KPMG

SAN JOAQUIN HILLS TRANSPORTATION CORRIDOR AGENCY

Financial Statements

June 30, 2007

(With Independent Auditors' Report Thereon)

SAN JOAQUIN HILLS TRANSPORTATION
CORRIDOR AGENCY

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KPMG LLP
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Independent Auditors' Report

The Honorable Board of Directors
San Joaquin Hills Transportation Corridor Agency

We have audited the accompanying financial statements of the San Joaquin Hills Transportation Corridor Agency (the Agency) as of and for the year ended June 30, 2007, 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 of America. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, 2007, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 2 through 7 is not a required part of the basic financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

September 25, 2007

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, 2007. Please read it in conjunction with the Agency's financial statements and accompanying notes.

Background

The 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 nonrecourse, 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, time-saving alternative route to Interstate 405 and Interstate 5 Freeways.

Financial Highlights

Tolls, fees, and fines collected in fiscal year 2007 (FY 2007) totaled $93,993 compared to $86,196 in the prior fiscal year, an increase of 9%.

The Agency received $30,000 from the Foothill/Eastern Transportation Corridor Agency (FETCA) in accordance with a mitigation agreement that both Agencies entered into during FY 2006.

Interest expense of $63,084 and principal payments of $15,520 on the Agency's long-term debt were made in FY 2007 compared to $43,665 and $34,910, respectively, in the prior fiscal year. Accretion on the Agency's capital appreciation bonds and convertible capital appreciation bonds totaled $47,315 compared to $62,614 in the prior fiscal year.

As of June 30, 2007, the Agency has $296,729 in restricted cash and investments, restricted under the 1993 and 1997 master indentures of trust. The Agency also has $12,971 in unrestricted cash.

Total net deficit at June 30, 2007 was $1,728,351. The deficit results primarily from the recording of long-term debt, proceeds of which funded the construction of the corridor. Ownership of the corridor was transferred to Caltrans upon completion. The net deficit is also attributable to accretion recorded on the capital appreciation bonds and convertible capital appreciation bonds, which is greater than principal payments made.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Agency's financial statements, which comprise the Statement of Net Assets (Deficit), Statement of Revenues, Expenses and Changes in Net Assets (Deficit), the Statement of Cash Flows, and notes to the financial statements.

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 recordable 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 operating, capital and related financing, and investing activities during the reporting period.

The Statement of Net Assets (Deficit) and the Statement of Revenues, Expenses and Changes in Net Assets (Deficit) report the Agency's net assets and related changes. Net assets are the difference between the recorded assets and liabilities. The recorded 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. Activities are financed by toll revenues, development impact fees, fees and fines, investment income, and federal grants.

(Continued)

(In thousands)

Financial Analysis

The following table summarizes the assets, liabilities, and net deficit of the Agency as of June 30, 2007 and 2006:

		2007	2006	Percent increase (decrease)
Assets:				
Current assets	$	136,470	93,253	46.3%
Capital assets, net		6,328	5,973	5.9
Noncurrent assets		181,766	152,116	19.5
Total assets		324,564	251,342	29.1
Liabilities:				
Bonds payable		2,002,067	1,970,272	1.6
Other liabilities		50,848	30,231	68.2
Total liabilities		2,052,915	2,000,503	2.6
Total net deficit	$	(1,728,351)	(1,749,161)	(1.2)

The purpose of the Agency is to provide traffic relief to Orange County through the construction and operation of the toll road. With nearly all construction complete, the Agency's primary focus is on operation of the facility and collection of tolls to extinguish the related long-term bond debt. The debt, issued in the form of tax-exempt revenue bonds, was issued initially to construct the toll road. Subsequent to completion, the road was transferred to Caltrans. The net deficit results primarily from using bond proceeds to construct the corridor, which was then contributed to Caltrans, as well as to fund noncapitalized expenses related to the corridors and from the accretion of interest on the bonds.

