



**FOOTHILL/EASTERN TRANSPORTATION  
CORRIDOR AGENCY**

Financial Statements

June 30, 2016 and 2015

(With Independent Auditors' Report Thereon)

**FOOTHILL/EASTERN TRANSPORTATION  
CORRIDOR AGENCY**

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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), which comprise the statements of net position as of June 30, 2016 and 2015, and the related statements of revenue, expenses, and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *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, 2016 and 2015, and the results of its operations and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



***Emphasis of Matters***

*Adoption of New Accounting Pronouncements*

As discussed in the *Significant Accounting Policies* note to the financial statements, in 2016 the Agency adopted Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement and Application* and GASB Statement No. 82, *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73*. During the year ended June 30, 2015, the Agency adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – An Amendment of GASB Statement No. 68*. Our opinion is not modified with respect to this matter.

***Other Matters***

*Required Supplementary Information*

U.S. generally accepted accounting principles require that management’s discussion and analysis on pages 3–7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**KPMG LLP**

September 29, 2016

## **FOOTHILL/EASTERN TRANSPORTATION CORRIDOR AGENCY**

### Management's Discussion and Analysis

(In thousands)

This discussion and analysis of the financial performance of the Foothill/Eastern Transportation Corridor Agency (the Agency) provides an overview of the Agency's financial activities for the fiscal years ended June 30, 2016 and 2015. 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 to provide traffic relief to Orange County through the construction and operation of toll roads. 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. The Agency's primary focus is the operation of the facilities and collection of tolls to repay the tax-exempt revenue bonds that were issued to construct the 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 revenue, but with a shortage of gas-tax revenue 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 and development impact fees, 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. The State Route 241, State Route 261, and State Route 133 Toll Roads serve as important, time-saving alternative routes to local freeways and arterial roads, with averages of approximately 207,000, 193,000, and 177,000 transactions per weekday as of June 30, 2016, 2015, and 2014, respectively.

#### **Financial Highlights**

Tolls, fees, and fines collected in fiscal year 2016 (FY16) totaled \$167,635 compared to \$149,902 in fiscal year 2015 (FY15), an increase of 11.8%.

As of June 30, 2016 and 2015, the Agency had \$399,095 and \$403,780, respectively, in restricted cash and investments that were subject to master indentures of trust for the bonds outstanding at each date. The Agency also had \$205,664 and \$151,348, respectively, in unrestricted cash.

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(In thousands)

The Agency's net position at June 30, 2016 and 2015 was \$(1,427,631) and \$(1,456,090), respectively. The negative net position results primarily from the inclusion in the Agency's financial statements of its long-term debt obligations, which were used to fund construction of the corridors, but not the related capital assets, since ownership of the corridors was transferred to Caltrans upon completion.

**Overview of the Financial Statements**

The Agency's financial statements include its statements of net position, statements of revenue, expenses, and changes in net position, statements 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 the assets and liabilities of the Agency as well as certain items labeled as deferred outflows and inflows of resources. The current year's revenue and expenses are taken into account regardless of when cash is received or paid. The statements of cash flows provide 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 statements of net position and the statements of revenue, expenses, and changes in net position report the Agency's net position and related changes. Net position is the difference between the total of recorded assets and deferred outflows and the total of liabilities and deferred inflows. The recorded activities include all toll revenue and operating expenses related to the operation of the Foothill/Eastern Transportation Corridors, as well as the Agency's construction-related activities and related financing costs. Activities are financed by toll revenue, development impact fees, fees and fines, and investment income.

**Financial Analysis**

The following table summarizes the net position of the Agency as of June 30, 2016 and 2015:

	<u>2016</u>	<u>2015</u>	<u>Percentage increase (decrease)</u>
Assets and deferred outflows:			
Current assets	\$ 245,789	227,001	8.3%
Capital assets, net	292,397	285,666	2.4
Other noncurrent assets	498,766	467,303	6.7
Deferred outflows	12,843	13,284	(3.3)
Total assets and deferred outflows	<u>1,049,795</u>	<u>993,254</u>	5.7
Liabilities and deferred inflows:			
Bonds payable	2,379,275	2,353,039	1.1
Net pension liability	8,918	7,556	18.0
Other liabilities	88,409	87,738	0.8
Deferred inflows	824	1,011	(18.5)
Total liabilities and deferred inflows	<u>2,477,426</u>	<u>2,449,344</u>	1.1
Net position	<u>\$ (1,427,631)</u>	<u>(1,456,090)</u>	2.0

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(In thousands)

As described in notes 5 and 7(e) to the accompanying financial statements, the decrease in capital assets from FY15 to FY16 reflects the reclassification of \$120,000 of payments made to the San Joaquin Hills Transportation Corridor Agency (SJHTCA) through 2009 that were originally recorded as construction in progress related to the 241 to I-5 connection project, offset by additions to continuing work in connection with the Agency's capital improvement plan. In connection with SJHTCA's November 2014 bond refinance transaction, the Agency's Board of Directors and SJHTCA's Board of Directors approved an agreement that provided for termination of the Mitigation Payment and Loan Agreement between the Agencies, concurrently with the closing of the transaction. The termination agreement also provided for SJHTCA to pay \$120,000 to the Agency, in annual installments beginning January 15, 2025 equal to 50% of SJHTCA's surplus funds, plus accrued interest. Accordingly, this amount was recorded during FY15 as a note receivable from SJHTCA and a reduction of construction in progress.

The category above labeled deferred outflows includes two components: the first is the amount by which the reacquisition price of bonds refunded in FY15 exceeded their net carrying value. This amount has been deferred and is being amortized over the remaining period during which the refunded bonds were scheduled to be paid. In addition, as described in notes 2 and 8 to the financial statements, the Agency adopted Governmental Accounting Standards Board (GASB) Statement No. 68 and recorded its proportionate share of the collective net pension liability applicable to the defined-benefit pension plan in which its employees participate, as well as deferred outflows and inflows of resources related to pensions. This resulted in an adjustment to the Agency's previously reported net position in order to record its net pension liability.

Following is a summary of the Agency's revenue, expenses, and changes in net position for the years ended June 30, 2016 and 2015:

	<b>2016</b>	<b>2015</b>	<b>Percentage increase (decrease)</b>
Operating revenue:			
Tolls, fees, and fines	\$ 167,635	149,902	11.8%
Development impact fees	28,349	24,901	13.8
Other revenue	533	386	38.1
Total operating revenue	196,517	175,189	12.2
Operating expenses	27,105	24,979	8.5
Operating income	169,412	150,210	12.8
Nonoperating expenses, net	(140,953)	(144,560)	(2.5)
Change in net position	28,459	5,650	
Net position at beginning of year	(1,456,090)	(1,461,740)	0.2
Net position at end of year	\$ (1,427,631)	(1,456,090)	(2.0)

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Management's Discussion and Analysis

(In thousands)

Tolls, fees, and fines comprised 85.3% of total revenue in FY16 compared to 85.6% of total revenue in FY15. Tolls, fees, and fines increased by 11.8% and 7.9%, respectively, over each of the two preceding years, primarily due to toll rate increases and increases in toll transactions. Development impact fees were \$28,349 in FY16 and \$24,901 in FY15, an increase of 13.8%, compared to an increase of 25.7% in FY15. The amounts of development impact fees collected fluctuate from year to year depending on residential and nonresidential development in Orange County within the area of benefit.

