

## OFFICIAL STATEMENT

NEW ISSUE – BOOK ENTRY ONLY

Ratings: Standard & Poor's: "AA"  
Moody's: "Aa2"  
See "Ratings" herein

**\$188,260,000**  
**ARIZONA TRANSPORTATION BOARD**  
**SUBORDINATED HIGHWAY REVENUE BONDS**  
**SERIES 2004B**

Dated: August 15, 2004

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

The Subordinated Highway Revenue Bonds, Series 2004B (the "Series 2004B Subordinated Bonds") are being issued by the Arizona Transportation Board (the "Board") as a separate series of fully registered bonds in denominations of \$5,000 or any integral multiple thereof.

Interest on the Series 2004B Subordinated Bonds is payable on January 1 and July 1 of each year, commencing January 1, 2005, by check mailed on each Interest Payment Date by the paying agent, initially J.P. Morgan Trust Company, National Association (the "Paying Agent"), to the registered owners thereof as of the 15th day of the month next preceding such Interest Payment Date. Principal and interest may be paid by wire transfer upon request of registered owners of \$1,000,000 or more in aggregate principal amount, as described herein. Principal of the Series 2004B Subordinated Bonds is payable upon presentation and surrender at the designated corporate trust office of the Paying Agent.

The maturities, interest rates and prices or yields of the Series 2004B Subordinated Bonds are shown on the reverse side of this cover page.

The Series 2004B Subordinated Bonds will be issued as registered bonds and will be registered 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 2004B Subordinated Bonds. Purchases of beneficial interests in such Series 2004B Subordinated Bonds will be made in book-entry only form. Purchasers will not receive certificates representing the ownership interest in the Series 2004B Subordinated Bonds purchased by them. So long as the Series 2004B Subordinated Bonds are registered in the name of Cede & Co., as nominee of DTC, payments of the principal, interest and premium, if any, on the Series 2004B Subordinated Bonds will be made directly by the Paying Agent to Cede & Co., as nominee of DTC. See "THE SERIES 2004B SUBORDINATED BONDS – General Description" and "APPENDIX D – BOOK-ENTRY-ONLY SYSTEM" herein.

The Series 2004B Subordinated Bonds are issued pursuant to the Board's 1991 Resolution, as supplemented (the "Subordinated Bond Resolution"), on a parity as to security and source of payment with the previously issued Series 2004A, Series 2003A, Series 1993A, Series 1993B and Series 1992B Subordinated Bonds (the "Subordinated Bonds") of the Board to be outstanding, after issuance of the Series 2004B Subordinated Bonds, in the aggregate principal amount of \$566,420,000 and any additional Subordinated Bonds subsequently issued on a parity therewith. **The Subordinated Bonds are issued subordinate to and not on parity as to security and source of payment with the Senior Bonds (as defined herein) of the Board currently outstanding in the aggregate principal amount of \$639,200,000 and any additional Senior Bonds subsequently issued on a parity therewith.**

Proceeds of the Series 2004B Subordinated Bonds are intended to be used to (i) finance portions of the Board's Five-Year Capital Program, (ii) pay interest on any bonds issued for highway purposes, and (iii) pay costs of issuing the Series 2004B Subordinated Bonds. See "PLAN OF FINANCE" herein.

The Series 2004B Subordinated Bonds are subject to optional redemption prior to maturity as more fully described herein.

**The Series 2004B Subordinated Bonds and all other Subordinated Bonds are special obligations of the Board payable from and secured solely by a subordinate lien on and pledge of the Pledged Revenues (as defined herein), which consist of a portion of the moneys derived from fees, excises, or license taxes relating to registration, operation or use of vehicles on the public highways of the State of Arizona, and to fuel used for the propulsion of such vehicles, that are deposited into the State Highway Fund subject to a prior lien and pledge for all payments required for the benefit of the Senior Bonds, all as described herein. The Series 2004B Subordinated Bonds are not obligations, general, special or otherwise, of the State of Arizona, do not constitute a legal debt of the State of Arizona, and are not enforceable against the State of Arizona.**

In the opinion of Squire, Sanders & Dempsey L.L.P., Bond Counsel, under existing law (i) assuming continuing compliance with certain covenants and the accuracy of certain representations, interest on the Series 2004B Subordinated Bonds 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 2004B Subordinated Bonds is exempt from Arizona state income tax. Interest on the Series 2004B Subordinated Bonds 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 tax aspects, see "TAX MATTERS" herein.

This cover page contains only a brief description of the Series 2004B Subordinated Bonds and the security therefor. It is not a summary of material information with respect to the Series 2004B Subordinated Bonds. Investors should read the entire Official Statement to obtain information necessary to make an informed investment decision.

The Series 2004B Subordinated Bonds are offered when, as and if issued and received by the Underwriters, subject to the approval of legality by Squire, Sanders & Dempsey L.L.P., Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the Underwriters by their counsel, Ballard Spahr Andrews & Ingersoll, LLP. It is expected that the Series 2004B Subordinated Bonds, in book-entry form, will be available for delivery to DTC in New York, New York, on or about September 8, 2004.

August 18, 2004

**Citigroup**

**Bear, Stearns & Co. Inc.**

**JPMorgan**

**George K. Baum & Co.**

**Lehman Brothers**

**Piper Jaffray**

**\$188,260,000**  
**ARIZONA TRANSPORTATION BOARD**  
**SUBORDINATED HIGHWAY REVENUE BONDS**  
**SERIES 2004B**

**MATURITY SCHEDULE**

<b>Year (July 1)</b>	<b>Amount</b>	<b>Interest Rate</b>	<b>Yield</b>	<b>CUSIP</b>
2012	\$10,630,000	5.00%	3.47%	040654 MF9
2013	11,160,000	5.00	3.63	040654 MG7
2014	11,715,000	5.00	3.74	040654 MH5
2015	12,305,000	5.00	3.85*	040654 MJ1
2016	12,920,000	5.00	3.93*	040654 MK8
2017	13,565,000	5.00	4.01*	040654 ML6
2018	14,245,000	5.00	4.09*	040654 MM4
2019	14,955,000	5.00	4.16*	040654 MN2
2020	15,700,000	5.00	4.24*	040654 MP7
2021	16,490,000	5.00	4.33*	040654 MQ5
2022	17,310,000	5.00	4.41*	040654 MR3
2023	18,180,000	5.00	4.48*	040654 MS1
2024	19,085,000	5.00	4.56*	040654 MT9

(Accrued interest to be added)

\* Priced to the July 1, 2014 optional redemption date.

**STATE OF ARIZONA**

Janet Napolitano  
*Governor*

**ARIZONA TRANSPORTATION BOARD**

Bill Jeffers  
*Chair*

Dallas "Rusty" Gant  
*Vice Chair*

Richard Hileman  
*Member*

James Martin  
*Member*

Joe Lane  
*Member*

Si Schorr  
*Member*

Delbert Householder  
*Member*

**STATE OF ARIZONA DEPARTMENT OF TRANSPORTATION**

Victor Mendez  
*Director*

Debra Brisk  
*Deputy Director*

Michael Ortega  
*State Engineer*

John Bogert  
*Chief of Staff*

Dale Buskirk  
*Division Director*  
*Transportation Planning Division*

Stacey Stanton  
*Division Director*  
*Motor Vehicle Division*

Vacant  
*Division Director*  
*Aeronautics Division*

Vacant  
*Division Director*  
*Public Transportation Division*

John McGee  
*Chief Financial Officer*

**FINANCIAL CONSULTANT**

RBC Dain Rauscher Inc.  
Phoenix, Arizona

**BOND COUNSEL**

Squire, Sanders & Dempsey L.L.P.  
Phoenix, Arizona

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John McGee  
John Fink  
(602) 712-7441

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, 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 Series 2004B Subordinated Bonds, 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 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 taxes 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, or the Department since the date hereof.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY ALLOW CONCESSIONS OR DISCOUNTS FROM SUCH INITIAL PUBLIC OFFERING PRICES TO DEALERS AND OTHERS, AND THE UNDERWRITERS MAY OVERALLOT OR ENGAGE IN TRANSACTIONS INTENDED TO STABILIZE THE PRICES OF THE SERIES 2004B SUBORDINATED BONDS 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 2004B Subordinated Bonds 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 2004B Subordinated Bonds as required by Rule 15c2-12 of the Securities and Exchange Commission. See "Continuing Disclosure Undertaking" and "Appendix C – 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.

The Paying Agent has neither furnished nor reviewed the information contained herein and assumes no responsibility for its accuracy or adequacy.

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- Appendix C – Form of Continuing Disclosure Undertaking
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## OFFICIAL STATEMENT

relating to

**\$188,260,000**

**Arizona Transportation Board  
Subordinated Highway Revenue Bonds  
Series 2004B**

### INTRODUCTION

This Official Statement (including the cover page and Appendices attached hereto) provides certain information in connection with the issuance by the Arizona Transportation Board (the "Board") of its Subordinated Highway Revenue Bonds, Series 2004B (the "Series 2004B Subordinated Bonds").

The Series 2004B Subordinated Bonds are issued pursuant to the State Highway Bonding Authorization Law, Title 28, Chapter 21, Article 1, Arizona Revised Statutes, as amended (the "Act"), and under and pursuant to a resolution adopted by the Board on September 27, 1991, as supplemented to date, including a supplemental resolution adopted on July 16, 2004 (the "2004B Subordinated Resolution") authorizing the Series 2004B Subordinated Bonds (collectively, the "Subordinated Bond Resolution").

Proceeds of the Series 2004B Subordinated Bonds are intended to be used for the purposes of (i) financing portions of the Board's Five-Year Capital Program (as described below), (ii) paying interest on any bonds issued for highway purposes, and (iii) paying costs of issuing the Series 2004B Subordinated Bonds (see "PLAN OF FINANCE").

The Series 2004B Subordinated Bonds are special obligations of the Board. The principal of and interest (collectively, "Debt Service") on the Series 2004B Subordinated Bonds, together with the outstanding Subordinated Bonds, are payable from and secured solely by a subordinate pledge of and lien on Pledged Revenues as provided in the Subordinated Bond Resolution, as more fully described under "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2004B SUBORDINATED BONDS." Additional bonds may be issued on a parity with the Board's outstanding Subordinated Bonds ("Additional Subordinated Bonds") under the conditions and in the manner provided in the Subordinated Bond Resolution. The Series 2004B Subordinated Bonds, the outstanding Subordinated Bonds and Additional Subordinated Bonds are collectively referred to as the "Subordinated Bonds." The aggregate principal amount of Subordinated Bonds that will be outstanding immediately after delivery of the Series 2004B Subordinated Bonds will be \$566,420,000.

**The Series 2004B Subordinated Bonds 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 funds of the State, the Board, or the Department other than the money pledged and otherwise available for the benefit of the registered owners ("Owners") of the Subordinated Bonds pursuant to the Act and the Subordinated Bond Resolution.**

The Series 2004B Subordinated Bonds, together with all other Subordinated Bonds, are issued subordinate to and not on a parity as to security and source of payment with all payments required by the Subordinated Bond Resolution and the Senior Bond Resolution (described below), for the benefit of the Board's outstanding Highway Revenue Bonds, Series 2003, Highway Revenue Bonds, Series 2002B, Highway Revenue Refunding Bonds, Series 2002A, Highway Revenue Bonds, Series 2002, Highway Revenue Bonds, Series 2001, and Highway Revenue Bonds, Series 1999, which together with any Additional Senior Bonds hereafter issued by the Board on a parity therewith, are referred to collectively as the "Senior Bonds."

The Senior Bonds were authorized by a resolution adopted by the Board on May 1, 1980, as supplemented to date, which resolution, as supplemented and as it may in the future be further supplemented in connection with the issuance of Additional Senior Bonds or otherwise, is collectively referred to as the "Senior Bond Resolution." The Subordinated Bond Resolution and the Senior Bond Resolution are sometimes hereinafter referred to as the "Bond Resolutions."

**Senior Bonds are payable from and secured solely by a lien on and pledge of the Pledged Revenues senior in all respects to payments required for the benefit of the Owners of the Subordinated Bonds. The aggregate principal amount of Senior Bonds that is currently outstanding is \$639,200,000.**

The Board may finance highway projects in whole or in part by the issuance of bonds up to the limit under the Act. The current limit is a principal amount of \$1,300,000,000 outstanding at any one time, including Senior Bonds and Subordinated Bonds, but excluding refunded bonds, unless an additional amount is authorized by the Legislature. The aggregate amount of Senior Bonds and Subordinated Bonds that will be outstanding immediately after the delivery of the Series 2004B Subordinated Bonds will be \$1,205,620,000.

Payments on the Series 2004B Subordinated Bonds are not subject to annual appropriation by the Legislature of the State nor are payments on the Series 2004B Subordinated Bonds subject to any constitutional or statutory limitation on expenditures.

The Arizona Legislature has previously and may in the future amend the Act and other statutes that govern Pledged Revenues. However, any such amendments would be subject to the covenants of the Board in the Bond Resolutions that the State will not limit or alter the rights vested in the Board to collect such fees and taxes as may be necessary to produce sufficient revenues to fulfill the terms of such Bond Resolutions or any agreement made with the Owners of the Senior Bonds and Subordinated Bonds or in any way impair the rights and remedies of such Owners until all Senior Bonds and Subordinated Bonds, together with interest thereon and interest on unpaid installments of interest and all costs and expenses in connection with any action or proceeding by or on behalf of any Owners, are fully met and discharged. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2004B SUBORDINATED BONDS – Pledged Revenues."

This Official Statement describes the terms of and security for the Series 2004B Subordinated Bonds and the use of proceeds of the Series 2004B Subordinated Bonds. These descriptions do not purport to be comprehensive or definitive. All references herein to the Bond Resolutions and the summary of the Subordinated Bond Resolution in Appendix E are qualified in their entirety by reference to the definitive forms thereof and are further qualified in their entirety by reference to laws and principles of equity relating to or affecting the enforceability of creditors' rights. Capitalized terms not defined herein or in "DEFINITIONS OF TERMS" in Appendix E shall have the meanings set forth in the Bond Resolutions. Copies of the Bond Resolutions may be obtained as set forth under "MISCELLANEOUS."

## **THE SERIES 2004B SUBORDINATED BONDS**

### **General Description**

The Series 2004B Subordinated Bonds are issuable as fully registered bonds. The Series 2004B Subordinated Bonds will bear interest from August 15, 2004, at the rates, and will mature on the dates and in the amounts, all as set forth on the inside cover page hereof. As described within "Appendix D – BOOK-ENTRY-ONLY SYSTEM", the Series 2004B Subordinated Bonds will be registered in the name of Cede & Co., as registered Owner and nominee of The Depository Trust Company ("DTC"), New York, New York. So long as DTC, or its nominee, Cede & Co., is the registered Owner of all of the Series 2004B Subordinated Bonds, all payments on the Series 2004B Subordinated Bonds will be made directly to DTC.

So long as Cede & Co. is the registered Owner of the Series 2004B Subordinated Bonds, as nominee for DTC, references herein to "Owners" or registered owners of the Series 2004B Subordinated Bonds (other than

under the caption "TAX MATTERS") shall mean Cede & Co., as aforesaid, and shall not mean the beneficial owners of such Series 2004B Subordinated Bonds (the "Beneficial Owners"). 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 Paying Agent (defined below) to DTC only, as registered Owner.

The Series 2004B Subordinated Bonds initially will be dated as shown on the cover page, and will be issued in denominations of \$5,000 or any integral multiple thereof. Interest on the Series 2004B Subordinated Bonds will be payable on each January 1 and July 1 (each such date is referred to herein as an "Interest Payment Date"), commencing January 1, 2005, and will accrue from their dated date. Interest on the Series 2004B Subordinated Bonds will be payable by check or draft mailed on the Interest Payment Date by the Paying Agent to the Owners thereof as shown on the registration books maintained by the bond registrar, initially J.P. Morgan Trust Company, National Association and its successors (the "Bond Registrar"), at the address appearing therein, at the close of business of the Bond Registrar on June 15 and December 15 of each year (the "Regular Record Date"). The principal of the Series 2004B Subordinated Bonds will be payable upon presentation and surrender thereof at the designated office of the paying agent, initially J.P. Morgan Trust Company, National Association and its successors (the "Paying Agent"). However, at the written request of the Owners of \$1,000,000 or more in aggregate principal amount of Series 2004B Subordinated Bonds, delivered to the Bond Registrar prior to a Regular Record Date, interest and principal may be paid by wire transfer at the Owner's expense to a bank account in the continental United States.

#### **Redemption Provisions**

The Series 2004B Subordinated Bonds maturing on or prior to July 1, 2014, are not subject to optional redemption prior to maturity. The Series 2004B Subordinated Bonds maturing on or after July 1, 2015 are subject to optional redemption, prior to maturity, at the election of the Board, in whole or in part, at any time, on or after July 1, 2014, at a redemption price equal to the principal amount of the Series 2004B Subordinated Bonds to be redeemed plus accrued interest to the date fixed for redemption, but without premium.

#### *Notice of Redemption.*

The Bond Registrar shall give notice by mail of the redemption of the Series 2004B Subordinated Bonds, not less than 30 days prior to the redemption date, to the registered Owners (Cede & Co., so long as the book-entry-only system is in effect) of any Series 2004B Subordinated Bonds or portions thereof to be redeemed at their last address appearing on the bond register of the Board. Such notice shall specify the maturities of the Series 2004B Subordinated Bonds to be redeemed, the redemption date and the place or places where amounts due upon such redemption will be payable and, if less than all of the Series 2004B Subordinated Bonds of like maturity are to be redeemed, the particular Series 2004B Subordinated Bonds or portions thereof to be redeemed. Any defect in the notice to the Owner of any Series 2004B Subordinated Bond which is to be redeemed shall not affect the validity of the proceedings for the redemption of any other Series 2004B Subordinated Bond. Any notice of redemption which is mailed shall be presumed to be given, whether or not such notice is received. Any failure on the part of a nominee of a Beneficial Owner of a Series 2004B Subordinated Bond to notify the Beneficial Owner shall not affect the validity of the redemption of such Series 2004B Subordinated Bond.

So long as the Series 2004B Subordinated Bonds are held under the Book-Entry-Only System (See Appendix D), notice of redemption shall be sent to Cede & Co., as the registered Owner. If on the redemption date, money for the redemption of the Series 2004B Subordinated Bonds or portions thereof to be redeemed, together with accrued interest thereon to the redemption date, is held by the Paying Agent and is available to pay the redemption price of the Series 2004B Subordinated Bonds or portions thereof to be redeemed on the redemption date, and if notice of redemption has been given as described in the preceding paragraph, then, from and after the redemption date, interest on the Series 2004B Subordinated Bonds or portions thereof so called for redemption shall cease to accrue.

If at the time of mailing of notice of an optional redemption of the Series 2004B Subordinated Bonds there has not been deposited with the State Treasurer in a subaccount in the Subordinated Bond Fund moneys or

Defeasance Obligations (as defined in the Subordinated Bond Resolution) sufficient to redeem all the Series 2004B Subordinated Bonds called for optional redemption, then such notice shall state that the optional redemption is conditional upon the deposit of moneys or Defeasance Obligations sufficient for the redemption with the State Treasurer not later than the opening of business on the redemption date, and such notice will be of no effect and such Series 2004B Subordinated Bonds shall not be optionally redeemed unless such moneys or Defeasance Obligations are so deposited.

### **Exchange and Transfer**

If the Series 2004B Subordinated Bonds are not in book-entry-only form, the following paragraph will be applicable.

The registration of any Series 2004B Subordinated Bond may be transferred upon the bond register of the Board by the Owner thereof, in person or by his or her duly authorized attorney, upon surrender of such Series 2004B Subordinated Bond at the designated office of the Bond Registrar accompanied by a written instrument of transfer satisfactory to the Bond Registrar and duly executed by the Owner or by his or her duly authorized attorney. Any Series 2004B Subordinated Bond may be exchanged at the designated office of the Bond Registrar for new Series 2004B Subordinated Bonds of any authorized denomination, aggregate principal amount and maturity as the surrendered Series 2004B Subordinated Bond. The Bond Registrar will not charge an administrative fee for any new Series 2004B Subordinated Bond 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 Bond Registrar is not required to exchange or transfer any Series 2004B Subordinated Bond 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 2004B Subordinated Bonds or Series 2004B Subordinated Bonds of a particular maturity or a particular Series 2004B Subordinated Bond 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 Subordinated Bond Resolution, such Series 2004B Subordinated Bonds will cease to be entitled to any lien, benefit or security under the Subordinated Bond Resolution, and all covenants, agreements and obligations of the Board to the Owners of such Series 2004B Subordinated Bonds will thereupon cease, terminate and become void and be discharged and satisfied.

Subject to the provisions of the Subordinated Bond Resolution, any outstanding Series 2004B Subordinated Bonds 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 the State Treasurer or with an escrow agent appointed for such purpose, moneys or Defeasance Securities (defined below) or both. The maturing principal and interest income on such Defeasance Securities, if any, shall be sufficient without reinvestment, together with any cash (as evidenced by a report of an independent nationally recognized certified public accounting firm or financial consulting firm), to pay the principal of and interest on such Series 2004B Subordinated Bonds to their maturity or to their prior redemption dates as may be specified by the Board. The moneys and Defeasance Securities shall be held irrevocably in trust for the Owners of such Series 2004B Subordinated Bonds, for the purpose of paying the principal of and interest on such Series 2004B Subordinated Bonds, as the same shall mature, come due or become payable upon prior redemption. Upon such deposit, the Series 2004B Subordinated Bonds so provided for shall no longer be outstanding under the Subordinated Bond Resolution. See "DEFEASANCE" in Appendix E hereof for further information concerning defeasance and a description of the Defeasance Securities.

## **PLAN OF FINANCE**

Approximately \$200,000,000 of the proceeds received from the sale of the Series 2004B Subordinated Bonds are intended to be used to finance portions of the Board's Five-Year Capital Program. Such proceeds may, but are not intended to, be used to pay interest on any bonds of the Board issued for highway purposes. The remaining portion of the proceeds received from the sale of the Series 2004B Subordinated Bonds will be used for paying costs of issuing the Series 2004B Subordinated Bonds.

## **SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2004B SUBORDINATED BONDS**

### **Legal Authority**

The Series 2004B Subordinated Bonds are special obligations of the Board and are being issued by the Board pursuant to the Act and the Subordinated Bond Resolution. Under the terms and provisions of the Act, the Board is authorized to issue bonds for the payment of highway obligations; the costs of construction, reconstruction, maintenance and repair of public highways and bridges; county, city and town roads and streets; acquisition of real properties for future highway needs; other related highway purposes; and for the refunding of any bonds previously issued.

The Act provides that the Board may issue bonds, including Senior Bonds and Subordinated Bonds, up to a total principal amount of \$1,300,000,000 outstanding at any time, excluding refunded bonds. The State Legislature has the right to increase or change the foregoing limitations and restrictions. See "Additional Bonds" below.

The Series 2004B Subordinated Bonds, the outstanding Subordinated Bonds and any Additional Subordinated Bonds that may subsequently be issued by the Board on a parity therewith pursuant to the Subordinated Bond Resolution, are subordinate to and not on a parity as to security and source of payment with all payments required for the benefit of the Board's Senior Bonds currently outstanding and those that may be subsequently issued by the Board. Immediately after the delivery of the Series 2004B Subordinated Bonds, there will be \$639,200,000 of Senior Bonds outstanding and \$566,420,000 of Subordinated Bonds outstanding. The issuance of the Series 2004B Subordinated Bonds is permitted under the Senior Bond Resolution.

### **General**

Payments of principal of and interest on the Series 2004B Subordinated Bonds and all other Subordinated Bonds are payable from and secured solely by a subordinate lien on and pledge of the Pledged Revenues on deposit in the State Highway Fund. The lien on and pledge of Pledged Revenues for Subordinated Bonds is in all respects subordinate to the lien on and pledge of Pledged Revenues for Senior Bonds. Pledged Revenues are the moneys deposited by the State Treasurer into the State Highway Fund that are derived from a portion of specified sources. In general, such sources are: motor vehicle fuel taxes, motor vehicle registration fees, motor carrier fees, motor vehicle license (in lieu) taxes, and motor vehicle operators' license fees and certain miscellaneous fees and revenues collected by the State of Arizona. For a discussion of the sources of the Pledged Revenues, see "Pledged Revenues" and "SOURCES AND APPLICATION OF PLEDGED REVENUES" herein.

As provided in the Act, all Pledged Revenues deposited into the State Highway Fund shall be immediately subject to the lien of the first pledge granted in the Senior Bond Resolution for the Senior Bonds and the lien of the subordinate pledge granted in the Subordinated Bond Resolution for the Subordinated Bonds, without any future physical delivery or further act.

In addition to Pledged Revenues, the Senior Bonds, the Series 2004B Subordinated Bonds and all other Subordinated Bonds are also payable from, but are not secured by a pledge of, all moneys to be deposited into the Arizona Highway User Revenue Fund. Arizona statutes currently require that if there are defaults in amounts

required by the Senior Bond Resolution and/or the Subordinated Bond Resolution to be deposited into the Bond Funds (as described under “SOURCES AND APPLICATION OF PLEDGED REVENUES – Funds and Accounts and Application of Pledged Revenues” below), then the Department shall deduct from the revenues that otherwise would be deposited into the Arizona Highway User Revenue Fund, prior to their deposit, an amount sufficient to make such required deposits into the Bond Funds. For a discussion of the revenues that are deposited to the Arizona Highway User Revenue Fund, see “SOURCES AND APPLICATION OF PLEDGED REVENUES - Arizona Highway User Revenue Fund” herein.

The Senior Bonds and the Subordinated Bonds are not subject to acceleration under any circumstances.

The Board may issue Additional Senior Bonds on a parity with the outstanding Senior Bonds as described under “Additional Bonds - *Additional Senior Bonds*” herein. The Board may issue Additional Subordinated Bonds on a parity with the Series 2004B Subordinated Bonds and the outstanding Subordinated Bonds as described under “Additional Bonds - *Additional Subordinated Bonds*” herein.

### **Special Obligations**

The Series 2004B Subordinated Bonds are special obligations of the Board and are payable solely from the sources specified in the Act and the Subordinated Bond Resolution. The Series 2004B Subordinated Bonds 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 funds of the State, the Board, or the Department other than the money pledged and otherwise available for the benefit of the Owners of the Subordinated Bonds pursuant to the Act and the Subordinated Bond Resolution.

### **Pledged Revenues**

The Series 2004B Subordinated Bonds, together with the outstanding Subordinated Bonds and any Additional Subordinated Bonds that may be subsequently issued, are payable from and secured solely by a lien on and pledge of the Pledged Revenues on deposit in the State Highway Fund, subordinate in all respects to payments required for the benefit of the Senior Bonds. The State Highway Fund is the operating fund of the Department from which the Department pays debt service on highway revenue bonds or other evidences of indebtedness, operational expenses of the Department and expenditures for highway construction and improvement and acquisition of rights of way. The State Highway Fund contains money derived from many sources. Only the money in the State Highway Fund derived from certain sources specified in the Bond Resolutions and the Act (described below and relating generally to motor vehicles) constitutes Pledged Revenues.

Certain specified revenues are deposited into the Arizona Highway User Revenue Fund. See “SOURCES AND APPLICATION OF PLEDGED REVENUES-Arizona Highway User Revenue Fund.” Each month, according to statutory allocations, 50.5% of moneys in the Arizona Highway User Revenue Fund (after certain statutory distributions) are transferred to the State Highway Fund. In addition to the distribution from the Arizona Highway User Revenue Fund, certain other moneys are distributed to and deposited in the State Highway Fund. Only moneys from specified sources that are paid into and are on deposit in the State Highway Fund constitute “Pledged Revenues.” See “SOURCES AND APPLICATION OF PLEDGED REVENUES-Arizona Highway User Revenues” herein for a more detailed discussion of such revenues.

The Arizona Legislature has previously altered and may in the future alter (1) the type and/or rate of the taxes, fees and charges relating to motor vehicles which are deposited into the Arizona Highway User Revenue Fund; (2) the allocation of such moneys between (a) deposits into the State Highway Fund, which upon such deposit become Pledged Revenues and (b) distributions to cities, towns and counties (or to other state funds); or (3) the type and/or rate of the taxes, fees and charges which are deposited directly into the State Highway Fund. For a discussion of certain recent changes made and under consideration by the Arizona Legislature, see “SOURCES AND APPLICATION OF PLEDGED REVENUES – Recent Legislation” below). The authority of the Arizona Legislature to make changes in use of moneys deposited into the Arizona Highway User Revenue Fund is subject to the requirement of the Arizona Constitution that revenues derived from fees or taxes related to the registration,

operation or use of motor vehicles, excluding the State's motor vehicle license (in lieu) tax, may only be used for highway-related purposes including, but not limited to, paying debt service on bonds issued under the Act. The Legislature's right to make such changes is further restricted by the Bond Resolutions in which the Board, as agent for the State and pursuant to the Act, has pledged and agreed with the Owners of the outstanding Senior Bonds and Subordinated Bonds that the State will not limit or alter the rights vested in the Board to collect such fees and taxes as may be necessary to produce sufficient revenues to fulfill the terms of the Bond Resolutions or any agreement made with the Owners of such Senior Bonds and Subordinated Bonds or in any way impair the rights and remedies of the Owners until all Senior Bonds and Subordinated Bonds, together with interest thereon and interest on unpaid installments of interest and all costs and expenses in connection with any action or proceeding by or on behalf of any Owners are fully met and discharged.

There is no requirement in the Bond Resolutions that amounts be deposited into the State Highway Fund in excess of the amounts necessary to make transfers to the Bond Funds, as described under "SOURCES AND APPLICATION OF PLEDGED REVENUES—Funds and Accounts and Application of Pledged Revenues."

#### **Additional Bonds**

The Board currently estimates that it may issue additional bonds under the Bond Resolutions in the aggregate principal amount of up to approximately \$268 million over the remainder of the current Five-Year Capital Program (ending FY 2009) to fund additional highway projects. Such additional bonds may be issued as either Additional Senior Bonds, Additional Subordinated Bonds, Second Subordinated Bonds (all as described below), or any combination thereof. The actual amount of additional bonds to be issued will depend upon, among other considerations, market conditions, cash flow requirements of the Board for construction, any increase in statutory limits on the principal amount of bonds that may be outstanding and other sources of funding available to meet such requirements.

***Additional Senior Bonds.*** Pursuant to the Senior Bond Resolution, the Board has previously issued and there are outstanding Senior Bonds in the aggregate principal amount of \$639,200,000. The Bond Resolutions provide that any outstanding Senior Bonds enjoy a pledge of and a claim upon Pledged Revenues prior to the claim in favor of any Subordinated Bonds.

Under the Senior Bond Resolution, Additional Senior Bonds may be issued on a parity with the outstanding Senior Bonds only when the Board certifies that:

- (a) all the payments of the principal of and interest on the then outstanding Senior Bonds are current; and
- (b) the Pledged Revenues for the preceding 12-month period were not less than 400% of the highest annual principal and interest payments on all outstanding Senior Bonds for the highest aggregate one-year period during the life of the outstanding Senior Bonds, including the principal and interest payments on the Additional Senior Bonds proposed to be issued, but excluding the principal and interest on any Senior Bonds to be refunded that shall not be outstanding immediately after the issuance of such proposed Additional Senior Bonds; and
- (c) subject to (e) below, the Additional Senior Bonds to be issued shall be payable as to principal and interest on such date or dates as the Board shall designate; and
- (d) the proceeds from the sale of the Additional Senior Bonds are to be used for any lawful highway purpose, including refunding any bonds; and
- (e) all other requirements of law existing on the date such Additional Senior Bonds are issued have been met.

Under the Subordinated Bond Resolution, the Board has agreed for the benefit of the Owners of Subordinated Bonds that the Board will not issue Additional Senior Bonds on parity with the outstanding Senior

Bonds unless the Pledged Revenues received by the State Treasurer in any 12 consecutive months out of the most recent preceding 18 months (as adjusted as permitted in the Subordinated Bond Resolution) were not less than 300% of the maximum aggregate Adjusted Debt Service Requirements (as defined in the Subordinated Bond Resolution) on all outstanding Senior Bonds and outstanding Subordinated Bonds, including the Senior Bonds to be issued but excluding any Senior Bonds or Subordinated Bonds to be refunded that shall not be outstanding immediately after the issuance of such Additional Senior Bonds, in the then current or any future Bond Year (as defined in the Subordinated Bond Resolution), during the life of the outstanding Senior Bonds, including the proposed Senior Bonds to be issued.

Under the Subordinated Bond Resolution, the Board has agreed for the benefit of the Owners of Subordinated Bonds that the Board will not issue Additional Senior Bonds for refunding purposes unless either the requirements described in the immediately preceding paragraph are met or unless the aggregate Adjusted Debt Service Requirements on Senior Bonds and Subordinated Bonds to be outstanding immediately after the date of issuance of the proposed refunding Senior Bonds is not, for each Bond Year from the then current Bond Year through the last Bond Year during which Senior Bonds and Subordinated Bonds are outstanding immediately prior to the issuance of the proposed refunding Senior Bonds, more than 105% of the aggregate Adjusted Debt Service Requirements by Bond Year on all Senior Bonds and Subordinated Bonds outstanding immediately prior to the issuance of the refunding Senior Bonds.

In addition to the requirements of the Senior Bond Resolution and the Subordinated Bond Resolution, certain additional statutory requirements, described below under the subheading "*Statutory Limitation on Issuance of Additional Bonds,*" must be met in order for the Board to issue Additional Senior Bonds.

***Additional Subordinated Bonds.*** Pursuant to the Subordinated Bond Resolution, the Board has previously issued and there are outstanding Subordinated Bonds in the aggregate principal amount of \$566,420,000 after giving effect to the issuance of the 2004B Subordinated Bonds. Under the Subordinated Bond Resolution, Additional Subordinated Bonds may be issued on a parity with the outstanding Subordinated Bonds only when the requirements of the Subordinated Bond Resolution have been met, including the requirement that the amount of Pledged Revenues deposited by the State Treasurer into the State Highway Fund during any 12 consecutive months out of the most recent preceding 18 months (as adjusted as permitted under the Subordinated Bond Resolution) was not less than 300% of the maximum aggregate Adjusted Debt Service Requirements in the then current or any future Bond Year on the outstanding Senior Bonds and the outstanding Subordinated Bonds, including the proposed series of Additional Subordinated Bonds but excluding any Senior Bonds or Subordinated Bonds to be refunded that shall not be outstanding immediately after the issuance of the Additional Subordinated Bonds.

Additional Subordinated Bonds may be issued at any time to refund in whole or in part any outstanding Subordinated Bonds, Senior Bonds or Second Subordinated Bonds, provided that the Board certifies that the aggregate Adjusted Debt Service Requirements on Senior Bonds and Subordinated Bonds to be outstanding immediately after the date of issuance of the proposed refunding Subordinated Bonds is not, for each Bond Year from the then current Bond Year through the last Bond Year during which Senior Bonds and Subordinated Bonds are outstanding immediately prior to the issuance of the proposed refunding Subordinated Bonds, more than 105% of the aggregate Adjusted Debt Service Requirements by Bond Year on all Senior Bonds and Subordinated Bonds outstanding immediately prior to the issuance of the refunding Subordinated Bonds. If the Board cannot satisfy the requirement of the preceding sentence, the Board may nevertheless issue Subordinated Bonds for the purpose of refunding in whole or in part any outstanding Subordinated Bonds, Senior Bonds or Second Subordinated Bonds upon compliance with the test described in the preceding paragraph.

For a more complete description of the requirements under the Subordinated Bond Resolution for the issuance of Additional Subordinated Bonds, see "AUTHORIZATION AND ISSUANCE OF ADDITIONAL SUBORDINATE BONDS" in Appendix E.

In addition to the requirements of the Subordinated Bond Resolution, certain additional statutory requirements, described below under the subheading "*Statutory Limitation on Issuance of Additional Bonds,*" must be met in order for the Board to issue Additional Subordinated Bonds.

**Second Subordinated Bonds.** The Board may, at any time, or from time to time, in accordance with the Bond Resolutions, issue or incur second subordinated bonds for any of its lawful purposes, which shall be payable out of, and which may be secured by a pledge of and lien on, amounts of Pledged Revenues remaining after all deposits to the funds established for the Senior Bonds and Subordinated Bonds required by the Bond Resolutions have been made; provided, however, that such pledge of and lien on Pledged Revenues shall be, and shall be expressed to be, subordinate and junior in all respects to the lien and pledge created by the Senior Bond Resolution as security for the Senior Bonds and shall also be subordinate and junior in all respects to the lien and pledge created by the Subordinated Bond Resolution as security for the Subordinated Bonds (such bonds being referred to herein as "Second Subordinated Bonds"). There are currently no Second Subordinated Bonds outstanding nor any plans to issue Second Subordinated Bonds.

