

South Bay Expressway
San Diego, California
Basic Financial Statements
For the Year ended June 30, 2013

**South Bay Expressway
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June 30, 2013**

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Board of Directors
San Diego Association of Governments
San Diego, California

Independent Auditor's Report

Report on the Financial Statements

We have audited the accompanying financial statements of the South Bay Expressway (SR 125), a major fund of the San Diego Association of Governments (SANDAG), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise SR 125's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; 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.

Auditor's Responsibility

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 auditor's 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 SR 125 as of June 30, 2013, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements SR 125, are intended to present the financial position, the changes in financial position and, where applicable, cash flows of only that portion of the the major fund of SANDAG that is attributable to the transactions of the SR 125. They do not purport to, and do not, present fairly the financial position of SANDAG as of June 30, 2013, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As described further in note 2 to the financial statements, the accompanying financial statements reflect certain changes in the reporting of deferred inflows and outflows, net position and certain items previously reported as assets and liabilities due to the implementation of Governmental Accounting Standards Board (“GASB”) Statements Nos. 63 and 65. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the *management’s discussion and analysis* be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board 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 audit 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 16, 2013 on our consideration of SR 125’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial

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reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SR 125's internal control over financial reporting and compliance.

Mayr Hoffman McCann P.C.

Irvine, California
December 16, 2013

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Management's Discussion and Analysis

This section of South Bay Expressway (or "SR125") basic financial statements presents the analysis of SR125's financial performance during the period from July 1, 2012, to June 30, 2013. Please read this management's discussion and analysis ("MD&A") in conjunction with the financial statements which follow this section.

Financial highlights

This year completes the first year since SR125 cut tolls up to 40 percent for customers using the Toll Road. The annual results have been positive leading to increased usage that has generated more revenues than budgeted. Operating costs remained under budget during the fiscal year 2013. Part of the cost savings are a direct result of the organizational structure implemented at the start of the fiscal year. The strong performance has allowed SR125 to stay on schedule to meet debt service obligations and reserve funding commitments.

Operational activities during this period generated a net operating income of \$4,018,537. While this is a positive achievement, significant interest expense of \$7,692,604 has contributed to the decrease in net position of \$3,754,405. Net position at the beginning of the year was 184,605,225. As a result of operations and financing activities, the assets of SR125 exceeded its liabilities as of June 30, 2013, by \$180,850,820.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to SR125's basic financial statements. The basic financial statements include (1) statement of net position; (2) statement of revenues, expenses, and changes in net position; (3) statement of cash flows; (4) notes to the basic financial statements.

Basic financial statements

The basic financial statements are designed to provide readers with a broad overview of SR125's finances, in a manner similar to a private sector business.

The *statement of net position* presents information on all of SR125's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of SR125 is improving or deteriorating.

The *statement of revenues, expenses, and changes in net position* presents information showing changes in SR125's net position during Fiscal Year 2013. All changes in net position are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. This statement reflects the results of SR125's operations for the period identified and can be used to determine SR125's credit worthiness and its ability to successfully recover all its costs through toll revenues and other charges.

The *statement of cash flows* presents information about SR125's cash receipts and cash payments during July 1, 2012 to June 30, 2013. This statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities.

Management's Discussion and Analysis

Notes to the basic financial statements

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 16-27.

Financial Analysis

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. In the case of SR125, assets exceeded liabilities by \$180,850,820 as of June 30, 2013.

| | Statement of Net Position | |
|----------------------------------|----------------------------------|-----------------------|
| | <u>2013</u> | <u>2012</u> |
| Current and other assets | \$ 22,311,291 | \$ 13,048,871 |
| Capital assets | <u>382,811,905</u> | <u>395,943,758</u> |
| Total assets | <u>405,123,196</u> | <u>408,992,629</u> |
| Liabilities | <u>224,272,376</u> | <u>224,387,404</u> |
| Total liabilities | <u>224,272,376</u> | <u>224,387,404</u> |
| Net Position: | | |
| Net Investment in Capital Assets | 224,076,124 | 238,550,941 |
| Restricted | 15,840,588 | 6,548,990 |
| Unrestricted | <u>(59,065,892)</u> | <u>(60,494,706)</u> |
| Total net position | <u>\$ 180,850,820</u> | <u>\$ 184,605,225</u> |

SR125's total net position decreased by \$3,754,405 as a result of program expenses exceeding program revenues.

