

**South Bay Expressway
San Diego, California
Basic Financial Statements**

For the Year ended June 30, 2014

Independent Auditor's Report	1
Management's Discussion and Analysis	4
Basic Financial Statements	
Statement of Net Position	12
Statement of Revenues, Expenses, and Changes in Net Position	13
Statement of Cash Flows	14
Notes to the Basic Financial Statements	16



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, 2014, 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.

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

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, 2014, 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, cash flows of only that portion of 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, 2014, 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.

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.

Mayer Hoffman McCann P.C.

Irvine, California
December 5, 2014

This page intentionally left blank.

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, 2013, to June 30, 2014. 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 second year since SR125 reduced 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 2014. 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 \$7,301,689. While this is a positive achievement, significant interest expense of \$7,920,355 has contributed to the decrease in net position of \$591,157. Net position at the beginning of the year was \$180,850,820. As a result of operations and financing activities, the assets of SR125 exceeded its liabilities as of June 30, 2014, by \$180,259,663.

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 2014. 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, 2013 to June 30, 2014. 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 17-28.

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 \$180,259,663 as of June 30, 2014.

	Statement of Net Position	
	<u>2013</u>	<u>2014</u>
Current and other assets	\$ 22,311,291	\$ 35,177,183
Capital assets	<u>382,811,905</u>	<u>369,723,028</u>
Total assets	<u>405,123,196</u>	<u>404,900,211</u>
Liabilities	<u>224,272,376</u>	<u>224,640,548</u>
Total liabilities	<u>224,272,376</u>	<u>224,640,548</u>
Net assets:		
Net Investment in Capital Assets	224,076,124	209,932,037
Restricted	15,840,588	28,767,211
Unrestricted	<u>(59,065,892)</u>	<u>(58,439,585)</u>
Total net position	<u>\$ 180,850,820</u>	<u>\$ 180,259,663</u>

SR125's total net position decreased by \$591,157 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, 2014, 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.

Management's Discussion and Analysis

Operating expenses have been under budget during FY 2014. 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 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 almost \$30 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. The statement below shows fiscal years 2013 and 2014 comparative results.

Statement of Revenues, Expenses, and Changes in Fund Net Position

	2013	2014
Revenues:		
Toll revenue, net	\$ 26,134,191	\$ 29,743,159
Total operating revenues	26,134,191	29,743,159
 Operating expenses:		
Payroll and other compensation expenses	4,064,851	4,266,680
General and administrative expenses	4,822,960	4,950,368
Depreciation	13,227,843	13,224,422
Total operating expenses	22,115,654	22,441,470
Net operating income (loss)	4,018,537	7,301,689
 Nonoperating revenue (expenses)		
Other income, net	11,400	21,106
Interest (expense) income, net	(7,673,221)	(7,904,059)
Loss on disposition of assets	(111,121)	(9,893)
Total nonoperating revenues (expenses)	(7,772,942)	(7,892,846)
Change in net position	(3,754,405)	(591,157)
Net position at beginning of year	184,605,225	180,850,820
Net position at end of year	\$ 180,850,820	\$ 180,259,663

Management's Discussion and Analysis

Capital Assets and Debt Administration

Capital Assets. SANDAG's investment in capital assets for government activities as of June 30, 2014, amounts to \$369,723,028 (net of accumulated depreciation). This investment in capital assets includes land, toll road, building, equipment, vehicles, software, and office furnishings.

SR125's Capital Assets (net of depreciation)

	Government Activities	
	2013	2014
Land	\$ 1,980,000	\$ 1,980,000
Toll road	376,151,970	363,390,699
Building	3,897,423	3,817,023
Equipment	379,925	178,230
Vehicles	138,080	179,734
Software	120,671	38,883
Office Furnishings	143,836	138,459
Total	\$ 382,811,905	\$ 369,723,028

There were no major capital asset events during the current fiscal year. Additional information on SR125's capital assets can be found in Note 4 on page 23 of this report.

Long-term Debt. At the end of the current fiscal year, SR125 had a total debt outstanding of \$165,997,664 and an unamortized fair value adjustment of \$56,145,839. 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 and also borrowed *TransNet* funds from the San Diego County Regional Transportation Commission ("SDCRTC") via a promissory note.

SR125's Outstanding Debt

	Government Activities	
	2013	2014
TIFIA Notes	\$ 100,572,989	\$ 103,645,154
Unamortized FV Adjustment	58,162,792	56,145,839
<i>TransNet</i> Notes	62,880,590	62,352,510
Total	\$ 221,616,371	\$ 222,143,503

Management's Discussion and Analysis

SR125's total debt increased by \$527,132 during the current fiscal year. Additional information on SR125's long-term debt can be found in Note 5 on page 23 of this report.