In addition to the requirements of the Bond Resolutions, certain additional statutory requirements, described below under the subheading "*Statutory Limitation on Issuance of Additional Bonds,*" must be met in order for the Board to issue Second Subordinated Bonds.

**Statutory Limitation on Issuance of Additional Bonds.** The Act limits the total principal amount of bonds issued thereunder, including Senior Bonds, Subordinated Bonds and Second Subordinated Bonds, that the Board may have outstanding at any time, excluding refunded bonds, to no more than \$1,300,000,000 unless an additional amount is authorized by the Arizona Legislature. The aggregate principal amount of Senior Bonds and Subordinated Bonds that will be outstanding immediately after the delivery of the Series 2004B Subordinated Bonds will be \$1,205,620,000. The Act presently provides that the Board may issue additional bonds (subject to the dollar limitation described above), which may be Senior Bonds, Subordinated Bonds or Second Subordinated Bonds, if the moneys pledged to the payment of such bonds for the preceding 12 month period exceed by two times the highest annual principal and interest payments on all the outstanding bonds and the bonds to be issued for the highest one-year period during the life of both the outstanding bonds and the bonds to be issued. In addition, for any additional bonds to be issued, the requirements of the applicable Bond Resolutions described above must also be met.

#### **Amendments to Subordinated Bond Resolution**

The Board may amend the Subordinated Bond Resolution pursuant to which the Series 2004B Subordinated Bonds are issued as described under "SUPPLEMENTAL RESOLUTIONS" in Appendix E.

Any act done pursuant to an amendment consented to as provided in the Subordinated Bond Resolution shall be binding upon the Owners of all of the Series 2004B Subordinated Bonds.

To obtain any such consent, the Board shall cause the Bond Registrar to mail a notice, first-class postage prepaid, to the registered Owners (Cede & Co., so long as the book-entry-only system is in effect) of the Series 2004B Subordinated Bonds at their addresses appearing on the registration books, briefly describing the proposed amendment.

### **SOURCES AND APPLICATION OF PLEDGED REVENUES**

The Series 2004B Subordinated Bonds and all other Subordinated Bonds are payable from and secured solely by a lien on and pledge of the Pledged Revenues on deposit in the State Highway Fund, subordinate in all respects to the lien on and pledge of Pledged Revenues for Senior Bonds. Moneys in the State Highway Fund that constitute Pledged Revenues consist primarily of moneys distributed from the Arizona Highway User Revenue Fund. The distribution of moneys to the State Highway Fund that constitute Pledged Revenues is more fully discussed below.

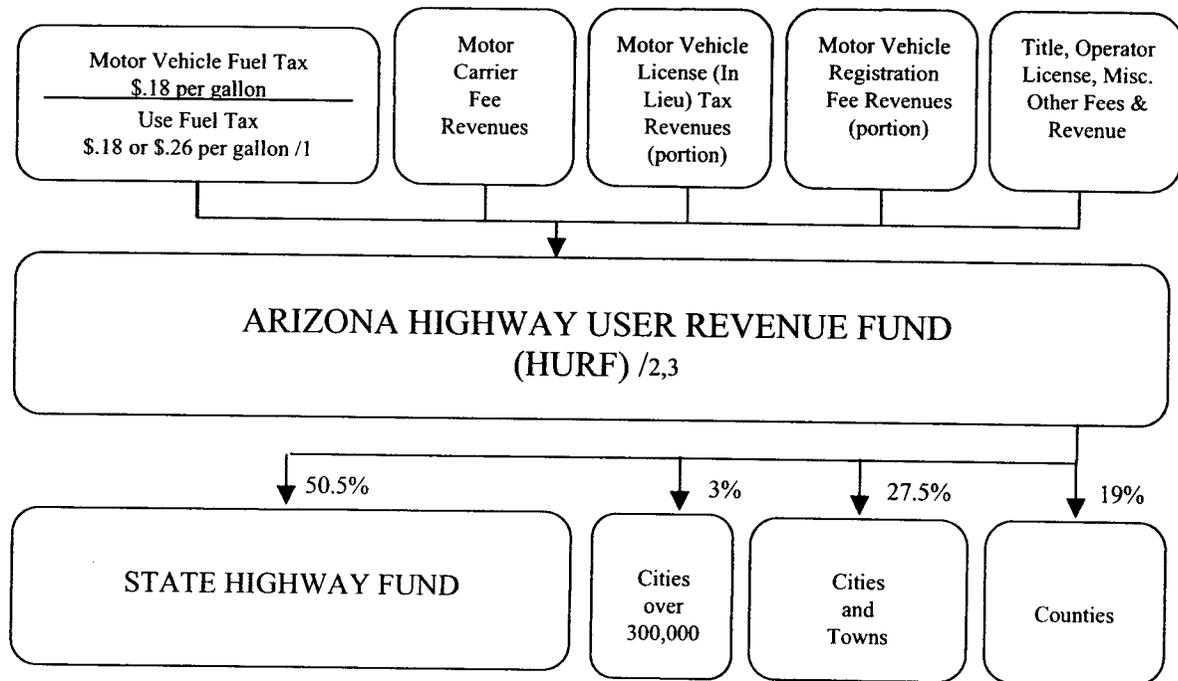
**Arizona Highway User Revenue Fund**

The State imposes motor vehicle fuel taxes and a variety of different types of taxes, fees and charges relating to the registration, operation and use of motor vehicles on the public highways of the State that are allocated by statute to the State Highway Fund and to the cities, towns and counties of the State, to finance highway improvements and other transportation-related expenses. These taxes, fees and charges are collected by various State officers and transferred to the Department for immediate transfer, after all exemptions and refunds, to the State Treasurer for deposit to the Arizona Highway User Revenue Fund. Each month, in accordance with statutory allocations, the State Treasurer distributes revenues transferred to the Arizona Highway User Revenue Fund primarily to the State Highway Fund and to the appropriate cities, towns and counties. Only after moneys from these specified sources are deposited to the State Highway Fund do they become Pledged Revenues. See “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2004B SUBORDINATED BONDS - Pledged Revenues” herein.

The taxes, fees and charges deposited to the Arizona Highway User Revenue Fund consist of (i) motor vehicle fuel taxes and use fuel taxes, (ii) motor vehicle registration fees, (iii) motor carrier fees, (iv) a portion of motor vehicle license (in lieu) taxes, and (v) motor vehicle operators’ license fees and miscellaneous fees and revenues. These revenue sources are further described below.

The following chart illustrates the flow of the revenues into the Arizona Highway User Revenue Fund and the distribution of such revenues.

**Arizona Highway User Revenue Fund Flow**



Notes:

- /1 The use fuel tax rate of \$.18 per gallon applies to vehicles under 26,001 pounds and other qualifying vehicles. The use fuel tax rate for all other vehicles is \$.26 per gallon.
- /2 For fiscal year 2005, the Arizona Legislature has authorized the transfer of \$1.0 million to the Economic Strength Project Fund to be expended for highway projects that provide economic benefits to the State or a local jurisdiction and \$0.4 million to the Motor Vehicle Division for its registration compliance program.
- /3 The Arizona Legislature has currently authorized a distribution from the Arizona Highway User Revenue Fund of \$51.6 million in fiscal year 2005 to the Arizona Department of Public Safety for highway patrol expenditures and a distribution of \$118 million of motor vehicle license (in lieu) tax revenues, which otherwise would have been distributed to the State Highway Fund, to the State General Fund. See “SOURCES AND APPLICATION OF PLEDGED REVENUES – Recent Legislation.”

**Arizona Highway User Revenues**

The following is a summary of the sources of revenue that are deposited to the Arizona Highway User Revenue Fund under existing statutes. Recent legislative changes are discussed below. This summary does not purport to be a complete description of each of these revenue sources and legislative changes and, accordingly, is qualified by reference to the Arizona Revised Statutes regarding these sources of revenue. The Arizona Legislature has altered and may in the future alter the statutes governing these revenue sources and their allocation. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2004B SUBORDINATED BONDS-Pledged Revenues" herein.

*Motor Vehicle Fuel Tax Revenues.* Motor vehicle fuel tax revenues consist of motor vehicle fuel (gasoline) taxes and motor vehicle use fuel (primarily diesel) taxes. These are excise taxes imposed upon fuel used in the propulsion of a motor vehicle on the public highways of the State. The motor vehicle fuel (gasoline) tax is currently assessed at the rate of \$.18 per gallon, and the use fuel (primarily diesel) tax is assessed at \$.18 per gallon for vehicles under 26,001 pounds and other qualifying vehicles and \$.26 per gallon for all other vehicles. The motor vehicle fuel tax is collected by the Department from licensed suppliers for each gallon of gasoline possessed, used or consumed in the State and the use fuel tax is collected by the Department from the supplier or paid by the user for the use of the highways in this State and remitted to the Department.

The following is a summary of the gallons of motor vehicle fuels imported into and consumed in the State, subject to the motor vehicle fuel tax (primarily gasoline fuel imported into the State) or motor vehicle use fuel tax (primarily diesel fuel consumed in the State), for each of the last ten fiscal years ended June 30, 2004.

**Motor Vehicle Fuels Imported or Consumed  
Based on Revenue Gallonage  
(000's Gallons)**

<b>Fiscal Year</b>	<b>Gasoline Fuel Imported (Net)</b>	<b>Diesel Fuel Consumed</b>	<b>Total</b>	<b>Percentage Change from Previous Year</b>
2004	2,575,172	750,962	3,326,133	4.3%
2003	2,482,727	707,808	3,190,536	2.8
2002	2,415,654	687,591	3,103,245	4.1
2001	2,324,443	657,627	2,982,069	2.9
2000	2,272,983	624,396	2,897,379	2.1
1999	2,208,129	630,057	2,838,186	7.5
1998	2,035,426	603,805	2,639,230	3.2
1997	2,021,962	535,821	2,557,783	2.8
1995	1,994,229	495,050	2,489,278	5.1
1995	1,901,663	466,043	2,367,706	1.3

Note: Totals may not add due to rounding.

Source: Arizona Department of Transportation, Office of Financial Planning.

*Motor Vehicle Registration Fee Revenues.* Motor vehicles are required to be registered in the State on a staggered monthly registration basis. The fee for passenger vehicles and non-commercial pickup trucks is \$8 and for motorcycles the fee is \$9, of which \$1 is paid to the motorcycle education fund. The fee for commercial motor vehicles, including trucks, buses and taxis, is \$12, plus a graduated registration fee based upon the declared gross weight of the motor vehicle. Commercial motor vehicles that operate in several states may instead pay fees which are prorated based on the ratio of operating mileage in the State to the total fleet operating mileage in all states. Motor vehicle registration fees are deposited in the Arizona Highway User Revenue Fund.

The following table sets forth the total number of motor vehicle registrations subject to renewal in the State by type of vehicle for each of the last ten calendar years ended December 31, 2003 and as of June 30, 2004.

**Motor Vehicle Registrations/1**

<u>Calendar Year</u>	<u>Passenger Vehicles</u>	<u>Trucks/1</u>	<u>Buses and Taxis</u>	<u>Trailers</u>	<u>Motorcycles</u>	<u>Total</u>
2004/2	4,057,721	443,930	3,506	475,945	98,747	5,079,849
2003	3,943,162	438,435	3,508	452,424	93,387	4,930,916
2002	3,808,204	441,820	3,386	420,146	84,604	4,758,160
2001	3,739,081	456,188	3,568	397,157	78,978	4,674,972
2000	3,638,250	419,186	3,791	353,241	73,340	4,487,808
1999	3,496,182	375,650	3,678	313,695	67,023	4,256,228
1998	3,433,142	335,244	2,409	173,846	69,347	4,013,987
1997	3,043,605	289,256	2,529	169,102	57,780	3,562,272
1996	2,807,928	305,493	3,018	283,638	69,070	3,469,147
1995	2,583,632	293,792	2,040	316,608	69,650	3,265,722
1994	2,428,868	289,708	2,279	294,237	67,808	3,082,900

1/ Includes commercial and non-commercial.

2/ As of June 30, 2004.

Source: Arizona Department of Transportation, Office of Financial Planning.

*Motor Vehicle License (In Lieu) Tax Revenues.* The motor vehicle license (in lieu) taxes are based upon the value of the vehicle (according to a statutory formula) and are collected with the vehicle registration fees. Pursuant to current Arizona statutes, these license taxes are distributed as follows: (i) 44.99% to the Arizona Highway User Revenue Fund, (ii) 24.59% to the general fund of the county where the motor vehicle is registered, (iii) 24.59% to the cities and towns of the county where the motor vehicle is registered, and (iv) 5.83% to the counties for the same use as Arizona Highway User Revenue Fund purposes. The above distribution percentages are blended since the tax rates vary between new and renewal vehicles.

*Motor Carrier Fee Revenues.* The motor carrier fee is imposed on commercial motor vehicles, whether common, contract or private carriers, with a gross weight in excess of 12,000 pounds. The motor carrier fee increases as the declared gross vehicle weight of the vehicle increases. All motor carrier fee revenues are deposited to the Arizona Highway User Revenue Fund.

*Motor Vehicle Operators' License Fees and Miscellaneous Fees and Revenues.* The balance of the Arizona Highway User Revenue Fund revenues include motor vehicle operators' license fees and miscellaneous fees and revenues. The miscellaneous fees and revenues include certificates of title fees, oversize permit fees, inquiry fees, investment income on moneys held in the Arizona Highway User Revenue Fund, certain fines, penalties and other miscellaneous fees.

**Recent Legislation**

From time to time legislation is enacted that alters or modifies the deposits of monies into, and the distribution of monies from, the Arizona Highway User Revenue Fund and/or the State Highway Fund, or otherwise affects the Department's capital and financing programs. The information provided below reflects the more significant legislative enactments that have occurred since 2001.

In 2001, legislation was enacted (HB 2636) which increased the principal amount of highway revenue bonds that may be outstanding at any one time (including Senior Bonds and Subordinated Bonds) from \$800 million to \$1 billion. Other 2001 legislation enacted (SB 1243 and HB 2631) increased the distribution of moneys from the Arizona Highway User Revenue Fund to the Arizona Department of Public Safety (DPS). SB 1243 and HB 2631 contained appropriations from the Arizona Highway User Revenue Fund to DPS totaling \$26.9 million in fiscal year 2002. Prior to the passage of this legislation, the amount to be distributed from the Arizona Highway User Revenue Fund in fiscal year 2002 was set in permanent statutes at \$10 million.

In the March 2002 special session, legislation was enacted (HB 2003) that increased the Arizona Highway User Revenue Fund distribution to the DPS by an additional \$10 million in fiscal year 2002. Another special session bill was enacted (HB 2004) that transferred \$15 million in fiscal year 2002 from the Arizona Highway User Revenue Fund to the State General Fund for reimbursement of fiscal year 2001 highway patrol costs. Overall, the amount distributed from the Arizona Highway User Revenue Fund to the DPS and the State General Fund in fiscal year 2002 totaled \$51.9 million (resulting in an overall decrease in distributions to the State Highway Fund for fiscal year 2002 of \$26.2 million).

During the 2002 regular session, legislation was enacted (HB 2588) which increased the amount of highway revenue bonds that may be outstanding at any one time (including Senior Bonds and Subordinated Bonds) from \$1 billion to \$1.3 billion. Another bill enacted during this session (HB 2706) included a \$28.9 million distribution from the Arizona Highway User Revenue Fund to the DPS in fiscal year 2003.

In the March 2003 special session, legislation was enacted (HB 2001) that increased the Arizona Highway User Revenue Fund distribution to DPS by an additional \$10 million in fiscal year 2003. As a result of the 2002 regular session and March 2003 special session legislation, and including \$15.5 million from the 2001 legislation (SB 1243), the total amount required to be distributed from the Arizona Highway User Revenue Fund to the DPS in fiscal year 2003 was \$54.5 million (resulting in a decrease in distributions to the State Highway Fund for fiscal year 2003 of \$27.5 million).

During the 2003 regular session, legislation was enacted (HB 2531) that distributed \$46.7 million from the Arizona Highway User Revenue Fund to the DPS in fiscal year 2004, resulting in a decrease in distributions to State Highway Fund for such year of \$23.6 million.

During the 2004 regular session, legislation was enacted (SB 1402) that will distribute \$51.6 million from the Arizona Highway User Fund to the DPS in fiscal year 2005, which will result in a decrease in distributions to the State Highway Fund for such year of \$26.1 million. Another bill enacted during the session (SB 1413) will require a one-time transfer in fiscal year 2005 of \$118 million to the State General Fund of the motor vehicle license (in lieu) tax revenues that otherwise would have been deposited in the State Highway Fund. The \$118 million represents approximately 73 percent of the motor vehicle license (in lieu) tax revenues previously forecasted by the Department to have been deposited in the State Highway Fund in fiscal year 2005.

### **Funds and Accounts and Application of Pledged Revenues**

The Senior Bond Resolution established the following funds and accounts for the payment of the principal of and interest on the Senior Bonds: a Senior Bond Fund, containing a Principal Account, a Redemption Account and an Interest Account; a Senior Bond Related Costs Fund; and a Senior Bond Reserve Fund. In order to facilitate the administration of the deposit of Pledged Revenues into the funds relating to the Senior Bonds, the Subordinated Bonds and the Second Subordinated Bonds, if any, the Bond Resolutions also established a Subordinated Bond Fund, a Subordinated Bond Related Costs Fund, a Subordinated Bond Reserve Fund, and other similar funds for the Second Subordinated Bonds (all of the above-referenced funds are collectively referred to herein as the "Bond Funds").

Upon the issuance of the Series 2004B Subordinated Bonds, no amounts are required by the Bond Resolutions to be deposited or maintained in any of the funds referenced above other than the Senior Bond Fund and the Subordinated Bond Fund. Subsequent Bond Resolutions may require deposits to additional funds.

The Bond Resolutions require that all Pledged Revenues paid into the State Highway Fund shall be accounted for by the Board and State Treasurer and held by the State Treasurer and deposited by the State Treasurer into the Bond Funds in the following order and manner:

(1) into the Interest Account in the Senior Bond Fund, on the first day of each month, an amount which in the aggregate is not less than one-fifth (1/5) of the amount of the next semiannual interest payment, net of any investment income deposited to such Account, coming due on the outstanding Senior Bonds; and then

(2) into the Principal Account in the Senior Bond Fund, on the first day of each month, one-eleventh (1/11) of the amount of the principal of the outstanding Senior Bonds coming due on the next principal payment date (whether by stated maturity or mandatory sinking fund redemption), net of any investment income deposited to such Account; and then

(3) into the account in the Highway Bond Proceeds Fund for any outstanding Series of Additional Senior Bonds at such times and in such amounts as may be specified by the provisions of any subsequent Senior Bond Resolution, an amount equal to the unreimbursed amounts, if any, theretofore expended from such account for payment of principal of and interest on any Senior Bonds; and then

(4) into the Senior Bond Related Costs Fund, at such times and in such amounts, if any, specified in any subsequent Senior Bond Resolution for payment of Bond Related Costs for any Additional Senior Bonds; and then

(5) into the Senior Bond Reserve Fund, at such times and in such amounts, if any, specified in any subsequent Senior Bond Resolution for deposit therein; and then

(6) into the Interest Account in the Subordinated Bond Fund, on or before the fifteenth day of the month preceding an interest payment date on the Outstanding Subordinated Bonds, an amount equal to the interest payment due on such interest payment date on the Outstanding Subordinated Bonds and on such dates and in such amounts as specified in any subsequent Subordinated Bond Resolution with respect to any series of Additional Subordinated Bonds; and then

(7) into the Principal Account in the Subordinated Bond Fund, on or before the fifteenth day of the month preceding a principal payment date (whether at maturity or by mandatory sinking fund redemption) on the Outstanding Subordinated Bonds, an amount equal to the principal payment due on such principal payment date on the Outstanding Subordinated Bonds and on such dates and in such amounts as specified in any subsequent Subordinated Bond Resolution with respect to any series of Additional Subordinated Bonds; and then

(8) into the Subordinated Bond Related Costs Fund, at such times and in such amounts, if any, specified in any subsequent Subordinated Bond Resolution, for deposit therein for payment of Bond Related Costs for any Additional Subordinated Bonds; and then

(9) into the Subordinated Bond Reserve Fund, at such times and in such amounts, if any, specified in any subsequent Subordinated Bond Resolution for deposit therein; and then

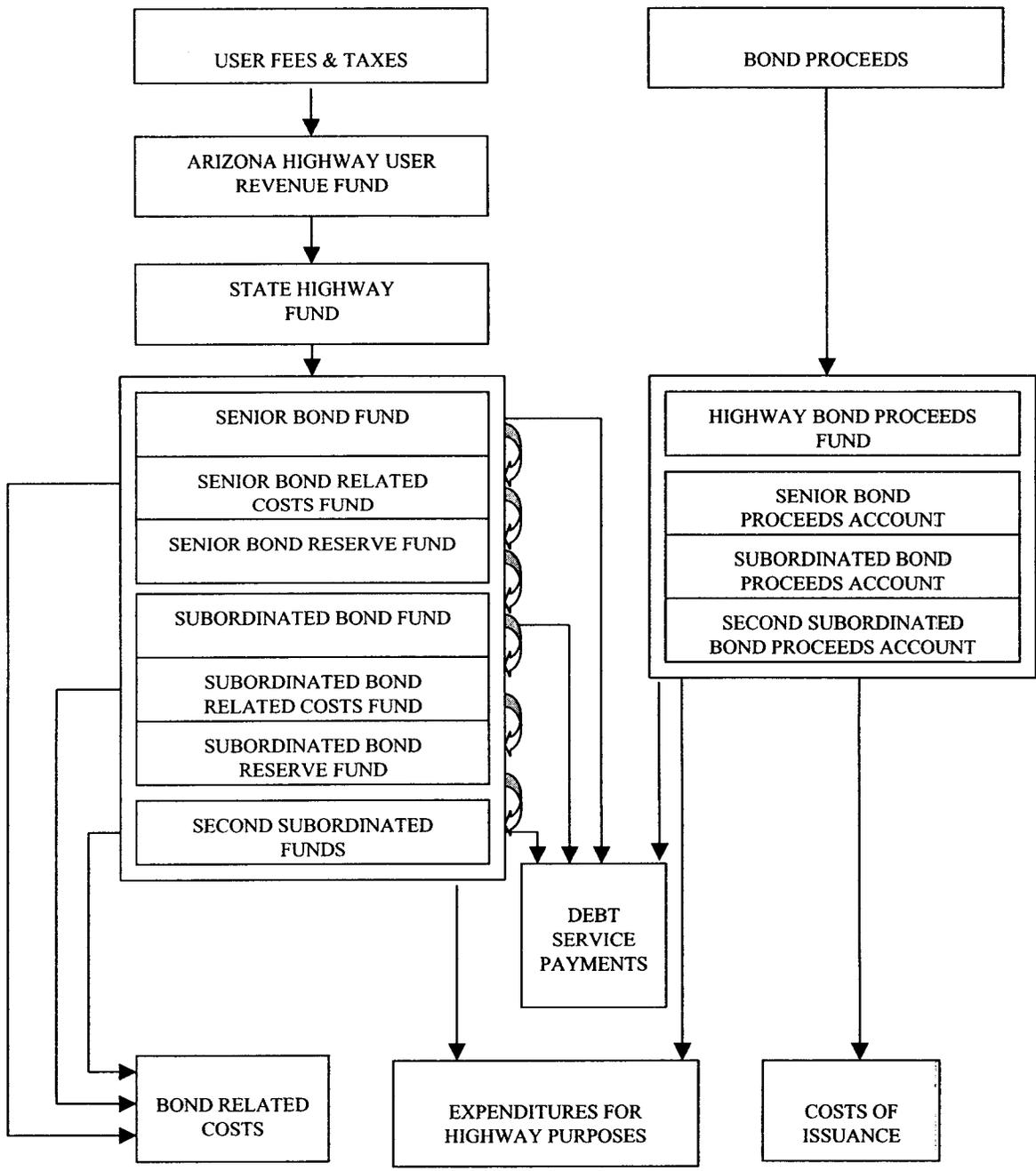
(10) into the Second Subordinated Funds, at such times and in such amounts, if any, specified pursuant to any subsequent resolution of the Board authorizing Second Subordinated Bonds for deposit therein; and then

(11) the remaining Pledged Revenues, if any, may be used and expended by the Board for any other lawful use of the State Highway Fund.

If there is a deficiency in the required deposit to any of the Bond Funds as provided above, and unless the Board uses lawfully available Pledged Revenues on deposit in the State Highway Fund or other lawfully available moneys to cure such deficiency, all additional Pledged Revenues deposited into the State Highway Fund shall be used to make up such deficiencies in such Bond Funds, but only in the priority of deposit set forth above, prior to making any deposits to any lower priority Bond Fund. See "ESTABLISHMENT OF FUNDS AND APPLICATION THEREOF – Use of Bond Funds" in Appendix E.

The Bond Resolutions provide that, to the extent that moneys in the Senior Bond Fund, Senior Bond Related Costs Fund and Senior Bond Reserve Fund are insufficient to pay, when due, principal of and interest on the Senior Bonds, the Senior Bonds shall have a first claim on moneys in all Subordinated Funds for the payment of principal and interest on the Senior Bonds. To the extent that investment earnings are credited to the Senior and Subordinated Bond Funds pursuant to the Bond Resolutions, subsequent deposits to the Senior and Subordinated Bond Funds shall be reduced by the amount so credited.

**HIGHWAY REVENUE BONDS  
FLOW OF FUNDS**



## REVENUES AND DEBT SERVICE COVERAGE

### Historical Revenues

The following table sets forth the sources of revenues which were deposited into the Arizona Highway User Revenue Fund and the State Highway Fund for each of the last ten fiscal years ended June 30, 2004.

#### Sources of Revenues Deposited in the Arizona Highway User Revenue Fund and State Highway Fund (000's)

Fiscal Year Ended	Motor Vehicle Fuel Tax Revenues/1	Motor Vehicle Registration Fee Revenues/2	Motor Carrier Tax Revenues/3	Motor Vehicle License Fees and Misc. Fees and Revenues	Motor Vehicle License (In Lieu) Tax Revenues	Total Deposited to Arizona Highway User Revenue Fund	Percentage Change	Total Distributed to State Highway Fund/4
2004	\$642,533	\$146,638	\$34,617	\$43,510	\$312,262	\$1,179,561	6.15%	\$561,131
2003	613,635	141,327	32,856	41,490	281,947	1,111,256	3.24	525,029
2002	596,325	138,210	29,347	41,873	270,641	1,076,395	4.41	510,236
2001	574,259	132,269	32,678	40,147	251,612	1,030,965	1.11	530,637
2000	565,736	140,345	36,563	40,409	236,547	1,019,599	3.75	528,721
1999	557,775	131,932	34,150	38,775	220,126	982,779	10.74	509,935
1998	508,543	101,722	63,846	36,426	176,950	887,487	-1.06	468,240
1997	488,701	101,528	90,186	41,294	175,253	896,962	4.35	468,542
1996	473,741	97,601	85,433	42,654	160,145	859,575	7.43	429,825
1995	451,089	86,159	92,103	39,238	131,562	800,152	3.10	399,605

/1 Reflects \$.08 per gallon surcharge on use fuel from January 1, 1994 through September 30, 1997. On January 1, 1998, the use fuel tax rate increased \$.09 per gallon to \$.27 per gallon for certain vehicles. On July 1, 2000 the use fuel tax rate decreased from \$.27 to \$.26 per gallon for certain vehicles.

/2 The implementation of Senate Bill 1144 on October 1, 1997 increased the weight and use registration fees charged to motor carriers.

/3 House Bill 2239 from the 1993 legislative session reduced motor carrier rates by an initial 24 percent and added an \$.08 per gallon use fuel surcharge on January 1, 1994. On October 1, 1997, Senate Bill 1144 was implemented which eliminated the motor carrier tax based on weight and distance, and replaced it with a motor carrier fee based on weight.

/4 Subject to certain adjustments, 50.5% of revenues deposited to the Arizona Highway User Revenue Fund are distributed to the State Highway Fund. Adjustments may include other distributions from the Arizona Highway User Revenue Fund as required by legislative enactments and amounts paid to third party collection agents. See "SOURCES AND APPLICATION OF PLEDGED REVENUES" herein. For fiscal years 1995 through 1997, also shown net of 7% distributed to cities with a population greater than 300,000 persons. For fiscal years 1997 through 2001, includes certain motor vehicle license tax revenues distributed to the State Highway Fund from other than the Arizona Highway User Revenue Fund.

Note: Totals may not add due to rounding.

Source: Arizona Department of Transportation, Office of Financial Planning.

### Projected Revenues

Recognizing the need for formal, well documented forecasts, the Department has developed a long-range forecasting model for revenues to be deposited to the Arizona Highway User Revenue Fund and distributed to the State Highway Fund. This model reflects underlying economic and energy-related trends. These trends are important in forecasting growth rates in personal income, motor vehicle fuel efficiency, employment, and population, all of which in turn are major components of the revenue forecast which follows.

The model uses a disaggregated structural regression-based econometric modeling approach. The use of this technique provides a framework that allows for the complex interaction of economic, demographic, and technological factors which influence collections over the long term. The key variables incorporated in the model

which influence growth in Arizona Highway User Revenue Fund collections are: (i) Arizona population, (ii) Arizona real per capita income, (iii) Arizona wage and salary employment, and (iv) Arizona vehicle fuel efficiency. Of these variables, Arizona population and Arizona real per capita income are the most important in projecting revenues.

In 1992, the Department expanded the capabilities of the model by retaining economic consultants to introduce a risk analysis process into the forecast development effort, thereby providing a means of dealing with the uncertainty concerning future values for the critical model variables. This procedure provides information concerning the range of potential future revenues and their probability of occurrence.

In October 1996, the Department commissioned a consultant to update the forecasting model. The new model was designed to incorporate certain economic data generated over the prior ten years which was not included in the original model. In addition, the consultant was asked to evaluate the inclusion of certain independent variables absent from the original model to enhance the model's forecasting accuracy. The consultant also eliminated some independent variables that were either not significant to the model or were not readily available. The model update was completed in September 1997 and takes into consideration 1997 legislative changes. Subsequent model updates were completed in September 2000 and 2003.

Over the years, the model has exhibited the ability to forecast revenues with a high degree of accuracy. For the 12-month periods ended June 30, 2004, 2003 and 2002, the forecast of collections to be deposited to the Arizona Highway User Revenue Fund which was made at the start of each such period, was within 2.6%, 0.3% and 1.0%, respectively, of actual collections in such periods.

The following table sets forth the Department's current forecast, as of November, 2003, of revenues anticipated to be deposited into the Arizona Highway User Revenue Fund and the amounts to be distributed to the State Highway Fund for each of the five fiscal years through June 30, 2009. The amounts shown for fiscal year 2005 and subsequent fiscal years reflect a number of factors, including:

- Anticipated growth in the amount of revenues deposited to the Arizona Highway User Revenue Fund; and
- Funding of the Arizona Department of Public Safety from the Arizona Highway User Revenue Fund in fiscal year 2005 of \$51.6 million and \$10 million per year thereafter (see "SOURCES AND APPLICATIONS OF PLEDGED REVENUES - Recent Legislation"); and
- One-time transfer of \$118 million in fiscal year 2005 to the State General Fund of motor vehicle license (in lieu) tax revenues that otherwise would have been deposited in the State Highway Fund (see "SOURCES AND APPLICATION OF PLEDGED REVENUES - Recent Legislation").

The prospective financial information included in this Official Statement has been prepared by, and is the responsibility of, the Department. The prospective financial information was not prepared with a view toward complying with the guidelines established by the American Institute of Certified Public Accountants with respect to prospective financial information, however, there is no requirement that such prospective financial information be prepared in accordance with such guidelines. In the view of the Department, the forecast included herein was prepared on a reasonable basis and represents the Department's forecast of revenues expected to be deposited in the Arizona Highway User Revenue Fund and State Highway Fund based on current law. However, this information is not fact and should not be relied upon as being necessarily indicative of future results, and readers of this Official Statement are cautioned not to place undue reliance on the prospective financial information.

Neither the Department's independent auditors, nor any other independent accountants, have compiled, examined, or performed any procedures with respect to the prospective financial information contained herein, nor have they expressed any opinion or any other form of assurance on such information or its achievability, and assume no responsibility for, and disclaim any association with, the prospective financial information. **THE ACTUAL REVENUES THAT WILL BE DEPOSITED IN THE ARIZONA HIGHWAY USER REVENUE FUND AND THE STATE HIGHWAY FUND MAY VARY FROM THE FORECAST BECAUSE OF CHANGES IN LAW, FLUCTUATING ECONOMIC CONDITIONS AND OTHER VARIABLES AFFECTING REVENUE GROWTH. SUCH VARIATIONS COULD BE MATERIAL.**

**Forecast of Revenues to be Deposited in the  
Arizona Highway User Revenue Fund and State Highway Fund  
Fiscal Years ending June 30, 2005 through June 30, 2009  
(000's)**

<u>Fiscal</u> <u>Year</u>	<b>Motor Vehicle Fuel Tax Revenues</b>	<b>Motor Vehicle Registration Fee Revenues</b>	<b>Motor Carrier Fee Revenues</b>	<b>Motor Vehicle Operators' License Fees and Misc. Fees and Revenues</b>	<b>Motor Vehicle License (In Lieu) Tax Revenues</b>	<b>Total Deposited to Arizona Highway User Revenue Fund</b>	<b>Total Distributed to State Highway Fund/1, 2</b>
2005	\$662,500	\$151,000	\$35,800	\$45,400	\$334,200	\$1,228,900	\$464,920
2006	676,700	153,400	35,600	46,500	343,800	1,256,000	617,884
2007	701,400	158,500	36,700	48,800	372,800	1,318,200	647,976
2008	723,800	163,500	37,800	50,900	401,500	1,377,500	676,986
2009	745,800	167,900	38,800	53,200	434,300	1,440,000	707,479

/1 Subject to certain adjustments, 50.5% of revenues deposited to the Arizona Highway User Revenue Fund are distributed to the State Highway Fund. Adjustments may include other distributions from the Arizona Highway User Revenue Fund as required by legislative enactments and amounts paid to third party collection agents. See "SOURCES AND APPLICATION OF PLEDGED REVENUES" herein.

/2 For a discussion of recent legislation and the impact of revenue transfers on forecasted Pledged Revenues for fiscal year 2005, see "SOURCES AND APPLICATION OF PLEDGED REVENUES – Recent Legislation" herein.

Note: Totals may not add due to rounding.

Source: Arizona Department of Transportation, Office of Financial Planning.

