CONNECTOR 2000 ASSOCIATION, INC.

FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2005 AND 2004

CONNECTOR 2000 ASSOCIATION, INC., GREENVILLE, SOUTH CAROLINA
(A Component Unit of the State of South Carolina)

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YEARS ENDED DECEMBER 31, 2005 AND 2004

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Connector 2000 Association, Inc.
Greenville, South Carolina

We have audited the accompanying basic financial statements of Connector 2000 Association, Inc. (the "Association"), a component unit of the State of South Carolina and of the South Carolina Department of Transportation, as of and for the years ended December 31, 2005 and 2004, as listed in the table of contents. These basic financial statements are the responsibility of Association. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Association as of December 31, 2005 and 2004, and its changes in financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 14 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Greene, Finney & Horton LLP

Greene, Finney & Horton, LLP
March 10, 2006
(Except for Note 9 to the basic financial statements as to which the date is June 12, 2006)

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Connector 2000 Association, Inc. (the "Association") annual financial report presents a discussion and analysis of the Association's financial performance for the years ended December 31, 2005 and 2004. Our analysis includes comparisons of 2005, 2004 and 2003 information. The 2004 management's discussion and analysis has been revised to reflect reclassifications between operating and nonoperating expense classifications to conform with 2005 financial statement presentation. We ask that you read this section of the report in conjunction with the basic financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- The year 2005 brought the Association's first scheduled toll rate increase. Toll transactions for 2005 declined from 2004 totals by 3.5% to 4,948,535, while toll transactions for 2004 increased over 2003 totals by 12.3% to 5,129,949. Daily average toll transactions were 13,558 in 2005 compared to 14,016 in 2004 and 12,510 in 2003. Since opening of the Southern Connector Toll Road, both toll transactions and toll revenues were still significantly less than amounts projected in the 1997 Traffic and Revenue Study prepared by Wilbur Smith Associates (discussed in the "Economic Factors and Next Year's Budget" section below).

- Despite the 2005 drop in toll transactions, revenues from operations increased in 2005 due to the toll increase. In 2005, total operating revenues were $4,661,419, and consisted of toll revenues of $4,660,649 and other operating revenues of $770. For 2004, operating revenues consisted of toll revenues of $3,769,428. Toll revenues increased 23.6% in 2005 over 2004, and 13.1% in 2004 over 2003.

- Total operating expenses in 2005 were $2,483,781 compared to $2,367,373 in 2004, an increase of 4.9% due primarily to an increase in salaries and professional fees. Total operating expenses in 2004 increased 0.2% over the 2003 total of $2,361,564.

- Due to continued withdrawals from the Senior Bonds Debt Service Reserve Account, nonoperating revenues from interest earned on repurchase agreements and money market accounts decreased 8.5% to $931,152 in 2005. In 2004, the decrease was 3.6%, to $1,017,596. Nonoperating expenses in 2005 were $22,781,718, and consisted primarily of $15,773,228 of interest expense on the Series 1998 Bonds, $5,243,007 of amortization expense related to the Association's Interest in its License Agreement with the South Carolina Department of Transportation ("SCDOT"), $1,500,000 of accrued license fees related to the Association's License Agreement with the SCDOT, and $126,463 of maintenance expense reimbursable under its License Agreement with the SCDOT. In 2004, nonoperating expenses were $20,502,925, and consisted primarily of $14,940,897 of interest expense, $5,243,008 of amortization expense related to the Association's Interest in its License Agreement with the SCDOT and $180,000 of SCDOT maintenance expense.

- To date, we have used approximately $3,250,206 of monies from our Senior Bonds Debt Service Reserve Account to pay portions of the debt service payments due from July 2003 through January 2006.

  The Association's total net deficit in 2005 increased by $19,672,928 over the course of the year's operations to $88,476,821. Of this increase, 15,773,228 was attributable to interest expense, of which $3,531,500 was cash payments of bond interest, $12,062,558 was accreted bond interest, $98,683 was interest accrued on the SCDOT license fees and maintenance expense, $80,280 was amortization of original issue discount, and $207 was miscellaneous interest expense. The Association's' 2004 increase in total net deficit was $18,083,274. Of the 2004 increase in the net deficit, $14,940,897 was attributable to interest expense, of which $3,531,500 was cash payments of bond interest, $11,322,962 was accreted bond interest, $80,280 was amortization of original issue discount, and $6,155 was miscellaneous interest expense.

- Capital assets net of accumulated depreciation were $167,865,406 at December 31, 2005, a decrease of approximately 3.1% from December 31, 2004. The December 31, 2004, capital assets net of accumulated depreciation decreased approximately 3.0% from December 31, 2003 to $173,220,585. The decreases resulted primarily from amortization of the Association's interest in its License Agreement with the SCDOT of $5,243,007 in 2005 and $5,243,008 in 2004. (See the "Capital Assets" section of this management's discussion and analysis and Note 1, item I and Note 5 to the basic financial statements for information about the accounting treatment of the Association's interest in the License Agreement.)

- The balance of bonds payable increased by 4.6% in 2005 to $276,586,978 due to accretions on the capital appreciation bonds. In 2004, the increase was 4.5%, to $264,444,140, and was also due to capital appreciation bond accretions.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

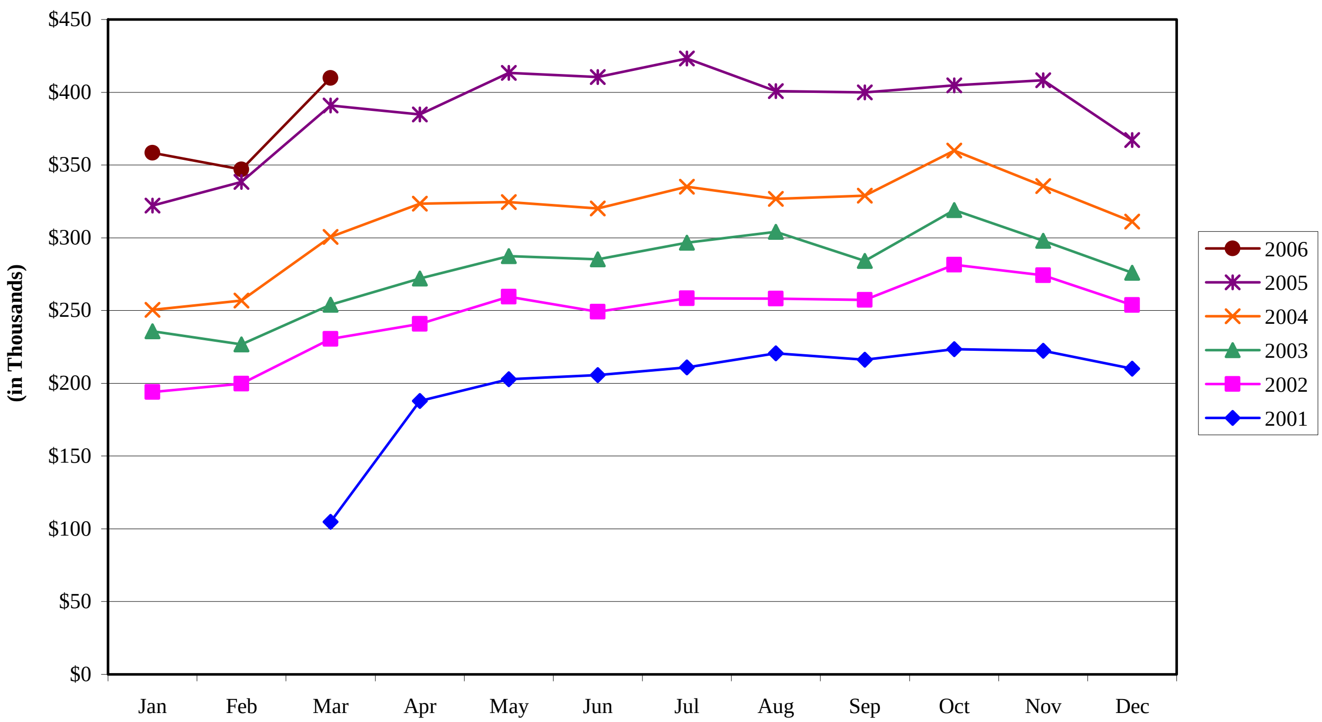
The sole corporate purpose of the Association is to design, finance, acquire, construct and operate the Southern Connector Toll Road. We issued $200,177,680 of Toll Road Revenue Bonds ("Southern Connector Project"), Series 1998 on February 11, 1998, to finance substantially all of the costs of the Southern Connector. Wilbur Smith Associates ("Wilbur Smith") prepared a Traffic and Revenue Study ("the Study") in connection with the sale of the Bonds. The Study was undertaken in order to determine an estimate of the utilization of the road, the appropriate toll rates for the highway and the resulting revenue the Association could reasonably expect to receive from the operation of the Southern Connector.

In the Study, Wilbur Smith estimated the Southern Connector's ramp-up period to be an approximately nine-month period. A "ramp-up" period is the time that traffic on a newly opened road will increase from the road's opening date to a stabilized volume. Ramp-up time is driven by how long it takes the motoring public to become familiar with a route, to "try it out" and ultimately build travel habits that result in the total demand for a facility. At the end of the estimated nine-month ramp-up period, Wilbur Smith projected the average number of "transactions" on the highway to be approximately 28,000 per day. When we say "transactions," we mean toll transactions. In other words, one vehicle passing through one tollgate and paying one toll equals one transaction. If a passenger car drove from Simpsonville (on the east side of the highway) to Anderson (on the west side of the highway) and back in a single day, that car would result in four "transactions" in that single round trip. It would pass through the east and west main line toll plazas once each way. Transactions occur at the two main line plazas and at the four ramp plazas. The main line plazas and the ramp plazas have different tolls. Different vehicle classifications (such as trucks and cars) also pay different tolls, so the translation of the number of transactions into toll revenues is a complicated process involving an estimate of where the traffic is going and the mix of vehicles traveling on the road.

