Financial Options Analysis

San Joaquin Hills Transportation Corridor Agency

April 12, 2007

Today's Presentation

- Analysis of acquisition transaction without Foothill-South
- Acquisition Issues
  - * Policy
    - ✓ Governance
    - ✓ Cost
    - ✓ Complexity/Risk
  - * Financing
    - ✓ Interest rate risk
    - ✓ Insurance
    - ✓ Federal Line of Credit
  - * Timing
- Direction from the Boards

Review of Analysis Scenarios

- San Joaquin Hills - Mitigation Agreement
  - Existing debt with mitigation payments and loans from Foothill/Eastern
- Foothill/Eastern with Foothill-South (Stand-Alone)
  - Issued as additional bonds in 2010 under existing F/E indenture
- Acquisition Transaction with Foothill South (One Step)
  - Acquisition transaction and project financing combined in 2010

Review of Analysis Scenarios

- Acquisition Transaction then Foothill-South (Two Step)
  - F/E and SJH acquisition transaction sold mid 2007 (or as soon as possible)
  - FTC-S financed in 2010 as additional bonds under the new agency indenture
- Acquisition Transaction Only
  - F/E and SJH acquisition transaction sold mid 2007 (or as soon as possible)
  - FTC-S not assumed
  - Analysis performed to calculate present value savings/dissavings only

Acquisition Transaction Only

- Same first step as Two-Step Acquisition/Foothill-South financing
  - First step refunds all existing debt while leaving capacity for Foothill-South debt
  - Final maturity date of 2047
    - Are there debt service savings?
      - Annual
      - Present Value
    - Are there net debt service savings?
      - What is the split between F/E and SJH?

Acquisition Transaction Only
Present Value Savings

	1st Step Of Acquisition Financing	Existing Foothill/Eastern Financing	Existing San Joaquin Financing	Total Existing Financing
Total Agency Debt Service	**11,514,208,456**	**5,701,064,717**	**4,413,040,478**	**10,114,105,195**
Present Value of Debt Service Difference		**375,250,660**	**82,406,692**	**457,657,352**
(PV'd to 7/2007 @ 5.13%)				
Less DSRF Applied		(297,900,000)	(161,398,060)	(459,298,060)
Less U & O Applied		(15,000,000)	(15,000,000)	(30,000,000)
Less Agency Funds Applied		(67,460,292)	(47,814,309)	(115,274,601)
Total Funds Applied		(380,360,292)	(224,212,369)	(604,572,661)
Plus DSRF Established		42,701,153	42,701,153	85,402,306
Plus U & O Established		15,000,000	15,000,000	30,000,000
Plus Agency Expense Reserve Established		24,000,000	24,000,000	48,000,000
Plus Agency Funds on Hand		167	166	333
Total Funds Established		81,701,320	81,701,319	163,402,639
Present Value Savings (Dissavings)		**76,591,688**	**(60,104,358)**	**16,487,330**

Acquisition Transaction Only Results

- Further improvement in interest rates, since Sept 2006, have enabled the current acquisition model to produce present value savings of $16.5M
- Acquisition scenario contains conservative assumptions regarding insurance costs and escrow yields that potentially cause savings to be understated
- San Joaquin has dissavings due to long call dates on convertible CABs, low coupons on CIBs and non-callable CABs
- Foothill/Eastern has savings due to the fact that all bonds are callable and coupon rates are generally higher than San Joaquin's

What is the Point of this Analysis?

- It is one way to illustrate the estimated “value added” by each step of the two-step acquisition
- Achieving present value savings under this scenario is a high standard as the new debt is structured to a later maturity in anticipation of the subsequent issuance of Foothill-South debt. The existing debt was not structured in this manner
- Under the two-step acquisition, the ultimate structure of the Foothill-South financing will not be determined until several years after the initial transaction
- Present value savings is often a key metric used in refunding transactions. The feasibility of an acquisition transaction is usually based on multiple factors

Policy Issues
Governance Goal

- Create a board structure for a new entity which will allow any new bond issue to be classified as “acquisition” rather than “refunding” bonds under federal tax law.

What are the Constraints Under Federal Tax Law?

