OFFICIAL STATEMENT

NEW ISSUE – Book-Entry Only **RATINGS: (See "RATINGS" herein)**

$104,385,000
ARIZONA TRANSPORTATION BOARD
GRANT ANTICIPATION NOTES
SERIES 2004B

Dated: October 1, 2004 **Due: July 1, as shown on the inside cover page hereof**

The Grant Anticipation Notes, Series 2004B (the "Series 2004B Notes") are being issued by the Arizona Transportation Board (the "Board") only as fully registered notes under a book-entry only system. The Series 2004B Notes will be registered initially in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the Series 2004B Notes. Purchases of beneficial interests in the Series 2004B Notes will be made in book-entry-only form in denominations of $5,000 or any integral multiple thereof. Purchasers will not receive certificates representing the ownership interest in the Series 2004B Notes purchased by them.

Interest on the Series 2004B Notes is payable on January 1 and July 1 of each year, commencing July 1, 2005, by check or draft mailed on each Interest Payment Date by the paying agent, initially J.P. Morgan Trust Company, National Association (the "Paying Agent").

So long as the Series 2004B Notes are registered in the name of DTC, or its nominee, payments of the principal of and interest on the Series 2004B Notes will be made directly by the Paying Agent to DTC which, in turn, is obligated to remit such payments to its participants for subsequent distribution to beneficial owners of the Series 2004B Notes, as described herein.

The Series 2004B Notes are being issued to (i) pay a portion of the costs of construction of the Series 2004B Project (as defined herein) and (ii) pay costs of issuing the Series 2004B Notes.

The maturities, interest rates and prices or yields of the Series 2004B Notes are shown on the reverse side of this cover page. The Series 2004B Notes are subject to redemption prior to their respective maturity dates as more fully described herein.

The Series 2004B Notes are special and limited obligations of the Board. The Series 2004B Notes, together with outstanding Notes previously issued by the Board and with any Additional Notes that are subsequently issued on a parity therewith (collectively, "Notes"), are payable from, and secured solely by a pledge of, amounts on deposit in the Grant Anticipation Note Fund and Note Proceeds Account (the "Pledged Funds"), created under the Note Resolution and held by the State Treasurer. The Board is required by the Note Resolution to deposit revenues received from the Federal Highway Administration under certain Grant Agreements into the Grant Anticipation Note Fund. Under certain conditions, the Board is also required to deposit other available Federal Aid Revenues and certain available State highway user revenues into the Grant Anticipation Note Fund. See "SECURITY AND SOURCES OF PAYMENT FOR THE NOTES" herein. **The Series 2004B Notes are not obligations, general, special or otherwise, of the State of Arizona (the "State"), do not constitute a legal debt of the State and are not enforceable against the State, nor shall payment thereof be enforceable out of any monies of the State, the Board or the Department of Transportation, other than from the Pledged Funds.**

Payment of the principal of and interest on the Series 2004B Notes when due will be insured by a financial guaranty insurance policy issued simultaneously with the delivery of the Series 2004B Notes by Ambac Assurance Corporation.

Ambac

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 Notes is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations, and (ii) interest on the Series 2004B Notes is exempt from Arizona state income tax. Interest on the Series 2004B Notes may be subject to certain federal taxes imposed only on certain corporations, including the corporate alternative minimum tax on a portion of that interest. For a more complete discussion of tax aspects, see "TAX MATTERS" herein.

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

The Series 2004B Notes are offered when, as and if issued, 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 on for the Underwriters by Greenberg Traurig, L.L.P. It is expected that the Series 2004B Notes in book-entry form will be available for delivery through the facilities of DTC on or about November 10, 2004.

Bear, Stearns & Co. Inc.

Citigroup **JPMorgan**

A.G. Edwards & Sons Inc.

October 27, 2004

$104,385,000
ARIZONA TRANSPORTATION BOARD
GRANT ANTICIPATION NOTES
SERIES 2004B

MATURITY SCHEDULE

Maturity (July 1)	Amount	Interest Rate	Yield	CUSIP
2008	$ 2,500,000	3.750%	2.320%	040647 BW8
2008	7,230,000	5.000	2.320	040647 CF4
2009	2,940,000	3.750	2.610	040647 BX6
2009	7,250,000	5.000	2.610	040647 CG2
2010	2,500,000	4.000	2.860	040647 BY4
2010	8,155,000	5.000	2.860	040647 CH0
2011	11,160,000	5.000	3.040	040647 BZ1
2012	11,730,000	5.000	3.210	040647 CA5
2013	12,320,000	5.000	3.350	040647 CB3
2014	12,935,000	5.000	3.450	040647 CC1
2015	13,575,000	5.000	3.550*	040647 CD9
2016	12,090,000	5.000	3.620*	040647 CE7

(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

Barclay Dick
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

CONTACT PERSONS CONCERNING THIS OFFERING:

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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"), the State of Arizona Department of Transportation (the "Department") or the Underwriters. 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 Notes, by any person in any jurisdiction where such offer or solicitation or sale would be unlawful.

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

The Series 2004B Notes will not be registered under the Securities Act of 1933, as amended, or any state securities law, and will not be listed on any stock or other securities exchange. Neither the Securities and Exchange Commission nor any other federal, state or other governmental entity or agency has passed upon the accuracy of this Official Statement.

The Board has undertaken to provide continuing disclosure with respect to the Series 2004B Notes as required by Rule 15c2-12 of the Securities and Exchange Commission. See "CONTINUING DISCLOSURE UNDERTAKING" and "APPENDIX E – FORM OF CONTINUING DISCLOSURE UNDERTAKING" herein.

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 EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE SERIES 2004B NOTES AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET IN ORDER TO FACILITATE THEIR DISTRIBUTION. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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OFFICIAL STATEMENT

relating to

$104,385,000

Arizona Transportation Board
Grant Anticipation Notes
Series 2004B

INTRODUCTION

This Official Statement (including the cover page and Appendices attached hereto) provides certain information in connection with the initial issuance by the Arizona Transportation Board (the "Board") of its Grant Anticipation Notes, Series 2004B (the "Series 2004B Notes") in the aggregate principal amount of $104,385,000. The Series 2004B Notes are issued pursuant to the Grant Anticipation Note law, Title 28, Chapter 21, Article 3, Arizona Revised Statutes (the "Act"), and under and pursuant to a resolution adopted by the Board on June 9, 2000, as supplemented to date, including a supplemental resolution adopted on September 17, 2004 (as it may be subsequently amended in accordance with its terms, collectively the "Note Resolution").

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

The Board establishes policy for the State of Arizona Department of Transportation (the "Department") and issues bonds and notes to finance the highway program of the State of Arizona (the "State"). The Department administers the State highway program. Under the Act, the Board is authorized to issue notes in anticipation of the receipt of revenues under one or more grant agreements between the Department and the Federal Highway Administration ("FHWA"). The Department has entered into grant agreements (collectively, the "Series 2004B Grant Agreement") with FHWA relating to the construction by the Department of certain controlled-access highways within Maricopa County, Arizona, and improvements related thereto (the "Series 2004B Project"). The Series 2004B Notes are being issued for the purpose of (i) paying a portion of the costs of the Series 2004B Project and (ii) paying the costs of issuing the Series 2004B Notes. See "PLAN OF FINANCE." The Department expects to use revenue received under the 2004B Grant Agreement and other available Federal Aid Revenues to pay the Debt Service on the Series 2004B Notes.

The Series 2004B Notes are special and limited obligations of the Board. The Debt Service on the Series 2004B Notes, together with the outstanding Notes and any Additional Notes that may be subsequently issued by the Board on a parity with the Series 2004B Notes (collectively, the "Notes"), are payable from and secured solely by a pledge of amounts on deposit in the Grant Anticipation Note Fund and Note Proceeds Account (collectively, the "Pledged Funds") created under the Note Resolution and held by the State Treasurer. After the issuance of the Series 2004B Notes, there will be $412,970,000 aggregate principal amount of Series 2001A, Series 2003A, Series 2004A and Series 2004B Notes outstanding. The Note Resolution requires the Board to deposit all revenues received from the FHWA under all Grant Agreements relating to Notes into the Grant Anticipation Note Fund (unless sufficient amounts have already been deposited in such Fund from other sources), which Fund shall only be used to pay Debt Service on Notes. Under certain conditions, the Board is also required to deposit into the Grant Anticipation Note Fund other available Federal Aid Revenues and certain available State highway user revenues. See "SECURITY AND SOURCES OF PAYMENT FOR THE NOTES." Payment of Debt Service on the Series 2004B Notes is not subject to annual appropriation by the Legislature of the State and such payments comply with all applicable constitutional or statutory limitation on expenditures.

The primary source of Federal Aid Revenues is amounts distributed to the Department by the federal government pursuant to the Federal Aid Authorization. The current interim federal authorization expires on May 31, 2005. See "INFORMATION CONCERNING THE FUNDING OF FEDERAL-AID HIGHWAYS-TEA-21 Reauthorization."

Payment of the principal of and interest on the Series 2004B Notes when due will be insured by a financial guaranty insurance policy issued by Ambac Assurance Corporation (the "Insurer").

The Series 2004B Notes are not obligations, general, special or otherwise, of the State, do not constitute a legal debt of the State and are not enforceable against the State, nor shall payment thereof be enforceable out of any monies of the State, the Board or the Department other than from the Pledged Funds.

This Official Statement describes the terms of and security for the Series 2004B Notes and the use of proceeds of the Series 2004B Notes. Also included are summaries of certain provisions of the Note Resolution, the Series 2004B Grant Agreement and the other Grant Agreements relating to the Notes and Title 23 of the U.S. Code and other provisions of Federal law which govern the Federal Aid Highway Program. These descriptions and summaries do not purport to be comprehensive or definitive. All references herein to the Note Resolution and the Grant Agreements are qualified in their entirety by reference to the definitive form thereof, all references to Federal laws and the Act are qualified in their entirety by reference to the complete statutes, regulations and published interpretations by Federal officials, and all references to the Series 2004B Notes are qualified by the forms thereof contained in the Note Resolution and are further qualified in their entirety by reference to laws and principles of equity relating to or affecting the enforceability of creditors' rights. Copies of the Note Resolution and the Grant Agreements may be obtained as set forth under "MISCELLANEOUS."

SERIES 2004B PROJECT

The Series 2004B Project consists of portions of certain controlled-access highways within Maricopa County, Arizona to be constructed by the Department, and for which the Series 2004B Grant Agreement has been executed with FHWA. The Department may also use the proceeds of the Series 2004B Notes to pay a portion of the construction costs of other controlled-access highway projects as additional grant agreements are executed with FHWA.

The FHWA has authorized portions of the Series 2004B Project as advance construction projects under Title 23 and has determined that the Series 2004B Project is eligible for Federal Aid Revenues under Title 23. The FHWA has agreed under the Series 2004B Grant Agreement to make payments to the Department in amounts equal to the Debt Service on the Series 2004B Notes, when due. Such payments may be used by the Department under Title 23 and the terms of the Series 2004B Grant Agreement to pay Debt Service on the Notes, including the Series 2004B Notes. As required by Title 23, the Series 2004B Project has been included by the metropolitan planning organization for Maricopa County in the transportation improvement program of Maricopa County and by the Board in the transportation improvement program of the State. See "INFORMATION CONCERNING THE FUNDING OF FEDERAL-AID HIGHWAYS – Regional Planning and Air Conformity." Under the Note Resolution, the Department has covenanted to comply with applicable law and the Series 2004B Grant Agreement to the extent required to receive all revenues from the FHWA under the 2004B Grant Agreement.

PLAN OF FINANCE

Approximately $115,000,000 of the proceeds received from the sale of the Series 2004B Notes will be used to pay a portion of the costs of the Series 2004B Project, and the balance of the proceeds will be used to pay the costs of issuing the Series 2004B Notes. The estimated sources and uses of the proceeds of the Series 2004B Notes (exclusive of accrued interest, which will be used to pay interest on the Series 2004B Notes) is as follows:

Sources:

Par Amount of Series 2004B Notes	$104,385,000.00
Net Original Issue Premium	11,551,292.95
Total Sources	$115,936,292.95

Uses:

Costs of Series 2004B Project	$115,000,000.00
Costs of Issuance (including Underwriters' Discount and Bond Insurance Premium)	936,292.95
Total Uses	$115,936,292.95

THE SERIES 2004B NOTES

General Description

The Series 2004B Notes will be issued in the principal amounts and with maturity dates shown on the inside cover page of this Official Statement. The Series 2004B Notes will be dated as of October 1, 2004 and shall bear interest from such date, payable on January 1 and July 1 of each year, commencing July 1, 2005. Interest shall be calculated based on a year of 360 days and twelve 30-day months.

As described in Appendix D – "BOOK-ENTRY-ONLY SYSTEM," the Series 2004B Notes, when issued, will be registered in the name of Cede & Co., as registered owner and nominee of The Depository Trust Company, New York, New York ("DTC"). So long as DTC, or its nominee Cede & Co., is the registered owner of all the Series 2004B Notes, all payments on the Series 2004B Notes will be made directly to DTC.

The principal of the Series 2004B Notes shall be payable in lawful money of the United States of America at the designated corporate trust office of the Paying Agent. J.P. Morgan Trust Company, National Association will initially serve as Paying Agent and Note Registrar for the Series 2004B Notes. Payment of the interest on any Series 2004B Note shall be made to the person whose name appears on the note registration books of the Note Registrar as the registered owner thereof (the "Owner") as of the close of business on the 15th day of the month preceding the Interest Payment Date (the "Record Date"). Interest will be paid by check or draft mailed to the Owner at the address shown on such registration books. At the option of any Owner of at least $1,000,000 in aggregate principal amount of the Series 2004B Notes, principal and interest shall be paid by wire transfer to a bank account located in the continental United States, at the expense of such Owner, if such Owner has made such request in writing to the Note Registrar prior to the Record Date. As long as the DTC book-entry-only system is in effect, Cede & Co. is the Owner and will receive all payments of Debt Service.

Any such interest not so punctually paid or duly provided for shall cease to be payable to the Owner on such Record Date and shall be paid to the person in whose name the Series 2004B Note is registered at the close of business on a Special Record Date for the payment of such defaulted interest to be fixed by the Paying Agent, notice whereof being given to the Owners not less than 10 days prior to such Special Record Date.

Redemption Provisions

Optional Redemption.

The Series 2004B Notes maturing on or prior to July 1, 2014, are not subject to optional redemption prior to maturity. The Series 2004B Notes maturing on and 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 Notes to be redeemed plus accrued interest to the date fixed for redemption, but without premium.

Notice of Redemption.

The Note Registrar shall give notice by mail of the redemption of the Series 2004B Notes, 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 Notes or portions thereof to be redeemed at their last address appearing on the note register of the Board. Such notice shall specify the maturities of the Series 2004B Notes 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 Notes of like maturity are to be redeemed, the particular Series 2004B Notes or portions thereof to be redeemed. Any defect in the notice to the Owner of any Series 2004B Note which is to be redeemed shall not affect the validity of the proceedings for the redemption of any other Series 2004B Note. 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 Note to notify the beneficial owner shall not affect the validity of the redemption of such Series 2004B Note.

So long as the Series 2004B Notes 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 Notes 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 Notes 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 Notes 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 Notes there has not been deposited with the Paying Agent moneys sufficient to redeem all the Series 2004B Notes called for optional redemption, then such notice shall state that the optional redemption is conditional upon the deposit of moneys sufficient for the redemption with the Paying Agent not later than the redemption date, and such notice will be of no effect and such Series 2004B Notes shall not be optionally redeemed unless such moneys are so deposited.

Exchange and Transfer

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

The registration of any Series 2004B Note may be transferred upon the note register of the Board by the Owner thereof, in person or by his or her duly authorized attorney, upon surrender of such Series 2004B Note at the designated office of the Note Registrar accompanied by a written instrument of transfer satisfactory to the Note Registrar and duly executed by the Owner or by his or her duly authorized attorney. Any Series 2004B Note may be exchanged at the designated office of the Note Registrar for new Series 2004B Notes of any authorized denomination, aggregate principal amount and maturity as the surrendered Series 2004B Note. The Note Registrar will not charge an administrative fee for any new Series 2004B Note issued upon any exchange or transfer, but may require the Owner requesting such exchange or transfer to pay any tax or other governmental charge required to be paid with respect to such exchange or transfer. The Note Registrar is not required to exchange or transfer any Series 2004B Note during the period commencing on June 15 and December 15 of each year and ending on the subsequent July 1 or January 1, respectively.

Defeasance

If the Board pays or causes to be paid, or there is otherwise paid, to the Owners of all outstanding Series 2004B Notes or Series 2004B Notes of a particular maturity or a particular Series 2004B Note within a maturity, the principal and interest due or to become due thereon, at the times and in the manner stipulated therein and in the Note Resolution, such Series 2004B Notes will cease to be entitled to any pledge, benefit or security under the Note Resolution, and all covenants, agreements and obligations of the Board to the Owners of such Series 2004B Notes will thereupon cease, terminate and become void and be discharged and satisfied.

Subject to the provisions of the Note Resolution, any outstanding Series 2004B Notes will be deemed to have been paid within the meaning and with the effect expressed in the foregoing paragraph if there has been deposited with an escrow agent appointed for such purpose either money in an amount which will be sufficient, or Defeasance Obligations as prescribed in the Note Resolution, the principal of and the interest on which, when due, will provide money which, together with the money, if any, deposited with the escrow agent at the same time, will be sufficient to pay when due the principal and interest due and to become due on such Series 2004B Notes on or prior to the maturity date thereof. See "Defeasance" in Appendix C.