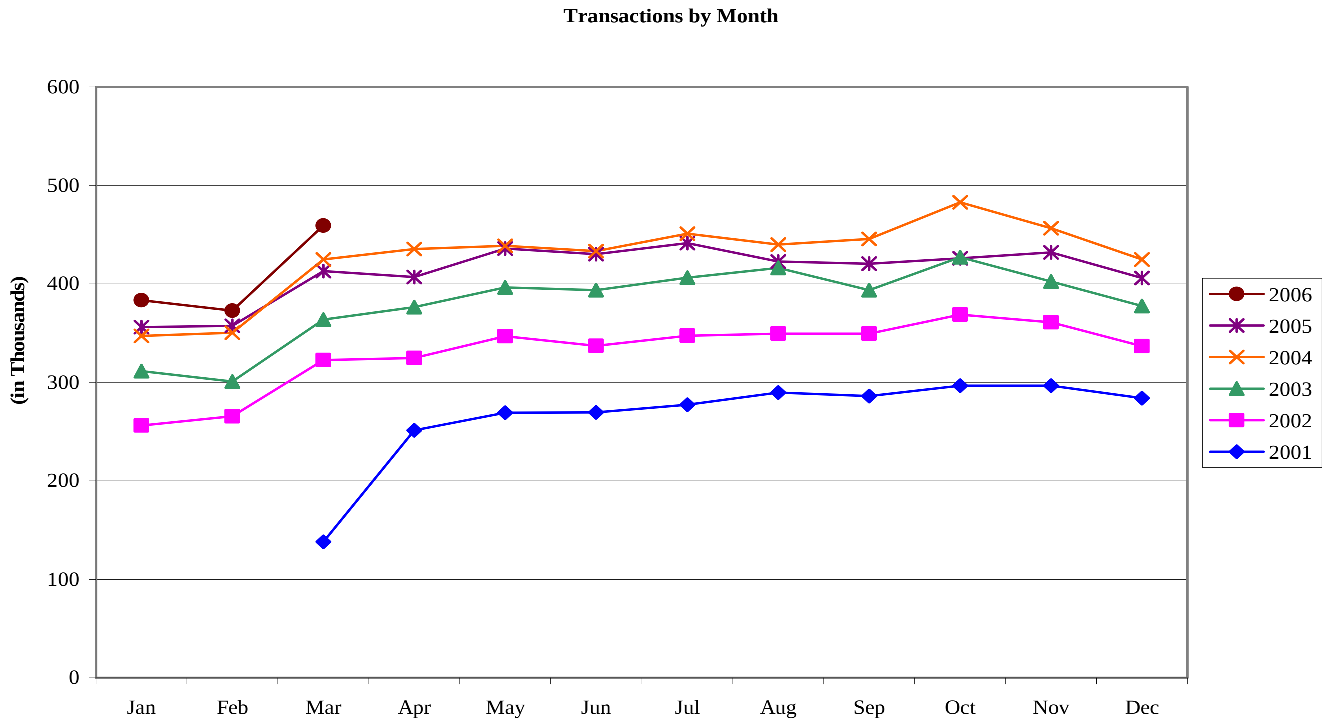
Since opening, actual demand for the Southern Connector Toll Road has been well below Wilbur Smith's projection. Additionally, the percentage of traffic consisting of trucks (which pay a higher toll) has been substantially less than what was projected. Consequently, our toll revenue has been substantially less than what was forecasted in the Study.

Instead of lasting only nine months, the actual ramp-up period for the Southern Connector Toll Road extended from the toll road's opening in late February 2001 through 2004, with both toll transactions and revenues increasing each year. Toll transactions averaged 14,016 per day for 2004, an increase of 12.0% over the 2003 average. Toll revenues for 2004 were $3,769,428, or 13.1% higher than 2003 toll revenues. In 2005 however, average toll transactions decreased 3.3% to 13,558 per day. The 2005 increase in toll rates more than compensated for the decrease in traffic, so our toll revenues for 2005 still increased by 23.6% to $4,660,649. We also had additional toll revenues, classified as "Other toll revenues" on our statement of revenues, expenses and changes in net assets, of $770 from the sale of a computer and the collection of fees for lost transponders.

Revenues by Month



Over the years, many factors have led to the lower-than-projected utilization of the Southern Connector. While certain circumstances are beyond our control, we have made concerted efforts to address those factors that we can influence in order to promote and publicize the Southern Connector. Although one of the principal purposes of the highway was to open southern Greenville County to new development, lack of such development along the Southern Connector has adversely affected utilization of the highway. However, we are actively working with local entities to promote and publicize development opportunities along the Southern Connector corridor. We have worked with the South Carolina Department of Transportation to rectify signage deficiencies. We have undertaken aggressive, award-winning advertising campaigns to make the public aware of the highway and the additional convenience it offers. Our staff has met individually with most of the large trucking firms located in and around the Southern Connector corridor. We have implemented a discount program for trucks that use the electronic toll system and have extended incentives to passenger cars for the acquisition of transponders. We have reduced our operating budget on several occasions and have established an operating reserve to be sure that funds are available to cover operating expenses even if there is a temporary downturn in traffic. We have undertaken to operate the Southern Connector as efficiently as possible while maintaining a level of customer service we believe necessary to grow traffic.



We believe that our efforts have been somewhat successful, despite the downturn in traffic in 2005. As the charts above present, even though transactions decreased during 2005, revenues increased significantly. The 2005 toll rate changes are discussed below. The charts also show continuing improvement in early 2006, when this management's discussion and analysis was written.

In January 2005, a scheduled toll rate increase approved by SCDOT went into effect. This 2005 toll increase was the first increase specified in the Association's License Agreement with SCDOT, which sets the toll rates for the entire 50-year term of the Agreement. Accordingly, toll revenues in 2005 increased by $891,221, or 23.6%. However, following a slight increase in transactions during the months of January and February, they decreased by 181,414, or 3.5%, for the year. The change in transactions was not unexpected following the increase in toll rates, and appears to signify the general public's negative reaction to the price increase based upon feedback received from toll patrons.

A schedule and explanation of the increased toll rates for 2005 follows:

	Location			
	East Plaza	West Plaza	SC Route 20 (On/Off Ramps)	Fork Shoals Rd. (On/Off Ramps)
2 Axles	$1.00	$1.00	$0.50	$0.50
2 Axle Discount Rate	$0.75	$0.75	N/A	N/A
3 Axles	$1.80	$1.80	$0.50	$0.50
3 Axle Discount Rate	$1.35	$1.35	N/A	N/A
4 Axles	$2.40	$2.40	$0.50	$0.50
4 Axle Discount Rate	$1.80	$1.80	N/A	N/A
5 Axles	$3.00	$3.00	$0.50	$0.50
5 Axle Discount Rate	$2.25	$2.25	N/A	N/A
6 Axles	$3.60	$3.60	$0.50	$0.50
6 Axle Discount Rate	$2.70	$2.70	N/A	N/A

One mainline toll plaza is located at the east end and one at the west end of the Southern Connector Toll Road. The toll for all 2-axle vehicles at the mainline plazas is $1.00. At both mainline plazas a higher toll is required for vehicles having more than 2 axles.[1] Unattended ramps are located at Fork Shoals Road and SC Route 20. A flat rate of $.50 per vehicle, regardless of the number of axles, is charged at these ramps.

Motorists have the option of establishing a prepaid toll account (Palmetto Pass), which allows them to travel through dedicated lanes without stopping and have their tolls automatically deducted from their prepaid toll account. Motorists with a Palmetto Pass account receive a 25% discount on all mainline toll plaza transactions. This 25% discount applies to all vehicles, regardless of the number of axles. No discount is applied to transactions at the unattended ramps.

The Association is required to charge tolls in each calendar year sufficient to produce net revenues after the payment of operating expenses equal to or greater than (a) 1.25 times the aggregate debt service on all outstanding senior bonds due in such year, plus (b) the amount required to replenish all previous withdrawals from the reserve funds established for the senior bonds. This bond covenant became effective January 1, 2005. The Association reviewed its financial condition, projected revenue collections and operating budget for 2005 and concluded that it did not expect to achieve net revenues sufficient to meet these requirements. In compliance with its bond documents, the Association circulated a request for proposals to transportation consulting firms of recognized experience in the areas of toll road forecasting for the preparation of a toll rate study. The Association interviewed the three firms who responded to the request for proposals and engaged a consultant. The Association received the completed toll rate study in June 2005. The rate study concluded that increasing toll levels to comply with the rate covenant would be impractical at this time. In the 2005 study, the consultant also recommended that additional toll rate increases be considered other than those scheduled.

[1] The License Agreement between SCDOT and Connector 2000 Association, Inc. provides for a per axle increase to $.65, but the Association, with SCDOT's knowledge, determined an increase to $.60 was more appropriate.

In 2006, we continue our quest to hold operating costs to a minimum while still providing efficient service to our customers. At $2,542,051, our 2006 operating budget reflects only a 2.3% increase over 2005 actual operating costs. This increase results primarily from personnel costs and insurance.

OVERVIEW OF THE FINANCIAL STATEMENTS

The 2005 annual report consists of two parts – management's discussion and analysis (this section), and the basic financial statements, including the notes to the basic financial statements.

The basic financial statements provide short-term and long-term information about the Association's overall financial status. The basic financial statements also include the disclosures that explain some of the information in the basic financial statements and provide more detailed data.

The Association follows governmental accounting principles generally accepted in the United States of America. We present our basic financial statements on an accrual basis of accounting that is similar to the accounting basis used by most private-sector companies. Under the accrual basis, the current year's revenues earned and expenses incurred are accounted for in the Statement of Revenues, Expenses and Changes in Net Assets regardless of when cash is received or paid. All of the Association's assets and liabilities are included in the Statement of Net Assets. *Net assets* – the difference between assets and liabilities – is one measure of the Association's financial health or financial position. (Please note that we use the term *net deficit* throughout this section and in the basic financial statements to describe our situation, where liabilities exceed assets, and the resulting amount of net assets is negative.) Over time, increases or decreases in the Association's net assets or deficit are one indicator of whether our financial health is improving or deteriorating. However, other factors such as transactions (including vehicle class and toll rates), development along the Southern Connector corridor and the physical condition of the Southern Connector, should be considered in order to assess the Association's overall financial position.

FINANCIAL ANALYSIS

<u>Net Assets (Deficit)</u>

During the year ended December 31, 2005, the Association's net deficit increased by $19,672,928 to $88,476,821. Total assets decreased approximately 2.9% to $192,029,957 while total liabilities increased approximately 5.2% to $280,506,778. For the year ended December 31, 2004, the Association's increase in its net deficit was $18,083,274 to $68,803,893. Total assets decreased by 3.2% to $197,815,537, and total liabilities increased by 4.5% to $266,619,430. (See Table 1 below.)

The net decrease in total assets for both years 2005 and 2004 resulted primarily from the fact that total revenues in these years were not sufficient to completely offset such nonoperating expenses as debt service interest payments and amortization of the Association's interest in its License Agreement with SCDOT.

The increase in total liabilities for both years 2005 and 2004 was due mainly to accretions on the capital appreciation bonds. These accretions caused the bonds payable portion of total liabilities to increase by 4.6% in 2005 and 4.5% in 2004. Capital appreciation bonds, or zero coupon bonds, are issued and initially recorded at amounts significantly less than their maturity values. Interest on capital appreciation bonds is not paid annually; instead, interest accretions simply increase the balance due on such bonds. Accordingly, such accretions are recorded as increases in interest expense and the corresponding bonds payable liability. In 2005, other liabilities increased by 80.2% mainly due to accruals for maintenance costs and license fees payable to SCDOT. See pages 9 and 10 for a full discussion of these maintenance costs and license fees. In 2004, the increase in other liabilities was 10.1%, due primarily to an accrual for maintenance costs payable to SCDOT.

Table 1
Net Assets (Deficit)

	2005	2004	2003
Current and Other Assets	$ 24,164,551	$ 24,594,952	$ 25,765,465
Capital Assets	167,865,406	173,220,585	178,530,430
Total Assets	192,029,957	197,815,537	204,295,895
Long-term Liabilities (Bonds Payable)	(276,586,978)	(264,444,140)	(253,040,898)
Other Liabilities	(3,919,800)	(2,175,290)	(1,975,616)
Total Liabilities	(280,506,778)	(266,619,430)	(255,016,514)
Net Assets (Deficit):			
Invested in Capital Assets, Net of Related Debt	(35,650,950)	(29,673,841)	(23,125,663)
Restricted for Debt Service	845,701	253,923	-
Restricted for Capital and Other Projects	10,788	11,452	800,188
Unrestricted	(53,682,360)	(39,395,427)	(28,395,144)
Total Net Assets (Deficit)	$ (88,476,821)	$ (68,803,893)	$ (50,720,619)

U.S. Generally Accepted Accounting Principles for governmental entities require the Association to classify its net assets in three categories as follows.