**Debt Service Requirements, Forecasted Pledged Revenues and Projected Debt Service Coverage**

The debt service requirements of the outstanding Senior Bonds, Subordinated Bonds, and of the Series 2004B Subordinated Bonds are set forth below. Based upon actual debt service and the Department's current forecasts of Pledged Revenues, the projected debt service coverage of the outstanding Senior Bonds, Subordinated Bonds and the Series 2004B Subordinated Bonds (assuming no issuance of Additional Senior Bonds or Additional Subordinated Bonds) is as follows:

Twelve Months Ending July 1	Forecasted Pledged Revenues(1)	Debt Service on		Projected Debt Service Coverage on Senior Bonds(2)	Debt Service on Subordinated Bonds	Series 2004B Subordinated Bonds			Total Debt Service	Total Senior and Subordinated Debt Service Requirements(2)		Projected Total Debt Service Coverage(2)
		Outstanding Senior Bonds	Outstanding Subordinated Bonds			Principal	Interest(3)	Debt Service		Requirements(2)	Requirements(2)	
2005	\$464,920,000	\$62,790,041	\$34,272,935	7.40	\$8,262,522	\$10,630,000	\$8,262,522	\$8,262,522	\$105,325,498	98,940,309	4.41	
2006	617,884,000	59,641,674	45,525,135	10.36	9,413,000	11,160,000	9,413,000	9,413,000	114,579,809	98,940,309	5.39	
2007	647,976,000	59,699,779	45,518,185	10.85	9,413,000	11,715,000	9,413,000	9,413,000	114,630,964	98,940,309	5.65	
2008	676,986,000	59,654,256	45,617,935	11.35	9,413,000	12,305,000	9,413,000	9,413,000	114,685,191	98,940,309	5.90	
2009	707,479,000	59,846,714	45,626,335	11.82	9,413,000	12,920,000	9,413,000	9,413,000	114,886,049	98,940,309	6.16	
2010		41,873,564	64,346,585		9,413,000	13,565,000	9,413,000	9,413,000	115,633,149	98,940,309		
2011		41,801,784	64,247,335		9,413,000	14,245,000	9,413,000	9,413,000	115,462,119	98,940,309		
2012		62,875,974	16,021,335		9,413,000	14,955,000	9,413,000	9,413,000	98,940,309	98,940,309		
2013		62,878,254	16,020,960		8,881,500	15,700,000	8,881,500	20,041,500	98,940,714	98,940,714		
2014		62,883,399	16,022,425		8,323,500	16,490,000	8,323,500	20,038,500	98,944,324	98,944,324		
2015		58,228,550	16,020,825		7,737,750	17,310,000	7,737,750	20,042,750	94,292,125	94,292,125		
2016		58,230,925	16,018,075		7,122,500	18,180,000	7,122,500	20,042,500	94,291,500	94,291,500		
2017		58,232,125	16,022,375		6,476,500	19,085,000	6,476,500	20,041,500	94,296,000	94,296,000		
2018		58,231,438	16,022,625		5,798,250	20,043,250	5,798,250	20,043,250	94,297,313	94,297,313		
2019		58,227,888	16,019,375		5,086,000	20,041,000	5,086,000	20,041,000	94,288,263	94,288,263		
2020		47,330,225	16,021,375		4,338,250	20,038,250	4,338,250	20,038,250	83,389,850	83,389,850		
2021		31,823,700	16,021,875		3,553,250	20,043,250	3,553,250	20,043,250	67,888,825	67,888,825		
2022		31,823,238	16,019,500		2,728,750	20,038,750	2,728,750	20,038,750	67,881,488	67,881,488		
2023			16,023,000		1,863,250	20,043,250	1,863,250	20,043,250	36,066,250	36,066,250		
2024					954,250	20,039,250	954,250	20,039,250	20,039,250	20,039,250		

- (1) From Department's forecasts for 2005 to 2009 described under "Projected Revenues" above. For a discussion of recent legislation and the impact of revenue transfers on forecasted Pledged Revenues, see "SOURCES AND APPLICATION OF PLEDGED REVENUES – Recent Legislation" herein.
- (2) Does not reflect debt service requirements on up to \$268 million of bonds the Board currently anticipates issuing under the Bond Resolutions in the future to fund the current Five-Year Capital Program. The issuance of such bonds may result in a decrease in the projected debt service coverage figures shown. Such bonds may only be issued by the Board, however, subject to meeting certain requirements of the Act and the Bond Resolutions. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2004B SUBORDINATED BONDS - Additional Bonds" for a further discussion of such requirements.
- (3) The first interest payment on the Series 2004B Subordinated Bonds is January 1, 2005.

## PROGRAM RESPONSIBILITY AND MANAGEMENT

### 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 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 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, operating, 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>
Bill Jeffers, Chair Transportation District 5 Navajo, Apache and Coconino Counties	Holbrook	2005
Dallas "Rusty" Gant, Vice Chair Transportation District 1 Maricopa County	Wickenburg	2006
Richard Hileman, Member Transportation District 6 Yavapai, Yuma, Mohave and La Paz Counties	Lake Havasu	2006
James W. Martin, Member Transportation District 3 Cochise, Greenlee and Santa Cruz Counties	Willcox	2007
Joe Lane, Member Transportation District 1 Maricopa County	Phoenix	2008
Si Schorr, Member Transportation District 2 Pima County	Tucson	2009
Delbert Householder, Member Transportation District 4 Gila, Graham and Pinal Counties	Thatcher	2010

## **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 products and services for a safe, efficient and cost-effective transportation system that links Arizona to the global economy, promotes economic prosperity and demonstrates respect for Arizona's environment and quality of life.

### *Responsibilities and Organization.*

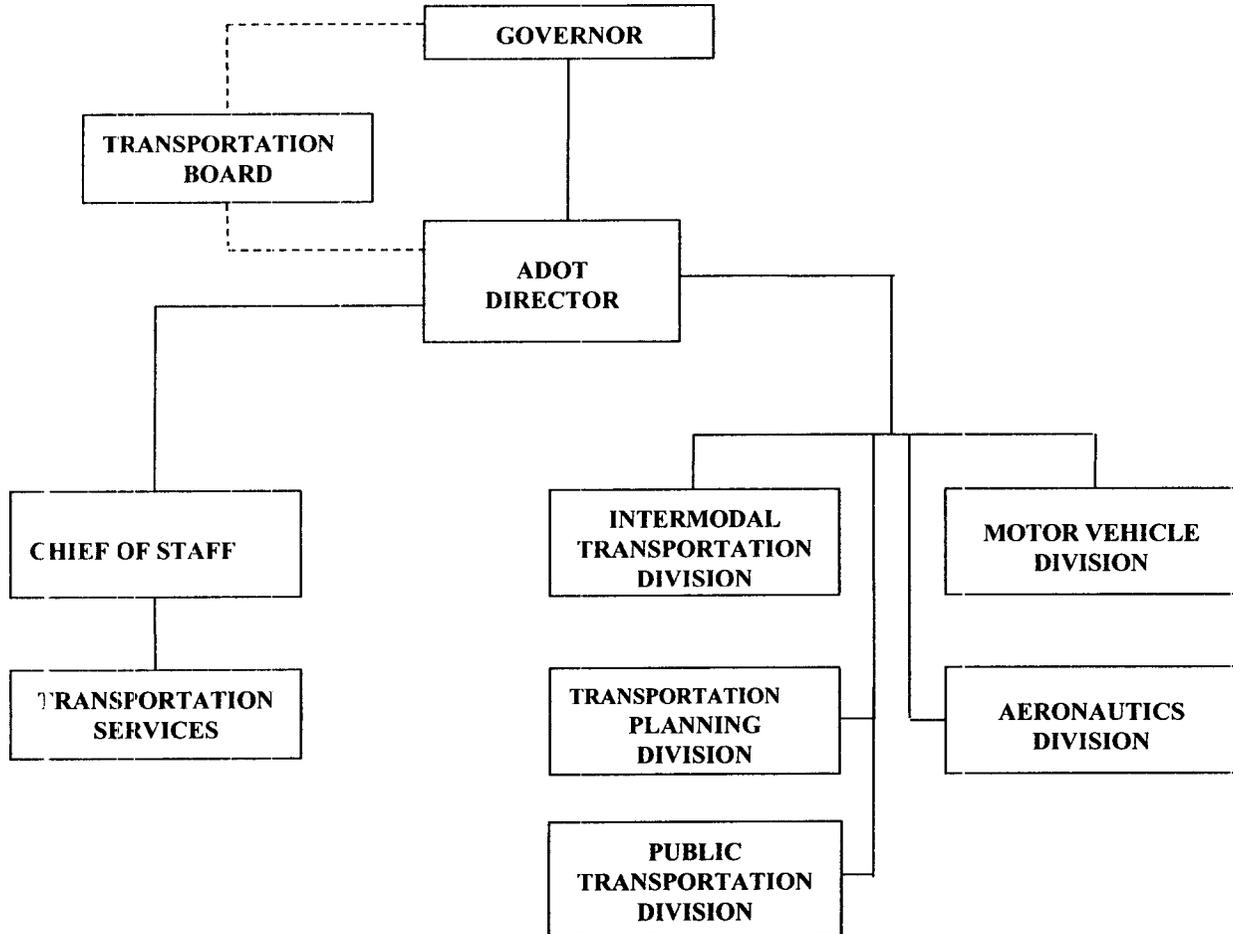
The Department administers the State highway system. The Department's responsibilities also include: (i) registration of motor vehicles and aircraft; (ii) transportation planning, coordination of transportation planning with local governments and annual development of a priority program of capital improvements for both highway and aviation transportation modes; (iii) design and construction of transportation facilities in accordance with a priority plan, and maintenance and operation of the State highway system; and (iv) 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 Freeway Plan 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 Administrative 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, Aeronautics Division, Transportation Planning Division and Public Transportation Division. In addition, the Transportation Services Group under the direction of the Chief of Staff contains units for Financial Management, Budget and Strategic Planning, Information Technology, Physical Plan Operations, Human Resources, Civil Rights, Audit and Analysis, Procurement, Safety, Training and Arizona Highways Magazine. The Transportation Services Group supports the Department's operating and planning divisions.

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

### ARIZONA DEPARTMENT OF TRANSPORTATION



*Intermodal Transportation Division.* The Intermodal Transportation Division is the largest of the four 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 in the State. The Motor Vehicle Division also collects motor vehicle fuel taxes, registration fees, motor carrier fees, motor vehicle operators' license fees and miscellaneous fees and revenues. The Motor Vehicle Division annually processes motor vehicle registrations and records, issues certificates of title for motor vehicles and processes drivers' license applications. The Motor Vehicle Division also operates 23 port-of-entry stations.

*Transportation Planning Division.* The Transportation Planning Division is responsible for the planning of the statewide transportation system including highways and airports. Its functions include traffic and travel studies and projections, five-year construction priority studies and coordination with local and regional transportation planning agencies. The Transportation Planning Division produces an annually updated Five-Year Capital Program for the Board, from which the Board establishes the priorities for highway and airport projects within the State.

*Aeronautics Division.* The Aeronautics Division coordinates general aviation in the State. The Aeronautics Division also is responsible for registering and licensing all general aviation aircraft, conducting the Local Airports Grant Program and representing the State at air service hearings.

*Public Transportation Division.* The Department has recently created a Public Transportation Division to support public transit planning throughout Arizona. The Public Transportation Division distributes planning, operational and capital funding for transit programs in rural areas, administers federal grants for transit planning in metropolitan areas, and will perform state regulatory safety oversight for the light rail system to be constructed in Maricopa County.

*Staff of the Department.*

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

**VICTOR MENDEZ**

*Director*

Mr. Mendez was appointed Director of the Department on October 23, 2001. Prior to his appointment as Director, Mr. Mendez served as Deputy Director of the Department since September 1999. As Deputy Director, Mr. Mendez assisted the director on the implementation of policy and coordinated each division to achieve the goals of the organization. Mr. Mendez has been with the Department since 1985. Prior to serving as Deputy Director, he served as Deputy State Engineer in charge of the Valley Transportation Group, a position he held since 1997. Previous to that, Mr. Mendez was an Assistant State Engineer in charge of statewide project management.

Mr. Mendez is a registered professional civil engineer and holds a Master of Business Administration degree from Arizona State University and a Bachelor of Science (Civil Engineering) degree from the University of Texas at El Paso.

**DEBRA BRISK**

*Deputy Director*

Ms. Brisk was appointed the Deputy Director of the Department on February 18, 2002. Prior to her appointment as Deputy Director, Ms. Brisk served as the Kingman District Engineer of the Department since January 1997. As the District Engineer for the Kingman District, Ms. Brisk coordinated and managed maintenance activities, construction programs and the implementation of policies and procedures, including implementing a proactive public outreach for the Department with all stakeholders in the northwestern area of Arizona. Ms. Brisk has been with the Department since 1985. Prior to serving as the District Engineer, she served as a Senior Resident Engineer for the Kingman District and the Globe District, positions she held since 1994. Previous to that, Ms. Brisk was a Design Team Leader within the roadway design area of the Department.

Ms. Brisk is a registered professional civil engineer and holds a Master of Organization Management degree from the University of Phoenix, and a Bachelor of Science (Civil Engineering) degree from South Dakota State University.

**MICHAEL ORTEGA**

*State Engineer*

Mr. Ortega was appointed State Engineer of the Department in July 2004. As State Engineer, Mr. Ortega will oversee the agency's highway development, construction and maintenance programs, including more than 6,800 miles of highways across Arizona.

Prior to his appointment as State Engineer, Mr. Ortega served as the city manager in Douglas, Arizona since 1995. He formerly served as the City of Douglas public works director and city engineer and managed the Pima County Department of Transportation and Flood Control District's engineering division.

Mr. Ortega is a registered professional engineer, and holds Masters of Business Administration and Bachelor of Science Civil Engineering degrees from the University of Arizona.

**JOHN BOGERT**

*Chief of Staff*

Mr. Bogert 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 Chief of Staff, Mr. Bogert oversees the Transportation Services Group which includes most of the Department's staff functions. In addition, Mr. Bogert assists the Director and Deputy Director in the day-to-day operations of the Department and 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.

**JOHN MCGEE**

*Chief Financial Officer*

Mr. McGee was named Chief Financial Officer for the Department in May 1999. Prior to assuming this position, he served as Finance Manager for the Department since December 1988. As Chief Financial Officer for the Department, he has oversight responsibility for the financial management of the Board's capital program, as well as responsibility for management of the Board's bond financing programs and financial planning activities. Prior to joining the Department, he was employed for sixteen years in various financial and managerial positions with Del Webb Development Company. Mr. McGee holds a bachelor's degree in accounting from Brigham Young University and a master's degree in Business Administration from Arizona State University.

**JOHN FINK**

*Finance Administrator*

Mr. Fink joined the Department in October 2001. As Finance Administrator, he assists the Chief Financial Officer with management of the Board's bond financing programs and is responsible for management of the state infrastructure bank program and resource administration. Prior to joining the Department, Mr. Fink managed the state infrastructure bank and bond financing programs for the Oregon Department of Transportation. Mr. Fink holds a Bachelor of Science degree in Chemical Engineering from the University of Michigan and a master's degree in Business Administration from Vanderbilt University.

**DALE BUSKIRK**

*Transportation Planning Division Director*

Mr. Buskirk was appointed Director of the Transportation Planning Division on April 28, 2003. Prior to his appointment, he served as the Division's Deputy Director. Mr. Buskirk has been employed by the Department since April of 1978. He holds a Bachelor of Administration degree from the University of Washington and a Master of Administration degree from Ohio University.

**STACEY STANTON**  
*Motor Vehicle Division Director*

Ms. Stanton was appointed Director of the Motor Vehicle Division in December of 1999, having been named interim Director in August of the same year. Ms. Stanton's prior experience at ADOT 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 Maricopa County Auto License Department and spent more than eight years in the State Senate as Aide to the Senate President and Arizona State Senate Transportation Analyst.

Ms. Stanton holds a Bachelor of Science (Political Science) degree from Arizona State University and is a Certified Public Manager.

*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, operation of the Motor Vehicle Division, general engineering activities, administrative functions and all other highway related operating expenses.

The Board's Five-Year Capital Program (the "Five-Year Capital Program") is funded from three primary sources: federal highway apportionments, highway user revenues, and the revenues generated by a one-half cent transportation excise (sales) tax levied in Maricopa County to construct urban freeways in the greater Phoenix metropolitan area. 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 Five-Year Capital 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.

**Summary of Revenues, Expenditures and Changes in Fund Balances**

Set forth on the following pages is a table which summarizes certain information for the Department's last three fiscal years ended June 30, 2003, derived from its audited financial statements. The information for the fiscal year ended June 30, 2003, should be read in conjunction with the audited basic financial statements of the Department for the fiscal year ended June 30, 2003, and the notes therein included as Appendix A. This information is presented for background information only. As described under "SECURITY AND SOURCES OF PAYMENTS FOR THE SERIES 2004B SUBORDINATED BONDS," the Series 2004B Subordinated Bonds are special obligations of the Board payable solely from a subordinate lien on Pledged Revenues, which Pledged Revenues are not segregated or identified in these tables.

**Arizona Department of Transportation  
State Highway Fund  
Summary of Revenues, Expenditures, and Changes in Fund Balances  
Fiscal years ended June 30, 2001 through June 30, 2003**

	<b>2001</b>	<b>2002</b>	<b>2003</b>
<b>Revenues:</b>			
Vehicle registration, title, license and related fees	\$210,086,489	\$228,894,803	\$235,005,553
Fuel and motor carrier taxes and fees	300,354,146	294,144,373	306,039,653
Reimbursement of construction expenditures -- federal aid	360,869,634	479,443,294	380,890,972
Other federal grants and reimbursements	4,879,115	5,388,898	6,895,652
Reimbursements from Arizona counties, cities and other state agencies	2,900,099	5,634,123	17,227,347
State appropriations	255,991	317,478	-
Interest on loans receivable	-	418,467	1,626,928
Interest on investments	13,844,679	14,388,418	8,600,892
Other	<u>16,689,696</u>	<u>17,101,259</u>	<u>7,218,420</u>
Total revenues	<u>909,879,849</u>	<u>1,045,731,113</u>	<u>963,505,417</u>
<b>Expenditures:</b>			
<b>Current:</b>			
Transportation -- appropriated by State legislature:			
Administration	48,149,597	56,229,911	51,484,986
Highway	43,116,888	43,578,170	44,008,345
Highway Maintenance	89,400,095	89,314,437	94,977,822
Motor Vehicle Division	73,442,885	77,613,135	77,487,708
Other	<u>1,021,429</u>	<u>2,091,895</u>	<u>1,747,235</u>
Total Transportation -- appropriated by State legislature	<u>255,130,894</u>	<u>268,827,548</u>	<u>269,706,096</u>
Transportation -- not appropriated by State legislature	6,360,624	7,479,691	9,594,090
Capital Outlay:			
Highway construction	620,188,336	701,666,645	632,619,838
Land, buildings and improvements -- appropriated by State legislature	5,418,193	-	-
Contracts and capital leases payable	909,714	-	-
Distributions to Arizona counties, cities and other state agencies	12,500,000	29,112,667	40,302,383
Interest on Notes Payable	<u>3,052,152</u>	<u>1,228,358</u>	<u>2,779,516</u>
Total Expenditures	<u>903,559,913</u>	<u>1,008,314,909</u>	<u>955,001,923</u>
Excess (deficiency) of revenues over (under) expenditures	6,319,936	37,416,204	8,503,494

**Arizona Department of Transportation**  
**State Highway Fund**  
**Summary of Revenues, Expenditures, and Changes in Fund Balances**  
**Fiscal years ended June 30, 2001 through June 30, 2003**  
**(Continued)**

	<b>2001</b>	<b>2002</b>	<b>2003</b>
<b>Other financing sources (uses):</b>			
Proceeds from contracts and capital leases payable	909,714	-	-
Operating transfers in	84,939,201	6,701,604	45,685,409
Operating transfers out:			
Debt service	(86,529,221)	(83,617,343)	(83,157,218)
Other	(20,007,142)	(175,058)	(16,124,075)
Total other financing (uses)	(20,687,448)	(77,090,797)	(53,595,884)
Net change in fund balance before accounting change	(14,367,512)	(39,674,593)	(45,092,390)
Cumulative effect of accounting change	-	-	40,398,858
Net change in fund balance	(14,367,512)	(39,674,593)	(4,693,532)
Fund balances, Beginning of year	<u>242,369,800</u>	<u>228,002,288</u>	<u>188,327,695</u>
<b>Fund balances, End of year</b>	<b><u>\$228,002,288</u></b>	<b><u>\$188,327,695</u></b>	<b><u>\$183,634,163</u></b>

Source: Provided by the Arizona Department of Transportation, Financial Management Services, from audited financial statements of the Department.

**Sunset Laws**

In order to encourage systematic legislative review of State agencies and statutes, State law provides for automatic termination of State agencies and statutes pursuant to a statutory schedule unless the State Legislature takes affirmative action to continue the agencies' or statutes' existence. The Department and the Board are scheduled for termination on July 1, 2008, and Title 28, Arizona Revised Statutes, which contains most of the transportation laws of the State, including 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, as well as traffic laws, is scheduled for termination on January 1, 2009. In addition, the Motor Vehicle Division of the Department is scheduled for termination on July 1, 2005 and the statutory provisions related to the Motor Vehicle Division are scheduled to terminate on January 1, 2006.

The termination statutes, commonly known as 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 authority and the provisions relating to the fees and taxes pertaining to the registration, operation and use of motor vehicles and motor vehicle fuel taxes have been reviewed twice and the existence of each was continued. While it is impossible at this time to predict what action, if any, the State Legislature will take, the Department is not aware of any factual matter which would cause the State Legislature to discontinue the existence of the Department or the Board or to discontinue the effects of or to amend Title 28 in such a manner as to be detrimental to the bondholders on or prior to their respective termination dates.

To protect holders of the outstanding Senior Bonds and Subordinated Bonds, including the Series 2004B Subordinated Bonds, the Arizona statutes provide that if the Act is repealed pursuant to the sunset laws, so long as there are any debts or other obligations payable from the Arizona Highway User Revenue 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, the pledge of revenues from that fund and the liens on that fund to pay the debts or other

obligations remain in full force and effect until the 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 to take affirmative action to continue the existence of the Department and the Board or the Act, on or prior to their respective termination dates, the State would be obligated to assume and make payments on the Series 2004B Subordinated Bonds from Pledged Revenues under the terms and conditions for payment contained in the Subordinated Bond 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 2004B Subordinated Bonds or in any way contest or affect the validity of the Series 2004B Subordinated Bonds, or which concerns the proceedings of the Board taken in connection with the issuance and sale of the Series 2004B Subordinated Bonds or the levy, pledge or application of Pledged Revenues, or the pledge and application of any funds provided for their payment, 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 Senior Bonds and Subordinated Bonds, its continued operations or its financial position.

## **LEGAL INVESTMENT**

To the extent governed by Arizona law, the Act provides that the Series 2004B Subordinated Bonds are securities in which all public officers and bodies of the State and political subdivisions of the State, all insurance companies and associations and other persons carrying on an insurance business, all banks, bankers, trust companies, savings banks and savings associations, including savings and loan associations, building and loan associations, investment companies and other persons carrying on a banking business, all administrators, guardians, executors, trustees and other fiduciaries and all other persons authorized to invest in bonds or other obligations of the State, may properly and legally invest money, including capital in their control or belonging to them. The Series 2004B Subordinated Bonds are also securities which may be deposited with and may be received by all public officers and bodies of the State and all municipalities and political subdivisions of the State for any purpose for which the deposit of bonds or other obligations of the State is now or may hereafter be authorized.

## **TAX MATTERS**

In the opinion of Squire, Sanders & Dempsey L.L.P., Bond Counsel, under existing law (i) interest on the Series 2004B Subordinated Bonds 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 2004B Subordinated Bonds is exempt from Arizona state income tax. Bond Counsel will express no opinion as to any other tax consequences regarding the Series 2004B Subordinated Bonds.

The opinion on federal 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 to be contained in the transcript of proceedings, and that are intended to evidence and assure the foregoing, including that the Series 2004B Subordinated Bonds 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 those certifications and representations.

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 in order for the interest to be and to continue to be so excluded from the date of issuance. Noncompliance with these requirements by the Board may cause the interest on the Series 2004B Subordinated Bonds to be included in gross income for federal income tax purposes and thus to be subject to federal income tax retroactively to the date of issuance of the Series 2004B Subordinated Bonds. The Board has covenanted to take the actions required of it for the interest on the Series 2004B Subordinated Bonds 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.

A portion of the interest on the Series 2004B Subordinated Bonds earned by certain corporations may be subject to a corporate alternative minimum tax. In addition, the interest on the Series 2004B Subordinated Bonds may be subject to a 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 2004B Subordinated Bonds. Bond Counsel will express no opinion regarding those consequences.

Purchasers of the Series 2004B Subordinated Bonds at other than their original issuance at the respective prices indicated on the inside cover of this Official Statement should consult their own tax advisers regarding other tax considerations such as the consequences of market discount.

#### **Original Issue Premium**

Certain of the Series 2004B Subordinated Bonds ("Premium Bonds") as indicated on the inside 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 Bond, based on the yield to maturity of that Premium Bond (or, in the case of Premium Bond 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 Bond), compounded semiannually. No portion of that bond premium is deductible by an owner of a Premium Bond. For purposes of determining the owner's gain or loss on the sale, redemption (including redemption at maturity) or other disposition of a Premium Bond, the owner's tax basis in the Premium Bond is reduced by the amount of bond premium that accrues 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 Bond for an amount equal to or less than the amount paid by that owner for the Premium Bond. A purchaser of a Premium Bond in the initial public offering at the price for that Premium Bond stated on the inside cover of this Official Statement who holds that Premium Bond to maturity (or, in the case of a callable Premium Bonds, to its earlier call date that results in the lowest yield on that Premium Bond) will realize no gain or loss upon the retirement of that Premium Bond.

Owners of Premium Bonds should consult their own tax advisers as to the determination for federal income tax purposes of the amount of bond premium properly accruable in any period with respect to the Premium Bonds and as to other federal tax consequences and the treatment of the 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, 2003 included in this Official Statement in Appendix A have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report appearing therein. Management's discussion and analysis of the Department's financial statements, as contained in Appendix A, refers to certain sections and schedules all of which are not included in this document.

## 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 August 15, 2004 (the "Disclosure Undertaking"), substantially in the form set forth as Appendix C, wherein the Board and the Department will agree, for the benefit of the Beneficial Owners of the Series 2004B Subordinated Bonds, to provide, or cause to be provided, certain annual financial information and operating data generally consistent with the information contained under the heading "REVENUES AND DEBT SERVICE COVERAGE – Historical Revenues" herein, and notice of the occurrence of certain events or failures to take certain required actions with respect to the Series 2004B Subordinated Bonds.

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 events listed in the Disclosure Undertaking, if material.

The obligations of the Board and the Department described in the Disclosure Undertaking will remain in effect until the Series 2004B Subordinated Bonds are no longer outstanding (within the meaning of the Subordinated Bond Resolution) or the Rule no longer applies to the Series 2004B Subordinated Bonds. 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 2004B Subordinated Bond 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 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 2004B Subordinated Bonds under the Subordinated Bond Resolution.

Continuing disclosure undertakings previously entered into by the Board and the Department called for the filing of certain annual financial information related to debt obligations of the Board by February 1, 2000. The Board and the Department filed the required information on April 20, 2000. Further, the Board and the Department filed notice of an upgrade in the credit rating of certain of its debt obligations approximately twelve months after such upgrade became effective. The Board and the Department are otherwise in material compliance with each and every disclosure undertaking into which they have entered pursuant to the Rule.

## RATINGS

The Series 2004B Subordinated Bonds have been rated "AA" and "Aa2", respectively, by Standard & Poor's Rating Services, a division of The McGraw-Hill Companies, Inc., and Moody's Investors Service. Such ratings reflect only the views of the rating organizations, and any explanation of the meaning or significance of the ratings may only be obtained from the rating agency. The Board and the Department furnished to the rating agencies certain information and materials, some of which have not been included in this Official Statement, relating to the Series 2004B Subordinated Bonds 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 their judgment circumstances so warrant. Any lowering or withdrawal of a rating may have an adverse effect on the marketability or market price of the Series 2004B Subordinated Bonds.

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 2004B Subordinated Bonds.

## **CERTAIN LEGAL MATTERS**

Legal matters incident to the issuance of the Series 2004B Subordinated Bonds and with regard to the exclusion of interest from gross income for federal income tax purposes (see "TAX MATTERS") are subject to the legal opinion of Squire, Sanders & Dempsey L.L.P., Bond Counsel, whose legal services have been retained by the Board. The signed legal opinion, dated and premised on law in effect as of the date of original delivery of the Series 2004B Subordinated Bonds, will be delivered to the Board at the time of original delivery. The text of that opinion will be printed on the Series 2004B Subordinated Bonds.

The proposed text of the legal opinion of Bond Counsel is set forth as Appendix B. The legal opinion to be delivered may vary from that text if necessary to reflect facts and law on the date of delivery. The opinion will speak only as of its date, and subsequent distribution of it by recirculation of the Official Statement or otherwise shall create no implication that Bond Counsel has reviewed or expresses any opinion concerning any of the matters referred to in the opinion subsequent to its date.

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 2004B Subordinated Bonds, the Senior Bond Resolution, the Subordinated Bond Resolution and the tax-exempt status of interest on the Series 2004B Subordinated Bonds (except for outstanding amounts of Senior Bonds and Subordinated Bonds), contained under the captions "INTRODUCTION", "THE SERIES 2004B SUBORDINATED BONDS", "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2004B SUBORDINATED BONDS", "SOURCES AND APPLICATION OF PLEDGED REVENUES" (excluding "—Recent Legislation" and financial data), "LEGAL INVESTMENT", "TAX MATTERS", "CONTINUING DISCLOSURE UNDERTAKING" (excluding the last paragraph thereunder), "APPENDIX B – PROPOSED FORM OF BOND COUNSEL OPINION," "APPENDIX C – FORM OF CONTINUING DISCLOSURE UNDERTAKING" and "APPENDIX E – SUMMARY OF THE SUBORDINATED BOND RESOLUTION" herein. 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 2004B Subordinated Bonds or the Board or the Department that may be made available to the prospective purchasers of the Series 2004B Subordinated Bonds or to others.

In addition to rendering the legal opinion, Bond Counsel will assist in the preparation of and advise the Board concerning documents for the bond transcript. Certain legal matters will be passed upon for the Underwriters by their counsel, Ballard Spahr Andrews & Ingersoll, LLP.

## **UNDERWRITING**

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Series 2004B Subordinated Bonds from the Board at a price of \$200,420,866.25 plus accrued interest. Based upon the initial offering yields of the Series 2004B Subordinated Bonds as shown on the inside cover hereof, the

Underwriters will receive compensation of \$701,848.25. The public offering prices may be changed from time to time by the Underwriters. The Underwriters may offer and sell the Series 2004B Subordinated Bonds to dealers (including dealers depositing the Series 2004B Subordinated Bonds 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 2004B Subordinated Bonds if any are purchased.

## MISCELLANEOUS

The Department and the Board have furnished the information in this Official Statement relating to the Department, the Board, the Arizona Highway User Revenue Fund and the State Highway Fund.

Copies of the Senior Bond Resolution and the Subordinated Bond Resolution discussed herein may be obtained from the Department's Chief Financial Officer, located at 206 South 17th Avenue, Phoenix, Arizona 85007 (telephone: 602-712-7441). All communications concerning this offering should be directed to Mr. John McGee, Chief Financial Officer.

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 State are fully set forth in the Subordinated Bond Resolution in accordance with the Act and this Official Statement is not to be construed as a contract or agreement between the Board, the Department or the State, and the purchasers or Owners of any of the Series 2004B Subordinated Bonds.

This Official Statement is submitted in connection with the sale of the Series 2004B Subordinated Bonds 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/ Bill Jeffers

Bill Jeffers, Chair

### ARIZONA DEPARTMENT OF TRANSPORTATION

/s/ Victor M. Mendez

Victor M. Mendez, Director

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**APPENDIX A**

**ARIZONA DEPARTMENT OF TRANSPORTATION  
FINANCIAL STATEMENTS  
YEAR ENDED JUNE 30, 2003  
WITH REPORT OF INDEPENDENT AUDITORS**

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## INDEPENDENT AUDITORS' REPORT

The Honorable Janet Napolitano  
Governor of the State of Arizona, and  
Members of the 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 (the "Department") as of and for the year ended June 30, 2003, which collectively compose the Department's basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the Department's management. 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, the financial statements of the Department of the State of Arizona (the "State") 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 that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2003, 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 respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Department as of June 30, 2003 and the respective changes in 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 4B to the basic financial statements, in fiscal year 2003, the Department changed its accounting policy related to the recording of state appropriated funds.

The management's discussion and analysis, budgetary comparison information and infrastructure assets reported using the modified approach information on pages 3 through 12, 51 through 54, and 55 through 58 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively compose the Department's basic financial statements. The introductory section, combining and individual nonmajor fund financial statements and statistical tables are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section and statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on them.

In accordance with Government Auditing Standards, a report has been issued on the consideration of the State of Arizona's internal control over financial reporting and tests of its compliance with certain provisions of laws, regulations, contracts and grants for which Arizona Department of Transportation is a department. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

*Deloitte & Touche LLP*

December 4, 2003

Arizona Department of Transportation  
Management's Discussion and Analysis  
June 30, 2003

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, 2003. We encourage readers to consider the information presented here in conjunction with the letter of transmittal, which can be found on pages i-v, and the Department's financial statements, which begin on page 13, with the accompanying notes and required supplementary information (RSI).

## Financial Highlights

### Government-wide:

- The net assets of the Department exceeded its liabilities at the close of the fiscal year by \$10.3 billion, compared to \$9.7 billion for fiscal year 2002, an increase of 6.5 percent. Of this amount, \$212.6 million represents *unrestricted net assets* and may be used to meet the Department's ongoing obligations to citizens and creditors as compared to \$221.2 million in 2002.
- The Department's investment in capital assets, net of related debt, is \$9.6 billion, compared to \$9.0 billion for fiscal year 2002, an increase of 6.7 percent. The Department's capital assets are \$11.4 billion, compared to \$10.7 billion for fiscal year 2002, an increase 6.6 percent. This increase is primarily attributable to the building of additional highways.
- The Department's non-current liabilities was \$2.0 billion, compared to \$1.9 billion for fiscal year 2002, an increase of 4.7 percent. The bonded debt increased by \$70.9 million (4.7 percent) as a result of new issuances, refundings and repayments.

### Fund Level:

- As of the close of the fiscal year, the governmental funds of the Department reported combined ending fund balances of \$452.9 million, as compared to \$413.0 million in 2002, a 9.7 percent increase over the prior fiscal year. Approximately \$65.1 million (14.4 percent) is available for spending at the government's discretion (unreserved fund balance) as compared to \$90.6 (22.0 percent) in 2002. At the end of the fiscal year, the unreserved fund balance for the General Fund was \$48.7 million.
- The proprietary funds reported net assets at year-end of \$65.1 million, as compared to \$86.3 million, a decrease of \$21.1 million over the prior year. This decrease was due to distributions to other state agencies.

## Overview of the Financial Statements

This discussion and analysis are 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. 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.

Arizona Department of Transportation  
Management's Discussion and Analysis  
June 30, 2003

- Other indicators of the Department's financial health include the condition of its roads and highways (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, aeronautics, highway, highway maintenance, motor vehicle division and other activities. 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 13-14 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 converting to 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.
- Deferred issuance costs are capitalized and amortized to expense as governmental activities, but reported as expenditures in the governmental fund statements.
- Unless due and payable, long-term liabilities, such as capital lease obligations, compensated absences, 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 are 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 15 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 to 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 reconciliation following the fund financial statements explains the differences between the government's activities, reported in the government-wide statement of activities, and the governmental funds.

The Department maintains sixteen 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 ten 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. The Schedule of Revenues and Expenditures -- Budget and Actual has been provided for the General Fund to demonstrate compliance with this budget and is presented as required supplementary information.

The governmental funds financial statements can be found on pages 15-22 of this report.

**Proprietary Funds.** When the Department charges customers for the services it provides -- whether to outside customers, other agencies or to other divisions of the Department -- 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 supplies and services to the general public. The Department's enterprise funds are the *Arizona Highways Magazine* Fund and 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 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 23-25 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 26.

**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 27-50 of this report.

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**Required Supplementary Information.** In addition to the basic financial statements including accompanying notes, this report presents certain required supplementary information concerning the Department's Schedule of Revenues and Expenditures – Budget and Actual for the General Fund and the modified approach to reporting infrastructure assets. Required supplementary information can be found on pages 51-58 of this report.

**Other Supplementary Information.** Other supplementary information includes the combining statements for the non-major governmental funds, agency funds and capital assets 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 59-66 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 analysis discuss the financial position and changes to financial position for the Department as a whole as of and for the fiscal year ended June 30, 2003.

The Department's combined net assets increased by \$632.1 million over the course of this fiscal year's operations, an increase of 6.5 percent. The net assets of the governmental activities increased by \$653.3 million or 6.8 percent and business-type activities decreased by \$21.1 million or 24.5 percent.

The following table reflects the condensed Statement of Net Assets as of June 30:

	Governmental Activities		Business-type Activities		Total	
	2003	2002	2003	2002	2003	2002
<b>Assets:</b>						
Current and other assets	\$ 851,633,105	\$ 833,488,297	\$ 220,185,188	\$ 235,245,607	\$ 1,071,818,293	\$ 1,068,733,904
Capital assets	11,438,563,961	10,733,547,800	1,125,754	1,439,057	11,439,689,715	10,734,986,857
Total assets	12,290,197,066	11,567,036,097	221,310,942	236,684,664	12,511,508,008	11,803,720,761
<b>Liabilities:</b>						
Other liabilities	200,791,918	213,447,052	4,484,163	4,760,226	205,276,081	218,207,278
Non-current liabilities	1,817,359,577	1,734,806,233	151,696,446	145,670,558	1,969,056,023	1,880,476,791
Total liabilities	2,018,151,495	1,948,253,285	156,180,609	150,430,784	2,174,332,104	2,098,684,069
<b>Net assets:</b>						
Invested in capital assets, net of related debt	9,621,204,384	8,998,741,567	1,125,754	1,439,057	9,622,330,138	9,000,180,624
Restricted	439,045,246	400,315,381	63,224,779	83,292,829	502,270,025	483,608,210
Unrestricted	211,795,941	219,725,864	779,800	1,521,994	212,575,741	221,247,858
Total net assets	\$10,272,045,571	\$ 9,618,782,812	\$ 65,130,333	\$ 86,253,880	\$10,337,175,904	\$ 9,705,036,692

The total assets of the Department were \$12.5 billion, while total liabilities were \$2.2 billion, resulting in a net assets balance of \$10.3 billion. By far, the largest portion of the Department's net assets, \$9.6 billion (93.1 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.

