FOOTHILL/EASTERN TRANSPORTATION CORRIDOR AGENCY

Financial Statements

June 30, 2007

(With Independent Auditors' Report Thereon)

FOOTHILL/EASTERN TRANSPORTATION CORRIDOR AGENCY

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KPMG LLP
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Independent Auditors' Report

The Honorable Board of Directors
Foothill/Eastern Transportation Corridor Agency:

We have audited the accompanying financial statements of the Foothill/Eastern 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 Foothill/Eastern 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 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, 2007. Please read it in conjunction with the Agency's financial statements.

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 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 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 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 toll booth. Today, more than 200,000 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.

Financial Highlights

Tolls, fees, and fines collected in fiscal year 2007 (FY 2007) totaled $115,419 compared to $104,727 in the prior fiscal year, an increase of 10.2%.

Interest expense of $53,065 and principal payments of $19,260 on the Agency's long-term debt were made in FY 2007 compared to $53,780 and $14,720, respectively, in the prior fiscal year. Accretion on the Agency's capital appreciation bonds and convertible capital appreciation bonds totaled $68,196 in FY 2007, compared to $64,316 in the prior fiscal year.

As of June 30, 2007, the Agency had $526,838 in restricted cash and investments, restricted under the 1995 and 1999 master indentures of trust. The Agency also had $99,773 in unrestricted cash.

Total net deficit at June 30, 2007 was $1,362,719. The deficit results primarily from the recording of long-term debt, proceeds of which funded the construction of the corridors. Ownership was transferred to Caltrans upon completion. The net deficit was also a result of accretion recorded on the capital appreciation bonds and convertible capital appreciation bonds, which was 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 in them. 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 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 federal grants.

(Continued)

(In thousands)

Financial Analysis

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

		2007	2006	Percent increase (decrease)
Assets:				
Current assets	$	202,518	197,146	2.7%
Capital assets, net		224,182	169,361	32.4
Other noncurrent assets		436,888	420,034	4.0
Total assets		863,588	786,541	9.8
Liabilities:				
Bonds payable		2,176,054	2,116,818	2.8
Other liabilities		50,253	50,120	0.3
Total liabilities		2,226,307	2,166,938	2.7
Total net deficit	$	(1,362,719)	(1,380,397)	(1.3)

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 initially to construct the roads. Subsequent to completion, the roads are transferred to Caltrans. The net deficit results primarily from using bond proceeds to construct the corridors, which were then contributed to Caltrans, and from the accretion of interest on the outstanding bonds.

Current assets have increased this year mainly due to higher earnings on investments and proceeds received from the issuance and sale of fixed rate Subordinate Lien Toll Road Revenue Bonds, Series 2007 (the 2007 Bonds) in the aggregate principal amount of $10,300 as disclosed in note 7 to the financial statements. These increases were offset by a scheduled mitigation payment made to San Joaquin Hills Transportation Corridor Agency (SJHTCA) totaling $30,000. More detailed information regarding this payment can be found in note 8(e) to the financial statements.

Capital assets, net have increased as a result of additions to construction in progress primarily related to the scheduled mitigation payment made to SJHTCA, preliminary design, and environmental planning costs associated with the future construction of the southern extension of the State Route 241 Toll Road, known as Foothill-South.

The increase in bonds payable results from the current year accretion on the capital appreciation bonds and the convertible capital appreciation bonds totaling $68,196, offset by a principal payment of $19,260, and the issuance and sale of the 2007 Bonds consisting of current interest bonds totaling $10,300. Other liabilities have slightly increased as a result of increased deferred revenue from FasTrak® patrons.

(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	$	115,419	104,727	10.2%
Development impact fees		20,194	25,696	(21.4)
Other revenue		800	395	102.5
Total operating revenues		136,413	130,818	4.3
Operating expenses		33,843	25,186	34.4
Operating income		102,570	105,632	(2.9)
Nonoperating revenue (expenses), net		(84,892)	(102,502)	(17.2)
Change in net deficit		17,678	3,130	464.8
Net deficit at beginning of year		(1,380,397)	(1,383,527)	(0.2)
Net deficit at end of year	$	(1,362,719)	(1,380,397)	(1.3)

Revenues for the Agency consist primarily of tolls, fees, and fines, which comprised 84.6% of total revenue in FY 2007 compared to 80.1% of total revenue in FY 2006. Tolls, fees, and fines increased 10.2% over the prior year primarily due to an increase in toll rates in July 2006.