Certain Powers of the Insurer with respect to Amendments to the Note Resolution

The Insurer (as defined below) may consent to certain amendments to the Note Resolution upon behalf of the owners of the Series 2004B Notes, without the consent of or notice to the Owners of the Series 2004B Notes so long as the Insurer's Policy (as defined below) is in effect and the Insurer has not lost its consent to rights under the Note Resolution and regardless of the current ratings on bonds insured by the Insurer, including the Series 2004B Notes, or the effect of any such action or amendment on the ratings on the Series 2004B Notes. See "Note Insurer as Owner" in Appendix C. Such amendments could result in the modification, waiver or removal of existing covenants or restrictions contained in the Note Resolution. The Insurer shall have sole discretion, with regard to the Series 2004B Notes, as to whether to consent to any proposed amendment on behalf of the Owners of the Series 2004B Notes, and shall incur no liability to any Owner of an Series 2004B Note in connection with granting any such consent.

MUNICIPAL BOND INSURANCE

Payment Pursuant to Financial Guaranty Insurance Policy

The following information has been furnished by Ambac Assurance Corporation ("Ambac Assurance" or the "Insurer") for use in this Official Statement. Reference is made to Appendix F for a specimen of the hereinafter described Policy.

Ambac Assurance has made a commitment to issue a financial guaranty insurance policy (the "Financial Guaranty Insurance Policy" or the "Policy") relating to the Series 2004B Notes effective as of the date of execution and delivery of the Series 2004B Notes. Under the terms of the Financial Guaranty Insurance Policy, Ambac Assurance will pay to The Bank of New York, in New York, New York or any successor thereto (the "Insurance Trustee") that portion of the principal and interest represented by the Series 2004B Notes which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Obligor (as such terms are defined in the Financial Guaranty Insurance Policy). Ambac Assurance will make such payments to the Insurance Trustee on the later of the date on which such principal and interest becomes Due for Payment or within one business day following the date on which Ambac Assurance shall have received notice of Nonpayment from the Paying Agent. The insurance will extend for the term of the Series 2004B Notes and, once issued, cannot be canceled by Ambac Assurance.

The Financial Guaranty Insurance Policy will insure payment only on stated maturity dates and on mandatory sinking fund installment dates, in the case of principal, and on stated dates for payment, in the case of interest. If the Series 2004B Notes become subject to mandatory redemption and insufficient funds are available for redemption of all outstanding Series 2004B Notes, Ambac Assurance will remain obligated to pay principal of and interest represented by outstanding Series 2004B Notes on the originally scheduled interest and principal payment dates including mandatory sinking fund redemption dates. In the event of any acceleration of the principal

represented by the Series 2004B Notes, the insured payments will be made at such times and in such amounts as would have been made had there not been an acceleration.

In the event the Paying Agent has notice that any payment principal or interest represented by a Series 2004B Notes which has become Due for Payment and which is made to an Owner by or on behalf of the Board has been deemed a preferential transfer and theretofore recovered from an Owner pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such Registered Owner will be entitled to payment from Ambac Assurance to the extent of such recovery if sufficient funds are not otherwise available.

The Financial Guaranty Insurance Policy does **not** insure any risk other than Nonpayment, as defined in the Policy. Specifically, the Financial Guaranty Insurance Policy does **not** cover:

1. Payment on acceleration, as a result of a call for redemption (other than mandatory sinking fund redemption) or as a result of any other advancement of maturity.

2. Payment of any redemption, prepayment or acceleration premium.

3. Nonpayment of principal or interest caused by the insolvency or negligence of the Paying Agent.

If it becomes necessary to call upon the Financial Guaranty Insurance Policy, payment of principal requires surrender of Series 2004B Notes to the Insurance Trustee together with an appropriate instrument of assignment so as to permit ownership of such Series 2004B Notes to be registered in the name of Ambac Assurance to the extent of the payment under the Financial Guaranty Insurance Policy. Payment of interest pursuant to the Financial Guaranty Insurance Policy requires proof of Owner entitlement to interest payments and an appropriate assignment of the Owner's right to payment to Ambac Assurance.

Upon payment of the insurance benefits, Ambac Assurance will become the owner of the Series 2004B Notes, appurtenant coupon, if any, or right to payment of principal or interest on such 2004B Notes and will be fully subrogated to the surrendering Owner's rights to payment.

Ambac Assurance Corporation

Ambac Assurance is a Wisconsin-domiciled stock insurance corporation regulated by the Office of the Commissioner of Insurance of the State of Wisconsin and licensed to do business in 50 states, the District of Columbia, the Territory of Guam and the Commonwealth of Puerto Rico and the U.S. Virgin Islands, with admitted assets of approximately $8,142,000,000 (unaudited) and statutory capital of approximately $4,824,000,000 (unaudited) as of June 30, 2004. Statutory capital consists of Ambac Assurance's policyholders' surplus and statutory contingency reserve. Standard & Poor's Credit Markets Services, a Division of The McGraw-Hill Companies, Moody's Investors Service and Fitch Ratings have each assigned a triple-A financial strength rating to Ambac Assurance.

Ambac Assurance has obtained a ruling from the Internal Revenue Service to the effect that the insuring of an obligation by Ambac Assurance will not affect the treatment for federal income tax purposes of interest on such obligation and that insurance proceeds representing maturing interest paid by Ambac Assurance under policy provisions substantially identical to those contained in the Financial Guaranty Insurance Policy shall be treated for federal income tax purposes in the same manner as if such payments were made by the Board.

Ambac Assurance makes no representation regarding the Series 2004B Notes or the advisability of investing in the Series 2004B Notes and makes no representation regarding, nor has it participated in the preparation of, this Official Statement other than the information supplied by Ambac Assurance and presented under the heading "MUNICIPAL BOND INSURANCE".

Available Information

The parent company of Ambac Assurance, Ambac Financial Group, Inc. (the "Company"), is subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and in accordance therewith files reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). These reports, proxy statements and other information can be read and copied at the SEC's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. The SEC maintains an internet site at http://www.sec.gov that contains reports, proxy and information statements and other information regarding companies that file electronically with the SEC, including the Company. These reports, proxy statements and other information can also be read at the offices of the New York Stock Exchange, Inc. (the "NYSE"), 20 Broad Street, New York, New York 10005.

Copies of Ambac Assurance's financial statements prepared in accordance with statutory accounting standards are available from Ambac Assurance. The address of Ambac Assurance's administrative offices and its telephone number are One State Street Plaza, 19th Floor, New York, New York 10004 and (212) 668-0340.

Incorporation Of Certain Documents By Reference

The following documents filed by the Company with the SEC (File No. 1-10777) are incorporated by reference in this Official Statement:

1. The Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003 and filed on March 15, 2004;

2. The Company's Current Report on Form 8-K dated April 21, 2004 and filed on April 22, 2004;

3. The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended March 31, 2004 and filed on May 10, 2004;

4. The Company's Current Report on Form 8-K dated July 21, 2004 and filed on July 22, 2004;

5. The Company's Quarterly Report on Form 10-Q for the fiscal quarterly period ended June 30, 2004 and filed on August 9, 2004;

6. The Company's Current Report on Form 8-K dated August 19, 2004 and filed on August 20, 2004; and

7. The Company's Current Report on Form 8-K dated October 20, 2004 and filed on October 20, 2004.

All documents subsequently filed by the Company pursuant to the requirements of the Exchange Act after the date of this Official Statement will be available for inspection in the same manner as described above in "**Available Information**".

THE INFORMATION RELATING TO THE INSURER, THE COMPANY AND THE FORM OF THE POLICY HAS BEEN FURNISHED BY THE INSURER. SUCH INFORMATION HAS NOT BEEN VERIFIED BY THE BOARD, ITS FINANCIAL ADVISOR OR BOND COUNSEL AND IS NOT TO BE CONSTRUED AS A PROMISE OR GUARANTEE AS TO ACCURACY OR COMPLETENESS BY THE BOARD, ITS FINANCIAL ADVISOR OR BOND COUNSEL.

SECURITY AND SOURCES OF PAYMENT FOR THE NOTES

Special Obligations and Legal Authority

The Series 2004B Notes are special and limited obligations of the Board and are payable from the Pledged Funds specified in the Note Resolution and described below. The Series 2004B Notes are not obligations, general, special or otherwise, of the State, do not constitute a legal debt of the State and are not enforceable against the State, nor shall payment thereof be enforceable out of any monies of the State, the Board or the Department, other than from the Pledged Funds.

The Act authorizes the Board to issue a Series of Notes to finance one or more highway projects after the Department has entered into a grant agreement with FHWA to reimburse the Department for the federally-eligible costs of such projects. The Department has entered into the Series 2004B Grant Agreement relating to the Series 2004B Project. Pursuant to the Act, the Board will issue the Series 2004B Notes in anticipation of the receipt by the Department of the Grant Revenues from FHWA under the Series 2004B Grant Agreement.

Creation of Pledged Funds

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

The Board pledges in the Note Resolution to the payment of the Debt Service on the Series 2004B Notes, the outstanding Notes and any Additional Notes that may be subsequently issued by the Board on a parity therewith (see "Additional Notes" below), funds on deposit in the Grant Anticipation Note Fund and the Note Proceeds Account (such deposits being the "Pledged Funds"), subject to the permitted use by the Department of moneys in the Note Proceeds Account to pay Project Costs. The funds in the Grant Anticipation Note Fund shall only be used to pay Debt Service on Notes. After issuance of the Series 2004B Notes, there will be $412,970,000 aggregate principal amount of Notes outstanding.

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

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

Deposits of Federal Aid Revenues

The Note Resolution defines "Federal Aid Revenues" as revenues or funds received by or on behalf of, or available to, the Department pursuant to "Federal Aid Authorization", which means Title 23, any extension of Title 23, or any successor to Title 23 authorizing federal funding of state highways (including, without limitation, Grant Revenues received pursuant to any Grant Agreement), which revenues or funds are not restricted under Federal Aid Authorization in a way that prohibits the Board from using them to pay Debt Service on Notes.

The Department has entered into the Series 2001A, 2003A, 2004A and 2004B Grant Agreements with FHWA relating to the Series 2001A, 2003A, 2004A and 2004B Notes. Under the provisions of these Grant Agreements, the FHWA has agreed to make payment to the Department for eligible project costs, to the extent

federal funds are available, of Grant Revenues in amounts equal to the Debt Service, when due, on the Series 2001A, 2003A, 2004A and 2004B Notes. The FHWA has determined that the Series 2001A, 2003A, 2004A and 2004B Projects are eligible for Federal Aid Revenues under Title 23. Under the Note Resolution, the Department has covenanted to comply with applicable law and such Grant Agreements to the extent required to receive all revenues from the FHWA under such Grant Agreements.

Pursuant to the Note Resolution, the Department has agreed that all Grant Revenues under any Grant Agreement relating to the Notes received by the Department shall on the day of receipt be deposited by the Department with the State Treasurer and the State Treasurer has agreed to deposit such Grant Revenues directly into the Grant Anticipation Note Fund, until the amount on deposit shall equal the aggregate of Debt Service on the Outstanding Notes, except as set forth in the last paragraph under this heading. The Note Resolution defines "Grant Revenues" as any and all revenues the Department receives under a Grant Agreement relating to Notes, the proceeds of the Notes and the income and gain from the investment of the Funds and Accounts held under the Note Resolution. Only after Grant Revenues and other Federal Aid Revenues are deposited into the Grant Anticipation Note Fund do they become Pledged Revenues.

The Act prohibits an Owner of a Note from compelling the payment of Grant Revenues to the Department. Title 23 and the Series 2001A, 2003A, 2004A and 2004B Grant Agreements expressly state that such Grant Agreements (1) do not create any right in any party (other than the Department) against FHWA and (2) do not constitute a commitment, guarantee or obligation on the part of the United States to provide for the payment of Debt Service on the Series 2001A, 2003A, 2004A and 2004B Notes.

For a discussion of Federal Aid Revenues and Federal Aid Authorization see "INFORMATION CONCERNING THE FUNDING OF FEDERAL-AID HIGHWAYS" and for a discussion of the amount of Federal Aid Revenues received by the Department see "FEDERAL AID REVENUES." The primary source of Federal Aid Revenue is amounts distributed to the Department by the federal government pursuant to Federal Aid Authorization. The current interim Federal Aid Authorization expires on May 31, 2005. See "INFORMATION CONCERNING THE FUNDING OF FEDERAL-AID HIGHWAYS – TEA-21 Reauthorization."

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

On or before October 15 of each Federal Fiscal Year (which commences on October 1) in which Debt Service is payable, the Director shall file with the State Treasurer and the Board a certificate calculating the Debt Service Coverage Ratio for such Federal Fiscal Year. The Debt Service Coverage Ratio is (a) the amount of Federal Aid Revenues that the Department estimates will be available to pay Debt Service on all Outstanding Notes payable during such Federal Fiscal Year, divided by (b) the Annual Debt Service due on all Outstanding Notes during such Federal Fiscal Year. If the Debt Service Coverage Ratio shown in such certificate is less than 1.30 (or for so long as the Director fails to file such certificate for each such Federal Fiscal Year), then the Note Resolution requires the State Treasurer from and after October 16 of each such Federal Fiscal Year to deposit all Federal Aid Revenues received by the State Treasurer directly into the Grant Anticipation Note Fund, until the amount on deposit in the Grant Anticipation Note Fund shall equal the aggregate of: (1) the amount of interest on all Outstanding Notes payable during such Federal Fiscal Year and (2) the amount of principal of all Outstanding Notes payable during such Federal Fiscal Year. If the Director's certificate shows the Debt Service Coverage Ratio is at least 1.30, then Federal Aid Revenues shall be deposited into the Federal Aid Revenues Subaccounts as described above.

On the fifth Business Day prior to any date on which Debt Service on any Note is payable, the Note Resolution requires the State Treasurer to transfer into the Grant Anticipation Note Fund, to the extent required in order to pay Debt Service payable on the Outstanding Notes on such date, moneys from the following sources and in

the following priority: First from the Federal Aid Revenues Subaccounts, Second from the Note Proceeds Account, Third from the State Highway Fund (exclusive of any moneys therein pledged to State highway revenue bonds) and Fourth from the Construction Account in the Regional Area Road Fund (to the extent the Notes were used for projects eligible to be paid from such Fund).

Federal Aid Revenues held in the Federal Aid Revenues Subaccounts and State moneys in the State Highway Fund and Regional Area Road Fund may be used at any time by the Department for any purpose permitted by State law, including, without limitation, paying costs of highways or operating expenses of the Department. The Department has programmed the use of moneys in the Federal Aid Revenues Subaccounts and State moneys in the State Highway Fund and Regional Area Road Fund for those purposes. Monies in the Note Proceeds Account at any time are planned to be used by the Department, prior to the maturity dates of the Notes, to pay Project Costs for which Notes were issued.

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

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

Use of Pledged Funds

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

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

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

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

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

Covenants Concerning Federal Aid Revenues

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

As soon as practicable after the start of each Federal Fiscal Year in which Debt Service is payable, the Note Resolution requires the Department and Board to take all actions, to the extent permitted by State law, required of them to obligate under the Federal Aid Authorization an amount of Federal Aid Revenues sufficient to pay, when due, the Debt Service on any Outstanding Notes payable in such Federal Fiscal Year (less only the amount on deposit at the start of such Federal Fiscal Year in the Grant Anticipation Note Fund and available to pay such Debt Service). The Board and the Department each covenant that until the Department has so obligated Federal Aid

Revenues, it shall not obligate any Federal Aid Revenues for any other purpose in any Federal Fiscal Year in which Debt Service is payable. The Department and Board have each specifically covenanted in the Note Resolution to take all actions, to the extent permitted by State law, required of them under Federal and State law, necessary to convert any Project which is an advance construction project under the Federal Aid Authorization, to a regular federal aid project in an amount sufficient to obligate Federal Aid Revenues in the amount required by this paragraph.

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

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

Additional Notes

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

The Board may issue, from time to time, one or more Series of Additional Notes in unlimited principal amounts for any lawful purpose permitted under the Act, which are payable from and secured by the Pledged Funds on a parity with the Series 2004B Notes, the outstanding Notes and any Additional Notes that may be subsequently issued, upon satisfaction of the requirements of the Note Resolution before such issuance. Those requirements include that an Authorized Officer of the Board certify that:

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

- one hundred fifty percent (150%) of the Annual Debt Service in any Federal Fiscal Year that ends on or before the expiration date of the Federal Aid Authorization then in effect, and

- three hundred percent (300%) of the Annual Debt Service in any Federal Fiscal Year that ends after the expiration date of the Federal Aid Authorization then in effect, and

- in either case, including the Annual Debt Service on the Series of Additional Notes proposed to be issued, but excluding, in the case of a Series of Additional Notes issued for refunding purposes, the Annual Debt Service on the Notes to be refunded; and

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

The Board will comply with these requirements prior to the issuance and delivery of the Series 2004B Notes.

