

In the opinion of Quint & Thimmig LLP, San Francisco, California, Bond Counsel, subject, however, to certain qualifications described in this Official Statement, under existing law, interest on the Series 2010A Bonds (i) is excludable from the gross income of the owners thereof for federal income tax purposes, and (ii) is not included as an item of tax preference in computing the federal alternative minimum tax for individuals and corporations, but interest on the Series 2010A Bonds is taken into account, however, in computing an adjustment used in determining the federal alternative minimum tax for certain corporations. In addition, in the opinion of Bond Counsel, interest on the Series 2010A Bonds is exempt from personal income taxation imposed by the State of California. See "TAX MATTERS" herein.



\$161,930,000
PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO
SENIOR SEWER REVENUE REFUNDING BONDS, SERIES 2010A
(Payable Solely From Installment Payments
Secured by Wastewater System Net Revenues)

Dated: Date of Delivery

Due: May 15, as shown on the inside cover page

The \$161,930,000 Public Facilities Financing Authority of the City of San Diego Senior Sewer Revenue Refunding Bonds, Series 2010A (Payable Solely From Installment Payments Secured by Wastewater System Net Revenues) (the "Series 2010A Bonds"), are being issued by the Public Facilities Financing Authority of the City of San Diego (the "Authority") pursuant to the provisions of the Joint Exercise of Powers Act (commencing with Section 6500) of the Government Code of the State of California (the "State") and an Indenture, dated as of May 1, 2009 (the "Original Indenture"), as supplemented by a First Supplemental Indenture, dated as of June 1, 2009, and by a Second Supplemental Indenture, dated as of April 1, 2010 (the Original Indenture, as so supplemented, is referred to herein as the "Indenture"), each by and between the Authority and The Bank of New York Mellon Trust Company, N.A., as trustee (the "Trustee"). The proceeds of the Series 2010A Bonds will be used to refund all or a portion of the Authority's outstanding Sewer Revenue Bonds, Series 1995, Sewer Revenue Bonds, Series 1997A, Sewer Revenue Bonds, Series 1997B, Sewer Revenue Bonds, 1999A, and Sewer Revenue Bonds, Series 1999B, make a deposit to the reserve fund established for the Series 2010A Bonds and certain Outstanding parity obligations and pay costs of issuance with respect to the Series 2010A Bonds. The Series 2010A Bonds constitute the third series of Bonds issued under and as such term is defined in the Indenture.

THE SERIES 2010A BONDS ARE LIMITED OBLIGATIONS OF THE AUTHORITY AND ARE PAYABLE SOLELY FROM THE REVENUES OF THE AUTHORITY PLEDGED FOR SUCH PURPOSE, AND AMOUNTS ON DEPOSIT IN CERTAIN FUNDS AND ACCOUNTS ESTABLISHED, UNDER THE INDENTURE. EXCEPT AS AFORESAID, THE SERIES 2010A BONDS DO NOT CONSTITUTE A DEBT OR LIABILITY OF THE AUTHORITY, THE CITY OR THE STATE AND NEITHER THE FAITH NOR CREDIT OF THE AUTHORITY, THE CITY OR THE STATE ARE PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF OR INTEREST ON THE SERIES 2010A BONDS. THE AUTHORITY HAS NO TAXING POWER.

The Series 2010A Bonds are limited obligations of the Authority primarily secured by Revenues (herein defined) of the Authority, which consist primarily of 2010A Installment Payments (herein defined) to be made by the City to the Authority, pursuant to the Master Installment Purchase Agreement, dated as of September 1, 1993, as amended and supplemented (the "Master Installment Purchase Agreement"), including as supplemented by the 2010-1 Supplement to the Master Installment Purchase Agreement, dated as of April 1, 2010 (the "2010-1 Supplement" and, together with the Master Installment Purchase Agreement, the "Installment Purchase Agreement"), each by and between the City and the Authority, and amounts on deposit in certain funds and accounts established under the Indenture (other than amounts on deposit in the Rebate Fund). The City has pledged Net System Revenues (herein defined) of the Wastewater System (herein defined) pursuant to the Installment Purchase Agreement to the payment of the Installment Payments (herein defined), including the 2010A Installment Payments. The City's pledge and assignment of and lien on the Net System Revenues securing the 2010A Installment Payments are, in all respects, on parity with the City's pledge and assignment of and lien on the Net System Revenues securing the other Parity Obligations (as described herein) under the Installment Purchase Agreement.

The principal of and interest on the Series 2010A Bonds and any premium upon the redemption of any thereof are not a debt of the City nor a legal or equitable pledge, charge, lien or encumbrance upon any of its property or upon any of its income, receipts or revenues but are secured by and payable solely from the Revenues of the Authority and amounts on deposit in certain funds and accounts established under the Indenture (other than amounts on deposit in the Rebate Fund).

Pursuant to the Installment Purchase Agreement, the City may incur additional obligations, payments with respect to which will be on parity with or subordinate in priority to the City's obligation to make 2010A Installment Payments, subject to satisfaction of the conditions specified in the Installment Purchase Agreement. Upon the incurrence of the 2010A Installment Payments and the refundings described herein, there will be Outstanding Parity Obligations in the aggregate principal amount of \$1,250,645,000 and Subordinated Obligations (as defined herein), consisting only of Existing SRF Loans (herein defined), in the aggregate principal amount of \$68,796,099. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS—Outstanding Obligations" herein.

The Series 2010A Bonds will accrue interest from their date of delivery and interest thereon will be payable on May 15 and November 15 of each year, commencing on May 15, 2010. The Series 2010A Bonds will bear interest at the respective rates per annum set forth on the inside cover page hereof. See "DESCRIPTION OF THE SERIES 2010A BONDS—General" herein and Appendix C—"SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto. The Series 2010A Bonds will be issued only in fully-registered form in denominations of \$5,000 and any integral multiple thereof, and when issued, will be registered in the name of Cede & Co., as the nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Series 2010A Bonds. Ownership interests in the Series 2010A Bonds may be purchased in book-entry form only. So long as DTC or its nominee is the Owner of the Series 2010A Bonds, principal and redemption premium, if any, of and interest on the Series 2010A Bonds will be made as described in Appendix F—"INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM" attached hereto.

The Series 2010A Bonds are subject to optional redemption and mandatory sinking fund redemption prior to maturity as described herein. See "DESCRIPTION OF THE SERIES 2010A BONDS—Redemption" herein.

This cover page contains information for general reference only. Potential purchasers are advised to read the entire Official Statement to obtain information essential to making an informed investment decision.

The Series 2010A Bonds are offered when, as and if issued, subject to the legal opinion of Quint & Thimmig LLP, San Francisco, California, Bond Counsel. Certain legal matters will be passed upon for the Authority by Quint & Thimmig LLP acting as Disclosure Counsel to the Authority for the Series 2010A Bonds, for the City by Jan I. Goldsmith, City Attorney, and for the Underwriters by their counsel, Stradling, Yocca, Carlson & Rauth, a Professional Corporation, Newport Beach, California. It is anticipated that the Series 2010A Bonds will be available for delivery through the facilities of DTC in New York, New York, on or about April 29, 2010.

Citi

Barclays Capital

Piper Jaffray

\$161,930,000
PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO
SENIOR SEWER REVENUE REFUNDING BONDS, SERIES 2010A
(Payable Solely From Installment Payments
Secured by Wastewater System Net Revenues)

MATURITY SCHEDULE*

Maturity Date (May 15)	Principal Amount	Interest Rate	Yield	Price	CUSIP†
2024	\$34,060,000	5.25%	4.30%	107.680% ^c	79730A HR2
2025	35,845,000	5.25	4.36	107.174 ^c	79730A HS0
2026	29,170,000	5.25	4.41	106.755 ^c	79730A HT8
2027	30,690,000	5.25	4.48	106.171 ^c	79730A HU5
2028	15,670,000	5.25	4.55	105.591 ^c	79730A HV3
2029	16,495,000	5.25	4.60	105.179 ^c	79730A HW1

^c All Bonds are priced to the 5/15/2020 par call date

† Copyright 2010, American Bankers Association. CUSIP® is a registered trademark of the American Bankers Association. CUSIP data herein is provided by the CUSIP Service Bureau, operated by Standard & Poor's, a division of The McGraw-Hill Companies, Inc. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP Services Bureau. CUSIP numbers have been assigned by an independent company not affiliated with the Authority or the City and are included solely for the convenience of the registered owners of the Series 2010A Bonds. None of the Authority, the City or the Underwriters is not responsible for the selection or uses of these CUSIP numbers, and no representation is made as to their correctness on the Series 2010A Bonds or as included herein. The CUSIP number for a specific maturity is subject to being changed after the issuance of the Series 2010A Bonds as a result of various subsequent actions including, but not limited to, a refunding in whole or in part or as a result of the procurement of secondary market portfolio insurance or other similar enhancement by investors that is applicable to all or a portion of certain maturities of the Series 2010A Bonds.

GENERAL INFORMATION ABOUT THE OFFICIAL STATEMENT

No dealer, broker, salesperson or other person has been authorized by the City or the Authority to give any information or to make any representations in connection with the offer or sale of the Series 2010A Bonds other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the City or the Authority. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the Series 2010A Bonds by a person in any jurisdiction in which it is unlawful for such person to make an offer, solicitation or sale.

This Official Statement is not a contract with the purchasers of the Series 2010A Bonds. Statements contained in this Official Statement which involve estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as a representation of facts. The summaries and references to documents, statutes and constitutional provisions referred to herein do not purport to be comprehensive or definitive and are qualified in their entirety by reference to each such document, statute and constitutional provision.

The information set forth herein has been obtained from the City and by other sources which are believed to be reliable. The information and expressions of opinion herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the City, the Authority or any other parties described herein since the date hereof.

The Underwriters have provided the following sentence for inclusion in this Official Statement: The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their responsibility to investors under the Federal securities law as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

This Official Statement is submitted in connection with the execution and delivery of the Series 2010A Bonds referred to herein and may not be reproduced or used, in whole or in part, for any other purpose.

The City maintains a website with investor information at <http://www.sandiego.gov/investorinformation>. However, the information presented there is not part of this Official Statement, is not incorporated by reference herein and should not be relied upon in making an investment decision with respect to the Series 2010A Bonds.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SERIES 2010A BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. THE UNDERWRITERS MAY OFFER AND SELL THE SERIES 2010A BONDS TO CERTAIN DEALERS AND DEALER BANKS AND BANKS ACTING AS AGENT AT PRICES LOWER THAN THE PUBLIC OFFERING PRICE STATED ON THE COVER PAGE HEREOF AND SAID PUBLIC OFFERING PRICE MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.

THE BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON AN EXCEPTION FROM THE REGISTRATION REQUIREMENTS CONTAINED IN SECTION 3(A)(2) OF SUCH ACT. THE BONDS HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE SECURITIES LAWS OF ANY STATE. THE INDENTURE HAS NOT BEEN QUALIFIED UNDER THE TRUST INDENTURE ACT OF 1939, AS AMENDED, IN RELIANCE UPON AN EXEMPTION CONTAINED IN SUCH ACT.

PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO

Joseph W. Craver, *Chair – Public Member*
John Chalker, *Vice Chair – Public Member*
There is one Public Member vacancy
Gail R. Granewich, *Secretary – City Treasurer*
William Anderson – *Assistant Executive Director of the Redevelopment Agency*

CITY OF SAN DIEGO

Mayor
Jerry Sanders

Members of the City Council

Sherri S. Lightner (District 1)	Carl DeMaio (District 5)
Kevin Faulconer (District 2)	Donna Frye (District 6)
Todd R. Gloria (District 3)	Marti Emerald (District 7)
Anthony Young (District 4)	Ben Hueso, <i>Council President</i> (District 8)

City Attorney
Jan I. Goldsmith

City Officials
Jay M. Goldstone, *Chief Operating Officer*
Mary Lewis, *Chief Financial Officer*
Gail R. Granewich, *City Treasurer*
Eduardo Luna, *City Auditor*
Kenton C. Whitfield, *City Comptroller*
Andrea Tevlin, *Independent Budget Analyst*
Elizabeth Maland, *City Clerk*

Public Utilities Department
Alex Ruiz, *Interim Director of Public Utilities*
Jim Fisher, *Assistant Director of Water Branch*
Ann Sasaki, *Assistant Director of Wastewater Branch*
Thomas Crane, *Assistant Director of Strategic Programs*

Special Services

BOND COUNSEL and DISCLOSURE COUNSEL
Quint & Thimmig LLP
San Francisco, California

FINANCIAL ADVISOR
First Southwest Company
Santa Monica, California

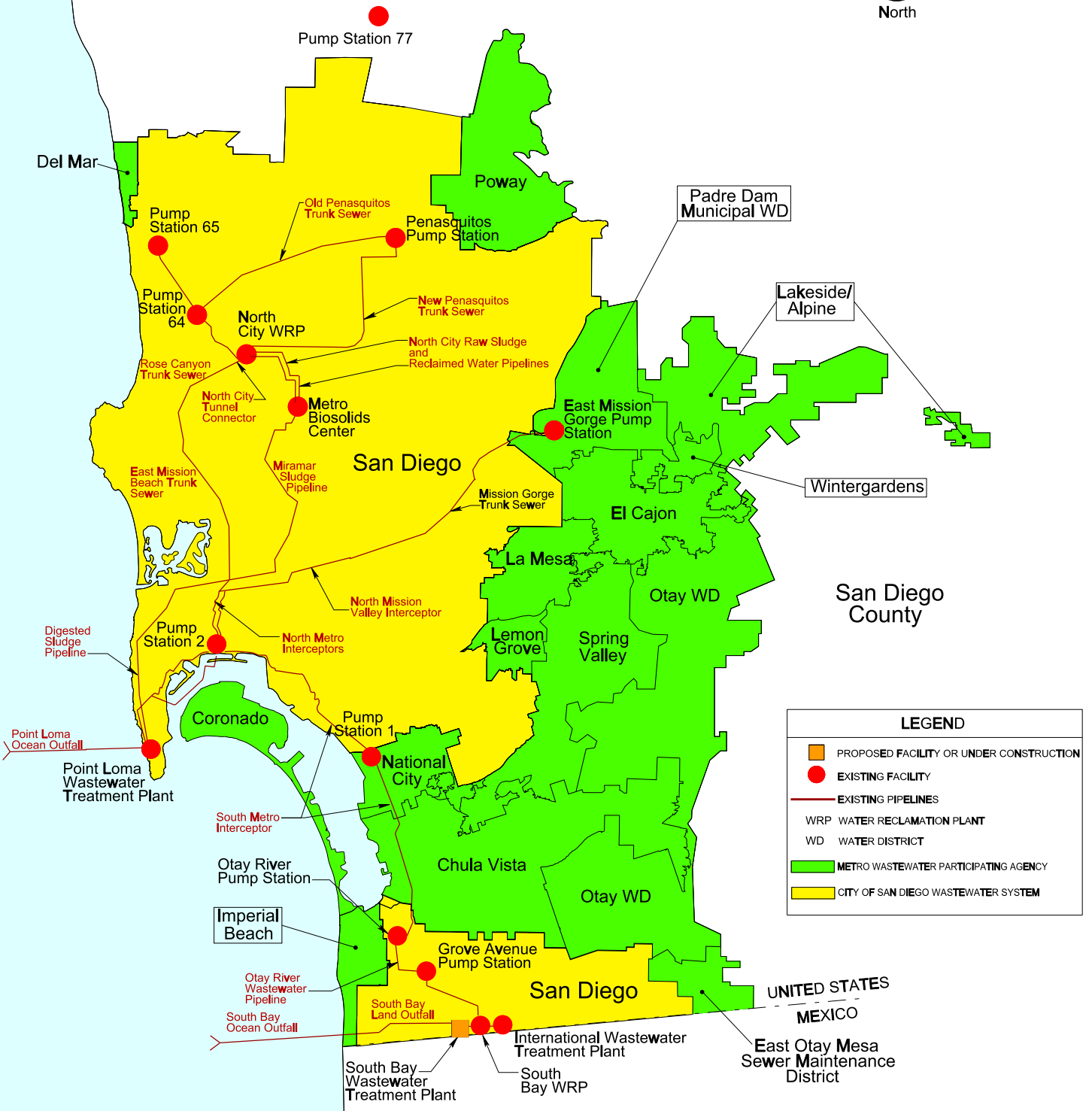
TRUSTEE
The Bank of New York Mellon Trust Company, N.A.
Los Angeles, California

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The City of San Diego Metropolitan Wastewater System



LEGEND	
	PROPOSED FACILITY OR UNDER CONSTRUCTION
	EXISTING FACILITY
	EXISTING PIPELINES
	WRP WATER RECLAMATION PLANT
	WD WATER DISTRICT
	METRO WASTEWATER PARTICIPATING AGENCY
	CITY OF SAN DIEGO WASTEWATER SYSTEM

OFFICIAL STATEMENT

\$161,930,000

**PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO
SENIOR SEWER REVENUE REFUNDING BONDS, SERIES 2010A
(Payable Solely From Installment Payments
Secured by Wastewater System Net Revenues)**

INTRODUCTION

This introduction is not a summary of this Official Statement. It is only a brief description of and guide to, and is qualified by, more complete and detailed information contained in the entire Official Statement, including the cover page, inside cover page and appendices hereto, and the documents described herein. All statements contained in this introduction are qualified in their entirety by reference to the entire Official Statement. References to and summaries of the laws of the State of California and any documents referred to herein do not purport to be complete and such references are qualified in their entirety by reference to the complete provisions of such laws and documents. All capitalized terms used in this Official Statement and not otherwise defined herein have the meanings given to such terms in the Indenture and the Installment Purchase Agreement. See APPENDIX B—"SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

General

The \$161,930,000 Public Facilities Financing Authority of the City of San Diego Senior Sewer Revenue Refunding Bonds, Series 2010A (Payable Solely From Installment Payments Secured by Wastewater System Net Revenues) (the "Series 2010A Bonds"), are being issued by the Public Facilities Financing Authority of the City of San Diego (the "Authority") pursuant to the provisions of the Joint Exercise of Powers Act (commencing with Section 6500) of the Government Code of the State of California (the "State") and an Indenture, dated as of May 1, 2009 (the "Original Indenture"), as supplemented by First Supplemental Indenture dated as of June 1, 2009, and by a Second Supplemental Indenture, dated as of April 1, 2010 (the Original Indenture, as so supplemented, is referred to herein as the "Indenture"), each by and between the Authority and The Bank of New York Mellon Trust Company, N.A., as trustee thereunder (the "Trustee"). The proceeds of the Series 2010A Bonds will be used to refund all of the Authority's outstanding Sewer Revenue Bonds, Series 1995 (the "Series 1995 Bonds"), Sewer Revenue Bonds, Series 1997A (the "Series 1997A Bonds"), Sewer Revenue Bonds, Series 1997B (the "Series 1997B Bonds"), Sewer Revenue Bonds, 1999A (the "Series 1999A Bonds"), and Sewer Revenue Bonds, Series 1999B (the "Series 1999B Bonds"), and to pay costs of issuance with respect to the Series 2010A Bonds.

The Series 2010A Bonds constitute the third series of Bonds issued under the Indenture, the first being the \$453,775,000 Senior Sewer Revenue Bonds, Series 2009A (the "Series 2009A Bonds") issued to refund certain outstanding obligations of the Authority, finance certain improvements to the Wastewater System, pay the costs of issuing the Series 2009A Bonds and fund the Reserve Fund, and the second being the \$634,940,000 Senior Sewer Revenue Refunding Bonds, Series 2009B (the "Series 2009B Bonds"), issued to refund certain outstanding obligations of the Authority, pay the costs of issuing the Series 2009B Bonds and fund the Reserve Fund.

The Series 2010A Bonds

The Series 2010A Bonds will accrue interest from their date of delivery and interest thereon will be payable on May 15 and November 15 of each year, commencing on May 15, 2010 (each, an “Interest Payment Date”). The Series 2010A Bonds will bear interest at the respective rates per annum set forth on the inside cover page hereof. See “DESCRIPTION OF THE SERIES 2010A BONDS—General.”

The Series 2010A Bonds will be issued only in fully-registered form in denominations of \$5,000 and any integral multiple thereof, and when issued, will be registered in the name of Cede & Co., as the nominee of The Depository Trust Company, New York, New York (“DTC”). DTC will act as securities depository for the Series 2010A Bonds. Ownership interests in the Series 2010A Bonds may be purchased in book-entry form only. So long as DTC or its nominee is the Owner of the Series 2010A Bonds, the principal and redemption premium, if any, of and interest on the Series 2010A Bonds will be made as described in APPENDIX E—“INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM.”

Security and Sources of Payment for the Series 2010A Bonds

The City of San Diego (the “City”) owns the Wastewater System and operates such system through its Public Utilities Department (the “Department”). The City has expanded the Wastewater System from time to time to satisfy its mission statement, which is to provide wastewater collection, treatment, discharge and disposal. See “THE WASTEWATER SYSTEM—Wastewater System Management,” “—Metropolitan Sub-System Facilities” and “—Municipal Sub-System Facilities.”

The Series 2010A Bonds are limited obligations of the Authority secured by a pledge of Revenues (herein defined) of the Authority, consisting primarily of 2010A Installment Payments (herein defined) to be made by the City pursuant to the Master Installment Purchase Agreement, dated as of September 1, 1993, as amended and supplemented (the “Master Installment Purchase Agreement”), including as supplemented by the 2010-1 Supplement to the Master Installment Purchase Agreement, dated as of April 1, 2010 (the “2010-1 Supplement” and, together with the Master Installment Purchase Agreement, the “Installment Purchase Agreement”), each by and between the City and the Authority, and amounts on deposit in certain funds and accounts established under the Indenture (other than amounts on deposit in the Rebate Fund). The City has pledged Net System Revenues (herein defined) of the Wastewater System pursuant to the Installment Purchase Agreement to the payment of the Installment Payments, including the 2010A Installment Payments. The pledge and assignment of and lien on the Net System Revenues securing the payment of the 2010A Installment Payments are, in all respects, on parity with the pledge and assignment of and lien on the Net System Revenues securing the payment of the other Parity Obligations (as defined in the Installment Purchase Agreement; and the bonds secured by a pledge of the revenues from such Parity Obligations are referred to herein as “Parity Bonds”) under the Installment Purchase Agreement. See “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS.”

THE SERIES 2010A BONDS ARE LIMITED OBLIGATIONS OF THE AUTHORITY AND ARE PAYABLE SOLELY FROM THE REVENUES OF THE AUTHORITY PLEDGED FOR SUCH PURPOSE, AND AMOUNTS ON DEPOSIT IN CERTAIN FUNDS AND ACCOUNTS ESTABLISHED, UNDER THE INDENTURE. EXCEPT AS AFORESAID, THE SERIES 2010A BONDS DO NOT CONSTITUTE A DEBT OR LIABILITY OF THE AUTHORITY, THE CITY OR THE STATE AND NEITHER THE FAITH NOR CREDIT OF THE AUTHORITY, THE CITY OR THE STATE ARE PLEDGED TO THE PAYMENT OF

THE PRINCIPAL OF OR INTEREST ON THE SERIES 2010A BONDS. THE AUTHORITY HAS NO TAXING POWER.

Redemption of the Series 2010A Bonds

The Series 2010A Bonds are subject to optional redemption and mandatory sinking fund redemption prior to maturity as described herein. See “DESCRIPTION OF THE SERIES 2010A BONDS—Redemption.”

Rate Covenant

The City has covenanted in the Installment Purchase Agreement to fix, prescribe and collect rates and charges for the Wastewater Service which will be at least sufficient (i) to pay during each Fiscal Year all Obligations (other than Parity Obligations) payable in such Fiscal Year, and (ii) to yield during each Fiscal Year Net System Revenues equal to 120% of the Debt Service (defined in the Installment Purchase Agreement generally to mean the aggregate amount of principal, sinking fund payments and interest payable in respect of all Parity Obligations for the applicable Fiscal Year) for such Fiscal Year. The Wastewater Service rendered by the City includes services relating to the Metropolitan Sub-System (herein defined), of which the Participating Agencies are a part. See “THE WASTEWATER SYSTEM—Participating Agencies” for a description of the rates and charges paid and to be paid by the Participating Agencies. See also “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS—Rate Covenant,” “WASTEWATER SYSTEM FINANCIAL OPERATIONS—Rate Stabilization Fund and Other Reserves,” “RISK FACTORS—Rate-Setting Process Under Proposition 218” and “CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES—Articles XIIC and XIID” and APPENDIX B—“SUMMARY OF PRINCIPAL LEGAL DOCUMENTS—Installment Purchase Agreement—Selected Covenants of the City—Amount of Rates and Charges; Rate Stabilization Fund.”

Reserve Fund

The Indenture requires the Authority to establish and maintain a Reserve Fund and the Authority must maintain therein or have credited thereto an amount of money equal to the Reserve Requirement. “Reserve Requirement” is defined to be, as of any date of calculation, the least of (i) 10% of the proceeds (within the meaning of Section 148 of the Internal Revenue Code of 1986, as amended (the “Code”)) of the Series 2009A Bonds, the Series 2009B Bonds, the Series 2010A Bonds and any Additional Bonds (defined herein) issued under the Indenture (collectively, the “Bonds”); (ii) 125% of average annual debt service on the then-Outstanding Bonds; or (iii) the Maximum Annual Debt Service for that and any subsequent Fiscal Year. See “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS—Reserve Fund” for a description of the Reserve Fund.

Outstanding Obligations

As of the date of delivery of the Series 2010A Bonds, there will be outstanding \$1,250,645,000 aggregate principal amount of Parity Obligations (the “Outstanding Parity Obligations”), and \$68,796,099 aggregate principal amount of Existing SRF Loans (herein defined) which constitute all of the Subordinated Obligations (the “Outstanding Subordinated Obligations”). The Outstanding Parity Obligations and the Outstanding Subordinated Obligations were incurred to finance the costs of certain improvements relating to the Wastewater System or to refund prior outstanding obligations relating to the Wastewater System. The Outstanding Parity Obligations consist of Installment Payments relating to three series of bonded indebtedness (reflecting the issuance of the Series 2010A Bonds and the defeasance of all Refunded Bonds (herein defined)). The Outstanding Subordinated

Obligations consist of eleven State Revolving Fund Loans (each, an “Existing SRF Loan” and collectively, the “Existing SRF Loans”). See “PLAN OF FINANCE” and “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS—Outstanding Obligations.” The City also expects to incur additional Obligations from time to time to finance a portion of the capital improvements to the Wastewater System, as described under the caption “Wastewater System Capital Improvement Program—Background,” and, as economic conditions allow, to refund outstanding obligations relating to the Wastewater System.

Incurrence of Additional Obligations

Pursuant to the Installment Purchase Agreement, the City may incur additional Obligations, payments with respect to which will be on parity with or subordinate in priority to the City’s obligation to make 2010A Installment Payments, subject to satisfaction of the conditions specified in the Installment Purchase Agreement. The Department applied for an additional State Revolving Fund Loan in the principal amount of approximately \$46.4 million in calendar year 2008 (the “Additional SRF Loan”) to finance a grit processing project at the Point Loma Plant (herein defined), which is a part of the Wastewater System CIP (herein defined). The Additional SRF Loan, approved by the City Council in October 2009, will constitute a Parity Obligation under the Installment Purchase Agreement. The City is awaiting final approval from the State for the Additional SRF Loan. The City also expects to incur additional Obligations from time to time to finance a portion of the capital improvements to the Wastewater System, as described under the caption “WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM—Background.” See “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS—Incurrence of Additional Obligations.”

Continuing Disclosure

The City has agreed to provide, or cause to be provided, in accordance with Rule 15c2-12(b)(5), promulgated by the U.S. Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (the “Rule”), certain annual financial information and operating data and, in a timely manner, notice of certain material events. These covenants have been made in order to assist the Underwriters in complying with the Rule. Beginning in March 2004 and continuing through Fiscal Year 2008, the City failed to comply with various filing deadlines for a number of undertakings due to the unavailability of audited financial statements for the City. Each required annual report and audited financial statement was subsequently filed. The City is current with its filings and is in compliance with its continuing disclosure obligations under the Rule. See “CONTINUING DISCLOSURE.”

Certain Information Regarding the City

The following provides a summary of certain matters regarding the City’s financial statements and certain investigations which may be ongoing relating to the City. Note, however, that the Series 2010A Bonds are payable from the Revenues pledged to such payment, and amounts in certain funds and accounts established, under the Indenture, are not expected to be directly impacted by the financial condition of the City. See “SECURITY FOR THE SERIES 2010A BONDS.” To the best knowledge of the City, the investigations relating to the City’s financial statements and disclosure practices do not involve matters directly related to the security for, or the payment of, the Series 2010A Bonds.

Investigations Regarding Misleading Disclosures

On November 14, 2006, the City entered into a cease-and-desist order (the “Order”) with the Securities and Exchange Commission (the “Commission”) relating to violations of the antifraud provisions of the federal securities laws in connection with the offer and sale of

municipal securities in calendar years 2002 and 2003, and other related public financial disclosures concerning its pension and retiree health care liabilities. The Commission concluded that the “City, through its officials, acted with scienter,” because “City officials acted recklessly in failing to disclose material information regarding [pension and retiree health care] liabilities.” The Order imposed certain remedial sanctions, including the retention of an independent consultant to review and assess the City’s policies, procedures and internal controls with respect to bond offerings, including disclosures made in its financial statements. On January 16, 2007, the City retained Stanley Keller of the law firm of Edwards Angell Palmer & Dodge, LLP to serve as Independent Consultant. The Independent Consultant is required to conduct annual reviews of the City’s policies, procedures and internal controls for a three year period, and provide copies of such reports to the Commission. The Independent Consultant’s final report was presented to the City Council on March 8, 2010. The Order settled all claims between the City and the Commission with respect to the alleged violations of the federal securities laws in 2002 and 2003.

Audited Financial Reports

As a result of the investigations into the City, the completion and release of the City’s audited financial statements were substantially delayed. The City issued its CAFRs with unqualified opinions for Fiscal Years 2003 through 2008 during the period from June 2007 through March 2009. The City received an unqualified opinion from its outside auditor on December 21, 2009, with respect to the Fiscal Year 2009 CAFR, which was received and filed with the City Council. The City is now current with respect to all financial reporting.

City Ratings

Beginning in 2004, as a result of the investigations into the City, Moody’s Investors Service, Inc. (“Moody’s”), and Fitch Ratings (“Fitch”) began to downgrade the credit ratings on the City’s obligations and changed the outlook on those ratings to negative. Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc. (“S&P”), placed the City’s credit rating on negative outlook and subsequently suspended its credit ratings on all City obligations. The City’s credit ratings were reinstated in May 2008 by S&P in connection with the release of its CAFRs for Fiscal Years 2003 through 2006. The City currently maintains ratings on its bonds and other City debt obligations from all three rating agencies to the extent that such bonds and debt obligations were rated at issuance or were subsequently rated.

Forward-Looking Statements

Certain statements included or incorporated by reference in this Official Statement constitute “forward-looking statements.” Such statements are generally identifiable by the terminology used such as “plan,” “expect,” “estimate,” “budget,” “projected” or other similar words. The achievement of certain results or other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Although such expectations reflected in such forward-looking statements are reasonable, there can be no assurance that such expectations will prove to be correct in whole or in part. Neither the City nor the Authority is obligated to issue any updates or revisions to the forward-looking statements if or when expectations, or events, conditions or circumstances on which such statements are based do or do not occur.

Tax Matters

In the opinion of Quint & Thimmig LLP, San Francisco, California, Bond Counsel, subject, however, to certain qualifications described in this Official Statement, under existing law, interest on the Series 2010A Bonds (i) is excludable from the gross income of the owners thereof for federal income tax purposes, and (ii) is not included as an item of tax preference in computing the federal alternative minimum tax for individuals and corporations, but interest on the Series 2010A Bonds is taken into account, however, in computing an adjustment used in determining the federal alternative minimum tax for certain corporations. In addition, in the opinion of Bond Counsel, interest on the Series 2010A Bonds is exempt from personal income taxation imposed by the State of California. See "TAX MATTERS."

Miscellaneous

Copies of the Indenture, the Installment Purchase Agreement, the 2010-1 Supplement, other financing documents may be obtained upon written request to the Trustee at The Bank of New York Mellon Trust Company, N.A., 700 South Flower Street, 5th Floor, Los Angeles, California 90017. The Trustee may charge for the duplication and mailing of documents.

THE AUTHORITY

The Authority is a joint powers authority duly organized and existing under and pursuant to that certain Second Amended and Restated Joint Exercise of Powers Agreement, dated as of October 29, 2002, by and between the City and the Redevelopment Agency of the City of San Diego (the "Members"), and under the provisions of Articles 1 through 4 (commencing with section 6500) of Chapter 5 of Division 7 of Title 1 of the California Government Code (the "Act"), and is authorized pursuant to Article 4 of the Act to borrow money for the purpose of financing the acquisition of bonds, notes and other obligations of, or for the purpose of making loans to, public entities, including the Members, and to provide financing for public capital improvements of public entities, including the Members.

PLAN OF FINANCE

A portion of the proceeds of the Series 2010A Bonds will be used to refund all of the Series 1995 Bonds, the Series 1997A Bonds, the Series 1997B Bonds, the Series 1999A Bonds, and the Series 1999B Bonds, collectively referred to herein as the "Refunded Bonds," as set forth in the following table.

REFUNDED BONDS

Series	Maturity Date(s)	Principal Amount	Redemption Price	Redemption Date	CUSIP†
1995	5/15/2025	\$43,850,000	100.0%	04/29/2010	79730A AT5
1997A	5/15/2027	\$22,565,000	100.0%	04/29/2010	79730A BU1
1997B	5/15/2027	\$8,260,000	100.0%	04/29/2010	79730A CS5
1999A	5/15/2029	\$67,020,000	100.5%	05/15/2010	79730A DV7
1999B	5/15/2029	\$37,080,000	100.5%	05/15/2010	79730A ES3

† Copyright 2010, American Bankers Association. CUSIP data is provided by Standard & Poor's CUSIP Service Bureau, a Division of the McGraw-Hill Companies, Inc., and is set forth herein for convenience of reference only. The City, the Authority and the Underwriters do not assume responsibility for the accuracy of such data.

In addition, proceeds of the Series 2010A Bonds will be used to make a deposit to the Costs of Issuance Account established under the Second Supplemental Indenture to be used to pay the Costs of Issuance of the Series 2010A Bonds.

ESTIMATED SOURCES AND USES OF FUNDS

The proceeds of the Series 2010A Bonds and their expected uses are set forth below:

SOURCES:

Principal Amount of the Series 2010A Bonds	\$161,930,000.00
Plus: Original Issuance Premium	10,782,027.45
Plus: Released Refunded Bonds Reserve Fund Moneys	20,506,695.00
Plus: Sewer Utility Cash Contribution ⁽¹⁾	5,547,913.42
Total Sources	\$198,766,635.87

USES:

Refunding of Series 1995 Bonds	\$ 44,848,805.56
Refunding of Series 1997A Bonds	23,104,679.58
Refunding of Series 1997B Bonds	8,457,551.67
Refunding of Series 1999A Bonds	69,030,600.00
Refunding of Series 1999B Bonds	38,192,400.00
Deposit to Reserve Fund ⁽²⁾	14,069,185.87
Costs of Issuance ⁽³⁾	1,063,413.19
Total Uses	\$198,766,635.87

(1) Represents previously budgeted interest payment.

(2) Represents the amount needed to increase the amount on deposit in the Reserve Fund to the amount of the Reserve Requirement under the Indenture in effect immediately following the issuance of the Series 2010A Bonds. Amounts deposited in the Reserve Fund will be derived from released Refunded Bonds Reserve Fund moneys.

(3) Includes Trustee fees, financial advisor fees, rating agency fees, bond counsel fees and expenses, disclosure counsel fees and expenses, Underwriters' discount, printing costs and other costs of issuing the Series 2010A Bonds.

DESCRIPTION OF THE SERIES 2010A BONDS

General

The Series 2010A Bonds will be issued as fully-registered bonds in denominations of \$5,000 and any integral multiple thereof and when issued, will be registered in the name of Cede & Co., as the nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Series 2010A Bonds. Ownership interests in the Series 2010A Bonds may be purchased in book-entry form only. So long as DTC or its nominee is the Owner of the Series 2010A Bonds, principal of redemption premium, if any, and interest on the Series 2010A Bonds will be made as described in APPENDIX E—"INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM."

The Series 2010A Bonds will accrue interest from their date of delivery and interest thereon will be payable on May 15 and November 15 of each year, commencing on May 15, 2010. The Series 2010A Bonds will bear interest at the respective rates set forth on the inside cover page hereof.

Interest on the Series 2010A Bonds will be calculated on the basis of a 360-day year, comprised of twelve thirty-day months. Interest coming due on a date which is not a Business Day will be payable on the immediately following Business Day. Each Series 2010A Bond will bear interest from the Interest Payment Date next preceding the date of authentication thereof, unless such date of authentication is during the period commencing after a Record Date through and including the next succeeding Interest Payment Date, in which event it will bear interest from such Interest Payment Date, or unless such date of authentication is on or before the first Record Date, in which event it will bear interest from its dated date; provided, however, that if on the date of authentication of any Series 2010A Bonds, interest is then in default on the Outstanding Series 2010A Bonds, such Series 2010A Bonds will bear interest from the Interest Payment Date to which interest has previously been paid or made available for payment on the Outstanding Series 2010A Bonds. Payment of interest on the Series 2010A Bonds due on or before the maturity or prior redemption thereof will be made to the Owner or Owners of record as of the Record Date preceding the applicable Interest Payment Date, on the registration books kept by the Trustee, such interest to be paid by check mailed by first class mail on such Interest Payment Date to such Owner at his address as it appears on such books; provided, that in the event the ownership of such Series 2010A Bonds is no longer maintained in book-entry form by the Depository, such payment will be made by wire transfer to any Owner of at least \$1,000,000 in aggregate principal amount of Series 2010A Bonds, in immediately available funds to an account in the continental United States designated in writing by such Owner to the Trustee prior to the applicable Record Date.

Redemption

Optional Redemption. The Series 2010A Bonds are subject to optional redemption, in whole or in part, at the option of the Authority (upon the direction of the City), at any time on or after May 15, 2020, from and to the extent of prepaid Series 2010A Installment Payments paid pursuant to the Indenture, at a redemption price equal to the principal amount of Series 2010A Bonds called for redemption, together with interest accrued thereon to the date fixed for redemption, without premium.

Notice of Redemption. Pursuant to the Indenture, each notice of redemption will be mailed to the Owners not more than 60 days nor less than 30 days prior to the redemption date and will state the date of such notice, the redemption price (including the name and appropriate address of the Trustee), and, in the case of Series 2010A Bonds to be redeemed in part only, the respective portions of the principal amount thereof to be redeemed. Each such notice will also state that on said date there will become due and payable on each of said Series 2010A Bonds thereof and in the case of a Series 2010A Bond to be redeemed in part only, the specified portion of the principal amount thereof to be redeemed, together with interest accrued thereon to the redemption date, and that from and after such redemption date, interest thereon will cease to accrue, and will require that such Series 2010A Bonds be then surrendered at the address of the Trustee specified in the redemption notice. Notice of redemption may be conditioned upon the occurrence of one or more events and may be revoked prior to the redemption date. Notice of redemption may be conditioned upon the occurrence of future events, including but not limited to the issuance of refunding bonds, and may be given and rescinded by the Trustee prior to the redemption date, upon written instruction of the Authority.