Operating expenses were \$27,105 in FY16 compared to \$24,979 in FY15, an increase of 8.5%. Included in operating expenses in FY16 is noncash depreciation expense on fixed assets of \$5,472, compared to \$4,902 in FY15. Excluding depreciation, operating expenses were \$21,633 in FY16 and \$20,077 in FY15, an increase of \$1,556.

Net nonoperating expenses for FY16 include investment income of \$5,405; interest expense of \$140,331; \$5,843 related to the cost of capital improvements contributed to Caltrans; and amortization of \$184 of prepaid bond insurance amortization. For FY15, net nonoperating expenses include investment income of \$11,692; interest expense of \$142,388; \$11,684 related to the cost of capital improvements contributed to Caltrans; costs of \$2,061 related to the long-term debt refinancing transaction that were paid and recorded as expense; and prepaid bond insurance amortization of \$119. Accrual basis interest expense included accretion on the Agency's capital appreciation bonds and convertible capital appreciation bonds of \$25,795 and \$22,086 in FY16 and in FY15, respectively. Interest expense in FY16 and FY15 also included noncash amortization of \$441 and \$416, respectively, related to a discount on the issuance of bonds and of \$1,323 and \$1,414, respectively, related to the deferred bond refunding costs.

**Capital Assets, Net**

The following table summarizes the Agency's capital assets, net of accumulated depreciation, at June 30:

	<b>2016</b>	<b>2015</b>
Construction in progress	\$ 256,268	247,802
Right-of-way acquisitions, grading, or improvements	15,014	15,014
Furniture and equipment	21,115	22,850
Total capital assets	\$ 292,397	285,666

Right-of-way acquisitions, grading, or improvements include easements and environmental mitigation parcels. Furniture and equipment includes facility and toll revenue equipment related to the corridor operations facility, transponders, toll and violations collection equipment, 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**

At June 30, 2016, 2015, and 2014, the Agency had outstanding bonds payable of \$2,379,275, \$2,353,039, and \$2,423,519, respectively. The changes in FY16 and FY15 are partially attributable to the accretion of principal on capital appreciation bonds of \$25,795 and \$22,086, respectively. The remainder of the FY15 change resulted from the bond refunding transaction.



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(In thousands)

All of the Agency's toll, fees, fines, and development impact fee 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 as of and for the years ended June 30, 2016 and 2015.

**Economic Factors**

After consideration of toll rate recommendations from the Agency's traffic consultant and the potential effects of traffic diversion, toll rates were approved by the Agency's Board of Directors for implementation effective July 1, 2016. The new toll rates are projected to result in a 3.4% increase in transactional toll revenue and reflect increases of 2% for FasTrak® toll rates and maintenance of the \$1.00 increment above the FasTrak® rates for non-FasTrak transactions.

The Agency continues to focus on customer incentives and promotions to attract new drivers, reward current customers, and increase total transactions and revenue.

**Contacting the Agency's Financial Management**

This financial report is designed to provide a general overview of the Agency's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Controller, Foothill/Eastern Transportation Corridor Agency, 125 Pacifica, Suite 100, Irvine, CA 92618 or to [info@thetollroads.com](mailto:info@thetollroads.com).

**FOOTHILL/EASTERN TRANSPORTATION  
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Statements of Net Position

June 30, 2016 and 2015

(In thousands)

	<b>2016</b>	<b>2015</b>
Assets:		
Current assets:		
Cash and investments	\$ 98,119	76,833
Restricted cash and investments	138,924	141,926
Receivables:		
Accounts, net of allowance of \$2,949 and \$2,639, respectively	6,304	4,395
Fees	21	936
Interest	1,470	1,436
Other assets	951	1,475
Total current assets	245,789	227,001
Noncurrent assets:		
Cash and investments	107,545	74,515
Restricted cash and investments	260,171	261,854
Capital assets, net	292,397	285,666
Unamortized prepaid bond insurance	10,555	10,739
Note receivable – San Joaquin Hills Transportation Corridor Agency	120,495	120,195
Total noncurrent assets	791,163	752,969
Deferred outflows of resources:		
Unamortized deferral of bond refunding costs	11,084	12,407
Pension costs	1,759	877
Total assets and deferred outflows	1,049,795	993,254
Liabilities:		
Current liabilities:		
Accounts payable	8,185	10,975
Unearned revenue	20,424	18,196
Due to San Joaquin Hills Transportation Corridor Agency	7,577	6,444
Employee compensated absences payable	511	411
Interest payable	51,712	51,712
Total current liabilities	88,409	87,738
Net pension liability	8,918	7,556
Long-term bonds payable	2,379,275	2,353,039
Total liabilities	2,476,602	2,448,333
Deferred inflows of resources:		
Pension costs	824	1,011
Total liabilities and deferred inflows	2,477,426	2,449,344
Net position:		
Net investment in capital assets	(1,944,744)	(1,924,032)
Restricted	317,869	325,273
Unrestricted	199,244	142,669
Total net position	\$ (1,427,631)	(1,456,090)

See accompanying notes to financial statements.

**FOOTHILL/EASTERN TRANSPORTATION  
CORRIDOR AGENCY**

Statements of Revenue, Expenses, and Changes in Net Position

Years ended June 30, 2016 and 2015

(In thousands)

	<b>2016</b>	<b>2015</b>
Operating revenue:		
Tolls, fees, and fines	\$ 167,635	149,902
Development impact fees	28,349	24,901
Other revenue	533	386
Total operating revenue	196,517	175,189
Operating expenses:		
Toll compliance and customer service	12,085	11,673
Depreciation	5,472	4,902
Salaries and wages	3,299	2,907
Toll systems	2,230	1,566
Marketing	1,045	1,410
Insurance	780	773
Toll facilities	662	739
Professional services	946	612
Facilities operations, maintenance, and repairs	202	174
Other operating expenses	384	223
Total operating expenses	27,105	24,979
Operating income	169,412	150,210
Nonoperating revenue (expenses):		
Investment income	5,405	11,692
Contribution of capital improvements to Caltrans	(5,843)	(11,684)
Costs of bond refunding	—	(2,061)
Amortization of prepaid bond insurance	(184)	(119)
Interest expense	(140,331)	(142,388)
Nonoperating expenses, net	(140,953)	(144,560)
Change in net position	28,459	5,650
Net position at beginning of year	(1,456,090)	(1,461,740)
Net position at end of year	\$ (1,427,631)	(1,456,090)

See accompanying notes to financial statements.

