

TRANSPORTATION CORRIDOR AGENCIES
ANNUAL REPORT 2003

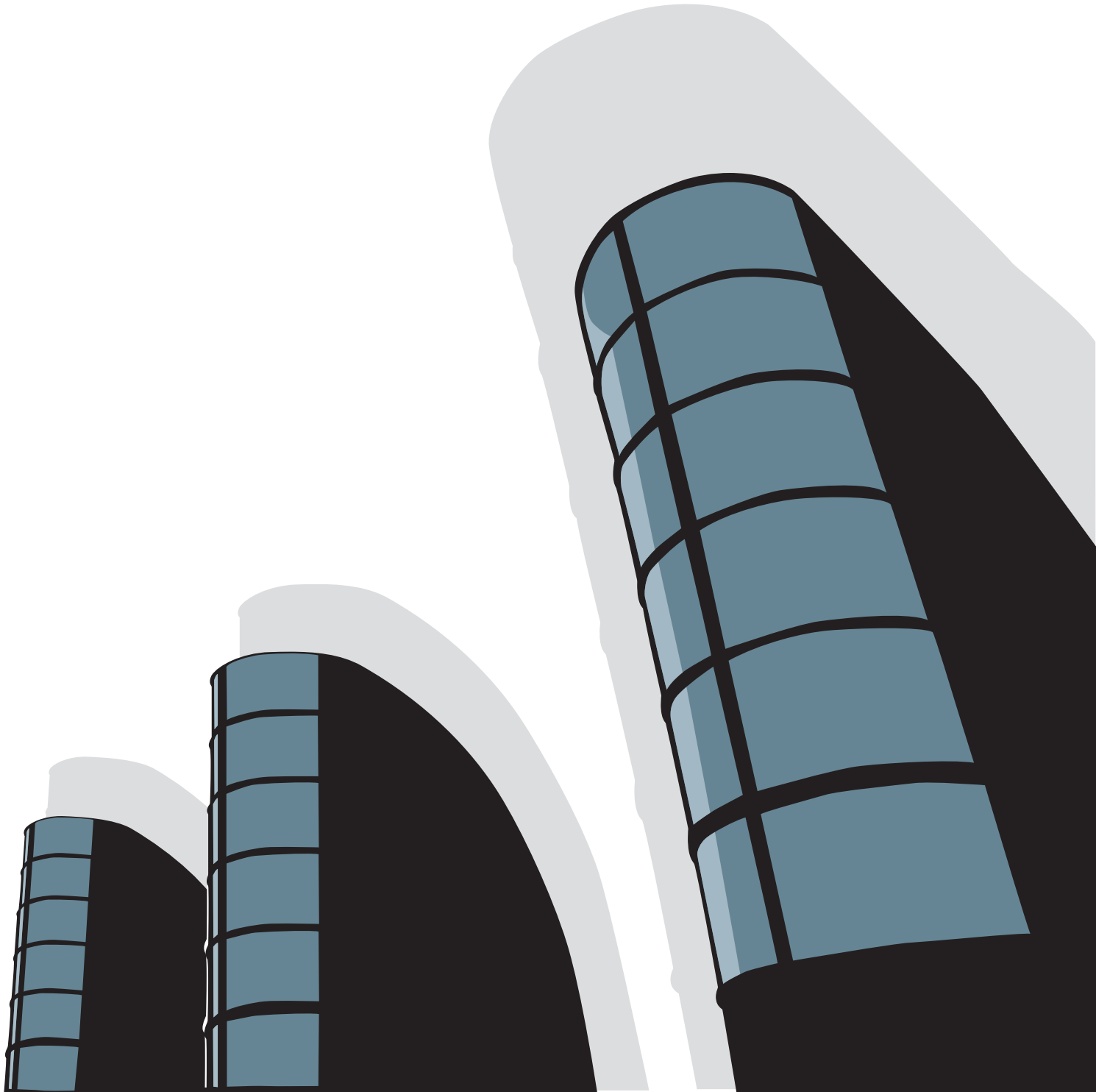
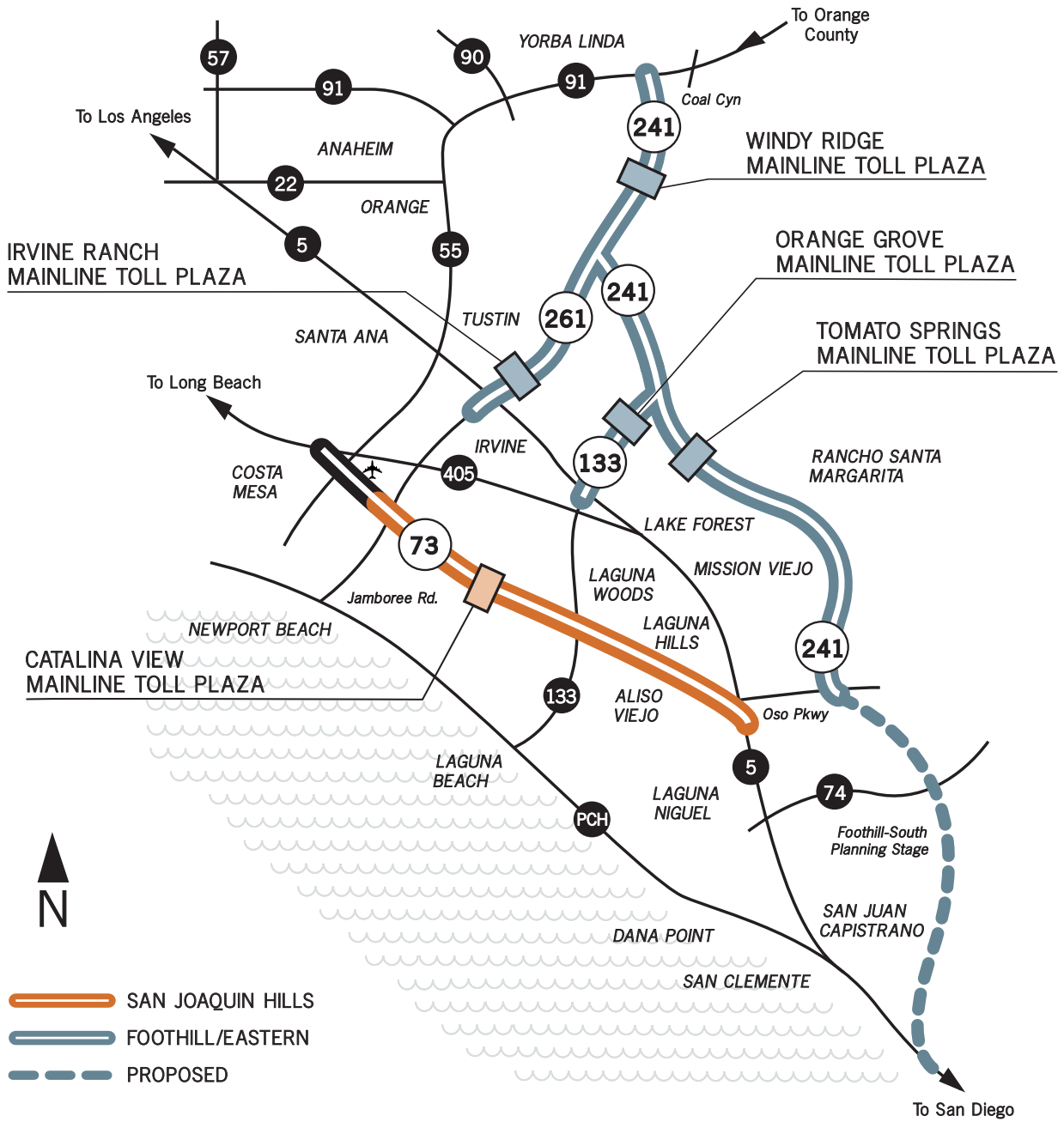


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TOLL ROAD SYSTEM MAP



ABOUT TCA

The Transportation Corridor Agencies were formed in 1986 to plan, design, finance, build and operate a 67-mile public toll road system in Orange County.

Today, the TCAs' toll road network spans 51 miles, carrying an estimated 280,000 vehicles per day. Since the first segment of the Foothill (241) Toll Road opened in 1993, commuters and businesses throughout southern California have grown to rely on the toll road network as a congestion-free alternative to area freeways.

WHY TOLL ROADS?

Studies conducted in the 1970s identified the need for several new highways to serve Orange County's booming population. Roughly sketched into county road plans by August 1981, the future San Joaquin Hills, Foothill and Eastern corridors were so-named because road planners weren't sure if they would be highways or freeways. No one initially envisioned them as toll roads.

In the 1970s and 1980s, the rising popularity of compact, fuel-efficient vehicles resulted in a decline of state and federal gas tax revenue, revenue that is set aside to maintain and build new roads. Without traditional tax revenue sources, local leaders turned to private land developers for "seed money" to help fund road construction until state or federal money was available.

TURNING TO TOLLS

In the mid-1980s, it became apparent that state or federal gas tax revenues were unavailable. Local leaders had to find some other revenue source to build roads or they wouldn't be built at all – a disastrous prospect given the county's explosive growth. The idea of charging tolls as a way to finance the proposed roads first surfaced in 1984, but no real decision was made until 1986 when two public joint-powers agencies were born.

The Foothill/Eastern Transportation Corridor Agency was formed to plan, finance, and operate the Foothill (241) and Eastern (241, 261, and 133) Corridors; the San Joaquin Hills Transportation Corridor Agency was formed to plan, finance, and operate the San Joaquin Hills (73) Corridor. A year later, state law gave the Agencies the authority to construct the new roads as toll facilities and issue bonds backed by future toll revenues and development impact fees.

PUBLIC INFRASTRUCTURE, PRIVATE INVESTMENT

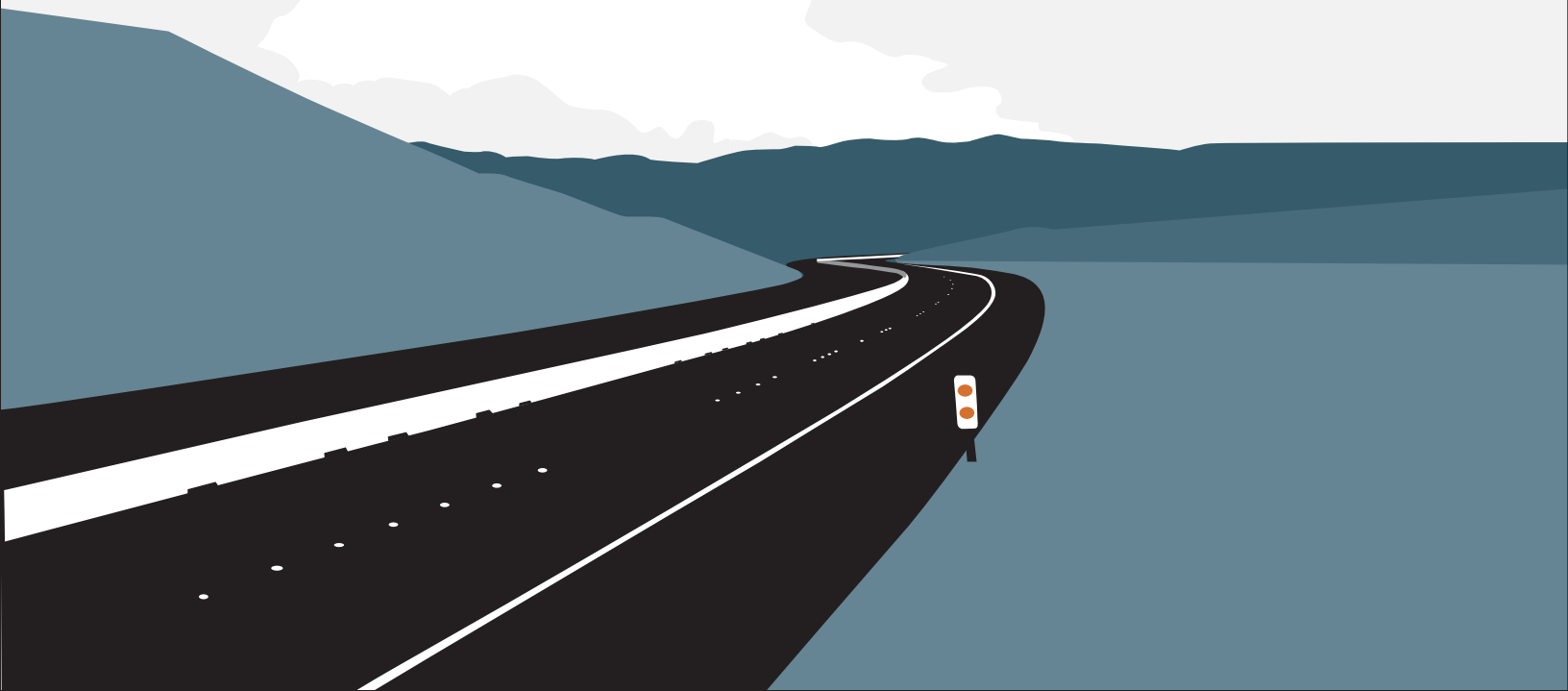
The 73, 241, 261, and 133 Toll Roads opened in phases between 1993 and 1998 – the first public highways to be constructed in Orange County since 1987. Unlike taxpayer-funded roads, toll road construction was funded by the sale of municipal bonds. Individual and institutional bond investors are repaid over time from future toll and development fee revenues.

As part of the state highway system, The Toll Roads are maintained by the state Department of Transportation, or Caltrans. However, taxpayers are not responsible for repaying the Agencies' debt if future toll revenues fall short since state or local tax revenues are not used to back bond payments.

COMMITMENT TO THE FUTURE

The future of the Transportation Corridor Agencies will be focused on the completion of the last segment of the Foothill (241) Toll Road. In 2004, the Foothill/Eastern Transportation Corridor Agency will reach a milestone in the environmental planning process for the project known as Foothill-South, when the draft Environmental Impact Statement/Subsequent Environmental Impact Report is released for public review. The project is the last piece of the TCAs 67-mile toll road network that has provided significant regional congestion relief since the first segment of the 241 Toll Road opened 10 years ago.

As the region's population increases and the economy grows, the Transportation Corridor Agencies remain committed to its mission of enhancing mobility, providing excellent customer service, and preserving the quality of life for residents and commuters.



BOARD MEMBERS

2003 F/ETCA BOARD OF DIRECTORS



Chairman Peter Herzog
Lake Forest



Mike Alvarez
Orange



Bill Campbell
County of Orange, 3rd District



Jim Dahl
San Clemente



Bob Hernandez
Anaheim



Brett Franklin
Santa Ana



Beth Krom
Irvine



Lance MacLean
Mission Viejo



Chris Norby
County of Orange, 4th District



Ken Ryan
Yorba Linda



Joe Snyder
Dana Point



David Swerdlin
San Juan Capistrano



Jim Thor
Rancho Santa Margarita



Tom Wilson
County of Orange, 5th District



Tracy Worley-Hagen
Tustin

2003 SJHTCA BOARD OF DIRECTORS



Chairwoman Linda Lindholm
Laguna Niguel



Gary Adams
Newport Beach



Bill Campbell
County of Orange, 3rd District



William Craycraft
Mission Viejo



Jim Dahl
San Clemente



Brett Franklin
Santa Ana



Bert Hack
Laguna Woods



Beth Krom
Irvine



Joel Lautensleger
Laguna Hills



Gary Monahan
Costa Mesa



William Ossenmacher
Dana Point



David Swerdlin
San Juan Capistrano



Tom Wilson
County of Orange, 5th District



Carmen Vali-Cave
Aliso Viejo

2003 HIGHLIGHTS

CONSTRUCTION PROJECTS The first new interchange at Glenwood/Pacific Park Drive on the 73 Toll Road was completed, serving the residents and businesses of Aliso Viejo. Three construction projects began this year to improve traffic flow on the 241 Toll Road. The addition of one northbound lane for four miles between Santa Margarita Parkway and Bake Parkway, the widening of the northbound Santa Margarita Parkway on-ramp, and the addition of a third FasTrak lane between the 241 and 133 Toll Roads will help ease heavy rush-hour traffic for commuters from Lake Forest, Rancho Santa Margarita, Mission Viejo, Coto de Caza, and canyon communities.

ENVIRONMENTAL MITIGATION The San Joaquin Hills Agency received concurrence from the U.S. Fish and Wildlife Service that it has met all mitigation obligations for 256 acres of revegetated and preserved coastal sage scrub habitat along the Bonita Creek Channel, Bonita Reservoir, and the former Coyote Canyon Landfill. Since biologists began monitoring the mitigation sites, 29 breeding California gnatcatchers have been observed, an indication that the mitigation areas serve as an important wildlife link for the region.

LANDSCAPING ENHANCEMENTS A \$3.4 million landscaping enhancement project began along the 241 and 261 Toll Roads. Targeted areas include slopes along the 261 north of Portola Parkway, at Portola Parkway and the Tomato Springs Mainline Toll Plaza on the 241, and at the Chapman/Santiago Canyon interchange in east Orange.

FOOTHILL-SOUTH The Foothill/Eastern Agency achieved a significant milestone in the continuing environmental review process for Foothill-South, the last segment of the 241 Toll Road. Twenty-one technical reports were completed analyzing potential environmental impacts on traffic, air quality, water, land-use, and other economic and environmental concerns. The reports will serve as the basis of the draft Environmental Impact Statement/Supplemental Environmental Impact Report that will be circulated in spring 2004 for public review.