- One constraint is that neither the F/ETCA or the SJHTCA may have a controlling interest in the new JPA

- This means that members of the New Board whose votes would be sufficient to approve actions of the new JPA, may not consist of, or be appointed by, a majority of the board of directors of either the F/ETCA or SJHTCA

Constraints of the Existing TCA Structure

- There are 21 member agencies (each existing supervisorial district constitutes a member agency)
  - 7 F/ETCA only
  - 6 SJHTCA only
  - 8 common to both F/ETCA and SJHTCA
  - The common members currently constitute a majority of the boards of directors for both SJHTCA and F/ETCA
  - Majority vote needed for action

2002 Board Structure Ad Hoc Committee

- Board Structure Approaches Discussed
  - Dilution of current membership by adding outside members
    - 9 member board
    - 31 member board
  - Change of voting structure
    - By member groups
    - By supermajority
  - Population based representation
  - Geo-political sub-group representation

2002 Board Structure Ad Hoc Committee

- Dilution of existing board not supported by ad hoc members present due to concerns over
  - Increased size of board and related effectiveness
  - Addition of unrelated members who are not accountable to political constituents

2002 Board Structure Ad Hoc Committee

- Lack of support for population based plan due to
  - Lack of political representation on highly impacted jurisdictions
  - No direct relationship between population size and road usage or revenues
  - Some larger cities have small DIF areas
- Geo-political approach was complex and involved rotating membership

Existing Member Agencies
Super Majority Vote

- Each of the existing 21 member agencies appoint one person to the board
- Major decisions must be approved by a super majority, 16 of 21 or 77% of the members present and voting
- In late 2002 and early 2003, each group of member agencies, Foothill/Eastern’s and San Joaquin’s, approved the amendment to the existing JPA agreements that allowed for the formation of a new JPA with the 21 member board structure
- The new JPA was named the Transportation Corridor System or TCS

What Happens to the Existing Boards? - Example

TCS Board

- Budget/Expenditures
- Financing
- Toll Rates
- Investments
- Fees/Fines
- Policy

F/ETCA Board

- Development Impact Fee Program
- Future Project Enhancement

SJHTCA Board

- Development Impact Fee Program
- Future Project Enhancement

Governance - 2007 Review

- Concept designed to protect Foothill-South bond issuance from a six-member opposition block appears viable
- F/E retains the right to finance, construct and collect tolls on FTC-S
- TCS commits to subsidize Foothill-South debt service if necessary
- Appraisal for acquisition would have to demonstrate that value exists to cover the anticipated subsidy
- In the absence of six opposition votes, F/E would convey its rights and the TCS would issue the bonds to finance Foothill-South
- No protection for an eight-member opposition block under any scenario

Governance – Toll Policy Issues

- Concern over ability of a six-member voting block to prevent adoption of TCS toll rate changes

- Concern over the need to bring scheduled toll rates changes to the TCS Board

Governance - Toll Policy Concept

Minimum Toll Rate Concept:

- Version implemented with 1999 F/E Refunding has a ten year duration and requires the Agency to adopt toll rates no less than those assumed in the T & R Study unless
  - Lower rates would produce greater revenues or
  - Lower rates would produce net toll revenues (without interest income) of at least 1.3 times annual debt service
    - This is more restrictive than the basic coverage requirement
- Concept could be adapted to reflect full duration of the acquisition transaction, retain adequate flexibility and still provide assurance to board members and bondholders

Policy Issues

Major Transaction Costs

	1997 Refunding	1999 Refunding	2004 Fixed Acquisition*	2007 Fixed Acquisition*
Amount of Bonds Insured	$745 M	$302 M	$1.9 B	$1.9 B
Total Debt Service Insured & Premium	$2.5 B @ 125 basis points	$562 M @ 145 basis points	$5.9 B @ 275 basis points	$5.6 B @ 275 basis points
Bond Insurance Cost	$30.9 M	$8.1 M	$166 M	$ 158 M
Average Underwriter's Takedown/ $1000 Bond	$11.39	$10.70	$8.98	$9.28
Total Underwriter's Takedown	$16.5 M	$17 M	$34.2 M	$36.8 M

* First of two-step transaction

Underwriter’s Discount

- Underwriter’s Discount has the following components:
  - Takedown
    - Commission to sales force for placing the bonds in the market
    - Higher Takedown motivates sales force for better placement at lower rates
    - One basis point (0.01%) savings on interest rate is worth several million $
  - Management Fees
    - Payment to members of the underwriting team for analysis, structuring, research, knowledge and infrastructure over past five years
  - Expense Reimbursement

