

Overview of Revenue Guarantee Finance Plan

October 20, 2011

In the transportation budget trailer bill ([AB 115](#)), the Legislature made 50% of the California High Speed Rail Authority's budget contingent on providing responses to a number of questions and concerns. The Authority issued a number of documents to the Legislature on October 14th, 2011 to comply with the law. We have posted the documents on our website:

[Revenue guarantees and alternative funding plans](#)
[Feasibility of "shared track" solution in the Bay Area](#)
[Bakersfield to LA Communications Plan](#)

These documents offer strong hints as to what the Authority's long awaited 2011 Business Plan will contain.

Bottom line: The Federal government will need to provide significant funds and everything rides on ridership.

Here is a synopsis of what was released:

- **Public money will fund the initial operating segment to the Central Valley**
The State will use the Proposition 1A bond money, as well as hoped for federal funds, to complete an Initial Operating Segment (IOS) between the Central Valley and somewhere either in the Los Angeles Basin or in the Bay Area (San Jose), with possible connector service to Metrolink and Caltrain. The cost of the IOS is not specified in the documents released.
- **The Authority will hope for plain vanilla Federal grants but will consider more exotic flavors of Federal funding**
The Authority will look at many different Federal programs for financial support. One idea mentioned is for the Federal government to implement legislation that would allow [qualified tax credit bonds](#) (QTCB) for infrastructure. With tax credit bonds, the State or some other entity can borrow the money and the Federal government takes care of the interest. Depending on the maturity of the bonds, the interest portion can be worth more than 70% of the value of the bonds. It should be noted that the [one program currently being considered](#) would allow [California to issue only \\$1 billion worth of such bonds](#). This would be equivalent to a grant of \$700 million or so.
- **No private money is expected until after the system is operational**

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The Authority has gotten the message loud and clear that until there are trains up and running with lots of passengers on them, there will not be significant private funding available. They note: “...the Authority has determined that attracting private capital investment prior to proving revenue operations without some form of revenue guarantee would be extremely expensive, if it was possible. This represents a different approach than was contemplated in the 2009 Business Plan and the April 2010 Addendum.”ⁱ

- **If the Federal government doesn’t give any more money, there is no project.**
“It would not appear practical to obtain the necessary funds to ‘match’ the State’s \$9 billion in voter-approved bonds, rendering impractical the ability to use the full \$9 billion of the voter-authorized state general obligation bonds. Under these circumstances, the completion of an Initial Operating Segment (i.e., an operating section that would generate net operating profits) would not appear practical, based on the Authority’s knowledge of the capital costs of various portions of the system, and the anticipated operating performance of such portions of the system.”ⁱⁱ

“Plan B” would go into effect. The tracks would be used to improve the existing Amtrak San Joaquin service to offer improved travel times.

- **The Authority will initially remain in charge of operations**
Unlike high speed rail around the world where the eventual operator is a partner in system design, the Authority will only bring in a private operator to provide short-term contract services for the Initial Operating Segment (presumably in the way Caltrain and Metrolink work now). They explain: *“This approach would involve relatively short-term contracts to serve the state until stable operations of the IOS are reached and longer-term concession or other similar contracts can be implemented together with private investment.”ⁱⁱⁱ*
- **Initial Operating Segment service is assumed to be profitable from year 1.**
The Authority indicates that the operator hired with the short-term contract services will be paid with project revenues forecast as *“more than sufficient to pay the compensation owed to the operator.”^{iv}* The business plan will include: *“ridership revenue projections and operations and maintenance expense projections for three different ridership demand scenarios – high, medium, and low – and the variables that are common and distinct between them... “these projections have demonstrated that the resulting anticipated net operating profit (ridership revenues less operating and maintenance costs) at each phase of passenger service operations is expected to be sufficient to avoid the need for any operating subsidy or other form of revenue guarantee. The projections arising out of each ridership demand scenario show net*

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operating profits starting in the first year of operations. These projections take into account an anticipated five-year ramp-up of ridership and revenue.”^v

CARRD anxiously awaits the public release of the full ridership model along with the data inputs used as the basis for the business plan.

- **Blended service in the Bay Area will be pursued if legal hurdles can be overcome.**
The Authority also responded to Legislators’ questions about a blended system by saying that it could work, but they are still awaiting an opinion from the Attorney General on whether it would comply with Prop 1A.

The **draft** business plan is due to be released November 1, 2011 with a final version due sometime in January 2012. Stakeholders will have an opportunity to offer comments and feedback on the draft. Some of CARRD’s preliminary questions are:

Is plan B the only plan B?

Should the possibility of limited federal funds influence how spend the \$6 billion dollars that is on the table?

Has the plan to use the tracks for San Joaquin service been fully thought through? Who would pick up the tab for maintenance? The existing Amtrak stations would have to move. Is this desirable?

What model is being used to forecast ridership?

The plan relies heavily on high ridership, making the quality of the forecasts critical to its credibility.

The ridership peer review panel hired by the Authority identified a number of shortcomings in the ridership model. We catalogued our concerns [here](#). According to the latest reports we have seen from the Authority, while some aspects of the model have been updated, many of the changes to the model have been put off until next year.

- Have the important changes been made?
- Will the Authority release the model and model inputs so that they can be independently assessed by those not on the Authority's payroll?

Independent forecast?

The presumption has been that someone with skin in the game, such as a private operator, would do their own forecasts, which would reduce the reliance on those produced by the Authority's consultants. As no one is being asked to take ridership risk, there is no one who will

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produce such forecasts. Is there any way to get independent forecasts?

Ridership risk?

The Authority says that they will not need to provide a revenue guarantee to a private operator as the operator will not take any ridership risk. By default, the state of California will be the one taking all the ridership risk. If the initial operating segment is not profitable, where will the money come from to cover shortfalls? Is there risk to state funding of other rail services? Is there any way to find someone to take some of the risk?

ⁱ Page 7 of Revenue Guarantee Finance Plan 2011-10-13

ⁱⁱ Page 12 of Revenue Guarantee Finance Plan 2011-10-13

ⁱⁱⁱ Page 7 of Revenue Guarantee Finance Plan 2011-10-13

^{iv} Page 7 of Revenue Guarantee Finance Plan 2011-10-13

^v Page 8 of Revenue Guarantee Finance Plan 2011-10-13