July 2, 2015

The Honorable Glenda Sanders
Presiding Judge of the Superior Court
700 Civic Center Drive West
Santa Ana, CA 92701

Dear Judge Sanders:

We are writing in response to the findings and recommendations concerning our agency that were outlined in the 2014-2015 Orange County Grand Jury report, *Joint Powers Authorities: Issues of Viability, Control, Transparency, and Solvency*.

**INTRODUCTORY COMMENTS**

It should be noted that the Grand Jury’s report was prepared after the agency responded to its request for background information in December 2014 and offered to answer questions that might arise concerning the information provided. No questions were posed to the agency by representatives of the Grand Jury during the process of preparing their report. Further, no opportunity was afforded the agency to provide feedback before the report was disseminated.

We are extremely disappointed by the quality of the report as it relates to our agency and our sister agency, the San Joaquin Hills Transportation Corridor Agency (SJHTCA), which operate under common management and are together known as the Transportation Corridor Agencies (TCA). The deficiencies in the report range from trivial inaccuracies (for example, our agency, the Foothill/Eastern Transportation Corridor Agency (F/ETCA)) is erroneously identified throughout the report as the “Foothill Transportation Corridor Agency” and the San Joaquin Hills Transportation Corridor Agency is erroneously identified as the “San Joaquin Transportation Corridor Agency”) to the much more serious misunderstandings and inaccuracies related to the agencies’ financial health and characterization of its debt.

**RESPONSES TO GRAND JURY’S FINDINGS**

F.4. Vertical Joint Powers Authorities with a single controlling entity, such as a city council, have the potential to use this organizational structure as a shell company to avoid other legal constraints on the controlling entity and to obfuscate taxpayer visibility.

We disagree wholly with this finding, as it is entirely inapplicable to our agency. F/ETCA is organized under the horizontal structure for joint powers authorities (JPAs) described in the Grand Jury’s report, rather than as a Vertical Joint Powers Authority. F/ETCA and SJHTCA are organized as separate legal entities. Each agency is governed by a separate Board of Directors comprised of representatives of the members of the respective JPA, who are Orange County Supervisors and elected officials from cities...
located along The Toll Roads (State Routes 73, 133, 241 and 261). Thus, there is no single controlling entity for either agency, as would be the case for Vertical Joint Powers Authorities.

F.5. Vertical Joint Powers Authorities in which the controlling entity transfers assets from itself to a Joint Powers Authority for the purpose of obtaining additional funding, or signs a long-term lease to a Joint Powers Authority to obtain assets, are avoiding transparency and are not acting in the best financial interest of the taxpayers.

We disagree wholly with this finding, as it is entirely inapplicable to our agency. As explained above, F/ETCA is organized under the horizontal structure for joint powers authorities described in the Grand Jury’s report, rather than as a Vertical Joint Powers Authority, and there is no single controlling entity. Further, there have been no transfers of assets from the JPA members to the agency and no instances involving the use of long-term leases to obtain assets.

F.8. The Foothill Transportation Corridor Agency and the San Joaquin Transportation Corridor Agency have a joint debt level of over $4.5 billion. The Grand Jury has determined that this debt level is excessive based on their revenues, and it threatens to render them insolvent.

In addition to this finding, the report further elaborates as follows: The Foothill Transportation Corridor Agency and the San Joaquin Transportation Corridor Agency have a joint debt level of over $4.5 billion, which is about 63% of the total debt reported by all of the JPAs in Orange County. This level of public debt on the citizens of Orange County is very significant. These two transportation agencies only have an income level of $292 million per year. With this extreme debt burden, the Grand Jury questions their ability to pay off the principal and interest, based on their current revenue level.

We disagree wholly with this finding, as it reflects both a misunderstanding of the nature of the agencies’ debt obligations and an erroneous conclusion about their solvency. The Toll Roads were built by issuing non-recourse toll revenue bonds to the private sector to fund construction. The tolls collected are pledged to repay the bond obligations. Thus, the Grand Jury’s characterization of the agencies’ bond obligations as “public debt” is inaccurate, as neither Orange County taxpayers nor the TCA member agencies are responsible for repayment of these debts.

F/ETCA first issued bonds to finance road construction in 1993, and has never failed to make a scheduled debt service payment. It has issued several series of refunding bonds, most recently in 2013 and 2015, to better align its debt service with its anticipated revenues. All of its senior lien debt is rated investment grade by Standard & Poor’s and Fitch Ratings. The official statements for the 2013 and 2015 refundings (copies of which are available online at the Municipal Securities Rulemaking Board’s EMMA website http://emma.msrb.org) contain detailed information comparing the agency’s anticipated annual net revenues with its expected annual debt service and showing more than adequate coverage. Moreover, in order to protect against unexpected revenue shortfalls, the agency has reserve funds of over $235,000,000 on deposit with the bond trustee which amounts to well over twice the amount of the principal and interest coming due on its bonds in the next fiscal year. In addition, the agency has unrestricted cash reserves of over $150,000,000.

In summary, contrary to the unsupported assertions made in the Grand Jury’s report that question F/ETCA’s solvency, we believe (as do the rating agencies that rate its bonds and the insurer who guarantees the payment of certain of those bonds) that its anticipated revenues will be more than sufficient each year to pay its operating expenses and service its debt.
RESPONSES TO GRAND JURY’S RECOMMENDATIONS

R.3. All Joint Powers Authorities should take the following actions to insure transparency to the taxpayers: (1) have an annual outside audit, (2) post the complete audit on their city website as a separate Joint Powers Authority entity, (3) send the audit to the County Controller and the State Auditor, and (4) ensure the required reports are filed annually to the County and the State.

This recommendation does not require implementation, as the agency has consistently fulfilled each applicable requirement to insure transparency. As was communicated in response to the Grand Jury’s original request for information, the agency:

1. Has an annual audit, which is at present conducted by KPMG LLP. We provided a copy of the agency’s most recent audited financial statements to the Grand Jury under cover of a letter dated December 29, 2014.
2. Posts a copy of the annual audited financial statements to its website. In the same letter dated December 29, 2014, we provided a link to this posting.
3. Provides copies each year of our audited financial statements to the California State Controller’s Office and to the Orange County Auditor-Controller’s office.
4. Files a required annual report with the California State Controller’s Office, as we communicated to the Grand Jury in the same letter dated December 29, 2014. We are aware of no similar reporting requirements imposed by Orange County.

R.6. The Foothill Transportation Corridor Agency and the San Joaquin Transportation Corridor Agency should address their solvency by an aggressive plan to reduce their public debt.

This recommendation does not require implementation. As described above, the agencies’ bond obligations cannot accurately be described as “public debt” and the results of their recent bond refunding transactions provide evidence that their solvency should not be in question.

We would be happy to discuss this matter further, in the interest of resolving the discrepancies outlined above.

Sincerely,

Foothill/Eastern Transportation Corridor Agency

Michael A. Kraman
Chief Executive Officer

cc: Orange County Grand Jury
700 Civic Center Drive West
Santa Ana, CA 92701