REVIEW OF PROPOSED PURCHASE

of the

SOUTHERN PACIFIC TRANSPORTATION COMPANY

PENINSULA RIGHT-OF-WAY

by the

PENINSULA CORRIDOR JOINT POWERS BOARD

Prepared for the

California Transportation Commission

Wilbur Smith Associates

May 20, 1991

EXECUTIVE SUMMARY

By letter agreement dated December 28, 1990, the Peninsula Corridor Study Joint Powers Board (JPB) and Southern Pacific Transportation Company (SP) set forth the terms and conditions under which the JPB would agree to acquire certain SP rail rights-of-way and associated rights and facilities in San Francisco, San Mateo, Santa Clara, and Alameda Counties. The proposed transaction is intended to facilitate the JPB's impending takeover of the Peninsula Commute Service (PCS). The JPB now proposes to submit an application to the California Transportation Commission (CTC) for funding under the Clean Air and Transportation Improvement Act (Proposition 116) to help complete the right-of-way acquisition.

The following review of the proposed transaction has been undertaken at the request of the CTC, and is intended to assist the Commission to determine if State funding should be allocated for all or part of the proposed purchase. The review is designed to address the following issues:

1. Determine if the negotiations between the JPB and SP have yielded results consistent with accepted methods for determining the value of rail rights-of-way involved in public sector acquisitions;

2. Determine the reasonableness of the proposed purchase prices for those elements that are to receive state funding;

3. Determine the serviceability by the Year 2000 of current or proposed rail operations to use those segments that are to benefit from state funding; and

4. Determine the feasibility of the proposed funding plan submitted by the JPB for the state-supported elements of the transaction.

5. Determine if the proposed purchase constitutes a desirable and cost-effective investment of funds available to the State for rail projects.

A - EVALUATION OF THE NEGOTIATION AND THE LETTER OF INTENT

Properties Proposed to be Purchased

Properties Proposed for State Funding

- Rights, title and interests (including existing improvements) in the SP main line between Fourth and Townsend in San Francisco, and Lick, a station at railroad milepost (MP) 51.4 in Santa Clara County, approximately 4.5 miles south of the San Jose passenger station. The proposed purchase of the main line generally includes the full width of the right-of-way. The proposed purchase excludes a track identified as Number 1 track, which runs parallel to the property being acquired from Santa Clara Junction (at MP 44.0) to the south end of Cahill Yard, just south of the San Jose station (about MP 47); it excludes the existing single track between San Jose and Lick (the underlying right-of-way is included in the proposed sale); and it excludes purely freight trackage at various points in all three counties.

- Trackage rights for JPB commute passenger trains over 25.4 miles of SP-owned main track between Lick and Gilroy. Exercise of these rights is subject to the JPB meeting certain conditions such as the provision of specified capital improvements to SP's physical plant.

Properties Not Proposed for State Funding

- Rights, title and interest in SP's Dumbarton Branch between Redwood City on the west and the West Wye at Newark. A small section of trackage rights over SP - retained trackage at Newark is included in the rights to be conveyed; these rights are included simply to facilitate possible future passenger train access to connections at Newark. They have no material effect on the price or structure of the proposed purchase.

- Rights, title and interest in that portion of the so-called Vasona Branch between its connection with the main line in San Jose, and a point called Vasona Junction, at the crossing of Winchester Boulevard in the City of Los Gatos.

Purchase Options - In addition to the properties identified in the Basic Transaction, the Letter-of-Intent specifies several properties that JPB may choose to purchase within five years from closing. These properties are detailed in the main body of the report. They are not currently proposed to be the subject of an application for State funding.

Additional Properties - Besides the rail lines and associated land included in the Basic Transaction and Purchase options, the Letter-of-Intent proposes to include in the sale a total of 31 acres of land for grade separations at several locations in Millbrae, Burlingame, San Mateo, Belmont, San Carlos and Redwood City; a total of 14 acres for expanded parking at nine locations in San Francisco, South San Francisco, Hillsdale, Belmont, San Carlos, Palo Alto, Mountain View, Sunnyvale and near Lawrence station; and a total of 10 acres of land to protect tunnels and slopes associated with the rail right-of-way. Structurally, the cost of those additional 55 acres is included in the proposed price for the main line element of the Basic Transaction.

Prices Proposed to be Paid

Exhibit ES-1 summarizes the prices proposed to be paid for various elements of the transaction, according to the Letter-of-Intent. The exhibit is structured to show the total price proposed for each element, as well as the price per route mile.

Since much of the main line mileage is double-track, it is also appropriate to consider the purchase price on a per-track mile basis[1] as follows:

[1] Mainline track miles are derived by multiplying the number of main tracks times the route miles. A double track railroad will have two track miles for each route mile.