Current assets have increased this year mainly due to higher earnings on investments and the receipt of a scheduled mitigation payment received from FETCA totaling $30,000 as detailed in note 6(c) to the financial statements.

Capital assets, net have increased as a result of additions to construction in progress related to costs associated with the Mainline widening project and the purchase of toll system upgrades in the current year.

The increase in bonds payable results from the current year accretion on the capital appreciation bonds and the convertible capital appreciation bonds totaling $47,315, offset by a principal payment of $15,520.

(Continued)

(In thousands)

The following is a summary of the Agency's revenues, expenses, and changes in net deficit for the years ended June 30, 2007 and 2006:

	2007	2006	Percent increase (decrease)
Operating revenues:			
Tolls, fees, and fines	$ 93,993	86,196	9.0%
Development impact fees	9,200	13,912	(33.9)
Other revenue	—	81	(100.0)
Total operating revenues	103,193	100,189	3.0
Operating expenses	14,064	12,944	8.7
Operating income	89,129	87,245	2.2
Nonoperating revenue (expenses), net	(68,319)	(67,878)	0.6
Change in net deficit	20,810	19,367	7.5
Net deficit at beginning of year	(1,749,161)	(1,768,528)	(1.1)
Net deficit at end of year	$ (1,728,351)	(1,749,161)	(1.2)

Revenues for the Agency consist primarily of tolls, fees, and fines, which comprised 91.1% of total revenue in FY 2007 as compared to 86% in FY 2006. Tolls, fees, and fines increased 9% over the prior year primarily due to an increase in toll rates in July 2006.

Operating expenses were $14,064 in FY 2007 compared to $12,944 in FY 2006, an increase of 8.7%. This increase is due to a $496 capital improvement project completed during the year, which was transferred to Caltrans, whereas in FY 2006, this project was included in construction in progress. The other primary operating expenses include payments to third-party contractors for systems and equipment, violation processing, service center, and toll collection operations. Also included in operating expenses is the noncash expense of depreciation on fixed assets of $1,168 compared to $1,157 in FY 2006.

Nonoperating revenue (expenses), net consists of investment income of $12,583 and a mitigation payment of $30,000 offset by arbitrage rebate of $503 and interest expense of $110,399. For FY 2006, nonoperating revenue (expenses), net consists of investment income of $8,781 and mitigation payments of $30,000 offset by arbitrage rebate of $380 and interest expense of $106,279. Interest expense comprised both interest payments and change in accrued interest on long-term debt and accretion of bonds outstanding.

The decrease in net deficit is primarily a result of the receipt of $30,000 in mitigation payments. Revenues earned by the Agency were sufficient to cover its current obligations, including debt service and operating expenses.

(Continued)

(In thousands)

Capital Assets, Net

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

		2007	2006
Construction in progress	$	620	414
Right-of-way acquisitions, grading, or improvements		119	119
Furniture, equipment, and vehicles		55	69
Toll revenue equipment		5,534	5,371
Total capital assets	$	6,328	5,973

The increase in construction in progress at June 30, 2007 is a result of the Catalina View Mainline widening project. Right-of-way acquisitions, grading, or improvements include easements and environmental mitigation parcels. Toll revenue equipment includes transponders, toll and violations collection equipment, toll booths and buildings, and changeable message signs.

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

Debt Administration

The Agency has outstanding bonds payable of $2,002,067 at June 30, 2007, an increase from the prior year of $31,795 due to the accretion of principal on convertible capital appreciation bonds and capital appreciation bonds totaling $47,315, offset by a principal payment of $15,520. All of the Agency's toll revenue, less certain expenses, as defined in the indentures of trust, are pledged to repay these bonds. There were no changes to the debt structure during FY 2007.

The Agency has several debt covenants contained in the master indentures of trust. Management of the Agency represents that the Agency was in compliance with all of its covenants during and as of the year ended June 30, 2007.