Effect of Redemption. If notice of redemption has been duly given as provided in the Indenture and money for the payment of the redemption price of the Series 2010A Bonds called for redemption is held by the Trustee, then on the redemption date designated in such notice, the Series 2010A Bonds will become due and payable, and from and after the date so designated, interest on the Series 2010A Bonds so called for redemption will cease to accrue, and the Owners of such Series 2010A Bonds will have no rights in respect thereof except to

receive payment of the redemption price thereof. A deficiency in any such notice will not affect the sufficiency of the proceedings for redemption. All Series 2010A Bonds redeemed pursuant to the provisions of the Indenture will be cancelled by the Trustee and will not be reissued, and the Trustee will thereupon deliver a certificate of cancellation to the Authority.

SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS

Source of Payment; Priority of Pledge of Net System Revenues

The Series 2010A Bonds are limited obligations of the Authority payable solely from the Revenues of the Authority pledged for such purpose under the Indenture and amounts on deposit in certain funds and accounts established under the Indenture. "Revenues" means all amounts received by or due to be paid to the Authority pursuant to or with respect to the Installment Purchase Agreement in connection with the Bonds and all interest or gain derived from the investment of money in any of the funds (other than the Rebate Fund) established under the Indenture. The 2010A Installment Payments are secured by and payable solely from Net System Revenues and are required to be paid by the City to the Authority. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS—Net System Revenues" for a description of Net System Revenues.

The pledge and right of payment from Net System Revenues securing the 2010A Installment Payments (which, in turn, secure the Series 2010A Bonds) is on parity with the pledge and right of payment from Net System Revenues securing the Installment Payments represented by the Authority's Outstanding Parity Obligations, which will be outstanding upon the incurrence of the 2010A Installment Payments, and any other Parity Obligations that may be issued from time to time in accordance with the Installment Purchase Agreement. See "PLAN OF FINANCE" and "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS—Incurrence of Additional Obligations" and "— Parity Obligations." All Parity Obligations, including Parity Installment Payment Obligations, are secured by a first priority lien on and pledge of Net System Revenues. All Parity Obligations are of equal rank with each other without preference, priority or distinction of any Parity Obligations over any other Parity Obligations.

The pledge and right of payment from Net System Revenues securing the 2010A Installment Payments (which, in turn, secure the Series 2010A Bonds) is senior to the pledge and right of payment from Net System Revenues securing the Subordinated Obligations, consisting of the eleven Existing SRF Loans. All Subordinated Obligations are secured by a second priority lien on and pledge of Net System Revenues that is junior and subordinate to the lien on and pledge of Net System Revenues securing Parity Obligations. All Subordinated Obligations are of equal rank with each other without preference, priority or distinction of any Subordinated Obligations over any other Subordinated Obligations. The Installment Purchase Agreement provides that, subject to satisfaction of the requirements set forth therein for the incurrence of additional Obligations of the City, nothing therein shall limit the ability of the City to grant liens on and pledges of Net System Revenues that are subordinate to the liens on and pledges of Net System Revenues for the benefit of Parity Obligations and Subordinated Obligations contained in the Installment Purchase Agreement. See APPENDIX B—"SUMMARY OF PRINCIPAL LEGAL DOCUMENTS—Installment Purchase Agreement—Commitment of Net System Revenues."

The Additional SRF Loan and any other State Revolving Fund Loans subsequent thereto are expected to constitute Parity Obligations. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS—Outstanding Obligations."

Sewer Revenue Fund

The City accounts for its wastewater operations through an enterprise fund known as the "Sewer Revenue Fund" (also referenced as the "Sewer Utility Fund" in the City's CAFRs). The Sewer Revenue Fund was established by an amendment to the Municipal Code of the City (the "City Municipal Code") on August 2, 1956. All System Revenues are deposited in the Sewer Revenue Fund.

All moneys in the Sewer Revenue Fund must first be used to pay: (1) directly or as otherwise required all Maintenance and Operation Costs of the Wastewater System; (2) to the Trustee amounts due in respect of Parity Installment Obligations for deposit in the Payment Fund for Parity Installment Obligations, the amounts specified in any Issuing Instrument, as payments due on account of Parity Obligations; (3) to the obligee specified therein, any payment due as to any Parity Obligation that is not a Parity Installment Obligation (including any Credit Provider Reimbursement Obligations designated as Parity Obligations), other than (A) payments due on account of Qualified Take or Pay Obligations and (B) payments due by the City under a Qualified Swap Agreement; (4) to the obligee specified therein, any payment due as to Qualified Take or Pay Obligations; and (5) to the counterparty specified in any Qualified Swap Agreement, the amounts or payments due under such Qualified Swap Agreement as Parity Obligations. In the event there are insufficient Net System Revenues to make all of the payments contemplated by clauses (2), (3), (4) and (5) of the immediately preceding sentence, then said payments shall be made as nearly as practicable, pro rata, based upon the respective unpaid principal amounts of said Parity Obligations. After such payments have been made, any remaining Net System Revenues must be used to make up any deficiency in the Reserve Funds or Reserve Accounts for Parity Obligations.

Notwithstanding anything in the Installment Purchase Agreement to the contrary, no payments from the Sewer Revenue Fund will be made in respect of any Subordinated Obligations unless the following conditions are met: (1) all Maintenance and Operation Costs of the Wastewater System are being and have been paid and are then current and (2) all deposits and payments contemplated by the Installment Purchase Agreement have been made in full and no deficiency in any Reserve Fund or Reserve Account for Parity Obligations shall exist, and there shall have been paid, or segregated within the Sewer Revenue Fund, the amounts payable during the current month pursuant to the Installment Purchase Agreement; provided, however, that if the amounts payable during any month pursuant to the Installment Purchase Agreement are not able to be determined at the time of the payment of any Subordinated Obligation due to periods in which the actual interest rate accruing in respect of any Parity Obligations cannot yet be determined, then no payments from the Sewer Revenue Fund shall be made in respect of any Subordinated Obligations unless there shall have been segregated within the Sewer Revenue Fund the maximum amount that may be payable in that month under the Installment Purchase Agreement as specified in the Issuing Instruments of the Parity Obligations and in accordance with applicable law.

Subject to the Installment Purchase Agreement, the City will apply any amounts thereafter remaining in the Sewer Revenue Fund (A) to the payment of Subordinated Credit Provider Expenses and (B) to the obligee specified therein, any payment due as to any Subordinated Obligations. In the event that there are insufficient Net System Revenues remaining in the Sewer Revenue Fund after the payments described in the Installment Purchase Agreement to make all payments contemplated by clause (B) of the immediately preceding sentence, then said payments shall be made as nearly practicable, pro rata based on the respective unpaid principal amounts of said Subordinated Obligations.

There are no Outstanding Qualified Take or Pay Obligations or Qualified Swap Agreements and there will be no such obligations or agreements as of the date of issuance of the Series 2010A Bonds.

Net System Revenues

“Net System Revenues” means, for any Fiscal Year, System Revenues for such Fiscal Year less Operation and Maintenance Costs of the Wastewater System for such Fiscal Year.

The term “System Revenues” is defined in the Installment Purchase Agreement to include all income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Wastewater System, including, without limiting the generality of the foregoing, (1) all income, rents, rates, fees, charges (including standby and capacity charges), or other moneys derived by the City from the wastewater services, facilities, and commodities or byproducts sold, furnished or supplied through the facilities of or in the conduct or operation of the business of the Wastewater System, and including, without limitation, investment earnings on the operating reserves to the extent that the use of such earnings is limited to the Wastewater System by or pursuant to law, earnings on any Reserve Fund for Obligations, but only to the extent that such earnings may be utilized under the Issuing Instrument for the payment of debt service for such Obligations; (2) the proceeds derived by the City directly or indirectly from the lease of a part of the Wastewater System; (3) any amount received from the levy or collection of taxes which are solely available and are earmarked for the support of the operation of the Wastewater System; and (4) amounts received under contracts or agreements with governmental or private entities and designated for capital costs; and (5) grants received from the United States of America or from the State of California; provided, however, that System Revenues shall not include: (a) in all cases, customers’ deposits or any other deposits or advances subject to refund until such deposits or advances have become the property of the City; and (b) the proceeds of borrowings. Notwithstanding the foregoing, there shall be deducted from System Revenues any amounts transferred, into a Rate Stabilization Fund as contemplated by the Installment Purchase Agreement, and there shall be added to System Revenues any amounts transferred out of such Rate Stabilization Fund to pay Maintenance and Operation Costs of the Wastewater System.

“Maintenance and Operation Costs of the Wastewater System” is defined in the Installment Purchase Agreement to include: (a) a Qualified Take or Pay Obligation and (b) the reasonable and necessary costs spent or incurred by the City for maintaining and operating the Wastewater System, calculated in accordance with generally accepted accounting principles, including (among other things) the reasonable expenses of management and repair and other expenses necessary to maintain and preserve the Wastewater System in good repair and working order, and including administrative costs of the City attributable to the Project and the Installment Purchase Agreement, salaries and wages of employees, payments to employees retirement systems (to the extent paid from Wastewater System Revenues), overhead, taxes (if any), fees of auditors, accountants, attorneys or engineers and insurance premiums, and including all other reasonable and necessary costs of the City or charges required to be paid by it to comply with the terms of the Obligations, including this Installment Purchase Agreement, including any amounts required to be deposited in the Rebate Fund pursuant to the Tax Certificate, fees and expenses payable to any Credit Provider (other than in repayment of a Credit Provider Reimbursement Obligation), and expenses incurred or accrued incident to the formation of an entity to which the City may transfer substantially all of the Metropolitan Sub-System pursuant to the Installment Purchase Agreement, but excluding in all cases (i) depreciation, replacement and obsolescence charges or reserves therefor, (ii) amortization of intangibles or other bookkeeping entries of a similar nature, (iii) costs of capital additions, replacements, betterments, extensions or improvements to the Wastewater System which under generally accepted accounting principles are chargeable

to a capital account or to a reserve for depreciation, (iv) charges for the payment of principal and interest on any general obligation bond heretofore or hereafter issued for Wastewater System purposes, and (v) charges for the payment of principal and interest on any debt service on account of any obligation on a parity with or subordinate to the Installment Payments.

Obligation of City under Installment Purchase Agreement

Pursuant to the Installment Purchase Agreement, the City commits, absolutely and unconditionally, to make Installment Payments (including the 2010A Installment Payments) to the Authority solely from Net System Revenues until such time as the Purchase Price has been paid in full (or provision for the payment thereof has been made pursuant to the Installment Purchase Agreement). The City will not discontinue or suspend any 2010A Installment Payments required to be made by it under the Installment Purchase Agreement when due, whether or not the Project or any part thereof is operating or operable or has been completed, or its use is suspended, interfered with, reduced or curtailed or terminated in whole or in part, and such 2010A Installment Payments will not be subject to reduction whether by offset or otherwise and will not be conditioned upon the performance or nonperformance by any party of any agreement for any cause whatsoever.

Under the Installment Purchase Agreement, the City has retained the right to transfer ownership of substantially all of the Metropolitan Sub-System, including amounts in the Sewer Revenue Fund attributable to the Metropolitan Sub-System and any amounts in the Rate Stabilization Fund agreed upon by the City and the transferee as being attributable to the Metropolitan Sub-System, to the Department or any other governmental agency whose primary purpose is to provide wastewater treatment and disposal services upon the satisfaction of certain conditions. See “WASTEWATER SYSTEM—General” and APPENDIX B—“SUMMARY OF PRINCIPAL LEGAL DOCUMENTS—Installment Purchase Agreement—Selected Covenants of the City—Transfer of Metropolitan System Components.”

Rate Covenant

The City has covenanted in the Installment Purchase Agreement to fix, prescribe and collect rates and charges for Wastewater Service, which will be at least sufficient (i) to pay during each Fiscal Year all Obligations (other than Parity Obligations) payable in such Fiscal Year, and (ii) to yield during each Fiscal Year Net System Revenues equal to 120% of the Debt Service (defined in the Installment Purchase Agreement generally to mean the aggregate amount of principal, sinking fund payments and interest payable in respect of all Parity Obligations for such Fiscal Year) for such Fiscal Year (the “Rate Covenant”). See APPENDIX B—“SUMMARY OF PRINCIPAL LEGAL DOCUMENTS—Installment Purchase Agreement—Selected Covenants of the City—Amount of Rates and Charges; Rate Stabilization Fund.” The Wastewater Service rendered by the City includes services relating to the Metropolitan Sub-System, of which the Participating Agencies are a part. See “THE WASTEWATER SYSTEM—Participating Agencies” for a description of the rates and charges paid and to be paid by the Participating Agencies. Obligations include Subordinated Obligations and other obligations. The City may make adjustments from time to time in such rates and charges and may make such classification thereof as it deems necessary to the fullest extent permitted by law, but the City will not reduce the rates and charges then in effect unless the Net System Revenues from such reduced rates and charges will at all times be sufficient to meet the requirements of Installment Purchase Agreement. Pursuant to the Installment Purchase Agreement, from time to time the City may deposit into the Rate Stabilization Fund, from current System Revenues, such amounts as the City shall determine and the amount of available current System Revenues shall be reduced by the amount so transferred. Amounts may be transferred from the Rate Stabilization Fund solely and exclusively to pay Maintenance and Operation Costs of the Wastewater System, and any amounts so transferred will be

deemed System Revenues when so transferred. All interest or other earnings upon amounts in the Rate Stabilization Fund may be withdrawn therefrom and accounted for as System Revenues. See “WASTEWATER SYSTEM FINANCIAL OPERATIONS—Rate Stabilization Fund and Other Reserves” and APPENDIX B—“SUMMARY OF PRINCIPAL LEGAL DOCUMENTS—Installment Purchase Agreement—Selected Covenants of the City—Amount of Rates and Charges; Rate Stabilization Fund.” See also “RISK FACTORS—Rate-Setting Process Under Proposition 218” and “CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES—Articles XIIC and XIID” for a description of State Constitutional limits upon the City’s rate-setting process.

Reserve Fund

The Indenture requires the Authority to maintain in the Reserve Fund an amount of money which, together with the amount already on deposit therein, including the stated amount of a Surety Bond, if any, then on deposit, is equal to the Reserve Requirement. The “Reserve Requirement” is defined to be, as of any date of calculation, the least of (i) ten percent (10%) of the proceeds (within the meaning of Section 148 of the Code) of the Bonds; (ii) 125% of average annual debt service on the then-Outstanding Bonds; or (iii) the Maximum Annual Debt Service for that and any subsequent Fiscal Year. The Authority may fund the Reserve Requirement by depositing into the Reserve Fund cash from the proceeds of Bonds issued under the Indenture or a Surety Bond. The Authority anticipates that in connection with the issuance of the Series 2010A Bonds it will make a deposit to the Reserve Fund of \$14,069,185.87 from released Refunded Bonds Reserve Fund moneys.

Outstanding Obligations

As of the date of delivery of the Series 2010A Bonds, there will be outstanding \$1,250,645,000 aggregate principal amount of Outstanding Parity Obligations and \$68,796,099 aggregate principal amount of Outstanding Subordinated Obligations. The Outstanding Parity Obligations and the Outstanding Subordinated Obligations were issued to finance the costs of certain improvements relating to the Wastewater System or to refund outstanding obligations of the Wastewater System. Upon the incurrence of the Series 2010A Installment Payments and the defeasance described herein, the Outstanding Parity Obligations will consist of Installment Payments relating to three series of bonded indebtedness. The Outstanding Subordinated Obligations consist of the Existing SRF Loans.

Table 1 below sets forth the Outstanding Parity Bonds (herein defined), the Series 2010A Bonds and Existing SRF Loans secured by Net System Revenues of the Wastewater System as of the date of delivery of the Series 2010A Bonds.

TABLE 1
OUTSTANDING PARITY BONDS AND EXISTING SRF LOANS
SECURED BY NET SYSTEM REVENUES OF THE WASTEWATER SYSTEM⁽¹⁾
As of April 29, 2010

Name of Issue	Original Issue Size	Principal Outstanding	Remaining Interest Payments	Total Principal and Interest	Scheduled Final Maturity
2009A Bonds	\$ 453,775,000	\$ 453,775,000	\$393,588,322	\$ 847,363,322	May 15, 2039
2009B Bonds	634,940,000	634,940,000	263,442,044	898,382,044	May 15, 2025
2010A Bonds	161,930,000	161,930,000	136,795,412	298,725,412	May 15, 2029
Existing SRF Loans ⁽²⁾	98,991,000	68,796,099	9,286,888 ⁽³⁾	78,082,987	April 30, 2026 ⁽⁴⁾
	<u>\$1,349,636,000</u>	<u>\$1,319,441,099</u>	<u>\$803,112,666</u>	<u>\$2,122,553,765</u>	

Source: Public Utilities Department.

- (1) Does not include the Additional SRF loan expected to be funded.
- (2) Data reflects the aggregate amount of the eleven Existing SRF Loans which are currently outstanding.
- (3) Reflects aggregate interest payments required to be paid under the Existing SRF Loans, regardless of the date of payment or prepayment by the City. See Note 6 —“Business-Type Activities Long-Term Liabilities” contained in APPENDIX A—“BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY INFORMATION AND CERTAIN EXCERPTS FROM THE COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE CITY OF SAN DIEGO FOR THE FISCAL YEAR ENDED JUNE 30, 2009” for a schedule of the Existing SRF Loans and their effective interest rates.
- (4) April 30, 2026 is the final scheduled maturity date for the existing SRF Loan with the furthest scheduled maturity date.

Incurrence of Additional Obligations

Pursuant to the Installment Purchase Agreement, the City may incur additional Obligations, payments with respect to which will be on parity with or subordinate in priority to the City’s obligation to make 2010A Installment Payments, subject to satisfaction of the conditions specified in the Installment Purchase Agreement.

Parity Obligations. The City may not create any Obligations the payments of which are senior or prior to the pledge and right of payment from Net System Revenues securing the Parity Obligations. The City may at any time and from time to time issue or create any other Parity Obligations, so long as there shall not have occurred and be continuing (i) an Event of Default under the Installment Purchase Agreement or any Issuing Instrument or (ii) an Event of Default or Termination Event (as defined in any Qualified Swap Agreement) under any Qualified Swap Agreement; and the City obtains or provides a certificate or certificates, prepared by the City or at the City’s option by a Consultant, showing that:

(1) the Net System Revenues as shown by the books of the City for any 12 consecutive month period out of the 18 consecutive months ending immediately prior to the incurring of such additional other Parity Obligations shall have amounted to at least 1.20 times the Maximum Annual Debt Service on all Parity Obligations Outstanding during such period; and

(2) the estimated Net System Revenues for the next 12 months following the date of issuance of such other Parity Obligations will be at least equal to 1.20 times the Maximum Annual Debt Service for all Parity Obligations which will be Outstanding immediately after the issuance of the proposed Parity Obligations.

The certificate or certificates described above in clause (2) above will not be required if the Parity Obligations being issued are for the purpose of refunding (i) then-Outstanding Parity Obligations if at the time of the issuance of such Parity Obligations a certificate of an Authorized City Representative is delivered showing that the sum of Debt Service in each Fiscal Year on all Parity Obligations Outstanding after the issuance of the refunding Parity Obligations will not exceed Debt Service in each corresponding Fiscal Year on all Parity Obligations Outstanding prior to the issuance of such refunding Parity Obligations; or (ii) then-Outstanding Balloon Indebtedness, Tender Indebtedness or Variable Rate Indebtedness, but only to the extent that the principal amount of such indebtedness has been put, tendered to or otherwise purchased by a standby purchase or other liquidity facility relating to such indebtedness. For additional information relating to the terms and conditions for the issuance of the Parity Obligations under the Installment Purchase Agreement, see APPENDIX B—"SUMMARY OF PRINCIPAL LEGAL DOCUMENTS—Installment Purchase Agreement—Additional Obligations."

Subordinated Obligations. The City may at any time issue or create Subordinated Obligations that are payable from Net System Revenues on a basis subordinate to the payment by the City of the Installment Payments securing the Outstanding Parity Bonds (as defined in the Installment Purchase Agreement), so long as no Event of Default has occurred and is continuing and no event of default or Termination Event (as defined in any Qualified Swap Agreement) under any Qualified Swap Agreement has occurred and is continuing, and provided the City obtains or provides a certificate or certificates, prepared by the City or at the City's option by a Consultant, showing that:

(1) the Net System Revenues as shown by the books of the City for any 12-consecutive month period out within the 18-consecutive months ending immediately prior to the incurring of such additional other Subordinated Obligations shall have amounted to at least 1.00 times the Maximum Annual Debt Service on all Obligations Outstanding immediately after the issuance of the proposed Subordinated Obligations; or

(2) the estimated Net System Revenues for the five Fiscal Years following the earlier of (a) the end of the period during which interest on those Subordinated Obligations is to be capitalized or, if no interest is to be capitalized, the Fiscal Year in which the Subordinated Obligations are issued; or (b) the date on which substantially all new facilities financed with such Subordinated Obligations are expected to commence operations, will be at least equal to 1.00 times the Maximum Annual Debt Service on all Obligations which will be Outstanding immediately after the issuance of the proposed Subordinated Obligations.

The certificate or certificates described above in clause (2) above will not be required if the Subordinated Obligations being issued are for the purpose of refunding (i) then-Outstanding Parity Obligations or Subordinated Obligations if at the time of the issuance of such Subordinated Obligations a certificate of an Authorized City Representative is delivered showing that the sum of Debt Service for all remaining Fiscal Years on all Parity Obligations and Subordinated Obligations Outstanding after the issuance of the refunding Subordinated Obligations will not exceed the sum of Debt Service for all remaining Fiscal Years on all Parity Obligations and Subordinated Obligations Outstanding prior to the issuance of such refunding Subordinated Obligations; or (ii) then-Outstanding Balloon Indebtedness, Tender Indebtedness or Variable Rate Indebtedness, but only to the extent that the principal amount of such indebtedness has been put, tendered to or otherwise purchased by a standby purchase or other liquidity facility relating to such indebtedness. For additional information relating to the terms and conditions for the issuance of the Subordinated Obligations under the Installment

Purchase Agreement, see APPENDIX B—“SUMMARY OF PRINCIPAL LEGAL DOCUMENTS—Installment Purchase Agreement—Additional Obligations.”

The obligation of the City to make all payments required by the Existing SRF Loans to the State Water Board is a Subordinated Obligation under the Installment Purchase Agreement and payable solely from Net System Revenues. Pursuant to the Existing SRF Loans, the City may incur additional Parity Obligations (the payments of which are senior or prior in right to the payment by the City of its obligations required by the Existing SRF Loans, and all other contracts between the City and the State Water Board that, by their terms, expressly provide therefor), including the 2010A Installment Payments, provided that (1) all Parity Obligations (including the Parity Obligations proposed to be incurred) shall have an “A” rating (without regard to any refinement or gradation of such rating category by a numerical modifier or otherwise) or better by at least two nationally recognized rating agencies; and (2) the City fixes, prescribes and collects rates and charges for Wastewater Service which will be sufficient to ensure that Net System Revenues to pay the obligations required by the Existing SRF Loans are at least 1.10 times the current year’s debt service on the Existing SRF Loans.

Annual Debt Service Requirements on Parity Bonds

Table 2 below sets forth the amounts required in each fiscal year for the payment of principal of and interest on the existing Parity Obligations and amounts payable on the Series 2010A Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS."

**TABLE 2
DEBT SERVICE ON ALL PARITY OBLIGATIONS**

Fiscal Year ending June 30	Outstanding Parity Bonds			Series 2010A Bonds			
	Principal	Interest	Total Principal and Interest	Principal	Interest	Total Principal and Interest	Total Debt Service ⁽¹⁾
2010	\$ 43,320,000	\$ 59,531,244	\$ 102,851,244	—	\$ 377,837	\$ 377,837	\$ 103,229,081
2011	42,620,000	51,367,731	93,987,731	—	8,501,325	8,501,325	102,489,056
2012	44,230,000	49,751,369	93,981,369	—	8,501,325	8,501,325	102,482,694
2013	46,120,000	47,866,369	93,986,369	—	8,501,325	8,501,325	102,487,694
2014	48,285,000	45,697,219	93,982,219	—	8,501,325	8,501,325	102,483,544
2015	50,535,000	43,449,919	93,984,919	—	8,501,325	8,501,325	102,486,244
2016	52,875,000	41,102,694	93,977,694	—	8,501,325	8,501,325	102,479,019
2017	55,410,000	38,573,394	93,983,394	—	8,501,325	8,501,325	102,484,719
2018	58,310,000	35,862,944	94,172,944	—	8,501,325	8,501,325	102,674,269
2019	61,210,000	32,958,194	94,168,194	—	8,501,325	8,501,325	102,669,519
2020	64,130,000	30,034,206	94,164,206	—	8,501,325	8,501,325	102,665,531
2021	67,225,000	26,941,406	94,166,406	—	8,501,325	8,501,325	102,667,731
2022	70,590,000	23,584,656	94,174,656	—	8,501,325	8,501,325	102,675,981
2023	74,095,000	20,073,869	94,168,869	—	8,501,325	8,501,325	102,670,194
2024	25,100,000	16,057,744	41,157,744	\$ 34,060,000	8,501,325	42,561,325	83,719,069
2025	26,355,000	14,802,744	41,157,744	35,845,000	6,713,175	42,558,175	83,715,919
2026	13,040,000	13,450,169	26,490,169	29,170,000	4,831,313	34,001,313	60,491,481
2027	13,695,000	12,798,169	26,493,169	30,690,000	3,299,888	33,989,888	60,483,056
2028	14,380,000	12,113,419	26,493,419	15,670,000	1,688,663	17,358,663	43,852,081
2029	15,100,000	11,394,419	26,494,419	16,495,000	865,988	17,360,988	43,855,406
2030	15,875,000	10,620,544	26,495,544	—	—	—	26,495,544
2031	16,710,000	9,785,169	26,495,169	—	—	—	26,495,169
2032	17,590,000	8,905,844	26,495,844	—	—	—	26,495,844
2033	18,515,000	7,980,213	26,495,213	—	—	—	26,495,213
2034	19,485,000	7,005,900	26,490,900	—	—	—	26,490,900
2035	20,515,000	5,980,538	26,495,538	—	—	—	26,495,538
2036	21,590,000	4,903,500	26,493,500	—	—	—	26,493,500
2037	22,725,000	3,770,025	26,495,025	—	—	—	26,495,025
2038	23,915,000	2,576,963	26,491,963	—	—	—	26,491,963
2039	25,170,000	1,321,425	26,491,425	—	—	—	26,491,425
Total ⁽¹⁾	<u>\$1,088,715,000</u>	<u>\$690,261,994</u>	<u>\$1,778,976,994</u>	<u>\$161,930,000</u>	<u>\$136,795,412</u>	<u>\$298,725,412</u>	<u>\$2,077,702,406</u>

Source: Department of Debt Management, City of San Diego.

(1) Amounts may not total due to rounding.

THE WASTEWATER SYSTEM

General

The “Wastewater System” consists of two sub-systems, the Municipal Sub-System (the “Municipal Sub-System”) and the Metropolitan Sub-System (the “Metropolitan Sub-System”). The Municipal Sub-System is a municipal sewage collection system for the City’s residents and consists of all elements required for the collection and conveyance of wastewater generated by the service area. The Municipal Sub-System consists of the piping and pumping facilities that service the City and ultimately discharge into the Metropolitan Sub-System. The Metropolitan Sub-System is a regional sewage treatment and disposal system that serves the City and various other public agencies, including cities situated within common drainage areas. The Metropolitan Sub-System includes all the facilities associated with treatment and disposal within the San Diego metropolitan area. The Metropolitan Sub-System treats and disposes of the wastewater generated by the City and certain amounts from 15 other cities and districts near the City. The Metropolitan Sub-System was designed to provide sufficient capacity to accommodate a regional population in excess of 2.5 million. As of June 30, 2009, the Wastewater System had approximately 275,000 customers, 15 Participating Agencies and approximately \$318.5 million in sewer service charge revenues. The Wastewater System is managed by the Department and covers approximately 450 square miles, including most of the City, and stretches from Del Mar and Poway to the north, Alpine and Lakeside to the east, and south to San Ysidro, California. The service area within the City is serviced by the Municipal Sub-System and the service area for the Participating Agencies is serviced by the Metropolitan Sub-System. The communities and agencies served by the Wastewater System form the third largest integrated metropolitan area in the State, surpassed only by the Los Angeles and San Francisco metropolitan areas. The map that follows the Table of Contents of this Official Statement sets forth the sewer service area boundaries of the Wastewater System.

The City, as operator of the Wastewater System, is the holder of two National Pollutant Discharge Elimination System (“NPDES”) permits, one for the discharge of sewage at the Point Loma Wastewater Treatment Plant (the “Point Loma Plant”) (the NPDES permit relating to the Point Loma Plant is referred to herein as the “Point Loma Discharge Permit”) and the other for the discharge of sewage at the South Bay Water Reclamation Plant (the “South Bay Plant”) (the NPDES permit relating to the South Bay Plant is referred to herein as the “South Bay Discharge Permit”). As the holder of such permits, the City is responsible for complying with the discharge requirements under Federal law, including the Clean Water Act (the “Clean Water Act”). The Metropolitan Sub-System provides advanced primary treatment of sewage at the Point Loma Plant. See “WASTEWATER SYSTEM REGULATORY REQUIREMENTS—Treatment of Sewage” for information regarding the waiver from secondary treatment standards of the Clean Water Act and the City’s current application to renew such waiver. The South Bay Plant and the North City Plant are designed to treat sewage to the secondary level and filter effluent to the tertiary level. The North City Plant is also capable of providing treatment beyond the tertiary level through the demineralization of a portion of the effluent, which is reclaimed water, to reduce total dissolved solids. Reclaimed water from the South Bay Plant is currently not required to undergo a demineralization process because the concentration of total dissolved solids from the plant is below the City’s established limit of 1,000 milligrams per liter.

Governance and Management of Wastewater System

General. The Wastewater System is owned by the City and operated by the City through the Department. The Department is comprised of four branches that are funded by both the Water Utility Fund and the Sewer Utility Fund. Though the different branches cover all the

tasks required by the Department, separate accounting is kept for each fund, The Department ultimately reports to the Mayor, who has operational authority over the Department and appoints managers and directors who are charged with the operations of the Department. The Director of Public Utilities, who reports to the Chief Operating Officer, oversees the Department. The day-to-day operational responsibility for the Department rests with the Business Support Branch Assistant Director, the Water Branch Assistant Director and the Wastewater Branch Assistant Director, each of whom reports to the Director of Public Utilities. The Assistant Director for Strategic Programs completes the Utilities Senior Executive Team and leads organizational efficiency and strategic planning efforts, as well as asset management functions. The Public Utilities management team is further comprised of Deputy Directors who head each of the ten major divisions, plus two Program Managers who report to the Water and Wastewater Branch Assistant Directors.

Prior to the completion of the reorganization of the Water and Wastewater Utilities into the joint Department on July 1, 2009, the Metropolitan Wastewater Department and the Water Department had separately managed the Wastewater Department and the Water Department since July 1, 1996. Prior to 1996, both enterprise funds were managed as a joint operation as the City's Water Utilities Department. The City Council retains the authority to approve the Department's budget, to set rates and charges of the Wastewater System, and to approve execution of certain contracts. For information on how the City sets the rates and charges of the Wastewater System see "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Establishment, Calculation and Collection of Sewer Service Charge Revenue and Treatment Plant Services Revenue—Sewer Service Charge Revenue." In accordance with the provisions of the City Municipal Code, the Wastewater System funds are administered in an enterprise account separate from the City's General Fund.

The Department's consolidation of certain administrative and financial functions common to the two enterprise funds created opportunities for greater efficiency, reduced personnel costs, and enhanced services to both internal personnel and external customers. Based on consolidation efforts for administration divisions, a total of 31 positions from the Water Utility Fund and the Sewer Utility Fund were reduced during the initial consolidation. Efforts are continuing to identify additional efficiencies and savings throughout the organization as a result of the consolidation.

Officers. The current Senior Executive officers of the Department managing the Water Utility Fund and Sewer Utility Fund and their respective biographies are as follows:

Alex Ruiz. Mr. Alex Ruiz currently serves as the City's Interim Director of Public Utilities. He was previously the City's Utilities Business Support Branch Assistant Director. Mr. Ruiz has been with the City for 21 years. In his capacity as Assistant Director, Mr. Ruiz oversees the day-to-day operations of all Business Support activities. Over the past 12 years, he has served in various management capacities within the Department, including Deputy Director of both the Customer Support Division and the Water Operations Division. Previous responsibilities have included assignments to the office of the City Manager for special project activities, including assignment as the City's Labor Relations Manager. Mr. Ruiz received his Bachelor's Degree from the University of California at San Diego.

Jim Fisher. Mr. Jim Fisher currently serves as the City's Utilities Water Branch Assistant Director and oversees the day-to-day operation and maintenance of the water system. Mr. Fisher holds a Bachelor of Science degree in Civil Engineering from San Diego State University and is a licensed Professional Civil Engineer in the State of California. Mr. Fisher has been with the City of San Diego for 19 years and has experience in the design, construction, operation, and maintenance of water systems. Mr. Fisher holds a Grade 5 Water Treatment Plant Operator and Grade 4 Distribution Operator certification with the State of California.

Ann Sasaki. Ms. Ann Sasaki is the Assistant Director for the Wastewater Branch. In this capacity, Ms. Sasaki is responsible for all operational divisions in the Sewer Utility Fund. This includes the Environmental Monitoring and Technical Services Division which provides Lab support to the Sewer Utility Fund and the Water Utility Fund, and the Engineering and Program Management Division which provides Capital Project Development and Management to the Sewer Utility Fund and the Water Utility Fund. Ms. Sasaki was appointed to the position of Assistant Director in July 2009. Ms. Sasaki began her career with the City of San Diego in 1986, as a Junior Engineer in the Water Utilities Department and later served as a Senior Civil Engineer. Ms. Sasaki earned a Bachelor of Science degree in Civil Engineering from California State University, Long Beach and a Masters in Business Administration from the University of San Diego. She is a licensed Professional Civil Engineer in the State of California.

Thomas Crane. Mr. Thomas Crane serves as the Assistant Director, Strategic Programs for the Department. Mr. Crane holds a Bachelor of Science degree in Civil Engineering from the University of Maryland and a Master of Engineering in Nuclear Engineering from Pennsylvania State University. Mr. Crane has been in this position for one year. He operated his own consulting business for 15 years after retiring from the United States Navy after more than thirty one years of service. He has extensive experience in infrastructure, contract and utilities management. He is a licensed Professional Engineer in the Commonwealth of Pennsylvania.

Branches.

The Business Support Branch is comprised of the following Divisions:

Long-Range Planning and Water Resources. This division provides long-range facilities planning, water and wastewater legislation and policy analysis, water resources development, watershed and resources protection and management of the City's recycled water and water conservation programs.

Financial and Information Technology. This division provides administrative support for the Water Utility Fund and the Sewer Utility Fund including: information systems, budget development and monitoring, rate setting and finance, contract and grant administration.

Customer Support. This division provides high quality customer focused care and service to Department patrons. The division handles and responds to more than 529,000 customer phone calls and emails annually including account/billing inquiries, water conservation information, water waste complaints and general water/sewer utility information. In addition, the division is responsible for customer billing and payment processing, meter reading and code enforcement, ensuring customer compliance with state backflow device requirements and public information.

Employee Services and Internal Controls. This division provides employee, management and strategic support services as well as safety, security, training and internal controls. The Employee Services and Internal Controls Division is also involved in a number of internal business support services, including services relating to contract formulation and administration, human resources, organizational development, and audit support.

The Water Branch is comprised of the following Divisions:

Water Construction and Maintenance Division. This division provides construction, maintenance and emergency response for the water system. The division maintains approximately 274,000 metered service connections, approximately 24,000 fire hydrants and

more than 46,000 isolation valves. In addition, the division provides 24-hour emergency response, new service installation, water main repair, Capital Improvement Program Support, and maintenance, installation and replacement of meters throughout the City.

System Operations Division. This division provides operations and maintenance of the City's potable and recycled water systems. The division operates and maintains 3 water treatment plants, 49 water pump stations, 31 treated water reservoirs and more than 950 water regulators. In addition, the division provides operational engineering support for the Water Branch and water supply management for the Department.

The Wastewater Branch is comprised of the following Divisions:

Engineering and Program Management. This division provides engineering services for the Water, Wastewater and Reclaimed Water Systems to ensure new facilities, repairs and upgrades are planned and implemented in a fiscally-sound manner to meet regulatory and environmental standards. This division also provides long-range master planning, development review, condition assessment, water and sewer modeling, planning and pre-design for infrastructure, energy management, environmental support, facility information management, and oversight of the implementation of the Water, Wastewater, and Reclaimed Water Systems' capital improvement programs.

Environmental Monitoring and Technical Services Division. This division provides laboratory services for the Water and Wastewater Systems to ensure water quality standards are maintained to meet regulatory and environmental standards.

Wastewater Collection Division. This division provides efficient operations and maintenance of the wastewater collection system.

Wastewater Treatment and Disposal Division. This division operates and maintains a wastewater treatment plant, two water reclamation plants, a bio-solids processing facility, and eight large wastewater pump stations. With these facilities, the division provides regional wastewater treatment and disposal services to the City and 15 surrounding cities and special districts.

Oversight.

The Independent Rates Oversight Committee ("IROC") was established by City ordinance in 2007 to assume and expand upon the oversight previously undertaken by the Public Utilities Advisory Commission, which no longer exists. There are 11 members on the IROC, all of whom are appointed by the Mayor and confirmed by the City Council. The membership of IROC consists of representatives of each rate class and professional experts in such fields as finance, engineering, construction and the environment. IROC serves as an official advisory body to the Mayor and the City Council on policy issues relating to the oversight of Department operations including, but not limited to, resource management, planned expenditures, service delivery methods, public awareness and outreach efforts, and efforts to achieve high quality and affordable utility services provided by the Department. IROC's duties and functions include reviewing reports from staff and an independent audit organization on rate and bond proceed expenditures, advising on the efficiency and performance of the Water System and the Wastewater System, advising on future cost allocation models, and the preparation of an annual public report on such issues to the Mayor and City Council. IROC meets at least every other month to review activities and issues for the Department.

On February 10, 2009, IROC issued its “Annual Report on the San Diego Water Department and Metropolitan Wastewater Department for the Fiscal Year 2008” (the “2008 IROC Report”). The 2008 IROC Report included a series of recommendations related to water conservation and wastewater reuse, including recommendations that the Department begin planning the upgrade of certain water treatment processes to fully implement indirect potable reuse strategies, develop additional capacity for such reuse and facilitate the transportation of the resulting purified water. The 2008 IROC Report also recommended adopting rate structures that encourage reuse of wastewater and reduced water consumption, and disclosing to ratepayers the potential financial impact of a failure to reduce water usage. With respect to capital improvements, the 2008 IROC Report recommended that the Department develop capital improvement programs that account for the risks associated with deferred maintenance and suboptimal rates of capital investment and exclude revenue constraint considerations to the extent possible, with a view towards reviewing and modifying their respective approaches to capital projects as risks and revenue constraints are realized. The 2008 IROC Report also recommended that the Department begin to fully fund a set of reserves created as internal reserves to track, protect and preserve savings from increasing efficiencies, changing priorities or other actions, thereby partially offsetting the amount of future rate increases. The Fiscal Year 2009 IROC Report was completed and released on March 22, 2010, and is expected to be presented to the City’s Natural Resources and Culture Committee in June 2010. See “WASTEWATER SYSTEM FINANCIAL OPERATIONS—Rate Stabilization Fund and Other Reserves” for a description of the recommendations relating to the Dedicated Reserve for Efficiency and Savings (as described herein).