TOLL ENFORCEMENT The TCAs completed the installation of dozens of new high-tech cameras to aid in toll violation enforcement. The new cameras, coupled with new optical character recognition software, increased the rate of clear vehicle license plate images to 80-90% systemwide. This has resulted in a significant increase in the number of vehicle license plates that are automatically processed.

OPERATIONAL SAVINGS Three toll operations contracts were successfully negotiated resulting in an annualized savings of approximately \$1.2 million.

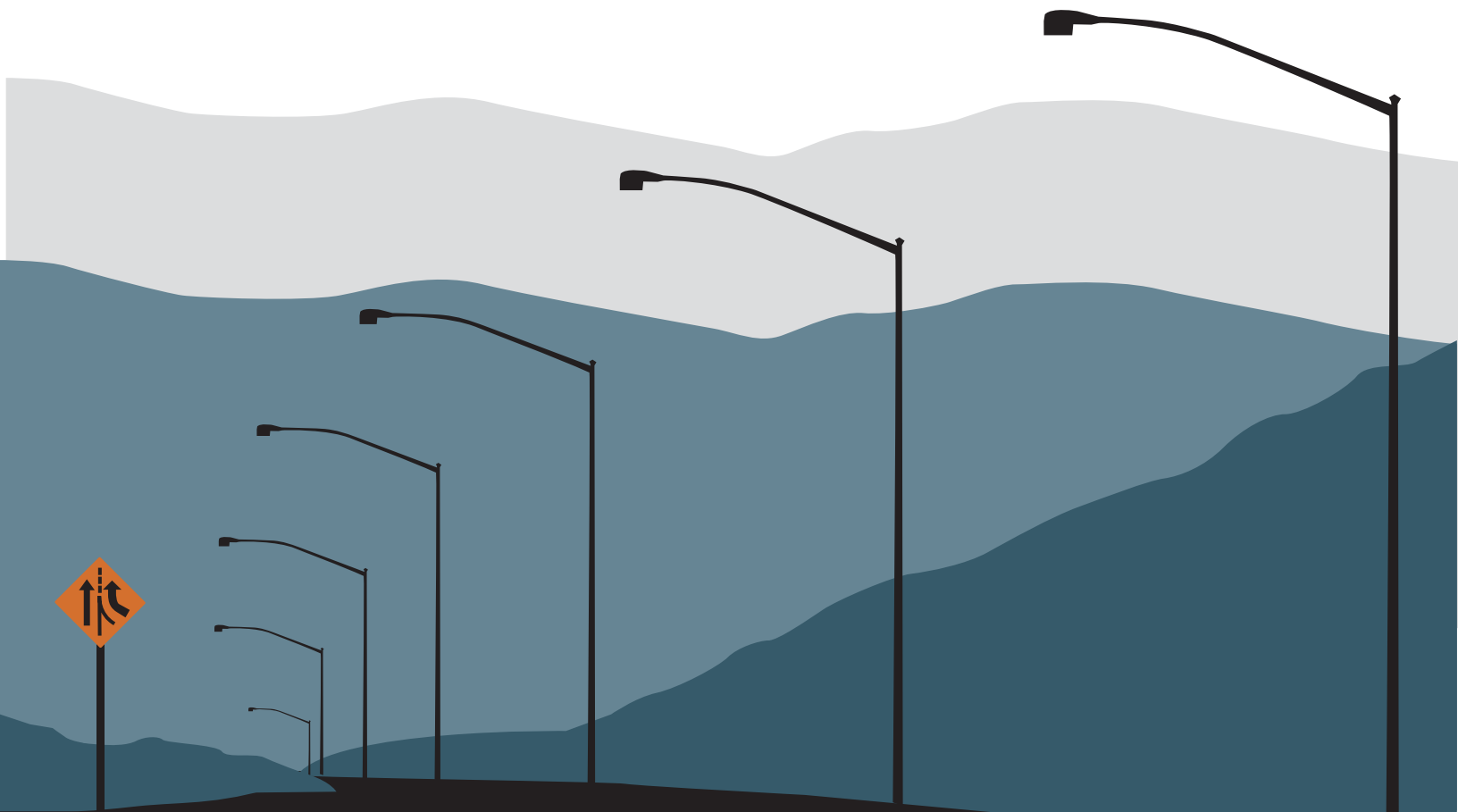
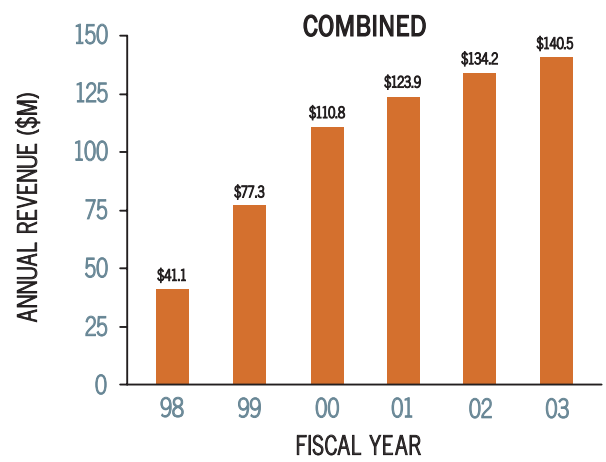
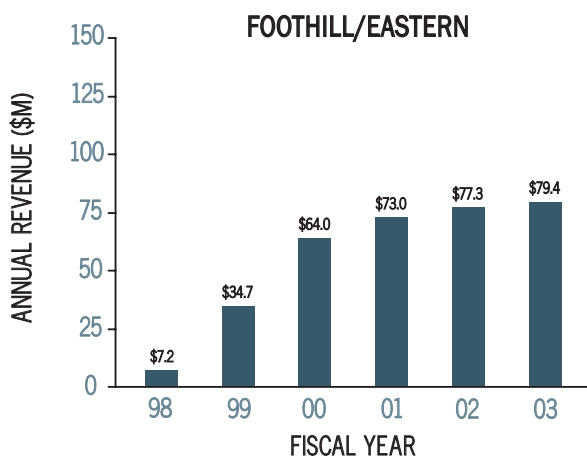
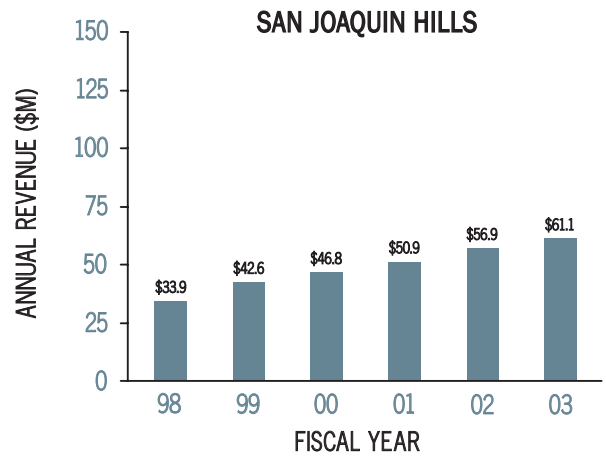
CONSOLIDATION STUDY The San Joaquin Hills and Foothill/Eastern Boards completed a number of steps in the analysis for a potential financial plan to combine the two Agencies. In FY2003, the agencies completed a traffic and revenue study, created the Transportation Corridor System (TCS), a third joint powers agency to potentially acquire the two Agencies, and adopted a 21-member TCS Board structure. A final decision on consolidation is expected in 2004.

COMMUNITY RELATIONS TCA representatives spent 2,500 hours at community events throughout Orange County promoting The Toll Roads and TCA initiatives. Ongoing outreach programs include informational presentations to homeowner and civic groups, event sponsorships, and supporting the business community through Chamber of Commerce events.



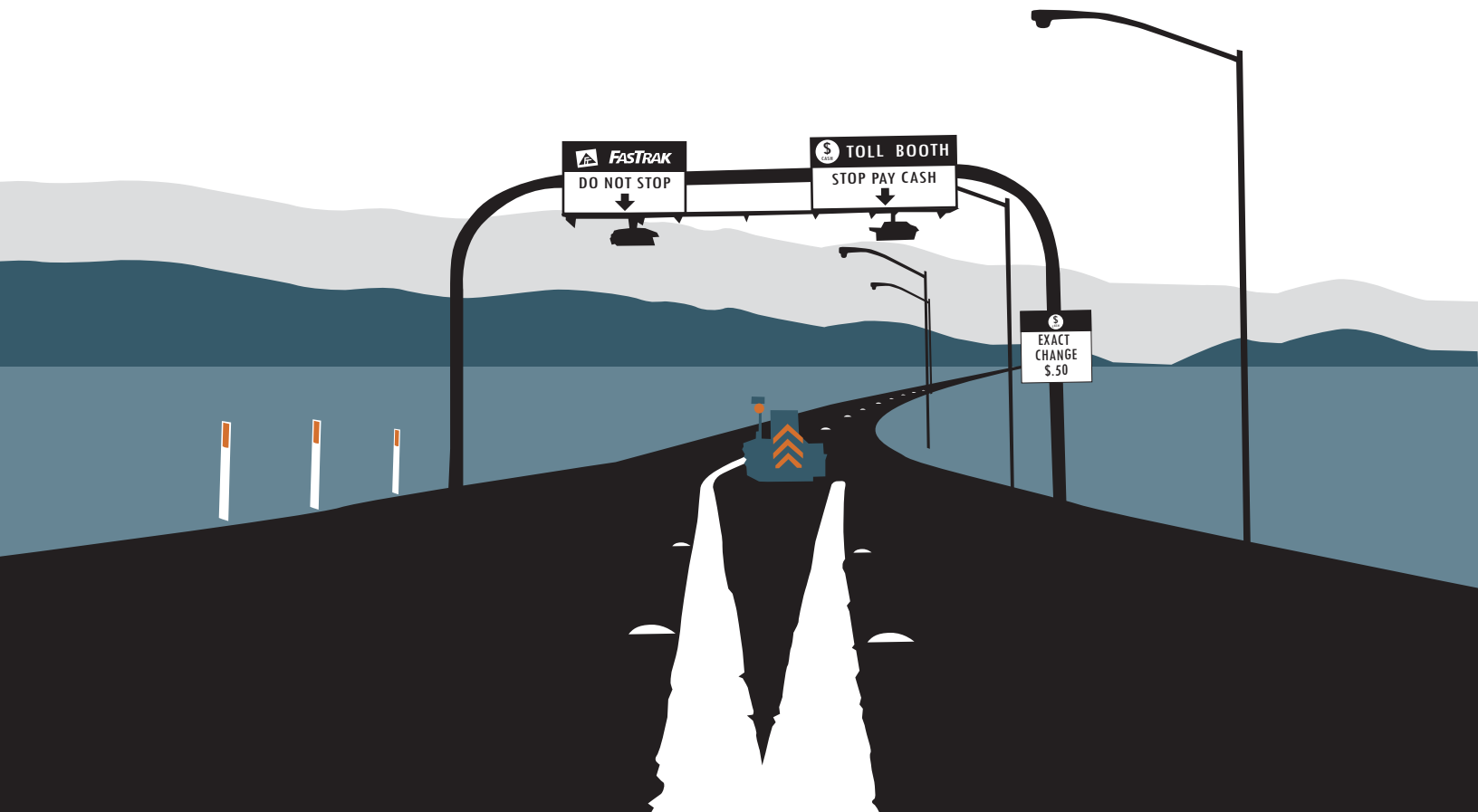
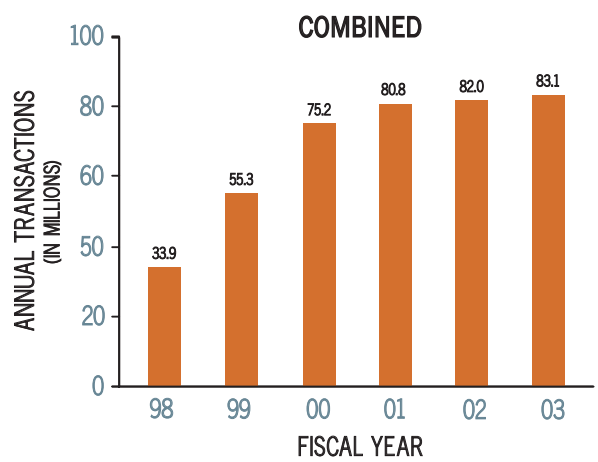
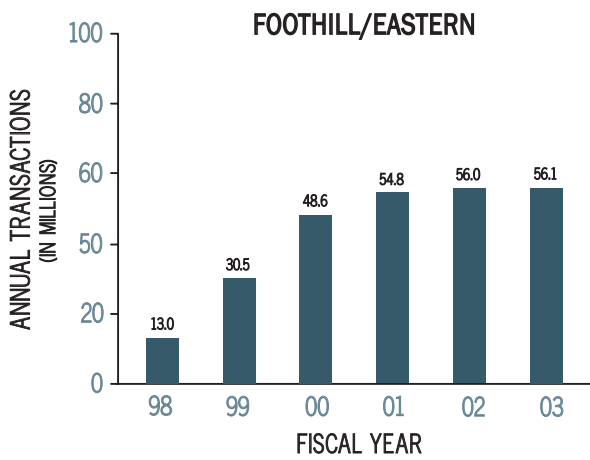
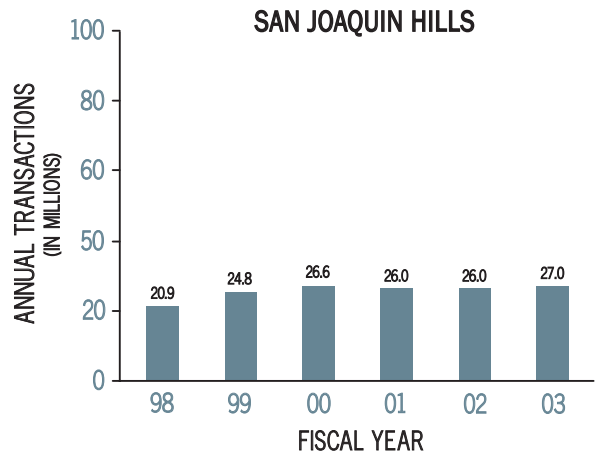
REVENUE GROWTH ANALYSIS

*Annual Revenue per Published Traffic & Revenue Reports



TRANSACTION GROWTH ANALYSIS

*Annual Transactions per Published Traffic & Revenue Reports



FY2003 SOURCES/REVENUES AND USES/EXPENSES

| SOURCES/REVENUES | SJHTCA | F/ETCA | TOTAL |
|---|----------------|----------------|------------|
| Tolls, Fees and Fines | \$ 63,117 | \$ 83,118 | \$ 146,235 |
| Development Impact Fees | 9,758 | 21,619 | 31,377 |
| Investment Income | 6,408 | 38,858 | 45,266 |
| Grants and Other | 3,715 | 1,122 | 4,837 |
| Total | \$ 82,998 | \$ 144,717 | \$ 227,715 |
| USES/EXPENSES | | | |
| Debt Interest and Accretion | \$ 99,966 | \$ 108,305 | \$ 208,271 |
| Debt Principal Payments | 18,025 | - | 18,025 |
| Operations | 43,007 | 58,612 | 101,619 |
| Capitalized Construction & Intangible Asset Costs | 5,459 | 30,087 | 35,546 |
| Purchase of Furniture, Facility & Toll Revenue Equipment | 1,378 | 3,487 | 4,865 |
| Total | \$ 167,835 (1) | \$ 200,491 (2) | \$ 368,326 |

(1) Uses/expenses are greater than sources/revenues primarily as a result of noncash items including accretion of \$56,523 and amortization and depreciation of \$31,895.

(2) Uses/expenses are greater than sources/revenues primarily as a result of noncash items including accretion of \$53,976 and amortization and depreciation of \$38,860.