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 competitively bidding the major operations related contracts. The Agency has achieved the required coverage ratio of 1.3x Annual Debt Service since the bonds were issued; however, absent capital infusion it was anticipated that compliance would not be maintained as early as fiscal year 2007.

(Continued)

In May 2004, the San Joaquin Hills and Foothill/Eastern boards of directors and their respective financial and legal advisors began developing and negotating a conceptual Mitigation and Loan Plan to help the Agency avoid technical default and enable FETCA to move forward with its extension of the State Route 241 Toll Road known as Foothill-South. In November 2005, the Agency and FETCA entered into an agreement, the terms of which include payments of $120,000 over four years from FETCA to mitigate for the projected loss of revenue due to the construction of Foothill-South and loans from the FETCA, as needed of up to $1,040,000 to assist the Agency in achieving its covenants to its bondholders. The agreement is discussed in note 6(c) to the financial statements. If the Agency determines that expected toll revenues, mitigation payments, and/or loan proceeds 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 still fall short of the debt ratio covenant, the Agency will repeat the process of analysis and implementation. Under this scenario, a failure to meet the debt ratio covenants will not constitute an event of default.

Economic Factors

The Agency is continuing to seek ways to increase revenue and encourage more drivers to use FasTrak®, which is considered the most cost-effective way for the Agency to collect tolls. Based on FY 2007 traffic and revenue growth and estimated growth for FY 2008, the Agency implemented toll rate increases at selected locations in July 2007.

In August 2003, the Agency and FETCA formed a joint powers agency, the Transportation Corridor System (TCS), to explore the possibility of purchasing the assets of both the Agency and FETCA and managing both toll roads as a single system. In August 2007, the TCS met to discuss a potential acquisition that would finance the purchase of the two Agencies through the issuance of new bonds. The proceeds of the sale of their assets would be used by the Agency and FETCA to defease or extinguish existing debt. A final decision by all three Agencies' board of directors on whether the acquisition will occur is anticipated in early 2008.

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 http://www.thetollroads.com/.

SAN JOAQUIN HILLS TRANSPORTATION
CORRIDOR AGENCY

Statement of Net Assets (Deficit)

June 30, 2007

(In thousands)

Assets:		
Current assets:		
Cash and investments	$	12,971
Restricted cash and investments		114,963
Receivables:		
Accounts, net of allowance of $353		608
Fees		40
Interest		4,670
Total receivables		5,318
Due from Foothill/Eastern Transportation Corridor Agency		2,670
Other assets		548
Total current assets		136,470
Noncurrent assets:		
Restricted cash and investments		181,766
Capital assets, net		6,328
Total assets		324,564
Liabilities:		
Current liabilities:		
Accounts payable		1,177
Deferred revenue		5,067
Due to Foothill/Eastern Transportation Corridor Agency		1,471
Employee compensated absences payable		227
Interest payable		41,251
Current portion of arbitrage rebate payable		1,490
Current portion of bonds payable		3,393
Total current liabilities		54,076
Arbitrage rebate payable		165
Long-term bonds payable		1,998,674
Total liabilities		2,052,915
Net assets (deficit):		
Invested in capital assets, net of related debt		(1,995,739)
Restricted		254,417
Unrestricted		12,971
Total net deficit	$	(1,728,351)

See accompanying notes to financial statements.

SAN JOAQUIN HILLS TRANSPORTATION
CORRIDOR AGENCY

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

Year ended June 30, 2007

(In thousands)

Operating revenues:		
Tolls, fees, and fines	$	93,993
Development impact fees		9,200
Total operating revenues		103,193
Operating expenses:		
Toll compliance and customer service		4,090
Salaries and wages		2,559
Toll systems		1,542
Toll collections		1,338
Depreciation		1,168
Insurance		991
Professional services		543
Contribution of capital improvements to Caltrans		496
Facilities rent		443
Toll facilities		353
Other operating expenses		541
Total operating expenses		14,064
Operating income		89,129
Nonoperating revenue (expenses):		
Mitigation agreement		30,000
Investment income		12,583
Arbitrage rebate		(503)
Interest expense		(110,399)
Nonoperating revenue (expenses), net		(68,319)
Change in net deficit		20,810
Net deficit at beginning of year		(1,749,161)
Net deficit at end of year	$	(1,728,351)

See accompanying notes to financial statements.