Participating Agencies

Regional Wastewater Disposal Agreement. The Metropolitan Sub-System provides “wholesale” treatment services, including some sewage transportation, treatment and disposal operations, to the cities of Chula Vista, Coronado, Del Mar, El Cajon, Imperial Beach, La Mesa, National City and Poway, and the East Otay Sewer Maintenance District, the Lakeside/Alpine Sanitation District, Lemon Grove Sanitation District, the Otay Water District, the Padre Dam Municipal Water District, the Spring Valley Sanitation District and the Winter Gardens Sewer Maintenance District (such cities and districts are collectively referred to as the “Participating Agencies”) pursuant to the Regional Wastewater Disposal Agreement, effective June 24, 1998 (the “Regional Wastewater Disposal Agreement”). The Regional Wastewater Disposal Agreement replaced separate sewage disposal agreements between the City and the Participating Agencies that were entered into as early as 1960 and applies to all facilities of the Metropolitan Sub-System required to comply with the Clean Water Act and the Ocean Pollution Reduction Act of 1994 (“OPRA”). See “WASTEWATER SYSTEM REGULATORY REQUIREMENTS—Treatment of Sewage.” The Regional Wastewater Disposal Agreement expires on December 31, 2050. On or before December 31, 2040, the parties will begin discussions on an agreement to provide wastewater treatment services beyond the year 2050. See “WASTEWATER SYSTEM FINANCIAL OPERATIONS—Management’s Discussion and Analysis.” The City has full ownership of the Metropolitan Sub-System, including all additions to the Metropolitan Sub-System and facilities constructed pursuant to the Regional Wastewater Disposal Agreement. In addition, the City has the authority to sell the Metropolitan Sub-System to a governmental entity or divest a portion of the Metropolitan Sub-System, subject to the Participating Agencies’ right of first refusal and the provisions of the Installment Purchase Agreement. See APPENDIX B—“SUMMARY OF PRINCIPAL LEGAL DOCUMENTS—Master Installment Purchase Agreement.”

Pursuant to the Regional Wastewater Disposal Agreement, the Participating Agencies are required to pay their respective share of planning, design and construction of Metropolitan Sub-System facilities and costs relating to the operation and maintenance of the Metropolitan Sub-System by the City. The amount to be paid by the Participating Agencies is calculated

based on a Sewer System Charge and a New Contract Capacity Charge (each as herein defined). The "Sewer System Charge" is a charge that is calculated annually, billed quarterly and based on flow and strength coming into the Metropolitan Sub-System. The "New Contract Capacity Charge" is an amount to be paid by any Participating Agency for the right to discharge any new or additional capacity into the Metropolitan Sub-System beyond its existing allotted capacity. The New Contract Capacity Charge is not expected to generate revenues in the near future because the Participating Agencies have not expressed any recent interest in new or additional capacity. Pursuant to the Regional Wastewater Disposal Agreement, the Participating Agencies pay their proportionate costs of the Metropolitan Sub-System, including operation and maintenance costs of all Metropolitan Sub-System facilities, based on flow and strength for all facilities, including water reclamation facilities (but excluding any water reclamation distribution pipelines) necessary to expand the Wastewater System as specified in the Regional Wastewater Disposal Agreement, and Wastewater System CIP costs, the aggregate costs of which constituted approximately 33% of the total Metropolitan Sub-System's operation and maintenance costs and Wastewater System CIP costs for the Fiscal Year 2009. Annual costs attributable to the Participating Agencies include those associated with administration, operation, maintenance, replacement, annual debt service costs and other periodic financing costs and charges, capital improvement, insurance premiums, claims payments and claims administration costs of the Metropolitan Sub-System.

The Department and the Participating Agencies are currently reviewing the Participating Agencies' obligation to pay their proportionate share of the cost of the Metropolitan Sub-System's share of debt coverage pursuant to the City's current rate case projections. The Department is working with the Participating Agencies through the Metropolitan Commission (the "Metropolitan Commission"), a coalition comprised of the Participating Agencies that was formed in 1998, to clarify that the Metropolitan Sub-System's share of debt coverage pursuant to the City's current rate case projections is included in the operation and maintenance costs payable under the Regional Wastewater Disposal Agreement and to determine the process for paying this cost. The Department billed approximately \$8 million in additional operation and maintenance charges to the Participating Agencies to cover projected debt coverage needs for Fiscal Year 2010 while discussions continue to develop a long term solution. The Participating Agencies have contributed to a portion of the operating reserve that is estimated to be their fair share. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS—Rate Covenant," "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Rate Stabilization Fund and Other Reserves" and "THE WASTEWATER SYSTEM—Metropolitan Sub-System Facilities."

The Participating Agencies have historically paid charges due and payable under the Regional Wastewater Disposal Agreement in a timely manner. Further, the Participating Agencies may only dispute amounts owed after payment of the amounts set forth in their respective invoices from the City.

Transportation Agreements. The Participating Agencies and the City are responsible for the retail collection operations within their respective jurisdictions. The Participating Agencies also transport collected sewage through large municipal trunk lines to the Metropolitan Sub-System. The collection systems and many of the transport trunk lines outside City limits are owned by the individual Participating Agencies. Transportation of wastewater through the Municipal Sub-System to the Metropolitan Sub-System is facilitated by 13 separate transportation agreements (each, a "Transportation Agreement" and, collectively, the "Transportation Agreements") each between the City and a Participating Agency. The City is in the process of negotiating nine of the Transportation Agreements, which have expired. Two others have been successfully executed in the past six months. The City and the Participating Agencies with expired Transportation Agreements have agreed to continue their operations pursuant to mutually acceptable terms until new agreements are executed. All

parties have, however, agreed upon an updated rate for the transportation of sewage. Such rate is calculated at the unit transportation rate per million gallons of flow for each mile the flow is transported in the Municipal Sub-System and by calculating the Participating Agency's respective share of any Wastewater System CIP costs incurred for municipal infrastructure utilized by its flow. The Department expects revenues from transportation charges to range from \$293,000 to \$305,000 for Fiscal Years 2010 to 2014. The City and the Participating Agencies have adjusted this rate annually for inflation in accordance with the California Consumer Price Index as determined by the State of California's Economic Forecast Index. The City expects to finalize all Transportation Agreements during calendar year 2010. The Transportation Agreement by and between the City and the City of Del Mar is scheduled to expire in 2013. The Transportation Agreement by and between the City and the East Otay Sewer Maintenance District is scheduled to expire in 2011. The City does not and will not have Transportation Agreements with the Spring Valley Sanitation District or the Otay Water District because such entities do not transport collected sewage through the Municipal Sub-System.

The City is also in ongoing negotiations with many of the Participating Agencies for payment of past capital improvement projects on portions of the Municipal Sub-System through which wastewater from such Participating Agencies flows. The Participating Agencies contribute to capital improvements for the Metropolitan Sub-System on a pay-as-you-go basis and by making annual debt service payments on Outstanding Obligations payable from the Sewer Revenue Fund based upon their respective allocable share of benefits derived from such improvements. Participating Agencies are only obligated to contribute to capital projects on portions of the Municipal Sub-System's infrastructure they use. While no past-due CIP payments from Participating Agencies were received in Fiscal Year 2009, the City expects to receive approximately \$9.6 million from the Participating Agencies in Fiscal Year 2011 for their respective shares of the past municipal infrastructure costs pursuant to the Transportation Agreements.

For the Fiscal Year 2009, of a total average daily sewage flow of approximately 167 million gallons per day ("mgd"), the total City flow through the Metropolitan Sub-System was approximately 109 mgd, which is 65% of the total average flow. None of the Participating Agencies are currently utilizing all of their capacity rights for sewage treatment and disposal. The City of Chula Vista expects that it will exceed its capacity rights in 2013. The Department expects the proportion of sewage flow from the City and the Participating Agencies to continue at their current levels.

The Participating Agencies in the Metropolitan Sub-System, their respective estimated population, current capacity rights and the percentage of total capacity represented by the capacity rights are set forth in the Table 3 below.

TABLE 3
METROPOLITAN SUB-SYSTEM
CITY AND PARTICIPATING AGENCIES FLOW AND CAPACITY RIGHTS
Fiscal Year 2009
(Unaudited)

Participating Agencies	Estimated Population ⁽¹⁾	Capacity Rights (in mgd)	% of Total Capacity	Average Flow (mgd)	% of Total Average Flow
City of Chula Vista	234,327	19,843	8.268%	16,543	9.893%
City of Coronado	16,734	3,078	1.283	1,863	1.114
City of Del Mar	4,575	0,821	0.342	0,566	0.338
City of El Cajon	98,500	10,260	4.275	7,653	4.577
City of Imperial Beach	28,600	3,591	1.496	2,246	1.343
City of La Mesa	57,085	6,634	2.764	5,035	3.011
City of National City	58,200	7,141	2.975	4,096	2.450
City of Poway	46,257	5,630	2.346	3,435	2.054
East Otay Mesa Sewer Maintenance District ⁽²⁾	195	1,000	0.417	0,008	0.005
Lakeside/Alpine Sanitation District ⁽²⁾	41,875	4,586	1.911	3,067	1.834
Lemon Grove Sanitation District	26,000	2,873	1.197	2,137	1.278
Otay Water District	5,100	1,231	0.513	0,571	0.341
Padre Dam Municipal Water District	72,700	5,882	2.451	2,499	1.494
Spring Valley Sanitation District ⁽²⁾	83,750	9,808	4.087	7,370	4.408
Winter Gardens Sewer Maintenance District ⁽²⁾	11,750	1,241	0.517	0,924	0.553
SUBTOTAL	785,648	83,619	34.841%	58,013	34.694%
City of San Diego	1,306,000	156,381	65.159	109,201	65.306
TOTAL	<u>2,091,648</u>	<u>240,000</u>	<u>100.000%</u>	<u>167,214⁽³⁾</u>	<u>100.000%</u>

Sources: Participating Agencies and Public Utilities Department, City of San Diego.

- (1) Participating Agencies provided population figures for their respective agencies and the population served by the Metropolitan System is from the latest SANDAG information.
- (2) These facilities use the County facility Plan for their population figures.
- (3) Excludes flow through plants that are not part of the Metropolitan Sub-System—Escondido Plant and Solana Beach (which is serviced by the San Elijo Plant), and flow of reclaimed water through the North City Plant.

The Participating Agencies have asserted that under the terms of the Regional Wastewater Disposal Agreement they should be apportioned a percentage of the capacity fees and revenues from the sale of reclaimed water from the South Bay Plant. The current amount in dispute is approximately \$2 million. The capacity fees and revenues from the sale of the reclaimed water are being held by the City pending resolution of this matter. See “— Participating Agencies; Regional Wastewater Disposal Agreement; Transportation Agreements.”

The City has the right to make all decisions with respect to the planning, design, construction, operation and maintenance of the Metropolitan Sub-System. Decisions on issues that impact the Participating Agencies are made with the advice of the Metropolitan Commission. The Metropolitan Commission consists of one representative from each Participating Agency and advocates for fair rates and other issues of importance to the Participating Agencies. Although the Metropolitan Commission may make recommendations to the City, the City retains ownership and decision-making authority over all elements of the Metropolitan Sub-System, including the capital improvements for the Metropolitan Sub-System.

Metropolitan Sub-System Facilities

General. The current Metropolitan Sub-System infrastructure, with the exception of the South Metropolitan Interceptor Pipeline, is located within the jurisdictional boundaries of the City and is concentrated along a kidney-shaped corridor running from Mission Bay to the north, and along the perimeter of the San Diego Bay to the south. The map that follows the Table of Contents of this Official Statement shows the geographic concentration of the Metropolitan Sub-System's infrastructure and identifies the major trunk lines that service the Participating Agencies. The Metropolitan Sub-System's infrastructure currently consists of three wastewater treatment plants, two ocean outfalls, a biosolids center, four pump stations and force mains and gravity flow interceptors. The Metropolitan Sub-System infrastructure also includes two interceptors, which collect and route wastewater to the Point Loma Plant from the Municipal Sub-System and the Participating Agencies. The Wastewater System CIP is dependent upon maintaining certain permits and waivers with respect to the Wastewater System under Federal and State law. If existing permits and waivers are not maintained, the City could incur costs in addition to those currently included in the City's budgets and projections. See "WASTEWATER SYSTEM REGULATORY REQUIREMENTS—Treatment of Sewage." The following is a summary description of the Metropolitan Sub-System's current facilities and their respective primary functions.

Point Loma Plant. The Point Loma Plant began operation in 1963. The site is part of the Fort Rosecrans military reservation and was acquired by the City from the U.S. Department of the Interior, Bureau of Land Management. The Point Loma Plant is the principal treatment facility in the Metropolitan Sub-System, with a permitted treatment capacity of 240 mgd flow with 432 mgd peak wet weather flow. During Fiscal Year 2009, the Point Loma Plant had an average daily flow rate of 157.5 mgd, including return flows from the Metropolitan Biosolids Center, North City Plant and South Bay Plant. The average daily flow rate at the Point Loma Plant accounted for approximately 91.8% of the wastewater flow generated within the Metropolitan Sub-System. Almost all the inflow to the Point Loma Plant is conveyed through the Metropolitan Sub-System's Pump Station No. 2, which is the terminus for the North Metropolitan Interceptor Pipeline and South Metropolitan Interceptor Pipeline. Flow from the North City Plant which is not distributed to reclaimed water users is returned to the sewage conveyance system and is treated at the Point Loma Plant. In addition, the Point Loma Plant serves as a standby facility for the North City Plant and the South Bay Plant in the event one or both of these facilities is taken off-line for maintenance purposes.

The Point Loma Plant currently provides advanced primary treatment of sewage in accordance with a waiver from the secondary treatment standards of the Clean Water Act, which was originally received by the City in 1995, and renewed on September 13, 2002 for the period through June 2008. The City applied for an extension of the waiver and, in December 2008, the City received a tentative decision from the United States Environmental Protection Agency (the "U.S. EPA") that the Point Loma Plant and Point Loma Ocean Outfall (defined herein) be granted a renewed waiver. This request is the City's second renewal. During this time, the present modified permit will be administratively continued. Pt Loma will continue to operate under the provisions of the modified permit that was adopted in 2002, in full compliance with the Clean Water Act section 301(h), as modified by the Ocean Pollution Reduction Act.

The Point Loma Plant continues to operate under the current waiver through the consideration and public comment process. See "WASTEWATER SYSTEM REGULATORY REQUIREMENTS—Treatment of Sewage." Treated wastewater from the Point Loma Plant is discharged through the Point Loma Ocean Outfall ("Point Loma Outfall"), which was built in 1963. In 1993, the Point Loma Outfall was extended 2.0 miles from its original length, which resulted in the present length of 4.5 miles. See "—Point Loma Ocean Outfall." Ongoing capital

improvements to the Point Loma Plant are included in the Wastewater System CIP. See “WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM.”

Operations at the Point Loma Plant are monitored and controlled from a distributed, computer-based control system located in the Point Loma Plant’s control center. Local control stations are also strategically located around the Point Loma Plant and can be used to access the entire plant control system.

Presently, the Point Loma Plant is capable of removing 85% to 90% of total suspended solids (“TSS”). The Point Loma Plant has increased its TSS removal rates through operational improvements of its chemical treatment processes. The wastewater treatment process currently employed at the Point Loma Plant consists of advanced primary treatment and a digester gas utilization facility. Dewatering of sludge is provided at the Metropolitan Biosolids Center (described below). Methane gas produced during the digestion is fed to a City-owned cogeneration plant where it is converted to electricity and used to provide power to operate the plant. Excess energy is sold back to the local electrical power grid. See “—Metropolitan Biosolids Center.”

North City Water Reclamation Plant. The North City Water Reclamation Plant (the “North City Plant”) is a sewage treatment facility that is capable of processing sewage to both secondary and tertiary treatment levels. The North City Plant commenced operations in 1997 and is located adjacent to Interstate 805 and Miramar Road in the northwestern quadrant of the City. The North City Plant operates pursuant to a “Waste Discharge and Water Recycling Requirements for the Production and Purveyance of Recycled Water,” Order No. 97-03, Addendum No. 1, which was adopted by the California Regional Water Quality Board (the “Regional Water Board”) on June 11, 2003 (the “North City Plant Permit”). The North City Plant Permit, as amended, is effective until it is revoked or further modified.

The North City Plant receives influent through the North City Tunnel Connector and from the Penasquitos Pump Station. The North City Plant process includes screening, grit removal, settling, flow equalization, activated sludge processing, tertiary filtration and effluent disinfection. The Metropolitan Biosolids Center (described below) digests and dewateres the sludge that is produced at the North City Plant. Support facilities of the North City Plant include an administration building, operation and maintenance building and chemical building. The North City Plant has a permitted capacity of 30 mgd average daily flow. Per the requirements of a grant the City received from the EPA for construction of the North City Plant, the City must treat flows equal to a minimum of 75% of the plant’s design capacity (i.e., at least 22.5 mgd). For Fiscal Year 2009, the plant operated at an average flowrate of approximately 22.7 mgd. The North City Plant is producing an average of 6.6 mgd of reclaimed water that is distributed to users through the Northern Water Distribution System. The North City Plant limits its production of reclaimed water to meet demand. Excess treated effluent is returned to the sewer system for conveyance to the Point Loma Treatment Plant and ocean outfall. Approximately 16.4 mgd is returned to the sewer system. See “—Point Loma Plant.” The solids that are removed during the sewage treatment process, either by sedimentation or biological oxidization, are pumped to the Metropolitan Biosolids Center for further treatment. See “—Metropolitan Biosolids Center.”

The North City Plant currently produces reclaimed water that serves approximately 465 meters and two wholesale users that resell the reclaimed water for landscape irrigation. Reclaimed water is also used for industrial processing, cooling towers, construction site dust suppression and soil compaction, decorative fountains and toilet and urinal flushing. Revenues from the sale of reclaimed water are collected by the Department for deposit in the Water Utility Fund and used to pay for the cost of the reclaimed water distribution system and then operations and maintenance costs for the distribution system.

In January 2004, the San Diego City Council authorized a comprehensive evaluation of all viable options to maximize the usage of recycled water. In March 2006, the City of San Diego, working in partnership with an Independent Advisory Panel and a City Assembly on Water Reuse, published the “City of San Diego Water Reuse Study” (the “Water Reuse Study”). The City’s Water Reuse Study included analysis and research on the health effects of reuse options and a public participation process. The Reuse Study’s stakeholders identified Reservoir Augmentation at the City’s San Vicente Reservoir as their preferred strategy. In October 2007, the San Diego City Council also recognized the strategy as their preferred alternative.

Conducting a Water Reuse Study was the first phase of a three-phased water reuse program that includes the development of a Demonstration Project (phase two) that could lead to implementation of a full-scale Indirect Potable Reuse Reservoir Augmentation project (phase three).

The City has initiated an Indirect Potable Reuse/Reservoir Augmentation Demonstration Project at North City to determine the feasibility of using advanced water treatment on recycled wastewater for augmentation of supplies in a local reservoir. Reservoir water would undergo further treatment before being distributed as drinking water; such project is not expected to materially affect the Wastewater System in the near future.

South Bay Water Reclamation Plant. The South Bay Plant commenced operations in 2002. This plant, located on Dairy Mart Road north of the International Border with Tijuana, Mexico, is a sewage treatment facility that is capable of processing sewage to both secondary and tertiary treatment levels. The South Bay Plant operates under an NPDES permit for the treatment and disposal of wastewater through the shared South Bay Ocean Outfall and Reclaimed Water Permit No. 2000-203 (the “Reclaimed Water Permit”), which authorizes water reclamation from the South Bay Plant. The Reclaimed Water Permit, as previously amended, is effective until it is revoked. See “WASTEWATER SYSTEM REGULATORY REQUIREMENTS—General.”

Untreated wastewater is pumped to the South Bay Plant’s headworks from the Otay River Pump Station and the Grove Avenue Pump Station, which divert flow from the South Metro Interceptor. The South Bay Plant has a permitted capacity of 15 mgd average daily flow. For Fiscal Year 2009 the plant operated at an average flowrate of approximately 8.5 mgd. The South Bay Plant produced an average of 4.7 mgd of reclaimed water that was distributed to users. The South Bay Plant limits its production of reclaimed water to meet demand. The South Bay Plant uses a phased tertiary process that allows the tertiary process to be bypassed when reclaimed water is not being produced, which increases efficiency and reduces plant operations and maintenance cost. Excess treated effluent is discharged to the South Bay Ocean Outfall for disposal. See “South Bay Ocean Outfall.” The South Bay Plant does not treat its own solids and cannot discharge its solids to the Metropolitan Biosolids Center directly. Primary sludge is pumped to the South Metropolitan Interceptor Pipeline and conveyed to the Point Loma Plant for further treatment and from there to the Metropolitan Biosolids Center for processing. See “—Point Loma Plant” and “—Metropolitan Biosolids Center.”

The City is seeking to increase use of reclaimed water generated by the South Bay Plant and has entered into an agreement with the Otay Water District pursuant to which the Otay Water District may purchase up to 6 mgd of reclaimed water for resale by the Otay Water District for landscape irrigation. During Fiscal Year 2009, 54% of the treated sewage was beneficially reused by the Otay Water District, the International Wastewater Treatment Plant, a federally owned and operated treatment facility in the Tijuana River Valley, or used for in-

plant purposes. During warmer periods of the year, almost the entire amount of wastewater treated at the South Bay Plant is reused.

Operations at the South Bay Plant are monitored and controlled from a distributed, computer-based control system located in the South Bay Plant's control center. Local control stations are also strategically located around the South Bay Plant and can be used to access the entire plant control system.

Point Loma Ocean Outfall. The Point Loma Ocean Outfall was constructed in 1963 to provide a method for disposal of all Point Loma Plant effluent. The original capacity of the 2.5 mile long, 108-inch diameter outfall has been estimated at 390 mgd under the original design configuration. The Point Loma Ocean Outfall Extension, a 2.0 mile extension of the original outfall, was completed in 1993, resulting in a 4.5-mile long outfall discharging treated sewage effluent at an approximate depth of 320 feet of water at the discharge point and a capacity of 432 mgd. The Point Loma Ocean Outfall uses a Y-shaped diffuser to provide for a wide dispersal of effluent into the ocean. It is one of the longest, deepest ocean outfalls in the United States. The Department believes that the length, depth, design and location of the Point Loma Ocean Outfall facilitates protection of ocean water beneficial uses.

South Bay Ocean Outfall. The South Bay Ocean Outfall discharges flows from the City's South Bay Plant and the International Boundary and Water Commission's International Treatment Plant. The South Bay Ocean Outfall consists of a land portion running 3.3 miles and an ocean portion discharging 3.5 miles off the coast at a depth of 95 feet. The outfall is jointly owned by the City and the International Boundary and Water Commission. The City has a 40% ownership interest in the South Bay Ocean Outfall, or approximately 133 mgd of the peak flow capacity of 333 mgd.

Metropolitan Biosolids Center. The Metropolitan Biosolids Center commenced operations in 1998 on a 39-acre site leased from the United States Navy within the Miramar Marine Corps Air Station located off Highway 52 in the north central portion of the City. The Metropolitan Biosolids Center is regulated under the Point Loma Plant's Modified Permit (hereinafter defined) because all waste streams from the Metropolitan Biosolids Center are sent to the Point Loma Plant for treatment. See "WASTEWATER SYSTEM REGULATORY REQUIREMENTS—Treatment of Sewage." The lease with the United States Navy (the "Prime Lease") expires in 2045. The United States Navy may terminate the Prime Lease during its term without the payment of any compensation to the City without cause only in the event of a national or military emergency or with cause if the City fails to cure any breach of the lease within 30 days notice from the United States Navy. In the event the Prime Lease is terminated during its term by the United States Navy, the City would be obliged to vacate the site and relocate this facility elsewhere.

The Metropolitan Biosolids Center discharges side streams (centrate) from the raw sludge thickening and biosolids (digested sludge) dewatering centrifuges as well as effluent from other internal processes to the Point Loma Plant. The Metropolitan Biosolids Center is an essential part of the Modified Permit described under the caption "WASTEWATER SYSTEM REGULATORY REQUIREMENTS—Treatment of Sewage—Relief From Secondary Treatment Requirements." The facility consists of anaerobic digestors, storage tanks, screening and dewatering systems, polymer injection systems, eight dewatering centrifuges, five thickening centrifuges, a state of the art odor control facility, chemical building, operations and maintenance building, and a privately operated cogeneration facility serving the energy needs of the Metropolitan Biosolids Center. The facility thickens and digests sludge from the North City Plant that is received through the 5-mile North City Raw Sludge Pipeline. In addition, the facility mechanically dewateres the North City Plant's digested sludge as well as the sludge

that is digested at the Point Loma Plant. The digested sludge from the Point Loma Plant is pumped to the Metropolitan Biosolids Center through the 17-mile Miramar Pipeline.

Once sludge is thickened, digested and dewatered at the Metropolitan Biosolids Center, the Department disposes of biosolids through landfill disposal, direct land application, or alternate daily cover. See “WASTEWATER SYSTEM REGULATORY REQUIREMENTS—Grant and Loan-Related Regulatory Requirements.” Due to the nature of operations at the Metropolitan Biosolids Center, the facility employs extensive odor control facilities to treat the foul air from the major treatment processes.

The Metropolitan Biosolids Center and North City Plant have privatized cogeneration plants which are owned and operated by Minnesota Methane San Diego, LLC (“MMSD”), a subsidiary of Fortistar Methane Group, LLC. The City has subleased methane gas rights from the adjacent landfill (the “Miramar Landfill”) and the Metropolitan Biosolids Center’s digester gas to MMSD (the “Landfill Gas Lease”), which burns the fuel in its cogeneration plants to produce electricity and heat. The City has purchase contracts (the “Cogeneration Facility Agreements”) with MMSD to buy electricity for operations at the Metropolitan Biosolids Center and the North City Plant. The Cogeneration Facility Agreements are scheduled to expire in June 2019. Any excess power that is generated is sold by MMSD to the power grid. This arrangement allows the Wastewater System, including portions used by the Participating Agencies, to decrease its dependence on external sources of power and reduces energy expenditures. The Participating Agencies do not receive revenues with respect to the Cogeneration Facility Agreements. Under the Landfill Gas Lease and the Cogeneration Facility Agreements, the City bears the risk of a possible termination of the Prime Leases. The Prime Leases allow the Federal government to terminate such lease in the event the City breaches the terms thereof or, in some instances, without breach by the City. If the United States Navy terminates the Prime Leases for its convenience, it will owe the City an equitable adjustment of the City’s rent on the parcels on which the Miramar landfill and the Metropolitan Biosolids Center stand. If the United States Navy terminates the Prime Leases for any reason, then the City must purchase MMSD’s facilities, including the landfill gas collection system installed by MMSD and the cogeneration plants at the Metropolitan Biosolids Center and the North City Plant at a purchase price equal to the greater of a “stipulated purchase price” (provided by formula in the contract, which takes into account such factors as initial and depreciated values) or the “fair market value” of the facilities, as each of these terms is defined in the agreements with MMSD. The maximum amount of exposure to the City for the loss of these facilities is estimated to be \$38 million. Such a loss would only arise upon the occurrence of a default by the City or termination by the United States Navy for its convenience. The City believes that it is unlikely that the United States Navy will terminate the Prime Leases for any reason other than an uncured breach by the City or in the event of a national or military emergency in part because of the United States Navy’s reliance on the landfill and the City’s substantial investments in placing regionally crucial wastewater infrastructure, such as the Metropolitan Biosolids Center at Miramar. See “RISK FACTORS—Utility Costs.”

Pump Stations. There are four pump stations that service the Metropolitan Sub-System. Two pump stations, Pump Station No. 1 and Pump Station No. 2, began operation in 1963. A third pump station, the Grove Avenue Pump Station, began operations in 2002 to pump wastewater to the South Bay Plant. The Otay River Pump Station was added to the Metropolitan Sub-System in 2003 to pump wastewater to the South Bay Plant. In addition, the Metropolitan Sub-System is serviced by the East Mission Gorge Pump Station, Sewage Pump Station No. 64, Sewage Pump Station No. 65 and Penasquitos Pump Station, which are part of the Municipal Sub-System.

Interceptors. The Metropolitan Sub-System interceptors consist of two major branches, the South Branch and the North Branch, which meet at Pump Station No. 2. Interceptor

capacities are adequate for current peak flows and the City models capacity consistent with all current regulations. Due to capacity limitations at Pump Station No. 2, the Department initiated the Wet Weather Storage Facility Project which is expected to be needed by 2011 in order to minimize the risk of sewage spills. The Wet Weather Storage Project will include the construction of an underground storage tank with a capacity of seven million gallons near Pump Station No. 2 to store excess wastewater flow during the peak wet weather flow period to relieve the capacity constraint at Pump Station No. 2. An alternative to the Wet Weather Storage Facility Project is the Wet Weather Intermittent Stream Discharge Project which the Department is currently studying. The Wet Weather Intermittent Stream Discharge Project will include a study of the feasibility of disposing the tertiary treated reclaimed water from the North City Plant to the streams or canyons during the peak wet weather flow period to relieve the capacity constraint at Pump Station No. 2. If Department deems that this project is feasible, the Wet Weather Intermittent Stream Discharge Project will require the acquisition of an NPDES permit from the Regional Water Board and the modification of existing reclaimed water and sewer facilities. The Wet Weather Storage Project can be deferred to 2015 if the Wet Weather Intermittent Stream Discharge Project is implemented.

Municipal Sub-System Facilities

The Municipal Sub-System consists of approximately 3,000 miles of trunk and collector mains, 79 sewer pump stations, including East Mission Gorge Pump Station, Sewage Pump Station No. 64, Sewage Pump Station No. 65, and Penasquitos Pump Station, serving approximately 275,000 accounts with connections to the sanitary sewer system. Approximately 83% of these connections are from accounts relating to single family dwellings, 11% are from accounts relating to multifamily dwellings and the remaining 6% are from accounts relating to commercial and industrial customers (these percentages include multiple accounts at some locations). On average, these accounts generate 109 mgd of wastewater which is conveyed by the Municipal Sub-System to the Metropolitan Sub-System for treatment and disposal. The Municipal Sub-System also includes 54 permanent flow monitoring stations which are utilized for multiple purposes, including strength-based billing, facility planning, sewer modeling, criticality evaluation, infiltration/inflow analysis and spill detection.

Additional Contractual Capacity to the Escondido Plant and the San Elijo Plant

The Department does not connect the Rancho Bernardo sewer service area to pipelines within the Municipal Sub-System. Pursuant to a sewage disposal agreement with the City of Escondido entered into in 1972, up to five mgd of sewage emanating from the Rancho Bernardo sewer service area of the City may be treated at Escondido's Hale Avenue Treatment Plant (the "Escondido Plant"). The Escondido Plant is not owned by the City and is not part of the Municipal Sub-System. This agreement is scheduled to terminate in 2022, fifty years from the date on which sewage flow commenced through the Escondido Plant, and may be extended at the City's option for an unlimited number of ten-year periods. The Escondido Plant, which can process up to 18 mgd of sewage, currently is treating approximately 3 mgd of flow from the City. The City of Escondido is considering options to increase its treatment capacity to accommodate expected population growth.

Pursuant to a sewage disposal agreement with the Solana Beach Sanitation District entered into in 1974, as amended and supplemented in 1975, the City has the right to connect to sewer lines within the Solana Beach Sanitation District. Pursuant to such agreement, the City may permit the connection to the Solana Beach Sanitation District of up to 300 EDUs, or 84,000 gallons per day, of sewage emanating from the portion of the City contiguous to Del Mar and Solana Beach may be treated at the San Elijo Water Reclamation Plant (the "San Elijo Plant"). Sewage treated at the San Elijo Plant is disposed through the San Elijo Ocean Outfall, which is owned by the City of Solana Beach and the Cardiff Sanitation District and operated

by the Solana Beach Sanitation District, the Cardiff Sanitation District and the City of Escondido. The San Elijo Plant and the San Elijo Ocean Outfall are not owned by the City and they are not part of the Municipal Sub-System. This sewage disposal agreement terminates in 2025 and contains no provisions for extension or renewal.

Historical Wastewater System Flow

Table 4 below sets forth total annual system flow through the Wastewater System (including the Point Loma Plant and the South Bay Plant) and through the City of Escondido to the Escondido Plant and the City of Solana Beach to the San Elijo Plant, and total annual reclaimed water flow through the North City Plant for Fiscal Years 2000 through 2009.

**TABLE 4
WASTEWATER SYSTEM
TOTAL ANNUAL FLOW
(In Million Gallons)⁽¹⁾
Fiscal Year 2000 through Fiscal Year 2009**

Fiscal Year Ended June 30	City Flow Through Point Loma Plant	Participating Agency Flow Through Point Loma Plant	City Flow Through Escondido Plant ⁽²⁾	City Flow Through San Elijo Plant ⁽²⁾	Reclaimed Water Through North City Plant	City Flow Through South Bay Plant	Total System Flow	Average MGD For The Year
2000	44,771	21,489	1,401	0	1,267	0	68,928	189
2001	44,735	21,437	1,412	0	879	0	68,463	188
2002	43,395	21,326	1,316	0	958	0	66,995	184
2003	42,567	22,188	1,353	0	1,201	1,637	68,946	189
2004	40,665	21,688	1,342	32	1,182	1,702	66,611	182
2005	43,817	23,124	1,439	32	522	1,726	70,660	194
2006	42,240	22,270	1,279	32	1,259	1,632	68,712	188
2007	38,295	21,886	1,106	32	1,544	2,949	65,812	180
2008	37,207	21,849	1,096	32	1,749	3,210	65,143	178
2009	36,752	21,174	1,065	32	2,402	3,106	64,531	177

Source: Public Utilities Department, City of San Diego.

(1) Wastewater System consists of the Metropolitan System (collects and treats the wastewater generated by the City and 15 other agencies) and the Municipal System (all elements required for the collection and conveyance of the wastewater generated by the City).

(2) The City does not treat flows through the Escondido Plant or the San Elijo Plant.

WASTEWATER SYSTEM REGULATORY REQUIREMENTS

General

Wastewater System operations are subject to Federal, State, and local environmental regulations that primarily address the quality of effluent that may be discharged from the Wastewater System, the disposal of sludge generated by the Wastewater System, and the nature of waste material (particularly industrial waste) discharged into the collection system. The Federal regulations that have the most significant effect on the Wastewater System are the Clean Water Act, which is administered by the U.S. EPA, the State Water Board and the Regional Water Board, the Federal Clean Air Act, and the Federal Resource Conservation and Recovery Act. The Wastewater System is in compliance with the major elements of each of the foregoing regulations and other programs managed by the Federal government and the State.

In addition to the general compliance mandates under the applicable Federal regulations, the City is subject to the specific requirements of the Final Consent Decree (herein defined) among the U.S. EPA and two environmental groups in connection with sewer spills from December 1996 to April 2001. See “—Collection of Sewage—The Municipal Sub-System Collection System.” To date, the City has met the targets established as part of the Final Consent Decree, except for one capital improvement project discussed below.

Collection of Sewage

General. The Clean Water Act and the NPDES permit system, including the Point Loma Discharge Permit and the South Bay Discharge Permit issued thereunder, set effluent limitations on the discharge of pollutants at treatment plants and generally prohibit the discharge of pollutants into navigable waterways. Such prohibited discharges from the collection system are also subject to injunctive or penalty proceedings by the Regional Water Board.

The Municipal Sub-System Collection System. The Clean Water Act prohibits the discharge of sewer to surface waters, including discharges as a result of sanitary sewer overflows (“SSOs”) into the collection system, except as authorized under an NPDES permit. The California Water Code has a broader interpretation of SSOs, to include waste discharges that could affect the quality of State waters, both surface and groundwater.

To provide a consistent, statewide regulatory approach to address SSOs, the State Water Board adopted the Statewide General Waste Discharge Requirements for Sanitary Sewer Systems, Water Quality Order No. 2006-0003 on May 2, 2006 (the “Sanitary Sewer Order”). The Sanitary Sewer Order requires public agencies that own or operate sanitary sewer systems to develop and implement a Sewer System Management Plan (“SSMP”) and report all SSOs to the State Water Board’s SSO database. The SSMP must include an operation and maintenance program, a current map of the sanitary sewer system, a rehabilitation and replacement plan, a training plan and an inventory of equipment and replacement parts.

In March 2001, two environmental groups filed suit against the City alleging that the Municipal Sub-System’s collection system was deficient as a result of sewer spills which had occurred since December 1996. The U.S. EPA and the State filed similar suits against the City in July 2003. The resulting settlements were memorialized in a Partial Consent Decree (the “Partial Consent Decree”) which expired on June 30, 2006 and a Second Partial Consent Decree (the “Second Partial Consent Decree”), which expired on June 30, 2007. Under the Partial Consent Decree and the Second Partial Consent Decree, the City agreed to rehabilitate or replace 200 miles of sewer pipeline by June 30, 2007. In 2007, the City, the United States, the EPA, the environmental groups entered into a final Consent Decree (the “Final Consent Decree” and, together with the Partial Consent Decree and the Second Partial Consent Decrees, the “Consent Decrees”).

The Final Consent Decree requires, among other things, increased sewer spill response and tracking, increased root control and replacement or rehabilitation of an additional 250 miles of pipeline between July 1, 2007 and June 30, 2013. The Final Consent Decree provides that the City will replace or rehabilitate 30 miles of pipeline in Fiscal Year 2008, 45 miles of pipeline per year from Fiscal Year 2009 to Fiscal Year 2012, and 40 miles of pipeline in Fiscal Year 2013. The City has replaced or rehabilitated approximately 49.48 miles of sewer pipeline, including 4.48 miles banked in Fiscal Year 2009. Between July 1, 2009, and January 31, 2010, the City awarded nine contracts for the completion of an additional 22.20 miles. The additional 22.20 miles of pipeline, combined with the 4.48 of banked miles, 14.49 of miles completed as of December 31, 2009, and a projected 3.83 miles from existing contracts, totals 45 miles of sewer pipeline for Fiscal Year 2010. The City may assert its right to extend the

deadline to replace or rehabilitate 45 miles of sewer pipeline during Fiscal Year 2010. The Final Consent Decree states that if more than the specified miles of pipeline are replaced, rehabilitated or permanently repaired in one year, the City may apply the excess amount against the requirement to replace, rehabilitate, or permanently repair pipeline in any future year. In addition, the Final Consent Decree requires an analysis of the feasibility of relocating sewer lines out of certain canyons by March 1, 2009, which has been completed. Further, the Final Consent Decree requires upgrades or replacement of more than 20 pump stations and force main upgrades, and court supervision of these upgrades at least through July 2013. The costs for bidding, constructing and completing the required work will depend on variables such as the cost of materials and labor. No civil penalty payment was required under the Consent Decrees. However, the Final Consent Decree provides that the City may be subject, at the discretion of the Federal government, to various stipulated penalties for subsequent violations of the provisions relating to, among other things, reporting and plan submissions, compliance milestone and SSOs. To date, the City has not been subject to any penalties resulting from alleged violations of the Final Consent Decree, but the City could be penalized for late completion of Sewer Pump Station No. 79 (SPS 79). See APPENDIX A—"BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY INFORMATION AND CERTAIN EXCERPTS FROM THE COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE CITY OF SAN DIEGO FOR THE FISCAL YEAR ENDED JUNE 30, 2009."

The Final Consent Decree requires the City to construct improvements to SPS 79. SPS 79 has been in operation since 1984. The facility is located in the Carmel Valley/Pacific Highlands Ranch area on the north side of San Dieguito Road, just east of the intersection of El Camino Real and San Dieguito Road. Section VII.C.8 of the Final Consent Decree requires the City to replace the pumps and motors, install a properly sized storage tank, complete electrical upgrades, improve odor control, add SCADA controls and alarms, and install a redundant force main approximately 8,230 feet in length. On September 18, 2007, the City Council authorized the City to negotiate an agreement with a local developer, Pardee Homes (Pardee), for the design and construction of upgrades to SPS 79. A future development project of Pardee's depends on the improvements to SPS 79.