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

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

The Board currently expects to issue Additional Notes during the next several years, in a principal amount of approximately $190 million, to fund Project Costs in addition to those for the Series 2004B Project. The Board also expects to issue bonds, notes or other obligations secured by revenue and funds other than the Pledged Funds. The actual amount of Additional Notes to be issued will depend upon, among other considerations, market conditions, cash flow requirements of the Board for construction, and other sources of funding available to meet such requirements.

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

Other Covenants for Protection of Note Owners

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

The Department shall keep proper books of record and account (separate from all other records and accounts) in which complete and correct entries shall be made of its transactions relating to the Federal Aid Revenues and the Pledged Funds, which records and accounts shall at all times be subject to the inspection of the Owners of an aggregate of not less than 10% in principal amount of the Notes then Outstanding or their representatives duly authorized in writing.

The Board is not required to pay Debt Service from any funds other than the Pledged Funds, provided the Board or Department, in its sole and absolute discretion, may pay Debt Service from sources other than the Pledged Funds, to the extent legally available for that purpose. Such other sources may include funds on deposit in the State Highway Fund and in the Regional Area Road Fund.

INFORMATION CONCERNING THE FUNDING OF FEDERAL-AID HIGHWAYS

The Federal-Aid Highway Program

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

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

The FAHP must be periodically reauthorized by Congress. The current interim authorization expires May 31, 2005. See "TEA-21 Reauthorization" below.

THE TERMS AND CONDITIONS OF PARTICIPATION IN THE FAHP AS DESCRIBED HEREIN ARE THOSE IN TEA-21 (AS HEREINAFTER DEFINED) AND ARE SUBJECT TO CHANGE AT THE DISCRETION OF CONGRESS. THERE CAN BE NO ASSURANCE THAT THE LAWS AND REGULATIONS NOW GOVERNING THE FAHP WILL NOT BE CHANGED IN THE FUTURE IN A MANNER THAT MAY ADVERSELY AFFECT THE ABILITY OF THE DEPARTMENT TO RECEIVE FEDERAL AID REVENUES SUFFICIENT TO ENABLE THE BOARD TO PAY DEBT SERVICE ON THE NOTES.

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

Funding under the FAHP is provided to states through a multi-step funding cycle that includes: 1) **multi-year authorization** by Congress of the funding for various highway programs; 2) **apportionment and allocation** of funds to the states each Federal Fiscal Year according to statutory formulas or, for some funding categories through administrative action; 3) **obligation** of funds, which is the Federal government's legal commitment (or promise) to pay or reimburse states for the Federal share of a project's eligible costs; 4) **appropriations** act by Congress specifying the amount of funds available for the year to liquidate obligations; 5) **program implementation** which covers the programming and authorization phases; and 6) **reimbursement** by the Federal government of the eligible project costs. Each of these steps is described in more detail under "Federal-Aid Funding Procedures" below.

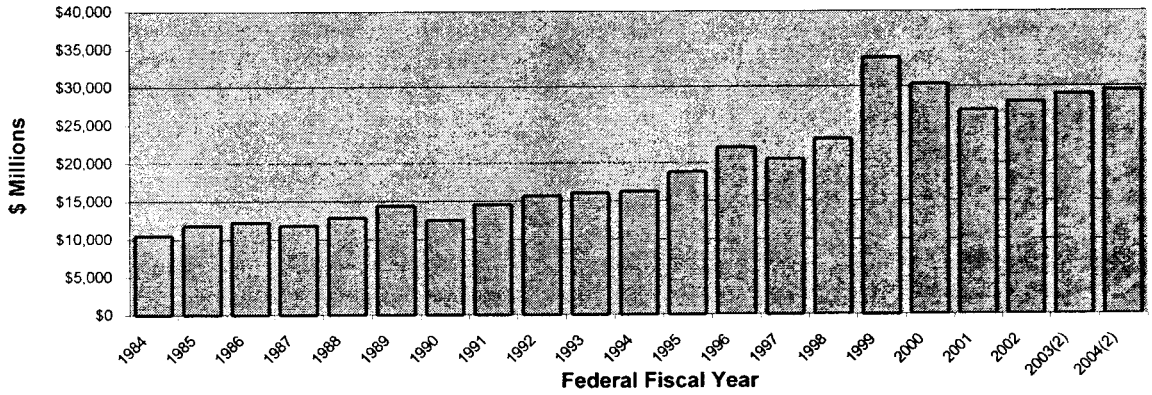
Title 23, United States Code, entitled "Highways", includes most of the laws that govern the FAHP arranged systematically or codified. Generally, Title 23 embodies those substantive provisions of highway law that Congress considers to be continuing and which need not be reenacted each time the FAHP is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

The Federal Highway Trust Fund

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

Federal gasoline excise taxes are the largest revenue source for the HTF. The majority of these tax revenues, including 15.44 cents per gallon out of the current 18.4 cents per gallon tax, go to the Highway Account. The following table shows annual and projected HTF collections in the Highway Account for the Federal Fiscal Years 1984 through 2004.

Receipts into the Highway Account of the Highway Trust Fund
1984-2004 (1)



(1) Excludes interest on balances.
(2) FFY 2003 actual and FFY 2004 estimate from the President's FFY 2005 Budget.

Source: FFY 1984 through FFY 2002, Highway Statistics 2002, Office of Highway Policy Information, FHWA, Table FE-210.

The imposition of the taxes that are dedicated to the HTF, as well as the authority to place the taxes in the HTF and to expend moneys from the HTF, all have expiration dates which must be extended periodically. The life of the HTF has been extended several times since its inception, most recently by TEA-21 (as described below). TEA-21 extended the imposition of taxes through September 30, 2005, and the transfer of the taxes to the HTF through June 30, 2006. The HTF is required under current federal law to maintain a positive balance to ensure that prior commitments for distribution of federal revenues can be met.

TEA-21

The Transportation Equity Act for the 21st Century ("TEA-21") is the immediately prior authorization act for the FAHP, having been enacted into law on June 9, 1998. TEA-21 authorized nearly $218 billion for highway, highway safety, transit, and other surface transportation programs over the six-year period from Federal Fiscal Years 1998 through 2003. This total reflected a 40 percent increase over the levels in the last major authorizing legislation, the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA). TEA-21 expired on September 30, 2003. See "TEA-21 Reauthorization" below.

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

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

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

Protected Funding

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

The highway firewall "protects" the obligation limitation for federal-aid highways, the motor carrier, and other highway safety programs that have contract authority. The firewall amount for highways is tied to the projected receipts of the Highway Account of the Highway Trust Fund and beginning with Federal Fiscal Year 2000 was adjusted each year during development of the President's budget as new receipt projections and actual receipts became available. The adjustment of authorizations is called Revenue Aligned Budget Authority (RABA). During Federal Fiscal Years 2000 to 2002, RABA distributions totaled approximately $9.2 billion. There was no RABA distribution in Federal Fiscal Year 2003.

Under TEA-21, a total of $198.5 billion in funding for surface transportation was protected from deficit reduction legislation. The total protected amount available for federal-aid highways under TEA-21 was $161.9 billion. The protected amount available for highways had two components: the amount behind the budgetary firewall of $157.5 billion and the amount of $4.4 billion for programs exempt from the obligation limitation. The protected funding for transit programs has a single component – the firewall amount of $36.5 million that was not tied to HTF receipts.

Authorizations in TEA-21 for Federal Fiscal Years 1998 through 2003 exceeded the protected funding levels by $15 billion for the highway program categories and $5 billion for transit programs. The authorizations in excess of protected levels remain part of the general discretionary budget category and may be made available by Congress through the annual appropriations process, but must compete each year with other budget priorities.

Highway Funding Equity-Minimum Funding

The minimum protected funding provision of TEA-21 was designed to ensure that each state have a minimum return on the tax contributions from that state into the Highway Account of the Highway Trust Fund. Under this provision, each state's share of apportionments was at least 90.5 percent of its percentage share of contributions to the Highway Account, based on the latest data available at the time of apportionment under TEA-21. Arizona remained a "donor" state, and the Department expects Arizona to continue to receive funds under the minimum funding provision for the foreseeable future.

Federal Aid Funding Procedures

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

(a) the FAHP is funded by dedicated revenues, from a user-tax source, deposited in a special trust fund (the Highway Trust Fund);

(b) the contract authority of the FHWA is established by a multi-year authorization act rather than through annual appropriation acts; and

(c) contract authority is not at risk during the annual appropriations process (as budget authority is in most other federal programs), although an appropriations act is required in order to liquidate obligations.

The following summarizes the major steps in funding the Federal-Aid Highway Program.

Authorization

The first and most important step in funding the FAHP is the development and enactment of authorizing legislation. Authorizing legislation for highways began with the Federal-Aid Road Act of 1916 and the Federal Highway Act of 1921. These acts provided the foundation for the FAHP as it exists today. Since that time, the FAHP has been continued or renewed through the passage of multi-year authorization acts. Since 1978, Congress has passed highway legislation as part of larger, more comprehensive, multi-year (i.e. four or more years) surface transportation acts. There is no guarantee, however, that reauthorization of the FAHP will occur on a multi-year basis. In fact the current interim reauthorization is for the period ending May 31, 2005. The current practice of establishing a minimum return to each state of the taxes paid by highway users in that state began in 1982 with the passage of the Surface Transportation Assistance Act.

The authorization act not only shapes and defines programs, but also sets upper limits (authorizations) on the funding for programs and includes provisions related to the operation of the Highway Trust Fund. The immediately prior legislative authorization for the FAHP was provided by TEA-21. For a discussion of interim reauthorization, see "TEA-21 Reauthorization" below.

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

The existence of dedicated revenues in the HTF and of multi-year contract authorizations are designed to provide a predictable and uninterrupted flow of reimbursements to the states. The risk of contract authority lapsing between authorizing acts is minimal, since sufficient unobligated balances generally exist that can be used by the states, with the approval of Congress, to cover gaps in funding between multi-year reauthorization acts. See "TEA-21 Reauthorization" and "Lapsing of Authorization" below.

Apportionment and Allocations

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

(a) Apportionments. The distribution of funds using a formula provided in law is called an apportionment. Most federal-aid funds are distributed to states through apportionments. Each Federal Fiscal Year, the FHWA has responsibility for apportioning authorized funding for the various highway programs among the states according to formulas established in the authorizing statute. Apportionment factors include items such as lane miles, vehicle miles traveled, taxes paid into the HTF and diesel fuel usage. Each highway program has a unique set of factors that determine the apportionments to the states. Annual apportionments are generally made on the first day of the Federal Fiscal Year.

(b) Allocations. Some categories do not have a legislatively mandated distribution formula. When there are no formulas in law, the distributions of funds are termed "allocations" which may be made at any time during the Federal Fiscal Year. In most cases, allocated funds are divided among states with qualifying projects applying general administrative criteria provided in the law.

Federal-aid highway apportionments are available to states for use for more than one year. Their availability does not terminate at the end of the Federal Fiscal Year, as is the case with most other Federal programs. In general, apportionments are available for three years plus the year that they are apportioned. Consequently, when new apportionments or allocations are made, the amounts are added to a state's carryover apportionments from the

previous year. Should a state fail to obligate a year's apportionments within the period of availability (usually a total of four years) specified for a given program, the funds will lapse.

Obligation

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

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

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

Highway Program Implementation

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

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

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

(a) Traditional Approach. Under the traditional highway funding approach, a state obligates the full Federal share of the funding for a project at the beginning of the project, concurrent with project authorization. The first step in the fiscal management process begins when a state requests authorization to use federal funds on a project. The project sponsor submits plans, specifications and estimates (PS&E's) for a project to the FHWA Division Office, and requests that the FHWA approve the use of federal funding for the appropriate Federal share of

the project. The project must be in the STIP and PS&Es must identify the category of federal funding that will be used.

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

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

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

The AC approach for authorizing projects allows states to finance projects that are eligible for federal aid without obligating the full Federal share of costs at the beginning of the project. This allows states to begin a project before accumulating all of the Obligation Authority needed to cover the Federal share of the project. Similar to the traditional approach, the state submits PS&E's to FHWA and requests project authorization. Under AC, however, FHWA is asked to authorize the project without obligating federal funds. The state will provide the up-front financing for the project and then at a later date "convert" the advance construction project to a regular federal-aid project and obligate the full Federal share of the project costs, when sufficient OA is available. At the time of conversion, the state can be reimbursed for the Federal share of costs incurred up to the point of conversion.

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

Reimbursement

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

TEA-21 Reauthorization

As noted above, the authorizations contained in TEA-21 expired on September 30, 2003 and no multi-year reauthorization has been enacted. Congress has passed six continuing resolutions to continue the FAHP on an interim basis. The most recent of these continuing resolutions, the Surface Transportation Extension Act of 2004, Part V ("Part V"), Public Law 108-310, was signed into law by the President on September 30, 2004, and extends the FAHP through May 31, 2005. Although Congress has not enacted a consolidated appropriations act for Federal

Fiscal Year 2005, Part V provides $24.5 billion in contract authority for the eight months ending May 31, 2005. The Consolidated Appropriations Act, 2004, Public Law 108-199 included a total of $34.2 billion in funding for the highway program in Federal Fiscal Year 2004, compared with $31.6 billion for Federal Fiscal Year 2003.

The President's proposal to re-authorize the FAHP is the Safe, Accountable, Flexible and Efficient Transportation Equity Act of 2003 (SAFETEA) which is a six-year proposal that authorizes a total of $256 billion for the federal surface transportation programs in Federal Fiscal Years 2004 through 2009. Funding for the core federal-aid highway programs totals in excess of $200 billion. The proposal retains the firewall and minimum guarantee provisions of TEA-21, and creates a new mechanism for determining the amount of any RABA distributions. If enacted as currently proposed in SAFETEA, the FHWA estimates that federal apportionments to Arizona during the six-year reauthorization would average approximately $508 million per year.

The U.S. House of Representatives and the Senate have each passed different reauthorization bills that provide higher levels of funding than SAFETEA. The Department cannot predict when federal reauthorization legislation may be enacted, funding levels or the substantive provisions that may be included in such legislation.

Lapsing of Authorization

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

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

- Access to Unobligated Balances: The 1987 Surface Transportation and Uniform Relocation Assistance Act expired on September 30, 1991 and ISTEA was not enacted until December 18, 1991. The FHWA was able to act administratively to keep federal-aid funding flowing because states could use their unobligated balances to provide contract authority to use new OA.

- Short-Term Authorization: ISTEA expired on September 30, 1997 and until approval of TEA-21 on June 9, 1998, no new long-term authorization legislation was enacted. Despite the lack of long-term authorizing legislation, states were provided an upper limit on OA through passage of an appropriations act plus access to their unobligated balances. On November 13, 1997 Congress passed the Surface Transportation Extension Act of 1997 ("STEA"), which provided a six-month authorization for highway funding and established a limit on the amount of new OA states could use at funding levels equal to about a quarter of FFY 1997 authorization levels. Since most states have unobligated balances of at least half their normal annual OA levels and an authorization act need not be in place for the FHWA to give states new OA, states were able to spend down prior unfunded Federal apportionments (contract authority) with newly allocated OA. The lack of an enacted authorization act during this period did not pose a threat to the continued flow of revenues, because dedicated highway user fees continued to flow into the HTF. Similarly, TEA-21 expired on September 30, 2003 and no new long-term authorization has yet been enacted. However, Congress has enacted several measurers which have reauthorized the FAHP for an interim period through May 31, 2005.

  As of the date of this Official Statement, reauthorization proposals are pending before Congress. See "-TEA 21 – Reauthorization" above. The Department cannot predict the outcome of such pending legislation.

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

Special Federal Provisions Relating to Debt-Financed Projects

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

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

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

- The project must be approved as a federal-aid, debt-financed (bond, certificate, note or other debt instrument) project in order to receive payments for eligible debt-related costs under Section 122. Once a project is selected for debt financing, the project is submitted to the appropriate FHWA Division Office for approval as an AC project under section 115 of Title 23. The AC designation ensures that the project follows federal-aid procedures and preserves the eligibility to reimburse debt-related costs through future federal-aid fund obligations.

- Debt-financed projects are subject to requirements of the Federal Clean Air Act and federal air quality conformity requirements, discussed below under "Regional Planning and Air Conformity."

- At the time the project agreement is signed, a state may make an election to seek reimbursement for debt service and/or related issuance costs in lieu of reimbursement for construction costs. If a state elects to receive debt service reimbursements, a debt service schedule will be included in the project agreement. If multiple projects are funded with the proceeds of a debt issue, each project will be assigned a prorated share of the debt-related costs.

- To comply with the intent of the fiscally constrained planning process, the Federal share of the debt-related costs (e.g., interest and principal payments, associated issuance costs, and on-going debt servicing expenses) anticipated to be reimbursed with federal-aid funds over the life of the debt obligations should be designated as AC. The planned amount of federal-aid reimbursements (AC conversion) should be included in the STIP, in accordance with FHWA procedures.

- Periodic debt service payments (federal-aid reimbursements) on the debt obligations would represent partial conversions of designated AC amounts to federal aid. A state can obligate such federal aid annually over the life of the permanent financing or a state can make the conversion in one lump sum upon project completion to help take out construction financing. A state would follow the normal procedures for conversion of an advance construction project.

- A state may seek federal-aid reimbursements for eligible debt-related costs as these costs are incurred. Issuance costs, debt service payments, and incidental costs represent costs incurred that may be reimbursed with federal-aid funds to the extent such costs are deemed eligible.