SR125 Activities

At the start of fiscal year 2013, the San Diego Association of Governments ("SANDAG") implemented two key program changes for ongoing operations and executed the SANDAG Board's acquisition goals. SANDAG's executive management made a key decision to utilize an in-sourced model for staffing based on the evaluation of the previous owner's streamlined resource model and SANDAG's experience in managing the team. Keeping with its promise, the SANDAG Board adopted a toll reduction strategy presenting the greatest opportunity to increase utilization of the roadway, mitigate congestion on Interstate 805, and provide the broadest discount to all users of the Toll Road. The option provided toll rates to be reduced up to 40 percent and was implemented on June 30, 2012.

Results through June 30, 2013, indicate that the toll reduction strategy is working: SANDAG is exceeding usage expectations and revenue targets set as part of the strategic plan for acquiring the toll road. Operating expenses have been under budget during FY 2013. The cost savings are a direct result of the organizational structure SANDAG implemented at the start of the fiscal year. With this organizational structure, SANDAG was able to retain the necessary expertise coupled with management's leadership to

Management's Discussion and Analysis

seamlessly transition to governmental ownership and practices. The steady performance has allowed SANDAG to stay on schedule to meet debt service obligation and funding reserve commitments.

As the Statement of Revenues, Expenses, and Changes in Net position illustrates, SR125 collected over \$26.1 million in revenues, which adequately covered operating expenses and debt obligations. SANDAG was able to effectively manage costs related to the operations of the facility. The positive performance has allowed SANDAG to deposit adequate funds in the reserve for major maintenance and capital expenditures. This was an important aspect to establishing and building reserve funds to plan for near term capital expenses related to roadway repairs, vehicle replacements, and enhancements to the tolling system. It should be noted that FY 2012 covered the period from December 21, 2011, to June 30, 2012

Statement of Revenues, Expenses, and Changes in Net Position

| | 2013 | 2012 |
|--|----------------|----------------|
| Revenues: | | |
| Toll revenue, net | \$ 26,134,191 | \$ 15,125,130 |
| Total operating revenues | 26,134,191 | 15,125,130 |
| Operating expenses: | | |
| Payroll and other compensation expenses | 4,064,851 | 2,207,232 |
| General and administrative expenses | 4,822,960 | 2,864,983 |
| Depreciation | 13,227,843 | 6,941,192 |
| Total operating expenses | 22,115,654 | 12,013,407 |
| Net operating income (loss) | 4,018,537 | 3,111,723 |
| Non operating revenue (expenses) | | |
| Other income, net | 11,400 | 9,701 |
| Interest (expense) income, net | (7,673,221) | (3,601,994) |
| Loss on disposition of transponders | (111,121) | - |
| Capital contribution | - | 192,000,000 |
| Acquisition costs | - | (6,914,205) |
| Total non operating revenues (expenses) | (7,772,942) | 181,493,502 |
| Change in net position | (3,754,405) | 184,605,225 |
| Net position at beginning of year | 184,605,225 | - |
| Net position at end of year | \$ 180,850,820 | \$ 184,605,225 |

Management's Discussion and Analysis

Requests for Information

This financial report is designed to provide a general overview of SR125's finances for all those interested. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the SR125 Finance Manager, SANDAG South/SR125, 1129 La Media Road, San Diego, CA 92154, or email the SR125 Finance Manager at customerservice@sbxthe125.com.

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Basic Financial Statements

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**South Bay Expressway
Statement of Net Position
For the Year ended June 30, 2013**

| | | 2013 |
|---|----|--------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ | 4,519,628 |
| Restricted cash and cash equivalents | | 15,840,588 |
| Billed receivables, net of allowance | | 1,444,357 |
| Prepaid expenses and other assets | | 506,718 |
| Total current assets | | 22,311,291 |
| Noncurrent assets: | | |
| Capital Assets: | | |
| Non-depreciable, Land | | 1,980,000 |
| Depreciable, net of accumulated depreciation | | 380,831,905 |
| Total noncurrent assets | | 382,811,905 |
| Total assets | | 405,123,196 |
| Liabilities and net Position | | |
| Current liabilities: | | |
| Accounts payable | | 765,432 |
| Accrued expenses and other liabilities | | 657,849 |
| Unearned Revenue | | 1,231,191 |
| Notes payable | | 1,185,068 |
| Unclaimed Customer Refunds | | 1,533 |
| Total current liabilities | | 3,841,073 |
| Noncurrent liabilities: | | |
| Notes payable | | 220,431,303 |
| Total noncurrent liabilities | | 220,431,303 |
| Total Liabilities | | 224,272,376 |
| Net Position: | | |
| Net investment in capital assets | | 224,076,124 |
| Restricted for: | | |
| Project Revenue Fund | | 79,004 |
| Project Debt Service Funds | | 448 |
| Major Maintenance & Capital Expenditure Reserve Funds | | 15,761,136 |
| Unrestricted | | (59,065,892) |
| Total net position | \$ | 180,850,820 |

