

California Legislature

Joint Legislative Audit Committee Assembly Transportation Committee

Joint Legislative Oversight Hearing

California High-Speed Rail Authority: Its Flawed Decision Making and Poor Contract Management Have Contributed to Billions in Cost Overruns and Delays in the System's Construction

Thursday, November 29, 2018

Background Paper

Introduction and Purpose

The purpose of today's hearing is to review the California State Auditor's Report on Costs and Contracting Practices for the California High-Speed Rail Authority (Authority). This audit was requested by Senator Beall (D-San Jose), and Assemblymembers Joaquin Arambula (D-Fresno) and Jim Patterson (R-Fresno). The request, approved by the Joint Legislative Audit Committee in January 2018, asked the Auditor to examine the efficacy and efficiency of the Authority's policies and practices as they build the High-Speed Rail Project. The Auditor laid out the scope and objectives for the report as follows:

- Review and evaluate the laws, rules, and regulations significant to the audit objectives.
- Review and assess the Authority's policies, procedures, and processes for managing contracts and containing costs for the project, including its processes for tracking, reviewing, and paying contractor invoices.
- Evaluate the Authority's process for reviewing and approving design-build contract change orders.
- To the extent possible, review and evaluate the Authority's efforts to determine the economic impact the project has had on communities in those areas where construction is under way.

- Determine the extent to which the Authority contracts with small and disadvantaged businesses.
- Review the Authority's sustainability policy and assess its compliance with the policy. Assess the Authority's efforts to evaluate the economic and environmental outcomes of its policy.
- Determine whether there are opportunities for the Authority to expedite the project and reduce costs through cooperation with other transportation entities, such as other transit or rail lines or through capturing additional value through construction of project facilities.
- Review and assess any other issues that are significant to the audit.

A Brief History of the California High-Speed Rail Project

Development of high-speed rail in California began more than 20 years ago. SB 1420 (Kopp), Chapter 796, Statutes of 1996, created the Authority to develop and implement intercity high-speed rail service fully coordinated with other public transportation services. The Authority reports to the California State Transportation Agency, and is governed by an eleven-member Board of Directors. The Governor appoints five members of the board, the Senate Rules Committee appoints two, and the Assembly Speaker appoints two. Additionally, the board includes two ex-officio, non-voting members, one member of the Assembly and one member of the Senate.

Key Legislation

Assembly Bill 3034 (Galgiani), Chapter 267, Statutes of 2008, directed the Safe, Reliable, High-Speed Passenger Train Bond Act for the 21st Century (Proposition 1A) to be placed before the voters in the fall of 2008. California voters approved the initiative, which authorized \$9.9 billion in general obligation bonds for two distinct purposes: \$9 billion to develop and construct a high-speed rail system connecting San Francisco Transbay Terminal to Los Angeles Union Station and Anaheim; and \$950 million for connecting intercity and commuter rail systems that would enhance those systems' capacity, safety, or connectivity to the high-speed rail system.

In July 2012, the Legislature approved SB 1029 (Committee on Budget and Fiscal Review), Chapter 152, Statutes of 2012, which appropriated nearly \$8 billion in federal and state funds to begin the construction between Madera and Bakersfield. SB 1029 funded three components envisioned in the Authority's 2012 revised business plan: the initial operating segment (IOS) \$5.8 billion, connectivity projects \$819 million, and the bookends – Los Angeles and San Francisco – \$1.1 billion. State funding came from Proposition 1A bond money.

A 2014-15 state budget trailer bill SB 862, (Committee on Budget and Fiscal Review), Chapter 36, Statutes of 2014, permanently set aside 25% of the revenues derived from the Cap and Trade program through 2030 for the Authority. In its 2018 business plan, the Authority estimates this brings in roughly \$750 million annually.

In 2016, the Legislature passed and the Governor signed into law AB 1889 (Mullin), Chapter 744, Statutes of 2016, which defined the Proposition 1A term “suitable and ready for high-speed train operation.” According to AB 1889, a segment is suitable and ready if the bond funds are used for capital projects that would enable high-speed trains to operate immediately or after additional planned investments are made on the corridor or usable segment, and passenger train service providers will benefit from the projects in the near-term. AB 1889 was clarifying legislation that allowed for bond money to be spent to improve existing rail segments to allow for high-speed rail trains.