The improvements to SPS 79 were supposed to be completed by December 2009. The City extended the original deadline of December 2008 to December 2009 as permitted by section VII.E.1 of the Final Consent Decree. The City does not have the authority under the Final Consent Decree to extend the project deadline any further, so the improvements to SPS 79 became overdue as of January 1, 2010. The EPA has the discretion to impose penalties on the City for late completion pursuant to Section XI.B of the Final Consent Decree, increasing in severity the later the project becomes:

1-14 days late	\$750/day
15-28 days late	\$1,500/day
28 days or more late	\$3,000/day

The improvements to SPS 79 are complete (except for punch-list items), and SPS 79 was returned to operation on April 6, 2010. Based on that date of completion, the EPA could penalize the City as much as \$235,500. The causes of the delay include a significant re-design of the project due to improvements the City made upstream of the project to reduce inflow and infiltration, bids for construction that were higher than expected, revised environmental documents, and problems with delivery of the new pumps.

In addition, under the Final Consent Decree the City may now be penalized by the EPA for SSOs over 1,000 gallons that reached navigable waters while the improvements to SPS 79 were late. The City is exempt from EPA penalties for SSOs as long as it is in compliance with the Final Consent Decree, but the delayed completion of improvements to SPS 79 temporarily

removed the exemption. Since January 1, 2010, the City has experienced three SSOs that reached navigable waters. Pursuant to Section XI.D of the Final Consent Decree, the City could be penalized up to \$6,000 for these SSOs:

<u>Date</u>	<u>Location</u>	<u>SSO volume</u>	<u>Penalty</u>
January 21, 2010	6241 Waverly Place	5,025 gallons	\$2,000
January 26, 2010	7011 Linda Vista Road	1,025 gallons	\$2,000
February 27, 2010	4635 Morena Boulevard	2,520 gallons	\$2,000

These penalties for SSOs do not include any fines that may be imposed by the San Diego Regional Water Quality Control Board, which is not signatory to the Final Consent Decree. See APPENDIX A—“BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY INFORMATION AND CERTAIN EXCERPTS FROM THE COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE CITY OF SAN DIEGO FOR THE FISCAL YEAR ENDED JUNE 30, 2009.”

Based on the Rate Model as of February 1, 2010, the estimated average annual cost of the Final Consent Decree for Fiscal Years 2010 through 2013 is \$99 million for capital projects, including pipeline repair and replacement and \$42 million (based on the budget for WWC for Fiscal Year 2010) for operations and maintenance, including increased cleaning of Wastewater System facilities and funding for video-monitoring. Such estimated average annual costs are included in the Wastewater System’s budget and the fiscal information set forth in Table 5 and Table 17. See “WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM” and “WASTEWATER SYSTEM FINANCIAL OPERATIONS—Financial Projections.” Some of the upgrades required by the Final Consent Decree are under construction. Upgrades required by the Final Consent Decree will be financed through the Wastewater System CIP, as described under “WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM—Background,” including with a portion of the proceeds of the Series 2009A Bonds. See “WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROJECTS—Capital Improvement Projects—Municipal Sub-System Projects.”

In 2001, the Department initiated a program to reduce SSOs by maintaining a system-wide cleaning schedule, video monitoring and assessing the condition of the oldest and most problematic sewer lines in the Wastewater System and increasing the number of miles of sewer lines replaced or rehabilitated annually. The Department has reduced sewer spills by 90% between calendar year 2000 and calendar year 2009. During calendar year 2009, there were 38 SSOs in the Municipal Sub-System.

Treatment of Sewage

The Clean Water Act generally requires that all wastewater treatment plants provide secondary treatment for sewage before it is discharged into waterways. The Clean Water Act allows wastewater treatment plants to apply for a waiver from the secondary treatment standards for certain ocean discharges (a “Treatment Waiver”). The Clean Water Act grants the U.S. EPA the discretion to grant or deny any Treatment Waiver. The South Bay Plant complies with the secondary treatment requirements of the Clean Water Act and therefore does not need a Treatment Waiver to operate. The City operates the Point Loma Plant subject to a Treatment Waiver from the U.S. EPA that must be renewed every five years.

The City first applied for a Treatment Waiver for the Point Loma Plant in 1979. In July 1988, subsequent to unsuccessful efforts by the City to obtain a Treatment Waiver, the United States of America, acting through the Department of Justice and the EPA, and the State sued the City for alleged violations of the Clean Water Act and the Point Loma Discharge Permit due to sewer overflows, failure to meet the secondary treatment requirements of the Clean

Water Act and alleged irregularities in the City's pretreatment program that regulates industrial waste. As a result of this lawsuit, the City paid a penalty of \$500,000, enacted a low flow toilet ordinance as a credit project, and agreed to a stipulated final order (the "Final Order") that required certain improvements to the Wastewater System, all of which the City has completed. The Final Order was eligible for termination on June 30, 2003, but has not been terminated because additional compliance orders were subsequently issued to address sewer spills. See "—Collection of Sewage."

In 1994, at the request of the City, the United States Congress adopted OPRA, amending the Clean Water Act to allow the City to apply for a Treatment Waiver, subject to certain conditions. These conditions required, among other things, that the City achieve a system capacity of 45 mgd of reclaimed wastewater per day by January 1, 2010, remove not less than 80% of TSS (on a monthly average) in the discharge of the Point Loma Plant, remove not less than 58% of the biochemical oxygen demand ("BOD") (on an annual average) in the discharge of the Point Loma Plant, and reduce the quantity of TSS discharged by the Wastewater System into the Pacific Ocean during the period of modification.

The City applied for and was granted the Point Loma Plant Treatment Waiver on November 9, 1995 (such Treatment Waiver, granted pursuant to OPRA, is referred to herein as a "Modified Permit"). The City must seek a renewal of its Modified Permit every five years if it seeks to renew the Point Loma Discharge Permit without implementing secondary treatment. The City has satisfied the OPRA requirements to achieve a system capacity of 45 mgd of reclaimed wastewater per day by constructing the North City Plant, which has a capacity of 30 mgd, and the South Bay Plant, which has a capacity of 15 mgd. The Point Loma Plant has consistently met or exceeded the 80% removal requirement for TSS and the 58% removal of BOD. The quantity of TSS discharged into the Pacific Ocean has conformed to OPRA requirements and all other permit requirements. The City, the U.S. EPA and certain environmental groups disagree on how the OPRA requirements may apply to future Modified Permits. Currently, there are no active lawsuits or appeals with respect to the OPRA requirements.

The City filed a renewal application for a Modified Permit and received a Tentative Decision and Tentative Order (the "2002 Tentative Order") on February 11, 2002. Initially, the California Coastal Commission objected to the consistency certification submitted by the City in connection with its request for a Modified Permit. The California Coastal Commission noted three areas of concern that it believed needed to be addressed in order for the discharges to be consistent with the applicable California Coastal Management Plan standards: (1) reduction in permitted levels of mass emissions; (2) commitments for water reclamation; and (3) additional monitoring provisions. Subsequently, the Regional Water Board modified its staff-recommended permit conditions and (1) reduced the total permitted mass emission loadings; (2) requested annual reports from its staff of the City's progress towards implementing water reclamation, which would be independent of the NPDES permit, and noted that it could impose future reclamation requirements if adequate progress was not forthcoming; and (3) instructed its staff to review and prepare for future adoption by the Regional Water Board modifications to the monitoring program, including specific provisions for deep ocean receiving stations, human pathogens, and long term trends, which would also be independent of the NPDES permit.

In separate proceedings, the City successfully appealed the actions of the California Coastal Commission and the Regional Water Board. In May 2002, the City resubmitted its consistency certification to the California Coastal Commission and appealed the Commission's consistency certification objection to the Secretary of Commerce. In addition, the City appealed the Regional Water Board's NPDES permit action modifying the mass emission limits to the State Water Board. In August 2002, the State Water Board ordered the mass emission limits to

be returned to the originally drafted levels. Subsequently, the City resubmitted its consistency certification for the waiver as modified and ordered by the State Water Board. The State Water Board concluded that the Regional Water Board had "...failed to make findings, either in its order or during its deliberations, that justify reducing the mass emissions limit for TSS...in the waste discharge requirements." The California Coastal Commission then approved the consistency certification for the treatment waiver.

The City appealed to the Environmental Appeals Board ("EAB") the provision of the 2002 Tentative Order requiring the City to comply with OPRA's requirements regarding reduction of the quantity of TSS discharged by the Wastewater System into the Pacific Ocean over the period of modification. Concurrent with the City's appeal, three environmental groups filed challenges to the Modified Permit contesting the maximum discharge limit of TSS and the EPA's interpretation of the OPRA requirements. The City's challenge and all the challenges filed by such environmental groups have been resolved by a Joint Stipulation for Withdrawal of Appeals ("Joint Stipulation for Withdrawal of Appeals") in which the City agreed to (a) evaluate improved ocean monitoring; (b) pilot test biological aerated filters as a form of technology to increase solids removal; and (c) study increased water reuse. The Joint Stipulation for Withdrawal of Appeals was approved by the EAB on March 29, 2004, and, as approved, confirmed the provisions of the current Modified Permit through June 2008 and reserved each of the parties' respective position on OPRA to future permits.

Based upon the Department's review of its annual biosolids reports from 2003 through 2007, the Department determined that the Metropolitan Biosolids Center and Point Loma Plant satisfied the criteria for biosolids disposal required by the Clean Water Act and for the use or disposal of sewage sludge that includes the analytical results. In December 2007, the City submitted an application to the U.S. EPA to request a renewal of the Modified Permit for the Point Loma Plant. The City's renewal application followed the same conventions as previous applications relative to OPRA. The U.S. EPA has permitted the City to operate pursuant to the existing Modified Permit until it renders a final decision with respect to the City's renewal application because the City filed a renewal application in a timely manner. The City received a Tentative Decision and Tentative Order to approve the Modified Permit for an additional five years (the "2008 Tentative Order") from the U.S. EPA on December 2, 2008. In January 2009, the City Council approved a resolution authorizing the City to negotiate and execute an agreement with two local environmental groups regarding the Modified Permit for the Point Loma Plant. Pursuant to such agreement, the two environmental groups agreed not to challenge the 2008 Tentative Order and the City is obligated to research options to increase the use of reclaimed wastewater and decrease discharges to the Pacific Ocean from the Point Loma Plant for a total cost not to exceed \$2 million. The U.S. EPA and the Regional Water Board held an initial, joint hearing in January 2009 to accept public comment on the 2008 Tentative Order. In June 2009, the State of California, Regional Water Quality Control Board, concurred with the EPA and concluded the public hearing process by unanimously approving the modified permit. On October 7, 2009 the California Coastal Commission voted 8 to 4 to approve the modified permit with the condition that the City come back in 2 years with the Recycled Water Study. On March 12, 2010, the California Coastal Commission adopted findings in support of their action on October 7, 2009, and concurred with the consistency certification for the proposed waiver. Modified Permits are reviewed by the U.S. EPA every five years. See "THE WASTEWATER SYSTEM—Metropolitan Sub-System Facilities—Point Loma Plant."

Although the City has obtained two successive Modified Permits from the EPA, the City can give no assurances that the U.S. EPA will renew or grant Modified Permits to the City in the future. If the City does not obtain a renewal of the Modified Permit (or any subsequent Modified Permit), the City may no longer be permitted to continue discharging sewage from the Point Loma Plant without complying with the secondary treatment requirements of the

Clean Water Act. The City considered two alternatives to address this contingency. One of these contemplates upgrading the Point Loma Plant with conventional secondary treatment capabilities. The City also considered, subject to verification of its effectiveness, an alternative to implement a new process for treating sewage at the Point Loma Plant that may entail less capital but greater maintenance and operation costs. The City could also be required to build additional solids processing facilities to reduce the burden at the Point Loma Plant or bring the Point Loma Plant into compliance with the secondary treatment requirements of the Clean Water Act if the quantity of TSS that the Wastewater System discharges into the Pacific Ocean increases above the levels required by OPRA, as finally determined by the EPA. Pursuant to the 2002 Tentative Order, a renewed Modified Permit will be granted based on, among other things, the continued satisfaction of the conditions established under OPRA, as set forth above.

The City estimates the cost of the alternatives to bring the Point Loma Plant into compliance with the secondary treatment requirements of the Clean Water Act will be between \$800 million and \$1.5 billion in capital costs, based on Fiscal Year 2008 calculations, if the 2008 Tentative Order is terminated and the Regional Water Board and U.S. EPA do not approve the Modified Permit. The larger amount assumes that, among other things, the City cannot access land from the United States Navy or the United States Park Service. Further, in the event the waiver is not approved for renewal, the City estimates there would also be an increase in operating and maintenance costs of approximately \$40 million per year, including additional energy and personnel costs, once the Point Loma Plant is fully operational at the secondary treatment level. Such estimated costs are not reflected in the financial information included in Table 5 and Table 17. See “WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM” and “WASTEWATER SYSTEM FINANCIAL OPERATIONS—Financial Projections.”

Discharge and Disposal of Sewage

Enacted in 1972, the Clean Water Act is a comprehensive revision of prior Federal water pollution control legislation requiring operators of wastewater treatment plants to operate such facilities in accordance with NPDES permits which set forth discharge limitations and reporting requirements applicable to wastewater treatment facilities. The NPDES permit sets effluent limitations on what is discharged into any public waters and prohibits any non-authorized discharges such as sewer system overflows. The Point Loma Plant and the South Bay Plant must each obtain an NPDES permit authorizing them to discharge sewage into the ocean because, at present, all of the Wastewater System’s sewage that is discharged into the ocean is discharged through either the Point Loma Plant or the South Bay Plant. The Regional Water Board adopted Waste Discharge Requirements (“WDR”) for the Point Loma Plant on April 10, 2002, and authorized the U.S. EPA to issue the Point Loma Discharge Permit in conjunction with the renewal of the Point Loma Plant’s NPDES permit for discharge to the Pacific Ocean pursuant to the Clean Water Act. The conditions of the WDR were appealed to the State Water Board by the City. The final permit was signed by the U.S. EPA Regional Administrator on September 13, 2002 and became effective on October 16, 2002. The Regional Water Board approved an addendum to the Point Loma Discharge Permit (“Addendum No. 1”) on June 11, 2003. Addendum No. 1 modified the monitoring and reporting program of the Point Loma Discharge Permit to incorporate recommendations of the Southern California Coastal Water Research Project’s Model Monitoring Program for Large Ocean Discharges in Southern California. The Regional Water Board adopted waste discharge requirements for the South Bay Plant on November 8, 2006, and authorized the issuance of the South Bay Discharge Permit for discharges into the Pacific Ocean. The South Bay Discharge Permit became effective January 1, 2007 and is scheduled to expire January 1, 2012.

In 1993, the U.S. EPA promulgated its “Standards for the Use or Disposal of Sewage Sludge” (Code of Federal Regulations Title 40, Part 503), which established, among other things, pollutant limitations, operational standards, management practices and other provisions intended to protect public health. In addition to Federal requirements, the City must also comply with State Water Board adopted Water Quality Order No. 2004-12-DWQ, which expands upon Federal regulations with respect to biosolids and streamlines the regulatory process for the use of biosolids as a soil amendment.

The City must also comply with effluent water-quality based State requirements. The California Water Code Article 4 (commencing with Section 13160) of Chapter 3 of Division 7 requires the State Water Board to formulate and adopt a water quality control plan for the ocean waters of the State known as the California Ocean Plan (the “Ocean Plan”). The Ocean Plan sets forth waste discharge limitations and monitoring and enforcement guidelines to ensure that water quality objectives are met. Section 303(c)(1) of the Clean Water Act and Section 13170.2(b) of the State Water Code require that ocean water quality standards be reviewed at least once every three years. In the event significant changes to the discharge requirement for TSS are approved with respect to the Ocean Plan, future waivers for the Point Loma Plant may be threatened. In September, 2009, the State Water Resources Control Board approved what it characterized as non-substantive amendments to the California Ocean Plan as part of its Triennial Review. The 2009 amended Ocean Plan is pending approval by the Office of Administrative Law. The TSS limitations in Table A of the Ocean Plan are unchanged.

The City’s proposed water reclamation projects are subject to the Porter-Cologne Water Quality Control Act of 1969, as amended (the “Porter Cologne Act”) and are being designed in consultation with State officials to comply with its requirements. The Porter-Cologne Act directly addresses the issues of water reclamation and reuse. A declared policy of the law is the development of facilities to reclaim wastewater to supplement existing surface and underground water supplies to meet their water requirements. The law requires the State Department of Health Services to establish statewide reclamation criteria for each type of use where such use involves public health.

State law AB 939 required the City to divert at least 50% of all solid waste from landfill disposal by January 1, 2000. For calendar year 2009, the City estimates that it diverted approximately 99% of biosolids from landfill disposal. Biosolids diversion is an integral part of the City’s compliance with AB 939, as biosolids were disposed of in the City’s landfill during the baseline year used for calculating the diversion rate. The City entered into a franchise disposal agreement with a private company pursuant to which the company shall be responsible for the disposal of all biosolids generated at the Metropolitan Biosolids Center through a combination of land application and alternative daily cover methods for landfill use. The City is considering alternative sludge disposal methods to employ in the event regulations change in the future.

Industrial Wastewater Control Program

The Point Loma Discharge Permit, the South Bay Discharge Permit and various Federal regulations require that the City control discharges from the Wastewater System by implementing an industrial wastewater control program (an “IWCP”). The Metropolitan Sub-System has had an IWCP in effect since 1972. The Metropolitan Sub-System’s IWCP was formally approved by the U.S. EPA in 1983. The Metropolitan Sub-System’s IWCP administers and enforces Federal general and specific discharge prohibitions, Federal categorical pretreatment standards, treatment plant-specific local limits and local source control programs within the City. The City’s Industrial Waste Ordinance lists Federal general and specific prohibitions and authorizes the issuance of permits, which include applicable

Federal and local discharge standards. The City's Industrial Waste Ordinance also authorizes administrative penalties and other enforcement measures in response to permit or ordinance violations. The City has entered into inter-jurisdictional pretreatment agreements (each, a "Pretreatment Agreement" and, collectively, the "Pretreatment Agreements") with thirteen of the Participating Agencies whose sewage is treated by the Department; agreements with the remaining two Participating Agencies are being finalized. The Pretreatment Agreements specify that each Participating Agency must either implement an equivalent IWCP or authorize the City to administer an IWCP in their respective agencies. The City currently administers the IWCP in each of the Participating Agencies. Collectively, the IWCP operated by the City regulates 1,466 dischargers throughout the Metropolitan Sub-System's tributary area. In addition, inspections have determined that an additional 2,191 facilities do not require permits at this time. Annual Pretreatment Program audits by the U.S. EPA and the Regional Water Quality Control Board have determined that the IWCP is in compliance with Point Loma Discharge Permit, South Bay Discharge Permit and Federal program requirements.

Grant and Loan Related Regulatory Requirements

The City is subject to regulatory requirements, in addition to those described above, as a condition of receipt of Federal grants received from the EPA, State grants and SRF low-interest loans under the Clean Water Act for the planning and construction of various improvements to the Wastewater System. Among other grant-related requirements are guidelines concerning planning methodologies, design criteria, construction activities, and the operation, maintenance and financing of facilities.

In connection with an U.S. EPA grant of approximately \$76 million that the City received and used for the construction of the North City Plant and other wastewater projects, the grant contained a condition that the City attempt to meet the goal of beneficial reuse of 25% of the flows treated at the North City Plant by December 31, 2003 and 50% by December 31, 2010. The City has diligently reported its progress and efforts to meet the goals set forth in the grant. The U.S. EPA has acknowledged the City's good faith efforts toward compliance with the beneficial reuse goals set forth in its grant and has not imposed any penalties or sanctions under the grant agreement. During Fiscal Year 2009, the City achieved beneficial reuse of 28% of the flows treated at the North City Plant. The City is continuing to explore alternative means to increase reclaimed water use. See "THE WASTEWATER SYSTEM—Metropolitan Sub-System Facilities—North City Water Reclamation Plant."

As a condition of certain other Federal grants, the State Water Board, as the delegate of the EPA, must approve the sewer service charge structures of the City and the Participating Agencies. Such service charge structures require the recovery of annual operations, maintenance and replacement costs from users of the system in a proportionate manner according to the customer's level of use. Such factors as volume, infiltration/inflow, delivery flow rate, and strength of sewage are to be considered for determining proportionate use. Sewer service charge rates for all retail users are reviewed periodically and established at a level necessary to generate sufficient revenues to recover the annual operations, maintenance and replacement costs. Sewer service charge rates for users are established to recognize the volume and strength characteristics of wastewater contributed to the Wastewater System. The City Council has taken various actions to adjust the Wastewater System's rate structure, including in connection with periodic review of the distribution of cost of services. See "WASTEWATER SYSTEM FINANCIAL OPERATIONS—City Council Actions Relating to Rate Changes." The City's rate structure has been approved by the State Water Board and no grant funds or costs under grant funded programs have been disallowed based on the nature of the rate structures.

WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM

Background

The Department prepares an 11-year Wastewater System CIP (consisting of the current budget year and a 10-year projection) on an annual basis, and the City incorporates the first year of such plan into the Wastewater System's annual budget. The EPM of the Department also prepares a 25-year internal Wastewater System CIP model in connection with the consideration of longer-term projects. The Wastewater System CIP presents the total estimated project cost since project inception, including expenditures, encumbrances, continuing appropriations, the annual budget for the current fiscal year and projections of expenses in subsequent years. The general objectives of the Wastewater System CIP are to meet Federal and State requirements and City policy regarding water pollution control, to provide satisfactory levels of service to users of the Wastewater System, and to maintain the integrity of the Wastewater System.

The Wastewater System CIP is an ongoing capital expenditure program. During the 1990's, the City completed several large wastewater treatment plant projects in response to litigation involving violations of the Clean Water Act. Beginning in 2000, the focus of the Wastewater System CIP shifted to the Municipal Sub-System. In April 2002, the City received an Administrative Order from the U.S. EPA directing the City to prepare and submit a plan for rehabilitation and replacement of sewer pipes and structures. In October 2007, the City signed the Final Consent Decree with the EPA, which obligates the City to replace or rehabilitate 250 miles of sewer pipeline between July 2007 and June 2013 and to replace or rehabilitate a number of trunk sewers and pump stations by certain dates. See "WASTEWATER SYSTEM REGULATORY REQUIREMENTS—Collection of Sewage—The Municipal Sub-System Collection System."

The Wastewater System CIP includes annual allocations projects, which are programmed expenditures that allow the City to plan for the expansion, renovation, relocation, or replacement of facilities and equipment that have reached or exceeded their anticipated service life, provides for emergency and accelerated construction needs, and provides for capital improvement project contingency needs. Any amount not allocated to a component task in a particular year is returned to the contributing fund. In addition, the Wastewater System CIP includes phased funding to accommodate, appropriate and contract for large projects to maximize the City's use of available funds by identifying defined portions or phases of projects on a contingent basis. The Wastewater System CIP also uses split funding, which allows two different revenue sources to be used to fund a capital project on a percentage basis.

Any ongoing project under the Wastewater System CIP, other than an annual allocation, that was initiated prior to the current Fiscal Year will have expenditures, encumbrances or continuing appropriations in the current Fiscal Year. The Department may budget additional funding for such projects during current and future Fiscal Years depending upon project scheduling. The Department includes the amounts it has budgeted for each Fiscal Year in an annual appropriation ordinance (each, an "Annual Appropriation Ordinance"), which becomes effective upon adoption by the City Council. Each Annual Appropriation Ordinance authorizes the City to appropriate revenues for expenditures relating to capital improvement projects for the applicable Fiscal Year. In addition, each Annual Appropriation Ordinance provides guidance regarding the administration of the Wastewater System CIP. Modifications to a project's budget may occur during the course of the Fiscal Year through City Council action. Appropriations for projects which are contained in the Wastewater System CIP for the Fiscal Year 2010 have been approved in the Annual Appropriation

Ordinance for the Fiscal Year 2010. However, the City is not obligated to expend funds based on any projections made for Fiscal Years 2011 to 2020 because such projections are not contained within the Annual Appropriation Ordinance.

The Department currently expects that approximately 80% of the costs of the Wastewater System CIP will be funded with the proceeds of debt financing and the remaining 20% will be paid on a pay-as-you-go basis from Net System Revenues. Table 5 sets forth the Wastewater System CIP for Fiscal Years 2010 through 2014 and the expected allocations between the Municipal Sub-System and Metropolitan Sub-Systems.

TABLE 5
WASTEWATER SYSTEM
PROJECTED CAPITAL IMPROVEMENT PROGRAM EXPENDITURE SUMMARY⁽¹⁾
Fiscal Years 2010 through 2014
(\$ In Thousands)
(Unaudited)

Expected Projects	2010	2011	2012	2013	2014	TOTAL
Municipal Sub-System Projects						
Trunk Sewers	\$14,214	\$ 45,511	\$ 47,433	\$ 22,919	\$ 27,718	\$157,795
Pipelines	40,743	51,857	68,770	77,571	60,356	299,297
Pump Stations	10,725	13,722	6,010	6,819	943	38,219
Miscellaneous	0	0	0	0	1,885	1,885
Subtotal Municipal Sub-System Projects	<u>\$65,682</u>	<u>\$111,090</u>	<u>\$122,213</u>	<u>\$107,309</u>	<u>\$ 90,902</u>	<u>\$497,196</u>
Metropolitan Sub-System Projects						
Treatment Plants	\$ 2,379	\$ 13,449	\$ 36,029	\$ 27,156	\$ 14,049	\$ 93,062
Pipelines	0	0	0	0	0	0
Large Pump Stations	3,337	6,401	1,157	3,088	7,584	21,567
Miscellaneous	3,487	5,056	6,281	5,677	5,315	25,816
Subtotal Metropolitan Sub-System Projects	<u>9,203</u>	<u>24,906</u>	<u>43,467</u>	<u>35,921</u>	<u>26,948</u>	<u>140,445</u>
TOTAL	<u>\$74,885</u>	<u>\$135,996</u>	<u>\$165,680</u>	<u>\$143,230</u>	<u>\$117,850</u>	<u>\$637,641</u>

Source: Public Utilities Department, City of San Diego; Reflects Rate Case as of February 1, 2010.

(1) Includes an assumed 3.5 percent annual increase in Wastewater System CIP project costs for Fiscal Years 2012 through 2014. Includes projects required by the Final Consent Decree and those required as part of the annual maintenance of the Wastewater System.

Capital Improvement Projects

Municipal Sub-System Projects. The following is a summary description of certain projects identified in the Wastewater System CIP to be constructed for the Municipal Sub-System, including Annual Allocation projects in all of these categories.

1. Trunk Sewers—These projects include replacement or rehabilitation of existing trunk sewers (larger than 15-inches in diameter) due to deterioration or insufficient capacity.
2. Pipelines—These projects include replacement or rehabilitation of various sewer mains located throughout the City due to deterioration or insufficient capacity.
3. Pump Stations—These projects include upgrades, renovations, restoration and replacement of major equipment at the Municipal Sub-System’s pump stations.
4. Miscellaneous—Other municipal projects such as developer projects.

Metropolitan Sub-System. The following is a summary description of certain projects identified in the Wastewater System CIP to be constructed for the Metropolitan Sub-System, including annual allocation projects in the majority of these categories.

1. Treatment Plants—These projects include renovations or upgrades at the North City Plant, the South Bay Plant, the Metropolitan Biosolids Center and the Point Loma Plant to implement operating efficiencies, optimize the existing facilities and comply with revised regulatory and operation plan requirements.
2. Pipelines—These projects include replacement or rehabilitation of various sewer interceptors which are deteriorating or have insufficient capacity.
3. Large Pump Stations—These projects include upgrades, renovations, restoration and replacement of major equipment for Metropolitan System Pump Stations, Pump Station No. 1 and Pump Station No. 2.
4. Miscellaneous—These projects include, among other things, projects for improvements to the Facilities Distributed Controls System, the Environmental Monitoring and Technical Services Lab, management of wet weather flows, the Metropolitan Facilities Control System Upgrade, which includes upgrades to the distributed controls system at the Metropolitan Biosolids Center, Point Loma Plant, North City Plant and South Bay Plant and Phase I of the Weather Storage Facility, which will implement intermittent stream discharge of reclaimed water from the North City Plant during heavy rain to reduce the capacity demand on the downstream sewer system.

Capital Improvement Financing Plan

Table 6 below sets forth the projected sources and uses of funds for the Wastewater System CIP for the Fiscal Years 2010 through 2014. New bond issues are assumed to be bonds secured by Installment Payments that are Parity Obligations. The amount of Installment Payments securing Parity Obligations may decrease if any of the new bond issues are not issued as Parity Obligations. Subject to final approval by the State Water Board in Fiscal Year 2010 the City will incur an additional Parity Obligation in the form of the Additional SRF Loan of \$46.4 million. The potential receipt of the Additional SRF Loan is not included in the City's Rate Model. However, the receipt of such funds is not expected to affect the overall projections because the Department will reduce its aggregate borrowing by a like amount for the period covered by its Rate Model. The State is currently reviewing an application for an additional SRF Loan of \$80 million for pipe rehabilitation with a response anticipated in early Fiscal Year 2011.

The Wastewater System CIP includes the costs of the projects described in Table 5 above. The 2010 Adopted Department Budget continues to focus the Wastewater System CIP on the annual appropriations, which include, among other things, the replacement of sewer mains, pipeline repair and rehabilitation, and upgrades to trunk sewers and pump stations as required by the Consent Decree. See "WASTEWATER SYSTEM REGULATORY REQUIREMENTS—Collection of Sewage." In the event the City fails to obtain successive Modified Permits or if the City fails to obtain clarification of OPRA in its favor (whether by judicial or legislative means), the capital costs of the Wastewater System CIP could increase substantially. See "WASTEWATER SYSTEM REGULATORY REQUIREMENTS—Treatment of Sewage." If the City is obligated to incur greater costs in repairing and rehabilitating the Municipal Sub-System than the City projects herein, the capital costs of the Wastewater System CIP could increase substantially. See "WASTEWATER SYSTEM REGULATORY REQUIREMENTS—Collection of Sewage."

TABLE 6
SOURCES AND USES OF FUNDS FOR CAPITAL EXPENDITURES OF THE
WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM
(\$ In Thousands)
(Unaudited)
Fiscal Years 2010 to 2014

	2010	2011	2012	2013	2014	Total
SOURCE OF FUNDS						
Carryover Balance of Acquisition Fund	\$134,908	\$ 75,000	\$147,544	\$ 15,000	\$109,280	\$ 481,732
New Bond Issue	—	202,085	—	232,756	—	434,841
Pay-as-You-Go	14,977	27,199	33,136	28,646	23,570	127,528
TOTAL SOURCES	<u>\$149,885</u>	<u>\$304,284</u>	<u>\$180,680</u>	<u>\$276,402</u>	<u>\$132,850</u>	<u>\$1,044,101</u>
USES OF FUNDS						
Costs of Issuance	—	\$ 6,063	—	\$6,983	—	\$ 13,046
Debt Service Reserve Fund	—	14,681	—	16,909	—	31,590
Capital Expenditures ⁽¹⁾⁽²⁾	\$ 74,885	135,996	\$165,680	143,230	\$117,850	637,641
Contribution to Construction Fund	75,000	147,544	15,000	109,280	15,000	361,824
TOTAL USES	<u>\$149,885</u>	<u>\$304,284</u>	<u>\$180,680</u>	<u>\$276,402</u>	<u>\$132,850</u>	<u>\$1,044,101</u>
	2010	2011	2012	2013	2014	Total
CAPITAL EXPENDITURES BY SYSTEM						
Municipal System	\$65,682	\$111,090	\$122,213	\$107,309	\$ 90,902	\$497,196
Metropolitan System	9,203	24,906	43,467	35,921	26,948	140,445
TOTAL SYSTEM	<u>\$74,885</u>	<u>\$135,996</u>	<u>\$165,680</u>	<u>\$143,230</u>	<u>\$117,850</u>	<u>\$637,641</u>

Source: Public Utilities Department, City of San Diego.

(1) Expenditures may include continuing appropriations from previous years.

(2) Projected cash expenditures for the Wastewater System Capital Improvement Program.

Environmental Compliance

The projects contained in the Wastewater System CIP are generally subject to the California Environmental Quality Act (“CEQA”), as amended (Division 13 of the California Public Resources Code). Under CEQA, a project which may have a significant effect on the environment and which is to be carried out or approved by a public agency must comply with a comprehensive environmental review process, including the preparation of an Environmental Impact Report (“EIR”). An EIR reflects not only an independent technical analysis of the project’s potential impacts, but also the comments of other agencies with some form of jurisdiction over the project and the comments of interested members of the public. Contents of an EIR include a detailed statement of the project’s potentially significant environmental effects; any such effects which cannot be avoided if the project is implemented; mitigation measures proposed to eliminate or minimize such effects; alternatives to the proposed project; and any significant irreversible environmental changes which would result from the project. If an agency determines that the project itself will not have a significant effect on the environment, it may adopt a written statement (called a “Negative Declaration”) to that effect and need not prepare an EIR. A Mitigated Negative Declaration (“MND”) is appropriate for projects that could potentially result in a significant environmental impact, but revisions or standard mitigation measures are incorporated into the project that clearly mitigate the impact. Statutory exemptions are activities that are not subject to CEQA. Wastewater System CIP projects can also be exempted if they fit a specific “category” of activities identified by the State Legislature. Once an agency approves or determines to carry out a project, either following an EIR process or after adopting a negative declaration, it must file a notice of such

determination. Any action or proceeding challenging the agency's determination must be brought within 30 days following the filing of such notice.

As part of its regular planning and budgetary process, the City prepares in accordance with local, State and Federal law and regulations separate environmental documents for each Wastewater System CIP project and evaluates the project under the City's environmental impact review procedures, which were developed in compliance with State law and regulations. The City requires that all environmental documents and evaluations be completed prior to any authorization of funding for construction by the City Council and the Mayor.

The Wastewater System CIP involves replacement, upgrading and increasing capacity of existing facilities. Accordingly, the City does not believe that environmental considerations will adversely affect the completion of the Wastewater System CIP within the contemplated budget or the current timetable.

Project Management for the Wastewater System Capital Improvement Program

The Department and the Engineering and Capital Projects Department ("E&CP"), which is a department within the City's Public Works Group, are responsible for the implementation of the Wastewater System CIP. The Department is responsible for selecting the projects that are included in the Wastewater Capital Improvement Program. Selection of such projects involves, among other things, assessing conditions, sewer modeling, preparing planning reports, prioritizing projects, scheduling and allocating the budget. Once the Department determines that a particular project should proceed, the Department sends a scope of work, planning report or 10% design, as appropriate, and the proposed schedule and budget to E&CP. E&CP is responsible for the design, construction and start-up of all Wastewater System CIP projects.

Each Fiscal Year, the Department and E&CP enter into a Service Level Agreement (each, an "SLA") which outlines the responsibilities of each department as it relates to the planning, design and construction of sewer improvements with respect to sewer mains, trunk sewers, pump stations and treatment plants. Pursuant to the SLA, E&CP provides engineering services including project management, design, environmental, permitting, land acquisition, scheduling, budget and construction management. E&CP implements the Wastewater System CIP from design of projects to completion, including capitalization of the final asset and management of warranty issues, as directed by the Department. The Department provides overall direction and policy for planning, financing, and operations and maintenance of the Wastewater System. Further, the Department funds the positions and non-personnel expenses, which are necessary for the service provider of a particular project to fulfill its responsibilities.

Contract Disputes

From time to time, the City is engaged in disputes with the contractors and subcontractors working on the Wastewater System CIP. As of January 4, 2010, there are no pending contract disputes with vendors or contractors working on the Wastewater System CIP in excess of \$1 million.

Insurance for Construction

The City requires the consultant or contractor selected to design or construct a Wastewater System CIP project to provide minimum insurance therefor. Design consultants are required to provide at a minimum commercial general liability insurance of \$1 million per occurrence (\$2 million aggregate), commercial auto liability insurance of \$1 million per occurrence, workers' compensation insurance of \$1 million, architect and engineer's

professional liability insurance of \$1 million per occurrence (\$2 million aggregate) and errors and omissions insurance for design-build projects. Construction contractors are required to provide at a minimum, among other things, commercial and general liability insurance aggregate limit of \$2 million (other than products/completed operations) and \$2 million (products/completed operations), personal injury insurance of \$1 million each occurrence, commercial automobile liability insurance of \$1 million combined single limit per accident, and contractors builders risk property insurance in an amount equal to 115% of the contract value. Further, depending upon the size and scope of a project, the City's Risk Management Department may require increased insurance coverage at any time and from time to time based upon its assessment of the degree of risk for such project.

WASTEWATER SYSTEM FINANCIAL OPERATIONS

General

The Department manages and operates the Wastewater System with funds derived primarily from service charges which are deposited in the Sewer Revenue Fund. The Sewer Revenue Fund was established in 1956. Funds in the Sewer Revenue Fund are used for the operation, maintenance and capital improvement of the Metropolitan Sub-System and the Municipal Sub-System. See "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Establishment, Calculation and Collection of Sewer Service Charges."

The primary sources of moneys deposited in the Sewer Revenue Fund are derived from revenues generated by sewer service charges to City residents and commercial enterprises, capacity charges on new, additional or larger connections to the Wastewater System within the City, revenues from the Participating Agencies pursuant to the Regional Sewage Disposal Agreement and interest income on fund balances. See "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Participating Agencies; Regional Wastewater Disposal Agreement; Transportation Agreements." The City also deposits into the Sewer Revenue Fund revenues received from the United States Navy pursuant to "Department of the Navy Negotiated Water and Sewage Contract" by and between the City and United States Navy.

Budgetary Process

The City budgets revenues and expenditures to support the costs the Department incurs to operate and maintain the Wastewater System. Each April, the Mayor submits the Department's budget for the following fiscal year to the City Council for approval. Budget estimates for the Wastewater System CIP are prepared based upon the needs of the Metropolitan Sub-System and the Municipal Sub-System. Cost information and schedules provided by the design and operations staff are used to prepare the capital budget for the Wastewater System. The Department prepares an 11-year Wastewater System CIP each year as part of its internal budget process. See "WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM—Background." The Wastewater System CIP consists of anticipated costs and a schedule for projects planned for completion and is based on planning information from prior years, progress toward stated goals and objectives, future and long-term needs and planning information developed during the Wastewater System CIP planning cycle. The Wastewater System CIP provides the basis for review of the annual budget for the Wastewater System CIP and near-term projects and is divided into projects for each of the Municipal Sub-System and the Metropolitan Sub-System to address their respective requirements.

The City commissions a wastewater cost of service, rate design and capacity fee study periodically. The goal of each study is to develop recommendations for the establishment of fair and equitable sewer rates for the City's users and a revenue program that will be acceptable to the State Water Board. Each study includes a review of the City's financial plan or rate case, usage characteristics, and rate structure. The City expects to commission the next wastewater cost of service study in calendar year 2011. See "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Calculation and Collection of Capacity Charges."

Establishment, Calculation and Collection of Sewer Service Charge Revenue and Treatment Plant Services Revenue

Sewer Service Charge Revenue. The City deposits sewer service charge revenues, which are primarily derived from sewer service charges to City residents and commercial enterprises into the Sewer Revenue Fund. Sewer service charges to City utility customers are collected on a municipal bill, which also includes water charges and storm drain fees. Bills are rendered on a bi-monthly basis for single family and most multifamily dwellings and on a monthly basis for industrial, commercial, and large multifamily dwellings. In accordance with the provisions of the City Municipal Code, these funds are administered in an enterprise account separate from the City's General Fund.

The City establishes fees based upon the costs incurred by the City to collect, treat and discharge wastewater and pay for required capital improvements. Staff within the Department and senior management within the City analyze rates and charges to determine the amounts necessary to support the Wastewater System based upon revenue and expenditure data from the various divisions of the Department. Staff evaluates the adequacy of revenues and recommends rate adjustments to correspond with projected changes in maintenance and operations costs and the timing and magnitude of capital expenditures. This rate and charge analysis is conducted annually for management purposes and whenever it is required to assist planned financings and proposed rate adjustments. See "WASTEWATER SYSTEM FINANCIAL OPERATIONS—City Council Actions Relating to Rate Changes."