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.

This page intentionally left blank.

Basic Financial Statements

This page intentionally left blank.

**South Bay Expressway
Statement of Net Position
For the Year ended June 30, 2014**

Assets

Current assets:

Cash and cash equivalents	\$	3,537,652
Restricted cash and cash equivalents		29,767,251
Billed receivables, net of allowance		1,540,101
Prepaid expenses and other assets		332,179
Total current assets		35,177,183

Noncurrent assets:

Capital Assets:

Non-depreciable, land		1,980,000
Depreciable, net of accumulated depreciation		367,743,028
Total noncurrent assets		369,723,028
Total assets		404,900,211

Liabilities and net assets

Current liabilities:

Accounts payable		714,593
Accrued expenses and other liabilities		464,495
Unearned revenue		1,316,425
Notes payable		1,468,175
Unclaimed customer refunds		1,533
Total current liabilities		3,965,221

Noncurrent liabilities:

Notes payable		220,675,327
Total noncurrent liabilities		220,675,327

Total Liabilities

224,640,548

Net Position:

Net investment in capital assets		209,932,037
Restricted for:		
Project Revenue Fund		261,009
Senior Obligations Debt Service Fund		986
Major Maintenance, Capital Expenditure & Extraordinary Reserve Funds		28,505,216
Unrestricted		(58,439,585)
Total net position	\$	180,259,663

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, 2014

Revenues:

Toll revenue, net	\$	29,743,159
Total operating revenues		<u>29,743,159</u>

Operating expenses:

Facilities, roadway and landscaping operations		1,367,169
Payroll and other compensation expenses		4,266,680
Administrative costs		1,740,851
Insurance		535,195
Utilities		376,015
Professional services		931,138
Depreciation		<u>13,224,422</u>
Total operating expenses		<u>22,441,470</u>

Net operating income (loss)		<u>7,301,689</u>
------------------------------------	--	------------------

Nonoperating revenue (expenses)

Other income, net		21,106
Interest income		16,296
Interest expense		(7,920,355)
Loss on disposition of assets		<u>(9,893)</u>
Total nonoperating revenues (expenses)		<u>(7,892,846)</u>

Change in net position		(591,157)
-------------------------------	--	-----------

Net position at beginning of year		<u>180,850,820</u>
Net position at end of year	\$	<u>180,259,663</u>

See accompany notes to the basic financial statements

**South Bay Expressway
Statement of Cash Flows
For the Year ended June 30, 2014**

Cash flows from operating activities:

Receipts from customers and users	\$	29,844,685
Rental and misc. income		21,106
Payments to employees for salaries and benefits		(4,266,680)
Payments for operations		(5,126,957)
Net cash provided by (used for) operating activities		20,472,154

Cash flows from capital and related financing activities:

Acquisition and construction of capital assets		(150,538)
Principal payment on debt		(1,185,068)
Interest paid		(6,208,156)
Net cash provided by (used for) capital and related financing activities		(7,543,762)

Cash flows from investing activities:

Proceeds from interest income		16,295
Net cash provided (used) by investing activities		16,295
Net increase (decrease) in cash and cash equivalents		12,944,687

Cash, beginning of period		20,360,216
Cash, end of period	\$	33,304,903

Reconciliation of operating income (loss) to net cash provided by operating activities:

Operating income (loss)	\$	7,301,689
Reconciling Items		
Depreciation Expense		13,224,422
(Increase) decrease in:		
Accounts receivable		(95,744)
Rental and misc. income		21,106
Prepaid expenses and other assets		179,639
Accounts payable		(50,839)
Accrued expenses and other liabilities		(193,354)
Unearned revenue		85,235
Total adjustments		13,170,464
Net cash provided (used) by operating activities	\$	20,472,154

There were no non cash financing or investing activities for year ended June 30, 2014

See accompany notes to the basic financial statements

This page intentionally left blank

South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2014

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, 2014

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

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

South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2014

seq., or the “Act”) for the purpose of exercising the common power of its participants to invest certain 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, 2014, fair value approximated cost and had an average maturity of 41 days.

Billed Receivables

Billed receivables are recognized when billed to other vendors and customers. As of June 30, 2014, 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, 2014, 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
Buuildng	50

South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2014

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.