- A state may make arrangements with the FHWA Division Office regarding the procedures under which it would submit a billing to FHWA for debt-related costs. A request for debt service payment can be timed so that reimbursements could be received shortly before the debt service payment date.

- A state may designate a trustee or other depository to receive federal-aid debt service payments directly from FHWA.

Regional Planning and Air Quality Conformity

For the Department to receive Grant Revenues under its Series 2001A, 2003A and 2004B Grant Agreements with FHWA relating to projects in Maricopa County, Title 23 requires that the Series 2001A, 2003A and 2004B Projects have been included in the approved Transportation Improvement Program ("TIP") for Maricopa County in effect at the time of execution of such Grant Agreements. The designated metropolitan planning organization ("MPO") has the responsibility to develop and approve the TIP. The Maricopa Association of Governments ("MAG") is the designated MPO for the Phoenix metropolitan area.

Title 23 requires the TIP to be based on a continuing and comprehensive transportation planning process carried out by MAG in cooperation with the Department and transit operators. MAG has included the Series 2001A, 2003A and 2004B Projects in its appropriate TIP. The Series 2004A Project is not required by federal law to be included in the TIP for Maricopa County because it is located outside of Maricopa County. The Federal Clean Air Act prohibits MAG from approving any transportation plan unless it is found to be in conformance with all applicable air quality plans. Federal law specifies the criteria for an air quality conformity determination and these include that the TIP and Regional Transportation Plan ("RTP") developed by MAG pass air conformity tests for emissions. The final determination of air quality conformity for the TIP and RTP is the responsibility of the FHWA and Federal Transit Administration. Federal regulations require that a new TIP be updated at least every two years and RTP every three years by the MPO. On December 9, 2003 and July 6, 2004, the FHWA and Federal Transit Administration jointly issued a Finding of Conformity for MAG's current TIP and RTP, the FY 2004-2007 MAG Transportation Improvement Program and Regional Transportation Plan , respectively.

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

FHWA published guidance specifically provides that a conformity lapse which occurs subsequent to a funding commitment and issuance of grant anticipation notes does not alter eligibility of the Department to receive Grant Revenues under such commitments. FHWA has advised the Department that the Series 2001A, 2003A, 2004A and 2004B Grant Agreements constitute such funding commitments for the Series 2001A, 2003A, 2004A and 2004B Projects. Because the Department has received these funding commitments, the Department anticipates that even if there were a determination of nonconformity for Maricopa County, the Notes would not be negatively impacted.

MAG failed to submit its 1999 Serious Area Carbon Monoxide Plan (the "1999 Carbon Monoxide Plan") by the February 28, 1998 deadline. This failure triggered the initiation by the EPA of two processes under federal law within Maricopa County: (1) sanctions could be imposed by the EPA after 18 months, including two-to-one offsets for stationary (industrial) sources of air pollution and/or loss of federal highway funds; and (2) a Federal Implementation Plan ("FIP") could be required after 24 months. If the EPA promulgates a FIP that contains a motor vehicle emissions budget, this budget would have to be used by MAG and met in subsequent conformity analyses. The submittal of a complete plan halts the imposition of the EPA sanctions and the EPA approval of the plan halts the imposition of the FIP. On September 9, 1999, the EPA made a completeness finding on this 1999 Carbon Monoxide Plan, which finding halted the sanctions process. On November 5, 1999, the EPA made an adequacy finding for the motor vehicle emissions budget in this Plan for transportation conformity purposes.

EPA sanctions process was also commenced as a result of actions relating to the MAG 1991 Moderate Area Particulate Plan for PM-10 (the "1991 PM-10 Plan"). The EPA initially approved this 1991 PM-10 Plan, but the U.S. Court of Appeals for the Ninth Circuit vacated that approval in 1996 as a result of a lawsuit brought by the Arizona Center for Law in the Public Interest ("ACLPI"). Thereafter, the EPA disapproved portions of the 1991 PM-10 Plan and on September 2, 1998, the EPA sanction process started, which required the State to correct within 18 months the deficiency that resulted in the disapproval or face the imposition of two sanctions. The first sanction was imposed on March 2, 2000, requiring two-to-one offsets for stationary industrial sources. The second sanction limiting highway funding was scheduled to be imposed no later than September 2, 2000. Prior to that date, the EPA published an interim final determination that the State had likely corrected the deficiencies in the 1991 PM-10 Plan, which determination stayed the two-to-one offset sanction and the limitation on highway funding.

In February 2000, MAG submitted a Revised MAG 1999 Serious Area Particulate Plan for PM-10 (the "1999 PM-10 Plan"), which the EPA officially approved and also granted the State's request to extend the deadline under the Federal Clean Air Act from 2001 to 2006 for attaining the PM-10 standards in Maricopa County. In July 2002, the ACLPI filed a lawsuit in the U.S. Court of Appeals for the Ninth Circuit (the "Lawsuit") against the EPA to challenge its approval of the 1999 PM-10 Plan and extension of the PM-10 attainment deadline. The main arguments in the Lawsuit were the failure of the Plan to include requirements to use certain diesel fuel and sufficiently stringent measures for agricultural sources of PM-10. On May 10, 2004 the Court vacated portions of the EPA's approval of the Plan and remanded to the EPA for further consideration of failure of the 1999 Plan to require certain diesel fuel and the extension of the 2001 deadline and rejected the other challenges in the lawsuit. A future determination of nonconformity in Maricopa County is possible as a result of future actions by the EPA or others.

As noted above, upon a determination of nonconformity or a lapse of air conformity in Maricopa County, with certain exceptions (including the Department previously obtaining a funding commitment from FHWA for construction of a specific highway project, as is the case for the Series 2001A, 2003A and 2004B Projects), Federal and non-federal monies cannot be spent for construction on highway projects within Maricopa County. A determination of nonconformity or lapse of conformity could limit the receipt by the Department of Federal Aid Revenues on projects in Maricopa County other than the Series 2001A, 2003A and 2004B Projects. However, the Department does not believe any conformity lapse, nor any future EPA sanctions, would adversely affect the ability of the Board to pay Debt Service on the Notes when due because, consistent with historical experience, the Department estimates that over 63% of its future Federal Aid Revenues will be derived from highway projects located outside of Maricopa County. The Department believes there is no significant risk of limitations upon the Department's receipt of Federal Aid Revenues from projects in other areas of the State because of a determination of nonconformity or a lapse of air quality conformity in those other areas.

FEDERAL AID REVENUES

The following tables identify prior Apportionments, Obligation Authority and Receipts of Federal Aid Revenues by the Department from Federal Fiscal Year 1992 through the Federal Aid Authorization ended September 30, 2003 and for Federal Fiscal Year 2004.

FEDERAL AID REVENUES
APPORTIONMENTS, OBLIGATION AUTHORITY AND RECEIPTS
FOR THE ARIZONA DEPARTMENT OF TRANSPORTATION
FEDERAL AID AUTHORIZATION PERIOD
(Intermodal Surface Transportation Efficiency Act of 1991)
Federal Fiscal Years 1992 Through 1997

Federal Fiscal Year	Apportionments	Obligation Authority	Actual Receipts
1992	$ 233,101,550	$ 238,218,749	$ 152,300,073
1993	252,834,626	221,392,942	179,740,061
1994	250,989,265	240,788,537	245,913,123
1995	265,186,888	252,757,024	213,379,038
1996	219,882,709	235,657,919	232,645,266
1997	300,114,264	282,854,998	294,640,603
Totals	$1,522,109,302	$1,471,670,169	$1,318,618,164

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

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

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

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

Source: Arizona Department of Transportation.

DEBT SERVICE REQUIREMENTS

The Debt Service requirements on the Series 2001A, 2003A, 2004A and 2004B Notes are set forth below:

12 Months Ending July 1	Series 2001A, 2003A and 2004A Notes Debt Service Requirements	The Series 2004B Notes		Total Series 2004B Notes Debt Service Requirements	Total Notes Debt Service Requirements
		Principal	Interest		
2005	$62,905,272		$3,844,688	$ 3,844,688	$66,749,960
2006	49,893,644		5,126,250	5,126,250	55,019,894
2007	52,021,969		5,126,250	5,126,250	57,148,219
2008	35,008,619	$ 9,730,000	5,126,250	14,856,250	49,864,869
2009	26,960,556	10,190,000	4,671,000	14,861,000	41,821,556
2010	26,964,306	10,655,000	4,198,250	14,853,250	41,817,556
2011	26,968,481	11,160,000	3,690,500	14,850,500	41,818,981
2012	26,958,281	11,730,000	3,132,500	14,862,500	41,820,781
2013	26,958,844	12,320,000	2,546,000	14,866,000	41,824,844
2014	26,950,356	12,935,000	1,930,000	14,865,000	41,815,356
2015	19,231,750	13,575,000	1,283,250	14,858,250	34,090,000
2016		12,090,000	604,500	12,694,500	12,694,500

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

MANAGEMENT OF STATE HIGHWAY PROGRAM

Arizona Transportation Board

The Board consists of seven members, with two members appointed from Transportation District 1 (Maricopa County) and one member from each of the other 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:

Name and Transportation District Represented	City of Residence	Term Expires January
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.

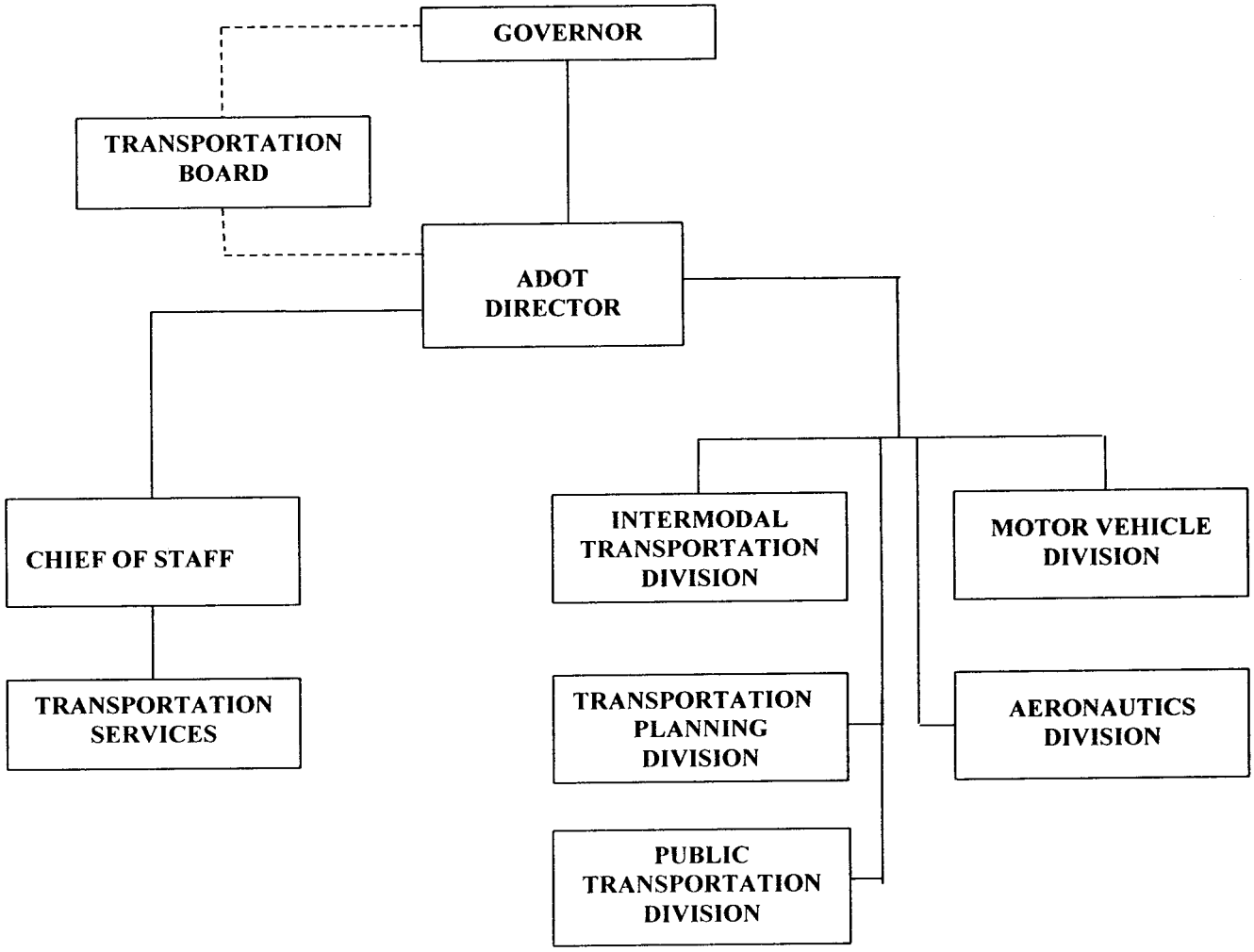
The Department's operating budget and capital outlay budget for buildings are reviewed by the Governor's office and funds for these purposes are appropriated by the State Legislature. The Department's capital outlay budget

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 pro-active 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 August 2004. As State Engineer, Mr. Ortega oversees the Department'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 for Douglas, Arizona since 1995. He also served as the City's Public Works Director/City Engineer.

Mr. Ortega is a registered professional engineer in Arizona and California, and holds Masters of Business Administration and Bachelor of Science in 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. The primary responsibilities of the Transportation Planning Division are: traffic and facilities data collection and analysis; transportation research; long-range, multimodal transportation planning; and, development of the transportation facilities contraction program. 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.

BARCLAY DICK
Aeronautics Division Director

Mr. Dick was appointed Director of the Aeronautics Division on September 20, 2004. Prior to that appointment, Mr. Dick enjoyed a 33-year airport management career with the Tucson Airport Authority. During his airport management career, Mr. Dick held such diverse positions as Project Director, Manager of Terminal Operations, Manager of Maintenance and Vice President for Operations and Safety.

Mr. Dick is an Accredited Airport Executive. He is a past president of the Arizona Airports Association and the Southwest Chapter of the American Association of Airport Executives. Between 1997 and 2003 he served on the national board of directors for the American Association of Airport Executives.

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 Program dictated by changing priorities, funding availability and other considerations. The Board adopts the revised Five-Year Capital Program on or before June 30 of each year following a series of public meetings throughout the State.

Sunset Laws

In order to encourage systematic legislative review of State agencies and statutes, State statutes provide for automatic termination of State agencies and statutes pursuant to a statutory schedule unless the State Legislature takes affirmative action to continue the existence of the agencies or statutes. These State statutes are commonly known as "Sunset Laws." Under the State Sunset Laws, the Department and the Board are scheduled for termination on July 1, 2008, and Title 28, Arizona Revised Statutes, is scheduled for termination on January 1, 2009. Title 28 contains most of the transportation laws of the State, including the Act authorizing Grant Anticipation Notes, the provisions relating to the fees and taxes pertaining to the registration, operation and use of motor vehicles, motor vehicle fuel taxes, the Arizona Highway User Revenue Fund, the State Highway Fund, as well as traffic laws.

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

If the State Legislature were to allow the Department to terminate on July 1, 2008, the State may no longer be eligible under federal law to receive Federal Aid Revenues. While there can be no assurance that the State Legislature will continue the Department after July 1, 2008, the Department is not aware of any matters which would cause the State Legislature to terminate the existence of the Department or the Board or to repeal Title 28 or to amend Title 28 in a manner detrimental to the holders of the Series 2004B Notes.

The State Sunset Laws provide that if Title 28 is repealed pursuant to the Sunset Laws, so long as there are any outstanding debts or other obligations, such as the Series 2004B Notes, payable from either the Arizona Highway User Revenue Fund or Regional Area Road Fund and provision has not been made for payment of those debts or obligations, the provisions of Title 28 relating to the Arizona Highway User Revenue Fund and Regional Area Road Fund shall remain in full force and effect until those debts or other obligations have been fully paid and satisfied (or provision is made therefor). In the opinion of Bond Counsel, in the event that the State Legislature fails, prior to the final maturity of the Series 2004B Notes, to take affirmative action to continue the existence of the Department, the Board and the Act, the State would be obligated to make payments on the Series 2004B Notes when due from the sources provided in the Note Resolution.

LITIGATION

There is no litigation or administrative action pending in any court or, to the best knowledge of the Department and the Board, threatened, which would restrain or enjoin the issuance, sale or delivery of the Series 2004B Notes or in any way contest or affect the validity of the Series 2004B Notes, or which concerns the proceedings of the Board taken in connection with the issuance and sale of the Series 2004B Notes or the execution, delivery and performance of the Series 2004B Grant Agreement, or the pledge and application of any funds provided for the payment of the Series 2004B Notes, or which contests the powers of the State, including the Department and the Board, with respect to the foregoing.

The Office of the Attorney General of the State has reviewed the status of pending lawsuits affecting the State and the Department in connection with their operations and has reported that there are several proceedings in which the Department is either a plaintiff or defendant and which are generally incidental to the operations of the

Department. The ultimate disposition of such pending legal proceedings cannot be predicted or determined at present. With regard to such pending litigation, it is the opinion of the Office of the Attorney General of the State that such pending litigation will not be finally determined so as to result, individually or in the aggregate, in a final judgment against the State or the Department which would materially and adversely affect the Department, its ability to pay Debt Service on the Series 2004B Notes, its continued operations or its financial position.