Sewer service charges are based on the characteristics of the wastewater discharged by each sewer user. All sewer users are charged based upon the amount of flow, solids and organic material which they discharge into the Wastewater System. As sewage discharge is not metered, water sales are used to approximate each customer's sewage flow. TSS and organics are based upon the standard industrial classification code or determined by site inspections and/or analyses as required or requested.

Each single family residential wastewater account is billed an account-specific fixed daily charge based on 95% of the prior winter's lowest daily average water consumption, based on usage for the months of December through March. The fixed charge for each account is adjusted annually on July 1st. Multifamily flow charge is based on 95% of actual water use on a month-to-month basis. Chemical Oxygen Demand ("COD") and TSS loadings components of the charge are the same for both single family residential and multifamily accounts and do not vary from month-to-month. These fixed strength loadings are incorporated into the class-specific fixed charges for commercial and industrial accounts and based on actual monthly water use and the percentage return COD loading and TSS loading which varies between industries.

Treatment Plant Services Revenue. Pursuant to the terms of the Regional Wastewater Disposal Agreement, the City bills each Participating Agency based on its use of the Wastewater System and its capacity rights. See "THE WASTEWATER SYSTEM—Participating Agencies; Regional Wastewater Disposal Agreement; Transportation Agreements." The City bills the Participating Agencies on a quarterly basis in arrears based on

the budget for the corresponding Fiscal Year. An audit is performed at the end of each Fiscal Year to confirm the amount of Metropolitan Sub-System expenditures. Actual expenditures are compared to the budget used to bill each Participating Agency and each Participating Agency is then given either a credit on a future bill or invoiced for any underpayment. The adjustments, which have ranged from \$1 million to \$10 million, reflect a reconciliation of amounts charged by the Department with actual expenditures of the Department and have historically been revenue-neutral to the Wastewater System. The Participating Agencies set the sewer service charges and capacity charges that they charge their respective customers in order to meet their own wastewater needs and their share of the Metropolitan Sub-System costs. The sewer service charges currently in effect for the various Participating Agencies are varied and are not controlled by the City. Any failure by a Participating Agency to generate sufficient capacity charges does not affect the obligation of such Participating Agency to pay amounts owed to the City under the Regional Wastewater Disposal Agreement.

Table 7 below sets forth the sources of sewer service charge revenues of the Sewer Revenue Fund for the Fiscal Years 2005 through 2009.

TABLE 7
WASTEWATER SYSTEM
HISTORICAL SOURCES OF SEWER SERVICE CHARGE REVENUES⁽¹⁾
Fiscal Year 2005 to 2009
(\$ In Thousands)

Source	2005	2006	2007	2008	2009
Single Family Domestic	\$ 90,708	\$ 94,086	\$ 95,757	\$104,565	\$112,564
Other Domestic	65,788	70,578	74,851	77,921	88,426
Commercial	59,424	61,501	65,245	71,376	68,640
Industrial	6,774	6,991	4,840	6,171	6,866
Outside City	3	0	0	0	0
Treatment Plant Service for Others ⁽²⁾	60,726	53,260	59,043	65,015	41,978
TOTAL⁽³⁾	\$283,423	\$286,416	\$299,736	\$325,048	\$318,474

Source: Comprehensive Annual Financial Report for Fiscal Years 2005 through 2009 for Total; Comptroller's Office, City of San Diego for all other line items.

- (1) Constitutes a component of System Revenues; does not include capacity charges or other operating revenues which are included in calculating Net System Revenues.
- (2) Includes sewer service charge revenues from Participating Agencies, the United States Navy and other agencies.
- (3) Audited.

Table 8 sets forth the ten largest customers of the Municipal Sub-System. The ten largest customers of the Municipal Sub-System in terms of billings in Fiscal Year 2009 account for approximately 8.88% of the Sewer Revenue Fund's total operating revenues for such Fiscal Year. The largest customer of the Municipal Sub-System is the United States Navy, which accounted for 3.57% of the Sewer Revenue Fund's total operating revenues for the Fiscal Year 2009. CP Kelco, the second largest customer of the Municipal Sub-System, contributed 1.49% of the Sewer Revenue Fund's total operating revenues for Fiscal Year 2009, and the Federal Government (other than the United States Navy), the third largest customer of the Municipal Sub-System, contributed 1.02% of the Sewer Revenue Fund's total operating revenues for Fiscal Year 2009. No other customer accounted for more than 1% of the Sewer Revenue Fund's total operating revenues for such Fiscal Year.

**TABLE 8
MUNICIPAL SUB-SYSTEM
TEN LARGEST CUSTOMERS
Fiscal Year 2009⁽¹⁾
(Unaudited)**

	Sewer Billings	Percent of Total Operating Revenue ⁽²⁾
U.S. Navy	\$11,513,264	3.57%
CP Kelco	4,811,759	1.49
University of California, San Diego	3,280,349	1.02
Federal Government ⁽³⁾	2,092,358	0.65
R.J. Donovan Correctional Facility	1,489,706	0.46
City of San Diego	1,434,366	0.44
East Mesa Detention Facility	1,129,748	0.35
San Diego State University	1,043,015	0.32
San Diego Unified School District	1,018,288	0.32
Marine Park Corporation	816,795	0.25
TOTAL⁽⁴⁾	\$28,629,648	8.88

Sources: Public Utilities Department (billings) and the Comptroller's Office (revenues), City of San Diego.

(1) Does not include Participating Agencies or customers served by Participating Agencies.

(2) Reflects percentage of total operating revenues of the Municipal Sub-System; includes revenues from Participating Agencies. See the line item entitled "Total Operating Revenues" in Table 14—"Statements of Revenues, Expenses and Changes In Fund Net Assets."

(3) Excludes the United States Navy.

(4) May not add up due to rounding.

City Council Actions Relating to Sewer Rate Changes

The Wastewater System's overall rate structure was revised in 2004 and in 2007 to provide a more equitable distribution of costs among the various classifications of sewer customers. The sewer billing rate under the existing rate structure is determined separately for each meter based upon three factors: (1) "The Percent Return to Sewer," calculated as the water delivered to the facility through the water meter less any water lost from the facility as evaporation, irrigation, or in products leaving the site divided by the water delivered to the facility; (2) "Total Suspended Solids" in the wastewater; and (3) effective October 1, 2004, COD of the wastewater. Incorporation of COD into the rate structure was designed to help the City meet requirements of certain grants issued pursuant to the Clean Water Act and loans granted pursuant to the State Water Board's SRF Loan Program. Under this rate structure, revenues derived from sewer fees and charges are used solely for the purpose of defraying costs incurred to provide sewer collection and transportation, treatment and disposal services; facilities and equipment maintenance, and capital projects. On February 26, 2007, the Mayor and the City Council approved sewer rate increases of 8.75%, 8.75%, 7.00% and 7.00% effective on May 1, 2007, May 1, 2008, May 1, 2009 and May 1, 2010, respectively. Through Fiscal Year 2009, the City received approximately \$72 million in service charge revenues in connection with such rate increases. The City expects to receive from Fiscal Year 2010 through Fiscal Year 2011 an aggregate amount of approximately \$165 million in additional service charge revenues to fund regulatory orders, replace infrastructure and meet operating and maintenance needs of the City's Wastewater System.

In addition to the rate increases set forth above, the City Council has temporarily adjusted rates for all City sewer customers in connection with settlement of *Shames v. City of San Diego*, a class action lawsuit filed on June 16, 2004 on behalf of all single family residential account holders in the City's Municipal Sub-System who held sewer accounts during any period between May 23, 1994 through September 30, 2004. The lawsuit alleged the City failed

to include a COD cost component in the rate structure during the aforementioned period, which led to overcharges on residential sewer fees that were disproportionate to the cost of service attributable to the parcel or land on which service was provided, as required by Article XIID, Section 6(b)(3) of the California State Constitution. See “CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES—California Constitution Articles XIIC and XIID.” The lawsuit also included a claim for breach of contract based on the receipt of Federal and State grants requiring a strength based revenue structure.

In 2007, the City settled the *Shames* case (the “Shames Settlement”) and agreed to reimburse certain “eligible” single family residential customers in the aggregate amount of \$35 million and to pay attorney’s fees to the plaintiffs’ counsel in the amount of \$5 million. The City adopted a COD cost component in its rate structure on June 8, 2004, pursuant to City Council Resolution R-299322, which was implemented on October 1, 2004. As part of the Shames Settlement, the City also agreed to permit an independent and qualified 501(c)(3) non-profit organization to place a solicitation insert into billing statements for single family residential account holders up to three times a year for five years. The billing inserts are designed to allow the organization to raise funds for the hiring and payment of experts who will review and evaluate the City’s future sewer rate setting activities. To satisfy the terms of the Shames Settlement, the City temporarily increased existing sewer rates for all City sewer customers by 3.05% on November 1, 2007 and increased existing sewer rates by an additional 3.05% on May 1, 2008. For “eligible” single family residential sewer customers, the City will reverse the two 3.05% rate increases applicable to all City sewer customers and pay the settlement obligation in the form of a monthly credit which is estimated to be \$3.25 per month. Per the Shames Settlement, “eligible” single family residential customers are those who received sewer service to their property in the ten-year period prior to October 1, 2004. The rate reversal and monthly credit for single family residential customers will end and the City will terminate the two 3.05% rate increases attributable to the Shames Settlement when the \$40 million settlement amount has been raised and distributed according to the Shames Settlement. The City expects this to occur for all single family residential customers in the fall of 2011. See “LITIGATION” for a description of ongoing litigation regarding multifamily customers and the California Restaurant Management System that may impact City Council actions relating to sewer service rates.

Table 9 sets forth the sewage service charges approved by the City Council in the last five fiscal years including sewer service charges that are currently in effect and those that have been approved and will be effective on May 1, 2010.

TABLE 9
WASTEWATER SYSTEM
APPROVED RATE INCREASES FOR SINGLE FAMILY RESIDENTIAL,
MULTIFAMILY AND COMMERCIAL AND INDUSTRIAL CUSTOMERS
Fiscal Years 2005 through 2010⁽¹⁾
(Unaudited)

Effective Date	Single Family Domestic ⁽²⁾	All Classes % Rate Increase	Uniform Base Fee	Single Family Residential \$/HCF water	Multifamily (Other Domestic) Usage Fee \$/HCF water	Commercial & Industrial Customers ⁽³⁾		
						\$/HCF Monthly Wastewater Flow	\$/LB Total Suspended Solids	\$/LB Chemical Oxygen Demand
October 1, 2004 ⁽⁴⁾	\$32.72	N/A	\$10.53	\$2.563	\$3.461	\$2.5613	\$0.3994	\$0.1436
March 1, 2005	35.17	7.50	11.32	2.755	3.721	2.7534	0.4294	0.1544
May 1, 2007	38.32	8.75	12.31	2.890	4.038	3.0257	0.4431	0.1801
November 1, 2007–Shames ⁽⁵⁾	39.49	3.05	12.69	2.978	4.161	3.1180	0.4566	0.1856
May 1, 2008	42.94	8.75	13.80	3.239	4.525	3.3908	0.4966	0.2018
May 1, 2008–Shames ⁽⁵⁾	44.25	3.05	14.22	3.338	4.663	3.4942	0.5117	0.2080
May 1, 2009	47.35	7.00	15.21	3.571	4.990	3.7388	0.5475	0.2225
May 1, 2010	50.67	7.00	16.28	3.821	5.339	4.0005	0.5859	0.2381

Source: Public Utilities Department, City of San Diego.

- (1) Includes sewer service charges that are currently in effect and those that have been approved by the City Council and will be effective on May 1, 2010.
- (2) Represents the average monthly amount and new customer amount.
- (3) Commercial and Industrial Customers' monthly charges are based upon volume of flow, TSS, and COD included effective October 1, 2004.
- (4) Reflects restructuring of sewer service charges which adds COD as a cost parameter and a uniform base fee for all single family residential customers, multifamily residential customers and commercial and industrial customers.
- (5) On June 16, 2004, a class action lawsuit, *Shames v. City of San Diego*, was filed against the City alleging that until October 2004 (when the City revised its sewer rate structure—See footnote (4)), single family residential customers were overcharged for sewer service, while other customers were undercharged. On May 18, 2007, the Superior Court for the County of San Diego approved an agreement to settle the lawsuit. This requires the City to reimburse “eligible” single family residential customers a total of \$40 million (less \$5 million for attorney’s fees and other costs) over the next four years.

Accounts Receivable

Typically, the City seeks to collect unpaid bills by: (i) issuing an initial shut-off notice 25 days after a bill is issued; (ii) issuing a final shut-off notice 38 days after a bill is issued; and (iii) shutting off the customer’s water service 45-51 days after a bill is issued. This procedure results in almost all past due bills being paid. If necessary, the City establishes time payments for customers who are unable to pay a past due amount. Accounts closed with an amount due and unpaid are referred to the City Treasurer for collection activities 75 days after the bill is issued but unpaid. An allowance is taken each Fiscal Year for accounts receivable that are not expected to be paid. During the Fiscal Years 2005 through 2009, accounts receivable amounts outstanding for more than 120 days ranged from approximately \$1.6 million to approximately \$2.6 million. Sewer service charges to City utility customers are collected on the municipal sewer bill, which also includes water charges and storm drain fees. Bills are currently invoiced every two months for single family dwellings and most multifamily dwellings and on a monthly basis for all other customers.

Table 10 below sets forth information related to accounts receivable and number of shut-offs.

TABLE 10
WASTEWATER CUSTOMER ACCOUNTS RECEIVABLE AND SHUT-OFFS
(\$ In Thousands)
For Fiscal Years 2005 to 2009

	2005	2006	2007	2008	2009
Sewer Service Revenue ⁽¹⁾	\$283,423	\$286,416	\$299,736	\$325,048	\$318,474
Accounts Receivable ⁽²⁾	421,157	\$18,881	\$21,541	\$21,101	\$20,112
Accounts Receivable Over 120 Days ⁽²⁾⁽³⁾	\$1,639	\$2,557	\$2,485	\$2,193	\$2,567
Number of Shut-Offs ⁽⁴⁾	24,459	21,230	20,451	22,420	23,650

Sources: Comprehensive Annual Financial Reports for the indicated years for Sewer Service Revenue; Public Utilities Department, City of San Diego, for all other line items.

- (1) Audited.
- (2) Excludes amounts payable by Participating Agencies.
- (3) Estimated.
- (4) Information provided by the Customer Information System does not differentiate between water and sewer shut-offs. Therefore, such numbers may not reflect the actual number for sewer shut-offs.

Calculation and Collection of Capacity Charges

A capacity charge is a one-time fee based on equivalent dwelling units (“EDUs”) for a new, additional or larger connection to the Municipal Sub-System within the City. Capacity fees are not treated as operating income for financial reporting purposes but are considered System Revenues, deposited in the Sewer Revenue Fund, and included in the calculation of debt service coverage. Pursuant to State law, capacity fees are applied only to capital expansion, bonds, contracts, or other indebtedness of the Wastewater System related to expansion. Capacity fees are primarily collected on new construction within the City and revenues therefrom vary based upon construction activity. See “WASTEWATER SYSTEM FINANCIAL OPERATIONS—Financial Projections” below for a schedule of projected capacity charges for the Municipal Sub-System.

Table 11 below sets forth the Sewer Revenue Fund's EDUs and Capacity Charge Revenues for Fiscal Years 2005 through 2009.

TABLE 11
MUNICIPAL SUB-SYSTEM
SEWER UTILITY FUND
HISTORICAL CAPACITY CHARGE REVENUES
Fiscal Years 2005 through 2009
(\$ In Thousands)

Fiscal Year	Equivalent Dwelling Units ⁽¹⁾	Capacity Charge Revenues ⁽²⁾
2005	4,772	\$14,665
2006	5,150	\$16,565
2007 ⁽³⁾	4,966	\$16,610
2008	3,492	\$11,851
2009 ⁽⁴⁾	2,651	\$10,361

Source: Public Utilities Department and the Comptroller's Office, City of San Diego.

- (1) Unaudited. Declining number of EDUs reflects a decline in new construction.
- (2) Unaudited supplemental information provided by the Comptroller's Office, City of San Diego.
- (3) From Fiscal Year 2006 to Fiscal Year 2007, the EDUs decreased while the capacity charge revenues increased due to the increase in capacity charge from \$3,710 to \$4,124 in Fiscal Year 2007 pursuant to City Council Resolution No. R-302378.
- (4) Amount for Fiscal Year 2009 includes a one-time payment for 1,432 EDUs resulting in Capacity Charge revenue of \$5.9 million from the City's General Fund in connection with the City's Convention Center dewatering project.

The City Council reviews capacity charges on a periodic basis. In June 1996, in response to a request by the City Manager to reduce sewer capacity charges in order to stimulate economic development and affordable housing, the City Council approved, retroactive to April 22, 1996, a 64% reduction of sewer capacity charges. On June 8, 2004, the City Council adopted a revised rate structure based on a full cost recovery analysis which increased the sewer capacity charge effective July 1, 2004 to \$3,710 per unit, which was a 48% increase from the then existing sewer capacity charge.

Pursuant to State Water Board guidelines and City policy, the City must use a fair and equitable apportioning of costs based on each user class' contributions of flow and strength of wastewater pollutants discharged. The Participating Agencies are billed based on their contribution of flow, TSS and COD per the terms outlined in the respective service contracts, which were reviewed and approved by the State Water Board in 1998. In calendar year 2003, the City commissioned a cost of service study to design a system of user charges for the City's wastewater service consistent with the State Water Board's revenue guidelines and City policies. This study indicated that changes to the City's existing sewer capacity charge for single family residential customers and multifamily customers in the magnitude of the July 1, 2004 sewer capacity charge increase referenced above would be required to fully recover the costs associated with providing additional facility capacity to new users and existing users requiring additional capacity. In October 2006, the City commissioned an additional utility cost of service study and rate design study for the Department in order to review revenue requirements and cost of service allocations, and to confirm that the City's system of user charges for the City's wastewater service remained consistent with the State Water Board's revenue guidelines and City policies. The resulting report estimated a full cost-recovery capacity fee of \$4,124 per EDU. On February 26, 2007, the City Council adopted a revised rate structure based on a full cost recovery analysis which increased the sewer capacity charge effective May 1, 2007 to \$4,124, which is an 11% increase from the prior sewer capacity charge.

Table 12 below summarizes the rate history of sewer capacity charges since July 1, 1991.

**TABLE 12
RATE HISTORY FOR SEWER CAPACITY CHARGES**

Effective Date	Sewer Capacity Charges (Per Unit)	% Change
July 1, 1991	\$4,484	16%
July 1, 1992	\$5,201	16
July 1, 1993	\$6,033	16
July 1, 1994	\$6,998	16
April 22, 1996 ⁽¹⁾	\$2,500	(64)
July 1, 2004 ⁽²⁾	\$3,710	48
May 1, 2007 ⁽³⁾	\$4,124	11

Source: Public Utilities Department, City of San Diego.

- (1) Capacity charge decreases to \$2,500 pursuant to City Council Resolution No. R-287543 to encourage building activity.
- (2) Capacity charge increases to \$3,710 pursuant to City Council Resolution No. R-299321 based on results of the Cost of Service Study.
- (3) Capacity charge increases to \$4,124 pursuant to City Council Resolution No. R-302378 dated February 26, 2007 based on results of the Cost of Service Study.

Table 13 below sets forth the projected capacity charges for the Fiscal Years 2010 through 2014. New system hook-ups (measured in EDUs) are projected, on a conservative basis, based on the historically low EDUs of the last year, increased at the estimated rate of population growth. See “—Calculation and Collection of Capacity Charges” for a schedule of historical capacity charge revenues.

**TABLE 13
PROJECTED CAPACITY CHARGES
Fiscal Year 2010 through 2014**

	2010	2011	2012	2013	2014
Single Family Monthly Service Charge (Average)	\$47.90	\$50.67	\$50.64	\$52.67	\$54.78
Single Family Residential Accounts	228,183	229,005	230,265	231,531	232,782
Total Service Charge Revenues ⁽¹⁾	\$307,856	\$327,085	\$334,110	\$345,667	\$361,911
Capacity Charge (Per EDU)	4,124	4,124	4,124	4,124	4,124
Annual EDUs	1,229	1,242	1,252	1,265	1,278
Total Capacity Charge Revenue ⁽¹⁾	\$5,068	\$5,122	\$5,163	\$5,217	\$5,270

Source: Public Utilities Department, Rate Model as of January 21, 2010.

- (1) In thousands.

Historical Revenues and Expenses

Table 14 below sets forth the Statements of Revenues, Expenses and Changes in Fund Net Assets for Fiscal Years 2005 through 2009. See also APPENDIX A—“BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY INFORMATION AND CERTAIN EXCERPTS FROM THE COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE CITY OF SAN DIEGO FOR THE FISCAL YEAR ENDED JUNE 30, 2009.” For purposes of calculating the Net System Revenues available to pay the City’s Obligations under the Installment Purchase Agreement, including the 2010A Installment Payments securing the Series 2010A Bonds, the following are not taken into account: amounts set forth in the line item “Depreciation,” interest earnings with respect to the Acquisition Fund set forth in the line item “Earnings on Investments,” amounts set forth in the line item “Gain (Loss) on Sale/Retirement of Capital Assets,” amounts set forth in the line item “Interest Expenses” and amounts

relating to assets contributed by developers (which constitute a portion of the amount set forth in the line item “Capital Contributions”). For Net System Revenues available to pay the City’s Obligations under the Installment Purchase Agreement for Fiscal Years 2005 through 2009, see Table 16—“CALCULATION OF HISTORIC SENIOR AND AGGREGATE DEBT SERVICE COVERAGE.”

TABLE 14
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS⁽¹⁾
(\$ In Thousands)
Fiscal Years 2005 through 2009
(Audited)

	2005	2006	2007	2008	2009
OPERATING REVENUES					
Sewer Service Charges:					
Inside City:					
Domestic ⁽²⁾	\$156,496	\$164,664	\$170,608	\$182,486	\$200,990
Commercial and Industrial ⁽²⁾	66,198	68,492	70,085	77,547	75,506
Outside City:					
Domestic, Commercial and Industrial ⁽²⁾	3	—	—	—	—
Treatment Plant Service for Others ⁽²⁾	60,726	53,260	59,043	65,015	41,978
Total Sewer Service Charges	\$283,423	\$286,416	\$299,736	\$325,048	\$318,474
Other Operating Revenues, Net	5,549	4,152	5,013	3,071	4,097
TOTAL OPERATING REVENUES	<u>\$288,972</u>	<u>\$290,568</u>	<u>\$304,749</u>	<u>\$328,119</u>	<u>\$322,571</u>
OPERATING EXPENSES					
Maintenance and Operations	\$112,548	\$109,257	\$111,086	\$110,492	\$119,470
Administration	89,634	90,749	79,164	91,158	71,300
Depreciation	74,863	64,922	69,696	71,138	76,554
TOTAL OPERATING EXPENSES	<u>\$277,045</u>	<u>\$264,928</u>	<u>\$259,946</u>	<u>\$272,788</u>	<u>\$267,324</u>
OPERATING INCOME (LOSS)	<u>\$11,927</u>	<u>\$25,640</u>	<u>\$44,803</u>	<u>\$55,331</u>	<u>\$55,247</u>
NONOPERATING REVENUES (EXPENSES)					
Earnings on Investments	7,015	6,578	12,505	17,757	13,454
Federal Grant Assistance	3	325	65	134	—
Other Agency Grant Assistance	—	136	—	—	167
Gain (Loss) on Sale/Retirement of Capital Assets	(13,297)	(443)	(9,004)	(2,057)	(3,525)
Debt Service Interest Expense	(57,668)	(54,132)	(44,735)	(48,571)	(46,151)
Other	7,394	4,313	3,093	4,524	5,244
TOTAL NONOPERATING REVENUES (EXPENSES)	<u>\$(56,553)</u>	<u>\$(43,223)</u>	<u>\$(38,076)</u>	<u>\$(28,213)</u>	<u>\$(30,811)</u>
INCOME (LOSS) BEFORE CONTRIBUTIONS AND TRANSFERS	\$ (44,626)	\$ (17,583)	\$ 6,727	\$ 27,118	\$ 24,436
Capital Contributions	21,426	31,976	59,785	25,359	28,780
Transfers from Other Funds	504	481	7,738	714	616
Transfers from Governmental Funds	—	—	80	9	1,238
Transfers to Other Funds	(598)	(147)	(220)	(1,214)	(59)
Transfers to Governmental Funds	(1,383)	(1,958)	(2,162)	(5,585)	(3,550)
CHANGE IN NET ASSETS	<u>\$(24,677)</u>	<u>\$12,769</u>	<u>\$71,948</u>	<u>\$46,401</u>	<u>\$51,461</u>
Net Assets at Beginning of Year	<u>\$1,833,538</u>	<u>\$1,808,861</u>	<u>\$1,821,630</u>	<u>\$1,893,578</u>	<u>\$1,939,979</u>
NET ASSETS AT END OF YEAR	<u>\$1,808,861</u>	<u>\$1,821,630</u>	<u>\$1,893,578</u>	<u>\$1,939,979</u>	<u>\$1,991,440</u>

Source: Audited data from Comprehensive Annual Financial Reports for Fiscal Years 2005 through 2009. Unaudited data from the Comptroller’s Office, City of San Diego.

- (1) Terms used in this Table 14 are derived from the City’s Comprehensive Annual financial Report for the indicated year. Certain terms included in this Table 14 do not have the meanings ascribed to them in the Installment Purchase Agreement. Also, amounts included in Table 14 reflect the application of generally accepted accounting principles (“GAAP”) and, as such, do not match tables in this Official Statement that were not prepared in accordance with GAAP.
- (2) Unaudited.

Management's Discussion and Analysis

The following discussion relates to certain items set forth in Table 14. Certain of the following information in connection with the financial condition and results of operations of the City Sewer Revenue Fund for Fiscal Year 2009 is unaudited and should be read in conjunction with certain of the information contained in APPENDIX A—BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY INFORMATION AND CERTAIN EXCERPTS FROM THE COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE CITY OF SAN DIEGO FOR THE FISCAL YEAR ENDED JUNE 30, 2009," and, specifically, the portion of the basic financial statements relating to the operation of the Sewer Revenue Fund.

Operating Revenues. Total operating revenues for Fiscal Year 2009 were \$322.6 million, which represented a decrease of \$5.5 million from total operating revenues in Fiscal Year 2008. The decrease was primarily due to a decrease in treatment plant services for others of \$23 million for prior year refunds and reduced billings, offset by an increase in service charge revenues of \$16.5 million.

Operating Expenses. Total operating expenses for Fiscal Year 2009 were \$267.3 million, a decrease of \$5.5 million from Fiscal Year 2008. Such decrease was the combined result of a decrease in administrative expenses of \$19.9 million, an increase in maintenance and operations of \$9.0 million, and an increase in depreciation of \$5.4 million. Administrative expenses during Fiscal Year 2009 include long range strategic planning, policy, information systems, and general and administrative expenses. Such expenses represented 27% of total operating expenses.

Maintenance and Operations expenses include expenses for three treatment plants, two of which are water reclamation plants, and a biosolids center. Operation and Maintenance costs were 45% of Operating Expenses and totaled \$119.5 million for Fiscal Year 2009. This increase of \$9.0 million was 8% greater than the corresponding amount for Fiscal Year 2008, due to reclassifying approximately \$5 million of administrative expenses, and approximately \$3 million of increased chemical expenses due to new regulations at the Point Loma Wastewater Treatment Plant.

Non-Operating Revenues. Non-operating revenues for Fiscal Year 2009 decreased by \$3.6 million from non-operating revenues received in Fiscal Year 2008. This decrease was primarily due to a decrease in interest earnings of \$4.3 million, and an increase in other revenue of \$.7 million.

Non-Operating Expenses. Non-operating expenses decreased by \$1.0 million to \$49.7 million during Fiscal Year 2009. The decrease was due to a \$1.5 million increase in losses attributable to the sale or retirement of capital assets and a decrease in debt service interest expense of \$2.4 million.

Reserves. As of June 30, 2009, the Sewer Utility Fund had total reserves of \$81.1 million, which included the amounts in the Rate Stabilization Fund, Operating Reserve, Appropriated Reserve, Dedicated Reserve for Efficiency and Savings (the "DRES") and Wastewater System Capital Improvement Program Reserve. As of January 31, 2009, the Sewer Utility Fund had total reserves of \$85.3 million. See "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Rate Stabilization Fund and Other Reserves."

Outstanding Obligations. As of June 30, 2009, the Sewer Utility Fund had outstanding Obligations in the principal amount of \$1.339 billion. Following the issuance of the Series 2010A Bonds, the Department will have outstanding Obligations in the principal amount of \$1,319,441,099. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A

BONDS—Outstanding Obligations” and APPENDIX A—“BASIC FINANCIAL STATEMENTS AND REQUIRED SUPPLEMENTARY INFORMATION FROM THE COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE CITY OF SAN DIEGO FOR FISCAL YEAR ENDED JUNE 30, 2009,” including certain information regarding the Department’s debt service coverage ratio requirements.

Rate Stabilization Fund and Other Reserves

The City has established accounts within the Sewer Utility Fund for five reserve funds: the Rate Stabilization Fund (“Rate Stabilization Fund”), the Operating Reserve (“Operating Reserve”), the Wastewater System Capital Improvement Program Reserve (“Capital Improvement Reserve”), the Appropriated Reserve (“Appropriated Reserve”) and the DRES. The Department operates these reserve funds in accordance with the City’s fiscal reserve policy (the “Fiscal Reserve Policy”). The City’s goals with respect to the Fiscal Reserve Policy are to provide adequate cash balances to ensure that the City meets its cash flow obligations, maximizes earnings on investments, minimizes borrowing costs and maintains the highest credit on its bonds and financial obligations. In the event amounts contained in a particular reserve are below the anticipated reserve level as stated in the Reserve Policy, the Mayor is to propose a plan as part of the budget for the subsequent fiscal year to replenish such reserve in a reasonable timeframe. As of the Fiscal Year 2009, the Sewer Utility Fund had total reserves of \$81.1 million. As of January 31, 2010, the Sewer Utility Fund had total reserves of \$85.3 million.

The Rate Stabilization Fund is funded from operating revenues and serves as a source of funds used to mitigate future rate increases. The Department expects the Rate Stabilization Fund to be maintained at a level equal to 20% of Net System Revenues less operating and non-operating expenses or \$21.3 million. As of June 30, 2009, the balance was \$19.3 million, which met the incremental target balance for Fiscal Year 2009. The Sewer Utility Fund requested a \$2 million increase to the fund on January 20, 2010, to attain the targeted \$21.3 million by Fiscal Year 2010. The use of amounts in the Rate Stabilization Fund does not require City Council action. However, the Rate Stabilization Fund may only be used upon the recommendation of the Department and approval of the Chief Financial Officer and must be used in a manner consistent with the Installment Purchase Agreement.

The Operating Reserve, which is a subset of cash on hand, is restricted for use in the event an emergency situation resulting in a loss of revenue occurs and prevents the Wastewater System from operating in its normal course of business. Amounts so used from the Operating Reserve must be replenished no later than the subsequent fiscal year. The Operating Reserve is calculated based on the annual operating budget for the fiscal year. The current Operating Reserve for Fiscal Year 2010 is 50 days of the budget for Maintenance and Operations costs, which is \$33.7 million. As of June 30, 2009, there was approximately \$31.7 million in the Operating Reserve. As of January 31, 2010, the Operating Reserve was \$33.7 million. The Operating Reserve is expected to increase to 70 days of the budget for Maintenance and Operation costs by Fiscal Year 2013, which is projected to be approximately \$48.4 million.

The Department funded the Capital Improvement Reserve, which may only be used for costs of the Wastewater System CIP, in the amount of \$5.0 million for Fiscal Year 2009. City Council action is required for any withdrawal from the Capital Improvement Reserve. As of January 31, 2010, approximately \$5.0 million remained in the Capital Improvement Reserve.

The Appropriated Reserve is budgeted annually for unanticipated expenditures. It may be used to fund operating or capital requirements. If the Appropriated Reserve is used to fund unanticipated operating expenses, the approval of the Director of the Public Works Department is required and, if the Appropriated Reserve is to be used for unanticipated

capital needs, City Council action in the form of an ordinance is required. The Appropriated Reserve was \$3.4 million at the end of Fiscal Year 2009. As of January 31, 2010, there was \$3.5 million in the Appropriated Reserve.

In Fiscal Year 2008, the City established the DRES to save funds obtained by increasing efficiencies, changing priorities or other actions related to reducing costs of the Wastewater System CIP or operations and maintenance of the Wastewater System. The 2008 IROC Report recommended that savings from the Sewer Utility Fund be transferred into the DRES in order to improve accountability with respect to such savings and to provide funding of the Wastewater System in future years in lieu of rate increases. The funds in the DRES may be used for accelerating Wastewater System CIP project schedules and reducing the need for future rate increases. At the end of each fiscal year, any savings not required for compliance with established reserve policies will be transferred into the DRES. At the end of four years, any funds transferred into the DRES and not used for capital improvements will be used to lower future rates for the Wastewater System. As of June 30, 2009, approximately \$21.8 million was on deposit in the DRES. As of January 31, 2010, \$21.8 million remained on deposit in the DRES.

Table 15 below sets forth the amounts in the several reserves in the Sewer Revenue Fund as of June 30, 2009.

TABLE 15
SEWER UTILITY FUND RESERVES
 (as of June 30, 2009)
 (\$ In Thousands)
 (Unaudited)

Fund	Reserve Amount
Rate Stabilization Fund	\$19,300
Operating Reserve	31,653
Capital Improvement Reserve	5,000
Appropriated Reserve	3,394
Dedicated Reserve for Efficiencies and Savings	21,792
Total	\$81,139

Source: Public Utilities Department and Comptroller's Office, City of San Diego.

Historical Debt Service Coverage

Table 16 below sets forth the total revenues of the Wastewater System, the maintenance and operation costs of the Wastewater System and the resulting debt service coverage for the Outstanding Parity Obligations for Fiscal Years 2005 through 2009.

TABLE 16
CALCULATION OF HISTORIC SENIOR AND AGGREGATE DEBT SERVICE COVERAGE
(\$ In Thousands)
Fiscal Years 2005 through 2009
(Unaudited)

Fiscal Year Ended June 30	System Revenues	Total Maintenance and Operations Costs of the Wastewater System	Net System Revenues	Senior Debt Service			Debt Service Coverage	All Obligations ⁽¹⁾	
				Principal	Interest	Total		Total Debt Service	Aggregate Debt Service Coverage
2005	322,542	204,163	118,379	26,120	50,935	77,055	1.54	84,789	1.40
2006	320,288	202,111	118,177	27,390	49,662	77,052	1.53	86,802	1.36
2007	343,921	202,632	141,289	28,760	48,291	77,051	1.83	96,408	1.47
2008	361,511	211,449	150,062	30,250	46,805	77,055	1.95	94,555	1.59
2009	353,446	197,379	156,067	31,700	45,356	77,056	2.03	94,305	1.65

Source: Statistical section (unaudited) of the Fiscal Year 2009 Comprehensive Annual Financial Report.

(1) All Obligations include Parity Obligations, Subordinated Obligations and the Existing SRF Loans.

Financial Projections

Table 17 below sets forth the financial forecast for Fiscal Years 2010 through 2014. Table 17 incorporates certain assumptions, including assumed inflation and interest rates, rate increases and the amount of indebtedness to be issued during this period adopted by the Department. Projections for the Fiscal Year 2010 represent the Department budget that will be submitted to the City Council as part of the annual budget process. Table 17 does not include in its projections the Additional SRF Loan, which remains subject to final approval by the State Water Board. In the event the City receives the Additional SRF Loan, the Authority will reduce the principal amount of bonds to be issued by the amount of such Additional SRF Loan.

The achievement of certain results or other expectations contained in Table 17 involve known and unknown risks, uncertainties and other factors which may cause actual results, performance or achievements reflected in Table 17 to be materially different from any future results, performance or achievements expressed or implied by such Table. Although, in the opinion of the Department, such projections are reasonable, there can be no assurance that any or all of such projections will be realized or predictive of future results.

TABLE 17
ESTIMATED NET SYSTEM REVENUES AND DEBT SERVICE COVERAGE
Fiscal Year 2010 through 2014
(\$ In Thousands)
(Unaudited)

DESCRIPTION	2010 Projected	2011 Projected	2012 Projected	2013 Projected	2014 Projected
Net Revenues ⁽¹⁾	\$ 167,312	\$190,252	\$179,734	\$184,743	\$194,164
Interest Earnings ⁽²⁾	9,658	11,460	15,725	18,265	20,439
Capacity Charges ⁽³⁾⁽⁴⁾	5,068	5,122	5,163	5,217	5,271
Rate Stabilization Fund Transfer ⁽⁵⁾	(2,000)	0	0	0	0
Total Net System Revenues	<u>\$180,038</u>	<u>\$206,834</u>	<u>\$200,622</u>	<u>\$208,225</u>	<u>\$219,874</u>
Projected Senior Debt Service ⁽⁶⁾	\$103,229	\$102,489	\$117,163	\$117,169	\$134,075
Debt Service Coverage	1.74x	2.02x	1.71x	1.78x	1.64x
Projected Senior Debt Service	\$103,229	\$102,489	\$117,163	\$117,169	\$134,075
Projected Subordinate Debt Service	6,059	6,059	6,059	6,059	6,059
Aggregate Debt Service ⁽⁷⁾⁽⁸⁾	<u>\$109,288</u>	<u>\$108,548</u>	<u>\$123,222</u>	<u>\$123,228</u>	<u>\$140,134</u>
Aggregate Debt Coverage ⁽⁹⁾	1.65x	1.91x	1.63x	1.69x	1.57x

Source: Public Utilities Department and Department of Debt Management, City of San Diego.

- (1) Net Revenues consists of Revenues, less Maintenance and Operation Costs of the Wastewater System. Revenues consists of sewer service charges, sewer treatment plant services, services to others, sale of power from cogeneration, contributions in aid, and other miscellaneous sources. Net Revenues assume a 4% annual rate increase to Sewer Service Charges in 2012, 2013 and 2014. Net Revenues in 2011 include a one-time expected payment from the City of El Cajon for its proportionate share of past capital improvement expenditures. This revenue is classified as "Contributions In Aid." Maintenance and Operation Costs are inflated at 4% each year, excluding personnel expenses
- (2) Excludes amounts in the Acquisition Fund.
- (3) The amounts for each of the Fiscal Years 2010 through 2014 assume an approximate average annual 1% EDU growth rate over each of the four fiscal years. See Table 13 and accompanying description of projected capacity charges.
- (4) See Table 13 for the components of the Capacity Charges.
- (5) Reflects transfer in Fiscal Year 2010 to the Rate Stabilization Fund. Amounts transferred to the Rate Stabilization Fund are deducted from System Revenues pursuant to the Installment Purchase Agreement.
- (6) Reflects actual debt service on the Series 2009A Bonds, Series 2009B Bonds, and Series 2010A Bonds, and estimated debt service on additional Parity Obligations projected to be issued in Fiscal Years 2011 and 2013. Excludes debt service for the Additional SRF Loan, which remains subject to review by the State Water Board. The receipt of funds with respect to the Additional SRF Loan is not expected to affect the overall projections because the Department will reduce its aggregate borrowing by a like amount for the period set forth above.
- (7) Includes Parity Obligations and Existing SRF Loan debt service.
- (8) Amounts may not total due to rounding.
- (9) Ratio of Total Net System Revenues to Aggregate Debt Service.