- The category "invested in capital assets, net of related debt" represents amounts invested in capital assets, less accumulated depreciation and amortization on those assets and less any liabilities (including bonds payable) that are attributable to the construction, acquisition, or improvement of those assets. However, if there are any bond proceeds that have not been spent yet, as was true for the Association at December 31, 2005 and 2004, the portion of bonds payable related to those unspent bond proceeds is not to be included in this category as a reduction of amounts invested in capital assets. Instead, the unspent portion of bonds payable is used to offset the appropriate restricted net asset category as discussed below. At December 31, 2005, the balance of this category of net assets was a deficit of $35,650,950, an increase of $5,977,109 over the 2004 deficit. The 2004 balance of this category of net assets was a deficit of $29,673,841, an increase of $6,548,178 over the 2003 deficit.

- The category "restricted net assets" represents the portion of net assets with attached constraints on the use of the assets. The constraints are externally imposed by such means or parties as debt covenants, laws, enabling legislation or creditors. This category includes any unspent bond proceeds restricted for certain purposes offset by bonds payable related to those unspent bond proceeds and interest accretions on capital appreciation bonds after project completion. Negative balances of restricted net assets are reclassified to the unrestricted net asset category. At December 31, 2005, the Association's net assets restricted for construction of the Southern Connector decreased to $10,788, and its net assets restricted for debt service increased to $845,701. The Association's 2004 balance of restricted net assets consisted of $11,452 of net assets restricted for construction of the Southern Connector and $253,923 of net assets restricted for debt service.

- The category "unrestricted net assets" represents the portion of net assets that can be used to finance daily operations and that have no constraints imposed. The balance of unrestricted net assets at December 31, 2005 was a deficit of $53,682,360, while the 2004 deficit was $39,395,427. The net deficit in this category increased $14,286,933 in 2005 and $11,000,283 in 2004, due primarily to the reclassification of negative balances of net assets restricted for debt service and debt service reserves.

A discussion of the changes in the net deficit for years 2005 and 2004 is presented below.

Changes in Net Assets (Deficit)

Although as presented in Table 2 on the next page, the Association's total revenues were not sufficient to cover its total expenses, there was some improvement in operations in both years 2005 and 2004.

2005 Compared to 2004

The increase in 2005 toll rates coupled with the Association's efforts to control costs allowed us to generate operating income of $2,177,638 in 2005, an increase of $775,583 over 2004. Total operating revenues in 2005 increased approximately 23.7%, while 2005 operating expenses increased approximately 4.9%. Nonoperating revenues, which consisted of interest earned on monies in bank accounts and investments, decreased 8.5% in 2005 to $931,152. In 2005, the nonoperating revenues fell short of nonoperating expenses by $21,850,566.

In 2005, total operating expenses increased $116,408 over 2004. This increase was due primarily to an increase in salaries and professional fees. In 2005, salaries increased $60,007, or 6.4%, due to the addition of personnel, the payment of overtime, internal promotions, and the payment of certain 2004 bonuses in 2005. Professional fees rose 53.1%, or $85,234, due to a toll rate study, financial advisory services and legal and accounting fees. The toll rate study was required in compliance with the bond documents. (See the "Economic Factors and Next Year's Budget" section of this management's discussion and analysis above.) The toll rate study cost $55,691 in 2005. The Association's financial advisory services increased because additional requested services were provided during the year. Our legal and accounting fees increased as reviews of legal and accounting information became more detailed, and because of our lobbying efforts to get toll violation legislation passed.

However, not all of our 2005 operating expenses increased. Due to our efforts to control costs wherever possible, the Association was able to decrease miscellaneous expenses by $24,641, or 60.2%; advertising by $12,489, or 37.8%; and contract labor by $10,881, or 24.8%.

In 2005, our nonoperating interest revenues decreased by $86,444, or 8.5%, to $931,152. The decrease occurred because we withdrew monies from our interest-bearing Senior Bonds Debt Service Reserve count to pay the interest debt service payments on the Senior Bonds. Monies in the Debt Service Reserve Accounts earn interest at 5.4% per year.

Table 2
Changes in Net Assets

		2005		2004		2003
Revenues:						
Operating revenues:						
Charges for Services (Toll Revenues)	$	4,660,649	$	3,769,428	$	3,333,252
Other		770		-		2,499
Nonoperating Revenues:						
Interest and Investment Earnings		931,152		1,017,596		1,055,826
Total Revenues		5,592,571		4,787,024		4,391,577
Expenses:						
Operating Expenses		2,483,781		2,367,373		2,361,564
Nonoperating Expenses		22,781,718		20,502,925		19,984,764
Total Expenses		25,265,499		22,870,298		22,346,328
Decrease in Net Assets (Deficit)		(19,672,928)		(18,083,274)		(17,954,751)
Beginning Net Assets (Deficit)		(68,803,893)		(50,720,619)		(32,765,868)
Ending Net Assets (Deficit)	$	(88,476,821)	$	(68,803,893)	$	(50,720,619)

The majority of our nonoperating expenses do not require any cash outlays. In 2005, the noncash portion totaled $19,250,011. Noncash, nonoperating interest expense was $12,241,521 in 2005. Noncash, nonoperating SCDOT deferred license fees and maintenance expense were $1,500,000 and $126,463, respectively, as discussed below. Noncash, nonoperating depreciation and amortization expenses totaled $5,382,027 in 2005 and decreased the carrying amounts of certain assets. The primary asset affected by amortization was the Association's interest in its License Agreement with SCDOT. (See the "Capital Assets" section of this management's discussion and analysis for more information.) The increase in these noncash, nonoperating expenses was 13.5% in 2005 and was due to the SCDOT deferred license fee, which is a new expense for 2005, and the increase in the amount of interest accretions on the Capital Appreciation Bonds under the bonds' accretion schedule.

Commencing in 2005, under its License Agreement with the SCDOT, the Association is obligated to pay SCDOT license fees of $125,000 per month for a period of twenty-five years and $1.00 per month for the remainder of the term of the license. The license fees are payable from any net revenues remaining after payment of operating costs of the Southern Connector, debt service, transfers to the Debt Service Reserve Accounts and the Renewal and Replacement Account, and payments to SCDOT for routine roadway maintenance as specified in the bond document. If toll revenues are not available to pay the license fees when due, then failure to pay the license fees is not considered default under the License Agreement, so long as the Toll Road Revenue Bonds are outstanding. Instead, the unpaid license fee amount shall be deferred and shall accrue interest at 5% per year compounded annually. The license fee expense payable to the SCDOT on January 1, 2005 was $1,500,000. We recorded this fee as a nonoperating expense. Since our toll revenues were insufficient to pay the license fee, it was deferred, and accrued interest of $75,000 in 2005.

Under its License Agreement with the SCDOT, the Association is also contractually obligated to reimburse SCDOT for its actual costs of routine roadway maintenance of the Southern Connector highway. The costs of roadway maintenance are to be paid from any net revenues remaining after payment of operating costs of the Southern Connector, debt service, and transfers to the Debt Service Reserve Accounts and the Renewal and Replacement Account that are required by the bond document. If revenues are not available to reimburse SCDOT for roadway maintenance costs, any unreimbursed amounts bear interest at 5% per year compounded annually. Maintenance costs for 2001 were stipulated in the License Agreement. The License Agreement states that after the first year, maintenance costs will be based on actual costs incurred by SCDOT. In 2005, we recorded SCDOT maintenance expense (a nonoperating expense) of $126,463 based on notification we received from the SCDOT of its actual costs of maintaining the Southern Connector. Since no revenues were available to pay this expense, it increased our SCDOT deferred maintenance payable account to $351,463 at December 31, 2005. In 2005, interest of $23,683 was accrued on the current and prior years' deferrals of maintenance costs.

2004 Compared to 2003

The increase in demand for the toll road during its ramp-up period coupled with the Association's efforts to control costs allowed us to generate operating income of $1,402,055 in 2004, an increase of $427,868 over 2003. Total operating revenues in 2004 increased approximately 13.0%, while 2004 operating expenses essentially remained the same as in 2003, increasing by only 0.2%. Nonoperating revenues, which consisted of interest earned on monies in bank accounts and investments, decreased 3.6% in 2004 to $1,017,596. In 2004, the nonoperating revenues fell short of nonoperating expenses by $19,485,329.

In 2004, total operating expenses increased only $5,809 over 2003. This net increase was comprised of an increase in 2004 direct operating expenses of the Southern Connector Toll Road of 8.0%, to $1,895,980, and a decrease in indirect operating expenses of 22.1%, to $471,393. The increase in expenses for direct operations was due primarily to equipment-related costs and employee health insurance. In 2004, the contract service fee for a full year of toll equipment maintenance was $311,261 compared to $135,664 in 2003, which only included five months of maintenance fees. Employee health and life insurance in 2004 was $161,772 compared to $112,968 in 2003. Several of the 2004 indirect operating expenses were reduced due to concerted efforts by management to control costs. As a result, professional fees decreased by $82,931. In addition, advertising, insurance and toll highway management fee expenses were trimmed by $59,397.

In 2004, our nonoperating interest revenues decreased by $38,230, or 3.6%, to $1,017,596. The decrease occurred because we reduced monies in our interest-bearing Construction Fund account and in the Senior Bonds Debt Service Reserve Account. In January 2004, $725,591 was transferred from the Construction Fund to the Senior Bonds Debt Service Account to a portion of the pay debt service on the Senior Bonds due January 1, 2008. The 2004 decrease in our Senior Bonds Debt Service Reserve Account occurred because we withdrew monies for interest payments on the bonds. Monies in the Construction Fund earned interest at approximately 1.7% per year in 2004, while monies in the Debt Service Reserve Accounts earned interest at 5.4% per year.

In 2004, the noncash portion of our nonoperating expenses totaled $16,965,270. Noncash, nonoperating interest expense that increased the balance due on the bonds was $11,403,242 in 2004. Noncash, nonoperating SCDOT deferred maintenance expense was $180,000 as discussed below. Noncash, nonoperating depreciation and amortization expenses totaled $5,382,028 in 2004 and decreased the carrying amounts of certain assets. The primary asset affected by amortization was the Association's interest in its License Agreement with SCDOT. (See the "Capital Assets" section of this management's discussion and analysis for more information.) The increase in these noncash, nonoperating expenses was 3.1% in 2004 and was due to the increase in the amount of interest accretions on the Capital Appreciation Bonds under the bonds' accretion schedule.

In 2004, we recorded SCDOT maintenance expense of $180,000 based on notification we received from the SCDOT of its actual costs of maintaining the Southern Connector. Since no revenues were available to pay this expense, it increased our SCDOT deferred maintenance account to $225,000 at December 31, 2004.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

Capital assets at December 31, 2005 and 2004 consisted of equipment and an intangible asset, the Association's interest in a License Agreement with SCDOT. This License Agreement grants the Association the rights to acquire, construct, finance and operate the Southern Connector Toll Road. Through research of governmental accounting literature and consultations with various governmental accounting specialists, we determined that our interest in the license agreement should be valued at the cost of construction of the Southern Connector, including interest capitalized during the construction period. Although the term of the License Agreement is for 50 years, it automatically terminates upon payment of all of the bonds, scheduled to happen in 2038. Therefore, we are amortizing our interest in that License Agreement over the shorter period of approximately 37 years, from opening of the Southern Connector Toll Road in 2001 to 2038.