TAX MATTERS

In the opinion of Squire, Sanders & Dempsey L.L.P., Bond Counsel, under existing law (i) interest on the Series 2004B Notes is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations and (ii) interest on the Series 2004B Notes is exempt from Arizona state income tax. An opinion to those effects will be included in the legal opinion of Bond Counsel. See "CERTAIN LEGAL MATTERS." Bond Counsel will express no opinion as to any other tax consequences regarding the Series 2004B Notes.

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 and the Department contained in the Note Resolution and the transcript of proceedings for the Series 2004B Notes and that are intended to evidence and assure the foregoing, including that the Series 2004B Notes are and will remain obligations the interest on which is excluded from gross income for federal income tax purposes. Bond Counsel will not independently verify the accuracy of 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 Series 2004B Notes 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 or the Department may cause the interest on the Series 2004B Notes 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 2004B Notes. The Board and the Department have covenanted to take the actions required of them for the interest on the Series 2004B Notes to be and to remain excluded from gross income for federal income tax purposes, and not to take any actions that would adversely affect that exclusion.

A portion of the interest on the Series 2004B Notes earned by certain corporations may be subject to a corporate alternative minimum tax. In addition, the interest on the Series 2004B Notes 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 or other tax consequences will depend upon the particular tax status or other tax items of the owner of the Series 2004B Notes. Bond Counsel will express no opinion regarding those consequences.

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

Original Issue Premium

The Series 2004B Notes ("Premium Notes") 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 note premium. For federal income tax purposes, note premium is amortized over the period to maturity of a Premium Note, based on the yield to maturity of that Premium Note (or, in the case of a

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

Owners of Premium Notes should consult their own tax advisors as to the determination for federal income tax purposes of the amount of note premium properly accruable in any period with respect to the Premium Notes and as to other federal tax consequences and the treatment of note 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 as Appendix B, 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 B, 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 October 1, 2004 (the "Disclosure Undertaking"), substantially in the form set forth as Appendix E, wherein the Board and the Department will agree, for the benefit of the beneficial owners of the Series 2004B Notes, to provide, or cause to be provided, certain annual financial information that is generally consistent with the information contained under the heading "FEDERAL AID REVENUES" herein for the prior Federal Fiscal Year, and notice of the occurrence of certain events or failures to take certain required actions with respect to the Series 2004B Notes.

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 Notes are no longer Outstanding or the Rule no longer applies to the Series 2004B Notes. The Disclosure Undertaking may be amended or waived upon receipt by the Board and the Department of an opinion of independent counsel to the effect that the amendment or waiver would not, in and of itself, cause the Disclosure Undertaking to violate the Rule.

A beneficial owner of a Note may seek to enforce the undertakings of the Board and the Department in the Disclosure Undertaking by an action for specific performance in any court of competent jurisdiction in Phoenix, Arizona after providing the Board and the Department with 30 days prior written notice of its failure to perform. Any failure of the Board or the Department to comply with any of its obligations in the Disclosure Undertaking shall not be a default or Event of Default with respect to the Series 2004B Notes under the Note 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

Fitch Ratings ("Fitch"), Moody's Investors Service, Inc. ("Moody's") and Standard & Poor's Ratings Services, a Division of The McGraw-Hill Companies, Inc. ("Standard & Poor's") have assigned the Series 2004B Notes ratings of "AAA," "Aaa," and "AAA" based on the issuance of the Financial Guaranty Insurance Policy by Ambac Assurance. The Series 2004B Notes have also been assigned underlying ratings of "AA," "Aa3," and "AA-" by Fitch, Moody's and Standard & Poor's respectively.

Such ratings reflect only the views of the rating organizations, and any explanation of the meaning or significance of each rating 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 have been included in this Official Statement, relating to the Series 2004B Notes and the Board and the Department. Generally, rating agencies base their ratings on such information and materials and on their own investigation, studies and assumptions. There can be no assurance that a rating when assigned will continue for any given period of time or that it will not be lowered or withdrawn entirely by a rating agency if in 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 Notes.

The Board and the Department expect to furnish each rating agency with information and materials that it may request. The Board and the Department, however, assume no obligation to furnish requested information and materials, and may issue debt for which a rating is not requested. Failure to furnish requested information and materials, or the issuance of the debt for which a rating is not requested, may result in the suspension or withdrawal of a rating on the Series 2004B Notes.

UNDERWRITING

The Underwriters have jointly and severally agreed, subject to certain conditions, to purchase the Series 2004B Notes from the Board at a price of $115,635,056.24 (being the aggregate principal amount of $104,385,000.00 plus net original issue premium of $11,551,292.95 and less an Underwriters' discount of $301,236.71) plus accrued interest. The public offering prices may be changed from time to time by the Underwriters. The Underwriters may offer and sell the Series 2004B Notes to dealers (including dealers depositing the Series 2004B Notes into investment trusts) and others at prices lower than such initial public offering prices. The Underwriters will be obligated to purchase all of the Series 2004B Notes if any are purchased.

CERTAIN LEGAL MATTERS

Legal matters incident to the issuance of the Series 2004B Notes 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 Notes, will be delivered to the Board at the time of original delivery. The text of that opinion will be printed on the Series 2004B Notes.

The proposed text of the legal opinion of Bond Counsel is set forth as Appendix A. 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 Notes, the Note Resolution, the Act and the

tax-exempt status of interest on the Series 2004B Notes (except for the outstanding principal amounts of the Notes), contained under the captions "INTRODUCTION," "THE SERIES 2004B NOTES," "SECURITY AND SOURCES OF PAYMENT FOR THE NOTES" (excluding discussions of Federal Aid Authorization), "TAX MATTERS," "CONTINUING DISCLOSURE UNDERTAKING" (excluding the last paragraph thereunder), "PROPOSED FORM OF OPINION OF BOND COUNSEL" contained in Appendix A, "SUMMARY OF CERTAIN PROVISIONS OF THE NOTE RESOLUTION" contained in Appendix C, and "CONTINUING DISCLOSURE UNDERTAKING" contained in Appendix E hereto. Bond Counsel has not been retained to pass upon, and will not express any opinion upon, any other information in this Official Statement or any other information pertaining to the Series 2004B Notes or the Board or the Department that may be made available to the prospective purchasers of the Series 2004B Notes 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 note transcript of proceeding. Certain legal matters will be passed upon for the Underwriters by their counsel, Greenberg Traurig, L.L.P.

MISCELLANEOUS

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

Copies of the Note Resolution and the Grant Agreements discussed herein may be obtained from the Department's 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.

All statements in this Official Statement involving matters of opinion, estimates, forecasts, projections, or the like, whether or not expressly so stated, are intended as such and not as representations of fact. No representation is made that any of such opinions or the like will be realized. The agreements of the Board and the Department are fully set forth in the Note Resolution in accordance with the Act and this Official Statement is not to be construed as a contract or agreement between the Board or the Department and the purchasers or Owners of any of the Series 2004B Notes.

This Official Statement is submitted in connection with the sale of the Series 2004B Notes and may not be reproduced or used, as a whole or in part, for any other purpose. This Official Statement has been duly authorized and approved by the Board and the Department and duly executed and delivered on their behalf by the officials signing below.

ARIZONA TRANSPORTATION BOARD

/s/ Bill Jeffers
Bill Jeffers, Chairman

ARIZONA DEPARTMENT OF TRANSPORTATION

/s/ Victor Mendez
Victor Mendez, Director

APPENDIX A

PROPOSED FORM OF OPINION OF BOND COUNSEL

November 10, 2004

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 $104,385,000 aggregate principal amount of the Grant Anticipation Notes, Series 2004B, dated as October 1, 2004 (the "Series 2004B Notes"). The Series 2004B Notes are issued under Title 28, Chapter 21, Article 3, Arizona Revised Statutes (the "Act"), and pursuant to resolutions adopted by the Board on June 9, 2000, as supplemented by the resolution adopted on April 20, 2001, as supplemented and amended by the resolution adopted April 18, 2003, as supplemented by the resolution adopted on April 16, 2004 and as supplemented by the resolution adopted on September 17, 2004 (collectively, the "Resolution"). The documents in the Transcript include a certified copy of the Resolution. All capitalized terms not defined herein shall have the meanings set forth in the Resolution. We have also examined a conformed copy of Series 2004B Notes of the first maturity.

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

1. The Series 2004B Notes and the Resolution 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. The Series 2004B Notes constitute special and limited obligations of the Board, and the principal of, premium, if any, and interest (collectively, "debt service") on the Series 2004B Notes, together with debt service on the outstanding 2001A Notes, 2003A Notes, 2004A Notes and any Additional Notes that may subsequently be issued under the Resolution on a parity therewith, are payable from, and are secured by a pledge solely of, amounts on deposit in the Grant Anticipation Note Fund and the Note Proceeds Account created under the Resolution, as defined and provided in the Resolution. Under the Resolution, the Department is required to deposit into the Grant Anticipation Note Fund: (a) the Grant Revenues, (b) certain Federal Aid Revenues, and (c) certain other revenues, all as defined and provided in the Resolution. The Series 2004B Notes and the payment of debt service thereon are not secured by a pledge of any moneys raised by taxation, and the Series 2004B Notes do not represent or constitute a general obligation or a pledge of the full faith and credit of the State of Arizona, the Board or the Department.

2. The Resolution creates a valid pledge of the Grant Anticipation Note Fund and the Note Proceeds Account for the Notes, which pledge is subject to no superior pledges granted under the Resolution.

3. The interest on the Series 2004B Notes is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), and is not treated as an item of tax preference for purposes of the alternative minimum tax imposed on individuals and corporations. The interest on the Series 2004B Notes is exempt from Arizona state income tax. We express no opinion as to any other tax consequences regarding the Series 2004B Notes.

Under the Code, portions of the interest earned on the Series 2004B Notes by certain corporations may be subject to a corporate alternative minimum tax, and interest on the Series 2004B Notes 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 covenants of the Board and Department and the accuracy, which we have not independently verified, of the representations and certifications of the Board and Department contained in the Transcript. The accuracy of those representations and certifications, and the compliance by the Board and Department with those covenants, may be necessary for the interest on the Series 2004B Notes 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 Notes 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 Notes.

We express no opinion as to the statement of insurance printed on the Series 2004B Notes referring to the financial guaranty insurance policy issued by Ambac Assurance Corporation or as to the insurance referred to in that statement.

Respectfully submitted,

APPENDIX B

ARIZONA DEPARTMENT OF TRANSPORTATION
AUDITED FINANCIAL STATEMENTS
FOR YEAR ENDED JUNE 30, 2003

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Deloitte.

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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 financials 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

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.

- 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.

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
Assets:						
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
Liabilities:						
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
Net assets:						
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.

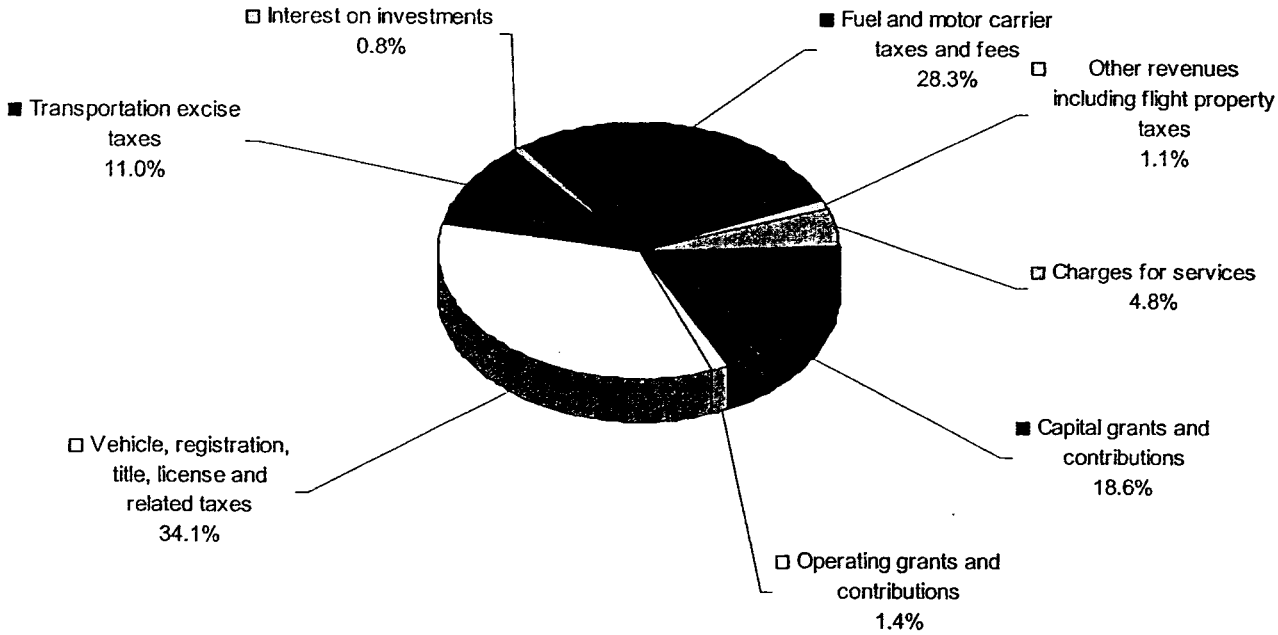
The following condensed financial information was derived from the government-wide Statement of Activities and reflects how the Department's net assets changed during the year:

	Governmental Activities		Business-type Activities		Total	
	2003	2002	2003	2002	2003	2002
Revenues:						
Program revenues:						
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
General revenues:						
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
Total revenues	2,444,679,221	2,416,637,378	16,342,995	17,846,342	2,461,022,216	2,434,483,720
Expenses:						
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
Total expenses	1,831,815,320	1,565,060,804	37,466,542	15,975,450	1,869,281,862	1,581,036,254
Change in net assets before accounting change	612,863,901	851,576,574	<21,123,547>	1,870,892	591,740,354	853,447,466
Cumulative effect of accounting change	40,398,858	-	-	-	40,398,858	-
Change in net assets	653,262,759	851,576,574	<21,123,547>	1,870,892	632,139,212	853,447,466
Net assets - July 1	9,618,782,812	8,767,206,238	86,253,880	84,382,988	9,705,036,692	8,851,589,226
Net assets - June 30	$ 10,272,045,571	$9,618,782,812	$ 65,130,333	$86,253,880	$ 10,337,175,904	$ 9,705,036,692

Governmental Activities:

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

Revenues - Governmental Activities

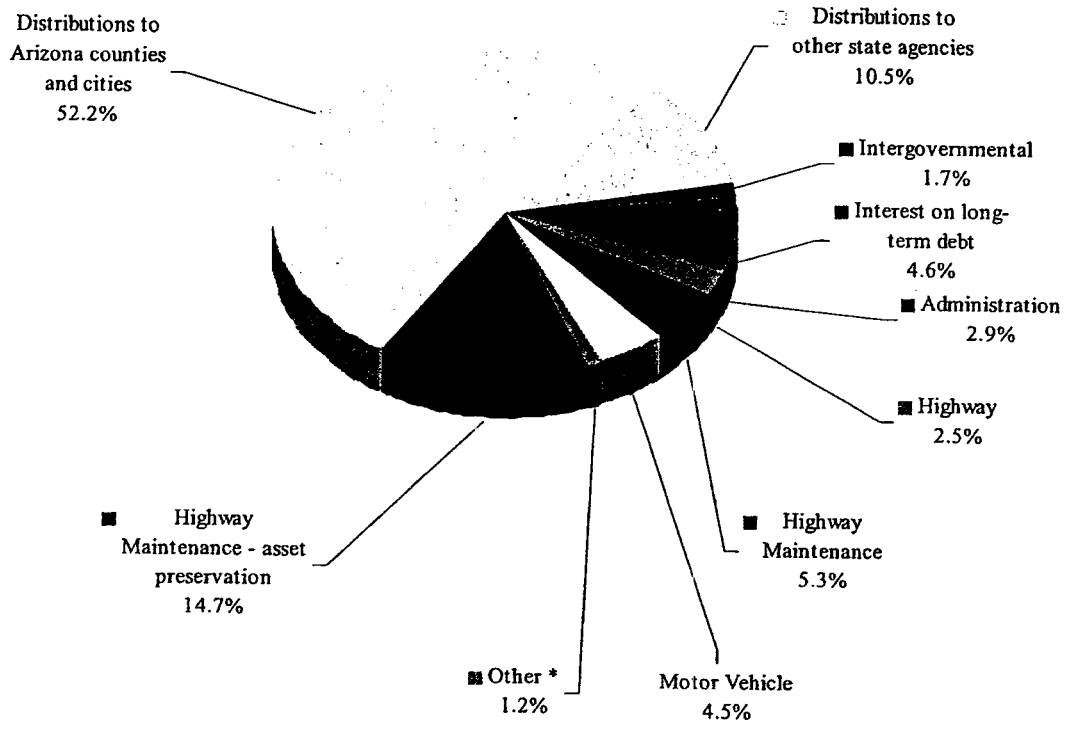


$2.2 billion (or 91.9 percent) of the Department's revenues are from the following four revenue sources:

- 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).