Exhibit ES-1

PRICE SUMMARY
JPB/SP TRANSACTION IN PROPOSED FINAL FORM
Peninsula Rail Right-of-Way Acquisition

	Price*	Route Miles	Price per Route Mile*
I - Basic Transaction			
A - Lines to Receive State Funding			
1. San Francisco - Lick	$242.3	51.4	$4.7
2. Gilroy Rights	8.0	25.4	0.3
Subtotal	**$250.3**	**76.8**	**$3.3**
B - Lines not to Receive State Funding			
3. Dumbarton	12.7	11.2	1.1
4. Vasona I	5.0	6.2	0.8
Subtotal	**$ 17.7**	**17.4**	**$1.0**
Total	**$268.0**	**94.2**	**$2.8**
II - Options			
a. Moffett	6.0	1.5	4.0
b. San Bruno	15.0	4.6	3.3
c. Vasona II(1)	21.0	8.2	2.6
d. Gilroy Purchase(1)	12.0	25.4	0.5
Total	**$ 54.0**	**39.7**	**$1.4**
Grand Total	**$322.0**	**108.5(2)**	**$3.0**

* Dollar amounts in millions.
(1) For 1/2 right-of-way only.
(2) Adjusted to count the 25.4 miles between Lick and Gilroy only once.

Wilbur Smith Associates; May 1991.

Segment:	San Francisco-Gilroy[2]
Price: (in millions)	$250.3
Route Miles	76.8
Price per Route Mile: (millions)	$3.26
Track Miles:	131.5
Price per Track Mile: (millions)	$1.90

These unit prices--both on a per-route-mile basis and on a per-track-mile basis--can now be seen to be closer to "representative" or "normal" prices for urban rail rights-of-way than might otherwise have seemed the case. That does not change the fact that the state-funded portion of JPB's proposed transaction, as presently structured, would settle at values at or near the high end of the national scale.

Exhibit ES-2 summarizes the JPB and LACTC transactions as they stand according to the Letters of Agreement from December and October 1990, respectively. To make the figures more comparable, the value of "operating" land associated with the respective purchases is included in both cases. The land is separately itemized and priced in LACTC's transaction, while it is not dealt with separately in JPB's, but the effect of including the price for this land on both sides of the comparison is to make the two transactions structurally similar.

When the two Basic Transactions are compared, the JPB proposal is seen to carry a price tag about 18% lower per track mile than the LACTC transaction. Considering the physical differences between the branch line right-of-way that comprises much of the Los Angeles Basin trackage, as compared to the double-track main line that comprises much of the JPB's Basic Transaction, the difference is not unreasonable. In any case, the two transactions overall generally show unit prices that are in the same order of magnitude.

Exhibit ES-3 breaks out both transactions' individual line segments, as well as the respective trackage rights components. Again, when lines with similar surrounding land-use characteristics are compared (e.g. the Santa Monica and Burbank Branches, with the Peninsula

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2 Purchase in Fee San Francisco-Lick; purchase of trackage rights, Lick-Gilroy.

Exhibit ES-2

COMPARISON OF LACTC and JPB TRANSACTIONS TO ACQUIRE SOUTHERN PACIFIC PROPERTIES IN CALIFORNIA

	JPB	LACTC
I - Comparison of Respective "Basic" Transactions		
Route Miles	94-miles	112-miles
Track Miles	149-miles	112-miles
Price	$268-million(2)	$245-million(1)
Price/Route Mile	$2.85-million	$2.19-million
Price/Track Mile	$1.80-million	$2.19-million
II - Comparison of Respective Total Transactions		
	JPB	LACTC(3)
Route Miles	108-miles	175-miles
Track Miles	163-miles	185-miles
Price	$322-million	$450-million
Price/Route Mile	$2.98-million	$2.57-million(4)
Price/Track Mile	$1.98-million	$2.43-million

(1) LACTC price includes all the "non-operating" property associated with the branch rights-of-way purchased in Fee. This property is included in this comparison because the proposed JPB transaction also includes considerable property that would have been considered "non-operating" property if the transaction were worded exactly like the LACTC one. The $245-million figure excluded the monies LACTC proposes to pay SP for the NPV of future rents.

(2) JPB price includes 55 acres of other land intended for parking, grade separation, and slope protection.

(3) LACTC figures include monies proposed to be paid to buy the NPV of future rents. No such provisions exist in the JPB/SP Letter of Intent.

(4) Includes non-operating properties associated with operating rights-of-way, as well as yard and station properties at Taylor Yard, Cornfield Yard, Chatsworth, Simi Valley and Moorpark.

