ATTACHMENT A

Orange County Transportation Authority
405 Project, Measure M2 Plan of Finance
October 2018

Introduction

On November 7, 2006, Orange County (OC) voters approved the renewal of the Measure M one-half cent sales tax for transportation improvements with 69.7 percent support. Voters originally endorsed Measure M in 1990 (known as M1) with a sunset in 2011. With the approval of Renewed Measure M (known as M2), the voters agreed to a continued investment of local tax dollars in OC's transportation infrastructure for 30 years, out to 2041.

Since M2's approval, OCTA's Board of Directors (Board) has continued to advance implementation of M2 through the adoption of a series of early delivery plans. These early delivery plans were designed to ensure the delivery of projects and programs through 2041 as promised to the voters, bring transportation improvements earlier to residents and commuters of OC and, as appropriate, address slower growth in sales tax revenue projections through strategic financing and successfully capturing and augmenting the program with external revenue.

By the year 2041, the M2 Transportation Investment Plan plans to deliver over $13.1 billion worth of transportation improvements to OC. Major improvement plans target OC freeways, streets and roads, transit, and environmental programs. The successful completion of the M2 Program is both a necessity to enhance the quality of life in OC, as well as a management challenge based on many variables. The successful completion of the M2 Program is both a necessity to enhance the quality of life in OC, as well as a management challenge based on many variables.

The 405 Improvement Project

The M2 Transportation Investment Plan lists 14 major freeway projects. The $1.91 billion I-405 Improvement Project (405 Project) is the largest project in the M2 Transportation Investment Plan and in OCTA's history. In April 2015, the Board identified $1.254 billion of M2 funds for the 405 Project.

OCTA, in cooperation with the California Department of Transportation, is widening the San Diego Freeway (I-405) between State Route 73 (SR-73) and Interstate 605 (I-605).

The 405 Project will improve 16 miles of I-405 between the SR-73 freeway in Costa Mesa and I-605 near the Los Angeles County line. The 405 Project scope includes adding one general-purpose lane in each direction between Euclid Street and I-605 and making improvements to freeway entrances, exits, and bridges. In addition, the 405 Project will add the 405 Express Lanes, incorporating the existing carpool lanes and a new lane in each direction between SR-73 and I-605. The 405 Express Lanes are expected to open in January 2023.

The general-purpose lanes portion of the 405 Project, 75% of the total cost, will be funded by a combination of local, state, and federal funds. The 405 Express Lanes portion of the 405 Project, 25% of the total cost, will be paid for by user-generated toll revenue from those who use the 405 Express Lanes.

OCTA awarded OC 405 Partners (DB Contractor) a $1.217 billion contract to design and construct the 405 Project. The DB Contractor was issued a Notice to Proceed 1 in January 2017 and a Notice to Proceed 2 in July 2017. The DB Contractor has started construction in certain areas of the 405 Project.

The 405 Project Plan of Finance

The OCTA staff has been working on the 405 Project for many years. A Major Investment Study for the 405 Project was completed in 2006. The 405 Project draft Plan of Finance began in 2015 and has evolved each year based on refined funding commitments, construction costs, and financing requirements. The current 405 Project Plan of Finance includes local, state, and federal funds and grant monies. The largest commitment of construction funding is from OCTA's M2 sales tax receipts. In addition, the 405 Project construction funding includes State Highway Operation and Protection Program (SHOPP) funds, and federal and state grants.

OCTA's M2 Ordinance No. 3 states that pay-as-you-go financing is preferred. Ordinance No. 3, Section 5, authorizes bond financing and places no limit on the par amount outstanding. Ordinance No. 3 also states that bonds may be issued "at any time before, on, or after the imposition of taxes" net of the California Department of Tax and Fee Administration fee and the 2% set aside for environmental mitigation.

Based on the projected construction spending curve for the 405 Project, OCTA's actual M2 sales tax receipts to date, and projected M2 sales tax receipts through 2023, OCTA's preference to complete the general purpose lanes portion of the 405 Project on a pay-as-you-go basis is unfeasible and bond financing is necessary. The cashflow to support this conclusion is outlined in the OCTA Fiscal Year 2018-19 Comprehensive Plan that was approved by the Board on September 24, 2018.