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:

- 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
Total	$ 11,438,563,961	$10,733,547,800	$ 1,125,754	$ 1,439,057	$11,439,689,715	$10,734,986,857

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

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	1,817,359,577
Business-type Activities	
Compensated absences	151,380
Notes payable	151,545,066
Total Business-type Activities	151,696,446
Total Non-Current Liabilities	$ 1,969,056,023

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

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

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Exhibit 1

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

	Governmental Activities	Business-type Activities	Total
ASSETS			
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	12,290,197,066	221,310,942	12,511,508,008
LIABILITIES			
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	2,018,151,495	156,180,609	2,174,332,104
NET ASSETS			
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	$ 10,272,045,571	$ 65,130,333	$ 10,337,175,904

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

Exhibit 2

Arizona Department of Transportation
Statement of Activities
For the fiscal year ended June 30, 2003

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net <Expenses> Revenues
Governmental Activities:					
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	1,831,815,320	117,412,098	34,160,325	453,757,521	<1,226,485,376>
Business-type Actvities:					
Arizona Highways Magazine	11,118,003	9,596,162	-	-	<1,521,841>
Highway Expansion and Extension Loan Program	26,348,539	3,881,239	-	-	<22,467,300>
Total business-type actvities	37,466,542	13,477,401	-	-	<23,989,141>
Total	$ 1,869,281,862	$130,889,499	$ 34,160,325	$453,757,521	$<1,250,474,517>

	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	1,839,349,277	2,865,594	1,842,214,871
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	$ 10,272,045,571	$ 65,130,333	$ 10,337,175,904

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

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

	General Fund (State Highway Fund)	Special Revenue Funds: Maricopa Regional Area Road Construction Fund	Special Revenue Funds: Motor Vehicle Division Clearing Fund	Special Revenue Funds: Highway User Revenue Fund
ASSETS				
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	$ 428,816,550	$ 85,494,943	$ 35,731,768	$ 165,121,180
LIABILITIES AND FUND BALANCES				
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	245,182,387	18,725,924	35,731,768	165,121,180
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	183,634,163	66,769,019	-	-
Total liabilities and fund balances	$ 428,816,550	$ 85,494,943	$ 35,731,768	$ 165,121,180

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
17,593,100	173,152,912	13,890,868	508,880,234
$ 18,545,006	$ 173,623,015	$ 40,685,964	$ 948,018,426
$ -	$ 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
-	13,936,223	16,436,450	495,133,932
-	-	-	4,692,945
-	-	-	20,000,000
18,545,006	-	2,240,673	20,785,679
-	159,686,792	5,623,184	342,323,783
-	-	-	48,696,430
-	-	16,385,657	16,385,657
18,545,006	159,686,792	24,249,514	452,884,494
$ 18,545,006	$ 173,623,015	$ 40,685,964	$ 948,018,426

Arizona Department of Transportation
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
For the fiscal year ended 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
Revenues:				
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
Total revenues	963,505,417	311,765,795	452,549,715	592,723,151
Expenditures:				
Current:				
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	-	-
Total Transportation - appropriated by State legislature	269,706,096	431,569	-	-

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
4,753,138	3,486,931	108,177,905	2,436,962,052
-	-	-	51,484,986
-	-	30,235,385	74,243,730
-	-	-	94,977,822
-	-	4,029,702	81,517,410
-	-	3,579,192	3,579,192
121,748	-	3,283	2,303,835
121,748	-	37,847,562	308,106,975

(continued)

Arizona Department of Transportation
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
For the fiscal year ended 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
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	507,292,216	93,775,472	-	-
Total expenditures	955,001,923	114,154,952	452,549,715	592,723,151
Excess <deficiency> of revenues over <under> expenditures	8,503,494	197,610,843	-	-
Other financing sources <uses>:				
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>	<53,595,884>	<224,301,628>	-	-
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	188,327,695	93,459,804	-	-
Fund balances - June 30	$ 183,634,163	$ 66,769,019	$ -	$ -

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
330,338,126	242,098,862	92,980,778	2,779,847,507
<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>
321,340,099	320,902,303	<21,927,678>	342,417,212
<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
$ 18,545,006	$ 159,686,792	$ 24,249,514	$ 452,884,494

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

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.

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.

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.

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

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.

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.

MAJOR FUNDS

Governmental Funds :

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

Proprietary Funds:

- Arizona Highway Magazine Fund
- Highway Expansion and Extension Loan Program Fund
- Internal Service Fund

NON-MAJOR FUNDS

Other Governmental Funds:

Special Revenue Funds:

- State Aviation Fund
- Safety Enforcement and Transportation Infrastucture Fund
- Motor Vehicle Liabitity Insurance Enforcement Fund
- Vehicle Inspection and Title Enforcement Fund
- Motor Carrier Safety Revolving Fund
- Motorcycle Safety Education Fund
- Underground Storage Tank Fund
- Economic Strength Project Fund
- Grant Anticipation Notes Fund
- Local Agency Deposits Fund

FIDUCIARY FUNDS

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.

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".

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:

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

Capital assets not subject to depreciation	$ 11,256,482,452
Capital assets subject to depreciation	182,081,509
	11,438,563,961
less Internal Service Fund (Equipment Fund) assets	<38,692,731>
	$ 11,399,871,230

2. 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	4,993,698
	$ 9,854,413

3. Long-term liabilities including bonds payable are not due and payable in the current period and are not reported in the current period on the fund statements. The detail for the $<1,631,297,915> difference are as follows:

Bonds payable	$ <1,624,667,663>
Deferred charges - issuance costs	3,049,126
Capital leases	<916,184>
Compensated absences	<8,763,194>
	$ <1,631,297,915>

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:

1. 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	<7,195,981>
	$ 826,535,416

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>

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>

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	1,385,665,135	587,621,490	<120,749,615>	1,852,537,010
Total capital assets, not being depreciated	10,545,933,828	835,499,014	<124,950,390>	11,256,482,452
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	<6,404,626>	42,897,596
Mobile fleet and aircraft	112,290,754	2,578,794	<1,868,462>	113,001,086
Total capital assets, being depreciated	332,768,080	9,879,055	<8,332,205>	334,314,930
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	<70,295,736>	<6,462,917>	1,496,917	<75,261,736>
Total accumulated depreciation	<145,154,108>	<13,848,706>	6,769,393	<152,233,421>
Total capital assets, being depreciated, net	187,613,972	<3,969,651>	<1,562,812>	182,081,509
Governmental activities capital assets, net	$ 10,733,547,800	$ 831,529,363	$ <126,513,202>	$ 11,438,563,961

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	2,424,705	12,427	<58,305>	2,378,827
Total capital assets, being depreciated	3,405,862	12,427	<58,305>	3,359,984
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	<1,974,705>	<319,901>	52,476	<2,242,130>
Total capital assets, being depreciated, net	1,431,157	<307,474>	<5,829>	1,117,854
Business-type activities capital assets, net	$ 1,439,057	$ <307,474>	$ <5,829>	$ 1,125,754

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	6,652,725
Total depreciation expense - governmental activities	$ 13,848,706
Business-type Activities	
Arizona Highways Magazine Fund	$ 319,901

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

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	4,993,698
	$ 9,854,413
Proprietary Fund:	
Arizona Highways Magazine Fund	$ 4,243,131

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
		$124,723,892

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.

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:			
	General Fund	Maricopa Regional Area Road Construction Fund	Debt Service Fund	Total
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	$45,685,409	$ 16,124,075	$321,326,591	$ 383,136,075

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:

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

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

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

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:

	Governmental Activities
Assets:	
Machinery and equipment	$ 1,838,444
Less accumulated depreciation	<228,964>
Total	$ 1,609,480

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

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

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

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%	361,380,000
		$ 932,700,000

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	$ 50,257,999
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	151,610,000	17,595,052
	$ 932,700,000	$445,981,523

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

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
Govermental activities	3.0% - 6.5%	$301,200,000
Govermental activities - capital appreciation	7.3% - 7.5%	30,000,000
Govermental activities - refunding	4.5% - 6.5%	157,200,000
		$488,400,000

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	80,375,000	1,566,542
	$ 488,400,000	$39,437,929

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 $182,295,000.

Grant Anticipation Notes currently outstanding are as follows:

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

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

Fiscal year ending June 30	Grant Anticipation Notes Principal	Grant Anticipation Notes 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
	$ 169,145,000	$ 17,602,245

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.

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	8,996,156
	Total refunded bonds deposited with escrow agents		$ 176,171,156

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
Governmental Activities:					
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>	488,400,000	199,400,000
Grant Anticipation Notes	182,295,000	-	<13,150,000>	169,145,000	36,755,000
Premium on Bonds	9,357,653	28,147,339	<3,082,329>	34,422,663	3,860,449
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	192,849,289	73,197,680	<85,608,493>	180,438,476	118,445,486
Total governmental activities	1,734,806,233	534,147,135	<451,593,791>	1,817,359,577	417,689,304
Business-type Activities:					
Compensated absences	134,092	173,438	<156,150>	151,380	151,380
Notes payable	145,536,466	6,008,600	-	151,545,066	151,545,066
Total business-type activities	145,670,558	6,182,038	<156,150>	151,696,446	151,696,446
Total non-current liabilities	$ 1,880,476,791	$540,329,173	$<451,749,941>	$ 1,969,056,023	$ 569,385,750

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.

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	110,244,788	66,769,019	-	159,686,792	5,623,184	342,323,783
Total Reserved Fund Balances	$ 134,937,733	$ 66,769,019	$18,545,006	$ 159,686,792	$ 7,863,857	$387,802,407

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-

insurance program, and, in the opinion of the Department's management, any unfavorable outcomes from these claims and actions would be covered by the self-insurance program. Accordingly, the Department has no risk of loss beyond adjustments to future years' premium payments to the state's self-insurance program. All estimated losses for unsettled claims and actions of the state are determined on an actuarial basis and are included in the State of Arizona's Comprehensive Annual Financial Report.

Claims

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

Grants

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

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.

Arizona Department of Transportation
Required Supplementary Information
June 30, 2003

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

	Budgeted Amounts		Actual	Variance with Final Budget - Positive
	Original	Final	Amounts	<Negative>
Revenues:				
Vehicle registration, title, license and related fees	$232,704,500	$ 232,704,500	$ 234,054,397	$ 1,349,897
Fuel and motor carrier taxes	300,487,300	300,487,300	301,520,791	1,033,491
Total revenues	533,191,800	533,191,800	535,575,188	2,383,388
Expenditures appropriated by state legislature in 2003 budget:				
Administration:				
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	2,116,000	2,116,000	2,116,000	-
Total Administration	49,973,300	50,806,100	50,754,625	51,475
Highway:				
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	2,493,900	6,080,000	5,930,035	149,965
Total Highway	43,173,300	44,521,200	44,370,927	150,273
Highway Maintenance:				
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	3,521,651	3,521,651	3,520,647	1,004
Total Highway Maintenance	94,836,651	96,675,551	94,092,233	2,583,318
Motor Vehicle:				
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	2,295,300	2,295,300	2,295,299	1

(continued)

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

	Budgeted Amounts		Actual	Variance with Final Budget - Positive
	Original	Final	Amounts	<Negative>
Motor Vehicle (continued):				
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
Vechicle 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	87,492,967	82,082,467	77,014,613	5,067,854
Air Quality Programs:				
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	51,100	51,100	51,100	-
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	315,301,096	313,910,196	300,410,341	13,499,855
Excess of revenues over expenditures	$217,890,704	$ 219,281,604	$ 235,164,847	$ 15,883,243

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).

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	1,081,803
Total revenues as reported on the Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds (General Fund - Exhibit 4)	$ 963,505,417

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	2,779,516
Total revenues as reported on the Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds (General Fund - Exhibit 4)	$ 955,001,923

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 it 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:

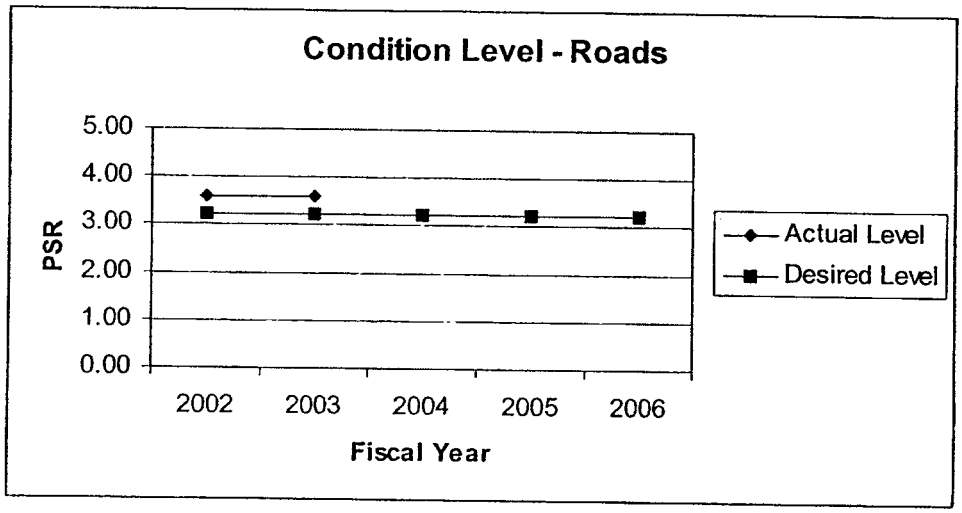

Figure 1

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 super-structure 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%.

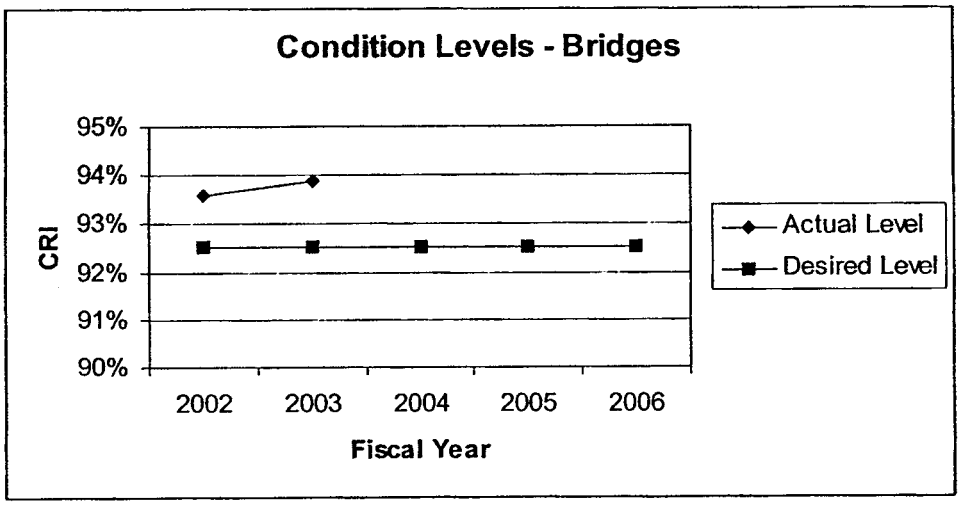

Figure 2

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

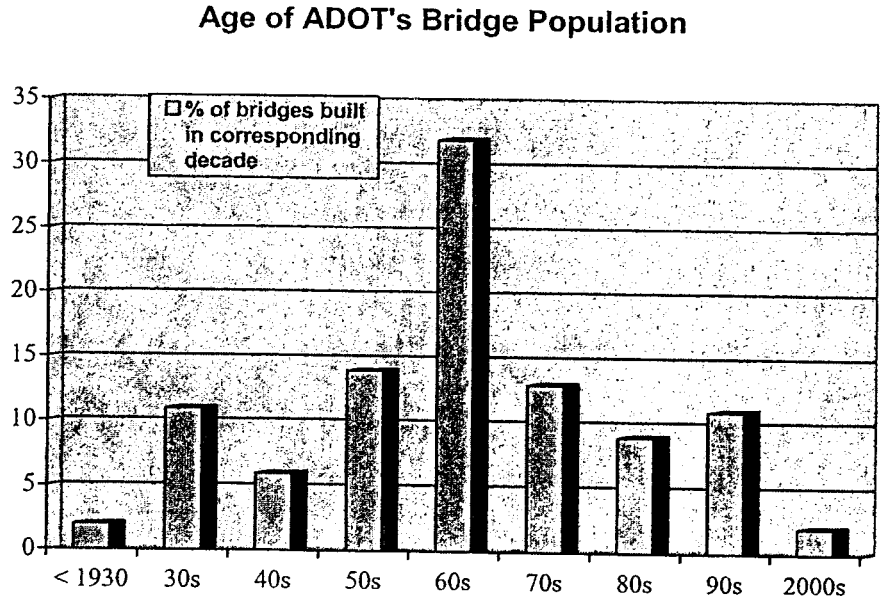

Figure 3

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 C

SUMMARY OF CERTAIN PROVISIONS OF THE NOTE RESOLUTION

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

DEFINITIONS

"Additional Notes" shall mean the Series 2001A Notes, the Series 2003A Notes, the Series 2004A Notes, the Series 2004B Notes and any Series of notes or other obligations that may be subsequently issued by the Board pursuant to applicable law, in accordance with the Note Resolution, on a parity (as provided in the Note Resolution) with the Notes then Outstanding.

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

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

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

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

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

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

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

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

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

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

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

"Director" shall mean the Director of the Arizona Department of Transportation.