Table 3
Changes in Capital Assets at Year-End
(Net of Depreciation)

	2005	2004	2003
Equipment, Net	$ 89,168	$ 201,340	$ 268,177
Interest in License Agreement with SCDOT, Net	167,776,238	173,019,245	178,262,253
Total Capital Assets, Net	$ 167,865,406	$ 173,220,585	$ 178,530,430

At December 31, 2005, the Association had $167,865,406 invested in capital assets. This amount represents a net decrease of $5,355,179, or 3.1%, from 2004 amounts. The amount invested at December 31, 2004, was $173,220,585, a net decrease of $5,309,845 (3.0%), from 2003 amounts. Our primary asset is our interest in the License Agreement with SCDOT. In 2005, its carrying amount decreased by 3.0% to $167,776,238, due to amortization of $5,243,007 taken during the year. Its 2004 carrying amount had decreased 2.9% to $173,019,245, due to amortization of $5,243,008 taken during the year.

In 2005, Equipment, Net decreased by 55.7%. The decrease included $112,172 of depreciation and $3,776 of write-offs of fully depreciated equipment. The 2004 decrease in Equipment, Net was 24.9%, and was composed of $46,279 of new vehicles offset by depreciation totaling $112,451 and write-offs of damaged equipment of $665.

SCDOT approved Final Completion of the Southern Connector effective December 22, 2003. Accordingly in January 2004, under the terms of the bond documents, we transferred $725,591 from the Construction Fund to the Debt Service Fund. Those monies have been set aside for the purpose of paying a portion of the debt service payment due January 1, 2008. The remaining balance in the Construction Fund is being used to pay for miscellaneous costs related to the Toll Road such as additional highway signs, reflective roadway markers and other items.

Debt Administration

Long-term debt at December 31, 2005 and 2004 included Toll Road Revenue Bonds with maturity dates ranging from 2008 to 2038. The balances of these bonds at December 31, 2005 and 2004 were $276,586,978 and $264,444,140, respectively. The balances increased by $12,142,838 or 4.6% in 2005 and by $11,403,242 or 4.5% in 2004 due to accretions on the Series 1998B Senior Capital Appreciation Bonds and on the Series 1998C Subordinate Capital Appreciation Bonds. Principal payments on the Series 1998A Senior Current Interest Bonds do not begin until January 2008. Due to the accretion schedule on the Capital Appreciation Bonds, the balance of bonds payable will continue to increase for the next several years. All of the bonds are payable solely by the Association from toll revenues. None are obligations of the State of South Carolina.

Currently, we are not receiving sufficient toll revenues to pay debt service on the Senior Bonds. We have withdrawn monies from our Senior Bonds Debt Service Reserve Account to meet debt service payments as follows:

Amount Withdrawn	Debt Service Payment Due Date
$72,320	January 1, 2003
$980,583	July 1, 2003
$650,000	January 1, 2004
$749,033	July 1, 2004
$536,203	January 1, 2005
$262,067	July 1, 2005
$ 0	January 1, 2006

We acknowledge that unless future traffic counts and toll revenues increase to a level that will allow the Association to pay debt service as well as operating expenses, we will continue to be required to use Senior Bonds Debt Service Reserve Account monies to meet some portion of our debt service obligations. (See Note 1, item J to the basic financial statements for more information about the Funds and Accounts created under the bond indenture and the required flow of the Association's funds.)

As a result of both lack of driver demand for the Southern Connector Toll Road and our need to use debt service reserve funds to meet the Association's debt service payment, in January 2003, Standard and Poor's ("S&P") downgraded the rating of our bonds to B-minus with a stable outlook. In January 2005 and 2006, S&P affirmed that rating and outlook. The Association's Series 1998C Subordinate Capital Appreciation Bonds are not rated.

The Association's bond indenture contains provisions pertaining to the replenishment of the Debt Service Reserve Accounts in the event that monies from these accounts are used to pay debt service. In 2003, because of our inability to replenish the Senior Bonds Debt Service Reserve Account, the Trustee declared that an event of default had occurred under the indenture. We have consulted our legal counsel regarding this matter, and believe that the Trustee has misinterpreted the terms of the indenture. Although to date, we have been unable to resolve this interpretation issue with the Trustee, we have worked with the Trustee towards a resolution. In April 2003, we entered into a Tolling Agreement with the Trustee. In April 2005, the Tolling Agreement was renewed through April 2006 and shall automatically be extended from year to year unless either party gives the other at least sixty (60) days written notice that the Tolling Agreement shall expire on the next succeeding April 30. The Trustee and the Association have agreed that the Association's inability to replenish the Senior Bonds Debt Service Reserve Account will not be considered an event of default while the Tolling Agreement is in effect. (See Note 1, item J and Note 11 to the basic financial statements for more information about the terms of the bond indenture and the debt service reserve replenishment issue.)

In January 2005, the Association became subject to the revenue covenant established in its bond documents. The terms of this revenue covenant and the Association's response are discussed in the "Economic Factors and Next Year's Budget" section of this management's discussion and analysis.

CONTACTING THE CONNECTOR 2000 ASSOCIATION, INC.

This financial report is designed to provide our bondholders, patrons and interested parties with a general overall view of the Association's finances and to demonstrate the Association's accountability for the money it receives. If you have any questions about this report or need additional financial information, please contact Connector 2000 Association, Inc., at Post Office Box 408, Piedmont, South Carolina 29673 or by telephone at (864) 527-2150.

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CONNECTOR 2000 ASSOCIATION, INC., GREENVILLE, SOUTH CAROLINA
(A Component Unit of the State of South Carolina and of the South Carolina Department of Transportation)

STATEMENTS OF NET ASSETS - PROPRIETARY FUND

DECEMBER 31, 2005 AND 2004

	Business-Type Activities - Enterprise Fund	
ASSETS	**2005**	**2004**
Current Assets:		
Cash and Cash Equivalents	$ 637,188	$ 682,006
Cash and Cash Equivalents - Restricted	1,690,113	790,859
Investments	313,340	202,945
Investments - Restricted	924,932	1,240,266
Interest Receivable	7,194	24,657
Prepaid Expenses	87,052	51,251
Inventory	86,978	89,997
Total Current Assets	3,746,797	3,081,981
Noncurrent Assets:		
Restricted Assets in Debt Service Reserve Funds:		
Investments	16,289,599	16,772,509
Interest Receivable	-	473,287
Total Noncurrent Restricted Assets in Debt Service Reserve Funds	16,289,599	17,245,796
Capital Assets:		
Equipment	585,821	589,597
Interest in License Agreement with SCDOT	192,472,174	192,472,174
Less: Accumulated Depreciation and Amortization	(25,192,589)	(19,841,186)
Total Capital Assets	167,865,406	173,220,585
Other Assets:		
Bond Issuance Costs (Net of Accumulated Amortization of $496,375)	1,861,755	1,924,455
Underwriters' Fees on Bonds (Net of Accumulated Amortization of $604,200)	2,266,400	2,342,720
Total Other Assets	4,128,155	4,267,175
TOTAL ASSETS	**192,029,957**	**197,815,537**
LIABILITIES		
Current Liabilities:		
Accounts Payable	50,918	38,776
Deferred Toll Revenue	138,044	123,659
Transponder Deposits	11,600	10,540
SCDOT Deferred Maintenance	351,463	225,000
SCDOT Deferred License Payable with Accrued Interest	1,500,000	-
Accrued Interest on SCDOT Deferred Maintenance and License Fee	98,683	-
Amounts Payable from Restricted Assets:		
Accrued Interest Payable	1,765,750	1,765,750
Requisitions Payable	3,342	11,565
Total Current Liabilities	3,919,800	2,175,290
Noncurrent Liabilities:		
Revenue Bonds Payable, Net	276,586,978	264,444,140
Total Noncurrent Liabilities	276,586,978	264,444,140
TOTAL LIABILITIES	**280,506,778**	**266,619,430**
NET ASSETS (DEFICIT)		
Invested in Capital Assets, Net of Related Debt	(35,650,950)	(29,673,841)
Restricted for:		
Debt Service	845,701	253,923
Capital Projects	10,788	11,452
Unrestricted	(53,682,360)	(39,395,427)
TOTAL NET ASSETS (DEFICIT)	**$ (88,476,821)**	**$ (68,803,893)**

CONNECTOR 2000 ASSOCIATION, INC., GREENVILLE, SOUTH CAROLINA
(A Component Unit of the State of South Carolina and of the South Carolina Department of Transportation)

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS - PROPRIETARY FUND

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

	Business-Type Activities - Enterprise Fund	
OPERATING REVENUES	**2005**	**2004**
Toll Revenues	$ 4,660,649	$ 3,769,428
Other Toll Road Revenues	770	-
TOTAL OPERATING REVENUES	**4,661,419**	**3,769,428**
OPERATING EXPENSES		
Reimbursed Direct Toll Road Expenses:		
Automobile	17,614	10,671
Bank Fees and Charges	35,759	41,351
Contract Labor	32,915	43,796
Contract Services	355,609	355,462
Credit Card Discount Fees	31,134	23,090
Employee Benefits	196,853	188,807
Miscellaneous	16,315	40,956
Office Supplies	19,687	26,128
Payroll Taxes	82,016	76,231
Repairs and Maintenance	41,608	37,815
Salaries	1,000,526	940,519
Telephone	27,660	31,900
Utilities	78,746	79,254
Total Reimbursed Direct Toll Road Expenses	1,936,442	1,895,980
Other Toll Road Expenses:		
Advertising	20,565	33,054
Depreciation	112,172	112,451
Insurance	138,478	134,592
Marketing	30,310	30,379
Professional Fees	245,814	160,580
Toll Highway Management Fees	-	337
Total Other Toll Road Expenses	547,339	471,393
TOTAL OPERATING EXPENSES	**2,483,781**	**2,367,373**
OPERATING INCOME	**2,177,638**	**1,402,055**
NONOPERATING REVENUES (EXPENSES)		
Interest Earned on Cash Equivalents and Investments	931,152	1,017,596
Interest Expense	(15,773,228)	(14,940,897)
SCDOT Maintenance Expense	(126,463)	(180,000)
SCDOT License Fees	(1,500,000)	-
Amortization for:		
Interest in License Agreement with SCDOT	(5,243,007)	(5,243,008)
Bond Issuance Costs	(62,700)	(62,700)
Underwriters' Fees	(76,320)	(76,320)
TOTAL NONOPERATING REVENUES (EXPENSES)	(21,850,566)	(19,485,329)
DECREASE IN NET ASSETS	(19,672,928)	(18,083,274)
NET ASSETS (DEFICIT), Beginning of Year	(68,803,893)	(50,720,619)
NET ASSETS (DEFICIT), End of Year	**$ (88,476,821)**	**$ (68,803,893)**

CONNECTOR 2000 ASSOCIATION, INC., GREENVILLE, SOUTH CAROLINA
(A Component Unit of the State of South Carolina and of the South Carolina Department of Transportation)

STATEMENTS OF CASH FLOWS - PROPRIETARY FUND

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

	Business-Type Activities - Enterprise Fund	
CASH FLOWS FROM OPERATING ACTIVITIES	**2005**	**2004**
Receipts from:		
Toll Collections	$ 4,676,094	$ 3,804,563
Other Toll Road Operations	770	-
Payments for:		
Toll Road Employees and Contract Labor	(1,312,310)	(1,249,353)
Toll Highway Management Fee	-	(337)
Vendors and Service Providers	(1,088,162)	(1,044,770)
NET CASH PROVIDED BY OPERATING ACTIVITIES	2,276,392	1,510,103
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchases of Capital Assets	-	(46,279)
Interest Paid on Bonds Payable	(3,531,707)	(3,537,655)
Other	-	7,400
NET CASH USED IN CAPITAL AND RELATED FINANCING ACTIVITIES	(3,531,707)	(3,576,534)
CASH FLOWS FROM INVESTING ACTIVITIES		
Change in Investments	687,849	626,074
Interest Received	1,421,902	1,029,877
NET CASH PROVIDED BY INVESTING ACTIVITIES	2,109,751	1,655,951
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**854,436**	**(410,480)**
CASH AND CASH EQUIVALENTS, Beginning of Year	1,472,865	1,883,345
CASH AND CASH EQUIVALENTS, End of Year	**$ 2,327,301**	**$ 1,472,865**