Operating expenses were $33,843 in FY 2007 compared to $25,186 in FY 2006, an increase of 34.4%. This increase is due to the contribution of capital improvements to Caltrans of $9,998 in FY 2007, compared to $562 in FY 2006. Capital improvement projects completed during the year were transferred to Caltrans, whereas in FY 2006, the majority of these projects were included in construction in progress. Also included in operating expenses are payments to third-party contractors for systems and equipment, violation processing, service center and toll collection operations, and the noncash expense of depreciation on fixed assets of $3,541 compared to $3,561 in FY 2006.

Nonoperating revenue (expenses), net consists of investment income of $36,374, offset by interest expense of $121,261 and amortization of $5. For FY 2006, nonoperating revenue (expenses), net consists of investment income of $15,594, offset by interest expense of $118,096. The increase in investment income is primarily related to the change in fair market value of investments held during each year. Interest expense comprises both interest payments and the change in accrued interest on long-term debt and accretion of bonds outstanding.

(In thousands)

The decrease in net deficit is primarily a result of an overall increase in operating revenues and investment income in the current year. The revenues earned by the Agency were sufficient to cover its current obligations, including debt service and operating expenses.

Capital Assets, Net

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

		2007	2006
Construction in progress	$	187,066	132,423
Right-of-way acquisitions, grading, or improvements		16,539	16,539
Furniture, equipment, and vehicles		97	123
Facility and toll revenue equipment		20,480	20,276
Total capital assets	$	224,182	169,361

Construction in progress at June 30, 2007 primarily represents improvements in progress related to the Foothill-South Corridor. Right-of-way acquisitions, grading, or improvements include easements and environmental mitigation parcels. Facility and toll revenue equipment includes the corridor operations facility, 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 $2,176,054 at June 30, 2007, an increase from the prior year of $59,236 due to the accretion of principal on convertible capital appreciation bonds and capital appreciation bonds of $68,196, offset by a principal payment of $19,260, and the issuance and sale of the 2007 Bonds in the aggregate principal amount of $10,300 as detailed in note 7 to the financial statements. All of the Agency's toll revenue, less certain expenses, as defined in the indentures of trust, is pledged to repay these bonds.

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.

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 May 2004, the San Joaquin Hills and Foothill/Eastern boards of directors and their respective financial and legal advisors began developing and negotiating a conceptual Mitigation and Loan Plan to help the SJHTCA avoid technical default and enable the Agency to move forward with Foothill-South. In November 2005, the Agency and the SJHTCA entered into an agreement, the terms of which include payments of $120,000 over four years to the SJHTCA to mitigate for the projected loss of revenue due to the construction of Foothill-South and loans as needed by SJHTCA, of up to $1,040,000 to assist SJHTCA in achieving its covenants to its bondholders. The agreement is disclosed in note 8(e) to the financial statements.

The Agency is focused on the completion of Foothill-South. The project includes the extension of 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. During FY 2006, the Agency's board of directors certified the Environmental Impact Statement/Supplemental Environmental Impact Report and selected a locally preferred Foothill-South alignment. The Agency is currently pursuing the required state and federal permits and performing analysis on financing options for Foothill-South. Construction is currently estimated to start in early 2011.

In April 2003, the Agency and SJHTCA formed a joint powers agency, the Transportation Corridor System (TCS), to explore the possibility of purchasing the assets of both the Agency and SJHTCA 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 SJHTCA 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, Foothill/Eastern Transportation Corridor Agency, 125 Pacifica, Suite 100, Irvine, California 92618 or to http://www.thetollroads.com/.

FOOTHILL/EASTERN TRANSPORTATION CORRIDOR AGENCY

Statement of Net Assets (Deficit)

June 30, 2007

(In thousands)

Assets

Current assets:		
Cash and investments	$	99,773
Restricted cash and investments		90,137
Receivables:		
Accounts, net of allowance of $938		1,015
Fees		69
Interest		9,366
Total receivables		10,450
Due from San Joaquin Hills Transportation Corridor Agency		1,471
Other assets		687
Total current assets		202,518
Noncurrent assets:		
Restricted cash and investments		436,701
Capital assets, net		224,182
Capitalized bond issuance costs, net		187
Total assets		863,588

Liabilities

Current liabilities:		
Accounts payable		8,232
Deferred revenue		11,499
Due to San Joaquin Hills Transportation Corridor Agency		2,670
Employee compensated absences payable		492
Interest payable		26,360
Note payable		1,000
Current portion of bonds payable		25,525
Total current liabilities		75,778
Long-term bonds payable		2,150,529
Total liabilities		2,226,307

Net Assets (Deficit)

Invested in capital assets, net of related debt		(1,952,872)
Restricted		490,380
Unrestricted		99,773
Total net deficit	$	(1,362,719)

See accompanying notes to financial statements.