Costs of Issuance

- Non-Contingent – paid regardless of transaction execution
  - Traffic and Revenue Consultant
  - Appraisal Consultant
  - Financial Advisors (part of fee)
  - Acquisition Counsel
  - Agency Counsel
  - Rating Agencies

Costs of Issuance

- Contingent – only paid upon transaction execution
  - Bond Insurance
  - Underwriter’s Discount & Expenses
  - Financial Advisors (part of fee)
  - Escrow Advisor
  - Bond Counsel
  - Trustee and Verification Agent
  - Printing

Policy Issues
Complexity & Risk of Bond Structure

- In 2004, two acquisition financing alternatives were proposed
  - All fixed rate bond structure
  - Synthetic fixed rate bond structure
    - 75% of the transaction was fixed rate
    - 25% of the transaction was variable rate with an interest rate swap
- While the synthetic fixed rate structure provided lower projected debt service and higher coverage, the complexity and risk of the auction rate securities and the interest rate swap was a cause for concern for several Board members

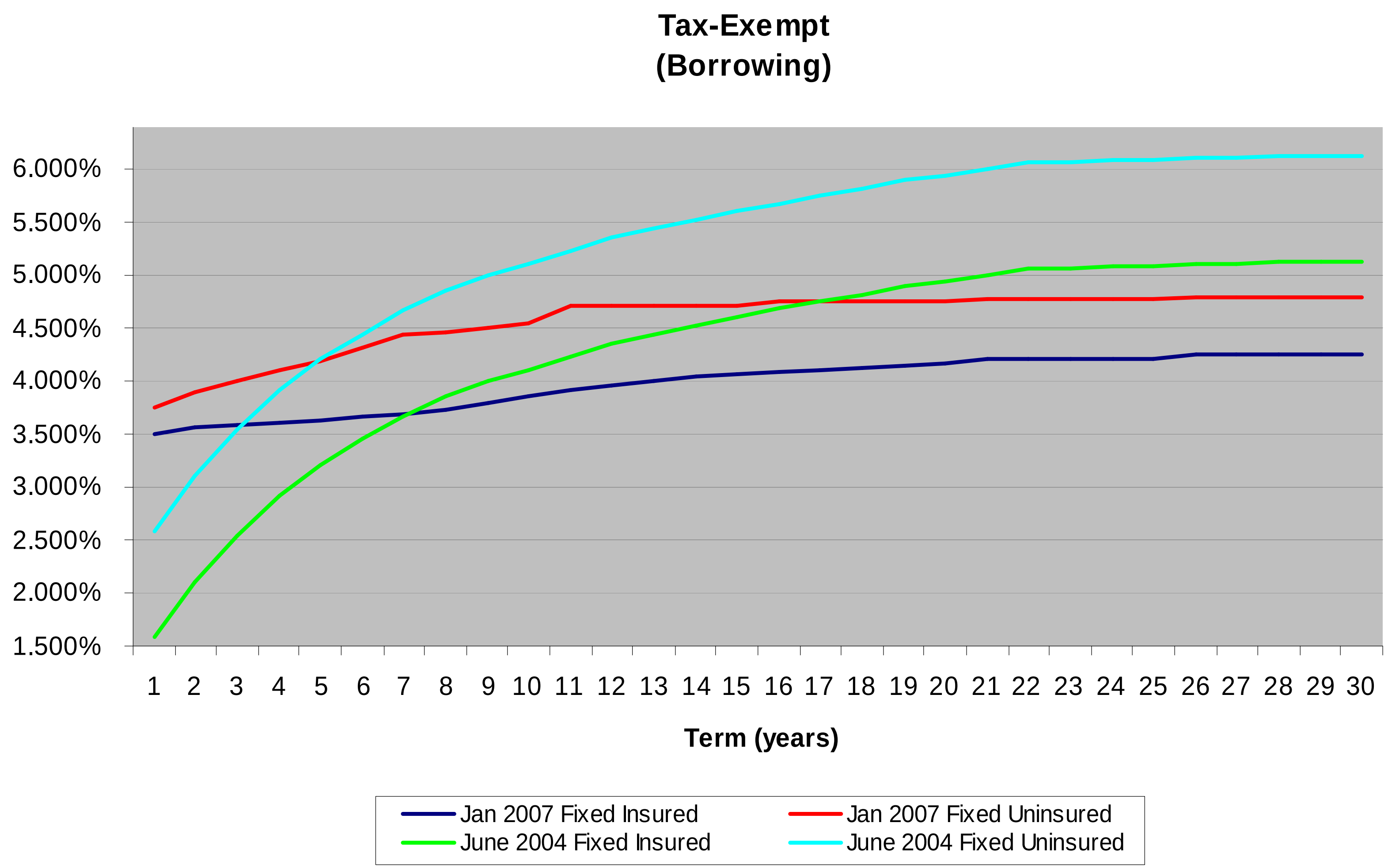
Complexity & Risk of Bond Structure

- All scenarios analyzed to date by the Joint Financial Options Ad Hoc Committee are all fixed rate bond structures
- Interest rate advantage between synthetic fixed and traditional fixed has narrowed primarily because the short end of the yield curve has risen
- Insurance premiums have increased for the underlying variable rate bonds
- All fixed rate structure is very favorable in today's interest rate environment

