

ON PHASE ONE'S COSTS, MARGINS AND ACCUMULATED DEBT OVER SIXTEEN YEARS

Brief Note # 16 – August 5th 2011

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

Finding: Repayment of the proposed Phase One construction costs exceeds the most likely operating margins, creating a serious burden for the State and taxpayers.

Background: A financial comparison of the 2009 Business Plan and the early 2011 estimates for Phase One shows two important changes over the past two years: 1) construction costs increased over 50%; and 2) the decreasing availability of 'free' Federal money. These changes create annual debt repayment requirements that nearly always exceed the estimated Operating Margins (revenue less operating expenses) between 2020 and 2035. **The State would be forced to pay or guarantee (subsidize) the debt servicing for construction costs under any plausible operating scenario.**

(A) The 100% Operating Margin Case -

The **2009 column** shows that if the annual debt servicing for \$43Billion of construction was \$1.8Billion, and the train's operations achieved the \$2.4Billion Annual Average Operating Margin the CHSRA asserted, the construction debt could be serviced in year one, and \$9Billion of cash accumulated for extensions.³ As the **2011 column** shows those results disappear if Federal grants don't exceed the current \$3Billion and construction costs \$66Billion (or more). [See note (a) in Figure for this estimate's validation.]

(B) The Some Operating Margin Case -

If the average fall-off of riders, ticket prices, and costs over the train's first sixteen years (2020-2035) is **only 25% less** than CHSRA's 2009 Plan, the annual cash shortfall for a \$43Billion construction bill would be \$0.9Billion, **adding \$15Billion to the State's debt**. Assume the **2011 costs** of \$66B, and the State (aka taxpayers) would have to provide \$3.7Billion yearly to service the debt. That accumulates to a negative **\$58Billion by 2035**.

(C) The No Operating Margin Case -

Assuming \$66Billion cost to build, if the train's revenues only equal operating costs, the annual shortfall of cash is \$4.6Billion only to service the construction debt; accumulating to a negative **\$74Billion by 2035**.

Conclusions: Now that \$43Billion for Phase One construction is highly improbable, and the prospects for additional Federal grants have greatly diminished, the reality is a \$66Billion construction bill that will have a cumulative **negative cash flow of somewhere between (\$35) Billion to (\$74) Billion by 2035**. This must be paid out of General Funds via additional taxes, or a reduction in other spending areas, such as education, public safety, and highway transportation. Since predicting long term future Operating Results is problematic, **the decision to proceed to build Phase One would exhibit a willingness to accept very negative financial results.**

ANALYSIS OF BUILDING, FINANCING & OPERATING PHASE ONE		
Construction In \$Billions Of Phase One (LA-SF)		
	2009	2011
Cost To Build Phase One	\$43B*	\$66B**
Less Federal Grants	\$18B*	\$3B**
Debt Required	\$25B	\$63B
Less Prop1A Bonds	\$9B*	\$9B*
Construction Debt (Private or Public)	\$16B	\$54B
Annual Debt Servicing Requirement¹	(\$1.8B)	(\$4.6B)
Impacts On Taxpayer's Of Phase One Cash Flows (2020-2035) (Cases based on the Average Annual Operating Margin in 2009 Operating Plan)		
(A) 100% of Operating Margin Case* 100% of Plan ² (ridership, ticket prices, and costs)	\$2.4B	\$2.4B
Annual Cash Excess (or Shortfall)	\$0.6B	(\$2.2B)
Cumulative Cash Flow by 2035	\$9.0B	(\$35B)
(B) Some Operating Margin Case** 75% of Plan (ridership, ticket prices, and costs)	\$0.9B	\$0.9B
Annual Cash Shortfall	(\$0.9B)	(\$3.7B)
Cumulative Negative Cash Flow by 2035	(\$15B)	(\$58B)
(C) No Operating Margin Case** (for example, 50% ridership, 70% of ticket prices 75% of operating costs in 2009 Plan)	\$0.0B	\$0.0B
Annual Cash Shortfall	(\$1.8B)	(\$4.6B)
Cumulative Negative Cash Flow by 2035	(\$29B)	(\$74B)

* HSRA Report To The Legislature; December 2009; page 93; Funding Sources Summary
 ** See: The Financial Analysis of the Proposed CHSR Project, June 2011, pgs. 8, 9, 14 at www.cc-hsr.org. The (a) CHSRA's August, 2011 Central Valley EIR has an average cost per mile, which when converted to YOY \$s, equals the cost per mile for these segments, as in Financial Analysis, in Exhibit 1. CHSRA's construction costs for Phase One, in the expected October 2011 Business Plan, should now be very close to the estimated \$66B.

¹ An all debt, versus debt and equity formula is used as debt is cheaper to the State than equity. Debt is assumed to be serviced at 6% over 30 years.
² HSRA Report To The Legislature; December 2009; page 83, "Table K, Net Surplus", averaged over 2020 to 2035
³ AB3034 states that the annual operating margins are to be used for expansion of the system to Oakland, Sacramento, Riverside and San Diego.