SAN JOAQUIN HILLS TRANSPORTATION CORRIDOR AGENCY

Statement of Cash Flows

Year ended June 30, 2007

(In thousands)

Cash flows from operating activities:		
Cash received from toll road patrons	$	94,349
Cash received from development impact fees		11,453
Cash payments to suppliers		(10,159)
Cash payments to employees		(2,574)
Net cash provided by operating activities		93,069
Cash flows from capital and related financing activities:		
Cash received from mitigation agreement		30,000
Cash payments for equipment		(1,305)
Cash payments for construction in progress		(639)
Cash payments for interest and principal		(59,185)
Net cash used in capital and related financing activities		(31,129)
Cash flows from investing activities:		
Cash received for interest, net of realized gains and losses		11,166
Cash payments for purchase of investments		(152,974)
Cash received from the maturity and sale of investments		108,922
Net cash used in investing activities		(32,886)
Net increase in cash and cash equivalents		29,054
Cash and cash equivalents at beginning of year		172,656
Cash and cash equivalents at end of year (note 4)	$	201,710
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	89,129
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation		1,168
Write-off of fixed assets		41
Contribution of capital improvements to Caltrans		496
Changes in operating assets and liabilities:		
Accounts receivable		56
Fees receivable		2,253
Due from Foothill/Eastern Transportation Corridor Agency		105
Other assets		(176)
Accounts payable, less accounts payable for fixed assets and construction in progress		(220)
Deferred revenue		230
Due to Foothill/Eastern Transportation Corridor Agency		(35)
Employee compensated absences payable		22
Total adjustments		3,940
Net cash provided by operating activities	$	93,069
Noncash transactions:		
Interest expense recorded for accretion of bonds outstanding	$	(47,315)
Unrealized gain on investments		616
Amortization of discount/premium on investments		116

See accompanying notes to financial statements.

(1) Reporting Entity

In recognition of the regional transportation needs in the County of Orange (the 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 (the 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 U.S. 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.

(a) Basis of Presentation

The Agency records revenue in part from fees and other charges for services to external users and, accordingly, has chosen to present its financial statements using the reporting model for special purpose governments engaged in business-type activities. This model allows all financial information for the Agency to be reported in a single column in each of the accompanying financial statements.

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 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.

(b) 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, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, 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.

(c) 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 for each board-designated category 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 U.S. generally accepted accounting principles. All budget appropriations lapse at year-end. Any budgeted expenses not incurred by each year-end must be reappropriated in the next fiscal year.

(d) 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.

(e) Investments

Investments in U.S. government securities and federal agency securities are carried at fair value based on quoted market prices. Commercial paper is carried at amortized cost (which approximates fair value). 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.

(f) 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.

(g) Capital Assets

Capital assets include easements and mitigation parcels, 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, with the exception of transponders, which are valued in total, and an estimated useful life in excess of three years.

The San Joaquin Hills Corridor and the related purchases of right-of-way, for which title vests with the California Department of Transportation (Caltrans), are not included as capital assets because the Agency does not have title to such assets or right-of-way. The costs of normal maintenance and repairs and mitigation that do not add to the value of the asset or materially extend asset lives are not capitalized.

Assets that are determined to be impaired are recorded at the lower of cost or estimated net realizable value.

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

Asset type	Useful life
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

(h) Deferred Revenue

Deferred revenue represents amounts collected from FasTrak® patrons for prepaid tolls.