TOLL ROAD USAGE STATISTICS

SAN JOAQUIN HILLS

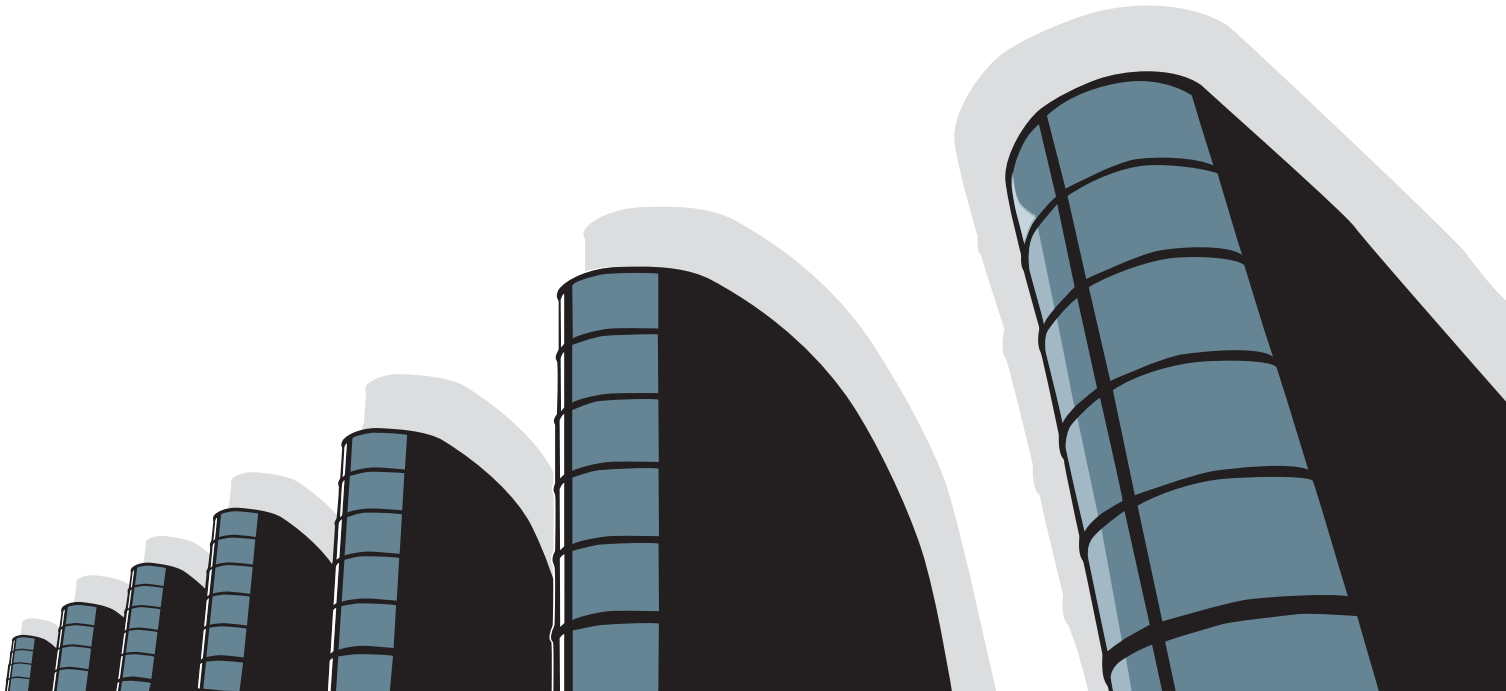
| | FY 2003 | FY 2002 |
|---|---------------|---------------|
| Transactional Toll Revenue | \$ 61,147,499 | \$ 56,864,910 |
| Total Transactions | 27,024,334 | 26,055,147 |
| Average Daily Transactional Toll Revenues | \$ 167,527 | \$ 155,794 |
| Average Weekly Transactions | 519,699 | 501,061 |
| Total FasTrak Transactions | 15,787,591 | 14,547,811 |
| Average Daily FasTrak Transactions | 43,254 | 39,857 |
| Average % of FasTrak | 58% | 56% |

FOOTHILL/EASTERN

| | FY 2003 | FY 2002 |
|---|---------------|---------------|
| Transactional Toll Revenue | \$ 79,383,504 | \$ 77,336,314 |
| Total Transactions | 56,136,264 | 55,998,440 |
| Average Daily Transactional Toll Revenues | \$ 217,489 | \$ 211,880 |
| Average Weekly Transactions | 1,079,544 | 1,076,893 |
| Total FasTrak Transactions | 35,401,580 | 33,105,780 |
| Average Daily FasTrak Transactions | 96,991 | 90,701 |
| Average % of FasTrak | 63 % | 59% |

COMBINED

| | FY 2003 | FY 2002 |
|---|----------------|------------|
| Transactional Toll Revenue | \$ 140,531,003 | \$ 134,201 |
| Total Transactions | 83,160,598 | 82,053,587 |
| Average Daily Transactional Toll Revenues | \$ 385,016 | \$ 367,675 |
| Average Weekly Transactions | 1,599,242 | 1,577,954 |
| Total FasTrak Transactions | 51,189,171 | 47,653,591 |
| Average Daily FasTrak Transactions | 140,244 | 130,558 |
| Average % of FasTrak | 62 % | 58% |



____ TECHNICAL ADVISORY COMMITTEE
____ SAN JOAQUIN HILLS COMMITTEE
____ FOOTHILL/EASTERN COMMITTEE
____ JOINT ADMINISTRATION COMMITTEE
____ LEGAL & LEGISLATIVE COMMITTEE
____ JOINT MARKETING COMMITTEE
 X SAN JOAQUIN HILLS BOARD OF DIRECTORS
____ FOOTHILL/EASTERN BOARD OF DIRECTORS

Report No. 5
File No. 2003S004

BOARD MEETING DATE: October 16, 2003

SUBJECT: Audited financial statements for San Joaquin Hills Transportation Corridor Agency for the year ended June 30, 2003

STAFF RECOMMENDATION:

Approve Audited Financial Statements for the San Joaquin Hills Transportation Corridor Agency for the year ended June 30, 2003

SUMMARY:

The audited financial statements for the year ended June 30, 2003 are presented in conformity with generally accepted accounting principles applicable to governmental entities, including the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, which was adopted by the Agency during the Fiscal Year. The presentation of the Agency's financial statements under the provisions of Statement 34 include presenting a section of Management's Discussion and Analysis, a Statement of Fund Net Assets, Statement of Revenues, Expenses and Changes in Fund Net Assets, and a Statement of Cash Flows for all of the Agency's activities.

Concurrent with the adoption of Statement 34, the Agency began accounting for the activity that was previously reported as the governmental funds (the Capital Project and Debt Service Funds) as proprietary fund activity and accordingly changed the basis of accounting from the modified accrual basis of accounting to the accrual method of accounting. A single enterprise fund presentation is now provided to reflect the fact that tolls are the main source of funds for bond repayments and that the Agency is now primarily an operating entity.

With the implementation of Statement 34, the Agency now records an intangible asset. The value of this asset, under governmental accounting rules, was based upon historical costs of the construction of the corridor and does not reflect the present value of projected toll revenues, which is the true value of the Agency's assets, as we do not own the road. By using historical costs, as required, the Agency's Statement of Net Assets shows a deficit. This deficit is purely a result of the intangible asset being recorded at historical cost of constructing the corridor, while the debt was issued under a projected revenue stream.

Accordingly, the Net Asset deficit does not indicate that the Agency cannot make operating and debt service payments.

REPORT WRITTEN BY:

Marybeth Hudson, Controller and Brenda Shott, Controller

REVIEWED BY:

| | |
|-----------------------------------|-------------------|
| Engineering/Environmental | <u>N/A</u> |
| Communications and Public Affairs | <u>N/A</u> |
| Finance | <u> </u> |
| Toll Operations | <u>N/A</u> |

ANNUAL FINANCIAL REPORT
San Joaquin Hills Transportation Corridor Agency
Year ended June 30, 2003
with Report of Independent Auditors

San Joaquin Hills Transportation Corridor Agency

Annual Financial Report

Year ended June 30, 2003

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Report of Independent Auditors

To the Honorable Board of Directors of the
San Joaquin Hills Transportation Corridor Agency

We have audited the accompanying financial statements of the San Joaquin Hills Transportation Corridor Agency (Agency) as of and for the year ended June 30, 2003, as listed in the table of contents. These financial statements are the responsibility of the Agency's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the San Joaquin Hills Transportation Corridor Agency as of June 30, 2003, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the financial statements, the Agency adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus, an amendment of GASB Statements No. 21 and 34*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*.

The Management's Discussion and Analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

ΕΨ

August 28, 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year Ended June 30, 2003

This discussion and analysis of the San Joaquin Hills Transportation Corridor Agency's (the Agency) financial performance provides an overview of the Agency's financial activities for the fiscal year ended June 30, 2003. Please read it in conjunction with the Agency's financial statements and accompanying notes.

Background

The San Joaquin Hills Transportation Corridor Agency was formed in 1986 as a Joint Powers Authority by the County of Orange and cities in Orange County, California. The Agency was created to plan, design, finance, construct and operate a 15-mile toll road, known as the San Joaquin Hills (State Route 73) Toll Road.

Planning began in the 1970s, when local transportation studies identified the need for new highways, including the San Joaquin Hills Transportation Corridor (State Route 73), to serve Orange County's growing population. In the early 1980s, the corridor was envisioned as a free highway funded through state or federal gas-tax revenues, but with a shortage of gas-tax revenues to fund transportation improvements and increasing costs of building new roads, local officials began to study alternative ways to fund road projects.

In the mid 1980s, two state laws were passed authorizing the Agency to collect tolls and development impact fees to fund road construction. With a pledged revenue stream from future tolls, the Agency issued non-recourse, toll-revenue bonds to fund road construction, rather than relying on the uncertainty of state gas-tax revenue. The Agency also reached an agreement with the California Department of Transportation (Caltrans) to assume ownership, liability, and maintenance of the State Route 73 Toll Road as part of the state highway system. This agreement eliminated the need for the Agency to seek additional funding sources for road maintenance.

In 1996, the State Route 73 Toll Road opened to traffic, the first publicly operated toll road in Southern California. Today, more than 90,000 transactions are recorded on the State Route 73 Toll Road every weekday, serving as an important, timesaving alternative route to Interstate 405 and Interstate 5 Freeways.

Financial Highlights

(in thousands)

Tolls, fees and fines collected in Fiscal Year 2003 (FY 2003) totaled \$63,117 compared to \$57,059 in the prior fiscal year, an increase of 10.6%.

Interest payments of \$43,738 and principal payments of \$18,025 on the Agency's long-term debt were made in FY 2003 compared to \$43,665 and \$14,105, respectively, in the prior fiscal year. Accretion on the Agency's Capital Appreciation Bonds and Convertible Capital Appreciation Bonds totaled \$56,523 compared to \$54,192 in the prior fiscal year.

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended June 30, 2003

Financial Highlights (continued)
(in thousands)

The Agency has implemented Governmental Accounting Standards Board Statement No. 34 and, accordingly, has recorded an intangible asset of \$1,246,194, valued at the underlying historical cost of constructing the corridor, which has been transferred to Caltrans. The intangible asset, while representing the Agency's right to collect tolls, does not reflect the present value of projected toll revenues. This intangible is being amortized over the life of the bonds, which have maturities through 2036.

As of June 30, 2003, the Agency has \$176,263 in restricted cash and investments governed under the 1993 and 1997 Master Indentures of Trust. The Agency also has \$4,952 in unrestricted cash.

Total net assets (deficit) at June 30, 2003 is \$(654,312). The deficit results primarily from the recording of long-term debt, proceeds of which not only funded the construction of the corridor, for which ownership was transferred to Caltrans upon completion of the corridor, but also other non-capitalized expenses related to the corridor.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Agency's financial statements which are comprised of the Statement of Fund Net Assets (Deficit), Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit) and the Statement of Cash Flows and notes to the financial statements. Concurrent with the adoption of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* (Statement 34), the Agency began accounting for the activity in its governmental funds (the Capital Projects and Debt Service Funds) as proprietary fund activity. An enterprise fund presentation is preferable to reflect the current activities of the Agency since tolls, which are user fees, are the primary source of funds for bond repayments.

The financial statements present the financial picture of the Agency from the economic resources measurement focus using the accrual basis of accounting. These statements include all assets of the Agency as well as all liabilities. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. The Statement of Cash Flows provides information about the Agency's cash receipts, cash payments and net changes in cash resulting from operations, capital financing activities and investing during the reporting period.

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended June 30, 2003

Overview of the Financial Statements (continued)

The Statement of Fund Net Assets (Deficit) and the Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit) report the Agency's net assets and changes in them. Net assets are the difference between the recorded assets and liabilities. The Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit) present information showing how the Agency's net assets changed during the fiscal year. The activities include all toll revenues and operating expenses related to the operation of the San Joaquin Hills Transportation Corridor. In addition, all of the Agency's construction related activities, including the design, construction and mitigation on the San Joaquin Hills Transportation Corridor, as well as all financing costs and administration of the project, are reflected in the Statements. The activities are financed by toll revenues, development impact fees, remaining bond proceeds, fees and fines, investment income, and state and federal grants.

Financial Analysis
(in thousands)

The following table summarizes the changes in net assets (deficit) of the Agency between June 30, 2003 and 2002:

| | 2003 | 2002 | Percent Increase (Decrease) |
|-----------------------------------|---------------------|---------------------|--|
| Assets: | | | |
| Current assets | \$ 53,229 | \$ 45,728 | 16.4% |
| Capital assets, net | 1,061,706 | 1,087,399 | (2.4) |
| Noncurrent assets | 133,527 | 139,604 | (4.4)% |
| Total assets | <u>1,248,462</u> | <u>1,272,731</u> | (1.9)% |
| Liabilities: | | | |
| Bonds payable | 1,875,292 | 1,836,794 | 2.1% |
| Other liabilities | 27,482 | 30,274 | (9.2)% |
| Total liabilities | <u>1,902,774</u> | <u>1,867,068</u> | 1.9% |
| Total net assets (deficit) | <u>\$ (654,312)</u> | <u>\$ (594,337)</u> | (10.1)% |

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended June 30, 2003

Financial Analysis (continued)
(in thousands)

The purpose of the Agency is to operate and collect tolls from the patrons of the corridor to extinguish the related long-term bond debt. The debt, issued in the form of tax-exempt bonds, was issued to construct the road, which subsequent to completion, are transferred to Caltrans. Upon implementation of Statement 34, and changing the financial statement presentation to an enterprise fund, the Agency recorded an intangible asset. The cost basis of this intangible asset is the underlying historical cost of constructing the corridor, which has been transferred to Caltrans. The intangible asset, while representing the Agency's right to collect tolls, does not reflect the present value of projected toll revenues. Additionally, the Agency recorded the long-term debt that was previously presented in the long-term debt account group in the 2002 financial statements. The net assets (deficit) results primarily from using bond proceeds to fund non-capitalized expenses related to the corridors and from the accretion of interest on the bonds.

The current assets of the Agency have increased due to an increase in restricted cash related to the funding requirements of the 1997 debt service funds for principal and interest payments and an increase in the fair market value of the investments held.

Capital assets, net have decreased slightly due to the amortization of the intangible asset. Amortization of the intangible asset is over the life of the outstanding bonds, which have maturities through 2036.

The increase in bonds payable results from the current year accretion on the capital appreciation bonds and the convertible capital appreciation bonds totaling \$56,523 offset by a principal payment of \$18,025. Other liabilities have decreased as a result of decreased construction payables due to the completion of the Glenwood Pacific interchange.

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended June 30, 2003

Financial Analysis (continued)
(in thousands)

The following is a summary of the Agency's revenues, expenses and changes in net assets (deficit) for the year ended June 30, 2003:

| | 2003 | Percent of Total Revenue |
|---|--------------|---|
| Operating revenues: | | |
| Tolls, fees and fines | \$ 63,117 | 86.3% |
| Development impact fees | 9,758 | 13.3% |
| Other revenue | 306 | 0.4% |
| Total operating revenues | 73,181 | 100.0% |
| Operating expenses | 43,007 | 58.8% |
| Operating income | 30,174 | 41.2% |
| Nonoperating revenue (expenses) | (90,149) | (123.2)% |
| Change in net assets (deficit) | (59,975) | (82.0)% |
| Net assets (deficit) at beginning of year | (594,337) | (812.1)% |
| Net assets (deficit) at end of year | \$ (654,312) | (894.1)% |

The primary source of revenues for the Agency is tolls, fees and fines at 86.3% of total revenue. The main operating expenses relate to payments to third-party contractors for systems and equipment, violation processing, service center and toll collection operations. Also included in operating expenses are the non-cash expenses of depreciation on fixed assets and amortization of the intangible asset amounting to \$31,895. Nonoperating revenue (expenses) consists of investment income totaling \$6,408, grant revenue of \$3,409 and interest expense of \$99,966. Interest expense is comprised of both interest payments on long-term debt, net of amounts capitalized, totaling \$43,443 and accretion of bonds outstanding of \$56,523. The decrease in net assets (deficit) is a result of both the non-cash expenses and the accretion of bonds outstanding. The revenues earned by the Agency were sufficient to cover its current obligations including debt service of \$43,738 and operating expenses, excluding depreciation and amortization.

In future years, when prior year information is available, a comparison of the Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit) will be provided.

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended June 30, 2003

Capital Assets, Net
(in thousands)

The following table summarizes the capital assets, net at June 30:

| | <u>2003</u> | <u>2002</u> |
|-----------------------------------|--------------------|---------------------|
| Construction in progress | \$ 9,367 | \$ 4,614 |
| Furniture, equipment and vehicles | 75 | 657 |
| Toll revenue equipment | 6,463 | 5,826 |
| Intangible assets | <u>1,045,801</u> | <u>1,076,302</u> |
| Total capital assets | <u>\$1,061,706</u> | <u>\$ 1,087,399</u> |

Construction in progress at June 30, 2003 represents costs for the Glenwood Pacific interchange which will be transferred to Caltrans in fiscal year 2004. Toll revenue equipment includes transponders, toll and violations collection equipment, toll booths and buildings and changeable message signs.

As of June 30, 2003, the Agency's intangible asset totaled \$1,045,801, net of accumulated amortization. The intangible asset balance is increased by the cost of improvements completed and transferred to Caltrans during the year, including capitalized interest. During the year ended June 30, 2003, the Agency completed improvements totaling \$410 and recorded capitalized interest of \$295. The current year amortization of the intangible asset, which is being amortized over the life of the bonds payable, amounted to \$31,207.