See accompany notes to the basic financial statements

South Bay Expressway
Statement of Revenues, Expenses, and Changes in Net Position
For the Year ended June 30, 2013

| | 2013 |
|--|--------------------|
| Revenues: | |
| Toll revenue, net | \$ 26,134,191 |
| Total operating revenues | 26,134,191 |
| Operating expenses: | |
| Facilities, Roadway and Landscaping Operations | 864,277 |
| Payroll and other compensation expenses | 4,064,851 |
| Administrative Costs | 1,778,018 |
| Insurance | 677,317 |
| Utilities | 336,215 |
| Professional Services | 1,167,133 |
| Depreciation | 13,227,843 |
| Total operating expenses | 22,115,654 |
| Net operating income (loss) | 4,018,537 |
| Nonoperating revenue (expenses) | |
| Other income, net | 11,400 |
| Interest income | 19,383 |
| Loss on disposition of transponders | (111,121) |
| Interest expense | (7,692,604) |
| Total nonoperating revenues (expenses) | (7,772,942) |
| Change in net position | (3,754,405) |
| Net position at beginning of year | 184,605,225 |
| Net position at end of year | \$ 180,850,820 |

See accompany notes to the basic financial statements

**South Bay Expressway
Statement of Cash Flows
For the Year ended June 30, 2013**

| | 2013 |
|--|----------------------|
| Cash flows from operating activities: | |
| Receipts from customers and users | \$ 25,938,428 |
| Payments for staff (Salaries and Benefits) | (4,064,851) |
| Payments for operations | (4,341,853) |
| Net cash provided by (used for) operating activities | 17,531,724 |
| Cash flows from capital and related financing activities: | |
| Acquisition and construction of capital assets | (207,111) |
| Principal Payment on Debt | (2,606,937) |
| Interest paid | (5,718,534) |
| Proceeds from interest income | 19,382 |
| Net cash provided by (used for) capital and related financing activities | (8,513,200) |
| Cash flows from investing activities: | |
| Rental and Misc. Income | 11,400 |
| Net cash provided (used) by investing activities | 11,400 |
| Net increase (decrease) in cash and cash equivalents | 9,029,924 |
| Cash, beginning of period | 11,330,292 |
| Cash, end of period | \$ 20,360,216 |
| Reconciliation of operating income (loss) to net cash provided by operating activities: | |
| Operating income (loss) | \$ 4,018,537 |
| Net cash provided by (used for) operating activities: | |
| (Increase) decrease in: | |
| Accounts receivable | (245,806) |
| Prepaid expenses and other assets | 4,911 |
| Depreciation Expense | 13,227,843 |
| Increase (decrease) in: | |
| Accounts payable | 192,867 |
| Accrued expenses and other liabilities | 233,449 |
| Unearned revenue | 98,390 |
| Unclaimed Customer Refunds | 1,533 |
| Total adjustments | 13,513,187 |
| Net cash provided (used) by operating activities | \$ 17,531,724 |

There were no non cash financing activities for the year ended June 30, 2013

See accompany notes to the basic financial statements

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**South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2013**

1. Organization and Operations

General

On December 21, 2011, San Diego Association of Governments (“SANDAG”) acquired the rights and interest in a Franchise Agreement between South Bay Expressway, LLC and the California Department of Transportation (“Caltrans”). Under the Agreement, SANDAG has contractual rights to develop and operate State Route 125 (the “Toll Road”), an 11.2 mile limited access highway in the County of San Diego. South Bay Expressway (or “SR125”) was established in December 2011 as a proprietary fund under the oversight of SANDAG to operate the Toll Road. As part of this acquisition, a fair value analysis of the acquired assets and liabilities has been performed as of the valuation date. As a result of this valuation analysis, there was a purchase price allocation to the assets and liabilities and those assets and liabilities were recorded at fair value.

Organization

SR125 is an integral part of the reporting entity of SANDAG, where it is classified as a proprietary fund. The accounts and activities of SR125 have been included within the scope of the basic financial statements of SANDAG because SANDAG has financial accountability and continuing oversight responsibility over SR125. SR125’s financial statements should be read in conjunction with those of SANDAG. Only the accounts and activities of SR125 are included herein; therefore, these financial statements do not purport to represent the financial position or results of operations of SANDAG as a whole.

