

OFFICIAL STATEMENT

NEW ISSUE – Book-Entry-Only

RATINGS: See “RATINGS” herein

\$43,825,000
ARIZONA TRANSPORTATION BOARD
GRANT ANTICIPATION REFUNDING NOTES
SERIES 2012

Dated: Date of Delivery

Due: July 1, as shown on the inside cover page hereof

The Grant Anticipation Refunding Notes, Series 2012 (the “Series 2012 Notes”) are being issued by the Arizona Transportation Board (the “Board”) only as fully registered notes under a book-entry-only system.

Interest on the Series 2012 Notes is payable on January 1 and July 1 of each year (each an “Interest Payment Date”), commencing January 1, 2013, by the paying agent, initially U.S. Bank National Association (the “Paying Agent”). Interest accrues from the date of delivery of the Series 2012 Notes.

The maturities, interest rates and prices or yields of the Series 2012 Notes are shown on the reverse side of this cover page. The Series 2012 Notes are not subject to redemption prior to their respective maturity dates as described herein.

The Series 2012 Notes will be registered initially in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”), which will act as securities depository for the Series 2012 Notes. Purchases of beneficial interests in the Series 2012 Notes will be made in book-entry-only form in denominations of \$5,000 or any integral multiple thereof. Purchasers will not receive certificates representing their ownership interests in the Series 2012 Notes. So long as the Series 2012 Notes are registered in the name of DTC, or its nominee, payments of the principal of and interest on the Series 2012 Notes will be made directly by the Paying Agent to DTC which, in turn, is obligated to remit such payments to its participants for subsequent distribution to beneficial owners of the Series 2012 Notes, as described herein.

The Series 2012 Notes are being issued to (i) refund in advance of maturity the Notes Being Refunded (as defined herein) and (ii) pay costs of issuing the Series 2012 Notes. See “PLAN OF REFUNDING” herein.

The Series 2012 Notes are limited obligations of the Board. The Series 2012 Notes, together with Outstanding Notes previously issued by the Board and with any Additional Notes that are subsequently issued on a parity therewith (collectively, “Notes”), are payable from, and secured solely by a pledge of, amounts on deposit in the Grant Anticipation Note Fund and Note Proceeds Account (collectively, the “Pledged Funds”) created under the Note Resolution and held by the Arizona State Treasurer. The Board is required by the Note Resolution to deposit revenues received from the Federal Highway Administration under certain Grant Agreements into the Grant Anticipation Note Fund. Under certain conditions, the Board is also required to deposit other available Federal Aid Revenues and certain available other revenues of the Arizona Department of Transportation (the “Department”) into the Grant Anticipation Note Fund. See “SECURITY AND SOURCES OF PAYMENT FOR THE NOTES” herein. **The Series 2012 Notes are not obligations, general, special or otherwise, of the State of Arizona (the “State”), do not constitute a legal debt of the State and are not enforceable against the State, nor shall payment thereof be enforceable out of any monies of the State, the Board or the Department, other than from the Pledged Funds.**

In the opinion of Squire Sanders (US) LLP, Bond Counsel, under existing law (i) assuming continuing compliance with certain covenants and the accuracy of certain representations, interest on the Series 2012 Notes is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations, and (ii) interest on the Series 2012 Notes is exempt from Arizona state income tax. Interest on the Series 2012 Notes may be subject to certain federal taxes imposed only on certain corporations, including the corporate alternative minimum tax on a portion of that interest. For a more complete discussion of the tax aspects, see “TAX MATTERS” herein.

This cover page contains only a brief description of the Series 2012 Notes and the security therefor. It is not a summary of material information with respect to the Series 2012 Notes. Investors should read this entire Official Statement to obtain information necessary to make an informed investment decision.

The Series 2012 Notes are offered when, as and if issued, subject to an opinion on certain legal matters relating to their issuance of Squire Sanders (US) LLP, Bond Counsel to the Board and Department, and certain other conditions. Certain legal matters will be passed on for the Underwriters by Ballard Spahr LLP. It is expected that the Series 2012 Notes in book-entry-only form will be available for delivery through the facilities of DTC on or about May 30, 2012.

Citigroup

J.P. Morgan

May 15, 2012

\$43,825,000
ARIZONA TRANSPORTATION BOARD
GRANT ANTICIPATION REFUNDING NOTES
SERIES 2012

MATURITY SCHEDULE

<u>Maturity (July 1)</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Yield (a)</u>	<u>CUSIP (b)</u>
2014	\$120,000	3.000%	0.46%	040647 DS5
2015	31,620,000	4.000	0.60	040647 DT3
2016	12,085,000	4.000	0.76	040647 DU0

- (a) Reoffering yields are furnished by the Underwriters. The Board and the Department do not take any responsibility for the accuracy thereof.
- (b) The CUSIP (Committee on Uniform Securities Identification Procedures) numbers have been assigned by an organization not affiliated with the Board, the Department, the Financial Advisor, the Underwriters, or the Paying Agent, and such parties are not responsible for the selection or use of the CUSIP numbers. CUSIP numbers are included solely for the convenience of bondholders and no representation is made as to the correctness of the CUSIP numbers listed herein. CUSIP numbers assigned to securities may be changed during the term of such securities based on a number of factors including, but not limited to, the refunding or defeasance of such issue or the use of secondary market financial products. None of the Board, the Department, the Financial Advisor, the Underwriters, or the Paying Agent or any of their counsel or agents has agreed to, nor is there any duty or obligation to, update this Official Statement to reflect any change or correction in the CUSIP numbers. CUSIP is a registered trademark of the American Bankers Association.

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*Assistant Director
Administrative Services Division*

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Deputy Chief Financial Officer

Kevin Biesty
*Government Relations and Policy
Development Office Director*

Matt Burdick
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No dealer, broker, salesman or other person has been authorized to give any information or to make any representations, other than those contained in this Official Statement, including the cover page and Appendices attached hereto (the "Official Statement"), in connection with the offering contained herein, and, if given or made, such information or representation must not be relied upon as having been authorized by the State of Arizona, the Arizona Transportation Board (the "Board"), or the State of Arizona Department of Transportation (the "Department"). This Official Statement does not constitute an offer to sell, or the solicitation of an offer to buy, any securities other than the securities offered hereby or an offer to sell or solicitation of offers to buy, nor shall there be any sale of the Grant Anticipation Refunding Notes, Series 2012 (the "Series 2012 Notes"), by any person in any jurisdiction where such offer or solicitation or sale would be unlawful.

The information contained in this Official Statement has been obtained from the Board, the Department, the Federal Highway Administration (the "FHWA") and other sources believed to be reliable, but the accuracy or completeness of such information is not guaranteed by, and should not be construed as a promise by, any of the foregoing. The presentation of such information, including tables of receipts from the FHWA and other sources, is intended to show recent historic information and is not intended to indicate future or continuing trends. No representation is made that the past experience, as shown by such financial and other information, will necessarily continue or be repeated in the future. This Official Statement contains, in part, estimates and matters of opinion, whether or not expressly stated to be such, which are not intended as statements or representations of fact or certainty, and no representation is made as to the correctness of such estimates and opinions, or that they will be realized. This Official Statement contains projections and forecasts which are forward looking statements concerning facts which may or may not occur in the future. All such forward looking statements may not be realized and must be viewed with an abundance of caution. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the State of Arizona, the Board, the Department or the Federal Aid Highway Program (as defined herein) since the date hereof.

The information in Appendix D – "BOOK-ENTRY-ONLY SYSTEM" attached hereto has been furnished by The Depository Trust Company and no representation is made by the Board, the Department or the underwriters identified on the cover page (the "Underwriters"), or any of their counsel or agents, as to the accuracy or completeness of such information.

A wide variety of other information, including financial information, concerning the Board and the Department is available from publications and websites of the Board and the Department and others. Any such information that is inconsistent with the information set forth in this Official Statement should be disregarded. No such information is a part of or incorporated into this Official Statement, except as expressly noted herein.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY ALLOW CONCESSIONS OR DISCOUNTS FROM THE INITIAL PUBLIC OFFERING PRICES SHOWN ON THE INSIDE FRONT COVER HEREOF TO DEALERS AND OTHERS, AND THE UNDERWRITERS MAY OVERALLOT OR ENGAGE IN TRANSACTIONS INTENDED TO STABILIZE THE PRICES OF THE SERIES 2012 NOTES AT LEVELS ABOVE THOSE THAT MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET IN ORDER TO FACILITATE THEIR DISTRIBUTION. SUCH STABILIZATION, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

The Series 2012 Notes will not be registered under the Securities Act of 1933, as amended, or any state securities law, and will not be listed on any stock or other securities exchange. Neither the Securities and Exchange Commission nor any other federal, state or other governmental entity or agency has passed upon the accuracy of this Official Statement.

The Board has undertaken to provide continuing disclosure with respect to the Series 2012 Notes as required by Rule 15c2-12 of the Securities and Exchange Commission. See "CONTINUING DISCLOSURE UNDERTAKING" and Appendix E – "FORM OF CONTINUING DISCLOSURE UNDERTAKING" herein.

The Underwriters have provided the following sentence for inclusion in this Official Statement: The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

TABLE OF CONTENTS

	Page
INTRODUCTION	1
THE GRANT AGREEMENTS	2
PLAN OF REFUNDING	2
MATHEMATICAL VERIFICATION	3
THE SERIES 2012 NOTES	3
General Description	3
Not Subject to Redemption	4
Exchange and Transfer	4
Defeasance	4
SECURITY AND SOURCES OF PAYMENT FOR THE NOTES	5
Limited Obligations and Legal Authority	5
Creation of Pledged Funds	5
Deposits and Uses of Federal Aid Revenues	5
Deposits of Certain Other Revenue into Grant Anticipation Note Fund	7
Use of Pledged Funds	7
Covenants Concerning Federal Aid Revenues	8
Additional Notes	8
Other Covenants for Benefit of Note Owners	9
INFORMATION CONCERNING THE FUNDING OF FEDERAL AID HIGHWAYS	10
The Federal Aid Highway Program	10
The Federal Highway Trust Fund	11
TEA-21	12
SAFETEA-LU	13
Federal Aid Funding Procedures	14
Lapsing of Authorization	17
Special Federal Provisions Relating to Debt-Financed Projects	19
Regional Planning and Air Quality Conformity	20
FEDERAL AID REVENUES	22
DEBT SERVICE REQUIREMENTS	24
MANAGEMENT OF THE STATE HIGHWAY PROGRAM	25
Arizona Transportation Board	25
Arizona Department of Transportation	25
Sunset Laws	32
LITIGATION	32
TAX MATTERS	33
General	33
Original Issue Discount and Original Issue Premium	34
INDEPENDENT AUDITORS	35
CONTINUING DISCLOSURE UNDERTAKING	35
RATINGS	36
UNDERWRITING	36
CERTAIN LEGAL MATTERS	37
FINANCIAL ADVISOR	37
MISCELLANEOUS	37
Appendix A – Proposed Form of Opinion of Bond Counsel	
Appendix B – Arizona Department of Transportation Audited Financial Statements for Year Ended June 30, 2011	
Appendix C – Summary of Certain Provisions of the Note Resolution	
Appendix D – Book-Entry-Only System	
Appendix E – Form of Continuing Disclosure Undertaking	

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OFFICIAL STATEMENT

relating to

\$43,825,000

Arizona Transportation Board Grant Anticipation Refunding Notes Series 2012

INTRODUCTION

The following introductory statement is subject in all respects to the more complete information set forth in this Official Statement. The descriptions and summaries of various documents hereinafter set forth do not purport to be comprehensive or definitive and are qualified in their entirety by reference to each document.

This Official Statement (including the cover page and Appendices attached hereto) provides certain information in connection with the initial issuance by the Arizona Transportation Board (the “Board”) of its Grant Anticipation Refunding Notes, Series 2012 (the “Series 2012 Notes”) in the aggregate principal amount of \$43,825,000. The Series 2012 Notes are issued pursuant to the State of Arizona’s Grant Anticipation Note law, Title 28, Chapter 21, Article 3, Arizona Revised Statutes (the “Act”), and under and pursuant to a resolution adopted by the Board on June 9, 2000, as supplemented to date, including by a supplemental resolution adopted on April 20, 2012 (as it may be subsequently amended in accordance with its terms, collectively, the “Note Resolution”).

Capitalized terms used in this Official Statement and not otherwise defined herein have the meanings set forth in Appendix C hereto.

The Board establishes policy for the State of Arizona Department of Transportation (the “Department”) and issues bonds and notes to finance the highway program of the State of Arizona (the “State”). The Department administers the State highway program. Under the Act, the Board is authorized to issue notes in anticipation of the receipt of revenues under one or more grant agreements between the Department and the Federal Highway Administration (“FHWA”). The Department has entered into several grant agreements with the FHWA (collectively, the “Grant Agreements”) relating to the construction by the Department of certain controlled-access highways in Maricopa County, Arizona, U.S. highways and State routes within the State, and improvements related thereto. The Series 2012 Notes are being issued for the purpose of (i) refunding in advance of maturity the Notes Being Refunded (as defined herein) and (ii) paying the costs of issuing the Series 2012 Notes. See “PLAN OF REFUNDING.” Under the existing Grant Agreements, FHWA has agreed to make payments to the Department in amounts equal to the principal of and interest on Series 2012 Notes, when due. The Department expects to use such revenues to pay the Debt Service on the Series 2012 Notes.

The Series 2012 Notes are limited obligations of the Board. The Debt Service on the Series 2012 Notes, together with the Debt Service on Outstanding Notes previously issued by the Board and any Additional Notes that may be subsequently issued by the Board on a parity with the Series 2012 Notes (collectively, the “Notes”), are payable from, and secured solely by a pledge of, amounts on deposit in the Grant Anticipation Note Fund and Note Proceeds Account (collectively, the “Pledged Funds”) created under the Note Resolution and held by the State Treasurer. After the issuance of the Series 2012 Notes, there will be \$373,365,000 aggregate principal amount of Series 2003A, Series 2004B, Series 2008A, Series 2009A, Series 2011A and Series 2012 Notes Outstanding. The Note Resolution requires the Board to deposit all Federal Aid Revenues received from the FHWA under all Grant Agreements relating to Notes into the Grant Anticipation Note Fund (unless sufficient amounts have already been deposited in such Fund from other sources), which Fund shall only be used to pay Debt Service on Notes. Under certain conditions, the Board is also required to deposit into the Grant Anticipation Note Fund other available Federal Aid Revenues and certain other available revenue of the Department. See “SECURITY AND SOURCES OF PAYMENT FOR THE NOTES – Deposits and Uses of Federal Aid Revenues” and “– Deposit of Certain Other

Revenue into Grant Anticipation Note Fund.” Payment of Debt Service on the Series 2012 Notes is not subject to annual appropriation by the Legislature of the State and such payments comply with all applicable constitutional or statutory limitation on expenditures.

The primary source of Federal Aid Revenues is amounts distributed to the Department by the federal government pursuant to the Federal Aid Authorization. The current Federal Aid Authorization, including the authority to collect taxes flowing into the Federal Highway Trust Fund, has been extended multiple times by Congress beyond its original scheduled expiration date of September 30, 2009. The most recent extension enacted by Congress is through June 30, 2012. Subsequent legislation is expected to be considered by Congress either to further extend the current Federal Aid Authorization or to enact a new Federal Aid Authorization. See “INFORMATION CONCERNING THE FUNDING OF FEDERAL AID HIGHWAYS-SAFETEA-LU.” **No assurances can be made, however, that Congress will further extend the current Federal Aid Authorization or will enact a new Federal Aid Authorization which will provide Federal Aid Revenues to the Department sufficient to pay Debt Service on the Notes when due.**

The Series 2012 Notes are not obligations, general, special or otherwise, of the State, do not constitute a legal debt of the State and are not enforceable against the State, nor shall payment thereof be enforceable out of any monies of the State, the Board or the Department, other than from the Pledged Funds.

This Official Statement describes the terms of and security for the Series 2012 Notes and the use of proceeds of the Series 2012 Notes. Also included are summaries of certain provisions of the Note Resolution, the Grant Agreements relating to the Notes and Title 23 of the United States Code (“Title 23”) and other provisions of federal law which govern the Federal Aid Highway Program. These descriptions and summaries do not purport to be comprehensive or definitive. All references herein to the Note Resolution and the Grant Agreements are qualified in their entirety by reference to the definitive form thereof, all references to federal laws and the Act are qualified in their entirety by reference to the complete statutes, regulations and interpretations by federal officials, and all references to the Series 2012 Notes are qualified by the forms thereof contained in the Note Resolution and are further qualified in their entirety by reference to laws and principles of equity relating to or affecting the enforceability of creditors’ rights. Copies of the Note Resolution and the Grant Agreements may be obtained as set forth under “MISCELLANEOUS.”

THE GRANT AGREEMENTS

The projects funded with the proceeds of the Notes Being Refunded consisted of portions of certain controlled-access highways, U.S. highways and State routes within the State that were constructed by the Department (the “Projects”).

In conjunction with the issuance of the Notes Being Refunded, the Department entered into the Grant Agreements with the FHWA, whereby the FHWA authorized portions of these Projects as advance construction projects under Title 23 and determined that these Projects are eligible for Federal Aid Revenues under Title 23. The FHWA has agreed under the Grant Agreements related to the Notes Being Refunded to make payments to the Department in amounts equal to the Debt Service on the Notes Being Refunded, when due. Such payments may be used by the Department under Title 23 and the terms of the Grant Agreements to pay Debt Service on the Notes, including the Series 2012 Notes. As required by Title 23, the Projects funded with the proceeds of the Notes Being Refunded were included by the metropolitan planning organization for Maricopa County, Arizona in the transportation improvement program of Maricopa County, Arizona and by the Board in the transportation improvement program of the State. See “INFORMATION CONCERNING THE FUNDING OF FEDERAL AID HIGHWAYS – Regional Planning and Air Conformity.” Under the Note Resolution, the Department has covenanted, to the extent permitted by State law, to comply with applicable law and the Grant Agreements to the extent required to receive all revenues from the FHWA under the Grant Agreements.

PLAN OF REFUNDING

A portion of the net proceeds received from the sale of the Series 2012 Notes will be placed in a trust account (the “Escrow Account”) with U.S. Bank National Association, escrow trustee (the “Escrow Trustee”) under

an escrow agreement (the “Escrow Agreement”), to be applied to the payment of certain outstanding Notes, as identified below (the “Notes Being Refunded”), and will be used to acquire United States Treasury Obligations (the “Defeasance Obligations”), the maturing principal of and interest on which, together with any other amounts in the Escrow Account, will be calculated to be sufficient to provide moneys to pay the principal and interest with respect to the Notes Being Refunded to their redemption dates as shown in the following table. See “MATHEMATICAL VERIFICATION” herein. Upon deposit of such moneys and Defeasance Obligations, the Notes Being Refunded will cease to be entitled to any pledge, benefit or security under the Note Resolution, and all covenants, agreements and obligations of the Board to the Owners of the Notes Being Refunded will thereupon cease, terminate and be discharged and satisfied, except for payments from the Escrow Account. The remaining balance of the proceeds will be used to pay the costs of issuing the Series 2012 Notes.

Dated Date of Issue	Series	Original Principal Amount	Maturity Dates Being Refunded	CUSIP (a) (040647)	Principal Amount Being Refunded	Redemption Date	Redemption Premium on Notes Being Refunded
07/01/2003	Grant Anticipation Notes, Series 2003A	\$148,955,000	07/01/2015 07/01/2015	BC2 BD0	\$18,335,000	07/01/2013	0%
10/01/2004	Grant Anticipation Notes, Series 2004B	104,385,000	07/01/2015 07/01/2016	CD9 CE7	25,665,000	07/01/2014	0%

(a) See footnote (b) on inside front cover.

MATHEMATICAL VERIFICATION

Concurrently with the delivery of and payment for the Series 2012 Notes, Grant Thornton LLP, a firm of independent certified public accountants, will deliver to the Board its verification report indicating that it has examined, in accordance with standards established by the American Institute of Certified Public Accountants, the mathematical accuracy of certain computations contained in schedules provided by the Underwriters, on behalf of the Board, relating to (a) the sufficiency of the anticipated receipts from the Defeasance Obligations, together with the initial cash deposit held in the Escrow Account, to pay interim interest payments and, when redeemed, the principal of and accrued interest on the Notes Being Refunded, and (b) the “yield” on the Defeasance Obligations, the Notes Being Refunded and the Series 2012 Notes.

The report of Grant Thornton LLP will state that the scope of its engagement was limited to verifying the mathematical accuracy of the computations contained in schedules provided to it by the Underwriters and that it has no obligation to update its report because of events occurring, or data or information coming to its attention, subsequent to the date of its report.

THE SERIES 2012 NOTES

General Description

The Series 2012 Notes will be issued in the principal amounts and with the maturity dates shown on the inside cover page of this Official Statement. The Series 2012 Notes will accrue interest from the date of their delivery and will bear interest from such date, payable on January 1 and July 1 of each year, commencing January 1, 2013 (each, an “Interest Payment Date”). Interest will be calculated based on a year of 360 days and twelve 30-day months.

As described in Appendix D – “BOOK-ENTRY-ONLY SYSTEM,” the Series 2012 Notes, when issued, will be registered in the name of Cede & Co., as registered owner and nominee of The Depository Trust Company, New York, New York (“DTC”). So long as DTC, or its nominee Cede & Co., is the registered owner of all the Series 2012 Notes, all payments on the Series 2012 Notes will be made directly to DTC.

The principal of the Series 2012 Notes will be payable in lawful money of the United States of America at the designated corporate trust office of the Paying Agent. U.S. Bank National Association will initially serve as

paying agent (the “Paying Agent”) and note registrar (the “Note Registrar”) for the Series 2012 Notes. Payment of the interest on any Series 2012 Note shall be made to the person whose name appears on the note registration books of the Note Registrar as the registered owner thereof (the “Owner”) as of the close of business on the 15th day of the month preceding the Interest Payment Date (the “Record Date”). Interest will be paid to the Owner at the address shown on such registration books. At the option of any Owner of at least \$1,000,000 in aggregate principal amount of the Series 2012 Notes, principal and interest will be paid by wire transfer to a bank account located in the continental United States, at the expense of such Owner, if such Owner has made such request in writing to the Note Registrar prior to the Record Date. As long as the DTC book-entry-only system is in effect, Cede & Co. is the Owner and will receive all payments of Debt Service.

Any such interest not so punctually paid or duly provided for will cease to be payable to the Owner on such Record Date and will be paid to the person in whose name the Series 2012 Note is registered at the close of business on a Special Record Date for the payment of such defaulted interest to be fixed by the Paying Agent, notice whereof being given to the Owners not less than 10 days prior to such Special Record Date.

Not Subject to Redemption

The Series 2012 Notes are not subject to optional redemption prior to their stated maturities.

Exchange and Transfer

If the Series 2012 Notes are not in book-entry-only form, the following paragraph will be applicable.

The registration of any Series 2012 Note may be transferred upon the note register of the Board by the Owner thereof, in person or by his or her duly authorized attorney, upon surrender of such Series 2012 Note at the designated office of the Note Registrar accompanied by a written instrument of transfer satisfactory to the Note Registrar and duly executed by the Owner or by his or her duly authorized attorney. Any Series 2012 Note may be exchanged at the designated office of the Note Registrar for new Series 2012 Notes of any authorized denomination, in the same aggregate principal amount and maturity as the surrendered Series 2012 Note. The Note Registrar will not charge an administrative fee for any new Series 2012 Note issued upon any exchange or transfer, but may require the Owner requesting such exchange or transfer to pay any tax or other governmental charge required to be paid with respect to such exchange or transfer. The Note Registrar is not required to exchange or transfer any Series 2012 Note during the period commencing on June 15 and December 15 of each year and ending on the subsequent July 1 or January 1, respectively.

Defeasance

If the Board pays or causes to be paid, or there is otherwise paid, to the Owners of all Outstanding Series 2012 Notes or Series 2012 Notes of a particular maturity or a particular Series 2012 Note within a maturity, the principal and interest due or to become due thereon, at the times and in the manner stipulated therein and in the Note Resolution, such Series 2012 Notes will cease to be entitled to any pledge, benefit or security under the Note Resolution, and all covenants, agreements and obligations of the Board to the Owners of such Series 2012 Notes will thereupon cease, terminate and become void and be discharged and satisfied.

Subject to the provisions of the Note Resolution, any Outstanding Series 2012 Notes will be deemed to have been paid within the meaning and with the effect expressed in the foregoing paragraph if there has been deposited with an escrow agent appointed for such purpose either money in an amount which will be sufficient, or Defeasance Obligations as prescribed in the Note Resolution, the principal of and the interest on which, when due, will provide money which, together with the money, if any, deposited with the escrow agent at the same time, will be sufficient to pay when due the principal and interest due and to become due on such Series 2012 Notes on or prior to the maturity date thereof. See “Defeasance” in Appendix C.

SECURITY AND SOURCES OF PAYMENT FOR THE NOTES

Limited Obligations and Legal Authority

The Series 2012 Notes are limited obligations of the Board and are payable from the Pledged Funds specified in the Note Resolution and described below. The Series 2012 Notes are not obligations, general, special or otherwise, of the State, do not constitute a legal debt of the State and are not enforceable against the State, nor shall payment thereof be enforceable out of any monies of the State, the Board or the Department, other than from the Pledged Funds.

The Act authorizes the Board to issue a Series of Notes to finance one or more highway projects after the Department has entered into a grant agreement with the FHWA to reimburse the Department for the Federally-eligible costs of such projects. The Department has previously entered into Grant Agreements relating to the Projects financed with proceeds of the Notes Being Refunded. Pursuant to the Act, the Board will issue the Series 2012 Notes in anticipation of the receipt by the Department of the Grant Revenues from the FHWA under the Grant Agreements.

The Grant Agreements expressly state that they do not constitute a commitment, guarantee or obligation on the part of the United States to provide for the payment of Debt Service on the Notes nor do they create any right of a third party against the United States for payment of the Notes.

Creation of Pledged Funds

Under the Note Resolution, the Board has established: (1) the Grant Anticipation Note Fund as a special separate fund held by the State Treasurer and (2) the Note Proceeds Account as a separate account in the State Highway Fund held by the State Treasurer. Under State law, public moneys of the State are held by the State Treasurer.

The Board pledges in the Note Resolution to the payment of the Debt Service on the Series 2012 Notes, the Outstanding Notes and any Additional Notes that may be subsequently issued by the Board on a parity therewith (see "Additional Notes" below), funds on deposit in the Grant Anticipation Note Fund and the Note Proceeds Account (such funds so deposited being the "Pledged Funds"), subject to the permitted use by the Department of moneys in the Note Proceeds Account to pay Project Costs. The funds in the Grant Anticipation Note Fund shall only be used to pay Debt Service on Notes. After issuance of the Series 2012 Notes, there will be \$373,365,000 aggregate principal amount of Notes Outstanding.

The Department and State Treasurer have agreed in the Note Resolution to deposit Grant Revenues when received from the FHWA under Grant Agreements relating to Notes into the Grant Anticipation Note Fund. See "-Deposits and Uses of Federal Aid Revenues" below.

The Note Resolution constitutes a contract between the Board and the Owners from time to time of the Notes, and the pledge, covenants and agreements of the Board and Department set forth in the Note Resolution are for the equal benefit, protection and security of the Owners of any and all of the Notes, all of which, regardless of the time or times of their issuance or maturity, will be of equal rank without preference, priority or distinction of any of the Notes over any other Note, except as expressly provided in or permitted by the Note Resolution. The pledge by the Board of the Pledged Funds is irrevocable so long as any Notes are Outstanding under the terms of the Note Resolution.

Deposits and Uses of Federal Aid Revenues

The Note Resolution defines "Grant Revenues" as any and all revenues the Department receives under a Grant Agreement relating to the Notes, the proceeds of the Notes and the income and gain from the investment of the Funds and Accounts held under the Note Resolution. The Note Resolution defines "Federal Aid Revenues" as revenues or funds received by or on behalf of, or available to, the Department pursuant to "Federal Aid Authorization," which means Title 23, any extension of Title 23, or any successor to Title 23 authorizing federal funding of state highways (including, without limitation, Grant Revenues received pursuant to any Grant

Agreement), which revenues or funds are not restricted under Federal Aid Authorization in a way that prohibits the Board from using them to pay Debt Service on Notes.

The Department has entered into the Series 2003A, 2004B, 2008A, 2009A and 2011A Grant Agreements with the FHWA relating to the Series 2003A, 2004B, 2008A, 2009A and 2011A Notes. Under the provisions of these Grant Agreements, the FHWA has agreed to make payments to the Department for eligible project costs, to the extent federal funds are available, of Grant Revenues in amounts equal to the Debt Service, when due, on the Series 2003A, 2004B, 2008A, 2009A, 2011A and 2012 Notes. The FHWA has determined that the Series 2003A, 2004B, 2008A, 2009A and 2011A Projects are eligible for Federal Aid Revenues under Federal Aid Authorization. Under the Note Resolution, the Department has covenanted, to the extent permitted by State law, to comply with applicable law and such Grant Agreements to the extent required to receive all Federal Aid Revenues from the FHWA under such Grant Agreements.

Pursuant to the Note Resolution, the Department has agreed that all Grant Revenues under any Grant Agreement relating to the Notes received by the Department shall on the day of receipt be deposited by the Department with the State Treasurer and the State Treasurer has agreed to deposit such Grant Revenues directly into the Grant Anticipation Note Fund, until the amount on deposit equals the aggregate of Debt Service on the Outstanding Notes, except as set forth in the last paragraph under this heading.

Only after Grant Revenues, other Federal Aid Revenues and certain other revenues (see “–Deposit of Certain Other Revenues into Grant Anticipation Note Fund” below) are deposited into the Grant Anticipation Note Fund do they become Pledged Funds.

The Act prohibits an Owner of a Note from compelling FHWA to pay Grant Revenues to the Department. Federal Aid Authorization and the Series 2003A, 2004B, 2008A, 2009A and 2011A Grant Agreements expressly state that such Grant Agreements (1) do not create any right in any party (other than the Department) against the FHWA and (2) do not constitute a commitment, guarantee or obligation on the part of the United States to provide for the payment of Debt Service on the Series 2003A, 2004B, 2008A, 2009A, 2011A and 2012 Notes.

For a discussion of Federal Aid Revenues and Federal Aid Authorization see “INFORMATION CONCERNING THE FUNDING OF FEDERAL AID HIGHWAYS” and for a discussion of the amount of Federal Aid Revenues received by the Department see “FEDERAL AID REVENUES.” The primary source of Federal Aid Revenues is amounts distributed to the Department by the federal government pursuant to Federal Aid Authorization. The current Federal Aid Authorization has been extended multiple times by Congress beyond its original scheduled expiration date of September 30, 2009. The most recent extension enacted by Congress is through June 30, 2012. Subsequent legislation is expected to be considered by Congress to either further extend the current Federal Aid Authorization or to enact a new Federal Aid Authorization. See “INFORMATION CONCERNING THE FUNDING OF FEDERAL AID HIGHWAYS – SAFETEA-LU.” **No assurances can be made, however, that Congress will further extend the current Federal Aid Authorization or will enact a new Federal Aid Authorization which will provide Federal Aid Revenues to the Department sufficient to pay Debt Service on the Notes when due.**

The Note Resolution also establishes the Federal Aid Revenues Subaccount in the Construction Account of the Regional Area Road Fund and the Federal Aid Revenues Subaccount in the State Highway Fund, which Subaccounts will be held by the State Treasurer and will be used by the Department as provided in the Note Resolution and as described below. *Monies in the Federal Aid Revenues Subaccounts are not Pledged Funds.* All Federal Aid Revenues (excluding Grant Revenues received under any Grant Agreement, which are required to be deposited directly into the Grant Anticipation Note Fund, as described above) received by the Department shall on the day of receipt be deposited with the State Treasurer and the State Treasurer shall (except under circumstances described in the third succeeding paragraph) deposit such revenues into the Federal Aid Revenues Subaccount in the State Highway Fund or in the Regional Area Road Fund, as required by State law.

Federal Aid Revenues held in the Federal Aid Revenues Subaccounts and State moneys in the State Highway Fund and Regional Area Road Fund may be used at any time by the Department for any purpose permitted by State law, including, without limitation, paying costs of highways or operating expenses of the Department. The

Department has programmed the use of moneys in the Federal Aid Revenues Subaccounts and State moneys in the State Highway Fund and Regional Area Road Fund for those purposes.

As discussed in prior paragraphs, there can be no assurance that any moneys will be in the Federal Aid Revenues Subaccounts, the Note Proceeds Account, the State Highway Fund or the Construction Account in the Regional Area Road Fund at times and in amounts necessary to cure any deficiency in the Grant Anticipation Note Fund to pay Debt Service on the Notes when due. Debt Service on the Notes is not subject to acceleration if there is a default in the payment of Debt Service, when due.

On or before October 15 of each Federal Fiscal Year (which commences on October 1) in which Debt Service on any Note is payable, the Director shall file with the State Treasurer and the Board a certificate calculating the Debt Service Coverage Ratio for such Federal Fiscal Year. The Debt Service Coverage Ratio is (a) the amount of Federal Aid Revenues that the Department estimates will be available to pay Debt Service on all Outstanding Notes payable during such Federal Fiscal Year, divided by (b) the Annual Debt Service due on all Outstanding Notes during such Federal Fiscal Year. If the Debt Service Coverage Ratio shown in such certificate is less than 1.30 (or for so long as the Director fails to file such certificate for each such Federal Fiscal Year), then the Note Resolution requires the State Treasurer from and after October 16 of each such Federal Fiscal Year to deposit all Federal Aid Revenues (including Grant Revenues received under Grant Agreements and all other Federal Aid Revenues) received by the State Treasurer directly into the Grant Anticipation Note Fund, until the amount on deposit in the Grant Anticipation Note Fund shall equal the aggregate of: (1) the amount of interest on all Outstanding Notes payable during such Federal Fiscal Year and (2) the amount of principal of all Outstanding Notes payable during such Federal Fiscal Year. If the Director's certificate shows the Debt Service Coverage Ratio is at least 1.30, then Federal Aid Revenues (which do not constitute Grant Revenues) shall be deposited into the Federal Aid Revenues Subaccounts as described above.

Deposits of Certain Other Revenue into Grant Anticipation Note Fund

On the fifth Business Day prior to any date on which Debt Service on any Note is payable, the Note Resolution requires the State Treasurer to transfer into the Grant Anticipation Note Fund, to the extent required in order to pay Debt Service payable on the Outstanding Notes on such date, moneys from the following sources and in the following priority: First from the Federal Aid Revenues Subaccounts, Second from the Note Proceeds Account, Third from the State Highway Fund (exclusive of any moneys therein pledged to State highway revenue bonds) and Fourth from the Construction Account in the Regional Area Road Fund (to the extent the proceeds of Notes were used for projects eligible to be paid from such Fund).

There can be no assurance that there will be moneys in these Accounts and Funds, described above, available to be transferred to the Grant Anticipation Note Fund in amounts necessary to pay Debt Service on Outstanding Notes when due. Only after such moneys are deposited into the Grant Anticipation Note Fund do such moneys become Pledged Funds.

If revenues that are not Grant Revenues are deposited into the Grant Anticipation Note Fund, then the Director may direct the State Treasurer in writing to deposit a specified amount of Grant Revenues received by the Department after such deposit (up to the amount of such deposit) into the fund or account (a) from which such deposit was transferred, or (b) into which such deposit would have been deposited in accordance with State law, as applicable.

Use of Pledged Funds

The State Treasurer is required by the Note Resolution to pay out of the Grant Anticipation Note Fund to the Paying Agent:

(1) on or before each Interest Payment Date for any Notes, an amount required for the interest payable on such date; and

(2) on or before each Principal Payment Date for any Notes, an amount required for the principal payment on such date; and

(3) on or before any optional redemption date for any Notes, an amount required for the payment of the redemption price on the Notes then to be optionally redeemed.

The Note Resolution provides that moneys in the Note Proceeds Account shall be used as follows: (a) to pay Project Costs; (b) to pay issuance costs; and (c) if any deficiency remains in the Grant Anticipation Note Fund, then the State Treasurer shall transfer moneys from the Note Proceeds Account to cure such deficiency, as described above. The State Treasurer shall make payments from the Note Proceeds Account to pay Project Costs upon direction of the Department.

Covenants Concerning Federal Aid Revenues

In the Note Resolution, the Department and Board each covenant to take all actions permitted by State law that may be required of the Department and the Board to receive an amount of Federal Aid Revenues sufficient to pay Debt Service when due, less only amounts on deposit in the Grant Anticipation Note Fund.

As soon as practicable after the start of each Federal Fiscal Year in which Debt Service is payable, the Note Resolution requires the Department and Board to take all actions, to the extent permitted by State law, required of them to obligate under the Federal Aid Authorization an amount of Federal Aid Revenues sufficient to pay, when due, the Debt Service on any Outstanding Notes payable in such Federal Fiscal Year (less only the amount on deposit at the start of such Federal Fiscal Year in the Grant Anticipation Note Fund and available to pay such Debt Service). The Board and the Department each covenant that until the Department has so obligated Federal Aid Revenues, it shall not obligate any Federal Aid Revenues for any other purpose in any Federal Fiscal Year in which Debt Service is payable. The Department and Board have each specifically covenanted in the Note Resolution to take all actions, to the extent permitted by State law, required of them under federal and State law, necessary to convert any Project which is an advance construction project under the Federal Aid Authorization, to a regular federal aid project in an amount sufficient to obligate Federal Aid Revenues in the amount required by this paragraph.

The Department has complied with all provisions of the current Federal Aid Authorization applicable to the Department necessary to be eligible to receive and continue to receive Federal Aid Revenues that both (a) may be used pursuant to the Federal Aid Authorization to pay Debt Service on the Notes and (b) are sufficient to pay Debt Service, when due, during the term of the Federal Aid Authorization, except the requirements on an annual basis in each future year to obligate Federal Aid Revenues as discussed in the prior paragraph. The Note Resolution requires the Department, to the extent permitted by State law, to comply with and satisfy all requirements which may be imposed by the FHWA upon the Department that are necessary to continue to receive Federal Aid Revenues under the Federal Aid Authorization (including, without limitation, Grant Revenues under the Grant Agreements) in amounts sufficient to pay all Debt Service when due (less amounts of Debt Service paid from other sources).

For a discussion of how the Federal Aid Revenues are obligated under the Federal Aid Authorization and other requirements of federal law that must be satisfied before the FHWA pays Grant Revenues and other Federal Aid Revenues to the Department, see “INFORMATION CONCERNING THE FUNDING OF FEDERAL AID HIGHWAYS – Federal Aid Funding Procedures” herein.

Additional Notes

The Board shall not issue any grant anticipation notes, bonds, debentures, other notes or other evidence of indebtedness that are payable out of, or secured by a pledge of, the Pledged Funds on a basis senior to the Notes.

The Board may issue, from time to time, one or more Series of Additional Notes in unlimited principal amounts for any lawful purpose permitted under the Act, which are payable from and secured by the Pledged Funds on a parity with the Series 2012 Notes, the Outstanding Notes and any Additional Notes that may be subsequently issued, upon satisfaction of the requirements of the Note Resolution before such issuance. Those requirements include that an Authorized Officer of the Board certify that:

(1) the amount of Federal Aid Revenues either (i) anticipated to be received by the Department during the Federal Fiscal Year in which the proposed Series of Additional Notes are to be issued, or (ii) received by the Department in either of the two prior Federal Fiscal Years preceding the authentication and delivery of the Series of Additional Notes then proposed to be issued, was not less than:

- one hundred fifty percent (150%) of the Annual Debt Service in any Federal Fiscal Year that ends on or before the expiration date of the Federal Aid Authorization then in effect, which includes any extension(s) or successors thereto, and
- three hundred percent (300%) of the Annual Debt Service in any Federal Fiscal Year that ends after the expiration date of the Federal Aid Authorization then in effect, which includes any extensions(s) or successors thereto, and
- in either case, including the Annual Debt Service on the Series of Additional Notes proposed to be issued, but excluding, in the case of a Series of Additional Notes issued for refunding purposes, the Annual Debt Service on the Notes to be refunded; and

(2) the Department has no information which indicates that Federal Aid Revenues will not be available to the Department during the term of the Federal Aid Authorization then in effect and any extension(s) thereto in amounts sufficient to pay, when due, Debt Service on the Notes to be Outstanding during such term.

The requirements of paragraphs (1) and (2) above may be revised or eliminated upon the Board's receipt of written evidence from each Rating Agency then maintaining an uninsured rating on the Outstanding Notes, to the effect that such revision or deletion will not by itself result in the withdrawal or reduction of any such uninsured rating by such Rating Agency.

The Board may also issue Additional Notes without complying with paragraphs (1) and (2) above for the purpose of refunding in whole or in part any Notes Outstanding under the Note Resolution, provided that the Board certifies that: (a) the Annual Debt Service for all Notes Outstanding immediately after the issuance of such proposed Refunding Notes for the current and each future Federal Fiscal Year to and including the Federal Fiscal Year of the latest maturity on any Notes then Outstanding is no greater than (b) the Annual Debt Service for all Notes Outstanding immediately prior to such issuance during the same Federal Fiscal Years. If the Board cannot satisfy the requirement of the preceding sentence, the Board may nevertheless issue Additional Notes for the purpose of refunding Notes upon compliance with the test described in the preceding paragraphs (1) and (2).

The Board will comply with the requirements noted in the preceding paragraph as of the issuance and delivery of the Series 2012 Notes.

The Board may issue Additional Notes in the future, but currently does not expect to issue any Additional Notes during the next two years. The Board does expect to issue bonds, notes or other obligations secured by revenue and funds other than the Pledged Funds. The actual amount of any Additional Notes to be issued in the future will depend upon, among other considerations, market conditions, cash flow requirements of the Board for construction, and other sources of funding available to meet such requirements.

For further discussion of the issuance of Additional Notes and the Board's authority to issue Subordinated Notes in any principal amount, see "Issuance of Additional Notes" and "Subordinated Notes" in Appendix C.

Other Covenants for Benefit of Note Owners

All moneys and Investment Securities held in the Grant Anticipation Note Fund and Note Proceeds Account shall be held by the State Treasurer on behalf of the Board and for the benefit and security of the Owners of the Notes, as provided in the Note Resolution.

The Department shall keep proper books of record and account (separate from all other records and accounts) in which complete and correct entries shall be made of its transactions relating to the Federal Aid Revenues and the Pledged Funds, which records and accounts shall at all times be subject to the inspection of the

Owners of an aggregate of not less than 10% in principal amount of the Notes then Outstanding or their representatives duly authorized in writing.

The Board is not required to pay Debt Service from any funds other than the Pledged Funds which includes deposits to the Grant Anticipation Note Fund as described under “– Deposits and Uses of Federal Aid Revenues” and “– Deposits of Certain Other Revenue into Grant Anticipation Note Fund.” The Board or Department may also choose to pay Debt Service from sources other than the Pledged Funds, to the extent legally available for that purpose. Such other sources may include funds on deposit in the State Highway Fund and in the Regional Area Road Fund.