Wilbur Smith Associates; May 1991.

Exhibit ES-3
(Page 1 of 2)
COMPARISON OF SELECTED SPECIFIC PROPERTIES
LACTC/SP Transaction vs. JPB/SP Transaction
CTC Rail Right-of-Way Review

Transaction	Property[1]	Miles	Price	Price per Mile	Notes/Comments
I - Properties for Purchase In Fee					
LACTC	Santa Monica Br.	14.2	$ 61.0	$4.3	Excludes NPV of Future Rents
LACTC	Burbank Br.	20.7	$104.1	$5.0	Excludes NPV of Future Rents
LACTC	Baldwin Park/ Azusa/State St.	60.4	$ 37.7	$0.6	Excludes NPV of Future Rents
LACTC	West Santa Ana Br.	12.7	$ 38.2	$3.0	Excludes NPV of Future Rents
LACTC	Alla Br.	1.6	$ 4.0	$2.5	Excludes NPV of Future Rents
LACTC	Taylor/Cornfield Yards	--	$ 80.5[2]	--	Excludes NPV of Future Rents
LACTC	Chatsworth/Ventura County Sites	--	$ 29.5	--	
JPB	Main Line	51.4	$242.3	$4.7	Includes 55 acres of ancillary property.
JPB	Dumbarton Bridge	11.2	$ 12.7	$1.1	
JPB	Vasona I	6.2	$ 5.0	$0.8	
JPB	San Bruno Option	4.6	$ 15.0	$3.3	Option price increases if not exercised in time.
JPB	Moffett Option	1.5	$ 6.0	$4.0	Option price increases if not exercised in time.

Exhibit ES-3
(Page 2 of 2)
COMPARISON OF SELECTED SPECIFIC PROPERTIES
LACTC/SP Transaction vs. JPB/SP Transaction
CTC Rail Right-of-Way Review

Transaction	Property[1]	Miles	Price	Price per Mile	Notes/Comments
II - Properties Representing One-Half Interest In Operating Rights-of-Way					
LACTC	Saugus/Moorpark	65.0	$ 50.0	$0.8	Interim use rights included without extra cost.
JPB	Lick-Gilroy	25.4	$ 20.0	$0.8	Price includes $8-million to be paid initially for perpetual trackage rights.
JPB	Vasona II	8.2	$ 21.0	$2.6	Interim use rights included without extra cost.

Note: All dollar amounts shown are in millions.

(1) Including, in the case of LACTC's transaction, the "non-operating" land; in JPB's transaction, the "other" land.

(2) As originally included in Purchase Agreement.

Wilbur Smith Associates; May 1991.

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main line), the per-mile and per-acre prices appear roughly comparable. Similarly, the proposed prices are similar for those main line rights-of-way where one-half the right-of-way width is eventually to be the subject of a public agency purchase.

JPB's Valuation Analysis and its Role in the Negotiation

As in the LACTC transaction, the price negotiations for the proposed JPB/SP agreement were founded upon a formal attempt to value major portions of the rights-of-way to be purchased. Consistent with the approach used by LACTC, JPB retained an appraiser who provided an Across-the-Fence valuation of the land, plus a Net Liquidation Value that discounted the ATF land value for a variety of physical reasons (size, shape, restricted access, etc), and for the time and cost of selling the land if it were hypothetically broken up and liquidated as individual parcels.

In the JPB/SP negotiations, Arthur Gimmy International, a San Francisco real estate appraisal firm with prior experience in railroad appraisal, appraised the main line between San Francisco and Alma station in San Jose, together with most of the Dumbarton Branch. This appraisal was done in the Summer of 1989. In December 1990, JPB requested that Gimmy update their 1989 appraisal, adding the portion of the railroad between Alma, Lick and Gilroy, and expanding the Dumbarton work to include the Wye connection at Redwood City and additional rights-of-way in and near Newark.

The Gimmy NLV yields land values around 30% of ATF--a result consistent with the results of the Eichel NLV used in the LACTC transaction. This can be seen in Exhibit ES-4, which summarizes Gimmy's 1989 and 1990 appraisals, and Exhibit ES-5, which compares Gimmy's 1989 appraisal with the 1989 Eichel appraisal used by LACTC. In both cases, appraised NLVs for those rights-of-way that were analyzed by the appraisers are about one-third of ATF; in both cases, the settlement prices being proposed are close to NLV, and certainly within the same order-of-magnitude with respect to each other.