More detailed information about the Agency's capital assets is presented in Note 5 to the financial statements.

Budgetary Highlights
(in thousands)

The Agency's Board of Directors adopts an annual budget prior to the beginning of a fiscal year. The expense budget for FY2003 was amended once during the year. The amendment was to provide funding for a traffic and revenue consultant in the amount of \$740.

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended June 30, 2003

Debt Administration
(in thousands)

The Agency has outstanding bonds payable of \$1,875,292 at June 30, 2003, an increase from the prior year of \$38,498 due to the accretion of principal on convertible capital appreciation bonds and capital appreciation bonds totaling \$56,523 offset by a principal payment of \$18,025. All the Agency's toll revenue, less certain expenses, as defined, is pledged to repay these bonds. There were no changes to the debt structure during fiscal year 2003.

The Agency has several debt covenants contained in the Master Indentures of Trust. The Agency was in compliance with all of its covenants during the year ended June 30, 2003.

While toll revenue has increased over the last several years and the Agency continues to pay its operating costs and debt service, revenue has not grown as fast as originally projected when the bonds were issued. Since 2000, the Agency has taken numerous measures to help bridge the gap between actual and projected revenue, including establishing the toll rate stabilization fund, implementing toll rate increases, defeasing debt with proceeds from the Orange County bankruptcy settlement, and reducing operational costs by transitioning to new customer service vendor. Under its present capital structure, it is anticipated that in fiscal 2005 the Agency will not meet the required coverage ratio of 1.3x Annual Debt Service, and will not be able to make full debt service payments in 2012. If during the process of preparing the fiscal year 2005 budget in June 2004, the Agency determines that expected revenues from the current toll rate schedule are not likely to provide the required debt service coverage, the Agency will take steps to increase toll revenues or decrease costs and hire a Traffic Consultant as set forth in the Indenture Covenant. If after implementation of such actions, Adjusted Net Toll Revenues for fiscal year 2005 still fall short of the debt ratio covenant, the Agency will repeat the process of analysis and implementation. Under this scenario, the failure to meet the debt ratio covenants will not constitute an event of default.

Economic Factors and Next Year's Budgets and Rates
(in thousands)

The Agency is continuing to seek ways to increase revenue and encourage more drivers to use FasTrak, the most cost-effective way for the Agency to collect tolls. Based on updated traffic and revenue data, received in FY 2004, the Agency will implement in October 2003 increased toll rates for cash and FasTrak patrons at the mainline toll plaza during weekday peak commute periods. The increases are expected to result in additional revenue for the Agency.

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended June 30, 2003

Economic Factors and Next Year's Budgets and Rates (continued)
(in thousands)

In April 2003, the Agency and the Foothill/Eastern Transportation Corridor Agency formed a joint powers agency, the Transportation Corridor System, to explore the possibility of purchasing the assets of both the Agency and the Foothill/Eastern Transportation Corridor Agency and managing both toll roads as a single system. The Transportation Corridor System would finance the purchase through the issuance of new bonds. The proceeds of the sale of their assets would be used by the San Joaquin and Foothill/Eastern Agencies to defease or extinguish their existing debt. A final decision on whether the acquisition will occur by all three Agencies' Boards of Directors is anticipated in the second quarter of fiscal 2004.

The Agency's 2004 Annual Budget adopted by the Board of Directors on June 12, 2003, provides for total revenue of \$75,225 including tolls, development impact fees, fees and fines and interest earnings. Budgeted expenses are \$82,482 and will be funded from current year revenues, capitalized interest and cash on hand from bond issuances, development impact fees and interest earnings. Debt service payments represent 80% of total expenses budgeted.

Contacting the Agency's Financial Management

This financial report is designed to provide a general overview of the Agency's finances for all those with an interest in its finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Controller, San Joaquin Hills Transportation Corridor Agency, 125 Pacifica, Suite 100, Irvine, California 92618 or to www.thetollroads.com.

San Joaquin Hills Transportation Corridor Agency

Statement of Fund Net Assets (Deficit)

June 30, 2003
(In Thousands)

Assets

Current assets:

| | |
|--|----------|
| Cash and investments | \$ 4,952 |
| Restricted cash and investments | 43,487 |
| Receivables: | |
| Accounts, net of allowance of \$656 | 851 |
| Fees | 304 |
| Interest | 1,837 |
| Total receivables | 2,992 |
| Due from Foothill/Eastern Transportation Corridor Agency | 1,446 |
| Other assets | 352 |
| Total current assets | 53,229 |

Noncurrent assets:

| | |
|---------------------------------|-----------|
| Restricted cash and investments | 132,776 |
| Fees receivable | 751 |
| Capital assets, net | 1,061,706 |

Total assets

1,248,462

Liabilities

Current liabilities:

| | |
|---|--------|
| Accounts payable | 1,933 |
| Deferred revenue | 3,274 |
| Due to Foothill/Eastern Transportation Corridor Agency | 1,041 |
| Capital lease payable to Foothill/Eastern Transportation Corridor Agency | 555 |
| Compensated employee absences payable | 207 |
| Interest payable | 20,472 |
| Current portion of bonds payable | 21,519 |
| Total current liabilities | 49,001 |

Long-term bonds payable

1,853,773

Total liabilities

1,902,774

Net assets (deficit)

| | |
|---|-----------|
| Invested in capital assets, net of related debt (deficit) | (813,586) |
| Restricted | 154,322 |
| Unrestricted | 4,952 |
| | 4,952 |

Total net assets (deficit)

\$ (654,312)

See accompanying notes.

San Joaquin Hills Transportation Corridor Agency

Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit)

Year ended June 30, 2003

(In Thousands)

| | |
|--|----------------------------|
| Operating revenues | |
| Tolls, fees and fines | \$ 63,117 |
| Development impact fees | 9,758 |
| Other revenue | 306 |
| Total operating revenues | <u>73,181</u> |
| Operating expenses | |
| Amortization | 31,207 |
| Salaries and wages | 1,438 |
| Systems and equipment | 1,388 |
| Toll collections | 1,364 |
| Service center | 1,305 |
| Violation processing | 1,266 |
| Operating expenses | 986 |
| Bank processing fees | 888 |
| Depreciation | 688 |
| Insurance | 670 |
| Facilities | 645 |
| Arbitrage rebate | 610 |
| Professional services | 334 |
| Utilities | 218 |
| Total operating expenses | <u>43,007</u> |
| Operating income | 30,174 |
| Nonoperating revenue (expenses) | |
| Grant revenue | 3,409 |
| Investment income | 6,408 |
| Interest expense | (99,966) |
| Nonoperating expenses | <u>(90,149)</u> |
| Change in net assets (deficit) | (59,975) |
| Net assets (deficit) at beginning of year | (594,337) |
| Net assets (deficit) at end of year | <u><u>\$ (654,312)</u></u> |

See accompanying notes.

San Joaquin Hills Transportation Corridor Agency

Statement of Cash Flows

Year Ended June 30, 2003
(In Thousands)

| | |
|--|-----------|
| Cash flows from operating activities | |
| Cash received from tollroad patrons | \$ 63,379 |
| Cash received from development impact fees | 9,598 |
| Cash received from Orange County bankruptcy settlement | 306 |
| Cash payments to suppliers | (9,141) |
| Cash payments to employees | (1,437) |
| Net cash provided by operating activities | 62,705 |
| Cash flows from capital and related financing activities | |
| Cash payments for toll related equipment | (1,328) |
| Cash payments to Foothill Eastern Transportation Corridor Agency for equipment lease | (1,276) |
| Cash payments for construction in progress | (6,838) |
| Cash payments for fixed assets transferred to Caltrans | (410) |
| Cash principal repayments | (18,025) |
| Cash payments for interest | (43,738) |
| Cash received from grants | 3,317 |
| Net cash used in capital and related financing activities | (68,298) |
| Cash flows from investing activities | |
| Cash received for interest | 6,360 |
| Cash received from the maturity of investments, net | 8,728 |
| Net cash provided from investing activities | 15,088 |
| Net increase in cash and cash equivalents | 9,495 |
| Cash and cash equivalents at beginning of year | 75,365 |
| Cash and cash equivalents at end of year | \$ 84,860 |
| Reconciliation of operating income to net cash provided by operating activities: | |
| Operating income | \$ 30,174 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | |
| Amortization | 31,207 |
| Depreciation | 688 |
| Write-off of fixed assets | 635 |
| Allowance for doubtful accounts | 106 |
| Changes in operating assets and liabilities: | |
| Accounts receivables | (185) |
| Fees receivable | (159) |
| Due from Foothill/Eastern Transportation Corridor Agency | (164) |
| Other assets | (116) |
| Accounts payable, less accounts payable for fixed assets and construction in progress | 19 |
| Deferred revenue | 100 |
| Due to Foothill/Eastern Transportation Corridor Agency | 374 |
| Compensated employee absences payable | 26 |
| Total adjustments | 32,531 |
| Net cash provided by operating activities | \$ 62,705 |
| Noncash Transactions | |
| Interest expense recorded for accretion of bonds outstanding | \$ 56,523 |

See accompanying notes.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (In Thousands)

June 30, 2003

1. Reporting Entity

In recognition of the regional transportation needs in the County of Orange (County), the California State Legislature has enacted various amendments to the California Government Code to authorize the financing of bridges and major thoroughfares by joint powers agencies. Pursuant to such authorization, the San Joaquin Hills Transportation Corridor Agency (Agency) was created in May 1986 by a joint exercise of powers agreement. Current members are the County and the Cities of Aliso Viejo, Costa Mesa, Dana Point, Irvine, Laguna Hills, Laguna Niguel, Laguna Woods, Mission Viejo, Newport Beach, San Clemente, San Juan Capistrano and Santa Ana (collectively, the member agencies). The purpose of the Agency is to plan, design, construct, finance, administer funds for, and operate the San Joaquin Hills Transportation Corridor. The Agency has the power to, among other things, incur debt and establish and collect tolls. The Agency is governed by a Board of Directors composed of representatives from the member agencies.

The financial statements comprise the activity of the Agency. There are no other organizations for which the Agency is financially accountable or for which it is fiscally responsible. This Agency and the Foothill/Eastern Transportation Corridor Agency (FETCA) are under common management and together are called the Transportation Corridor Agencies. However, each agency has an independent governing board.

2. Summary of Significant Accounting Policies

The accounting policies of the Agency are in conformity with generally accepted accounting principles applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing accounting and financial reporting principles.

Basis of Presentation

The Agency adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* (Statement 34), GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus, an amendment of GASB Statements No. 21 and 34* (Statement 37); and GASB Statement No. 38, *Certain Financial Statement Note Disclosures* (Statement 38) in fiscal year 2003, effective July 1, 2002. Significant reporting changes resulting from the implementation of the new financial reporting

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) (In Thousands)

2. Summary of Significant Accounting Policies (continued)

Basis of Presentation (continued)

models include management's discussion and analysis, providing an analysis of the Agency's overall financial position and results of operations and financial statements prepared using the accrual basis of accounting for all the Agency's activities.

Concurrent with the adoption of Statements 34, 37 and 38 on July 1, 2002, the Agency began accounting for the activity that was previously reported as the governmental funds (the Capital Project and Debt Service Funds) as proprietary fund activity and, accordingly, changed the basis of accounting from the modified accrual basis of accounting to the accrual method of accounting. An enterprise fund presentation is preferable to reflect the current activities of the Agency since tolls, which are user fees, are the primary source of funds for bond repayments. The impact of this change and of the implementation of Statements 34, 37 and 38 on the beginning fund balance is as follows:

| | |
|---|----------------------------|
| Beginning Fund Balance, Capital Projects Fund | \$ 13,082 |
| Beginning Fund Balance, Debt Service Fund | 138,881 |
| Beginning Equity, Enterprise Fund | <u>29,933</u> |
| Total beginning Fund Balance/Equity – July 1, 2002 | 181,896 |
| Adjustments to restate July 1, 2002 Fund/Equity balances: | |
| Record long-term debt | (1,836,794) |
| Record intangible asset | 1,245,488 |
| Record accumulated amortization on intangible asset | (169,186) |
| Record interest payable | (20,472) |
| Record construction in progress and furniture | 5,271 |
| Record liabilities of the general long-term debt group | <u>(540)</u> |
| Beginning Net Assets (Deficit), as restated | <u><u>\$ (594,337)</u></u> |

The invested in capital assets, net of related debt (deficit) and the net asset (deficit) result primarily from using bond proceeds to fund non-capitalized expenses related to the corridors and from the accretion of interest on the bonds.

The Agency's basic financial statements consist of a Statement of Fund Net Assets (Deficit), a Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit) and Statement of Cash Flows. The Statements report information on all of the activities of the Agency.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) (In Thousands)

2. Summary of Significant Accounting Policies (continued)

Basis of Presentation (continued)

The Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit) includes all of the Agency's revenues and expenses. Revenues include tolls, fees, fines, development impact fees, investment income, rental income and grants. Expenses include depreciation and amortization, operation costs and interest.

The Agency distinguishes operating revenues and expenses from nonoperating items in the preparation of its financial statements. Operating revenues and expenses generally result from the collection of tolls, fees and fines on the corridors. The Agency's operating expenses include amortization, depreciation, materials, services and other expenses related to the operation of the corridors. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Basis of Accounting

The financial statements are prepared using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. Under GASB Statement No. 20, the Agency does not apply Financial Accounting Standards Board pronouncements issued after November 30, 1989.

Restricted resources are used in accordance with the Agency's Master Indentures of Trust. Unrestricted resources are used at the Agency's discretion. When both restricted and unrestricted resources are available for use, it is the Agency's policy to determine on a case by case basis when to use restricted or unrestricted resources.

Budget

Fiscal year budgets are prepared by the Agency staff for estimated revenues and expenses. The Board of Directors adopts the annual budget at the June Board meeting for the fiscal year commencing the following July. The approval of the budget requires the consent of at least two-thirds of the Board members. No expenditures in excess of the total budget are made without the approval of at least two-thirds of the Board members, at which time a revised and amended budget is required to be submitted to the Board of Directors. All budgets are adopted on a basis consistent with generally accepted accounting principles. All budget appropriations lapse at year-end. Any amounts not disbursed by each year-end must be reappropriated in the next fiscal year.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) (In Thousands)

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents generally consist of cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

Investments

Investments in U.S. government and agency securities are carried at fair value based on quoted market prices. Treasury mutual funds are carried at fair value based on the fund's share price.

The Agency classifies investments as current or noncurrent based on how readily the investment is expected to be converted to cash and whether any restrictions limit the Agency's ability to use the resources.

Receivables

Receivables include amounts due from member agencies for development impact fees collected on behalf of the Agency, credit card receivables, construction receivables, interoperable agency receivables, patron violation receivables and interest.

Capital Assets

Capital assets include the intangible asset, toll and violation collection equipment, transponders, toll booths, buildings, changeable message signs, vehicles, furniture and construction in progress. Capital assets are defined by the Agency as assets with an initial, individual cost of more than five thousand dollars and an estimated useful life in excess of three years. Such assets are recorded at cost.

The San Joaquin Hills Corridor and the related purchases of right-of-way, for which title vests with the California Department of Transportation, are not included as capital assets because the Agency does not have title to such assets or right-of-way. However, the costs expended for these items were used as the basis for valuing the Agency's intangible asset.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) (In Thousands)

2. Summary of Significant Accounting Policies (continued)

Capital Assets (continued)

Capital assets are depreciated or amortized using the straight-line method over the following estimated useful lives:

| <u>Asset Type</u> | <u>Useful Life</u> |
|-------------------------------|----------------------------|
| Toll booths and buildings | 28-30 years |
| Changeable message signs | 15 years |
| Toll revenue equipment | 5 years |
| Vehicles | 5 years |
| Other equipment and furniture | 3-5 years |
| Intangible asset | Over the life of the bonds |

Allocation of Common Costs

Expenses have been allocated between administration and construction costs, which are capitalized, in accordance with California Government Code Section 66484.3, paragraph(g). Under this section, the term “construction” is defined as design, acquisition of right-of-way, actual construction, including but not limited to all direct and indirect costs of environmental, engineering, accounting, legal, administration of construction contracts and other necessary services. Administration costs are defined as office, personnel and other customary and normal expenses associated with the direct management and administration of the Agency. Administration expenses, as defined, are limited to a base amount adjusted annually based on the Consumer Price Index.