INFORMATION CONCERNING THE FUNDING OF FEDERAL AID HIGHWAYS

The Federal Aid Highway Program

The Federal Aid Highway Program (“FAHP”) is an “umbrella” term that encompasses most of the federal programs providing highway funds to the states. The major funding for the FAHP is made available in six core programs: the Interstate Maintenance Program, the Highway Bridge Program, the National Highway System Program, the Surface Transportation Program, the Congestion Mitigation and Air Quality Program and the Highway Safety Improvement Program. The FHWA is the federal agency within the U.S. Department of Transportation responsible for administering the FAHP. The FAHP is financed from the transportation user-related revenues deposited in the Federal Highway Trust Fund. The primary source of revenues in the Federal Highway Trust Fund is derived from the federal excise taxes on motor fuels. Other taxes include excise taxes on tires, trucks and trailers, and truck use taxes.

The FAHP is a reimbursement program. Once projects are approved by the FHWA and funds are obligated, the federal government makes payments to the states for costs as they are incurred on projects, which may include debt service on obligations issued to finance a project. With few exceptions, the federal government does not pay for the entire cost of a federal-aid project. Federal reimbursements are typically to be matched with state and/or local funds. The maximum federal share is specified in the federal legislation authorizing the program. Most projects have an 80 percent federal share, while Interstate construction and maintenance projects typically have been funded with a 90 percent federal share. Because Arizona is a “public lands” state (a state with a high ratio of public lands to total area), it qualifies for certain sliding scales for the percentage of federal participation. For most projects in Arizona, the federal share has been 94.3 percent.

The FAHP must be periodically reauthorized by Congress. The current multi-year authorization, SAFETEA-LU (as herein defined), became law on August 10, 2005 and has been extended multiple times by Congress beyond its original expiration date of September 30, 2009. The most recent extension enacted by Congress is through June 30, 2012. Subsequent legislation is expected to be considered by Congress to either further extend SAFETEA-LU or to enact a new Federal Aid Authorization. See “SAFETEA-LU” below. **No assurances can be made, however, that Congress will further extend SAFETEA-LU or will enact a new Federal Aid Authorization which will provide Federal Aid Revenues to the Department sufficient to pay Debt Service on the Notes when due.**

THE TERMS AND CONDITIONS OF PARTICIPATION IN THE FAHP AS DESCRIBED HEREIN ARE THOSE IN SAFETEA-LU AND ARE SUBJECT TO CHANGE AT THE DISCRETION OF CONGRESS. THERE CAN BE NO ASSURANCE THAT THE LAWS AND REGULATIONS NOW GOVERNING THE FAHP WILL NOT BE CHANGED IN THE FUTURE IN A MANNER THAT MAY ADVERSELY AFFECT THE ABILITY OF THE DEPARTMENT TO RECEIVE FEDERAL AID REVENUES SUFFICIENT TO ENABLE THE BOARD TO PAY DEBT SERVICE ON THE NOTES.

Although the FHWA provides funding for eligible highway projects, federal-aid highways are under the administrative control of the state or local government responsible for their operation and maintenance.

Funding under the FAHP is provided to states through a multi-step funding cycle that includes: 1) *multi-year authorization* by Congress of the funding for various highway programs; 2) *apportionment and allocation* of

funds to the states each Federal Fiscal Year according to statutory formulas or, for some funding categories through administrative action; 3) *obligation* of funds, which is the federal government's legal commitment (or promise) to pay or reimburse states for the federal share of a project's eligible costs; 4) *appropriations* by Congress specifying the amount of funds available for the year to liquidate obligations; 5) *program implementation* which covers the programming and authorization phases; and 6) *reimbursement* by the federal government of the eligible project costs. Each of these steps is described in more detail under "– Federal-Aid Funding Procedures" below.

Title 23 entitled "Highways", includes most of the laws that govern the FAHP arranged systematically or codified. Generally, Title 23 embodies those substantive provisions of highway law that Congress considers to be continuing and which need not be reenacted each time the FAHP is reauthorized. Periodically, sections of Title 23 may be amended or repealed through surface transportation acts.

The Federal Highway Trust Fund

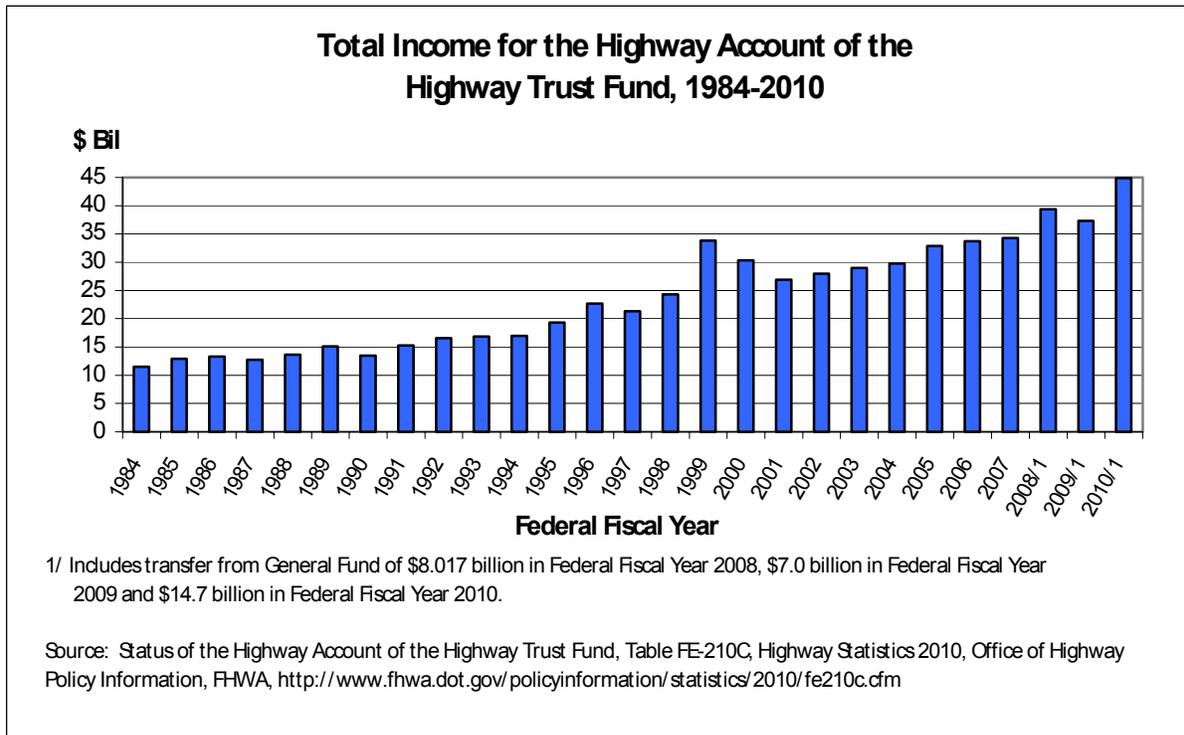
The Federal Highway Trust Fund ("HTF") provides the primary funding for the FAHP. Funded by a collection of federally-imposed motor vehicle user fees, primarily fuel taxes, the HTF is a fund established by federal law to hold dedicated highway-user revenues that are used for reimbursement of a state's cost of eligible transportation projects (which may include debt service on obligations issued to finance a federal-aid project), including highway projects. The HTF is composed of two accounts: the Highway Account, which funds highway and intermodal programs, and the Mass Transit Account. The Highway Account receives approximately 84% of gasoline tax revenues and 88% of diesel fuel revenues, with the remaining share of such revenues deposited in the Mass Transit Account.

The HTF was created by Congress in 1956 as a user-supported fund. The revenues of the HTF were intended for financing highways, with the taxes dedicated to the HTF paid by the users of the highways. This principle is still in effect, but the tax structure has changed since it was initially adopted in 1956. Major revisions occurred as a result of the Surface Transportation Assistance Act (STAA) of 1982 and the Deficit Reduction Act of 1984. These acts increased the motor-fuel taxes for the first time since 1959. The 1982 STAA also established a special Mass Transit Account in the HTF to receive part of the motor-fuel tax. During the time that SAFETEA-LU was being developed, a number of changes impacting the Highway Trust Fund were adopted in the American Jobs Creation Act of 2004, which replaced the reduced tax rates that applied to gasohol with a credit paid from the General Fund of the Treasury and ended the retention of a portion of the tax on gasohol by the General Fund. These actions, coupled with a number of provisions to reduce tax evasion, provided increased tax revenues to the Highway Trust Fund.

The imposition of the taxes that are dedicated to the HTF, as well as the authority to place the taxes in the HTF and to expend moneys from the HTF, all have expiration dates which must be extended periodically. The life of the HTF has been extended several times through multi-year authorizations since its inception, most recently by SAFETEA-LU (as described below). The passage of SAFETEA-LU extended the imposition of taxes and the transfer of the taxes to the HTF through September 30, 2011. Provisions for full or partial exemption from highway user taxes were also extended. Additionally, provision for deposit of almost all of the highway user taxes into the HTF was also extended through September 30, 2009. In addition, SAFETEA-LU authorized funding expenditures from the HTF through September 30, 2009. Subsequently, there have been ten (10) program extensions and fourteen (14) continuing resolution/appropriations acts to date related to SAFETEA-LU, which collectively have extended current funding and expenditures through June 30, 2012. Additional legislation is expected to be considered by Congress to either further extend SAFETEA-LU or to enact a new Federal Aid Authorization for the HTF. **No assurances can be made, however, that Congress will further extend SAFETEA-LU or will enact a new Federal Aid Authorization for the HTF which will provide Federal Aid Revenues to the Department sufficient to pay Debt Service on the Notes when due.**

Federal law not only regulates the imposition of the taxes for, but also their deposit into and expenditure from, the HTF. Federal gasoline excise taxes are the largest revenue source for the HTF. The majority of these tax revenues, including 15.44 cents per gallon out of the current 18.4 cents per gallon tax, go to the Highway Account.

The following table shows annual Total Income for the Highway Account for the Federal Fiscal Years 1984 through 2010, the latest available year.



Various proposals are being considered to address the HTF’s future funding. There can be no assurance that any such proposals will be enacted by Congress.

TEA-21

Until the enactment of SAFETEA-LU on August 10, 2005, the Transportation Equity Act for the 21st Century (“TEA-21”) was the previous multi-year authorization act for the FAHP, having been enacted into law on June 9, 1998. TEA-21 authorized nearly \$218 billion for highway, highway safety, transit, and other surface transportation programs over the six-year period from Federal Fiscal Years 1998 through 2003. This total reflected a 40 percent increase over the levels in the last major authorizing legislation, the Intermodal Surface Transportation Efficiency Act of 1991 (“ISTEA”). TEA-21 was scheduled to expire on September 30, 2003 but was the subject of multiple interim reauthorization extensions until the enactment of SAFETEA-LU. See “SAFETEA-LU” below.

The State received an average of \$432.8 million in obligation authority of Federal Aid Revenues per Federal Fiscal Year over the six year duration of TEA-21. This total compares to an average of \$235 million of Federal Aid Revenues received annually under ISTEA. See “FEDERAL AID REVENUES” herein.

A limitation on obligations and the process for distribution was included for each of the years in TEA-21. Through the limitation on obligations, Congress controlled the program and made it more responsive to prevailing budget and economic policy. The obligation ceilings set in TEA-21 for Federal Fiscal Years 1998 through 2003 were based on a protected level of spending for transportation (as discussed below).

A significant change in the FAHP introduced by TEA-21 was the attempt to maintain funding levels for transportation through reduced incentives to divert such funds to other uses (i.e. reductions in highway or transit spending as a result of federal deficit reduction legislation will not allow increased spending in other non-transportation programs) as further discussed below.

Protected Funding

New budget categories were established under TEA-21 for highway and transit discretionary spending, effectively establishing a budgetary “firewall” between each of those programs and all other domestic discretionary programs. Prior to TEA-21, the highway and transit discretionary programs competed for annual budgetary resources with other domestic programs. The new categories are still subject to budget constraints, but reductions in highway or transit spending will not allow increased spending in other non-transportation programs. This removes the principal incentive for Congress to limit highway or transit spending.

The highway firewall “protects” the obligation limitation for federal-aid highways, the motor carrier, and other highway safety programs that have contract authority. The firewall amount for highways is tied to the projected receipts of the Highway Account of the Highway Trust Fund and beginning with Federal Fiscal Year 2000 was adjusted each year during development of the President’s budget as new receipt projections and actual receipts became available. The adjustment of authorizations is called Revenue Aligned Budget Authority (“RABA”). RABA distributions to the states are formula driven and are somewhat unpredictable. For example, in Federal Fiscal Years 2003 through 2006 there were no RABA distributions, but in Federal Fiscal Year 2007, approximately \$842 million was distributed to the states, of which the State received approximately \$15.6 million. Since Federal Fiscal Year 2008 no RABA funds have been distributed and no future distributions are anticipated.

Highway Funding Equity-Minimum Funding

The minimum protected funding provision of TEA-21 was designed to ensure that each state have a minimum return on the tax contributions from that state into the Highway Account of the Highway Trust Fund. Under this provision, each state’s share of apportionments was at least 90.5 percent of its percentage share of contributions to the Highway Account, based on the latest data available at the time of apportionment under TEA-21.

SAFETEA-LU

The Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (“SAFETEA-LU”), passed the Congress and was signed into law by the President on August 10, 2005 and authorized a total of \$286.4 billion for the federal surface transportation programs in Federal Fiscal Years 2004 through 2009. This represented a 38% increase in authorization over TEA-21. The core federal-aid highway program was authorized to be funded at these levels: \$34.4 billion (FFY05), \$36 billion (FFY06), \$38.2 billion (FFY07), \$39.6 billion (FFY08) and \$41.2 billion (FFY09). Since the original expiration of SAFETEA-LU on September 30, 2009, Congress has passed multiple program extensions, continuing resolutions and appropriations acts which continue the funding for SAFETEA-LU at essentially the FFY09 level, through June 30, 2012.

SAFETEA-LU retained the firewall and equity bonus (formerly called the minimum guarantee) provisions of TEA-21, increasing each state’s minimum rate of return of HTF contributions from 90.5% in TEA-21 to 92% by 2008. All states were also guaranteed a total six-year average highway funding increase of at least 19 percent, when compared to the state’s six-year TEA-21 funding total. Arizona is a “donor” state and is expected to remain one for the foreseeable future and, as a result, has continued to receive funds under the minimum rate of return provisions.

As part of its annual budget forecast issued on January 24, 2007, the nonpartisan Congressional Budget Office (“CBO”) reported that if Congress adhered to the highway and safety spending levels authorized in SAFETEA-LU, absent other measures, the Highway Account of the Federal Highway Trust Fund would go into deficit early in Federal Fiscal Year 2009, before SAFETEA-LU expired. The CBO baseline projected that if the SAFETEA-LU spending levels were maintained for Federal Fiscal Years 2007-2009, there would be a deficit in the Highway Account at the end of Federal Fiscal Year 2009 in the amount of \$3.616 billion.

On September 5, 2008, the FHWA notified the states that, as a result of record high fuel prices and a slowing economy, receipts flowing into the Highway Account of the Highway Trust Fund had slowed considerably. As a result, the FHWA announced that, absent Congressional action, the cash balance in the Highway Account would probably be insufficient to fully pay all reimbursement requests from the states beginning the week of September 8, 2008.

In response to the projected shortfalls, Congress enacted two separate laws to maintain a positive balance in the HTF through the end of Federal Fiscal Year 2009 (September 30, 2009). The first, H.R. 6532, enacted on September 15, 2008, transferred \$8.017 billion from the General Fund to the Highway Trust Fund to cover the then-anticipated shortfall for Federal Fiscal Year 2009. These funds restored revenues that had been shifted from the Highway Trust Fund to the General Fund as a result of federal budget negotiations in 1998. The second, H.R. 3357, enacted on August 7, 2009 transferred an additional \$7 billion from the General Fund to the HTF to cover an additional shortfall through the remainder of Federal Fiscal Year 2009. For information regarding actions since September 30, 2009, see “Lapsing of Authorization” below.

Federal Aid Funding Procedures

The FAHP continues to enable the construction of an extensive national transportation system through reimbursement of a large percentage of state expenditures for approved highway projects. The financial assurance provided by the FAHP is unusual among federal programs in that:

- (a) the FAHP is funded by dedicated revenues, from a user-tax source, deposited in a special trust fund (the Highway Trust Fund);
- (b) the contract authority of the FHWA is established by a multi-year authorization act rather than through annual appropriation acts; and
- (c) contract authority is not at risk during the annual appropriations process (as budget authority is in most other federal programs), although an appropriations act is required in order to liquidate obligations.

The following summarizes the major steps in funding the FAHP.

Authorization

The first and most important step in funding the FAHP is the development and enactment of authorizing legislation. Authorizing legislation for highways began with the Federal-Aid Road Act of 1916 and the Federal Highway Act of 1921. These acts provided the foundation for the FAHP as it exists today. Since that time, the FAHP has been continued or renewed through the passage of multi-year authorization acts. Since 1978, Congress has passed highway legislation as part of larger, more comprehensive, multi-year (i.e. four or more years) surface transportation acts. There is no guarantee, however, that reauthorization of the FAHP will occur on a multi-year basis. The current reauthorization (SAFETEA-LU) was for the period ending September 30, 2009, but has been extended multiple times by Congress beyond its original expiration date, currently through June 30, 2012. Subsequent legislation is expected to be considered by Congress to either further extend SAFETEA-LU or to enact new Federal Aid Authorization for the FAHP. **No assurances can be made, however, that Congress will further extend the current SAFETEA-LU or will enact new authorization to fund the FAHP which will provide Federal Aid Revenues to the Department sufficient to pay Debt Service on the Notes when due.** The current practice of establishing a minimum return to each state of the taxes paid by highway users in that state began in 1982 with the passage of the Surface Transportation Assistance Act.

The federal authorization act not only shapes and defines programs, but also sets upper limits (authorizations) on the funding for programs and includes provisions related to the operation of the Highway Trust Fund. Once Congress has established authorizations, the next step involves how funds are made available to states. Typically, federal programs operate using appropriated budget authority which means that funds, although authorized, are not available until passage of an appropriations act. However, most programs within the FAHP do not require this two-step process. Through what is termed “contract authority” (a special type of budget authority), authorized amounts become available for obligation according to the provisions of the authorization act without further legislative action. For the FAHP, funds authorized for a Federal Fiscal Year are available for distribution through apportionments or allocations. The use of contract authority gives the states advance notice of the level of federal funding at the time an authorization act is enacted, eliminating much of the uncertainty associated with the authorization-appropriation sequence.

The existence of dedicated revenues in the HTF and of multi-year contract authorizations is designed to provide a predictable and uninterrupted flow of reimbursements to the states. The risk of contract authority lapsing between authorizing acts is minimal, since sufficient unobligated balances generally exist that can be used by the states, with the approval of Congress, to cover gaps in funding between multi-year reauthorization acts. See “SAFETEA-LU” above and “Lapsing of Authorization” below.

Apportionment and Allocations

For most components of the FAHP, the authorization act sets the distribution of contract authority to be apportioned and/or allocated to the states. The authorized amount for a given Federal Fiscal Year is distributed to the states through apportionments and allocations.

- (a) **Apportionments**. The distribution of funds using a formula provided in law is called an apportionment. Most federal-aid funds are distributed to states through apportionments. Each Federal Fiscal Year, the FHWA has responsibility for apportioning authorized funding for the various highway programs among the states according to formulas established in the authorizing statute. Apportionment factors include items such as lane miles, vehicle miles traveled, taxes paid into the HTF and diesel fuel usage. Each highway program has a unique set of factors that determine the apportionments to the states. Annual apportionments are generally made on the first day of the Federal Fiscal Year.
- (b) **Allocations**. Some categories do not have a legislatively mandated distribution formula. When there are no formulas in law, the distributions of funds are termed “allocations” which may be made at any time during the Federal Fiscal Year. In most cases, allocated funds are divided among states with qualifying projects applying general administrative criteria provided in the law.

Federal-aid highway apportionments are available to states for use for more than one year. Their availability does not terminate at the end of the Federal Fiscal Year, as is the case with most other federal programs. In general, apportionments are available for three years plus the year that they are apportioned. Consequently, when new apportionments are made, the amounts are added to a state’s carryover apportionments from the previous year. Should a state fail to obligate a year’s apportionments within the period of availability (usually a total of four years) specified for a given program, the funds will lapse.

Obligation

Obligation is the legal commitment (or promise) of the federal government to pay, through reimbursement to a state, the federal share of an approved project’s eligible costs, which may include debt service on obligations issued to finance a project. This process is important to the states because it allows states to award contracts with assurance that the federal government will reimburse its share of incurred costs. Once an obligation is made, the federal government is to reimburse the states when bills or payments become due. However, Congress places a restriction or “ceiling” on the amount of federal assistance that may be promised (obligated) during a specified time period. The obligation limitation is the amount of authorized funding that Congress allows states to obligate in an individual year. This is a statutory budgetary control that does not affect the apportionment or allocation of funds. Rather, it controls the rate at which these funds can be used.

Once Congress establishes an overall obligation limitation, the FHWA distributes Obligation Authority (“OA”) to states proportionately based on each state’s share of apportioned and allocated revenues. The actual ratio of OA to apportionment and allocations may vary from state to state, since some federal-aid programs are exempt from the obligation limitation. During the Federal Fiscal Year, states submit requests to the FHWA to obligate funds, representing the federal share of specific projects. As a state obligates funds, its balance of OA is reduced. A state’s OA (unlike its apportionments and allocations of authorized funding) must be used before the end of the Federal Fiscal Year for which it is made available; if not, it will be distributed to other states to ensure that the total limitation nationwide will be used. A state may receive additional OA through a redistribution process each year in August which reallocates OA from states or programs unable to fully obligate their share to other states that are able to obligate more than their initial share. The State typically uses all of its OA in each Federal Fiscal Year and historically also receives additional OA that has been redistributed by the FHWA.

Although a ceiling on obligations restricts how much funding may be used in a Federal Fiscal Year, the state has flexibility within the overall limitation to mix and match the type of program funds it obligates, based on its individual needs, as long as it does not exceed the ceiling in total. Also, the unobligated balance of apportionments or allocations that the state has remaining at the end of any Federal Fiscal Year is carried over for use by that state during the next Federal Fiscal Year.

Highway Program Implementation

In order to receive federal reimbursements for transportation projects, states are required to develop long-range transportation plans that are based on realistic projections of state and federal funding. Projects are not eligible for federal reimbursements unless they are either directly identified in a long-range plan or consistent with policies and objectives identified in long-range plans and are included in the three-year State Transportation Improvement Program (“STIP”) which lists all projects proposed for financing in that three-year period. The STIP requires FHWA approval.

States are required to follow federal fiscal management procedures as they implement projects that are included in the STIP. These fiscal management processes ensure that the process is managed efficiently from project authorization to actual payment of FHWA reimbursements to the state. Further, states are required to use a detailed accounting system to track project expenditures and reimbursements. In addition, a federal system tracks payments to states.

States may request FHWA approval for eligible projects either through the traditional process or through the advance construction procedure as discussed below:

(a) Traditional Approach. Under the traditional highway funding approach, a state obligates the full federal share of the funding for a construction project at the beginning of the project, concurrent with project authorization. The first step in the fiscal management process begins when a state requests authorization to use federal funds on a project. The project sponsor submits plans, specifications and estimates (“PS&Es”) for a project to the FHWA Division Office, and requests that the FHWA approve the use of federal funding for the appropriate federal share of the project. The project must be in the STIP and PS&Es must identify the category of federal funding that will be used.

The FHWA evaluates the PS&Es to ensure that the project is eligible for federal funding and meets a variety of federal requirements. Provided that all requirements are satisfied, the FHWA authorizes federal participation on the project, and obligates the federal share of project costs. By obligating the funds, the FHWA makes a commitment to reimburse the state for the federal share of eligible project costs. It sets aside the appropriate amount of the state’s OA, and also sets aside an equivalent amount of apportionments by program. Accordingly, the state must have sufficient OA to cover the level of federal participation it is requesting.

Once authorization for a project has been obtained, the state advertises the project and receives bids. The state awards the contract to the lowest responsive bidder and submits a request to the FHWA asking for any necessary adjustments to federal obligations to reflect the actual bid amount. If approved, the amounts agreed to are included in a project agreement which identifies the funds that will be encumbered by the state, and the amount that will be reimbursed by the federal government.

(b) Advance Construction Approach. In more recent years, the FHWA has implemented several new fiscal management techniques that provide states additional flexibility in managing their OA and cash flow. Advance construction (“AC”) and partial conversion of advance construction are two key techniques that facilitate federal-aid project funding.

The AC approach for authorizing projects allows states to finance projects that are eligible for federal aid without obligating the full federal share of costs at the beginning of the project. This allows states to begin a project before accumulating all of the apportionments and OA needed to cover the federal share of the project. Similar to the traditional approach, the state submits PS&Es to the FHWA and requests project authorization. Under AC, however, the FHWA is asked to authorize the project without obligating federal funds. The state will provide the up-front financing for the project and then at a later date “convert” the advance construction project to a regular

federal-aid project and obligate the full federal share of the project costs, when sufficient OA is available. At the time of conversion, the state can be reimbursed for the federal share of costs incurred up to the point of conversion.

Partial conversion of AC is a form of advance construction in which the state converts, obligates, and receives reimbursement for only a portion of its funding of an AC project in a given year. This removes any requirement to wait until the full amount of OA for the project is available. The state can therefore obligate varying amounts for the project's eligible cost in each year, depending on how much of the state's OA is available. Using the technique to partially convert the federal share makes bond and note financing more viable and federal-aid funds available to support a greater number of projects. The National Highway System Act of 1995 provided additional flexibility in the use of advance construction by allowing partial conversion of advance construction as implemented through a Federal Register Notice dated July 19, 1995.

Reimbursement

The FAHP is a reimbursement program. As work progresses on a federal-aid highway project, a state will pay the contractor for completed work from available state funds. The state electronically transmits vouchers for the federal share of completed work and certifies to the FHWA that the claims for payment are in accordance with the terms of the project agreements, and applicable state and federal laws or regulations. After review and approval by the FHWA Division office, payment is scheduled for the date requested by the state. Payment is transferred directly from a Federal Reserve Bank to the state's financial institution account by wire transfer, and is generally scheduled to be made within two days of the submission of the state's electronic bill.

Lapsing of Authorization

All federal programs must be authorized through legislation enacted by Congress that defines the programs and establishes maximum funding levels, and for most programs annual appropriations acts are necessary in order to create budget authority. For most federal domestic discretionary programs, a lapsed authorization may have little or no effect on a program, so long as revenues are appropriated. For the FAHP, the consequences of lapsed authorization caused when Congress fails to enact reauthorization legislation are somewhat different. While Congress may pass interim legislation, the existence of contract authority and a dedicated revenue stream means that the FHWA usually has been able to continue to provide OA by administrative action.

Though recent federal surface transportation legislation has been authorized for four to six years at a time, there occasionally have been periods, including now, in which the previous authorizing legislation had expired and future multi-year legislation had yet to be enacted. In such circumstances, Congress and/or the FHWA have historically found ways to avoid disruptions to state highway programs and have been able to maintain the flow of federal revenues to states in each instance. Three mechanisms in particular have been used in more recent periods to keep revenues flowing:

- **Access to Unobligated Balances:** The 1987 Surface Transportation and Uniform Relocation Assistance Act expired on September 30, 1991 and ISTEA was not enacted until December 18, 1991. The FHWA was able to act administratively to keep federal-aid funding flowing by allowing states to use their unobligated balances to provide contract authority to use new OA.
- **Short-Term Authorization:** ISTEA expired on September 30, 1997 and until approval of TEA-21 on June 9, 1998, no new long-term authorization legislation was enacted. Despite the lack of long-term authorizing legislation, states were provided an upper limit on OA through passage of an appropriations act plus access to their unobligated balances. On November 13, 1997 Congress passed the Surface Transportation Extension Act of 1997 ("STEA"), which provided a six-month authorization for highway funding and established a limit on the amount of new OA states could use at funding levels equal to about a quarter of FFY 1997 authorization levels. Since most states have unobligated balances of at least half their normal annual OA levels and an authorization act need not be in place for the FHWA to give states new OA, states were able to spend down prior unfunded federal apportionments (contract authority) with newly allocated OA. The lack of an enacted authorization act during this period did not pose a threat to the continued flow of revenues, because dedicated highway user fees continued to flow into the HTF. Similarly, TEA-21 expired on September 30, 2003 and Congress enacted twelve interim authorization

measures for varying periods over twenty-two months until the enactment of SAFETEA-LU on August 10, 2005.

- **General Fund Transfers:** In response to a projected shortfall in the HTF for FFY 2010, Congress approved a transfer from the General Fund to the HTF in the amount of \$14.7 billion. This funding was in addition to two previous General Fund transfers of approximately \$8.0 billion in FFY 2008 and \$7.0 billion in FFY 2009.

On September 30, 2009, SAFETEA-LU expired without enactment of a new multi-year reauthorization program. In order to avoid a halt in the Federal Aid Highway Program, Congress has enacted ten (10) program extensions and fourteen (14) continuing resolution/appropriations acts to date, as shown in the tables below, to extend SAFETEA-LU through June 30, 2012.

SAFETEA-LU Program Extension Acts*	
Public Law	Program Extended Through
111-68	10/31/09
111-88	12/18/09
111-118	2/28/10
111-144	3/28/10
111-147	9/30/10
111-147	12/31/10
111-322	3/4/11
112-5	9/30/11
112-30	3/31/12
112-102	6/30/12

* Extension acts provide contract authority and extend the expiration of the various programs within SAFETEA-LU. Budget or obligation authority is also required to utilize Federal Aid Highway Program funding, and has been provided under several continuing resolutions and/or appropriation acts - see table to right.

SAFETEA-LU Continuing Resolutions and Appropriations Acts**	
Public Law	Budget Authorized Through
111-68	10/31/09
111-88	12/18/09
111-117	9/30/10
111-242	12/3/10
111-290	12/18/10
111-317	12/21/10
111-322	3/4/11
112-4	3/18/11
112-6	4/8/11
112-8	4/15/11
112-10	9/30/11
112-33	10/4/11
112-36	11/18/11
112-55	9/30/12

** Continuing resolutions/appropriations acts provide obligation authority. Contract authority is also required to utilize Federal Aid Highway Program funding, and has been provided under several acts extending the programs in SAFETEA-LU - see table to left.

Subsequent legislation is expected to be considered by Congress to either further extend SAFETEA-LU or to enact new Federal Aid Authorization to fund the Federal Aid Highway Program. **No assurances can be made, however, that Congress will further extend SAFETEA-LU or will enact new authorization to fund the FAHP which will provide Federal Aid Revenues to the Department sufficient to pay Debt Service on the Notes when due.** If SAFETEA-LU or a new authorization program is not authorized at sufficient funding and spending levels to address the shortfalls in fuel taxes collected and the decline in vehicle miles traveled in the United States in recent years, the Federal Highway Trust Fund could continue to experience deficits.

ALTHOUGH THESE MEASURES HAVE BEEN ENACTED BY CONGRESS AND/OR THE FHWA IN THE PAST, NO ASSURANCE CAN BE GIVEN THAT SUCH MEASURE WILL BE ENACTED IN THE FUTURE TO MAINTAIN THE FLOW OF FEDERAL-AID FUNDING UPON EXPIRATION OF SAFETEA-LU OR TERMINATION OF A SUBSEQUENT AUTHORIZATION PERIOD.

Special Federal Provisions Relating to Debt-Financed Projects

The National Highway System Act (“NHS”) of 1995 made several changes affecting the financing of federal-aid highway projects, including AC procedures, as previously discussed, and payments to states for debt financing.

Section 311 of the NHS Act significantly expanded the eligibility of bond, notes and other debt instrument financing costs for federal-aid reimbursement. This change to the FAHP was codified into permanent highway law as an amendment to Section 122 of Title 23 of the United States Code. Under section 122, various debt-related costs are eligible for reimbursement, including principal and interest payments, issuance costs, insurance, and other costs incidental to a financing.

The FHWA has issued guidelines for debt-financed projects. Key provisions of these guidelines are as follows:

- The project must be approved as a federal-aid, debt-financed (bond, certificate, note or other debt instrument) project in order to receive payments for eligible debt-related costs under Section 122. Once a project is selected for debt financing, the project is submitted to the appropriate FHWA Division Office for approval as an AC project under section 115 of Title 23. The AC designation ensures that the project follows federal-aid procedures and preserves the eligibility to reimburse debt-related costs through future federal-aid fund obligations.
- Debt-financed projects are subject to requirements of the Federal Clean Air Act and federal air quality conformity requirements, discussed below under “Regional Planning and Air Conformity.”
- At the time the project agreement is signed, a state may elect to seek reimbursement for debt service and/or related issuance costs in lieu of reimbursement for construction costs. If a state elects to receive debt service reimbursements, a debt service schedule will be included in the project agreement. If multiple projects are funded with the proceeds of a debt issue, each project will be assigned a prorated share of the debt-related costs.
- To comply with the intent of the fiscally constrained planning process, the federal share of the debt-related costs (e.g., interest and principal payments, associated issuance costs, and on-going debt servicing expenses) anticipated to be reimbursed with federal-aid funds over the life of the debt obligations should be designated as AC. The planned amount of federal-aid reimbursements (AC conversion) should be included in the STIP, in accordance with FHWA procedures.
- Periodic debt service payments (federal-aid reimbursements) on the debt obligations would represent partial conversions of designated AC amounts to federal aid. A state can obligate such federal aid annually over the life of the permanent financing or a state can make the conversion in one lump sum upon project completion to help take out construction financing. A state would follow the normal procedures for conversion of an advance construction project.
- A state may seek federal-aid reimbursements for eligible debt-related costs as these costs are incurred. Issuance costs, debt service payments, and incidental costs represent costs incurred that may be reimbursed with federal-aid funds to the extent such costs are deemed eligible.
- A state may make arrangements with the FHWA Division Office regarding the procedures under which it would submit a billing to the FHWA for debt-related costs. A request for debt service payment is timed so that reimbursements will be received shortly before the debt service payment date.
- A state may designate a trustee or other depository to receive federal-aid debt service payments directly from the FHWA.

Regional Planning and Air Quality Conformity

For the Department to receive Grant Revenues under its Series 2003A, 2004B, 2008A, 2009A and 2011A Grant Agreements with the FHWA relating to projects in Maricopa County, Arizona, Title 23 requires that the Series 2003A, 2004B, 2008A, 2009A and 2011A Projects have been included in the approved Transportation Improvement Program (“TIP”) for Maricopa County in effect at the time of execution of such Grant Agreements. The designated metropolitan planning organization (“MPO”) has the responsibility to develop and approve the TIP. The Maricopa Association of Governments (“MAG”) is the designated MPO for the Phoenix metropolitan area.

Title 23 requires the TIP to be based on a continuing and comprehensive transportation planning process carried out by MAG in cooperation with the Department and transit operators. MAG has included the Series 2003A, 2004B, 2008A, 2009A and 2011A Projects in its appropriate TIP. Portions of the Series 2011A Project are not required by Federal law to be included in the TIP for Maricopa County because they are located outside of Maricopa County. The Federal Clean Air Act prohibits MAG from approving any transportation project, program, or plan unless it is found to be in conformance with all applicable air quality plans. Federal law specifies the criteria for an air quality conformity determination and these include that the TIP and Regional Transportation Plan (“RTP”) developed by MAG pass air conformity tests for emissions. The final determination of air quality conformity for the TIP and RTP is the responsibility of the FHWA and Federal Transit Administration. Federal regulations require that a new TIP and RTP be updated at least every four years by the MPO.

The latest update of the TIP and RTP occurred in 2010. On August 25, 2010, the FHWA and Federal Transit Administration jointly issued a Finding of Conformity for MAG’s current TIP and RTP, the FY 2011-2015 MAG Transportation Improvement Program and Regional Transportation Plan 2010 Update, respectively. In addition, the FHWA and FTA made a new Finding of Conformity for the TIP and RTP, as amended, on March 15, 2012.

MAG conducts air quality conformity analyses on the TIP and RTP since portions of Maricopa County are designated as nonattainment or maintenance for carbon monoxide, eight-hour ozone, and particulate matter (PM-10). A summary of the air quality status of the Maricopa County Nonattainment Area is provided below. For carbon monoxide, the U. S. Environmental Protection Agency (“EPA”) approved the MAG Carbon Monoxide Maintenance Plan which indicates that the standard will be maintained through 2015 and redesignated the Maricopa County Nonattainment Area as having met the air quality standard for carbon monoxide, effective April 8, 2005. There have been no violations of the carbon monoxide standard since 1996. It is anticipated that a Carbon Monoxide Maintenance Plan revision demonstrating continued attainment of the standard through December 2025 will be submitted to EPA by April 8, 2013.

For ozone, the EPA designated the area nonattainment for the 1997 eight-hour ozone standard, effective June 15, 2004. The area was classified as a Basic nonattainment area with a June 15, 2009 attainment date. In accordance with Federal Clean Air Act requirements, the MAG 2007 Eight-Hour Ozone Plan for the Maricopa Nonattainment Area was submitted to EPA by June 15, 2007. The MAG Eight-Hour Ozone Plan demonstrated that the air quality standard would be met by June 15, 2009. No violations of the eight-hour ozone standard have occurred since 2004. In February 2009, the MAG 2009 Eight-Hour Ozone Redesignation Request and Maintenance Plan for the Maricopa Nonattainment Area (the “Maintenance Plan”) for the .08 parts per million standard were submitted to EPA. The Maintenance Plan demonstrates continued attainment of the eight-hour ozone standard through the year 2025. There have been no violations of the 1997 eight-hour ozone standard at any monitor since 2004. The EPA has strengthened the ozone standard over time. On March 12, 2008, EPA revised the eight-hour ozone standard to 0.075 parts per million. On April 11, 2012, the EPA published a proposed rule to approve the MAG 2007 Eight-Hour Ozone Plan for the Maricopa Nonattainment Area. EPA has stated it expects to finalize designations of the 2008 ozone standard by May 31, 2012.

For particulate matter, the Maricopa County Nonattainment Area is classified as a Serious Area for PM-10. As required by Clean Air Act Section 189 (d), the MAG 2007 Five Percent Plan for PM-10 was submitted to the EPA by the December 31, 2007 deadline. On December 2, 2009, the Arizona Center for Law in the Public Interest filed a lawsuit against EPA for failure to take action on the Five Percent Plan by June 30, 2009, in accordance with the Clean Air Act. On July 2, 2010, EPA published a proposed consent decree in the Federal Register, which indicated that EPA would propose action on the MAG Five Percent Plan for PM-10 by September 3, 2010, and

finalize the action by January 28, 2011. On September 9, 2010, EPA published a proposed rule to approve in part and disapprove in part the Five Percent Plan for PM-10 for the Maricopa County nonattainment area.

On January 25, 2011, the Arizona Department of Environmental Quality voluntarily withdrew the MAG 2007 Five Percent Plan for PM-10 to include new information. On February 14, 2011, EPA took final action to find that Arizona failed to make a State Implementation Plan submittal required under the Clean Air Act and this action triggered the sanctions clocks, described below. If a complete plan is not submitted by August 14, 2012, the first sanction for tighter controls on major industries would be imposed. If a complete plan is still not submitted by February 14, 2013, the second sanction involving the loss of federal highway funds would be imposed. It is important to note that highway funding sanctions would involve the loss of federal highway funds (\$1.7 billion) and a federal implementation plan would be imposed. Upon imposition of highway funding sanctions, conformity would also lapse, which would place the \$7.4 billion TIP at risk.

On March 12, 2012, the Draft MAG 2012 Five Percent Plan for PM-10 for the Maricopa Nonattainment Area was made available for a 30-day public review and comment period. It is anticipated that the MAG Regional Council may take action on the Draft MAG 2012 Five Percent Plan on May 23, 2012. Following MAG Regional Council action, the MAG 2012 Five Percent Plan would be submitted to EPA.

If EPA finds that Arizona has made a complete plan submittal by August 14, 2012 addressing the 189 (d) requirements, the eighteen month sanction clock for tighter controls on major industries and the twenty-four month highway sanction clock would stop. The EPA approval of the plan by February 14, 2013 would stop the federal implementation plan from being imposed.

According to Federal regulations, conformity on a TIP and RTP will lapse if: (1) more than four years pass after conformity determination without MAG determining conformity of a new TIP and RTP, or (2) EPA imposes sanctions upon highway funding based on failure to remedy a finding by EPA that the State failed to submit an air quality implementation plan, or the EPA issues an incompleteness determination of a plan revision or disapproves any plan. During a conformity lapse in Maricopa County, the following restrictions would apply in Maricopa County: (1) most highway projects in the TIP could not proceed to construction; (2) reimbursement from Federal Aid Revenues for expenditures on most highway projects would stop; and (3) expenditure of non-Federal funds on most highway projects would be prohibited. Certain types of projects may proceed during a conformity lapse including projects that have received funding commitments from the FHWA for construction prior to the lapse.

FHWA guidance issued on March 25, 2004 specifically provides that a conformity lapse which occurs subsequent to a funding commitment and issuance of grant anticipation notes does not alter eligibility of the Department to receive Grant Revenues under such commitments. The FHWA has advised the Department that the Series 2003A, 2004B, 2008A, 2009A and 2011A Grant Agreements constitute such funding commitments for the Series 2003A, 2004B, 2008A, 2009A and 2011A Projects. Because the Department has received these funding commitments, the Department anticipates that, even if there were a determination of nonconformity for Maricopa County, the Notes would not be negatively impacted.

As noted above, upon a determination of nonconformity or a lapse of air conformity in Maricopa County, with certain exceptions (including the Department previously obtaining a funding commitment from the FHWA for construction of a specific highway project, as is the case for the Series 2003A, 2004B, 2008A, 2009A and 2011A Projects), Federal and non-Federal monies cannot be spent for construction on highway projects within Maricopa County. A determination of nonconformity or lapse of conformity could limit the receipt of Federal Aid Revenues by the Department on projects in Maricopa County other than the Series 2003A, 2004B, 2008A, 2009A and 2011A Projects. However, the Department does not believe any conformity lapse, nor any future EPA sanctions, would adversely affect the ability of the Board to pay Debt Service on the Notes when due because, consistent with historical experience, the Department estimates that over 63% of its future Federal Aid Revenues will be derived from highway projects located outside of Maricopa County. The Department believes there is no significant risk of limitations upon the Department's receipt of Federal Aid Revenues from projects in other areas of the State because of a determination of nonconformity or a lapse of air quality conformity in those other areas.

FEDERAL AID REVENUES

The following tables identify actual and estimated Apportionments, Obligation Authority and Receipts of Federal Aid Revenues by the Department from Federal Fiscal Year 1998 through the Federal Fiscal Year ending September 30, 2012.