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Exhibit ES-4
APPRAISAL SUMMARY
1989 AND 1990 APPRAISALS
CTC Rail Right-of-Way Review

Line Segment	1989 ATF	1989 NLV	1990 ATF	1990 NLV
Main Line[(1)]	$786.0	$240.6	$870.3	$236.9
NLV as % of ATF	30.6%		27.2%	
Settlement as % of ATF	30.8%		27.8%	
Settlement as % of NLV[(2)]	100.7%		102.3%	

(1) In 1989, mainline was appraised to Alma; in 1990, to Lick.
(2) Excluding Dumbarton and Vasona branches.
Note: All dollar amounts quoted are in millions.

Wilbur Smith Associates; April 1991.

Exhibit ES-5
JPB AND LACTC TRANSACTIONS
ATF/NLV SETTLEMENT PRICE RATIOS
CTC Rail Right-of-Way Review

	JPB[(1)]	LACTC
ATF	$786.0-million	$671.5-million
NLV	$240.6-million	$212.4-million
Settlement Price	$242.3-million[(2)]	$245.0-million[(2)]
NLV ÷ ATF (percentage)	30.6%	31.5%
Settlement ÷ NLV (percentage)	100.7%	115.0%
Settlement ÷ ATF (percentage)	30.8%	36.5%

(1) 1989 valuation study used to compare with LACTC to preserve comparability.
(2) Prices for "Core" routes and associated properties; JPB figures exclude Vasona and Dumbarton.

Wilbur Smith Associates; April 1991.

From all this we can conclude that, strictly as an exercise in valuation, the Gimmy appraisal is a competent analysis performed in accordance with professionally accepted methods. That Gimmy's appraisal yields relatively high land values for the Basic Transaction properties (in the $6.50-$7.00 per square foot range fully discounted) appears to reflect his judgement that much of the Peninsula right-of-way would become developable land if it were really liquidated. Consequently, in an area where undiscounted land values in 1989 were frequently found to be in excess of $20 per square foot, and in San Francisco were found to be between $100 and $150 per square foot, the perception that major sections of the right-of-way do have a practical alternative highest and best use implies a fairly high NLV even with aggressive discounts for time and cost-of-sale.

Sequence of Offers and Counteroffers

Exhibit ES-6 summarizes the chronology of the negotiations between the JPB and SP from the initial SP offer in February, 1989 to signing of the Letter of Intent in December 1990.

Initially, SP offered to sell only the mainline and Dumbarton Branches combined for $359.0 million. In the December 1990 Letter of Intent, SP has effectively agreed to accept something less than $255.0 million for the same properties: the definition of the main and Dumbarton lines involved in the proposed transaction now includes more of each line than was initially included in the SP offer, since the main line is now proposed to be sold all the way to Lick (as opposed to San Jose), and the Dumbarton Branch sale is defined as extending to the Newark Wye instead of to a point west of the connection.

The initial JPB offer of $180.0 million for the main and Dumbarton lines, plus the Moffett Drill track and Vasona I, is now proposed to be an equivalent offer of $266.0 million for the same properties as defined in the Letter of Intent. The Moffett Drill is now, of course, an option, so the structure of the initial JPB offer is no longer strictly comparable to the structure of the current Letter of Intent.

Roughly speaking, then, the parties began about $180.0 million apart (with different line "packages" proposed), and settled for prices that represent something near the midpoint of the initial difference in price, adjusted to reflect equivalent properties. On the whole, SP reduced its asking

Exhibit ES-6

SUMMARY
SEQUENCE OF OFFERS, ACQUISITION OF SP PENINSULA PROPERTIES
CTC Rail Right-of-Way Review

Date	SP Offer	JPB Offer	Notes/Comments
02/27/89	$359-million	–	4th and Townsend to Cahill, plus Dumbarton Branch.
10/16/89	–	$180-million	Above lines, plus Cahill-Lick, Moffett Drill, Vasona Branch, etc.
12/15/89	$300-million	–	Now includes Lick and Moffett, but not Vasona.
07/20/90	–	$225-million	$200-million for "Core"; $25-million option for San Bruno Branch.
08/09/90 09/04/90	$275-million	–	Main line only to Santa Clara Junction (MP 44) includes Dumbarton and San Bruno, but not Lick, Moffett, Vasona. Includes free trackage rights to Lick in perpetuity.
10/08/90	–	$255-million	$225-million for "Core;" $30-million for options in San Bruno, Vasona, Moffett.
10/24/90	$340-million	–	SP adds 1/2 interest in Lick-Gilroy ($20-million); Vasona I ($15-million); and 1/2 interest in Vasona II ($30-million). Moffett now in the base price, as is Santa Clara Junction - Lick, except for Track No. 1. Also, San Bruno Branch is a $15-million option: Base price for Core is therefore $260-million.
11/07/90	$330-million	–	$260-million remains base price for Core, but now excludes Moffett, and includes Vasona I. Options: San Bruno ($45-million); Moffett ($5-million); 1/2 Vasona II ($30-million); 1/2 Gilroy ($20-million).
11/20/90	–	$330-million	Slight changes in property lines. Core price = $260-million, but now includes SF-Lick, all of Dumbarton, and Vasona I. Option: Total $70-million for interest in 4 branches.
12/28/90	$322-million	$322-million	Minor adjustments: Vasona II could be purchased for $21-million instead of $30-million depending on purchase date. Moffett option now $6-million. Gilroy rights $8-million; purchase option $12-million.