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

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

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

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

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

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

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

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

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

"Grant Agreement" shall mean, collectively, (a) the Grant Agreements, between the FHWA and the Department, relating to the Series 2001A Project therein described, with the following Federal Aid Project Nos.: ACNHSTPCM 060-(C)(1) and STP 600-8 (010), (b) the Grant Agreements, between the FHWA and the Department, relating to the Series 2003A Project therein described, with the following Federal Aid Project Nos.:

AC-NH 060-B(006), AC-STP 060-B(008), AC-STP 202-C(001), AC-STP 202-C(002), AC-STP 202-C(006), AC-STP 202-C(008), AC-STP 202-B(005), AC-STP 202-C(005) and AC-STP 202-C(007), (c) the Grant Agreements, between the FHWA and the Department, relating to the Series 2004A Project therein described with the following Federal Aid Project No.: AC-STP-FLH 039-1(042), (d) the Grant Agreements between FHWA and Department, relating to the Series 2004B Projects therein described, with the following Federal Aid Project Nos.: AC-STP-CM 202-C(003), AC-STP 202-C(009) and AC-STP 202-C(001), and (e) for a subsequent Series of Additional Notes and if required by the Act, the federal-aid project agreement or agreements (or similar agreement or agreements relating to receiving Federal Aid Revenues for the Project or Projects that is the subject of such agreement), entered into between the FHWA and the Department relating to the Project or Projects to be financed thereby and identified in the Supplemental Resolution authorizing such Series, as each may be amended in accordance with its terms.

"Grant Anticipation Note Fund" shall mean the Grant Anticipation Note Fund created in the Act and established in the Note Resolution.

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

"Interest Payment Date" shall mean (a) for the Series 2001A Notes, July 1 and January 1 commencing on January 1, 2002, (b) for the Series 2003A Notes, July 1 and January 1 commencing on January 1, 2004, (c) for the Series 2004A Notes, July 1 and January 1 commencing on January 1, 2005, (d) for the Series 2004B Notes, July 1 and January 1 commencing on July 1, 2005 and (e) for a Series of Additional Notes, the dates identified in the Supplemental Note Resolution authorizing such Series.

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

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

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

(c) certain refunded bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state which are not callable prior to maturity or as to which irrevocable instructions have been given to the trustee of such bonds or other obligations by the obligor to give due notice of redemption and to call such bonds for redemption on the date or dates specified in such instructions;

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

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

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

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

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

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

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

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

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

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

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

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

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

"Note Insurer" shall mean with respect to the Series 2001A Notes, MBIA, with respect to the Series 2004A and 2004B Notes, Ambac, and with respect to any other Series of Additional Notes, the bond insurer, if any, named in the applicable Supplemental Note Resolution.

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

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

"Note Registrar" shall mean (a) for the Series 2001A, 2003A, 2004A and 2004B Notes, J.P. Morgan Trust Company, National Association (successor to Bank One Trust Company, N.A.) and (b) for a Series of Additional Notes, the institution set forth in the Supplemental Note Resolution authorizing such Series, and its successor or successors hereafter appointed in the manner provided herein.

"Note Resolution" shall mean the Original Resolution and the Supplemental Note Resolution.

"Notes" shall mean collectively (a) the Series 2001A Notes, (b) the Series 2003A Notes, (c) the Series 2004A Notes, (d) the Series 2004B Notes and (e) Additional Notes issued subsequently under the Note Resolution.

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

"Outstanding" with reference to Notes or "Notes Outstanding" shall mean, as of the applicable date, all Notes which have been authenticated and delivered, or which are being authenticated and delivered under the Note Resolution, except: (a) Notes canceled upon surrender, exchange or transfer, or canceled after purchase in the open market or because of payment at or redemption prior to maturity; (b) any Note (or any portion thereof) (i) for the payment or redemption of which there shall be held in trust under the Note Resolution and set aside for such payment or redemption, moneys and/or Defeasance Obligations (not callable at the option of the issuer thereof) maturing or redeemable at the option of the holder thereof not later than such maturity or redemption date which, together with income to be earned on such Defeasance Obligations prior to such maturity or redemption date, will be sufficient to pay the principal or redemption price thereof, as the case may be, together with interest thereon to the date of maturity or redemption, and (ii) in the case of any such Note (or any portion thereof) to be redeemed prior to maturity, the notice of the redemption of which shall have been irrevocably given in accordance with the Note Resolution or provided for in a manner satisfactory to the Note Registrar; (c) Notes deemed paid pursuant to the provisions of the Note Resolution; and (d) Notes in lieu of which others have been authenticated hereunder.

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

"Paying Agent" shall mean (a) for the 2001A, 2003A, 2004A and 2004B Notes, J.P. Morgan Trust Company, National Association (successor to Bank One Trust Company, N.A.) and (b) for a Series of subsequent Additional Notes, the institution set forth in the Supplemental Note Resolution authorizing such Series, and its successor or successors hereafter appointed in the manner provided herein.

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

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

"Project" shall mean, collectively, (a) for the Series 2001A Notes, the Series 2001A Project described in the Series 2001A Grant Agreements; (b) for the Series 2003A Notes, the Series 2003A Projects described in the Grant Agreements relating to such Series of Notes; (c) for the Series 2004A Notes, the Series 2004A Project described in the Grant Agreement relating to such Series of Notes; (d) for the Series 2004B Notes, the Series 2004B Project described in the Grant Agreement relating to such Series of Notes and (e) for any Series of subsequent Additional Notes, the project or projects described in the Grant Agreement or Agreements, if any, related thereto or otherwise described in the Supplemental Note Resolution authorizing such Series.

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

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

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

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

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

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

"Series 2001A Notes" shall mean the Series 2001A Notes authorized as a Series of Additional Notes under the Note Resolution.

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

"Series 2004A Notes" shall mean the Series 2004A Notes authorized as a series of Additional Notes under the Note Resolution.

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

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

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

"Supplemental Note Resolution" shall mean, collectively, any resolution of the Board which (a) shall supplement or amend the Original Resolution, including the amendments in the Resolution adopted by the Board on April 18, 2003, and (b) may be adopted by the Board in accordance with Article X of the Original Resolution and,

with reference to determining the terms of the Series 2001A Notes, shall mean the Resolution adopted by the Board on April 20, 2001, with reference to determining the terms of the Series 2003A Notes, shall mean the Resolution adopted by the Board on April 18, 2003, with reference to determining the terms of the Series 2004A Notes, shall mean the Resolution adopted by the Board April 16, 2004 and with reference to determining the terms of the Series 2004B Notes, shall mean the Resolution adopted by the Board September 17, 2004, together with the applicable Certificate of Award for each Series.

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

Issuance of Additional Notes

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

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

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

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

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

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

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

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

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

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

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

Subordinated Notes

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

Proceeds of the Subordinated Notes shall not be used to pay, or as security for the payment of, the Notes and proceeds of the Notes shall not be used to pay, or as security for the payment of, the Subordinated Notes. The Supplemental Resolution authorizing such Subordinated Notes shall contain the following (or less favorable to the holders thereof) provisions:

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

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

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

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

Security for Notes; Pledged Funds

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

The Board is not obligated to pay Debt Service from any funds other than the Pledged Funds; provided that the Board and Department are not prohibited, in their sole and absolute discretion, from making payments of Debt Service from sources other than Pledged Funds, to the extent legally available for that purpose; provided, the Department shall be obligated to deposit all Grant Revenues and Federal Aid Revenues as required by the Note

Resolution, and the State Treasurer shall be obligated, as required by the Note Resolution, to transfer lawfully available moneys from the State Highway Fund, the Regional Area Road Fund and the Note Proceeds Account to the Grant Anticipation Note Fund.

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

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

Investment of Grant Anticipation Note Fund and Note Proceeds Account

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

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

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

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

Note Insurer as Owner

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

Any provision regarding consents, approvals, directions, appointments or requests by a Note Insurer, upon behalf of the Owners of the Notes insured by its Note Insurance Policy or for itself, shall be deemed to not require or permit such consents, approvals, directions, appointments, requests or notices to such Note Insurer during the time

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

Particular Covenants of the Board

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

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

Creation of Other Pledges. The Board shall not (i) issue any bonds, notes, debentures, or other evidences of indebtedness of similar nature, payable out of or secured by a pledge of the Pledged Funds or other moneys, securities or funds held or set aside by the State Treasurer or by any Fiduciaries under the Note Resolution, except Additional Notes and Subordinated Notes and (ii) create or cause to be created any pledge, lien or charge equal to or superior to the pledge of the Notes on the Pledged Funds, or such moneys, securities or funds.

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

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

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

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

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

The Board shall do and perform or cause to be done and performed all acts and things required to be done or performed by or on behalf of the Board under the provisions of the Act and the Note Resolution, including

ordering the State Treasurer and Department to perform all acts and things required to be done or performed by the State Treasurer and Department under the provisions of the Act and the Note Resolution.

Substitution, Addition and Amendment of Series 2003A, 2004A and 2004B Grant Agreements

At any time prior to or after the issuance of the Series 2003A, 2004A and 2004B Notes, the Department may substitute for any existing Series 2003A, 2004A or 2004B Grant Agreement, a replacement Grant Agreement, so long as:

a. after giving effect to such substitution, the aggregate of the payments scheduled to be made under all the Series 2003A, Series 2004A or 2004B Grant Agreements by the Federal Highway Administration is at least equal to the aggregate scheduled Debt Service on the Outstanding Series 2003A, 2004A or 2004B Notes, as applicable, when due;

b. the replacement Grant Agreement qualifies as a "Grant Agreement" under the Act; and

c. the applicable representations and warranties of the Board and, as appropriate, the Department, concerning the Series 2000A Grant Agreement and the Series 2000A Project contained in the Note Resolution shall also apply to, and shall be deemed to expressly include, such replacement Series 2003A, 2004A or 2004B Grant Agreement and the Series 2003A, 2004A or 2004B Project therein described.

The Department may amend any Series 2003A, 2004A or 2004B Grant Agreement (including, without limitation, amending the timing and amount of the payments scheduled to be made thereunder by the Federal Highway Administration) so long as, after giving effect to such amendment, the aggregate of the payments scheduled to be made under all the Series 2003A, 2004A or 2004B Grant Agreement by the Federal Highway Administration is at least equal to the aggregate scheduled Debt Service on the Outstanding Series 2003A, 2004A or 2004B Notes, as applicable, of such series when due.

Events of and Remedies Upon Default

The following events shall constitute an Event of Default under the Note Resolution:

(a) if default shall be made in the due and punctual payment of the principal or redemption price of any Note when and as the same shall become due and payable, whether at maturity or by call for redemption, or otherwise;

(b) if default shall be made in the due and punctual payment of any installment of interest on any Note, when and as such interest installment shall become due and payable;

(c) if default shall be made by the Board, Director or Department in the performance or observance of any other of the covenants, agreements or conditions on its part in the Note Resolution or in the Notes contained, and such default shall continue for a period of 60 days after written notice thereof to the Board and Director by the Owners of not less than 25% in principal amount of the Notes Outstanding; provided, however, if the failure stated in the notice can be cured within a period of time not materially detrimental to the rights of the Owners of Notes but cannot be cured within the applicable 60-day period, then the 60-day period shall be extended if corrective action is instituted by the Board, Department or Director, as applicable, within the 60-day period and diligently pursued until the failure is corrected; and provided, further, that if by reason of force majeure, the Board, the Department or Director, as applicable, is unable to carry out the agreements on its part herein contained, the Board, Department or Director, as applicable, shall not be deemed in default under this paragraph (iii) during the continuance of such inability (but force majeure shall not excuse any other Event of Default); or

(d) any warranty, representation or other statement by or on behalf of the Board, the Department or Director, as applicable, contained in the Note Resolution is false or misleading in any material respect.

Upon the occurrence and continuation of an Event of Default under Subsection (a) or (b) above, any Owner of a Note on which payment of Debt Service has not been paid when due shall have the right to institute any action permitted under State law to enforce such payment as provided in the Note Resolution.

Upon the occurrence and continuation of any other Event of Default, the Owners of at least ten percent (10%) of the principal amount of the Notes Outstanding affected by such Event of Default shall have the right to institute any action permitted under State law as a result of such Event of Default to enforce compliance with the provisions of the Note Resolution.

Application of Pledged Funds After Default

During the continuance of an Event of Default, the Board shall order the State Treasurer to apply the Pledged Funds and any other available moneys, including any moneys, securities and funds received by the State Treasurer pursuant to any right given or action taken under the provisions of the Note Resolution, as follows and in the following order:

(a) Expenses of Fiduciaries - to the payment of the reasonable and proper fees (including reasonable attorneys' fees), charges, expenses and liabilities of the Fiduciaries;

(b) Debt Service - to the payment of the interest and principal or redemption price then due on the Notes, as follows:

First: Interest - To the payment to the persons entitled thereto of all installments of interest then due in the order of the maturity of such installments, together with accrued and unpaid interest on the Notes theretofore called for redemption, and, if the amount available shall not be sufficient to pay in full any installment or installments maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon, to the persons entitled thereto, without any discrimination or preference; and

Second: Principal or Redemption Price - To the payment to the persons entitled thereto of the unpaid principal or redemption price of any Notes which shall have become due, whether at maturity or by call for redemption, in the order of their due dates, and, if the amount available shall not be sufficient to pay in full all the Notes due on any date, then to the payment thereof ratably, according to the amounts of principal or redemption price due on such date, to the persons entitled thereto without any discrimination or preference;

Unconditional Obligation. Nothing in the Note Resolution or in the Notes contained shall affect or impair the obligation of the Board, which is absolute and unconditional, to pay at the respective dates of maturity and places therein expressed the Debt Service on the Notes to the respective Owners thereof, or affect or impair the right of action, which is also absolute and unconditional, of any Owner to enforce such payment of its Note in accordance with its terms. A judgment requiring a payment of money entered against the Board may be satisfied only from Pledged Funds.

Effect of Waiver and Other Circumstances. No delay or omission of any Owner to exercise any right or power arising upon the happening of an Event of Default shall impair any right or power or shall be construed to be a waiver of any such Event of Default or be an acquiescence therein; and every power and remedy given under the Note Resolution to the Owners may be exercised from time to time and as often as may be deemed expedient by the Owners.

The Owners of not less than a majority in principal amount of the Notes at the time Outstanding, or their attorneys-in-fact duly authorized, may on behalf of the Owners of all of the Notes waive any past default under the Note Resolution and its consequences, except a default in the payment of Debt Service on any of the Notes before any such waiver shall be effective. No such waiver shall extend to any subsequent or other default or impair any right consequent thereon.

Remedies Not Exclusive. No remedy by the terms of the Note Resolution conferred upon or reserved to the Owners of a Series of Notes is intended to be exclusive of any other remedy, but each and every such remedy shall be cumulative and shall be in addition to every other remedy given under the Note Resolution or, except as

otherwise provided in the Note Resolution, existing at law or in equity or by statute on or after the date of execution and delivery of the applicable Series of Notes.

Rights of Note Insurer upon Default. (a) Except in certain situations, the applicable Note Insurer shall be entitled, but not obligated, to act on behalf of all Owners of the series of Notes that are insured by its Note Insurance Policy in the exercise of all rights and remedies upon an Event of Default including, but without limitation, control, institution and direction of legal proceedings and the granting of any waivers with respect to the foregoing upon behalf of such Owners; and (b) the Owners of the applicable Series of Notes shall not have the right or be permitted to exercise any of the rights or remedies granted or permitted to them upon an Event of Default without the express written consent of the Note Insurer (if any) insuring such Series.

Supplemental Resolutions Without Consent of Owners.

For any one or more of the following purposes and at any time or from time to time, a Supplemental Resolution of the Board may be adopted amending or supplementing the Note Resolution, without notice to or consent of any Owner, which Supplemental Resolution, when adopted, shall be fully effective in accordance with its terms:

(a) to cure any ambiguity, inconsistency or formal defect or omission in the Note Resolution or to make changes permitted in the definition of "Federal Fiscal Year";

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

(c) to add to the limitations and restrictions in the Note Resolution, other limitations and restrictions to be observed by the Board or Department which are not contrary to or inconsistent with the Note Resolution as theretofore in effect;

(d) to confirm, as further assurance, any pledge under, and the subjection to any pledge created or to be created by, the Note Resolution of the amounts on deposit in the Grant Anticipation Note Fund and Note Proceeds Account and to pledge any additional revenues, moneys, securities or agreements as may be permitted by law for deposit in the Grant Anticipation Note Fund and Note Proceeds Account or for the payment of Debt Service;

(e) notwithstanding any other provisions of the Note Resolution, to authorize, in compliance with all applicable laws, a Series of Additional Notes having terms and provisions different than the terms and provisions theretofore provided in the Note Resolution including, but not limited to, provisions relating to a Note Insurance Policy insuring such Series, the timing of the payment of interest and principal, authorizing the form of Notes for such Series of Additional Notes and otherwise to provide amendments or modifications of provisions of the Note Resolution relative to a Series of Additional Notes; provided that neither the issuance of such Additional Notes nor any such amendments or modifications shall in any manner impair or adversely affect the rights or security of the Owners of a Series of Notes then Outstanding or other persons tinder the Note Resolution;

(f) to authorize one or more Series of Subordinated Notes and, in connection therewith, specify and determine the provisions thereof, and also any other matters and things relative to such Subordinated Notes which are not contrary to or inconsistent with the Note Resolution as theretofore in effect, or to amend, modify or rescind any such authorization, specification or determination at any time prior to the first authentication and delivery of such Subordinated Notes;

(g) to comply with the provisions of any federal or state securities law, including, without limitation, the Trust indenture Act of 1939, as amended, or to comply with the Code or to comply with the Federal Aid Authorization;

(h) to make any amendments with the prior written confirmation from each Rating Agency then maintaining an uninsured, underlying rating on the Notes, that such amendments will not, in itself, result in such

uninsured, underlying rating on the Notes following such amendment being lower than such rating on the Notes immediately prior to such amendment; and

(i) to modify any of the provisions of the Note Resolution in any other respect whatever, provided that (i) such modification shall be, and be expressed to be, effective only after all Notes of each Series Outstanding at the date of the adoption of such Supplemental Resolution shall cease to be Outstanding and (ii) such Supplemental Resolution shall be specifically referred to in the text of all Subordinated Bonds of any Series authenticated and delivered after the date of the adoption of such Supplemental Resolution and of Subordinated Bonds issued in exchange therefor or in place thereof.