FEDERAL AID REVENUES APPORTIONMENTS, OBLIGATION AUTHORITY AND RECEIPTS FOR THE ARIZONA DEPARTMENT OF TRANSPORTATION FEDERAL AID AUTHORIZATION PERIOD (Transportation Equity Act for the 21st Century) Federal Fiscal Years 1998 Through 2003

Federal Fiscal Year	Apportionments	Obligation Authority	Actual Receipts
1998	\$ 352,565,695	\$ 318,639,756	\$ 259,394,779
1999	433,407,164	384,609,615	432,737,810
2000	475,048,758	418,113,461	412,173,350
2001	521,578,989	466,560,234	459,056,486
2002	546,097,028	514,412,037	459,409,075
2003	468,201,715	494,189,012	460,654,075
Totals	<u>\$2,796,899,349</u>	<u>\$2,596,524,115</u>	<u>\$2,483,425,575</u>

FEDERAL AID REVENUES APPORTIONMENTS, OBLIGATION AUTHORITY AND RECEIPTS FOR THE ARIZONA DEPARTMENT OF TRANSPORTATION FEDERAL AID AUTHORIZATION PERIOD (Surface Transportation Extension Act of 2004, Part V) Federal Fiscal Year 2004

Federal Fiscal Year	Apportionments	Obligation Authority	Actual Receipts
2004	\$535,913,033	\$524,702,519	\$416,954,003

**FEDERAL AID REVENUES
 APPORTIONMENTS, OBLIGATION AUTHORITY AND RECEIPTS
 FOR THE ARIZONA DEPARTMENT OF TRANSPORTATION
 FEDERAL AID AUTHORIZATION PERIOD
 (Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users)
 Federal Fiscal Years 2005 Through 2009**

Federal Fiscal Year	Apportionments	Obligation Authority	Actual Receipts
2005	\$ 600,156,301	\$ 587,105,795	\$ 472,988,762
2006	647,507,598	601,928,889	408,438,371
2007	696,659,693	668,847,370	410,390,890
2008	714,764,393	705,031,817	579,336,692
2009 (a)	734,702,687	690,763,728	556,443,510
Totals	\$3,393,790,672	\$3,253,677,599	\$2,427,598,225

(a) Does not include rescissions of unobligated balances of apportionments enacted in 2009.

**FEDERAL AID REVENUES
 APPORTIONMENTS, OBLIGATION AUTHORITY AND RECEIPTS
 FOR THE ARIZONA DEPARTMENT OF TRANSPORTATION
 FEDERAL AID AUTHORIZATION PERIOD
 (Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users)
 Under Extensions Enacted For Federal Fiscal Years 2010 through 2012 (a)**

Federal Fiscal Year	Apportionments	Obligation Authority	Actual Receipts
2010	\$749,060,035	\$706,891,731	\$509,909,143
2011	759,261,430	712,957,546	727,004,396
2012 (b)	708,704,000	656,395,000	745,791,000

- (a) Does not include rescissions of unobligated balances of apportionments enacted in 2010 and 2011, or restoration of the FFY 2009 rescissions that occurred in FFY 2010.
- (b) The amount shown for federal fiscal year 2012 is estimated by the Department. **The information presented constitutes “forward looking statements” which must be read with an abundance of caution and may not be realized or may not occur in the future.**

Source: Arizona Department of Transportation.

On February 17, 2009, President Barack Obama signed the \$787 billion American Recovery and Reinvestment Act (“ARRA”) of 2009 (Public Law Number 111-5). The law appropriated approximately \$26.66 billion to the states for highway infrastructure investment. The State was apportioned \$521,958,401 of ARRA funds for investment in state and local highway projects. The apportionments require no state match, and come with 100% obligation authority. These apportionments and obligation authority under ARRA are in addition to the apportionment and obligation authority amounts shown in the table above.

DEBT SERVICE REQUIREMENTS ^(a)

The Debt Service requirements on the Outstanding Series 2003A, 2004B, 2008A, 2009A and 2011A Notes, together with the Debt Service requirements on the Series 2012 Notes, are set forth below:

Fiscal Year Ended June 30	Series 2003A, 2004B, 2008A, 2009A and 2011A Notes Debt Service Requirements (b)	The Series 2012 Notes		Total Notes Debt Service Requirements
		Principal	Interest (c)	
2012	\$55,437,756			\$55,437,756
2013	53,352,906		\$1,902,649	55,255,556
2014	60,914,531	\$120,000	1,751,800	62,786,331
2015	31,526,531	31,620,000	1,748,200	64,894,731
2016	44,334,231	12,085,000	483,400	56,902,631
2017	19,162,881			19,162,881
2018	19,163,031			19,163,031
2019	19,165,081			19,165,081
2020	19,166,831			19,166,831
2021	19,162,181			19,162,181
2022	19,164,131			19,164,131
2023	19,163,731			19,163,731
2024	19,163,138			19,163,138
2025	19,165,038			19,165,038
2026	19,166,025			19,166,025

- (a) Figures may not total due to rounding.
- (b) Excludes debt service on the Notes Being Refunded.
- (c) First interest payment date is January 1, 2013.

Pursuant to the Note Resolution, the Board may issue Additional Notes subject to meeting certain ratios of historical Federal Aid Revenue to Annual Debt Service, or for refunding purposes to decrease Debt Service without regard to those ratios. For additional information concerning these conditions, see "SECURITY AND SOURCES OF PAYMENT FOR THE NOTES – Additional Notes."

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MANAGEMENT OF STATE HIGHWAY PROGRAM

Arizona Transportation Board

The Board consists of seven members, with two members appointed from Transportation District 1 (Maricopa County) and one member from each of the other five transportation districts within the State. Each member of the Board is appointed by the Governor of the State, subject to confirmation by the State Senate, for a term of six years expiring on a staggered basis on the third Monday in January. The Board is responsible, among other duties, for: (i) issuing bonds for State highway purposes; (ii) establishing a complete system of State highway routes; (iii) determining which State highway routes or portions thereof will be accepted into the State highway system, and which will be improved; (iv) establishing, opening, relocating, altering, vacating, or abandoning any portion of a State route or State highway; (v) determining priority program planning with respect to highway transportation facilities and monitoring the status of such programs; and (vi) distributing money appropriated from the State Aviation Fund for planning, design, development, acquisition of interests in land, and construction and improvement of publicly owned and operated airport facilities in the counties, cities and towns of the State.

The following sets forth information with respect to each member of the Board:

<u>Name and Transportation District Represented</u>	<u>City of Residence</u>	<u>Term Expires January</u>
Barbara Ann Lundstrom, Chair Transportation District 3 Cochise, Greenlee and Santa Cruz Counties	Nogales	2013
Victor Flores, Vice Chair Transportation District 1 Maricopa County	Phoenix	2014
William J. Feldmeier, Member Transportation District 6 Yavapai, Yuma, Mohave and La Paz Counties	Prescott	2012
Stephen W. Christy, Member Transportation District 2 Pima County	Tucson	2015
Kelly O. Anderson, Member Transportation District 4 Gila, Graham and Pinal Counties	Maricopa	2016
Hank Rogers, Member Transportation District 5 Apache, Coconino and Navajo Counties	Eagar	2017
Joseph E. La Rue, Member Transportation District 1 Maricopa County	Sun City	2018

Arizona Department of Transportation

General.

The Department was established by the State Legislature in July 1974 by combining the former Arizona Highway Department (originally established in 1927) and the State Department of Aeronautics (originally established

in 1952). The Department's mission is to provide a safe, efficient, and cost-effective transportation system for the State.

Responsibilities and Organization.

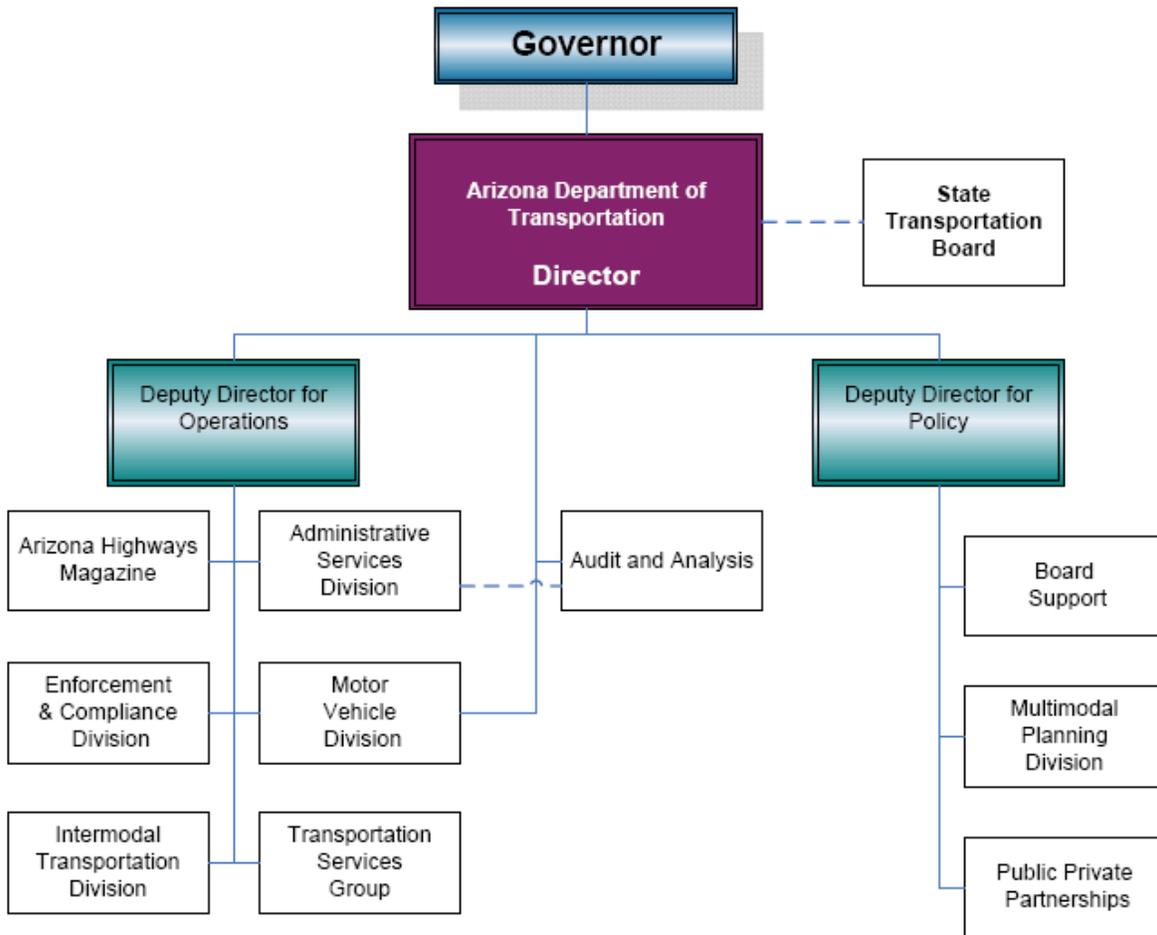
The Department administers the State highway system. The Department's responsibilities also include: (i) registration of motor vehicles and aircraft; (ii) transportation planning, coordination of transportation planning with local governments and annual development of a priority program of capital improvements for both highway and aviation transportation modes; (iii) design and construction of transportation facilities in accordance with a priority plan; (iv) maintenance and operation of the State highway system; and (v) research and evaluation of new transportation systems and cooperative efforts with and advice to local governments concerning the development and operation of public transit systems.

The Department's operating budget and capital outlay budget for buildings are reviewed by the Governor's office and funds for these purposes are appropriated by the State Legislature. The Department's capital outlay budget for the acquisition of land and the development, construction, and improvement of the State highway system is approved by the Board. The recommended budgeting of funds for the Maricopa County Regional Transportation Plan Freeway Program is determined by the Department taking into consideration the priorities recommended by the Maricopa Association of Governments. The funds are allocated by the Board as part of the statewide Five-Year Capital Program.

The Director of the Department serves as the Chief Executive Officer of the Department. The Director is appointed by the Governor and confirmed by the Senate, and is directly responsible to the Governor. The Department has organized itself into five divisions: Intermodal Transportation Division, Motor Vehicle Division, Enforcement and Compliance Division, Multimodal Planning Division, and Administrative Services Division. The Department also includes certain other operational and business units. The Transportation Services Group under the direction of the Deputy Director for Operations contains units for Financial Management, Budget and Strategic Planning, Human Resources, Civil Rights, Information Technology, and Training. The Transportation Services Group supports the Department's operating and planning divisions.

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The Department's table of organization and a brief description of each of the divisions is set forth below:



Intermodal Transportation Division. The Intermodal Transportation Division is the largest of the five divisions of the Department. The Intermodal Transportation Division is responsible for the management and maintenance of the existing State highway system and related facilities as well as the location, design, and construction of new highways and facilities that are a part of the State highway system.

Motor Vehicle Division. The Motor Vehicle Division regulates motor vehicles and drivers in the State through registration and licensing. The Motor Vehicle Division also collects various fees and taxes including: motor vehicle registration, motor carrier, motor vehicle operators' license and non-operating identification cards, aircraft registration, and miscellaneous fees and revenues. The Motor Vehicle Division annually processes millions of motor vehicle registrations and records, issues certificates of title for motor vehicles, and processes drivers' license applications while maintaining oversight of over 50 offices and more than 150 authorized third parties.

Multimodal Planning Division. The Multimodal Planning Division is responsible for the planning of the statewide transportation system including highways, transit, rail, and airports. Its functions include traffic and travel studies and projections, five-year construction programming studies, and coordination with local and regional transportation planning agencies. The Multimodal Planning Division produces an annually updated Five-Year Capital Program, from which the Board establishes the priorities for highway and airport projects within the State. The Multimodal Planning Division also distributes federal funding for planning, operational, and capital acquisitions for transit programs in smaller cities, towns, and rural areas, administers federal grants for transit planning in metropolitan areas, and performs state regulatory safety oversight for the light rail system in Maricopa County. The

Multimodal Planning Division also coordinates general aviation in the State and is responsible for administering the Local Airports Grant Program.

Enforcement and Compliance Division. The Enforcement and Compliance Division (ECD) is comprised of the Enforcement Services Section, Executive Hearing Office, and the Office of the Inspector General. The programs of ECD include responsibility for the State's 23 ports of entry, commercial vehicle weight enforcement, fuel tax enforcement, collection of various fees, registration compliance, various administrative hearings, criminal investigations involving license and title fraud, and internal affairs.

Administrative Services Division. The Administrative Services Division provides Department-wide support functions including Audit and Analysis, Equipment Services, Facilities Management, The Grand Canyon Airport, Procurement, Office of Environmental Services, and Safety and Health.

Staff of the Department.

Information concerning the primary administrative personnel of the Department is set forth below:

JOHN HALIKOWSKI

Director

Mr. Halikowski was appointed Director of the Department in February 2009 to lead Arizona's transportation agency responsible for planning, building, and operating a multi-modal system in one of the historically fastest growing areas of the country; collecting and distributing transportation revenue; and providing title, registration, and driver license services. Prior to his appointment he served for twelve years as the Director of Research at the Arizona House of Representatives where he was responsible for drafting, presenting, researching, and working with affected constituencies on transportation related legislation. He was deeply involved in major legislation that included the Maricopa County Transportation plan, State Highway Construction Acceleration, Privatization, DUI, Transportation Finance, and Graduated Driver Licensing. He also previously spent six years at the Department serving in various capacities including Deputy Director and Operations Chief of the Department's Motor Vehicle Division. Mr. Halikowski has completed the American Association of State Highway Transportation Officials (AASHTO) Leadership Academy. In addition, he presently chairs the AASHTO Standing Committee on Research and is a member of the AASHTO Climate Change Steering Committee.

Mr. Halikowski received his Bachelor of Arts Degree in Communications and graduated summa cum laude, from Arizona State University. He has also completed the Wharton Transportation Executive Program.

JOHN BOGERT

Deputy Director for Operations

Mr. Bogert was appointed Deputy Director for Operations in September 2011. Prior to this appointment, he was the Department's Chief of Operations since 2009 and Chief of Staff of the Department since 2000. Mr. Bogert originally joined the Department in 1989 as chief auditor. Prior to joining the Department, Mr. Bogert was vice president of internal audit for Del Webb Corporation. His prior experience includes nine years with national and local public accounting firms and three years of teaching at Arizona State University and Fort Lewis College.

As Deputy Director for Operations, Mr. Bogert oversees the day-to-day operations of the Department. He is responsible for establishing administrative and program policy in support of the Department's strategic plan.

Mr. Bogert obtained a Bachelor of Business Administration degree in Accounting from Eastern New Mexico University and a Master's degree in Accounting from Arizona State University, and is a Certified Public Accountant.

FLOYD ROEHRICH, JR.

Deputy Director for Policy

Mr. Roehrich was appointed Deputy Director for Policy in September 2011. In his position as Deputy Director for Policy, Mr. Roehrich is responsible for all transportation planning and assists with public/private partnership activities within the Department. He also serves as the primary liaison to the Board and assists the Director on various policy matters. He was previously the State Engineer of the Department since August 2008. Mr. Roehrich has been with the Department since 1989, with the exception of a two year period where he worked for a private engineering consulting firm in the Phoenix area. Previously, Mr. Roehrich served as Deputy State Engineer, Valley Transportation Program overseeing the urban highway system within Maricopa County. Since starting as a roadway design team leader in 1989, Mr. Roehrich has held technical and management positions in various Department groups, to include Roadway Design, Local Government Engineer, Phoenix Construction District, and Valley Project Management.

Mr. Roehrich is an Arizona registered professional civil engineer and holds a Bachelor of Science (Civil Engineering) degree from North Dakota State University. Mr. Roehrich retired in 2004 with the rank of Colonel from the Army National Guard.

KRISTINE WARD

Assistant Director for Finance and Accounting

Ms. Ward was appointed Assistant Director for Finance and Accounting in December 2011. As such, Ms. Ward is the Department's chief financial officer and is responsible for all financial, accounting, and revenue and fuel tax administration within the Department. Prior to joining the Department, Ms. Ward served as the Deputy Director of the Department of Revenue from 2005-2011, and was responsible for the Department's fiscal and tax processing operations. Before the Department of Revenue, Ms. Ward served three Governors in the Office of Strategic Planning and Budgeting in various roles including Director and Deputy Director.

Ms. Ward holds a Bachelor of Science degree in Business with a concentration in finance from Bowie State University and a Master's degree in Public Administration from Arizona State University.

LISA DANKA

Deputy Chief Financial Officer

Ms. Danka joined the Department in November 2009, and is responsible for overseeing the State's federal-aid highway funding program, cash management, and tracking the Board's Five Year Construction Program budget. Prior to joining the Department, Ms. Danka was the Assistant Deputy Director for Finance and Investment at the Arizona Department of Commerce. In this capacity, she oversaw eight business tax credit, grant and loan programs, the State's private activity bond program, and served as the Executive Director of the Greater Arizona Development Authority.

Ms. Danka holds a Bachelor of Arts degree in Political Science from Western Illinois University and a Master's degree in Business Administration from Bradley University. Ms. Danka has also completed the Wharton Transportation Executive Program.

JENNIFER TOTH, P.E.

State Engineer

Ms. Toth was appointed State Engineer in the Intermodal Transportation Division in September 2011. She was previously the Director of the Multimodal Planning Division since July 2009. Ms. Toth has been with the Department since 1997, with the exception of a three-year period where she worked as an Associate Vice-President for a private engineering consulting firm in the Phoenix Area. In her position as State Engineer, Ms. Toth is responsible for overseeing the pre-construction, construction, and maintenance of more than 6,700 miles of highways and 4,000 bridges across the state. Since starting with the Department, Ms. Toth has held various technical and management positions in various departments throughout the Department.

Ms. Toth obtained a Bachelor of Science Degree in Civil Engineering from the University of Houston and a Master's degree in Civil Engineering (Construction Management) from the University of Houston and is a registered professional engineer in the State.

STACEY STANTON

Motor Vehicle Division Director

Ms. Stanton was appointed Director of the Motor Vehicle Division ("MVD") in December of 1999, having been named interim Director in August of the same year. Ms. Stanton's prior experience at the Department includes having served as MVD Deputy Director; MVD Assistant Director for Policy and Legislative Support and MVD Assistant Division Director Metro Program. She also served as the Deputy Director for the Maricopa County Auto License Department and spent more than eight years in the State Senate as Aide to the Senate President and as the Arizona State Senate Transportation Analyst.

Ms. Stanton holds a Bachelor of Science degree in Political Science from Arizona State University and is a Certified Public Manager. Additionally, Ms. Stanton sits on the American Association of Motor Vehicle Administrators (AAMVA) International and Region IV Boards of Directors.

TERRY W. CONNER

Enforcement and Compliance Division Director

Mr. Conner was appointed Director of the newly formed Enforcement and Compliance Division in July, 2010. Prior to his appointment, Mr. Conner served for over 30 years with the Arizona Department of Public Safety (DPS). During his career with the DPS, Mr. Conner served in a number of command and executive level assignments including Criminal Investigations, Agency Support, and Highway Patrol. Mr. Conner was instrumental in the development of the Arizona Counter Terrorism and Information Center and was the homeland security coordinator for DPS prior to his retirement.

Mr. Conner has an extensive background in highway safety issues at both the local and national level. He served a year long assignment with the National Highway Traffic Safety Administration in Washington DC, where he developed and implemented a comprehensive program for police executives on occupant protection issues. Mr. Conner also served as the law enforcement representative from the International Association of Chiefs of Police, to the National Committee on Uniform Traffic Control Devices.

SCOTT OMER

Multimodal Planning Division Director

Mr. Omer was appointed Director for the Department's Multimodal Planning Division in September, 2011. He oversees the Department's development of multimodal plans and programs and is responsible for regional and statewide multimodal planning, transportation programming, traffic data collection and analysis, transportation research, and cooperative planning with Native American Tribes and Metropolitan Planning Organizations. He also oversees the research activity of the Department that enables innovation in transportation.

Mr. Omer first joined the Department's Yuma District in February 1993 and was assigned to Regional Traffic where he spent 13 years working in Traffic, Development and Operations. In 2006, Mr. Omer left the Department to work for the City of Yuma as a Capital Improvement Program (CIP) Project Manager. He joined Parsons Brinckerhoff in April of 2007 as a Senior Project Manager, and was the Western Region Project Manager for Building a Quality Arizona (bqAZ), and the Program Manager for Local Government ARRA Projects in the Eastern MAG Region. In April 2010, he returned to the Department as the Director of the Planning and Programming Group in the Multimodal Planning Division. Mr. Omer is certified as a Professional Transportation Planner (PT[™]) and a Certified Public Manager (CPM).

JOHN NICHOLS

Administrative Services Division Director

Mr. Nichols was appointed Director of the Administrative Services Divisions in December 2009. In this capacity, he is responsible for various support functions including Audit and Analysis, Equipment Services, Facilities Management, Grand Canyon Airport, Procurement, Office of Environmental Services, Public Records and Safety and Health. Mr. Nichols has been with the Department since 1997 and has held various other positions including Central Region Equipment Manager, Maintenance Operations Manager and, most recently, Physical Plant Administrator. Prior to joining the Department, Mr. Nichols was Fleet Manager for Arizona State University and he has completed a 21-year career with the United States Air Force.

KEVIN BIESTY

Government Relations and Policy Development Director

Mr. Biesty joined the Department's Motor Vehicle Division in February of 2000 as the Division's legislative liaison. He is now serving as the Department's Government Relations and Policy Development Office Director. Prior to joining the Department, he served as Legislative Liaison for the Arizona Department of Economic Security and prior to that served on staff at the Arizona State Senate. Mr. Biesty received his Bachelors Degree in Business Management from the University of Phoenix.

MATT BURDICK

Assistant Director for Communications

Matt Burdick has been part of the Department's communications group since 1996 and currently serves as the Assistant Director for Communications. As such, he is responsible for activities that support the delivery of the Department's transportation programs and services through communication, outreach and partnering. From 1996 to 2006, Mr. Burdick served as a Department media spokesperson and managed communication programs to inform and involve local governments, stakeholders and the public in the implementation of transportation projects.

Mr. Burdick holds two degrees from Arizona State University with a Master's degree in Mass Communication from the Walter Cronkite School of Journalism and a Bachelor's degree in Marketing from the W. P. Carey School of Business.

Funding the Department

The Department has several major sources of revenue available for financing its capital program and day-to-day operations. The operating budget, which is appropriated by the State Legislature, is funded primarily by the Department's share of revenues deposited in the Arizona Highway User Revenue Fund. Included in the highway operating budget are maintenance, general engineering activities, administrative functions, and all other highway related operating expenses.

The Board's Five-Year Capital Program is funded from three primary sources: Federal highway apportionments, highway user revenues, and the revenues generated by a voter-authorized transportation excise tax levied in Maricopa County, Arizona for the funding of highways in Maricopa County. Debt financing supplements these three sources of revenues to ensure timely and cost effective accomplishment of the Five-Year Capital Program. The Five-Year Capital Program identifies the improvements to be made by the Department to the State Highway System during the next five fiscal years and contains detailed information about each project including location, description, estimated cost, and timing. Improvements are scheduled based primarily upon project priority, funding availability, and engineering and construction considerations.

The Five-Year Capital Program is updated annually by the Board in accordance with a statutorily defined and scheduled process designed to assure that the improvements to the State Highway System that are of highest priority to the State are made and funded in an orderly way, consistent with statutory guidelines and Board policies. Initially, a preliminary Five-Year Capital Program is developed by the Director of the Department based upon the Board's guidelines and input from transportation professionals at the state and local level, from state and local elected officials, and from the general public. Also considered in determining the priority of the projects to be

included in the Five-Year Capital Program are user benefits, public need, land use, safety, road conditions, continuity of improvements, and availability of funds. Each update to the Five-Year Capital Program includes projects to be scheduled for the fifth year of the forthcoming five year period as well as modifications to the Program dictated by changing priorities, funding availability, and other considerations. The Board adopts the revised Five-Year Capital Program on or before June 30 of each year following a series of public meetings throughout the State.

Sunset Laws

In order to encourage systematic legislative review of State agencies and statutes, State statutes provide for automatic termination of State agencies and statutes pursuant to a statutory schedule unless the State Legislature takes affirmative action to continue the existence of the agencies or statutes. These State statutes are commonly known as "Sunset Laws." Under the State Sunset Laws, the Department and the Board are scheduled for termination on July 1, 2016, and Title 28, Arizona Revised Statutes, is scheduled for termination on January 1, 2017. Title 28 contains most of the transportation laws of the State, including the Act authorizing the Notes, the provisions relating to the fees and taxes pertaining to the registration, operation and use of motor vehicles and motor vehicle fuel taxes, the Arizona Highway User Revenue Fund and the State Highway Fund, the Act, as well as traffic laws of the State.

The State Sunset Laws provide a system for automatic committee and legislative review of agencies and statutes prior to their termination. Since the enactment of the Sunset Laws, the Department's existence and authority; the Act and the statutes relating to the fees and taxes pertaining to the registration, operation, and use of motor vehicles; and motor vehicle fuel taxes have been reviewed and continued three times.

If the State Legislature were to allow the Department to terminate on July 1, 2016, the State may no longer be eligible under federal law to receive Federal Aid Revenues. While there can be no assurance that the State Legislature will continue the Department after July 1, 2016, the Department is not aware of any matters which would cause the State Legislature to terminate the existence of the Department or the Board or to repeal Title 28 or to amend Title 28 in a manner detrimental to the Owners of the Series 2012 Notes.

The State Sunset Laws provide that if Title 28 is repealed pursuant to the Sunset Laws, so long as there are any outstanding debts or other obligations, such as the Series 2012 Notes, payable from either the Arizona Highway User Revenue Fund or the Regional Area Road Fund and provision has not been made for payment of those debts or obligations, the provisions of the Act regarding the Arizona Highway User Revenue Fund and Regional Area Road Fund shall remain in full force and effect until those debts or other obligations have been fully paid and satisfied (or provision is made therefor). In the opinion of Bond Counsel, in the event that the State Legislature fails, prior to the final maturity of the Series 2012 Notes, to take affirmative action to continue the existence of the Department, the Board or the Act on or prior to their effective termination dates, the State would be obligated to make payments on the Series 2012 Notes, when due, from the sources provided in the Note Resolution.

LITIGATION

There is no litigation or administrative action pending in any court or, to the best knowledge of the Department and the Board, threatened, which would restrain or enjoin the issuance, sale or delivery of the Series 2012 Notes or in any way contest or affect the validity of the Series 2012 Notes, or which concerns the proceedings of the Board taken in connection with the issuance and sale of the Series 2012 Notes or the performance of the Grant Agreements or the pledge and application of any funds provided for the payment of the Series 2012 Notes, or which contests the powers of the State, including the Department and the Board, with respect to the foregoing.

The Office of the Attorney General of the State has reviewed the status of pending lawsuits affecting the State and the Department in connection with their operations and has reported that there are several proceedings in which the Department is either a plaintiff or defendant and which are generally incidental to the operations of the Department. The ultimate disposition of such pending legal proceedings cannot be predicted or determined at present. With regard to such pending litigation, it is the opinion of the Office of the Attorney General of the State that such pending litigation will not be finally determined so as to result, individually or in the aggregate, in a final

judgment against the State or the Department which would materially and adversely affect the Department, its ability to pay Debt Service on the Series 2012 Notes, its continued operations or its financial position.

TAX MATTERS

General

In the opinion of Squire Sanders (US) LLP, Bond Counsel, under existing law: (i) interest on the Series 2012 Notes is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the “Code”), and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; and (ii) interest on the Series 2012 Notes is exempt from Arizona state income tax. Bond Counsel expresses no opinion as to any other tax consequences regarding the Series 2012 Notes.

The opinion on tax matters will be based on and will assume the accuracy of certain representations and certifications, and continuing compliance with certain covenants, of the Board and the Department contained in the transcript of proceedings and that are intended to evidence and assure the foregoing, including that the Series 2012 Notes are and will remain obligations the interest on which is excluded from gross income for federal income tax purposes. Bond Counsel will not independently verify the accuracy of the certifications and representations of the Board and the Department, or the continuing compliance with the covenants by the Board and the Department.

The opinion of Bond Counsel is based on current legal authority and covers certain matters not directly addressed by such authority. It represents Bond Counsel’s legal judgment as to exclusion of interest on the Series 2012 Notes from gross income for federal income tax purposes but is not a guaranty of that conclusion. The opinion is not binding on the Internal Revenue Service (“IRS”) or any court. Bond Counsel expresses no opinion about (i) the effect of future changes in the Code and the applicable regulations under the Code or (ii) the interpretation and the enforcement of the Code or those regulations by the IRS.

The Code prescribes a number of qualifications and conditions for the interest on state and local government obligations to be and to remain excluded from gross income for federal income tax purposes, some of which require future or continued compliance after issuance of the obligations. Noncompliance with these requirements by the Board or the Department may cause loss of such status and result in the interest on the Series 2012 Notes being included in gross income for federal income tax purposes retroactively to the date of issuance of the Series 2012 Notes. The Board and the Department each has covenanted to take the actions required of it for the interest on the Series 2012 Notes to be and to remain excluded from gross income for federal income tax purposes, and not to take any actions that would adversely affect that exclusion. After the date of issuance of the Series 2012 Notes, Bond Counsel will not undertake to determine (or to so inform any person) whether any actions taken or not taken, or any events occurring or not occurring, or any other matters coming to Bond Counsel’s attention, may adversely affect the exclusion from gross income for federal income tax purposes of interest on the Series 2012 Notes or the market value of the Series 2012 Notes.

A portion of the interest on the Series 2012 Notes earned by certain corporations may be subject to a federal corporate alternative minimum tax. In addition, interest on the Series 2012 Notes may be subject to a federal branch profits tax imposed on certain foreign corporations doing business in the United States and to a federal tax imposed on excess net passive income of certain S corporations. Under the Code, the exclusion of interest from gross income for federal income tax purposes may have certain adverse federal income tax consequences on items of income, deduction or credit for certain taxpayers, including financial institutions, certain insurance companies, recipients of Social Security and Railroad Retirement benefits, those that are deemed to incur or continue indebtedness to acquire or carry tax-exempt obligations, and individuals otherwise eligible for the earned income tax credit. The applicability and extent of these and other tax consequences will depend upon the particular tax status or other tax items of the owner of the Series 2012 Notes. Bond Counsel will express no opinion regarding those consequences.

Payments of interest on tax-exempt obligations, including the Series 2012 Notes, are generally subject to IRS Form 1099-INT information reporting requirements. If a Series 2012 Note owner is subject to backup

withholding under those requirements, then payments of interest will also be subject to backup withholding. Those requirements do not affect the exclusion of such interest from gross income for federal income tax purposes.

Legislation affecting tax-exempt obligations is regularly considered by the United States Congress, and may also be considered by the State Legislature. Court proceedings may also be filed the outcome of which could modify the tax treatment of obligations such as the Series 2012 Notes. There can be no assurance that legislation enacted or proposed or actions by a court after the date of issuance of the Series 2012 Notes will not have an adverse effect on the tax status of interest on the Series 2012 Notes or the market value or marketability of the Series 2012 Notes. These adverse effects could result, for example, from changes to federal or state income tax rates, changes in the structure of federal or state income taxes (including replacement with another type of tax), or repeal (or reduction in the benefit) of the exclusion of interest on the Series 2012 Notes from gross income for federal or state income tax purposes for all or certain taxpayers.

For example, both the American Jobs Act of 2011 proposed by President Obama on September 12, 2011, and introduced into the Senate on September 13, 2011, and the federal budget for fiscal year 2013 as proposed by President Obama on February 13, 2012, contain provisions that could, among other things, result in additional federal income tax for tax years beginning after 2012 on taxpayers that own tax-exempt obligations, including the Series 2012 Notes, if they have incomes above certain thresholds.

Prospective purchasers of the Series 2012 Notes should consult their own tax advisers regarding pending or proposed federal and state tax legislation and court proceedings, and prospective purchasers of the Series 2012 Notes at other than their original issuance at the respective prices indicated on the inside front cover of this Official Statement should also consult their own tax advisers regarding other tax considerations such as the consequences of market discount, as to all of which Bond Counsel expresses no opinion.

Bond Counsel's engagement with respect to the Series 2012 Notes ends with the issuance of the Series 2012 Notes, and, unless separately engaged, Bond Counsel is not obligated to defend the Board or the owners of the Series 2012 Notes regarding the tax status of interest thereon in the event of an audit examination by the IRS. The IRS has a program to audit tax-exempt obligations to determine whether the interest thereon is includible in gross income for federal income tax purposes. If the IRS does audit the Series 2012 Notes, under current IRS procedures, the IRS will treat the Board as the taxpayer and the beneficial owners of the Series 2012 Notes will have only limited rights, if any, to obtain and participate in judicial review of such audit. Any action of the IRS, including but not limited to selection of the Series 2012 Notes for audit, or the course or result of such audit, or an audit of other obligations presenting similar tax issues, may affect the market value of the Series 2012 Notes.

Original Issue Discount and Original Issue Premium

Certain of the Series 2012 Notes ("Discount Notes") as indicated on the inside front cover of this Official Statement were offered and sold to the public at an original issue discount ("OID"). OID is the excess of the stated redemption price at maturity (the principal amount) over the "issue price" of a Discount Note. The issue price of a Discount Note is the initial offering price to the public (other than to bond houses, brokers or similar persons acting in the capacity of underwriters or wholesalers) at which a substantial amount of the Discount Notes of the same maturity is sold pursuant to that offering. For federal income tax purposes, OID accrues to the owner of a Discount Note over the period to maturity based on the constant yield method, compounded semiannually (or over a shorter permitted compounding interval selected by the owner). The portion of OID that accrues during the period of ownership of a Discount Note (i) is interest excluded from the owner's gross income for federal income tax purposes to the same extent, and subject to the same considerations discussed above, as other interest on the Series 2012 Notes, and (ii) is added to the owner's tax basis for purposes of determining gain or loss on the maturity, redemption, prior sale or other disposition of that Discount Note. The amount of OID that accrues each year to a corporate owner of a Discount Note is taken into account in computing the corporation's liability for federal alternative minimum tax. A purchaser of a Discount Note in the initial public offering at the price for that Discount Note stated on the cover of this Official Statement who holds that Discount Note to maturity will realize no gain or loss upon the retirement of that Discount Note.

Certain of the Series 2012 Notes ("Premium Notes") as indicated on the inside front cover of this Official Statement were offered and sold to the public at a price in excess of their stated redemption price (the principal

amount) at maturity. That excess constitutes bond premium. For federal income tax purposes, bond premium is amortized over the period to maturity of a Premium Note, based on the yield to maturity of that Premium Note (or, in the case of a Premium Note callable prior to its stated maturity, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on that Premium Note), compounded semiannually. No portion of that bond premium is deductible by the owner of a Premium Note. For purposes of determining the owner's gain or loss on the sale, redemption (including redemption at maturity) or other disposition of a Premium Note, the owner's tax basis in the Premium Note is reduced by the amount of bond premium that is amortized during the period of ownership. As a result, an owner may realize taxable gain for federal income tax purposes from the sale or other disposition of a Premium Note for an amount equal to or less than the amount paid by the owner for that Premium Note. A purchaser of a Premium Note in the initial public offering at the price for that Premium Note stated on the cover of this Official Statement who holds that Premium Note to maturity (or, in the case of a callable Premium Note, to its earlier call date that results in the lowest yield on that Premium Note) will realize no gain or loss upon the retirement of that Premium Note.

Owners of Discount and Premium Notes should consult their own tax advisers as to the determination for federal income tax purposes of the amount of OID or bond premium properly accruable or amortizable in any period with respect to the Discount or Premium Notes and as to other federal tax consequences and the treatment of OID and bond premium for purposes of state and local taxes on, or based on, income.

INDEPENDENT AUDITORS

The basic financial statements of the Department as of and for the year ended June 30, 2011, included in this Official Statement as Appendix B, have been audited by Heinfeld, Meech & Co., P.C., independent auditors, as stated in their report appearing therein. The Department neither requested nor obtained the consent of Heinfeld, Meech & Co., P.C. to include their report and Heinfeld, Meech & Co., P.C. has performed no procedures subsequent to rendering their opinion on the financial statements.

CONTINUING DISCLOSURE UNDERTAKING

In accordance with the requirements of Rule 15c2-12 (the "Rule") promulgated by the Securities and Exchange Commission (the "Commission"), the Board and the Department will execute a written Continuing Disclosure Undertaking, dated as of the date of delivery of the Series 2012 Notes (the "Disclosure Undertaking"), substantially in the form set forth as Appendix E, wherein the Board and the Department will agree, for the benefit of the beneficial owners of the Series 2012 Notes, to provide or cause to be provided, certain annual financial information that is generally consistent with the information contained under the heading "FEDERAL AID REVENUES" herein for the prior Federal Fiscal Year, and notice of the occurrence of certain events or failures to take certain required actions with respect to the Series 2012 Notes. Pursuant to the Rule, such disclosures are to be provided to the Municipal Securities Rulemaking Board ("MSRB") in a format prescribed by the MSRB. Currently, the MSRB requires filing such disclosures in electronic format through the Electronic Municipal Market Access website ("EMMA").

The Board and the Department may from time to time choose to provide notice of the occurrence of other events, in addition to those required in the Disclosure Undertaking, but the Board and the Department do not undertake to commit to provide any notice of the occurrence of any event except those certain events listed in the Disclosure Undertaking. Such notices will be provided through EMMA.

The obligations of the Board and the Department described in the Disclosure Undertaking will remain in effect until the Series 2012 Notes are no longer Outstanding or the Rule no longer applies to the Series 2012 Notes. The Disclosure Undertaking may be amended or waived upon receipt by the Board and the Department of an opinion of independent counsel to the effect that the amendment or waiver would not, in and of itself, cause the Disclosure Undertaking to violate the Rule.

A beneficial owner of a Series 2012 Note may seek to enforce the undertakings of the Board and the Department in the Disclosure Undertaking by an action for specific performance in any court of competent jurisdiction in Phoenix, Arizona after providing the Board and the Department with 30 days prior written notice of

its failure to perform. Any failure of the Board or the Department to comply with any of its obligations in the Disclosure Undertaking shall not be a default or Event of Default with respect to the Series 2012 Notes under the Note Resolution.

The Board and the Department are in material compliance with each and every disclosure undertaking into which they have entered pursuant to the Rule.

RATINGS

Fitch Ratings (“Fitch”), Moody’s Investors Service, Inc. (“Moody’s”) and Standard & Poor’s Ratings Services, a Division of The McGraw-Hill Companies, Inc. (“Standard & Poor’s”) have assigned the Series 2012 Notes ratings of “AA,” “Aa2” and “AA,” respectively.

A rating is not a recommendation to buy, sell or hold securities, and reflects only the views of the rating organizations; any explanation of the meaning or significance of any rating may only be obtained from the respective rating agency. The Board and the Department furnished to the rating agencies certain information and materials, some of which have not have been included in this Official Statement, relating to the Series 2012 Notes and the Board and the Department. Generally, rating agencies base their ratings on such information and materials and on their own investigation, studies and assumptions. There can be no assurance that a rating when assigned will continue for any given period of time or that it will not be lowered or withdrawn entirely by a rating agency if in its judgment circumstances so warrant. Any lowering or withdrawal of a rating or other actions of a rating agency relating to its rating on the Series 2012 Notes may have an adverse effect on the marketability or market price of the Series 2012 Notes.

The Board and the Department expect to furnish each rating agency with information and materials that it may request. The Board and the Department, however, assume no obligation to furnish requested information and materials, and may issue debt for which a rating is not requested. Failure to furnish requested information and materials, or the issuance of the debt for which a rating is not requested, may result in the suspension or withdrawal of a rating on the Series 2012 Notes.

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Series 2012 Notes from the Board at a price of \$48,604,887.15 (being the aggregate principal amount of \$43,825,000.00 plus original issue premium of \$4,860,734.90 and less an Underwriters’ discount of \$80,847.75, plus accrued interest. The public offering prices may be changed from time to time by the Underwriters. The Underwriters may offer and sell the Series 2012 Notes to dealers (including dealers depositing the Series 2012 Notes into investment trusts) and others at prices lower than such initial public offering prices. The Underwriters will be obligated to purchase all of the Series 2012 Notes if any are purchased.

Citigroup, Inc., the parent company of Citigroup Global Markets Inc., an underwriter of the Series 2012 Notes, has entered into a retail brokerage joint venture with Morgan Stanley. As part of the joint venture, Citigroup Global Markets Inc. will distribute municipal securities to retail investors through the financial advisor network of a broker-dealer, Morgan Stanley Smith Barney LLC. As part of this arrangement, Citigroup Global Markets Inc. will compensate Morgan Stanley Smith Barney LLC for its selling efforts with respect to the Series 2012 Notes.

