

San Joaquin Hills
Transportation
Corridor Agency
Chair: Patricia Kelley
Mission Viejo



Foothill/Eastern
Transportation
Corridor Agency
Chair: Peggy Huang
Yorba Linda

August 25, 2021

Honorable Erick L. Larsh
Presiding Judge of the Superior Court of California
700 Civic Center Drive West
Santa Ana, CA 92701

Dear Judge Larsh:

Please find the San Joaquin Hills Transportation Corridor Agency's and the Foothill/Eastern Transportation Corridor Agency's (TCA) responses to the subject report as approved by the TCA Boards of Directors at their August 12, 2021, Boards of Directors meeting.

If you have any questions, please contact TCA's clerk of the board, Kaylee Doolittle, at (949)754-3492.

Sincerely,

Samuel Johnson
Chief Executive Officer

Enclosure

cc: Orange County Grand Jury
San Joaquin Hills Transportation Corridor Agency Board of Directors
Foothill/Eastern Transportation Corridor Agency Board of Directors

TRANSPORTATION CORRIDOR AGENCIES (TCA) FORMAL RESPONSES TO THE 2020-2021 ORANGE COUNTY GRAND JURY'S FINDINGS AND RECOMMENDATIONS

FINDINGS

F1. When the TCA completes the 91 Express Connector, its major necessary construction work will be finished.

Joint TCA Response: The San Joaquin Hills Transportation Corridor Agency (SJHTCA) and the Foothill/Eastern Transportation Corridor Agency (F/ETCA) Boards of Directors review and adopt each Agency's Capital Improvement Plan (CIP) on an annual basis, including the Fiscal Year 2022 CIP that was reviewed and adopted by the Boards at their June 10, 2021, meeting. Within the adopted CIP, both the SJHTCA and F/ETCA have on-system projects identified for completion post-2035 that will require significant financial commitments and are well beyond the completion date for the 241/91 Express Connector. As the recommendation(s) tied to this finding are focused on the expenditure of funds, it should also be noted that the analysis appears to ignore the cost of future replacements and improvements to the extensive array of equipment and technology that exist across the 420+ lane miles of highways the Agencies have already constructed. Based on these planned system improvements, TCA wholly disagrees with the finding.

F2. By focusing on bond payoff, the TCA could retire its debt by 2037.

Joint TCA Response: This finding is more complex than presented by the Grand Jury. The Boards have taken proactive steps to develop a plan for the Agencies' financial futures that include early bond payments, targeting longest dated bond maturities. Like all other bond issuers, TCAs bonds cannot simply be paid early without a significant cost impact. Combined, the Agencies have over 10 bond series/issuances with multiple subseries and maturities that have to be considered in light of specific call dates (when the issuer can buy the bonds back prior to maturity) and other provisions. These provisions need to be considered because the indentures (contracts) for the bonds specify the call dates or other provisions for which the investors are paid a return on their investment through those call dates, if applicable, or until their bonds mature.

Bond issuers, such as TCA, can place funds into an escrow account that pays investors interest for the entire period until the call date as scheduled and then pays the principal at the call date. However, the longer the period of time until the call date, the more costly the funding of the escrow. The cost of applying this approach today could eliminate the benefit of retiring the bonds early. Placing these funds in escrow also precludes policy makers' use of the monies for funding capital projects, operational enhancements and retaining the Agencies' unique position of having its pension liability fully funded.

It should also be noted that restricted debt service reserve funds cannot be used to pay down the bonds and must still be held in trust as security for the bondholders. These funds would only become available after the bonds are paid down.

In light of these details, TCA's Boards have been developing strategies, policies and priorities that allow for financially feasible early bond payments as part of their strategic planning efforts. In addition to the technical aspects and significant costs related to early retirement of debt, the Boards have other financial considerations, including the cost of future improvements to the system which were not included in the Grand Jury's analysis. Current and future SJHTCA and F/ETCA Boards will continue to take steps to reduce debt and evaluate options for early retirement while considering needs for system improvements and implementation costs along with the cost of operational enhancements while also ensuring sufficient funds are set aside to weather changing market conditions. For the various reasons noted above, TCA cannot agree with this finding.

- F3. Based on the TCA's current debt repayment plan, the total cost of the toll roads will amount to \$28 billion by 2053.

Joint TCA Response: The wording of this finding could be somewhat misleading as someone reading it without reading the body of the report could conclude that costs and projected revenues are "one in the same" which would be in error. The Grand Jury's report includes a section titled "What is the cost of the Toll Roads?" that includes opinions about different ways to calculate the cost and value of a major asset. The first method presented by the Grand Jury was the cost of construction. The Grand Jury noted that consistent with standard accounting practices, capital expenses include construction and material costs as well as engineering and other direct overhead to support the road-building project. The Grand Jury's analysis closely matched the \$2.8 billion of initial roadway segments and subsequent capital projects reported in the SJHTCA's and F/ETCA's 2021 CIP reports.