3. Cash and Investments

A summary of cash and investments as of June 30, 2014, are as follows:

Cash and cash equivalents	\$	3,537,652
Cash restricted for project retentions		261,009
Cash restricted for debt service		986
Cash restricted for major maintenance, capital and extraordinary expenditures		28,505,216
Cash restricted for project contingency		<u>1,000,040</u>
Total cash and investments	\$	<u>33,304,903</u>

South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2014

Cash, cash equivalents, and investments as of June 30, 2014 consisted of the following:

SANDAG SR125
Detail of Portfolio Balances (by Investment Type)
as of June 30, 2014

	<u>Market Value</u>	<u>Wtd. Avg. Days to Maturity</u>	<u>Rating S&P</u>	<u>Moody's</u>
Cash, restricted cash, and cash equivalents:				
Demand deposits:				
Checking - SR125 Payment Account	\$ 1,338,260	1	Not rated	Not rated
Checking - SR125 Collection Account & Other	353,767	1	Not rated	Not rated
Money Market Deposits - SANDAG Toll Road Project	251,000	1	Not rated	Not rated
Money Market Deposits - SANDAG Toll Road Project	354,514	1	Not rated	Not rated
Money Market Deposits - SANDAG Toll Road Project	10,009	1	Not rated	Not rated
Money Market Deposits - SANDAG Toll Road Project	663	1	Not rated	Not rated
Money Market Deposits - SANDAG Toll Road Project	64	1	Not rated	Not rated
Money Market Deposits - SANDAG Toll Road Project	260	1	Not rated	Not rated
Money Market Deposits - SANDAG Toll Road Project	1,000,040	1	Not rated	Not rated
Total demand deposits	3,308,577	1		
Investments:				
California Asset Management Program (CAMP):				
California Asset Management Program (CAMP):	1,845,624	41	AAAm	-
CAMP Cash Reserve Portfolio (SANDAG SR-125) - Project Maint	20,746,638	41	AAAm	
CAMP Cash Reserve Portfolio (SANDAG SR-125) - Extraordinary Reserve	7,404,064	41	AAAm	
Total California Asset Management Program	29,996,326	41		
Total cash, cash equivalents, and investments (90 or less days)	\$ 33,304,903	37		

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

South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2014

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.

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, 2014

4. Capital Assets

Capital asset activity for the year ended June 30, 2014, 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	36,531	-	243,464
Computer equipment	529,229	9,191	-	538,420
Vehicles	189,873	104,816	(25,072)	269,617
Fixed operating equipment	172,136	-	-	172,136
Software	245,364	-	-	245,364
Toll road	395,599,469	-	-	395,599,469
Building	4,020,000	-	-	4,020,000
Total capital assets, being depreciated	<u>400,963,004</u>	<u>150,538</u>	<u>(25,072)</u>	<u>401,088,470</u>
Less accumulated depreciation for:				
Furniture & office equipment	(63,098)	(41,907)	-	(105,005)
Computer equipment	(268,952)	(176,460)	-	(445,412)
Vehicles	(51,793)	(48,168)	10,079	(89,882)
Fixed operating equipment	(52,488)	(34,427)	-	(86,915)
Software	(124,693)	(81,788)	-	(206,481)
Toll road	(19,447,498)	(12,761,272)	-	(32,208,770)
Building	(122,577)	(80,400)	-	(202,977)
Total accumulated depreciation	<u>(20,131,099)</u>	<u>(13,224,422)</u>	<u>10,079</u>	<u>(33,345,442)</u>
Total capital assets, being depreciated, net	<u>380,831,905</u>	<u>(13,073,884)</u>	<u>(14,993)</u>	<u>367,743,028</u>
Governmental activities capital assets, net	<u>\$ 382,811,905</u>	<u>\$ (13,073,884)</u>	<u>\$ (14,993)</u>	<u>\$ 369,723,028</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

South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2014

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.

Long-term liability activity for the period July 1, 2013 to June 30, 2014, 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	\$ 58,965,792	\$ -	(656,988)	\$ 58,308,804	\$ 1,468,175
Tranche B	36,981,382	3,403,206	-	40,384,588	-
Tranche C	3,179,965	325,946	-	3,505,911	-
Series D	1,445,850	-	-	1,445,850	-
Total TIFIA notes	<u>100,572,989</u>	<u>3,729,152</u>	<u>(656,988)</u>	<u>103,645,153</u>	<u>1,468,175</u>
Unamortized FV Adjustment	58,162,792	-	(2,016,953)	56,145,839	-
Total TIFIA notes & Unamortized	<u>158,735,781</u>	<u>3,729,152</u>	<u>(2,673,941)</u>	<u>159,790,992</u>	<u>1,468,175</u>
TransNet notes					
Category B	528,080	-	(528,080)	-	-
Category C	62,352,510	-	-	62,352,510	-
Total TransNet notes	<u>62,880,590</u>	<u>-</u>	<u>(528,080)</u>	<u>62,352,510</u>	<u>-</u>
Total long-term liabilities	<u>\$ 221,616,371</u>	<u>\$ 3,729,152</u>	<u>\$ (3,202,021)</u>	<u>\$ 222,143,501</u>	<u>\$ 1,468,175</u>

SR125 reported \$1,468,175 as current notes payable and \$220,675,327 as noncurrent liabilities in the Statement of Net position on page 13.