Labor Relations

General. The City has five (5) labor organizations which represent classified employees. They are the International Association of Firefighters Local 145, the Police Officers Association, the Municipal Employees Association, the American Federation of State, County, and Municipal Employees Local 127, and the California Teamsters Local 911 who represent

lifeguards. A sixth labor organization, the Deputy City Attorneys Association represents unclassified deputy city attorneys.

As of January 26, 2010, there were 827.5 regular full-time wastewater employees of the Department, of which 461 are represented by the Municipal Employees Association (“MEA”) and 329 are represented by American Federation of State, County and Municipal Employees, AFL-CIO, Local 127 (“AFSCME Local 127”). The remaining 37.5 employees are unrepresented. The two bargaining units represent approximately 95% of the Department’s employees.

Contracts for Fiscal Year 2010 and 2011. On April 14, 2009, the City Council unanimously approved the terms of the labor agreements for Fiscal Years 2010 and 2011 for the MEA, the International Association of Firefighters Local 145 (“IAFF Local 145”) and DCAA. Negotiations with the remaining two bargaining units, AFSCME Local 127 and the Police Officers Association (“POA”), did not end in agreement. The City Council imposed on both unions the terms and conditions of employment contained in the Mayor’s last, best and final offer for Fiscal Year 2010. Pursuant to the labor agreements for the bargaining units and the terms and conditions approved for AFSCME Local 127 and POA, all five bargaining units and the City’s unclassified and unrepresented employees will be held to a general salary freeze and subject to a 6% reduction in overall compensation which has been implemented through salary reductions, decreases in the City-paid allotment of the employee share for employee health care, retirement and other employment benefits, fewer paid holidays and mandatory furloughs. Each bargaining unit reached the 6% target through a different combination of these measures. The compensation reductions also apply to management and unrepresented City employees, including the Mayor, his staff, and some independent departments. Departments not under Mayoral control including some City Council offices did not participate in some or all of the compensation reductions.

The City is currently engaged in contract negotiations for Fiscal Year 2011 with the POA, AFSCME Local 127, and the California Teamsters Local 911. Negotiations are ongoing with a target date for completion being April 15, 2010.

Pension Benefit Agreement. On July 28, 2008, the City Council ratified an agreement regarding the creation of new pension benefits for non-safety City employees with MEA, AFSCME Local 127 and DCAA (the “New Pension Plan”). The City expects to save on its pension costs over time as new hires are included under the New Pension Plan. The New Pension Plan became effective on July 1, 2009 and applies to non-safety employees hired on or after the effective date. The New Pension Plan lowers the defined benefit factor at age 55 and 60 from 2.50% to 1.00% and from 2.55% to 2.00%, respectively, and modifies the benefit formula (which currently permits retirees to receive up to 90.00% of their highest one year salary) by limiting compensation available under the pension plan to 80.00% of the highest three years average of compensation. In addition, the New Pension Plan establishes a retiree medical trust into which both the City and employees will equally contribute 0.25% of salary and establishes a new defined contribution component in addition to the defined benefit component. The New Pension Plan includes mandatory employee contributions of 1.00% of salary, with a City match component. See Note 12 to the City’s Fiscal Year 2009 audited financial statements attached hereto as APPENDIX A—“BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY INFORMATION AND CERTAIN EXCERPTS FROM THE COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE CITY OF SAN DIEGO FOR THE FISCAL YEAR ENDED JUNE 30, 2009.”

Insurance and Liability Claims

The Department is self-insured for workers' compensation and long-term disability and for public liability claims exposure up to \$5 million per occurrence. For liability between \$5 million and \$50 million, the Department is covered by the City, which purchases insurance in collaboration with the California State Association of Counties—Excess Insurance Authority, a statewide joint powers authority risk pool, in layers for its public liability exposure.

The City participates in the joint purchase of property insurance and flood insurance through the CSAC-EIA pool which includes flood and earthquake coverage for scheduled locations, including bond financed locations of the Wastewater System. This joint purchase of the City's "all risk" property insurance, insuring approximately \$2.73 billion of City property, provides coverage for loss to City property under the primary policy up to approximately \$25 million per occurrence, with a \$25,000 deductible. Depending on availability and affordability of earthquake insurance, the City may elect not to purchase such coverage in the future. The City does not maintain any casualty insurance on the pipelines of the Wastewater System because such insurance is not commercially available.

Table 18 below sets forth the accrued estimated liabilities and expenditures for liability claims of the Wastewater System for Fiscal Years 2005 through 2009.

TABLE 18
LIABILITY CLAIMS BUDGETED AND EXPENDITURES
Fiscal Years 2005 to 2009
(Unaudited)

Fiscal Year	Budgeted Liabilities	Expenditures ⁽¹⁾
2005	\$2,589,000	\$1,814,378
2006	2,589,000	500,928
2007	2,589,000	1,052,219
2008	1,283,412	1,612,392
2009	1,283,412	884,769

Source: Public Utilities Department and Risk Management Department, City of San Diego.

(1) Over-budget expenditures are paid from Sewer Revenue Fund balance available for appropriation.

Investment of Funds

General. Amounts in the funds and accounts of the Sewer Revenue Fund are invested by the City Treasurer in the Treasurer's Pooled Investment Fund (the "City Pool") described below and the City accounts for such amounts separately from other funds of the City.

City Pool. In accordance with the Charter of the City and authority granted by the City Council, the City Treasurer is responsible for investing the unexpended cash in the City Pool. Responsibility for the daily investment of funds in the City Pool is delegated to the City's Chief Investment Officer. The City and certain related entities are the only participants in the City Pool; there are no other City Pool participants either voluntary or involuntary in the City Pool. The investment objectives of the City Pool are preservation of capital, liquidity and return.

Oversight and Reporting Requirements. The City Treasurer provides an investment report on a monthly basis to the Chief Financial Officer, the City Comptroller and the City Council and annually presents the Investment Policy to the Chief Financial Officer, the Investment Advisory Committee and the City Council. The Investment Advisory Committee is comprised of two City employees, currently the Chief Financial Officer and the Director of Debt Management, and three investment professionals from the private sector and is charged with

overseeing the review of the City's Investment Policy and practices of the City Treasurer and recommending changes thereto. Investments in the City Pool are audited annually by an independent firm of certified public accountants as part of the overall audit of the City's financial statements.

The City's investments division uses outside services to provide investment portfolio valuations and accounting and reporting services. These services provide monthly portfolio valuation, investment performance statistics, and other portfolio reports that are distributed to the Office of the City Treasurer accounting section and the Office of the Comptroller of the City for review and reconciliation. The Office of the City Treasurer's accounting section prepares a series of monthly reports, including the portfolio market valuation, and distributes these to the Mayor, City Council, Chief Financial Officer, and other officials.

Authorized Investments. Investments in the City Pool are governed by State law and further restricted by the City's Investment Policy. The Investment Policy is prepared with safety of principal being the foremost objective. Permitted investments include U.S. Treasury securities, U.S. Agency securities, U.S. Agency mortgage backed securities, corporate medium term notes, money market instruments, non-negotiable FDIC-insured certificates of deposit and the Local Agency Investment Fund (California State Pool). Reverse repurchase agreements ("reverse repos") are restricted to 20% of the base value of the portfolio and are governed by various maturity restrictions as well. The main operating funds of the City are managed in two separate portfolios. In its management of the "Liquidity" portfolio, comprising about 35% of total funds, the City invests in a variety of debt securities with maturities ranging from one day to one year. The remaining 65% of funds are managed in a separate "Core" portfolio that consists of a variety of debt securities ranging from one day to five years; performance is measured against the Merrill Lynch one- to three-year U.S. Treasury Index. The 35% Liquidity/65% Core portfolio split serves as a guideline. The actual split may vary due to market conditions or other factors. Safety of principal and liquidity are paramount considerations in the management of both portfolios.

Pool Liquidity and Other Characteristics. The City Pool (including both the "Liquidity" and the "Core" portfolios) is highly liquid. Based on preliminary and unaudited month-end data as of December 31, 2009, approximately 13% of the pool investments mature within 62 days, 16% within 92 days and 22% within 184 days, 34% within 1 year, 72% within 2 years, 99% within 3 years, and 100% within 5 years (on a cumulative basis). As of December 31, 2009, the Pool had a weighted average maturity of 1.44 years (524 days) and its weighted average yield was 1.143%. For purposes of calculating weighted average maturity, the City Treasurer treats investments in the State-wide Local Agency Investment Fund (California State Pool) as maturing within one day. The Liquidity portfolio had a duration of 0.40 years and the Core portfolio had a duration of 1.85 years as of December 31, 2009. Duration is a measure of the price volatility of the portfolio and reflects an estimate of the projected increase or decrease in the value of the portfolio based upon a decrease or increase in interest rates. Accordingly, the Liquidity portfolio should decrease in market value by 0.40% for every 1% increase in market interest rates while the Core portfolio should decrease in market value by 1.85% for every 1% increase in market interest rates. The City Pool's composition is designed with a goal of having sufficient liquid funds available to meet disbursement requirements. The composition and value of investments under management in the City Pool will vary from time to time depending on cash flow needs of the City, maturity or sale of investments, purchase of new securities, and fluctuations in interest rates.

Table 19 below sets forth the City Pool results at December 31, 2009.

TABLE 19
CITY OF SAN DIEGO POOLED INVESTMENT FUND
at December 31, 2009
(\$ In Thousands)
(Unaudited)

Investment Instrument	Book Value	Fair Value	Percent of Total ⁽¹⁾
U.S. Treasury Bills and Notes	\$ 926,952	\$ 927,188	44.96%
Federal Agency Securities ⁽²⁾	753,964	754,388	36.57
Medium Term Notes (Corporate) ⁽³⁾	194,391	195,636	9.43
Money Market Instruments ⁽⁴⁾	136,340	136,340	6.62
Local Agency Investment Fund	49,891	49,891	2.42
TOTAL INVESTMENTS	\$2,061,538	\$2,063,443	100.00%

Source: Office of the City Treasurer, City of San Diego.

(1) Based on book value.

(2) Federal National Mortgage Association ("Fannie Mae") securities and Federal Home Loan Mortgage Corporation ("Freddie Mac") securities represent 20.24% and 27.25%, respectively, of total Federal Agency Securities, which is approximately 7.40% and 9.97%, respectively, of the City Pool.

(3) These notes consist of both fixed and floating interest rate securities. The notes with floating interest rates are reset at intervals ranging from one day to three months. 65.48% of these notes were issued under the Temporary Liquidity Guarantee Program and are backed by the full faith and credit of the FDIC.

(4) These securities consist of commercial paper, negotiable certificates of deposit, Certificate of Deposit Account Registry Service certificate of deposit, term and overnight repurchase agreements, money market mutual funds, banker's acceptances, bank notes and/or thrift notes.

San Diego City Employees' Retirement System

The City faces significant financial challenges in addressing an unfunded pension liability to the San Diego City Employees' Retirement System ("SDCERS"), which, as of June 30, 2009, was approximately \$2.106 billion. The challenges posed by the unfunded pension liability are significant and, together with significant costs related to postemployment healthcare benefits, pose a threat to the future fiscal health of the City. However, as explained below under the caption, "Sewer Utility Fund Share of Contribution to Pension System and NPO," the Sewer Utility Fund's proportionate share of the City's annual required contributions to the Pension System is approximately 4.95% (equal to approximately \$7.6 million, assuming a City pension payment of \$154.2 million) for Fiscal Year 2010. Estimates of the Sewer Utility Fund's share of the City's annual contributions of approximately \$14.4 million for each of Fiscal Years 2008 through 2011 were included in the 2007 Rate Case model that served as the basis for the annual rate increases in effect through Fiscal Year 2011 that were approved by the City Council. For Fiscal Years 2009 and 2010, the actual contributions required from the Sewer Utility Fund were less than the amounts that were assumed in the 2007 Rate Case model.

The City's annual required contribution ("ARC") payment for Fiscal Year 2011 will be \$231.7 million if paid on July 1, 2010. The Sewer Utility Fund's expected proportionate share of the ARC payment is 7.08%, which would result in a contribution by the Sewer Utility Fund of approximately \$16.4 million for Fiscal Year 2011. The Sewer Utility Fund's proportionate share is increasing in Fiscal Year 2011 primarily due to a Department reorganization which resulted in budgeted positions being moved from the Water Utility Fund to the Sewer Utility Fund. These positions were previously fully captured as a non-personnel expense in a service level agreement between the two funds. This reorganization of positions will have no material impact on the Fiscal Year 2011 operations and maintenance budget for the Sewer Utility Fund.

The amounts and percentages set forth under this caption relating to the City's Pension System, including, for example, actuarial accrued liabilities and funded ratios, are based upon

numerous demographic and economic assumptions, including investment return rates, inflation rates, salary increase rates, cost of living adjustments, postemployment mortality, active member mortality, and rates of retirement. The prospective purchasers of the Series 2010A Bonds are cautioned to review and carefully assess the reasonableness of the assumptions set forth in the documents that are cited as the sources for the information under this caption. In addition, the prospective purchasers of the Series 2010A Bonds are cautioned that such sources and the underlying assumptions speak as of their respective dates, and are subject to change, any one of which could cause a significant change in the UAAL (as defined below).

SDCERS is considered part of the City's financial reporting entity and is included in the City's CAFR as a pension system trust fund. SDCERS does prepare its own CAFR, the most recent of which is for Fiscal Year 2009.

UAAL and its Calculation. According to the June 30, 2009 Annual Actuarial Valuation of SDCERS, prepared by Cheiron, Inc. ("Cheiron") dated as of January 8, 2010 (the "2009 Valuation"), the funded ratio (the actuarial value of assets available for benefits to total actuarial accrued liability) of the City's portion of the SDCERS fund¹ was 66.5%, and the SDCERS fund had an unfunded actuarial accrued liability (the "UAAL") of \$2.106 billion. Thus, for every dollar of benefits due (all vested liabilities), SDCERS had \$.66 in assets available for payment as of June 30, 2009. The UAAL is the difference between total actuarially accrued liabilities (the "AAL") which was approximately \$6.282 billion as of June 30, 2009, and actuarially calculated assets allocated to funding, which was approximately \$4.175 billion as of June 30, 2009.

Global financial markets experienced significant volatility in fiscal year 2009 and SDCERS experienced an actuarial investment loss of \$811.4 million in the City's plan during that period. According to the City's June 30, 2008 Annual Actuarial Valuation (the "2008 Valuation") and the 2009 Valuation, the actuarial value of assets (City's portion) as of June 30, 2008 and June 30, 2009 were respectively \$4.660 billion and \$4.175 billion. The market value of assets (City's portion) as of June 30, 2008 and June 30, 2009, as reported in the 2008 Valuation and the 2009 Valuation, respectively, were \$4.409 billion and \$3.479 billion. A decline in the actuarial value of assets over time will result in an increase to the City's ARC in comparison to the amounts estimated in the Five-Year Financial Outlook for Fiscal Years 2010-11 through 2014-15; however, the impact on the Sewer Utility Fund would be expected to be minimal. See the text under the headings "—City Contributions to SDCERS" and "—Sewer Utility Fund Share of Contributions to Pension System and NPO" below.

Actuarial Assumptions. The following are the principal actuarial assumptions used by SDCERS' actuary in preparing the valuation as of June 30, 2009:

1. Investment Return Rate: 7.75% a year, net of administrative expenses, compounded annually.
2. Inflation Rate: 4.00% a year, compounded annually.
3. Interest Credited to Member Contributions: 7.75% compounded annually.
4. Salary Increase Rates: Comprised of a 4.00% inflation rate and 0.5% to 8.0% merit component.
5. Annual Cost-of-Living Adjustments: 2.00% per year, compounded annually.

¹ The City participates in SDCERS along with the San Diego County Regional Airport Authority ("Airport Authority") and the San Diego Unified Port District ("Port District"). The information herein refers only to the City's participation in SDCERS and not to the participation of the Airport Authority or the Port District.

6. Additional Assumptions: Additional assumptions were used regarding rates of separation from active membership, post-retirement mortality, active member mortality and rates of retirement.

“Smoothing” Methodology. In determining the actuarial value of its assets, SDCERS, as permitted by applicable actuarial guidelines, uses an expected value of assets “smoothing” methodology to reduce the impact of market volatility on plan assets. The market value of assets represents, as of the valuation date, the value of the assets as if they were liquidated on that date. The actuarial value of assets is a value that attempts to smooth annual investment return performance over multiple years to reduce annual contribution volatility. The actuarial value of assets is used to determine SDCERS’ contribution rates for the City. As of June 30, 2009, the market value of plan assets was \$3.479 billion, and the actuarial value was \$4.175 billion. By the smoothing method used in the 2009 Valuation, the calculation of the actuarial value of assets at June 30, 2009 started with the actuarial value of assets at June 30, 2008, added to that 100% of the actuarially assumed rate of return, plus the contribution towards plan assets, less payments out from plan assets, plus 25% of the difference between the expected actuarial value of assets at June 30, 2009 (using the above calculation) and the actual market value of assets at June 30, 2009. In no event will the actuarial value of assets ever be less than 80% of the market value of assets nor greater than 120% of the market value of assets. The impact of this smoothing methodology will vary each year depending upon the year’s actual market value compared to the expected value of assets, either as a net gain or a net loss. The City expects SDCERS to employ the smoothing method used in the 2009 Valuation to valuations for future fiscal years. As a result of the smoothing methodology, even a healthy increase in the market value of the SDCERS’ plan assets as of June 30, 2010 would have a limited impact on improving the fiscal year 2012 ARC. For example, holding all other actuarial assumptions constant, an annual investment return of 25% for fiscal year 2010 is estimated to result in an ARC of \$244.2 million on a citywide basis for fiscal year 2012 (compared to an ARC of \$231.7 million for fiscal year 2011). This is primarily due to the fact that, because of the smoothing methodology, approximately 45% of fiscal year 2009’s market loss has yet to be captured in future ARC calculations and only 25% of any fiscal year 2010 gains will be included in the fiscal year 2012 ARC calculation.

City Contributions to SDCERS. The City’s ARC consists of: (i) the “normal cost,” being the present value of the benefits that SDCERS expects to become payable in the future attributable to a current year’s employment, and (ii) payments made to amortize the UAAL. SDCERS currently amortizes the UAAL over several different closed periods: the amortization of changes in the UAAL due to assumption changes is over 30 years, the amortization of changes in the UAAL due to benefit changes is over five years, the outstanding balance of the Fiscal Year 2007 UAAL is amortized over 20 years (such that, as of Fiscal Year 2009, 18 years of amortization remain), and subsequent yearly gains and losses are amortized over 15 years. Finally, if necessary, there is an additional UAAL cost component to ensure that there is no negative amortization in any year, all as approved by the SDCERS Board of Administration in its administrative capacity pursuant to its plenary authority over the Pension System. See Note 12 to the City’s audited financial statements attached hereto in Appendix A for a description of the shorter amortization period prescribed by the City Charter. For several years, the City was paying less than the full ARC. The reasons for this are numerous, including prior agreements between the City and SDCERS, earnings on pension assets at greater than the previous actuarially assumed rate of 8% being credited against contributions, payments pursuant to litigation settlements that were mistakenly characterized as “contingent” and therefore not made in certain years, and other reasons explained in detail in Note 12 to the City’s 2009 audited financial statements. See APPENDIX A—“BASIC FINANCIAL STATEMENTS AND REQUIRED SUPPLEMENTARY INFORMATION FROM THE COMPREHENSIVE ANNUAL FINANCIAL REPORT OF THE CITY OF SAN DIEGO FOR FISCAL YEAR 2009” attached hereto.

Due to the City's prior practice of funding the Pension System at less than actuarially required levels, the City has a Net Pension Obligation ("NPO"), which is the cumulative difference between the annual pension cost ("Annual Pension Cost") to the City of the Pension System and the actual contribution in a particular year. The Annual Pension Cost is equal to (i) the ARC, (ii) one year's interest on the NPO, and (iii) an adjustment to the ARC to offset, approximately, the amount included in item (i) for amortization of the past contribution deficiencies.

In Fiscal Year 2009, the City's total pension payment, including its pension ARC and its contribution for the Preservation of Benefits Plan referenced in the CAFR for Fiscal Year 2009 (the "Preservation of Benefits Plan"), was \$163.6 million. The City's NPO at the end of Fiscal Year 2009 was \$177.8 million. The City's pension payment for Fiscal Year 2010 is \$154.2 million and has been paid in full. The City anticipates contributing an additional \$1.4 million for the Preservation of Benefits Plan for Fiscal Year 2010.

Table 20 below sets forth the City's portion of SDCERS historical funding progress for Fiscal Years 2005 through 2009.

TABLE 20
CITY OF SAN DIEGO
Schedule of Funding Progress
Fiscal Years 2005 through 2009
(\$ In Thousands)
(Unaudited)

Valuation Date (June 30)	Valuation Assets	AAL	Funded Ratio	UAAL ⁽¹⁾
2005 ⁽¹⁾⁽²⁾	\$2,983,080	\$4,436,017	67.25%	\$1,452,937
2006 ⁽¹⁾	3,981,932	4,982,700	79.92	1,000,768
2007 ⁽³⁾	4,413,411	5,597,653	78.84	1,184,242
2008	4,660,346	5,963,550	78.15	1,303,204
2009	4,175,229	6,281,593	66.47	2,106,364

Source: City of San Diego Comprehensive Annual Financial Report with respect to data for Fiscal Years 2005 through 2008. 2009 Valuation for Fiscal Year 2009.

- (1) Projected Unit Cost method used for determining actuarial accrued liability.
- (2) For Fiscal Year 2005, the actuarial accrued liability, the UAAL and the funded ratio have been adjusted to reflect the impact of the Corbett contingent settlement benefit. The actuarial valuation provided by the actuary for Fiscal Year 2005 does not include this contingent benefit in the funded ratio. However, the valuations prepared by the actuary for Fiscal Years 2006 through Fiscal Year 2009 do include the impact of the Corbett contingent settlement benefit. See Note 12 to the CAFR for Fiscal Year 2009 attached hereto as APPENDIX A.
- (3) Reflects revised actuarial methodologies. The actuarial accrued liability was calculated using the Entry Age Normal method beginning in Fiscal Year 2007. Prior to Fiscal Year 2007, the Projected Unit Cost method was used.

Sewer Utility Fund Share of Contribution to Pension System and NPO. For Fiscal Year 2009, the Sewer Utility Fund's proportionate share to fully fund the City's contribution to the pension system was \$7.6 million, and for Fiscal Year 2010 such share is \$7.6 million. The Sewer Utility Fund's 2007 Rate Case projection, which was the basis for the sewage service charge increases set forth in Table 9 and approved by the City Council (see "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Establishment, Calculation and Collection of Sewer Service Charge Revenue and Treatment Plant Services Revenue" and "—Calculation and Collection of Capacity Charges"), included \$14.4 million as the Sewer Utility Fund's estimated annual proportionate share of the City's ARC for Fiscal Years 2008 through 2011. The City expects that the \$57.6 million total estimate included in the Sewer Utility Fund's 2007 Rate Case projection for Fiscal Years 2008 through 2011 will be sufficient to pay the Sewer Utility Fund's

proportionate share to fully fund the City's contribution to the Pension System for such years. The Sewer Utility Fund's share of the NPO at June 30, 2009, is approximately \$10.8 million. See the City's Fiscal Year 2009 audited financial statements attached hereto, line item entitled "Non-Current Liabilities Net Pension Obligation" under the table entitled "Proprietary Funds Statement of Net Assets."

The following Table 21 sets forth, for Fiscal Years 2008 through 2011, the City's total pension contributions (including its core pension contribution and the Preservation of Benefits (POB) Plan contribution), the pension contributions included in the Sewer Utility Fund's 2007 Rate Case projection and the corresponding actual, budgeted or projected contributions, which have been lower than the 2007 rate case projections in total for Fiscal Years 2008 through 2011 (2007 rate case projections are from 2008 through 2011).

TABLE 21
CITY OF SAN DIEGO AND SEWER UTILITY FUND
PENSION CONTRIBUTION
Fiscal Years 2008 through 2011
(\$ In Millions)

Fiscal Year ending June 30	ARC ⁽¹⁾	Total City Pension Contribution ⁽²⁾	Department Rate Case Projection ⁽³⁾	Actual/ Budgeted/Projected ⁽²⁾
2008	\$140.1	\$166.6 ⁽⁴⁾	\$14.4	\$10.2 ⁽⁵⁾
2009	165.7	163.6 ⁽⁴⁾	14.4	7.6 ⁽⁵⁾
2010	155.2	155.6 ⁽⁴⁾	14.4	7.6 ⁽⁶⁾
2011	231.7 ⁽⁷⁾	233.2 ⁽⁴⁾	14.4	16.4 ⁽⁶⁾

Source: The City of San Diego Comprehensive Annual Financial Report for the Fiscal Year ended June 30, 2008 and June 30, 2009; City of San Diego Financial Management Department and the Public Utilities Department.

- (1) Includes core pension ARC and POB Plan ARC. Per IRS guidelines, the City may not pre-fund the POB Plan. Therefore, plan contributions may differ from the ARC in any given year. See footnote 4.
- (2) FY 2008 and 2009: Audited; FY 2010: Budgeted; and FY 2011: Projection.
- (3) Reflects projections as of the date of the 2007 Rate Case.
- (4) FY 2008: Includes \$137.7 million core pension contribution per SDCERS June 30, 2006 Actuarial Valuation, \$1 million POB Plan contribution, and \$27.9 million in additional voluntary contributions. FY 2009: Includes \$161.7 million core pension contribution per SDCERS June 30, 2007 Actuarial Valuation, \$1.2 million POB Plan contribution, and \$700,000 in additional voluntary contributions. FY 2010: Includes \$154.2 million core pension contribution per SDCERS June 30, 2008 Actuarial Valuation and a budgeted \$1.4 million POB Plan contribution. FY 2011: Includes the core pension contribution per SDCERS June 30, 2009 Actuarial Valuation and a projected \$1.5 million POB Plan contribution.
- (5) Actual. The Sewer Utility Fund's proportionate share to fully fund the City's pension contribution (excluding contributions for the POB Plan), was 6.16% for Fiscal Year 2008 and 4.68% for Fiscal Year 2009. The Department contributes to the POB Plan only if its employees receive benefits thereunder. The Department was not required to contribute to the POB Plan in Fiscal Year 2008 or 2009. The Department's contribution to the POB, if any, for subsequent Fiscal Years will be determined at the end of the respective fiscal years. See footnote (6) below for a discussion of adjustments to the proportionate share.
- (6) Fiscal Year 2010 budgeted amount and Fiscal Year 2011 projected amount, assuming the Sewer Utility Fund's proportionate share to fully fund the City's pension contribution (excluding contributions for the POB Plan), is 4.95% and 7.08%, respectively. The Sewer Utility Fund's proportionate share is established at the beginning of a Fiscal Year and may increase or decrease during the year and from year to year depending on a variety of factors, including the number of covered employees attributable to the Sewer Utility Fund, the retirement benefits accruing to such employees and end-of-the-year payroll adjustments.
- (7) The POB Plan ARC has not yet been determined for FY 2011 and, accordingly, has not been included.

Actual and budgeted amounts set forth above reflect amounts necessary for the City to satisfy its pension contribution requirement for each fiscal year and may be more or less than the amounts projected in the 2007 Rate Case. To date, amounts included in the Sewer Utility Fund's 2007 Rate Case for Fiscal Years 2008-2011 have in total exceeded the amounts actually required to satisfy the Sewer Utility Fund's pension contribution requirement.

In addition to the City's ARC payment, the City has entered into a court-approved class action settlement in the case of *William J. McGuigan v. City of San Diego, et. al.*, that requires the City to make a payment of the remaining settlement amount of approximately \$32.8 million plus any interest accrued under the settlement to SDCERS by June 8, 2011. Due to the unreasonable hardship that would result if the City were required to make this payment within the proscribed time period, the City will seek to modify the settlement agreement to allow the City to pay the remaining settlement amount over four years. The modified settlement, if approved by the Court, would not significantly affect the Sewer Utility Fund's payment of its proportionate share of the McGuigan settlement. If the modified settlement is approved, the Sewer Utility Fund's payment would be approximately \$2.3 million if made on the expected payment date of June 30, 2010. If the settlement is not modified, the Sewer Utility Fund's proportionate share of the payment would be approximately \$2.4 million if paid on June 8, 2011. This lawsuit involved the underfunding of the pension system by the City and all payments made under the settlement are credited against the UAAL.

Postemployment Healthcare Benefits

The City provides retiree healthcare benefits, also known as other postemployment benefits ("OPEB"), to certain health-eligible retired employees through a plan administered by SDCERS. The City's OPEB plan includes approximately 5,400 retirees, 8,900 active employees and 600 terminated vested members as of June 30, 2009. Historically, OPEB expenses were funded on a pay-as-you-go basis. Beginning in Fiscal Year 2008, the City entered into an agreement with the California Public Employees Retirement System ("CalPERS") as a participating employer in the CalPERS Employers Retirement Benefits Trust ("CERBT") to pre-fund future OPEB expenses. In fiscal year 2009, the City contributed approximately \$25.6 million to SDCERS to pay current OPEB expenses and contributed an additional amount of approximately \$23.9 million to the CERBT. In fiscal year 2010, the City budgeted approximately \$32.1 million to SDCERS to pay current OPEB expenses and budgeted an additional contribution of approximately \$25 million to the CERBT. As of December 31, 2009, the balance in the CERBT was approximately \$50.3 million.

The Sewer Utility Fund's proportionate share of the City's pay-as-you-go contribution for OPEB was approximately \$2.0 million for Fiscal Year 2009. The Sewer Utility Fund's proportionate share of the contribution to CERBT was approximately \$1.9 million. For Fiscal Year 2010, the Sewer Utility Fund is budgeted to contribute approximately \$2.5 million and \$2 million, respectively, as its proportionate share of the City's pay-as-you-go OPEB contribution and the CERBT contribution.

As of the date of this Official Statement, the City has not fully funded its ARC for OPEB (i.e., the sum of the normal cost of the postemployment benefits plus amortization of the OPEB UAAL). The City has not projected the amounts necessary to fully fund its OPEB ARC payments beyond the amounts set forth in its October 2009 Five-Year Financial Outlook and does not expect to fully fund its OPEB ARC payment in that timeframe, as outlined in the October 2009 Five-Year Financial Outlook. All future contributions for postemployment healthcare benefits will be credited toward the City's ARC for retiree healthcare liabilities in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 43, "Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans" ("GASB 43"), and GASB Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions" ("GASB 45"). See Note 13 to the Fiscal Year 2009 audited financial statements attached hereto in Appendix A.

In connection with compliance with GASB 43 and GASB 45, the City has calculated its net OPEB obligation ("NOPEBO") as of June 30, 2009 to be approximately \$93.9 million. The NOPEBO is the cumulative difference between the City's annual OPEB cost and City's

contributions to OPEB in a particular year, including the OPEB liability or asset at transition, if any. Annual OPEB cost is equal to (i) the ARC for OPEB, (b) one year's interest on the NOPEBO from prior years (which the City determined to be zero at the beginning of Fiscal Year 2008, the transition year, in accordance with GASB 45), and (c) an adjustment to the ARC for OPEB to offset the effect of actuarial amortization of past under- or over-contributions. The Sewer Utility Fund's proportionate share of the City's NOPEBO as of June 30, 2009 was \$6.9 million. The City intends to pre-fund the CERBT with approximately \$25 million on an annual basis, as described in Note 13 to the Fiscal Year 2009 audited financial statements attached hereto in Appendix A.

An actuarial valuation of the City's postemployment medical benefit program as of June 30, 2009 (the "2009 OPEB Valuation") was performed by Buck Consultants for the purpose of determining the City's annual cost in accordance with GASB 45. The valuation, dated September 17, 2009, reflected a discount rate of 6.69% based on the City's actual and expected contributions to CERBT, inflation factors for increases in healthcare costs and premium costs, and a 30-year amortization period (open basis). According to the 2009 OPEB Valuation, using the assumptions described above and consistent with GASB 45, the UAAL for OPEB for all retirees, deferred retirement participants, vested terminated and active members was \$1.32 billion and the ARC for OPEB will be \$120.32 million for Fiscal Year 2011 (as reported in the actuarial valuation dated June 30, 2009).

Table 22 below sets forth the retiree health contributions included in the Sewer Utility Fund's 2007 Rate Case projection for Fiscal Years 2008 through 2011 and the corresponding actual, budgeted or projected amounts, which have been lower than the projected amounts set forth in the 2007 Rate Case. Amounts budgeted for future years may be lower than amounts set forth in the 2007 Rate Case projection. The City expects that such amount will be sufficient to pay the Sewer Utility Fund's proportionate share to fund the City's contribution to OPEB for such years. Projections sets forth in the Sewer Utility Fund's 2007 Rate Case include amounts through Fiscal Year 2011, years through which sewer rates were approved by the City Council.

**TABLE 22
WASTEWATER SYSTEM
RETIREE HEALTH CONTRIBUTION
Fiscal Years 2008 through 2011
(\$ In Millions)**

Fiscal Year ending June 30	ARC	Total City Contribution	Rate Case Projection	Actual/ Budgeted /Projected ⁽¹⁾
2008	\$ 91.6	\$53.6	\$4.4	\$4.2 ⁽²⁾
2009	104.5	49.5	6.7	3.9 ⁽²⁾
2010	113.4	57.1	9.1	4.5 ⁽³⁾
2011	120.3	62.2	9.1	5.5 ⁽⁴⁾

Source: The City of San Diego Comprehensive Annual Financial Report for the Fiscal Year ended June 30, 2008 and June 30, 2009; City of San Diego Financial Management Department and the Public Utilities Department.

- (1) Consists of the Sewer Utility Fund's proportionate share of pay-as-you-go postemployment healthcare benefits and its proportionate share of contributions to CalPERS for OPEB. The Sewer Utility Fund's proportionate share of OPEB for Fiscal Year 2008 was 7.84% and for Fiscal Year 2009 was 7.88%. Proposed and projected amounts reflect an assumed Sewer Utility Fund proportionate share of 7.96% for Fiscal Year 2010 and 8.8% for Fiscal Year 2011. The Sewer Utility Fund's proportionate share may increase or decrease from year to year depending on a variety of factors, including the number of covered employees attributable to the Sewer Utility Fund and the retirement benefits accruing to such employees.
- (2) Actual.
- (3) Proposed Budget.
- (4) Projected Department contribution based on the Sewer Utility Fund's proportionate share (see footnote (1) above) of the City's aggregate pay-as-you-go postemployment healthcare contributions and OPEB contributions through CalPERS, as set forth in the June 30, 2009 Annual Actuarial Valuation.

RISK FACTORS

The ability of the City to pay principal of and interest on the Series 2010A Bonds depends primarily upon the receipt by the City of Net System Revenues. Some of the events which could prevent the City from receiving a sufficient amount of Net System Revenues to enable it to pay the principal of and interest on the Series 2010A Bonds are summarized below. The following description of risks is not intended to be an exhaustive list of the risks associated with the purchase of the Series 2010A Bonds and the order of the risks set forth below does not necessarily reflect the relative importance of the various risks.

Limited Obligations

The obligation of the City to pay the 2010A Installment Payments securing the Series 2010A Bonds is a limited obligation of the City and is not secured by a legal or equitable pledge or charge or lien upon any property of the City or any of its income or receipts, except the Net System Revenues. The obligation of the City to make the 2010A Installment Payments does not constitute an obligation of the City to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation. The City is obligated under the Installment Purchase Agreement to make the Installment Payments solely from Net System Revenues.

No assurance can be made that Net System Revenues, estimated or otherwise, will be realized by the City in amounts sufficient to pay the 2010A Installment Payments. Among other matters, drought, general and local economic conditions and changes in law and government regulations (including initiatives and moratoriums on growth) could adversely affect the amount of Net System Revenues realized by the City. In addition, the realization of future Net System Revenues is subject to, among other things, the capabilities of management of the City, the ability of the City to provide sewer service to its retail customers and the

Participating Agencies, the ability of the City to establish, maintain and collect charges for the Wastewater Service to its retail customers and the Participating Agencies and the ability of the City to establish, maintain and collect rates and charges sufficient to pay for Operation and Maintenance costs and the 2010A Installment Payments. See “WASTEWATER SYSTEM FINANCIAL OPERATIONS—Historical Revenues and Expenses.”

Wastewater System Expenses and Collections

The Operation and Maintenance costs of the Wastewater System are expected to increase in the next five years. See “WASTEWATER SYSTEM FINANCIAL OPERATIONS—Financial Projections.” However, there can be no assurance that the City’s projected future Maintenance and Operation costs for the Wastewater System will actually be as projected by the Department and described in this Official Statement. In addition, demands on the Wastewater System will increase due to population growth and regulatory requirements in the future. Further, although the City has covenanted to prescribe, revise and collect rates and charges for Wastewater Service in amounts necessary to pay the 2010A Installment Payments, there can be no assurance that such amounts will be collected in the amounts and at the times necessary to pay the 2010A Installment Payments sufficient to provide for the payment of the Series 2010A Bonds.

Rate-Setting Process Under Proposition 218

Proposition 218, which added Articles XIIC and XIID to the California Constitution, affects the City’s ability to impose future rate increases, and no assurance can be given that future rate increases will not encounter majority protest opposition or be challenged by initiative action authorized under Proposition 218. During the last two Proposition 218 rate increase hearings with respect to the Wastewater System, the Office of the City Clerk received approximately 6% of the aggregate protests required to prevent the increase. In the event that future proposed rate increases cannot be imposed as a result of majority protest or initiative, the City might thereafter be unable to generate Net System Revenues in the amounts required by the Installment Purchase Agreement to pay 2010A Installment Payments. Proposition 218 also affects the Participating Agencies’ ability to collect sewer service charges and impose future rate increases in amounts sufficient to make payments under the Regional Wastewater Disposal Agreement and the Transportation Agreements. There can be no assurance that the Participating Agencies have complied or will comply with the provisions of Proposition 218 or that the Participating Agencies’ ability to impose future rate increases will not be adversely affected by majority protests or initiatives. The Participating Agencies are required to pay the amounts due under the Regional Wastewater Disposal Agreement regardless of the source of payment. However, if the Participating Agencies are unable to pay amounts due and payable for any reason, the City’s ability to generate Net System Revenues in the amounts required by the Installment Purchase Agreement to pay 2010A Installment Payments could be adversely affected. See “CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES—Articles XIIC and XIID.”

Notwithstanding the foregoing, the City has covenanted to fix, prescribe and collect rates and charges for Wastewater Service at a level at least sufficient to meet its debt requirements, as set forth under “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS—Rate Covenant.” The current sewer rates for customers within the City have been approved by the Mayor and the City Council and have been imposed in compliance with Proposition 218. See “CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES—Articles XIIC and XIID.”

Statutory and Regulatory Compliance

Claims against the Wastewater System for failure to comply with applicable laws and regulations could be significant. Such claims are payable from assets of the Wastewater System or from other legally available sources. In addition to claims by private parties, changes in the scope and standards for public agency Wastewater Systems such as that operated by the Department may also lead to administrative orders issued by Federal or State regulators. Future compliance with such orders can also impose substantial additional costs on the Sewer Revenue Fund. See “WASTEWATER SYSTEM REGULATORY REQUIREMENTS.” No assurance can be given that the cost of compliance with such laws, regulations and orders would not adversely affect the ability of the Wastewater System to generate Net System Revenues sufficient to pay the 2010A Installment Payments. See “WASTEWATER SYSTEM REGULATORY REQUIREMENTS—Collection of Sewage,” “—Treatment of Sewage” and “—Discharge and Disposal of Sewage.” However, the City has covenanted in the Installment Purchase Agreement to fix, prescribe and collect rates and charges for the Wastewater System which will yield Net System Revenues for each fiscal year sufficient to pay debt service on the Parity Obligations, including the 2010A Installment Payments securing the Series 2010A Bonds. All proposed increases for such rates and charges for the Wastewater System are subject to the restrictions and requirements of Articles XIII C and XIII D of the California Constitution.