J.P. Morgan Securities LLC (“JPMS”), one of the underwriters of the Series 2012 Notes, has entered into negotiated dealer agreements (each, a “Dealer Agreement”) with each of UBS Financial Services Inc. (“UBSFS”) and Charles Schwab & Co., Inc. (“CS&Co”) for the retail distribution of certain securities offerings, including the Series 2012 Notes, at the original issue prices. Pursuant to each Dealer Agreement, each of UBSFS and CS&Co will purchase Series 2012 Notes from JPMS at the original issue price less a negotiated portion of the selling concession applicable to any Series 2012 Notes that such firm sells.

Certain of the Underwriters and their respective affiliates have, from time to time, performed, and may in the future perform, various investment banking services for the Board and Department for which they received or

will receive customary fees and expenses. In the ordinary course of their various business activities, the Underwriters and their respective affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (which may include bank loans and/or credit default swaps) for their own account and for the accounts of their customers and may at any time hold long and short positions in such securities and instruments. Such investment and securities activities may involve securities and instruments of Board.

CERTAIN LEGAL MATTERS

Certain legal matters incident to the issuance of the Series 2012 Notes and the tax-exempt status of interest on the Series 2012 Notes (see “TAX MATTERS”) are subject to the legal opinion of Squire Sanders (US) LLP, Bond Counsel to the Board and the Department. The signed legal opinion of Bond Counsel, substantially in the form attached hereto as Appendix A, dated and premised on law in effect as of the date of issuance, will be delivered on the date of issuance of the Series 2012 Notes.

In its capacity as Bond Counsel, Bond Counsel has participated in the preparation of, and has reviewed those portions of, this Official Statement pertaining to the Series 2012 Notes, the Note Resolution, the Act and the tax-exempt status of interest on the Series 2012 Notes (except for the outstanding principal amounts of the Notes), contained under the captions “INTRODUCTION,” “PLAN OF REFUNDING,” “THE SERIES 2012 NOTES,” “SECURITY AND SOURCES OF PAYMENT FOR THE NOTES,” “TAX MATTERS,” “CONTINUING DISCLOSURE UNDERTAKING” (excluding the last paragraph thereunder), “PROPOSED FORM OF OPINION OF BOND COUNSEL” contained in Appendix A, “SUMMARY OF CERTAIN PROVISIONS OF THE NOTE RESOLUTION” contained in Appendix C, and “FORM OF CONTINUING DISCLOSURE UNDERTAKING” contained in Appendix E hereto. Bond Counsel has not been retained to pass upon, and will not express any opinion upon, any other information in this Official Statement or any other information pertaining to the Series 2012 Notes or the Board or the Department that may be made available to the prospective purchasers of the Series 2012 Notes or to others.

Certain legal matters will be passed upon for the Underwriters by their counsel, Ballard Spahr LLP. All the legal opinions to be delivered concurrently with the delivery of the Series 2012 Notes express the professional judgment of the attorneys rendering the opinions or advice regarding the legal issues and other matters expressly addressed therein. By rendering a legal opinion or advice, the giver of such opinion or advice does not become an insurer or guarantor of the result indicated by that opinion or advice, or the transaction on which the opinion or advice is rendered, or of the future performance of parties to the transaction. Nor does the rendering of an opinion or advice guarantee the outcome of any legal dispute that may arise out of the transaction.

FINANCIAL ADVISOR

RBC Capital Markets, LLC is employed as the Financial Advisor to the Board in connection with the issuance of the Series 2012 Notes. The fees for Financial Advisor are contingent upon the issuance, sale and delivery of the Series 2012 Notes.

The Financial Advisor is not obligated to undertake, and has not undertaken to make, an independent verification and does not guarantee the accuracy, completeness, or fairness of the information in this Official Statement.

MISCELLANEOUS

The Department and the Board have furnished the information in this Official Statement relating to the Department and the Board.

Copies of the Note Resolution and the Grant Agreements discussed herein may be obtained from the Department’s Assistant Director for Finance and Accounting, located at 206 South 17th Avenue, Phoenix, Arizona 85007 (telephone: 602-712-4675). All communications concerning this offering should be directed to Ms. Lisa Danka.

All statements in this Official Statement involving matters of opinion, estimates, forecasts, projections, or the like, whether or not expressly so stated, are intended as such and not as representations of fact. No representation is made that any of such opinions or the like will be realized. The agreements of the Board and the Department are fully set forth in the Note Resolution in accordance with the Act and this Official Statement is not to be construed as a contract or agreement between the Board or the Department and the purchasers or Owners of any of the Series 2012 Notes.

This Official Statement is submitted in connection with the sale of the Series 2012 Notes and may not be reproduced or used, as a whole or in part, for any other purpose. This Official Statement has been duly authorized and approved by the Board and the Department and duly executed and delivered on their behalf by the officials signing below.

ARIZONA TRANSPORTATION BOARD

/s/ Victor Flores
Victor Flores, Vice Chair

ARIZONA DEPARTMENT OF TRANSPORTATION

/s/ John S. Halikowski
John S. Halikowski, Director

APPENDIX A
PROPOSED FORM OF OPINION OF BOND COUNSEL

[Closing Date]

To: Arizona Transportation Board
Phoenix, Arizona

Ladies and Gentlemen:

We have served as bond counsel to our client the Arizona Transportation Board (the "Board") and not as counsel to any other person in connection with the issuance by the Board of its \$43,825,000 Arizona Transportation Board, Grant Anticipation Refunding Notes, Series 2012 (the "Series 2012 Notes"), dated the date of this letter.

The Series 2012 Notes are issued pursuant to Title 28, Chapter 21, Article 3, Arizona Revised Statutes, as amended (the "Act"), and the resolution adopted by the Board on June 9, 2000, as supplemented and amended to date, including as supplemented by the Eighth Supplemental Resolution adopted by the Board on April 20, 2012 (collectively, the "Resolution"). Capitalized terms not otherwise defined in this letter are used as defined in the Resolution.

In our capacity as bond counsel, we have examined the transcript of proceedings relating to the issuance of the Series 2012 Notes, a copy of the signed and authenticated Series 2012 Note of the first maturity, the Resolution and such other documents, matters and law as we deem necessary to render the opinions set forth in this letter.

Based on that examination and subject to the limitations stated below, we are of the opinion that under existing law:

1. The Series 2012 Notes and the Resolution are valid and binding obligations of the Board, enforceable in accordance with their respective terms.
2. The Series 2012 Notes constitute special obligations of the Board, and the principal of and interest and any premium on (collectively, "debt service") the Series 2012 Notes, together with debt service on any other obligations issued and outstanding on a parity with the Series 2012 Notes, as provided in the Resolution, are payable from and secured solely by the pledge of amounts on deposit in the Grant Anticipation Note Fund, the Note Proceeds Account and from certain other funds, all as defined and provided in the Resolution. Under the Resolution, the Arizona Department of Transportation (the "Department") is required to deposit into the Grant Anticipation Note Fund: (a) the Grant Revenues, (b) certain Federal Aid Revenues, and (c) certain other revenues, all as defined and provided in the Resolution. The payment of debt service on the Series 2012 Notes is not secured by a pledge of any money raised by taxation, and the Series 2012 Notes do not represent or constitute a general obligation or a pledge of the faith and credit of the Board, the State of Arizona, the Department or any of its political subdivisions.
3. The Resolution creates a valid pledge of the Grant Anticipation Note Fund and the Note Proceeds Account for the Notes, which pledge is subject to no superior pledges granted under the Resolution.
4. Interest on the Series 2012 Notes is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code") and is not an

item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; however, portions of the interest on the Series 2012 Notes earned by certain corporations may be subject to a corporate alternative minimum tax. The interest on the Series 2012 Notes is exempt from Arizona state income tax. We express no opinion as to any other tax consequences regarding the Series 2012 Notes.

The opinions stated above are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. In rendering all such opinions, we assume, without independent verification, and rely upon (i) the accuracy of the factual matters represented, warranted or certified in the proceedings and documents we have examined and (ii) the due and legal authorization, execution and delivery of those documents by, and the valid, binding and enforceable nature of those documents upon, any parties other than the Board.

In rendering those opinions with respect to treatment of the interest on the Series 2012 Notes under the federal tax laws, we further assume and rely upon compliance with the covenants in the proceedings and documents we have examined, including those of the Board. Failure to comply with certain of those covenants subsequent to issuance of the Series 2012 Notes may cause interest on the Series 2012 Notes to be included in gross income for federal income tax purposes retroactively to their date of issuance.

The rights of the owners of the Series 2012 Notes and the enforceability of the Series 2012 Notes and the Resolution are subject to bankruptcy, insolvency, arrangement, fraudulent conveyance or transfer, reorganization, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion, and to limitations on legal remedies against public entities.

The opinions rendered in this letter are stated only as of this date, and no other opinion shall be implied or inferred as a result of anything contained in or omitted from this letter. Our engagement as bond counsel with respect to the Series 2012 Notes has concluded on this date.

Respectfully submitted,

APPENDIX B

ARIZONA DEPARTMENT OF TRANSPORTATION AUDITED FINANCIAL STATEMENTS FOR YEAR ENDED JUNE 30, 2011

The information in this Appendix B is presented for background information only. As described under "SECURITY AND SOURCES OF PAYMENT FOR THE NOTES", the Series 2012 Notes are special and limited obligations of the Board payable from, and are secured by a pledge solely of, the Pledged Funds, which Pledged Funds are not segregated or identified in Appendix B.

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HEINFELD, MEECH & CO., P.C.
CERTIFIED PUBLIC ACCOUNTANTS



INDEPENDENT AUDITORS' REPORT

The Honorable Janice K. Brewer
Governor of the State of Arizona

Members of the Arizona State Legislature

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Arizona Department of Transportation (Department), as of and for the year ended June 30, 2011, which collectively comprise the Department's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the management of the Arizona Department of Transportation. Our responsibility is to express opinions 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1.A, the financial statements of the Arizona Department of Transportation are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of Arizona that is attributable to the Arizona Department of Transportation. They do not purport to, and do not, present fairly the financial position of the State of Arizona, as of June 30, 2011, and the changes in its financial position, and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Arizona Department of Transportation, as of June 30, 2011, and the respective changes in its financial position, and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 4.A, the Department implemented the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, for the year ended June 30, 2011, which represents a change in accounting principle.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2011 on our consideration of the Arizona Department of Transportation'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 reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 14, budgetary comparison information on pages 54 and 55, and information about infrastructure assets reported using the modified approach on pages 56 through 60 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's financial statements as a whole. The accompanying supplementary information such as the Introductory Section, Supplementary Information, and Statistical Section, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the financial statements. The Supplementary Information is the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The Introductory Section and Statistical Section have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Heinfeld, Meech & Co., P.C.

HEINFELD, MEECH & CO., P.C.
Certified Public Accountants

November 30, 2011

Arizona Department of Transportation
Management's Discussion and Analysis
June 30, 2011

As management of the Arizona Department of Transportation (Department), we offer readers of the Department's financial statements this narrative overview and analysis of the financial activities of the Department for the fiscal year ended June 30, 2011. We encourage readers to consider the information presented here in conjunction with the Letter of Transmittal, which can be found on pages i-iv, and the Department's basic financial statements, which begin on page 15, with the accompanying notes and Required Supplementary Information (RSI).

Financial Highlights

Government-wide:

- The net assets of the Department at the close of the fiscal year are \$16.0 billion, compared to \$15.4 billion for fiscal year 2010, an increase of 4.2 percent. Of this amount, \$126.1 million represents *unrestricted net assets* and may be used to meet the Department's ongoing obligations to citizens and creditors as compared to \$125.8 million at the end of 2010.
- The Department's capital assets are \$18.0 billion, compared to \$17.3 billion for fiscal year 2010, an increase of 3.9 percent. This increase is attributable to the results of increased highway construction activity. The Department's *invested in capital assets, net of related debt*, is \$15.2 billion, compared to \$14.6 billion for fiscal year 2010, an increase of 3.7 percent.
- The Department's non-current liabilities are \$3.1 billion, compared to \$3.0 billion in 2010. The Department had \$150.3 million more in bonds outstanding in 2011 than in 2010. During fiscal year 2011, there were \$338.6 million in bonds issued and \$188.3 million in bonds repaid.

Fund Level:

- As of the close of the fiscal year, the governmental funds of the Department reported combined ending fund balances of approximately \$1.1 billion, as compared to approximately \$938.8 million in 2010.
- The total restricted fund balance is \$949.5 million; of this amount, approximately \$945.6 million is restricted for capital projects. The nonspendable portion of fund balance represents \$9.8 million in inventories while the remainder of \$126.8 million represents the committed fund balance portion.
- The proprietary funds reported net assets at year-end of \$76.4 million, as compared to \$75.0 million in 2010.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction of the Department's basic financial statements. The Department's basic financial statements consist of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other Required Supplementary Information in addition to the basic financial statements.

Government-wide Financial Statements (Reporting the Department as a Whole)

The government-wide financial statements are designed to present an overall picture of the financial position of the Department. These statements consist of the Statement of Net Assets and the Statement of Activities, and are prepared using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Net Assets combines and consolidates the Department's current financial resources with capital assets and long-term obligations. This statement includes all of the Department's non-fiduciary assets and liabilities.

Arizona Department of Transportation
Management's Discussion and Analysis (continued)
June 30, 2011

Net assets are the difference between the Department's assets and liabilities, and represent one measure of the Department's financial health.

- An increase or decrease in the Department's net assets from one year to the next is an indicator of whether its financial health is improving or declining.
- Other indicators of the Department's financial health include the condition of its roads and bridges (infrastructure) and economic trends affecting the Department's future tax revenues.

The Statement of Activities focuses on both the gross and net cost of various activities (governmental and business-type); these costs are paid by the Department's general tax and other revenues. This statement summarizes the cost of providing specific Department services and includes all current year revenues and expenses.

The Statement of Net Assets and the Statement of Activities divide the Department's activities into two types:

Governmental Activities

The Department's basic services are reported here, including administration, highway, highway maintenance, and motor vehicle. Taxes, fees, and federal grants finance most of these activities.

Business-type Activities

Activities for which the Department charges a fee to customers to pay most or all of the costs of certain services it provides are reported as business-type activities. The Department's *Arizona Highways Magazine* and Highway Expansion and Extension Loan Program (HELP) are reported here.

The government-wide financial statements can be found on pages 15-16 of this report.

This report includes two schedules (Exhibit 3.1 and Exhibit 4.1) that reconcile the amounts reported on the governmental fund financial statements (prepared using the modified accrual basis of accounting and current financial resources measurement focus) with governmental activities (prepared using the accrual basis of accounting and economic resources measurement focus) on the appropriate government-wide statements. The following summarizes the impact of utilizing Governmental Accounting Standards Board Statement 34 (GASB 34) reporting:

- Capital assets used in governmental activities are not reported on governmental fund statements.
- Other long-term assets that are not available to pay for current period expenditures are not reported on governmental fund statements.
- Internal service fund activities are reported as governmental activities, but reported as proprietary funds in the fund financial statements.
- Bond issuance costs are capitalized and amortized to expense as governmental activities, but reported as expenditures in the governmental fund statements.
- Unless currently due and payable, long-term liabilities, such as capital lease obligations, compensated absences, bonds, notes payable, and others only appear as liabilities on the government-wide statements.
- Capital outlay spending results in capital assets on the government-wide statements, but is reported as expenditures on the governmental fund statements.
- Bond and note proceeds result in liabilities on the government-wide statements, but are recorded as other financing sources on the governmental fund statements.

- Certain other outflows represent either increases or decreases in liabilities on the government-wide statements, but are reported as expenditures on the governmental fund statements.

Fund Financial Statements (Reporting the Department's Major Funds)

The fund financial statements begin on page 17 and provide detailed information about the major individual funds. A fund is an accounting entity with a self-balancing set of accounts that the Department uses to keep track of specific sources of funding and spending for a particular purpose. The Department, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the Department can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental Funds A majority of the Department's activities are reported in governmental funds. Reporting of these funds focuses on how financial resources flow in and out of the funds, and amounts remaining at year-end for future spending. Governmental funds are accounted for using the modified accrual basis of accounting, which measures cash and other assets that can be readily converted to cash. The governmental fund statements provide a detailed short-term view of the Department's general governmental operations and the basic services it provides. This information should help determine whether there are more or less current financial resources available for the Department's programs. The reconciliations following the fund financial statements explain the differences between the government's activities, reported in the government-wide statement of activities, and the governmental funds.

The Department maintains fifteen individual governmental funds. Information is presented separately in the governmental funds Balance Sheet and the governmental funds Statement of Revenues, Expenditures, and Changes in Fund Balances for the General Fund (State Highway Fund), Maricopa Regional Area Road Construction Fund, Motor Vehicle Division Clearing Fund, Highway User Revenue Fund, Debt Service Fund, and Capital Projects Fund which are considered to be major funds. Data from the other nine governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major governmental funds are provided in the form of combining statements elsewhere in this report.

The legislature appropriates an annual budget for the Department's General Fund (State Highway Fund). The Budgetary Comparison Schedule – General Fund (State Highway Fund) has been provided to demonstrate compliance with this budget and is presented as Required Supplementary Information.

The governmental funds financial statements can be found on pages 17-24 of this report.

Proprietary Funds When the Department charges customers for the services it provides, these services are generally reported in proprietary funds. Proprietary funds (enterprise and internal service) utilize full accrual accounting, the same method used by private sector businesses. Enterprise funds report activities that provide goods and services to outside customers, to other agencies, or to other divisions of the Department. The Department's enterprise funds are the *Arizona Highways Magazine* Fund and the Highway Expansion and Extension Loan Program Fund. The internal service fund reports activities that provide supplies and services for the Department's other programs and activities and other state agencies. The Equipment Revolving Fund is the Department's only internal service fund. Internal service fund activities are reported as governmental activities on the government-wide statements.

The proprietary funds financial statements can be found on pages 25-27 of this report.

Fiduciary Funds Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the Department's own programs.

The fiduciary fund financial statement can be found on page 28.

Notes to the Financial Statements The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 29-53 of this report.

Required Supplementary Information In addition to the basic financial statements, including accompanying notes, this section presents certain Required Supplementary Information including the Department's Budgetary Comparison Schedule – General Fund (State Highway Fund) and the modified approach to reporting infrastructure assets. Required Supplementary Information can be found on pages 54-60 of this report.

Supplementary Information Other Supplementary Information includes the combining statements for the non-major governmental funds and agency funds, and is presented immediately following the Required Supplementary Information on budget and infrastructure assets. Combining and individual fund statements and schedules can be found on pages 61-66 of this report.

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of the Department's financial health. The following tables, graphs, and analyses address the financial position and changes to financial position for the Department as a whole as of and for the fiscal years ended June 30, 2011 and 2010.

The Department's combined net assets increased by \$642.8 million over the course of this fiscal year's operations, an increase of 4.2 percent. The net assets of the governmental activities increased by \$641.4 million, or 4.2 percent, and business-type activities increased by \$1.4 million, an increase of 1.9 percent over the previous year. The overall increase in the Department's net assets was due to an increase in the Department's infrastructure resulting from more construction and a greater reliance on federal grants.

In February 2009, President Obama signed the American Recovery and Reinvestment Act (ARRA) as an economic stimulus package. The money set aside by this program was to be distributed through a variety of agencies, and to be used for projects such as improving education, building roads, public transportation, criminal justice, health care, and many other areas. The highway construction projects included pavement preservation, traffic interchange reconstruction, roadway widening, bridge rehabilitation, safety fence replacement, and other transportation uses. Construction contracts have been awarded for nearly all projects, and more than half the funds have been expended. As of the end of the fiscal year, the transit project has expended \$9.7 million while the highway construction projects have expended \$454.3 million.

Arizona Department of Transportation
Management's Discussion and Analysis (continued)
June 30, 2011

The following table reflects the condensed Statement of Net Assets as of June 30, 2011 and 2010:

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
Assets						
Current and other assets	\$ 1,401,025,969	\$ 1,243,979,734	\$ 79,028,924	\$ 77,737,935	\$ 1,480,054,893	\$ 1,321,717,669
Capital assets	<u>17,975,953,546</u>	<u>17,306,880,407</u>	<u>53,658</u>	<u>92,231</u>	<u>17,976,007,204</u>	<u>17,306,972,638</u>
Total assets	<u>19,376,979,515</u>	<u>18,550,860,141</u>	<u>79,082,582</u>	<u>77,830,166</u>	<u>19,456,062,097</u>	<u>18,628,690,307</u>
Liabilities						
Other liabilities	291,218,260	281,070,327	2,508,827	2,652,237	293,727,087	283,722,564
Non-current liabilities	<u>3,131,004,477</u>	<u>2,956,482,084</u>	<u>136,069</u>	<u>129,361</u>	<u>3,131,140,546</u>	<u>2,956,611,445</u>
Total liabilities	<u>3,422,222,737</u>	<u>3,237,552,411</u>	<u>2,644,896</u>	<u>2,781,598</u>	<u>3,424,867,633</u>	<u>3,240,334,009</u>
Net assets						
Invested in capital assets, net of related debt	15,159,085,525	14,620,099,073	53,658	92,231	15,159,139,183	14,620,191,304
Restricted	669,811,122	566,793,388	76,192,180	75,619,251	746,003,302	642,412,639
Unrestricted	<u>125,860,131</u>	<u>126,415,269</u>	<u>191,848</u>	<u><662,914></u>	<u>126,051,979</u>	<u>125,752,355</u>
Total net assets	<u>\$15,954,756,778</u>	<u>\$15,313,307,730</u>	<u>\$ 76,437,686</u>	<u>\$ 75,048,568</u>	<u>\$16,031,194,464</u>	<u>\$15,388,356,298</u>

In rounded figures, the total assets of the Department were \$19.4 billion, while total liabilities were \$3.4 billion, resulting in a net assets balance of \$16.0 billion. The majority of the Department's net assets, \$15.2 billion (95.0 percent), was invested in capital assets (e.g., land, infrastructure, buildings, machinery, and equipment), net of any related debt used to acquire those assets. The Department uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the Department's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other resources, since the capital assets themselves cannot be used to liquidate these liabilities.

The governmental activities reported an increase in capital assets with the largest increase being in the area of construction in progress. The Department issued two bonds in fiscal year 2011 which caused the non-current liabilities to increase for the governmental activities. The business-type activities reported a small increase in net assets for fiscal year 2011; this was primarily due to the receipt of an interfund loan.

Arizona Department of Transportation
Management's Discussion and Analysis (continued)
June 30, 2011

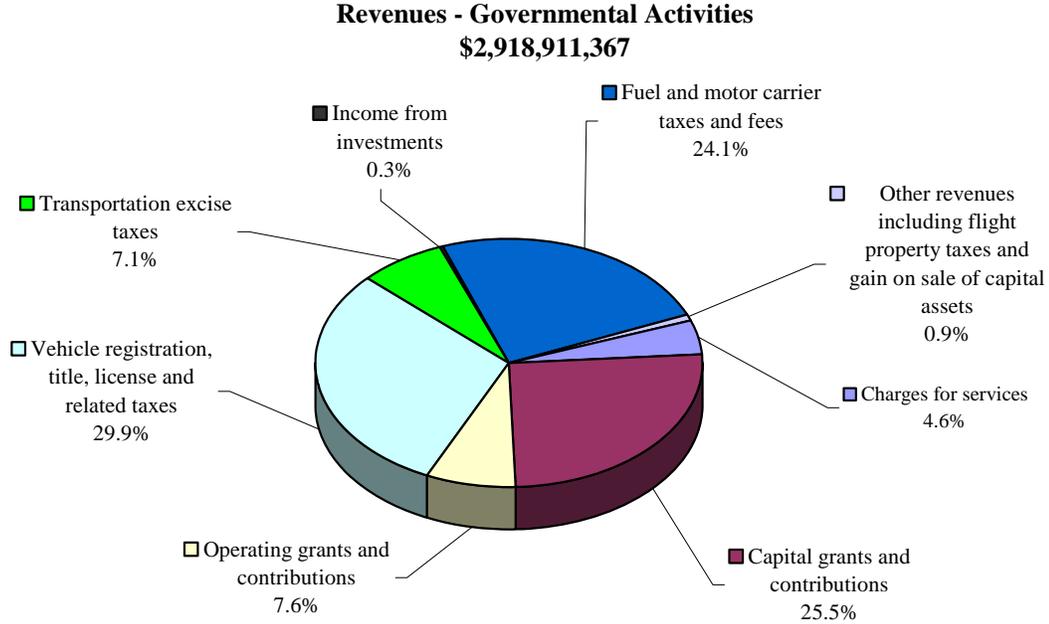
The following condensed financial information was derived from the government-wide Statement of Activities and reflects how the Department's net assets changed during the year, compared to the prior year:

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
Revenues						
Program revenues:						
Charges for services	\$ 133,661,283	\$ 124,307,064	\$ 5,772,911	\$ 6,541,051	\$ 139,434,194	\$ 130,848,115
Operating grants and contributions	220,759,085	146,935,991	-	-	220,759,085	146,935,991
Capital grants and contributions	743,718,082	575,447,784	-	-	743,718,082	575,447,784
General revenues:						
Transportation excise taxes	206,545,412	199,672,233	-	-	206,545,412	199,672,233
Vehicle registration, title, license and related taxes	874,191,798	893,287,384	-	-	874,191,798	893,287,384
Fuel and motor carrier taxes and fees	704,726,732	690,503,437	-	-	704,726,732	690,503,437
Flight property taxes	9,798,513	9,526,737	-	-	9,798,513	9,526,737
Income from investments	9,414,904	16,346,982	554,941	514,171	9,969,845	16,861,153
Gain <loss> on sale of capital assets	3,604,096	707,616	-	-	3,604,096	707,616
Other	12,491,462	8,257,587	-	-	12,491,462	8,257,587
Total revenues	2,918,911,367	2,664,992,815	6,327,852	7,055,222	2,925,239,219	2,672,048,037
Expenses						
Administration	93,040,027	65,781,111	-	-	93,040,027	65,781,111
Highway	37,069,567	34,720,987	-	-	37,069,567	34,720,987
Highway maintenance	129,699,887	102,931,834	-	-	129,699,887	102,931,834
Motor vehicle	99,948,875	102,925,906	-	-	99,948,875	102,925,906
Non-capital, including asset preservation	345,590,127	122,747,606	-	-	345,590,127	122,747,606
Distributions to Arizona counties and cities	1,024,756,349	1,057,720,144	-	-	1,024,756,349	1,057,720,144
Distributions to other state agencies	254,702,299	251,391,647	-	-	254,702,299	251,391,647
Local governmental assistance	163,035,322	83,229,758	-	-	163,035,322	83,229,758
Interest on long-term debt	128,768,466	129,626,215	-	-	128,768,466	129,626,215
Arizona Highways Magazine	-	-	5,664,153	6,288,136	5,664,153	6,288,136
Highway Expansion and Extension Loan Program	-	-	125,981	147,040	125,981	147,040
Total expenses	2,276,610,919	1,951,075,208	5,790,134	6,435,176	2,282,401,053	1,957,510,384
Change in net assets before transfers	642,300,448	713,917,607	537,718	620,046	642,838,166	714,537,653
Transfers	<851,400>	-	851,400	-	-	-
Change in net assets	641,449,048	713,917,607	1,389,118	620,046	642,838,166	714,537,653
Net assets - July 1	15,313,307,730	14,599,390,123	75,048,568	74,428,522	15,388,356,298	14,673,818,645
Net assets - June 30	\$ 15,954,756,778	\$ 15,313,307,730	\$76,437,686	\$75,048,568	\$ 16,031,194,464	\$ 15,388,356,298

Arizona Department of Transportation
Management's Discussion and Analysis (continued)
June 30, 2011

Governmental Activities

The following chart depicts revenues of the governmental activities for the fiscal year ended June 30, 2011:



\$2.3 billion (or 79.5 percent) of the Department's revenues are from the following three revenue sources:

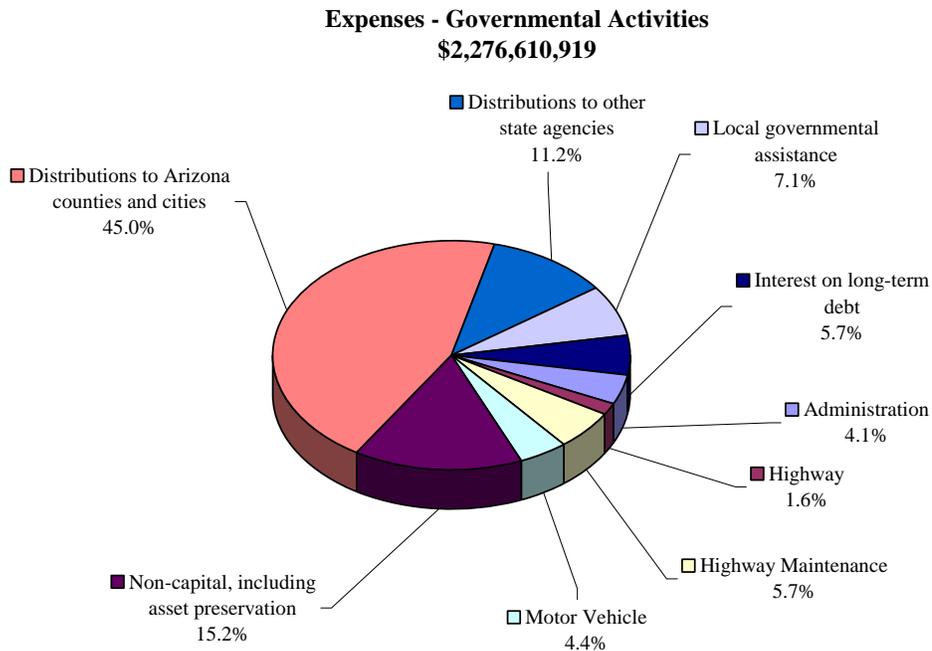
- Vehicle registration, title, license, and related taxes comprise the Department's largest revenue source of \$874.2 million (29.9 percent).
- Capital grants and contributions represent the Department's second largest revenue source of \$743.7 million (25.5 percent).
- Fuel and motor carrier taxes and fees represent the Department's third largest revenue source of \$704.7 million (24.1 percent).

The Department's two main funding sources, the Highway User Revenue Fund (HURF) and the Maricopa County Transportation Excise Tax, posted positive year-over-year growth in fiscal year 2011 for the first time since fiscal year 2007. HURF collections totaled approximately \$1.2 billion, an increase of 0.9 percent from fiscal year 2010 and equal to the Department's estimate. Maricopa County Transportation Excise Tax collections totaled \$309.2 million, an increase of 3.4 percent over fiscal year 2010, and 2.7 percent above the Department's estimate. The Transportation Excise Tax distribution to the Department was \$206.5 million compared to \$199.7 million for fiscal year 2010. Both revenue sources remained under pressure during fiscal year 2011 due to high unemployment, lower personal income and population growth, and lower home values. Fuel prices spiked in February and March 2011, which caused consumers to curtail their spending, but fuel prices did eventually move downward during the last few months of the fiscal year.

Capital grants and contributions increased from fiscal year 2010 due to an increase in the amount received in federal aid for fiscal year 2011. The increase in the Maricopa Regional Area Road Construction Fund was due to projects which utilized federal ARRA funding, and therefore, increased the capital grants and contributions revenue.

Arizona Department of Transportation
 Management's Discussion and Analysis (continued)
 June 30, 2011

The following chart depicts expenses of the governmental activities for the fiscal year ended June 30, 2011:



\$1.6 billion (or 71.4 percent) of the Department's expenses were for the following:

- Distributions to Arizona counties and cities comprise the Department's largest expense of \$1.0 billion (45.0 percent).
- Non-capital, including asset preservation, represents the Department's second largest expense of \$345.6 million (15.2 percent).
- Distributions to other state agencies represent the Department's third largest expense of \$254.7 million (11.2 percent).

Distributions to Arizona counties and cities decreased in fiscal year 2011 as compared to fiscal year 2010. As in the previous fiscal year, various legislative budget bills addressed the deficit in the State General Fund, in part by sweeping funds and transferring excess fund balances from state agencies to the State General Fund. The Department's distributions to other state agencies increased in fiscal year 2011 due to the legislative action.

The large increase in administration expense was primarily in the General Fund (State Highway Fund) due to the Department wanting to better reflect the expenses for direct and indirect cost pools. The increase in local government assistance was due to increased project activity, both revenue and expenditures increased in fiscal year 2011.

Business-type Activities

Net assets for business-type activities increased by \$1.4 million in fiscal year 2011. Total revenues were \$6.3 million, with charges for services representing 91.2 percent and income from investments 8.8 percent. The total expenses for business-type activities were \$5.8 million.

The Highway Expansion and Extension Loan Program had a decrease in total revenues (operating and non-operating) of \$364 thousand which was primarily due to the Department choosing not to loan money because the return on investment was not sufficient to merit the risk. Interest revenue increased this fiscal year due to the fund not issuing any new loans and receiving loan repayments, which increased average cash balances during the year.

The *Arizona Highways Magazine* had a decrease in operating revenues of \$356 thousand primarily due to a reduction in the number of subscribers for the monthly publication; and a reduction in the purchases of related products such as calendars, books, and holiday gift catalog items. Typically magazine subscribers also purchase these related products. This decline in demand is consistent with industry trends for many other consumer periodicals with revenues based predominantly on annual subscriptions, as well as an overall weaker economy, especially in Arizona where the majority of subscribers are located.

Financial Analysis of the Department's Funds

As previously mentioned, the Department uses fund accounting to ensure and demonstrate compliance with budgetary and legal requirements. The following is a brief discussion of financial highlights from the fund financial statements.

Governmental Funds The focus of the Department's governmental funds financial statements (pages 17-24) is to provide information on near-term inflows, outflows, and balances of spendable resources. All major governmental funds are discretely presented on these financial statements, while the non-major governmental funds are combined into a single column. Combining statements for the non-major governmental funds may be found on pages 61-64.

As of the end of the fiscal year, the fund balances of the governmental funds totaled \$1.1 billion, an increase of \$147.3 million over the previous fiscal year. Of the \$1.1 billion balance, \$87.3 million or 8.0 percent constitutes the unassigned portion of the fund balance, which was available for spending for the general purposes of the Department. The remaining fund balance of \$998.8 million, or 92.0 percent, is distributed into the following: \$9.8 million for inventories and \$22.6 million for land held for resale as nonspendable; \$946.0 million represents those funds that are restricted and used to pay for capital projects while \$3.5 million represents those funds that are restricted and used to pay for debt service; \$10.2 million represents that portion of the fund balance that is committed; and \$6.7 million represents those funds that have been assigned.

The General Fund (State Highway Fund) is the primary operating fund of the Department. At the end of the current fiscal year, the unassigned fund balance of the General Fund (State Highway Fund) was \$73.5 million; the nonspendable fund balance was \$32.4 million; the restricted fund balance was \$229.6 million; and the committed fund balance was \$6.3 million.

The Maricopa Regional Area Road Construction Fund is a major special revenue fund that receives a portion of Maricopa County Transportation Excise Tax monies that are used to provide a funding source for the construction of new freeways and other routes, improvements to existing freeways and other routes, and improvements to the arterial street system within Maricopa county. Total revenues collected in the fund in fiscal year 2011 were \$431.6 million; Transportation Excise Tax revenue of \$206.5 million (or 47.9 percent) was the bulk of the revenue. The remaining revenue was mainly federal revenue and income from investments.

The Debt Service Fund is used for the accumulation of resources for, and the payment of, general long-term debt principal and interest of the governmental funds. The other financing sources of \$331.5 million were transferred in from the General Fund (State Highway Fund) (\$154.4 million), Maricopa Regional Area Road Construction Fund (\$88.3 million), and Grant Anticipation Notes Fund (\$88.8 million), and were used to pay the debt service.

Arizona Department of Transportation
Management's Discussion and Analysis (continued)
June 30, 2011

The Capital Projects Fund is used to account for financial resources used for the acquisition or construction of major capital facilities in the governmental funds. During the fiscal year, the Department's expenditures were \$334.3 million. Capital outlay expenditures of \$266.1 million (79.6 percent) accounted for the majority of the expenditures in the Capital Projects Fund. This expenditure for the acquisition and construction of new highways was converted to capital assets on the government-wide statements.

Budget Variances

As a consequence of lower revenue collections and legislative fund sweeps, the Department reduced its fiscal year 2011 operating spending levels in order to ensure that there would be sufficient cash in the General Fund (State Highway Fund) to cover debt service, contractor payments, fund transfers, and daily operational expenses. Accordingly, actual expenditures for fiscal year 2011 were less than the Department's appropriated budget. Variances reflect personnel savings resulting from the statewide hiring freeze, operational savings from the elimination of non-mission critical overtime and travel; and deferred roadway equipment replacement, facility repair, and routine highway repair and maintenance. Reference the budgetary comparison schedule on page 54.

Capital Assets and Debt Administration

Capital Assets (See Note 5A to the financial statements for additional information)

The Department's investment in capital assets for its governmental and business-type activities as of June 30, 2011, amounts to \$18.0 billion (net of accumulated depreciation), a \$669.0 million increase over the previous fiscal year.

	Governmental Activities		Business-type Activities		Total	
	2011	2010	2011	2010	2011	2010
Land	\$ 2,619,089,147	\$ 2,494,102,975	\$ 7,900	\$ 7,900	\$ 2,619,097,047	\$ 2,494,110,875
Buildings and improvements	110,771,178	112,867,876	35,069	68,859	110,806,247	112,936,735
Improvements other than buildings	25,532,416	22,374,013	-	-	25,532,416	22,374,013
Mobile fleet and aircraft	41,920,580	41,292,766	-	-	41,920,580	41,292,766
Machinery and equipment	12,089,608	12,318,584	10,689	15,472	12,100,297	12,334,056
Infrastructure	11,604,565,886	11,036,788,230	-	-	11,604,565,886	11,036,788,230
Construction in progress	3,561,984,731	3,587,135,963	-	-	3,561,984,731	3,587,135,963
Total	<u>\$ 17,975,953,546</u>	<u>\$ 17,306,880,407</u>	<u>\$ 53,658</u>	<u>\$ 92,231</u>	<u>\$ 17,976,007,204</u>	<u>\$ 17,306,972,638</u>

As provided by accounting principles generally accepted in the United States (GAAP), the Department has elected to record its infrastructure assets using the modified approach, as defined in GASB Statement 34. Assets accounted for under the modified approach include 6,722 center lane miles (18,771 travel lane miles) and 4,741 bridges that the Department is responsible for maintaining.

The Five-Year Transportation Facilities Construction Program (Program) is a dynamic program and adjustments are made to the annual plans based on the needs of the Department to maintain the condition level of the roads and bridges at a level equal to, or greater than, the goals established by the Department. The Program is updated annually and adjustments are made monthly during the fiscal year, as circumstances may require.

The Department manages its roads using the Present Serviceability Rating (PSR), which measures the condition of the pavement and its ability to serve the traveling public. The PSR uses a five-point scale (5 excellent, 0 impassable) to characterize the condition of the roadway. The Department's serviceability rating goal is 3.23 for the overall system. The Department's most recent assessment indicated that an overall rating of 3.69 was achieved for fiscal year 2011.

The Department manages its bridges using the Arizona Bridge Information and Storage System (ABISS). The Department determines the condition rating based on standards developed by the Federal Highway Administration and additional internal criteria. It is the policy of the Department to maintain a Condition Rating Index (CRI) of 92.5 percent or better. In fiscal year 2011, a CRI of 93.1 percent was achieved.

Arizona Department of Transportation
Management's Discussion and Analysis (continued)
June 30, 2011

In addition to many smaller projects, the following major highway construction contracts in excess of \$10 million were started during fiscal year 2011:

Description	Contract		Fiscal Year 2011
	Start Date	Contract Amount	Construction Expenditures ¹
System enhancement/traffic management engineering State Route 101 Interstate 10 - Tatum Boulevard in Maricopa County.	12/17/2010	\$ 89,955,200	\$ 51,875,078
System enhancement/traffic management engineering State Route 202L HOV Lanes, Gilbert Road to Interstate 10 in Maricopa County.	7/16/2010	84,688,947	57,610,825
Capacity additions and major widening on Interstate 10 Interstate 8 to State Route 87 (Sunland Gin Road to Picacho Peak TI) in Pinal County.	8/4/2010	31,313,131	17,975,159
Capacity additions and reconstruction on Interstate 10 Val Vista Road to Earley Road in Pinal County.	10/15/2010	31,279,308	4,305,854
Capacity additions and reconstruction on State Route 260 in Doubtful Canyon in Gila County.	10/15/2010	29,359,129	4,583,045
Capacity additions and reconstruction on Interstate 10 and State Route 90 traffic interchange in Cochise County.	9/1/2010	27,602,268	9,752,446
System enhancement/traffic management engineering State Route 143 Sky Harbor Boulevard traffic interchange in Maricopa County.	10/15/2010	17,816,566	5,243,831
Capacity additions and major widening on US Highway 93 at Deluge Wash in Mohave County.	11/19/2010	13,847,988	4,529,331
System enhancements/safety improvements on State Route 85 at Gila Bend in Maricopa County.	12/17/2010	13,473,722	2,781,923
System enhancement regional supplemental noise walls in Maricopa County.	3/18/2011	13,256,416	1,715,755
Capacity additions and major widening on US Highway 93 at Wagon Bow Ranch in Mohave County.	11/19/2010	12,088,729	3,605,129
Construction of new bridges on State Route 89A at Viewpoint Drive traffic interchange in Yavapai County.	10/15/2010	11,352,403	5,537,668
Pavement preservation Interstate 10 State Line to Fortuna in Yuma County.	1/21/2011	10,994,201	6,815,570

¹ Construction Expenditures are strictly those costs paid to the primary contractor for each project shown.

Furthermore, the following major highway construction projects had expenditures in excess of \$15 million in fiscal year 2011. These project expenditures include payments made to construction contractors (as shown above) as well as utility, design, right-of-way, and landscaping costs:

Location Description	Fiscal Year 2011
	Project Expenditures ²
State Route 202L HOV Lanes, Gilbert Road to Interstate 10 in Maricopa County.	\$ 61,486,435
State Route 101 Interstate 10 - Tatum Boulevard in Maricopa County.	54,570,008
State Route 303L Interstate 10/State Route 303L Traffic Interchange in Maricopa County.	47,032,275
Interstate 10 Salt River to Baseline Road in Maricopa County.	39,920,907
State Route 303L Lake Pleasant Parkway to Interstate 17 in Maricopa County.	31,960,989
State Route 303L from Happy Valley Parkway to Lake Pleasant Parkway in Maricopa County.	22,720,317
US Highway 93 at Hoover Dam in Mohave County.	22,037,855
Interstate 10 Sarival Avenue to Dysart Road in Maricopa County.	19,766,482
Interstate 10 Interstate 8 to State Route 87 (Sunland Gin Road to Picacho Peak TI) in Pinal County.	18,830,490
State Route 260 at Little Green Valley in Gila County.	16,169,956
US Highway 60/Grand Ave SR 303L to 99th Avenue in Maricopa County.	16,104,570

² Project Expenditures include not only construction costs, but also engineering and design work, payroll (if applicable), and any other project related costs.