As of June 30, 2003, the Department is able to report positive balances in all three categories of net assets, both for the governmental and business-type activities. The same situation held true for the prior fiscal year.

There was a decrease of \$20.1 million in restricted net assets for the Department's business-type activities. The bulk of this decrease was due to a \$20.0 million distribution from the Highway Expansion and Extension Loan Program Fund to other state agencies.

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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:

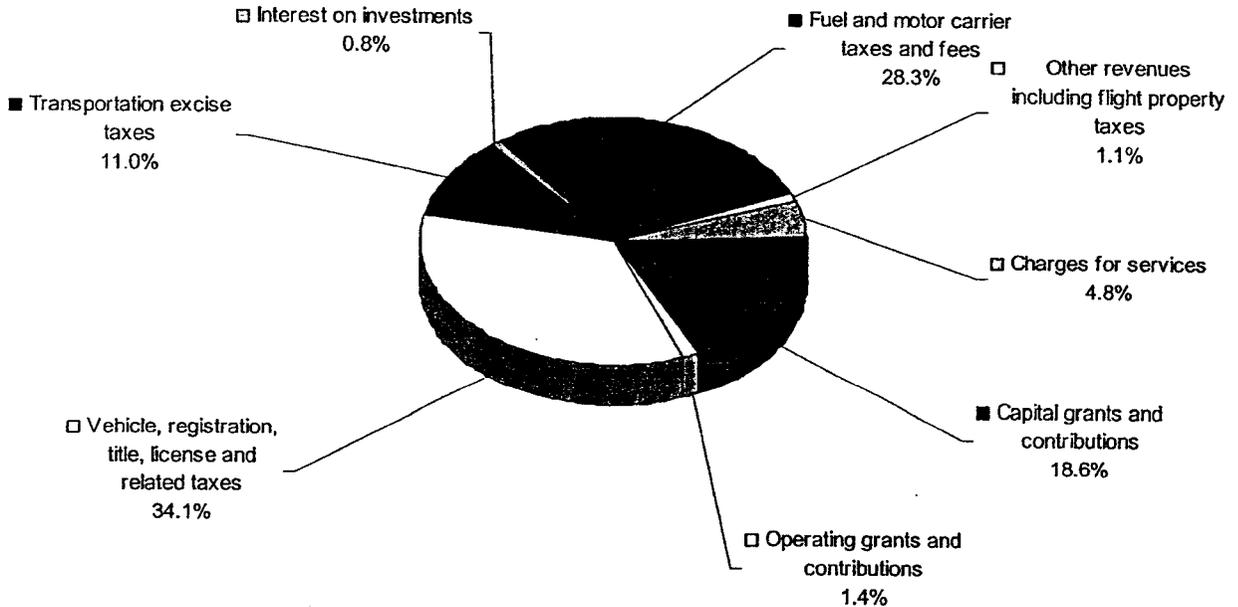
	Governmental Activities		Business-type Activities		Total	
	2003	2002	2003	2002	2003	2002
<b>Revenues:</b>						
<b>Program revenues:</b>						
Charges for services	\$ 117,412,098	\$ 112,724,784	\$ 13,477,401	\$ 11,840,350	\$ 130,889,499	\$ 124,565,134
Operating grants and contributions	34,160,325	56,480,747	-	-	34,160,325	56,480,747
Capital grants and contributions	453,757,521	470,771,977	-	-	453,757,521	470,771,977
<b>General revenues:</b>						
Transportation excise taxes	268,720,901	267,563,343	-	-	268,720,901	267,563,343
Vehicle, registration, title, license and related taxes	832,492,117	899,092,103	-	-	832,492,117	899,092,103
Fuel and motor carrier taxes and fees	691,003,491	547,129,189	-	-	691,003,491	547,129,189
Flight property taxes	6,026,213	6,528,347	-	-	6,026,213	6,528,347
Interest on investments	19,802,902	29,862,802	2,440,375	5,624,632	22,243,277	35,487,434
Other	21,303,653	26,484,086	425,219	381,360	21,728,872	26,865,446
<b>Total revenues</b>	<b>2,444,679,221</b>	<b>2,416,637,378</b>	<b>16,342,995</b>	<b>17,846,342</b>	<b>2,461,022,216</b>	<b>2,434,483,720</b>
<b>Expenses:</b>						
Administration	52,533,318	57,864,409	-	-	52,533,318	57,864,409
Aeronautics	3,848,091	3,750,673	-	-	3,848,091	3,750,673
Highway	45,643,844	46,543,229	-	-	45,643,844	46,543,229
Highway Maintenance	96,352,820	91,569,523	-	-	96,352,820	91,569,523
Motor Vehicle	83,090,207	82,904,097	-	-	83,090,207	82,904,097
Other	8,460,021	6,844,145	-	-	8,460,021	6,844,145
Highway Maintenance - asset preservation	268,383,806	89,146,668	-	-	268,383,806	89,146,668
Transportation - not appropriated by State legislature	9,590,932	7,482,406	-	-	9,590,932	7,482,406
Distributions to Arizona counties and cities	957,056,532	915,219,274	-	-	957,056,532	915,219,274
Distributions to other state agencies	192,536,424	149,340,401	-	-	192,536,424	149,340,401
Intergovernmental	30,235,385	24,791,275	-	-	30,235,385	24,791,275
Interest on long-term debt	84,083,940	89,604,704	-	-	84,083,940	89,604,704
Arizona Highways Magazine	-	-	11,118,003	10,710,728	11,118,003	10,710,728
Highway Expansion and Extension Loan Program	-	-	26,348,539	5,264,722	26,348,539	5,264,722
<b>Total expenses</b>	<b>1,831,815,320</b>	<b>1,565,060,804</b>	<b>37,466,542</b>	<b>15,975,450</b>	<b>1,869,281,862</b>	<b>1,581,036,254</b>
<b>Change in net assets before accounting change</b>	<b>612,863,901</b>	<b>851,576,574</b>	<b>&lt;21,123,547&gt;</b>	<b>1,870,892</b>	<b>591,740,354</b>	<b>853,447,466</b>
<b>Cumulative effect of accounting change</b>	<b>40,398,858</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>40,398,858</b>	<b>-</b>
<b>Change in net assets</b>	<b>653,262,759</b>	<b>851,576,574</b>	<b>&lt;21,123,547&gt;</b>	<b>1,870,892</b>	<b>632,139,212</b>	<b>853,447,466</b>
<b>Net assets - July 1</b>	<b>9,618,782,812</b>	<b>8,767,206,238</b>	<b>86,253,880</b>	<b>84,382,988</b>	<b>9,705,036,692</b>	<b>8,851,589,226</b>
<b>Net assets - June 30</b>	<b>\$ 10,272,045,571</b>	<b>\$ 9,618,782,812</b>	<b>\$ 65,130,333</b>	<b>\$ 86,253,880</b>	<b>\$ 10,337,175,904</b>	<b>\$ 9,705,036,692</b>

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**Governmental Activities:**

The following chart depicts revenues of the governmental activities for the fiscal year ended June 30, 2003:

**Revenues - Governmental Activities**



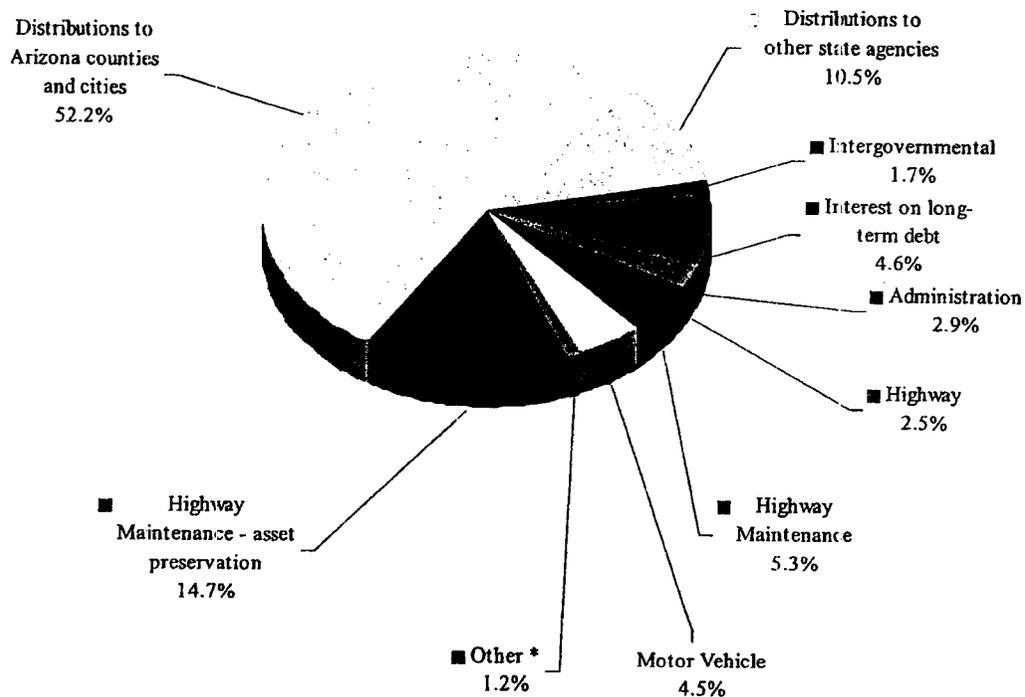
\$2.2 billion (or 91.9 percent) of the Department's revenues are from the following four revenue sources:

- Vehicle, registration, title, license and related taxes represent the Department's largest revenue source of \$832.5 million (34.1 percent).
- Fuel and motor carrier taxes and fees represent the Department's second largest revenue source of \$691.0 million (28.3 percent).
- Capital grants and contributions represent the Department's third largest revenue source of \$453.8 million (18.6 percent).
- Transportation excise taxes represent the Department's fourth largest revenue source of \$268.7 million (11.0 percent).

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The following chart depicts expenses of the governmental activities for the fiscal year ended June 30, 2003:

**Expenditures - Governmental Activities**



\*Other includes expenditures for Aeronautics and Transportation – not appropriated by State legislature

\$1.4 billion (or 77.4 percent) of the Department's expenditures were for the following:

- Distributions to Arizona counties and cities \$957.0 million (52.2 percent).
- Highway Maintenance -- asset preservation \$268.4 million (14.7 percent).
- Distributions to other state agencies \$192.5 million (10.5 percent).

**Business-type Activities:**

Net assets for business-type activities decreased by \$21.1 million during the fiscal year. Of the total revenues of \$16.3 million, charges for services represented 82.5 percent and interest on investments 14.9 percent. The total expenses for business-type activities were \$37.5 million. Factors contributing to these results included:

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- The Arizona Highways Magazine's deficit of \$1.1 million. Half of this deficit is due to a distribution to other state agencies and the remaining deficit is attributable to a decrease in magazine sales as a result of the down turn in the economy.
- The Highway Expansion and Extension Loan Program's decline of \$20.1 million. This deficit also is due to a distribution to other state agencies.

**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 15-22) 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 nonmajor governmental funds are combined into a single column. Combining statements for the non-major governmental funds may be found on pages 59-62.

As of the end of the fiscal year, the fund balances of the governmental funds totaled \$452.9 million, an increase of \$39.9 million over the previous fiscal year. Of this balance, \$65.1 million or 14.4 percent constitutes unreserved fund balance, which was available for spending for the general purposes of the Department. The remaining fund balance of \$387.8 million, or 85.6 percent, was reserved for the following: 1) \$4.7 million for inventories, 2) \$20.0 million to liquidate an interfund receivable to the HELP, 3) \$20.8 million to pay debt service, and 4) \$342.3 million to pay for capital projects.

The General Fund is the main operating fund of the Department. At the end of the current fiscal year, the unreserved fund balance of the General Fund was \$48.7 million and the reserved fund balance was \$134.9 million. As a measure of the General Fund's liquidity, it may be useful to compare both the unreserved fund balance and the total fund balance to the total fund expenditures. Unreserved fund balance represents 5.1 percent of total General Fund expenditures, while total fund balance represents 19.2 percent of the same amount.

**Capital Assets and Debt Administration**

**Capital Assets (Note 5A):**

The Department's investment in capital assets for its governmental and business-type activities as of June 30, 2003, amounts to \$11.4 billion (net of accumulated depreciation), a \$.7 billion increase over the previous fiscal year.

	Governmental Activities		Business-type Activities		Total	
	2003	2002	2003	2002	2003	2002
Land	\$ 1,839,172,464	\$ 1,715,941,418	\$ 7,900	\$ 7,900	\$ 1,839,180,364	\$ 1,715,949,318
Buildings and improvements	96,966,010	97,635,066	311,784	345,600	97,277,794	97,980,666
Improvements other than buildings	31,619,008	31,703,310	-	-	31,619,008	31,703,310
Mobile fleet and aircraft	37,739,350	41,995,018	-	-	37,739,350	41,995,018
Machinery and equipment	15,757,141	16,280,578	806,070	1,085,557	16,563,211	17,366,135
Infrastructure	7,564,772,978	7,444,327,275	-	-	7,564,772,978	7,444,327,275
Construction in progress	1,852,537,010	1,385,665,135	-	-	1,852,537,010	1,385,665,135
<b>Total</b>	<b>\$ 11,438,563,961</b>	<b>\$10,733,547,800</b>	<b>\$ 1,125,754</b>	<b>\$ 1,439,057</b>	<b>\$11,439,689,715</b>	<b>\$10,734,986,857</b>

As provided by GASB 34, the Department has elected to record its infrastructure assets using the modified approach. Assets accounted for under the modified approach include approximately 6,801 centerline miles (18,129 travel lane miles) and 4,463 bridges that the Department is responsible for maintaining.

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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 most recent assessment indicated that an overall rating of 3.6 was achieved for fiscal year 2003.

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 2003, a CRI of 93.9 percent was obtained.

In addition to many smaller projects, each of the following major highway construction projects in excess of \$20 million were started during fiscal year 2003:

Project Description	Contract Start	Contract Amount
Construction on State Route 260 in the vicinity of Camp Verde	10/24/2002	\$23,376,195
Construction of a four lane divided highway on the Kohl's Ranch section of State Route 260	5/13/2003	\$22,785,441
Construction of two overpasses on Grand Avenue (US 60); one at 43rd Avenue and Camelback Road and another at 51st Avenue and Bethany Home Road	12/24/2002	\$20,180,265
Construction of the Santan Freeway (Loop 202) from Dobson Road to Arizona Avenue	6/25/2003	\$31,919,593
Construction of HOV lanes, roadway and drainage improvements on SR 51, from Interstate 10 to Shea Boulevard	1/22/2003	\$84,925,003

**Non-Current Liabilities (Note 5G):**

Governmental Activities	
Highway revenue bonds	\$ 932,700,000
Transportation excise tax revenue bonds	488,400,000
Grant anticipation notes	169,145,000
Premium on bonds	34,422,663
Compensated absences	11,337,254
Capital leases	916,184
Notes payable	180,438,476
Total governmental activities	<u>1,817,359,577</u>
Business-type Activities	
Compensated absences	151,380
Notes payable	151,545,066
Total Business-type Activities	<u>151,696,446</u>
Total Non-Current Liabilities	<u>\$ 1,969,056,023</u>

As of June 30, 2003, the Department had \$1.59 billion in outstanding bonds payable. This total includes \$932.7 million in Highway Revenue Bonds (HURF), \$488.4 million in Transportation Excise Tax Revenue Bonds (RARF) and \$169.1 million in Grant Anticipation Notes (GANs). The Department has \$34.4 million in unamortized

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premium on bonds. The Department had capital leases outstanding of \$.9 million for acquisition of data processing equipment and notes payable of \$332.0 million for the following:

1. General Fund - \$108,270,286 for loans from the HELP Fund and \$61,867,175 for principal and interest for Board Fund Obligations (BFO) for highway construction.
2. Maricopa Regional Area Road Construction Fund - \$8,031,335 for a loan from the City of Mesa for advance construction of a section of Loop 202.
3. Equipment Fund - \$2,269,680 for purchase of snow plows using capital leases.
4. HELP Fund - \$151,545,066 for principal and interest for BFO used for capitalizing Arizona's State Infrastructure Bank.

The bonds have been sold in 30 separate issues between 1986 and 2003. All bonds outstanding as of June 30, 2003, are scheduled to mature not later than July 1, 2022. The bonds are obligations of the Transportation Board and are not obligations of the State of Arizona.

Of the \$4.6 billion total in bonds issued between 1986 and 2003, \$1.3 billion, or approximately 28 percent, have been refunding issues to lower debt service costs. These efforts have resulted in cumulative debt service savings of \$67.0 million in current dollars and \$47.8 million on a present value basis.

The senior lien HURF bonds have been rated AAA/Aa1 by Standard & Poor's Rating Services Group and Moody's Investors Service, respectively. The Department's subordinate lien HURF bonds are rated AA/Aa2. The senior lien RARF bonds are rated AA/Aa2, while the subordinate lien RARF bonds are rated A/Aa3. The Grant Anticipation Notes are rated AA-/Aa3/AA with the additional rating provided by Fitch Ratings.

Laws 1999, Chapter 189 (SB 1201), Arizona Revised Statute 28-7678, authorized the Transportation Board to issue nonnegotiable Board Funding Obligations (BFOs) for purchase by the Arizona State Treasurer. The law restricts the Transportation Board to issuing \$100 million in fiscal years 2000, 2001 and 2004. The BFOs are used to capitalize Arizona's State Infrastructure Bank, which allows the Department and political subdivisions to apply for loans from the HELP Fund established by this legislation.

Laws 2001, Chapter 238 (HB 2636), Arizona Revised Statute 28-7510, increased the HURF bonding cap to \$1 billion from \$800 million. Additionally, the legislation authorized the Transportation Board to issue an additional \$100 million in BFOs in fiscal year 2002 and increased the BFO authority in fiscal year 2004 to \$200 million from \$100 million. The distribution of this additional BFO authority is \$60 million to the State Highway Fund and \$40 million to the HELP Fund in fiscal years 2002 and 2004.

Laws 2003, Chapter 4 (HB 2588), Arizona Revised Statute 28-7510, increased the HURF bonding cap to \$1.3 billion from \$1.0 billion.

#### **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. 17<sup>th</sup> Avenue, Phoenix, Arizona, 85007 or by visiting our website at <http://www.dot.state.az.us/ABOUT/fms/cafr/cindex.htm>.

Arizona Department of Transportation  
Statement of Net Assets  
June 30, 2003

	Governmental Activities	Business-type Activities	Total
<b>ASSETS</b>			
Unrestricted cash on deposit with the State Treasurer	\$ 154,330,482	\$ 1,559,016	\$ 155,889,498
Receivables:			
Notes and loans	9,854,413	136,882,915	146,737,328
Subscriptions, net of allowance for doubtful accounts	-	438,764	438,764
Accrued interest	2,294,300	256,740	2,551,040
Taxes and fees	68,682,711	-	68,682,711
Other, net of allowance for doubtful accounts	8,512,849	45,322	8,558,171
Due from U.S. Government for reimbursable construction costs	69,928,896	-	69,928,896
Due from other state agencies	303,917	380,496	684,413
Internal balances	18,731,249	<18,731,249>	-
Inventories	7,064,928	2,659,047	9,723,975
Prepaid items	-	683,969	683,969
Deferred charges	3,049,126	-	3,049,126
Restricted cash on deposit with the State Treasurer	508,880,234	96,010,168	604,890,402
Capital assets not subject to depreciation (Note 5A)	11,256,482,452	7,900	11,256,490,352
Capital assets subject to depreciation, net of accumulated depreciation (Note 5A)	182,081,509	1,117,854	183,199,363
Total assets	<u>12,290,197,066</u>	<u>221,310,942</u>	<u>12,511,508,008</u>
<b>LIABILITIES</b>			
Accounts payable and other current liabilities	6,154,254	122,789	6,277,043
Accrued payroll and other accrued expenses	5,279,742	118,243	5,397,985
Contracts and retainage payable	86,041,430	-	86,041,430
Due to Arizona counties and cities	96,472,721	-	96,472,721
Due to other state agencies	6,843,771	-	6,843,771
Deferred revenues (Note 5C)	-	4,243,131	4,243,131
Non-current liabilities (Note 5H):			
Due within one year	417,689,304	151,696,446	569,385,750
Due in more than one year	1,399,670,273	-	1,399,670,273
Total liabilities	<u>2,018,151,495</u>	<u>156,180,609</u>	<u>2,174,332,104</u>
<b>NET ASSETS</b>			
Invested in capital assets, net of related debt	9,621,204,384	1,125,754	9,622,330,138
Restricted for:			
Loans and other financial assistance	-	63,224,779	63,224,779
Debt service	21,602,726	-	21,602,726
Capital projects	417,442,520	-	417,442,520
Unrestricted	211,795,941	779,800	212,575,741
Total Net Assets	<u>\$ 10,272,045,571</u>	<u>\$ 65,130,333</u>	<u>\$ 10,337,175,904</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, 2003

Functions/Programs	Expenses	Program Revenues			Net <Expenses> Revenues
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
<b>Governmental Activities:</b>					
Administration	\$ 52,533,318	\$ -	\$ -	\$ -	\$ <52,533,318>
Aeronautics	3,848,091	717,168	-	241,996	<2,888,927>
Highway	45,643,844	-	8,721,239	453,515,525	416,592,920
Highway Maintenance	96,352,820	-	-	-	<96,352,820>
Motor Vehicle	83,090,207	107,395,461	-	-	24,305,254
Other	8,460,021	4,219,205	-	-	<4,240,816>
Highway Maintenance - asset preservation	268,383,806	-	-	-	<268,383,806>
Transportation - not appropriated by State legislature	9,590,932	-	-	-	<9,590,932>
Distributions to Arizona counties and cities	957,056,532	-	-	-	<957,056,532>
Distributions to other state agencies	192,536,424	-	-	-	<192,536,424>
Intergovernmental	30,235,385	5,080,264	25,439,086	-	283,965
Interest on long-term debt	84,083,940	-	-	-	<84,083,940>
Total governmental activities	<u>1,831,815,320</u>	<u>117,412,098</u>	<u>34,160,325</u>	<u>453,757,521</u>	<u>&lt;1,226,485,376&gt;</u>
<b>Business-type Activities:</b>					
Arizona Highways Magazine	11,118,003	9,596,162	-	-	<1,521,841>
Highway Expansion and Extension Loan Program	<u>26,348,539</u>	<u>3,881,239</u>	-	-	<u>&lt;22,467,300&gt;</u>
Total business-type activities	<u>37,466,542</u>	<u>13,477,401</u>	-	-	<u>&lt;23,989,141&gt;</u>
Total	<u>\$ 1,869,281,862</u>	<u>\$ 130,889,499</u>	<u>\$ 34,160,325</u>	<u>\$ 453,757,521</u>	<u>\$ &lt;1,250,474,517&gt;</u>
			Governmental Activities	Business-type Activities	Total
Net <expenses>			\$ <1,226,485,376>	\$ <23,989,141>	\$ <1,250,474,517>
General revenues:					
Transportation excise taxes			268,720,901	-	268,720,901
Vehicle, registration, title, license and related taxes			832,492,117	-	832,492,117
Fuel and motor carrier taxes and fees			691,003,491	-	691,003,491
Flight property taxes			6,026,213	-	6,026,213
Interest on investments			19,802,902	2,440,375	22,243,277
Other			21,303,653	425,219	21,728,872
Total general revenues			<u>1,839,349,277</u>	<u>2,865,594</u>	<u>1,842,214,871</u>
Change in net assets before accounting change			612,863,901	<21,123,547>	591,740,354
Cumulative effect of accounting change (Note 4B)			40,398,858	-	40,398,858
Change in net assets			653,262,759	<21,123,547>	632,139,212
Net assets - July 1			9,618,782,812	86,253,880	9,705,036,692
Net assets - June 30			<u>\$ 10,272,045,571</u>	<u>\$ 65,130,333</u>	<u>\$ 10,337,175,904</u>

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

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Arizona Department of Transportation  
Balance Sheet  
Governmental Funds  
June 30, 2003

	Special Revenue Funds			
	General Fund (State Highway Fund)	Maricopa Regional Area Road Construction Fund	Motor Vehicle Division Clearing Fund	Highway User Revenue Fund
<b>ASSETS</b>				
Unrestricted cash on deposit with the State Treasurer	\$ 135,587,075	\$ -	\$ -	\$ -
Receivables:				
Accrued interest	519,719	70,867	-	140,336
Interfund	103,504,830	-	-	19,855,426
Taxes and fees	-	-	9,898,405	58,784,306
Notes and loans	1,872,566	2,988,149	-	-
Other	4,376,755	584,969	-	-
Amounts due from:				
U.S. Government	67,767,176	26,867	-	-
Other state agencies	250,696	-	-	-
Inventories	4,692,945	-	-	-
Restricted cash on deposit with the State Treasurer	110,244,788	81,824,091	25,833,363	86,341,112
Total assets	<u>\$ 428,816,550</u>	<u>\$ 85,494,943</u>	<u>\$ 35,731,768</u>	<u>\$ 165,121,180</u>
<b>LIABILITIES AND FUND BALANCES</b>				
Liabilities:				
Accounts payable	\$ 1,700,008	\$ 2,244	\$ 1,877,823	\$ -
Accrued payroll and other accrued expenditures	6,926,653	-	-	-
Contracts and retainage payable	62,204,676	7,704,197	-	-
Interfund payables	1,401,209	-	19,936,487	83,386,196
Amounts due to:				
Arizona counties and cities	-	-	11,925,878	81,734,984
Other state agencies	331,374	-	920,880	-
Surety and rental deposits	608,440	-	1,070,700	-
Deferred revenue	1,872,566	2,988,149	-	-
Notes payable	170,137,461	8,031,334	-	-
Total liabilities	<u>245,182,387</u>	<u>18,725,924</u>	<u>35,731,768</u>	<u>165,121,180</u>
Fund balances:				
Reserved for:				
Inventories	4,692,945	-	-	-
Interfund receivables	20,000,000	-	-	-
Debt service	-	-	-	-
Capital projects	110,244,788	66,769,019	-	-
Unreserved reported in:				
General fund	48,696,430	-	-	-
Non-major special revenue funds	-	-	-	-
Total fund balances	<u>183,634,163</u>	<u>66,769,019</u>	<u>-</u>	<u>-</u>
Total liabilities and fund balances	<u>\$ 428,816,550</u>	<u>\$ 85,494,943</u>	<u>\$ 35,731,768</u>	<u>\$ 165,121,180</u>

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

Debt Service Fund	Capital Projects Fund	Other Governmental Funds (See Exhibit 9)	Total Governmental Funds
\$ -	\$ -	\$ 15,838,121	\$ 151,425,196
951,906	470,103	130,358	2,283,289
-	-	93,720	123,453,976
-	-	-	68,682,711
-	-	4,993,698	9,854,413
-	-	3,551,125	8,512,849
-	-	2,134,853	69,928,896
-	-	53,221	303,917
-	-	-	4,692,945
<u>17,593,100</u>	<u>173,152,912</u>	<u>13,890,868</u>	<u>508,880,234</u>
<u>\$ 18,545,006</u>	<u>\$ 173,623,015</u>	<u>\$ 40,685,964</u>	<u>\$ 948,018,426</u>
\$ -	\$ 511,907	\$ 166,347	\$ 4,258,329
-	-	98,648	7,025,301
-	13,424,316	2,774,381	86,107,570
-	-	-	104,723,892
-	-	2,811,859	96,472,721
-	-	5,591,517	6,843,771
-	-	-	1,679,140
-	-	4,993,698	9,854,413
-	-	-	178,168,795
-	<u>13,936,223</u>	<u>16,436,450</u>	<u>495,133,932</u>
-	-	-	4,692,945
-	-	-	20,000,000
8,545,006	-	2,240,673	20,785,679
-	159,686,792	5,623,184	342,323,783
-	-	-	48,696,430
-	-	16,385,657	16,385,657
<u>18,545,006</u>	<u>159,686,792</u>	<u>24,249,514</u>	<u>452,884,494</u>
<u>\$ 18,545,006</u>	<u>\$ 173,623,015</u>	<u>\$ 40,685,964</u>	<u>\$ 948,018,426</u>

Arizona Department of Transportation  
Statement of Revenues, Expenditures, and Changes in Fund Balances  
Governmental Funds  
For the fiscal year ended June 30, 2003

	General Fund (State Highway Fund)	Special Revenue Funds		
		Maricopa Regional Area Road Construction Fund	Motor Vehicle Division Clearing Fund	Highway User Revenue Fund
<b>Revenues:</b>				
Transportation excise taxes	\$ -	\$268,720,901	\$ -	\$ -
Vehicle registration, title, license and related taxes and fees	235,005,553	-	187,081,179	471,691,029
Fuel and motor carrier taxes and fees	306,039,653	-	265,376,535	117,811,745
Reimbursement of construction expenditures - federal aid	380,890,972	31,053,085	-	-
Other federal grants and reimbursements	6,895,652	-	-	-
Reimbursements from Arizona counties and cities	15,943,303	-	-	-
Reimbursements from other state agencies	-	3,794,763	-	-
Distributions from other state agencies	1,284,044	-	-	-
Interest on loans receivable	1,626,928	608,611	-	-
Interest on investments	8,600,892	1,265,657	-	1,101,748
Flight property taxes	-	-	-	-
Grand Canyon National Park Airport	-	-	-	-
Sale of capital assets	1,713,913	5,514,666	-	-
Rental income	1,184,752	447,243	-	-
Insurance recovery	1,081,803	-	-	-
Other	3,237,952	360,869	92,001	2,118,629
<b>Total revenues</b>	<u>963,505,417</u>	<u>311,765,795</u>	<u>452,549,715</u>	<u>592,723,151</u>
<b>Expenditures:</b>				
<b>Current:</b>				
Transportation - appropriated by				
State legislature:				
Administration	51,484,986	-	-	-
Highway	44,008,345	-	-	-
Highway maintenance	94,977,822	-	-	-
Motor Vehicle	77,487,708	-	-	-
Aeronautics	-	-	-	-
Other	1,747,235	431,569	-	-
<b>Total Transportation - appropriated by State legislature</b>	<u>269,706,096</u>	<u>431,569</u>	-	-

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

Debt Service Fund	Capital Projects Fund	Other Governmental Funds (See Exhibit 10)	Total Governmental Funds
\$ -	\$ -	\$ -	\$ 268,720,901
-	-	46,244,728	940,022,489
-	-	1,640,647	690,868,580
-	-	47,514,484	459,458,541
-	-	-	6,895,652
-	-	-	15,943,303
-	-	5,080,264	8,875,027
-	-	-	1,284,044
-	-	250,137	2,485,676
4,753,138	3,486,931	493,168	19,701,534
-	-	6,026,213	6,026,213
-	-	717,168	717,168
-	-	-	7,228,579
-	-	-	1,631,995
-	-	-	1,081,803
-	-	211,096	6,020,547
<u>4,753,138</u>	<u>3,486,931</u>	<u>108,177,905</u>	<u>2,436,962,052</u>
-	-	-	51,484,986
-	-	30,235,385	74,243,730
-	-	-	94,977,822
-	-	4,029,702	81,517,410
-	-	3,579,192	3,579,192
<u>121,748</u>	-	<u>3,283</u>	<u>2,303,835</u>
<u>121,748</u>	-	<u>37,847,562</u>	<u>308,106,975</u>

(continued)

Arizona Department of Transportation  
Statement of Revenues, Expenditures, and Changes in Fund Balances  
Governmental Funds  
For the fiscal year ended June 30, 2003

	General Fund (State Highway Fund)	Special Revenue Funds		
		Maricopa Regional Area Road Construction Fund	Motor Vehicle Division Clearing Fund	Highway User Revenue Fund
Transportation - not appropriated by State legislature	\$ 9,594,090	\$ -	\$ -	\$ -
Distributions to Arizona counties and cities	-	7,502,057	410,049,076	526,536,488
Distributions to other state agencies	40,302,383	-	42,500,639	66,186,663
Interest on notes payable	2,779,516	-	-	-
Debt service:				
Principal	-	-	-	-
Interest	-	-	-	-
Bond issuance costs	-	-	-	-
Highway maintenance - asset preservation	125,327,622	12,445,854	-	-
Capital outlay	<u>507,292,216</u>	<u>93,775,472</u>	-	-
Total expenditures	<u>955,001,923</u>	<u>114,154,952</u>	<u>452,549,715</u>	<u>592,723,151</u>
Excess <deficiency> of revenues over <under> expenditures	8,503,494	197,610,843	-	-
<b>Other financing sources &lt;uses&gt;:</b>				
Interfund transfers in	45,685,409	16,124,075	-	-
Interfund transfers out for debt service	<83,157,218>	<216,335,971>	-	-
Interfund transfers out other	<16,124,075>	<24,089,732>	-	-
Proceeds from sale of bonds	-	-	-	-
Proceeds from sale of refunding bond	-	-	-	-
Premium from sale of bonds	-	-	-	-
Payment to refunded bond escrow agent	-	-	-	-
Total other financing sources <uses>	<u>&lt;53,595,884&gt;</u>	<u>&lt;224,301,628&gt;</u>	-	-
Net change in fund balances before accounting change	<45,092,390>	<26,690,785>	-	-
Cumulative effect of accounting change (Note 4B)	40,398,858	-	-	-
Net change in fund balances	<4,693,532>	<26,690,785>	-	-
Fund balances - July 1	<u>188,327,695</u>	<u>93,459,804</u>	-	-
<b>Fund balances - June 30</b>	<u>\$ 183,634,163</u>	<u>\$ 66,769,019</u>	<u>\$ -</u>	<u>\$ -</u>

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

Debt Service Fund	Capital Projects Fund	Other Governmental Funds (See Exhibit 10)	Total Governmental Funds
\$ -	\$ -	\$ -	\$ 9,594,090
-	-	12,968,911	957,056,532
-	-	40,794,189	189,783,874
-	-	-	2,779,516
248,055,000	-	-	248,055,000
82,147,870	-	-	82,147,870
13,508	2,410,400	-	2,423,908
-	8,392,477	2,392	146,168,345
-	231,295,985	1,367,724	833,731,397
<u>330,338,126</u>	<u>242,098,862</u>	<u>92,980,778</u>	<u>2,779,847,507</u>
<325,584,988>	<238,611,931>	15,197,127	<342,885,455>
321,326,591	-	-	383,136,075
-	-	<21,833,402>	<321,326,591>
-	<21,501,401>	<94,276>	<61,809,484>
-	331,475,000	-	331,475,000
90,530,000	-	-	90,530,000
17,218,635	10,928,704	-	28,147,339
<107,735,127>	-	-	<107,735,127>
<u>321,340,099</u>	<u>320,902,303</u>	<u>&lt;21,927,678&gt;</u>	<u>342,417,212</u>
<4,244,889>	82,290,372	<6,730,551>	<468,243>
-	-	-	40,398,858
<4,244,889>	82,290,372	<6,730,551>	39,930,615
22,789,895	77,396,420	30,980,065	412,953,879
<u>\$ 18,545,006</u>	<u>\$ 159,686,792</u>	<u>\$ 24,249,514</u>	<u>\$ 452,884,494</u>

## 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 Administrative 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 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: 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services or privileges provided by a given function and 2) grants and contributions that are restricted to meeting the operational or capital

Arizona Department of Transportation  
Notes to the Financial Statements  
June 30, 2003

requirements of a particular function. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

### **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 proprietary funds follow GASB pronouncements and those Financial Accounting Standard Board Statements (FASB) 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 proprietary 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 judgements, 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 Maricopa County transportation excise tax monies collected by the Department of Revenue. These monies are used for the construction of certain state highways within Maricopa County.

The *Motor Vehicle Division Clearing Fund* is a special revenue fund which accounts for the collection and disbursement of certain Motor Vehicle Division revenues.

Arizona Department of Transportation  
Notes to the Financial Statements  
June 30, 2003

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 State Highway Fund, the Department of Public Safety, the Arizona State Parks, the Economic Strength Project Fund, and incorporated cities and counties.