Expenses directly related to the Agency were charged entirely to the Agency, and those incurred on behalf of both the Agency and FETCA were allocated between the two agencies based on the estimated benefit to each. In addition, the Agency also has amounts due from FETCA related to FETCA FasTrak customers incurring tolls on the Agency’s corridor and has amounts due to FETCA related to the Agency’s FasTrak customers incurring tolls on State Routes 241, 261 and 133. At June 30, 2003, the Agency has a net receivable due from FETCA of \$405 for such items.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) (In Thousands)

2. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Development Impact Fees

Development impact fees and refunds consist of the following for the year ended June 30, 2003:

| | |
|-----------------------------|-----------------|
| City of Irvine | \$ 4,399 |
| City of Costa Mesa | 1,854 |
| County of Orange | 1,497 |
| City of Laguna Niguel | 1,033 |
| City of Dana Point | 299 |
| City of Santa Ana | 284 |
| City of Newport Beach | 232 |
| City of San Juan Capistrano | 220 |
| City of Laguna Woods | 43 |
| City of Laguna Hills | 18 |
| City of Mission Viejo | 7 |
| City of San Clemente | (128) |
| | <u>\$ 9,758</u> |

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) (In Thousands)

4. Cash and Investments

Cash and investments and restricted cash and investments held with trustee consist of the following at June 30, 2003:

| | Cash and Cash | | |
|-------------------------------|--------------------------|--------------------|-------------------|
| | Equivalents | Investments | Total |
| Demand deposits | \$ 4,673 | \$ — | \$ 4,673 |
| Treasury money market | 17,417 | — | 17,417 |
| Commercial paper | — | 4,779 | 4,779 |
| Cash held with trustee | 62,770 | — | 62,770 |
| Investments held with trustee | — | 91,576 | 91,576 |
| | <u>\$ 84,860</u> | <u>\$ 96,355</u> | <u>\$ 181,215</u> |

These amounts are reflected in the accompanying financial statements as:

| | |
|--|-------------------|
| Cash and investments | \$ 4,952 |
| Current restricted cash and investments | 43,487 |
| Noncurrent restricted cash and investments | 132,776 |
| | <u>\$ 181,215</u> |

Restricted cash and investments, as required by the bond indentures, represent investments of bond proceeds, prepaid cash deposits for future toll payments and cash collected from toll revenues. The investments of bond proceeds are managed by the Agency and are held by a financial institution, which acts as trustee.

Authorized Investments

The Agency maintains its cash and investments in accordance with the California Government Code, the Master Indentures of Trust and the Agency's Investment Policy, which limits the Agency's cash and investments to certain deposits and securities generally consisting of high-grade debt instruments.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) (In Thousands)

4. Cash and Investments (continued)

Cash

Cash consists of demand deposits, a guaranteed bank investment contract and bank money market funds, which are covered by federal deposit insurance for the first \$100 or by collateral held in the pledging bank's trust department for the benefit of the Agency. Cash is classified in three categories of credit risk. Category 1 includes amounts insured or collateralized with securities held by the Agency or its agent in the Agency's name. Category 2, of which there are none, includes investments which are uninsured and unregistered with securities held by the counterparty's trust department or agent in the Agency's name. Category 3, of which the Agency has none, includes uncollateralized amounts.

Cash by credit risk and carrying amount and bank balance consist of the following at June 30, 2003:

| | <u>Carrying Amount</u> | <u>Bank Balance</u> |
|------------|----------------------------|-------------------------|
| Category 1 | \$ 62,875 | \$ 62,868 |
| Category 2 | 4,569 | 4,517 |
| Total cash | <u>\$ 67,444</u> | <u>\$ 67,385</u> |

Credit Risk, Carrying Amount and Fair Value of Investments

Investments are classified in three categories of credit risk. Category 1 includes investments that are insured or registered in the Agency's name, or securities held by the Agency or its agent in the Agency's name. Category 2, of which the Agency has none, includes investments, which are uninsured and unregistered, with securities held by the counterparty's trust department or agent in the Agency's name. Category 3, of which the Agency has none, includes investments, which are uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the Agency's name.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued)
(In Thousands)

4. Cash and Investments (continued)

Credit Risk, Carrying Amount and Fair Value of Investments (continued)

Investments by credit risk and fair value consist of the following at June 30, 2003:

| | Category 1 | Carrying Value | Fair Value |
|---|-----------------------|---------------------------|-----------------------|
| U.S. Government securities: | | | |
| Treasury notes | \$ 6,003 | \$ 6,003 | \$ 6,003 |
| Treasury bills | 30,396 | 30,396 | 30,396 |
| Principal-only strips | 16,358 | 16,358 | 16,358 |
| U.S. Agency securities: | | | |
| Federal Home Loan Mortgage Corporation bonds/notes | 10,986 | 10,986 | 10,986 |
| Resolution Funding Corporation coupon strips | 4,818 | 4,818 | 4,818 |
| Federal National Mortgage Association bonds/notes | 11,342 | 11,342 | 11,342 |
| Federal Home Loan Bank bonds | 302 | 302 | 302 |
| Sallie Mae Bonds | 11,371 | 11,371 | 11,371 |
| Commercial Paper | 4,779 | 4,779 | 4,779 |
| | <u>\$ 96,355</u> | 96,355 | 96,355 |
| Investments not subject to risk categorization: | | | |
| Treasury mutual funds | | 17,416 | 17,416 |
| Total investments | | <u>\$ 113,771</u> | <u>\$ 113,771</u> |

The Agency invests in principal-only strips in part to maximize yields and in part to meet scheduled debt service requirements. These securities provide cash flows based on interest payments and maturing principal from underlying U.S. Treasury notes. Accordingly, such investments are affected by changes in interest rates.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued)
(In Thousands)

5. Capital Assets

Capital assets activity consists of the following:

| | Balance at Beginning of Year | Additions | Deletions | Balance at End of Year |
|---|---|--------------------|-------------------|-----------------------------------|
| Construction in process | \$ 4,614 | \$ 5,163 | \$ (410) | \$ 9,367 |
| Furniture and equipment | 657 | 18 | (600) | 75 |
| Toll revenue equipment | 9,336 | 1,360 | (556) | 10,140 |
| Intangible asset | 1,245,488 | 706 | – | 1,246,194 |
| | <u>1,260,095</u> | <u>7,247</u> | <u>(1,566)</u> | <u>1,265,776</u> |
| Toll revenue equipment accumulated depreciation | (3,510) | (688) | 521 | (3,677) |
| Intangible asset – accumulated amortization | (169,186) | (31,207) | – | (200,393) |
| | <u>\$ 1,087,399</u> | <u>\$ (24,648)</u> | <u>\$ (1,045)</u> | <u>\$ 1,061,706</u> |

Total interest of \$295 was capitalized as construction in progress during the year ended June 30, 2003.

Transfer of Ownership

Ownership of the San Joaquin Hills Transportation Corridor was transferred to Caltrans during the year ended September 30, 1997, upon satisfaction of all conditions contained within the Cooperative Agreement between the Agency and Caltrans. Subsequent to the transfer, the Agency incurred expenditures for improvements and enhancements to major thoroughfares already transferred to Caltrans. The improvements and enhancements are covered by separate project specific Cooperative Agreements with Caltrans and were transferred to Caltrans in the current year. The balance of construction in progress represents capital improvements in progress primarily related to the Glenwood Pacific Interchange.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) (In Thousands)

5. Capital Assets (continued)

Intangible Asset

With the adoption of Statement 34, the Agency was required to record the bonds payable that were issued to finance the construction of the San Joaquin Hills Transportation Corridor on the Statement of Fund Net Assets (Deficit). Upon completion of the corridor, Caltrans assumed ownership and liability of the corridor, however the Agency has the right to collect all future toll revenue from the corridor until the bonds payable are fully repaid. As a result, the Agency recorded an intangible asset. The value of the asset is based on the underlying historical cost of constructing the corridor and does not reflect the present value of the projected toll revenues. The net asset (deficit) on the Statement of Fund Net Assets (Deficit) results primarily from using bond proceeds to fund non-capitalized expenses related to the corridors and from the accretion of interest on the bonds.

The intangible asset recorded is being amortized on a straight-line basis over the life of the bonds payable, which have maturities through 2036. At June 30, 2003, the intangible asset is \$1,045,801, net of accumulated amortization of \$200,393.

6. Contributions in Lieu of Development Impact Fees and Fee Credits

The Agency enters into agreements with developers whereby the developers receive fee credits against future development impact fee assessments for contributions of rights-of-way, grading or improvements. Fee credits may be utilized by the developer to offset against current or future fees owed to the Agency and, to the extent that the Agency determines that excess funds are available, may be reimbursable at the Agency's discretion. The changes in outstanding fee credits for the year ended June 30, 2003 are as follows:

| | |
|--|------------------|
| Outstanding fee credits at beginning of year | \$ 15,591 |
| Interest issued on unused fee credits | 1,513 |
| Fee credits utilized | <u>(5,426)</u> |
| Outstanding fee credits at end of year | <u>\$ 11,678</u> |

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued)
(In Thousands)

7. Long-Term Obligations

The following is a summary of changes in general long-term obligations during the year ended June 30, 2003:

| | Balance at Beginning of Year | Additions/ Accretions | Reductions | Balance at End of Year | Due Within One Year |
|------------------------------|---|----------------------------------|--------------------|---------------------------------------|------------------------------------|
| Series 1997A Toll Road | | | | | |
| Refunding Revenue Bonds: | | | | | |
| Current Interest Bonds | \$ 604,885 | \$ - | \$ - | \$ 604,885 | \$ - |
| Convertible Capital | | | | | |
| Appreciation Bonds | 526,562 | 30,505 | - | 557,067 | - |
| Capital Appreciation Bonds | 485,167 | 26,018 | (18,025) | 493,160 | 21,519 |
| Series 1993 Senior Lien Toll | | | | | |
| Road Revenue Bonds: | | | | | |
| Current Interest Bonds | 220,180 | - | - | 220,180 | - |
| Total bonds payable | <u>\$ 1,836,794</u> | <u>\$ 56,523</u> | <u>\$ (18,025)</u> | <u>\$ 1,875,292</u> | <u>\$ 21,519</u> |

Toll Road Revenue Bonds

In October 1997, the Agency issued \$1,448,274 in the aggregate principal amount of serial, term and capital appreciation toll road refunding revenue bonds consisting of current interest bonds in the principal amount of \$604,885, convertible capital appreciation bonds in the principal amount of \$404,289 and capital appreciation bonds in the principal amount of \$439,100. The 1997 bonds are subordinate to the remaining 1993 bonds of \$220,180 and are collateralized by net revenues, as defined in the Master Indentures, consisting primarily of toll revenues less current expenses.

Interest on the 1997 current interest bonds is payable semiannually at rates ranging from 5.25% to 5.50%. The bonds mature in annual installments from January 15, 2028 to January 15, 2030. The bonds are subject to early redemption, at the option of the Agency, beginning January 15, 2007 by payment of accrued interest, principal and a premium of up to 2.00%.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) *(In Thousands)*

7. Long-Term Obligations (continued)

Toll Road Revenue Bonds (continued)

The 1997 convertible capital appreciation bonds accrue interest at rates ranging from 5.60% to 5.75% compounded semiannually. Interest is payable semiannually based on accreted amounts commencing on July 15, 2007. The bonds mature in annual installments from January 15, 2016 to January 15, 2024. The bonds are subject to early redemption, at the option of the Agency, beginning January 15, 2014 by payment of accrued interest, principal and a premium up to 2.00%.

The 1997 capital appreciation bonds accrue interest at rates ranging from 4.20% to 5.67% compounded semiannually. The bonds mature in annual installments from January 15, 2000 to January 15, 2036.

Interest on the remaining 1993 current interest bonds is payable semiannually at a rate of 5.00%. The bonds mature on January 1, 2033. The bonds are subject to early redemption, at the option of the Agency, beginning January 1, 2003 by payment of accrued interest and principal with no premium.

The Master Indentures require the trustee to hold bond proceeds, toll revenues and any other proceeds included in pledged funds for debt service. These monies are included in the restricted investments held by the trustee. The Agency has several debt covenants contained in the Master Indentures of Trust. The Agency was in compliance with all of its covenants during the year ended June 30, 2003.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued)
(In Thousands)

7. Long-Term Obligations (continued)

Toll Road Revenue Bonds (continued)

The following is a summary of the Agency's annual debt service requirements by fiscal year for the 1993 Senior Lien Toll Road Revenue Bonds and the 1997 Toll Road Refunding Revenue Bonds as of June 30, 2003:

| | Principal | Interest | Total |
|-------------|------------------|-----------------|--------------|
| 2004 | \$ 21,519 | \$ 44,201 | \$ 65,720 |
| 2005 | 28,467 | 45,778 | 74,245 |
| 2006 | 30,946 | 47,629 | 78,575 |
| 2007 | 13,075 | 46,110 | 59,185 |
| 2008 | 2,785 | 83,204 | 85,989 |
| 2009 – 2013 | 68,554 | 449,107 | 517,661 |
| 2014 – 2018 | 182,793 | 472,861 | 655,654 |
| 2019 – 2023 | 359,179 | 432,035 | 791,214 |
| 2024 – 2028 | 465,331 | 483,245 | 948,576 |
| 2029 – 2033 | 627,170 | 392,734 | 1,019,904 |
| 2034 – 2036 | 75,473 | 359,821 | 435,294 |
| | \$ 1,875,292 | \$ 2,856,725 | \$ 4,732,017 |

Included in principal is \$281,735 related to accreted principal on convertible capital appreciation bonds and capital appreciation bonds.

A portion of the Series 1997A Toll Refunding Bonds was used to purchase U.S. government securities, which were placed in an irrevocable escrow fund to be used for the debt service payments related to the refunded bonds. The amount of the refunded bonds outstanding, which were eliminated in the financial statements, as a result of the refunding escrow was \$932,042.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) *(In Thousands)*

7. Long-Term Obligations (continued)

Toll Road Revenue Bonds (continued)

In March 2000, approximately \$37,000 in bankruptcy proceeds and development impact fees were used to purchase government securities that were placed in an irrevocable escrow fund for future debt service payments related to the 1997 capital appreciation bonds. The amount of the refunded 1997 capital appreciation bonds outstanding, which have been eliminated in the financial statements, as of June 30, 2003, was \$39,045.

Line of Credit

The Agency obtained a line of credit from the Federal Highway Administration in the aggregate amount of \$120,000 available upon completion of the toll road. The agreement provides for borrowings of up to \$12,000 per year, which expire at the end of each year if not used, from the date of completion of the construction of the toll road until December 31, 2007. The available balance remaining as of June 30, 2003 is \$60,000. Borrowings are available only to the extent revenues from toll operations and standard reserves are less than necessary for debt service.

Borrowings under the facility for debt service shall bear interest at the 30-year United States Treasury Bond rate plus 48 basis points on the date such loans are made and are due within 30 years. Borrowings for operations shall bear interest at a corresponding Treasury Note rate plus 48 basis points and are due within three years. At June 30, 2003, there were no borrowings outstanding on the line of credit.

Formation of a New Joint Powers Agency

While the Agency has currently been able to pay its operating costs and debt service payments, actual revenues continue to run below projected revenues. Since 2000, the Agency has taken numerous measures to help bridge the gap between actual and projected revenue, including establishing the toll rate stabilization fund, implementing toll rate increases, defeasing debt with proceeds from the Orange County bankruptcy, and reducing operational costs by transitioning to a new customer service vendor. Under the Agency's present capital structure, it is anticipated that in fiscal 2005 the Agency will

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) (In Thousands)

7. Long-Term Obligations (continued)

Formation of a New Joint Powers Agency (continued)

not meet the required coverage ratio of 1.3x Annual Debt Service and will not be able to make full debt service payments in 2012. If during the process of preparing the fiscal year 2005 budget in June 2004, the Agency determines that expected revenues from the current toll rate schedule are not likely to provide the required debt service coverage, the Agency will take steps to increase toll revenues or decrease costs and hire a Traffic Consultant as set forth in the Indenture Covenant. If after implementation of such actions, Adjusted Net Toll Revenues for fiscal year 2005 still fall short of the debt ratio covenant, the Agency will repeat the process of analysis and implementation. Under this scenario, the failure to meet the debt ratio covenants will not constitute an event of default.

To establish long-term financial stability, the Agency's Board of Directors has taken several steps in the form of rate increases and cost cutting measures. The Agency's Board of Directors has been engaged in discussions with the Board of Directors of the FETCA to consider selling all assets and liabilities of the two Agencies to a newly formed Joint Powers Agency. In April 2003, the Agencies formed an Exploratory Joint Powers Agency, the Transportation Corridor System, to explore the possibility of purchasing the assets of both the Agency and FETCA and managing both toll roads as a single system. The Transportation Corridor System would finance the acquisition through the issuance of new bonds. The Agency and FETCA would use the proceeds from the sale of their assets to simultaneously defease or extinguish their existing debt. Studies are moving forward, and a final decision on whether the acquisition will occur by all three Agencies' Board of Directors is anticipated in the second quarter of fiscal 2004.

8. Commitments and Contingencies

Toll Collection and Revenue Management System Agreements

The Agency and FETCA entered into agreements with various contractors for a customer service center, hardware maintenance, toll collection systems operation and maintenance, toll attendant staffing and supervision, and violation processing. The agreements expire on various dates from December 31, 2003 through October 31, 2015. Additionally, all agreements are cancelable by the Agency, without further obligation, upon written notice, generally within 90 days.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) (In Thousands)

8. Commitments and Contingencies (continued)

Corridor Operations Facility Lease

In January 2000, the Agency relocated to the Corridor Operations Facility and signed a lease agreement with FETCA. Future minimum payments through June 30, 2003 due to FETCA under the terms of the lease agreement are \$593. Future minimum payments after June 30, 2003 are based on the fair market rental value and adjust annually.

Project Costs

As of June 30, 2003, the Agency has outstanding contracts for approximately \$5,324 for improvements and enhancements to the existing corridor.

Litigation

The Agency is a defendant in various legal actions. Management believes that the ultimate resolution of these actions will not have a significant effect on the Agency's financial position or results of operations.