Arizona Department of Transportation
Management's Discussion and Analysis (continued)
June 30, 2011

Non-Current Liabilities (See Note 5F to the financial statements for additional information)

The Department's non-current liabilities for its governmental and business-type activities as of June 30, 2011, amount to \$3.1 billion, an increase of \$174.5 million from the previous fiscal year. The increase in capital leases was due to entering into new lease agreements in fiscal year 2011.

Governmental Activities	2011	2010
Highway revenue bonds	\$1,600,855,000	\$1,672,625,000
Transportation excise tax revenue bonds	877,845,000	743,815,000
Grant anticipation notes (GARVEE bonds)	392,495,000	304,480,000
Premium on bonds	180,225,182	158,600,871
Compensated absences	14,782,649	14,946,119
Capital leases	4,909,960	1,303,783
Advances and notes payable	59,891,686	60,711,311
Total governmental activities	3,131,004,477	2,956,482,084
Business-type Activities		
Compensated absences	136,069	129,361
Total business-type activities	136,069	129,361
Total non-current liabilities	\$ 3,131,140,546	\$ 2,956,611,445

The Department has issued revenue bonds in 51 separate issues between 1980 and 2011. All bonds outstanding as of June 30, 2011, are scheduled to mature on various dates, but none later than July 1, 2033. The bonds are obligations of the Transportation Board of the State of Arizona Department of Transportation (Transportation Board) and are not obligations of the State of Arizona. This data was gathered from the various bond records on file from the 1980s to the present.

Of the \$7.6 billion total in bonds issued between 1980 and 2011, \$1.4 billion, or approximately 18 percent, have been refunding issues to lower debt service costs. These efforts have resulted in cumulative debt service savings of \$82.4 million in current dollars and \$60.5 million on a present value basis.

The senior lien Highway Revenue Bonds have been rated AAA/Aaa by Standard & Poor's Ratings Services and Moody's Investors Service, respectively. The Department's subordinate lien Highway Revenue Bonds are rated AAA/Aa1. The Department's Transportation Excise Tax Revenue Bonds are rated AA+/Aa1. The Department's Grant Anticipation Notes ("GARVEE bonds") are rated AA/Aa2/AA with the additional rating provided by Fitch Ratings.

Refer to Note 6C, subsequent events, on page 53, for additional information.

Requests for Information

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with an overview of the Department's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Controller, Arizona Department of Transportation, 206 S. 17th Avenue, Phoenix, Arizona, 85007, or by visiting our website at http://www.azdot.gov/Inside_ADOT/fms/PDF/CAFR11.pdf.

Basic Financial Statements

Government-wide Financial Statements – include the Statement of Net Assets and the Statement of Activities and use the accrual basis of accounting for financial reporting.

Governmental Funds Financial Statements – include the Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balances for the major governmental funds and use the modified accrual basis of accounting for financial reporting. Also include the reconciliations to the government-wide financial statements.

Proprietary Funds Financial Statements – include the Statement of Net Assets, the Statement of Revenues, Expenses, and Changes in Fund Net Assets and the Statement of Cash Flows for the business-type activities and use the accrual basis of accounting for financial reporting.

Fiduciary Funds Financial Statement – includes the Statement of Net Assets for assets being held for parties outside of the Department.

Notes to the Financial Statements

Arizona Department of Transportation
Statement of Net Assets
June 30, 2011

	Governmental Activities	Business-type Activities	Total
Assets			
Unrestricted cash on deposit with the State Treasurer	\$ 38,926,510	\$ 1,646,696	\$ 40,573,206
Receivables:			
Subscriptions, net of allowance for doubtful accounts	-	102,269	102,269
Accrued interest	-	110,994	110,994
Taxes and fees	66,422,378	-	66,422,378
Notes and loans	6,216,929	4,424,033	10,640,962
Other, net of allowance for doubtful accounts	9,352,651	161,222	9,513,873
Due from U.S. Government for reimbursable costs	133,445,157	-	133,445,157
Internal balances	<24,550>	24,550	-
Inventories	13,043,516	473,234	13,516,750
Other assets/prepaid items	22,605,923	392,045	22,997,968
Deferred charges	21,568,357	-	21,568,357
Restricted cash on deposit with the State Treasurer	1,089,469,098	71,693,881	1,161,162,979
Capital assets not subject to depreciation (Note 5A)	17,785,639,764	7,900	17,785,647,664
Capital assets subject to depreciation, net of accumulated depreciation (Note 5A)	<u>190,313,782</u>	<u>45,758</u>	<u>190,359,540</u>
Total assets	<u>19,376,979,515</u>	<u>79,082,582</u>	<u>19,456,062,097</u>
Liabilities			
Accounts payable and other current liabilities	17,706,520	32,227	17,738,747
Accrued payroll and other accrued expenses	14,246,106	92,445	14,338,551
Contracts and retainage payable	136,803,973	-	136,803,973
Due to other state agencies	14,937,093	-	14,937,093
Due to Arizona counties and cities	107,524,568	30,590	107,555,158
Unearned revenues (Note 5C)	-	2,353,565	2,353,565
Non-current liabilities (Note 5F):			
Due within one year	210,010,060	136,069	210,146,129
Due in more than one year	<u>2,920,994,417</u>	<u>-</u>	<u>2,920,994,417</u>
Total liabilities	<u>3,422,222,737</u>	<u>2,644,896</u>	<u>3,424,867,633</u>
Net assets			
Invested in capital assets, net of related debt	15,159,085,525	53,658	15,159,139,183
Restricted:			
Loans and other financial assistance	-	76,192,180	76,192,180
Debt service	3,263,593	-	3,263,593
Capital projects	666,547,529	-	666,547,529
Unrestricted	<u>125,860,131</u>	<u>191,848</u>	<u>126,051,979</u>
Total net assets	<u>\$ 15,954,756,778</u>	<u>\$ 76,437,686</u>	<u>\$ 16,031,194,464</u>

The notes to the financial statements are an integral part of this statement.

Arizona Department of Transportation
Statement of Activities
for the fiscal year ended June 30, 2011

Functions/Programs	Expenses	Program Revenues			Net <Expenses> Revenues
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities					
Administration	\$ 93,040,027	\$ 10,769,571	\$ -	\$ 3,843,690	\$ <78,426,766>
Highway	37,069,567	2,797,580	50,302,930	739,874,392	755,905,335
Highway maintenance	129,699,887	2,667,173	-	-	<127,032,714>
Motor vehicle	99,948,875	117,426,959	-	-	17,478,084
Non-capital, including asset preservation	345,590,127	-	-	-	<345,590,127>
Distributions to other state agencies	254,702,299	-	-	-	<254,702,299>
Distributions to Arizona counties and cities	1,024,756,349	-	-	-	<1,024,756,349>
Local governmental assistance	163,035,322	-	170,456,155	-	7,420,833
Interest on long-term debt	128,768,466	-	-	-	<128,768,466>
Total governmental activities	<u>2,276,610,919</u>	<u>133,661,283</u>	<u>220,759,085</u>	<u>743,718,082</u>	<u><1,178,472,469></u>
Business-type Activities					
Arizona Highways Magazine	5,664,153	5,619,322	-	-	<44,831>
Highway Expansion and Extension Loan Program	125,981	153,589	-	-	27,608
Total business-type activities	<u>5,790,134</u>	<u>5,772,911</u>	<u>-</u>	<u>-</u>	<u><17,223></u>
Total	<u>\$ 2,282,401,053</u>	<u>\$ 139,434,194</u>	<u>\$ 220,759,085</u>	<u>\$ 743,718,082</u>	<u>\$ <1,178,489,692></u>
			Governmental Activities	Business-type Activities	Total
Net <expenses> revenues			\$ <1,178,472,469>	\$ <17,223>	\$ <1,178,489,692>
General revenues:					
Transportation excise taxes			206,545,412	-	206,545,412
Vehicle registration, title, license, and related taxes and fees			874,191,798	-	874,191,798
Fuel and motor carrier taxes and fees			704,726,732	-	704,726,732
Flight property taxes			9,798,513	-	9,798,513
Income from investments			9,414,904	554,941	9,969,845
Gain on sale of capital assets			3,604,096	-	3,604,096
Other			12,491,462	-	12,491,462
Transfers			<851,400>	851,400	-
Total general revenues			<u>1,819,921,517</u>	<u>1,406,341</u>	<u>1,821,327,858</u>
Change in net assets			641,449,048	1,389,118	642,838,166
Net assets - July 1			<u>15,313,307,730</u>	<u>75,048,568</u>	<u>15,388,356,298</u>
Net assets - June 30			<u>\$ 15,954,756,778</u>	<u>\$ 76,437,686</u>	<u>\$ 16,031,194,464</u>

The notes to the financial statements are an integral part of this statement.

Governmental Funds Financial Statements

Major Funds

General Fund (State Highway Fund)

This fund is used to account for all financial transactions applicable to the general operations of the Department. The fund receives money from the Highway User Revenue Fund including vehicle registration, title, license, and related fees, and fuel and motor carrier taxes. Reimbursements for certain construction expenditures are received from the federal government, Arizona cities and counties, and other state agencies. The fund also receives interest and other revenues. The fund disburses money primarily for the design, construction, improvement, and maintenance of state highways, parts of highways forming state routes, and highways under cooperative agreements with the United States and day-to-day operating expenses.

Maricopa Regional Area Road Construction Fund

This fund receives certain Maricopa County transportation excise tax monies collected by the Department of Revenue. These monies are used for the construction of new freeways and other routes, improvements to existing freeways and other routes, and improvements to the arterial street system within Maricopa County.

Motor Vehicle Division Clearing Fund

This fund accounts for the collection and disbursement of Motor Vehicle Division revenues.

Highway User Revenue Fund

This fund receives all revenues collected by the Department and its agents that are not designated for other purposes. The revenues include: motor fuel taxes, a portion of vehicle license tax, vehicle registration fees, driver license fees, dealer fees, permits, and other miscellaneous fees. These monies are distributed to the General Fund (State Highway Fund), the Department of Public Safety, the Economic Strength Project Fund, incorporated cities, counties, and other legislatively appropriated entities.

Debt Service Fund

This fund is used to administer all payments of principal and interest on bonds and notes issued by the Arizona Transportation Board for Highway Revenue Bonds, Transportation Excise Tax Revenue Bonds, and Grant Anticipation Notes (GARVEE bonds).

Capital Projects Fund

This fund is used to administer bond proceeds for Arizona Transportation Board Highway Revenue Bonds, Arizona Transportation Board Transportation Excise Tax Revenue Bonds, and Grant Anticipation Notes (GARVEE bonds). These monies are expended for the construction of projects in the Five-Year Transportation Facilities Construction Program.

Non-Major Funds

Other Governmental Funds are the non-major funds and are all special revenue funds. These funds can be found on Exhibit 9 and Exhibit 10.

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Arizona Department of Transportation
Balance Sheet
Governmental Funds
June 30, 2011

	Special Revenue Funds			
	General Fund (State Highway Fund)	Maricopa Regional Area Road Construction Fund	Motor Vehicle Division Clearing Fund	Highway User Revenue Fund
Assets				
Unrestricted cash on deposit with the State Treasurer	\$ 18,986,777	\$ -	\$ -	\$ -
Receivables:				
Interfund (Note 5D)	82,450,212	1,626,600	-	16,213,341
Taxes and fees	-	-	11,049,320	55,373,058
Notes and loans	1,910,694	-	-	-
Other (net)	3,323,343	2,076,407	-	-
Amounts due from U.S. Government	78,769,683	27,427,847	-	-
Inventories	9,765,026	-	-	-
Deferred charges	-	-	8,128,423	-
Land held for resale	22,605,923	-	-	-
Restricted cash on deposit with the State Treasurer	<u>229,558,642</u>	<u>411,303,936</u>	<u>38,789,437</u>	<u>94,609,454</u>
Total assets	<u>\$ 447,370,300</u>	<u>\$ 442,434,790</u>	<u>\$ 57,967,180</u>	<u>\$ 166,195,853</u>
Liabilities and fund balances				
Liabilities:				
Accounts payable	\$ 9,395,656	\$ -	\$ 7,741,188	\$ -
Accrued payroll and other accrued expenditures	13,249,008	150,009	-	11,738
Contracts and retainage payable	80,038,045	34,881,239	-	-
Interfund payables (Note 5D)	926,085	-	18,304,893	81,934,378
Amounts due to:				
Other state agencies	-	-	9,428,907	-
Arizona counties and cities	-	-	22,284,942	84,249,737
Surety and rental deposits	177,148	-	207,250	-
Deferred revenue (Note 5C)	<u>1,910,694</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>105,696,636</u>	<u>35,031,248</u>	<u>57,967,180</u>	<u>166,195,853</u>
Fund balances: (Note 5G)				
Nonspendable	9,765,026	-	-	-
Restricted	229,558,642	400,703,542	-	-
Committed	<u>102,349,996</u>	<u>6,700,000</u>	<u>-</u>	<u>-</u>
Total fund balances	<u>341,673,664</u>	<u>407,403,542</u>	<u>-</u>	<u>-</u>
Total liabilities and fund balances	<u>\$ 447,370,300</u>	<u>\$ 442,434,790</u>	<u>\$ 57,967,180</u>	<u>\$ 166,195,853</u>

The notes to the financial statements are an integral part of this statement.

Debt Service Fund	Capital Projects Fund	Total Non-Major Governmental Funds (See Exhibit 9)	Total Governmental Funds
\$ -	\$ -	\$ 18,313,493	\$ 37,300,270
-	-	2,831,702	103,121,855
-	-	-	66,422,378
-	-	4,306,235	6,216,929
-	-	3,952,901	9,352,651
-	-	27,247,627	133,445,157
-	-	-	9,765,026
-	-	-	8,128,423
-	-	-	22,605,923
<u>1,276,310</u>	<u>299,704,097</u>	<u>14,227,222</u>	<u>1,089,469,098</u>
<u>\$ 1,276,310</u>	<u>\$ 299,704,097</u>	<u>\$ 70,879,180</u>	<u>\$ 1,485,827,710</u>
\$ -	\$ -	\$ 66,297	\$ 17,203,141
-	-	232,195	13,642,950
-	-	21,884,689	136,803,973
-	1,626,600	220,651	103,012,607
-	-	5,508,186	14,937,093
-	-	989,889	107,524,568
-	-	-	384,398
-	-	<u>4,306,235</u>	<u>6,216,929</u>
-	<u>1,626,600</u>	<u>33,208,142</u>	<u>399,725,659</u>
-	-	-	9,765,026
1,276,310	298,077,497	19,908,994	949,524,985
-	-	<u>17,762,044</u>	<u>126,812,040</u>
<u>1,276,310</u>	<u>298,077,497</u>	<u>37,671,038</u>	<u>1,086,102,051</u>
<u>\$ 1,276,310</u>	<u>\$ 299,704,097</u>	<u>\$ 70,879,180</u>	<u>\$ 1,485,827,710</u>

Arizona Department of Transportation
 Reconciliation of the Balance Sheet of Governmental Funds
 to the Statement of Net Assets
 June 30, 2011

Total fund balances - governmental funds (Exhibit 3) \$ 1,086,102,051

Amounts reported for governmental activities in the Statement of Net Assets (Exhibit 1) are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds (Note 4 B1). 17,933,520,314

Internal service funds are used by management to charge the costs of equipment rentals to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets (Exhibit 5). 45,853,301

Other long-term assets are not available to pay for current-period expenditures and, therefore, are deferred in the funds (Note 4 B2). 6,216,929

Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the funds (Note 4 B3). <3,116,935,817>

Net assets of governmental activities (Exhibit 1) \$ 15,954,756,778

The notes to the financial statements are an integral part of this statement.

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Arizona Department of Transportation
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
for the fiscal year ended June 30, 2011

	Special Revenue Funds			
	General Fund (State Highway Fund)	Maricopa Regional Area Road Construction Fund	Motor Vehicle Division Clearing Fund	Highway User Revenue Fund
Revenues				
Transportation excise taxes	\$ -	\$ 206,545,412	\$ -	\$ -
Vehicle registration, title, license, and related taxes and fees	224,245,586	-	462,430,932	292,818,459
Fuel and motor carrier taxes and fees	304,669,062	-	14,391,769	348,899,622
Flight property taxes	-	-	-	-
Reimbursement of construction expenditures - federal aid	423,464,766	218,478,410	-	-
Other federal grants and reimbursements	50,302,930	-	-	-
Reimbursements from Arizona counties and cities	7,109,276	1,954,138	-	-
Distributions from other state agencies	845,000	-	-	-
Interest on loans receivable	113,329	-	-	-
Income from investments	3,039,740	2,127,157	-	379,061
Grand Canyon National Park Airport	-	-	-	-
Rental income	1,313,529	1,240,770	-	-
Other	<u>2,946,766</u>	<u>1,290,630</u>	<u>-</u>	<u>2,991,647</u>
Total revenues	<u>1,018,049,984</u>	<u>431,636,517</u>	<u>476,822,701</u>	<u>645,088,789</u>
Expenditures				
Current:				
Administration	79,232,477	479,831	-	-
Highway	34,222,358	2,958,816	-	-
Highway maintenance	120,716,320	-	-	-
Motor vehicle	<u>85,956,241</u>	<u>-</u>	<u>4,152,052</u>	<u>4,429,832</u>
Total current expenditures	<u>320,127,396</u>	<u>3,438,647</u>	<u>4,152,052</u>	<u>4,429,832</u>

The notes to the financial statements are an integral part of this statement.

Debt Service Fund	Capital Projects Fund	Total Non-Major Governmental Funds (See Exhibit 10)	Total Governmental Funds
\$ -	\$ -	\$ -	\$ 206,545,412
-	-	11,840,369	991,335,346
-	-	36,766,279	704,726,732
-	-	9,798,513	9,798,513
-	-	94,859,933	736,803,109
-	-	169,440,082	219,743,012
-	-	1,014,814	10,078,228
-	-	-	845,000
-	-	322,797	436,126
917,012	2,508,886	110,860	9,082,716
-	-	798,410	798,410
-	-	-	2,554,299
-	-	2,683,600	9,912,643
<u>917,012</u>	<u>2,508,886</u>	<u>327,635,657</u>	<u>2,902,659,546</u>
59,374	336,434	1,368,588	81,476,704
-	-	163,035,322	200,216,496
-	-	-	120,716,320
-	-	3,576,830	98,114,955
<u>59,374</u>	<u>336,434</u>	<u>167,980,740</u>	<u>500,524,475</u>

(continued)

Arizona Department of Transportation
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
for the fiscal year ended June 30, 2011

	Special Revenue Funds			
	General Fund (State Highway Fund)	Maricopa Regional Area Road Construction Fund	Motor Vehicle Division Clearing Fund	Highway User Revenue Fund
Expenditures (continued)				
Intergovernmental:				
Distributions to other state agencies	\$ 42,735,250	\$ 267,113	\$ 86,690,979	\$ 86,417,639
Distributions to Arizona counties and cities	32,234,127	39,786,379	385,979,670	554,241,318
Debt service:				
Principal	12,177,217	732,242	-	-
Interest	36,328	-	-	-
Bond issuance costs	-	-	-	-
Non-capital, including asset preservation	187,163,794	60,310,429	-	-
Capital outlay	282,103,646	156,190,273	-	-
Total expenditures	<u>876,577,758</u>	<u>260,725,083</u>	<u>476,822,701</u>	<u>645,088,789</u>
Excess <deficiency> of revenues over <under> expenditures	141,472,226	170,911,434	-	-
Other financing sources <uses>				
Transfers in	-	-	-	-
Transfers out for debt service	<154,458,652>	<88,261,828>	-	-
Transfers out other	<2,400,000>	-	-	-
Sale of capital assets	3,711,987	-	-	-
Insurance recovery	2,529,280	-	-	-
Debt issuance	17,532	11,095,085	-	-
Premium from debt issuance	-	-	-	-
Total other financing sources <uses>	<u><150,599,853></u>	<u><77,166,743></u>	-	-
Net change in fund balances	<9,127,627>	93,744,691	-	-
Fund balances - July 1	350,801,291	313,658,851	-	-
Fund balances - June 30	<u>\$ 341,673,664</u>	<u>\$ 407,403,542</u>	<u>\$ -</u>	<u>\$ -</u>

The notes to the financial statements are an integral part of this statement.

Debt Service Fund	Capital Projects Fund	Total Non-Major Governmental Funds (See Exhibit 10)	Total Governmental Funds
\$ -	\$ -	\$ 38,098,718	\$ 254,209,699
-	-	10,270,451	1,022,511,945
188,310,000	-	-	201,219,459
144,711,874	-	-	144,748,202
-	2,098,655	-	2,098,655
-	65,704,593	-	313,178,816
-	266,126,129	4,829,523	709,249,571
<u>333,081,248</u>	<u>334,265,811</u>	<u>221,179,432</u>	<u>3,147,740,822</u>
<332,164,236>	<331,756,925>	106,456,225	<245,081,276>
331,546,772	-	-	331,546,772
-	-	<88,826,292>	<331,546,772>
-	-	-	<2,400,000>
-	-	-	3,711,987
-	-	-	2,529,280
-	338,585,000	-	349,697,617
-	38,875,926	-	38,875,926
<u>331,546,772</u>	<u>377,460,926</u>	<u><88,826,292></u>	<u>392,414,810</u>
<617,464>	45,704,001	17,629,933	147,333,534
1,893,774	252,373,496	20,041,105	938,768,517
<u>\$ 1,276,310</u>	<u>\$ 298,077,497</u>	<u>\$ 37,671,038</u>	<u>\$ 1,086,102,051</u>

Arizona Department of Transportation
 Reconciliation of the Statement of Revenues,
 Expenditures, and Changes in Fund Balances of Governmental Funds
 to the Statement of Activities
 for the fiscal year ended June 30, 2011

Net change in fund balances - total governmental funds (Exhibit 4)	\$ 147,333,534
Amounts reported for governmental activities in the Statement of Activities (Exhibit 2)	
are different because:	
Capital outlays are reported as expenditures in governmental funds (Note 4 C1).	668,694,189
Bond proceeds provide current financial resources to governmental funds. However, issuing debt increases long-term liabilities in the statement of net assets. Governmental funds report the effect of issuance costs, premiums, discounts, and similar items when the debt is first issued, whereas these amounts are deferred and amortized in the statement of activities (Note 4 C2).	<386,474,888>
Repayment of long-term debt is reported as an expenditure in governmental funds, but the repayment reduces long-term liabilities in the statement of net assets (Note 4 C2).	217,199,195
Internal service funds are used by management to charge the cost of equipment rentals to individual funds. The net loss of the internal service funds is reported with governmental activities (Note 4 C3).	1,365,912
Some items reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds (Note 4 C4).	<u><6,668,894></u>
Change in net assets of governmental activities (Exhibit 2)	<u>\$ 641,449,048</u>

The notes to the financial statements are an integral part of this statement.

Proprietary Funds Financial Statements

Major Funds

Arizona Highways Magazine Fund

The fund consists of receipts generated from the sale of the *Arizona Highways Magazine* and other branded products. The fund provides for the production and sale of the *Magazine* and related products that promote the State of Arizona.

Highway Expansion and Extension Loan Program Fund

This fund is an innovative financing mechanism to administer monies designated to provide loans and credit enhancement assistance to the Department and to sponsors of local transportation projects.

Non-Major Fund

Internal Service Fund

The Equipment Revolving Fund is primarily funded by the charges it collects from the Department of Transportation, other state agencies, and local organizations to support the repair and maintenance of vehicles and equipment.

Arizona Department of Transportation
Statement of Net Assets
Proprietary Funds
June 30, 2011

	Business-type Activities - Enterprise Funds			Governmental Activities - Internal Service Fund
	Highway Expansion and Extension Loan Program Fund	Arizona Highways Magazine Fund	Total	
Assets				
Current assets:				
Unrestricted cash on deposit with the State Treasurer	\$ -	\$ 1,646,696	\$ 1,646,696	\$ 1,626,240
Receivables:				
Interfund	-	22,338	22,338	-
Subscriptions, net of allowance for doubtful accounts	-	102,269	102,269	-
Accrued interest	110,994	-	110,994	-
Loans	3,893,583	-	3,893,583	-
Other, net allowance for doubtful accounts	-	161,222	161,222	-
Inventories	-	473,234	473,234	3,278,490
Prepaid items	-	392,045	392,045	-
Restricted cash on deposit with the State Treasurer	71,693,881	-	71,693,881	-
Total current assets	<u>75,698,458</u>	<u>2,797,804</u>	<u>78,496,262</u>	<u>4,904,730</u>
Non-current assets:				
Loans receivable	530,450	-	530,450	-
Capital assets not subject to depreciation	-	7,900	7,900	-
Capital assets subject to depreciation, net of accumulated depreciation	-	45,758	45,758	42,433,232
Total non-current assets	<u>530,450</u>	<u>53,658</u>	<u>584,108</u>	<u>42,433,232</u>
Total assets	<u>76,228,908</u>	<u>2,851,462</u>	<u>79,080,370</u>	<u>47,337,962</u>
Liabilities				
Current liabilities:				
Accounts payable	-	32,227	32,227	118,981
Accrued payroll and other accrued expenses	2,499	89,946	92,445	603,156
Interfund payables	-	-	-	131,586
Due to Arizona counties and cities	30,590	-	30,590	-
Unearned revenues (Note 5C)	-	2,353,565	2,353,565	-
Compensated absences	3,639	132,430	136,069	587,413
Total current liabilities	<u>36,728</u>	<u>2,608,168</u>	<u>2,644,896</u>	<u>1,441,136</u>
Non-current liabilities:				
Compensated absences	-	-	-	43,525
Total non-current liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>43,525</u>
Total liabilities	<u>36,728</u>	<u>2,608,168</u>	<u>2,644,896</u>	<u>1,484,661</u>
Net assets				
Invested in capital assets, net of related debt	-	53,658	53,658	42,433,232
Restricted for loans and other financial assistance	76,192,180	-	76,192,180	-
Unassigned	-	189,636	189,636	3,420,069
Total net assets	<u>\$ 76,192,180</u>	<u>\$ 243,294</u>	<u>76,435,474</u>	<u>\$ 45,853,301</u>
Adjustment to reflect the consolidation of internal service fund activities related to enterprise funds			<u>2,212</u>	
Net assets of business-type activities			<u>\$ 76,437,686</u>	

The notes to the financial statements are an integral part of this statement.

Arizona Department of Transportation
Statement of Revenues, Expenses, and
Changes in Fund Net Assets
Proprietary Funds
for the fiscal year ended June 30, 2011

	<u>Business-type Activities - Enterprise Funds</u>			Governmental Activities - Internal Service Fund
	Highway Expansion and Extension Program Fund	Arizona Highways Magazine Fund	Total	
Operating revenues				
Sales and charges for services (net of write off \$46,256)	\$ -	\$ 5,061,950	\$ 5,061,950	\$ 24,420,139
Interest on loans receivables	153,589	-	153,589	-
Other	-	557,372	557,372	95,701
Total operating revenues	<u>153,589</u>	<u>5,619,322</u>	<u>5,772,911</u>	<u>24,515,840</u>
Operating expenses				
Publication and promotional cost	-	1,755,970	1,755,970	-
Repair and maintenance	-	13,065	13,065	1,250,313
Fuel and lubricants	-	-	-	11,264,070
Salaries and related benefits	46,057	1,552,596	1,598,653	11,091,549
Shipping and postage	-	678,975	678,975	-
Supplies	394	7,314	7,708	100,658
Equipment purchase and rental	-	23,376	23,376	201,784
Professional and outside services	37,500	476,707	514,207	46,337
Travel	-	13,581	13,581	30,802
Depreciation	-	38,574	38,574	7,558,221
Other	60	180,654	180,714	750,468
Total operating expenses	<u>84,011</u>	<u>4,740,812</u>	<u>4,824,823</u>	<u>32,294,202</u>
Operating income <loss>	69,578	878,510	948,088	<7,778,362>
Non-operating revenues <expenses>				
Income from investments	545,321	9,620	554,941	19,816
Investment expense	<41,970>	<757>	<42,727>	<1,081>
Gain <loss> on sale/disposal of capital assets	-	-	-	35,273
Insurance recoveries	-	-	-	137,893
Interest on capital leases	-	-	-	<5>
Distributions to other state agencies	-	<921,700>	<921,700>	<492,600>
Total non-operating revenues <expenses>	<u>503,351</u>	<u><912,837></u>	<u><409,486></u>	<u><300,704></u>
Capital contributions	-	-	-	7,895,494
Transfer in	-	851,400	851,400	2,400,000
Transfer out	-	-	-	<851,400>
Changes in net assets	572,929	817,073	1,390,002	1,365,028
Total net assets - July 1	<u>75,619,251</u>	<u><573,779></u>		<u>44,488,273</u>
Total net assets - June 30	<u>\$ 76,192,180</u>	<u>\$ 243,294</u>		<u>\$ 45,853,301</u>
Adjustment to reflect the consolidation of internal service fund activities related to enterprise funds			<884>	
Change in net assets of business-type activities			<u>\$ 1,389,118</u>	

The notes to the financial statements are an integral part of this statement.

Arizona Department of Transportation
Statement of Cash Flows
Proprietary Funds
for the fiscal year ended June 30, 2011

	Business-type Activities - Enterprise Funds			Governmental Activities - Internal Service Fund
	Highway Expansion and Extension Loan Program Fund	Arizona Highways Magazine Fund	Total	
Cash flows from operating activities				
Receipts from customers	\$ 74,325	\$ 4,992,849	\$ 5,067,174	\$ -
Receipts from other funds	-	-	-	14,577,064
Receipts from other agencies, Arizona counties, and cities	4,380,450	-	4,380,450	9,971,161
Payments to suppliers	<37,954>	<3,072,577>	<3,110,531>	<14,172,405>
Payments to employees	<45,415>	<1,542,074>	<1,587,489>	<11,092,855>
Other receipts <payments>	-	557,372	557,372	95,701
Net cash provided <used> by operating activities	<u>4,371,406</u>	<u>935,570</u>	<u>5,306,976</u>	<u><621,334></u>
Cash flows from non-capital financing activities				
Distributions to other state agencies	-	<921,700>	<921,700>	<492,600>
Transfers from <to> other funds	-	851,400	851,400	1,548,600
Net cash provided <used> by non-capital financing activities	<u>-</u>	<u><70,300></u>	<u><70,300></u>	<u>1,056,000</u>
Cash flows from capital and related financing activities				
Proceeds from sale of capital assets	-	-	-	120,427
Acquisition of capital assets	-	-	-	<126,831>
Insurance recoveries	-	-	-	137,893
Interest on capital leases	-	-	-	<5>
Net cash provided <used> by capital and related financing activities	<u>-</u>	<u>-</u>	<u>-</u>	<u>131,484</u>
Cash flows from investing activities				
Income from investments	545,321	9,620	554,941	19,816
Investment expense	<41,970>	<757>	<42,727>	<1,081>
Net cash provided <used> by investing activities	<u>503,351</u>	<u>8,863</u>	<u>512,214</u>	<u>18,735</u>
Net increase <decrease> in cash	4,874,757	874,133	5,748,890	584,885
Cash - July 1	66,819,124	772,563	67,591,687	1,041,355
Cash - June 30	<u>\$ 71,693,881</u>	<u>\$ 1,646,696</u>	<u>\$ 73,340,577</u>	<u>\$ 1,626,240</u>
Reconciliation of operating <loss> income to net cash provided <used> by operating activities				
Operating <loss> income	\$ 69,578	\$ 878,510	\$ 948,088	\$ <7,778,362>
Adjustment to reconcile operating <loss> income to net cash provided by operating activities:				
Depreciation	-	38,574	38,574	7,558,221
Net changes in assets and liabilities:				
Receivables	4,301,186	39,340	4,340,526	-
Inventories	-	40,943	40,943	<671,055>
Prepaid items	-	75,547	75,547	-
Accounts payable	-	<39,424>	<39,424>	112,280
Accrued payroll and other accrued expenses	144	4,312	4,456	34,062
Unearned revenues	-	<108,442>	<108,442>	-
Compensated absences	498	6,210	6,708	<4,566>
Advance/interfund payable	-	-	-	128,086
Net cash provided <used> by operating activities	<u>\$ 4,371,406</u>	<u>\$ 935,570</u>	<u>\$ 5,306,976</u>	<u>\$ <621,334></u>
Non-cash capital and financing activities				
Certain vehicles were contributed to the Equipment Revolving Fund by the General Fund totaling \$7,895,474				

The notes to the financial statements are an integral part of this statement.

fiscal year
2011

Comprehensive
Annual Financial Report
For the fiscal year ended June 30, 2011

Fiduciary Funds Financial Statements

Agency Funds

Highway Properties - Privilege Tax Fund

This fund collects monies from renters of properties previously acquired by the Department for use in future highway development. Monies collected are distributed to the Department of Revenue.

Highway Properties - 24 Percent Fund

This fund collects 24 percent of the Department's rental income from properties for use in future highway development. Monies collected are distributed to the local counties.

Arizona Department of Transportation
Statement of Net Assets
Agency Fund
June 30, 2011

Assets

Restricted cash on deposit with the State Treasurer	<u>\$ 415,227</u>
Total assets	<u>\$ 415,227</u>

Liabilities

Due to Arizona counties	<u>\$ 415,227</u>
Total liabilities	<u>\$ 415,227</u>

The notes to the financial statements are an integral part of this statement.



Notes to the Financial Statements

Arizona Department of Transportation
Index – Notes to the Financial Statements
June 30, 2011

	<u>Page</u>
Note 1 – Summary of Significant Accounting Policies	30
A – Reporting Entity.....	30
B – Government-wide and Fund Financial Statements.....	30
C – Measurement Focus, Basis of Accounting, and Financial Statement Presentation	31
D – Assets, Liabilities, and Net Assets/Fund Balance	33
E – Revenues and Expenditures/Expenses	36
F – Interfund Activity and Balances	37
Note 2 – Funds by Classification.....	38
Note 3 – Budgeting, Budgetary Control, and Legal Compliance	38
Note 4 – Accounting Pronouncements and Reconciliation of Government-wide and Fund Financial Statements	39
A – New Accounting Pronouncements.....	39
B – Explanations of Reconciling Items of the Balance Sheet of Governmental Funds to the Statement of Net Assets	40
C – Explanations of Reconciling Items of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities	41
Note 5 – Detailed Notes on all Funds	43
A – Capital Assets	43
B – Construction Commitments	44
C – Deferred/Unearned Revenues	45
D – Interfund Receivables, Payables, Advances, and Transfers.....	45
E – Leases.....	46
F – Non-Current Liabilities	47
G – Fund Balances.....	52
Note 6 – Other Information	52
A – Contingent Liabilities	52
B – Pension and Other Postemployment Benefits	52
C – Subsequent Events	53

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Arizona Department of Transportation (Department) conform in all material respects to accounting principles generally accepted in the United States of America (GAAP) as applicable to governments. The Governmental Accounting Standards Board (GASB) is the primary standard-setting body for establishing governmental accounting and financial reporting principles, which are primarily set forth in the GASB's *Codification of Governmental and Financial Reporting Standards* (GASB Codification). Following is a summary of the Department's significant accounting policies.

A. Reporting Entity

The Department is a department of the State of Arizona (State) and is not a legally separate entity. The Department has no component units. The Director of the Department serves as the Chief Executive Officer and is directly responsible to the governor. The governor appoints a seven-member Transportation Board of the State of Arizona Department of Transportation (Transportation Board) which has responsibility for establishing a complete system of state highway routes, approving all highway construction contracts, and distributing monies for local airport facilities' projects through a grant program.

The Department is responsible for the construction and maintenance of all state highways. The Department cooperates with the various cities and counties within the state in the construction and maintenance of state roads and with the Federal Highway Administration in the construction and maintenance of interstate and other highways. Assistance in the development of local airports, registering motor vehicles and aircraft, licensing drivers, and the publishing of the *Arizona Highways Magazine* are also responsibilities of the Department.

B. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all of the non-fiduciary activities of the government. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by federal reimbursement, taxes, and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for services.

The **Statement of Net Assets** presents the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and is reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

Restricted net assets result when constraints placed on asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources which are imposed by management, but can be removed or modified by management or the Transportation Board.

The **Statement of Activities** demonstrates the degree to which the direct expenses of a given function are offset by program revenues. *Direct expenses* are those that are clearly identified with a specific function. *Program revenues* include: charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function; and grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

Fund Financial Statements

Separate statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major proprietary funds are reported as separate columns in the fund financial statements, with non-major funds being reported in a single column.

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the full *accrual basis of accounting*, as are the proprietary funds. Revenues are recorded when earned and expenses are recorded when the liability is incurred, regardless of the timing of related cash flows. Taxes are recognized as revenues in the year they are levied for transportation excise, aircraft licensing, aviation and motor fuel, flight property, and underground storage tanks. Motor carrier and vehicle license taxes are recognized when received. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

As allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the Department's enterprise funds follow GASB pronouncements and those Financial Accounting Standard Board (FASB) Statements and Interpretations, Accounting Principle Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement. The enterprise funds do not follow any FASB Statements and Interpretations issued after November 30, 1989.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Department considers revenues to be available if they are collected within 60 days of the end of the fiscal year, e.g., federal revenue reimbursements, vehicle license taxes, and highway user revenue taxes. Expenditures generally are recorded when a liability is incurred as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due and payable.

Financial Statement Presentation

The Department reports the following major governmental funds:

The *General Fund*, known as the State Highway Fund, is the primary operating fund. It accounts for all financial resources except for those required to be accounted for in another fund. Expenditures are reported for general operations of the Department, including road and bridge repairs, maintenance and construction, planning and development, engineering, and administration. Revenues are received from the following primary sources: fuel and motor carrier taxes and fees; vehicle registrations, titles, licenses and related fees; and federal grants.

The *Maricopa Regional Area Road Construction Fund* is a special revenue fund that receives a portion of Maricopa County Transportation Excise Tax monies collected by the Department of Revenue. These monies are expended for the construction of new freeways and other routes, improvements to existing freeways and other routes, and improvements to the arterial street system, which are included in the Maricopa County Regional Transportation Plan.

The *Motor Vehicle Division Clearing Fund* is a special revenue fund which accounts for the collection and disbursement of certain Motor Vehicle Division revenues (e.g., vehicle registration, title, license, and related taxes and fees, and fuel and motor carrier taxes and fees).

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

The *Highway User Revenue Fund* is a special revenue fund which collects motor vehicle and liquid use fuel taxes and receives certain Motor Vehicle Division revenues from the Motor Vehicle Division Clearing Fund. These monies are distributed to the General Fund (State Highway Fund), the Department of Public Safety, the Economic Strength Project Fund, incorporated cities, towns, counties, and other legislatively appropriated entities.

The *Debt Service Fund* is used to account for the accumulation of resources for, and the payments of, general long-term debt principal and interest of the governmental funds.

The *Capital Projects Fund* is used to account for financial resources to be used for the acquisition or construction of major capital facilities in the governmental funds.

The Department reports the following major proprietary funds:

The *Highway Expansion and Extension Loan Program Fund* is an innovative financing mechanism to administer funds designated to provide loan and credit enhancement assistance to sponsors of local transportation projects.

The *Arizona Highways Magazine Fund* publishes and markets the *Arizona Highways Magazine* and various other products that promote the State of Arizona.

Additionally, the Department reports the following funds:

The *Internal Service Fund*, which accounts for purchases and maintenance of equipment and materials to be used by other divisions in the Department and other government agencies. The Equipment Revolving Fund is the Department's only internal service fund.

The *Agency Fund* is custodial in nature (assets equal liabilities) and does not involve measurement of results of operations. The Highway Properties – 24 Percent Fund (which is not included in the government-wide statements) is the Department's only agency fund.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges for services by the Equipment Revolving Fund to the other governmental functions. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as *program revenues* include: charges for services, operating grants and contributions, and capital grants and contributions. Internally dedicated resources are reported as *general revenues* rather than program revenues. Likewise, general revenues include all taxes.

Proprietary funds distinguish *operating revenues* and expenses from *non-operating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues are charges for services and magazine subscriptions. The Department also recognizes as operating revenues interest on loan receivables and other revenues intended to recover the cost of services. Operating expenses for the enterprise funds and the internal service fund include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

When both restricted and unrestricted resources are available for use, the Department generally expends the restricted resources first, and then unrestricted resources, as they are needed to maintain appropriate cash balances and finance the construction program.

D. Assets, Liabilities, and Net Assets/Fund Balance

Deposits and Investments

The Department's cash includes petty cash, bank accounts, and deposits with the State Treasurer for pooled investments. All investments are carried in the name of the State of Arizona. State statutes require the State Treasurer to invest these pooled funds in collateralized time certificates of deposit, repurchase agreements, obligations of the U.S. Government, or other permitted investments. All investments are carried at fair value. These balances are not subject to GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, and GASB Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*, classification because they are included in the state's investment pool.

The investment pool is not required to register (and is not registered) with the Securities and Exchange Commission under the 1940 Investment Advisors Act. The activity and performance of the pool is reviewed monthly by the State Board of Investment in accordance with Arizona Revised Statutes, §35-311. The fair value of investments is measured on a monthly basis. Participant shares are purchased and sold based on the Net Asset Value (NAV) of the shares. The NAV is determined by dividing the fair value of the portfolio by the total shares outstanding. The State Treasurer does not contract with an outside insurer in order to guarantee the value of the portfolio or the price of shares redeemed. As of June 30, 2011, the State's investment pool 5 was rated AAAF/S1+ by Standard & Poor's Ratings Service. The weighted average maturity at year end for investment pool 5 was twenty-seven days while for investment pool 7 it was forty-seven days.

State statutes require the State Treasurer to maintain separate investment accounts for the portions of the Highway Revenue Bond Proceeds Fund relating to the Highway Revenue Bond issues and the Maricopa Regional Area Road Bond Proceeds Fund relating to the Transportation Excise Tax Revenue Bond issues. These funds may be invested by the Treasurer in the state's investment pool.

The Department's investments are included in the state investment pool and these investments are not shown in the Department's name. From the perspective of the Department, the pool functions as both a cash management pool and a demand deposit account. Therefore, the Department presents its equity in the internal pool as required in GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, and carries the investments at amortized cost, which approximates fair value.

The Department has restricted cash for payment of capital projects for Maricopa and Pima Counties, for future debt service payments, and for the Statewide Transportation Acceleration Needs account.

Receivables, Payables and Advances

Activities between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as interfund receivables/payables. All other outstanding balances between the U.S. Government, Arizona counties and cities, and other state agencies are reported as due to/from. Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as internal balances.

Advances between funds, as reported in the fund financial statements, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources. The other receivables and subscriptions receivable are shown net of allowance for doubtful accounts. For other receivables comprising recoverable insurance claims, the amount reserved for doubtful accounts is comprised of 100% of balances greater than six years old, 95% of balances from four to six years old, and a percentage of balances less than four years old. The subscriptions receivable allowance for doubtful accounts is equivalent to an estimated number of issues delivered on outstanding subscription payments past due more than 90 days.

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

Notes receivable represents loans made to parties purchasing assets previously owned by the Department for highway construction purposes.