**FOOTHILL/EASTERN TRANSPORTATION  
CORRIDOR AGENCY**

Statements of Cash Flows

Years ended June 30, 2016 and 2015

(In thousands)

	<b>2016</b>	<b>2015</b>
Cash flows from operating activities:		
Cash received from toll road patrons	\$ 169,087	152,022
Cash received from development impact fees	29,264	23,985
Cash received from other revenue	533	386
Cash payments to suppliers	(21,327)	(15,796)
Cash payments to employees	(3,069)	(2,706)
Net cash provided by operating activities	174,488	157,891
Cash flows from capital and related financing activities:		
Cash payments for acquisition of capital assets	(17,156)	(38,095)
Cash paid in connection with bond refunding transaction	—	(96,403)
Cash payments for interest and principal	(112,772)	(127,043)
Net cash used in capital and related financing activities	(129,928)	(261,541)
Cash flows from investing activities:		
Cash receipts for interest and dividends	7,078	8,578
Cash receipts from the maturity and sale of investments	292,095	441,441
Cash payments for purchase of investments	(375,052)	(310,108)
Net cash provided by (used in) investing activities	(75,879)	139,911
Net increase (decrease) in cash and cash equivalents	(31,319)	36,261
Cash and cash equivalents at beginning of year	129,607	93,346
Cash and cash equivalents at end of year (note 4)	\$ 98,288	129,607
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 169,412	150,210
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	5,472	4,902
Changes in operating assets and liabilities:		
Accounts receivable	(1,909)	(1,003)
Fees receivable	915	(916)
Due to/from San Joaquin Hills Transportation Corridor Agency	1,133	1,342
Other assets	524	(34)
Accounts payable	(3,517)	1,408
Deferred revenue	2,228	1,781
Net pension liability and related accounts	130	(349)
Employee compensated absences payable	100	550
Total adjustments	5,076	7,681
Net cash provided by operating activities	\$ 174,488	157,891

**FOOTHILL/EASTERN TRANSPORTATION  
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Statements of Cash Flows

Years ended June 30, 2016 and 2015

(In thousands)

	<b>2016</b>	<b>2015</b>
Noncash capital and related financing and investing activities:		
Bond refunding, including the following elements:		
Proceeds of new bonds issued	\$ —	87,008
Escrow deposit to repay principal on refunded bonds	—	(179,990)
Transaction costs charged to expense	—	(2,061)
Prepaid bond insurance	—	(1,360)
Interest expense recorded for accretion of bonds outstanding	(25,795)	(22,086)
Amortization of bond discount recorded as interest expense	(441)	(416)
Amortization of deferred bond refunding cost recorded as interest expense	(1,323)	(1,414)
Amortization of prepaid bond insurance	(184)	(119)
Contribution of capital improvements to Caltrans	(5,843)	(11,684)
Writeoff of fully depreciated capital assets	(1,097)	(1,331)
Interest accrued on note receivable from San Joaquin Hills Transportation Corridor Agency	300	195
Change in unrealized gain/loss on investments	1,539	5,490
Amortization of discount/premium on investments	(2,856)	(2,629)

See accompanying notes to financial statements.

**FOOTHILL/EASTERN TRANSPORTATION  
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Notes to Financial Statements

June 30, 2016 and 2015

(In thousands)

**(1) Reporting Entity**

In recognition of the regional transportation needs in the County of Orange (County), the California State Legislature 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. The Agency is governed by a Board of Directors comprising representatives from the member agencies. The Agency has the power to, among other things, incur debt and establish and collect tolls.

The financial statements comprise the activities of the Agency. There are no other organizations for which the Agency is financially accountable or for which it is fiscally responsible. The 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 (U.S. GAAP) 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 revenue and expenses from nonoperating items in the preparation of its financial statements. Operating revenue 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 revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

**(b) Basis of Accounting**

The financial statements are prepared using the accrual basis of accounting. Revenue is recognized when earned, and expenses are recognized when incurred. During the year ended June 30, 2015, the Agency implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – An Amendment of GASB Statement*

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(In thousands)

*No. 68.* The effect of the adoption of these standards was a decrease to beginning net position as of July 1, 2015 of \$8,039. During the year ended June 30, 2016, the Agency implemented GASB Statement No. 72, *Fair Value Measurement and Application* and GASB Statement No. 82, *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73.* There was no effect on net position as a result of adoption of these standards.

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's staff for estimated revenue 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. GAAP. 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, except for money market funds, are stated at fair value on a recurring basis. Money market funds with maturities of one year or less are recorded at amortized cost.

The Agency adopted GASB Statement 72, *Fair Value Measurement Applications*, effective, July 1, 2015. This statement addresses accounting and fair value reporting issues related to fair value measurements by clarifying the definition of fair value, establishing general principles for measuring fair value, providing additional fair value application guidance, and enhancing disclosures about fair value measurements. This statement established a three-level hierarchy of inputs to valuation techniques used to measure fair value.

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

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June 30, 2016 and 2015

(In thousands)

**(f) Receivables**

Receivables include amounts due from member agencies for development impact fees collected on behalf of the Agency, credit card receivables, interoperable receivables due from other California toll agencies, receivables from patrons for violations and tolls, and interest.

**(g) Capital Assets**

Capital assets include construction in progress, environmental mitigation sites, easements, the corridor operations facility, transponders, toll and violations collection equipment, buildings, changeable message signs, vehicles, and furniture. 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 that are valued in total, and an estimated useful life in excess of one year.

As described further in note 5, the Foothill/Eastern Transportation Corridors and the related purchases of rights 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 these assets. The costs of normal maintenance and repairs and mitigation that do not add value to the assets or materially extend asset lives are not capitalized.

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

Asset type	Useful life
Buildings	20–30 years
Changeable message signs	15 years
Toll revenue equipment	5 years
Vehicles	5 years
Leasehold improvements, other equipment, and furniture	5–10 years

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

**(h) Unearned Revenue**

Unearned revenue represents prepaid tolls collected from patrons, including those using FasTrak®, an electronic toll collection system.

**(i) Unamortized Deferral of Bond Refunding Costs**

Deferred bond refunding costs represent certain costs related to the issuance of bonds. These costs have been recorded as deferred outflows of resources, and are being amortized over the remaining period during which the refunded bonds were scheduled to be repaid, as more fully detailed in note 6.



**FOOTHILL/EASTERN TRANSPORTATION  
CORRIDOR AGENCY**

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(In thousands)

**(j) Pension Plan**

Qualified permanent employees of the Agency participate in a cost-sharing multiple-employer defined-benefit pension plan administered by the Orange County Employees Retirement System (OCERS). For purposes of measuring the Agency's net pension liability, deferred outflows/inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the plan and additions to/deductions from the plan's fiduciary net position have been determined on the same basis as they are reported by OCERS. For this purpose, plan contributions are recognized when they are due and payable in accordance with plan terms. Investments are reported at fair value.

**(k) Revenue Recognition**

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

**(l) Transactions with SJHTCA**

As described in note 7(e), payments of \$120,000 to SJHTCA through 2009 that were originally recorded as construction in progress were reclassified as a note receivable from SJHTCA and a reduction of construction in progress in 2015.

Expenses directly related entirely to the Agency are charged to the Agency, and those incurred on behalf of both the Agency and SJHTCA are allocated between the two agencies based on the estimated benefit to each. In addition, the Agency has amounts due from SJHTCA related to SJHTCA customers who incur tolls on the Agency's corridors and other expenses and amounts due to SJHTCA related to the Agency's customers who incur tolls on State Route 73. At June 30, 2016 and 2015, the Agency had net payables to SJHTCA of \$7,577 and \$6,444, respectively.

**(m) Net Position**

The Agency's net position is classified within the following categories:

*Net investment in capital assets:* Represents the Agency's capital assets, net of accumulated depreciation and the outstanding principal balances of debt attributable to the acquisition, construction, and improvement of those assets.

*Restricted:* Represents the Agency's assets subject to externally imposed conditions, related primarily to restricted bond proceeds and certain revenue collected, net of related liabilities.

*Unrestricted:* Represents the remainder of the Agency's net position not included in the categories above.