The second method presented by the Grand Jury focused on the total of all revenues collected by TCA since inception through the scheduled final maturity date of the bonds. The \$28 billion "cost" represents the forecasted revenue that was derived from the financial data contained within each Agency's official statement (2013 and 2014 bond documents) and provided to the Grand Jury, as requested. The Grand Jury's calculated figure represents historical actuals and potential revenue collected over 60 years of operations, including forecasted revenue from 2021 through 2053. The forecast for bond revenue assumes excess revenue over operations and debt service to ensure sufficient margins through a long-term economic period, requiring reserves for downturns. However, this figure does not reflect future Board decisions that could alter those projections or allocate expenditures against those funds, including early payment of bonds, operational enhancements, and transportation infrastructure improvements beyond the 241/91 Express Connector.

If excess funds are collected, these amounts would be available for future Boards' consideration of early payment of bonds or additional infrastructure improvements that would be paid with cash, rather than incurring additional toll revenue debt or paid with taxpayer funded obligations such as state or federal grants, or sales tax secured bonds.

The last method presented by the Grand Jury was based on "the sum of borrowed principal plus interest on debt service" and included principal and interest payments through the scheduled

final maturity date of the bonds. This method assumes that the current interest rates and payment amounts are static and ignores both the Boards' policies to reduce debt and recent experiences with F/ETCA reducing debt service payments by more than \$600 million. Future scheduled payments have been decreasing as a result of TCA's bond refunding efforts to reduce interest payments and will decrease further as the Agencies continue to execute the policies to reduce debt and make early bond payments. Additionally, as recognized by the Grand Jury, the outstanding bonds and associated revenue have allowed TCA to fund additional improvements such as the Oso Parkway Bridge, with cash rather than issuing additional bonds. For these reasons, TCA disagrees with this finding.

F4. The TCA can cover its debt obligations without the use of Development Impact Fees.

Joint TCA Response: TCA constructed The Toll Roads in advance of collecting Development Impact Fees (DIFs) by issuing non-recourse toll revenue bonds that are pledged for repayment through the collection of tolls and DIFs. The Agencies' master indentures of trust pledge and assign "Pledged Funds" to the applicable indenture trustee, and each of the definitions of the term "Pledged Funds" includes DIFs. Accordingly, all of each Agency's outstanding bonds are secured by such fees.

When developers build revenue generating projects, they have a responsibility to underwrite some of the cost of the infrastructure that is required to support their projects. Water lines, sewer lines, schools and roads are all part of the infrastructure needed. Thus, DIFs are paid by developers to ensure they pay for the infrastructure from which they benefit, and DIFs ensure that developers' projects have the infrastructure support they need to succeed. TCA's structure for DIFs and the annual escalation was created in partnership with developers understanding the value transportation infrastructure would have for their business and Orange County's quality of life.

While both Agencies have successfully navigated two of the greatest economic downturns of the 21st century, it is not fiscally prudent to take a position that assumes that any future downturn could be managed as successfully without the availability of both the Agencies' revenue streams. For these reasons, TCA cannot agree with the finding of the Grand Jury.

F5. Even when the TCA's debt is retired, the roads will likely not become toll-free.

Joint TCA Response: The assessment and decision on covering the cost of maintaining and improving South County's transportation infrastructure will be coincident to the repayment of all outstanding bonds and discussions between South Orange County policy makers and Caltrans. The needs and ability to cover these costs, as well as decisions regarding revenue, will be addressed through appropriate planning studies and negotiations for which the member cities and county's representatives will have a full seat at the table. However, based on 1) the increased costs associated with maintenance and rehabilitation of the 420 lane-miles of highways and 130+ bridges/structures the TCA has built, most of which will be 50+ years old; 2) the transition to electric vehicles which will not support "gas tax based" transportation revenues; and 3) the continued scarcity of state and federal funds for transportation infrastructure projects, TCA agrees with the finding.

F6. Maintaining two agencies creates cost inefficiencies and extends the amount of time required by SJHTCA to pay off its debt.

Joint TCA Response: The Agencies have been in place for nearly 30 years, and during this maturation process, efficiencies in administration and operations have been honed and are extremely effective. As the Grand Jury noted, a single staff manages both Agencies; procurement processes and contracts are shared; and joint board and committee meetings are employed to further promote efficiency and avoid rework. Merging the two distinct Agencies would be a complicated endeavor, both legally and financially, with little reward. Each Agency issued non-recourse toll revenue bonds to pay for the construction of The Toll Roads. Because those bonds are only secured by toll revenues and DIFs, the bond indentures do not allow either Agency to transfer its right to receive revenues to another agency while any of the Agency's bonds remain outstanding. In order to merge the Agencies, all outstanding bonds would need to be defeased (i.e., replaced with new bonds as substitute income-producing collateral). The cost of this process would greatly outweigh any potential benefits because a defeasance of all of the bonds would require the issuance of new bonds to generate enough cash to be placed in an escrow to the call dates of the various bonds, making this process very expensive and likely extending the maturity dates beyond those of the existing bonds. For these reasons, TCA wholly disagrees with the finding.