Risk Management

The Agency maintains insurance coverage for various risks including but not limited to property, liability, earthquake and flood coverage. Coverage is purchased at levels in accordance with the Agency's Master Indentures of Trust.

Commitment to Transportation Corridor System

The Agency has committed to pay up to \$600 of Transportation Corridor System's expenses incurred related to the purchase of the assets of both the Agency and FETCA. At June 30, 2003, no expenses had been incurred related to this commitment.

9. Lease Payable to FETCA

The Agency has a capital lease agreement with FETCA for a toll collection and revenue management system. Future minimum payments due to FETCA under the terms of this capital lease agreement are \$563 due in 2004. The present value of the future lease payments is \$555, reflecting interest of \$8.

San Joaquin Hills Transportation Corridor Agency

Notes to Financial Statements (continued) *(In Thousands)*

10. Employees' Retirement Plan

The Agency's employees participate in the Orange County Employees Retirement System (OCERS), a cost-sharing multiple-employer public employee retirement system established in 1945. OCERS provides for retirement, death, disability and cost-of-living benefits and is subject to the provisions of the County Employees Retirement Law of 1937 and other applicable statutes. OCERS issues a publicly available financial report that includes financial statements and required supplementary information.

Plan members contribute a percentage of their annual covered salary at actuarially determined rates based on the age of entry into the plan; however, the Agency pays up to 6% of the employee's required contribution. The Agency is required to contribute 5.66% into the plan. The Agency has contributed approximately \$83, \$16 and \$13 to the plan for the years ended June 30, 2003, 2002 and 2001, respectively.

____ TECHNICAL ADVISORY COMMITTEE
____ SAN JOAQUIN HILLS COMMITTEE
____ FOOTHILL/EASTERN COMMITTEE
____ JOINT ADMINISTRATION COMMITTEE
____ LEGAL & LEGISLATIVE COMMITTEE
____ JOINT MARKETING COMMITTEE
____ SAN JOAQUIN HILLS BOARD OF DIRECTORS
X FOOTHILL/EASTERN BOARD OF DIRECTORS

Report No. 4
File No. 2003F008

BOARD MEETING DATE: October 16, 2003

SUBJECT: Audited financial statements for Foothill Eastern Transportation Corridor Agency for the year ended June 30, 2003

STAFF RECOMMENDATION:

Approve Audited Financial Statements for the Foothill Eastern Transportation Corridor Agency for the year ended June 30, 2003

SUMMARY:

The audited financial statements for the year ended June 30, 2003 are presented in conformity with generally accepted accounting principles applicable to governmental entities, including the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, which was adopted by the Agency during the Fiscal Year. The presentation of the Agency's financial statements under the provisions of Statement 34 include presenting a section of Management's Discussion and Analysis, a Statement of Fund Net Assets, Statement of Revenues, Expenses and Changes in Fund Net Assets, and a Statement of Cash Flows for all of the Agency's activities.

Concurrent with the adoption of Statement 34, the Agency began accounting for the activity that was previously reported as the governmental funds (the Capital Project and Debt Service Funds) as proprietary fund activity and accordingly changed the basis of accounting from the modified accrual basis of accounting to the accrual method of accounting. A single enterprise fund presentation is now provided to reflect the fact that tolls are the main source of funds for bond repayments and that the Agency is now primarily an operating entity.

With the implementation of Statement 34, the Agency now records an intangible asset. The value of this asset, under governmental accounting rules, was based upon historical costs of the construction of the corridor and does not reflect the present value of projected toll revenues, which is the true value of the Agency's assets, as we do not own the road. By using historical costs, as required, the Agency's Statement of Net Assets shows a deficit. This deficit is purely a result of the intangible asset being recorded at historical cost of constructing the corridor, while the debt was issued under a projected revenue stream. Accordingly, the Net Asset deficit does not indicate that the Agency cannot make operating and debt service payments.

REPORT WRITTEN BY:
Controller

Brenda Shott, Controller and Marybeth Hudson,

REVIEWED BY:

Engineering/Environmental N/A

Communications and Public Affairs N/A

Finance

Toll Operations N/A

ANNUAL FINANCIAL REPORT
Foothill/Eastern Transportation Corridor Agency
Year ended June 30, 2003
with Report of Independent Auditors

Foothill/Eastern Transportation Corridor Agency

Annual Financial Report

Year ended June 30, 2003

Contents

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Report of Independent Auditors

To the Honorable Board of Directors of the
Foothill/Eastern Transportation Corridor Agency

We have audited the accompanying financial statements of the Foothill/Eastern Transportation Corridor Agency (Agency) as of and for the year ended June 30, 2003, as listed in the table of contents. These financial statements are the responsibility of the Agency's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Foothill/Eastern Transportation Corridor Agency as of June 30, 2003, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the financial statements, the Agency adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus, an amendment of GASB Statements No. 21 and 34*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*.

The Management's Discussion and Analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

ΕΨ

August 28, 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year ended June 30, 2003

This discussion and analysis of the Foothill/Eastern Transportation Corridor Agency's (the Agency) financial performance provides an overview of the Agency's financial activities for the fiscal year ended June 30, 2003. Please read it in conjunction with the Agency's financial statements.

Background

The Foothill/Eastern Transportation Corridor Agency was formed in 1986 as a Joint Powers Authority by the County of Orange and cities in Orange County, California. The Agency was created to plan, design, finance, construct and operate the Foothill (State Route 241) and Eastern (State Route 241, State Route 261, and State Route 133) Toll Roads.

Planning began in the 1970s, when local transportation studies identified the need for new highways, including the Foothill and Eastern Transportation Corridors (State Route 241, State Route 261, and State Route 133), to serve Orange County's growing population. In the early 1980s, the corridor was envisioned as a free highway funded through state or federal gas-tax revenues, but with a shortage of gas-tax revenues to fund transportation improvements and increasing costs of building new roads, local officials began to study alternative ways to fund road projects.

In the mid 1980s, two state laws were passed authorizing the Agency to collect tolls and development impact fees to fund road construction. With a pledged revenue stream from future tolls, the Agency issued non-recourse, toll-revenue bonds to fund road construction, rather than relying on the uncertainty of state gas-tax revenue. The Agency also reached an agreement with the California Department of Transportation (Caltrans) to assume ownership, liability, and maintenance of the State Route 241, State Route 261, and State Route 133 Toll Roads as part of the state highway system. This agreement eliminated the need for the Agency to seek additional funding sources for road maintenance.

In 1993, the first 3.2-mile segment of the Foothill (State Route 241) Toll Road opened to traffic, the first toll road in Southern California to use FasTrak, an electronic toll-collection system that allowed drivers to pay tolls without stopping at a tollbooth. Today, more than 170,000 transactions are recorded on the State Route 241, State Route 261, and State Route 133 Toll Roads every weekday, serving as an important, timesaving alternative route to local freeways and arterial roads.

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year ended June 30, 2003

Financial Highlights
(in thousands)

Tolls, fees and fines collected in Fiscal Year 2003 (FY 2003) totaled \$83,118 compared to \$78,299 in the prior fiscal year, an increase of 6.2%.

Interest payments on the Agency's long-term debt in FY 2003 were \$54,769, which is consistent with the prior fiscal year. Accretion on the Agency's Capital Appreciation Bonds and Convertible Capital Appreciation Bonds totaled \$53,976 in FY 2003, compared to \$50,899 in the prior fiscal year.

The Agency has implemented Governmental Accounting Standards Board Statement No. 34 and, accordingly, has recorded an intangible asset of \$1,413,271, valued at the underlying historical cost of constructing the corridors, which have been transferred to Caltrans. The intangible asset, while representing the Agency's right to collect tolls, does not reflect the present value of projected toll revenues. This intangible asset is being amortized over the life of the bonds, which have maturities through 2040.

As of June 30, 2003, the Agency has \$462,480 in restricted cash and investments governed under the 1995 and 1999 Master Indentures of Trust. The Agency also has \$74,617 in unrestricted cash.

Total net assets (deficit) at June 30, 2003 is \$(72,276). The deficit results primarily from the recording of long-term debt, proceeds of which not only funded the construction of the corridors, for which ownership was transferred to Caltrans upon completion of the corridors, but also other non-capitalized expenses related to the corridors.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Agency's financial statements which are comprised of the Statement of Fund Net Assets (Deficit), Statement of Revenue, Expense and Changes in Fund Net Assets (Deficit) and the Statement of Cash Flows, and notes to the financial statements. Concurrent with the adoption of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* (Statement 34), the Agency began accounting for the activity in its governmental funds (the Capital Projects and Debt Service Funds) as proprietary fund activity. An enterprise fund presentation is preferable to reflect the current activities of the Agency since tolls, which are user fees, are the primary source of funds for bond repayments.

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year ended June 30, 2003

Overview of the Financial Statements (continued)

The financial statements present the financial picture of the Agency from the economic resources measurement focus using the accrual basis of accounting. These statements include all assets of the Agency as well as all liabilities. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. The Statement of Cash Flows provides information about the Agency's cash receipts, cash payments and net changes in cash resulting from operations, capital financing activities and investing during the reporting period.

The Statement of Fund Net Assets (Deficit) and the Statement of Revenue, Expense and Changes in Fund Net Assets (Deficit) report the Agency's net assets and changes in them. Net assets are the difference between the recorded assets and liabilities. The Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit) present information showing how the Agency's net assets changed during the fiscal year. The activities include all toll revenues and operating expenses related to the operation of the Foothill/Eastern Transportation Corridors. In addition, all of the Agency's construction related activities, including the design, construction and mitigation on the Foothill/Eastern Transportation Corridors, as well as all financing costs and administration of the project, are reflected in the Statements. The activities are financed by toll revenues, development impact fees, remaining bond proceeds, fees and fines, investment income, and state and federal grants.

Financial Analysis
(in thousands)

The following table summarizes the changes in net assets (deficit) for the Agency between June 30, 2003 and 2002:

| | 2003 | 2002 | Percent Increase (Decrease) |
|-----------------------------------|--------------------|--------------------|-----------------------------------|
| Assets: | | | |
| Current assets | \$ 145,077 | \$ 106,316 | 36.5% |
| Capital assets, net | 1,385,844 | 1,391,626 | (0.4)% |
| Noncurrent assets | 401,883 | 400,253 | (0.4)% |
| Total assets | 1,932,804 | 1,898,195 | 1.8% |
| Liabilities: | | | |
| Bonds payable | 1,962,421 | 1,908,445 | 2.8% |
| Other liabilities | 42,659 | 39,826 | 7.1% |
| Total liabilities | 2,005,080 | 1,948,271 | 2.9% |
| Total net assets (deficit) | \$ (72,276) | \$ (50,076) | (44.3)% |

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year ended June 30, 2003

Financial Analysis (continued)
(in thousands)

The purpose of the Agency is to plan, finance, design and construct the remaining portions of the corridor system and to operate and collect tolls from the patrons of the corridors to extinguish the related long-term bond debt. The debt, issued in the form of tax-exempt bonds, was issued to construct the roads, which subsequent to completion, are transferred to Caltrans. Upon implementation of Statement 34, and changing the financial statement presentation to an enterprise fund, the Agency recorded an intangible asset. The cost basis of this intangible asset is the underlying historical cost of constructing the corridors, which have been transferred to Caltrans. The intangible asset, while representing the Agency's right to collect tolls, does not reflect the present value of projected toll revenues. Additionally, the Agency recorded the long-term debt that was previously presented in the long-term debt account group in the 2002 financial statements. The net assets (deficit) results primarily from using bond proceeds to fund non-capitalized expenses related to the corridors and from the accretion of interest on the bonds.

The current assets of the Agency have increased due to the receipt of development impact fees in the current year of over \$21,000, an increase in restricted cash related to the 1999 debt service reserve fund from revenues of \$13,000 and interest of \$9,000 and an increase in the fair market value of the investments held.

Capital assets, net have decreased slightly due to the amortization of the intangible asset. Amortization of the intangible asset is over the life of the outstanding bonds, which have maturities through 2040.

The increase in bonds payable results from the current year accretion on the capital appreciation bonds and the convertible capital appreciation bonds totaling \$53,976. Other liabilities have increased as a result of increased construction payables due to ongoing capital improvements.

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year ended June 30, 2003

Financial Analysis (continued)
(in thousands)

The following is a summary of the Agency's revenues, expenses and changes in net assets (deficit) for the year ended June 30, 2003:

| | 2003 | Percent of Total Revenue |
|---|-------------|---|
| Operating revenues: | | |
| Tolls, fees and fines | \$ 83,118 | 78.9% |
| Development impact fees | 21,619 | 20.5% |
| Other revenue | 618 | 0.6% |
| Total operating revenues | 105,355 | 100.0% |
| Operating expenses | 58,612 | 55.6% |
| Operating income | 46,743 | 44.4% |
| Nonoperating revenue (expenses) | (68,943) | (65.4)% |
| Change in net assets (deficit) | (22,200) | (21.0)% |
| Net assets (deficit) at beginning of year | (50,076) | (47.3)% |
| Net assets (deficit) at end of year | \$ (72,276) | (68.3)% |

The primary source of revenues for the Agency is tolls, fees and fines at 78.9% of total revenue. The main operating expenses relate to payments to third-party contractors for systems and equipment, violation processing, service center and toll collection operations. Also included in operating expenses are the non-cash expenses of depreciation on fixed assets and amortization of the intangible asset amounting to \$38,860. Nonoperating revenue (expenses) consists of investment income totaling \$38,858, grant revenue of \$504 and interest expense of \$108,305. Interest expense is comprised of both interest payments on long-term debt, net of amounts capitalized, totaling \$54,329 and accretion of bonds outstanding of \$53,976. The decrease in net assets (deficit) is a result of both the non-cash expenses and the accretion of bonds outstanding. The revenues earned by the Agency were sufficient to cover its current obligations including debt service of \$54,769 and operating expenses, excluding depreciation and amortization.

In future years, when prior year information is available, a comparison of the Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit) will be provided.

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year ended June 30, 2003

Capital Assets, Net
(in thousands)

The following table summarizes the capital assets, net at June 30:

| | <u>2003</u> | <u>2002</u> |
|--|---------------------|---------------------|
| Construction in progress | \$ 88,210 | \$ 59,371 |
| Right-of-way acquisitions, grading or improvements | 29,316 | 29,316 |
| Furniture, equipment and vehicles | 79 | 483 |
| Facility and toll revenue equipment | 22,839 | 25,110 |
| Intangible asset | 1,245,400 | 1,277,346 |
| Total capital assets | <u>\$ 1,385,844</u> | <u>\$ 1,391,626</u> |

Construction in progress at June 30, 2003 primarily represents improvements in progress related to the Foothill South Corridor, capital improvements including landscaping on the Eastern corridor, the Foothill–North road widening and the Rancho Santa Margarita ramp widening. Right-of-way primarily represents acquisitions made related to the Foothill–South Corridor. Facility and toll revenue equipment includes the corridor operations facility, transponders, toll and violations collection equipment, toll booths and buildings and changeable message signs.

As of June 30, 2003, the Agency's intangible asset totaled \$1,245,400, net of accumulated amortization. The intangible asset balance is increased by the cost of improvements completed and transferred to Caltrans during the year, including capitalized interest. During the year ended June 30, 2003, the Agency completed improvements totaling \$808 and recorded capitalized interest of \$440. The current year amortization of the intangible asset, which is being amortized over the life of the bonds payable, amounted to \$33,194.

More detailed information about the Agency's capital assets is presented in Note 5 to the financial statements.

Budgetary Highlights
(in thousands)

The Agency's Board of Directors adopts an annual budget prior to the beginning of a fiscal year. The expense budget for FY 2003 was amended once during the year. The amendment was to provide funding for a traffic and revenue consultant in the amount of \$357.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Year ended June 30, 2003

Debt Administration (in thousands)

The Agency has outstanding bonds payable of \$1,962,421 at June 30, 2003, an increase from the prior year of \$53,976 due to the accretion of principal on convertible capital appreciation bonds and capital appreciation bonds. All the Agency's toll revenue, less certain expenses, as defined, is pledged to repay these bonds. There were no changes to the debt structure during fiscal year 2003.

The Agency has several debt covenants contained in the Master Indentures of Trust. The Agency was in compliance with all of its covenants during the year ended June 30, 2003.

Economic Factors and Next Year's Budgets and Rates

The Agency is continuing to seek ways to increase revenue and encourage more drivers to use FasTrak, the most cost-effective way for the Agency to collect tolls. Based on updated traffic and revenue data, received in FY 2004, the Agency will implement, in October 2003, increased toll rates for cash and FasTrak patrons at one toll plaza during weekday peak commute periods. The increases are expected to result in additional revenue for the Agency.

In April 2003, the Agency and the San Joaquin Hills Transportation Corridor Agency formed a joint powers agency, the Transportation Corridor System, to explore the possibility of purchasing the assets of both the Agency and the San Joaquin Hills Transportation Corridor Agency and managing both toll roads as a single system. The Transportation Corridor System would finance the purchase through the issuance of new bonds. The proceeds of the sale of their assets would be used by the San Joaquin and Foothill/Eastern Agencies to defease or extinguish their existing debt. A final decision on whether the acquisition will occur by all three Agencies' Boards of Directors is anticipated in the second quarter of fiscal 2004.