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 \$8,042,784 and \$765,015, respectively, these added to the ending balances of their respective tranches. The following table shows the three tranches, initial principal amounts and interest rates.

South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2014

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)

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
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	2,431,142	3,723,704
2020 - 2024	29,755,213	15,516,527
2025 - 2026	<u>21,481,547</u>	<u>2,135,751</u>
Total	<u>\$ 58,308,804</u>	<u>\$ 36,249,779</u>

Tranche B-2

Maturity (Jan 1, Jul 1)	Principal Amount*	Interest Amount
2015	\$ -	\$ -
2016	-	-
2017	-	-
2018	-	-
2019	-	-
2020 - 2024	-	-
2025 - 2029	13,314,402	28,188,810
2030 - 2034	87,246,689	33,385,348

South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2014

	2035	<u>18,745,944</u>		<u>1,078,770</u>
	Total	\$ 119,307,035		<u>\$ 62,652,928</u>
Accrued interest (FY 2015-2035)		<u>(78,922,447)</u>		
		<u>\$ 40,384,588</u>		

* The principal amount includes the initial principal balance of \$32,341,804 and total deferred interest of \$78,922,447 added to the principal balance over the life of the loan.

Tranche C-2

	<u>Maturity</u> <u>(Jan 1, Jul 1)</u>	<u>Principal</u> <u>Amount**</u>		<u>Interest</u> <u>Amount</u>
	2015	\$ -	\$	-
	2016	-		-
	2017	-		-
	2018	-		-
	2019	-		-
	2020 – 2024	-		-
	2025 – 2029	-		-
	2030 – 2034	-		-
	2035 - 2036	<u>25,925,727</u>		<u>1,939,095</u>
	Total	\$ 25,925,727		<u>\$ 1,939,095</u>
Accrued interest (FY 2015-2034)		<u>(22,419,816)</u>		
		<u>\$ 3,505,911</u>		

** The principal amount includes the initial principal balance of \$2,740,896 and total deferred interest of \$22,419,816 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

**South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2014**

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, 2014, SR125 did not accrue Series D interest due to the uncertain future events that may affect obligations under the Series D agreement.

Fair Value Adjustment

SANDAG purchased the Toll Road for \$341,445,850, consisting of a cash payment of \$245,816,491, a promissory note (Series D) of \$1,445,850 and an assumption of the TIFIA tranches totaling \$94,183,509. A fair value analysis of the acquired assets and liabilities has been performed as of December 21, 2011. It was determined the fair value of the consideration paid by SANDAG was approximately \$402,884,950, resulting in a fair value adjustment of \$61,439,100.

For fair value purposes, the assumed TIFIA long-term debt was revalued based on SANDAG's cost of capital. At the date of acquisition, the weighted average yield of Tranches A-C was approximately 8.5 percent and Series D was 14 percent. These debt instruments were revalued at fair value using SANDAG's cost of debt of 4.46 percent. The Fair Value Adjustment is being amortized over the life of the TIFIA long-term debt using the effective interest method.

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.

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, 2014, the revised outstanding principal amount for the total *TransNet* debt was \$62,352,510. Accrued interest of \$3,666,019 was included in the ending balance as of June 30, 2014.

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

Category C

<u>Maturity (Jan 1, July 1)</u>	<u>Principal Amount ***</u>	<u>Interest Amount</u>
2015	\$ -	\$ 2,649,982
2016	-	2,649,982
2017	-	2,649,982
2018	-	2,649,982

South Bay Expressway
Notes to the Basic Financial Statements
For the Year ended June 30, 2014

2019	-	2,649,982
2020 – 2024	4,105,024	12,995,637
2025 – 2029	17,799,740	10,625,087
2030 – 2034	18,854,350	7,096,568
2035 - 2037	<u>21,593,396</u>	<u>1,796,349</u>
 Total	 <u>\$ 62,352,510</u>	 <u>\$ 45,763,551</u>

*** 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 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 FY14 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 FY14 CAFR.