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 of the governmental funds.

The Department reports the following major proprietary funds:

The *Highway Expansion and Extension Loan Program Fund* (HELP) 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 fund types:

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 Fund is the Department's only internal service fund.

The *Agency Funds* are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. The Department has two agency funds, the Highway Properties – Privilege Tax and the Highway Properties – 24% Lieu Tax (not included in the government-wide statements).

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 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: 1) charges for services, 2) operating grants and contributions, and 3) 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, then unrestricted resources as they are needed to maintain appropriate cash balances and finance the construction program.

Arizona Department of Transportation  
Notes to the Financial Statements  
June 30, 2003

**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 or obligations of the U.S. Government. 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*, classification because they are included in the state's investment pool.

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. 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*.

***Receivables and Payables***

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 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".

The other receivables and subscriptions receivables are shown net of allowance for doubtful accounts. Other receivables in excess of 180 days comprise the insurance claims net of allowance for doubtful accounts. The subscriptions receivable allowance for doubtful accounts is equal to two (2) percent of outstanding subscriptions at June 30, 2003.

Notes receivable represents real estate mortgage loans made to individuals purchasing homes previously owned by the Department for highway construction purposes. The loans were made at a fixed rate and mature ten years from the date of origination.

***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 shows a reservation for inventory 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 proprietary 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.

Arizona Department of Transportation  
Notes to the Financial Statements  
June 30, 2003

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 and the Highway Extension and Expansion Loan Program Fund (enterprise fund) are classified as restricted assets on the balance sheet because they are maintained in separate bank accounts and their use is limited by applicable bond covenants or state statutes. Effective July 1, 1981, state law required accumulation of at least 15 percent, which in fiscal year 1996 was modified to 12.6 percent, of the revenues allocated each year to the General Fund from the Highway User Revenue Fund for the design, purchase of right-of-way or construction of controlled-access highways which 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 assets' lives 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.

The Department depreciates non-infrastructure capital assets on a straight-line basis using the following estimated useful lives. Modular buildings are included on the Statement of Net Assets under the machinery and equipment category, however, modular buildings have an estimated useful life of fifteen (15) years.

Assets	Years
Buildings and improvements	40
Improvements other than building	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-type 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.

***Deferred Revenues***

In the government-wide statements and proprietary fund financial statements, deferred revenues are recognized when cash, receivables, or other assets are received prior to being recognized. In the governmental funds, amounts are reported as deferred revenues until they are available to liquidate liabilities of the current period. Deferred 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 deferred revenues relate to unearned

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subscriptions' income for the *Arizona Highways Magazine*. Unearned subscription income is recorded when subscription orders are received and is amortized as income over the terms of the related subscriptions. Costs associated with the selling of subscriptions are expensed in the year incurred. In the fund statements, the deferred revenues represent the amount for the notes receivable for real estate mortgage loans made to individuals who purchased homes previously owned by the Department for highway construction purposes. The loans were made at a fixed rate and mature ten years from the date of origination.

***Compensated Absences***

It is the Department's policy to permit employees to accumulate earned but unused sick leave and vacation benefits. There is no liability for unpaid accumulated sick leave for the Department. All vacation pay 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 state 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.

Employees are allowed to accumulate up to 240 hours of vacation leave (320 hours for exempt employees) which is paid when vacation is taken or upon termination of employment at the individual's then current rate of pay. The liabilities for vacation 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, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

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.

***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.

***Reservations***

Fund balances for governmental funds are classified as either reserved or unreserved in the fund financial statements. Reserved fund balances reflect either: 1) funds legally segregated for a specific purpose, or 2) assets, which by their nature, are not available for expenditure. Unreserved fund balances reflect the balances available for appropriation for the general purposes of the fund. Note 5I provides a disaggregation of reserved fund balances.

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**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, Aeronautics, Highway, etc). Additionally, revenues are classified between program and general revenues. Program revenues include: 1) charges for services, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenue rather than as program revenue. General revenues include all taxes and interest 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, and Distributions to other state agencies, Debt service, Capital outlay, etc.).

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 bonds. Capital outlay includes expenditures for real property or infrastructure (e.g. bridges and roads).

Revenues and expenses of proprietary funds are classified as operating and non-operating and as sub-classified by object (e.g., salaries, equipment rental, depreciation, etc). 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 proceeds 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 loss from the Equipment 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.

<b>MAJOR FUNDS</b>	<b>NON-MAJOR FUNDS</b>
Governmental Funds :	Other Governmental Funds:
General Fund (State Highway Fund)	Special Revenue Funds:
	State Aviation Fund
Special Revenue Funds:	Safety Enforcement and Transportation
Maricopa Regional Area Road	Infrastructure Fund
Construction Fund	Motor Vehicle Liability Insurance
Motor Vehicle Division Clearing Fund	Enforcement Fund
Highway User Revenue Fund	Vehicle Inspection and Title
	Enforcement Fund
Debt Service Fund	Motor Carrier Safety Revolving Fund
	Motorcycle Safety Education Fund
Capital Projects Fund	Underground Storage Tank Fund
	Economic Strength Project Fund
Proprietary Funds:	Grant Anticipation Notes Fund
Arizona Highway Magazine Fund	Local Agency Deposits Fund
Highway Expansion and Extension	
Loan Program Fund	
	<b>FIDUCIARY FUNDS</b>
Internal Service Fund	Agency Funds:
	Highway Properties - Privilege Tax Fund
	Highway Properties - 24% Lieu Tax Fund

## 3. BUDGETING, BUDGETARY CONTROL, AND LEGAL COMPLIANCE

Annual budgets for the operating expenditures and capital outlay including land, building and improvements for the General Fund (State Highway Fund) are submitted to the Governor in accordance with state law. The budgets are legally enacted as appropriations after approval by the state legislature and signature by the Governor. The legal level of control for operating expenditures is at the program level and expenditure budgets are appropriated using a lump sum format with special line items. Expenditure details for personal services, employee related expenditures and all other operating expenditures are specifically budgeted within all divisions. In certain divisions, other specific programs are budgeted in addition to these categories. Revenue budgets are developed internally by the Department and are not a 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 program, the allocation of funds between personal services, employee-related expenses, and other operating expenses is an internal decision for the program manager. Accordingly, transfers between line items such as personal services and other operating expenses within a particular program may be made by the program manager. Transfers of funds between programs require the approval of the Director of the Department of Administration. 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 year-end unless exempted by the legislature.

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The capital outlay appropriation includes state highway construction and land, buildings and improvements for the General Fund. A legal limitation is adopted for land, buildings 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. A legal limitation is not adopted for the other special revenue funds, the debt service funds, capital projects funds, proprietary funds and fiduciary funds.

**4. ACCOUNTING CHANGES**

**A. New Accounting Pronouncements**

*Statement No. 40, Deposit and Investment Risk Disclosures – an amendment to GASB Statement No. 3*

In March 2003, GASB adopted Statement No. 40. This Statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this Statement also should be disclosed. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2004. Earlier application is encouraged. The Department has not adopted this statement, but does not believe it will have a material impact.

*Statement No. 41, Budgetary Comparison Schedules – Perspective Differences – an amendment to GASB Statement No 34.*

In May 2003, GASB issued Statement No. 41, an amendment to Statement 34; which clarifies the budgetary presentation requirements for governments with significant budgetary perspective differences that result in their not being able to present budgetary comparison information for their general fund and major special revenue funds. These governments are required to present budgetary comparison schedules as required supplementary information (RSI) based on the fund, organization, or program structure that the government uses for its legally adopted budget.

The provisions of this Statement should be implemented simultaneously with Statement 34. For governments that have implemented Statement 34 prior to the issuance of this Statement, the requirements of this Statement are effective for financial statements for periods beginning after June 15, 2002.

**B. Cumulative Effect of Change in Accounting Policy**

It has been the Department's policy to record state appropriated funds to the State Highway Fund (General Fund) as expenditures in the General Fund. The accumulation of these funds has reduced the cash balance held with the State Treasurer's Office and the General Fund's unrestricted fund balance by \$40,398,858. During 2003 the state determined that it would no longer require the Department to record these appropriations as expenditures. In addition, the state made the decision that the Department would be credited for the previously recorded \$40,398,858. This change in policy has been reflected in the statements as a "Cumulative Effect of Accounting Change".

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

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

- 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	\$ 11,256,482,452
Capital assets subject to depreciation	<u>182,081,509</u>
	11,438,563,961
less Internal Service Fund (Equipment Fund) assets	<u>&lt;38,692,731&gt;</u>
	<u>\$ 11,399,871,230</u>

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

General Fund (State Highway Fund)	\$ 1,872,566
Maricopa Regional Area Road Construction Fund	2,988,149
State Aviation Fund	<u>4,993,698</u>
	<u>\$ 9,854,413</u>

- 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 \$<1,631,297,915> difference are as follows:

Bonds payable	\$ <1,624,667,563>
Deferred charges - issuance costs	3,049,126
Capital leases	<916,184>
Compensated absences	<u>&lt;8,763,194&gt;</u>
	<u>\$ &lt;1,631,297,915&gt;</u>

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

The governmental fund statement of revenues, expenditures, and changes in fund balances includes a reconciliation between net changes 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 explain these differences between the governmental fund statement of revenues, expenditures, and changes in fund balances and the government-wide statement of activities:

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

Capital outlay	\$ 833,731,397
less depreciation expense	<u>&lt;7,395,981&gt;</u>
	<u>\$ 826,335,416</u>

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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 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 \$<93,874,374> difference are as follows:

Debt issued or incurred:

Issuance of Highway Revenue Bonds	\$ <156,475,000>
Issuance of Transportation Excise Tax Revenue Bonds	<80,475,000>
Issuance of Highway Revenue Bonds	<185,055,000>
Premium on bonds	<28,147,339>
	<450,152,339>

Principal repayments:

Highway Revenue Bonds	44,490,000
Transportation Excise Tax Revenue Bonds	190,415,000
Grant Anticipation Notes	13,150,000
Amortization of premium and discount	2,754,057
Bond issuance costs	2,423,908
Payment to refunded bond escrow agent	103,045,000
	356,277,965
	\$ <93,874,374>

3. The Internal Service 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 adjustment for the Internal Service Fund close those funds by charging additional amounts to participating governmental activities to completely cover the Internal Service Fund costs for the year.

Internal Service Fund (Equipment Fund):

Changes in net assets	\$ <1,809,171>
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4. Some expenses reported in the Statement of Activities do not require the use of current financial resources and therefore, are not reported as expenditures in the governmental funds. The details are as follows:

Asset Preservation	\$ <122,215,462>
Disposal of Capital Assets	5,113,035
Capital lease	641,293
Notes & Loans	<1,716,451>
Compensated absences	657,858
	\$ <117,519,727>

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**5. DETAILED NOTES ON ALL FUNDS**

**A. Capital Assets**

Capital asset activity for the year ended June 30, 2003, was as follows:

Governmental Activities	July 1, 2002 Beginning Balance	Increases	Decreases	June 30, 2003 Ending Balance
Capital assets, not being depreciated:				
Land	\$ 1,715,941,418	\$ 127,127,909	\$ <3,896,863>	\$ 1,839,172,464
Infrastructure:	7,444,327,275	120,749,615	<303,912>	7,564,772,978
Construction in progress	<u>1,385,665,135</u>	<u>587,621,490</u>	<u>&lt;120,749,615&gt;</u>	<u>1,852,537,010</u>
Total capital assets, not being depreciated	<u>10,545,933,828</u>	<u>835,499,014</u>	<u>&lt;124,950,390&gt;</u>	<u>11,256,482,452</u>
Capital assets, being depreciated:				
Buildings	142,715,993	2,590,789	<59,117>	145,247,665
Improvements other than buildings	32,948,803	219,780	-	33,168,583
Machinery and equipment	44,812,530	4,489,692	<5,404,626>	42,897,596
Mobile fleet and aircraft	<u>112,290,754</u>	<u>2,578,794</u>	<u>&lt;1,868,462&gt;</u>	<u>113,001,086</u>
Total capital assets, being depreciated	<u>332,768,080</u>	<u>9,879,055</u>	<u>&lt;8,332,205&gt;</u>	<u>334,314,930</u>
Less accumulated depreciation for:				
Buildings	<45,080,927>	<3,221,703>	20,975	<48,281,655>
Improvements other than buildings	<1,245,493>	<304,082>	-	<1,549,575>
Machinery and equipment	<28,531,952>	<3,860,004>	5,251,501	<27,140,455>
Mobile fleet and aircraft	<u>&lt;70,295,736&gt;</u>	<u>&lt;6,462,917&gt;</u>	<u>1,496,917</u>	<u>&lt;75,261,736&gt;</u>
Total accumulated depreciation	<u>&lt;145,154,108&gt;</u>	<u>&lt;13,848,706&gt;</u>	<u>5,769,393</u>	<u>&lt;152,233,421&gt;</u>
Total capital assets, being depreciated, net	<u>187,613,972</u>	<u>&lt;3,969,651&gt;</u>	<u>&lt;1,562,812&gt;</u>	<u>182,081,509</u>
Governmental activities capital assets, net	<u>\$ 10,733,547,800</u>	<u>\$ 831,529,363</u>	<u>\$ &lt;125,513,202&gt;</u>	<u>\$ 11,438,563,961</u>
Business-type Activities	July 1, 2002 Beginning Balance	Increases	Decreases	June 30, 2003 Ending Balance
Capital assets, not being depreciated:				
Land	\$ 7,900	\$ -	\$ -	\$ 7,900
Capital assets, being depreciated:				
Buildings	981,157	-	-	981,157
Machinery and equipment	<u>2,424,705</u>	<u>12,427</u>	<u>&lt;58,305&gt;</u>	<u>2,378,827</u>
Total capital assets, being depreciated	<u>3,405,862</u>	<u>12,427</u>	<u>&lt;58,305&gt;</u>	<u>3,359,984</u>
Less accumulated depreciation for:				
Buildings	<635,557>	<33,816>	-	<669,373>
Machinery and equipment	<1,339,148>	<286,085>	52,476	<1,572,757>
Total accumulated depreciation	<u>&lt;1,974,705&gt;</u>	<u>&lt;319,901&gt;</u>	<u>52,476</u>	<u>&lt;2,242,130&gt;</u>
Total capital assets, being depreciated, net	<u>1,431,157</u>	<u>&lt;307,474&gt;</u>	<u>&lt;5,829&gt;</u>	<u>1,117,854</u>
Business-type activities capital assets, net	<u>\$ 1,439,057</u>	<u>\$ &lt;307,474&gt;</u>	<u>\$ &lt;5,829&gt;</u>	<u>\$ 1,125,754</u>

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Depreciation expense was charged to functions/programs as follows:

Governmental Activities:	
Administration	\$ 1,127,674
Aeronautics	268,300
Highway	2,527,077
Highway Maintenance	1,462,070
Motor Vehicle	1,810,860
Capital assets held by the Department's internal service fund are charged to the various functions based on their usage of the assets	<u>6,652,725</u>
Total depreciation expense - governmental activities	<u>\$ 13,848,706</u>
Business-type Activities	
Arizona Highways Magazine Fund	<u>\$ 319,901</u>

**B. Construction Commitments**

The Department's outstanding commitments for contracts at June 30, 2003, was \$650,737,726.

	Spent-to-Date	Remaining Commitment
Construction Contracts:		
Rural Roadways	\$ 279,036,945	\$128,967,342
Small Urban Roadways	113,632,415	42,351,345
Urban Roadways	40,089,268	30,001,730
Large Urban Roadways	400,803,319	245,064,386
Sub-total	833,561,947	446,384,803
Design Contracts	722,092,515	117,999,340
Other Commitments	110,804,363	86,353,583
Total	\$1,666,458,825	\$650,737,726

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**C. Deferred Revenues**

In the fund financial statements, the deferred revenues represent the amount for notes receivable for real estate mortgage loans made to individuals who purchased homes previously owned by the Fund for highway construction purposes. The loans were made at a fixed rate and mature ten years from the date of origination. The State Aviation Fund amount represents loans to various local governments for construction of hangars, taxiways extension, runways, etc. These loans were made at a fixed rate and with various maturities. The proprietary fund includes the amount for unearned subscriptions. The following schedule is a summary of the amounts outstanding as of June 30, 2003:

Governmental Funds:	
General Fund (State Highway Fund)	\$ 1,872,566
Maricopa Regional Area Road Construction Fund	2,988,149
State Aviation Fund	<u>4,993,698</u>
	<u>\$ 9,854,413</u>
Proprietary Fund:	
Arizona Highways Magazine Fund	<u>\$ 4,243,131</u>

**D. Securities Held in Lieu of Retention**

In accordance with Arizona law, a contractor may assign to the Department securities in lieu of retention and will deposit with the bank, cash, time certificates of deposit in federally insured banks licensed by the State of Arizona (Certificates of Deposit), securities of or guaranteed by the United States of America (Treasury Bills), or other eligible securities as defined in the Arizona Revised Statutes, Title 35, Chapter 2, Article 2, Section 35-313 (Eligible Investments). At June 30, 2003, the bank held assignment on securities aggregating approximately \$23 million in lieu of contractor retentions for construction. These additional securities are not reflected in the accompanying financial statements.

**E. Interfund Receivables, Payables, and Transfers**

The balances of current interfund receivables and payables as of June 30, 2003, were:

Receivables	Payables	Amount
General Fund (State Highway Fund)	Highway User Revenue Fund	\$ 83,386,196
	Motor Vehicle Division Clearing Fund	118,634
	Highway Expansion and Extension Loan Program Fund	20,000,000
Highway Expansion and Extension Loan Program Fund	General Fund	1,269,916
Highway User Revenue Fund	Motor Vehicle Division Clearing Fund	19,724,133
	General Fund	131,293
Non-major governmental funds	Motor Vehicle Division Clearing Fund	93,720
		<u>\$124,723,892</u>

The General Fund receivable of \$83,386,196 is an accrual for fuel tax revenues imposed in fiscal year 2003 from the Highway User Revenue Fund that were collected in fiscal year 2004.

The Highway User Revenue Fund receivable of \$19,724,133 is an accrual for vehicle license taxes due in fiscal year 2003 from the Motor Vehicle Division Clearing Fund that were collected in fiscal year 2004.

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In a prior fiscal year, the General Fund loaned \$20 million to the Highway Expansion and Extension Loan Program Fund to increase its loan capacity. The loan is due no later than December 31, 2008.

Interfund transfers for the year ended June 30, 2003, consisted of the following:

	Interfund Transfer In:			Total
	General Fund	Maricopa Regional Area Road Construction Fund	Debt Service Fund	
Interfund Transfer Out:				
General Fund	\$ -	\$ 16,124,075	\$ 83,157,218	\$ 99,281,293
Capital Projects Fund	21,501,401	-	-	21,501,401
Maricopa Regional Area Road Construction Fund	24,089,732	-	216,335,971	240,425,703
Other Governmental Funds	94,276	-	21,833,402	21,927,678
Total	<u>\$45,685,409</u>	<u>\$ 16,124,075</u>	<u>\$321,326,591</u>	<u>\$ 383,136,075</u>

The General Fund (\$83,157,218), the Maricopa Regional Area Road Construction Fund (\$216,335,971) and Other Governmental Funds - Grant Anticipation Notes Fund (\$21,833,402) made transfers to the Debt Service Fund to pay bond debt service.

**F. 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, 2003, approximated \$4,157,000.

In fiscal year 2002, the Department renegotiated its long-term lease with the City of Phoenix for a facility located on Washington Street in Phoenix. The future operating lease commitments are as follows:

<u>Year Ending June 30</u>	<u>Amount</u>
2004	\$ 695,427
2005	736,335
2006	777,243
2007	818,150
Future operating lease commitments	<u>\$ 3,027,155</u>

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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:

<u>Year Ending June 30</u>	<u>Amount</u>
2004	\$ 101,820
2005	101,820
2006	101,820
2007	101,820
2008	101,820
Thereafter	<u>587,472</u>
Future operating lease commitments	<u>\$ 1,096,572</u>

Capital Leases

The Department has entered into lease agreements as lessee for financing the acquisition of modular 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:

	<u>Governmental Activities:</u>
Assets:	
Machinery and equipment	\$ 1,838,444
Less accumulated depreciation	<u>&lt;228,964&gt;</u>
Total	<u>\$ 1,609,480</u>

The future minimum lease obligations and the net present value of these minimums lease payments as of June 30, 2003, were as follows:

<u>Year Ending June 30</u>	<u>Governmental Activities</u>
2004	\$ 405,025
2005	307,506
2006	186,142
2007	<u>86,672</u>
Total minimum lease payments	985,345
Less amount representing interest	<u>&lt;69,161&gt;</u>
Present value of minimum lease payments	<u>\$ 916,184</u>

**G. Non-Current Liabilities**

Arizona Transportation Board Highway Revenue Bonds

The Transportation Board issued Senior and Subordinated Highway Revenue Bonds to provide funds for acquisition of right-of-way and construction of federal, state and local highways. The original amount of Highway Revenue Bonds issued in prior years and outstanding at the start of the fiscal year was \$734,155,000. During the year, Highway Revenue Bonds totaling \$341,530,000 were issued to (i) finance portions of the Transportation Board's Five-Year

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Transportation Facilities Construction Program, (ii) pay costs of issuing the Bonds, and (iii) refund portions of the Board's outstanding Senior 1993 Refunding Bonds in the aggregate principal amount of \$98,495,000.

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. Arizona Revised Statutes prohibit the total principal amount of Arizona Highway Revenue Bonds, excluding refunded bonds, from exceeding \$1.3 billion. Highway Revenue Bonds currently outstanding are as follows:

Purpose	Interest Rates	Amount
Governmental activities	2.0% - 8.8%	\$ 571,320,000
Governmental activities - refunding	2.3% - 6.0%	<u>361,380,000</u>
		<u>\$ 932,700,000</u>

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

Fiscal year ending June 30	Highway Revenue Bonds	
	Principal	Interest
	2004	\$ 49,665,000
2005	51,645,000	45,865,500
2006	54,985,000	43,076,792
2007	57,955,000	40,161,540
2008	60,645,000	37,424,558
2009-2013	284,715,000	137,273,648
2014-2018	221,480,000	74,326,434
2019-2022	<u>151,610,000</u>	<u>17,595,052</u>
	<u>\$ 932,700,000</u>	<u>\$ 445,981,523</u>

Arizona Transportation Board Transportation Excise Tax Revenue Bonds

The Maricopa County Regional Area Road Bond 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 transportation excise taxes collected by the Arizona Department of Revenue on behalf of Maricopa County. The outstanding amount of Transportation Excise Tax Revenue Bonds issued in prior years was \$407,925,000. During the year, Transportation Excise Tax Revenue Bonds totaling \$80,475,000 were issued to (i) finance the acquisition of land and the design and construction of certain controlled access highways within Maricopa County, Arizona, (ii) pay costs of issuing the Bonds and (iii) refund in advance of maturity portions of the Board's outstanding Senior 1998 Series A Revenue Bonds in the aggregate principal amount of \$4,550,000.

The Bond Resolution adopted by the Transportation Board on July 25, 1986, established a debt service reserve requirement equal to the maximum annual interest due in the current year or future years on any series of outstanding Transportation Excise Tax Revenue Bonds. The Second Supplemental Transportation Excise Tax Revenue Bond Resolution adopted by the Transportation Board on September 22, 1988, gives the Transportation Board the option, which it has elected, of acquiring debt service reserve insurance policies in lieu of the debt service reserve requirement. Accordingly, no debt service reserve is reflected in the accompanying financial statements. The policies (aggregating \$70,063,698 at June 30, 2003) were issued by Financial Guaranty Insurance Company, except for the 1993 Series Subordinated Bonds policies, which were issued by MBIA Insurance Corporation, and the 1995 Series A and Series B Subordinated Bonds policies which were issued by AMBAC Assurance Corporation. These policies are noncancelable

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and insure payment, up to the policy amount, of the bond interest on their respective payment dates. The policies shall terminate on the earlier of July 1, 2005, or the date when no respective bonds are outstanding under the bond resolution. The premiums on these insurance policies are recorded as expenditures in the year of payment.

The carrying basis of the 1988 Series A Capital Appreciation Bonds increases as a result of accretion of the original issuance discount. At June 30, 2003, the carrying basis was \$27,329,152. At June 30, 2003, the outstanding balance was \$30,000,000.

All Transportation Excise Tax Revenue Bonds mature no later than December 15, 2005. Transportation Excise Tax Revenue Bonds currently outstanding are as follows:

Purpose	Interest Rates	Amount
Governmental activities	3.0% - 6.5%	\$301,200,000
Governmental activities - capital appreciation	7.3% - 7.5%	30,000,000
Governmental activities - refunding	4.5% - 6.5%	157,200,000
		<u>\$488,400,000</u>

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
2004	\$ 199,400,000	\$23,553,235
2005	208,625,000	14,318,152
2006	<u>80,375,000</u>	<u>1,566,542</u>
	<u>\$ 488,400,000</u>	<u>\$39,437,929</u>

Arizona Transportation Board Grant Anticipation Notes

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 issued was \$132,295,000.

Grant Anticipation Notes currently outstanding are as follows:

Purpose	Interest Rates	Amount
Governmental activities	4.0% - 5.3%	\$ 169,145,000

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

Fiscal year ending June 30	Grant Anticipation Notes	
	Principal	Interest
2004	\$ 36,755,000	\$ 7,488,470
2005	49,000,000	5,400,850
2006	38,540,000	3,209,175
2007	37,000,000	1,307,500
2008	7,850,000	196,250
	<u>\$ 169,145,000</u>	<u>\$ 17,602,245</u>

Notes Payable

The Department's outstanding notes payable as of June 30, 2003, was \$331,983,542. The governmental activities notes payable was \$180,438,476 and business-type activities was \$151,545,066. The notes payable represent the General Fund loan payable to HELP for \$108,270,285, the Maricopa Regional Area Road Construction Fund loan payable to the City of Mesa for \$8,031,335, the Equipment Fund loan payable to creditors for \$2,269,680 and the Board Funding Obligations for loans from the State Treasurer for \$213,412,241. The total outstanding for Board Funding Obligations are as follows:

1. Laws 1999, Chapter 189 (SB 1201) authorized a Board Funding Obligation (BFO) of \$100,000,000 to HELP in fiscal year 2000. Both the principal and interest of the BFO are due on March 14, 2004 (\$55,524,200) and June 27, 2004 (\$54,616,614) respectively.
2. Laws 2001, Chapter 238 (HB 2636) authorized a Board Funding Obligation (BFO) of \$40,000,000 to HELP in fiscal year 2002. Interest accrued to date is \$1,404,252. Both the principal and interest of the BFO are due no later than May 30, 2004.
3. Laws 2001, Chapter 238 (HB 2636) authorized a Board Funding Obligation (BFO) of \$60,000,000 to the State Highway Fund in fiscal year 2002. Interest accrued to date is \$1,867,175. Both the principal and interest of the BFO are due no later than June 27, 2004.

Refunded Bonds Deposited with Escrow Agents

In prior years (\$132,346,156) and fiscal year 2003 (\$103,045,000), the Transportation Board 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.

The Department refunded the Highway Refunding Senior Series 1993 Bonds (\$98,495,000) and the Transportation Excise Tax Senior 1998 Series A Revenue Bonds (\$4,550,000) to reduce its total debt service payments by \$7,455,370 and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$6,269,294.

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Refunded bonds of the Department deposited with escrow agents at June 30, 2003, are as follows:

Original Issue	Type	Escrow Maturity Date	Balance
1993 Senior	Highway Refunding Bonds	July 1, 2003	\$ 98,495,000
1999 Senior	Highway Refunding Bonds	July 1, 2009	64,130,000
1998 Series A Senior	Transportation Excise Tax Revenue Bonds	July 1, 2005	4,550,000
1988 Series A	Transportation Excise Tax Revenue Bonds Capital Appreciation Bonds	July 1, 2005	<u>8,996,156</u>
Total refunded bonds deposited with escrow agents			<u>\$ 176,171,156</u>

Changes in non-current liabilities

The activity for the year ended June 30, 2003, was as follows:

	Beginning Balance July 1, 2002	Additions	Reductions	Ending Balance June 30, 2003	Due Within One Year
<b>Governmental Activities:</b>					
Bonds and Notes:					
Highway Revenue Bonds	\$ 734,155,000	\$341,530,000	\$ <142,985,000>	\$ 932,700,000	\$ 49,665,000
Transportation Excise Tax Tax Revenue Bonds	602,890,000	80,475,000	<194,965,000>	438,400,000	199,400,000
Grant Anticipation Notes	182,295,000	-	<13,150,000>	169,145,000	36,755,000
Premium on Bonds	<u>9,357,653</u>	<u>28,147,339</u>	<u>&lt;3,082,329&gt;</u>	<u>34,422,663</u>	<u>3,860,449</u>
Total bonds and notes	1,528,697,653	450,152,339	<354,182,329>	1,624,667,663	289,680,449
Capital leases	1,557,477	468,838	<1,110,131>	916,184	367,436
Compensated absences	11,701,814	10,328,278	<10,692,838>	11,337,254	9,195,933
Notes payable	<u>192,849,289</u>	<u>73,197,680</u>	<u>&lt;85,608,493&gt;</u>	<u>180,438,476</u>	<u>118,445,486</u>
Total governmental activities	<u>1,734,806,233</u>	<u>534,147,135</u>	<u>&lt;451,593,791&gt;</u>	<u>1,817,359,577</u>	<u>417,689,304</u>
<b>Business-type Activities:</b>					
Compensated absences	134,092	173,438	<156,150>	151,380	151,380
Notes payable	<u>145,536,466</u>	<u>6,008,600</u>	<u>-</u>	<u>151,545,066</u>	<u>151,545,066</u>
Total business-type activities	<u>145,670,558</u>	<u>6,182,038</u>	<u>&lt;156,150&gt;</u>	<u>151,696,446</u>	<u>151,696,446</u>
Total non-current liabilities	<u>\$ 1,880,476,791</u>	<u>\$540,329,173</u>	<u>\$ &lt;451,749,941&gt;</u>	<u>\$ 1,969,056,023</u>	<u>\$ 569,385,750</u>

Internal service funds predominantly serve the governmental funds. Accordingly, long-term liabilities for them are included as part of the above totals for governmental activities. At year-end, \$577,612 of internal service funds compensated absences and \$2,269,680 of notes payable are included in the above amounts.

**H. Short-term Debt**

The Department had no short-term debt activity for the fiscal year ended June 30, 2003.

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**I. Fund Balances**

**Reservations**

The line entitled "Reserved Fund Balances" on the Governmental Funds Balance Sheet at June 30, 2003, consisted of the following:

	General Fund	Maricopa Regional Area Road Construction Fund	Debt Service Fund	Capital Projects Fund	Other Governmental Funds	Total
Reserved Fund Balances:						
Inventories	\$ 4,692,945	\$ -	\$ -	\$ -	\$ -	\$ 4,692,945
Interfund receivables	20,000,000	-	-	-	-	20,000,000
Debt Service	-	-	18,545,006	-	2,240,673	20,785,679
Capital Projects Fund	<u>110,244,788</u>	<u>66,769,019</u>	-	<u>159,686,792</u>	<u>5,623,184</u>	<u>342,323,783</u>
Total Reserved Fund Balances	<u>\$ 134,937,733</u>	<u>\$ 66,769,019</u>	<u>\$ 18,545,006</u>	<u>\$ 159,686,792</u>	<u>\$ 7,863,857</u>	<u>\$ 387,802,407</u>

Effective July 1, 1981, State law required accumulation of at least 15 percent, which in fiscal year 1996 was modified to 12.6 percent, of the revenues allocated each year to the General Fund from the Highway User Revenue Fund for the design, purchase of right-of-way or construction of controlled-access highways which are included in the regional transportation plan of counties with populations in excess of 400,000 (Maricopa and Pima counties). At June 30, 2003, approximately \$107.5 million was reserved in the General Fund for this purpose. The remaining \$2.7 million was restricted for highway construction from Federal Highway Fatality monies. The loan to the General Fund for \$20.0 million is reserved for the receivable from the Highway Expansion and Extension Loan Program Fund.

The Maricopa Regional Area Road Construction Fund is reserved for capital projects. Capital Projects Fund is reserved for capital projects based on the debt covenants. The Debt Service Fund reserve is for future debt service payments.

**6. OTHER INFORMATION**

**A. Subsequent Events**

On August 6, 2003, the Transportation Board issued \$148,955,000 in Grant Anticipation Notes, Series 2003A to (i) finance a portion of the costs of various projects on the Maricopa County Regional Freeway System, (ii) refund all the Board's Outstanding Series 2000A Notes and (iii) pay a portion of the costs of issuing the Notes. The Series 2003A Notes are due January 1, 2004, through July 1, 2015. Net proceeds totaled \$134,181,000 (after receipt of \$10,162,013 reoffering premium and payment of \$249,072 in underwriting fees and costs of issuance).

In August 2003, the Department repaid in advance of scheduled maturity \$100,000,000 of the BFOs deposited to the HELP in fiscal year 2000, and \$60,000,000 of the BFOs deposited to the General Fund in fiscal year 2002. With interest, the total amount repaid was \$172,693,633. Concurrent with these repayments, the Department borrowed \$160,000,000 (\$100,000,000 deposited to HELP and \$60,000,000 deposited to the General Fund) under a new series of BFOs that are payable no later than August 2007.

**B. 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-

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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.

**C aims**

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.

**C Retirement Plan**

The Arizona State Retirement System Board administers the Arizona State Retirement Plan (Plan), a cost sharing multi-employer public employee defined benefit plan, for the benefit of Arizona employees and employees of certain other governmental entities. Plan provisions, including death, disability, and retirement benefits, are established by state statute. Substantially all employees of the Department are covered by the Plan.

The Arizona State Retirement System (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 System, 3300 North Central Avenue, P. O. Box 33910, Phoenix, Arizona 85067-3910 or by calling (602) 240-2000 or (800) 621-3778.

Arizona Revised Statutes provide statutory authority for employee and employer contributions. The employee and employer contribution rate for the year ended June 30, 2003, was computed to be 2.49 percent of covered payroll by an actuarial valuation performed at June 30, 2001. Contributions for the years ended June 30, 2001, 2002 and 2003 were \$4,032,399, \$3,959,972 and \$4,093,262, respectively, for both the employees and the Department, which were equal to the required contributions for each year.

The Department's total payroll for fiscal year 2003 was \$165.0 million. The Plan is funded through payroll deductions from employees' gross earnings and amounts contributed by the Department. Retirement benefits are obligations of the Plan and not of the Department. The Arizona Revised Statutes provide statutory authority for employee and employer contributions. The contribution requirement for fiscal year 2003 was \$4.1 million by both the employees and the Department.