Wilbur Smith Associates; May 1991.

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asking price more than JPB raised its offering price, particularly if the transaction is defined strictly in terms of the main line.

Evaluation of Proposed Terms

In addition to specifying the property limits and prices to be included in the proposed transaction, the Letter of Intent sets forth a number of terms and conditions that the parties propose to include in the transaction. The principal provisions are evaluated in this sub-section, as follows:

Reciprocal Grants of Trackage Rights - Since the structure of the proposed agreement involves shared use of rail rights-of-way by both SP freight and JPB passenger trains, there are a number of provisions in the Letter of Intent stipulating that the parties intend to grant each other certain reciprocal trackage rights. These rights are generally intended to allow SP freight trains continued access to Peninsula and San Francisco points, and to allow JPB commute passenger trains access to points beyond Lick to Gilroy. These trackage rights arrangements are all reasonable in their provisions, and consistent with standard industry practices.

Operating Arrangements - The Letter of Intent specifies that the JPB will dispatch train and control operations on all the lines it is acquiring in fee. SP would retain ownership of and control over the No. 1 track between Santa Clara Junction and the east end of Cahill Yard, the existing single main track between Cahill and Lick, and the main track between Lick and Gilroy; relevant sections of the trackage affected by these provisions have been described previously.

Additional language in the Letter of Intent provides for the parties to operate the planned double-track line between San Jose and Lick as shared or "paired" track. Such arrangements are a standard industry method for improving the flexibility and utilization of multiple-track rail lines where different individual tracks may be owned by separate entities.

None of the proposed commitments on the part of the JPB constitute an unreasonable or unfair burden on the public sector--such commitments are typical of shared passenger- and freight-use rail lines operating under conditions when the passenger operation is dominant. JPB clearly retains control over policy and scheduling, and the commute trains have unrestricted priority on the main line between San Francisco and San Jose.

Capital Improvements - As part of the proposed agreement, JPB commits to fund certain capital improvements to portions of the affected rail lines which will remain under SP ownership and control. In this respect, the JPB-SP transaction differs from the LACTC-SP Purchase Agreement where the Commission obligates itself to construct additional trackage which then comes under LACTC ownership and control.

The commitments JPB proposes to make to funding capital improvements are all reasonable--particularly since they have the effect of shielding the JPB from a specific obligation to purchase additional SP right-of-way. The capital costs to upgrade No. 1 Track between Santa Clara Junction and Cahill are estimated at between $750,000 and $800,000 above what Caltrans is already expecting to spend in its 1991 capital improvement program. The capital costs for the track improvements between Lick and Gilroy are estimated to total less than $10.0 million, including those to provide a storage yard facility at Gilroy.

Maintenance Costs - The Letter of Intent specifies that for the first four years following closure of the transaction, JPB will absorb all the maintenance-of-way costs on the acquired lines. The Letter of Intent does not provide a rationale for this provision, but it appears intended to compensate for the fact that since Caltrans took over, SP has been under-compensated for the use of the San Francisco-San Jose main line.

After the fourth year on the purchased portions of the main line, and after closing on the trackage rights portions, maintenance costs will be shared between the parties. The cost allocation will be determined by applying the so-called Speed Factor Gross Ton Formula (SFGTF). Essentially, this formula is a mathematical way to apportion track-related maintenance costs between freight and passenger trains on tracks where use is shared. The formula is accepted within the industry as one of the standard ways to allocate shared cost responsibility, and its proposed use in this transaction is perfectly reasonable.

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Other Costs - The other costs to be shared under the shared-use arrangements will include operating and administration costs not clearly attributable to either the JPB or SP and accident liability costs. The Letter of Intent specifies that shared general and administrative costs will be apportioned by the SFGTF; and accident liability will be handled according to industry custom for joint-facilities agreements. Such liability generally rests with each party to the agreement, except in case of negligence by one party.

These provisions seem reasonable and in accord with standard industry practice.