Earthquakes, Wildfires and Other Natural Disasters

Although the City has not experienced any significant damage from seismic activities, the geographic area in which the City is located is subject to unpredictable seismic activity. Southern California is characterized by a number of geotechnical conditions which represent potential safety hazards, including expansive soils and areas of potential liquefaction and landslide. Earthquakes or other natural disasters could interrupt operation of the Wastewater System and thereby interrupt the ability of the City to realize Net System Revenues sufficient to pay the 2010A Installment Payments securing the payment of the Series 2010A Bonds. The San Andreas, Rose Canyon, Elsinore and San Jacinto fault zones are all capable of producing earthquakes in the San Diego area. In anticipation of such potential disasters, the City designs and constructs all facilities of the Wastewater System to the seismic codes in effect at the time of design of the project. The Wastewater System has not experienced any significant losses of facilities or services as a result of earthquakes. Facilities within the Wastewater System generally consist of pipelines and connections, flow control facilities, and pumping stations, which are not typically vulnerable to damage by wildfires. All treatment facilities, pumping stations and piping structures are designed in accordance with appropriate seismic design requirements.

The above ground facilities within the Wastewater System are designed to be tolerant to damage by wildfires through the use of fire resistant material where possible, such as concrete and masonry blocks. In addition, the Department works closely with the City’s fire department to ensure that proper vegetative clearances are maintained in and around the properties and facilities of the Wastewater System. The Department watches for wildfires that may threaten the facilities of the Wastewater System and operations and maintenance crews are dispatched to ensure that all above-ground facilities remain safe and operational. Further, during fires, the Department works closely with the City’s fire department and law enforcement officers to monitor and protect facilities of the Wastewater System to ensure continuous operation. One pump station sustained minor damage from the October 2007 wildfires in San Diego County.

Although the City has implemented disaster preparedness plans and made improvements to Wastewater System facilities in connection with such natural disasters, there can be no assurance that these or any additional measures will be adequate in the event that a

natural disaster occurs, nor that costs of preparedness measures will be as currently anticipated. Further, damage to components of the Wastewater System could cause a material increase in costs for repairs or a corresponding material adverse impact on Net System Revenues. The City is not obligated under the Installment Purchase Agreement to procure and maintain, or cause to be procured and maintained, nor does the City plan to procure and maintain, earthquake insurance on the Wastewater System.

Risks Relating to the Water Supply

The ability of the Wastewater System to operate effectively can be affected by the water supply available to the City, which is situated in an arid and semi-desert environment that is currently subject to drought conditions. If the water supply decreases significantly, whether by operation of mandatory supply restrictions, prohibitively high water costs or otherwise, flow within the Wastewater System will diminish and Net System Revenues available to pay the 2010A Installment Payments may be adversely affected. Under current estimates, Wastewater System operations and Net System Revenues are not expected to be materially adversely affected if the Department is ordered to conserve up to 20% of its annual water supply, receives an unexpectedly low water allocation, or becomes subject to penalties or additional expenses because of an inability to meet the conservation goal. Further, the Department anticipates that any such reduction in Net System Revenues would be offset in part by reductions in the amount of sewage collected and treated by the Department, which would reduce operational expenses.

Security of the Wastewater System

The safety of the Wastewater System within the operational areas of the Department is maintained via a combination of regular inspections by the Department employees, electronic monitoring, and analysis of unusual incident reports. All above-ground facilities, operated and maintained by WWTD, including the Point Loma Plant, the Metropolitan Biosolids Center, the North City Plant and South Bay Plant and pumping stations within the Wastewater System, are controlled access facilities with fencing, gates, closed circuit television systems and security officers at appropriate points. Smaller, above-ground and subterranean pumping stations, operated and maintained by WWC, are locked with padlock or internal locking mechanisms and most are monitored via access/intrusion alarms. Security improvements are evaluated on an ongoing basis. The electronic operations and controls have been evaluated and exposure reduced through a series of technology systems enhancements and integration.

Military conflicts and terrorist activities may adversely impact the operations and finances of the Wastewater System. The Department continually plans and prepares for emergency situations and immediately responds to ensure sewer services are maintained. However, there can be no assurance that any existing or additional safety and security measures will prove adequate in the event that terrorist activities are directed against the Wastewater System or that costs of security measures will not be greater than presently anticipated. Further, damage to certain components of the Wastewater System could require the City to increase expenditures for repairs to the Wastewater System significantly enough to adversely impact the City's ability to pay debt service on the Series 2010A. The City has established within the Sewer Revenue the Operating Reserve, which is currently funded at a minimum of 50 days' operating costs (to be gradually increased to 70 days of operating costs in Fiscal Years 2010 to Fiscal Year 2013 which may be used under certain circumstances for repairs to the Wastewater System. See "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Rate Stabilization Fund and Other Funds and Accounts."

Utility Costs

No assurance can be given that any future significant reduction or loss of power would not materially adversely affect the operations of the Wastewater System. The volume of wastewater conveyed and treated in the Wastewater System on a daily basis requires a significant amount of electrical and thermal power. Electricity is needed to run several assets including, among other things, pumps, lights, computers, mechanical valves and machinery. Thermal energy, usually generated by electrical power or by burning natural gas, provides heat and cooling necessary for both buildings and the wastewater treatment process. Energy in excess of the amount necessary to power the Metropolitan Biosolids Center reduces the amount of energy purchased by the Department from the local power grid for use at facilities in the Wastewater System. The Department cannot guarantee that prices for electricity or gas will not increase, which could adversely affect the Wastewater System's financial condition. Such increases in sewer rates and such other charges as well as increases in electricity and gas costs are eligible to be "passed through" to the City's sewer customers as increased sewer rates in accordance with the City Municipal Code. Such "pass through" rate increases are subject to Proposition 218 notice requirements. See "CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES—Articles XIII C and XIII D."

The Department operates an energy efficiency program at its facilities as a component of its ongoing commitment to protect the environment by preserving our natural resources, reducing power consumption, using renewable energy sources, seeking cheaper sources of power and serving the needs of all our customers. Energy savings, if any, directly benefit the residents of the City by helping to maintain lower sewer rates while providing renewable electric energy to the region.

Impact of Current Fiscal Crisis on Wastewater System Revenues

Since 2008, the United States financial markets have been experiencing extreme volatility precipitated by major economic disruptions, including a severe economic recession and significant credit and liquidity problems. The City cannot predict the extent to which the fiscal problems will continue to be encountered in this and in any future Fiscal Years, and, it is not clear what additional measures, if any, will be taken by the State or Federal government to address the continuing fiscal crisis. Accordingly, the City cannot predict the final outcome of future State or Federal actions or the impact that such actions will have on the Wastewater System's finances and operations.

Pursuant to the Installment Purchase Agreement, the City is obligated to fix, prescribe and collect rates and charges for Wastewater Service that will be at least sufficient to pay during each Fiscal Year all Obligations (other than Parity Obligations) payable in such Fiscal Year, and to yield during each Fiscal Year Net System Revenues equal to 120% of Debt Service (defined generally to mean the aggregate amount of principal, sinking fund payments and interest payable in respect of all Parity Obligations for such Fiscal Year). The Installment Purchase Agreement also prohibits the City from reducing the rates and charges then in effect unless the Net System Revenues from such reduced rates and charges will at all times be sufficient to meet the requirements of the Installment Purchase Agreement. Further, the Indenture provides that upon the occurrence and continuance of any Event of Default (as defined in the Indenture), including nonpayment of principal of or interest on the Series 2010A Bonds, the holders of the Series 2010A Bonds may proceed to enforce their beneficial rights by mandamus, or other suit, action or proceeding at law or in equity, which includes an action for specific performance by the City with respect to its rate covenant and any other agreement contained in the Installment Purchase Agreement. See also "RISK FACTORS—Rate-Setting Process Under Proposition 218" and "CONSTITUTIONAL LIMITATIONS ON TAXES AND

WASTEWATER RATES AND CHARGES—Articles XIIC and XIID” for a description of limitations on the rate-setting process under the California Constitution.

The Department has taken the current fiscal crisis into consideration in its projections of capacity charges for the current and subsequent fiscal years. In Fiscal Year 2009, \$10.4 million was generated which includes a one-time Capacity Charge of \$5.9 million from a dewatering project at the San Diego Convention Center. The Department projects that \$5.0 million will be generated in Fiscal Year 2010. The Capacity Charge revenue projections for Fiscal Years 2011 and through Fiscal Year 2014 assume an average annual growth rate of approximately 1% in EDUs.

The Department has also considered the effects of the housing market on the other components of System Revenues, including revenues generated from sewer service charges. Notwithstanding housing foreclosures and related account closings, usage of the Wastewater System has remained stable. Accordingly, the Department expects that the current housing conditions will not adversely affect the ability of the Wastewater System to generate Net System Revenues sufficient to pay the 2010A Installment Payments. However, the City cannot predict the extent to which the current or any future financial crisis will impact its ability to generate Net System Revenues in the amounts required by the Installment Purchase Agreement to pay 2010A Installment Payments. In particular, the City cannot predict the extent to which an economic recession and credit crisis will affect future wastewater flow, the impact of any reduced demand on the Wastewater System’s finances and operations or whether a sustained fiscal crisis would create sufficient pressure on the City to effect a reduction in sewer fees.

Acceleration; Limitations on Remedies

The Indenture provides that, upon and during the continuance of an Event of Default thereunder, the Trustee may, subject to certain conditions, declare the principal of all Bonds, including the Series 2010A Bonds, then Outstanding and the interest accrued thereon to be due and payable immediately. The foregoing notwithstanding, the remedy of acceleration is subject to the limitations on legal remedies against public entities in the State, including a limitation on enforcement obligations against funds needed to serve the public welfare and interest. Also, any remedies available to the Owners of the Series 2010A Bonds upon the occurrence of an Event of Default under the Indenture are in many respects dependent upon judicial actions which are often subject to discretion and delay and could prove both expensive and time consuming to obtain.

Further, enforceability of the rights and remedies of the Owners of the Series 2010A Bonds, and the obligations incurred by the City, may become subject to the Federal bankruptcy code and applicable bankruptcy, insolvency, reorganization, moratorium, or similar laws relating to or affecting the enforcement of creditor’s rights generally, now or hereafter in effect, equity principles which may limit the specific enforcement under State law of certain remedies, the exercise by the United States of America of the powers delegated to it by the Constitution, the reasonable and necessary exercise, in certain exceptional situations, of the police powers inherent in the sovereignty of the State and its governmental bodies in the interest of serving a significant and legitimate public purpose, and the limitations on remedies against counties in the State. Bankruptcy proceedings, or the exercise of powers by the Federal or State government, if initiated, could subject the Owners of the Series 2010A Bonds to judicial discretion and interpretation of their rights in bankruptcy or otherwise and consequently may entail risks of delay, limitation, or modification of their rights.

CONSTITUTIONAL LIMITATIONS ON TAXES AND WASTEWATER RATES AND CHARGES

Article XIII A

Article XIII A of the State Constitution provides that the maximum ad valorem tax on real property cannot exceed 1% of the “full cash value,” which is defined as “the county assessor’s valuation of real property as shown on the 1975-76 tax bill under ‘full cash value’ or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment,” subject to exceptions for certain circumstances of transfer or reconstruction and except with respect to certain voter approved debt. The “full cash value” is subject to annual adjustment to reflect increases, not to exceed 2% per year, or decreases in the consumer price index or comparable local data, or to reflect reduction in property value caused by damage, destruction or other factors.

Article XIII A requires a vote of two-thirds of the qualified electorate to impose special taxes, while generally precluding the imposition of any additional ad valorem, sales or transaction tax on real property. As amended, Article XIII A exempts from the 1% tax limitation any taxes above that level required to pay debt service on certain voter-approved general obligation bonds for the acquisition or improvement of real property. In addition, Article XIII A requires the approval of two-thirds of all members of the State Legislature to change any State laws resulting in increased tax revenues.

Under California law, any fee which exceeds the reasonable cost of providing the service for which the fee is charged is a “special tax,” which under Article XIII A must be authorized by a two-thirds vote of the electorate. Accordingly, if a portion of the City’s water or sewer user rates or Capacity Fees were determined by a court to exceed the reasonable cost of providing service, the City would not be permitted to continue to collect that portion unless it were authorized to do so by a two-thirds majority of the votes cast in an election to authorize the collection of that portion of the rates or fees. The reasonable cost of providing wastewater services has been determined by the State Controller to include depreciation and allowance for the cost of capital improvements. In addition, the California courts have determined that fees such as capacity fees will not be special taxes if they approximate the reasonable cost of constructing the water or wastewater capital improvements contemplated by the local agency imposing the fee. See “WASTEWATER SYSTEM FINANCIAL OPERATIONS—Historical Revenues and Expenses.”

Article XIII B

Article XIII B of the California Constitution limits the annual appropriations of proceeds of taxes by State and local government entities to the amount of appropriations of the entity for the prior fiscal year, as adjusted for changes in the cost of living, changes in population and changes in services rendered by the entity. User fees and charges are considered proceeds of taxes only to the extent they exceed the reasonable costs incurred by a governmental entity in supplying the goods and services for which such fees and charges are imposed.

To the extent that assessments, fee and charges collected by the City are used to pay the costs of maintaining and operating the Wastewater System and payments due on the Series 2010A Bonds (including the funding of the Reserve Fund), the City believes that such moneys are not subject to the annual appropriations limit of Article XIII B.

Articles XIIC and XIID

On November 5, 1996, the voters of the State approved Proposition 218, a constitutional initiative, entitled the “Right to Vote on Taxes Act” (“Proposition 218”). Proposition 218 added Articles XIIC and XIID to the California Constitution and contained a number of interrelated provisions affecting the ability of local governments, including the City, to levy and collect both existing and future taxes, assessments, fees and charges.

Section 1 of Article XIIC requires majority voter approval for the imposition, extension or increase of general taxes and Section 2 thereof requires two-thirds voter approval for the imposition, extension or increase of special taxes. These voter approval requirements of Article XIIC reduce the flexibility of the City to raise revenues by the levy of general or special taxes and, given such voter approval requirements, no assurance can be given that the City will be able to enact, impose, extend or increase any such taxes in the future to meet increased expenditure requirements. The City has not enacted, imposed, extended or increased any tax since the effective date of Proposition 218.

Section 3 of Article XIIC expressly extends the initiative power to give voters the power to reduce or repeal local taxes, assessments, fees and charges, regardless of the date such taxes, assessments, fees or charges were imposed. Section 3 expands the initiative power to include reducing or repealing assessments, fees and charges, which had previously been considered administrative rather than legislative matters and therefore beyond the initiative power. This extension of the initiative power is not limited by the terms of Article XIIC to fees imposed after November 6, 1996, the effective date of Proposition 218, and absent other legal authority could result in the reduction in any existing taxes, assessments or fees and charges imposed prior to November 6, 1996.

“Fees” and “charges” are not expressly defined in Article XIIC or in SB 919, the Proposition 218 Omnibus Implementation Act enacted in 1997 to prescribe specific procedures and parameters for local jurisdictions in complying with Article XIIC and Article XIID (“SB 919”). However, on July 24, 2006, the California Supreme Court ruled in *Bighorn-Desert View Water Agency v. Virjil (Kelley)* (the “Bighorn Decision”) that charges for ongoing water delivery are property-related fees and charges within the meaning of Article XIID and are also fees or charges within the meaning of Section 3 of Article XIIC. The California Supreme Court held that such water service charges may, therefore, be reduced or repealed through a local voter initiative pursuant to Section 3 of Article XIIC.

In the Bighorn Decision, the Supreme Court did state that nothing in Section 3 of Article XIIC authorizes initiative measures that impose voter-approval requirements for future increases in fees or charges for water delivery. The Supreme Court stated that water providers may determine rates and charges upon proper action of the governing body and that the governing body may increase a charge which was not affected by a prior initiative or impose an entirely new charge.

The Supreme Court further stated in the Bighorn Decision that it was not holding that the initiative power is free of all limitations and was not determining whether the initiative power is subject to the statutory provision requiring that water and wastewater service charges be set at a level that will pay debt service on bonded debt and operating expenses. Such initiative power could be subject to the limitations imposed on the impairment of contracts under the contract clause of the United States Constitution. Additionally, SB 919 provides that the initiative power provided for in Proposition 218 “shall not be construed to mean that any owner or beneficial owner of a municipal security, purchased before or after (the effective date of Proposition 218) assumes the risk of, or in any way consents to, any action by initiative measure that constitutes an impairment of contractual rights” protected by the United States

Constitution. No assurance can be given that the voters of the City will not, in the future, approve initiatives which repeal, reduce or prohibit the future imposition or increase of assessments, fees or charges, including the City's sewer service fees and charges, which are the source of Net System Revenues pledged to the payment of debt service on Series 2008 Bonds and other Outstanding Obligations.

Notwithstanding the fact that sewer service charges may be subject to reduction or repeal by voter initiative undertaken pursuant to Section 3 of Article XIII C, the City has covenanted to levy and charge rates which meet the requirements of the Installment Purchase Agreement in accordance with applicable law.

Article XIII D defines a "fee" or "charge" as any levy other than an ad valorem tax, special tax, or assessment imposed upon a parcel or upon a person as an incident of property ownership, including a user fee or charge for a property-related service. A "property-related service" is defined as "a public service having a direct relationship to a property ownership." In the Bighorn Decision, the California Supreme Court held that a public water agency's charges for ongoing water delivery are fees and charges within the meaning of Article XIII D. Article XIII D requires that any agency imposing or increasing any property-related fee or charge must provide written notice thereof to the record owner of each identified parcel upon which such fee or charge is to be imposed and must conduct a public hearing with respect thereto. The proposed fee or charge may not be imposed or increased if a majority of owners of the identified parcels file written protests against it. As a result, the local government's ability to increase such fee or charge may be limited by a majority protest.

In addition, Article XIII D also includes a number of limitations applicable to existing fees and charges including provisions to the effect that (i) revenues derived from the fee or charge shall not exceed the funds required to provide the property-related service; (ii) such revenues shall not be used for any purpose other than that for which the fee or charge was imposed; (iii) the amount of a fee or charge imposed upon any parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel; and (iv) no such fee or charge may be imposed for a service unless that service is actually used by, or immediately available to, the owner of the property in question. Property-related fees or charges based on potential or future use of a service are not permitted.

The City's current sewer rates comply with the notice and substantive provisions of Article XIII D. Three lawsuits filed against the City challenging the sewer rates as they were structured prior to October 2004, before the City incorporated a COD component. The Shames Settlement resulted in a \$35 million rebate to eligible single family residential customers and \$5 million in attorneys' fees, as discussed previously under Wastewater System Financial Operations. The two other lawsuits were filed on behalf of local restaurants and multifamily residential customers are still pending. See "LITIGATION" for a description of the two lawsuits.

Article XIII D establishes procedural requirements for the imposition of assessments, which are defined as any charge upon real property for a special benefit conferred upon the real property. Standby charges are classified as assessments. Procedural requirements for assessments under Article XIII D include conducting a public hearing and mailed protest procedure, with notice to the record owner of each parcel subject to the assessment. The assessment may not be imposed if a majority of the ballots returned oppose the assessment, with each ballot weighted according to the proportional financial obligation of the affected parcel. To provide guidance to City staff regarding the conduct of Proposition 218 "property-related fee" protest proceedings, the City Council adopted Resolution R-302245 in January 2007 establishing additional procedures for submitting protests against proposed increases to sewer rates, including the provision of notice of a proposed change in sewer fees to all owners

of record on each identified parcel and all wastewater customers of the City as reflected in the billing records of the City at the time the notice is given, and additional procedures for the tabulation of protests against proposed increases to sewer service charges, including guidelines for determining when a valid protest has been submitted.

The City and the City Attorney are of the opinion that current sewer fees and charges that are subject to Proposition 218 comply with the provisions thereof and that the City will continue to comply with the rate covenant set forth in the Installment Purchase Agreement in conformity with the provisions of Article XIID of the California State Constitution. Should it become necessary to increase the sewer fees and charges above current levels, the City would be required to comply with the requirements of Article XIID in connection with such proposed increase. Under existing standards, the City and the City Attorney are of the opinion that rates and charges may be established at levels which would permit deposits to a Rate Stabilization Fund or maintenance of uncommitted cash reserves. See "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Financial Projections."

The interpretation and application of Proposition 218 will ultimately be determined by the courts or through implementing legislation with respect to a number of the matters described above, and it is not possible at this time to predict with certainty the outcome of such determination or the nature or scope of any such legislation.

TAX MATTERS

Federal tax law contains a number of requirements and restrictions which apply to the Series 2010A Bonds, including investment restrictions, periodic payments of arbitrage profits to the United States, requirements regarding the proper use of bond proceeds and the facilities financed therewith, and certain other matters. The Authority and the City have covenanted to comply with all requirements that must be satisfied in order for the interest on the Series 2010 Bonds to be excludable from gross income for federal income tax purposes. Failure to comply with certain of such covenants could cause interest on the Series 2010 Bonds to become includable in gross income for federal income tax purposes retroactively to the date of issuance of the Series 2010 Bonds.

Subject to the Authority's and the City's compliance with the above referenced covenants, under present law, in the opinion of Quint & Thimmig LLP, Bond Counsel, interest on the Series 2010 Bonds (i) is excludable from the gross income of the owners thereof for federal income tax purposes, and (ii) is not included as an item of tax preference in computing the federal alternative minimum tax for individuals and corporations, but interest on the Series 2010 Bonds is taken into account, however, in computing an adjustment used in determining the federal alternative minimum tax for certain corporations.

Bond Counsel expects to deliver an opinion at the time of delivery of the Series 2010 Bonds in substantially the form set forth in APPENDIX C—"FORM OF BOND COUNSEL'S OPINION."

Bond Counsel's opinion represents its legal judgment based upon its review of the law and the facts that it deems relevant to render such opinion and is not a guarantee of a result.

The Internal Revenue Code of 1986, as amended (the "Code"), includes provisions for an alternative minimum tax ("AMT") for corporations in addition to the corporate regular tax in certain cases. The AMT, if any, depends upon the corporation's alternative minimum taxable income ("AMTI"), which is the corporation's taxable income with certain adjustments.

One of the adjustment items used in computing the AMTI of a corporation (with certain exceptions) is an amount equal to 75% of the excess of such corporation's "adjusted current earnings" over an amount equal to its AMTI (before such adjustment item and the alternative tax net operating loss deduction). "Adjusted current earnings" would include certain tax exempt interest, including interest on the Series 2010A Bonds.

Ownership of the Series 2010A Bonds may result in collateral federal income tax consequences to certain taxpayers, including, without limitation, corporations subject to the branch profits tax, financial institutions, certain insurance companies, certain S corporations, individual recipients of Social Security or Railroad Retirement benefits and taxpayers who may be deemed to have incurred (or continued) indebtedness to purchase or carry tax exempt obligations. Prospective purchasers of the Series 2010 Bonds should consult their tax advisors as to applicability of any such collateral consequences.

The issue price (the "Issue Price") for each maturity of the Series 2010 Bonds is the price at which a substantial amount of such maturity of the Series 2010 Bonds is first sold to the public. The Issue Price of a maturity of the Series 2010 Bonds may be different from the price set forth, or the price corresponding to the yield set forth, on the cover page hereof.

If the Issue Price of a maturity of the Series 2010 Bonds is less than the principal amount payable at maturity, the difference between the Issue Price of each such maturity, if any, of the Series 2010 Bonds (the "OID Bonds") and the principal amount payable at maturity is original issue discount.

For an investor who purchases an OID Bond in the initial public offering at the Issue Price for such maturity and who holds such OID Bond to its stated maturity, subject to the condition that the Authority and the City comply with the covenants discussed above, (a) the full amount of original issue discount with respect to such OID Bond constitutes interest which is excludable from the gross income of the owner thereof for federal income tax purposes; (b) such owner will not realize taxable capital gain or market discount upon payment of such OID Bond at its stated maturity; (c) such original issue discount is not included as an item of tax preference in computing the alternative minimum tax for individuals and corporations under the Code, but is taken into account in computing an adjustment used in determining the alternative minimum tax for certain corporations under the Code, as described above; and (d) the accretion of original issue discount in each year may result in an alternative minimum tax liability for corporations or certain other collateral federal income tax consequences in each year even though a corresponding cash payment may not be received until a later year. Owners of OID Bonds should consult their own tax advisors with respect to the state and local tax consequences of original issue discount on such OID Bonds.

Owners of Bonds who dispose of Bonds prior to the stated maturity (whether by sale, redemption or otherwise), purchase Bonds in the initial public offering, but at a price different from the Issue Price or purchase Bonds subsequent to the initial public offering should consult their own tax advisors.

If a Bond is purchased at any time for a price that is less than the Bond's stated redemption price at maturity or, in the case of an OID Bond, its Issue Price plus accreted original issue discount reduced by payments of interest included in the computation of original issue discount and previously paid (the "Revised Issue Price"), the purchaser will be treated as having purchased a Series 2010A Bond with market discount subject to the market discount rules of the Code (unless a statutory de minimis rule applies). Accrued market discount is treated as taxable ordinary income and is recognized when a Bond is disposed of (to the extent such accrued discount does not exceed gain realized) or, at the purchaser's election, as it accrues. Such treatment would apply to any purchaser who purchases an OID

Bond for a price that is less than its Revised Issue Price even if the purchase price exceeds par. The applicability of the market discount rules may adversely affect the liquidity or secondary market price of such Bond. Purchasers should consult their own tax advisors regarding the potential implications of market discount with respect to the Series 2010 Bonds.

An investor may purchase a Series 2010A Bond at a price in excess of its stated principal amount. Such excess is characterized for federal income tax purposes as “bond premium” and must be amortized by an investor on a constant yield basis over the remaining term of the Bond in a manner that takes into account potential call dates and call prices. An investor cannot deduct amortized bond premium relating to a tax exempt bond. The amortized bond premium is treated as a reduction in the tax exempt interest received. As bond premium is amortized, it reduces the investor’s basis in the Bond. Investors who purchase a Bond at a premium should consult their own tax advisors regarding the amortization of bond premium and its effect on the Bond’s basis for purposes of computing gain or loss in connection with the sale, exchange, redemption or early retirement of the Bond.

There are or may be pending in the Congress of the United States legislative proposals, including some that carry retroactive effective dates, that, if enacted, could alter or amend the federal tax matters referred to above or affect the market value of the Series 2010 Bonds. It cannot be predicted whether or in what form any such proposal might be enacted or whether, if enacted, it would apply to bonds issued prior to enactment. Prospective purchasers of the Series 2010 Bonds should consult their own tax advisors regarding any pending or proposed federal tax legislation. Bond Counsel expresses no opinion regarding any pending or proposed federal tax legislation.

The Internal Revenue Service (the “Service”) has an ongoing program of auditing tax exempt obligations to determine whether, in the view of the Service, interest on such tax exempt obligations is includable in the gross income of the owners thereof for federal income tax purposes. It cannot be predicted whether or not the Service will commence an audit of the Series 2010 Bonds. If an audit is commenced, under current procedures the Service may treat the Authority as a taxpayer and the Bondholders may have no right to participate in such procedure. The commencement of an audit could adversely affect the market value and liquidity of the Series 2010 Bonds until the audit is concluded, regardless of the ultimate outcome.

Payments of interest on, and proceeds of the sale, redemption or maturity of, tax exempt obligations, including the Series 2010 Bonds, are in certain cases required to be reported to the Service. Additionally, backup withholding may apply to any such payments to any Bond owner who fails to provide an accurate Form W-9 Request for Taxpayer Identification Number and Certification, or a substantially identical form, or to any Bond owner who is notified by the Service of a failure to report any interest or dividends required to be shown on federal income tax returns. The reporting and backup withholding requirements do not affect the excludability of such interest from gross income for federal tax purposes.

The Bonds are issued to refund bonds issued before January 1, 2009, and therefore are treated as issued before 2009 for purposes of section 265(b)(7) of the Code relating to interest expense deductibility for financial institutions. The treatment of interest expense for financial institutions owning such Bonds may be less favorable than the treatment provided to owners of tax exempt bonds treated as issued in 2009 or 2010. Financial institutions should consult their tax advisors concerning such treatment.

In the further opinion of Bond Counsel, interest on the Series 2010A Bonds is exempt from California personal income taxes.

Ownership of the Series 2010A Bonds may result in other state and local tax consequences to certain taxpayers. Bond Counsel expresses no opinion regarding any such collateral consequences arising with respect to the Series 2010 Bonds. Prospective purchasers of the Series 2010 Bonds should consult their tax advisors regarding the applicability of any such state and local taxes.

CONTINUING DISCLOSURE

Pursuant to the Continuing Disclosure Certificate of the City (the "Disclosure Certificate"), the City has agreed to provide, or cause to be provided, to Municipal Securities Rulemaking Board in the manner prescribed by the Securities Exchange Commission certain annual financial information and operating data concerning the City. The annual report to be filed by the City is to be filed not later than 270 days following the end of the City's Fiscal Year (currently June 30), commencing with the Annual Report for Fiscal Year 2009, and is to include audited financial statements of the City.

Beginning in March 2004, the City failed to comply with undertakings related to 21 bond issues for each of fiscal years 2003 through 2007 due to the unavailability of the City's audited financial statements. The circumstances regarding the unavailability of the City's audited financial statements are described under the caption entitled "INTRODUCTION—Certain Information Regarding the City." Each required annual report and audited financial statement was subsequently filed. Prior to March 2004, the City had never failed to comply with its undertakings with regard to Rule 15c2-12.

The City has timely filed the annual reports and financial statements for Fiscal Year 2008 with respect to securities secured by the Sewer Revenue Fund, the Water Utility Fund and the City's General Fund. The City Council received and filed the fiscal year 2009 audited financial statements on February 1, 2010, and the corresponding continuing disclosure filings were made on March 25, 2010.

The City's covenants in the Continuing Disclosure Certificate have been made in order to assist the Underwriters in complying with the Rule. A failure by the City to comply with any of the covenants therein is not an event of default under the Indenture.

LITIGATION

There is no litigation pending against the City or, to the knowledge of its respective executive officers, threatened, seeking to restrain or enjoin the issuance, sale, execution or delivery of the Series 2010A Bonds or in any way contesting or affecting the validity of the Series 2010A Bonds or the Authorizations or any proceedings of the City taken with respect to the issuance or sale thereof, or the pledge or application of any moneys or security provided for the payment of the Series 2010A Bonds or the use of the proceeds of the Series 2010A Bonds.

There are no pending lawsuits that, in the opinion of the City Attorney, challenge the validity of the above issue, the corporate existence of the City, or the title of the executive officers to their respective offices. In connection with this review, attention has been given to not only litigation pending against the City, but also litigation pending against the Department. The Office of the City Attorney has prepared the following summary, as of May 14, 2009, certain claims and lawsuits (for which the estimated loss to the City as of such date exceeds \$1 million ("Material Litigation")) pending against the Sewer Revenue Fund for

construction claims and certain other alleged liabilities arising during the ordinary course of operations of the Wastewater System:

- There are two class action lawsuits pending, each alleging that the City failed to include a COD cost component in the sewer rate structure prior to October 2004, which led to overcharges on sewer fees for certain customer groups that were disproportionate to the cost of service for such customer groups. While the allegations in both lawsuits are similar to those set forth in *Shames*, a class action lawsuit on behalf of all single family residential account holders that was settled in 2007 (see “WASTEWATER SYSTEM FINANCIAL OPERATIONS—City Council Actions Relating to Sewer Rate Changes”), the City’s defenses and potential liability relative to the two pending lawsuits are different from those in *Shames*.

- *California Restaurant Management System v. City of San Diego*. Plaintiffs filed this class action case on August 20, 2007 on behalf of local food establishments, alleging that from 1994 to 2004 the City failed to properly calculate the food establishments’ proportionate impact on the cost of operating and maintaining the Wastewater System and seeking to recover their alleged overpayment. The class was certified by the court on May 15, 2009. The Court granted the City’s motion for summary judgment in October, 2009, ending the case without liability to the City. Plaintiffs have appealed the Court’s decision. In the event of a successful appeal and an adverse ruling the City estimates the liability could range from \$0 to \$5 million.

- *Edmond A. Vigneau v. City of San Diego*. Plaintiffs filed this case on September 17, 2008 on behalf of multifamily residential customers, alleging the City overcharged them for sewer service from 2000 to 2004, before the City incorporated a COD component. Notwithstanding the absence of a COD cost component, the City believes that the plaintiffs may have been undercharged because other aspects of the pre-October 2004 sewer rate for this customer group, including the base fee for service, may have been too low. The Court denied plaintiff’s request for class action status in November 2009, keeping only the named plaintiffs in the case and substantially reducing the City’s potential liability. It is unknown whether plaintiffs will appeal the decision. In the event of a successful appeal and an adverse ruling the City estimates the liability could range from \$0 to \$5 million, but the City anticipates the plaintiffs’ likelihood of successfully proving overages is remote.

- *Timothy Cresto, et al. v. Taylor Woodrow Homes, Inc., et al; Christopher Smith, et al. v. Taylor Woodrow Homes, et al.* On August 21, 2007, two sets of plaintiffs filed lawsuits alleging that the City, Taylor Woodrow Homes, Inc. and certain other related parties effected an inverse condemnation of and caused dangerous conditions on their respective properties in a housing development known as Santaluz, by contributing to the plaintiffs’ exposure to hydrogen sulfide gas, which allegedly emanated from the Wastewater System. The cases have been coordinated for discovery and settlement purposes. In the event of an adverse ruling, the City estimates the aggregate liability resulting from these two cases could range from \$0 to \$20 million. The City has filed cross-complaints against the developer, the design engineer and the contractors seeking indemnity for any damages that may be awarded to the plaintiffs.

- *The Grande North at Santa Fe Place HOA v. Bosa Development, et al.* In September 2009, plaintiff HOA filed a lawsuit against the City alleging that high levels of hydrogen sulfide gas from the City’s sewer system have corroded and damaged the

building's plumbing. Plaintiff claims the City's sewer system is defective because it does not include an "odorless connection" where the HOA's sewer lateral connects to the City's trunk sewer. The City's potential liability is currently unknown, as the City has yet to learn the extent of the damage to plaintiff's plumbing, if any, allegedly caused by hydrogen sulfide gas. Liability could be significant, if it is determined that the plumbing to all 221 condominium units needs to be replaced.

- *The Grande South at Santa Fe Place HOA v. Bosa Development, et al.* In February, 2010, the City was served with a lawsuit with the same allegations as The Grande North, but for its sister development The Grande South. The allegations and potential liability are the same in both cases.

The City believes it has sufficient defenses against such claims and lawsuits and in no event should these claims and lawsuits result in judgments or settlements which, in the aggregate, would have a material adverse effect on the Sewer Revenue Fund's financial position.

LEGAL OPINION

The validity of the Series 2010A Bonds and certain other matters are subject to the approving opinion of Quint & Thimmig LLP, San Francisco, California, Bond Counsel. A complete copy of the proposed form of opinion of Bond Counsel is contained in APPENDIX C attached hereto. Certain legal matters will be passed upon for the Authority by Quint & Thimmig LLP acting as Disclosure Counsel to the Authority for the Series 2010A Bonds, and by Jan I. Goldsmith, City Attorney, and for the Underwriters by their counsel, Stradling, Yocca, Carlson & Rauth, A Professional Corporation, Newport Beach, California.

RATINGS

Moody's, S&P and Fitch have assigned the Series 2010A Bonds their ratings of "A2," "A+" and "AA-," respectively, and issued "stable" outlooks in connection with their ratings. Such ratings reflect only the views of such organizations and any desired explanation of the significance of such ratings should be obtained from the rating agency furnishing the same, at the following addresses: Standard & Poor's Ratings Services, 55 Water Street, New York, New York 10041; Fitch Ratings, One State Street Plaza, New York, New York 10004; Moody's Investors Service, Inc., 7 World Trade Center, 250 Greenwich Street, New York, New York 10007. Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own.

There is no assurance such ratings will continue for any given period of time or that such ratings will not be revised downward or withdrawn entirely by the rating agencies, if in the judgment of such rating agencies, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Series 2010A Bonds.

UNDERWRITING

The Series 2010A Bonds are being purchased by the Underwriters named on the cover page to this Official Statement (collectively, the "Underwriters"). The Underwriters have

agreed, subject to certain conditions, to purchase the Series 2010A Bonds at a purchase price of \$171,991,922.77, equal to the original principal amount thereof, plus an original issue premium of \$10,782,027.45, less an Underwriters' discount in the amount of \$720,104.68. The Underwriters may offer and sell the Series 2010A Bonds to certain dealers and others at prices lower than the offering prices. The offering prices may be changed from time to time by the Underwriters.

One of the Underwriters, Piper Jaffray & Co. ("Piper"), has entered into an agreement (the "Distribution Agreement") with Advisors Asset Management, Inc. ("AAM") for the distribution of certain municipal securities offerings allocated to Piper at the original offering prices. Under the Distribution Agreement, if applicable to the Series 2010A Bonds, Piper will share with AAM a portion of the fee or commission, exclusive of management fees, paid to Piper.

FINANCIAL ADVISOR

First Southwest Company, Santa Monica, California served as Financial Advisor to the City with respect to the sale of the Series 2010A Bonds. The Financial Advisor has not undertaken to make an independent verification or to assume responsibility for the accuracy, completeness, or fairness of the information contained in this Official Statement.

FINANCIAL STATEMENTS FOR FISCAL YEAR 2009

The City's basic financial statements include the financial statements of the Sewer Revenue Fund. The City's 2009 basic financial statements have been audited by Macias Gini & O'Connell LLP (the "Independent Auditors"), independent certified public accountants, as stated in their report.

Those portions of the City's 2009 basic financial statements relating to the Sewer Revenue Fund, including all of the City's basic financial statements for Fiscal Year 2009 audited by Independent Auditors, are included in APPENDIX A. APPENDIX A also includes the unaudited management's discussion and analysis, unaudited required supplementary information with respect to the City's Pension System and CERBT and General Fund budgetary information. Certain of the data and information set forth in APPENDIX A do not pertain to the Sewer Revenue Fund but have been included in APPENDIX A for purposes of context. The City's CAFRs are available in their entirety on the City's website at <http://www.sandiego.gov>. However, the information presented there is not part of this Official Statement, is not incorporated by reference herein and should not be relied upon in making an investment decision with respect to the Series 2010A Bonds. The City's General Fund does not secure payment of debt service on the Series 2010A Bonds.

The Independent Auditors did not review this Official Statement and the City did not request the consent of the Independent Auditors to append the City's financial statements to this Official Statement. Accordingly, the Independent Auditors did not perform any procedures relating to any of the information in this Official Statement.

MISCELLANEOUS

This Official Statement has been duly approved, executed and delivered by the Authority and the City.

There are appended to this Official Statement a summary of certain provisions of the principal and legal documents, portions of the City's 2009 CAFR, including financial statements of the Sewer Revenue Fund, the proposed form of opinion of Bond Counsel, and a general description of the City and a description of the Book-Entry Only System. The Appendices are integral parts of this Official Statement and must be read together with all other parts of this Official Statement.

This Official Statement is not to be construed as a contract or agreement between the Authority or the City and the purchasers or holders of any of the Series 2010A Bonds. Any statements made in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended merely as an opinion and not as representations of fact. The information and expressions of opinion herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the financial condition, results of operations or any other affairs of the City, the Authority or the Corporation since the date hereof.