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(In thousands)

**(n) Use of Estimates**

The preparation of financial statements in conformity with U.S. GAAP 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

**(3) Development Impact Fees**

The sources of development impact fees for the years ended June 30, 2016 and 2015 were as follows:

	<u>2016</u>	<u>2015</u>
City of Irvine	\$ 23,725	19,368
City of Lake Forest	2,357	2,416
City of Tustin	1,119	338
City of Yorba Linda	518	658
City of San Juan Capistrano	168	612
City of Anaheim	159	52
County of Orange	109	1,016
City of Rancho Santa Margarita	84	6
City of San Clemente	73	117
City of Mission Viejo	25	284
City of Orange	12	4
City of Santa Ana	—	30
	<u>\$ 28,349</u>	<u>24,901</u>

**(4) Cash and Investments**

Cash and investments as of June 30, 2016 and 2015 are classified in the accompanying financial statements as follows:

	<u>2016</u>	<u>2015</u>
Current cash and investments	\$ 98,119	76,833
Noncurrent cash and investments	107,545	74,515
Current restricted cash and investments	138,924	141,926
Noncurrent restricted cash and investments	260,171	261,854
	<u>\$ 604,759</u>	<u>555,128</u>

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(In thousands)

Cash and investments as of June 30, 2016 consist of the following:

	<b>Cash and cash equivalents</b>	<b>Investments</b>	<b>Total</b>
Cash on hand	\$ 1	—	1
Deposit accounts	14,175	—	14,175
Money market funds	3,418	—	3,418
Commercial paper	6,995	10,178	17,173
U.S. Treasury securities	—	61,882	61,882
Federal agency and U.S. government- sponsored enterprise notes and bonds	—	98,520	98,520
Corporate notes	—	49,163	49,163
Investments held with trustee per debt agreements:			
Money market funds	34,322	—	34,322
Commercial paper	220	—	220
U.S. Treasury securities	39,157	113,479	152,636
Federal agency and U.S. government-sponsored enterprise notes and bonds	—	140,519	140,519
Corporate notes	—	32,730	32,730
Total	<u>\$ 98,288</u>	<u>506,471</u>	<u>604,759</u>

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(In thousands)

Cash and investments as of June 30, 2015 consist of the following:

	<b>Cash and cash equivalents</b>	<b>Investments</b>	<b>Total</b>
Cash on hand	\$ 2	—	2
Deposit accounts	15,224	995	16,219
Money market funds	7,425	—	7,425
Commercial paper	—	27,980	27,980
U.S. Treasury securities	—	36,858	36,858
Federal agency and U.S. government- sponsored enterprise notes and bonds	24,599	59,234	83,833
State and local bonds	—	11,936	11,936
Corporate notes	—	11,076	11,076
Investments held with trustee per debt agreements:			
Money market funds	34,359	—	34,359
Commercial paper	—	4,563	4,563
U.S. Treasury securities	—	189,057	189,057
Federal agency and U.S. government-sponsored enterprise notes and bonds	47,998	83,822	131,820
Total	\$ <u>129,607</u>	<u>425,521</u>	<u>555,128</u>

**(a) Cash Deposits**

**Custodial Credit Risk Related to Cash Deposits**

Custodial credit risk for deposits is the risk that, in the event of failure of a depository financial institution, the Agency will not be able to recover its deposits or will not be able to recover collateral securities that are in possession of an outside party.

At June 30, 2016 and 2015, the carrying amounts of the Agency's cash deposits were \$14,175 and \$15,224, respectively, and the corresponding aggregate bank balances were \$15,815 and \$16,125, respectively. The differences of \$1,640 and \$901 were principally due to outstanding checks. The Agency's custodial credit risk is mitigated in that the full amounts of the bank balances outlined above were insured by federal depository insurance or collateralized in accordance with Section 53652 of the California Government Code with securities held by the pledging financial institution in the Agency's name.

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(In thousands)

**(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, maximum maturity, and maximum percentage investment. Both the policy and the Agency's debt agreements generally require that all securities must be issued by companies with a long-term debt rating of at least "A" by two of the Nationally Recognized Statistical Rating Organizations (NRSRO) or at least "AA" by one NRSRO. The policy also indicates specific rating requirements for certain types of investments. Further, there are percentage limitations on the purchase of specific types of securities, based on the purchase price of the security as compared to the market value of the total portfolio at the time of purchase. However, the policy does not require sales of individual securities due to subsequent changes in market value that cause their values to exceed the prescribed maximum percentages of the portfolio.

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

Authorized investment type	Maximum maturity	Maximum percentage of portfolio*	Maximum percentage investment in one issuer	Specific rating requirement
U.S. Treasury bills, notes, and bonds	5 years	100	100	N/A
Federal agency and U.S. government-sponsored enterprise notes and bonds	5 years	100	35	N/A
Federal agency mortgage- backed securities	5 years	20	15	Second highest ratings category by an NRSRO
Certificates of deposit	** 5 years	100	5	Long-term debt rating in one of highest ratings categories by two NRSROs
Certificates of Deposit Account Registry Service	5 years	30	5	Long-term debt rating in one of highest ratings categories by two NRSROs

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Authorized investment type	Maximum maturity	Maximum percentage of portfolio*	Maximum percentage investment in one issuer	Specific rating requirement
Negotiable certificates of deposit	5 years	30	5	Long-term debt rating in one of highest ratings categories by two NRSROs
Banker's acceptances	180 days	30	5	Drawn on and accepted by a bank that carries the highest short-term ratings category by one NRSRO
Commercial paper	270 days	25	Lesser of 5% of portfolio or 10% of outstanding paper of issuer	Highest short-term rating by an NRSRO
Repurchase agreements	90 days	25	5	N/A
Medium-term maturity corporate notes	5 years	30	5	Long-term debt rating in one of highest ratings categories by two NRSROs
State of California Local Agency Investment Fund	N/A	Lesser of \$50 million or 15% of portfolio	5	N/A
County or local agency investment pools	N/A	15	5	N/A
Shares in a California common law trust	N/A	20	5	Highest rating category by an NRSRO
Asset-backed securities	5 years	20	5	Highest rating by one NRSRO; issuer must also have one of the three highest ratings from two NRSROs
Money market mutual funds	N/A	20	5	Highest applicable rating by two NRSROs
Bonds or notes issued by the State of California, any local agency in the state, or any other state	5 years	30	5	One of the three highest rating categories by at least two NRSROs

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

\*\* The full amounts of principal and accrued interest must be insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration (NCUA).

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The investment of debt proceeds and toll revenue held by the Agency's bond trustee is governed by provisions of the debt agreements, rather than by the general provisions of the California Government Code or the Agency's investment policy. The following table identifies the investment types that are authorized for these funds, and if applicable, the specific rating requirements:

<b>Investments authorized by debt agreements</b>	<b>Specific rating requirement</b>
U.S. government obligations	N/A
U.S. federal agency debt instruments	N/A
State and local government debt securities	One of the two highest rating categories by Moody's and S&P, and if rated by Fitch, in one of the two highest rating categories
Certificates of deposit, savings accounts, deposit accounts, or money market deposits insured by the Federal Deposit Insurance Corporation (FDIC)	N/A
Certificates of deposit collateralized by U.S. government or federal agency obligations	N/A
Federal funds or bankers' 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 with terms up to 30 days, secured by U.S. government or federal agency obligations	A or better by both Moody's and S&P and, if rated by Fitch, A or better
Medium-term corporate notes with maximum maturity of five years	One of the three highest applicable rating categories, or approved in writing, by S&P, and, if rated by Fitch, 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	* N/A

\* 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.

