Reducing Financial Risks of California HSR

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Sacramento
California shouldn’t bear the risk of HSR

The current structure of the California HSR project maximizes the financial and technology risks for the state, and has not and will not attract capital partners. Recent proposals announced during the Governor’s trip to Asia involve loans to California, but do not reduce underlying risks to taxpayers of a system that may not work and will have huge budget overruns.

SNCF America wishes to propose an alternative.
Current approach maximizes risks to public.

The current approach of the California HSR project can be compared to that of BART or other U.S. transit systems. The system is designed by engineering firms without operating experience, who lack incentive to avoid hazards and massive inefficiencies.

The public is left to pay for an overly expensive design which incorporates major inefficiency and may not be profitable or even affordable to operate.
Loans by technology vendors don’t avoid risk.

Just because vendors may offer to give California a multi-billion dollar loan does not mean the risk either of design flaws or operating losses will be reduced. As Americans discovered with Amtrak’s Acela, a service funded with loans that doesn’t live up to speed claims can set back progress for decades.

The taxpayer still pays for systems that don’t work.
How can California reduce HSR project risk?

HSR service operators have the strongest interest in project success, as investors who must turn a profit.

- Operators have a huge stake in the system being designed and built properly and quickly
- Operators understand best how to design and integrate the various elements of the system
- Operators are best at identifying and addressing technical and commercial risks and opportunities
- Operators are willing to take on a major share of financial risk
CHSRA leaves operator out of key decisions.

By CHSRA plans, operator is involved too late to play meaningful role in design of infrastructure, leading to:

- poor financial performance
- lower ridership
- higher infrastructure and operation costs
- integration risks and delayed completion
- lack of interest from private capital

Current designs are driven by capital cost rather than optimized operational and financial performance.
How to obtain early investment by an operator:

- The Pre-Development Agreement Model

- What does this model look like?
PDA differs from other project management systems by having the eventual operator involved in design of the project, to optimize project financial feasibility.

The process starts with a bid process in which the agency seeks bids from qualified operators to select a partner to assist in completion and operation of the HSR system. The chosen operator would partner with the CHSRA on the pre-development study for twelve months.
PDA Model: International Success Story

This model has been successfully used throughout the world on rail and bridge projects. Of particular interest is the success of the Currituck Sound Bridge, in North Carolina. The state previously had given up on the bridge, lacking confidence about finances.

A European consortium approached N.C. with the PDA process to determine whether the bridge tolls could pay for the capital costs of the bridge. The study results were positive, the bridge was constructed successfully and is profitable today.
The partners review all aspects of the HSR project:

- Ridership projections
- Route selection
- Frequency of train service
- Environmental concerns
- Financial and business plans
- Capital costs
- Supervision of consultants

At end of study, the decision is made whether to proceed.
PDA Model: It Lets Operator Influence Design

Procurement:
- RFQ
- Qualification of Proposers
- Proposals Due
- Operator Chosen

Cost Mechanism:
- Step 1: 12-Mo Pre-Development Study
  - At Cost
  - Negotiation of final agreement
  - Begin corridor construction

- Step 2: Design & Construct Network
  - Cost Plus

- Step 3: Ramp up Revenue Service
  - Return on Capital Invested
  - Monetization process

- Step 4: Long-term Ops & Maintenance
  - Profit Sharing
PDA Model: Full Sequence of Development

RFQ issued

Select qualified teams (operator+financial partners)

RFP issued to qualified teams

PDA award (with right to negotiate Concession)

Pre-Development Study

Design & Construction of Full System

Negotiation of Concession Agreement

Performance of 12-month Pre-Development Study

Ramp Up Revenue Service Operation & Maintenance (for pre-determined period)

Monetize system via award to long-term Operator

Termination/Breakage Fee

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PDA Model: Operator Selection Process

- RFP Issued to Qualified Operators/Bidders (including their financing partners)
- Award Pre-Development Agreement to Operator (Includes right of negotiation of Concession)
Stage 1– Preliminary Development  12 months

Operator and CHSRA work to resolve core viability issues and conclude Development Agreement. Operator shares in risks by providing its services at cost.

After 12 months, Operator forms consortium with capital sources and contractors to provide required private equity, debt and construction services for next stage.
The Consortium partners with CHSRA to develop the HSR system. The Consortium invests a portion of the required equity to build the system and is paid for its services on a cost-plus basis.
Establish Stabilized Operation – As the HSR System becomes operational, the Operating Partner assumes operations, establishes an operating history and prepares the system for a long-term concession. The Operating Partner is paid on a cost-plus basis and the Operating Consortium shares in profits and losses.
Monetization (4 mo.) & Long-term Operation (30-50 yr.) Consortium and CHSRA market the equity in the system via a long-term concession PPP. CHSRA and Consortium share in profits, if any. Equity with a longer investment horizon and lower cost of funds may replace Consortium’s initial equity. CHSRA becomes a true regulator overseeing the concession.
PDA Model: The key to a successful HSR project

Procuring an operator, now, allows CHSRA to:

- meet FRA deadlines & maintain federal funding
- attract private equity and coordinate financing sources
- identify and address key project risks and opportunities (e.g.: ridership, alignment, etc.)
- expedite commencement of initial phases of the system
- address ongoing public concerns
- procure and integrate construction components
- provide construction management
- ensure system success
Suggested Timeline

Timeline required to meet FRA deadlines and maintain federal funding

**Procurement:**
- RFP Issued: 10/30/10
- Proposals Due: 1/30/11
- Operator Chosen: 6/30/11

**Step 1:**
- Perform 12-Month Pre-Development Study
- Complete negotiation of Agreement
- Begin corridor construction 9/30/12

Illustrative End Date: 6/30/12
Cost Mechanism: At Cost

**Step 2:**
- Design & Construction of System

Illustrative End Date: 9/30/19
Cost Mechanism: Cost Plus

**Step 3:**
- Ramp up Revenue Service
- Monetization Process Completed by: 9/30/23

Illustrative End Date: 9/30/22
Cost Mechanism: Return on Capital Invested

**Step 4:**
- Monetization & Long-term Operations & Maintenance

Illustrative End Date: 9/30/53
Cost Mechanism: Profit Sharing
Thank you

Denis Doute
CEO
SNCF America
Palo Alto, California