Reconciliation of Cash and Cash Equivalents -
Statements of Cash Flows to Statements of Net Assets

	2005	2004
Unrestricted Cash and Cash Equivalents - Current Assets	$ 637,188	$ 682,006
Restricted Cash and Cash Equivalents - Current Assets	1,690,113	790,859
Total Cash and Cash Equivalents Shown on Statement of Net Assets	**$ 2,327,301**	**$ 1,472,865**

CONNECTOR 2000 ASSOCIATION, INC., GREENVILLE, SOUTH CAROLINA
(A Component Unit of the State of South Carolina)

STATEMENTS OF CASH FLOWS - PROPRIETARY FUND (CONTINUED)

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

	Business-Type Activities - Enterprise Fund	
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES	**2005**	**2004**
Operating Income	$ 2,177,638	$ 1,402,055
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation Expense	112,172	112,451
Loss on Disposal of Capital Assets	-	665
Change In:		
Prepaid Expenses	(35,801)	(6,746)
Inventory	3,019	(17,996)
Accounts Payable	12,142	(9,184)
Deferred Toll Revenue	14,385	33,415
Transponder Deposits	1,060	1,720
Requisitions Payable	(8,223)	(6,277)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 2,276,392	$ 1,510,103
NONCASH INVESTING, CAPITAL AND FINANCING ITEMS		
Amortization of Interest in License Agreement with SCDOT	$ 5,243,007	$ 5,243,008
Amortization of Bond Issuance Costs	62,700	62,700
Amortization of Underwriters Fees on Bonds	76,320	76,320
Amortization of Original Issue Discount on Series 1998A Bonds	80,280	80,280
Interest Accreted on Series 1998B and 1998C Bonds	12,062,558	11,322,962
Accrual of Interest Payable	1,765,750	1,765,750
SCDOT Deferred Maintenance	126,463	180,000
SCDOT Deferred License Fees	1,500,000	-
TOTAL NONCASH INVESTING, CAPITAL AND FINANCING ITEMS	$ 20,917,078	$ 18,731,020

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

Connector 2000 Association, Inc. (the "Association") is a South Carolina nonprofit corporation organized as a "public benefit corporation" under the South Carolina Nonprofit Corporation Act of 1994. The Articles of Incorporation of the Association were originally filed with the South Carolina Secretary of State on January 12, 1996, and were amended by a filing on March *5*, 1997. The Internal Revenue Service has issued a letter dated October 20, 1997, determining that the Association is an exempt organization that is not a private foundation under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code"). The Association was formed to assist the South Carolina Department of Transportation ("SCDOT") in the financing, acquisition, construction, and operation of turnpikes, highway projects, and other transportation facilities.

Although the Association was formed in 1996, its first financial activity occurred during February, 1998. At that time, the Association entered into a license agreement (the "License Agreement") with the SCDOT that grants the Association rights and obligations to finance, acquire, construct, and operate an approximately 16 mile fully controlled access toll highway (the "Southern Connector") and to construct the South Carolina Highway 153 Extension (the "SC 153 Extension") (collectively, the "Projects"). Toll road revenue bonds were issued on February 11, 1998, to finance the construction of the Southern Connector.

The Association is only responsible for financing the Southern Connector portion of the Projects. The SCDOT provided financing for the SC 153 Extension portion of the Projects. The accompanying basic financial statements do not include any assets, liabilities or expenses related to the SC 153 Extension.

The State of South Carolina Office of Comptroller General has determined that the Association is a component unit of the State of South Carolina and of the SCDOT because of its fiscal dependence upon the SCDOT, and the fact that the SCDOT also determines the toll rates that will be charged. The Association is governed by a Board of Directors approved by the SCDOT.

The basic financial statements of the Association have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). For the purpose of applying GAAP, the Association's management has determined that the Association should be treated as a governmental entity. The Governmental Accounting Standards Board ("GASB"), which has jurisdiction over accounting, and financial reporting standards applicable to governmental entities, and the Financial Accounting Standards Board ("FASB"), which has jurisdiction over such standards applicable to nongovernmental entities, have agreed on a definition of a governmental entity that is to be used when determining whether governmental GAAP is applicable. Since (a) the Association is a public benefit corporation, (b) the members of the Association's Board of Directors must be approved by the SCDOT, and (c) upon dissolution of the Association, all of the Association's net assets will revert to the SCDOT, the Association meets the criteria set forth in the definition of a governmental entity. Accordingly, the accompanying basic financial statements of the Association have been prepared in accordance with GAAP applicable to governmental unit proprietary funds.

The Association has no component units.

B. Measurement Focus, Basis of Presentation, and Accounting

The government-wide basic financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all of the activities of the Association (the "Primary Government").

Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely, to a significant extent, on fees and charges for support. The Association has no governmental-type activities for the years ended December 31, 2005 and 2004.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Measurement Focus, Basis of Presentation, and Accounting (Continued)

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *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 or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as *general revenues*. The comparison of direct expenses with program revenues identifies the extent to which each governmental function is self-financing or draws from the general revenues of the Association.

The **government-wide basic financial statements** are reported using the *economic resources measurement focus* and the *accrual basis of accounting.* Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Since the Association uses only enterprise funds (see following sections for more details) to account for its activity, there are no differences between the government-wide basic financial statements and the fund basic financial statements.

The accounts of the government are organized and operated on the basis of funds. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. There are a minimum number of funds maintained to keep the accounts consistent with legal and managerial requirements. The Association uses only the following fund type:

Proprietary fund types are accounted for based on the flow of economic resources measurement focus and use of the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The Association applies all applicable GASB pronouncements, as well as the requirements of FASB Statements and Interpretations, Accounting Principles Board (“APB”) Opinions, and Accounting Research Bulletins (“ARBs”), issued on or before November 30, 1989, unless they conflict with or contradict GASB pronouncements. The Association has elected not to follow the aforementioned guidance issued after November 30, 1989 as allowed by GAAP. Proprietary funds are made up of two classes: enterprise funds and internal service funds. The association does not have any internal service funds and has one enterprise fund.

Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises — where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. For purposes of GAAP reporting, the Association has one major Enterprise Fund:

The **Enterprise Fund** is used to account for all of the operations of the Association. All activities of the Association in financing, acquiring, constructing and operating the toll road are accounted for in this fund.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Measurement Focus, Basis of Presentation, and Accounting (Continued)

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the proprietary fund's principal ongoing operations. Operating expenses for proprietary funds 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 nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the Association's policy to use restricted resources first, then unrestricted resources as they are needed.

The Association generally follows the authoritative guidance in GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Fund and Governmental Entities That Use Proprietary Fund Accounting,* to distinguish operating from non-operating revenues and expenses. Thus, the principal operating revenues of the Association are toll revenues received from patrons. Operating expenses of the Association consist of the costs of operating the Southern Connector, including administrative expenses and depreciation of equipment. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. Non-operating revenues include interest earned on cash equivalents and investments. Non-operating expenses include amortization (a) of its intangible interest in the License Agreement with SCDOT, (b) of bond issuance and (b) underwriters' fees. In addition, interest expense on the Association's debt, license fees to the SCDOT, and maintenance expenses to the SCDOT are reported as non-operating expenses.

In years prior to 2001, the Association was considered to be in the Development Stage since its activities consisted of construction of the Southern Connector. In 2001, upon commencement of toll road operations, the Association ceased development stage accounting for its activities.

C. Use of Estimates

The preparation of basic financial statements in conformity with governmental GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

D. Budget

The Association's Board of Directors adopts an annual non-appropriated operating budget. The Board of Directors also approves any amendments to the budget during the year. The budget is prepared using a modified accrual (non-GAAP) basis for Revenue Fund (as defined in the Trust Agreement) expenses. Expenses are recognized in the period in which they are paid rather than the period in which they are incurred for budgetary control purposes. Depreciation and amortization are not recognized as expenses, but capital outlays are recognized as expenses for budgetary control purposes. The expenses are reclassified for the purpose of preparing basic financial statements in accordance with governmental GAAP. Since the Association's activities are accounted for in a proprietary fund, a budget-to-actual comparison is not presented in the accompanying basic financial statements.

E. Cash and Cash Equivalents

The Association considers all investments with maturities of three months or less when purchased to be cash equivalents. The amounts shown in the basic financial statements as "cash and cash equivalents" of the Association represent cash on hand, deposits in banks and funds invested in open ended money market mutual funds.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

F. Investments

The Trust Agreement requires that all bond proceeds received by the Association be held in trust to be expended in accordance with the indenture guidelines. All monies held in trust that are not insured by the Federal Deposit Insurance Corporation ("FDIC") must be secured by and/or invested in investment securities as defined in the Trust Agreement. Investment securities include, but are not limited to, direct obligations of, or obligations guaranteed by, the United States of America or an agency thereof (Note 2). The Association's investments are stated at fair market value (quoted market price or the best available estimate thereof).

G. Receivables

All of the Association's receivables are reported net of any allowances for uncollectible amounts and any discounts.

H. Prepaid Expenses

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenses in the accompanying basic financial statements.

I. Interest in License Agreement with SCDOT

The Association's License Agreement with SCDOT grants to the Association various rights and obligations pertaining to the financing, acquisition, construction, and operation of the Southern Connector and construction of the SC 153 Extension. The terms of the License Agreement provide that the Association finance and construct the Southern Connector and construct the SC 153 Extension with financing provided by the SCDOT. However, the SCDOT at all times retained fee simple title to the Southern Connector and to the SC 153 Extension, to all real property and improvements thereon, and to all rights-of-way acquired during construction.

The Southern Connector was opened for traffic on February 27, 2001, and began collecting tolls on March 14, 2001. On July 22, 2001, the Southern Connector attained Substantial Completion. On December 22, 2003, the Southern Connector attained Final Completion. Beginning one year after the date of Final Completion, the Association is required to pay a monthly license fees to SCDOT (See Note 5 for further details).

The Association's interest in the License Agreement constitutes an intangible asset relating to the Southern Connector that began generating revenues upon commencement of operations. In order to account for its interest in the License Agreement, the Association capitalized all costs of acquisition and construction of the Southern Connector, including interest expense incurred during the construction period. (See Note 1, item P.) Upon commencement of operations, the Association began amortizing its interest in the License Agreement on a straight-line basis over the remaining term of the License Agreement through 2038 (See Note 5 for further details).

The Association's basic financial statements do not reflect any of the costs of construction of the SC 153 Extension because those costs were directly financed and paid by the SCDOT.

J. Restricted Assets

Certain proceeds of the Revenue Bonds are restricted by applicable bond covenants for construction, payment of operating, and other expenses, or are set aside as reserves to ensure repayment of the bonds. Certain other assets are accumulated and restricted on a monthly basis in accordance with the Trust Agreement for the purposes of paying debt interest payments, due on a semiannual basis, and principal payments, due on an annual basis, and for the purpose of maintaining reserve funds at the required levels.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

J. Restricted Assets (Continued)

The Trust Agreement provisions govern payments from the restricted accounts. Limited types of expenses may be funded from these restricted accounts. The funds and accounts are established as follows:

The *Construction Fund* was established for purposes of holding bond proceeds and investment earnings, which are used to pay the costs of constructing the Southern Connector.