The provisions of subparagraph (g) shall not be deemed to constitute a waiver by the Board or Owners of any right, remedy or power which it may have in the absence of those provisions to contest the application to the Resolution or the Notes of any change in law.

Supplemental Resolutions Requiring Consent of Owners

(a) Exclusive of Supplemental Resolutions described above and subject to the terms and provisions contained in this paragraph and not otherwise, with the consent of the applicable Note Insurer, the Owners of not less than a majority in aggregate principal amount of the Notes Outstanding and affected by the Supplemental Resolution, shall have the right, from time to time, anything contained in the Note Resolution to the contrary notwithstanding, to consent to and approve, as provided in the Note Resolution, the adoption by the Board and the effectiveness of such other Supplemental Resolutions as shall be deemed necessary and desirable by the Board for the purpose of modifying, altering, amending, adding to or rescinding, in any particular, any of the terms or provisions contained in the Note Resolution.

(b) Notwithstanding any provision of subsection (a) to the contrary, the applicable Note Insurer, upon behalf of Owners of the applicable Series of Notes affected by the Supplemental Resolution, shall have the right to give the consents and approvals required of the Owners of the Notes of such Series, for any amendment to the Note Resolution under subsection (a) affecting such Owners, exclusive of any Supplemental Resolution described in (c), which Supplemental Resolution described in clause (c) shall require the consent of the Owners described in (a) above and of the Note Insurer.

(c) Nothing herein shall permit, or be construed as permitting, (i) an extension of the maturity of the principal of, or the interest on, any Note issued hereunder, or (ii) a reduction in the principal amount of, or redemption premium on, any Note or the rate of interest thereon, or (iii) a privilege or priority of any Note or Notes over any other Note or Notes, or (iv) a reduction in the aggregate principal amount of the Notes required for consent to such Supplemental Resolutions, or (v) permit the creation of any pledge ranking prior to the pledge granted under the Note Resolution on the Pledged Funds or any part thereof, or (vi) deprive the Owner of any Note then Outstanding of the pledge created hereunder on the Pledged Funds, without the prior consent of 100% of the Owners of the Notes affected by such Supplemental Resolution.

Defeasance

Subject to the provisions of the Note Resolution, any Outstanding Notes shall be deemed to have been paid and are not entitled to the lien, benefit and security of the Note Resolution if: (i) in case any of said Notes are to be redeemed on any date prior to their maturity, the Board shall have given to the Note Registrar instructions accepted in writing by the Note Registrar to mail as provided in the Note Resolution notice of redemption of such Notes (other than Notes which have been purchased or otherwise acquired by the Board and delivered to the Note Registrar as hereinafter provided prior to the mailing of such notice of redemption, (ii) there shall have been deposited with an Escrow Agent appointed by the Board for such purposes under an irrevocable escrow agreement, in trust for the Owners of such Notes, (A) moneys (including moneys withdrawn and deposited pursuant to the Note Resolution) in an amount which shall be sufficient, and/or (B) noncallable Defeasance Obligations (including any Defeasance Obligations issued or held in book-entry form on the books of the Department of the Treasury of the United States) the principal of and the interest on which when due will provide moneys which, together with the moneys, if any, deposited with the Escrow Agent at the same time, shall be sufficient (without regard to further investment or reinvestment of either the principal amount thereof or the interest earnings therefrom, which earnings

are to be held likewise in trust and so committed, except as provided herein) to pay when due the Debt Service due and to become due on said Notes on or prior to the redemption date or maturity date thereof, as the case may be; (iii) in the event said Notes are not by their terms subject to redemption within the next succeeding 60 days, the Board shall have given the Note Registrar in form satisfactory to it instructions to mail, first class postage prepaid, a notice to the Owners of such Notes as of the close of business on the date on which the Notes are deemed to be paid and discharged at its address as it appears on the note register on that date on which the Notes are deemed to be paid and discharged, (iv) the Board shall have received a report of an independent nationally recognized firm of certified public accountants or a financial consulting firm of recognized standing in the field of municipal bonds to the effect that the amount of moneys and the principal of and interest when due on the Defeasance Obligations deposited at the same time with the Escrow Agent shall be sufficient to pay when due the Debt Service due and to become due on said Notes through the redemption or maturity date thereof, as the case may be; and (v) the Board shall furnish to the Escrow Agent an opinion of Bond Counsel to the effect that such provision for paying such Notes (assuming compliance by the Board and the Escrow Agent with their duties under the escrow agreement) will not, by itself, cause such Notes to be included in gross income for federal income tax purposes. The notice of defeasance shall: (1) state the numbers of the Notes deemed to be paid and discharged; (2) that the deposit required by (ii) above has been made with the Escrow Agent and that said Notes are deemed to have been paid in accordance with this paragraph; and (3) state such maturity or redemption date upon which the moneys are expected to be available for the payment of the Debt Service on said Notes (other than Notes which have been purchased or otherwise acquired by the Board and delivered to the Note Registrar as hereinafter provided prior to the mailing of the notice of redemption referred to in clause (1) hereof.

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APPENDIX D

BOOK-ENTRY-ONLY SYSTEM

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 Notes. The Series 2004B Notes will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Series 2004B Note will be issued for each maturity of the Series 2004B Notes, totaling in the aggregate the principal amount of the Series 2004B Notes, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, FICC, 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** and **www.dtc.org**.

Purchases of beneficial interests in the Series 2004B Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2004B Notes on DTC's records. The ownership interest of each actual purchaser of a beneficial interest in a Series 2004B Note ("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 Notes are to be accomplished by entries made on the books of Direct Participants and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2004B Notes, except in the event that use of the book-entry system for the Series 2004B Notes is discontinued.

To facilitate subsequent transfers, all Series 2004B Notes deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Series 2004B Notes 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 Notes; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2004B Notes are credited, which may or may not be the Beneficial Owners. The Direct Participants and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Series 2004B Notes may wish to take certain steps to augment transmission to them of notices of significant events with respect to the Series 2004B Notes such as redemptions, defaults, and proposed amendments to the Note Resolution. Beneficial Owners of Series 2004B Notes may wish to ascertain that the nominee holding the Series 2004B Notes for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Bond Registrar and request that copies of notices be provided directly to them.

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

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Series 2004B Notes 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 Series 2004B Notes 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 Notes will be made by the Paying Agent to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the Board or the Paying Agent on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Paying Agent, or the Board, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, 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 depository with respect to the Series 2004B Notes at any time by giving reasonable notice to the Paying Agent or the Board. Under such circumstances, in the event that a successor depository is not obtained, Series 2004B Notes are required to be printed and delivered. The Board may decide to discontinue use of a book-entry-only system through DTC (or a successor securities depository). In that event, Series 2004B Notes 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 NOTES UNDER THE NOTE RESOLUTION; (3) THE SELECTION BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY PERSON TO RECEIVE PAYMENT IN THE EVENT OF A PARTIAL REDEMPTION OF THE SERIES 2004B NOTES; (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 NOTES; (5) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS THE OWNER OF SERIES 2004B NOTES; OR (6) ANY OTHER MATTERS.

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

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

FORM OF CONTINUING DISCLOSURE UNDERTAKING

THIS CONTINUING DISCLOSURE UNDERTAKING ("Undertaking"), dated as of October 1, 2004 is executed and delivered by the ARIZONA TRANSPORTATION BOARD (the "Board") and the DEPARTMENT OF TRANSPORTATION (the "Department" which, together with the Board, is referred to as the "Issuer"), in connection with the issuance by the Board of its $104,385,000 Grant Anticipation Notes, Series 2004B, dated as of October 1, 2004 (the "2004B Notes").

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 below, in accordance with the Rule (defined below) for the benefit of the beneficial owners of the 2004B Notes.

Section 2. Definitions. The terms set forth below shall have the following meanings in this Undertaking, unless the context clearly otherwise requires.

"*Annual Information*" means, for the most recent Federal Fiscal Year, the type of financial information set forth under the heading "FEDERAL AID REVENUES" in the final Official Statement, dated October 27, 2004, for the 2004B Notes.

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

"*Central Post Office* " means, as of any date, any entity then recognized by the Securities and Exchange Commission as eligible to receive filings and submit such filings to the NRMSIRs and any applicable SID. As of the date of this undertaking, the Central Post Office is:

DisclosureUSA.org
P.O. Box 684667
Austin, Texas 78768-4667
Fax: (512) 476-6403
http://www.disclosureUSA.org

"*Federal Fiscal Year*" means the 12-month period beginning on October 1 of each year or such other 12-month period as the federal government shall adopt as its fiscal year.

"*Filing Date*" means the first day of the eighth month following the end of each Fiscal Year (or the next succeeding business day if that day is not a business day), beginning February 1, 2005.

"*Fiscal Year*" means the 12-month period beginning on July 1 of each year or such other 12-month period as the State shall adopt as its fiscal year.

"*MSRB*" means the Municipal Securities Rulemaking Board.

"*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
P.O. Box 840
100 Business Park Drive
Princeton, New Jersey 08542-0840
Telephone: (609) 279-3225
Fax: (609) 279-5962 or (609) 279-2066 or
1-800-395-9403
http://www.bloomberg.com
E-Mail: munis@bloomberg.com

Federal Express address:
Bloomberg Business Park
100 Business Park Drive
Skillman, New Jersey 08558-3629

Standard & Poor's (NRMSIR)
55 Water Street, 45th Floor
New York, New York 10041
Telephone: (212) 438-4595 (Repository)
Fax: (212) 438-3975
http://www.standandpoors.com
E-Mail: nrmsir_repository@sandp.com
Customer Service: (212) 438-3600

FT Interactive Data NRMSIR
Attn: Disclosure
100 William Street, 15th Floor
New York, New York 10038
Telephone: (212) 771-6999; (800) 689-8466
Fax: (212) 771-7390
E-Mail: NRMSIR@FTID.com
Website: http://www.ftid.com

DPC Data, Inc.
Attn: NRMSIR
One Executive Drive
Fort Lee, New Jersey 07024
Telephone: (201) 346-0701
Fax: (201) 947-0107
E-Mail: nrmsir@dpcdata.com
Website: http://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 2004B Notes 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 2004B Notes. The Issuer hereby agrees to provide or cause to be provided to each NRMSIR and to any SID (or in the alternative to a Central Post Office):

(a) Annual Information for the preceding Federal Fiscal Year and unaudited financial statements of the Department for the preceding Fiscal Year if Audited Financial Statements are not provided at the same time, not later than the Filing Date for each Fiscal Year; and

(b) Audited Financial Statements for the preceding Fiscal Year, not later than the later of the Filing Date for each Fiscal Year or 30 days after receipt thereof by the Department.

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 to each NRMSIR or to the MSRB and to any SID (or in the alternative to a Central Post Office), in a timely manner:

(a) notice of the occurrence of any Specified Event with respect to the 2004B Notes, 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.

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 2004B Notes. Any beneficial owner of a 2004B Note may enforce the Issuer's obligation to provide or cause to be provided a filing that is due in accordance with Section 3 or 4 hereof by commencing an action in a court of competent jurisdiction in Phoenix, Arizona to seek specific performance by court order to compel the Issuer to make such filings; provided that any beneficial owner seeking to require the Issuer to comply with this Undertaking shall first provide at least 30 days' prior written notice to the Board and the Department of the Issuer's failure, giving reasonable detail of such failure, following which notice the Issuer shall have 30 days to comply. The right of a beneficial owner to enforce any provision of this Undertaking shall be limited to a right to obtain specific enforcement of the Issuer's obligations hereunder and 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 2004B Notes under the Resolution (as defined in the 2004B Notes).

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 2004B Notes are no longer outstanding (within the meaning of the Resolution) or (b) the Rule no longer applies to these 2004B Notes.

Section 9. Dissemination Agent. The Issuer may, from time to time, appoint or engage a dissemination agent to assist it in carrying out its obligations under this Undertaking, and may discharge any such agent, with or without appointing a successor dissemination agent.

Section 10. Beneficiaries. This Undertaking shall inure solely to the benefit of the Issuer and the beneficial owners from time to time of the 2004B Notes and shall create no rights in any other person or entity.

Section 11. Recordkeeping. The Issuer shall maintain records of all Annual Information and notice of 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.

IN WITNESS WHEREOF, the parties hereto have caused this Continuing Disclosure Undertaking to be executed and delivered by their duly authorized officers in conjunction with the issuance of the 2004B Notes.

ARIZONA TRANSPORTATION BOARD

By: _____
Bill Jeffers
Its: Chair

ARIZONA DEPARTMENT OF
TRANSPORTATION

By: _____
Victor Mendez
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. Note calls;
9. Defeasances;
10. Release, substitution, or sale of property securing repayment of the securities; and
11. Rating changes.

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APPENDIX F

SPECIMEN FINANCIAL GUARANTY INSURANCE POLICY

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Ambac

Financial Guaranty Insurance Policy

Ambac Assurance Corporation
One State Street Plaza, 15th Floor
New York, New York 10004
Telephone: (212) 668-0340

Obligor:

Policy Number:

Obligations:

Premium:

Ambac Assurance Corporation (Ambac), a Wisconsin stock insurance corporation, in consideration of the payment of the premium and subject to the terms of this Policy, hereby agrees to pay to The Bank of New York, as trustee, or its successor (the "Insurance Trustee"), for the benefit of the Holders, that portion of the principal of and interest on the above-described obligations (the "Obligations") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Obligor.

Ambac will make such payments to the Insurance Trustee within one (1) business day following written notification to Ambac of Nonpayment. Upon a Holder's presentation and surrender to the Insurance Trustee of such unpaid Obligations or related coupons, uncanceled and in bearer form and free of any adverse claim, the Insurance Trustee will disburse to the Holder the amount of principal and interest which is then Due for Payment but is unpaid. Upon such disbursement, Ambac shall become the owner of the surrendered Obligations and/or coupons and shall be fully subrogated to all of the Holder's rights to payment thereon.

In cases where the Obligations are issued in registered form, the Insurance Trustee shall disburse principal to a Holder only upon presentation and surrender to the Insurance Trustee of the unpaid Obligation, uncanceled and free of any adverse claim, together with an instrument of assignment, in form satisfactory to Ambac and the Insurance Trustee duly executed by the Holder or such Holder's duly authorized representative, so as to permit ownership of such Obligation to be registered in the name of Ambac or its nominee. The Insurance Trustee shall disburse interest to a Holder of a registered Obligation only upon presentation to the Insurance Trustee of proof that the claimant is the person entitled to the payment of interest on the Obligation and delivery to the Insurance Trustee of an instrument of assignment, in form satisfactory to Ambac and the Insurance Trustee, duly executed by the Holder or such Holder's duly authorized representative, transferring to Ambac all rights under such Obligation to receive the interest in respect of which the insurance disbursement was made. Ambac shall be subrogated to all of the Holders' rights to payment on registered Obligations to the extent of any insurance disbursements so made.

In the event that a trustee or paying agent for the Obligations has notice that any payment of principal of or interest on an Obligation which has become Due for Payment and which is made to a Holder by or on behalf of the Obligor has been deemed a preferential transfer and theretofore recovered from the Holder pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such Holder will be entitled to payment from Ambac to the extent of such recovery if sufficient funds are not otherwise available.

As used herein, the term "Holder" means any person other than (i) the Obligor or (ii) any person whose obligations constitute the underlying security or source of payment for the Obligations who, at the time of Nonpayment, is the owner of an Obligation or of a coupon relating to an Obligation. As used herein, "Due for Payment", when referring to the principal of Obligations, is when the scheduled maturity date or mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity; and, when referring to interest on the Obligations, is when the scheduled date for payment of interest has been reached. As used herein, "Nonpayment" means the failure of the Obligor to have provided sufficient funds to the trustee or paying agent for payment in full of all principal of and interest on the Obligations which are Due for Payment.

This Policy is noncancelable. The premium on this Policy is not refundable for any reason, including payment of the Obligations prior to maturity. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Obligation, other than at the sole option of Ambac, nor against any risk other than Nonpayment.

In witness whereof, Ambac has caused this Policy to be affixed with a facsimile of its corporate seal and to be signed by its duly authorized officers in facsimile to become effective as its original seal and signatures and binding upon Ambac by virtue of the countersignature of its duly authorized representative.

President

AMBAC ASSURANCE CORPORATION CORPORATE SEAL WISCONSIN

Secretary

Effective Date:

Authorized Representative

THE BANK OF NEW YORK acknowledges that it has agreed to perform the duties of Insurance Trustee under this Policy.

Form No.: 2B-0012 (1/01)

Authorized Officer of Insurance Trustee

ORIGINAL

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