Inventories and Prepaid Items

The governmental activities inventory is valued at cost, which approximates market, using the moving average method. This inventory is accounted for using the consumption method. Under this method, inventories are recorded as expenditures as they are used. The fund financial statement reports inventory as nonspendable for the like amount indicating it does not constitute available expendable resources. No reservation of net assets is shown in the government-wide statements for inventories.

The business-type activities' inventories are stated at the lower of cost or market. Costs of enterprise fund inventories consisting of resale products and supplies are generally determined by moving average cost and specific identification methods, respectively. Costs of the internal service fund's inventories (consisting of vehicle parts and supplies, fuels and lubricants, and other supplies) are determined by moving average cost methods.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both the government-wide and fund financial statements.

Restricted Assets

Certain proceeds of the Department's governmental revenue bonds, as well as certain resources of the General Fund (State Highway Fund) and the Highway Expansion and Extension Loan Program Fund (enterprise fund) are classified as restricted assets on the balance sheet because they are maintained in separate accounts and their use is limited by applicable bond covenants or state statutes. State law requires 12.6 percent of the revenues allocated each year to the General Fund (State Highway Fund) from the Highway User Revenue Fund be allocated for design, purchase of right-of-way, or construction of controlled-access highways, arterial streets, and local highways that are included in the regional transportation plan of counties with populations in excess of 400,000 (Maricopa and Pima counties). State Transportation Board policy further allocates 2.6 percent of the revenues allocated each year to the General Fund (State Highway Fund) from the Highway User Revenue Fund for the design, purchase of right-of-way, or construction of controlled-access highways, that are included in the regional transportation plan of counties with populations in excess of 400,000 (Maricopa and Pima counties). The debt service fund is used to report the resources set aside for payment of future debt service. Bond proceeds are deposited in the capital projects fund and are restricted for acquisitions of right-of-way and construction of federal, state, and local highways.

Capital Assets

Capital assets, which include land, buildings and improvements, improvements other than buildings, machinery and equipment, infrastructure, and construction in progress, are reported in the applicable governmental or business-type columns in the government-wide financial statements. Capital assets are defined by the Department as assets with an initial, individual cost of \$5,000 or more and an estimated useful life in excess of one year. Purchased capital assets are recorded at historical cost or estimated historical cost if historical cost is not available. Donated capital assets are recorded at estimated fair value at the date of donation.

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. Outlays for capital assets are capitalized at the time of the purchase or, in the case of infrastructure, at the time of final acceptance by the Department from the contractor. Asset preservation costs are expensed as incurred.

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

The Department depreciates non-infrastructure capital assets on a straight-line basis using the following estimated useful lives:

Assets	Years
Buildings and improvements	20-40
Improvements other than buildings	20-40
Machinery and equipment	5-15
Mobile fleet and aircraft	5-15

Infrastructure was capitalized for the first time in fiscal year 2002. The infrastructure assets are reported in the governmental activities column of the Statement of Net Assets. The Department's infrastructure assets consist of roads and bridges and are presented using the modified approach and, therefore, are not depreciated.

In order to utilize the modified approach, the Department is required to maintain an asset management system that includes an up-to-date inventory of eligible infrastructure assets, perform condition assessments of eligible assets and summarize the results using a measurement scale, estimate each year the annual amount to maintain and preserve the assets at the condition level established and disclosed by the Department, and document that the assets are being preserved approximately at or above the established condition level.

Deferred/Unearned Revenues

In the government-wide statements and proprietary fund financial statements, deferred/unearned revenues are recorded when cash, receivables, or other assets are received prior to revenue being recognized. In the governmental funds, amounts are reported as deferred revenues until they are available to liquidate liabilities of the current period. Deferred/unearned revenues are reported in the government-wide statements for the business-type activities and in the fund statements for both the governmental and proprietary funds. In the government-wide statements, the unearned revenues relate to unearned subscription revenue for the *Arizona Highways Magazine*. Unearned subscription revenue is recorded when subscription orders are received and is amortized as revenue over the terms of the related subscriptions. Costs associated with the selling of subscriptions are expensed in the year incurred. In the fund statements for the General Fund (State Highway Fund), the deferred revenue represents the amount for the notes receivable for loans made to parties who purchased assets previously owned by the Department for highway construction purposes. For the Non-Major Governmental Funds, the deferred revenue represents loans to various local governments for airport capital improvements designed to generate airport revenues and/or related airport economic development efforts. Loans are typically for construction of aircraft storage hangars, fuel dispensing and storage facilities, and terminal buildings. Loan rates vary and are based on the Bond Buyer Index (BBI) for 25 year national revenue bonds. Loan periods are typically 10 to 25 years in length.

Compensated Absences

It is the Department's policy to permit employees to accumulate earned but unused sick leave and vacation benefits as well as compensatory time. There is no liability for unpaid accumulated sick leave for the Department. All vacation pay and compensatory time is accrued when incurred in the government-wide and proprietary fund financial statements.

Effective July 1, 1998, state employees are eligible to receive payment for an accumulated sick leave balance of 500 hours or more with a maximum of 1,500 hours, upon retirement directly from state service. The benefit value is calculated by taking the employee's hourly rate of pay at the retirement date, multiplied by the number of sick hours at the retirement date, times the eligibility percentage. The eligibility percentage varies based upon the number of accumulated sick hours from 25 percent for 500 hours to a maximum of 50 percent for 1,500 hours. The maximum benefit value is \$30,000. The benefit is paid out in annual installments over three years. The Retiree Accumulated Sick Leave Fund is accounted for on the state's financial statements as an Internal Service Fund.

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

Employees are allowed to accumulate up to 240 hours of vacation leave (320 hours for uncovered employees) and up to 240 hours of compensatory time which is paid when vacation or compensatory time is taken or upon termination of employment at the individual's then current rate of pay. The liabilities for vacation and compensatory time outstanding as of June 30 for both the governmental and proprietary funds are reported on the Statement of Net Assets.

Long-term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities. Bond premiums and discounts are deferred and amortized using the straight-line method. Bonds payable are reported net of the applicable premium or discount. Debt issuance costs are reported as deferred charges and amortized over the term of the related debt. Other long-term obligations also include amounts that other governmental entities advance the Department for highway road construction projects.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as issuance costs, during the current period. The face amount of the debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures. Advances from other governmental entities are recorded as debt issuance in other financing sources.

Net Assets/Fund Balance

The difference between assets and liabilities is "Net Assets" on the government-wide and proprietary statements and "Fund Balance" on the governmental fund statements.

Fund balances for governmental funds may be classified as nonspendable, restricted, committed, assigned, or unassigned in the fund financial statements. Nonspendable fund balance describes that portion of fund balance that cannot be spent because of its form; restricted fund balance describes that portion of fund balance that reflects resources that are subject to externally enforceable legal restrictions; committed fund balance describes that portion which has self-imposed limitations; assigned fund balance describes that portion of fund balance that reflects a governments' intended use of resources; and unassigned fund balance represents net resources in excess of what can properly be classified in one of the other categories.

The State applies restricted resources first when expenditures are incurred for purposes for which either restricted or unrestricted (committed, assigned, and unassigned) amounts are available. Similarly, within unrestricted fund balance, committed amounts are reduced first followed by assigned, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of the unrestricted fund balance classifications could be used.

E. Revenues and Expenditures/Expenses

In the government-wide Statement of Activities, revenues and expenses are segregated by activity (governmental or business-type), then further by function (e.g., Administration, Highway). Additionally, revenues are classified between program and general revenues. Program revenues include charges for services, operating grants and contributions, and capital grants and contributions. Internally dedicated resources are reported as general revenue rather than as program revenue. General revenue includes all taxes and income on investments.

In the governmental fund financial statements, revenues are reported by source. Expenditures are reported by function (e.g., Administration, Distributions to Arizona counties and cities, Distributions to other state agencies, Debt service, Capital outlay).

The Distributions to Arizona counties and cities and Distributions to other state agencies are shared tax revenues that are distributed based on statutory requirements. Debt service includes both interest and principal outlays related to

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

bonds, loans, advances, board funding obligations, and capitalized leases. Capital outlay includes expenditures for real property or infrastructure (i.e., bridges and roads).

Revenues and expenses of proprietary funds are classified as operating and non-operating and are sub-classified by object (e.g., salaries, equipment rental, depreciation). Operating revenues and expenses generally result from providing services and producing and delivering goods. All other revenues and expenses are reported as non-operating.

Other Financing Sources <Uses>

Other financing sources are additions to the governmental fund balances in the fund financial statements and include resources and financing provided by bond issuance, sale of capital assets, capital leases, insurance recovery, and transfers from other funds. Other financing uses are reductions of governmental fund resources in fund financial statements normally resulting from transfers to other funds.

F. Interfund Activity and Balances

Interfund Activity

As a general rule, the effect of interfund activity has been eliminated from the government-wide statements. Exceptions to this rule are activities between the funds reported as governmental activities and the funds reported as business-type activities (e.g., the transfer of the gain or loss from the Equipment Revolving Fund).

Interfund Balances

Interfund receivables and payables have been eliminated from the Statement of Net Assets, except for the residual amounts due between governmental and business-type activities.

2. FUNDS BY CLASSIFICATION

The following table lists all of the funds whose balances are reflected in this financial report.

FUND TYPES

MAJOR FUNDS

Governmental Funds:

- General Fund (State Highway Fund)
- Special Revenue Funds:
 - Maricopa Regional Area Road Construction Fund
 - Motor Vehicle Division Clearing Fund
 - Highway User Revenue Fund
- Debt Service Fund
- Capital Projects Fund

Proprietary Funds:

- Enterprise Funds:
 - Arizona Highways Magazine Fund
 - Highway Expansion and Extension Loan Program Fund
- Internal Service Fund
- Equipment Revolving Fund

FIDUCIARY FUNDS

Agency Fund:

- Highway Properties–24 Percent Fund

NON-MAJOR FUNDS

Other Governmental Funds:

- Special Revenue Funds:
 - State Aviation Fund
 - Safety Enforcement and Transportation Infrastructure Fund
 - Motor Vehicle Liability Insurance Enforcement Fund
 - Motor Vehicle Inspection and Title Enforcement Fund
 - Motor Carrier Safety Revolving Fund
 - Underground Storage Tank Fund
 - Economic Strength Project Fund
 - Grant Anticipation Notes Fund
 - Local Agency Deposits Fund

3. BUDGETING, BUDGETARY CONTROL, AND LEGAL COMPLIANCE

An annual budget for the operating expenditures of the General Fund (State Highway Fund) is submitted to the governor in accordance with state law. The budget is legally enacted as appropriations after approval by the state legislature and signature of the governor. The legal level of control for operating expenditures is set at the agency level and expenditure budgets are appropriated using a lump-sum by agency format with a special line-item appropriation for highway maintenance. Expenditure details for personal services, employee-related expenditures, and all other operating expenditures are specifically allocated within all divisions. In certain divisions, other specific programs are allocated in addition to these categories. Revenue budgets are developed internally by the Department and are not part of the appropriation process.

Amendments to the approved appropriations require legislative approval. However, since the Department's appropriation is a lump sum appropriation, the allocation of funds between personal services, employee-related expenditures, and other operating expenditures is an internal decision. Accordingly, transfers between line items such as personal services and other operating expenditures within a particular program may be made by the program manager. Expenditures may not exceed appropriations. All transfers of funds are reported to the Department's Office of Strategic Planning and Budgeting for monitoring purposes.

Budgets are prepared on the cash basis except that liabilities incurred before the end of the fiscal year and paid within the first month of the subsequent fiscal year are charged against the prior fiscal year's budget. The Department's appropriations lapse at fiscal year-end unless exempted by the legislature.

In addition, budgets for capital outlay, including land, building, and improvements for the State Highway Fund and State Aviation Fund, are also submitted to the governor in accordance with state law. The capital outlay appropriation includes state highway construction and land, building, and improvements for the State Highway Fund. A legal limitation is adopted for land, building, and improvements; however, legislation allows the Department to spend in excess of its appropriation for state highway construction up to the current fund balance. The Department monitors expenditures through an internal budgetary process and the Five-Year Transportation Facilities Construction Program approved by the Transportation Board.

4. ACCOUNTING PRONOUNCEMENTS AND RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

A. New Accounting Pronouncements

Statement No. 51 Accounting and Financial Reporting for Intangible Assets

The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies, thereby enhancing the comparability of the accounting and financial reporting of such assets among state and local governments. This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. This Statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. Such guidance should be applied in addition to the existing authoritative guidance for capital assets. The provisions of this Statement are effective for periods beginning after June 15, 2009. The Department has implemented this Statement as appropriate.

Statement No. 53 Accounting and Financial Reporting for Derivative Instruments

This Statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. Governments enter into derivative instruments as investments; as hedges of identified financial risks associated with assets or liabilities, or expected transactions; or to lower the cost of borrowing. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2009. The Department has implemented this Statement as appropriate.

Statement No. 54 Fund Balance Reporting and Governmental Fund Type Definitions

The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The initial distinction that is made in reporting fund balance information is identifying amounts that are considered *nonspendable*, such as fund balance associated with inventories. This Statement also provides for additional classification as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent. Governments also are required to classify and report amounts in the appropriate fund balance classifications by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent. Disclosures of the policies in the notes to the financial statements is required. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2010. The Department has implemented this Statement as appropriate.

Statement No. 57 OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans

The objectives of this Statement are to address issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer other post-

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

employment benefit (OPEB) plans (i.e., agent employers). In addition, this Statement clarifies that when actuarially determined OPEB measures are reported by an agent multiple-employer OPEB plan and its participating employers, those measures should be determined as of a common date and at a minimum frequency to satisfy the agent multiple-employer OPEB plan's financial reporting requirements. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2011. The Department will implement this Statement as appropriate. There will be no impact to the Department.

Statement No. 58 *Accounting and Financial Reporting for Chapter 9 Bankruptcies*

The objective of this Statement is to provide accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. It requires governments to remeasure liabilities that are adjusted in bankruptcy when the bankruptcy court confirms (i.e., approves) a new payment plan. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2009. The Department has implemented this Statement as appropriate. There was no impact to the Department.

Statement No. 59 *Financial Instruments Omnibus*

The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2010. The Department has implemented this Statement as appropriate. There was no impact to the Department.

B. Explanations of Reconciling Items of the Balance Sheet of Governmental Funds to the Statement of Net Assets

The governmental funds Balance Sheet includes a reconciliation between total fund balances – governmental funds and net assets of governmental activities as reported on the government-wide Statement of Net Assets. The following explanations are necessary to clarify these differences between the governmental fund Balance Sheet and the government-wide Statement of Net Assets:

1. Capital assets are not included on the fund statements, but are included on the government-wide statement as follows:

Capital assets not subject to depreciation	\$ 17,785,639,764
Capital assets subject to depreciation	<u>190,313,782</u>
	17,975,953,546
Less Internal Service Fund (Equipment Revolving Fund) assets	<u><42,433,232></u>
	<u>\$ 17,933,520,314</u>

2. Deferred revenues for assets shown in the fund statements for the following funds:

Governmental funds:	
General Fund (State Highway Fund)	\$ 1,910,694
State Aviation Fund	<u>4,306,235</u>
	<u>\$ 6,216,929</u>

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

3. Long-term liabilities, including bonds payable, are not due and payable in the current period and are not reported in the current period on the fund statements. The detail for the difference is as follows:

Bonds payable	\$ <3,051,420,182>
Deferred charges - bond issuance costs	13,439,934
Capital leases	<4,909,960>
Compensated absences	<14,151,711>
Advances and notes payable	<59,891,686>
Business activity share of Equipment Revolving Fund gain <loss>	<2,212>
	\$ <3,116,935,817>

C. Explanations of Reconciling Items of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities

The governmental funds Statement of Revenues, Expenditures, and Changes in Fund Balances includes a reconciliation between net change in fund balances – total governmental funds and changes in net assets of governmental activities as reported on the government-wide Statement of Activities. The following explanations are necessary to clarify these differences between the governmental fund Statement of Revenues, Expenditures, and Changes in Fund Balances and the government-wide Statement of Activities:

1. Governmental funds report capital outlay as expenditures. However, in the Statement of Activities, these costs are removed; some costs are capitalized as assets while other costs are expensed as follows:

Capital outlay	\$ 709,249,572
Reduction in construction in progress resulting from certain infrastructure project being reclassified from capital outlay to non-capital	<20,610,496>
Change in net capital assets – Internal Service Fund (Equipment Revolving Fund)	<378,950>
Assets removed from service, net of accumulated depreciation	<4,079,135>
Other	62,982
Less depreciation expense – governmental funds	<7,991,563>
Less depreciation expense – Internal Service Fund (Equipment Revolving Fund)	<7,558,221>
	\$ 668,694,189

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

2. The issuance of long-term debt (e.g., bonds) provides current financial resources to governmental funds, while the repayment of principal of long-term debt consumes current financial resources of the governmental funds. Neither transaction, however, has any effect on net assets. Also, the government reports the effect of debt issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are amortized in the Statement of Activities. The details of this difference are as follows:

Debt issued or incurred:	
Issuance of Transportation Excise Tax Revenue Bonds	\$ <180,000,000>
Issuance of Grant Anticipation Notes (GARVEE bonds)	<158,585,000>
Premium on bonds	<38,875,926>
Bond issuance costs	2,098,655
Advances and notes payable	<11,112,617>
	<u>\$ <386,474,888></u>
Principal repayments:	
Highway Revenue Bonds	\$ 71,770,000
Transportation Excise Tax Revenue Bonds	45,970,000
Grant Anticipation Notes (GARVEE bonds)	70,570,000
Amortization of premium and discount	17,251,615
Amortization of debt issuance costs	<1,271,879>
Repayment of advances and notes payable	11,932,242
Repayment of capital leases	977,217
	<u>\$ 217,199,195</u>

3. The Internal Service Fund (Equipment Revolving Fund) is used by the Department to charge the cost for purchases and maintenance of equipment and material to be used by other funds and state agencies. The gain <loss> in the Internal Service Fund (Equipment Revolving Fund) represents over <under> billing and must be eliminated from the government-wide Statement of Activities for the business activity.

Internal Service Fund (Equipment Revolving Fund):	
Changes in net assets	\$ 1,365,028
Business activity share of Equipment Revolving Fund <gain> loss	884
	<u>\$ 1,365,912</u>

4. Some items reported in the Statement of Activities do not provide or require the use of current financial resources and, therefore, are not reported in the governmental funds. The details are as follows:

Notes and loans receivables	\$ <2,244,404>
Compensated absences	158,904
Assumption of lease by General Fund (State Highway Fund)	<4,583,394>
	<u>\$ <6,668,894></u>

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

5. DETAILED NOTES ON ALL FUNDS

A. Capital Assets

Capital assets activity for the year ended June 30, 2011, was as follows:

Governmental Activities	July 1, 2010 Beginning Balance	Increases	Decreases Including Transfers	June 30, 2011 Ending Balance
Capital assets, not being depreciated:				
Land	\$ 2,494,102,975	\$ 118,197,052	\$ 6,789,120	\$ 2,619,089,147
Infrastructure	11,036,788,230	578,082,384	<10,304,728>	11,604,565,886
Construction in progress	<u>3,587,135,963</u>	<u>537,415,498</u>	<u><562,566,730></u>	<u>3,561,984,731</u>
Total capital assets, not being depreciated	<u>17,118,027,168</u>	<u>1,233,694,934</u>	<u><566,082,338></u>	<u>17,785,639,764</u>
Capital assets, being depreciated:				
Buildings and improvements	188,530,128	2,024,501	<57,584>	190,497,045
Improvements other than buildings	29,563,802	4,224,254	-	33,788,056
Machinery and equipment	47,485,411	3,192,221	<1,988,935>	48,688,697
Mobile fleet and aircraft	<u>132,603,589</u>	<u>8,067,989</u>	<u><617,103></u>	<u>140,054,475</u>
Total capital assets, being depreciated	<u>398,182,930</u>	<u>17,508,965</u>	<u><2,663,622></u>	<u>413,028,273</u>
Less accumulated depreciation for:				
Buildings and improvements	<75,662,252>	<4,081,413>	17,798	<79,725,867>
Improvements other than buildings	<7,189,789>	<1,065,851>	-	<8,255,640>
Machinery and equipment	<35,166,827>	<3,047,498>	1,615,236	<36,599,089>
Mobile fleet and aircraft	<u><91,310,823></u>	<u><7,355,022></u>	<u>531,950</u>	<u><98,133,895></u>
Total accumulated depreciation	<u><209,329,691></u>	<u><15,549,784></u>	<u>2,164,984</u>	<u><222,714,491></u>
Total capital assets, being depreciated, net	<u>188,853,239</u>	<u>1,959,181</u>	<u><498,638></u>	<u>190,313,782</u>
Governmental activities capital assets, net	<u>\$ 17,306,880,407</u>	<u>\$ 1,235,654,115</u>	<u>\$ <566,580,976></u>	<u>\$ 17,975,953,546</u>
Business-type Activities	July 1, 2010 Beginning Balance	Increases	Decreases	June 30, 2011 Ending Balance
Capital assets, not being depreciated:				
Land	\$ 7,900	\$ -	\$ -	\$ 7,900
Capital assets, being depreciated:				
Buildings and improvements	981,157	-	-	981,157
Machinery and equipment	<u>2,182,794</u>	<u>-</u>	<u>-</u>	<u>2,182,794</u>
Total capital assets, being depreciated	<u>3,163,951</u>	<u>-</u>	<u>-</u>	<u>3,163,951</u>
Less accumulated depreciation for:				
Buildings and improvements	<912,296>	<33,792>	-	<946,088>
Machinery and equipment	<u><2,167,323></u>	<u><4,782></u>	<u>-</u>	<u><2,172,105></u>
Total accumulated depreciation	<u><3,079,619></u>	<u><38,574></u>	<u>-</u>	<u><3,118,193></u>
Total capital assets, being depreciated, net	<u>84,332</u>	<u><38,574></u>	<u>-</u>	<u>45,758</u>
Business-type activities capital assets, net	<u>\$ 92,232</u>	<u>\$ <38,574></u>	<u>\$ -</u>	<u>\$ 53,658</u>

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

Depreciation expense was charged to functions/programs as follows:

Governmental Activities:	
Administration	\$ 2,441,878
Highway	2,140,556
Highway Maintenance	1,867,615
Motor Vehicle	<u>1,541,514</u>
	7,991,563
Capital assets held by the Department's internal service fund are charged to the various functions based on their usage of the assets	<u>7,558,221</u>
Total depreciation expense - governmental activities	<u>\$ 15,549,784</u>
Business-type Activities	
Arizona Highways Magazine Fund	<u>\$ 38,574</u>

B. Construction Commitments

The Department's outstanding commitments for contracts at June 30, 2011, were \$378,887,082.

	Expenditures To Date	Remaining Commitment
Construction contracts:		
Rural roadways	\$1,130,649,750	\$182,736,133
Small urban roadways	244,259,565	4,821,582
Urban roadways	99,628,786	9,089,089
Large urban roadways	964,162,602	48,228,507
General roadways	<u>160,720,002</u>	<u>12,741,591</u>
Sub-total	2,599,420,705	257,616,902
Design contracts	735,600,304	51,348,500
Other commitments	<u>245,644,492</u>	<u>69,921,680</u>
Total	<u>\$3,580,665,501</u>	<u>\$378,887,082</u>

Area type designations for highways and roads are primarily determined by geographic location and population, as noted below:

Rural – outside of urbanized areas and urban clusters, generally long roads carrying little traffic.

Urban – interstate highways, freeways, expressways, principal arteries serving major centers of activity in metropolitan areas.

Small Urban – in areas of 5,000 to 49,999 in population.

Urban – in areas of less than 200,000 in population.

Large Urban – in areas of equal to or greater than 200,000 in population.

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

C. Deferred/Unearned Revenues

In the fund financial statements, the deferred/unearned revenues represent the amount for notes receivable for loans made to parties who purchased assets previously owned by the fund for highway construction purposes. The State Aviation Fund amount represents loans to various local governments for construction of hangars, taxiway extensions, runways, etc. These loans were made at fixed interest rates and with various maturity dates. The proprietary fund includes the amount for unearned subscriptions. The following schedule is a summary of the amounts outstanding as of June 30, 2011:

Governmental funds:		
General Fund (State Highway Fund)	\$ 1,910,694	
State Aviation Fund	<u>4,306,235</u>	
	<u>\$ 6,216,929</u>	
Proprietary funds:		
Arizona Highways Magazine Fund	<u>\$ 2,353,565</u>	

D. Interfund Receivables, Payables, Advances, and Transfers

The balances of current interfund receivables and payables as of June 30, 2011, were:

Receivables	Payables	Amount
Governmental activities:		
General Fund (State Highway Fund)	Highway User Revenue Fund	\$ 81,934,378
	Motor Vehicle Division Clearing Fund	163,597
	Equipment Service Fund	131,586
	Local Agency Deposits Fund	33,097
	Non-Major Governmental Funds	187,554
Maricopa Regional Area Road Fund	Capital Projects Fund	1,626,600
Highway User Revenue Fund	Motor Vehicle Division Clearing Fund	15,292,853
	General Fund (State Highway Fund)	920,488
Local Agency Deposits Fund	General Fund (State Highway Fund)	5,597
Non-Major Governmental Funds	Motor Vehicle Division Clearing Fund	<u>2,826,105</u>
		<u>103,121,855</u>
Business-type activities:		
Arizona Highways Magazine	Motor Vehicle Division Clearing Fund	<u>22,338</u>
		<u>\$ 103,144,193</u>

The General Fund (State Highway Fund) receivable of \$81,934,378 is an accrual for fuel taxes imposed in fiscal year 2011 from the Highway User Revenue Fund that will be collected in fiscal year 2012.

The Highway User Revenue Fund receivable of \$15,292,853 is an accrual for vehicle license taxes due in fiscal year 2011 from the Motor Vehicle Division Clearing Fund that will be collected in fiscal year 2012.

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

Interfund transfers for the year ended June 30, 2011, consisted of the following:

	Interfund Transfers In:			
Interfund Transfers Out:	Debt Service Fund	Internal Service Fund (Equipment Fund)	Arizona Highways Magazine Fund	Total
General Fund (State Highway Fund)	\$ 154,458,652	\$ 2,400,000	\$ -	\$ 156,858,652
Maricopa Regional Area Road Construction Fund	88,261,828	-	-	88,261,828
Non-Major Governmental Funds	88,826,292	-	-	88,826,292
Internal Service Fund (Equipment Fund)	-	-	851,400	851,400
Total	\$ 331,546,772	\$ 2,400,000	\$ 851,400	\$ 334,798,172

The General Fund (State Highway Fund) (\$154,458,652), the Maricopa Regional Area Road Construction Fund (\$88,261,828), and Non-Major Governmental Funds - Grant Anticipation Notes Fund (\$88,826,292) made transfers to the Debt Service Fund to pay bond debt service. The General Fund (State Highway Fund) transferred money to the Internal Service Fund (Equipment Revolving Fund) to provide for continuing operating expenditures. The Internal Service Fund (Equipment Revolving Fund) transferred money to the Proprietary Fund (Arizona Highway Magazine) to provide for continuing operating expenditures.

E. Leases

Operating Leases

The Department leases data processing equipment, other equipment, and certain facilities from various lessors. The majority of these leases are for a one-year term, renewable annually. Total rental expenditures (excluding interfund transactions) for the fiscal year ended June 30, 2011, approximated \$3.5 million.

In fiscal year 2002, the Department entered into a lease agreement with the city of Phoenix for a facility located on East Washington Street in Phoenix. During fiscal year 2010, the Department renegotiated the lease with the city. This renegotiated lease, effective July 1, 2010, will result in fewer square feet being leased by the Department than had been the case under the original lease. The future operating lease commitments are as follows:

Year ending June 30	Amount
2012	\$ 535,510
Future operating lease commitments	\$ 535,510

In fiscal year 2003, the Department entered into a long-term lease to build a structure to house lab facilities in Gilbert, Arizona. The future operating lease commitments are as follows:

Year ending June 30	Amount
2012	\$ 127,635
2013	97,758
Future operating lease commitments	\$ 225,393

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

Capital Leases

The Department has entered into lease agreements as lessee for financing the acquisition of various vehicles, equipment, and modular office buildings. These lease agreements qualify as capital leases for accounting purposes and, therefore, have been recorded at the present value of their future minimum lease payments as of the inception date. The assets acquired through capital leases are as follows:

	Governmental Activities
Assets:	
Machinery and equipment	\$ 4,583,394
Modular office buildings	2,109,711
Less accumulated depreciation	<375,614>
Total	\$ 6,317,491

The future minimum lease obligations and the net present value of these minimum lease payments as of June 30, 2011, were as follows:

Year Ending June 30	Governmental Activities
2012	\$ 1,291,883
2013	974,664
2014	974,663
2015	974,663
2016	924,004
2017	61,174
Total minimum lease payments	5,201,051
Less amount representing interest	<291,091>
Present value of minimum lease payments	\$ 4,909,960

F. Non-Current Liabilities

Arizona Transportation Board Highway Revenue Bonds

The Transportation Board has issued Senior and Subordinate Lien Highway Revenue Bonds to provide funds for acquisition of right-of-way, design, and construction of federal and state highways. The original amount of Highway Revenue Bonds issued in prior years and outstanding at the start of the fiscal year was \$1,672,625,000.

The Highway Revenue Bonds are secured by a prior lien on and a pledge of motor vehicle and related fuel fees and taxes of the General Fund (State Highway Fund). On September 21, 2006, House Bill 2206 became effective and eliminated the restriction that limited the principal amount of Highway Revenue Bonds that could be outstanding at any time to \$1.3 billion. Also, during fiscal year 2007, the Transportation Board received legislative authority to begin issuing Highway Revenue Bonds with maturities up to 30 years in length, replacing the 20 year maturity requirement that had been in place since 1980.

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

Highway Revenue Bonds currently outstanding are as follows:

Purpose	Interest Rates	Amount
Governmental activities	3.625% - 5.5%	\$ 1,394,360,000
Governmental activities - refunding	4.0% - 5.25%	206,495,000
		<u>\$ 1,600,855,000</u>

Annual debt service requirements to maturity for Highway Revenue Bonds are as follows:

Fiscal year ending June 30	Highway Revenue Bonds		
	Principal	Interest	Total
2012	\$ 75,415,000	\$ 80,361,575	\$ 155,776,575
2013	79,230,000	76,588,215	155,818,215
2014	83,235,000	72,555,075	155,790,075
2015	87,445,000	68,328,871	155,773,871
2016	91,835,000	63,934,607	155,769,607
2017-2021	502,445,000	245,705,051	748,150,051
2022-2026	420,080,000	123,432,212	543,512,212
2027-2031	177,255,000	48,400,124	225,655,124
2032-2033	83,915,000	6,340,750	90,255,750
	<u>\$ 1,600,855,000</u>	<u>\$ 785,646,480</u>	<u>\$ 2,386,501,480</u>

The Department has pledged future motor vehicle and related fuel fees and taxes to repay \$1,600,855,000 in outstanding Highway Revenue Bonds issued since 2001. Proceeds from the bonds finance portions of the Transportation Board's Five-Year Transportation Facilities Construction Program. The bonds are payable solely from motor vehicle and related fuel fees and taxes and are payable through 2033. The total principal and interest remaining to be paid on the bonds is \$2,386.5 million. Principal and interest paid for the current year and total pledged revenues were \$155.8 million and \$503.3 million, respectively. The annual principal and interest payments on the bonds required 31.0 percent of the pledged revenues.

Arizona Transportation Board Transportation Excise Tax Revenue Bonds

The Maricopa Regional Area Road Construction Fund is used to record all payments of principal and interest for Transportation Excise Tax Revenue Bonds issued by the Transportation Board. These bonds are secured by a portion of transportation excise taxes collected by the Arizona Department of Revenue on behalf of Maricopa County. The original amounts of Transportation Excise Tax Revenue Bonds issued in prior years and outstanding at the start of the fiscal year was \$743,815,000. During the year, Transportation Excise Tax Revenue Bonds totaling \$180,000,000 were issued to pay (1) costs of design, right-of-way purchase, or construction of certain freeways and other routes within Maricopa County, Arizona and (2) costs of issuing the bonds.

All Transportation Excise Tax Revenue Bonds mature no later than July 1, 2025. Transportation Excise Tax Revenue Bonds currently outstanding are as follows:

Purpose	Interest Rates	Amount
Governmental activities	2.0% - 5.25%	\$ 877,845,000

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

Annual debt service requirements to maturity for Transportation Excise Tax Revenue Bonds are as follows:

Fiscal year ending June 30	Transportation Excise Tax Revenue Bonds		
	Principal	Interest	Total
2012	\$ 45,235,000	\$ 43,232,307	\$ 88,467,307
2013	47,375,000	41,093,757	88,468,757
2014	49,680,000	38,785,307	88,465,307
2015	52,025,000	36,441,307	88,466,307
2016	54,525,000	33,945,131	88,470,131
2017-2021	315,225,000	127,111,793	442,336,793
2022-2025	313,780,000	40,090,426	353,870,426
	<u>\$877,845,000</u>	<u>\$360,700,028</u>	<u>\$1,238,545,028</u>

The Department has pledged future transportation excise taxes to repay \$877,845,000 in outstanding Transportation Excise Tax Revenue Bonds issued since 2007. Proceeds from the bonds pay the costs of design, right-of-way purchase, or construction of certain freeways and other routes within Maricopa County. The bonds are payable solely from transportation excise taxes and are payable through 2025. The total principal and interest remaining to be paid on the bonds is \$1,238.5 million. Principal and interest paid for the current year and total pledged revenues were \$88.5 million and \$206.6 million, respectively. The annual principal and interest payments on the bonds required 42.7 percent of the pledged revenues.

Arizona Transportation Board Grant Anticipation Notes (GARVEE)

The Grant Anticipation Notes Fund administers all payments of principal and interest for notes issued by the Transportation Board and is secured by revenues received from the Federal Highway Administration under grant agreements and certain other federal-aid revenues. The original amount of Grant Anticipation Notes (GARVEE – Grant Anticipation Revenue Vehicles) issued in prior years and outstanding at the start of the fiscal year was \$304,480,000. During the year, Grant Anticipation Notes (GARVEE bonds – Grant Anticipation Revenue Vehicles) totaling \$158,585,000 were issued to pay (1) cost of the projects (as specified) and (2) costs of issuing the bonds.

Grant Anticipation Notes (GARVEE) currently outstanding are as follows:

Purpose	Interest Rates	Amount
Governmental activities	2.5% - 5.0%	\$ 324,110,000
Governmental activities - refunding	3.50% - 5.0%	68,385,000
		<u>\$ 392,495,000</u>

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

Annual debt service requirements to maturity for Grant Anticipation Notes (GARVEE) are as follows:

Fiscal year ending June 30	Grant Anticipation Notes		
	Principal	(GARVEE) Interest	Total
2012	\$ 43,885,000	\$ 19,301,988	\$ 63,186,988
2013	45,340,000	17,181,888	62,521,888
2014	55,265,000	15,018,713	70,283,713
2015	53,330,000	12,286,531	65,616,531
2016	47,355,000	9,673,731	57,028,731
2017-2021	64,780,000	31,040,005	95,820,005
2022-2026	82,540,000	13,282,063	95,822,063
	<u>\$392,495,000</u>	<u>\$ 117,784,919</u>	<u>\$510,279,919</u>

The Department has pledged federal revenues to repay \$392,495,000 in outstanding Grant Anticipation Notes (GARVEE – Grant Anticipation Revenue Vehicles) issued since 2003. Proceeds from the bonds pay the costs of design, right-of-way purchase, or construction of certain freeways and other routes within Arizona. The bonds are payable solely from federal revenues and are payable through 2026. The total principal and interest remaining to be paid on the bonds is \$510.3 million. Principal and interest paid for the current year and total pledged revenues were \$85.4 million and \$643.6 million, respectively. The annual principal and interest payments on the bonds required 13.3 percent of the pledged revenues.

Refunded Bonds Deposited with Escrow Agents

In prior fiscal years, the Transportation Board had refinanced various bond issues through refunding arrangements. Under the terms of the refunding bond issues, sufficient assets to pay all principal, redemption premium, if any, and interest on the refunded bond issues have been placed in irrevocable trust accounts at commercial banks and invested in U.S. Government securities which, together with interest earned thereon, will provide amounts sufficient for future payment of principal and interest of the issues refunded. The assets, liabilities, and financial transactions of these trust accounts and the liability for the defeased bonds are not reflected in the financial statements of the Department.

Refunded bonds of the Department deposited with escrow agents at June 30, 2011, are as follows:

Original Issue	Type	Escrow Maturity Date	Balance
2002 Series B - Senior	Highway Revenue Bonds	July 1, 2012	\$ 48,595,000
	Total refunded bonds deposited with escrow agent		<u>\$ 48,595,000</u>

Advances and Notes Payable

The Department's outstanding advances and notes payable as of June 30, 2011, were \$59,891,686 in governmental activities. The advances and notes payable represent amounts for other intergovernmental advances.

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

Annual debt service requirements to maturity for advances and notes payable are as follows:

Fiscal year ending June 30	Governmental Activities		Business-type Activities		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
2012	\$ 16,783,282	\$ -	\$ -	\$ -	\$ 16,783,282	\$ -
2016	22,545,778	-	-	-	22,545,778	-
2021	151,430	-	-	-	151,430	-
2022	20,411,196	-	-	-	20,411,196	-
	<u>\$ 59,891,686</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 59,891,686</u>	<u>\$ -</u>

Changes in non-current liabilities

The activity for the fiscal year ended June 30, 2011, was as follows:

	Beginning Balance July 1, 2010	Additions	Reductions	Ending Balance June 30, 2011	Due Within One Year
Governmental Activities					
Bonds and notes:					
Highway Revenue Bonds	\$ 1,672,625,000	\$ -	\$ <71,770,000>	\$ 1,600,855,000	\$ 75,415,000
Transportation Excise Tax Revenue Bonds	743,815,000	180,000,000	<45,970,000>	877,845,000	45,235,000
Grant Anticipation Notes (GARVEE)	304,480,000	158,585,000	<70,570,000>	392,495,000	43,885,000
Premium on bonds	158,600,871	38,875,926	<17,251,615>	180,225,182	15,659,847
Total bonds and notes	2,879,520,871	377,460,926	<205,561,615>	3,051,420,182	180,194,847
Capital leases	1,303,783	4,583,394	<977,217>	4,909,960	1,189,745
Compensated absences	14,946,119	11,918,980	<12,082,450>	14,782,649	11,842,186
Advances and notes payable	60,711,311	11,112,617	<11,932,242>	59,891,686	16,783,282
Total governmental activities	<u>2,956,482,084</u>	<u>405,075,917</u>	<u><230,553,524></u>	<u>3,131,004,477</u>	<u>210,010,060</u>
Business-type Activities					
Compensated absences	129,361	90,447	<83,739>	136,069	136,069
Total business-type activities	<u>129,361</u>	<u>90,447</u>	<u><83,739></u>	<u>136,069</u>	<u>136,069</u>
Total non-current liabilities	<u>\$ 2,956,611,445</u>	<u>\$ 405,166,364</u>	<u>\$ <230,637,263></u>	<u>\$ 3,131,140,546</u>	<u>\$ 210,146,129</u>

The Internal Service Fund predominantly serves the governmental funds. Accordingly, long-term liabilities for that fund are included as part of the above totals for governmental activities. At year-end, \$630,938 of the Internal Service Fund's compensated absences is included in the above amounts.

The capital leases will be liquidated by the General Fund (State Highway Fund). The General Fund (State Highway Fund) has paid compensated absences in the past while the advances and notes payable will be repaid with funds from the General Fund (State Highway Fund) and the Maricopa Regional Area Road Construction Fund.

Bonds and notes issued by the Department require compliance with a number of covenants. The Department believes that it is in compliance with all such covenants. In addition, certain of the Department's obligations are subject to Internal Revenue Service regulations pertaining to issuance of tax-exempt debt by governmental entities. The Department does not have and has not accrued a liability under these regulations.

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

G. Fund Balances

The Department's fund balance, as of June 30, 2011, is composed of the following:

	Nonspendable	Restricted	Committed	Total
Administration	\$ -	\$ 3,481,884	\$ 95,235,069	\$ 98,716,953
Highway Operations	-	945,558,404	160,410	945,718,814
Highway Maintenance	-	-	5,660,837	5,660,837
Motor Vehicle	-	-	3,149,801	3,149,801
Inventories	9,765,026	-	-	9,765,026
Land Held for Resale	-	-	22,605,923	22,605,923
Other	-	484,697	-	484,697
	<u>\$ 9,765,026</u>	<u>\$ 949,524,985</u>	<u>\$ 126,812,040</u>	<u>\$ 1,086,102,051</u>

6. OTHER INFORMATION

A. Contingent Liabilities

Risk Management Insurance Losses

The Department is exposed to various risks of loss related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Department is a participant in the state's self-insurance program and, in the opinion of the Department's management, any unfavorable outcomes from these claims and actions would be covered by the self-insurance program. Accordingly, the Department has no risk of loss beyond adjustments to future years' premium payments to the state's self-insurance program. All estimated losses for unsettled claims and actions of the state are determined on an actuarial basis and are included in the State of Arizona's Comprehensive Annual Financial Report.

Claims

The Department has a variety of claims pending against it that arose during the normal course of its activities. Management of the Department believes, based on the advice of legal counsel, that losses, if any, resulting from settlement of these claims will not have a material effect on the financial position of the Department.

Grants

Amounts received or receivable from grant agencies are subject to audit and adjustment by grantor agencies, principally the federal government. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of expenditures which may be disallowed by the grantor cannot be determined at this time although the Department expects such amounts, if any, to be immaterial.

Light Rail Transit System

Arizona Revised Statutes, §28-9201, requires the Department to establish, implement, and enforce minimum safety standards for light rail transit systems. If a violation of the safety standards is discovered, the Department shall report the violation in writing to the Federal Transit Administration. Furthermore, the organization that operates a light rail transit system shall include a safety oversight function and pay the Department's costs resulting from administration.

B. Pension and Other Postemployment Benefits

Plan descriptions – The Department contributes to a cost-sharing, multiple-employer defined benefit pension plan; a cost-sharing, multiple-employer defined benefit health care plan; and a cost-sharing, multiple-employer defined

Arizona Department of Transportation
Notes to the Financial Statements (continued)
June 30, 2011

benefit long-term disability plan, all of which are administered by the Arizona State Retirement (System). The System (through its Retirement Fund) provides retirement (i.e., pension), death, and survivor benefits; the Health Benefit Supplement Fund provides health insurance premium benefits (i.e., a monthly subsidy); and the Long-Term Disability Fund provides long-term disability benefits. Benefits are established by state statute. The System is governed by the Arizona State Retirement System Board according to the provisions of Arizona Revised Statutes, Title 38, Chapter 5, Article 2.