2018 Business Plan Funding Shortfall

State law requires that, every even year, the Authority submit a business plan to the Legislature outlining key information about the project, including available funding and projected costs. In April 2018, the Authority released the draft of the latest plan, utilizing “cost ranges” for the first time. Previously, the Authority included single-number estimates rather than a range of potential costs.

The 2018 business plan, released in its final form on June 1, 2018, made it clear that there is a significant funding gap between what is needed to complete Phase I of the project, and what is available. The high-speed rail system is planned in two phases. Phase I of the project is scheduled to be built from San Francisco to Los Angeles, and Phase II is planned to extend high-speed rail service to Sacramento and San Diego.

Recognizing this, the Authority set forth an incremental plan to finish Phase I, starting with a “Valley to Valley” segment running from Silicon Valley to the Central Valley. This segment is estimated to cost between \$25.13 billion and \$36.84 billion; however, available funding from all sources totals between \$19 billion and \$26.86 billion. Total Phase I cost of the project, running from San Francisco to Anaheim, is estimated to be between \$63.2 billion and \$98.1 billion.

Policymakers will have to decide in the near future if, when, and how funding streams should be identified and increased to cover the shortfall.

Audit Results/Areas of Concern

The audit focused on several major areas.

First, the Authority’s failure to plan adequately prior to starting construction will cost taxpayers an additional \$2.1 billion on the first three construction packages. The rush to begin construction without a viable plan in place to acquire land had a domino effect on costs. The early uncertainty over which land parcels were needed resulted in delays in reaching agreements with existing rail lines and utility systems to relocate their infrastructure, in turn leading to delays in acquiring needed parcels. Although the Authority was aware of the risks inherent in beginning construction early, it chose to move ahead regardless.

Second, the Authority has not successfully managed its contracts. Although multiple audits over the years have pointed out these management issues, the Authority continues to experience deficiencies in contract handling and oversight. Deliverables are not tracked, internal policies set up to oversee multi-million dollar contracts are not enforced, and the Authority’s heavy reliance

on outside contractors to oversee its work has led to millions in questionable charges and change orders.

Third, the constant delays and slow pace of construction means that it is highly unlikely, barring a rapid increase in the construction rate, that the Authority will meet a key federal deadline of completing the Central Valley construction by 2022. Missing this deadline may mean that California must repay the federal government as much as \$3.5 billion. Getting an extension on the 2022 deadline is likely impossible, as it would require an act of Congress.

Finally, the audit looked into the reporting and monitoring of environmental impacts of the project, and small, disabled veteran, and disadvantaged business inclusion goals. The Authority has laudable goals in these areas, yet their environmental mitigation implementation plan does not include measurable, process-focused metrics related to its construction activities. While the Authority's inclusionary efforts for small, disabled veteran, and disadvantaged businesses appear to meet their goals, contracts with public entities are excluded from the reporting requirements. To better understand the full impact of the Authority's contracts with small, disabled veteran, and disadvantaged businesses, the audit finds that the public would be best served by a higher degree of transparency by including the exempted contracts in their reporting.

High-Speed Rail Authority's Response

The Authority, in its response to the audit, has agreed with the Auditor's recommendations and identified actions it is taking or planning to take to implement them.

However, it is worth noting that in a 2012 audit done by the California State Auditor the Authority pledged to address previously cited project management issues¹, yet it continues to struggle in this area. Further, the Authority's own internal audits in 2015 and 2016 made it clear that contract management oversight was an ongoing issue². It is unclear at this point just what the Authority will be doing differently that will allow it to exercise rigorous oversight.

Next Steps

The Legislature must confront a number of key issues in the management and oversight of the High-Speed Rail construction in the coming months. Future funding sources must be identified; project management oversight must be rigorous and ongoing, and the possibility of having to repay \$3.5 billion in federal funds is looming.

¹ California State Auditor Report Number 2011-504, <https://www.auditor.ca.gov/reports/recommendations/2011-504>

² California High-Speed Rail Authority website, http://hsr.ca.gov/docs/brdmeetings/2015/brdmtg_031015_FA_Contract_Management.pdf and http://hsr.ca.gov/docs/brdmeetings/2016/brdmtg_052016_FA_Audits_Contract_Management_Follow_Up.pdf