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Notes to Financial Statements

June 30, 2016 and 2015

(In thousands)

At June 30, 2016 and 2015, all of the Agency's investments were rated at or above the minimum levels required by its investment policy and its debt agreements, as shown below:

Investment type	June 30, 2016		June 30, 2015	
	S&P	Moody's	S&P	Moody's
U.S. Treasury bills	A-1+	P-1	AA+	Aaa
U.S. Treasury notes	AA+	Aaa	AA+	Aaa
U.S. Treasury strips	—	—	AA+	Aaa
Federal agency and U.S. government-sponsored enterprise notes and bonds*	AA+/A-1+	Aaa/ P-1	AA+/A-1+	Aaa/ P-1
Money market funds	AAAm	Aaa-mf	AAAm	Aaa-mf
Commercial paper:				
Abbey National North America	—	—	A-1	P-1
Bank of Tokyo-Mitsubishi UFJ Ltd	A-1	P-1	—	—
Exxon Mobil Corp	A-1+	P-1	—	—
General Electric Capital	—	—	A-1+	P-1
Honda Motor Corp	A-1	P-1	—	—
Praxair	A-1	P-1	—	—
Rabobank USA Fin Corp	A-1	P-1	A-1	P-1
Toyota Motor Credit Corp	A-1+	P-1	A-1+	P-1
Corporate notes – Medium term:				
Apple Inc.	AA+	Aa1	—	—
American Honda Finance	A+	A1	—	—
Berkshire Hathaway Inc	AA	Aa2	—	—
Chevron Corporation	AA-	Aa2	—	—
Deere & Company	A	A2	—	—
Exxon Mobil Corp	AA+	Aaa	—	—
General Electric Capital	AA+	A1	—	—
Intel Corp	A+	A1	—	—
JP Morgan Chase & Co	A-	A3	—	—
Oracle Corporation	AA-	A1	—	—
New York Life	—	—	AA+	Aaa
Pepsico Inc	A	A1	—	—
Toyota Motor Credit Corp	AA-	Aa3	—	—
United Health Group	A+	A3	A+	A3
US Bancorp	A+	A1	—	—
Visa Inc	A+	A1	—	—
Wells Fargo and Company	A	A2	—	—



**FOOTHILL/EASTERN TRANSPORTATION  
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June 30, 2016 and 2015

(In thousands)

<u>Investment type</u>	<u>June 30, 2016</u>		<u>June 30, 2015</u>	
	<u>S&amp;P</u>	<u>Moody's</u>	<u>S&amp;P</u>	<u>Moody's</u>
State and local bonds:				
San Francisco Bay Area Toll Authority	—	—	AA	Aa3
New York State Urban Development University of California	—	—	AAA	Aa1
Regents Revenue	—	—	AA	Aa2

\* Ratings are indicated to the extent available. However, in some instances, discounted federal agency bonds are not rated.

**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 with the exception of a money market account that is deposited in the Agency's primary bank. 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 held at June 30, 2016 that are governed by the Agency's investment policy and its bond agreements, including money market funds of \$37,740, commercial paper of \$7,215, and U.S. Treasury securities of \$39,157 that are considered cash equivalents, is as follows:

<u>Investment type</u>	<u>Fair value</u>	<u>Remaining maturity (in years)</u>			
		<u>Less than one</u>	<u>One to two</u>	<u>Two to five</u>	<u>More than five</u>
Federal agency and U.S. government-sponsored enterprise notes and bonds	\$ 239,039	92,655	98,380	48,004	—
U.S. Treasury securities	214,518	154,850	47,896	11,772	—
Corporate notes	81,893	12,053	31,037	38,803	—
Money market funds	37,740	37,740	—	—	—
Commercial paper	17,393	17,393	—	—	—
Total	\$ 590,583	314,691	177,313	98,579	—

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At June 30, 2016, with the exception of investments issued or explicitly guaranteed by the U.S. government and money market mutual funds, there were no investments in any issuers that accounted for 5% or more of the Agency's total investments, other than investments with Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, and Federal Home Loan Bank that represented 14%, 13%, and 8%, respectively, of the Agency's total investments, as permitted by the Agency's investment policy and the applicable bond indentures.

A summary of the Agency's investments held at June 30, 2015 that are governed by the Agency's investment policy and its bond agreements, including money market funds of \$41,784 and federal agency securities of \$72,597 that are considered cash equivalents, is as follows:

Investment type	Fair value	Remaining maturity (in years)			
		Less than one	One to two	Two to five	More than five
U.S. Treasury securities	\$ 225,915	18,226	133,301	74,388	—
Federal agency and U.S. government-sponsored enterprise notes and bonds	215,653	131,485	54,094	30,074	—
Money market funds	41,784	41,784	—	—	—
Commercial paper	32,543	32,543	—	—	—
State and local bonds	11,936	11,936	—	—	—
Corporate notes	11,076	5,001	6,075	—	—
Certificates of deposit	995	995	—	—	—
Total	\$ 539,902	241,970	193,470	104,462	—

At June 30, 2015, with the exception of investments issued or explicitly guaranteed by the U.S. government and money market mutual funds, there were no investments in any issuers that accounted for 5% or more of the Agency's total investments, other than investments with Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, and Federal National Mortgage Association that represented 17%, 9%, and 8% of the Agency's total investments, as permitted by the Agency's investment policy and the applicable bond indentures.

**Facts and Assumptions**

Because investing is not a core part of the Agency's mission, the Agency determines that the disclosures related to these investments only need to be disaggregated by major type. The Agency chooses a tabular format for disclosing the levels within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset, as follows:

- Level 1 inputs are quoted prices in active markets for identical assets.
- Level 2 inputs are significant other observable inputs.
- Level 3 inputs are significant unobservable inputs.

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(In thousands)

Debt securities classified in Level 2 of the fair value hierarchy are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices. Commercial paper is valued based on quoted prices in active markets of similar securities.

At June 30, 2016 and 2015, the Agency had the following fair value measurements:

<u>Investment type</u>	<u>June 30, 2016</u>			
	<u>Fair value</u>	<u>Quoted prices in active markets for identical assets (Level 1)</u>	<u>Significant other observable inputs (Level 2)</u>	<u>Significant unobservable inputs (Level 3)</u>
Federal agency and U.S. government-sponsored enterprise notes and bonds	\$ 214,518	—	214,518	—
U.S. Treasury securities	239,039	—	239,039	—
Corporate notes	81,893	—	81,893	—
Commercial paper	17,393	—	17,393	—
Total	<u>\$ 552,843</u>	<u>—</u>	<u>552,843</u>	<u>—</u>

Money market funds in the amount of \$37,740 are excluded from table above because they are recorded at amortized cost.

**FOOTHILL/EASTERN TRANSPORTATION  
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(In thousands)

June 30, 2015				
Investment type	Fair value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
U.S. Treasury securities	\$ 225,915	—	225,915	—
Federal agency and U.S. government-sponsored enterprise notes and bonds	215,653	—	215,653	—
Commercial paper	32,543	—	32,543	—
State and local bonds	11,936	—	11,936	—
Corporate notes	11,076	—	11,076	—
Certificates of deposit	995	—	995	—
Total	\$ 498,118	—	498,118	—

Money market funds in the amount of \$41,784 are excluded from table above because they are recorded at amortized cost.