SANDAG’s Board of Directors provides executive oversight and decision making related to SR125. SANDAG’s Executive Team provides management oversight and has established a management team to oversee the day to day operations of the Toll Road.

2. Summary of Significant Accounting Policies

The basic financial statements of SR125 have been prepared in conformity with generally accepted accounting principles (GAAP) in the United States as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body of established governmental accounting and financial reporting principles. The more significant of SR125’s accounting policies are described below.

Measurement focus, basis of accounting, and financial statement presentation

The SR125 basic financial statements are reported using the *economic resources* measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

**South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2013**

Toll revenue, net, includes toll charges earned, net of promotions and an uncollectible accounts allowance. Customer accounts are opened by the deposit of prepaid tolls into a FasTrak transponder account. Prepaid tolls are held as customer deposits until such time the customer travels the roadway and incurs a toll charge. At that time, revenues are earned and charged against the customer's account. Revenues from cash-paying customers are recognized at the time the transactions occur.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash in bank accounts and cash on hand.

Restricted Cash

Restricted cash consists of cash in bank and cash in money market accounts and funds and are restricted in accordance with the Master Trust Agreement ("MTA"). Such restrictions are related to the use of trustee-controlled accounts and the order of priority of withdrawals from such accounts which are subject to the approval of the secured lenders under the notes payable or their representative agents.

SR125's investment policies are consistent with SANDAG's policies and in accordance with California Government Code Section 53601. SR125 is authorized to invest in the following:

- Treasury obligations
- Federal agencies and U.S. government-sponsored enterprises
- State obligations
- Local agency obligations
- Repurchase agreements
- Bankers' acceptances
- Commercial paper
- Medium-term notes
- Negotiable and non-negotiable certificates of deposit
- State of California's local agency investment fund
- San Diego County Treasurer's pooled investment fund
- Savings/money market accounts
- California asset management programs
- Money market funds
- Mortgage and asset-backed obligations

In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, investments were stated at fair value.

SR125 is a voluntary participant in the California Asset Management Program ("CAMP"), which is an investment pool offered by the California Asset Management Trust (the "Trust"). The Trust is a joint powers authority and public agency created by the Declaration of Trust and established under the provisions of the California Joint Exercise of Powers Act (California Government Code Section 6500 et seq., or the "Act") for the purpose of exercising the common power of its participants to invest certain

**South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2013**

proceeds of debt issues and surplus funds. In accordance with Section 53601(p) of the California Government Code, CAMP's investments are limited to investments permitted by subdivisions (a) to (n), inclusive, of Section 53601. SR125 reports its investments in CAMP at the fair value amounts provided by CAMP. On June 30, 2013, fair value approximated cost and had an average maturity of 54 days.

Billed Receivables

Billed receivables are recognized when billed to other vendors and customers. As of June 30, 2013, an allowance for uncollectible accounts was provided for billed receivables. The allowance is determined by management to be uncollectible amounts based on historical collection percentages and other information.

Prepaid expenses and other assets

Payments made to vendors for services that will benefit periods beyond June 30, 2013, are recorded as prepaid items.

Capital Assets

Capital assets represent the acquisition valuation of assets that include furniture and equipment, office and computer equipment, vehicles, software, building and leasehold improvements, and the toll road, net of depreciation. To meet the criteria for capitalization, an asset must have a useful life in excess of one year and an initial, individual cost equal to or greater than \$5,000. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

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

Depreciation of capital assets is computed using the straight-line method over the estimated useful life of the asset as presented in the table on the next page. Depreciation on assets acquired from the purchase of the Toll Road and other assets were valued on the acquisition date at fair value.

| Assets | Years |
|------------------------------|-------|
| Furniture & office equipment | 5 |
| Computer equipment & Other | 3 |
| Vehicles | 5 |
| Leasehold improvements | 5 |
| Software | 3 |
| Toll road | 31 |
| Buildng | 50 |

**South Bay Expressway
Notes to the Basic Financial Statements
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Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of certain assets and liabilities and the related reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management believes that the estimates are reasonable.

Recently issued and adopted accounting principles

The accompanying financial statements reflect the implementation of GASB Statements Nos. 63 and 65. Significant impacts of GASB Statement No. 63 include changing the title of the statement of net assets to the statement of net position and reformatting the statement of net position to add separate sections for deferred inflows of resources and deferred outflows of resources. Significant impacts of GASB Statement No. 65 include reclassifying as deferred inflows of resources and deferred outflows of resources certain balances that were previously reported as assets and liabilities. GASB Statement No. 65 also required that debt issuance costs be reported as expenses when incurred.