A total of $1.136 billion is programmed from M2 funds for the 405 Project. The current 405 Project Plan of Finance sources for the 405 Project include $243 million pay-as-you-go M2 funds and approximately $900 million of bond proceeds from the sale of M2 sales tax revenue bonds in 2019 and 2021. OCTA's M2 sales tax revenue bonds are currently rated Aa2, AA+, and AA+ by Moody's, Standard & Poor's (S&P), and Fitch respectively.

OCTA carefully reviewed the debt financing options for the 405 Express Lanes portion of the 405 Project (25% of total costs) that must be financed with non-M2 bond proceeds. In January 2016, OCTA decided to pursue a Transportation Infrastructure Finance and Innovation Act (TIFIA) loan.

TIFIA loans generally have lower interest rates than toll revenue bonds, and TIFIA loans provide more flexible debt repayment structures than toll revenue bonds. In February 2016, OCTA submitted a Letter of Interest (LOI) for a TIFIA loan. In July 2016, OCTA received an indicative rating from S&P with a Plan of Finance based on pay-as-you-go M2 funds in 2017 and 2018, SHOPP funds, state and federal grants, and M2 bond issuance proceeds in 2019 and 2021. In August 2016, OCTA met with TIFIA loan officials and presented a similar plan of finance, which also included selling M2 sales tax revenue bonds in 2019 and 2021.

OCTA closed a 35-year $628.93 million TIFIA loan in July 2017. The non-recourse TIFIA loan is secured solely by future net toll revenues from the 405 Express Lanes. M2 funds cannot be used to repay the TIFIA loan.

The TIFIA loan interest rate is 2.91%, one basis point above the 30-year U.S. Treasury rate on the day of the TIFIA loan closing. The TIFIA loan matures December 1, 2057. The TIFIA loan is rated Baa2 by Moody's. The rating reflects the completion risk of the 405 Project, the ramp-up risk, and the toll revenue risks of the new 405 Express Lanes. Based on the strong 405 Express Lanes toll revenue projections and the success of the new 91 Express Lanes in Riverside County and the Interstate 10 and Interstate 110 Express Lanes in Los Angeles County, the credit rating of the 405 Express Lanes are expected to improve over time.

The Build America Bureau (Bureau), which administers TIFIA loans for the U.S. Department of Transportation, ultimately required OCTA to secure committed M2 funds prior to the close of the TIFIA loan. Although OCTA had sufficient debt capacity to issue senior lien M2 bonds in the amount necessary to complete the funding of the 405 Project before the TIFIA loan financial close date, to satisfy the Bureau's committed funds requirement OCTA chose a cost-effective solution to secure a $900 million line of credit (LOC) secured by a subordinate lien on future M2 receipts. Through a competitive procurement, OCTA selected Bank of America Merrill Lynch (BAML) to provide the LOC required by the Bureau. The BAML LOC is structured with two tranches, with one tranche for $400 million maturing July 1, 2019 and one tranche for $500 million maturing on July 1, 2021.