**(5) Capital Assets**

Capital assets activity for the year ended June 30, 2016 was as follows:

	Balance at beginning of year	Additions	Transfers/ deletions	Balance at end of year
Construction in progress	\$ 247,802	15,076	(6,610)	256,268
Right-of-way acquisitions, grading, or improvements	15,014	—	—	15,014
Furniture and equipment	43,087	3,737	(1,097)	45,727
	305,903	18,813	(7,707)	317,009
Accumulated depreciation	(20,237)	(5,472)	1,097	(24,612)
	\$ 285,666	13,341	(6,610)	292,397

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(In thousands)

Capital assets activity for the year ended June 30, 2015 was as follows:

	<u>Balance at beginning of year</u>	<u>Additions</u>	<u>Transfers/ deletions</u>	<u>Balance at end of year</u>
Construction in progress	\$ 346,643	35,531	(134,372)	247,802
Right-of-way acquisitions, grading, or improvements	15,014	—	—	15,014
Furniture and equipment	39,352	5,066	(1,331)	43,087
	<u>401,009</u>	<u>40,597</u>	<u>(135,703)</u>	<u>305,903</u>
Accumulated depreciation	<u>(16,666)</u>	<u>(4,902)</u>	<u>1,331</u>	<u>(20,237)</u>
	<u>\$ 384,343</u>	<u>35,695</u>	<u>(134,372)</u>	<u>285,666</u>

Right-of-way acquisitions, grading, and improvements include easements and environmental mitigation parcels. Furniture and equipment include transponders, toll and violations collection equipment, buildings, vehicles, and leasehold improvements.

***Transfers/Deletions***

Ownership of the Foothill/Eastern Transportation Corridor construction, rights-of-way, grading, and improvements was transferred to Caltrans during the year ended June 30, 1999 upon satisfaction of all conditions contained within the Cooperative Agreements between the Agency and Caltrans. The Agency incurs additional costs for improvements and enhancements to the thoroughfares previously transferred to Caltrans. These improvements and enhancements are covered by separate project-specific Cooperative Agreements with Caltrans. They are transferred to Caltrans on an ongoing basis and recognized as contribution expense; expenses of \$5,843 and \$11,684 were recognized during the years ended June 30, 2016 and 2015, respectively. The balance of construction in progress at June 30, 2016 and 2015 represents additional capital improvements, which will also be transferred to Caltrans upon completion.

As described in note 7(e), payments of \$120,000 to SJHTCA through 2009 that were originally recorded as construction in progress were reclassified in 2015 and reflected as a note receivable from SJHTCA and a reduction of construction in progress.

During the year ended June 30, 2015, the Agency completed its All Electronic Tolling (AET) conversion project and expenditures of \$2,688 related to the installation of new toll equipment were transferred from construction in progress.

**FOOTHILL/EASTERN TRANSPORTATION  
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Notes to Financial Statements

June 30, 2016 and 2015

(In thousands)

**(6) Long-Term Obligations**

Following is a summary of changes in long-term obligations during the year ended June 30, 2016:

	<u>Balance at beginning of period</u>	<u>Additions/ accretions</u>	<u>Reductions</u>	<u>Balance at end of period</u>	<u>Due within one year</u>
Series 2013 Toll Road Refunding Revenue Bonds:					
Current Interest Bonds	\$ 1,947,490	—	—	1,947,490	—
Capital Appreciation Bonds	143,342	8,711	—	152,053	—
Convertible Capital Appreciation Bonds	214,242	13,253	—	227,495	—
Series 2015 Toll Road Refunding Revenue Bonds:					
Capital Appreciation Bonds	88,363	3,831	—	92,194	—
Total bonds payable	2,393,437	25,795	—	2,419,232	—
Less unamortized discount on 2013 bonds	(40,398)	—	441	(39,957)	
Total bonds payable less unamortized discount	\$ 2,353,039	25,795	441	2,379,275	

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June 30, 2016 and 2015

(In thousands)

Following is a summary of changes in long-term obligations during the year ended June 30, 2015:

	<u>Balance at beginning of period</u>	<u>Additions/ accretions</u>	<u>Reductions</u>	<u>Balance at end of period</u>	<u>Due within one year</u>
Series 2013 Toll Road Refunding Revenue Bonds:					
Current Interest Bonds	\$ 1,947,490	—	—	1,947,490	—
Capital Appreciation Bonds	135,083	8,259	—	143,342	—
Convertible Capital Appreciation Bonds	201,770	12,472	—	214,242	—
Series 2015 Toll Road Refunding Revenue Bonds:					
Capital Appreciation Bonds	—	88,363	—	88,363	—
Series 1995A Senior Lien Toll Road Revenue Bonds:					
Current Interest Bonds	179,990	—	(179,990)	—	—
Total bonds payable	2,464,333	109,094	(179,990)	2,393,437	—
Less unamortized discount on 2013 bonds	(40,814)	—	416	(40,398)	
Total bonds payable less unamortized discount	\$ 2,423,519	109,094	(179,574)	2,353,039	

In February 2015, the Agency issued \$87,008 of Senior Lien Toll Road Refunding Revenue Bonds (2015 Capital Appreciation Bonds); together with certain funds held in trust, the proceeds of the issuance were used to refund the previously unrefunded portion of the Series 1995A Senior Lien Toll Road Revenue Bonds, at par value plus accrued interest. In connection with this transaction, the Agency realized an economic gain (as measured by the difference in present value of the scheduled debt service payments on the old and new debt) of approximately \$34 million. In addition, the Agency incurred bond insurance premiums of \$1,360 related to a portion of the bonds, which is being amortized over the life of those bonds, and other transaction costs of \$2,061, which has been recorded as expense.

In December 2013, the Agency issued \$2,274,617 of Series 2013 Toll Road Refunding Revenue Bonds (2013 Bonds); the proceeds of the issuance were used to refund the outstanding balance of the 1999 Bonds. The reacquisition price of the refunded bonds exceeded their net carrying amount by \$14,534; this amount was considered a deferred loss for accounting purposes and is being amortized through 2040, the remaining period during which the refunded bonds were scheduled to be repaid. In addition, the Agency incurred bond insurance premiums of \$9,533, which is being amortized over the life of the 2013 bonds. The 2013 Bonds were issued at a discount of \$41,009, which is being amortized over the life of the bonds.

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The 2013 current interest bonds include \$1,374,440 of Senior Term Bonds that mature in installments from January 2042 through January 2053; \$375,000 of Term Rate Bonds that mature in installments from January 2050 through January 2053; and \$198,050 of Junior Lien Bonds that mature in installments from January 2023 through January 2043. Interest on the 2013 current interest bonds is payable semiannually at rates ranging from 5.00% to 6.50%. The Senior Term Bonds and the Junior Lien Bonds are subject to early redemption on or after January 15, 2024, at the option of the Agency, by payment of principal and accrued interest. The Term Rate Bonds are subject to early redemption, at the option of the Agency, by payment of principal and accrued interest, on or after the dates ranging from July 15, 2017 through July 15, 2022.

The 2013 capital appreciation bonds accrue interest at rates ranging from 3.75% to 7.125%, compounded semiannually, and are scheduled to mature in annual installments from January 2020 to January 2042. The bonds are subject to early redemption, at the option of the Agency, based on an independent make-whole calculation.

The 2013 convertible capital appreciation bonds accrue interest, compounded semiannually based on accreted amounts, at rates ranging from 5.30% to 6.85% through January 15, 2024. After this date, interest is payable semiannually based on accreted amounts. The bonds are scheduled to mature in annual installments from January 2025 to January 2042. The bonds are subject to early redemption on or after January 15, 2031, at the option of the Agency, by payment of the accreted amounts and accrued interest.

The 2015 capital appreciation bonds accrue interest at rates ranging from 4.21% to 4.42%, compounded semiannually, and are scheduled to mature in annual installments from January 2033 to January 2035.