3. Cash and Investments

A summary of cash and investments as of June 30, 2013, are as follows:

| | |
|--|----------------------|
| Cash and investments | \$ 4,519,628 |
| Cash restricted for project retentions | 79,004 |
| Cash restricted for debt service | 448 |
| Cash restricted for major maintenance & capital expenditures | <u>15,761,136</u> |
| Total cash and investments | <u>\$ 20,360,216</u> |

**South Bay Expressway
Notes to the Basic Financial Statements
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Cash, cash equivalents, and investments as of June 30, 2013 consisted of the following:

**SANDAG SR125
Detail of Portfolio Balances (by Investment Type)
as of June 30, 2013**

| | <u>Market Value</u> | <u>Wtd. Avg. Days to Maturity</u> | <u>Rating</u> | |
|--|-----------------------------|---|----------------|----------------|
| | | | <u>S&P</u> | <u>Moody's</u> |
| Cash, restricted cash, and cash equivalents: | | | | |
| Demand deposits: | | | | |
| Checking - SR125 Payment Account | \$ 2,423,015 | 1 | Not rated | Not rated |
| Checking - SR125 Collection Account & Other | 252,230 | 1 | Not rated | Not rated |
| Money Market Deposits - SANDAG Toll Road Project | 69,000 | 1 | Not rated | Not rated |
| Money Market Deposits - SANDAG Toll Road Project | 354,338 | 1 | Not rated | Not rated |
| Money Market Deposits - SANDAG Toll Road Project | 10,004 | 1 | Not rated | Not rated |
| Money Market Deposits - SANDAG Toll Road Project | 300 | 1 | Not rated | Not rated |
| Money Market Deposits - SANDAG Toll Road Project | 9 | 1 | Not rated | Not rated |
| Money Market Deposits - SANDAG Toll Road Project | 15,406,798 | 1 | Not rated | Not rated |
| Money Market Deposits - SANDAG Toll Road Project | 138 | 1 | Not rated | Not rated |
| Money Market Deposits - SANDAG Toll Road Project | <u>1</u> | <u>1</u> | Not rated | Not rated |
| Total demand deposits | <u><u>18,515,833</u></u> | <u><u>1</u></u> | | |
| Investments: | | | | |
| California Asset Management Program (CAMP): | | | | |
| California Asset Management Program (CAMP): | <u>1,844,383</u> | <u>54</u> | AAAm | - |
| Total California Asset Management Program | <u><u>1,844,383</u></u> | <u><u>54</u></u> | | |
| Total cash, cash equivalents, and investments (90 or less days) | <u><u>\$ 20,360,216</u></u> | <u><u>6</u></u> | | |

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates that will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. As a means of limiting its exposure to fair value losses arising from the rising interest rates, SANDAG's investment policy, which is adopted by SR125, limits investments to a maximum maturity of five years or 1,825 days from purchase date. The total portfolio shall not exceed SR125's anticipated liquidity needs for operations for the next six months. SR125 is in compliance with all maturity provisions of the investment policy.

**South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2013**

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by nationally recognized statistical rating organizations (S&P and Moody's). SR125 is in compliance with all minimum rating requirements of the investment policy.

Concentration of Credit Risk

The investment policy limits the amount of the percentage of the portfolio that can be invested by type of investment for certain types of investments. SR125 is in compliance with investment type percentages of the total portfolio of the investment policy.

Custodial Credit Risk

The California Government Code requires California banks and savings and loan associations to secure SANDAG's cash deposits by pledging securities as collateral. This Code states that collateral pledged in this manner shall have the effect of perfecting a security interest in such collateral superior to those of a general creditor. Thus, collateral for cash deposits is considered to be held in SANDAG's name.

The market value of pledged securities must equal at least 110 percent of SANDAG's cash deposits. California law also allows institutions to secure SANDAG deposits by pledging first trust deed mortgage notes having a value of 150 percent of SANDAG's total cash deposits. SANDAG may waive collateral requirements for cash deposits, which are fully insured up to \$250,000 by the Federal Deposit Insurance Corporation; SANDAG, however, has not waived the collateralization requirements.