In addition to the potential acquisition, the Agency is also focused on the completion of the extension of State Route 241, known as Foothill-South, and several ongoing capital improvement projects. By the end of December 31, 2003, the Agency anticipates completion of road, ramp, and bridge widening projects that began in 2002 to improve traffic flow on the State Route 241. In 2004, the Agency expects to move forward with plans for Foothill-South, which would extend the State Route 241 Toll Road south from its current end near Rancho Santa Margarita and Mission Viejo to the I-5 Freeway near San Clemente. A draft Environmental Impact Statement/Supplemental Environmental Impact Report is expected to be released for public review in the second quarter of fiscal 2004 to satisfy state and federal environmental laws. The draft document, which is the next critical step in the environmental planning process, analyzes the potential environmental impacts of three toll road alignments, with variations, and three non-toll

MANAGEMENT'S DISCUSSION AND ANALYSIS
Year ended June 30, 2003

Economic Factors and Next Year's Budgets and Rates (continued)

road project alternatives. The environmental process is complex and involves coordination among more than two dozen local, regional, state and federal agencies. Many steps must be accomplished before construction can begin, including the development of a plan of finance, but the Agency anticipates a tentative construction start date of 2005 with completion in 2008.

The Agency's 2004 Annual Budget adopted by the Board of Directors on June 12, 2003, includes total revenue of \$135.3 million, including tolls, development impact fees, fees and fines and interest earnings. Budgeted expenses are \$138.5 million and will be funded from current year revenues, capitalized interest and cash on hand. Debt service payments represent 43.3% of total expenses budgeted.

Contacting The Agency's Financial Management

This financial report is designed to provide a general overview of the Agency's finances for all those with an interest in its finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Controller, Foothill/Eastern Transportation Corridor Agency, 125 Pacifica, Suite 100, Irvine, California 92618 or to www.thetollroads.com.

Foothill/Eastern Transportation Corridor Agency

Statement of Fund Net Assets (Deficit)

June 30, 2003
(In Thousands)

Assets

Current assets:

| | |
|---|-----------|
| Cash and investments | \$ 74,617 |
| Restricted cash and investments | 60,597 |
| Receivables: | |
| Accounts, net of allowance of \$1,222 | 1,523 |
| Fees | 478 |
| Interest | 5,644 |
| Total receivables | 7,645 |
| Due from San Joaquin Hills Transportation Corridor Agency | 1,041 |
| Lease receivable from San Joaquin Hills Transportation Corridor Agency | 555 |
| Other assets | 622 |
| Total current assets | 145,077 |

Noncurrent assets:

| | |
|---------------------------------|------------------|
| Restricted cash and investments | 401,883 |
| Capital assets, net | 1,385,844 |
| Total assets | 1,932,804 |

Liabilities

Current liabilities:

| | |
|---|--------|
| Accounts payable | 7,730 |
| Deferred revenue | 6,660 |
| Due to San Joaquin Hills Transportation Corridor Agency | 1,446 |
| Compensated employee absences payable | 345 |
| Interest payable | 25,478 |
| Current portion of bonds payable | 5,176 |
| Total current liabilities | 46,835 |

| | |
|-------------------------|-----------|
| Long-term bonds payable | 1,957,245 |
| Long-term note payable | 1,000 |

| | |
|--------------------------|------------------|
| Total liabilities | 2,005,080 |
|--------------------------|------------------|

Net assets (deficit)

| | |
|---|-----------|
| Invested in capital assets, net of related debt (deficit) | (577,577) |
| Restricted | 430,684 |
| Unrestricted | 74,617 |

| | |
|-----------------------------------|--------------------|
| Total net assets (deficit) | \$ (72,276) |
|-----------------------------------|--------------------|

See accompanying notes.

Foothill/Eastern Transportation Corridor Agency

Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit)

Year Ended June 30, 2003

(In Thousands)

Operating revenues

| | |
|--------------------------|-----------|
| Tolls, fees and fines | \$ 83,118 |
| Development impact fees | 21,619 |
| Other revenue | 618 |
| Total operating revenues | 105,355 |

Operating expenses

| | |
|--------------------------|--------|
| Amortization | 33,194 |
| Depreciation | 5,666 |
| Systems and equipment | 3,053 |
| Service center | 2,823 |
| Toll collections | 2,617 |
| Salaries and wages | 2,423 |
| Violation processing | 2,344 |
| Bank processing fees | 1,613 |
| Operating expenses | 1,056 |
| Marketing | 1,045 |
| Facilities | 928 |
| Insurance | 803 |
| Utilities | 638 |
| Professional services | 409 |
| Total operating expenses | 58,612 |

| | |
|------------------|--------|
| Operating income | 46,743 |
|------------------|--------|

Nonoperating revenue (expenses)

| | |
|---|-------------|
| Investment income | 38,858 |
| Grant revenue | 504 |
| Interest expense | (108,305) |
| Nonoperating expenses | (68,943) |
| Change in net assets (deficit) | (22,200) |
| Net assets (deficit) at beginning of year | (50,076) |
| Net assets (deficit) at end of year | \$ (72,276) |

See accompanying notes.

Foothill/Eastern Transportation Corridor Agency

Statement of Cash Flows

For the Year Ended June 30, 2003

(In Thousands)

| | |
|---|------------|
| Cash flows from operating activities | |
| Cash received from toll road patrons | \$ 83,156 |
| Cash received from development impact fees | 22,996 |
| Cash received from property rental | 602 |
| Cash received from miscellaneous revenue sources | 16 |
| Cash payments to suppliers | (16,425) |
| Cash payments to employees | (2,409) |
| Net cash provided by operating activities | 87,936 |
| Cash flows from capital and related financing activities | |
| Cash payments for toll related equipment | (3,399) |
| Cash payments for construction in progress | (26,481) |
| Cash payments for interest | (54,769) |
| Cash payments for fixed assets transferred to Caltrans | (808) |
| Cash received from grants | 504 |
| Net cash used in capital and related financing activities | (84,953) |
| Cash flows from investing activities | |
| Cash received for interest | 38,480 |
| Cash payments for purchases of investments, net | (21,583) |
| Net cash provided from investing activities | 16,897 |
| Net increase in cash and cash equivalents | 19,880 |
| Cash and cash equivalents at beginning of year | 185,661 |
| Cash and cash equivalents at end of year | \$ 205,541 |
| Reconciliation of operating income to net cash provided by operating activities: | |
| Operating income | \$ 46,743 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | |
| Depreciation | 5,666 |
| Amortization | 33,194 |
| Write-off of fixed assets | 496 |
| Allowances for doubtful accounts | 644 |
| Changes in operating assets and liabilities: | |
| Accounts receivable | (1,268) |
| Fees receivable | 1,377 |
| Accounts payable, less accounts payable for fixed assets and construction in progress | (253) |
| Deferred revenue | 434 |
| Due from San Joaquin Hills Transportation Corridor Agency | 902 |
| Due to San Joaquin Hills Transportation Corridor Agency | 164 |
| Other assets | (206) |
| Compensated employee absences payable | 43 |
| Total adjustments | 41,193 |
| Net cash provided by operating activities | \$ 87,936 |
| Noncash Transactions | |
| Interest expense recorded for accretion of bonds outstanding | \$ 53,976 |

See accompanying notes.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements

(In Thousands)

June 30, 2003

1. Reporting Entity

In recognition of the regional transportation needs in the County of Orange (County), the California State Legislature has enacted various amendments to the California Government Code to authorize the financing of bridges and major thoroughfares by joint powers agencies. Pursuant to such authorization, the Foothill/Eastern Transportation Corridor Agency (Agency) was created in January 1986 by a joint exercise of powers agreement. Current members are the County and the Cities of Anaheim, Dana Point, Irvine, Lake Forest, Mission Viejo, Orange, Rancho Santa Margarita, San Clemente, San Juan Capistrano, Santa Ana, Tustin and Yorba Linda (collectively, the member agencies). The purpose of the Agency is to plan, design, construct, finance and administer funds for development of the Foothill and Eastern Transportation Corridors, including thoroughfares and bridges. The Agency is governed by a Board of Directors comprised of representatives from the member agencies. The Agency has the power to, among other things, incur debt and establish and collect tolls.

These financial statements comprise the activity of the Agency. There are no other organizations for which the Agency is financially accountable or for which it is fiscally responsible. This Agency and the San Joaquin Hills Transportation Corridor Agency (SJHTCA) are under common management and together are called the Transportation Corridor Agencies. However, each agency has an independent governing board.

2. Summary of Significant Accounting Policies

The accounting policies of the Agency are in conformity with generally accepted accounting principles applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing accounting and financial reporting principles.

Basis of Presentation

The Agency adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* (Statement 34), GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus, an amendment of GASB Statements No. 21 and 34*, (Statement 37) and GASB Statement No. 38 *Certain Financial Statement Note Disclosures* (Statement 38) in fiscal year 2003, effective July 1, 2002. Significant reporting changes resulting from the implementation of the new financial reporting models include management's discussion and analysis, an analysis of the Agency's overall financial position and results of operations, and financial statements prepared using the accrual basis of accounting for all of the Agency's activities.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

Basis of Presentation (continued)

Concurrent with the adoption of Statements 34, 37 and 38 on July 1, 2002, the Agency began accounting for the activity that was previously reported as the governmental funds (the Capital Projects and Debt Service Funds) as proprietary fund activity and, accordingly, changed the basis of accounting from the modified accrual basis of accounting to the accrual method of accounting. An enterprise fund presentation is preferable to reflect the current activities of the Agency since tolls, which are user fees, are the primary source of funds for bond repayments. The impact of this change and of Statements 34, 37 and 38 on the beginning fund balance is as follows:

| | |
|---|--------------------|
| Beginning Fund Balance, Capital Projects Fund | \$ 140,152 |
| Beginning Fund Balance, Debt Service Fund | 319,605 |
| Beginning Equity, Enterprise Fund | 59,132 |
| Total beginning Fund Balance/Equity July 1, 2002 | <u>518,889</u> |
| Adjustments to restate July 1, 2002 Fund/Equity balances: | |
| Record long-term debt | (1,908,445) |
| Record intangible asset | 1,412,023 |
| Record accumulated amortization on intangible asset | (134,677) |
| Record interest payable | (25,478) |
| Record construction in progress and furniture | 89,170 |
| Record note payable | (1,000) |
| Record liabilities of the General Long-Term Debt Group | (558) |
| Beginning Net Assets (Deficit), as restated | <u>\$ (50,076)</u> |

The invested in capital assets, net of related debt (deficit) and the net asset (deficit) result primarily from using bond proceeds to fund non-capitalized expenses related to the corridors and from the accretion of interest on the bonds.

The Agency's basic financial statements consist of a Statement of Fund Net Assets (Deficit), Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit) and Statement of Cash Flows. The Statements report information on all of the activities of the Agency.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

Basis of Presentation (continued)

The Statement of Revenues, Expenses and Changes in Fund Net Assets (Deficit) includes all of the Agency's revenues and expenses. Revenues include tolls, fees, fines, development impact fees, investment income, rental income and grants. Expenses include depreciation and amortization, operation costs and interest.

The Agency distinguishes operating revenues and expenses from nonoperating items in the preparation of its financial statements. Operating revenues and expenses generally result from the collection of tolls, fees and fines on the corridors. The Agency's operating expenses include amortization, depreciation, materials, services and other expenses related to the operation of the corridors. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Basis of Accounting

The financial statements are prepared using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. Under GASB Statement No. 20, the Agency does not apply Financial Accounting Standards Board pronouncements issued after November 30, 1989.

Restricted resources are used in accordance with the Agency's Master Indentures of Trust. Unrestricted resources are used at the Agency's discretion. When both restricted and unrestricted resources are available for use, it is the Agency's policy to determine on a case by case basis when to use restricted or unrestricted resources.

Budget

Fiscal year budgets are prepared by the Agency staff for estimated revenues and expenses. The Board of Directors adopts the annual budget at the June Board meeting for the fiscal year commencing the following July. The approval of the budget requires the consent of at least two-thirds of the Board members. No expenditures in excess of the total budget are made without the approval of at least two-thirds of the Board members, at which time a revised and amended budget is required to be submitted to the Board of Directors. All budgets are adopted on a basis consistent with generally accepted accounting principles. All budget appropriations lapse at year-end. Any amounts not disbursed by each year-end must be reappropriated in the next fiscal year.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents generally consist of cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

Investments

Investments in U.S. government, U.S. agency securities and corporate notes are carried at fair value based on quoted market prices. Treasury mutual funds are carried at fair value based on the fund's share price. The State of California Local Agency Investment Fund (LAIF) is carried at fair value based on the value of each participating dollar as provided by LAIF. Commercial paper is carried at amortized cost (which approximates fair value).

The Agency classifies investments as current or noncurrent based on how readily the investment is expected to be converted to cash and whether any restrictions limit the Agency's ability to use the resources.

Receivables

Receivables include amounts due from member agencies for development impact fees collected on behalf of the Agency, credit card receivables, interoperable agency receivables, patron violation receivables and interest.

The lease receivable from SJHTCA represents amounts due from SJHTCA in conjunction with a lease purchase agreement described in Note 10. The due from SJHTCA represents amounts due related to SJHTCA FasTrak patrons using the Foothill/Eastern Corridors.

Capital Assets

Capital assets include the intangible asset, the corridor operations facility, transponders, toll and violations collection equipment, toll booths, buildings, changeable message signs, vehicles, furniture and construction in progress. Capital assets are defined by the Agency as assets with an initial, individual cost of more than five thousand dollars and an estimated useful life in excess of three years. Such assets are recorded at cost.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

Capital Assets (continued)

The Foothill/Eastern Corridors and the related purchases of right-of-way, for which title vests with the California Department of Transportation, are not included as capital assets because the Agency does not have title to such assets or right-of-way. However, the costs expended for these items were used as the basis for valuing the Agency's intangible asset.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Capital assets are depreciated or amortized using the straight-line method over the following estimated useful lives:

| <u>Asset Type</u> | <u>Useful Life</u> |
|-------------------------------|----------------------------|
| Toll booths and buildings | 28-30 years |
| Toll revenue equipment | 5 years |
| Changeable message signs | 15 years |
| Vehicles | 5 years |
| Other equipment and furniture | 3-5 years |
| Intangible asset | Over the life of the bonds |

Allocation of Common Costs

Expenses have been allocated between administration and construction costs, which are capitalized, in accordance with California Government Code Section 66484.3, paragraph(g). Under this section, the term "construction" is defined as design, acquisition of right-of-way, actual construction including, but not limited to, all direct and indirect costs of environmental, engineering, accounting, legal, administration of construction contracts and other necessary services. Administration costs are defined as office, personnel and other customary and normal expenses associated with the direct management and administration of the Agency. Administration expenses, as defined, are limited to a base amount adjusted annually based on the Consumer Price Index.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

2. Summary of Significant Accounting Policies (continued)

Allocation of Common Costs (continued)

Expenses directly related to the Agency were charged entirely to the Agency, and those incurred on behalf of both the Agency and SJHTCA were allocated between the two agencies based on the estimated benefit to each. In addition, the Agency also has amounts due from SJHTCA related to SJHTCA FasTrak customers incurring tolls on the Agency's corridors and has amounts due to SJHTCA related to the Agency's FasTrak customers incurring tolls on State Route 73. At June 30, 2003, the Agency has a net payable due to SJHTCA of \$405 for such items.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Development Impact Fees

Development impact fees consist of the following for the year ended June 30, 2003:

| | |
|--------------------------------|------------------|
| County of Orange | \$ 6,480 |
| City of Irvine | 5,559 |
| City of Lake Forest | 3,601 |
| City of San Clemente | 2,609 |
| City of Yorba Linda | 798 |
| City of Orange | 754 |
| City of Mission Viejo | 663 |
| City of Santa Ana | 402 |
| City of Anaheim | 380 |
| City of Tustin | 211 |
| City of Rancho Santa Margarita | 162 |
| | <u>\$ 21,619</u> |

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

4. Cash and Investments

Cash and investments and restricted cash and investments at June 30, 2003 consist of the following:

| | Cash and Cash | | |
|-------------------------------|--------------------------|--------------------|-------------------|
| | Equivalents | Investments | Total |
| Pooled investments | \$ — | \$ 250 | \$ 250 |
| Demand deposits | 10,826 | — | 10,826 |
| Treasury money market | 13,035 | — | 13,035 |
| Commercial Paper | — | 9,759 | 9,759 |
| U.S. Agency securities | — | 56,348 | 56,348 |
| Cash held with trustee | 181,680 | — | 181,680 |
| Investments held with trustee | — | 265,199 | 265,199 |
| | <u>\$ 205,541</u> | <u>\$ 331,556</u> | <u>\$ 537,097</u> |

These amounts are reflected in the accompanying financial statements as:

| | |
|--|-------------------|
| Cash and investments | \$ 74,617 |
| Current restricted cash and investments | 60,597 |
| Noncurrent restricted cash and investments | 401,883 |
| | <u>\$ 537,097</u> |

Restricted cash and investments, as required by the bond indentures, represents investments of bond proceeds, prepaid cash deposits for future toll payments and cash collected from toll revenues. Also included in restricted cash and investments is \$250 deposited with the LAIF. The investments of the bond proceeds are managed by the Agency and are held by a financial institution, which acts as trustee. The LAIF is a special fund of the California State Treasury, through which local governments may pool investments. The fair value of the Agency's position in the LAIF is the same as the value of the pooled shares. Investments in the LAIF consist primarily of certificates of deposit, commercial paper and government securities.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

4. Cash and Investments (continued)

Authorized Investments

The Agency maintains its cash and investments in accordance with the California Government Code, the Master Indentures and the Agency's Investment Policy, which limits the Agency's cash and investments to certain deposits and securities generally consisting of high-grade debt instruments.