(i) Revenue Recognition

Toll revenue is recognized at the time the vehicle passes through the toll plaza. Other revenues are recognized when earned.

(j) 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 and other expenses. At June 30, 2007, the Agency has a net receivable due from FETCA of $1,199 for such items.

(k) Net Assets

The Agency's net assets are classified into the following net asset categories:

Invested in Capital Assets, Net of Related Debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, and improvement of those assets and the assets transferred to Caltrans.

Restricted: Net assets subject to externally imposed conditions that can be fulfilled by the actions of the Agency or by the passage of time. These net assets relate primarily to restricted bond proceeds and certain revenues collected.

Unrestricted: All other categories of net assets.

(l) Use of Estimates

The preparation of financial statements in conformity with U.S. 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.

(In thousands)

(3) Development Impact Fees

The sources of development impact fees were the following for the year ended June 30, 2007:

City of Irvine	$	4,222
County of Orange		2,331
City of Costa Mesa		1,058
City of Laguna Niguel		338
City of Laguna Woods		318
City of San Juan Capistrano		300
City of Aliso Viejo		250
City of San Clemente		152
City of Newport Beach		126
City of Dana Point		97
City of Laguna Hills		8
	$	9,200

(4) Cash and Investments

Cash and investments as of June 30, 2007 are classified in the accompanying financial statements as follows:

Cash and investments	$	12,971
Current restricted cash and investments		114,963
Noncurrent restricted cash and investments		181,766
	$	309,700

Cash and investments as of June 30, 2007 consist of the following:

		Cash and cash equivalents	Investments	Total
Cash on hand	$	40	—	40
Demand deposits		464	—	464
Money market		33,728	—	33,728
Commercial paper		—	25,642	25,642
Federal agency securities		—	28,017	28,017
Cash held with trustee		152,067	—	152,067
Investments held with trustee per debt agreements		15,411	54,331	69,742
Total	$	201,710	107,990	309,700

(a) Cash Deposits

Custodial Credit Risk Related to Cash Deposits

The custodial credit risk for deposits is the risk that the Agency will not be able to recover deposits or will not be able to recover collateral securities that are in possession of an outside party. This risk is mitigated in that of the total cash balance, $100 was insured by federal depository insurance, $40 was cash on hand, $34,092 was collateralized in accordance with Section 53652 of the California Government Code with securities held by the pledging financial institution in the Agency's name and $152,067 was in an investment agreement collateralized with securities held by the Agency's trustee in the Agency's name with a market value of at least 104% with respect to Government National Mortgage Association securities, and 105% with respect to Federal National Mortgage Association securities and Federal Home Loan Mortgage Corporation securities.

At June 30, 2007, the carrying amount of the Agency's cash deposits was $152,531 and the corresponding bank balance was $152,286. The difference of $245 was principally due to deposits in transit. The Agency's petty cash fund and toll change funds totaled $40.

(b) Investments

Credit Risk and Concentration of Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The Agency mitigates these risks by holding a diversified portfolio of high-quality investments. The Agency's investment policy sets specific parameters by type of investment for credit quality, maturity length, and maximum percentage investment. Both the policy and the Agency's debt agreements state that generally, all securities must be issued by companies with a long-term debt rating of at least "A" by two of the Nationally Recognized Rating Agencies (NRRA) or at least "AA" by one NRRA. The policy and debt agreements also indicate specific rating requirements for certain types of investments. Percentage limitations on specific types of securities shall be based on the purchase price of the security as compared to the market value of the portfolio at the time of purchase and does not require sales in a portfolio for subsequent changes in market value of the total portfolio to avoid exceeding the prescribed allocation level.

(In thousands)

The table below identifies the investment types that are authorized by the Agency's investment policy. The table also identifies certain provisions of the Agency's investment policy that addresses interest rate risk and concentration of credit risk. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the Agency, rather than the general provisions of the Agency's investment policy.