The master indentures of trust require the trustee to hold bond proceeds, toll revenue, 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.



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Following is a summary of the annual debt service requirements by fiscal year for the Agency's long-term debt obligations as of June 30, 2016:

	<u>Principal</u>	<u>Interest<sup>(1)</sup></u>	<u>Total</u>
2017	\$ —	112,770	112,770
2018	—	112,770	112,770
2019	—	112,770	112,770
2020	4,087	113,345	117,432
2021	7,132	114,223	121,355
2022–2026	44,372	630,858	675,230
2027–2031	117,195	694,316	811,511
2032–2036	207,276	767,661	974,937
2037–2041	231,095	892,152	1,123,247
2042–2046	612,790	459,037	1,071,827
2047–2051	804,610	226,509	1,031,119
2052–2053	390,675	21,770	412,445
	<u>\$ 2,419,232</u>	<u>4,258,181</u>	<u>6,677,413</u>

<sup>(1)</sup> Includes payments scheduled on January 1 and January 15 of the indicated fiscal year and July 1 and July 15 of the following fiscal year, to coincide with the annual debt service calculations used for covenant compliance purposes.

Included in principal at June 30, 2016 and 2015 is \$57,608 and \$31,813, respectively, related to accreted principal on convertible capital appreciation bonds and capital appreciation bonds.

A portion of the net proceeds of a prior bond refunding 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 a previously refunded portion of the 1995 bonds. As of June 30, 2016 and 2015, the amount of the previously refunded 1995 bonds outstanding, which were previously eliminated from the financial statements as a result of the refunding, was \$803,404 and \$753,132, respectively.

**(7) Commitments and Contingencies**

**(a) Toll Collection and Revenue Management System Agreements**

The Agency and SJHTCA have entered into agreements with contractors for various services, including toll collection systems operation and maintenance. The agreements expire on various dates through June 30, 2025 and are cancelable by the Agency, without further obligation, with advance written notice.

**(b) Project Costs**

As of June 30, 2016, the Agency has outstanding commitments and contracts related to construction activities of approximately \$15.8 million.

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**(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 in accordance with the Agency's master indentures of trust, as applicable.

**(e) *Mitigation Payment and Loan Agreement***

On November 10, 2005, the Agency's Board of Directors and the Board of Directors of SJHTCA, entered into a Mitigation Payment and Loan Agreement (the Agreement). The terms of the Agreement called for the Agency to make payments totaling \$120,000 over four years to SJHTCA to mitigate for anticipated loss of revenue due to the construction of the 241 to I-5 connection project. All scheduled payments totaling \$120,000 were made to SJHTCA as of June 2009 and were recorded as construction in progress.

In addition, the Agency committed to provide loans to SJHTCA on an as-needed basis up to \$1,040,000, subject to the terms of the Agreement, to assist SJHTCA in achieving its required debt service coverage ratio. Payments of accrued interest and outstanding principal would begin in the fiscal year when SJHTCA achieved a surplus in revenue in excess of the amount needed to meet the debt coverage requirement. All principal and accrued interest would be due and payable on January 1, 2037 to the extent that SJHTCA had surplus revenue available to pay all amounts due. The Agreement also stipulated that the Agency would not be obligated to make loans to SJHTCA prior to securing the necessary funds for constructing the 241 to I-5 connection project unless the Agency determined that it would not build the project. If the commencement and diligent pursuit of the construction of the 241 to I-5 connection project did not occur by June 30, 2015, the mitigation payments would be added to the principal amount of the loan. No amounts were loaned in connection with this arrangement.

On August 14, 2014, the Agency's Board of Directors and the Board of Directors of SJHTCA approved an agreement that provided for termination of the Mitigation Payment and Loan Agreement concurrently with the closing of a refinance transaction proposed by SJHTCA. The closing of this refinance transaction occurred on November 6, 2014. The termination agreement also provided for SJHTCA to pay \$120,000 to the Agency, in annual installments beginning January 15, 2025 equal to 50% of SJHTCA's surplus funds as defined in the agreement. Interest accrual based on the average annual yield of the State of California Pooled Money Investment Account commenced upon closing of the transaction and interest is payable annually beginning January 15, 2025.

As a result of this agreement, the aggregate payments of \$120,000 that were made to SJHTCA through 2009 have been reclassified as a note receivable from SJHTCA and a reduction of construction in progress.

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**(8) 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 SJHTCA. Lease payments are based on the estimated fair market rental value and are adjusted annually. The Agency received lease revenue for the years ended June 30, 2016 and 2015 of \$471 and \$386, respectively.

**(9) Employees' Retirement Plans**

**Defined-Benefit Plan** – Qualified permanent employees of the Agency participate in a cost-sharing multiple-employer defined-benefit pension (the Plan) administered by OCERS, a public employee retirement system established in 1945. The Plan is subject to the provisions of the County Employees Retirement Law of 1937 (California Government Code Section 31450 et. seq.); the California Public Employees' Pension Reform Act of 2013 (Government Code Section 7522 et. seq.); and other applicable statutes.

**(a) Benefits**

The Plan provides retirement, disability, and death benefits to eligible plan members and their beneficiaries. Monthly retirement benefits are determined by benefit formulas that depend upon the classification of employees; the date of entering membership in OCERS or a reciprocal plan; retirement age; years of service; and final average compensation. The Agency's members hired prior to January 1, 2013 are subject to a benefit formula of 2.0% of final average compensation per year of service, based upon retirement at age 55. Members hired on or after January 1, 2013 are subject to a benefit formula of 2.5% at 67.

Amounts payable for retired members are subject to annual cost-of-living adjustments based upon changes in the Consumer Price Index for the prior calendar year. Adjustments are limited to a maximum increase or decrease of 3% per year.

**(b) Contributions**

Employer and employee contribution requirements are determined as percentages of covered payroll amounts and vary based upon the age of each employee at the date of entering membership in OCERS or a reciprocal plan. Employer contribution rates are determined using the entry age normal actuarial cost method based upon a level percentage of payroll. Employer contribution rates ranged from 21.08% to 56.35% for the year ended December 31, 2015, and from 21.04% to 57.28% for the year ended December 31, 2014. Employee contributions are established by the OCERS Board of Retirement and guided by applicable state statutes. Employee contribution rates ranged from 9.08% to 15.63% for the year ended December 31, 2015, and from 8.93% to 15.63% for the year ended December 31, 2014. The contributions from the Agency recognized by the plan, measured as the total amounts of additions to the plan's fiduciary net position for the years ended December 31, 2015 and 2014, were \$949 and \$896, respectively, and equaled 100% of the required contributions, and represented 23.2% and 20.9% of the Agency's covered payroll, respectively.