FOOTHILL/EASTERN 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	$	115,419
Development impact fees		20,194
Other revenues		800
Total operating revenues		136,413
Operating expenses:		
Contribution of capital improvements to Caltrans		9,998
Toll compliance and customer service		7,573
Depreciation		3,541
Toll systems		3,143
Salaries and wages		3,043
Toll collections		2,472
Marketing		1,099
Toll facilities		1,066
Insurance		930
Professional services		393
Facilities operations, maintenance, and repairs		207
Other operating expenses		378
Total operating expenses		33,843
Operating income		102,570
Nonoperating revenue (expenses):		
Investment income		36,374
Amortization		(5)
Interest expense		(121,261)
Nonoperating revenue (expenses), net		(84,892)
Change in net deficit		17,678
Net deficit at beginning of year		(1,380,397)
Net deficit at end of year	$	(1,362,719)

See accompanying notes to financial statements.

FOOTHILL/EASTERN 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	$	116,578
Cash received from development impact fees		20,634
Cash received from property rental		443
Cash received from miscellaneous revenue sources		357
Cash payments to suppliers		(17,505)
Cash payments to employees		(3,105)
Net cash provided by operating activities		117,402
Cash flows from capital and related financing activities:		
Cash received from issuance of bonds		10,300
Cash payments for bond issuance costs		(192)
Cash payments for equipment		(3,419)
Cash payments for construction in progress		(65,455)
Cash payments for interest and principal		(72,672)
Net cash used in capital and related financing activities		(131,438)
Cash flows from investing activities:		
Cash received for interest, net of realized gains and losses		29,133
Cash payments for purchase of investments		(285,631)
Cash received from the maturity and sale of investments		284,125
Net cash provided by investing activities		27,627
Net increase in cash and cash equivalents		13,591
Cash and cash equivalents at beginning of year		350,985
Cash and cash equivalents at end of year (note 4)	$	364,576
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	102,570
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation		3,541
Contribution of capital improvements to Caltrans		9,998
Write-off of fixed assets		9
Changes in operating assets and liabilities:		
Accounts receivable		55
Fees receivable		440
Accounts payable, less accounts payable for fixed assets and construction in progress		(104)
Deferred revenue		1,174
Due from San Joaquin Hills Transportation Corridor Agency		35
Due to San Joaquin Hills Transportation Corridor Agency		(105)
Other assets		(227)
Employee compensated absences payable		16
Total adjustments		14,832
Net cash provided by operating activities	$	117,402
Noncash transactions:		
Interest expense recorded for accretion of bonds outstanding	$	(68,196)
Unrealized gain on investments		1,026
Amortization of discount/premium on investments		4,569

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 Foothill/Eastern Transportation Corridor Agency (the 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, administer funds for, and operate 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 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 contribution expense, 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. As provided in 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, interagency receivables, patron violation receivables, and interest.

(Continued)

(g) Capital Assets

Capital assets include construction in progress, environmental mitigation sites, easements, 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, with the exception of transponders, which are valued in total, and an estimated useful life in excess of three years. Such assets are recorded at cost.

The Foothill/Eastern Transportation Corridors 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 value to 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 they are 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 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 other expenses and has amounts due to SJHTCA related to the Agency's FasTrak® customers incurring tolls on State Route 73. At June 30, 2007, the Agency has a net payable due to SJHTCA 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 assets contributed 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.

(Continued)

(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	$	9,313
City of Tustin		5,290
City of San Clemente		2,168
City of Mission Viejo		928
City of Lake Forest		909
City of Santa Ana		626
County of Orange		389
City of Yorba Linda		367
City of San Juan Capistrano		107
City of Rancho Santa Margarita		67
City of Anaheim		26
City of Orange		3
City of Dana Point		1
	$	20,194

(4) Cash and Investments

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

Cash and investments	$	99,773
Current restricted cash and investments		90,137
Noncurrent restricted cash and investments		436,701
	$	626,611

(In thousands)

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

		Cash and cash equivalents	Investments	Total
Cash on hand	$	99	—	99
Demand deposits		3,507	—	3,507
Money market		39,875	—	39,875
Commercial paper		—	14,337	14,337
Federal agency securities		—	77,081	77,081
Cash held with trustee		297,900	—	297,900
Investments held with trustee per debt agreements		23,195	170,617	193,812
Total	$	364,576	262,035	626,611

(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, $99 was cash on hand, $43,282 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 $297,900 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 $301,407 and the corresponding bank balance was $301,601. The difference of $194 was principally due to outstanding checks. The Agency's petty cash fund and toll change funds totaled $99.