Authorized investment type	Maximum maturity	Maximum percentage of portfolio*	Maximum investment in one issuer	Specific rating requirement
U.S. Treasury Bills, Notes, and Bonds	5 years	100%	100%	
Federal Agency and U.S. Government-Sponsored Enterprise Notes and Bonds	5 years	100%	25%	
Federal Agency Mortgage-Backed Securities	5 years	20%	20%	
Negotiable Certificates of Deposit	5 years	30%	30%	"AA" or better by two NRRA
Banker's Acceptances	180 days	30%	25%	Drawn on and accepted by a bank which is rated "AA" or better by two NRRA
Commercial Paper	270 days	15%	10% of outstanding paper of an issuing corporation	P1, A1, F1, or D1 by two NRRA
Repurchase Agreements	90 days	25%	25%	
Reverse Repurchase Agreements	30 days	10%	10%	
Medium-Term Maturity Corporate Notes	5 years	30%	30%	

(In thousands)

Authorized investment type	Maximum maturity	Maximum percentage of portfolio*	Maximum investment in one issuer	Specific rating requirement
State of California Local Agency Investment Fund	N/A	30%	30%	
County or Local Agency Investment Pools	N/A	15%	15%	
Asset-Backed Securities	5 years	20%	20%	“AAA” by one NRRA issuer must have underlying rating of “A: or better from two NRRA
Shares in a California Common Law Trust	N/A	None	None	
Money Market Mutual Funds	N/A	15%	15%	
Investment Agreements	10 years	40%	40%	

* Excluding amounts held by trustee, which are subject to provisions of the bond indentures.

At June 30, 2007, 5% or more of the Agency’s investments were in the Federal National Mortgage Association, General Electric Capital Corporation, and the Federal Home Loan Bank as authorized by the Agency’s investment policy. These investments are 10%, 9%, and 5%, respectively, of the Agency’s investments.

Investment of debt proceeds and toll revenues held by the Agency's trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Agency's investment policy. The table below identifies the investment types that are authorized for these moneys and if noted the specific rating requirements.

Investments authorized by debt agreements*	Specific rating requirement
Government Obligations (including U.S. Treasury strips and RFCO strips)	
Federal Agency debt instruments	
Negotiable Certificates of Deposit insured by FDIC, BIF, and SAIF or secured by government obligations	Two highest ratings by 2 NRRA
Banker's Acceptances	Prime-1 or A3 or better by Moody's, A-1 or A or better by S&P and, if rated by Fitch, F-1 or A or better
Commercial Paper	Prime-1 or better by Moody's and A-1 or better by S&P and, if rated by Fitch, F-1 or better
Repurchase Agreements	A or better by both Moody's and S&P and, if rated by Fitch, A or better
Medium-Term Maturity Corporate Notes	One of the three highest applicable rating categories, or approved in writing, by S&P, and, if rated by Fitch, rated in one of the three highest applicable rating categories
Money Market Mutual Funds	AAAm-G; AAA-m or AA-m by S&P and, if rated by Moody's, Aaa, Aa1, or Aa2 and, if rated by Fitch, AAA or AA
Investment Agreements	

* Other investments may be allowed if the Agency certifies to the trustee that the investment was approved in writing by each rating agency, which has assigned a rating to the Agency's bonds, and by the Agency's bond insurer.

At June 30, 2007, all of the Agency's investments held were rated at or above the minimum required rating per the Agency's investment policy and debt agreements: the federal agency securities and U.S. Treasury bills that were held by the Agency were rated AAA by Standard & Poors and AAA by Moody's; the Money Market Funds were rated AAA by Standard & Poors; Commercial Paper was rated A-1 by Standard & Poors and P1 by Moody's; and the counterparty to the investment agreement was rated AAA by Standard & Poors and Fitch, and Aaa by Moody's.