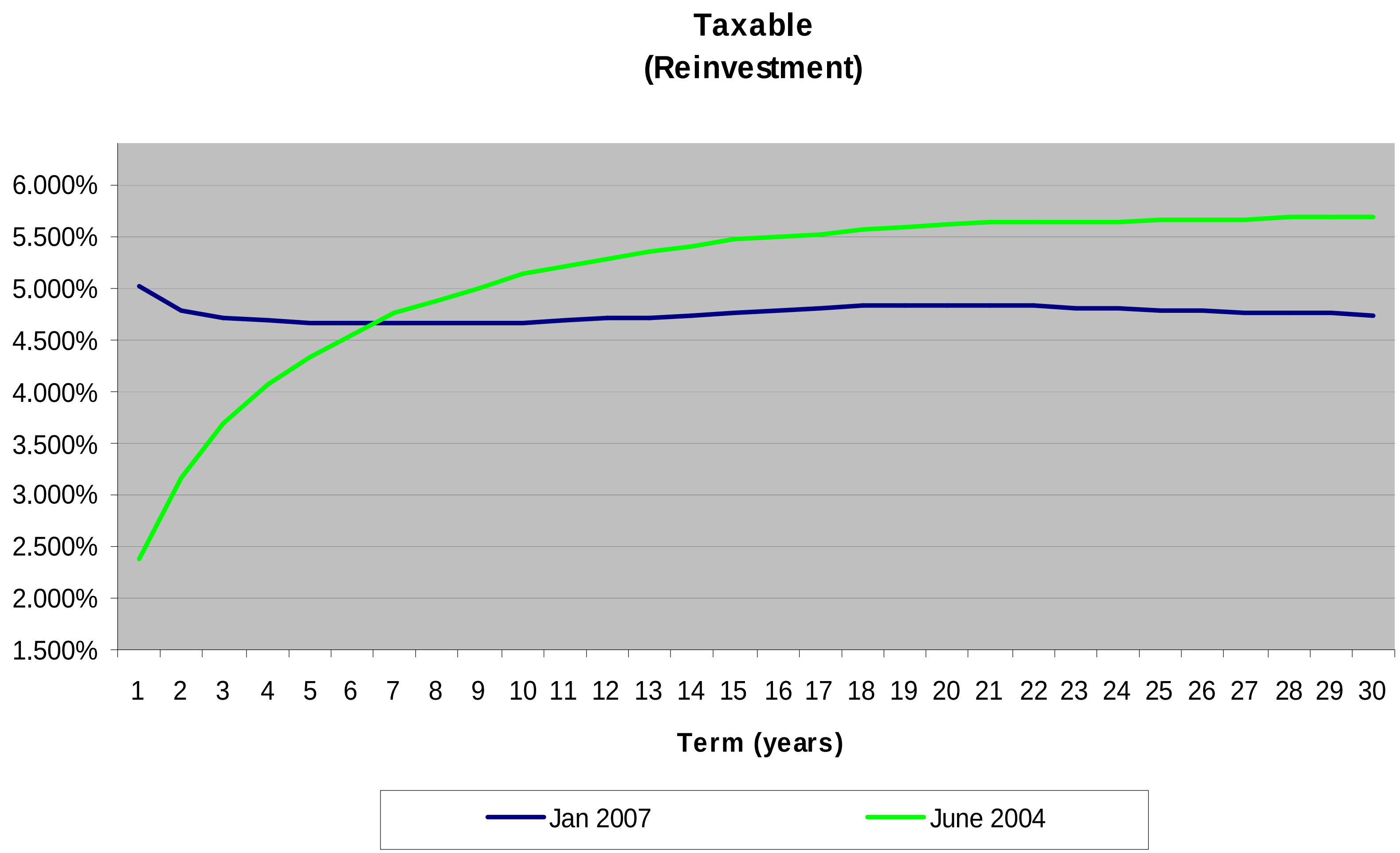
Financing Issues
Interest Rate Risk

- Interest rates have moved in our favor since 2004
  - Long-term tax-exempt borrowing rates are lower
  - Short-term taxable reinvestment rates are higher
- Based on historical trends, this interest rate environment is more likely to hold or start moving against us than to continue moving in our favor
- Interest rates and market capacity issues could change dramatically while an acquisition transaction is refined and finalized

Interest Rates – Tax-Exempt Borrowing



Interest Rates – Taxable Reinvestment



Financing Issues
Bond Insurance

- Diversifies bond mix to expand potential investor base, thereby lowering interest costs
- Tax law prohibits the purchase of insurance for tax-exempt municipal debt unless interest savings exceed the cost of the insurance
- Cost and terms must be negotiated with insurance companies
- Insurance companies seek to minimize their risk by placing restrictions on the issuance of additional parity debt
  - Issuance of subordinate debt not restricted

Financing Issues
Federal Line of Credit

- Existing lines are nearing their ten year expiration
  - San Joaquin's $120M FLOC expires in December 2007
  - Foothill/Eastern's $120M FLOC expires in December 2009
- The $240M evergreen FLOC obtained in 2003 could only be executed in conjunction with an acquisition transaction, therefore it was effectively mothballed
- Subsequent tax law interpretations would require revisit of FLOC structure
- Agencies would need to renegotiate the deal with FHWA or forgo

Timing Issues

- No imminent financial crisis exists
- Current market presents an attractive financial opportunity
- Each Agency has seven new board members
- July target date for new CEO to join the Agencies
- Updated project cost estimate for FTC-S due in October
- Investment grade T & R study for existing corridors takes six months
- Earliest anticipated date for environmental approval is 2010

- Interest rate uncertainty

Benefits of a Potential Acquisition Transaction

- Consolidates policy-making for the Toll Road System
- Diversifies revenues providing a stronger finance structure
- Provides more financing capacity for Foothill-South
  - Two-step acquisition has least risk to rising rates
    - * 85% of transaction is executed in near-term rate environment