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**(c) Pension Liabilities, Pension Expense, and Deferred Outflows/Inflows of Resources**

For purposes of reporting under GASB Statement No. 68, OCERS arranged for determination of the plan's collective net pension liability; deferred outflows and inflows of resources related to pensions; and pension expense, as well as the proportionate share of each amount applicable to the plan's participating employers, using measurement dates of December 31, 2015 and 2014, with respective actuarial valuations as of December 31, 2014 and 2013 and standard procedures to roll forward to the respective measurement dates. The Agency's reporting dates are June 30, 2016 and 2015. The proportionate shares of these amounts attributable to the Transportation Corridor Agencies have been determined by OCERS's actuary based upon actual employer contributions within each rate group and further allocated between the Agency and SJHTCA on the basis of their respective shares of covered payroll to determine the amounts reportable by the Agency, as indicated below:

		<u>Percentage of collective amount</u>		<u>Covered payroll</u>
OCERS collective net pension liability at December 31, 2015	\$ 5,716,605	100%	\$	1,521,036
Proportionate share attributable to Transportation Corridor Agencies	12,713	0.22%		6,088
Share allocable to Foothill/ Eastern Transportation Corridor Agency	8,918	0.16		4,083
Agency's share of collective net pension liability as a percentage of its covered payroll				218%
Plan's fiduciary net position as a percentage of the total pension liability	67.10%			

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		<u>Percentage of collective amount</u>		<u>Covered payroll</u>
OCERS collective net pension liability at December 31, 2014	\$ 5,082,481	100%	\$	1,513,206
Proportionate share attributable to Transportation Corridor Agencies	10,683	0.21%		6,118
Share allocable to Foothill/ Eastern Transportation Corridor Agency	7,556	0.15		4,287
Agency's share of collective net pension liability as a percentage of its covered payroll				176%
Plan's fiduciary net position as a percentage of the total pension liability	69.42%			

		<u>December 31</u>	
		<u>2015</u>	<u>2014</u>
OCERS collective deferred outflows of resources	\$	987,429	389,055
Proportionate share attributable to Transportation Corridor Agencies		1,824	453
Share allocable to Foothill/Eastern Transportation Corridor Agency		1,237	317
OCERS collective deferred inflows of resources	\$	611,993	538,504
Proportionate share attributable to Transportation Corridor Agencies		1,165	1,443
Share allocable to Foothill/Eastern Transportation Corridor Agency		824	1,011

		<u>Year ended June 30</u>	
		<u>2015</u>	<u>2014</u>
OCERS collective pension expense	\$	669,600	566,324
Proportionate share attributable to Transportation Corridor Agencies		1,796	1,594
Share allocable to Foothill/Eastern Transportation Corridor Agency		1,204	1,117

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The Agency's deferred outflows of resources related to pensions as of June 30, 2016 and 2015 are attributable to the following:

	<b>2016</b>	<b>2015</b>
Net difference between projected and actual earnings on pension plan investments	\$ 1,205	317
Differences between expected and actual experience	32	—
Contributions to the plan subsequent to the measurement date of the collective net pension liability	522	560
Total deferred outflows related to pensions	\$ 1,759	877

The Agency's deferred inflows of resources related to pensions as of June 30, 2016 and 2015 are attributable to the following:

	<b>2016</b>	<b>2015</b>
Differences between expected and actual experience	\$ 363	444
Changes of assumptions or other inputs	461	567
Total deferred inflows related to pensions	\$ 824	1,011

The amount of \$522, representing as of June 30, 2016 the Agency's balance of deferred outflows of resources related to contributions subsequent to the measurement date, will be recognized as a reduction of the net pension liability in the year ending June 30, 2017. The other amounts of the Agency's balances of deferred outflows and deferred inflows of resources as of June 30, 2016 will be recognized in pension expense as follows:

Year ending June 30:	
2017	\$ 127
2018	127
2019	127
2020	56
2021	(25)
2022	1
	\$ 413

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**(d) Actuarial Assumptions and Other Inputs**

The following significant methods and assumptions were used to measure the plan's total pension liability as of December 31, 2015 and 2014:

- Actuarial experience study – Three-year period ended December 31, 2013
- Inflation rate – 3.00%
- Projected salary increases – 4.25% to 17.50%, depending upon service and nature of employment
- Cost-of-living adjustments – 3.00%

The mortality assumptions were based on the results of the actuarial experience study for the period January 1, 2011 through December 31, 2013 using the RP-2000 Combined Healthy Mortality Table projected with the Society of Actuaries Scale BB to 2020. The mortality assumptions were then customized to account for the plan's membership experience.

The discount rate used to measure the plan's total pension liability was 7.25%. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rates and that employer contributions will be made at actuarially determined rates. Based on those assumptions, the plan's fiduciary net position was projected to be available to make all projected future benefit payments for current plan members. Therefore, the long-term expected rate of return on plan investments was applied to all periods of projected benefit payments to determine the total pension liability. The long-term expected rate of return should be determined without reduction for plan administrative expense. The 7.25% investment return assumption is net of administrative expenses, assumed to be 16 basis points. The investment rate of return assumption remained the same for reporting purposes due to the immaterial impact administrative expenses has on the overall assumed rate of return. The long-term expected rate of return on plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return are developed for each major asset class. These returns are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentages and by adding expected inflation and deducting expected investment expenses.

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The target allocation and projected arithmetic real rate of return for each major asset class, after deducting inflation but before deducting investment expenses, used in the derivation of the long-term expected rate of return assumption are summarized in the following table:

Asset class:	<u>Target allocation</u>	<u>Long-term expected real rate of return</u>
Large cap U.S. equity	\$ 14.90%	5.92%
Small/Mid cap U.S. equity	2.73	6.49
Developed international equity	10.88	6.90
Emerging international equity	6.49	8.34
Core bonds	10.00	0.73
Global bonds	2.00	0.30
Emerging market debt	3.00	4.00
Real estate	10.00	4.96
Diversified credit (U.S.)	8.00	4.97
Diversified credit (Non-U.S.)	2.00	6.76
Hedge funds	7.00	4.13
GTAA	7.00	4.22
Real return	10.00	5.86
Private equity	6.00	9.60
Total	<u>\$ 100.00%</u>	



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The following table presents the Agency's proportionate share of the plan's net pension liability, calculated using the discount rate of 7.25%, as well as what its proportionate share of the net pension liability would be if it were calculated using a discount rate one percentage point lower (6.25%) or one percentage point higher (8.25%) than the current discount rate:

	<b>December 31</b>	
	<b>2015</b>	<b>2014</b>
Net pension liability, as calculated:		
With current discount rate of 7.25%	\$ 8,918	7,556
With a 1% decrease, to 6.25%	12,064	10,941
With a 1% increase, to 8.25%	5,615	4,644

**(e) Plan's Fiduciary Net Position**

OCERS provides publicly available financial information, including comprehensive annual financial reports and actuarial valuations, on the following Web site: [www.ocers.org](http://www.ocers.org). Detailed information about the plan's fiduciary net position is included in the comprehensive annual financial report for the fiscal year ended December 31, 2015, which may also be obtained by calling (714) 558-6200.

**(f) Employee Contributions**

As described above, plan members contribute a percentage of their annual covered salaries at actuarially determined rates based on the age of entry into the plan. For employees who were hired prior to January 1, 2013, the Agency paid up to 7% of each employee's required contribution through June 30, 2013. However, this percentage was reduced to 4.5% as of July 1, 2013 and to 2.0% as of July 1, 2014. As of July 1, 2015, the Agency's payments toward the employees' required contributions were fully eliminated. In addition to the pension expense determined in accordance with the requirements of GASB No. 68 as described above, the Agency incurred expense of \$62 for the year ended June 30, 2015 related to its subsidization of employee contributions.

**Defined-Contribution Plan** – The Agency also sponsors a defined-contribution plan under the provisions of Internal Revenue Code Section 457 that permits employees to defer portions of their pretax compensation. The Agency provides matching contributions to a related Section 401(a) plan, at a rate of 50% of the employees' deferral contributions, up to a maximum of 2% of each employee's related compensation. In connection with this plan, the Agency incurred \$78 and \$57 of expense for the years ended June 30, 2016 and 2015, respectively.