RECOMMENDATIONS

R1. The Grand Jury recommends the TCA develop and implement a written plan to pay off all debt by 2040, the original maturity date of the initial debt offering. The written plan should be completed by December 31, 2021, with annual written updates on December 31 of each successive year. This allows for completion of the 91 Express Connector and other projects currently in planning. This will result in debt service savings of approximately \$1 billion. (F1, F2)

Joint TCA Response: As noted in response to Findings 1 and 2, the Grand Jury's analysis did not take several aspects into consideration, including the fact that the Boards have recently taken proactive steps to develop a plan for the Agencies' financial futures through strategic planning discussions and adoption of debt management strategies, which include early bond payments and Capital Improvement Plans that consider needed future improvements. These planned improvements were considered within the original environmental documents. The Boards have been forward thinking and considering the potential construction necessary to complete full build-out of The Toll Roads including:

- *An additional 85 lane miles within the median areas of SR 73, 133, 241 and 261, along with associated toll system modifications*
- *Widening of 50 bridges requiring extensive excavation, pile-driven foundations and structural steel, concrete and post-tensioning*
- *Improvements to signage, utilities, drainage, grading, water treatment basins, and various safety features.*

Additionally, like all other bond issuers, TCA's bonds cannot simply be paid early without a significant cost. Call provisions need to be considered because the indentures for the bonds specify call dates or other provisions for which the investors are paid a return on their investment through those call dates or until their bonds mature. Issuers can place funds into an escrow that pays investors interest until the call date as scheduled and then pays the principal at the call date, but the longer the period of time until the call date, the more costly the funding of the escrow. Once funds are placed in escrow for this purpose, future policy makers would be precluded from considering these monies for funding capital projects, operational enhancements and retaining the Agency's unique position of having its pension liability fully funded.

In light of these details, the TCA Boards have been developing strategies, policies and priorities that allow for financially feasible early bond payments as part of their strategic planning efforts. In addition to the technical aspects and significant costs related to early retirement of debt, the Boards have other financial considerations, including the cost of future improvements to the system which were not included in the Grand Jury's analysis. Current and future SJHTCA and F/ETCA Boards will continue to take steps to reduce debt and evaluate options for early retirement while considering needs for improvements and implementation costs along with the cost of operational enhancements, while also ensuring sufficient funds are set aside to weather changing market conditions. Early bond payments will remain a priority; however, as TCA continues to refine the timing and cost of future improvements needed to maintain free-flow traffic conditions on The Toll Roads, without issuing additional toll revenue debt or creating additional unmet needs for the state or other tax-based revenue sources, TCA will need to retain flexibility in how future policy makers achieve those goals. Therefore, this recommendation will not be implemented because it is not warranted.

R2. The Grand Jury recommends the TCA eliminate DIFs once the debt is paid off. Until that time, the DIFs should be used exclusively for the payoff of debt. (F4)

Joint TCA Response: The Agencies' respective Joint Powers Agreements already authorize the elimination of DIFS once the bonds are retired; however, using DIFs exclusively for the payoff of debt ignores the potential for any contribution towards infrastructure investments and also ignores the potential impacts of economic downturns; therefore, this recommendation does not warrant implementation.

R3. The Grand Jury recommends the TCA research the possibility of merging the two agencies and develop a written plan of action by December 31, 2021. Merging allows for the elimination of any cost redundancies present in the two agencies. It also allows SJHTCA to pay off its debt at the same time as F/ETCA. (F6)

Joint TCA Response: Merging the two Agencies is a complicated financial endeavor with little reward and a loss of representation and decision-making authority. Each Agency issued non-recourse toll revenue bonds to pay for the construction of The Toll Roads. Because those bonds are only secured by toll revenues and DIFs, the bond indentures do not allow either Agency to transfer its right to receive revenues to another agency while any of the Agency's bonds remain outstanding. In order to merge the Agencies, all outstanding bonds would need to be defeased

(i.e., replaced with new bonds as substitute income-producing collateral). The cost of this process would greatly outweigh any potential benefits because a defeasance of all of the bonds would require the issuance of new bonds to generate enough cash to be placed in an escrow to the call dates of the various bonds, making this process very expensive and likely extending the maturity dates beyond those of the existing bonds.

While the Grand Jury offered its thoughts on a revised voting structure, it contradicted the Grand Jury's perspectives that the Agencies needed to act more independently. The recommendation would also be in contradiction to the Agencies political design in ensuring that the cities mostly impacted by decisions related to the individual corridors had an equal vote in decision making. For these reasons, this recommendation will not be implemented because it is not reasonable.