South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2013

4. Capital Assets

Capital asset activity for the year ended June 30, 2013, was as follows:

| | <u>Beginning Balance</u> | <u>Increases</u> | <u>Decreases</u> | <u>Ending Balance</u> |
|--|--------------------------|------------------------|---------------------|-----------------------|
| Governmental activities: | | | | |
| Capital assets, not being depreciated: | | | | |
| Land | \$ 1,980,000 | \$ - | \$ - | \$ 1,980,000 |
| Total capital assets, not being depreciated | <u>1,980,000</u> | <u>-</u> | <u>-</u> | <u>1,980,000</u> |
| Capital assets, being depreciated: | | | | |
| Furniture & office equipment | 206,933 | - | - | 206,933 |
| Computer equipment | 529,229 | - | - | 529,229 |
| Transponder tags | 149,057 | - | (149,057) | - |
| Vehicles | 159,230 | 30,642 | - | 189,872 |
| Fixed operating equipment | 172,137 | - | - | 172,137 |
| Software | 245,364 | - | - | 245,364 |
| Toll road | 395,423,000 | 176,469 | - | 395,599,469 |
| Building | 4,020,000 | - | - | 4,020,000 |
| Total capital assets, being depreciated | <u>400,904,950</u> | <u>207,111</u> | <u>(149,057)</u> | <u>400,963,004</u> |
| Less accumulated depreciation for: | | | | |
| Furniture & office equipment | (21,711) | (41,387) | - | (63,098) |
| Computer equipment | (92,543) | (176,410) | - | (268,953) |
| Transponder tags | (15,639) | (22,297) | 37,936 | - |
| Vehicles | (16,706) | (35,087) | - | (51,793) |
| Fixed operating equipment | (18,060) | (34,427) | - | (52,487) |
| Software | (42,905) | (81,788) | - | (124,693) |
| Toll road | (6,691,451) | (12,756,047) | - | (19,447,498) |
| Building | (42,177) | (80,400) | - | (122,577) |
| Total accumulated depreciation | <u>(6,941,192)</u> | <u>(13,227,843)</u> | <u>37,936</u> | <u>(20,131,099)</u> |
| Total capital assets, being depreciated, net | <u>393,963,758</u> | <u>(13,020,732)</u> | <u>(111,121)</u> | <u>380,831,905</u> |
| Governmental activities capital assets, net | <u>\$ 395,943,758</u> | <u>\$ (13,020,732)</u> | <u>\$ (111,121)</u> | <u>\$ 382,811,905</u> |

5. Long-Term Liabilities

SANDAG financed the Toll Road acquisition by assuming existing debt obligations and entering into promissory notes for the remaining funds necessary to complete the purchase. SANDAG assumed the existing TIFIA loans of \$94,183,509 via the Second Amended and Restated TIFIA Loan Agreement. In addition to the TIFIA loans, SANDAG entered into a Series D Agreement with TIFIA for \$1,445,850. SANDAG also borrowed *TransNet* funds totaling \$254,068,974 from the San Diego County Regional Transportation Commission (“SDCRTC”) via a promissory note. This amount was later reduced by \$192,000,000 through a project swap approved on March 23, 2012.

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Long-term liability activity for the period July 1, 2012 to June 30, 2013, was as follows:

| | <u>Beginning Balance</u> | <u>Additions</u> | <u>Reductions</u> | <u>Ending Balance</u> | <u>Due One Year</u> |
|---|--------------------------|---------------------|--------------------|-----------------------|---------------------|
| Governmental Activities: | | | | | |
| TIFIA Notes | | | | | |
| Tranche A | \$ 59,100,810 | \$ - | (135,018) | \$ 58,965,792 | \$ 656,988 |
| Tranche B | 33,868,979 | 3,112,403 | - | 36,981,382 | - |
| Tranche C | 2,884,701 | 295,264 | - | 3,179,965 | - |
| Series D | 1,445,850 | - | - | 1,445,850 | - |
| Total TIFIA notes | <u>97,300,340</u> | <u>3,407,667</u> | <u>(135,018)</u> | <u>100,572,989</u> | <u>656,988</u> |
| Unamortized FV Adjustment | 60,092,478 | - | (1,929,686) | 58,162,792 | - |
| Total TIFIA notes & Unamortized FV adjustment | <u>157,392,818</u> | <u>3,407,667</u> | <u>(2,064,704)</u> | <u>158,735,781</u> | <u>656,988</u> |
| TransNet notes | | | | | |
| Category B | 3,000,000 | - | (2,471,920) | 528,080 | 528,080 |
| Category C | 59,995,933 | 2,356,577 | - | 62,352,510 | - |
| Total TransNet notes | <u>62,995,933</u> | <u>2,356,577</u> | <u>(2,471,920)</u> | <u>62,880,590</u> | <u>528,080</u> |
| Total long-term liabilities | <u>\$ 220,388,751</u> | <u>\$ 5,764,244</u> | <u>(4,536,624)</u> | <u>\$ 221,616,371</u> | <u>\$ 1,185,068</u> |

SR125 reported \$1,185,068 as current notes payable and \$220,431,303 as noncurrent liabilities in the Statement of Net position on page 12.