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Schedule of Revenues and Expenditures  
Budget and Actual - General Fund (State Highway Fund)  
For the fiscal year ended June 30, 2003

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive <Negative>
	Original	Final		
<b>Revenues:</b>				
Vehicle registration, title, license and related fees	\$232,704,500	\$ 232,704,500	\$ 234,054,397	\$ 1,349,897
Fuel and motor carrier taxes	<u>300,487,300</u>	<u>300,487,300</u>	<u>301,520,791</u>	<u>1,033,491</u>
Total revenues	<u>533,191,800</u>	<u>533,191,800</u>	<u>535,575,188</u>	<u>2,383,388</u>
<b>Expenditures appropriated by state legislature in 2003 budget:</b>				
<b>Administration:</b>				
Personal services	19,154,500	18,071,000	18,075,962	<4,962>
Employee related expenditures	3,845,100	4,394,700	4,395,092	<392>
Other operating expenditures	24,857,700	26,224,400	26,167,571	56,829
Attorney General Legal Service	<u>2,116,000</u>	<u>2,116,000</u>	<u>2,116,000</u>	<u>-</u>
Total Administration	<u>49,973,300</u>	<u>50,806,100</u>	<u>50,754,625</u>	<u>51,475</u>
<b>Highway:</b>				
Personal services	33,176,900	30,954,500	30,954,335	165
Employee related expenditures	7,502,500	7,486,700	7,486,557	143
Other operating expenditures	<u>2,493,900</u>	<u>6,080,000</u>	<u>5,930,035</u>	<u>149,965</u>
Total Highway	<u>43,173,300</u>	<u>44,521,200</u>	<u>44,370,927</u>	<u>150,273</u>
<b>Highway Maintenance:</b>				
Personal services	28,086,900	29,400,000	28,599,295	800,705
Employee related expenditures	7,535,500	10,400,000	10,210,487	189,513
Other operating expenditures	55,692,600	53,353,900	51,761,804	1,592,096
Maintenance carryover	<u>3,521,651</u>	<u>3,521,651</u>	<u>3,520,647</u>	<u>1,004</u>
Total Highway Maintenance	<u>94,836,651</u>	<u>96,675,551</u>	<u>94,092,233</u>	<u>2,583,318</u>
<b>Motor Vehicle:</b>				
Personal services	45,831,200	45,644,000	45,525,147	118,853
Employee related expenditures	12,045,700	14,088,200	14,005,259	82,941
Other operating expenditures	20,136,300	12,870,500	12,556,595	313,905
Fee Accounting and Revenue Management System	398,229	398,229	54,692	343,537
Integrated Inventory System	320,411	320,411	43,514	276,897
Judicial Fee Programming	250,000	250,000	150,000	100,000
Security Enhancement	2,687,700	2,687,700	5,245	2,682,455
Security Enhancement Issue	2,174,462	2,174,462	1,186,773	987,689
License plates and tabs	<u>2,295,300</u>	<u>2,295,300</u>	<u>2,295,299</u>	<u>1</u>

(continued)

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Schedule of Revenues and Expenditures  
Budget and Actual - General Fund (State Highway Fund)  
For the fiscal year ended June 30, 2003

	Budgeted Amounts		Actual Amounts	Variance with Final Budget - Positive <Negative>
	Original	Final		
<b>Motor Vehicle (continued):</b>				
Public Information Service	\$ 150,000	\$ 150,000	\$ 150,000	\$ -
Plate and Fee to Owner	75,071	75,071	74,988	83
MVD One-time Trailer Fees Administration	44,285	44,285	562	43,723
MVD Electronic Certificate of Title System	320,209	320,209	301,772	18,437
MVD Attorney General Legal Services	137,000	137,000	137,000	-
Abandoned Vehicle Administration	501,300	501,300	449,504	51,796
Vehicle Registration Enforcement	48,100	48,100	30,894	17,206
Trailers Permit Registration	72,700	72,700	42,372	30,328
MVD Fuel Dispenser Labels	5,000	5,000	4,997	3
Total Motor Vehicle Division	<u>87,492,967</u>	<u>82,082,467</u>	<u>77,014,613</u>	<u>5,067,854</u>
<b>Air Quality Programs:</b>				
Administration air quality project:				
Personal services	38,600	38,600	38,600	-
Employee related expenditures	12,300	12,300	12,300	-
Other operating expenditures	200	200	200	-
Total Air Quality Programs	<u>51,100</u>	<u>51,100</u>	<u>51,100</u>	<u>-</u>
Capital outlay - land, buildings and improvements	9,666,415	9,666,415	4,167,101	5,499,314
Arizona Department of Public Safety transfers	28,266,600	28,266,600	28,266,600	-
Expenditures appropriated by state legislature by carryover of previous year's unexpended budget	1,840,763	1,840,763	1,693,142	147,621
Total expenditures	<u>315,301,096</u>	<u>313,910,196</u>	<u>300,410,341</u>	<u>13,499,855</u>
Excess of revenues over expenditures	<u>\$217,890,704</u>	<u>\$ 219,281,604</u>	<u>\$ 235,164,847</u>	<u>\$ 15,883,243</u>

*The notes to required supplementary information are an integral part of this statement.*

Notes to Required Supplementary Information – Budgetary Reporting

*Budgets and budgetary accounting*

Annual budgets for the operating expenditures and capital outlay including land, building and improvements for the General Fund (State Highway Fund) are submitted to the Governor in accordance with state law. The budgets are legally enacted as appropriations after approval by the state legislature and signature by the Governor. The legal level of control for operating expenditures is at the program level and expenditure budgets are appropriated using a lump sum format with special line items. Expenditure details for personal services, employee related expenditures and all other operating expenditures are specifically budgeted within all divisions. In certain divisions, other specific programs are budgeted in addition to these categories. Revenue budgets are developed internally by the Department and are not a 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 program, the allocation of funds between personal services, employee-related expenses, and other operating expenses is an internal decision for the program manager. Accordingly, transfers between line items such as personal services and other operating expenses within a particular program may be made by the program manager. Transfers of funds between programs require the approval of the Director of the Department of Administration. 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 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 that is subject to legislative appropriation.

The capital outlay appropriation includes state highway construction and land, buildings and improvements for the General Fund. A legal limitation is adopted for land, buildings 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.

The Department has elected to report the budgetary comparison as required supplementary information (RSI). The Department is required to report as notes to RSI: any budgetary expenditures in excess of appropriations, budgetary basis of accounting used for the adopted budgets and reconciliation between the budgetary basis of accounting and accounting principles generally accepted in the United States (GAAP).

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**Explanation of differences between budgetary inflows and outflows and GAAP revenues and expenditures:**

**Sources/inflows of resources:**

Actual amounts from the Schedule of Revenues and Expenditures - Budget and Actual	\$ 535,575,188
Net (increase) decrease in receivable related to fuel and motor carrier taxes and vehicle registration, title, license, and related fees not recognized as revenue on budgetary basis	5,470,018
Revenues which are on the modified accrual basis and not recognized on budgetary basis:	
Federal aid reimbursements of construction expenditures from the Federal Highway Administration	380,890,972
Federal grants and reimbursements related to elderly and disabled assistance, planning assistance and community assistance from the Federal Transit Administration	6,895,652
State and local reimbursements related to grants from Arizona counties, cities and other state agencies	15,943,303
Distribution from other state agencies	1,284,044
Investment interest and loan interest income from Treasurer and loan agreements	10,227,820
Other income	3,237,952
Sale of capital assets	1,713,913
Rental income	1,184,752
Insurance recovery	<u>1,081,803</u>
Total revenues as reported on the Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds (General Fund - Exhibit 4)	<u>\$ 963,505,417</u>

**Uses/outflows of resources:**

Actual amounts from the Schedule of Revenues and Expenditures - Budget and Actual	\$ 300,410,341
Net increase (decrease) in accounts payable, accrued payroll and other accruals not recognized as expenditures for budgetary basis	1,757,078
Expenditures which are on the modified accrual basis and not recognized on budgetary basis:	
Transportation expenditures from sources not appropriated by state legislature	9,594,090
Capital outlay are outflows of highway construction expenditures from state appropriation and federal aid reimbursements	503,097,493
Highway maintenance - asset preservation	125,327,622
Distributions to other state agencies	12,035,783
Interest expense on loans borrowed from the Highway Expansion and Extension Loan Program	<u>2,779,516</u>
Total revenues as reported on the Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds (General Fund - Exhibit 4)	<u>\$ 955,001,923</u>

**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 approximately 6,801 centerline miles (18,129 travel lane miles) of roads and 4,463 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 State Transportation Board on an annual basis, the Five-Year Transportation Facilities Construction 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 Five-Year Transportation Facilities Construction Program in effect for fiscal year 2003 and beyond was adopted by the Transportation Board on June 25, 2002.

The following information pertains to the condition assessment and maintenance of infrastructure assets.

**Roads**

The mission of the ADOT 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 ADOT PMS both work toward the same basic goal, the efficient, effective management of ADOT 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 travelling public (as documented in 1961 after 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 travelling 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:

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

Information About Infrastructure Assets Reported Using the Modified Approach - continued

The goal of the Arizona Department of Transportation 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 2003, an overall rating of 3.6 was achieved, as shown in the following graph:

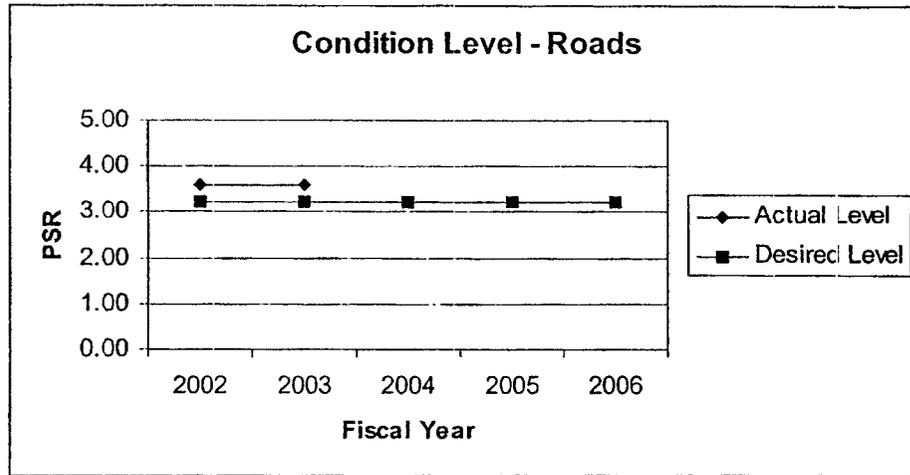


Figure 1

Preservation of the roads is accomplished through programs managed primarily by the ADOT PMS, as well as other units within the Department. The estimated and actual expenditures for fiscal years 2002 and 2003 were as follows:

Fiscal Year	Estimated Expenditures (in millions)	Actual Expenditures (in millions)
2002	\$227.4	\$234.8
2003	\$243.5	\$220.8

**Bridges**

ADOT's bridge assets constitute a significant portion of all infrastructure assets in Arizona. As of June 30, 2003, ADOT owns and maintains 4,463 bridges with an approximate total deck area of 40,841,425 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 superstructure condition, and the substructure condition. The bridge joints condition rating is an Arizona specific rating

Information About Infrastructure Assets Reported Using the Modified Approach - continued

item not included in the FHWA condition rating guidelines, whereas the three other 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, 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 ADOT'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 ADOT to maintain state highway bridges so that the CRI exceeds 92.5%. In fiscal year 2003, the CRI was computed at 93.9%.

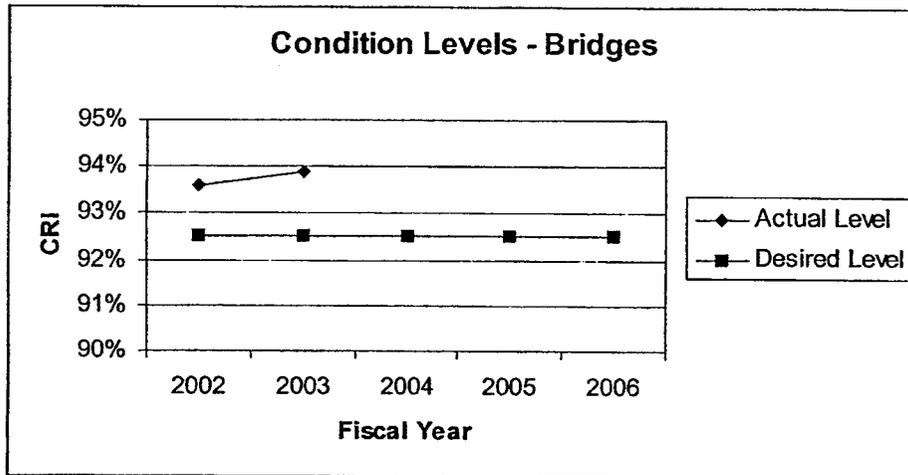


Figure 2

Bridges represent a major public investment and their inspection and maintenance is an essential function of the Department in its mission of products and services for a safe, efficient, and cost effective transportation system. Figure 3 indicates that approximately 65% of the bridges in the state were constructed prior to the 1970s while only 22% have been constructed in the last two decades.

Information About Infrastructure Assets Reported Using the Modified Approach - continued

**Age of ADOT's Bridge Population**

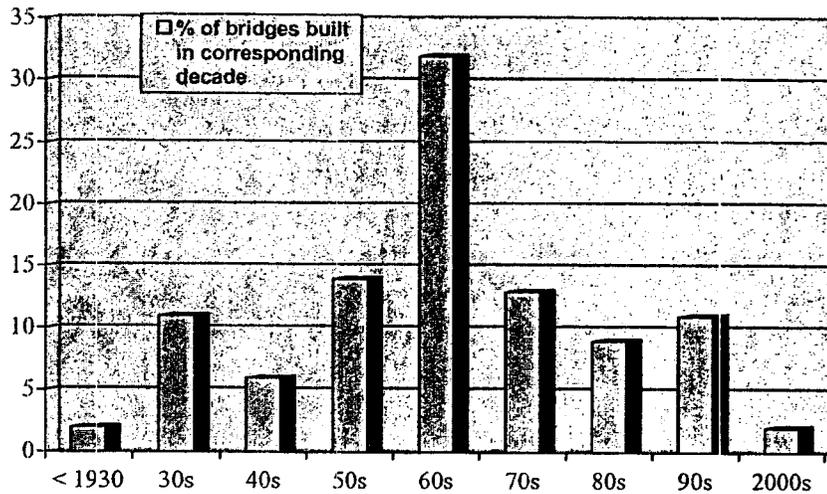


Figure 3

Preservation of the bridges is accomplished through programs managed by the Bridge Group. The estimated and actual expenditures for fiscal years 2002 and 2003 were as follows:

Fiscal Year	Estimated Expenditures (in millions)	Actual Expenditures (in millions)
2002	\$14.4	\$18.2
2003	\$13.6	\$15.8

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## APPENDIX B

### PROPOSED FORM OF BOND COUNSEL OPINION

To: Arizona Transportation Board  
Phoenix, Arizona

We have examined the transcript of proceedings (the "Transcript") relating to the issuance by the Arizona Transportation Board (the "Board") of its \$188,260,000 aggregate principal amount of bonds designated the Arizona Transportation Board, Subordinated Highway Revenue Bonds, Series 2004B (the "Series 2004B Subordinated Bonds"), dated as of August 15, 2004. The Series 2004B Subordinated Bonds are issued under Title 28, Chapter 21, Article 1, Arizona Revised Statutes, as amended (the "Act"), and pursuant to a resolution adopted by the Board on July 16, 2004, which supplemented the Resolution adopted on September 27, 1991, as supplemented to date (collectively, the "Subordinated Bond Resolutions"). The documents in the Transcript include a certified copy of the Subordinated Bond Resolutions. All capitalized terms not defined herein shall have the meanings set forth in the Subordinated Bond Resolutions. We have also examined a conformed copy of a Series 2004B Subordinated Bond of the first maturity.

Based on this examination, we are of the opinion that, under existing law:

1. The Series 2004B Subordinated Bonds and the Subordinated Bond Resolutions are valid, legal, binding and enforceable in accordance with their respective terms, subject to bankruptcy laws and other laws affecting creditors' rights and to the exercise of judicial discretion.
2. The Series 2004B Subordinated Bonds constitute special obligations of the Board, and the principal of and interest (collectively, "debt service") on the Series 2004B Subordinated Bonds, together with debt service on the Outstanding Subordinated Bonds and on any Additional Subordinated Bonds that may subsequently be issued under the Subordinated Bond Resolutions on a parity with the Outstanding Subordinated Bonds and the Series 2004B Subordinated Bonds (collectively, "Subordinated Bonds"), as provided in the Subordinated Bond Resolutions, are payable from and secured solely by the moneys paid into the State Highway Fund that constitute Pledged Revenues (as defined in the Resolutions). The Series 2004B Subordinated Bonds and the payment of debt service thereon are not secured by an obligation or pledge of any moneys raised by taxation other than the Pledged Revenues, and the Series 2004B Subordinated Bonds do not represent or constitute a general obligation or a pledge of the full faith and credit of the Board or the State of Arizona.
3. The Subordinated Bond Resolutions create a valid lien and pledge on the moneys that constitute Pledged Revenues paid into the State Highway Fund for the Subordinated Bonds, which lien and pledge is subject to no prior liens or pledges granted under the Act, except for the prior pledge of the Pledged Revenues made in the Senior Bond Resolution for the payment of principal of, premium, if any, and interest on the Senior Bonds that are currently outstanding and may be subsequently issued by the Board.
4. The interest on the Series 2004B Subordinated Bonds 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 alternative minimum tax imposed on individuals and corporations. The interest on the Series 2004B Subordinated Bonds is exempt from Arizona state income tax. We express no opinion as to any other tax consequences regarding the Series 2004B Subordinated Bonds.

Under the Code, portions of the interest earned on the Series 2004B Subordinated Bonds by certain corporations may be subject to a corporate alternative minimum tax, and interest on the Series 2004B Subordinated Bonds may be subject to a branch profits tax imposed on certain foreign corporations doing business in the United States and to a tax imposed on excess net passive income of certain S corporations.

In giving the foregoing opinions, we have assumed and relied upon continuing compliance with the Board's covenants and the accuracy, which we have not independently verified, of the representations and certifications of the Board contained in the Transcript. The accuracy of those representations and certifications, and the continuing compliance by the Board with those covenants, may be necessary for the interest on the Series 2004B Subordinated Bonds to be and to remain excluded from gross income for federal income tax purposes and for certain of the other tax effects stated above. Failure to comply with certain of those covenants subsequent to issuance of the Series 2004B Subordinated Bonds could cause interest thereon to be included in gross income for federal income tax purposes retroactively to the date of issuance of the Series 2004B Subordinated Bonds.

Respectfully submitted,

[To be signed "Squire, Sanders & Dempsey L.L.P."]

## APPENDIX C

### FORM OF CONTINUING DISCLOSURE UNDERTAKING

THIS CONTINUING DISCLOSURE UNDERTAKING (“Undertaking”), dated as of August 15, 2004 is executed and delivered by the ARIZONA TRANSPORTATION BOARD (the “Board”) and the ARIZONA 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 \$188,260,000 Subordinated Highway Revenue Bonds, Series 2004B, dated as of August 15, 2004 (the “Bonds”).

The Board and the Department each covenants and agrees as follows:

**Section 1. Purpose of this Undertaking.** This Undertaking is executed and delivered by the Issuer, as of the date set forth above, in accordance with the Rule (defined below) for the benefit of the beneficial owners of the Bonds.

**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 the type of financial information and operating data set forth under the heading “REVENUES AND DEBT SERVICE COVERAGE – Historical Revenues” in the final Official Statement, dated August 18, 2004 for the Bonds.

“*Audited Financial Statements*” means the audited general purpose financial statements of the Department, prepared in conformity with generally accepted accounting principles.

“*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, 2005.

“*Fiscal Year*” means each fiscal year of the Department.

“*MSRB*” means the Municipal Securities Rulemaking Board.

“*NRMSIRs*” means, as of any date, any Nationally Recognized Municipal Securities Information Repository then recognized by the Securities and Exchange Commission for purposes of the Rule. As of the date of this Undertaking, the NRMSIRs are:

Bloomberg Municipal Repository  
100 Business Park Drive  
Skillman, New Jersey 08558  
Phone: (609) 279-3225  
Fax: (609) 279-5962  
e-mail: [munis@Bloomberg.com](mailto:munis@Bloomberg.com)  
[www.bloomberg.com/markets/muni\\_contactinfo.html](http://www.bloomberg.com/markets/muni_contactinfo.html)

FT Interactive Data  
Attn: NRMSIR  
100 William Street  
New York, NY 10038  
Phone: (212) 771-6899  
Fax: (212) 771-7390  
e-mail: [NRMSIR@ftid.com](mailto:NRMSIR@ftid.com)  
[www.interactivedata.com](http://www.interactivedata.com)

Standard & Poor's Securities Evaluations, Inc.  
55 Water Street, 45<sup>th</sup> Floor  
New York, NY 10041  
Phone: (212) 438-4595  
Fax: (212) 438-3975  
e-mail: nrmsir\_repository@sandp.com  
www.jjkenny.com/jjkenny/pser\_descript\_data\_rep.html

DPC Data, Inc.  
One Executive Drive  
Fort Lee, New Jersey 07024  
Phone: (201) 346-0701  
Fax: (201) 947-0107  
e-mail: NRMSIR@dpcdata.com  
www.dpcdata.com

"Rule" means Rule 15c2-12, as adopted by the Securities and Exchange Commission under the Securities and Exchange Act of 1934, as the same may be amended from time to time.

"SID" means any public or private repository designated by the State as the state repository and recognized as such by the Securities and Exchange Commission for purposes of the Rule. As of the date of this Agreement, no SID exists within the State.

"Specified Event" means the occurrence of any of the events with respect to the Bonds set forth in Exhibit I hereto.

"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 Bonds. The Issuer hereby agrees to provide or cause to be provided to each NRMSIR and to any SID:

(a) Annual Information for the preceding Fiscal Year and unaudited financial statements of the Board 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.

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 such entities receive the information on or before the date specified.

Section 4. Notice of Material Specified Events and Failure to Provide Annual Information. The Issuer agrees to provide or cause to be provided, in a timely manner, to each NRMSIR or to the MSRB, and to any SID:

(a) notice of the occurrence of any Specified Event with respect to the Bonds, if that Specified Event is material; and

(b) notice of its failure to provide or cause to be provided the Annual Information on or prior to the applicable Filing Date.

Notwithstanding the foregoing, (i) notice of Specified Events consisting of optional calls or defeasances need not be

given under this subsection any earlier than the notice of the underlying event is given to the registered owners of the affected Bonds pursuant to the terms of the Bonds, and (ii) notice of the occurrence of a mandatory, scheduled redemption, not otherwise contingent upon the occurrence of an event, is not required if the terms of the redemption under which the redemption is to occur are set forth in detail in the Official Statement and the only open issue is which Bonds will be redeemed in the case of a partial redemption (such as mandatory sinking fund redemption).

If the responsible officials of the Issuer become aware of the occurrence of a Specified Event, the Issuer shall diligently proceed to determine whether that Specified Event is material and, if so, the Issuer shall prepare and provide or cause to be provided notice of the occurrence of that material Specified Event in accordance with this Section.

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 material 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 Bonds. Any beneficial owner of a Bond may enforce the Issuer's obligation to provide or cause to be provided a filing that is due to each NRMSIR and any SID in accordance with Section 3 or to each NRMSIR or to the MSRB and any SID in accordance with Section 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 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 Bonds under the Bond Resolution (as defined in the Bonds).

Section 7. Amendments; Waiver. Notwithstanding any other provision of this Undertaking, the Issuer may amend this Undertaking, and any provision of this Undertaking may be waived, if such amendment or waiver is supported by a legal opinion, addressed to the Issuer, of an independent counsel who is expert in federal securities laws selected by the Department, to the effect that such amendment or waiver would not, in and of itself, cause this Undertaking to violate the Rule. The Annual Information prepared immediately following any amendment or waiver shall explain the reason for the amendment or waiver and the impact of the change in the type of information being provided.

Section 8. Termination of Undertaking. This Undertaking shall terminate when (a) the Bonds are no longer outstanding (within the meaning of the Bond Resolution) or (b) the Rule no longer applies to these Bonds.

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 Bonds 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 material 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.

Dated as of: August 15, 2004

ARIZONA TRANSPORTATION BOARD

By \_\_\_\_\_  
Its Chair

ARIZONA DEPARTMENT OF TRANSPORTATION

By \_\_\_\_\_  
Its Director

**EXHIBIT I**  
**SPECIFIED EVENTS**

1. Principal and interest payment delinquencies;
2. Non-payment related defaults;
3. Unscheduled draws on debt service reserves reflecting financial difficulties;
4. Unscheduled draws on credit enhancements reflecting financial difficulties; \*
5. Substitution of credit or liquidity providers, or their failure to perform; \*
6. Adverse tax opinions or events affecting the tax-exempt status of the security;
7. Modifications to rights of security holders;
8. Bond calls;
9. Defeasances;
10. Release, substitution, or sale of property securing repayment of the securities; and
11. Rating changes.

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\* The Board has not obtained or provided, and does not expect to obtain or provide, any credit enhancement or liquidity providers for the Bonds.

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## APPENDIX D

### BOOK-ENTRY-ONLY SYSTEM

**This information concerning DTC and DTC's book-entry system has been obtained from DTC and neither the Board nor the Department takes responsibility for the accuracy thereof. The Owners should confirm this information with DTC or the DTC participants.**

The Depository Trust Company, New York, New York ("DTC"), will act as securities depository for the Series 2004B Subordinated Bonds. The Series 2004B Subordinated Bonds 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 Series 2004B Subordinated Bond will be issued for each maturity of the Series 2004B Subordinated Bonds, totaling in the aggregate the principal amount of the Series 2004B Subordinated Bonds, and will be deposited with DTC.

DTC, the world's largest 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 2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instrument from over 85 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, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. 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"). DTC has Standard & Poor's highest rating: AAA. 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](http://www.dtcc.com).

Purchases of beneficial interests in the Series 2004B Subordinated Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2004B Subordinated Bonds on DTC's records. The ownership interest of each actual purchaser of a beneficial interest in a Series 2004B Subordinated Bond ("Beneficial Owner") is in turn to be recorded on the Direct Participants' and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are 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 beneficial ownership interests in the Series 2004B Subordinated Bonds 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 the Series 2004B Subordinated Bonds, except in the event that use of the book-entry system for the Series 2004B Subordinated Bonds is discontinued.

To facilitate subsequent transfers, all Series 2004B Subordinated Bonds 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 2004B Subordinated Bonds with DTC and their registration in the name of Cede & Co. or such other nominee effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2004B Subordinated Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2004B Subordinated Bonds 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 2004B Subordinated Bonds may wish to take certain steps to augment transmission to them of notices of significant events with respect to the Series 2004B Subordinated Bonds such as redemptions, defaults, and proposed amendments to the Subordinated Bond Resolution. Beneficial Owners of Series 2004B Subordinated Bonds may wish to ascertain that the nominee holding the Series 2004B Subordinated Bonds 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 the notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Series 2004B Subordinated Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in the Series 2004B Subordinated Bonds to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Series 2004B Subordinated Bonds unless authorized by a Direct Participant in accordance with DTC's procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Board 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 2004B Subordinated Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal, redemption premium, if any, and interest payments represented by the Series 2004B Subordinated Bonds 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, redemption premium, if any, and interest 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 shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct Participants and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Series 2004B Subordinated Bonds at any time by giving reasonable notice to the Paying Agent or the Board. Under such circumstances, in the event that a successor securities depository is not obtained, Series 2004B Subordinated Bonds 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 2004B Subordinated Bonds will be printed and delivered to DTC.

THE BOARD AND THE DEPARTMENT WILL HAVE NO RESPONSIBILITY OR OBLIGATION TO DTC, TO DIRECT PARTICIPANTS OR TO INDIRECT PARTICIPANTS 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 2004B SUBORDINATED BONDS UNDER THE SUBORDINATED BOND 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 2004B SUBORDINATED BONDS; (4) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY AMOUNT WITH RESPECT TO THE PRINCIPAL OR REDEMPTION PREMIUM, IF ANY, OR INTEREST DUE WITH RESPECT TO THE SERIES 2004B SUBORDINATED BONDS; (5) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS THE OWNER OF SERIES 2004B SUBORDINATED BONDS; OR (6) ANY OTHER MATTERS.

So long as Cede & Co. is the registered Owner of the Series 2004B Subordinated Bonds, as nominee for ETC, references in this Official Statement to "Owner" or registered owners of the Series 2004B Subordinated Bonds (other than under the caption "TAX MATTERS") shall mean Cede & Co., as aforesaid, and shall not mean the Beneficial Owners of such Series 2004B Subordinated Bonds.

When reference is made in this Official Statement 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

### SUMMARY OF THE SUBORDINATED BOND RESOLUTION

The following is a summary of certain provisions of the Subordinated Bond Resolution. This summary does not purport to be a full statement of the terms of the Subordinated Bond Resolution and, accordingly, is qualified by reference thereto and is subject to the full text thereof, copies of which may be obtained as described under "MISCELLANEOUS" in forepart of this Official Statement. Capitalized terms not defined in this summary or in the Official Statement shall have the respective meanings set forth in the Subordinated Bond Resolution.

#### DEFINITIONS OF TERMS

*"Accreted Value"* shall mean (a) with respect to any Additional Senior Bonds that are Capital Appreciation Bonds, the meaning given to such term in the applicable Senior Bond Resolution, and (b) with respect to any Additional Subordinated Bonds that are Capital Appreciation Bonds, an amount equal to the principal amount of such Capital Appreciation Subordinated Bond (determined on the basis of the initial principal amount per \$5,000 at maturity thereof) plus the amount assuming compounding (as set forth in the applicable Subordinated Bond Resolution) of earnings which would be produced on the investment of such initial amount, beginning on the dated date of such Capital Appreciation Subordinated Bond and ending at the maturity date thereof, at a yield which, if produced until maturity, will produce \$5,000 at maturity. As of any Valuation Date, the Accreted Value of any Capital Appreciation Subordinated Bonds shall mean the amount set forth for such date in the applicable Subordinated Bond Resolution authorizing such Subordinated Bonds and as of any date other than a Valuation Date, the sum of (i) the Accreted Value on the preceding Valuation Date and (ii) the product of (1) a fraction, the numerator of which is the number of days having elapsed from the preceding Valuation Date and the denominator of which is the number of days from such preceding Valuation Date to the next succeeding Valuation Date, and (2) the difference between the Accreted Values for such Valuation Dates.

*"Act"* shall mean Title 28, Chapter 21, Article 1, Arizona Revised Statutes, as amended.

*"Additional Senior Bonds"* shall mean any Senior Bonds or other obligations that may be issued by the Board pursuant to applicable law, in accordance with the Senior Bond Resolution, on a parity (as provided in the Senior Resolution) with the Senior Bonds then Outstanding.

*"Additional Subordinated Bonds"* shall mean any Subordinated Bonds or other obligations that may be issued by the Board pursuant to applicable law, in accordance with the Subordinated Bond Resolution, on a parity (as provided in the Subordinated Bond Resolution) with the Outstanding Series 1992B, 1993A, 1993B, 2003A, 2004A and 2004B Subordinated Bonds and any other Series of Subordinated Bonds then Outstanding.

*"Adjusted Debt Service Requirements"* shall mean, for any period, as of any date of calculation (a) with respect to the Senior Bonds, the aggregate Debt Service Requirements on the Senior Bonds for such period taking into account for any Additional Senior Bonds such adjustments, if any, as may be provided in the Senior Bond Resolution authorizing such Senior Bonds, and (b) with respect to any Subordinated Bonds, the aggregate Debt Service Requirements on Subordinated Bonds during such period, taking into account the following adjustments:

(i) With respect to Interim Subordinated Bonds, the aggregate Debt Service Requirements thereon shall be determined as if each Series of Interim Subordinated Bonds were payable (1) with level annual Bond Service Charges over a period of 20 years (or such longer period as may be permitted by the Act and selected by the Board), commencing the date on which such Series is anticipated by the Board to be refinanced or refunded (but not more than 5 years from original issuance of such Interim Subordinated Bonds) and (2) with interest at the average of the Bond Buyer's 11 Bond Index (or any successor or, if discontinued, a similar index selected by the Authorized Board Representative) published during the 90 day period ending not more than 40 days from the date of calculation.

(ii) With respect to Subordinated Bonds that bear interest at a Variable Interest Rate, the aggregate Debt Service Requirements thereon shall be determined as if each such Bond bore interest at the Assumed Rate; provided, however, if the Board (1) enters into a Qualified Swap Agreement with a Swap Provider requiring the Board to pay a fixed interest rate on a notional amount, and (2) has made a determination that such Qualified Swap Agreement was entered into for the purpose of providing substitute interest payments for a particular maturity of Subordinated Bonds in a principal amount equal to the notional amount of the Qualified Swap Agreement, then during the term of such Qualified Swap Agreement and so long as the Swap Provider under such Qualified Swap Agreement is not in default under such Qualified Swap Agreement, the interest rate on such Subordinated Bonds shall be determined as if such Subordinated Bonds bore interest at the fixed interest rate payable by the Board under such Qualified Swap Agreement.

(iii) With respect to Subordinated Bonds that bear interest at a fixed interest rate, if the Board (1) enters into a Qualified Swap Agreement with a Swap Provider requiring the Board to pay a variable interest rate on a notional amount and (2) has made a determination that such Qualified Swap Agreement was entered into for the purpose of providing substitute interest payments for a particular maturity of Subordinated Bonds in a principal amount equal to the notional amount of the Qualified Swap Agreement, then during the term of such Qualified Swap Agreement and so long as the Swap Provider under such Qualified Swap Agreement is not in default under such Qualified Swap Agreement, the interest rate on such Subordinated Bonds shall be determined as if such Bonds bore interest at an Assumed Rate on the notional amount of such Subordinated Bonds.

(iv) With respect to Optional Tender Bonds, the aggregate Debt Service Requirements thereon shall not include amounts payable upon mandatory or optional tender, but shall be deemed to include all periodic Bond Related Costs and other payments to the provider of any Liquidity Facility, and shall not be based upon the terms of any reimbursement obligation to such provider except to the extent and for periods during which Bond Related Costs and other payments are required to be made pursuant to such reimbursement obligation due to such provider advancing funds.

(v) With respect to Subordinated Bonds that have Credit Enhancement, the aggregate Debt Service Requirements thereon shall be deemed to include all periodic Bond Related Costs and other payments to the provider of the Credit Enhancement, but shall not be based upon the terms of any reimbursement obligation to such provider except to the extent and for periods during which Bond Related Costs and other payments are required to be made pursuant to such reimbursement obligation due to such provider advancing funds.

(vi) The aggregate Debt Service Requirements for any period on any Subordinated Bonds shall not include any interest which is payable from Capitalized Interest (defined below) which is to be deposited into the applicable Interest Account in the Subordinated Bond Fund at the time of such computation for the period in question, and which is available and is to be applied under the applicable Subordinated Bond Resolution to make interest payments on such Subordinated Bond when due. "*Capitalized Interest*" means that portion of the proceeds of any Series of Subordinated Bonds that are restricted to be used to pay interest due or to become due on such Subordinated Bonds, including funds held in connection with Subordinated Crossover Refunding Bonds.

(vii) With respect to Subordinated Crossover Refunding Bonds, the aggregate Debt Service Requirements thereon until the Crossover Refunding Bonds Break Date shall be disregarded.

For purposes of this definition, the principal and interest portions of the Accreted Value of Capital Appreciation Subordinated Bonds and the Appreciated Value of any Deferred Income Subordinated Bonds becoming due at maturity or by virtue of Mandatory Sinking Fund Requirements shall be included in the calculations of accrued and unpaid and accruing interest or principal installments in such manner and during such period of time, in both cases as is specified in the Subordinated Bond Resolution authorizing such Capital Appreciation Subordinated Bonds or Deferred Income Subordinated Bonds.

*“Appreciated Value”* shall mean (a) with respect to any Additional Senior Bonds that are Deferred Income Bonds, the meaning given to such term in the applicable Senior Bond Resolution, and (b) with respect to any Additional Subordinated Bonds that are Deferred Income Bonds until the Interest Commencement Date thereon, an amount equal to the principal amount of such Deferred Income Subordinated Bond (determined on the basis of the initial principal amount per \$5,000 at the Interest Commencement Date thereof) plus the amount, assuming compounding (as set forth in the applicable Subordinated Bond Resolution) of earnings which would be produced or the investment of such initial amount, beginning on the dated date of such Deferred Income Subordinated Bond and ending on the Interest Commencement Date, at a yield which, if produced until the Interest Commencement Date, will produce \$5,000 at the Interest Commencement Date. As of any Valuation Date, the Appreciated Value of any Additional Subordinated Bonds that are Deferred Income Bonds shall mean the amount set forth for such date in the Subordinated Bond Resolution authorizing such Deferred Income Subordinated Bonds and as of any date other than a Valuation Date, the sum of (i) the Appreciated Value on the preceding Valuation Date and (ii) the product of (1) a fraction, the numerator of which is the number of days having elapsed from the preceding Valuation Date and the denominator of which is the number of days from such preceding Valuation Date to the next succeeding Valuation Date, and (2) the difference between the Appreciated Values for such Valuation Dates.

*“Assumed Rate”* shall mean the lesser of (a) the Maximum Interest Rate on such Subordinated Bond, or (b) the interest rate which both Rating Agencies indicate in written evidence to the Board will not, by itself, result in a reduction or withdrawal of each of their respective ratings on the Subordinated Bonds that is in effect prior to such lower rate being used as the Assumed Rate.

*“Bond Issuance Costs”* shall mean all printing, publication or advertising expenses with respect to the sale and issuance of any Senior Bonds or Subordinated Bonds; all fees, expenses and costs of Registrars and Paying Agents retained by the Board; all fees, expenses and costs of attorneys, Bond Counsel, accountants, feasibility consultants, computer programmers or other experts employed to aid in the sale and issuance of the Senior Bonds or Subordinated Bonds, and all other costs related thereto; and all other costs, fees and expenses incurred or reasonably related to the issuance and sale of the Senior Bonds or Subordinated Bonds that may under the Act be paid from proceeds of bonds.