  - One-step acquisition execution tied to Foothill-South environmental approval
    - * Structural advantage over stand-alone financing is lost if interest rates rise too much

Benefits of a Potential Acquisition Transaction

- Eliminates uncertainty of funding under Mitigation Agreement
  - Loan funding is subordinate to Foothill-South and near-term CIP
  - Loan funding is not backed by any pledge to raise tolls
- May achieve present value savings over existing debt on the first step of the two-step acquisition transaction
- May be able to renegotiate the evergreen Federal Line of Credit
- Provides flexibility for a future restructuring if revenues are not realized as planned
- Achieves earliest Sunset Date for the Agencies

Conclusion of Joint Ad Hoc

- Updated toll revenue projections for San Joaquin Hills validate the Board’s diligent management and improve the future financial outlook despite the infeasibility of the current refunding option

- The cost-effective financing of Foothill-South is a top-priority goal

- The risk that interest rates will rise prior to the Foothill-South financing date is a real concern to the Committee

Conclusion of Joint Ad Hoc

- The two step acquisition provides the most protection against rising interest rates and diversifies revenues

- The recommendation of the Ad Hoc Committee is for the Foothill/Eastern and San Joaquin Hills Boards to direct the Finance Team to further develop a two step acquisition financing

- A comprehensive update of the 2003 Traffic & Revenue Study will be needed

Direction Sought from Boards

- Direct the Joint Financial Options Ad Hoc Committee to work with the Finance Team to continue development of a viable two step acquisition financing

- Direct the Joint Financial Options Ad Hoc Committee to return to the Board with a preliminary time-line for the proposed financing and to continue to update the Boards on a regular basis as to the status of the project

Next Steps

- Approve Agenda Item 9, a contract with Vollmer & Associates to perform a comprehensive update to the 2003 Traffic and Revenue Studies
- Future Agenda items to include:
  - Adopt toll schedule for T & R Studies
  - Update contracts for financial advisors
  - Finalize board structure for acquiring entity
  - Elect officers for acquiring entity and commence operations
  - Appoint Finance Team for acquiring entity