Assignment of Easements, Leases, and Licenses - The Letter of Intent stipulates that SP will convey or assign all existing leases and licenses except for a perpetual, non-exclusive easement for SP's fiber optics' communication lines. This easement, which extends roughly from San Francisco to Newhall Yard in Santa Clara, does not prohibit the JPB from developing its own fiber optics system, although any such development would presumably have to compete with the already existing one.

There is a pipeline easement on a portion of the property to be acquired; this easement conveys. Altogether, the existing rental revenue from the rent and leases that do convey is estimated at about $425,000 annually.

The rental income stream from all the grade crossing and parking lot-related land–including the parcels with reversion rights–remains with SP for ten years, or until the JPB exercises their proprietary rights by entering upon the land to construct the grade separation(s) or expanded commute facilities. At present, the total of this current rental income remaining with SP is estimated at about $500,000 annually.

The rather convoluted provisions of this part of the Letter of Intent reflect the fact that the inclusion of this land in the transaction at all is the result of a negotiated compromise. Since the parcels are not separately priced or paid for, SP's negotiators have taken the position that the current benefits should continue to accrue to SP until the land is really needed by the JPB's commute rail service. The JPB has included the land as part of its strategy to ensure that property is available for future enhancements to the system–property that might not be available

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later if left out of the current settlement. The JPB has worked to get this land included without--as in the LACTC transaction--specifically paying an extra line-item price for it.

In the context of the overall transaction, we do not believe that either the liquidated land value of the 55 acres or the present value of the income stream from the retained rents and leases has material effect--positive or negative--on the State's interest in funding portions of the proposed transaction. The financial weight that can be attached to these provisions is simply not great enough to materially affect either the price or utility of the properties the JPB intends to acquire.

<u>Indemnification of Title</u> - Except for portions of the San Bruno Branch right-of-way (in the Option package) SP agrees to warrant title sufficient to guarantee continued rail use on the properties JPB proposes to acquire. This warranty is to be supplied by a combination of title insurance and direct indemnities mutually agreeable to the parties.

<u>Labor Protection</u> - Since SP currently operates the PCS under Caltrans' contract, the issue of liability for labor protection arising from a change in ownership of the Peninsula rail line has been a serious concern in the JPB-SP negotiation, whereas it played no role in the LACTC-SP negotiation because no prior service exists. The exposure to this labor protection liability arises because interpretations of the Interstate Commerce Act generally impose labor protection conditions when rail lines are sold, or operating authority transferred.

The Letter of Intent specifies that SP will assume labor protection responsibility arising from legal or contractual sources, and will indemnify the JPB and the State against labor protection claims arising from the transaction. In return, JPB agrees to instruct its rail operator to "give first consideration" for employment to those persons already currently engaged in functions related to Peninsula commute operations.

Since this language does not bind either the JPB or its operator to hire any specific employee or number of employees in any functional area, it seems to us a reasonable quid-pro-quo, given the broad nature of SP's retained responsibility. It is clear that the proposed language without-

protects the JPB's ability to introduce more labor-efficient operating practices into the PCS once the transaction is complete.

Toxic Waste Contamination - SP agrees in the Letter of Intent to completely indemnify the JPB and its individual agencies from liabilities due to possible prior contamination of the acquired rights-of-way while under SP ownership and control. The SP specifically warrants the "baseline" condition of the property at the close of escrow, as validated by a jointly-sponsored environmental analysis.

Since the SP's indemnification of the JPB is strongly worded to protect the JPB, we conclude that the State's interests with respect to protection from toxic waste contamination are adequately addressed.

Conditions to Closing - The Letter of Intent specifies the following general conditions to closing:

- JPB must obtain financing;
- JPB must complete its Due Diligence; and
- Operating and other Implementing Agreements must be in place.

In all respects, these conditions to closing are reasonable, and consistent with those attached to LACTC's Purchase Agreement with SP.

B - EVALUATION OF PROPOSED FUNDING PLANS

JPB Funding Proposal for Right-of-Way Acquisition

The latest available JPB proposal (dated April 30, 1991) for funding the right-of-way purchase, unlike an earlier proposal, calls for $73.3 million in local funds for the San Francisco-San Jose/Lick main line right-of-way plus $4.0 million for San Jose-Gilroy track rights. It assumes that all of the $120.0 million in State Proposition 116 bond funds specifically earmarked for right-of-way acquisition and all of the other $53.0 million in Proposition 116 funds to be allocated to the Peninsula corridor will be made available for right-of-way acquisition in this fiscal year. In view of the present shortage of State bond funds, this particular funding approach appears to be impractical.