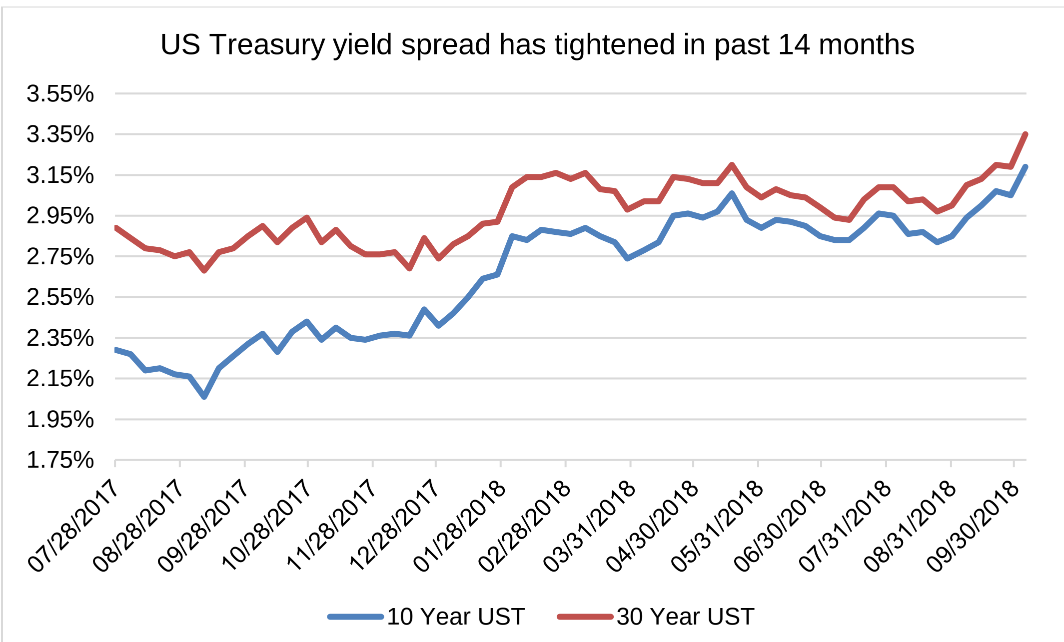
Current M2 Projections

In July 2018, OCTA presented a revised M2 sales tax forecast to the Board. The sales tax for the M2 Program is forecasted to be $13.1 billion through 2041. This represents a decrease of $0.4 billion compared to the previous year's forecast of $13.5 billion. MuniServices' average annual short-term growth rate decreased by 70 basis points. The collective growth rates projected by Chapman University,

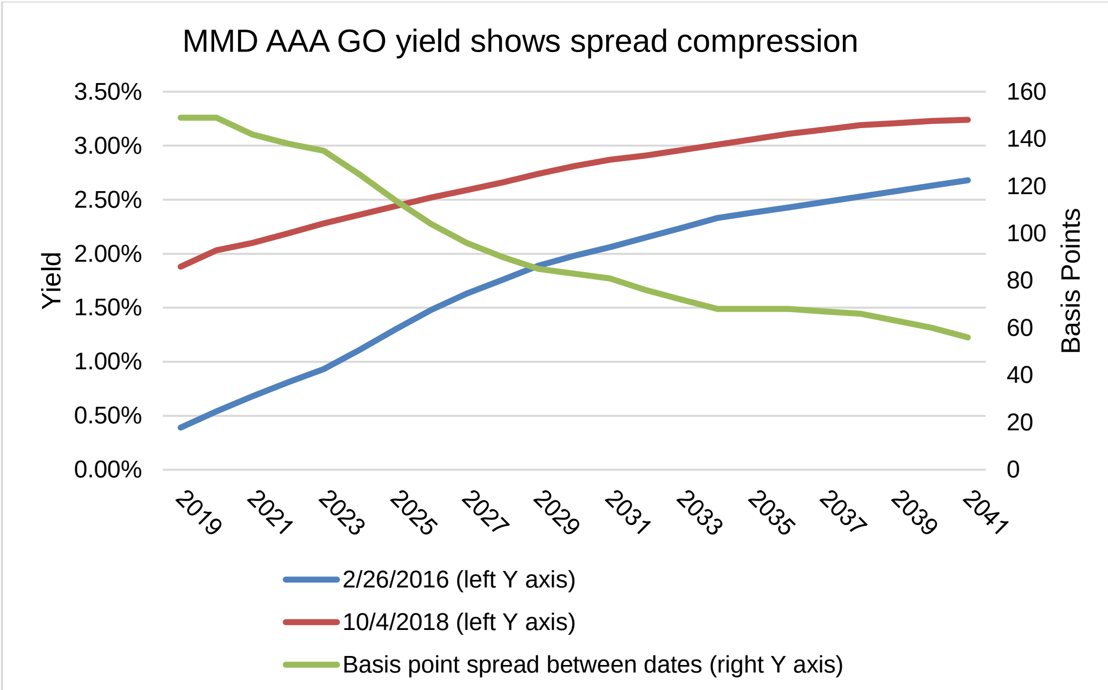
University of California, Los Angeles, and California State, Fullerton from 2017 to 2018 also decreased. The anticipated decline in short-term growth rates was driven by anticipated lower growth in general retail as online sales grow, slowing of growth in new auto sales, slowing of new construction, and declines in IT infrastructure spending due to trends toward cloud storage and software solutions. The long-term anticipated decline was due to lower inflation, lower payroll job growth, lower population growth, and higher migration outside of OC.