The *Revenue Fund* was established to hold all revenues from toll road operations. The Trust Agreement provides that all revenues from the operation of the Southern Connector shall be delivered by the Association to the Trustee immediately upon receipt by, or on behalf of, the Association and shall be deposited by the Trustee into the Revenue Fund. The Trustee is obligated to transfer money on a monthly basis from the Revenue Fund to the other various funds established under the Trust Agreement in the priority listed below:

1. Operating costs budgeted for the next succeeding month shall be distributed to the Association.

2. The Association shall transfer amounts to the Rebate Fund so that the amounts deposited equal the required amounts.

3. The Trustee shall transfer to the Senior Bonds Debt Service Account amounts which, when added to other amounts in the Senior Bonds Debt Service Account, and available for such purposes, will provide for the accumulation, in substantially equal monthly installments, of the amounts required to pay the sum of:

    a. any interest to become due and payable on each series of outstanding Senior Bonds on the next interest payment date (within the next six months) for such Series; and

    b. any principal installments to become due and payable on any series of outstanding Senior Bonds on or before the next date (within the next 12 months) on which such principal installment is payable.

4. If the Senior Bonds Debt Service Reserve Account contains less than the Senior Bonds Debt Service Reserve Account Requirement, the Trustee shall transfer into the Senior Bonds Debt Service Reserve Account, an amount equal to 1/24 of the Senior Bonds Debt Service Reserve Account Requirement or the amount needed to attain the Senior Bonds Debt Service Reserve Account Requirement, whichever is less. The transfers shall continue until the Senior Bonds Debt Service Reserve Account contains the Senior Bonds Debt Service Reserve Account Requirement.

5. The Trustee shall transfer to the Subordinate Bonds Debt Service Account amounts which, when added to other amounts in the Subordinate Bonds Debt Service Account and available for such purposes, will provide for the accumulation, in substantially equal monthly installments, or otherwise as may be provided in any Supplemental Indenture, of the amounts required to pay the sum of:

    a. any interest to become due and payable on each series of outstanding Subordinate Bonds (within the next six months) on the next interest payment date for such Series; and

    b. any principal installments to become due and payable on any series of outstanding Subordinate Bonds on or before the next date (within the next 12 months) on which such principal installment is payable.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

J. Restricted Assets (Continued)

6. If the Subordinate Bonds Debt Service Reserve Account contains less than the Subordinate Bonds Debt Service Reserve Account Requirement, the Trustee shall transfer into the Subordinate Bonds Debt Service Reserve Account, an amount equal to 1/60 of the Subordinate Bonds Debt Service Reserve Account Requirement or the amount needed to attain the Subordinate Bonds Debt Service Reserve Account Requirement, whichever is less. All transfers shall continue until the Subordinate Bonds Debt Service Reserve Account contains the Subordinate Bonds Debt Service Reserve Account Requirement.

7. After the date of Final Completion of the Southern Connector Project, the Trustee shall deposit into the Renewal and Replacement Fund the amounts included in the annual budget of the Association, which are required pursuant to the Renewal and Replacement Plan then in effect under the License Agreement.

8. The Trustee shall pay to SCDOT amounts certified by an Authorized Association Representative as being due SCDOT for (i.) the Maintenance Costs reimbursable to SCDOT under the License Agreement, together with any accruals from prior periods and interest owed thereon under the License Agreement and (ii.) any reimbursements to SCDOT for condemnation awards for rights of way for the Southern Connector Project in excess of the amounts reserved therefore on the Completion Date.

9. The Trustee shall pay amounts certified by an Authorized Association Representative as being due SCDOT for the License Fee owing to SCDOT under the License Agreement, together with any accruals from prior periods and any interest owed thereon under the License Agreement.

10. Money remaining in the Revenue Fund shall be used by the Trustee to make or provide for all deposits, payments, or transfers certified by an Authorized Association Representative as being required by any agreement or other instrument creating or evidencing any obligation of the Association which is not a Senior Bond or Subordinate Bond, at the time and in the amount provided for in such instrument.

11. The Trustee shall transfer any money remaining in the Revenue Fund at the end of any fiscal year to the Program Fund.

The *Debt Service Fund***,** consisting of the Senior Bonds Debt Service Account and the Subordinate Bonds Debt Service Account**,** was established as a sinking fund for the payment of interest and principal on the revenue bonds.

The *Debt Service Reserve Fund,* consisting of the Senior Bonds Debt Service Reserve Account and the Subordinate Bonds Debt Service Reserve Account, was established for the purpose of paying bond interest and maturing principal in the event that monies held in the Debt Service Fund and other funds would be insufficient for such purposes.

The *Renewal and Replacement Fund* was established for the purpose of holding monies in reserve to pay the costs of reconstruction, renewal, repair, and replacement of the Southern Connector. At December 31, 2005 and 2004, this account was inactive.

The *Program Fund,* consisting of the Retained Balance and the General Account, was established to hold monies in reserve to pay debt service if monies in other accounts are insufficient for such purpose and to pay other fees and costs as defined in the Trust Agreement. The *Program Fund Retained Balance Account* was inactive at December 31, 2005 and 2004.

The *Rebate Fund* was established for the purpose of holding and paying arbitrage investment earnings to the U.S. Treasury. As a result of investing tax exempt bond proceeds at rates of return not exceeding the maximum amount that is permitted under the applicable tax code, at December 31, 2005 and 2004, the *Rebate Fund* was inactive.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

K. Compensated Absences

The Association grants its regular full time employees 10 vacation days and 10 holidays per year. Employees receive no sick days but are allowed to use vacation or holiday time when sick. All vacation and holiday time must be taken in the year earned. Therefore, at year end there are no accumulating vacation or holiday benefits, thus there is no liability that must be recognized. At December 31, 2005 and 2004, no liability or expense was recorded in these basic financial statements.

L. Capital Assets

All capital assets, including the Association's intangible interest in its License Agreement with SCDOT, are stated at cost. The Association adopted asset capitalization policies recommended by the State of South Carolina's Office of Comptroller General.

Pursuant to this policy, equipment with costs greater than $5,000 and intangible assets with costs in excess of $100,000 are capitalized. Equipment depreciation is computed using the straight-line method over the equipment's estimated useful life of five years. A full year of depreciation is taken in the year an asset is placed in service. The Association's interest in its License Agreement with SCDOT is amortized over the term of the License Agreement, which ends year 2038 (See Note 5 for further details). When capital assets are disposed of, the cost and accumulated depreciation is removed from the books. The resulting gain or loss is included in operations.

M. Bonds Payable and Related Bond Issuance Costs, Discounts, and Fees

The current and non-current portions of bonds payable are recorded as liabilities in the accompanying statement of net assets. Bond issuance costs, discounts, and underwriters' fees on all bonds are deferred and amortized over the terms of the bonds. Bond discounts are amortized using the bonds outstanding method, which approximates the effective interest method. Bond issuance costs and underwriters' fees are amortized using the straight-line method.

Bond discounts are presented as a reduction of the face amount of the related revenue bonds payable whereas bond issuance costs and underwriters' fees are recorded as other assets.

N. Rebatable Arbitrage

Arbitrage involves the investment of proceeds resulting from the sale of tax-exempt securities in a taxable investment that yields a higher rate, which produces income in excess of interest costs. Federal law requires entities to rebate to the government such income on tax-exempt debt if the yield from those earnings exceeds the effective yield on the related tax-exempt debt issued. The Federal Government only requires arbitrage to be calculated, reported and paid every five years or at maturity of the debt, whichever is earlier. However, the potential liability is calculated annually for financial reporting purposes, and any arbitrage rebate liability incurred is recognized at that time. The liability is recorded using the revenue reduction method, whereby the rebate is recorded as a reduction of interest revenue. At December 31, 2005 and 2004, no such liability had been incurred.

O. Net Assets

Proprietary Fund Equity is classified as net assets (deficit) and displayed as the following three components:

Invested in capital assets, net of related debt — Consists of capital assets, including restricted capital assets, net of accumulated depreciation and amortization, and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets (including the accreted interest liability that was capitalized during its Development Stage).

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

O. Net Assets (Continued)

Restricted net assets — Consists of net assets with constraints placed on their use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation. In all cases, if individual restricted net asset categories are negative, the negative balance is eliminated and reclassified against unrestricted net assets.

Unrestricted net assets — All other net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

Unless otherwise dictated in the Trust Agreement, the Association's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

The Association's net deficit at December 31, 2005 and 2004 has resulted from shortfalls since commencement of operations due to lower than expected traffic counts and toll revenue. The Association anticipates that future development along the Southern Connector corridor will encourage increased traffic, which in turn, will generate toll revenues that will reduce the deficit.

P. Interest Capitalization

In accordance with FASB Statement No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants*, the Association capitalized the interest costs incurred during the construction of the Southern Connector. The amount of interest capitalized for assets constructed with tax-exempt borrowings consisted of the interest cost of the borrowings, including amortization of the original issue discount, less interest earned on the related interest-bearing investments acquired with proceeds of the related tax-exempt borrowings, incurred prior to commencement of toll road operations.

Q. Reclassifications

Certain amounts in the prior year have been reclassified to conform to the current year presentation.

NOTE 2 – DEPOSITS AND INVESTMENTS

The Association's Trust Agreement requires that all fund bank deposits that are not insured by the FDIC be collateralized by investment securities. The types of investment securities that may be used as collateral are: obligations of, or guaranteed by, the United States of America or certain of its agencies; repurchase agreements with underlying securities that are obligations of, or guaranteed by, the United States of America or certain of its agencies; certain obligations of, or guaranteed by, any state within the territorial United States of America; agreements that provide for the forward delivery of any securities previously described; investments in money market mutual funds rated "AAAm", "AAm", "AAAmG", or better; unsecured investment agreements with any bank or financial institution, the unsecured debt or counter-party rating of which is "investment grade" rated as of the date of acquisition; and any other obligation which, at the date of acquisition, is rated by a rating agency in one of the two highest rating categories for long-term obligations or in the highest rating category for short-term obligations.

NOTE 2 – DEPOSITS AND INVESTMENTS (CONTINUED)

Deposits

Custodial Credit Risk for Deposits: Custodial credit risk for deposits is the risk that, in the event of a bank failure, the Association's deposits might not be recovered. The Association does not have a formal deposit policy for custodial credit risk but follows the guidelines outlined in the Association's Trust Agreement (as noted above). As of December 31, 2005 and 2004, approximately $951,000 and $320,000 of the Association's bank balances of approximately $1,451,000 and $888,000 (with a carrying value of $1,397,569 and $886,035), respectively, were uninsured and uncollateralized. None of the deposits noted above were held by the South Carolina State Treasurer.

Investments

As of December 31, 2005 and 2004, the Association had the following investments as defined by GASB:

Investment Type	Credit Rating ^	Fair Value	Percentage of Total Investments	Weighted Average Maturity (In Years)
December 31, 2005:				
Open Ended Treasury Money Market Funds	AAAm, Aaa, NR	$ 1,244,186	6.7%	0.066
United States Treasury Note	N/A	718,931	3.9%	1.870
Repurchase Agreements	N/A	16,494,486	89.4%	12.000
Total Fair Value/Weighted Average Maturity		$ 18,457,603		10.800
December 31, 2004:				
Open Ended Treasury Money Market Funds	AAAm, Aaa, NR	$ 790,858	4.2%	0.120
United States Treasury Note	N/A	718,931	3.8%	2.870
Repurchase Agreements	N/A	17,292,761	92.0%	13.000
Total Fair Value/Weighted Average Maturity		$ 18,802,550		12.070

^ If available, credit ratings are for Standard & Poor's, Moody's Investors Service and Fitch Ratings.
N/A – Credit ratings are not required for investments issued or explicitly guaranteed by the United States government.
NR – Not rated.

