Background: The litmus test of the CHSRA's ability to attract $38-54Billion of private capital will be the perceived reasonableness of both aspects of their projected operating margin (or operating surplus) – the ability to gather estimated revenues and pay operating expenses to create a long-term stream of positive operating margins and therefore a Return On Investment (ROI) for investors. This Note addresses the reasonableness of CHSRA's assumptions about operating expenses.

After reviewing the Authority's 2009 Business Plan, two separate authors pointed out:

"Investors in new businesses expect to be presented with detailed line item operating statements on a quarterly basis for five years forward and annual statements for subsequent years." [2] None were presented in either the 2008 or 2009 Business Plans.

The CHSRA's 2009 contained *"no risk management strategy . . . murkily noting that "the risk would be mitigated by policies that continue to draw people to reside in California and encourage high-speed rail as an alternative mode of transportation."* [3]

"There is not one word in this section of the document (CHSRA's 2009 Report) *that acknowledges fixed versus variable operating costs"*[4]

Page 80 of the 2009 Report says that in the first *". . . 13 years, operating costs are projected to be essentially flat."* Mr. Bushell responds that before allowing for inflation; *"Assuming that all costs from 2023 through 2035 will be almost constant . . . and all have the same average rate of inflation runs counter to past experience. Medical insurance and fuel will be major cost items for a system such as this . . . no business operator has been able to successfully contain these"*

The 2009 Report (Page 81,Table I) says that insurance costs are zero, but page 82 says: "Insurance is assumed to be handled by the Authority and the state in the initial phase through an owner-controlled program (OCIP)." Mr. Bushell responds: *"This business has assets that will need to be insured, even if self insured; and there are costs associated with that which need to be revealed."*

In response to Table J (page 82) of CHSRA's 2009 Report, Mr. Bushell said: "*It is surprising that despite forecasting fifteen consecutive years of substantial operating surpluses there is no discussion of any tax provision with respect to such surpluses."*

Conclusions: The 2009 Plan's operating expenses bear little resemblance to the quality of an investment-grade document the private sector will demand for due diligence work and further postpones, if not negates, the possibility of raising $38-$54Billion.

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[1] This paper is largely based on Alan Bushell's analysis of pages 64-91 of the CHSRA's 2009 Report to the Legislature and page 70 of the Addendum of April 8, 2010. Mr. Bushell has over twenty years of starting, restarting, rescuing and running companies. His work appears as Appendix C to The Financial Risks of California's Proposed High-Speed Rail Project; October 2010, found at http://www.cc-hsr.org/

[2] Ibid: Bushell, pg. 2

[3] Julian, Liam: The Trouble with High-Speed Rail; *Policy Review; March 24th 2010; at* http://www.hoover.org/publications/policy-review/article/5296 s

[4] Op. cit – Bushell, pg. 1