Senior Debt - TIFIA Secured Loan

The TIFIA loans are divided into three separate notes or tranches, each of which have different principal amounts, interest rates, and payment commencement and due dates. The loans are secured by first liens on the project revenue, the contract rights related to the Toll Road, and a deed of trust on the leasehold interest in the Toll Road's right of way. Tranches B-2 and C-2 include accrued interest of \$4,639,578 and \$439,070, respectively, these added to the ending balances of their respective tranches. The following table shows the three tranches, initial principal amounts and interest rates.

| Tranche | Initial Principal Amount | Interest Rate |
|---------|--------------------------------|---|
| A-2 | \$ 59,100,810 | 6.0% through December 31,2015 7.0% from January 1, 2016 to December 31, 2020 8.0% from January 1, 2021 to December 31, 2025 9.0% from January 1, 2026 to June 30, 2026 (maturity date) |
| B-2 | \$ 32,341,804 | 9.0% through June 30, 2035 (maturity date) |
| C-2 | \$ 2,740,896 | 10.0% through December 31, 2035 (maturity date) |

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The principal requirements to maturity for the three tranches (excluding unamortized FV adjustment) are as follows:

Tranche A-2

| Maturity (Jan 1, Jul 1) | Principal Amount | Interest Amount |
|----------------------------|----------------------|----------------------|
| 2014 | \$ 656,988 | \$ 3,533,930 |
| 2015 | 1,468,175 | 3,482,998 |
| 2016 | 1,140,315 | 3,664,849 |
| 2017 | 637,212 | 3,886,914 |
| 2018 | 1,395,200 | 3,839,036 |
| 2019 - 2023 | 23,262,609 | 16,962,722 |
| 2024 - 2026 | <u>30,405,293</u> | <u>4,413,260</u> |
| Total | <u>\$ 58,965,792</u> | <u>\$ 39,783,709</u> |

Tranche B-2

| Maturity (Jan 1, Jul 1) | Principal Amount* | Interest Amount |
|---------------------------------|----------------------|----------------------|
| 2014 | \$ - | \$ - |
| 2015 | - | - |
| 2016 | - | - |
| 2017 | - | - |
| 2018 | - | - |
| 2019 – 2023 | - | - |
| 2024 – 2028 | 5,085,861 | 18,079,475 |
| 2029 – 2033 | 70,501,007 | 40,066,106 |
| 2034 - 2035 | <u>43,720,167</u> | <u>4,507,347</u> |
| Total | \$ 119,307,035 | <u>\$ 62,652,928</u> |
| Accrued interest (FY 2014-2025) | <u>(82,325,653)</u> | |
| | <u>\$ 36,981,382</u> | |

* The principal amount includes the initial principal balance of \$36,981,382 and total deferred interest of \$82,325,653 added to the principal balance over the life of the loan.

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Tranche C-2

| <u>Maturity (Jan 1, Jul 1)</u> | <u>Principal Amount**</u> | <u>Interest Amount</u> |
|------------------------------------|-------------------------------|----------------------------|
| 2014 | \$ - | \$ - |
| 2015 | - | - |
| 2016 | - | - |
| 2017 | - | - |
| 2018 | - | - |
| 2019 – 2023 | - | - |
| 2024 – 2028 | - | - |
| 2029 – 2033 | - | - |
| 2034 - 2036 | <u>25,925,727</u> | <u>1,939,095</u> |
| Total | \$ 25,925,727 | <u>\$ 1,939,095</u> |
| Accrued interest (FY 2014-2034) | <u>(22,745,762)</u> | |
| | <u>\$ 3,179,965</u> | |

** The principal amount includes the initial principal balance of \$3,179,965 and total deferred interest of \$22,745,762 added to the principal balance over the life of the loan.