The System issues a Comprehensive Annual Financial Report that includes financial statements and required supplementary information. The most recent report may be obtained by writing the Arizona State Retirement System, 3300 North Central Avenue, P.O. Box 33910, Phoenix, AZ 85067-3910, or by calling (602) 240-2000 or (800) 621-3778.

Funding policy – The Arizona state legislature establishes and may amend active plan members’ and the Department’s contribution rates. For the year ended June 30, 2011, active plan members were required by statute to contribute at the actuarially determined rate of 9.85 percent (9.6 percent for retirement and 0.25 percent for long-term disability) of the members’ annual covered payroll and the Department was required by statute to contribute at the actuarially determined rate of 9.85 percent (9.01 percent for retirement, 0.59 percent for health insurance premium, and 0.25 percent for long-term disability) of the members’ annual covered payroll.

The Department’s contributions for the current and two preceding years, all of which were equal to the required contributions, were as follows:

Fiscal year ended June 30	Retirement Fund	Health Benefit Supplement Fund	Long-Term Disability Fund	Total
2011	\$ 14,551,983	\$ 1,175,632	\$ 423,310	\$ 16,150,925
2010	13,068,245	2,585,137	702,369	16,355,751
2009	13,762,453	2,551,648	910,496	17,224,597

The Department's total payroll for fiscal year 2011 was \$169.3 million. The System is funded through payroll deductions from employees' gross earnings and amounts contributed by the Department. Retirement benefits, health care benefits, and long term disability benefits are obligations of the System and not of the Department. The Arizona Revised Statutes provide statutory authority for employee and employer contributions. The contribution requirement for fiscal year 2011 was \$16.2 million each by both the employees and the Department.

C. Subsequent Events

On September 7, 2011, Moody’s Investors Service notified the Department of a rating downgrade on \$1.6 billion of the Transportation Board’s outstanding Highway Revenue Bonds. Moody’s downgraded the senior lien Highway Revenue Bonds from Aaa to Aa1 and the subordinate lien Highway Revenue Bonds from Aa1 to Aa2.

On October 13, 2011, the Transportation Board issued \$159,460,000 in Transportation Excise Tax Revenue Bonds (Maricopa County Regional Area Road Fund) 2011 Series to pay the costs of design, right-of-way purchase, or construction of certain freeways and other routes within Maricopa County, Arizona; and the costs of issuing the 2011 Series Bonds. The 2011 Series Bonds were issued as senior lien bonds and mature from July 1, 2012 through July 1, 2025. Net proceeds totaled \$179,416,417 (after receipt of \$20,734,786 reoffering premium and payment of \$778,369 in underwriting fees and costs of issuance). The bonds were rated Aa1 and AA+ by Moody's Investors Service and Standard & Poor’s Ratings Service, respectively.

On October 17, 2011, Standard & Poor’s Ratings Service notified the Department of a rating downgrade on \$330 million of the Transportation Board’s outstanding subordinate lien Highway Revenue Bonds. Standard & Poor’s downgraded the bonds from AAA to AA+, with a negative outlook. The ratings on the senior lien bonds were unaffected by this downgrade; however, Standard & Poor’s also placed a negative outlook on the senior lien Highway Revenue Bonds.

fiscal year
2011

Comprehensive
Annual Financial Report
For the fiscal year ended June 30, 2011

Required Supplementary Information (Other than MD&A)

Budgetary Comparison Schedule – General Fund (State Highway Fund)

Note to Required Supplementary Information

Information About Infrastructure Assets Reported Using the Modified Approach

Arizona Department of Transportation
 Required Supplementary Information
 June 30, 2011

Budgetary Comparison Schedule
 General Fund (State Highway Fund)
 for the fiscal year ended June 30, 2011

	<u>Budgeted Amounts</u>		Actual Amounts	Variance with Final Budget - Positive <Negative>
	Original	Final		
Expenditures appropriated by State legislature in 2011 budget				
Department of Transportation	\$325,794,900	\$325,794,900	\$ 288,069,123	\$ 37,725,777
Timing differences:				
Prior year appropriation expenditures expended in current budgetary year			12,272,742	
Basis differences:				
Net increase <decrease> from cash basis for budgeting purposes and modified accrual basis for financial reporting purposes			5,011,714	
Entity differences:				
Funds not appropriated, but included for financial reporting purposes			14,773,817	
Perspective differences:				
Expenditures on modified accrual basis and not recognized on budgetary basis:				
Capital outlay and asset preservation			469,267,440	
Distributions to Arizona counties and cities			32,234,127	
Distributions to other state agencies			42,735,250	
Interest expense			36,328	
Principal repayment of debt			<u>12,177,217</u>	
Total expenditures as reported on the Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds (General Fund) - Exhibit 4				<u>\$ 876,577,758</u>

The note to required supplementary information is an integral part of this schedule.

Arizona Department of Transportation
Required Supplementary Information (continued)
June 30, 2011

Note to Required Supplementary Information

1. Budgets and budgetary accounting

An annual budget for the operating expenditures of the General Fund (State Highway Fund) is submitted to the governor in accordance with state law. The budget is legally enacted as appropriations after approval by the state legislature and signature of the governor. The legal level of control for operating expenditures is set at the agency level and expenditure budgets are appropriated using a lump-sum by agency format with a special line-item appropriation for highway maintenance. Expenditure details for personal services, employee-related expenditures, and all other operating expenditures are specifically allocated within all divisions. In certain divisions, other specific programs are allocated in addition to these categories. Revenue budgets are developed internally by the Department and are not part of the appropriation process.

Amendments to the approved appropriations require legislative approval. However, since the Department's appropriation is a lump sum appropriation by agency, the allocation of funds between personal services, employee-related expenditures, and other operating expenditures is an internal decision. Accordingly, transfers between line items such as personal services and other operating expenditures within a particular program may be made by the program manager. Expenditures may not exceed appropriations. All transfers of funds are reported to the Department's Office of Strategic Planning and Budgeting for monitoring purposes.

Budgets are prepared on the cash basis except that liabilities incurred before the end of the fiscal year and paid within the first month of the subsequent fiscal year are charged against the prior fiscal year's budget. The Department's appropriations lapse at fiscal year-end unless exempted by the legislature.

For financial reporting purposes, the accompanying financial statements present the legally adopted budget for the operations of the General Fund (State Highway Fund) that is subject to legislative appropriation.

In addition, budgets for capital outlay, including land, building, and improvements for the General Fund (State Highway Fund) and State Aviation Fund, are also submitted to the governor in accordance with state law. The capital outlay appropriation includes state highway construction and land, building, and improvements for the General Fund (State Highway Fund). A legal limitation is adopted for land, building, and improvements; however, legislation allows the Department to spend in excess of its appropriation for state highway construction up to the current fund balance. The Department monitors expenditures through an internal budgetary process and the Five-Year Transportation Facilities Construction Program approved by the Transportation Board.

Arizona Department of Transportation
Required Supplementary Information (continued)
June 30, 2011

Information About Infrastructure Assets Reported Using the Modified Approach

As allowed by Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments* (GASB 34), the Arizona Department of Transportation (Department) reports its roads and bridges using the modified approach. Assets accounted for under the modified approach include 6,722 center lane miles (18,771 travel line miles) of roads and 4,741 bridges that the Department is responsible to maintain.

In order to utilize the modified approach, the Department is required to:

- Maintain an asset management system that includes an up to date inventory of eligible infrastructure assets.
- Perform condition assessments of eligible assets and summarize the results using a measurement scale.
- Estimate each year the annual amount to maintain and preserve the assets at the condition level established and disclosed by the Department.
- Document that the assets are being preserved approximately at or above the established condition level.

As adopted by the Transportation Board of the State of Arizona Department of Transportation (Transportation Board) on an annual basis, the Five-Year Transportation Facilities Construction Program (Program) contains estimated expenditures for highway system improvements and the preservation of existing roadway and bridges. Both of these factors impact the condition assessment of the roads and bridges as described in the following sections. The Program in effect for fiscal year 2011 and beyond was adopted by the Transportation Board on June 18, 2010.

This Program is a dynamic instrument and adjustments are made to the annual plans based on the needs of the Department to maintain the condition level of the roads and bridges at a level equal to, or greater than, the goals established by the Department. In addition, not only are adjustments made during the life of the Program, circumstances may require that refinements to the individual components of the Program be made during the fiscal year.

In comparing Estimated to Actual Expenditures in the tables that follow, significant variances can occur. These variances are primarily due to the methodology used in the preparation of the Program. In this Program, the Estimated Expenditures for the current year are based on “programmed” projects which may or may not be spent in the current year of the Program. Programmed expenditures consist of those items that are planned for the future, with contracts that have not yet been awarded. Furthermore, the Actual Expenditures will include projects that were programmed for a prior year’s Estimated Expenditures, but which did not occur, or were not completed, in the prior year.

The following information pertains to the condition assessment and maintenance of infrastructure assets and reflects the Department’s success in achieving condition levels that exceed the established levels.

Roads

The mission of the Department’s Pavement Management Section (PMS) is to develop and provide a cost effective pavement rehabilitation construction program that preserves the state’s investment in its highway system and enhances public transportation and safety. The requirements of GASB 34 and the PMS both work toward the same basic goal, the efficient, effective management of the Department’s assets to produce long-term benefits while minimizing expenditures.

The PMS has developed performance goals for the condition level of the pavement in the state highway system. These goals require periodic assessment of pavement conditions and the budget level needed to meet that goal. The goal is expressed as a measure called “Serviceability” which can be defined as the ability of a pavement to serve the traveling public (as documented in 1961 after American Association of State Highway and Transportation Officials (AASHTO) Road Test, 1956-1961). Serviceability is based on detailed measurements of objective features of the pavement. Many surveys since the original road test have shown that these measurements closely track the subjective opinion of the traveling public. Most commonly, this number is called Present Serviceability Rating and abbreviated as PSR. PSR is a five-point scale (5 excellent, 0 impassable), similar to the Weaver/AASHTO Scale shown as follows:

Arizona Department of Transportation
 Required Supplementary Information (continued)
 June 30, 2011

Information About Infrastructure Assets Reported Using the Modified Approach (continued)

Numerical Rating	PSR	Weaver/AASHTO Scale
5	Excellent	Perfect
4	Good	Very Good
3	Fair	Good
2	Poor	Fair
1	Very Poor	Poor
0	Impassable	Very Poor

The goal of the Department is to maintain a condition level (PSR) rating of 3.23 or better for all roads in the state highway system. Annually, Transportation Material Technicians drive over the system with inertial profiling equipment and measure the roughness of the pavement. This process is continuous throughout the year in order to assess the condition level of all pavement on an annual basis. As of the end of fiscal year 2011, an overall rating of 3.69 was achieved, as shown in the following graph:

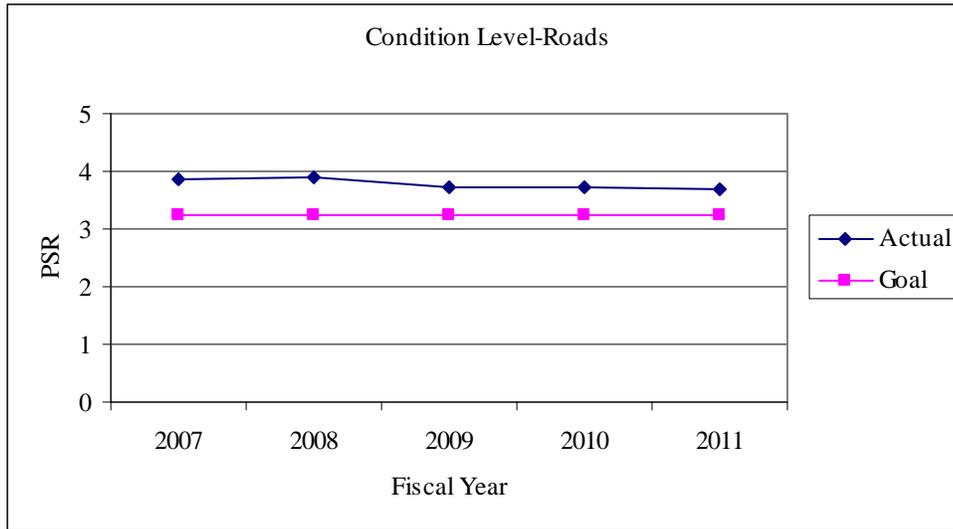


Figure 1

Preservation of the roads is accomplished through programs managed primarily by the Department’s PMS, as well as other units within the Department. The estimated (as specified in the Program as programmed amounts) and actual expenditures for fiscal years 2007 through 2011 were as follows:

Fiscal Year	Estimated Expenditures (in millions)	Actual Expenditures (in millions)
2007	\$216.4	\$196.5
2008	260.7	247.9
2009	264.4	236.0
2010	227.4	220.9
2011	265.7	373.4

Arizona Department of Transportation
Required Supplementary Information (continued)
June 30, 2011

Information About Infrastructure Assets Reported Using the Modified Approach (continued)

Bridges

The Department's bridge assets constitute a significant portion of all infrastructure assets in Arizona. As of June 30, 2011, the Department owns and maintains 4,741 bridges with an approximate total deck area of 46,854,728 square feet. Bridges, for purposes of this report, include all structures erected over an opening or depression with a centerline of 20 feet or more. Information related to these bridges is stored and updated in the Arizona Bridge Information and Storage System (ABISS). This system is used to efficiently manage the bridge inventory through storing all bridge related data and assisting bridge engineers in arriving at appropriate bridge preservation decisions. Also, ABISS is used for reporting bridge inventory and condition, on a biennial basis, to the Federal Highway Administration (FHWA).

A Condition Rating Index (CRI) is used to track the condition of the bridge network. The CRI is based on four selected bridge inspection condition ratings, which in turn are based on standards established in the FHWA's "Recording and Coding Guide for the Structural Inventory of the Nation's Bridges." The four selected condition ratings that are included in the CRI computation are: the bridge joints condition, the deck condition, the super-structure condition, and the sub-structure condition. The bridge joints condition rating is an Arizona-specific rating item not included in the FHWA condition rating guidelines, whereas the other three condition ratings are federally mandated condition ratings. The CRI is computed by subtracting from one the ratio of the sum of the deck areas of all bridges with a condition rating of four or less (see table below), which indicates that the rated element is at best in a poor condition, to the total sum of the deck areas. The rating system in this guide is as follows:

Numerical Rating	Condition Rating
9	Excellent
8	Very Good
7	Good
6	Satisfactory
5	Fair
4	Poor
3	Serious
2	Critical
1	Imminent Failure

Management of the bridge inventory is a major function of the Department's Bridge Group and regularly scheduled biennial inspections are made of all bridges. A civil or structural engineer, licensed to practice in Arizona, performs these inspections. It is the policy of the Department to maintain state highway bridges so that the CRI exceeds 92.5%. In fiscal year 2011, the CRI was computed at 93.1%.

Information About Infrastructure Assets Reported Using the Modified Approach (continued)

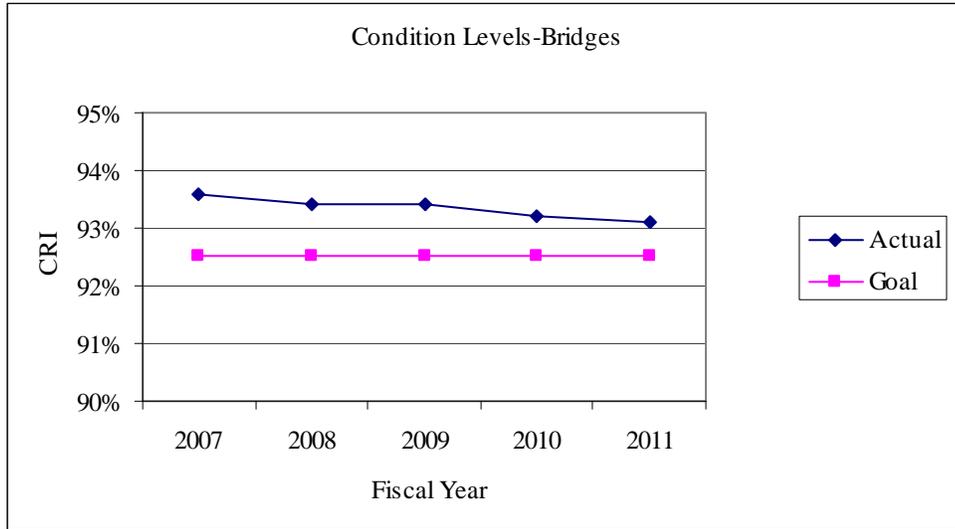


Figure 2

Bridges represent a major public investment, and their inspection and maintenance is an essential function of the Department in its mission of providing products and services for a safe, efficient, and cost effective transportation system. Figure 3 indicates that approximately 57% of the bridges in the state were constructed prior to the 1970s while only 13% have been constructed since 2000.

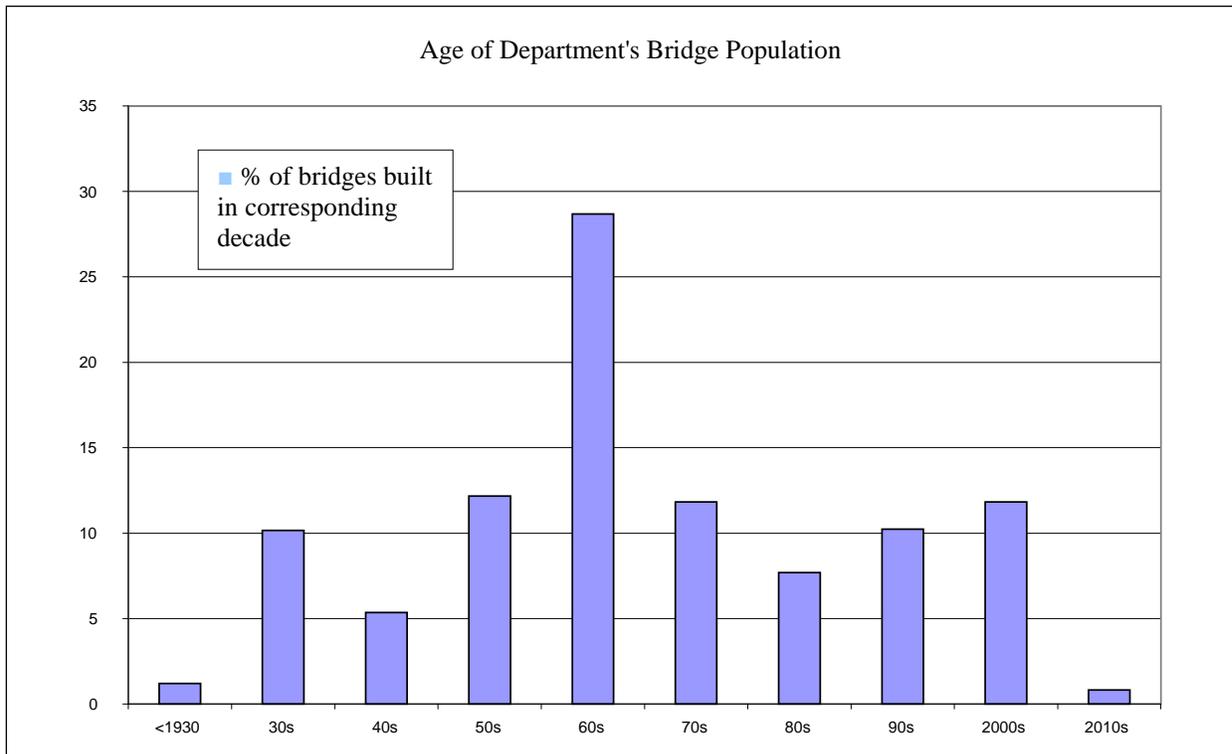


Figure 3

Arizona Department of Transportation
Required Supplementary Information (continued)
June 30, 2011

Information About Infrastructure Assets Reported Using the Modified Approach (continued)

Preservation of the bridges is accomplished through programs managed by the Bridge Group. The estimated (as specified in the Program as programmed amounts) and actual expenditures for fiscal years 2007 through 2011 were as follows:

Fiscal Year	Estimated Expenditures (in millions)	Actual Expenditures (in millions)
2007	\$17.1	\$22.5
2008	13.4	18.1
2009	14.3	17.3
2010	16.1	22.4
2011	11.8	26.0

Actual expenditures on bridge preservation have exceeded estimated expenditures in each of the past five fiscal years. These higher-than-estimated expenditures have been the result of an ongoing effort to maintain the ability of an older inventory of bridges to serve a growing population. This trend explains why the higher expenditures have occurred simultaneously with a decline, during the same period, of the bridge network's Condition Rating Index (CRI), as described above.

APPENDIX C

SUMMARY OF CERTAIN PROVISIONS OF THE NOTE RESOLUTION

Below is a brief description of certain provisions of the Note Resolution in its current form. This description does not purport to be comprehensive or definitive, and is qualified in its entirety by reference to the Note Resolution as it may be amended as described below. Copies of the Note Resolution are available as described under "MISCELLANEOUS." Capitalized words and terms not otherwise defined herein shall have the same meanings as in the Note Resolution.

DEFINITIONS

"Additional Notes" shall mean the Series 2003A Notes, the Series 2004B Notes, the Series 2008A Notes, the Series 2009A Notes, the Series 2011A Notes, the Series 2012 Notes and any Series of notes or other obligations that may be subsequently issued by the Board pursuant to applicable law, in accordance with the Note Resolution, on a parity (as provided in the Note Resolution) with the Notes then Outstanding.

"Annual Debt Service" shall mean, for the applicable Federal Fiscal Year, the aggregate Debt Service required to be made during such Federal Fiscal Year on the Outstanding Notes; provided that interest payable on a Series of Notes in any Federal Fiscal Year shall be excluded from the determination of Annual Debt Service in such Federal Fiscal Year to the extent that amounts are on deposit in the Grant Anticipation Note Fund and available to pay such interest on such Series.

"Authorized Officer" shall mean the Chair or Vice-Chair of the Board, the Director of the Department, the Assistant Director for Finance and Accounting of the Department or any other person or persons at the time designated to act on behalf of the Board by written certificate furnished to the Note Registrar and the Paying Agent containing the specimen signatures of such person or persons and signed on behalf of the Board by its Chair or other duly authorized agent.

"Bond Counsel" shall mean a firm of attorneys of national reputation experienced in the field of municipal bonds whose opinions are generally accepted by purchasers of municipal bonds, which is selected by the Board.

"Business Day" shall mean any day other than a Saturday, Sunday, legal holiday in the State or a day on which either the Note Registrar, the Paying Agent, the State Treasurer or the Department is closed.

"Code" shall mean the Internal Revenue Code of 1986, as amended from time to time, the Treasury Regulations (whether temporary or final) under that Code or the statutory predecessor of that Code, and any amendments of, or successor provisions to, the foregoing and any official rulings, announcements, notices, procedures and judicial determinations regarding any of the foregoing, all as and to the extent applicable. Unless otherwise indicated, reference to a Section means that Section of the Code, including any applicable successor section or provision and such applicable Treasury Regulations, rulings, announcements, notices, procedures and determination pertinent to that section.

"Debt Service" shall mean, for any applicable time period or date, the scheduled principal of and premium, if any, and interest on the Notes accruing for that period or due and payable on that date.

"Debt Service Coverage Certificate" shall mean a certificate of an Authorized Officer that sets forth, for the Federal Fiscal Year therein specified, (a) the Department's estimate of the amount of Federal Aid Revenues that will be available to the Department for the payment when due of Debt Service payable in such Federal Fiscal Year, (b) the Annual Debt Service due on the Outstanding Notes during such Federal Fiscal Year and (c) the ratio of (a) to (b) (which is the Debt Service Coverage Ratio).

"Debt Service Coverage Ratio" shall mean the ratio set forth in the applicable Debt Service Coverage Certificate.

“Defeasance Obligations” shall mean the following: (a) Cash; (b) U.S. Treasury Certificates, Notes and Bonds (including State and Local Government Series - “SLGs”); (c) Direct obligations of the United States Treasury which have been stripped by the Treasury itself, CATS, TIGRS and similar securities; (d) The interest component of Note Resolution Funding Corp. (REFCORP) strips which have been stripped by request of the Federal Reserve Bank of New York in book entry form; (e) Pre-refunded municipal bonds described in clause (c) of definition of “Investment Securities,” and (f) Obligations issued by the following agencies which are backed by the full faith and credit of the U.S.: U.S. Export-Import Bank (Eximbank) -direct obligations or fully guaranteed certificates of beneficial ownership; Farmers Home Administration (FmHA) - certificates of beneficial ownership; Federal Financing Bank; General Services Administration - participation certificates; U.S. Maritime Administration - guaranteed Title XI financing; U.S. Department of Housing and Urban Development (HUD) - project notes, local authority bonds, new communities debentures - U.S. government guaranteed debentures, U.S. Public Housing notes and bonds - U.S. government guaranteed public housing notes and bonds.

“Department” shall mean the Arizona Department of Transportation and any successor to its functions.

“Depository” shall mean any bank, trust company, national banking association, savings and loan association, savings bank or other banking association selected by the State Treasurer as a depository of moneys and securities held under the provisions of the Note Resolution, but not including the Note Registrar or Paying Agent or the Escrow Agent.

“Director” shall mean the Director of the Arizona Department of Transportation.

“Escrow Agent” shall mean the State Treasurer and any bank or trust company appointed to hold funds for purposes of defeasance of Notes and meeting the qualifications of a successor Paying Agent under the Note Resolution.

“Federal Aid Authorization” shall mean, as applicable, (a) Title 23, (b) any extension of Title 23, or (c) any successor to Title 23 authorizing Federal funding of state highways.

“Federal Aid Revenues” shall mean revenues or funds received by or on behalf of, or available to, the Department pursuant to Federal Aid Authorization (including, without limitation, Grant Revenues received pursuant to the Grant Agreement) which revenues or funds are not restricted under Federal Aid Authorization in a way that prohibits the Board to use them to pay Debt Service.

“Federal Aid Revenues Subaccount” shall mean, collectively, the Federal Aid Revenues Subaccount established under the Note Resolution in the State Highway Fund and in the Regional Area Road Fund.

“Federal Direct Payment Notes” shall mean any Note issued by the Board which (a) constitutes a Build America Bond or Recovery Zone Facility Bond under the American Recovery and Reinvestment Tax Act of 2009, as it may be amended, or (b) qualifies under any other State or federal law providing for the payment by the United States of America (or by the State from revenues that are not a part of Pledged Funds), to the Board or the Department or the designee of either, of amounts of money related to all or a portion of the interest (or principal, as applicable) payable on such Note.

“Federal Fiscal Year” shall mean the 12 month period beginning on October 1 of each year or such other 12-month period as the Federal government shall adopt as its fiscal year for purposes of Federal Aid Revenues.

“Federal Highway Administration” shall mean the U.S. Department of Transportation, Federal Highway Administration (“FHWA”) and any successor to its functions.

“Fiduciary” shall mean the Depository and any Note Registrar, Paying Agent or Escrow Agent for any Note.

“Fiscal Year” shall mean the 12 month period beginning on July 1 of each year or such other 12 month period as the State shall adopt as its fiscal year.

“Funds and Accounts” shall mean, collectively, the Grant Anticipation Note Fund and any accounts created therein and the Note Proceeds Account and any subaccounts created therein.

“Grant Agreements” shall mean, collectively, (a) the Grant Agreements, between the FHWA and the Department, relating to the Series 2003A Project therein described, with the following Federal Aid Project Nos.: AC-NH 060-B(006), AC-STP 060-B(008), AC-STP 202-C(001), AC-STP 202-C(002), AC-STP 202-C(006), AC-STP 202-C(008), AC-STP 202-B(005), AC-STP 202-C(005) and AC-STP 202-C(007), (b) the Grant Agreements, between FHWA and Department, relating to the Series 2004B Projects therein described, with the following Federal Aid Project Nos.: AC-STP-CM 202-C(003), AC-STP 202-C(009) and AC-STP 202-C(001), (c) the Grant Agreement, between FHWA and Department, relating to the Series 2008A Project therein described, with the following Federal Aid Project No.: AC-IM 010-B(201), (d) the Grant Agreement, between FHWA and Department, relating to the Series 2009A Project therein described, with the following Federal Aid Project No.: AC-IM-010-B(201) and AC-IM-010-B(202), and (e) the Grant Agreements, between the FHWA and the Department, relating to the Series 2011A Project therein described, with the following Federal Aid Projects Nos.: AC-NH-EB-STP-CMAQ 101-A(208), AC-IM 017-B(210), AC-IM-STP-TE-HES 010-D(013), AC-NH 053-2(043), AC-NH-STP 093-B(202), AC-NH 093-B(202), AC- STP 093-B(203), and other Federal Aid Projects as subsequently identified; and (f) for a subsequent Series of Additional Notes and if required by the Act, the Federal-aid project agreement or agreements (or similar agreement or agreements relating to receiving Federal Aid Revenues for the Project or Projects that is the subject of such agreement), entered into between the FHWA and the Department relating to the Project or Projects to be financed thereby and identified in the Supplemental Resolution authorizing such Series, as each may be amended in accordance with its terms.

“Grant Anticipation Note Fund” shall mean the Grant Anticipation Note Fund created by the Act and established in the Note Resolution.

“Grant Revenues” shall mean any and all revenues the Department receives under the Grant Agreement, the proceeds of the Notes and the income and gain from the investment of the Funds and Accounts held hereunder.

“Interest Credit Payments” shall mean, with respect to Federal Direct Payment Notes, the amount of money during each Note year which the United States of America (or the State, as applicable) is obligated to pay with respect to the interest (or principal, as applicable) payable on any Federal Direct Payment Note.

“Interest Payment Date” shall mean (a) each January 1 and July 1 for the Series 2003A Notes, Series 2004B Notes, Series 2008A Notes, Series 2009A Notes and Series 2011A Notes (b) for the Series 2012 Notes, each January 1 and July 1, commencing January 1, 2013, and (c) for a Series of Additional Notes, the dates identified in the Supplemental Note Resolution authorizing such Series.

“Investment Securities” shall mean and include any of the following securities, if and to the extent the same are at the time the investment is purchased legal under State law for investment for the Funds and Accounts:

(a) any bonds or other obligations which as to principal and interest constitute direct obligations of, or are unconditionally guaranteed as to full and timely payment of principal and interest by, the United States of America;

(b) bonds, debentures, or other evidences of indebtedness issued or guaranteed by the following United States government sponsored agencies: Federal Home Loan Mortgage Corporation, Farm Credit System, Federal Home Loan Banks, Federal National Mortgage Association, Student Loan Marketing Association, Financing Corporation, Resolution Trust Corporation, Resolution Funding Corporation or any other government-sponsored agencies which are not backed by the full faith and credit of the U.S. government which has been or may hereafter be created pursuant to an Act of Congress as an agency or instrumentality of the United States of America;

(c) certain refunded bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state which are not callable prior to maturity or as to which irrevocable instructions have been given to the trustee of such bonds or other obligations by the obligor to

give due notice of redemption and to call such bonds for redemption on the date or dates specified in such instructions;

(d) project notes issued by public agencies or municipalities and fully secured as to the payment of both principal and interest by a requisition or payment agreement with the United States of America;

(e) direct and general obligations of any state of the United States of America, to the payment of the principal of and interest on which the full faith and credit of such state is pledged, provided that at the time of their purchase hereunder such obligations are rated in one of the three highest Rating Categories by any Rating Agency;

(f) obligations of any state of the United States of America or any political subdivision of any state of the United States of America or any agency or instrumentality of any such state or political subdivision which shall be rated at the time of their purchase hereunder in one of the three highest Rating Categories by any Rating Agency;

(g) direct and general obligations of the State to the payment of the principal of and interest on which the full faith and credit of the State are pledged or any bonds or other obligations which as to principal and interest are unconditionally guaranteed by the State, provided that at the time of their purchase hereunder such obligations are rated in one of the three highest Rating Categories by any Rating Agency;

(h) certificates or other instruments that evidence ownership of the right to payments of principal of or interest on obligations of any state of the United States of America or any political subdivision thereof or any agency or instrumentality of any state or political subdivision, provided that such obligations shall be held in custody by a bank or trust company or a national banking association having capital stock, surplus and undivided earnings aggregating at least \$50,000,000, and provided further that the payments of all principal of and interest on such certificates or such obligations shall be fully insured or unconditionally guaranteed as to payment pursuant to a credit support arrangement provided by one or more financial institutions or insurance companies or associations which shall be rated at the time of purchase thereof in one of the three highest Rating Categories by any Rating Agency, or, in the case of an insurer providing municipal bonds insurance policies insuring the payment, when due, of the principal of and interest on municipal bonds, such insurance policy shall result in such municipal bonds being so rated at the time of purchase hereunder;

(i) certificates that evidence ownership of the right of payments of principal or interest on obligations described in clauses (a) to (g), provided that such obligations shall be held in custody by a bank or trust company or a national banking association having capital stock, surplus and undivided earnings aggregating at least \$50,000,000;

(j) certificates of deposit, whether negotiable or non-negotiable, and banker's acceptances of any bank or trust company in the United States which are rated at the time of purchase in one of the three highest Rating Categories by any Rating Agency;

(k) any repurchase agreements collateralized by securities described in clauses (a) to (g) above with any registered broker/dealer subject to the Securities Investors' Protection Corporation jurisdiction or any commercial bank, if such broker/dealer or bank has uninsured, unsecured and unguaranteed obligations rated (an "unsecured rating") at the time of purchase thereof at least "Prime-1" or "A" by Moody's, at least "A-1" or "A" by S&P, provided (i) a specific written agreement governs the transaction; (ii) the securities are held by a depository acting solely as agent for the State Treasurer, and such third party is (A) a Federal Reserve Bank, or (B) a bank which is a member of the Federal Deposit Insurance Corporation and with combined capital, surplus and undivided profits of not less than \$25 million, and the State Treasurer shall have received written confirmation from such third party that it holds such securities; (iii) a perfected first security interest under the Uniform Commercial Code, or book entry procedures prescribed at 31 C.F.R. 306.1 et seq. or 31 C.F.R. 350.0 et seq. in such securities is created for the benefit of the State Treasurer; (iv) the repurchase agreement has a term of one year or less, or the collateral securities will be valued no less frequently than monthly and will be liquidated if any deficiency in the required collateral percentage is not restored within two Business Days of such valuation; (v) the repurchase agreement matures at least ten days (or other appropriate liquidation period) prior to an interest payment date; and (vi) the fair market value of the securities in relation to the amount of the repurchase obligation, including principal and interest, is equal to at least 100%;

(l) investment agreements which represent the unconditional obligation of one or more banks, insurance companies or other financial institutions, or are guaranteed by a financial institution, in either case that has an unsecured rating, or which agreement is itself rated, as of the date of execution thereof, in one of the three highest Rating Categories by any Rating Agency;

(m) commercial paper which is rated at the time of purchase thereof at least “Prime” by Moody’s;

(n) Bond, debentures, notes or other evidences of indebtedness which are issued by entities organized in doing business in the United States which are rated, at the time of purchase, in one of the three highest Rating Categories by any Rating Agency;

(o) any other investment permitted by State law that is rated at the time of purchase in one of the three highest Rating Categories by any Rating Agency; and

(p) shares of an Investment Company, organized under the Investment Company Act of 1940, as amended, which invests its assets exclusively in obligations of the type described in clauses (a) to (o).

“Note Insurer” shall mean with respect to the 2004B Notes, Ambac, and with respect to any other Series of Additional Notes, the bond insurer, if any, named in the applicable Supplemental Note Resolution.

“Note Issuance Costs” shall mean all printing, publication or advertising expenses with respect to the sale and issuance of the Notes; all fees, expenses and costs of Note Registrar and Paying Agent in connection with the issuance of Notes; all fees, expenses and costs of attorneys, Bond Counsel, financial consultants, accountants, feasibility consultants, computer programmers or other experts employed to aid in the sale and issuance of the Notes, and all other costs related thereto; premiums and other expenses of obtaining a Note Insurance Policy; and all other costs, fees and expenses incurred or reasonably related to the issuance and sale of the Notes that may under the Act be paid from proceeds of the Notes.

“Note Proceeds Account” shall mean the Note Proceeds Account in the State Highway Fund established in the Note Resolution.

“Note Registrar” shall mean (a) for the 2003A and 2004B Notes, J.P. Morgan Trust Company, National Association (successor to Bank One Trust Company, N.A.), (b) for the Series 2008A Notes, Series 2009A Notes, Series 2011A Notes and Series 2012 Notes, U.S. Bank National Association, and (c) for a Series of Additional Notes, the institution set forth in the Supplemental Note Resolution authorizing such Series, and its successor or successors hereafter appointed in the manner provided herein.

“Note Resolution” shall mean the Original Resolution and the Supplemental Note Resolution.

“Notes” shall mean collectively (a) the Series 2003A Notes, (b) the Series 2004B Notes, (c) the Series 2008A Notes, (d) the Series 2009A Notes, (e) Series 2011A Notes, (f) the Series 2012 Notes, and (g) Additional Notes issued subsequently under the Note Resolution.

“Original Resolution” shall mean the Resolution adopted by the Board on June 9, 2000 establishing the Grant Anticipation Note financing program.

“Outstanding” with reference to Notes or “Notes Outstanding” shall mean, as of the applicable date, all Notes which have been authenticated and delivered, or which are being authenticated and delivered under the Note Resolution, except: (a) Notes canceled upon surrender, exchange or transfer, or canceled after purchase in the open market or because of payment at or redemption prior to maturity; (b) any Note (or any portion thereof) (i) for the payment or redemption of which there shall be held in trust under the Note Resolution and set aside for such payment or redemption, moneys and/or Defeasance Obligations (not callable at the option of the issuer thereof) maturing or redeemable at the option of the holder thereof not later than such maturity or redemption date which, together with income to be earned on such Defeasance Obligations prior to such maturity or redemption date, will be sufficient to pay the principal or redemption price thereof, as the case may be, together with interest thereon to the

date of maturity or redemption, and (ii) in the case of any such Note (or any portion thereof) to be redeemed prior to maturity, the notice of the redemption of which shall have been irrevocably given in accordance with the Note Resolution or provided for in a manner satisfactory to the Note Registrar; (c) Notes deemed paid pursuant to the provisions of the Note Resolution; and (d) Notes in lieu of which others have been authenticated under the Note Resolution.

“Owner” shall mean any person in whose name any Note is registered on the note register maintained by the Note Registrar.

“Paying Agent” shall mean (a) for the 2003A and 2004B Notes, J.P. Morgan Trust Company, National Association (successor to Bank One Trust Company, N.A.), (b) for the Series 2008A Notes, Series 2009A Notes, Series 2011A Notes and Series 2012 Notes, U.S. Bank National Association, and (c) for a Series of subsequent Additional Notes, the institution set forth in the Supplemental Note Resolution authorizing such Series, and its successor or successors hereafter appointed in the manner provided herein.

“Pledged Funds” shall mean all Grant Revenues, Federal Aid Revenues and other moneys that are deposited into the Grant Anticipation Note Fund or Note Proceeds Account, including Investment Securities and investment income thereon held in such Fund and Account.

“Principal Payment Dates” shall mean each date upon which the principal of any Series of the Notes shall be payable, whether by stated maturity or mandatory sinking fund redemption.

“Project” shall mean, collectively, (a) for the Series 2003A Notes, the Series 2003A Projects described in the Grant Agreements relating to such Series of Notes; (b) for the Series 2004B Notes, the Series 2004B Project described in the Grant Agreement relating to such Series of Notes; (c) for the Series 2008A Notes, the Series 2008A Project described in the Grant Agreement relating to such Series of Notes, (d) for the Series 2009A Notes, the Series 2009A Project described in the Grant Agreement relating to such Series of Notes, (e) for the Series 2011A Notes, the Series 2011A Project described in the Grant Agreements related to such Series of Notes, and (f) for any Series of subsequent Additional Notes, the project or projects described in the Grant Agreement or Agreements, if any, related thereto or otherwise described in the Supplemental Note Resolution authorizing such Series.

“Project Costs” shall mean, without limiting the use of proceeds of the Notes permitted under the Act, (a) all Note Issuance Costs, (b) all amounts necessary to create and fund reserve funds, to pay Debt Service on the Notes or to provide credit enhancement or liquidity for the Notes, (c) all costs, expenses and liabilities paid or incurred or to be paid or incurred in connection with the design, right-of-way acquisition or construction of the Project, (d) costs for which the Director shall be entitled to receive reimbursement pursuant to the Grant Agreement, and (e) such other costs, fees, charges and expenses or otherwise which may be paid under the Act from proceeds of Notes.

“Rating Agency” shall mean Moody’s Investors Service, Inc. (“Moody’s”) or Standard & Poor’s Rating Services, a Division of the McGraw-Hill Companies, Inc. (“S&P”), or Fitch, Inc. (“Fitch”), or any or all, as applicable, or their successors or assigns.

“Rating Categories” shall mean the rating as published by a Rating Agency in its written compilations of ratings and any written supplement or amendment thereto and any such rating shall be determined on the generic rating without regard to any modifiers and shall be long term ratings unless otherwise provided herein.

“Regional Area Road Fund” shall mean the Regional Area Road Fund created in Section 28-6302, A.R.S., for Maricopa County.

“Regular Record Date” shall mean the 15th day immediately preceding each Interest Payment Date or the Business Day immediately preceding such 15th day, if such 15th day is not a Business Day.

“Series” shall mean the separate Series of Notes identified as such under the Supplemental Note Resolution authorizing the same.

“Series 2003A Notes” shall mean the Series 2003A Notes authorized as a Series of Additional Notes under the Note Resolution.

“Series 2004B Notes” shall mean the Series 2004B Notes authorized as a series of Additional Notes under the Note Resolution.

“Series 2008A Notes” shall mean the Series 2008A Notes authorized as a series of Additional Notes under the Note Resolution.

“Series 2009A Notes” shall mean the Series 2009A Notes authorized as a series of Additional Notes under the Note Resolution.

“Series 2011A Notes” shall mean the Series 2011A Notes authorized as a series of Additional Notes under the Note Resolution.

“Series 2012 Notes” shall mean the Series 2012 Notes authorized as a series of Additional Notes under the Note Resolution.

“State Highway Fund” shall mean the State Highway Fund created in Section 28-6991, A.R.S.

“Subordinated Notes” shall mean notes or other obligations described under “Subordinated Notes” in this Appendix C.

“Supplemental Note Resolution” shall mean, collectively, any resolution of the Board which (a) shall supplement or amend the Original Resolution, including the amendments in the Resolution adopted by the Board on April 18, 2003, and (b) may be adopted by the Board in accordance with Article X of the Original Resolution and with reference to determining the terms of the Series 2003A Notes, shall mean the Resolution adopted by the Board on April 18, 2003, with reference to determining the terms of the Series 2004A Notes, shall mean the Resolution adopted by the Board on April 16, 2004, with reference to determining the terms of the Series 2004B Notes, shall mean the Resolution adopted by the Board on September 17, 2004, with reference to determining the terms of the Series 2008A Notes, shall mean the Resolution adopted by the Board on November 16, 2007, with reference to determining the terms of the Series 2009A Notes, shall mean the Resolution adopted by the Board on March 13, 2009, with reference to determining the terms of the Series 2011A Notes, shall mean the Resolution adopted by the Board on December 17, 2010, and with reference to determining the terms of the Series 2012 Notes, shall mean the Resolution adopted by the Board on April 20, 2012 together with the applicable Certificate of Award for each Series.