In addition, the specific funding sources and commitments for some of the local funds have not yet been specified. (See Exhibit ES-7.) The $35.2 million from San Mateo County could come from the San Mateo Transportation Authority 1/2-cent sales tax allocation for "Caltrain Improvements," approved in 1988, and JPB representatives have indicated that a source for the relatively small San Francisco share has been identified. However, there is no indication that the $30.8 million Santa Clara share will be committed.

It should also be noted that the PCS application of May 9 relates to a $250.3 million project, whereas the "basic transaction" for the right-of-way purchase was negotiated at $268.0 million–the $17.7 million difference being for the Dumbarton and Vasona I elements of the transaction. JPB representatives have indicated their intention to remove the Dumbarton and Vasona I elements from the "basic transaction" and make them parts of the "option package". However, agreement by the railroad to this change has not yet been confirmed.

<u>Funding for Future Operations</u>

Caltrain operating deficits in future years will represent a much greater financial burden on the local agencies after the State withdraws its operating support in 1994. The projected magnitudes of these future deficits will depend upon:

(1) Whether service is expanded as planned;
(2) The cost structure of the operating agreement under which the service is provided; and
(3) The level of patronage and fare revenues attained.

General resolutions of commitment to operate the service following right-of-way acquisition have been formally made. Specific agreements as to the sharing of the local responsibility for operating subsidies have not yet been confirmed.

Exhibit ES-7

PROPOSED JOINT POWERS BOARD FUNDING PLAN - AS OF APRIL 30, 1991
Peninsula Rail Right-of-Way Acquisition

Funding Source	S.F. to Lick Right-of-Way(1)	San Jose-Gilroy Track Rights(2)	Subtotal	Dumbarton Vasona I	Total
State Proposition 116 [99636(d)]	$120.0	--	$120.0	--	$120.0
State Proposition 116 [99636(a),(b),(c),(1)]	49.0	--	49.0	--	49.0
State Proposition 116 [99636(c)(2)]	--	4.0	4.0	--	4.0
State Subtotal	**$169.0**	**$4.0**	**$173.0**	**--**	**$173.0**
San Francisco County	7.3	--	7.3	N/A	N/A
San Mateo County	35.2	--	35.2	N/A	N/A
Santa Clara County	30.8	$4.0	34.8	N/A	N/A
Local Subtotal	**$ 73.3**	**$4.0**	**$ 77.3**	**$17.7**	**$ 95.0**
TOTAL	$242.3	$8.0	$250.3	$17.7	$268.0

Note: All dollar amounts are in millions.

(1) For 51.4 miles (657 acres) of right-of-way and facilities in current use for rail operations plus property for future expansion of parking and grade separations.

(2) For rights to operate up to eight trains per day utilizing existing tracks to serve Gilroy, Morgan Hill and Southern San Jose.

Wilbur Smith Associates; May 1991.

Information available for this review from official locally-prepared plans indicates that the financial capacity exists to fund the projected deficits if the level of rail service is not increased, although certain capital projects might be affected; the local capacity to fund operating support needs from existing funding sources with the planned service expansion program (as well as other programs) appears not to be adequate.

Local Capacity to Fund Other Capital Needs

The overall program for Caltrain improvements includes:

(1) Right-of-way acquisition;

(2) An Interim Upgrade Program of capital improvements including a new maintenance facility;

(3) A San Jose-Gilroy extension;

(4) Grade separations; and

(5) A San Francisco downtown extension.

Use of local funds for right-of-way acquisition as currently proposed would impact the capacity of the local agencies to fund certain other elements of the Caltrain program, the San Francisco downtown extension in particular. Capital funding for Santa Clara County projects also would be reduced.

San Mateo County has available $174.0 million in local sales tax funds earmarked specifically for Caltrain improvements (including right-of-way acquisition as well as other capital needs). This would be sufficient to cover the specified San Mateo County share of the right-of-way purchase and other elements of the Caltrain program except the San Francisco extension. San Mateo County also has $183.0 million, in addition to programmed State funds, for a major grade separation program which would not be impacted by the specified San Mateo County share for the right-of-way purchase. On the other hand, the Santa Clara County local share is not yet committed; the specific source of this money is not known, and the potential impacts on other Santa Clara projects remains undetermined.

C - PROJECT JUSTIFICATION

Key Issues

The fundamental issues with respect to project justification are:

1. Should the rail right-of-way be preserved for the development of upgraded rail transportation services over the long-range;

2. Should the right-of-way be acquired to preserve it vs. a leasing arrangement; and

3. How should the voter mandates of Proposition 116 as related to the Peninsula Corridor be implemented given the current financial crisis. This issue involves the $120.0 million allocation which is specified in the legislation to be used for right-of-way acquisition, and the additional $53.0 million which may be used for right-of-way acquisition or other capital improvement needs.