Series D Obligation

The Series D Agreement provides that SANDAG will pay TIFIA, to the extent of available project revenue, \$1,445,850 plus interest at the rate of 14 percent per year compounded semi-annually. Payments are only due, and can only be made, after full payment of the existing TIFIA loan and full satisfaction of the *TransNet* loan. Any amounts remaining unpaid as of December 31, 2042, are automatically forgiven. Prepayment of the Series D Note is possible, but only at the value the note will have on December 31, 2042. The Series D loan is secured by a third lien, behind the TIFIA and *TransNet* notes, on the project revenues, but no other project assets are pledged to Series D. The only event of default is SANDAG's failure to maintain the Toll Covenant. The Series D Agreement further provides that SANDAG's obligations are non-recourse and that the holders of Series D can only look to the revenues of the Toll Road for repayment in the event of a default. As of June 30, 2013, SR125 did not accrue Series D interest due to the uncertain future events that may affect obligations under the Series D agreement.

Subordinated Debt – TransNet Secured Loan

The terms of the *TransNet* promissory note called for SANDAG to borrow the principal amount of \$254,068,974 from the SDCRTC. As required by the *TransNet* Ordinance, SANDAG will be required to ensure the *TransNet* revenues are made whole. Therefore, the interest rate SANDAG was charged was 4.25 percent based on recent *TransNet* borrowing history. The promissory note was a permitted subordinated debt under the bond transaction documents for *TransNet*. The promissory note requires that the proceeds of the promissory note only be used for costs associated with the Toll Road franchise.

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On March 23, 2012, the *TransNet* Extension Ordinance was amended to modify the Expenditure Plan such that the improvements on I-805, valued at a remaining \$134 million in 2002 dollars (or \$192 million in 2010 dollars), would be removed from the Expenditure Plan. As a result, the initial amount borrowed from *TransNet* was reduced by \$192 million. As of June 30, 2013, the revised outstanding principal amount for the total *TransNet* debt was \$62,880,590. Accrued interest of \$3,666,019 was included in the ending balance as of June 30, 2013.

The principal requirements to maturity for the *TransNet* promissory note are as follows:

Category B

| Maturity (Jan 1, July 1) | Principal Amount | Interest Amount |
|-----------------------------|---------------------|--------------------|
| 2014 | \$ 528,080 | \$ 24,244 |
| Total | \$ 528,080 | \$ 24,244 |

Category C

| Maturity (Jan 1, July 1) | Principal Amount *** | Interest Amount |
|-----------------------------|-------------------------|----------------------|
| 2014 | \$ - | \$ 2,649,982 |
| 2015 | - | 2,649,982 |
| 2016 | - | 2,649,982 |
| 2017 | - | 2,649,982 |
| 2018 | - | 2,649,982 |
| 2019 – 2023 | 2,868,637 | 13,130,553 |
| 2024 – 2028 | 17,407,279 | 11,369,043 |
| 2029 – 2033 | 16,182,516 | 7,821,301 |
| 2034 - 2038 | 25,894,078 | 2,842,725 |
| Total | \$ 62,352,510 | \$ 48,413,532 |

*** The principal amount includes the initial principal balance of \$58,686,491 and total deferred interest of \$3,666,019 added to the principal balance over the life of the loan.

6. Risk Management

Insurance coverage is maintained for SR125 by SANDAG through commercial insurance. See SANDAG's Comprehensive Annual Financial Report (CAFR) for further details, which may be obtained from SANDAG, 401 B Street, Suite 800, San Diego, CA 92101, (619) 699-1900.

7. Retirement Plan

SANDAG contributes to the California Public Employees' Retirement System (CalPERS), an agent multiple-employer public employees retirement system, defined benefit pension plan that acts as a

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common investment and administrative agent for participating public entities within the state of California. Employees in Regular, Limited Term, or Tolling Operations Personnel (TOP) positions start participating in PERS upon employment. Temporary, Intern, Part-time, and Seasonal (TIPS) employees may gain eligibility for PERS if they have worked 1,000 hours or more in a fiscal year. Membership becomes effective the first day of the following pay period once the eligibility requirement has been met. Employees are eligible to retire at age 50 with at least five years of credited service. Annual retirement benefits are determined based on age at retirement, the length of membership service, and the amount of earnings based on the highest 12 consecutive months' full-time equivalent monthly pay. PERS also provides death and disability benefits. Additional plan information can be located in the Notes of SANDAG FY13 CAFR

8. Other post-employment benefits (OPEB)

Pursuant to requirements of the state retirement system in which SANDAG participates, SANDAG adopted a policy to provide post-retirement health care benefits to retired employees through CalPERS, a single-employer benefit plan, which covers all of SANDAG's employees. Information on OPEB funding policy, funding status, plan cost and asset can be found in the Notes of SANDAG FY13 CAFR.