Current Capital Market Conditions

Capital market conditions have changed due to monetary policy since OCTA's original draft Plan of Finance in 2016. Since mid-2016, based on continuing positive economic indicators, the Federal Reserve has been gradually increasing the Fed Funds Rate which has resulted in rising short-term interest rates. For example, the two-year U.S. Treasury rate has risen from 0.75% in February 2016 when OCTA submitted its LOI for a TIFIA loan to 2.88% on October 5, 2018. However, long-term rates have been relatively steady. The spread between 10-year and 30-year US Treasury rates has tightened significantly since OCTA closed on its TIFIA loan July 26, 2017 (see chart below). Over the past six months, the spread between the 10-year and 30-year U.S. Treasury has averaged 15 basis points; the result has been a flattening yield curve.



The chart below illustrates the flattening of the municipal bond yield curve based on the Municipal Market Data (MMD) general obligation (GO) yields. In 2017, OCTA's M2 sales tax revenue bonds traded in a range of 10 to 15 basis points above the MMD GO benchmark. Today OCTA's bonds can trade at yields almost identical to or through the MMD GO benchmark.



Many economists and capital market observers expect short- and long-term interest rates to rise in 2019.

The Tax Cuts and Jobs Act of 2017 signed in December 2017 has had a significant impact on the tax-exempt bond market. Among many other provisions that affected tax-exempt debt, the Tax Cuts and Jobs Act of 2017 signed in December 2017 eliminated advance refundings and the State and Local Tax Deduction.

After a surge in tax-exempt bond issuance in December 2017, most municipal market observers predicted that 2018 tax-exempt bond issuance will be down 10% to 35% from the prior year. In addition to lower new issue volume, the elimination of SALT has increased the demand for California tax-exempt bonds.

Construction Fund Reinvestment

The increase in taxable short-term interest rates will have a positive impact on the reinvestment of the proposed 2019 M2 bond issuance. Therefore, OCTA could experience higher interest income on its bond proceeds than it pays in debt service.

The M2 bond proceeds must be invested pursuant to the permitted Investment Securities in the Indenture for the 2010 M2 sales tax revenue bonds. (Investment Securities is a defined term within the Indenture. The Investment Securities definition in the M2 indenture requires that Investment Agreements must be with providers that have minimum ratings of Aa2 by Moody’s and AA by S&P.) Prior to the anticipated sale of the 2019 M2 sales tax revenue bonds, the OCTA staff will review current reinvestment rates and flexibility afforded by purchasing highly rated Investment Securities with maturities that approximate the estimated 405 Project construction spend requirements, the active management of the bond proceeds by one of the portfolio managers under contract with OCTA, or an investment agreement.

2018 405 Project Plan of Finance: Goals

The goal of the 405 Project Plan of Finance is to establish OCTA's objectives for the M2 financings required to complete the funding of the 405 Project, as well to leave sufficient M2 debt capacity to meet the needs of the Next 10 Delivery Plan project delivery requirements. The establishment of clear, measurable objectives is a prerequisite to the formulation of a 2018 405 Project Plan of Finance strategy. Objectives include:

- Achieving the lowest possible borrowing cost;
- Taking advantage of today's low long-term interest rates;
- Providing M2 sales tax revenue bond proceeds as needed;
- Maximizing future financial management flexibility; and
- Minimizing risk.

2018 Financing Team and Anticipated Cost of Issuance Expenses and Underwriting Fees

In September 2016, the Board selected 11 firms to serve on an underwriting pool for a period of five years. At the time of the selection, staff specified that senior managers and co-managers would be selected for future debt issuances from the underwriting pool on a project-by-project basis. On August 17, 2018, OCTA issued a mini request for proposals to the 11 firms from the underwriting pool. Of those 11 firms, six firms have been selected to serve on the underwriting team for the upcoming 405 Project issuance. The recommended firms are BAML as senior, Citi as co-senior, and Barclays, Goldman, JP Morgan, and Stifel as the four co-managers.