Cash

Cash consists of demand deposits and bank money market funds that are covered by federal depository insurance for the first \$100 or by collateral held in the pledging bank's trust department for the benefit of the Agency. Cash is classified in three categories of credit risk. Category 1 includes amounts insured or collateralized with securities held by the Agency or its agent in the Agency's name. Category 2 includes amounts collateralized by securities held by the pledging financial institutions' trust department or agent in the Agency's name. Category 3, of which the Agency has none, includes uncollateralized amounts.

Cash by credit risk, carrying amount and bank balance consist of the following at June 30, 2003:

| | Carrying Amount | Bank Balance |
|------------|----------------------------|-------------------------|
| Category 1 | \$ 181,902 | \$ 181,845 |
| Category 2 | 10,604 | 11,989 |
| Total cash | <u>\$ 192,506</u> | <u>\$ 193,834</u> |

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

4. Cash and Investments (continued)

Credit Risk, Carrying Amount and Fair Value of Investments

Investments are also classified in three categories of credit risk. Category 1 includes investments that are insured or registered in the Agency's name, or securities held by the Agency or its agent in the Agency's name. Category 2, of which there are none, includes investments which are uninsured and unregistered with securities held by the counterparty's trust department or agent in the Agency's name. Category 3, of which the Agency has none, includes investments, which are uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the Agency's name.

Investments by credit risk and fair value consist of the following at June 30, 2003:

| | Category 1 | Carrying Value | Fair Value |
|---|-----------------------|---------------------------|-----------------------|
| U.S. Government securities: | | | |
| Treasury bills | \$ 31,311 | \$ 31,311 | \$ 31,311 |
| Treasury notes | 16,045 | 16,045 | 16,045 |
| Principal-only strips | 12,383 | 12,383 | 12,383 |
| U.S. Agency securities: | | | |
| Resolution Funding Corporation coupon strips | 132,826 | 132,826 | 132,826 |
| Federal National Mortgage Association bonds/ notes | 51,912 | 51,912 | 51,912 |
| Federal Home Loan Bank bonds/notes | 39,827 | 39,827 | 39,827 |
| Federal Home Loan Mortgage Corporation bonds/notes | 25,665 | 25,665 | 25,665 |
| Student Loan Marketing Association | 2,602 | 2,602 | 2,602 |
| Federal Farm Credit Bank notes | 1,495 | 1,495 | 1,495 |
| Corporate notes | 509 | 509 | 509 |
| Commercial paper | 16,731 | 16,731 | 16,731 |
| | <u>\$ 331,306</u> | | |
| Investments not subject to risk categorization: | | | |
| State of California Local Agency Investment Fund | | 250 | 250 |
| Treasury money market funds | | 13,035 | 13,035 |
| Total investments | | <u>\$ 344,591</u> | <u>\$ 344,591</u> |

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

4. Cash and Investments (continued)

The Agency invests in principal-only strips in part to maximize yields and in part to meet scheduled debt service requirements. These securities provide cash flows based on interest payments and maturing principal from underlying U.S. Treasury notes. Accordingly, such investments are affected by changes in interest rates.

LAIF funds are held as collateral under a memorandum of understanding with the City of Irvine. LAIF investments in derivatives are immaterial.

5. Capital Assets

Capital asset consists of the following:

| | Balance at Beginning of Year | Additions | Transfers/ Deletions | Balance at End of Year |
|---|---------------------------------------|-------------------|-------------------------|------------------------------|
| Construction in process | \$ 59,371 | \$ 29,886 | \$ (1,047) | \$ 88,210 |
| Right-of-way acquisitions, grading or improvements | 29,316 | - | - | 29,316 |
| Furniture, equipment and vehicles | 483 | 18 | (422) | 79 |
| Facility and toll revenue equipment | 49,097 | 3,469 | (1,185) | 51,381 |
| Intangible asset | 1,412,023 | 1,248 | - | 1,413,271 |
| | <u>1,550,290</u> | <u>34,621</u> | <u>(2,654)</u> | <u>1,582,257</u> |
| Facility and toll revenue equipment – accumulated depreciation | (23,987) | (5,666) | 1,111 | (28,542) |
| Intangible asset – accumulated amortization | (134,677) | (33,194) | - | (167,871) |
| | <u>\$1,391,626</u> | <u>\$ (4,239)</u> | <u>\$ (1,543)</u> | <u>\$ 1,385,844</u> |

Total interest of \$440 was capitalized as construction in progress during the year ended June 30, 2003.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

5. Capital Assets (continued)

Transfer of Ownership

Ownership of the Foothill/Eastern Transportation Corridor construction, right-of-way, grading and improvements were transferred to Caltrans during the year ended June 30, 1999 upon satisfaction of all conditions contained within the Cooperative Agreements between the Agency and Caltrans. For the year ended June 30, 2003, the Agency incurred expenditures for improvements and enhancements to major thoroughfares already transferred to Caltrans. The improvements and enhancements are covered by separate project specific Cooperative Agreements with Caltrans and are transferred on an ongoing basis. The balance of construction in progress represents capital improvements in progress including Foothill South.

Intangible Asset

With the adoption of Statement 34, the Agency was required to record the bonds payable that were issued to finance the construction of the Foothill and Eastern Transportation Corridors on the Statement of Fund Net Assets (Deficit). Upon completion of the corridors, Caltrans assumed ownership and liability of the corridors, however, the Agency has the right to collect all future toll revenue from the corridors until the bonds payable are fully repaid. As a result, the Agency recorded an intangible asset. The value of the asset is based on the underlying historical cost of constructing the corridors and does not reflect the present value of the projected toll revenues. The net asset (deficit) on the Statement of Fund Net Assets (Deficit) results primarily from using bond proceeds to fund non-capitalized expenses related to the corridors and from the accretion of interest on the bonds.

The intangible asset recorded is being amortized on a straight-line basis over the life of the bonds payable, which have maturities through 2040. At June 30, 2003, the intangible asset is \$1,245,400, net of accumulated amortization of \$167,871.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

6. Contributions in Lieu of Development Impact Fees and Fee Credits

The Agency enters into agreements with developers whereby the developers receive fee credits against future development impact fee assessments for contributions of rights-of-way, grading or improvements. Fee credits may be utilized by the developer to offset against current or future fees owed to the Agency and, to the extent that the Agency determines that excess funds are available, may be reimbursable at the Agency's discretion. The changes in outstanding fee credits for the year ended June 30, 2003 are as follows:

| | |
|--|-----------------|
| Outstanding fee credits at beginning of year | \$ 5,533 |
| Interest issued on unused fee credits | 15 |
| Fee credits utilized | (227) |
| Outstanding fee credits at end of year | <u>\$ 5,321</u> |

7. Long-Term Obligations

The following is a summary of changes in long-term obligations during the year ended June 30, 2003:

| | <u>Balance at Beginning of Year</u> | <u>Additions/ Accretions</u> | <u>Reductions</u> | <u>Balance at End of Year</u> | <u>Due Within One Year</u> |
|--|---|----------------------------------|-------------------|---------------------------------------|------------------------------------|
| Series 1999 Toll Road Refunding Revenue Bonds: | | | | | |
| Current Interest Bonds | \$ 831,965 | \$ - | \$ - | \$ 831,965 | \$ 5,175 |
| Capital Appreciation Bonds | 437,126 | 26,646 | - | 463,772 | - |
| Convertible Capital Appreciation Bonds | 459,364 | 27,330 | - | 486,694 | - |
| Series 1995A (fixed rate) Senior Lien Toll Road Revenue Bonds: | | | | | |
| Current Interest Bonds | 179,990 | - | - | 179,990 | - |
| Total bonds payable | <u>1,908,445</u> | <u>53,976</u> | <u>-</u> | <u>1,962,421</u> | <u>5,175</u> |
| Notes payable | 1,000 | - | - | 1,000 | - |
| Total long-term obligations | <u>\$ 1,909,445</u> | <u>\$ 53,976</u> | <u>\$ -</u> | <u>\$ 1,963,421</u> | <u>\$ 5,175</u> |

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

7. Long-Term Obligations (continued)

Toll Road Revenue Bonds

In August 1999, the Agency issued serial, term and capital appreciation toll road refunding revenue bonds (1999 Refunding Bonds) in the aggregate principal amount of \$1,588,144 consisting of current interest bonds in the principal amount of \$831,965, convertible capital appreciation bonds in the principal amount of \$388,223 and capital appreciation bonds in the principal amount of \$367,956. The 1999 Refunding Bonds are subordinate to the remaining 1995 bonds (1995 Unrefunded Bonds) of \$179,990 and are collateralized by net revenues, as defined in the Master Indentures, consisting primarily of toll revenues less current expenses.

The 1995 Unrefunded Bonds are current interest bonds. Interest on the bonds is payable semiannually at a rate of 5.00% and is capitalized through January 1, 2032. The bonds mature on January 1, 2035. The bonds are subject to early redemption, at the option of the Agency, beginning January 1, 2005 by payment of accrued interest and principal with no premium.

Interest on the 1999 current interest bonds is payable semiannually at rates ranging from 4.38% to 5.75%. The bonds mature in annual installments from January 15, 2004 to January 15, 2040. The bonds are subject to early redemption, at the option of the Agency, beginning January 15, 2010 by payment of accrued interest, principal and a premium of up to 1.00%.

The 1999 convertible capital appreciation bonds accrue interest at rates ranging from 5.80% to 5.88% compounded semiannually. Interest is payable semiannually based on accreted amounts commencing on January 15, 2010. The bonds mature in annual installments from January 15, 2020 to January 15, 2029. The bonds are subject to early redemption, at the option of the Agency, beginning January 15, 2014 by payment of accrued interest, principal and a premium up to 1.00%.

The 1999 capital appreciation bonds accrue interest at rates ranging from 5.63% to 6.09% compounded semiannually. The bonds mature in annual installments from January 15, 2017 to January 15, 2038. The bonds are subject to early redemption, at the option of the Agency, beginning January 15, 2010 by payment of accrued interest, principal and a premium up to 2.00%.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

7. Long-Term Obligations (continued)

Toll Road Revenue Bonds (continued)

The Master Indentures of Trust require the trustee to hold bond proceeds, toll revenues and any other proceeds included in pledged funds for debt service. These monies are included in the restricted investments held by the trustee. The Agency has several debt covenants contained in the Master Indentures of Trust. The Agency was in compliance with all of its covenants during the year ended June 30, 2003.

The following is a summary of the Agency's annual debt service requirements by fiscal year for the 1995 Senior Lien Toll Road Revenue Bonds and the 1999 Toll Road Refunding Bonds as of June 30, 2003:

| | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|-------------|---------------------|---------------------|---------------------|
| 2004 | \$ 5,175 | \$ 54,770 | \$ 59,945 |
| 2005 | 7,915 | 54,544 | 62,459 |
| 2006 | 14,720 | 54,148 | 68,868 |
| 2007 | 19,260 | 53,412 | 72,672 |
| 2008 | 25,525 | 52,569 | 78,094 |
| 2009 – 2013 | 62,995 | 390,871 | 453,866 |
| 2014 – 2018 | 146,961 | 486,242 | 633,203 |
| 2019 – 2023 | 241,740 | 673,707 | 915,447 |
| 2024 – 2028 | 325,640 | 529,531 | 855,171 |
| 2029 – 2033 | 256,142 | 867,972 | 1,124,114 |
| 2034 – 2038 | 312,528 | 987,624 | 1,300,152 |
| 2039 – 2040 | 543,820 | 47,919 | 591,739 |
| | <u>\$ 1,962,421</u> | <u>\$ 4,253,309</u> | <u>\$ 6,215,730</u> |

Included in principal is \$194,287 related to accreted principal on convertible capital appreciation bonds and capital appreciation bonds.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

7. Long-Term Obligations (continued)

Toll Road Revenue Bonds (continued)

The net proceeds of the 1999 Refunding Bonds plus additional 1995 series monies were used to purchase U.S. government securities, which were placed in an irrevocable escrow fund to be used for the debt service payments related to the refunded bonds. The amount of the refunded bonds outstanding, which were eliminated from the financial statements, in fiscal year 2000 is \$1,082,761.

Line of Credit

The Agency obtained a line of credit from the Federal Highway Administration in the aggregate amount of \$120,000 available upon completion of the toll road. The agreement provides for borrowings of up to \$12,000 per year, which expires at the end of each year if not used, from the date of completion of the construction of the toll road and is scheduled to end on December 31, 2009. The available balance remaining as of June 30, 2003 is \$84,000. Borrowings are available only to the extent revenues from toll operations and standard reserves are less than necessary for debt service.

Borrowings under the facility for debt service shall bear interest at the 30-year United States Treasury Bond rate plus 48 basis points on the date such loans are made and are due within 30 years. Borrowings for operations shall bear interest at a corresponding Treasury Note rate plus 48 basis points and are due within three years. At June 30, 2003, there were no borrowings outstanding on the line of credit.

Notes Payable

During a prior fiscal year, the Agency executed a \$1,000 note payable in conjunction with the purchase of a conservation easement. The note payable is due 30 days after the sale of bonds for the acquisition and development of the Foothill Transportation Corridor south of Oso Parkway provided, however, that if the bond sale does not occur by July 1, 2007, the Agency has no obligation to make any payments.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

8. Commitments and Contingencies

Toll Collection and Revenue Management System Agreements

The Agency and SJHTCA entered into agreements with various contractors for a customer service center, hardware maintenance, toll collection systems operation and maintenance, toll attendant staffing and supervision, and violation processing. The agreements expire on various dates from December 31, 2003 through October 31, 2015. Additionally, all agreements are cancelable by the Agency, without further obligation, upon written notice, generally within 90 days.

Project Costs

As of June 30, 2003, the Agency has outstanding contracts for remaining corridor construction of approximately \$66,112.

Litigation

The Agency is a defendant in various legal actions. Management believes that the ultimate resolution of these actions will not have a significant effect on the Agency's financial position or results of operations.

Risk Management

The Agency maintains insurance coverage for various risks including but not limited to property, liability, earthquake and flood coverage. Coverage is purchased at levels in accordance with the Agency's Master Indentures of Trust.

Commitment to Transportation Corridor System

The Agency has committed to pay up to \$600 of Transportation Corridor System's expenses incurred related to the purchase of the assets of both the Agency and SJHTCA. At June 30, 2003, no expenses had been incurred related to this commitment.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

9. Lease Receivable from SJHTCA

The Agency has a lease receivable from SJHTCA for a toll collection and revenue management system. Future minimum payments due from SJHTCA at June 30, 2003 are \$563 due in 2004. The present value of the future lease payments is \$555, reflecting interest of \$8.

10. Corridor Operations Facility Lease

In January 2000, the Agency, along with SJHTCA, relocated to the Corridor Operations Facility. At that time a lease agreement was executed between the Agency (Lessor) and SJHTCA (Lessee). Included on the Statement of Revenue, Expenses and Change in Fund Net Assets (Deficit) are lease payments by SJHTCA of \$575. The lease agreement expires at the earliest occurrence of 1) dissolution of the Agency, 2) sale of the facility or 3) dissolution of the SJHTCA. Future minimum lease payments receivable from SJHTCA under the lease agreement at June 30, 2003 are \$593.

11. Employees' Retirement Plan

The Agency's employees participate in the Orange County Employees Retirement System (OCERS), a cost-sharing multiple-employer public employee retirement system established in 1945. OCERS provides for retirement, death, disability and cost-of-living benefits and is subject to the provisions of the County Employees Retirement Law of 1937 and other applicable statutes. OCERS issues a publicly available financial report that includes financial statements and required supplementary information.

Plan members contribute a percentage of their annual covered salary at actuarially determined rates based on the age of entry into the plan; however, the Agency pays up to 6% of the employee's required contribution. The Agency is required to contribute 5.66% into the plan. The Agency has contributed approximately \$158, \$27 and \$25 to the plan for the years ended June 30, 2003, 2002 and 2001, respectively.

Foothill/Eastern Transportation Corridor Agency

Notes to Financial Statements (continued)

(In Thousands)

12. Formation of a New Joint Powers Agency

The Agency's Board of Directors has been engaged in discussions with the Board of Directors of the SJHTCA to consider selling all assets and liabilities of the two Agencies to a newly formed Joint Powers Agency. In April 2003, the Agencies formed an Exploratory Joint Powers Agency, the Transportation Corridor System, to explore the possibility of purchasing the assets of both the Agency and SJHTCA and managing both toll roads as a single system. The Transportation Corridor System would finance the acquisition through the issuance of new bonds. The Agency and SJHTCA would use the proceeds from the sale of their assets to simultaneously defease or extinguish their existing debt. Studies are moving forward, and a final decision on whether the acquisition will occur by all three Agencies' Board of Directors is anticipated in the second quarter of fiscal 2004.