“Title 23” shall mean Chapter 1 of Title 23, United States Code, as amended and supplemented from time to time, and regulations, rules, policies and procedures thereunder and any successor or replacement provision of law.

Issuance of Additional Notes

No additional notes or other obligations of the Board payable on a priority senior to the pledge of the Pledged Funds for the payment of the Notes shall be created or incurred without the prior written consent of the Owners of 100% of the Outstanding Notes.

Additional notes or other obligations of the Board payable on a parity with the Notes out of the Pledged Funds may be created or incurred, but only if a certificate of an Authorized Officer, dated the date of issuance, certifies as follows:

a. All payments required by the Note Resolution to be made into the Grant Anticipation Note Fund as of the date of issuance of such Additional Notes have been made in full;

b. No Event of Default shall have occurred and be continuing under the Note Resolution; unless such Event of Default will cease to continue upon the issuance of the Additional Notes and the application of the proceeds thereof;

c. The amount of Federal Aid Revenues either (i) anticipated to be received by the Department during the Federal Fiscal Year in which the proposed Series of Additional Notes are to be issued, or (ii) received by the Department in either of the two prior Federal Fiscal Years preceding the issuance of the proposed Series of Additional Notes, was not less than:

- 150% of the Annual Debt Service in any Federal Fiscal Year that ends on or before the expiration date of the Federal Aid Authorization then in effect; and
- 300% of the Annual Debt Service in any Federal Fiscal Year that ends after the expiration date of the Federal Aid Authorization then in effect; and
- in either case, including the Annual Debt Service on the Series of Additional Notes proposed to be issued, but excluding, in the case of a Series of Additional Notes issued for refunding purposes, the Annual Debt Service on the Notes to be refunded; and

d. the Department has no information which indicates that Federal Aid Revenues will not be available to the Department during the term of the Federal Aid Authorization then in effect in amounts sufficient to pay, when due, Debt Service on the Notes to be Outstanding during such term.

The requirements of paragraphs (c) and (d) above may be revised or deleted upon the Board's receipt of written evidence, from each Rating Agency then maintaining an unsecured, underlying rating on the Outstanding Notes, to the effect that such revision or deletion will not itself result in the withdrawal or reduction of any such underlying, unsecured rating on the Outstanding Notes by such Rating Agency.

The proceeds of the Additional Notes may be used: (a) to pay Note Issuance Costs; (b) to refund Notes or other obligations of the Board or Department as permitted by law; (c) to pay Projects Costs, (d) for any other purpose permitted by law, or (e) any combination thereof.

The Board may also issue Additional Notes, from time to time, for the purpose of refunding in whole or in part any Notes Outstanding under the Note Resolution, provided that the Director certifies that: (a) Annual Debt Service for all Notes Outstanding immediately after the issuance of such proposed Refunding Notes for the current and each future Federal Fiscal Year to and including the Federal Fiscal Year of the latest maturity on any Notes then Outstanding is no greater than (b) the Annual Debt Service for all Notes Outstanding immediately prior to such issuance during the same Federal Fiscal Years as in (a). If the Board cannot satisfy the requirement of the preceding sentence, the Board may nevertheless issue Additional Notes for the purpose of refunding Notes upon compliance with the test described in the preceding paragraphs.

Nothing in the Note Resolution prohibits the payment of Debt Service on any Series of Additional Notes from being otherwise (i) secured and protected from sources or by instruments not applicable to other Series of Notes, or (ii) not secured and protected from sources or by instruments applicable to other Series of Notes.

Subordinated Notes

The Board may, in accordance with the terms of the Note Resolution, issue or incur Subordinated Notes payable out of, and secured by a pledge of, moneys in subordinated subaccounts in the Grant Anticipation Note Fund remaining after all deposits to the Grant Anticipation Note Fund for the Notes have been made in accordance with the Note Resolution; provided, however, that such pledge shall be subordinate to the pledge created by the Note Resolution in the Grant Anticipation Note Fund as security for the Notes.

Proceeds of the Subordinated Notes shall not be used to pay, or as security for the payment of, the Notes and proceeds of the Notes shall not be used to pay, or as security for the payment of, the Subordinated Notes. The

Supplemental Resolution authorizing such Subordinated Notes shall contain the following (or less favorable to the holders thereof) provisions:

(1) If any Event of Default with respect to the Notes is continuing, the Owners of all Notes Outstanding shall be entitled to receive payment in full of all Debt Service on the Notes before the holders of the Subordinated Notes are entitled to receive any accelerated payments from the subordinated account in the Grant Anticipation Note Fund.

(2) No Note Owner can be prejudiced in their right to enforce the subordination by any act or failure to act by the Board or any other party.

(3) The Subordinated Notes may provide that the above provisions are solely for the purpose of defining the relative rights of the Owners of all Notes and holders of Subordinated Notes and nothing therein shall impair the obligation of the Board under such Subordinated Resolution or prevent the holders of the Subordinated Notes from exercising all remedies permitted by applicable law subject to the rights of the Owners of Notes listed in (1) and (2) above.

Any issue of Subordinated Notes may have such rank or priority with respect to other Subordinated Notes as may be provided in the Supplemental Resolution authorizing such issue of Subordinated Notes.

Security for Notes; Pledged Funds

The Notes are special and limited obligations of the Board and are payable solely from a pledge by the Board of amounts on deposit in the Grant Anticipation Note Fund and Note Proceeds Account and the moneys and investments on deposit in such Fund and Account shall constitute Pledged Funds. Such pledge by the Board shall be irrevocable so long as any Notes are Outstanding under the terms of the Note Resolution. The Board may withdraw moneys from the Note Proceeds Account to pay Project Costs. Moneys in the Grant Anticipation Note Fund shall be used solely to pay Debt Service on Notes, when due.

The Board is not obligated to pay Debt Service from any funds other than the Pledged Funds; provided that the Board and Department are not prohibited, in their sole and absolute discretion, from making payments of Debt Service from sources other than Pledged Funds, to the extent legally available for that purpose; provided, the Department shall be obligated to deposit all Grant Revenues and Federal Aid Revenues as required by the Note Resolution, and the State Treasurer shall be obligated, as required by the Note Resolution, to transfer lawfully available moneys from the State Highway Fund, the Regional Area Road Fund and the Note Proceeds Account to the Grant Anticipation Note Fund.

The Board shall not issue any grant anticipation notes, bonds, debentures, other notes or other evidences of indebtedness that are payable out of, or secured by a pledge of, the Pledged Funds on a basis senior to the Notes or on a parity with the Notes except for Additional Notes as described above under "Issuance of Additional Notes". The Board may issue other grant anticipation notes, bonds, other notes or other obligations under applicable law secured by revenue and funds other than the Pledged Funds.

All moneys and Investment Securities held in the Grant Anticipation Note Fund and Note Proceeds Account shall be held by the State Treasurer on behalf of the Board and for the benefit and security of the Owners of the Notes to the extent provided in the Note Resolution.

Investment of Grant Anticipation Note Fund and Note Proceeds Account

Except as provided in the Note Resolution, the State Treasurer shall invest, at the request of an Authorized Officer, any moneys held as a part of the Grant Anticipation Note Fund and Note Proceeds Account in Investment Securities. Subject to the provisions described below, the State Treasurer shall follow the directions of the Authorized Officer with respect to the type, amount and maturity of those investments and whether those investments should be sold, surrendered or exchanged; provided that in any case, the maturities or availability of the investments shall coincide with the respective dates as of which payments are required to be made from the

respective Fund and Account. Such investments shall be held by or under the control of the State Treasurer and shall be deemed at all times to constitute a part of the Fund or Account from which they shall have been made.

Any earnings and profit realized from those investments shall be credited, and any loss resulting therefrom shall be charged, to the Grant Anticipation Note Fund.

The State Treasurer shall sell and reduce to cash a sufficient portion of investments, whenever the cash balance in the Fund or Account is insufficient to pay the current requirements from that Fund or Account. The State Treasurer shall sell or redeem investments credited to the Fund or Account to produce moneys which are sufficient at the times required for the purposes of paying principal and interest on the Notes. The State Treasurer shall not be responsible (i) for any of the investments credited to the Fund or Account made in accordance with the Note Resolution; (ii) for accepting any Investment Securities deposited thereto by the Board; or (iii) for liquidating an amount of the investments credited to any Fund or Account which is greater than the amount which may be necessary for the purposes hereof.

The Board shall not authorize or make any investment which would violate any provisions of State or Federal law including the Federal tax code.

Note Insurer as Owner

Except as otherwise provided in a Supplemental Note Resolution and subject to the next paragraph, for purposes of determining whether (a) pursuant to the Note Resolution the requisite percentage in aggregate principal amount of Notes of any Series then Outstanding shall have directed the time, method and place of conducting any remedy or proceeding described therein or shall have waived any Event of Default or its consequences or (b) pursuant to any other provision of the Note Resolution (except for certain amendments to the Note Resolution, which shall require the consent of the Owners of the Notes affected) the requisite percentage in aggregate principal amount of Notes of any Series then Outstanding shall have requested, demanded or consented to, the taking of action or the failure to take action described in such provision, the Note Insurer, upon behalf of the Owners of the Series of Notes insured by its Note Insurance Policy, shall have the right to give such consents, approvals, directions or requests for and upon behalf of the Owners of such Series.

Any provision regarding consents, approvals, directions, appointments or requests by a Note Insurer, upon behalf of the Owners of the Notes insured by its Note Insurance Policy or for itself, shall be deemed to not require or permit such consents, approvals, directions, appointments, requests or notices to such Note Insurer during the time in which (a) such Note Insurer is in default in its obligation to make payments under its Note Insurance Policy, (b) its Note Insurance Policy shall at any time for any reason cease to be valid and binding on such Note Insurer, or shall be declared to be null and void, or the validity or enforceability of any provision thereof is being contested by such Note Insurer or any governmental agency or authority, or if such Note Insurer is denying further liability or obligation under its Note Insurance Policy, (c) a petition has been filed and is pending against such Note Insurer under any bankruptcy, reorganization, arrangement, insolvency, readjustment of debt, dissolution or liquidation law of any jurisdiction, whether now or hereafter in effect, and has not been dismissed within 60 days after such filing, or (d) such Note Insurer has filed a petition, which is still pending, in voluntary bankruptcy or seeking relief under any provision of any bankruptcy, reorganization, arrangement, insolvency, readjustment of debt, dissolution or liquidation law of any jurisdiction, whether now or hereafter in effect, or consented to the filing of any petition against it under any such law.

Particular Covenants of the Board

Pledged Funds. The Board has not made a pledge of the Pledged Funds, except as set forth in the Note Resolution to secure the Notes. The Board shall at all times, to the extent permitted by law, enforce, defend, preserve and protect the pledge of the Pledged Funds and all the rights of the Owners under the Note Resolution against all claims and demands of all persons whomsoever.

Payment of Notes. The Board shall duly and punctually pay or cause to be paid the principal and interest on every Note, at the dates and places and in the manner and from the sources provided in the Note Resolution.

Creation of Other Pledges. The Board shall not (i) issue any bonds, notes, debentures, or other evidences of indebtedness of similar nature, payable out of or secured by a pledge of the Pledged Funds or other moneys, securities or funds held or set aside by the State Treasurer or by any Fiduciaries under the Note Resolution, except Additional Notes and Subordinated Notes and (ii) create or cause to be created any pledge, lien or charge equal to or superior to the pledge of the Notes on the Pledged Funds, or such moneys, securities or funds without the prior written consent of the Owners of 100% of the Outstanding Notes affected by such pledge.

Accounts and Reports. The Board shall cause the Department to keep or cause to be kept proper books of record and account (separate from all other records and accounts) in which complete and correct entries shall be made of its transactions relating to the Federal Aid Revenues and each Fund and Account established under the Note Resolution, which records and accounts shall at all reasonable times be subject to the inspection of the Owners of an aggregate of not less than 10% in principal amount of the Notes then Outstanding or their representatives duly authorized in writing.

Offices for Servicing Notes. The Board shall maintain one or more agencies or offices where Notes may be presented for payment, registration, transfer or exchange, for the service upon the Board of notices, demands and other documents, and for the performance of other services as provided in the Note Resolution.

The Board has appointed the Note Registrar to maintain an agency for the registration, transfer or exchange of Notes, for the service upon the Board of such notices, demands and other documents, for the mailing of notice to Owners of Notes for certain purposes, and for the performance of other services as provided in the Note Resolution, and the Note Registrar shall continuously maintain or make arrangements to provide such services.

The Board has appointed the Paying Agent as its agent to maintain such agency for the payment or redemption of Notes.

Further Assurance. At any and all times the Board shall, as far as it may be authorized by law and to the extent not inconsistent with the Note Resolution, comply with any reasonable request of the State Treasurer or of the Owners of at least twenty-five percent (25%) of the principal amount of the Outstanding Notes, to pass, make, do, execute, acknowledge and deliver, all and every further resolutions, acts, deeds, conveyances, assignments, transfers and assurances as may be necessary or desirable for the better assuring, pledging and confirming all and singular the rights, moneys, securities and funds hereby pledged, or intended so to be pledged.

The Board shall do and perform or cause to be done and performed all acts and things required to be done or performed by or on behalf of the Board under the provisions of the Act and the Note Resolution, including ordering the State Treasurer and Department to perform all acts and things required to be done or performed by the State Treasurer and Department under the provisions of the Act and the Note Resolution.

Substitution, Addition and Amendment of Series 2003A, 2004B, 2008A, 2009A and 2011A Grant Agreements

At any time prior to or after the issuance of the Series 2003A, 2004B, 2008A, 2009A and 2011A Notes, the Department may add additional Grant Agreements or substitute for any existing Series 2003A, 2004B, 2008A, 2009A or 2011A Grant Agreement, a replacement Grant Agreement, so long as:

(a) after giving effect to such substitution, the aggregate of the payments scheduled to be made under all the Series 2003A, Series 2004B, Series 2008A, Series 2009A or Series 2011A Grant Agreements by the Federal Highway Administration is at least equal to the aggregate scheduled Debt Service on the Outstanding Series 2003A, 2004B, 2008A, 2009A or 2011A Notes, as applicable, when due;

(b) the additional or substituted Grant Agreement qualifies as a "Grant Agreement" under the Act; and

(c) the applicable representations and warranties of the Board and, as appropriate, the Department, concerning the Series 2000A Grant Agreement and the Series 2000A Project contained in the Note Resolution shall also apply to, and shall be deemed to expressly include, such additional or substitute Series 2003A, 2004B, 2008A, 2009A or 2011A Grant Agreement and the Series 2003A, 2004B, 2008A, 2009A or 2011A Project therein described.

The Department may amend any Series 2003A, 2004B, 2008A, 2009A or 2011A Grant Agreement (including, without limitation, amending the timing and amount of the payments scheduled to be made thereunder by the Federal Highway Administration) so long as, after giving effect to such amendment, the aggregate of the payments scheduled to be made under all the Series 2003A, 2004B, 2008A, 2009A or 2011A Grant Agreement by the Federal Highway Administration is at least equal to the aggregate scheduled Debt Service on the Outstanding Series 2003A, 2004B, 2008A, 2009A, 2011A, or 2012 Notes, as applicable, of such series when due.

Events of and Remedies Upon Default

The following events shall constitute an Event of Default under the Note Resolution:

(a) if default shall be made in the due and punctual payment of the principal or redemption price of any Note when and as the same shall become due and payable, whether at maturity or by call for redemption, or otherwise;

(b) if default shall be made in the due and punctual payment of any installment of interest on any Note, when and as such interest installment shall become due and payable;

(c) if default shall be made by the Board, Director or Department in the performance or observance of any other of the covenants, agreements or conditions on its part in the Note Resolution or in the Notes contained, and such default shall continue for a period of 60 days after written notice thereof to the Board and Director by the Owners of not less than 25% in principal amount of the Notes Outstanding; provided, however, if the failure stated in the notice can be cured within a period of time not materially detrimental to the rights of the Owners of Notes but cannot be cured within the applicable 60-day period, then the 60-day period shall be extended if corrective action is instituted by the Board, Department or Director, as applicable, within the 60-day period and diligently pursued until the failure is corrected; and provided, further, that if by reason of force majeure, the Board, the Department or Director, as applicable, is unable to carry out the agreements on its part herein contained, the Board, Department or Director, as applicable, shall not be deemed in default under this paragraph (iii) during the continuance of such inability (but force majeure shall not excuse any other Event of Default); or

(d) any warranty, representation or other statement by or on behalf of the Board, the Department or Director, as applicable, contained in the Note Resolution is false or misleading in any material respect.

Upon the occurrence and continuation of an Event of Default under Subsection (a) or (b) above, any Owner of a Note on which payment of Debt Service has not been paid when due shall have the right to institute any action permitted under State law to enforce such payment as provided in the Note Resolution.

Upon the occurrence and continuation of any other Event of Default, the Owners of at least ten percent (10%) of the principal amount of the Notes Outstanding affected by such Event of Default shall have the right to institute any action permitted under State law as a result of such Event of Default to enforce compliance with the provisions of the Note Resolution.

Application of Pledged Funds After Default

During the continuance of an Event of Default, the Board shall order the State Treasurer to apply the Pledged Funds and any other available moneys, including any moneys, securities and funds received by the State Treasurer pursuant to any right given or action taken under the provisions of the Note Resolution, as follows and in the following order:

(a) Expenses of Fiduciaries - to the payment of the reasonable and proper fees (including reasonable attorneys' fees), charges, expenses and liabilities of the Fiduciaries;

(b) Debt Service - to the payment of the interest and principal or redemption price then due on the Notes, as follows:

First: Interest - To the payment to the persons entitled thereto of all installments of interest then due in the order of the maturity of such installments, together with accrued and unpaid interest on the Notes theretofore called for redemption, and, if the amount available shall not be sufficient to pay in full any installment or installments maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon, to the persons entitled thereto, without any discrimination or preference; and

Second: Principal or Redemption Price - To the payment to the persons entitled thereto of the unpaid principal or redemption price of any Notes which shall have become due, whether at maturity or by call for redemption, in the order of their due dates, and, if the amount available shall not be sufficient to pay in full all the Notes due on any date, then to the payment thereof ratably, according to the amounts of principal or redemption price due on such date, to the persons entitled thereto without any discrimination or preference;

Unconditional Obligation. Nothing in the Note Resolution or in the Notes contained shall affect or impair the obligation of the Board, which is absolute and unconditional, to pay at the respective dates of maturity and places therein expressed the Debt Service on the Notes to the respective Owners thereof, or affect or impair the right of action, which is also absolute and unconditional, of any Owner to enforce such payment of its Note in accordance with its terms. A judgment requiring a payment of money entered against the Board may be satisfied only from Pledged Funds.

Effect of Waiver and Other Circumstances. No delay or omission of any Owner to exercise any right or power arising upon the happening of an Event of Default shall impair any right or power or shall be construed to be a waiver of any such Event of Default or be an acquiescence therein; and every power and remedy given under the Note Resolution to the Owners may be exercised from time to time and as often as may be deemed expedient by the Owners.

The Owners of not less than a majority in principal amount of the Notes at the time Outstanding, or their attorneys-in-fact duly authorized, may on behalf of the Owners of all of the Notes waive any past default under the Note Resolution and its consequences, except a default in the payment of Debt Service on any of the Notes before any such waiver shall be effective. No such waiver shall extend to any subsequent or other default or impair any right consequent thereon.

Remedies Not Exclusive. No remedy by the terms of the Note Resolution conferred upon or reserved to the Owners of a Series of Notes is intended to be exclusive of any other remedy, but each and every such remedy shall be cumulative and shall be in addition to every other remedy given under the Note Resolution or, except as otherwise provided in the Note Resolution, existing at law or in equity or by statute on or after the date of execution and delivery of the applicable Series of Notes.

Rights of Note Insurer upon Default. (a) Except in certain situations, the applicable Note Insurer shall be entitled, but not obligated, to act on behalf of all Owners of the series of Notes that are insured by its Note Insurance Policy in the exercise of all rights and remedies upon an Event of Default including, but without limitation, control, institution and direction of legal proceedings and the granting of any waivers with respect to the foregoing upon behalf of such Owners; and (b) the Owners of the applicable Series of Notes shall not have the right or be permitted to exercise any of the rights or remedies granted or permitted to them upon an Event of Default without the express written consent of the Note Insurer (if any) insuring such Series.

Supplemental Resolutions Without Consent of Owners.

For any one or more of the following purposes and at any time or from time to time, a Supplemental Resolution of the Board may be adopted amending or supplementing the Note Resolution, without notice to or consent of any Owner, which Supplemental Resolution, when adopted, shall be fully effective in accordance with its terms:

(a) to cure any ambiguity, inconsistency or formal defect or omission in the Note Resolution or to make changes permitted in the definition of "Federal Fiscal Year";

(b) to add to the covenants and agreements of the Board or Department in the Note Resolution, other covenants and agreements to be observed by the Board or Department which are not contrary to or inconsistent with the Note Resolution as theretofore in effect;

(c) to add to the limitations and restrictions in the Note Resolution, other limitations and restrictions to be observed by the Board or Department which are not contrary to or inconsistent with the Note Resolution as theretofore in effect;

(d) to confirm, as further assurance, any pledge under, and the subjection to any pledge created or to be created by, the Note Resolution of the amounts on deposit in the Grant Anticipation Note Fund and Note Proceeds Account and to pledge any additional revenues, moneys, securities or agreements as may be permitted by law for deposit in the Grant Anticipation Note Fund and Note Proceeds Account or for the payment of Debt Service;

(e) notwithstanding any other provisions of the Note Resolution, to authorize, in compliance with all applicable laws, a Series of Additional Notes having terms and provisions different than the terms and provisions theretofore provided in the Note Resolution including, but not limited to, provisions relating to a Note Insurance Policy insuring such Series, the timing of the payment of interest and principal, authorizing the form of Notes for such Series of Additional Notes and otherwise to provide amendments or modifications of provisions of the Note Resolution relative to a Series of Additional Notes; provided that neither the issuance of such Additional Notes nor any such amendments or modifications shall in any manner impair or adversely affect the rights or security of the Owners of a Series of Notes then Outstanding or other persons under the Note Resolution;

(f) to authorize one or more Series of Subordinated Notes and, in connection therewith, specify and determine the provisions thereof, and also any other matters and things relative to such Subordinated Notes which are not contrary to or inconsistent with the Note Resolution as theretofore in effect, or to amend, modify or rescind any such authorization, specification or determination at any time prior to the first authentication and delivery of such Subordinated Notes;

(g) to comply with the provisions of any Federal or state securities law, including, without limitation, the Trust indenture Act of 1939, as amended, or to comply with the Code or to comply with the Federal Aid Authorization;

(h) to make any amendments with the prior written confirmation from each Rating Agency then maintaining an unsecured, underlying rating on the Notes, that such amendments will not, in itself, result in such unsecured, underlying rating on the Notes following such amendment being lower than such rating on the Notes immediately prior to such amendment;

(i) to modify any of the provisions of the Note Resolution in any other respect whatever, provided that (i) such modification shall be, and be expressed to be, effective only after all Notes of each Series Outstanding at the date of the adoption of such Supplemental Resolution shall cease to be Outstanding and (ii) such Supplemental Resolution shall be specifically referred to in the text of all Subordinated Bonds of any Series authenticated and delivered after the date of the adoption of such Supplemental Resolution and of Subordinated Bonds issued in exchange therefor or in place thereof; and

(j) To make the Board or Department eligible, or to continue to qualify, to receive Interest Credit Payments for Federal Direct Payment Notes.

The provisions of subparagraph (g) shall not be deemed to constitute a waiver by the Board or Owners of any right, remedy or power which it may have in the absence of those provisions to contest the application to the Resolution or the Notes of any change in law.

Supplemental Resolutions Requiring Consent of Owners

(a) Exclusive of Supplemental Resolutions described above and subject to the terms and provisions contained in this paragraph and not otherwise, with the consent of the applicable Note Insurer, the Owners of not less than a majority in aggregate principal amount of the Notes Outstanding and affected by the Supplemental

Resolution, shall have the right, from time to time, anything contained in the Note Resolution to the contrary notwithstanding, to consent to and approve, as provided in the Note Resolution, the adoption by the Board and the effectiveness of such other Supplemental Resolutions as shall be deemed necessary and desirable by the Board for the purpose of modifying, altering, amending, adding to or rescinding, in any particular, any of the terms or provisions contained in the Note Resolution.

(b) Notwithstanding any provision of subsection (a) to the contrary, the applicable Note Insurer, upon behalf of Owners of the applicable Series of Notes affected by the Supplemental Resolution, shall have the right to give the consents and approvals required of the Owners of the Notes of such Series, for any amendment to the Note Resolution under subsection (a) affecting such Owners, exclusive of any Supplemental Resolution described in (c), which Supplemental Resolution described in clause (c) shall require the consent of the Owners described in (a) above and of the Note Insurer.

(c) Nothing herein shall permit, or be construed as permitting, (i) an extension of the maturity of the principal of, or the interest on, any Note issued hereunder, or (ii) a reduction in the principal amount of, or redemption premium on, any Note or the rate of interest thereon, or (iii) a privilege or priority of any Note or Notes over any other Note or Notes, or (iv) a reduction in the aggregate principal amount of the Notes required for consent to such Supplemental Resolutions, or (v) permit the creation of any pledge ranking prior to the pledge granted under the Note Resolution on the Pledged Funds or any part thereof, or (vi) deprive the Owner of any Note then Outstanding of the pledge created hereunder on the Pledged Funds, without the prior consent of 100% of the Owners of the Notes affected by such Supplemental Resolution.

Defeasance

Subject to the provisions of the Note Resolution, any Outstanding Notes shall be deemed to have been paid and are not entitled to the lien, benefit and security of the Note Resolution if: (i) in case any of said Notes are to be redeemed on any date prior to their maturity, the Board shall have given to the Note Registrar instructions accepted in writing by the Note Registrar to mail as provided in the Note Resolution notice of redemption of such Notes (other than Notes which have been purchased or otherwise acquired by the Board and delivered to the Note Registrar as hereinafter provided prior to the mailing of such notice of redemption, (ii) there shall have been deposited with an Escrow Agent appointed by the Board for such purposes under an irrevocable escrow agreement, in trust for the Owners of such Notes, (A) moneys (including moneys withdrawn and deposited pursuant to the Note Resolution) in an amount which shall be sufficient, and/or (B) noncallable Defeasance Obligations (including any Defeasance Obligations issued or held in book-entry form on the books of the Department of the Treasury of the United States) the principal of and the interest on which when due will provide moneys which, together with the moneys, if any, deposited with the Escrow Agent at the same time, shall be sufficient (without regard to further investment or reinvestment of either the principal amount thereof or the interest earnings therefrom, which earnings are to be held likewise in trust and so committed, except as provided herein) to pay when due the Debt Service due and to become due on said Notes on or prior to the redemption date or maturity date thereof, as the case may be; (iii) in the event said Notes are not by their terms subject to redemption within the next succeeding 60 days, the Board shall have given the Note Registrar in form satisfactory to it instructions to mail, first class postage prepaid, a notice to the Owners of such Notes as of the close of business on the date on which the Notes are deemed to be paid and discharged at its address as it appears on the note register on that date on which the Notes are deemed to be paid and discharged, (iv) the Board shall have received a report of an independent nationally recognized firm of certified public accountants or a financial consulting firm of recognized standing in the field of municipal bonds to the effect that the amount of moneys and the principal of and interest when due on the Defeasance Obligations deposited at the same time with the Escrow Agent shall be sufficient to pay when due the Debt Service due and to become due on said Notes through the redemption or maturity date thereof, as the case may be; and (v) the Board shall furnish to the Escrow Agent an opinion of Bond Counsel to the effect that such provision for paying such Notes (assuming compliance by the Board and the Escrow Agent with their duties under the escrow agreement) will not, by itself, cause such Notes to be included in gross income for Federal income tax purposes. The notice of defeasance shall: (1) state the numbers of the Notes deemed to be paid and discharged; (2) that the deposit required by (ii) above has been made with the Escrow Agent and that said Notes are deemed to have been paid in accordance with this paragraph; and (3) state such maturity or redemption date upon which the moneys are expected to be available for the payment of the Debt Service on said Notes (other than Notes which have been purchased or otherwise acquired by the Board and delivered to the Note Registrar as hereinafter provided prior to the mailing of the notice of redemption referred to in clause (1) hereof.

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APPENDIX D

BOOK-ENTRY-ONLY SYSTEM

THE INFORMATION PROVIDED IN THIS APPENDIX HAS BEEN PROVIDED BY DTC. NO REPRESENTATION IS MADE BY THE BOARD, THE DEPARTMENT, BOND COUNSEL, THE FINANCIAL ADVISOR OR THE UNDERWRITERS AS TO THE ACCURACY OR ADEQUACY OF SUCH INFORMATION PROVIDED BY DTC OR AS TO THE ABSENCE OF MATERIAL ADVERSE CHANGES IN SUCH INFORMATION SUBSEQUENT TO THE DATE HEREOF.

DTC will act as securities depository for the Series 2012 Notes. The Series 2012 Notes will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each maturity of the Series 2012 Notes with the same interest rate, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is a wholly owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants" and, together with the Direct Participants, "Participants"). DTC has a Standard & Poor's rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Series 2012 Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2012 Notes on DTC's records. The ownership interest of each actual purchaser of each Series 2012 Note ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct Participant or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2012 Notes are to be accomplished by entries made on the books of Direct Participants and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Series 2012 Notes, except in the event that use of the book-entry system for the Series 2012 Notes is discontinued.

To facilitate subsequent transfers, all Series 2012 Notes deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Series 2012 Notes with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2012 Notes; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2012 Notes are credited, which may or may not be the Beneficial Owners. The Direct Participants and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Series 2012 Notes may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2012 Notes, such as redemptions, tenders, defaults, and proposed amendments to the Series 2012 Note documents. For example, Beneficial Owners of Series 2012 Notes may wish to ascertain that the nominee holding the Series 2012 Notes for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Bond Registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Series 2012 Notes within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Series 2012 Notes unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Paying Agent as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 2012 Notes are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, interest and redemption payments on the Series 2012 Notes will be made by the Paying Agent to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Board or the Paying Agent, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Paying Agent or the Board, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, interest and redemption proceeds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Paying Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct Participants and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Series 2012 Notes at any time by giving reasonable notice to the Paying Agent or the Board. Under such circumstances, in the event that a successor depository is not obtained, Series 2012 Note certificates are required to be printed and delivered.

The Board may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Series 2012 Note certificates will be printed and delivered to DTC.

NONE OF THE BOARD, THE DEPARTMENT, THE BOND REGISTRAR AND PAYING AGENT WILL HAVE RESPONSIBILITY OR OBLIGATION TO THE BENEFICIAL OWNERS WITH RESPECT TO (1) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC, ANY DIRECT PARTICIPANT, OR ANY INDIRECT PARTICIPANT; (2) ANY NOTICE THAT IS PERMITTED OR REQUIRED TO BE GIVEN TO THE OWNERS OF THE SERIES 2012 NOTES UNDER THE NOTE RESOLUTION; (3) THE SELECTION BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY PERSON TO RECEIVE PAYMENT IN THE EVENT OF A PARTIAL REDEMPTION OF THE SERIES 2012 NOTES; (4) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY AMOUNT WITH RESPECT TO THE PRINCIPAL OR INTEREST DUE WITH RESPECT TO THE SERIES 2012 NOTES; (5) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS THE OWNER OF SERIES 2012 NOTES; OR (6) ANY OTHER MATTERS.

So long as Cede & Co. is the registered Owner of the Series 2012 Notes, as nominee for DTC, references herein to Owner of the Series 2012 Notes (other than under the caption "TAX MATTERS") shall mean Cede & Co., as aforesaid, and shall not mean the Beneficial Owners of such Series 2012 Notes.

When reference is made to any action which is required or permitted to be taken by the Beneficial Owners, such reference shall only relate to those permitted to act (by statute, regulation or otherwise) on behalf of such Beneficial Owners for such purposes. When notices are given, they shall be sent by the Board or the Bond Registrar to DTC only.

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APPENDIX E
FORM OF CONTINUING DISCLOSURE UNDERTAKING

\$43,825,000
ARIZONA TRANSPORTATION BOARD
GRANT ANTICIPATION REFUNDING NOTES
SERIES 2012

CONTINUING DISCLOSURE UNDERTAKING

THIS CONTINUING DISCLOSURE UNDERTAKING (“Undertaking”), dated May 30, 2012, is executed and delivered by the ARIZONA TRANSPORTATION BOARD (the “Board”) and the DEPARTMENT OF TRANSPORTATION (the “Department” which, together with the Board, is referred to as the “Issuer”), in connection with the issuance by the Board of its \$43,825,000 aggregate principal amount of notes designated the Arizona Transportation Board, Grant Anticipation Refunding Notes, Series 2012, dated May 30, 2012 (the “2012 Notes”).

The Board and the Department each covenant and agree as follows:

Section 1. Purpose of this Undertaking. This Undertaking is executed and delivered by the Issuer, as of the date set forth below, in accordance with the Rule (defined below) for the benefit of the Beneficial Owners of the 2012 Notes.

Section 2. Definitions. The terms set forth below shall have the following meanings in this Undertaking, unless the context clearly otherwise requires.

“*Annual Information*” means, for the most recent Federal Fiscal Year, the type of financial information set forth under the heading “FEDERAL AID REVENUES” in the final Official Statement, dated May 15, 2012, for the 2012 Notes.

“*Audited Financial Statements*” means the audited financial statements of the Department, prepared in conformity with generally accepted accounting principles.

“*Beneficial Owner*” means any person which (a) has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any 2012 Notes (including persons holding 2012 Notes through nominees, depositories or other intermediaries), or (b) is treated as the owner of any 2012 Notes for federal income tax purposes.

“*EMMA*” means the Electronic Municipal Market Access system of the MSRB. Information regarding submissions to EMMA is available at <http://emma.msrb.org>.

“*Federal Fiscal Year*” means the 12-month period beginning on October 1 of each year or such other 12-month period as the federal government shall adopt as its fiscal year.

“*Filing Date*” means the first day of the eighth month following the end of each Fiscal Year (or the next succeeding business day if that day is not a business day), beginning February 1, 2013.

“*Fiscal Year*” means the 12-month period beginning on July 1 of each year or such other 12-month period as the State shall adopt as its fiscal year.

“*MSRB*” means the Municipal Securities Rulemaking Board.

“*Rule*” means Rule 15c2-12(b)(5), as adopted by the SEC under the Securities Exchange Act of 1934, as the same may be amended from time to time, and including any official interpretations thereof issued either before or after the effective date of this Undertaking which are applicable to this Undertaking.

“*SEC*” means the Securities and Exchange Commission.

“*Specified Event*” means the occurrence of any of the events with respect to the 2012 Notes set forth in Sections 4(a) and (b) below.

“*State*” means the State of Arizona.

Section 3. Filing of Annual Information and Audited Financial Statements. The Issuer is the only Obligated Person (as defined in the Rule) for the 2012 Notes. The Issuer hereby agrees to provide or cause to be provided to the MSRB, in a format and with identifying information prescribed by the MSRB:

(a) Annual Information for the preceding Federal Fiscal Year and unaudited financial statements of the Department for the preceding Fiscal Year if Audited Financial Statements are not provided at the same time, not later than the Filing Date for each Fiscal Year; and

(b) Audited Financial Statements for the preceding Fiscal Year, not later than the later of the Filing Date for each Fiscal Year or 30 days after receipt thereof by the Department.

Currently, the MSRB requires filing such information electronically through EMMA. Audited Financial Statements are expected to be available together with the Annual Information. The Issuer is required to deliver, or cause to be delivered, such information in such manner and by such time so that the MSRB receives the information on or before the date specified.

Section 4. Notice of Specified Events and Failure to Provide Annual Information.

(a) The Issuer agrees to provide to the MSRB, in a format and with identifying information prescribed by the MSRB, notice of the occurrence of any of the following events (1) through (9) with respect to 2012 Notes, in a timely manner not in excess of ten business days after the occurrence of the following events:

- (1) Principal and interest payment delinquencies;
- (2) Unscheduled draws on debt service reserves reflecting financial difficulties¹;
- (3) Unscheduled draws on credit enhancements reflecting financial difficulties²;
- (4) Substitution of credit or liquidity providers, or their failure to perform²;
- (5) Adverse tax opinions, the Issuance by the Internal Revenue Service of proposed or final determination of taxability or of Notices of Proposed Issue (IRS Form 5701 TEB);
- (6) Tender offers;
- (7) Defeasances;
- (8) Rating changes; or

¹ The 2012 Notes are not secured by a debt service reserve as of the date of issue.

² No credit enhancement has been obtained for the 2012 Notes as of the date of issue.

- (9) Bankruptcy, insolvency, receivership or similar event of the Issuer.

Note: for the purposes of the event identified in subparagraph (9), the event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for the Issuer in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under State or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the Issuer, or if such jurisdiction has been assumed by leaving the existing governmental body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the Issuer.

(b) The Issuer agrees to provide to the MSRB, in a format and with identifying information prescribed by the MSRB, notice of the occurrence of any of the following events (10) through (16) with respect to 2012 Notes, in a timely manner not in excess of ten business days after the occurrence of the following events, if material:

- (10) Unless described in subparagraph (a)(5) above, other material notices or determinations by the Internal Revenue Service with respect to the tax status of 2012 Notes or other material events affecting the tax status of 2012 Notes;
- (11) Modification to rights of security holders;
- (12) Note calls;
- (13) Release, substitution or sale of property securing repayment of 2012 Notes;
- (14) Non-payment related defaults;
- (15) The consummation of a merger, consolidation, or acquisition involving the Issuer or the sale of all or substantially all of the assets of the Issuer, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms; or
- (16) Appointment of a successor or additional trustee or the change of name of a trustee for the 2012 Notes.

(c) The Issuer acknowledges that it must make a determination whether a Specified Event listed in subsection (b) is material under applicable federal securities laws in order to determine whether a filing is required under subsection (b).

(d) The Issuer agrees to provide to the MSRB and in a format and with identifying information prescribed by the MSRB, notice of the Issuer's failure to file the Annual Information on or prior to the applicable Filing Date.

(e) Notwithstanding the foregoing, notice of the Specified Event described in subsection 4(b)(12) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to Holders of affected Notes pursuant to the Resolution (as defined in the 2012 Notes).

(f) Currently, the MSRB requires filing of notice of Specified Events electronically through EMMA.

Section 5. Additional Information. Nothing in this Undertaking shall be deemed to prevent the Issuer from disseminating any other information, using the means of dissemination set forth in this Undertaking or any other means of communication, or including any other information in any Annual Information or providing notice of the

occurrence of an event, in addition to that which is required by this Undertaking. If the Issuer chooses to include any information from any document or notice of occurrence of an event in addition to that which is specifically required by this Undertaking, the Issuer shall have no obligation under this Undertaking to update such information or include it in any future Annual Information or notice of Specified Events.

Section 6. Failure to Perform. The Issuer agrees that its agreements set forth in Sections 3 and 4 of this Undertaking are intended to be for the benefit of the Beneficial Owners from time to time of the 2012 Notes. Any Beneficial Owner of a 2012 Note may enforce the Issuer's obligation to provide or cause to be provided a filing that is due in accordance with Section 3 or 4 hereof by commencing an action in a court of competent jurisdiction in Phoenix, Arizona to seek specific performance by court order to compel the Issuer to make such filings; provided that any Beneficial Owner seeking to require the Issuer to comply with this Undertaking shall first provide at least 30 days' prior written notice to the Board and the Department of the Issuer's failure, giving reasonable detail of such failure, following which notice the Issuer shall have 30 days to comply. The right of a Beneficial Owner to enforce any provision of this Undertaking shall be limited to a right to obtain specific enforcement of the Issuer's obligations hereunder, and no person or entity shall be entitled to recover monetary damages under this Undertaking, and provided further that any failure of the Issuer to comply with any provisions of this Undertaking shall not be a default or an Event of Default with respect to the 2012 Notes under the Resolution.

Section 7. Amendments; Waiver. The Board reserves the right to amend this Undertaking, and noncompliance with any provision of this Undertaking may be waived, as may be necessary or appropriate to (a) achieve its compliance with the Rule or any other applicable federal securities law or rule, (b) cure any ambiguity, inconsistency or formal defect or omission and (c) address any changes in circumstances arising from a change in legal requirements, change in law or change in the identity, nature or status of the Board. Any such amendment or waiver shall not be effective unless the Undertaking (as amended or taking into account such waiver) would have materially complied with the requirements of the Rule at the time of the primary offering of the 2012 Notes, after taking into account any applicable amendments to or official interpretations of the Rule, as well as any change in circumstances, and until the Board shall have received either (i) a written opinion of bond counsel or other qualified independent special counsel selected by Board that the amendment or waiver would not materially impair the interests of Holders or Beneficial Owners or (ii) the written consent to the amendment or waiver of the Holders of at least a majority of the principal amount of the 2012 Notes then outstanding.

In the event of any amendment or waiver of a provision of this Undertaking, the Issuer shall describe such amendment in the Annual Information or Audited Financial Statements, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or, in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the Issuer. In addition, if the amendment relates to the accounting principles to be following in preparing Audited Financial Statements, (1) notice of such change shall be given in the same manner as Section 3, and (ii) the Annual Information or the Audited Financial Statement for the year in which the change is made shall present a comparison (in narrative form and also, if feasible, in quantitative form) between the Audited Financial Statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

Section 8. Termination of Undertaking. This Undertaking shall terminate when (a) the 2012 Notes are no longer outstanding (within the meaning of the Resolution) or (b) the Rule no longer applies to these 2012 Notes.

Section 9. Dissemination Agent. The Issuer may, from time to time, appoint or engage a dissemination agent to assist it in carrying out its obligations under this Undertaking, and may discharge any such agent, with or without appointing a successor dissemination agent.

Section 10 Beneficiaries. This Undertaking shall inure solely to the benefit of the Issuer and the Beneficial Owners from time to time of the 2012 Notes and shall create no rights in any other person or entity.

Section 11. Recordkeeping. The Issuer shall maintain records of all Annual Information and notice of Specified Events including the content of such disclosure, the names of the entities with whom such disclosures were filed and the date of filing such disclosure.

Section 12. Governing Law. This Undertaking shall be governed by the laws of the State.

IN WITNESS WHEREOF, the parties hereto have caused this Continuing Disclosure Undertaking to be executed and delivered by their duly authorized officers as of this 30th day of May 2012.

ARIZONA TRANSPORTATION BOARD

By: _____
Name: Victor Flores
Its: Vice Chair

ARIZONA DEPARTMENT OF TRANSPORTATION

By: _____
Name: John Halikowski
Its: Director

(Signature page of Continuing Disclosure Undertaking)