Interest Rate Risk: The Association does not have a formal policy limiting investment maturities that would help manage its exposure to fair value losses from increasing interest rates.

Custodial Credit Risk for Investments: Custodial credit risk for investments is the risk that, in the event of a bank failure, the government will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Association does not have a formal investment policy for custodial credit risk but follows the guidelines outlined in the Association's Trust Agreement (as noted earlier). As of December 31, 2005 and 2004, none of the Association's investments were exposed to custodial credit risk.

Concentration of Credit Risk for Investments*:* The Association places no limit on the amount the Association may invest in any one issuer. Investments issued by or explicitly guaranteed by the U.S. Government and investments in mutual funds, external investment pools and other pooled investments are exempt from concentration of credit risk disclosures. All of the Association's investments in repurchase agreements are with Lehman Brothers.

NOTE 2 – DEPOSITS AND INVESTMENTS (CONTINUED)

Investments (Continued)

The investment types listed in the preceding table include all investment types in which monies were held during the year ended December 31, 2005 and 2004. None of the investments above were with the South Carolina State Treasurer.

The following schedule reconciles deposits and investments within the footnotes to the amounts in the statement of net assets:

Statements of Net Assets			Notes		
	2005	2004		2005	2004
Unrestricted Current Assets:					
Cash and Cash Equivalents	$ 637,188	682,006	Deposits	1,397,569	$ 886,035
Investments	313,340	202,945	Investments	18,457,603	18,802,550
Restricted Current Assets:					
Cash and Cash Equivalents	1,690,113	790,859			
Investments	924,932	1,240,266			
Noncurrent Assets:					
Restricted Investments	16,289,599	16,772,509			
	$ 19,855,172	19,688,585		19,855,172	$ 19,688,585

See Note 1, item J and Note 9 for additional information about restrictions on deposits in and balances of the various Trust Funds at December 31, 2005 and 2004.

NOTE 3 – RECEIVABLES

At December 31, 2005 and 2004, the Association had an interest receivable of $7,194 and $497,944, respectively.

NOTE 4 – CAPITAL ASSETS

The following tables summarize the changes in capital assets of the Association during the past two years and their balances at December 31, 2005 and 2004:

Description	Balance December 31, 2004	Additions	Disposals	Balance December 31, 2005
Capital Assets:				
Interest in License Agreement with SCDOT	$ 192,472,174	-	-	$ 192,472,174
Equipment	589,597	-	(3,776)	585,821
Subtotal Capital Assets	193,061,771	-	(3,776)	193,057,995
Less: Accumulated Depreciation/Amortization:				
Interest in License Agreement with SCDOT	19,452,929	5,243,007	-	24,695,936
Equipment	388,257	112,172	(3,776)	496,653
Subtotal Accum. Depreciation/Amortization	19,841,186	5,355,179	(3,776)	25,192,589
Totals	$ 173,220,585	(5,355,179)	-	$ 167,865,406

NOTE 4 – CAPITAL ASSETS (CONTINUED)

Description	Balance December 31, 2003	Additions	Disposals	Balance December 31, 2004
Capital Assets:				
Interest in License Agreement with SCDOT	$ 192,472,174	-	-	$ 192,472,174
Equipment	546,643	46,279	(3,325)	589,597
Subtotal Capital Assets	193,018,817	46,279	(3,325)	193,061,771
Less: Accumulated Depreciation/Amortization:				
Interest in License Agreement with SCDOT	14,209,921	5,243,008	-	19,452,929
Equipment	278,466	112,451	(2,660)	388,257
Subtotal Accum. Depreciation/Amortization	14,488,387	5,355,459	(2,660)	19,841,186
Totals	$ 178,530,430	(5,309,180)	(665)	$ 173,220,585

At December 31, 2005 and 2004, depreciation and amortization expense related to capital assets was $5,355,179 and $5,355,459, respectively. See Note 1, item L for additional information about the Association's capitalization policy, and its methods of calculating depreciation and amortization.

The Association had no construction commitments outstanding at December 31, 2005 and 2004, respectively.

NOTE 5 – INTEREST IN LICENSE AGREEMENT WITH SCDOT

On February 11, 1998, the Association entered into the License Agreement with the SCDOT regarding the construction and operation of the Southern Connector and SC 153 Extension Projects (the "Projects"). The License Agreement grants to the Association, the exclusive right (1) to acquire, in the name of the SCDOT, rights-of-way and other real property necessary to the development and operation of the Projects, (2) to develop and construct the Projects, (3) to finance the Southern Connector, (4) to operate, repair, renew and replace the Southern Connector in accordance with the terms of the agreement, and (5) to collect tolls from the users of the Southern Connector.

In order to finance the Southern Connector, the Association issued three series of toll road revenue bonds pursuant to the Trust Agreement, more particularly described in Note 9 (the "Bonds"). Interest on the Bonds is exempt from both federal income tax and South Carolina income tax. The Bonds are special limited obligations of the Association, payable solely from net revenues and monies held in certain accounts and other property included in the trust estate established by the Trust Agreement. The bonds are not, and shall never, constitute indebtedness to the State of South Carolina, the SCDOT, or any agency, department or political subdivision of the State of South Carolina. (See Note 9 for additional information.)

The License Agreement specifies that, upon its termination, the Association is to convey to the SCDOT full title to all property and improvements acquired in whole, or in part, with proceeds of the Bonds. (As stated in the License Agreement, the title to all real property and improvements thereon acquired or constructed during the term of the License Agreement is held by the SCDOT.) The License Agreement specifies a termination date of 50 years after substantial completion of the Southern Connector. However, the License Agreement automatically terminates upon repayment, redemption, or defeasance of the Bonds and all other project debt. Since the Bonds mature January 1, 2038, management considers that date to be the effective termination date of the License Agreement.

NOTE 5 – INTEREST IN LICENSE AGREEMENT WITH SCDOT (CONTINUED)

In order to fulfill its responsibilities under the License Agreement, the Association entered into an agreement (the "Development Agreement") with Interwest Carolina Transportation Group, LLC (the "Developer") whereby the Developer agreed to perform the obligations of the Association under the License Agreement with respect to construction of the Southern Connector and the SC 153 Extension and assumed various additional responsibilities. In order to fulfill its responsibilities under the Development Agreement, the Developer in turn entered into contracts with various subcontractors for the performance of certain obligations. The Developer agreed to complete the construction of the Southern Connector at a guaranteed price of $173,802,263, which included acquisition of all rights-of-way, relocation of utilities and railroads, and all design and construction activities, including toll plazas, toll collection equipment, operations systems and other costs. The Developer commenced construction on February 27, 1998. On February 23, 2001, the Association received notification from the SCDOT of its acceptance of the roadways and bridges, thereby permitting the Association to commence operations of the Southern Connector. On February 27, 2001, the Southern Connector was opened to the public. At that time, traffic was allowed on the Southern Connector free for a two-week introductory period. Toll collection operations began on March 14, 2001. Substantial completion was reached on July 22, 2001. On December 22, 2003, the Southern Connector attained Final Completion.

The Association will be required to pay a license fee to the SCDOT in the amount of $125,000 per month for a period of 25 years, commencing thirteen months (first payment was due February 1, 2005) after Final Completion of the Southern Connector and of $1 per month thereafter for the remainder of the term of the License Agreement. Payment of the monthly license fees was to commence on the first day of the calendar month following the first anniversary of the Final Completion date of the Southern Connector. Payment of the license fee is ninth in priority according to the flow of funds set forth in Note 1. Item J. So long as any project debt remains outstanding, any license fees not paid when due will be deferred and will accrue interest at a rate of 5% per annum compounded annually. At December 31, 2005, the Association has unpaid SCDOT deferred license fees and related interest of $1,500,000 and $75,000, respectively.

The SCDOT is responsible for maintaining the Southern Connector (costs of maintenance are to be reimbursed by the Association in eighth priority in the flow of funds set forth in Note 1, item J.) At December 31, 2005, the Association has unpaid SCDOT deferred maintenance and related interest of $351,463 and $23,683, respectively. At December 31, 2004, the Association had unpaid SCDOT deferred maintenance of $225,000. The SCDOT is responsible for setting the toll rates in accordance with the terms of the License Agreement. The SC 153 Extension, the costs of which are not included in the accompanying basic financial statements, is operated, maintained, renewed, and replaced by the SCDOT as part of the South Carolina Highway System.

The Association's rights under the License Agreement, as described above, constitute an intangible asset that is valued and recorded at an amount equal to the cost of construction of the Southern Connector, including related capitalized interest. (See Note 1, item I for additional information.)

NOTE 6 – ACCRUED INTEREST PAYABLE

At December 31, 2005 and 2004, accrued interest payable was $1,765,750, which consisted of the Senior Current Interest Bond (Series 1998A) payment which is due January 1 of 2006 and 2005, respectively. Interest is paid January 1 and July 1 of each year to holders of the Senior Bonds at rates of 5.250% and 5.375% per annum.

NOTE 7 – REQUISITIONS PAYABLE

Requisitions payable consisted of requisitions for payment of professional fees and services that had been incurred as of December 31, 2005 and 2004, but were not yet paid. The Association's general manager approves all requisitions prior to payment from the Construction Fund.

NOTE 8 – INTEREST COSTS INCURRED

Interest costs expensed during the years ended December 31, 2005 and 2004, totaled $15,773,228 and $14,940,897, respectively.

NOTE 9 – BONDS PAYABLE

As discussed in Notes 1 and 5, the Association issued three series of tax-exempt toll road revenue Bonds pursuant to the Trust Agreement. All of the Bonds were issued on February 11, 1998. The Bonds are special limited obligations of the Association that are not, and shall never, constitute indebtedness to the State of South Carolina, the SCDOT, or any agency, department or political subdivision of the State of South Carolina, including the County of Greenville, South Carolina and the City of Greenville, South Carolina. Following is a brief description of each bond issue:

Series 1998A: Series 1998A Senior Current Interest Toll Road Revenue Bonds which were dated 2/11/98 - $66,200,000 original principal amount at issuance; interest payable semi-annually on January 1 and July 1 at rates of 5.250% and 5.375%; $21,400,000 of bonds mature January, 2023; $44,800,000 of bonds mature January, 2038. There was an original issue discount on the Series 1998A bonds at issuance of $2,693,952.

Series 1998B: Series 1998B Senior Capital Appreciation Toll Road Revenue Bonds which were dated 2/11/98 - $87,385,622 original principal amount at issuance; interest accretes at various rates ranging from 5.30% to 5.85%; $438,100,000 of bonds mature serially from January 2008 to January 2038.

Series 1998C: Series 1998C Subordinate Capital Appreciation Toll Road Revenue Bonds which were dated 2/11/98 - $46,592,058 original principal amount at issuance; interest accretes at various rates ranging from 6.15% to 6.30%; $241,800,000 of bonds mature serially from January 2008 to January 2038.