This review determined that:

1. The Peninsula rail right-of-way should be preserved for the development of improved rail transportation over the long-term;

2. The prospects for preserving the right-of-way and passenger rail service in the corridor in the absence of public acquisition are uncertain; and

3. The Proposition 116 mandate to allocate $120.0 million to this corridor for right-of-way acquisition requires local commitments which have not yet been adequately specified. In addition, sufficient State Bond funds appear not to be available in sufficient amount to allocate all of this amount for this project in this fiscal year. Use of all of the additional $53.0 million in State Bond funds for acquisition of rights-of-way (as proposed) would reduce the amount of State funding available for planned passenger rail service improvements.

D - FINDINGS AND CONCLUSIONS

Following are the primary findings and conclusions of this Review of the proposed transaction between the Peninsula Joint Powers Bond and the Southern Pacific Transportation Company.

1. Given the capacity and level of utility of the mainline railroad plant being acquired, the proposed price for the mainline and associated trackage rights is not unreasonable.

2. The use of a net liquidated valuation (NLV) analysis underlying the negotiated prices for the mainline properties to be purchased in fee is consistent with legal and ICC precedent. The proposed settlement price is close to NLV.

3. Both the valuation work and the negotiation yielded prices consistent with those agreed to by SPT and LACTC in their negotiation for purchase of rights-of-way in Southern California.

4. The NLV itself is methodologically consistent with accepted practice: discount factors are appropriately applied, and parcel values are further discounted for time and cost-of-sale.

5. The sequence of offers and counteroffers indicates that SPT reduced its asking price by a greater amount than the JPB raised their offering price, when equivalent properties are compared.

6. The operating arrangements proposed in the Letter-of-Intent are reasonable and consistent with standard industry practice.

7. The capital improvements to which the JPB proposes to commit are reasonable in scale, and justified by the scope of the proposed commute operation.

8. The formula proposed for use in allocating maintenance costs is an accepted industry standard.

9. The proposed formula for assigning the value of rents and leases on acquired properties is somewhat convoluted, but its provisions are not without justification and, in any case, have no material effect on the value of the transaction.

10. The Letter of Intent adequately indemnifies the JPB for defects in title, for toxic waste contamination, and for liabilities due to potential labor protection.

11. The project for which State funding is requested includes only those parts of the transaction which relate to:

    (a) Rights-of-way in current use by the existing Caltrain service between San Francisco and San Jose;

    (b) Right-of-way and facilities between San Jose and Lick, required to access a new maintenance facility planned for early implementation;

    (c) Additional property to expand station parking and provide for future grade separation projects (which are already funded); and

    (d) Track rights for the service extension to Gilroy which is an early implementation project. Thus, most of the property for which State funds are requested would be used for active passenger service prior to Year 2000.

12. JPB plans for funding the right-of-way acquisition have been modified since this Review was initiated to include a substantial local funding share. This was in direct response to cautions given during the Review regarding the evident shortage of State funds for rail projects.

13. The current JPB right-of-way acquisition funding proposal (JPB Application of May 9, 1991 for funding under the Clean Air and Transportation Improvement Act) calls for use in this fiscal year of all $173 million in State Proposition 116 funds earmarked for the Peninsula

Corridor. Given the current State financial crisis and the projected level of State Rail Bond funds to be available this year and next, this proposal is impractical.

14. The specific sources of local funding for the proposed right-of-way purchase are uncertain. The specified Santa Clara County share of the proposed local commitment, in particular, has not been confirmed.

15. The JPB has resolved to continue the Caltrain service following right-of-way acquisition. However, specific local agreements for funding the projected operating subsidies have not yet been confirmed by all parties. The total magnitude of the local subsidy to be funded is projected to be at least double the present level after 1993 when State operating support is scheduled to end.

16. The primary justifications for use of State funds for the right-of-way purchase are:

    (a) Long-term preservation of the right-of-way for transportation purposes;

    (b) Uncertainty regarding the Southern Pacific's willingness to extend the existing operating agreement after 1992 at a price the local agencies could afford, and the potential ability of the Southern Pacific to terminate service and sell-off parts of the right-of-way in the absence of a mutually acceptable operating agreement or public acquisition of the right-of-way; and

    (c) The voter mandate of Proposition 116 to expend $120.0 million in State Rail Bond funds for Peninsula Corridor right-of-way acquisition.

17. A more practical plan than presently exists for funding the right-of-way purchase is needed which either relies less on State Proposition 116 Rail Bond funds or defers the expenditure of Proposition 116 funds--with local funds advanced based on an assurance from the State that the full amount of Proposition 116 funds specifically mandated for the Peninsula Corridor will subsequently be made available according to a specified schedule.