*“Bond Related Costs”* shall mean all costs, fees and expenses of the Board incurred or reasonably related to any Liquidity Facility, Credit Enhancement, Reserve Fund Guaranty, any remarketing or other secondary market transactions, Qualified Swap Agreement (whether requiring the Board to pay fixed or variable amounts) that the Board has determined was entered into for the purposes of providing substitute interest payments for a particular maturity of Subordinated Bonds, any fees of Bond Counsel, attorneys, financial advisors, remarketing agents, rebate consultants, accountants and other advisors retained by the Board in connection with a Series, and any other fees, charges and expenses that may be lawfully incurred by the Board relating to Senior Bonds or Subordinated Bonds; including, without limitation, any obligation of the Board to a provider of a Credit Enhancement, Liquidity Facility or Reserve Fund Guaranty for a Series, to repay or reimburse any amounts paid by such provider due to a payment under such Enhancement, Facility or Guaranty and any interest on such repayment obligation unless any such amount constitutes a Bond Service Charge for such Series.

*“Bond Service Charges”* shall mean, for any applicable time period or date, the scheduled principal of and premium, if any, and interest on the Senior Bonds or Subordinated Bonds, as applicable, accruing for that period or due and payable on that date. In determining Bond Service Charges accruing for any period or due and payable on any date, Mandatory Sinking Fund Requirements accruing for that period or due on that date shall be included.

*“Bond Year”* shall mean the twelve (12) month period commencing at 12:01 a.m. on July 2 of each year and ending at 12:01 a.m. the succeeding July 2, or, in the discretion of the Board, any other twelve (12) month period designated by an official action of the Board

*“Capital Appreciation Bonds”* shall mean any Additional Senior Bonds or Additional Subordinated Bonds as to which interest is payable only at the maturity or prior redemption thereof. For the purposes of (i) receiving payment of the redemption price, if any, of a Capital Appreciation Bond that is redeemed prior to maturity, and (ii) computing the principal amount of Capital Appreciation Bonds held by the Owner thereof in giving any notice,

consent, request, or demand pursuant to the applicable Bond Resolution for any purpose whatsoever, the principal amount of a Capital Appreciation Bond as of a specific date shall be deemed to be its Accreted Value as of such date.

*“Credit Enhancement”* shall mean any agreement with a bank, trust company, insurance company, surety bonding company, pension fund or other financial institution that provides increased credit on or security for any Series (or portion thereof) of Senior Bonds or Subordinated Bonds.

*“Crossover Refunding Bonds”* shall mean any Additional Senior Bonds or Additional Subordinated Bonds the proceeds of which: (i) are deposited in a segregated account in the Highway Bond Proceeds Fund established for such purpose, (ii) cannot be applied to the purpose for which such Crossover Refunding Bonds are to be issued until the Crossover Refunding Bonds Break Date, (iii) must be certified by an Authorized Board Representative to be sufficient, together with the investment income thereon, after the payment of Bond Issuance Costs and Bond Related Costs, if any, to pay the Bond Service Charges on such Series on and prior to such Crossover Refunding Bonds Break Date and (iv) other than paying or providing for the payment of Bond Issuance Costs and Bond Related Costs, if any, cannot be used for any purpose (subject to lien of the Senior Bonds and other requirements of the Senior Bond Resolution) other than the payment of Bond Service Charges on such Crossover Refunding Bonds on and prior to the Crossover Refunding Bonds Break Date.

*“Crossover Refunding Bonds Break Date”* shall mean the date specified in the Senior Bond Resolution or Subordinated Bond Resolution authorizing a Series of Crossover Refunding Bonds as the date upon which the proceeds of such Crossover Refunding Bonds can be applied to the purpose of which such Crossover Refunding Bonds are to be issued upon the satisfaction of certain conditions, which conditions shall be set forth in such Resolution.

*“Debt Service Requirements”* shall mean during the applicable period and as of any date of calculation (a) with respect to any Series of Outstanding Senior Bonds, the aggregate of the Bond Service Charges on such Series, as provided in the applicable Senior Bond Resolution, and (b) with respect to any Series of Outstanding Subordinated Bonds, the aggregate of the Bond Service Charges on such Series. For purposes of this definition, the scheduled principal and interest portions of the Accreted Value of Capital Appreciation Subordinated or Senior Bonds and the Appreciated Value of Deferred Income Subordinated or Senior Bonds becoming due at maturity or by virtue of mandatory sinking fund redemption shall be included in the calculations in such manner and during such period of time as is specified in the Senior or Subordinated Bond Resolution authorizing such Capital Appreciation Bonds or Deferred Income Bonds.

*“Deferred Income Bonds”* shall mean any Additional Senior Bonds or Subordinated Bonds as to which accruing interest is not paid prior to the Interest Commencement Date specified in the Senior or Subordinated Bond Resolution authorizing such Series.

*“Depository”* shall mean any bank, trust company, national banking association, savings and loan association, savings bank or other banking association selected by the Board as a depository of moneys and securities held under the provisions of the Subordinated Bond Resolution, and may include the Bond Registrar.

*“Fiduciary”* shall mean the Bond Registrar, Depository, Paying Agent and Escrow Agent for any Subordinated Bonds.

*“First Supplemental Subordinated Bond Resolution”* shall mean the Supplemental Resolution adopted by the Board authorizing the issuance of the Series 1992A and 1992B Subordinated Bonds.

*“Fourth Supplemental Resolution”* means the Supplemental Resolution adopted by the Board on July 16, 2004 authorizing the Series 2004B Subordinated Bonds and referred to in forepart of the Official Statement as the 2004B Subordinated Resolution.

*"Highway Bond Proceeds Fund"* shall mean the Highway Bond Proceeds Fund established by the 1980 Resolution and the Act, including all Accounts therein.

*"Highway Purpose Costs"* shall mean, without limiting the use of proceeds of Senior Bonds or Subordinated Bonds permitted under the Act, (i) all Bond Issuance Costs, (ii) all Bond Related Costs, (iii) all amounts necessary to create and fund reserve funds and to pay interest on Senior Bonds and Subordinated Bonds as provided in the applicable Senior Bond Resolution or Subordinated Bond Resolution, (iv) all costs, expenses and liabilities paid or incurred or to be paid or incurred in connection with the design, right-of-way purchase or construction of highways, and (v) such other costs, fees, charges and expenses or otherwise which may be incurred pursuant to the Act and may be payable from the Highway Bond Proceeds Fund.

*"Interest Commencement Date"* shall mean, with respect to any particular Deferred Income Bonds, the date specified in the applicable Senior or Subordinated Bond Resolution authorizing such Deferred Income Bonds (which date must be prior to the maturity date for such Deferred Income Bonds), after which interest accruing on such Deferred Income Bonds shall be payable with the first such payment date being the applicable interest payment date immediately succeeding such Interest Commencement Date.

*"Interim Subordinated Bonds"* shall mean any Subordinated Bonds issued by the Board which are declared by the Board prior to the issuance thereof either (a) to be issued in anticipation of being refinanced or refunded with Senior Bonds or Subordinated Bonds or (b) to be intended to be paid with moneys that are not Pledged Revenues.

*"Investment Securities"* shall mean and include any of the following securities, if and to the extent the same are at the time legal for investment of the Board's funds:

(i) 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;

(ii) 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;

(iii) any 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 (a) which are not callable prior to maturity or as to which irrevocable instructions have been given to the trustee of such bond 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, (b) which are secured as to principal and interest and redemption premium, if any, by a fund consisting only of cash or bonds or other obligations of the character described in clauses (i) and (ii) hereof which fund may be applied only to the payment of such principal of and interest and redemption premium, if any, on such bonds or other obligations on the maturity date or dates thereof or the redemption date or dates specified in the irrevocable instructions referred to in subclause (a) of this clause (iii), as appropriate, and (c) as to which the principal of and interest on the bonds and obligations of the character described in clauses (i) and (ii) hereof which have been deposited in such fund along with any cash on deposit in such fund are sufficient to pay principal of and interest and redemption premium, if any, on the bonds or other obligations described in this clause (iii) on the maturity date or dates thereof or on the redemption date or dates specified in the irrevocable instructions referred to in subclause (a) of this clause (iii), as appropriate;

(iv) 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;

(v) 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 such obligations are rated in one of the two highest Rating Categories by both Rating Agencies;

(vi) 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 in one of the two highest Rating Categories by both Rating Agencies;

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

(viii) 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 two highest Rating Categories by both Rating Agencies, or, in the case of an insurer providing municipal bond 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;

(ix) certificates that evidence ownership of the right of payments of principal or interest on obligations described in clauses (i) to (vii), 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;

(x) 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 two highest Rating Categories by both Rating Agencies;

(xi) any repurchase agreements collateralized by securities described in clauses (i) to (vii) 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 an uninsured, unsecured and unguaranteed obligation rated (an "unsecured rating") at the time of purchase thereof at least "Prime-1" or "A" by Moody's and at least "A-1" or "A" by S&P, provided (1) a specific written agreement governs the transaction; (2) 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; (3) 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; (4) the repurchase agreement has a term of 1 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; (5) the repurchase agreement matures at least ten days (or other appropriate liquidation period) prior to an interest payment date; and (6) 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%;

(xii) 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 two highest Rating Categories by both Rating Agencies;

(xii) any other investment permitted by State law that is rated at the time of purchase in one of the two highest Rating Categories by both Rating Agencies; and

(xiv) 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 (i) to (xiii).

*"Liquidity Facility"* shall mean any agreement with a bank, trust company, insurance company, surety bonding company, pension fund or other financial institution under which it agrees to purchase Optional Tender Bonds.

*"Mandatory Sinking Fund Requirements"* shall mean the principal amount of term bonds which are required to be redeemed by mandatory sinking fund redemption, in the principal amount, at the prices and on the dates as set forth in the applicable Senior Bond Resolution or Subordinated Bond Resolution.

*"Maximum Interest Rate"* shall mean, with respect to any particular Additional Senior Bonds that have a Variable Interest Rate, the meaning given to such term in the applicable Senior Bond Resolution, and with respect to any particular Subordinated Bonds that bear interest at a Variable Interest Rate, shall mean a numerical rate of interest, which shall be set forth in the Subordinated Bond Resolution authorizing such Additional Subordinated Bonds, that shall be the maximum rate of interest such Subordinated Bonds that bear interest at a Variable Interest Rate may at any time bear.

*"Optional Tender Bonds"* shall mean Additional Senior Bonds or Additional Subordinated Bonds which by their terms may be tendered by and at the option of, or are required to be tendered by, the Owner thereof for payment or purchase by the Board or another party prior to the stated maturity thereof, or the maturities of which may be extended by and at the option of the Owner thereof.

*"Outstanding"* shall mean (a) when used with respect to Senior Bonds, the Senior Bonds which have been issued and remain unpaid except for those Senior Bonds that are considered no longer outstanding in accordance with the provisions of the applicable Senior Bond Resolution, and (b) when used with reference to Subordinated Bonds, as of any date, shall mean Subordinated Bonds theretofore or thereupon being authenticated and delivered under the applicable Subordinated Bond Resolution, except:

(i) Subordinated Bonds canceled pursuant to the applicable Subordinated Bond Resolution at or prior to such date;

(ii) Subordinated Bonds (or portions of Subordinated Bonds) for the payment or redemption or purchase for cancellation of which sufficient moneys shall be held in trust under the Subordinated Bond Resolution and set aside for such purpose (whether at or prior to the maturity or redemption date), provided that if such Subordinated Bonds (or portions thereof) are to be redeemed, notice of such redemption shall have been given or provision satisfactory to the Bond Registrar shall have been made for the giving of such notice as provided in the Subordinated Bond Resolution;

(iii) Subordinated Bonds in lieu of or in substitution for which other Subordinated Bonds shall have been authenticated and delivered under the Subordinated Bond Resolution;

(iv) Subordinated Bonds deemed to have been paid as described in “Defeasance” below; and

(v) Optional Tender Subordinated Bonds deemed tendered in accordance with the provisions of the Subordinated Bond Resolution authorizing such Subordinated Bonds on the applicable tender, adjustment or conversion date, if interest thereon shall have been paid through such applicable date and the purchase price thereof shall have been paid or amounts are available for such payment as provided therein.

“*Pledged Revenues*” shall mean (a) all moneys derived from fees, excises, or license taxes relating to registration, operation or use of vehicles on the public highways, or to fuel used for the propulsion of such vehicles, paid into the State Highway Fund as prescribed by Article IX, Section 14 of the Constitution of the State of Arizona, and the vehicle license tax monies distributed pursuant to Section 28-5808, Arizona Revised Statutes, and paid into the State Highway Fund, and (b) to the extent permitted by law, including the Act and the Constitution of the State, such additional or other money as the Board may, by a subsequent Subordinated Bond Resolution or Senior Bond Resolution, as applicable, add to the definition of Pledged Revenues.

“*Qualified Swap Agreement*” shall mean an agreement between the Board and a Swap Provider under which the Board agrees to pay the Swap Provider an amount calculated at an agreed-upon rate based upon a notional amount and the Swap Provider agrees to pay the Board an amount calculated at an agreed-upon rate based upon such notional amount, where (a) the Swap Provider, or the person who guarantees the obligation of the Swap Provider to make its payments to the Board, has unsecured long-term obligations rated, or (b) the swap agreement itself is rated, in each case as of the date the swap agreement is entered into, by both Rating Agencies in either (i) a Rating Category not less than the Rating Category then in effect on the Subordinated Bonds subject to such swap agreement or (ii) such lower Rating Category which both Rating Agencies indicate in written evidence to the Board will not, by itself, result in a reduction or withdrawal of each of their respective ratings on the Subordinated Bonds subject to such swap agreement that is in effect prior to entering into such swap agreement.

“*Rating Agency*” shall mean Moody’s Investors Service (“Moody’s”) or Standard & Poor’s Corporation (“S&P”) or both, 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, unless otherwise specified in the Subordinated Bond Resolution, shall be long term ratings.

“*Refunding Subordinated Bonds*” shall mean all Subordinated Bonds, whether issued in one or more Series, authenticated and delivered on original issuance pursuant to the Subordinated Bond Resolution.

“*Reserve Fund Guaranty*” shall mean a letter of credit, surety bond or similar arrangement representing the unconditional and irrevocable obligation of a financial institution to pay to the Paying Agent upon request made by the Paying Agent up to an amount stated therein for application as provided in a subsequent Subordinated Bond Resolution which Guaranty shall be held as part of the Subordinated Bond Reserve Fund.

“*Second Subordinated Bonds*” shall mean any bonds or other obligations that may be hereafter issued by the Board pursuant to applicable law, which are payable from a pledge of Pledged Revenues, which pledge is junior and subordinated to that in favor of the Senior Bonds and Subordinated Bonds, as described in “Second Subordinated Bonds” below.

“*Second Supplemental Subordinated Bond Resolution*” means the Supplemental Resolution adopted by the Board authorizing the Series 1993A and 1993B Subordinated Bonds.

“*Series*” shall mean the separate series of Senior Bonds identified as such under the applicable Senior Bond Resolution and the separate series of Subordinated Bonds identified as such under the applicable Subordinated Bond Resolution.

“*Senior Bonds*” shall mean, collectively, the Outstanding Series 1999 Bonds, Series 2001 Bonds, Series 2002 Bonds, Series 2002A Bonds, Series 2002B Bonds, Series 2003 Bonds and any Additional Senior Bonds.

“*Senior Bond Resolution*” shall mean, collectively, the 1980 Resolution, the 1999 Resolution, the 2001 Resolution, the 2002 Resolution as amended and supplemented by the 2002A Resolution, the 2002B Resolution, the 2003 Resolution and the resolution or resolutions of the Board adopted hereafter authorizing Additional Senior Bonds, each to the extent applicable by their terms to Outstanding Senior Bonds; in each case as amended or supplemented from time to time in accordance with its terms.

“*State Highway Fund*” shall mean the State Highway Fund established by Section 28-6991, Arizona Revised Statutes.

“*Subordinated Bond Resolution*” shall mean (a) the Subordinated Resolution adopted by the Board on September 27, 1991 (the “1991 Resolution”) authorizing the issuance of the Series 1991A Subordinated Bonds and containing the lien on and pledge of Pledged Revenues for the Subordinated Bonds and other terms governing Subordinated Bonds, (b) when used with reference to the Series 1992B Subordinated Bonds, the 1991 Resolution and the First Supplemental Subordinated Bond Resolution authorizing the issuance of the Series 1992B Subordinated Bonds, (c) when used with reference to the Series 1993A and 1993B Subordinated Bonds, the 1991 Resolution and Second Supplemental Subordinated Bond Resolution authorizing the issuance of the Series 1993A and 1993B Subordinated Bonds, (d) when used with reference to the Series 2003A and Series 2004A Subordinated Bonds, the 1991 Resolution and Third Supplemental Subordinated Bond Resolution authorizing the issuance of the Series 2003A Subordinated Bonds and Series 2004A Subordinated Bonds, (e) when used with reference to the Series 2004B Subordinated Bonds, the 1991 Resolution and the Fourth Supplemental Resolution, and (f) when used with reference to a Series of Additional Subordinated Bonds issued hereafter by the Board, the 1991 Resolution and the Supplemental Resolution of the Board authorizing such Series, in each case as amended or supplemented from time to time in accordance with its terms.

“*Subordinated Bonds*” shall mean any bonds or other obligations of the Board permitted under applicable law and issued pursuant to the Subordinated Bond Resolution which are on a parity with the Series 1992B, 1993A, 1993B, 2003A, Series 2004A and 2004B Subordinated Bonds and which share a lien on the Pledged Revenues subordinate only to the Senior Bonds.

“*Supplemental Resolution*” shall mean (a) with respect to Senior Bonds, any resolution of the Board which shall supplement or amend a Senior Bond Resolution pursuant to its terms, and (b) with respect to Subordinated Bonds, any resolution of the Board which shall supplement or amend the Subordinated Bond Resolution adopted by the Board in accordance with the Subordinated Bond Resolution.

“*Swap Provider*” shall mean the counterparty with whom the Board enters into a Qualified Swap Agreement.

“*Third Supplemental Subordinated Bond Resolution*” means the Supplemental Resolution adopted by the Board on September 19, 2003 authorizing the Series 2003A Subordinated Bonds and the Series 2004A Subordinated Bonds.

“*Valuation Date*” shall mean (i) with respect to any Additional Subordinated Bonds that are Capital Appreciation Bonds, the date or dates set forth in the Subordinated Bond Resolution authorizing such Subordinated Bonds on which specific Accreted Values are assigned to such Bonds and (ii) with respect to any Additional Subordinated Bonds that are Deferred Income Bonds, the date or dates prior to the Interest Commencement Date set forth in the Subordinated Bond Resolution authorizing such Bonds on which specific Appreciated Values are assigned to such Bonds.

“*Variable Interest Rate*” shall mean with respect to any Additional Senior Bonds, the meaning given to such term in the applicable Senior Bond Resolution and with respect to any Additional Subordinated Bonds, a variable interest rate or rates to be borne by a Series of Subordinated Bonds or any one or more maturities within a Series of Subordinated Bonds. The method of computing such variable interest rate shall be specified in the Subordinated Bond Resolution authorizing such Series of Subordinated Bonds.

## **AUTHORIZATION AND ISSUANCE OF ADDITIONAL SUBORDINATED BONDS**

One or more Series of Additional Subordinated Bonds may be authenticated and delivered upon original issuance at any time or from time to time for any lawful purpose under the Act. The proceeds, including accrued interest, of the Additional Subordinated Bonds of each Series shall be applied simultaneously with the delivery of such Subordinated Bonds as provided in the Supplemental Resolution authorizing such Series.

Additional Subordinated Bonds may be issued for such purposes, other than Additional Subordinated Bonds issued for refunding purposes upon certification with respect to the aggregate Adjusted Debt Service Requirements described below, upon satisfaction of certain conditions including certification by the Board that the sum of (i) (A) the amount of Pledged Revenues deposited by the State Treasurer into the State Highway Fund in any twelve consecutive months out of the most recent eighteen months preceding the issuance of such Series of Subordinated Bonds then proposed to be issued (provided, that in the event that state legislation is enacted that changes the rate of any of the fees, excises or license taxes comprising Pledged Revenues or changes any of the transactions subject to the fees, excises or license taxes comprising Pledged Revenues, at any time subsequent to the beginning of such twelve month period, then the Authorized Board Representative shall estimate and use for these purposes the Pledged Revenues which would have been deposited into the State Highway Fund in such twelve month period if such changed rate or such change in such transactions had been in effect for the entire twelve consecutive month period); plus (B) the amount of any other moneys received by the State Treasurer during the period described in (A) and which constitute Pledged Revenues was not less than (ii) three hundred percent (300%) of the maximum aggregate Adjusted Debt Service Requirements on Outstanding Senior Bonds and Outstanding Subordinated Bonds in the then current or any future Bond Year, including the maximum Adjusted Debt Service Requirements on the Series of Subordinated Bonds then proposed to be issued but excluding the Adjusted Debt Service Requirements on any Senior Bonds or Subordinated Bonds to be refunded that shall not be Outstanding immediately after the issuance of such Series.

Additional Subordinated Bonds may be issued for refunding purposes (“Refunding Subordinated Bonds”) upon satisfaction of certain conditions including either (i) that the conditions set forth in the immediately preceding paragraph are met or (ii) a certification by the Board setting forth (A) by Bond Year, the aggregate Adjusted Debt Service Requirements due on all Senior Bonds and Subordinated Bonds Outstanding immediately prior to the date of issuance of such Refunding Subordinated Bonds for the then current and each future Bond Year during which such Bonds are Outstanding; (B) the aggregate Adjusted Debt Service Requirements for each Bond Year set forth in (A) above on all Senior Bonds and Subordinated Bonds to be Outstanding immediately after the issuance of the proposed Refunding Subordinated Bonds; and (C) that the aggregate Adjusted Debt Service Requirement set forth for each Bond Year pursuant to (B) above is not more than 105% of that set forth for such Bond Year pursuant to (A) above.

## **ESTABLISHMENT OF FUNDS AND APPLICATION THEREOF**

**The Pledge of the Subordinated Bond Resolution**. The Subordinated Bonds are special obligations of the Board and are payable from and secured as to payment of Bond Service Charges thereon, in accordance with their terms and the provisions of the Subordinated Bond Resolution, solely from a lien on and by a pledge of all Pledged Revenues, but subject, however, to the prior first lien on and first pledge of Pledged Revenues made in the Senior Bond Resolution for payment of principal of and interest on all Senior Bonds. The Subordinated Bond Resolution has pledged and assigned as security for the payment of Bond Service Charges on the Subordinated Bonds in accordance with their terms and the provisions of the Subordinated Bond Resolution, to the extent not required to pay the Bond Service Charges on the Senior Bonds, amounts on deposit in the Subordinated Bond Fund, Subordinated Bond Reserve Fund, Subordinated Bond Related Costs Fund, Second Subordinated Bond Fund,

Second Subordinated Bond Related Costs Fund, Second Subordinated Bond Reserve Fund and Highway Bond Proceeds Fund.

Subject to the prior lien on Pledged Revenues in favor of the Senior Bonds under the Senior Bond Resolution, the Board shall use all Pledged Revenues in the State Highway Fund, to the extent lawfully available, to avoid a default in payment of Bond Service Charges on the Subordinated Bonds, when due.

As provided in the Act, all Pledged Revenues deposited into the State Highway Fund shall be immediately subject to the lien of the pledge granted in the Senior Bond Resolution for the Senior Bonds and in the Subordinated Bond Resolution for the Subordinated Bonds, without any future physical delivery or further act, and the lien of such pledge for Subordinated Bonds shall be valid and binding from the date of issuance of the Series 1991A Subordinated Bonds on October 17, 1991 as against all parties having claims of any kind in tort, contract or otherwise against the Board irrespective of whether such parties have notice thereof of such pledge.

**Establishment of Funds.** The Board shall cause the State Treasurer to establish and maintain the following special funds to be held separate and apart from all other State moneys: (a) Highway Bond Proceeds Fund (which is created in the Act and the Senior Bond Resolution) and shall create therein a separate account for each Series of Senior Bonds, Subordinated Bonds and Second Subordinated Bonds; (b) Senior Bond Fund (which is the same fund as the Bond Fund created in the Senior Bond Resolution); (c) Senior Bond Related Costs Fund; (d) Senior Bond Reserve Fund; (e) Subordinated Bond Fund; (f) Subordinated Bond Related Costs Fund; (g) Subordinated Bond Reserve Fund; (h) Second Subordinated Bond Fund; (i) Second Subordinated Bond Related Costs Fund; and (j) Second Subordinated Bond Reserve Fund (collectively, "Bond Funds").

**Deposits into Bond Funds; General.** The Board shall make deposits of Pledged Revenues into the Bond Funds as provided in the Subordinated Bond Resolution and as further specified in subsequent Senior Bond Resolutions regarding the Senior Bonds, in subsequent Subordinated Bond Resolutions and in subsequent Senior Bond Resolutions authorizing Second Subordinated Bonds; provided, however, no such subsequent specification of deposits into the Bond Funds shall be inconsistent with the requirements of the Senior Bond Resolution existing on the date of the Subordinated Bond Resolution; or with the requirements of the Subordinated Bond Resolution.

**Subordinated Bond Proceeds Account.** Moneys in the Subordinated Bond Proceeds Account for each series of Subordinated Bonds shall be used (1) to pay all Bond Issuance Costs in connection with the issuance of the applicable Subordinated Bonds; (2) to pay Highway Purpose Costs in the manner provided in the 1980 Resolution; (3) if a Senior Bond Payment Deficiency (defined below under "Use of Bond Funds") remains after transfers from all other Bond Funds, Related Costs Funds and Reserve Funds, to satisfy such Senior Bond Payment Deficiency; (4) if a Subordinated Bond Payment Deficiency (defined below under "Use of Bond Funds") remains after transfers from the Funds for the Subordinated Bonds and the Second Subordinated Bonds, and there is no Senior Bond Payment Deficiency, to satisfy such Subordinated Bond Payment Deficiency; and (5) if a Second Subordinated Bond Payment Deficiency (defined below under "Use of Bond Funds") remains after transfers from the Funds for the Second Subordinated Bonds, and there is no Senior Bond Payment Deficiency or Subordinated Bond Payment Deficiency, to satisfy such Second Subordinated Bond Payment Deficiency.

**Deposit of Pledged Revenues Into Bond Funds.** All Pledged Revenues paid into the State Highway Fund shall be accounted for by the Board and State Treasurer and held by the State Treasurer and deposited by the State Treasurer into the Bond Funds in the following order and manner:

On the dates provided below, the Board shall, as Pledged Revenues are received, segregate from the Pledged Revenues the following amounts and the State Treasurer shall transfer such amounts to the Bond Funds and Accounts in the following order:

(1) into the Interest Account in the Senior Bond Fund, on the first day of each month, an amount which in the aggregate is not less than one-fifth (1/5) of the amount of the next semiannual interest payment coming due on the Outstanding Senior Bonds; and then

(2) into the Principal Account in the Senior Bond Fund, on the first day of each month, one-eleventh (1/11) of the amount of the principal of the Outstanding Senior Bonds coming due on the next principal payment date (whether by stated maturity or mandatory sinking fund redemption); provided however that, so long as investment income on investments from accounts in the Highway Bond Proceeds Fund is transferred to the Senior Bond Fund, the Board need only transfer the amount necessary to cause the Principal Account and the Interest Account in the Senior Bond Fund to be current at the date payments are required to be made from such Accounts to pay principal of and interest on the Outstanding Senior Bonds; and then

(3) into the account in the Highway Bond Proceeds Fund for any Outstanding Series of Additional Senior Bonds at such times and in such amounts as may be specified in any subsequent Senior Bond Resolution, an amount equal to the unreimbursed amounts theretofore expended from such account for payment of principal of and interest on any Senior Bonds; and then

(4) into the Senior Bond Related Costs Fund, at such times and in such amounts, if any, specified in any subsequent Senior Bond Resolution for payment of Bond Related Costs for any Additional Senior Bonds; and then

(5) into the Senior Bond Reserve Fund, at such times and in such amounts, if any, specified in any subsequent Senior Bond Resolution for deposit therein; and then

(6) into the Interest Account in the Subordinated Bond Fund, on or before the fifteenth day of the month preceding an interest payment date on the Outstanding Subordinated Bonds, an amount equal to the interest payment due on such interest payment date on the Outstanding Subordinated Bonds and on such dates and in such amounts as specified in any subsequent Subordinated Bond Resolution with respect to any Series of Additional Subordinated Bonds; and then

(7) into the Principal Account in the Subordinated Bond Fund, on or before the fifteenth day of the month preceding a principal payment date (whether at maturity or by mandatory sinking fund redemption) on the Outstanding Subordinated Bonds, an amount equal to the principal payment due on such principal payment date on the Outstanding Subordinated Bonds, less in the case of mandatory sinking fund redemption, the amount of credit described in the applicable Subordinated Bond Resolution, and on such dates and in such amounts as specified in any subsequent Subordinated Bond Resolution with respect to any Series of Additional Subordinated Bonds; and then

(8) into the Subordinated Bond Related Costs Fund, at such times and in such amounts, if any, specified in any subsequent Subordinated Bond Resolution for deposit therein for payment of Bond Related Costs for any Additional Subordinated Bonds; and then

(9) into the Subordinated Bond Reserve Fund, at such times and in such amounts, if any, specified in any subsequent Subordinated Bond Resolution for deposit therein; and then

(10) into the Interest Account in the Second Subordinated Bond Fund at such times and in such amounts, if any, specified pursuant to the resolution of the Board authorizing the Second Subordinated Bonds for deposit therein; and then

(11) into the Principal Account in the Second Subordinated Bond Fund at such times and in such amounts, if any, specified pursuant to the resolution of the Board authorizing the Second Subordinated Bonds for deposit therein; and then

(12) into the Second Subordinated Bond Related Costs Fund at such times and in such amounts, if any, specified pursuant to the resolution of the Board authorizing the Second Subordinated Bonds for deposit therein; and then

(13) into the Second Subordinated Bond Reserve Fund at such times and in such amounts, if any, specified pursuant to the resolution of the Board authorizing the Second Subordinated Bonds for deposit therein; and then

(14) the remaining Pledged Revenues, if any, may be used and expended by the Board for any other lawful use of the State Highway Fund.

If there is a deficiency in the required deposit to any of the Bond Funds as provided above, and unless the Board uses lawfully available Pledged Revenues on deposit in the State Highway Fund or other lawfully available moneys to cure such deficiency, all additional Pledged Revenues deposited into the State Highway Fund shall be used to make up such deficiencies in such Bond Funds, but only in the priority of deposit set forth above, prior to making any deposits to any lower priority Bond Fund.

The provisions of clauses (1) through (5) above may be amended by any Senior Bond Resolution hereafter adopted by the Board and shall be deemed to have been amended to conform to the provisions of such subsequent Senior Bond Resolution, provided, however, that such an amendment shall not impair or adversely affect the rights or security of the Owners of the Subordinated Bonds then Outstanding or the Second Subordinated Bonds then Outstanding.

#### **Use of Bond Funds**

*Use of Senior Bond Fund.* Moneys in the Senior Bond Fund shall be used by the State Treasurer to pay principal of (whether at maturity or mandatory sinking fund redemption) premium, if any, and interest on the Senior Bonds, as provided in the applicable Senior Bond Resolution and the Senior Bonds. All moneys at any time paid or transferred to the Senior Bond Fund shall be kept separate and apart from all other moneys in the hands of the State Treasurer and shall be held in trust for the benefit of the holders of the Outstanding Senior Bonds and coupons entitled to be paid therewith, and shall be used solely for the purpose of paying the Bond Service Charges on the Outstanding Senior Bonds as the same become due and for no other purpose. Neither the Board, the State of Arizona, nor any tort or contract claimant nor Owner of Subordinated Bonds shall ever have any claim upon or beneficial interest in any of the moneys of the Pledged Revenues in the Senior Bond Fund.

*Use of Senior Bond Related Costs Fund.* Moneys, if any, in the Senior Bond Related Costs Fund shall be used by the State Treasurer to pay Bond Related Costs, when due, with respect to Additional Senior Bonds as provided in the Senior Bond Resolution authorizing any such Series of Additional Senior Bonds, upon written direction from the Authorized Board Representative. To the extent moneys in the Senior Bond Fund are insufficient to pay, when due, principal of and interest on the Senior Bonds (a "Senior Bond Payment Deficiency"), the State Treasurer shall, after use of moneys in the Senior Bond Reserve Fund, use moneys in the Senior Bond Related Costs Fund to pay such Deficiency, except as otherwise provided in the Senior Bond Resolution authorizing any such Series of Additional Senior Bonds.

*Use of Senior Bond Reserve Fund.* Moneys, if any, in the Senior Bond Reserve Fund shall be used by the State Treasurer: (a) to pay any Senior Bond Payment Deficiency; and then (b) to the extent moneys in the Senior Bond Related Costs Fund are insufficient to pay, when due, the Bond Related Costs with respect to the Additional Senior Bonds as provided in the Senior Bond Resolution authorizing any such Series of Additional Senior Bonds (a "Senior Bond Related Costs Deficiency"), to pay any remaining Senior Bond Related Costs Deficiency, except as otherwise provided in the Senior Bond Resolution authorizing any such Series of Additional Senior Bonds.

*Use of Subordinated Bond Fund.* Moneys in the Subordinated Bond Fund shall be used by the State Treasurer: (i) after use (in the following order) of the Senior Bond Reserve Fund, the Senior Bond Related Costs Fund, the Second Subordinated Bond Reserve Fund, the Second Subordinated Bond Related Costs Fund, the Second Subordinated Bond Fund, the Subordinated Bond Reserve Fund and the Subordinated Bond Related Costs Fund to pay any Senior Bond Payment Deficiency, to pay any remaining Senior Bond Payment Deficiency; and then (ii) to pay principal of (whether at maturity or mandatory sinking fund redemption), premium, if any, and

interest on the Subordinated Bonds as specified in the Subordinated Bond Resolution with respect to the Subordinated Bonds.

All moneys at any time paid or transferred to the Subordinated Bond Fund shall be kept separate and apart from all other moneys in the hands of the State Treasurer and shall be held in trust for the benefit of the Owners of the Outstanding Subordinated Bonds entitled to be paid therewith and shall be used solely for the purpose of paying the principal of and interest on the Outstanding Subordinated Bonds as the same become due and for no other purpose, subject to the provisions of (i) of the prior paragraph under this heading "Use of Subordinated Bond Fund". Neither the Board, the State of Arizona nor any tort or contract claimant nor holder of any Second Subordinated Bonds shall ever have any claim upon or beneficial interest in any of the moneys of the Pledged Revenues in the Subordinated Bond Fund.

The Board shall order the State Treasurer to pay out of the Subordinated Bond Fund to the respective Paying Agents (i) on or before each interest payment date, the amount from the Interest Account required for the interest payable on such due date; and (ii) on or before each principal payment date, the amount from the Principal Account required for the principal payment on such due date (whether at stated maturity or by mandatory sinking fund redemption); and (iii) on or before any optional redemption date for the Subordinated Bonds, the amount from the redemption account required for the payment of the redemption price on the Subordinated Bonds then to be optionally redeemed. The Board shall furnish or cause to be furnished to the State Treasurer a certificate setting forth the amount to be paid on Subordinated Bonds that bear interest at a Variable Interest Rate on each interest payment date, which certificate shall be furnished on or prior to the appropriate Regular Record Date with respect to any interest payment date. The Board shall order the State Treasurer also to pay out of the Interest Account in the Subordinated Bond Fund the accrued interest included in the purchase price of Subordinated Bonds purchased for retirement.

Amounts accumulated in the Principal Account of the Subordinated Bond Fund with respect to any mandatory sinking fund requirement may and, if so ordered by the Authorized Board Representative, shall be applied by the State Treasurer, on or prior to the 35th day next preceding the next mandatory sinking fund redemption date, to the purchase of Subordinated Bonds of the Series and maturity for which such mandatory sinking fund requirement was established. All purchases of any Subordinated Bonds shall be made at prices not exceeding the applicable mandatory sinking fund redemption price of such Subordinated Bonds plus accrued interest, and such purchases shall be made by an Authorized Board Representative. The Board shall receive a credit for any such Bonds so purchased. As soon as practicable after the 35th day preceding the next mandatory sinking fund redemption date, the Bond Registrar shall proceed to call for redemption, by giving notice as provided in the Subordinated Bond Resolution on such mandatory sinking fund redemption date, the Subordinated Bonds of the Series and maturity for which such mandatory sinking fund requirement was established (except in the case of Subordinated Bonds maturing on a mandatory sinking fund redemption date) in such amount as shall be necessary to complete the retirement of the unsatisfied balance of such mandatory sinking fund requirement after making allowance for any credit for Subordinated Bonds purchased or redeemed which the Board has directed the State Treasurer to apply as a credit against such unsatisfied balance.