(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

(In thousands)

(NRRA) or at least "AA" by one NRRA. The policy also indicates specific rating requirements for certain types of investments. Percentage limitations on specific types of securities are based on the purchase price of the security, as compared to the market value of the portfolio, at the time of purchase. The policy does not require sales in a portfolio for subsequent changes in market value of the total portfolio to avoid exceeding the prescribed allocation level.

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

(Continued)

(In thousands)

Authorized investment type	Maximum maturity	Maximum percentage of portfolio*	Maximum investment in one issuer	Specific rating requirement
Repurchase Agreements	90 days	25%	25%	
Reverse Repurchase Agreements	30 days	10%	10%	
Medium-Term Maturity Corporate Notes	5 years	30%	30%	
State of California Local Agency Investment Fund	N/A	15%	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 U.S. Resolution Funding Corporation, the Federal National Mortgage Association, the Federal Home Loan Bank, and the Federal Home Loan Mortgage Corporation as authorized by the Agency's investment policy. These investments are 19%, 7%, 5%, and 5%, respectively, of the Agency's total 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.

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, U.S. Treasury bills, U.S. Treasury strips, and U.S. Treasury notes that were held by the Agency were rated AAA by Standard & Poors and AAA by Moody's; the RFCO strips were rated AAA by Moody's; Commercial Paper was rated A1 by Standard & Poors and P1 by Moody's; the Money

(Continued)

(In thousands)

Market Funds were rated AAA by Standard & Poors; and the counterparty to the investment agreement was rated AAA by Standard & Poors and Fitch, and Aaa by Moody's.

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 the Agency's investments governed by both the Agency's investment policy and its bond agreements, including cash held with the trustee of $297,900; money market funds of $39,875; and investments held with trustee of $23,195 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**	**More than 60 months**
Investment agreement	$ 297,900	—	—	297,900	—
RFCO strips	121,096	8,769	8,348	22,792	81,187
Federal agency securities	103,621	86,534	17,087	—	—
Money market funds	39,875	39,875	—	—	—
U.S. Treasury bills	32,980	32,980	—	—	—
Commercial paper	18,417	18,417	—	—	—
U.S. Treasury strips	4,694	—	—	—	4,694
U.S. Treasury notes	4,422	4,422	—	—	—
Total	$ 623,005	190,997	25,435	320,692	85,881

(In thousands)

(5) Capital Assets

Capital assets consist of the following:

		Balance at beginning of year	Additions	Transfers/ deletions	Balance at end of year
Construction in progress	$	132,423	64,641	(9,998)	187,066
Right-of-way acquisitions, grading, or improvements		42,526	—	—	42,526
Furniture, equipment, and vehicles		176	—	(52)	124
Facility and toll revenue equipment		33,214	3,728	(4,170)	32,772
		208,339	68,369	(14,220)	262,488
Impairment loss on right-of-way acquisitions, grading, or improvements		(25,987)	—	—	(25,987)
Furniture and equipment accumulated depreciation		(53)	(26)	52	(27)
Facility and toll revenue equipment accumulated depreciation		(12,938)	(3,515)	4,161	(12,292)
	$	169,361	64,828	(10,007)	224,182

(a) 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 Agreement between the Agency and Caltrans. For the year ended June 30, 2007, 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. Upon completion, these capital assets will also be transferred to Caltrans and recognized as a contribution expense.

(6) Capitalized Bond Issuance Costs

Capitalized bond issuance costs consist of legal costs, underwriting fees, printing and other costs incurred to obtain, secure and sell the Series 2007 fixed rate Subordinate Lien Toll Road Revenue Bonds (note 7). The issuance costs for the Series 2007 Bonds have an original cost of $192 and will be amortized over the 37 month term of the Bonds using the straight-line method. Accumulated amortization of these Bond issuance costs totals $5 for the year ended June 30, 2007.