Cost of issuance expenses for debt issuances are paid at the closing of a financing transaction. These costs include legal fees, financial advisory fees, rating fees, printing, roadshow, and other miscellaneous expenditures. Nossaman LLP will serve as bond counsel on the transaction. The estimated cost of issuance expenses for a M2 debt issuance will total approximately $550,000. In addition to these costs, the projected underwriting fees for the transaction are estimated at approximately $582,000. Staff will determine the exact cost of issuance expenses for the transaction and provide those figures to the Board for approval.

2018 405 Project Plan of Finance Recommendation

With Board approval, OCTA plans to issue M2 sales tax revenue bonds producing approximately $400 million in bond proceeds in early 2019 and M2 sales tax revenue bonds producing approximately $500 million in bond proceeds in 2021.

The Bureau will allow OCTA to reduce the required LOC amount when OCTA issues M2 sales tax revenue bonds as planned. The $400 million of M2 sales tax revenue bond proceeds in 2019 will reduce TIFIA's requirement for committed funds provided by the BAML LOC from $900 million to $500 million when the $400 million M2 bond proceeds are deposited with OCTA's trustee. OCTA currently pays BAML a fee of 26 basis points, totaling $1.04 million annually, for the $400 million tranche maturing July 2019.

Similarly, when OCTA sells the planned $500 million of M2 sales tax revenue bonds in 2021 and deposits the $500 million M2 sales tax revenue bond proceeds with its trustee, TIFIA will no longer have a requirement for committed funds and the BAML LOC will terminate. OCTA currently pays BAML a fee of 36 basis points, totaling $1.8 million annually, for the outstanding $500 million tranche maturing July 2021

OCTA staff continues to review various financing options and variables which could change its current 405 Project Plan of Finance recommendation. The recent underwriter's proposals suggested several interesting alternatives to OCTA's current plans to issue M2 sales tax revenue bonds producing approximately $400 million in bond proceeds in early 2019.

- Most of the underwriters discussed the potential benefits of issuing the entire $900 million 405 Project funding requirements in 2019. The potential benefits of issuing $900 million in 2019 included: locking in the current low interest rates; potential interest savings if interest rates were to climb significantly between 2019 and 2021; and early termination of the entire BAML LOC.
- Several underwriters suggested a hybrid approach involving the simultaneous issuance of $400 million of M2 sales tax revenue bonds in 2019 and a two-year $500 million Bond Anticipation Notes (BANs), which would provide BAN proceeds to replace the TIFIA requirement for the $500 million LOC and could potentially be reinvested at a higher interest rate that could offset the cost of the BANs. The $500 million BANs would then be repaid with the proceeds of the 2021 M2 sales tax revenue bonds.
- One underwriter suggested issuing subordinate lien M2 bonds rather than the current plan to issue senior lien M2 bonds. The potential benefit would be to preserve the current attractive debt service coverage of the M2 senior lien bonds and, due to today's market conditions, pay a similar interest rate.
- One underwriter suggested pursuing a TIFIA loan secured by a subordinate lien of M2 bonds for several of OCTA's Next 10 Delivery Plan projects. Such

a TIFIA loan may offer attractive pricing and would preserve the current attractive debt service coverage of the M2 senior lien bonds.

OCTA’s staff will continue to evaluate if there are attractive alternatives to the current plan to issue $400 million of M2 sales revenue bonds in 2019.

Future Issuances

In addition to the $900 million for the 405 Project, OCTA expects to issue an additional $1 billion in bonds from 2023 through 2041, based on M2 revenue forecasts and project funding requirements.

Conclusion

The Plan of Finance will be reviewed on an ongoing basis. Market changes and revisions in sales tax collections may affect the current strategy. As such, any changes to the strategy of the Plan of Finance will be submitted to the Board of Directors for approval.