(In thousands)

Custodial Credit Risk

Custodial credit risk for investments is the risk that the Agency will not be able to recover the value of investment securities that are in the possession of an outside party. All securities owned by the Agency are deposited in the Agency's trustee bank, which is different from the Agency's primary bank, in the Agency's name. Securities are not held in broker accounts.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Agency mitigates this risk by matching maturity dates, to the extent possible, with the Agency's expected cash flow.

A summary of all the Agency's investments governed by both the Agency's investment policy and its bond agreements, including cash held with the trustee of $152,067, money market funds of $33,728, and investments held with trustee in the amount of $15,411 that are considered cash equivalents held at June 30, 2007, is as follows:

			Remaining maturity		
Investment type		**Fair value**	**12 Months or less**	**13 to 24 Months**	**25 to 60 Months**
Investment agreement	$	152,067	152,067	—	—
Federal agency securities		57,753	28,885	19,443	9,425
U.S. Treasury bills		38,987	38,987	—	—
Money market funds		33,728	33,728	—	—
Commercial paper		26,661	26,661	—	—
Total	$	309,196	280,328	19,443	9,425

(In thousands)

(5) Capital Assets

Capital assets activity consists of the following:

	Balance at beginning of year	Additions	Transfers/ deletions	Balance at end of year
Construction in progress	$ 414	702	(496)	620
Right-of-way acquisitions, grading, or improvements	5,231	—	—	5,231
Furniture and equipment	109	—	(39)	70
Toll revenue equipment	9,753	1,358	(1,568)	9,543
	15,507	2,060	(2,103)	15,464
Impairment loss on right-of-way acquisitions, grading, or improvements	(5,112)	—	—	(5,112)
Furniture and equipment accumulated depreciation	(40)	(14)	39	(15)
Toll revenue equipment accumulated depreciation	(4,382)	(1,154)	1,527	(4,009)
	$ 5,973	892	(537)	6,328

Transfer of Ownership

Ownership of the San Joaquin Hills Transportation Corridor was transferred to Caltrans during the year ended June 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 are recognized as a contribution expense when transferred to Caltrans.

(In thousands)

(6) Long-Term Obligations

The following is a summary of changes in general long-term obligations during the year ended June 30, 2007:

		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		659,595	20,405	—	680,000	—
Capital Appreciation Bonds		485,612	26,910	(15,520)	497,002	3,393
Series 1993 Senior Lien Toll Road Revenue Bonds:						
Current Interest Bonds		220,180	—	—	220,180	—
Total bonds payable	$	1,970,272	47,315	(15,520)	2,002,067	3,393

(a) *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 1997A 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 1997A 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%.

The 1997A 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 of up to 2.00%.

The 1997A 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.

(In thousands)

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 moneys are included in the restricted cash and investments held by the trustee.

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 1997A Toll Road Refunding Revenue Bonds as of June 30, 2007:

		Principal[1]	Interest[1]	Total
2008	$	3,393	82,594	85,987
2009		7,593	83,115	90,708
2010		11,498	84,104	95,602
2011		13,551	85,231	98,782
2012		25,435	89,322	114,757
2013 – 2017		187,804	442,374	630,178
2018 – 2022		392,180	351,864	744,044
2023 – 2027		470,911	446,606	917,517
2028 – 2032		575,131	399,355	974,486
2033 – 2036		314,571	346,408	660,979
	$	2,002,067	2,410,973	4,413,040

(1) Includes payments on January 1 and January 15 of such fiscal year and July 1 and July 15 of the next fiscal year.

Included in principal is $480,522 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 portion of the 1993 bonds. As of June 30, 2007, the amount of the refunded bonds outstanding, which were previously eliminated in the financial statements as a result of the refunding escrow, was $879,533.

(In thousands)

(b) 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, 2007 is $12,000. 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, 2007, there were no borrowings outstanding on the line of credit.

(c) Debt Compliance

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 competitively bidding the major operations related contracts. The Agency has achieved the required coverage ratio of 1.3x Annual Debt Service since the bonds were issued; however, absent capital infusion it was anticipated that compliance would not be maintained as early as fiscal year 2007.