(Continued)

(In thousands)

(7) Long-Term Obligations

The following is a summary of changes in 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 2007 (fixed rate) Subordinate Lien Toll Road Revenue Bonds:					
Current Interest Bonds	$ —	10,300	—	10,300	—
Series 1999 Toll Road Refunding Revenue Bonds:					
Current Interest Bonds	804,155	—	(19,260)	784,895	25,525
Capital Appreciation Bonds	553,850	33,760	—	587,610	—
Convertible Capital Appreciation Bonds	578,823	34,436	—	613,259	—
Series 1995A (fixed rate) Senior Lien Toll Road Revenue Bonds:					
Current Interest Bonds	179,990	—	—	179,990	—
Total bonds payable	$ 2,116,818	78,496	(19,260)	2,176,054	25,525

(a) *Toll Road Revenue Bonds*

In May 2007, the Agency issued term toll road revenue bonds (2007 Bonds) consisting of current interest bonds in the principal amount of $10,300. The 2007 Bonds are junior and subordinate to the 1999 Bonds (1999 Refunding Bonds) and remaining 1995 bonds (1995 Unrefunded Bonds) and are collateralized by net revenues, as defined in the master indentures, consisting primarily of toll revenues less current expenses.

Interest on the 2007 Bonds is payable semiannually at a rate of 5.25%. The bonds mature on July 15, 2010. The bonds are subject to early redemption, at the option of the Agency, beginning July 15, 2008 by payment of accrued interest, principal, and if redeemed prior to July 15, 2009, a premium of 1.00%.

The 1999 Refunding Bonds were issued by the Agency in August 1999, and included serial, term, and capital appreciation toll road refunding revenue 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 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 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 of up to 2.00%.

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 of up to 1.00%.

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

(In thousands)

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, the 1999 Toll Road Refunding Bonds, and the 2007 Subordinate Lien Toll Road Revenue Bonds as of June 30, 2007:

		Principal[1]	Interest[1]	Total
2008	$	25,525	52,485	78,010
2009		31,360	51,072	82,432
2010		—	90,741	90,741
2011		14,840	90,092	104,932
2012		11,390	89,690	101,080
2013 – 2017		142,786	451,508	594,294
2018 – 2022		236,162	534,137	770,299
2023 – 2027		362,830	555,800	918,630
2028 – 2032		417,575	677,136	1,094,711
2033 – 2037		350,462	898,899	1,249,361
2038 – 2040		583,124	269,810	852,934
	$	2,176,054	3,761,370	5,937,424

[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 $444,690 related to accreted principal on convertible capital appreciation bonds and capital appreciation bonds.

The net proceeds of the 1999 Refunding Bonds plus additional 1995 series moneys 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. 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 $818,159.

(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 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, 2007 is $36,000. 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.

(In thousands)

(8) Commitments and Contingencies

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

(b) Project Costs

As of June 30, 2007, the Agency has outstanding commitments and contracts for remaining corridor construction of Foothill-South and improvements on existing construction of approximately $30,503.

(c) 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.

(d) 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.

(e) Mitigation Payment and Loan Agreement

On November 10, 2005 the Agency’s board of directors, with the board of directors of the SJHTCA, entered into a Mitigation Payment and Loan Agreement (The Agreement). The terms of The Agreement call for the Agency to make payments totaling $120,000 over four years to the SJHTCA to mitigate for anticipated loss of revenue due to the construction of Foothill-South. The first two payments of $15,000 each were made to the SJHTCA 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.

The Agency will also provide loans, on an as-needed basis, to SJHTCA, up to $1,040,000 to assist SJHTCA in achieving its debt service coverage of 1.3x. The Agreement provides that the Agency loans will be made only to the extent that surplus revenues are available. The Agreement also stipulates that the Agency 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 SJHTCA. 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 SJHTCA has a surplus in revenues that exceeds the amount needed to meet the debt coverage requirement. All principal and accrued interest will be due and payable on January 1, 2037 to the extent that SJHTCA 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 were outstanding on the loan.

(9) 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). 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, 2007 are $475 through June 30, 2008.

(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. The funding and trend information required by GASB Statement 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 $693, $476, and $464 to the plan for the years ended June 30, 2007, 2006, and 2005, respectively.

(11) Transportation Corridor System

In April 2003, the Agency and SJHTCA formed a joint powers agency, the Transportation Corridor System (TCS), to explore the possibility of purchasing the assets of both the Agency and SJHTCA 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 SJHTCA 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.