Bonds payable changes during 2005 and 2004 and balances at December 31, 2005 and 2004, were as follows:

	Balance December 31, 2004	Increases	Decreases	Balance December 31, 2005
Senior Bonds				
Series 1998A	$ 66,200,000	-	-	$ 66,200,000
Original Issue Discount on Series 1998A	(2,138,682)	80,280	-	(2,058,402)
Subtotal Series 1998A	64,061,318	80,280	-	64,141,598
Series 1998B	129,238,442	7,554,282	-	136,792,724
Subordinate Bonds:				
Series 1998C	71,144,380	4,508,276	-	75,652,656
Totals	**264,444,140**	**12,142,838**	**-**	**$ 276,586,978**

NOTE 9 – BONDS PAYABLE (CONTINUED)

	Balance December 31, 2003	Increases	Decreases	Balance December 31, 2004
Senior Bonds				
Series 1998A	$ 66,200,000	-	-	$ 66,200,000
Original Issue Discount on Series 1998A	(2,218,962)	80,280	-	(2,138,682)
Subtotal Series 1998A	63,981,038	80,280	-	64,061,318
Series 1998B	122,101,517	7,136,925	-	129,238,442
Subordinate Bonds:				
Series 1998C	66,958,343	4,186,037	-	71,144,380
Totals	**$ 253,040,898**	**11,403,242**	**-**	**$ 264,444,140**

Additions to bonds payable represents the amortization of original issue discount on the Series 1998A Senior Current Interest Toll Road Revenue Bonds, and accretions on the Series 1998B Senior Capital Appreciation Toll Road Revenue Bonds and 1998C Subordinate Capital Appreciation Toll Road Revenue Bonds. At December 31, 2005 and 2004, no principal payments on bonds were due within one year.

A summary of the debt service requirements to maturity for the Bonds is as follows as of December 31, 2005:

Year Ending December 31	Principal	Interest	Totals
2006	$ -	3,531,500	$ 3,531,500
2007	-	3,531,500	3,531,500
2008	6,200,000	3,507,875	9,707,875
2009	6,700,000	3,460,625	10,160,625
2010	7,300,000	3,410,750	10,710,750
2011-2015	51,200,000	16,198,000	67,398,000
2016-2020	78,900,000	14,470,750	93,370,750
2021-2025	115,200,000	12,258,063	127,458,063
2026-2030	154,000,000	9,333,688	163,333,688
2031-2035	187,100,000	5,493,251	192,593,251
2036-2038	139,500,000	989,000	140,489,000
Totals	$ 746,100,000	76,185,002	$ 822,285,002

As discussed in Note 1, item J, the terms of the Trust Agreement require the establishment of bank fund accounts as listed below. The proceeds of the Bonds were allocated among, and deposited into, certain of these accounts. The monies deposited into these accounts were invested as provided in the Trust Agreement. Authorized payments of construction costs, debt service, arbitrage rebates, operating costs, and renewal and replacement costs may only be paid from certain funds as specified in the Trust Agreement. Payment of debt service of the Bonds is secured by the Trust Estate, which includes all monies deposited into these various funds, excluding amounts in the rebate account and in the renewal and replacement account. The Trust Estate also includes the Association's interest in Revenues as defined in the Trust Agreement, the Association's interest in the License Agreement with the SCDOT, and any other property pledged as security for the Bonds.

NOTE 9 – BONDS PAYABLE (CONTINUED)

The accounts established by the Trust Agreement and their balances at December 31, 2005 and 2004, were as follows:

Fund	Amount 2005	Amount 2004
Construction	$ 10,788	$ 11,423
Revenue	47,117	38,304
Debt Service	2,604,257	2,019,702
Debt Service Reserve	16,289,599	16,772,509
Total	$ 18,951,761	$ 18,841,938

During the years ended December 31, 2005 and 2004, payments from the various accounts were made in accordance with the terms of the Trust Agreement.

The Trust Agreement contains certain other bond covenants including, but not limited to, the following:

- The Association is prohibited from taking any action, or omitting to take any action, that would cause the Bonds to lose their tax-exempt status.

- After the Southern Connector is completed and operational, an Engineer (as defined) must inspect the toll road annually and submit a report documenting the physical condition of the toll road, offering advice, recommendations and a cost estimate as to the proper operation of the toll road during the ensuing fiscal year, offering advice and recommendations regarding the insurance to be carried, and stating the amount to be deposited into the Renewal and Replacement Fund for the next fiscal year. During 2005, the Association notified the trustee that funding of the Renewal and Replacement Fund was seventh in the flow of funds listing of the trust agreement. To the extent that revenues are insufficient to make any such deposits, the amounts to be transferred to the Renewal and Replacement Funds are to be deferred.

- Beginning on the first day of the second full fiscal year immediately following the later of (i) the Final Completion date of the Southern Connector, and (ii) the last date through which interest on any of the bonds is to be paid from proceeds of the bonds, the tolls charged by the Association shall equal or exceed the greater of (a) 1.25 times the aggregate debt service on all outstanding Senior Bonds due in that fiscal year, and (b) the amount required to fund all transfers to the Senior Bonds Debt Service Reserve Fund as defined in the Trust Agreement, and to equal not less than 1.10 times the aggregate debt service on all outstanding Bonds due in that fiscal yea ("Revenue Covenant"). The Trust Agreement also specifies actions to be taken if the Association determines that revenues may be inadequate to meet this Revenue Covenant. Effective January 2005, the Association increased toll rates from $.75 to $1.00 per two axle vehicle along with corresponding increases to larger multi-axle vehicles in accordance with the toll schedule established by the SCDOT in the License Agreement. In 2005, the Association hired an outside traffic consultant to prepare a toll rate study in accordance with the Revenue Covenant. The traffic consultant report was issued in June 2005, and confirmed that increasing toll levels to comply with the Revenue Covenant was impractical at that time and would not result in compliance with the debt service requirement of the Revenue Covenant. In 2006, the Association also engaged the traffic consultant to review its operations and make a recommendation regarding maximization of net toll revenue. The consultant delivered its report to the Association on June 12, 2006. In its report, the consultant recommended to the Association to request the SCDOT to (a) increase mainline plaza toll rates in $0.25 installments annually for three years beginning January 1, 2008, and (b) increase tolls at the ramp plazas to be one-half of the mainline toll. In addition, the consultant recommended that the Association gradually phase out the discount it offers to its PalPass customers and revise its toll rates for multi-axle vehicles.

NOTE 9 – BONDS PAYABLE (CONTINUED)

- Prior to the end of each fiscal year, the Association is required to file an annual budget for the next fiscal year with the Trustee.

- The Association monitors the covenants for compliance throughout the year. The Association believes it was in compliance with its bond covenants throughout 2005 and 2004.

NOTE 10 – RISK MANAGEMENT

The Association is exposed to various types of risk including loss related to torts; theft of, damage to, and destruction of assets; injuries to construction workers and others; professional design; and damage to property of others. The Association obtained commercial insurance covering all of its known risks of loss as follows:

Automobile Liability	Professional Design	Worker's Compensation
Crime	Directors and Officers	Force Majeure
Builder's Risk	General Liability	

No claim settlements have exceeded insurance coverage during the past three years. There were no significant reductions in insurance coverage during the years ended December 31, 2005 and 2004.

NOTE 11 – CONTINGENCIES

On March 21, 2003, the Trustee sent Notice #2 to the registered owners of the Bonds. In such notice, the Trustee informed the bondholders of a dispute concerning the interpretation Section 505 (1) of the Trust Agreement. As previously communicated to the bondholders, on January 2, 2003, the Trustee made a withdrawal of approximately $72,320 from the Senior Bonds Debt Service Reserve Account in order to pay a portion of interest payment then due on the Association's Series 1998A Senior Current Interest Bonds. On February 6, 2003, the Trustee notified the Association by letter that there were not sufficient Revenues available to replenish the Senior Bonds Debt Service Reserve Account to the level that existed prior to such withdrawal. The Trustee contends that Section 505(1) of the Trust Agreement requires the Association to deliver to the Trustee on or before the last day of each month monies sufficient to replenish the Senior Bonds Debt Service Reserve Account to the Senior Bonds Debt Service Reserve Account Requirement. The Association reminded the Trustee that the Indenture is a "lock box" structure, all of the Revenues available to pay the Bonds and replenish the funds and accounts of the Indenture are already transferred to the Trustee. The Association contends that the provisions of Section 505(1) merely direct the Trustee as to the disposition of Revenues among the various accounts and the ordering of transfers of such revenues. The Trustee and the Association were unable to resolve their differences in the interpretation of such section of the Trust Agreement and the Trustee notified the bondholders that an event of Default had occurred under Section 902(3) of the Trust Agreement. The Trustee informed bondholders it intends to forebear from initiating legal actions in connection with the alleged default and solicited their comment and direction. The Trustee and the Association entered into a Tolling Agreement dated as of April 16, 2003, (the "Tolling Agreement") whereby, among other matters, the Trustee and the Association agreed that the above-described event would not be deemed to be an Event of Default under the Trust Agreement during the term of the Tolling Agreement.

In the Tolling Agreement, the Association agrees not to assert any defense it may have based on the lapse of time under the statute of limitations during the term of the Tolling Agreement relating to the above-described events. This original agreement was to expire on April 30, 2004, but the expiration date could be extended upon mutual written agreement of the parties. In April 2004, the Association and the Trustee amended the Tolling Agreement by extending the term of the Tolling Agreement until April 30, 2005. The amendment also provided for the Tolling Agreement to automatically be extended thereafter for additional periods ending April 30th of each year unless either party gives the other at least sixty days advance written notice that the Tolling Agreement shall expire on the next succeeding April 30th. Currently, the Association and Trustee are working under the extended Tolling Agreement as neither party has given notice of its expiration.

NOTE 12 – OTHER MATTERS

In prior years, the Association was a Development Stage Enterprise focused on construction of the Southern Connector. During the Development Stage, expenses incurred by the Association increased its net deficit, since no toll road operations had begun and no revenues were earned. The road was opened to public traffic in early 2001 and toll collection commenced March 14, 2001.

Since commencing operations, the Southern Connector has experienced significantly lower traffic counts than those projected during the Traffic and Revenue Study performed in 1997 during the planning phase of the Southern Connector Project - less than half of the traffic volume projected in the Revenue Study.

Several factors have contributed to this shortfall. The Southern Connector is the first toll road in Upstate South Carolina. Since citizens in the Greenville, South Carolina vicinity are unaccustomed to using toll roads, they have been resistant to the concept of paying tolls. Furthermore, the Southern Connector was envisioned as a means of fostering development in southern Greenville County, and its corridor runs through a largely undeveloped area, serving as a thruway connecting Interstate 385 with Interstate 85. This lack of development, coupled with the fact that the Southern Connector was opened almost nine months ahead of schedule, means that the demand for the toll road is in its infancy. In addition, current economic conditions have slowed potential economic development along the Southern Connector.

Due to the factors discussed above, the Association's revenues for 2005 and 2004 fell well short of amounts anticipated, and the Association suffered a decrease in net assets (loss) of approximately $19.7 million for 2005 and $18.1 million for 2004. In addition, the Association used a portion of its debt service reserve fund to help fund a portion of its 2005 and 2004 interest payments. In compliance with the provisions of the Continuing Disclosure Agreement, the Association has filed the required "Event Notice" for each withdrawal from the Senior Bonds Debt Service Reserve Account used to pay a portion of the interest payments. Unless revenues increase sharply in the coming years, the Association will continue to have to draw monies from its debt service reserve funds to support interest payments and eventually will need them to begin making principal payments on its senior capital appreciation toll revenue bonds starting in 2008.