On November 10, 2005, the Agency's board of directors, with the board of directors of FETCA, entered into a Mitigation Payment and Loan Agreement (the Agreement). The terms of The Agreement call for FETCA to make payments to the Agency totaling $120,000 over four years to mitigate for the anticipated loss of revenue due to the construction of Foothill-South. The first two payments of $15,000 each were made by FETCA as scheduled in November 2005 and June 2006 and the third payment of $30,000 was made on June 30, 2007. Remaining payments are due as follows:

$	30,000	On the date construction bonds are issued to construct Foothill-South or June 30, 2008, whichever comes first.
	30,000	On the first anniversary of the date the construction bonds are issued to construct Foothill-South or June 30, 2009, whichever comes first.

FETCA will also provide loans, on an as-needed basis, up to $1,040,000 to assist the Agency in achieving its debt service coverage of 1.3x. Accrued interest will not count toward the $1,040,000 principal limitation. Payments of accrued interest and outstanding principal will begin in the fiscal year when the Agency has a surplus in revenues that exceeds the amount needed to meet the debt coverage requirement. All principal and accrued interest is due and payable on January 1, 2037 to the extent that the Agency has surplus revenues available to pay all amounts due. The agreement provides the ability to extend the payments beyond this date if necessary. At June 30, 2007, no amounts had been borrowed.

The Agreement was designed to meet the near-term needs of each Agency while preserving the flexibility to continue to pursue alternatives. The Agreement provides that FETCA loans will be made only to the extent that surplus revenues are available; the Agency's obligation to repay the loans is, in turn, secured by and payable only from its surplus revenues. The Agreement also stipulates that FETCA will not be obligated to increase toll rates to ensure sufficient revenues are available and that any liens or revenue pledges required in order to finance Foothill-South and complete certain other capital projects would have priority over loans to the Agency.

If the Agency determines that expected toll revenues, mitigation payments, and/or loan proceeds 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 still fall short of the debt ratio covenant, the Agency will repeat the process of analysis and implementation. Under this scenario, a failure to meet the debt ratio covenants will not constitute an event of default.

(7) Commitments and Contingencies

(a) 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 through October 31, 2015. Additionally, all agreements are cancelable by the Agency, without further obligation, upon written notice, generally within 90 days.

(b) 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 at June 30, 2007 due to FETCA under the terms of the lease agreement through June 30, 2008 are $475. Future minimum payments after June 30, 2008 are based on the fair market rental value and adjust annually.

(c) Project Costs

As of June 30, 2007, the Agency has outstanding commitments and contracts of approximately $4,873 for improvements and enhancements to the existing corridor.

The Agency also has a commitment to Caltrans to provide a maintenance facility for State Route 73. At June 30, 2007, the Agency has earmarked $5,100 in order to fulfill the commitment.

(d) 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.

(e) 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.

(8) 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. The funding and trend information required by GASB No. 27, *Accounting for Pensions by State and Local Government Employers*, for the Agency is not available; however, 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 7% of the employee's required contribution. The Agency is also required to contribute a percentage of each employee's covered salary into the plan. The Agency has contributed all of its required contributions of approximately $307, $208, and $197 to the plan for the years ended June 30, 2007, 2006, and 2005, respectively.

(9) Transportation Corridor System

In August 2003, the Agency and FETCA formed a joint powers agency, the Transportation Corridor System (TCS), to explore the possibility of purchasing the assets of both the Agency and FETCA and managing both toll roads as a single system. In August 2007, the TCS met to discuss a potential acquisition that would finance the purchase of the two Agencies through the issuance of new bonds. The proceeds of the sale of their assets would be used by the Agency and FETCA to defease or extinguish existing debt. A final decision by all three Agencies' board of directors on whether the acquisition will occur is anticipated in early 2008.