In the event of the refunding of any Subordinated Bonds, the Board may order the State Treasurer to withdraw from the Subordinated Bond Fund all, or any portion of, the amounts accumulated therein with respect to Bond Service Charges on the Subordinated Bonds being refunded and deposit such amounts with the Escrow Agent to be held for the payment of Bond Service Charges on the Subordinated Bonds being refunded; provided that such withdrawal may not be made unless immediately thereafter the Subordinated Bonds being refunded shall be deemed to have been paid pursuant to the defeasance provisions of the Subordinated Bond Resolution.

Use of Subordinated Bond Related Costs Fund. Moneys, if any, in the Subordinated Bond Related Costs Fund shall be used by the State Treasurer:

- (a) after use (in the following order) of the Senior Bond Reserve Fund, the Senior Bond Related Costs Fund, the Second Subordinated Bond Reserve Fund, the Second Subordinated Bond Related

Costs Fund, the Second Subordinated Bond Fund and the Subordinated Bond Reserve Fund to pay any Senior Bond Payment Deficiency, to pay any remaining Senior Bond Payment Deficiency; and then

(b) after use (in the following order) of the Senior Bond Reserve Fund, the Second Subordinated Bond Reserve Fund, the Second Subordinated Bond Related Costs Fund and the Subordinated Bond Reserve Fund to pay any Senior Bond Related Costs Deficiency, to pay any remaining Senior Bond Related Costs Deficiency; and then

(c) after use (in the following order) of the Second Subordinated Bond Reserve Fund, the Second Subordinated Bond Related Costs Fund and the Subordinated Bond Reserve Fund to pay any deficiency in the Senior Bond Reserve Fund (a "Senior Bond Reserve Fund Deficiency"), to pay any remaining Senior Bond Reserve Fund Deficiency; and then

(d) to the extent moneys in the Subordinated Bond Fund are insufficient to pay principal of (whether at maturity or on mandatory sinking fund redemption) and interest on Subordinated Bonds when due (a "Subordinated Bond Payment Deficiency"), after use of moneys in the Subordinated Bond Reserve Fund, to pay any remaining Subordinated Bond Payment Deficiency; and then

(e) to pay the Bond Related Costs, if any, when due, with respect to Additional Subordinated Bonds as provided in the Subordinated Bond Resolution authorizing such Subordinated Bonds, upon written direction from the Authorized Board Representative to make such payment.

*Use of Subordinated Bond Reserve Fund.* Moneys, if any, in the Subordinated Bond Reserve Fund shall be used by the State Treasurer:

(i) after use (in the following order) of the Senior Bond Reserve Fund, the Senior Bond Related Costs Fund, the Second Subordinated Bond Reserve Fund, the Second Subordinated Bond Related Costs Fund, and the Second Subordinated Bond Fund to pay any Senior Bond Payment Deficiency, to pay any remaining Senior Bond Payment Deficiency; and then

(ii) after use (in the following order) of the Senior Bond Reserve Fund, the Second Subordinated Bond Reserve Fund and the Second Subordinated Bond Related Costs Fund, to pay any Senior Bond Related Costs Deficiency, to pay any remaining Senior Bond Related Costs Deficiency; and then

(iii) after use (in the following order) of the Second Subordinated Bond Reserve Fund and the Second Subordinated Bond Related Costs Fund to pay any Senior Bond Reserve Fund Deficiency, to pay any remaining Senior Bond Reserve Fund Deficiency; and then

(iv) to the extent moneys in the Subordinated Bond Fund are insufficient to pay any Subordinated Bond Payment Deficiency, to pay any remaining Subordinated Bond Payment Deficiency; and then

(v) to the extent moneys in the Subordinated Bond Related Costs Fund are insufficient to pay, when due, the Subordinated Bond Related Costs as provided in the applicable Subordinated Bond Resolution (the "Subordinated Bond Related Costs Deficiency"), to pay any remaining Subordinated Bond Related Costs Deficiency.

*Use of Second Subordinated Bond Fund.* Moneys, if any, in the Second Subordinated Bond Fund shall be used by the State Treasurer:

(i) after use (in the following order) of the Senior Bond Reserve Fund, the Senior Bond Related Costs Fund, the Second Subordinated Bond Reserve Fund and the Second Subordinated Bond

Related Costs Fund to pay any Senior Bond Payment Deficiency, to pay any remaining Senior Bond Payment Deficiency; and then

(ii) after use (in the following order) of the Subordinated Bond Reserve Fund, the Subordinated Bond Related Costs Fund, the Second Subordinated Bond Reserve Fund and the Second Subordinated Bond Related Costs Fund to pay any Subordinated Bond Payment Deficiency, to pay any remaining Subordinated Bond Payment Deficiency; and then

(iii) to pay principal of (whether at maturity or mandatory sinking fund redemption), premium, if any, and interest on the Second Subordinated Bonds, as provided in the applicable resolution of the Board authorizing the Second Subordinated Bonds.

All moneys at any time paid or transferred to the Second Subordinated Bond Fund shall be kept separate and apart from all other moneys in the hands of the State Treasurer and shall be held in trust for the benefit of the owners of the Outstanding Second Subordinated Bonds entitled to be paid therewith and shall be used solely for the purpose of paying the principal of and interest on the Outstanding Second Subordinated Bonds as the same become due and for no other purpose, subject to the provisions of clauses (i) and (ii) above. Neither the Board, the State of Arizona nor any tort or contract claimant shall ever have any claim upon or beneficial interest in any of the moneys of the Pledged Revenues in the Second Subordinated Bond Fund. The Board shall order the State Treasurer to pay debt service on the Second Subordinated Bonds from the Second Subordinated Bond Fund at the times and in the amounts provided in the resolution authorizing such Second Subordinated Bonds.

*Use of Second Subordinated Bond Related Costs Fund.* Moneys, if any, in the Second Subordinated Bond Related Costs Fund shall be used by the State Treasurer:

(a) after use (in the following order) of the Senior Bond Reserve Fund, the Senior Bond Related Costs Fund and the Second Subordinated Bond Reserve Fund to pay any Senior Bond Payment Deficiency, to pay any remaining Senior Bond Payment Deficiency; and then

(b) after use of the Senior Bond Reserve Fund and the Second Subordinated Bond Reserve Fund to pay any Senior Bond Related Costs Deficiency, to pay any remaining Senior Bond Related Costs Deficiency; and then

(c) after use of the Second Subordinated Bond Reserve Fund to pay any Senior Bond Reserve Fund Deficiency, to pay any remaining Senior Bond Reserve Fund Deficiency; and then

(d) after use (in the following order) of the Subordinated Bond Reserve Fund, the Subordinated Bond Related Costs Fund and the Second Subordinated Bond Reserve Fund to pay any Subordinated Bond Payment Deficiency, to pay any remaining Subordinated Bond Payment Deficiency; and then

(e) after use of the Subordinated Bond Reserve Fund and the Second Subordinated Bond Reserve Fund to pay any Subordinated Bond Related Costs Deficiency, to pay any remaining Subordinated Bond Related Costs Deficiency; and then

(f) to the extent there is a deficiency in the amount required to be deposited into the Subordinated Bond Reserve Fund (a "Subordinated Bond Reserve Deficiency"), after use of moneys in the Second Subordinated Bond Reserve Fund, to pay such Subordinated Bond Reserve Deficiency; and then

(g) to the extent moneys in the Second Subordinated Bond Fund are insufficient to pay principal of (whether at maturity or on mandatory sinking fund redemption) and interest on Second Subordinated Bonds when due in accordance with their terms (a "Second Subordinated Bond Payment Deficiency"), after use of moneys in the Second Subordinated Bond Reserve Fund, to pay any such Second

Subordinated Bond Payment Deficiency, except as otherwise provided in the resolution authorizing such Second Subordinated Bonds; and then

(h) to pay the Bond Related Costs, when due, with respect to Second Subordinated Bonds as provided in the resolution authorizing such Second Subordinated Bonds, upon written direction from the Authorized Board Representative to make such payment.

Use of Second Subordinated Bond Reserve Fund. Moneys, if any, in the Second Subordinated Bond Reserve Fund shall be used by the State Treasurer:

(a) after use (in the following order) of the Senior Bond Reserve Fund and the Senior Bond Related Costs Fund to pay any Senior Bond Payment Deficiency, to pay any remaining Senior Bond Payment Deficiency; and then

(b) after use of the Senior Bond Reserve Fund to pay any Senior Bond Related Costs Deficiency, to pay any remaining Senior Bond Related Costs Deficiency; and then

(c) to pay any Senior Bond Reserve Fund Deficiency; and then

(d) after use (in the following order) of the Subordinated Bond Reserve Fund and the Subordinated Bond Related Costs Fund to pay any Subordinated Bond Payment Deficiency, to pay any remaining Subordinated Bond Payment Deficiency; and then

(e) after use of the Subordinated Bond Reserve Fund to pay any Subordinated Bond Related Costs Deficiency, to pay any remaining Subordinated Bond Related Costs Deficiency; and then

(f) to pay any Subordinated Bond Reserve Fund Deficiency; and then

(g) to pay any Second Subordinated Bond Payment Deficiency, except as otherwise provided in the resolution authorizing such Second Subordinated Bonds; and then

(h) to the extent there is a deficiency in the amount required to be deposited into the Second Subordinated Bond Related Costs Fund to pay, when due, any Bond Related Costs relating to the Second Subordinated Bonds, as provided in the resolution authorizing the Second Subordinated Bonds (a "Second Subordinated Bond Related Costs Deficiency"), to pay any such Second Subordinated Bond Related Costs Deficiency, except as otherwise provided in the resolution authorizing such Second Subordinated Bonds.

**Second Subordinated Bonds.** The Board may, at any time, or from time to time, in accordance with the Subordinated Bond Resolution, the Senior Bond Resolution and applicable law, issue Second Subordinated Bonds for any of its lawful purposes, which Second Subordinated Bonds may be payable out of, and which may be secured by a pledge of and lien on, the Pledged Revenues remaining after all deposits to the funds established for the Senior Bonds and Subordinated Bonds required by the Senior Bond Resolution and Subordinated Bond Resolution have been made as provided in the Subordinated Bond Resolution; provided, however, that such pledge of and lien on Pledged Revenues shall be subordinate and junior in all respects to the lien and pledge created by the Senior Bond Resolution as security for the Senior Bonds and shall also be subordinate and junior in all respects to the lien and pledge created by the Subordinated Bond Resolution as security for the Subordinated Bonds as provided in the Subordinated Bond Resolution.

**Investment of Subordinated Bond Fund, Subordinated Bond Reserve Fund and Subordinated Bond Related Costs Funds.**

Any moneys held as a part of any of the Subordinated Bond Fund, Subordinated Bond Reserve Fund and Subordinated Bond Related Costs Fund (collectively, the "Subordinated Funds") shall be invested or reinvested in

Investment Securities, at the request of the Authorized Board Representative; 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 Subordinated Funds and Accounts.

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 Subordinated Fund or account from which they shall have been made. Except as provided for the Subordinated Bond Reserve Fund, any profit realized from those investments shall be credited, and any loss resulting therefrom shall be charged, to the respective Subordinated Fund and Accounts from which the investments shall have been made.

The State Treasurer shall sell and reduce to cash a sufficient portion of investments, whenever the cash balance in any of the Subordinated Funds or Accounts is insufficient to pay the current requirements from that Subordinated Fund or account. The State Treasurer shall sell or redeem investments credited to the respective Subordinated Funds and Accounts to produce moneys which are sufficient at the times required for the purposes of paying principal and interest on Subordinated Bonds, without the necessity for and without restriction by reason of any further order of the Board.

**Valuation.** For the purpose of determining the amount on deposit to the credit of any Subordinated Fund or account (except the Subordinated Bond Reserve Fund which shall be determined as provided in the subsequent Subordinated Bond Resolution requiring a deposit into such Fund), the value of obligations in which money in any Subordinated Fund or account shall have been invested shall be computed at market value or the amortized cost thereof, whichever is lower.

#### **PARTICULAR COVENANTS OF THE BOARD**

**Payment of Subordinated Bonds.** The Board shall duly and punctually pay or cause to be paid the Bond Service Charges on every Subordinated Bond, at the dates and places and in the manner provided in the Subordinated Bonds and the Subordinated Bond Resolution.

**Limitation on Additional Senior Bonds.** The Board covenants, for the benefit of the Owners of Subordinated Bonds, not to issue Additional Senior Bonds unless an Authorized Board Representative delivers to the Bond Registrar prior to the issuance of such Additional Senior Bonds a certificate evidencing either (a) or (b):

(a) that (i) the sum of:

(A) the amount of Pledged Revenues deposited by the State Treasurer into the State Highway Fund in any twelve consecutive months out of the most recent eighteen months preceding the issuance of such Series of Additional Senior Bonds then proposed to be issued (provided, that in the event that state legislation is enacted that changes the rate of any of the fees, excises or license taxes comprising Pledged Revenues or changes any of the transactions subject to the fees, excises or license taxes comprising Pledged Revenues, at any time subsequent to the beginning of such twelve month period, then the Authorized Board Representative shall estimate and use for these purposes the Pledged Revenues which would have been deposited into the State Highway Fund in such twelve month period if such changed rate or such change in such transactions had been in effect for the entire twelve consecutive month period); plus

(B) the amount of any other moneys received by the State Treasurer during the period described in (A) and which constitute Pledged Revenues,

(ii) was not less than three hundred percent (300%) of the maximum aggregate Adjusted Debt Service Requirements on Outstanding Senior Bonds and Outstanding Subordinated Bonds in the then current or any future Bond Year, including the maximum Adjusted Debt

Service Requirements on the Series of Additional Senior Bonds then proposed to be issued but excluding the Adjusted Debt Service Requirements on any Senior Bonds or Subordinated Bonds to be refunded that shall not be Outstanding immediately after the issuance of such Series of Additional Senior Bonds; or

(b) in the case of proposed Additional Senior Bonds to be issued for refunding purposes:

(i) by Bond Year, the aggregate Adjusted Debt Service Requirements due on all Senior Bonds and Subordinated Bonds then Outstanding immediately prior to the date of issuance of such refunding Additional Senior Bonds for the then current and each future Bond Year during which such Bonds are Outstanding; and

(ii) the aggregate Adjusted Debt Service Requirements for each Bond Year set forth in (i) above on all Senior Bonds and Subordinated Bonds to be Outstanding immediately after the issuance of such proposed refunding Additional Senior Bonds; and

(iii) that the aggregate Adjusted Debt Service Requirements set forth for each Bond Year pursuant to (ii) above is not more than 105% of that set forth for such Bond Year pursuant to (i) above.

**Creation of Other Liens.** Except for Senior Bonds, the Board shall not issue any bonds, notes, debentures, or other evidences of indebtedness of similar nature, other than the Subordinated Bonds, payable out of or secured by a pledge or assignment of the amounts on deposit in the Subordinated Bond Fund, the Subordinated Bond Reserve Fund and the Subordinated Bond Related Costs Fund.

**Agreement of State.** The Board, as agent for the State of Arizona, agrees, pursuant to the Act, that the State of Arizona will not limit or alter the rights vested in the Board to collect such fees, excises and taxes as may be necessary to produce sufficient revenues to meet the expense of the State Highway System and to fulfill the terms of the Subordinated Bond Resolution and any agreement made with the Owners of Subordinated Bonds or in any way impair the rights and remedies of the Owners of any Subordinated Bonds until all Subordinated Bonds issued under the authority of the Act, together with interest thereon and interest on any unpaid installments of interest and all costs and expenses in connection with any action or proceeding by or on behalf of any Owners, are fully met and discharged.

**Limit on Supplemental Resolutions.** The Board covenants not to adopt a Supplemental Resolution which would amend the provisions regarding the pledge for the Subordinated Bonds, the flow of funds or application of Pledged Revenues contained in the Subordinated Bond Resolution in any manner which would impair or adversely affect the rights or security of the Owners of Subordinated Bonds then Outstanding under the Subordinated Bond Resolution.

**Tax Covenant for the Series 2004B Subordinated Bonds.** The Board covenants (a) that it will take or cause to be taken such actions that may be required of it for the interest on the Series 2004B Subordinated Bonds to be and remain excluded from gross income for federal income tax purposes, (b) that it will not take or authorize to be taken any actions that would adversely affect that exclusion, and (c) that it, or persons acting for it, will, among other acts of compliance, (i) apply the proceeds of the Series 2004B Subordinated Bonds to the governmental purposes of the borrowing, (ii) restrict the yield on investment property, (iii) make timely and adequate payments to the federal government as required under the Tax Compliance Certificate of the Board and the Department relating to the Series 2004B Subordinated Bonds, (iv) maintain books and records and make calculations and reports, and (v) refrain from certain uses of those proceeds and, as applicable, of property financed with such proceeds, all in such manner and to the extent necessary to assure such exclusion of that interest under the Code. The Board also covenants that it will use, and will restrict the use and investment of, the proceeds of the Series 2004B Subordinated Bonds in such manner and to such extent as may be necessary to comply with the Code.

## SUPPLEMENTAL RESOLUTIONS

**Supplemental Resolutions Effective when Adopted.** 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 Subordinated Bond Resolution, which, when adopted, shall be fully effective in accordance with its terms:

(a) To cure any ambiguity, inconsistency or formal defect or omission in the Subordinated Bond Resolution;

(b) To cure any inconsistency between the Subordinated Bond Resolution and the Senior Bond Resolution in effect prior to the Subordinated Bond Resolution;

(c) To close the Subordinated Bond Resolution against, or provide limitations and restrictions (in addition to the limitations and restrictions contained in the Subordinated Bond Resolution) on, the issuance of Additional Subordinated Bonds or the issuance of Additional Senior Bonds or other evidences of indebtedness;

(d) To add to the covenants and agreements of the Board in the Subordinated Bond Resolution, other covenants and agreements to be observed by the Board which are not contrary to or inconsistent with the Subordinated Bond Resolution as theretofore in effect;

(e) To add to the limitations and restrictions in the Subordinated Bond Resolution, other limitations and restrictions to be observed by the Board which are not contrary to or inconsistent with the Subordinated Bond Resolution as theretofore in effect;

(f) To authorize Additional Subordinated Bonds and, in connection therewith, specify and determine the matters and things referred to as general terms and provisions of Subordinated Bonds in the Subordinated Bond Resolution, and also any other matters and things relative to such Additional Subordinated Bonds which are not contrary to or inconsistent with the Subordinated Bond Resolution as theretofore in effect, or to amend, modify or rescind any such authorization, specification or determination at any time prior to the first issuance of such Additional Subordinated Bonds;

(g) To authorize, in compliance with all applicable law, Additional Subordinated Bonds of each Series to be issued in the form of coupon Subordinated Bonds and, in connection therewith, specify and determine the matters and things relative to the issuance of such coupon Subordinated Bonds, including provisions relating to the timing and manner of provision of any notice required to be given under the Subordinated Bond Resolution to the Owners of such coupon Subordinated Bonds, which are not contrary to or inconsistent with the Subordinated Bond Resolution as theretofore in effect or to amend, modify or rescind any such authorization, specification or determination at any time prior to the first issuance of such coupon Subordinated Bonds;

(h) To authorize, in compliance with all applicable law, Additional Subordinated Bonds to be issued in the form of Additional Subordinated Bonds issued and held in book-entry form on the books of the Board or any Fiduciary appointed for that purpose by the Board and, in connection therewith, make such additional changes in the Subordinated Bond Resolution, not adverse to the rights of the Owners of the Additional Subordinated Bonds, as are necessary or appropriate to accomplish or recognize such book-entry form Additional Subordinated Bonds and specify and determine the matters and things relative to the issuance of such book-entry form Subordinated Bonds as are appropriate or necessary;

(i) Notwithstanding any other provisions of the Subordinated Bond Resolution, to authorize, in compliance with all applicable laws, Additional Subordinated Bonds having terms and provisions different than the terms and provisions theretofore provided in the Subordinated Bond Resolution, including but not limited to provisions relating to the timing of the payment of interest, and maturity amounts, valuation of investments as of a

given time, and authorizing the form of bond for such Additional Subordinated Bonds and otherwise to provide amendments or modifications of provisions of the Subordinated Bond Resolution relative to such Additional Subordinated Bonds; provided that neither the issuance of such Additional Subordinated Bonds nor any such amendments or modifications shall in any manner impair or adversely affect the rights or security of the Owners of Subordinated Bonds then Outstanding or other persons under the Subordinated Bond Resolution;

(j) To confirm, as further assurance, any pledge or assignment under, and the subjection to any security interest, pledge or assignment created or to be created by, the Subordinated Bond Resolution of the amounts on deposit in the Subordinated Bond Fund, Subordinated Bond Reserve Fund and Subordinated Bond Related Costs Fund and to pledge any additional revenues, moneys, securities or agreements as may be permitted by law and the Senior Bond Resolution for deposit in the Subordinated Bond Fund, Subordinated Bond Reserve Fund and Subordinated Bond Related Costs Fund;

(k) 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;

(l) To amend provisions of the clauses regarding the flow of funds for the Senior Bonds as provided in the Subordinated Bond Resolution; and

(m) To modify any of the provisions of the Subordinated Bond Resolution in any other respect whatever, provided that (i) such modification shall be, and be expressed to be, effective only after all Subordinated Bonds 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.

**Supplemental Resolutions Effective With Consent of Owners.** At any time or from time to time any modification or amendment of the Subordinated Bond Resolution and of the rights and obligations of the Board and of the Owners of the Subordinated Bonds thereunder, in any particular, may be made by a Supplemental Resolution, with the written consent given as provided in the Subordinated Bond Resolution (i) of the Owner of at least a majority in principal amount of the Subordinated Bonds Outstanding at the time such consent is given and (ii) in case less than all of the several Series of Subordinated Bonds then Outstanding are affected by the modification or amendment, of the Owners of at least a majority in principal amount of the Subordinated Bonds of each Series so affected and Outstanding at the time such consent is given; provided, however, that if such modification or amendment will, by its terms, not take effect so long as any Subordinated Bonds of any specified like Series and maturity remain Outstanding, the consent of the Owners of such Subordinated Bonds shall not be required and such Subordinated Bonds shall not be deemed to be Outstanding for the purpose of this calculation of Outstanding Subordinated Bonds.

The provider of Credit Enhancement for a Series of Subordinated Bonds has the right, on behalf of the Owners of such Series, to consent to amendments to the Subordinated Bond Resolution, without notice to or consent of such Owners. Such rights will terminate if the provider of Credit Enhancement is in default of its obligations to make payments under its Credit Enhancement and upon the occurrence of certain other events affecting such provider.

No such modification or amendment shall permit a change: (i) in the terms of redemption (including mandatory sinking fund requirements) or maturity of the principal of any Outstanding Subordinated Bond; or of any installment of interest thereon or a reduction in the principal amount or the redemption price thereof or in the rate of interest thereon without the consent of the Owner of such Subordinated Bond; or (ii) which shall reduce the percentages or otherwise affect the classes of Subordinated Bonds the consent of the Owners of which is required to effect any such modification or amendment; or (iii) in any of the rights or obligations of any Fiduciary without its written assent thereto.

## **DEFAULTED INTEREST**

Any interest on any Subordinated Bond which is payable, but is not punctually paid or duly provided for, on any Interest Payment Date (hereinafter "Defaulted Interest"), shall cease to be payable to the Owner on the relevant Regular Record Date by virtue of having been such Owner; and such Defaulted Interest shall be paid to the persons in whose names such Subordinated Bonds are registered at the close of business on a date (hereinafter the "Special Record Date") for the payment of such Defaulted Interest, which shall be fixed in the following manner. The Board shall notify the Paying Agent in writing of the amount of Defaulted Interest proposed to be paid on each such Subordinated Bond and the date of the proposed payment, and at the same time the Board shall deposit with the Paying Agent an amount of money equal to the aggregate amount proposed to be paid in respect of such Defaulted Interest or shall make arrangements satisfactory to the Paying Agent for such deposit prior to the date of the proposed payment, such money when deposited to be held in trust for the benefit of the persons entitled to such Defaulted Interest as provided in the Subordinated Bond Resolution. Thereupon the Paying Agent shall fix a Special Record Date for the payment of such Defaulted Interest which shall be not more than 15 nor less than 10 days prior to the date of the proposed payment and not less than 10 days after the receipt by the Paying Agent of the notice of the proposed payment. The Paying Agent shall promptly notify the Board of such Special Record Date and, in the name and at the expense of the Board, shall cause notice of the proposed payment of such Defaulted Interest and the Special Record Date therefor to be mailed, first class postage prepaid, to each Owner at his address as it appears in the registration books of the Board, not less than 10 days prior to such Special Record Date.

## **DEFEASANCE**

The lien of the Subordinated Bond Resolution and all covenants, agreements and other obligations of the Board under the Subordinated Bond Resolution shall cease, terminate and become void and be discharged and satisfied in the event that the Bonds are deemed to be paid and discharged pursuant to the terms of the Subordinated Bond Resolution.

Subject to the provisions of the Subordinated Bond Resolution, any Outstanding Subordinated Bonds shall, prior to the maturity or redemption date thereof, be deemed to have been paid and shall cease to be entitled to any lien, benefit or security under the Subordinated Bond Resolution, whenever the following conditions are met if: (i) in case any of said Subordinated Bonds are to be redeemed on any date prior to their maturity, the Board shall have given to the Bond Registrar instructions accepted in writing by the Bond Registrar to mail (as provided in the Subordinated Bond Resolution) notice of redemption of such Subordinated Bonds (other than Subordinated Bonds which have been purchased or otherwise acquired by the Board and delivered to the Bond Registrar prior to the mailing of such notice of redemption) on said date; (ii) there shall have been deposited with an Escrow Agent appointed for such purposes under an irrevocable escrow agreement, in trust for the Owners of such Subordinated Bonds, either moneys in an amount which shall be sufficient, or Defeasance Securities as defined below (including any Defeasance Securities 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 to pay when due the Bond Service Charges due and to become due on said Subordinated Bonds on or prior to the redemption date or maturity date thereof, as the case may be; (iii) in the event said Subordinated Bonds are not by their terms subject to redemption within the next succeeding 60 days, the Board shall have given the Bond Registrar in form satisfactory to it instructions to mail a notice to the Owners of such Subordinated Bonds that the deposit required by (ii) above has been made with the Escrow Agent and that said Subordinated Bonds are deemed to have been paid in accordance with the Subordinated Bond Resolution; and stating such maturity or redemption date upon which moneys are expected to be available for the payment of the Bond Service Charges on said Subordinated Bonds (other than Subordinated Bonds which have been purchased or otherwise acquired by the Board and delivered to the Bond Registrar prior to the mailing of the notice of redemption referred to in clause (i) hereof; and (iv) the Board shall have received a report of an independent nationally recognized firm of certified public accountants to the effect that the amount of moneys and the principal of and interest when due on the Defeasance Securities deposited at the same time with the Escrow Agent shall be sufficient to pay when due the Bond Service Charges due and to become due on said Subordinated Bonds on or prior to the redemption or maturity date thereof, as the case may be.

“Defeasance Securities” means if and to the extent the same are at the time legal for investment of the Board’s funds:

(1) 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 and obligations issued by the Resolution Trust Corporation;

(2) direct and general obligations of any state of the United States or any political subdivision thereof to the payment of the principal of and interest on which the full faith and credit of such state or political subdivision are pledged or any bonds or other obligations which as to principal and interest are unconditionally guaranteed as to full and timely payment of principal and interest by such state or political subdivision, provided that at the time of their purchase such obligations are rated in the highest Rating Category by both Rating Agencies;

(3) certificates or other instruments that evidence ownership or 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 (A) such obligations shall be held in trust 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 (B) that the payments of all principal of and interest on such certificates or such obligations shall be fully insured or unconditionally guaranteed by, or otherwise unconditionally payable pursuant to Credit Enhancement provided by, one or more financial institutions or insurance companies or associations which shall be rated at the time of purchase thereof in the highest Rating Category by both Rating Agencies, or, in the case of an insurer providing municipal bond 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 rated at the time of purchase in the highest Rating Category by both Rating Agencies;

(4) certificates of other instruments that evidence ownership or the right to payments of principal or interest on obligations of the character described in clauses (1), (2) or (3) or specified portions thereof, provided that (A) such obligations shall be held in custody of a bank or trust company or a national banking association having capital stock, surplus and undivided earnings aggregating at least \$50,000,000, (B) the owner of the investment is the real party in interest and has the right to proceed directly against the obligor of the United States obligations and (C) the obligations are not available to satisfy any claim of the custodian of the underlying obligation or any person claiming through the custodian or to whom the custodian may be obligated;

(5) any 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 (A) which are (x) not callable prior to maturity or (y) as to which irrevocable instructions have been given 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, (B) which are secured as to principal and interest and redemption premium, if any, by a fund consisting only of cash or bonds or other obligations of the character described in clauses (1), (2) and (3), which fund may be applied only to the payment of such principal of and interest and redemption premium, if any, on such bonds or other obligations on the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable instructions, as appropriate, and (C) as to which the principal of and interest on the bonds and obligations of the character described in clauses (1), (2) and (3), hereof which have been deposited in such fund along with any cash on deposit in such fund are sufficient to pay, without reinvestment, principal of and interest and redemption premium, if any, on the bonds or other obligations described in this clause (5) on the maturity date or dates thereof or on the redemption date or dates specified in the irrevocable instructions referred to in subclause (y) of this clause (5), as appropriate.

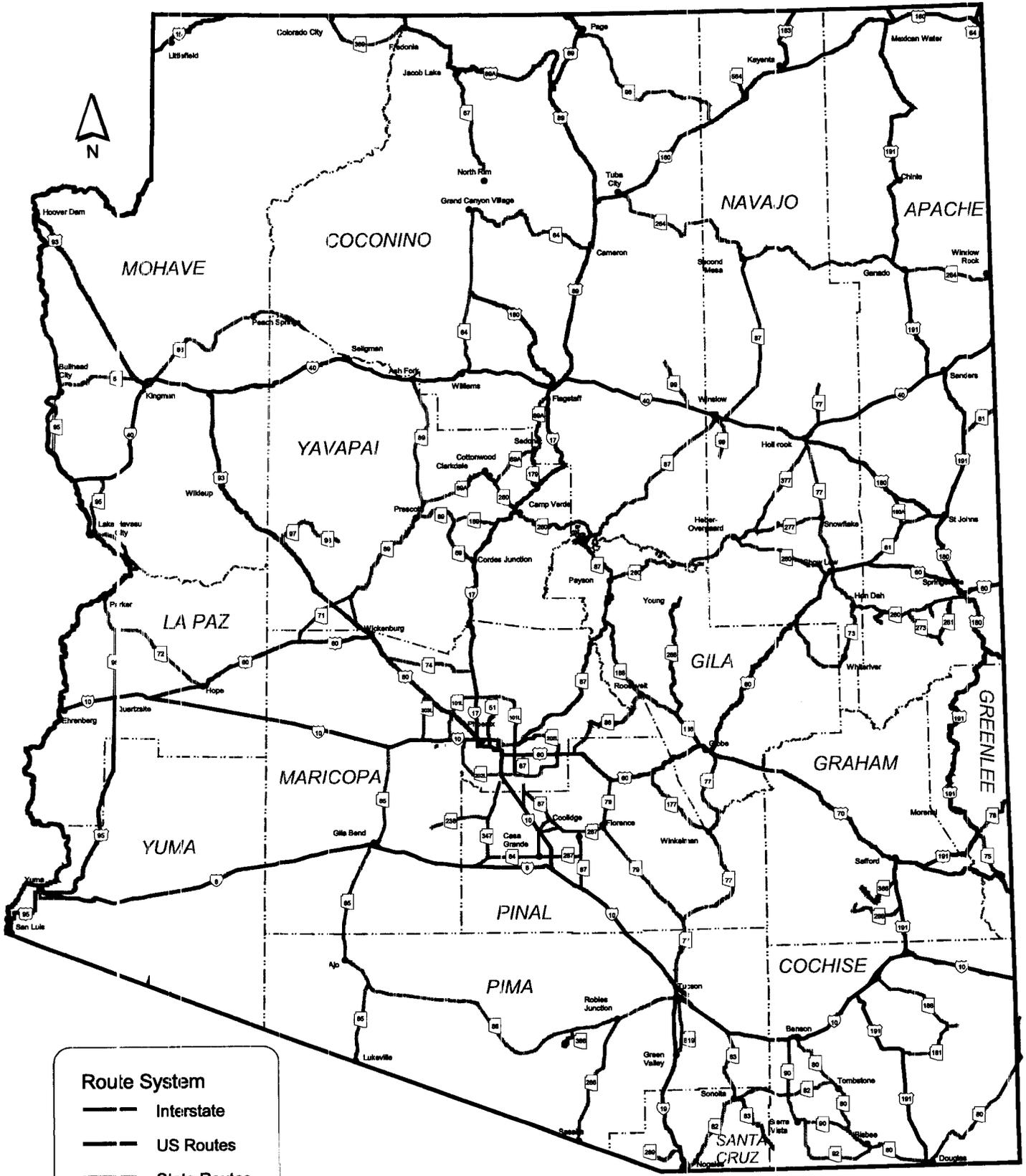
Defeasance Securities shall consist of securities which are not subject to redemption prior to their maturity other than at the option of the holder thereof, or shall consist of securities as to which an irrevocable notice of redemption of such securities on a specified redemption date has been given and such securities are not otherwise subject to redemption prior to such specified date.

For purposes of determining whether Subordinated Bonds that bear interest at a Variable Interest Rate shall be deemed to have been paid, by the deposit of moneys, or Defeasance Securities and moneys, if any, in accordance with the Subordinated Bond Resolution, the interest to come due on such Subordinated Bonds that bear interest at a Variable Interest Rate on or prior to the maturity date or redemption date thereof, as the case may be, shall be calculated at the Maximum Interest Rate permitted by the terms thereof; provided, however, that if on any date, as a result of such Subordinated Bonds that bear interest at a Variable Interest Rate having borne interest at less than such Maximum Interest Rate for any period, the total amount of moneys and Defeasance Securities on deposit with the Escrow Agent for the payment of interest on such Subordinated Bonds that bear interest at a Variable Interest Rate is in excess of the total amount which would have been required to be deposited with the Escrow Agent on such date in respect of such Subordinated Bonds that bear interest at a Variable Interest Rate in order to satisfy the provisions of the Subordinated Bond Resolution, the Escrow Agent shall, if requested by the Board, deposit the amount of such excess into the State Highway Fund free and clear of any trust, lien, pledge or assignment securing the Subordinated Bonds or otherwise existing under the Subordinated Bond Resolution.

Optional Tender Subordinated Bonds shall be deemed to have been paid in accordance with the Subordinated Bond Resolution only if, in addition to satisfying the requirements stated above, there shall have been deposited with the Escrow Agent moneys in an amount which shall be sufficient to pay when due the maximum amount of Bond Service Charges on such Optional Tender Subordinated Bonds which could become payable to the Owners of such Optional Tender Subordinated Bonds upon the exercise of any options provided to the Owners of such Optional Tender Subordinated Bonds; provided, however, that if, at the time a deposit is made with the Escrow Agent pursuant to the Subordinated Bond Resolution, the options originally exercisable by the Owner of an Optional Tender Subordinated Bond are not longer exercisable, such Bond shall not be considered an Optional Tender Subordinated Bond for purposes of this subsection.

Notwithstanding the foregoing, any provisions of the Subordinated Bond Resolution which relate to: (i) the maturity of Subordinated Bonds; (ii) the interest payments and dates thereof; (iii) the optional and mandatory redemption provisions; (iv) the credits against the mandatory sinking fund requirements; (v) the exchange, transfer and registration of Subordinated Bonds; (vi) the replacement of mutilated, destroyed, lost or stolen Subordinated Bonds; (vii) the safekeeping and cancellation of Subordinated Bonds; (viii) the nonpresentment of Subordinated Bonds; (ix) the holding of moneys in trust; (x) the repayments to the Board from the Subordinated Funds; (xi) the timely payment of any rebate of Excess Earnings to the United States and any other provisions which relate to exclusion of interest on the Subordinated Bonds from gross income for federal income tax purposes; and (xii) the duties of the Fiduciaries in connection with all of the foregoing and payment of their fees and expenses; shall remain in effect and shall be binding upon the Board, the Fiduciaries and the Owners, notwithstanding the release, discharge and satisfaction of the Subordinated Bond Resolution. These provisions of the Subordinated Bond Resolution shall survive the release, discharge and satisfaction of the Subordinated Bond Resolution.

# State Highway System



**Route System**

- Interstate
- US Routes
- State Routes