PUBLIC FACILITIES FINANCING
AUTHORITY OF THE CITY OF SAN
DIEGO

By /s/ Joseph W. Craver
Chairperson, Board of Commissioners

THE CITY OF SAN DIEGO

By /s/ Mary Lewis
Chief Financial Officer

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APPENDIX A

**BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY
INFORMATION AND CERTAIN EXCERPTS FROM THE COMPREHENSIVE
ANNUAL FINANCIAL REPORT OF THE CITY OF SAN DIEGO FOR THE
FISCAL YEAR ENDED JUNE 30, 2009**

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INTRODUCTORY SECTION

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THE CITY OF SAN DIEGO

December 21, 2009

Citizens and Interested Parties,

The San Diego economy has been severely impacted by the ongoing recession and recent economic data is mixed regarding the timing of any potential recovery. Federal stimulus funds contributed to positive GDP growth nationally in the third quarter of calendar year 2009 and local leading economic indicators have increased in each of the past six months showing some economic stabilization. However, State and local unemployment rates are at twenty-five year highs and property foreclosures continue to adversely affect home values. Lower consumer spending has significantly reduced economic activity in the City, resulting in decreased government revenues. Continued revenue reductions will affect the ability of the City to provide services to its citizens.

The City's fiscal challenges have been exacerbated by the State's ongoing budget crisis. The State legislature suspended the requirements of Proposition 1A (2004) in an effort to balance the State's FY 2010 budget. Proposition 1A is intended to prevent local revenues from being taken by the State; however, Proposition 1A can be suspended with the declaration of a fiscal emergency by the Governor and a vote of two-thirds of the Legislature. In fiscal year 2010, the State will borrow approximately \$1.9 billion in property tax revenue from local jurisdictions to help balance the State budget; the City's share of this is approximately \$35.8 million. However, the City will recover this property tax revenue during fiscal year 2010 through a securitization program established by the California Statewide Communities Development Authority. The State also passed Assembly Bill (AB) 26 4x, which requires redevelopment agencies statewide to pay a total of \$2.05 billion of their property tax revenues to the State over the next two years. The impact to the City's Redevelopment Agency (RDA) will be approximately \$56 million in fiscal year 2010 and \$11 million in fiscal year 2011. The State continues to struggle to balance its budget resulting in ongoing uncertainty with respect to the City's expected revenues.

Economic Development Activities

The City addressed the economic downturn in fiscal year 2009 by increasing community investment, promoting business growth and retention, and by competing successfully for federal stimulus funds. The City division of Economic Growth Services (EGS) worked to create and retain jobs and taxable investment in the City of San Diego. EGS consists of two focused work units: the Business Expansion, Attraction, and Retention Team and the Government Incentives Team. These two teams work directly with businesses, business organizations, and City departments to create a business-friendly environment that promotes a stable economy. Economic growth, energy independence, revenue enhancement, and community revitalization are accomplished by attracting new companies, retaining and/or expanding existing companies, making San Diego competitive in emerging markets, and revitalizing older business communities.

Due to the economic downturn, Economic Growth Services has placed a strong emphasis on its business retention mission. In fiscal year 2009 EGS developed and executed successful business retention efforts for Sony Electronics, Cricket Corporation, Circle Foods, Lockheed Martin, Eli Lilly, and CamelBak. These efforts resulted in the creation or retention of approximately 2,900 San Diego based jobs. In the current fiscal year, EGS worked with Alliant Techsystems, Inc to retain or create 200 San Diego based jobs. The capital investments made by the companies EGS assisted in fiscal year 2009 and fiscal year 2010 represent a cumulative investment of more than \$368 million of construction and renovation activity for our local economy.

The "Certificate of Deposit Account Registry Service" (CDARS) is a deposit-placement service designed to allow FDIC-insured depository institutions to accept deposits of more than \$100,000 (currently \$250,000) and obtain full coverage for the depositor by spreading the funds among as many separate FDIC insured institutions as necessary so that no institution holds more than \$250,000 (principal plus interest) for each depositor. To support local reinvestment, the City increased its CDARS investment from \$5 million to \$15 million in fiscal year 2009. The City plans to increase the allowable investment in the CDARS program to approximately \$40 million in fiscal year 2010. The authorized CDARS investment program allows the City to invest millions of dollars into fully insured FDIC non-negotiable certificates of deposit. The initial deposit is split among small community banks throughout the country so that any single Certificate of Deposit at a financial institution does not exceed the \$250,000 FDIC insurance limit. The banks participating in the CDARS network send an equal amount of funds back to local San Diego banks to ensure that they retain funds equal to the City's initial deposit for reinvestment in the local community. The City's investment in the CDARS program assures that the full amount deposited at local banks stays in San Diego for reinvestment in the community.

According to the stimulus tracking website Recovery.org, California received more American Recovery and Reinvestment Act (ARRA) dollars than any other state and the San Diego region received the second largest total of stimulus dollars of any region in California (trailing Los Angeles). As of November 19, 2009, the San Diego region received 201 projects totaling over \$2.1 billion. The City of San Diego can expect to see at least \$340 million in stimulus funding. Of this amount, approximately \$290 million is for Federal projects and will not come directly through the City; the remaining \$50 million is expected to come to the City over the next six months. Projects including the modernization of Otay Mesa's Port of Entry and the San Ysidro border expansion project will alleviate congestion and improve the productivity and efficiency of US/Mexico border relations. This money will come either directly to the City in the form of block grants and competitive awards (\$49 million) or to our partner agencies in which the City participates, such as the San Diego Association of Governments and the San Diego Workforce Partnership (\$126 million), or to federal agencies pursuing major construction projects within the City of San Diego (\$164 million not including military projects). These ARRA funds will be used on transportation, housing, public safety and energy projects that will not only create jobs but will provide long term benefits for the City and the region.

Fiscal Challenges

The City of San Diego has faced significant financial challenges over the last several years and has made a determined effort to improve its overall financial condition and the quality of its financial statements, internal controls, and disclosure controls and procedures. A few of the City's achievements include (1) the release of audited financial statements for fiscal years 2003-2008 in a two year period; (2) the implementation of an annual five-year

financial outlook as a prudent planning tool; (3) the strengthening of the City's General Fund reserves; (4) fully funding the Annual Required Contribution (ARC) to the City's pension system since fiscal year 2006; (5) new pension plans for police and for non-public safety employees hired on or after July 1, 2009; (6) participation in a California Public Employees' Retirement System (CALPERs) trust for pre-funding of post-employment healthcare benefits for retired City employees; (7) rating upgrades from the national rating agencies, including, in the case of one agency, the reinstatement of the City's credit rating; and (8) re-entering the public bond market in 2009 and issuing \$1.6 billion in debt (new money and refunding) after a five year absence.

The City issued the Fiscal Year 2010 First Quarter Budget Monitoring Report on November 17, 2009, which presented a review of actual expenditures and receipts through September 2009 and projects annual expenditures and revenues for the General Fund through year end. Based on this analysis, the City expects a shortfall of approximately \$7.5 million in fiscal year 2010, primarily as a result of declining sales tax and Transient Occupancy Tax (TOT) revenues. The decline in major revenues is partially offset by conservative spending and a hiring freeze that has been in effect since August 2009.

The Five Year Financial Outlook (Outlook) issued on October 1, 2009, identified a projected deficit for fiscal year 2011 of \$179 million. The sensitivity analysis in the Outlook estimates a deficit range of \$168 to \$200 million, primarily resulting from the possible fluctuation of three major revenues: property tax; sales tax; and TOT. On November 24, the Mayor presented a proposed 18 month budget for the remainder of fiscal year 2010 and fiscal year 2011 to remediate the projected fiscal year 2011 deficit of \$179 million. On December 14, 2009 the City Council adopted the fiscal year 2010 budget revisions and the fiscal year 2011 proposed budget. The fiscal year 2011 budget framework approved by the City Council includes a combination of transfers, new revenue, and annual expenditure reductions that will impact services to City residents. Further action, including labor negotiations and additional City Council approval, will be necessary to implement all recommended adjustments. If the budget is implemented on January 1, 2010 as recommended, savings of approximately \$24 million in fiscal year 2010 will be set aside to assist in balancing the fiscal year 2011 budget.

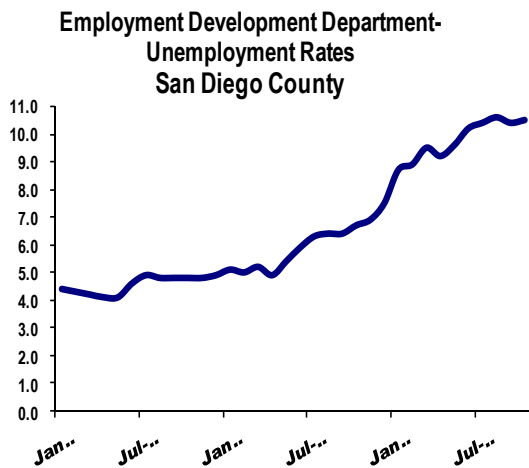
The City publicly issued a \$125 million Tax and Revenue Anticipation Notes (TRAN) on July 1, 2009 and does not currently foresee the need to issue additional notes to meet any General Fund liquidity needs for the remainder of fiscal year 2010. The City treasury holds approximately \$2 billion that is invested primarily in US Treasuries and agencies, and consistent with the City's investment policy, has sufficient liquidity to meet all currently foreseeable cash demands. The General Fund reserves are approximately \$79 million as of the issuance of this report, which includes \$55 million set aside in an Emergency Reserve Fund that can be accessed by a two-thirds vote of City Council.

Readers of these financial statements should pay particular attention to Notes 12, 13, 18, and 22, concerning Pension Plans, Other Post Employment Benefits, Contingencies, and Subsequent Events, respectively. The notes, along with the other financial and operational data included in the City's CAFR, must be read in their entirety to obtain a complete understanding of the City's financial position as of June 30, 2009.

Our Underlying Fundamentals

The City has a diversified economy, with the principal employers being government, high-tech industries, particularly biotech and telecommunications, and the tourism industry. The City's economic base is also anchored by higher education and major scientific research

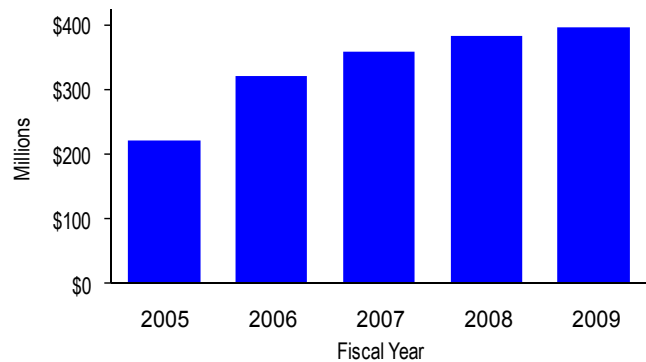
institutions, including the University of California, San Diego, San Diego State University, Scripps Research Institute, the Salk Institute for Biological Studies, and the San Diego Supercomputer Center.



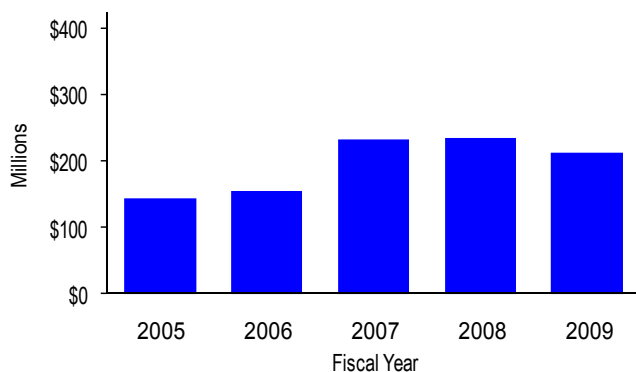
Like all regions around the country, San Diego County's economy has been impacted by the economic recession. In the past three years unemployment has more than doubled, rising from an average in 2006 of 4.0% to 10.5% as of October 2009. The recession has slowed both residential and commercial development within our region. This combined with a contraction in business payrolls and reduced travel spending has driven the unemployment rate to historic levels.

The City's property tax revenue has grown over the last five years, although at a decreasing rate. In fiscal year 2009 General Fund property tax revenues were \$398.7 million compared to \$384.3 million in fiscal year 2008, representing a 3.8% growth. However, due to the continued decline in home prices, the budgeted fiscal year 2010 property tax revenue in the General Fund was projected to decline 4.0% over fiscal year 2009 actuals. Subsequently, based on updated information from the County, the City revised its estimate for property tax revenue for fiscal year 2010 showing a smaller decrease of 1.5% over the fiscal year 2009 actual property tax revenue.

**City of San Diego
General Fund - Property Tax Revenue**



**City of San Diego
General Fund - Sales Tax Revenue**

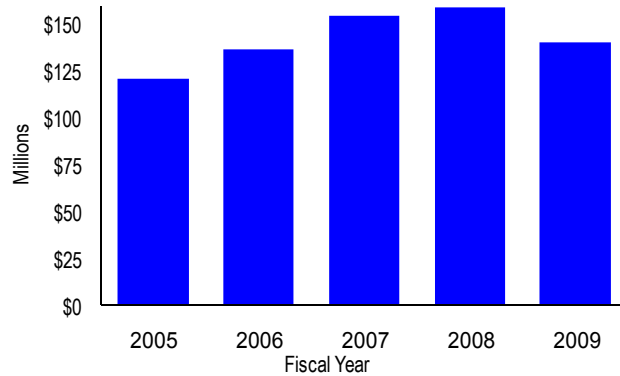


The impact of lower business and consumer spending has had a significant effect on sales tax revenues. In fiscal year 2009, actual General Fund sales tax revenues (including safety sales tax) were \$212.9 million, a 9.6% decline from 2008 sales tax revenues of \$235.6 million. For fiscal year 2010, the City budgeted a decline of 1.3% in sales tax revenues. However, the first quarter actual sales tax receipts were significantly below the budgeted amount. The City's adjusted projection for fiscal year 2010 is now \$191.2 million, or 10.2% lower than actual

revenue received for fiscal year 2009.

San Diego remains a top tourist destination due to the region's natural attractions; however, the tourism industry has not escaped the impact of the deteriorating economy. The City's Transient Occupancy Tax (TOT) rate is currently 10.5% and is allocated according to the Municipal Code. As such, the General Fund receives 52% of these revenues to be used for general governmental purposes, and the TOT fund receives the remaining 48% for the purpose of promoting the City as a tourism destination. The General Fund portion of TOT represents approximately 7% of the revenue from the fiscal year 2010 General Fund Adopted Budget. In fiscal year 2009, San Diego experienced an 11.7% decrease in TOT revenue from fiscal year 2008. For fiscal year 2010, the City budgeted an increase of 2.9% in TOT tax over 2009 actuals. Based on receipts from the first three months of fiscal year 2010, the City adjusted its estimate for TOT tax receipts to \$127.6 million which reflects a 9.3% decline from fiscal year 2009 actuals.

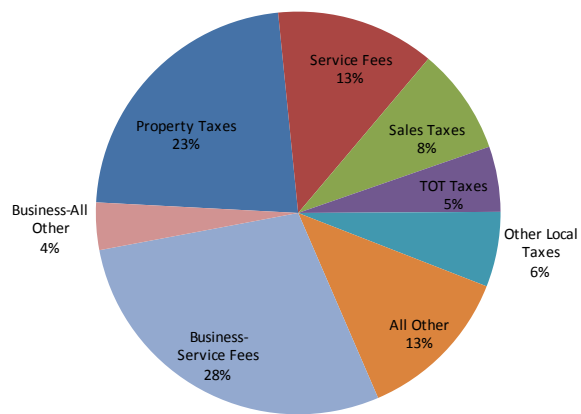
**City of San Diego
Total Transient Occupancy Tax Revenue**



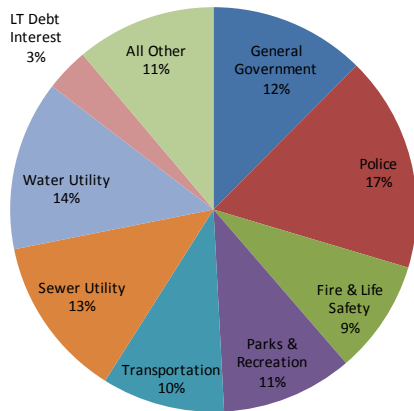
Financial Health

The City's total government-wide revenues, which are generated through a combination of governmental and business-type activities, have remained approximately the same over the prior three years, improving by 1%. While property tax revenues and business-type charges for services revenue for water and wastewater services have grown during this period, sales tax and TOT have declined. For fiscal year 2010, property tax revenue is projected to decline by 1.5%. Other major revenue sources are also trending flat to declining as well. Total government-wide revenues for fiscal year 2009 were \$2.7 billion; governmental activities were \$1.8 billion and business-type activities were \$.9 billion, and are illustrated in the chart to the right.

Total Government-Wide Revenues



Total Government-Wide Expenses



Over the last three years, the City’s total government-wide expenses have increased approximately 4%. These expenses supported all public services and the significant fiscal obligations of the City, including funding of the City’s pension system, post-employment healthcare benefits, and capital improvements. Total expenses for fiscal year 2009 were \$2.5 billion. Governmental activities were \$1.7 billion, of which 38% was spent on public safety for police, fire, and life safety services. Business-type activities were \$.8 billion, of which 85% of these expenses were for water and wastewater expenses.

The City’s unfunded pension liability remains a significant obligation of the City. The City has aggressively confronted this deficit, fully funding the City’s Annual Required Contribution (ARC) beginning in fiscal year 2006, and has made significant additional payments in excess of the ARC into the pension fund in certain years. The San Diego City Employees’ Retirement System (SDCERS) is the administrator of the City’s employee pension funds. On an annual basis, the pension fund portfolio and future pension obligations are evaluated by an independent actuary to determine the full pension liability. The June 30, 2008 valuation calculated the unfunded pension liability to be approximately \$1.303 billion. The June 30, 2009 actuarial report is not complete as of the issuance of this report.

Pension Funding Progress (Thousands)			
Actuarial Valuation Date	Actuarial Value of Assets	UAAL	Funded Ratio
6/30/2005	\$ 2,983,080	\$ 1,452,937	67.3%
6/30/2006	3,981,932	1,000,768	79.9%
6/30/2007	4,413,411	1,184,242	78.8%
6/30/2008	4,660,346	1,303,204	78.2%

In fiscal year 2009, the global financial markets experienced significant declines. The effects of the market declines have been wide ranging and impact even the most diversified investment portfolios. The SDCERS investment portfolio is no exception. SDCERS employs a long-term investment strategy. The City’s ARC is determined using an asset smoothing methodology which dampens the volatility of the market value of assets which occurs from fluctuations in market conditions. The ARC payment for fiscal year 2011 has not been determined by the SDCERS actuary as of the issuance of this report; however, it has been estimated by the SDCERS actuary, presented to the Board on July 17, 2009 and September 18, 2009, to be approximately \$224 million. This is an increase of \$70 million, or 45%, over the ARC payment of \$154 million the City is obligated to fund in fiscal year 2010. Any significant increase in the fiscal year 2011 ARC payment will require the City to reduce operating expenses which will affect services and programs.

In fiscal year 2008, Governmental Accounting Standards Board Statement 45 (“GASB 45”) went into effect requiring all municipal

Retiree Healthcare Liabilities (Thousands)			
Actuarial Valuation Date	Actuarial Value of Assets	UAAL	Funded Ratio
6/30/2008	\$ 29,637	\$ 1,206,070	2.4%
6/30/2009	41,497	1,317,880	3.1%

governments to report on Other Post Employment Benefits (retiree healthcare costs) in a manner similar to reporting on pension benefits. The City's actuarial valuation for retiree healthcare costs estimated an unfunded actuarial accrued liability (UAAL) of \$1.318 billion as of June 30, 2009. The City is participating in a trust administered by CalPERS to fund this long-term liability and, to date, has contributed \$54 million to the CalPERS trust. The fair value of these assets as of June 30, 2009 was \$41.5 million. The City is not currently fully funding the ARC for retiree healthcare, which is \$120.3 million for fiscal year 2011. The amount budgeted for fiscal year 2010 is \$57.1 million, of which \$32.1 million will fund the pay-go portion and \$25 million is expected to be transferred to the CalPERS trust by fiscal year end.

Governmental Funds (Tax Supported Operations)

The City's General Fund finished fiscal year 2009 with unrestricted cash and investments of approximately \$87 million. As a fiscal precaution against natural disasters or unforeseen events, the City maintains an emergency reserve fund that can only be accessed for qualifying emergencies as declared by the Mayor and/or City Council and approved by at least a 2/3 vote of the City Council. The General Fund Reserve Policy set a funding goal of 7.0% of General Fund revenue by the end of fiscal year 2009. The General Fund reserve was actually 7.7% of General Fund revenue at June 30, 2009, resulting in a total reserve balance of \$78.3 million. This balance is reported within the General Fund Balance Sheet as Undesignated Fund Balance. The reserves are currently cash funded within the City Treasury's pooled cash portfolio. The goal is to establish General Fund reserves at 8% of revenues by fiscal year 2012.

The Fiscal year 2010 Budget adopted in June 2009 reflected a reduction of expense growth by reducing program expenditures and imposing an across the board 6% reduction in compensation for all City employees. The City also was successful in redesigning the pension benefit package for most employees hired after July 1, 2009. Due to a projected decline in the City's major revenues, management addressed the City's projected budgetary imbalance by proposing, and City Council then adopting, a Fiscal year 2010 Budget that reduced spending on current services while also attempting to mitigate service level reductions. Council adopted a Fiscal year 2010 Budget in June 2009 that balanced estimated revenues to expenditures.

During fiscal year 2009, total long-term liabilities of the City's governmental activities increased by \$198 million. This was primarily the result of the capital improvement 2009A lease revenue bond issue for \$103 million for various capital improvement projects and an increase to the Net Other-Postemployment Benefits Obligation of \$45 million. Overall, our annual interest costs for governmental activities were approximately \$84 million in fiscal year 2009, which represents approximately 5% of our total governmental activities expenses.

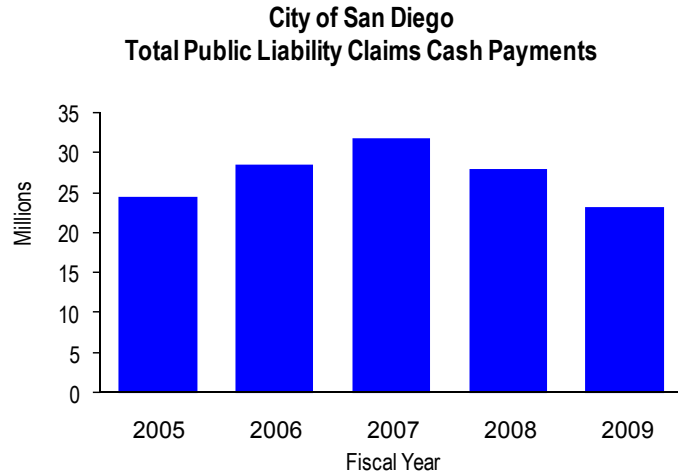
The City's capital assets are essential to providing services to its residents and maintaining the quality of its environment. During fiscal year 2009, total capital assets for governmental activities increased by \$120 million. This was funded by a combination of developer contributions, grant monies, and city-funded capital improvement programs.

The City's capital improvement backlog is estimated to be approximately \$800 to \$900 million according to the most recent Five Year Financial Outlook. This amount is the most recent estimate and includes the cost of needed repairs to City facilities, streets and storm drains but does not include alleys, sidewalks or soft costs. The City is in the process of

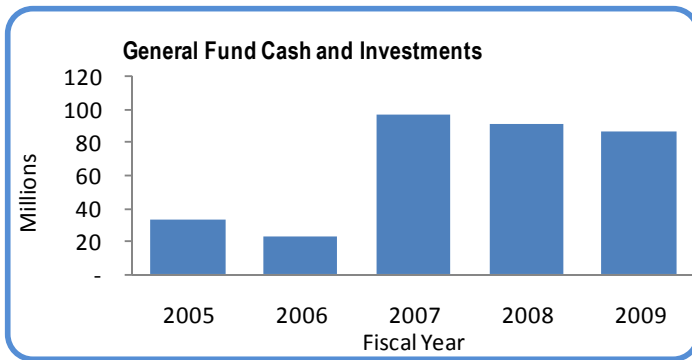
assessing and updating its cost estimate for its capital improvement backlog. These costs have been deferred because the City has not had the necessary funding resources. As mentioned above, the City issued \$103 million in bonds to fund deferred projects during fiscal year 2009. The bond proceeds will be used to fund deferred capital improvement projects within the City.

The City's Public Liability Fund, which accounts for governmental fund-related claims, has a deficit of approximately \$49 million as of June 30, 2009. This deficit includes an accrued liability for actuarially calculated claims costs, incurred but not reported claims, and allocated and unallocated losses of approximately \$59 million, offset with the cash reserves collected in the fund. This fund has seen significantly higher claims since fiscal year 2005, largely as a result of the legal claims and investigations stemming from the pension fund

underpayment and related financial disclosure issues; however, most of these unusual costs were paid through fiscal year 2007 and fiscal year 2008. The Workers' Compensation Fund, which accounts for both governmental and business-type claims, has a deficit of \$114 million as of June 30, 2009. This deficit includes an accrued liability for actuarially calculated liabilities for open and unreported claims, as well as a provision for the allocated loss adjustment expense totaling approximately \$148 million, offset with the cash reserves collected in the fund. The total liability for workers compensation has declined since fiscal year 2007 due to a downward trend in the number of claims and the effect of State legislation regarding workers compensation reform enacted in 2004. Per the City Reserve Policy, the City has budgeted funds annually to establish cash reserves to reach the goal of 50% of the estimated outstanding liabilities in each fund. While the City is committed to funding reserves in the Worker's Compensation and Public Liability funds, and has included funding for these reserves in the fiscal year 2010 budget, the goal of funding 50% of outstanding liabilities in both funds by 2014 is being reassessed given the economic downturn and continued decline in General Fund revenues.

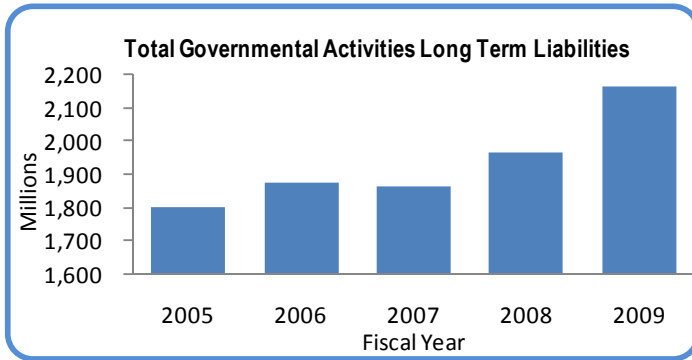


Governmental Activities Key Indicators



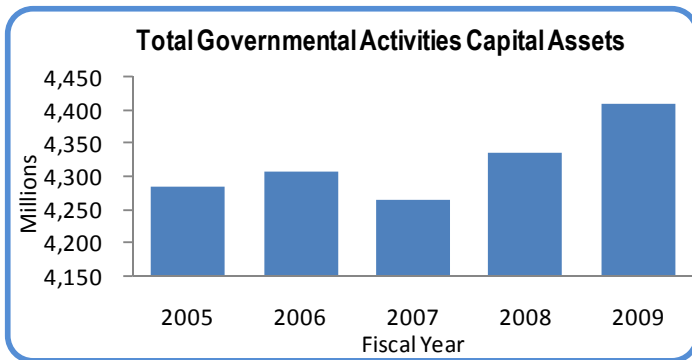
General Fund Cash

Continued expenditure savings due to vacancies and management imposed reductions in discretionary spending have helped the City to maintain a relatively stable cash position.



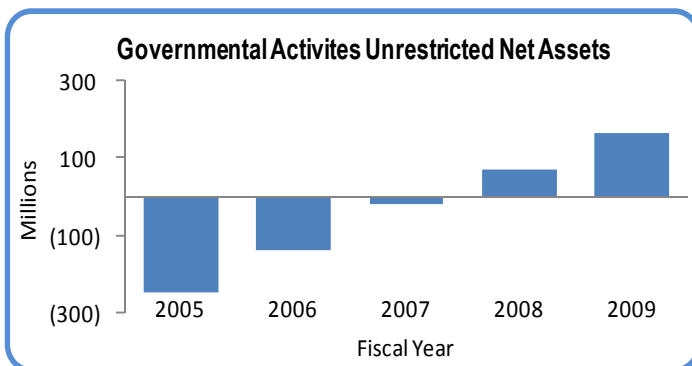
Total Long Term Liabilities

The City issued \$103 million in Lease Revenue Bonds to finance various public improvements during FY 2009. The City's obligation related to Other Post-employment Benefits also increased \$45 million in FY 2009, together creating an increase in total long term liabilities of approximately 10.1%.



Capital Assets

Capital Assets increased by approximately \$120 million during FY 2009. This included capital expenditures related to the City's new ERP system, seismic retrofitting of the City's bridge infrastructure, and infrastructure and improvements to repair street damage resulting from the Mt. Soledad landslide.



Unrestricted Net Assets

Unrestricted Net Assets increased approximately \$92 million in FY 2009. This was primarily the result of Redevelopment Agency revenues exceeding expenses to fund multi-year capital improvements.

Business-Type Activities

The majority of the City's business-type activities are related to utilities that provide water and wastewater services. The Water and Metropolitan Wastewater Departments have been consolidated into a single Public Utilities Department and continue to serve several regional agencies outside of the City's boundaries. The utilities operations are mainly supported by fees charged to customers. The Independent Rate Oversight Committee (an independent committee of stakeholders) monitors utility rates and expenditures on behalf of the ratepayers.

The City's Water Utility Fund issued \$485 million of Water Revenue and Revenue Refunding Bonds, Series 2009A and 2009B during fiscal year 2009 to prepay outstanding principal of \$207 million of Subordinated Water Revenue Notes, Series 2007A and 2008B; refund \$94 million of Certificates of Undivided Interest, Series 1998 monies; and to finance capital improvements on the water system. The publicly offered Water 2009A and 2009B Revenue Refunding Bonds are secured by and payable solely from net system revenues of the Water Utility Fund. The City's Wastewater Utility Fund issued \$1.089 billion of Senior Sewer Revenue Bonds to finance capital improvements to the wastewater system; fully refund \$224 million in wastewater revenue notes; and to refund approximately \$683 million in wastewater revenue bonds. The net change in these notes and bonds payable during fiscal year 2009 is the primary reason the business-type long term liabilities increased \$344 million over fiscal year 2008.

For the year ended June 30, 2009, the City's business-type activities closed with restricted and unrestricted cash and investment balances totaling \$1.2 billion, an increase over fiscal year 2008 of approximately \$319 million as a result of the debt issues discussed above.

While the City's capital assets for business-type activities have continued to increase in value, deferred maintenance remains an ongoing challenge. The City maintains a network of over 3,000 miles of water pipes and over 3,000 miles of sewer and waste water lines.

Compliance with environmental regulations generally requires infrastructure construction, including the replacement of water distribution systems, treatment plant upgrades, the replacement of wastewater collection systems, and improving sewage treatment capacity. The City has agreed with various state and federal regulators to build significant infrastructure upgrades. In June 2009, the City received tentative approval of a third five-year waiver permit from the Environmental Protection Agency (EPA) and the state Regional Water Quality Control Board to continue operating the Point Loma Wastewater Treatment Plant at advanced primary treatment level. The City is still working with the California Coastal Commission to receive final wording on a consistency determination in support of this EPA decision. The resolution is anticipated in early 2010.

The City is also facing challenges to the future of its water supplies. A persistent regional drought and judicial decisions regarding management of the State Water Project has put significant pressure on San Diego's regional water supplies. The City of San Diego imports as much as 90% of its water supply. The reliability of that supply has been reduced because of court decisions, weather conditions, the diminishing availability of stored water, and dwindling supplies of new water. The City continues to work with its water wholesalers (the San Diego County Water Authority and the Metropolitan Water District of Southern California) to address these supply issues but currently operates under a mandatory water conservation target to achieve an 8% reduction in overall use. The City's performance from June through September has averaged a monthly reduction of over 12%. The availability of

water has legal implications and could potentially affect City Council findings regarding state mandated water supply assessments for future development. These assessments must demonstrate the long-term availability of water for large projects before those projects can be approved by local jurisdictions. At this time, it is unclear what effect limitations to water supplies would have on the City's economy and its revenues as the most recent project assessments have all been able to find potable water offsets through the increased use of reclaimed water. The Mayor also proposed and the City Council approved in October 2009 a revised Landscape Ordinance in advance of the state's requirement to do so by January 2010. The City is also moving forward with the California Department of Public Health to undertake a demonstration project intended to verify that highly treated municipal wastewater can be placed in a drinking water reservoir.

Best Practice Operating Improvements

The City took a major leap forward on July 1, 2009 when it went live with its new SAP Enterprise Resource Planning (ERP) financial system. After two years of planning, the City successfully began the transition to an integrated financial system which allowed us to eliminate over a dozen legacy software applications. Throughout fiscal year 2010, core functionality modules will be implemented, eliminating even more costly legacy software applications and hardware. The addition of the ERP system and a well trained workforce are expected to significantly improve the City's financial operations and reporting capabilities.

Internal controls over financial operations and reporting continue to be a focus issue for the City. As part of the ERP system, the City has invested in an integrated internal controls module called Governance, Risk and Compliance (GRC). GRC, coupled with new process and procedure documents, are expected to improve our internal control environment. In addition, the City has established a comprehensive plan and has the proper staffing in place to complete the remediation of weaknesses in internal controls over financial reporting within 14 months.

The Five Year Financial Outlook

In October 2009, the City released an updated Five-Year Financial Outlook (the Outlook) for fiscal years 2011 through 2015. This document is an examination of the City's long range fiscal condition and financial challenges. The City updates the Outlook periodically to account for changed circumstances.

The City's General Fund was the primary focus of the 2011-2015 Outlook. Approximately 68% of the City's major revenues consist of four revenue sources: property tax, sales tax, TOT, and franchise fees. Nearly 70% of the City's General Fund expenditures are personnel expenses. Negative economic factors have resulted in a downward revision to revenue projections for the fiscal year 2010 annual budget, which served as a base for the Outlook. The Outlook discussed risks and opportunities that affect fiscal decisions and the City's ability to accomplish its strategic financial goals over the next five-year period. These goals include:

- Meet contractual obligations and fund mandated programs
- Contribute the full payment of the Annual Required Contribution (ARC) for the City's pension system
- Maintain or enhance General Fund and other reserves according to the City's Reserve Policy
- Preserve City services to the fullest extent possible

Five Year Outlook for Fiscal Years 2011 - 2015					
GENERAL FUND	Forecast FY 2011	Forecast FY 2012	Forecast FY 2013	Forecast FY 2014	Forecast FY 2015
<i>Projected Revenues</i>					
Property Tax	\$ 396.4	\$ 404.5	\$ 416.7	\$ 433.4	\$ 450.7
Sales Tax	182.7	192.7	200.2	208.1	218.8
Transit Occupancy Tax	71.9	74.1	76.7	79.7	82.9
Franchise Fees	75.0	76.7	78.5	80.3	82.2
Other Revenues	335.6	346.1	353.3	355.3	362.0
	1,061.6	1,094.1	1,125.4	1,156.8	1,196.6
<i>Projected Expenses</i>					
Salary, Wages & Benefits	611.8	620.9	627.2	636.2	622.7
Operating Expenses	351.5	363.1	366.0	382.5	390.6
Pension Expense	217.8	206.5	225.2	242.5	258.7
Retiree Healthcare Expense	43.2	46.8	50.4	54.2	57.8
General Fund Reserves	4.2	7.9	2.5	2.5	3.2
Liability Funding	12.2	7.8	10.1	4.8	-
	1,240.7	1,253.0	1,281.4	1,322.7	1,333.0
General Fund Projected Shortfall	\$ (179.1)	\$ (158.9)	\$ (156.0)	\$ (165.9)	\$ (136.4)

The impact of continued declines in major revenue sources and increased costs for pension funding are the leading factors in the fiscal year 2011 forecasted budget deficit of \$179 million.

Because of the severity of the budget shortfall, the Mayor has indicated that cuts to services and programs will be inevitable in order for the City to maintain a balanced budget. Within the City, this will mean a workforce reduction combined with expenditure savings from reduced or eliminated programs and services. The Mayor's budget plan for fiscal year 2011 does not include contributions to fund reserves; however, the plan proposes that reserves will not be spent and will be maintained at current levels.

Looking Forward

These are difficult economic times, and the City has set challenging goals for its future. The City believes these goals are achievable with continued fiscal discipline and greater government efficiency. In some revenue categories, San Diego has relatively low taxes and fees compared to most other large municipalities in the United States. San Diego enjoys an ideal location with agreeable weather year round. The diversity of industry, education and tourism well positions the City for an early economic rebound when the economy begins its eventual recovery.

Out of these challenging times, San Diego is restructuring its operations, services and programs so that the City will emerge with a sound, fundamentally sustainable municipal business model. We have addressed the issues that have created prior difficulties for this City, and we are structuring ourselves for long-term solvency and flexibility. We will continue to live within our means and balance our annual budgets.

Purpose, Background, and Scope of this Report

San Diego City Charter § 111 requires the City to submit an annual report, including a Statement of Net Assets, and requires that all accounts of the City be audited by an independent auditor. Pursuant to this requirement, the Comprehensive Annual Financial Report ("CAFR") of the City of San Diego ("City") for the fiscal year ended June 30, 2009, is hereby submitted. The audit firm of Macias Gini & O'Connell LLP has issued an unqualified opinion on the City of San Diego's financial statements. The independent auditor's report is located at the front of the financial section of this report.

The CAFR has been prepared in conformance with the principles and standards for reporting as set forth by the Governmental Accounting Standards Board (GASB). Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the management of the City and its related agencies. The City's objective is to provide you with reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements. Additionally, the City continues to construct and improve a comprehensive internal control framework in order to ensure acceptable management of taxpayer funds.

To the best of our knowledge and belief, the data as presented, is accurate in all material respects; it is presented in a manner designed to present fairly the financial position and results of operations of the governmental activities, business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining funds of the City and its related agencies; and all disclosures necessary to enable the reader to gain an understanding of the City's, as well as its related agencies', financial activities have been included.

A narrative introduction, overview, and analysis of the financial statements can be found in Management's Discussion and Analysis (MD&A), which immediately follows the independent auditor's report. The MD&A complements this letter of transmittal and should be read in conjunction with it. The CAFR is organized into three sections:

- The introductory section includes information about the organizational structure of the City, the City's economy, and selected other financial information.
- The financial section is prepared in accordance with governmental accounting standards. It includes the MD&A (unaudited), the independent auditor's report, the audited basic financial statements, notes to the basic financial statements, required supplementary information (unaudited), and supplementary information (unaudited).
- The statistical section contains historical statistical data on the City's financial data and debt statistics, as well as miscellaneous physical, demographic, economic, and social data of the City. This section of the CAFR is unaudited.

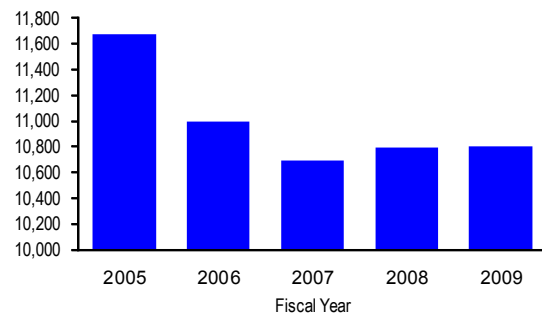
Profile of the City of San Diego

The City of San Diego was incorporated in 1850. The City comprises 342 square miles and, as of January 1, 2009, the California Department of Finance estimates the population to be 1,353,993. The City, with approximately 10,800 employees, provides a full range of governmental services including police and fire protection, sanitation and health services, the construction and maintenance of streets and infrastructure, recreational activities and cultural events, and the maintenance and operation of the water and sewer utilities.

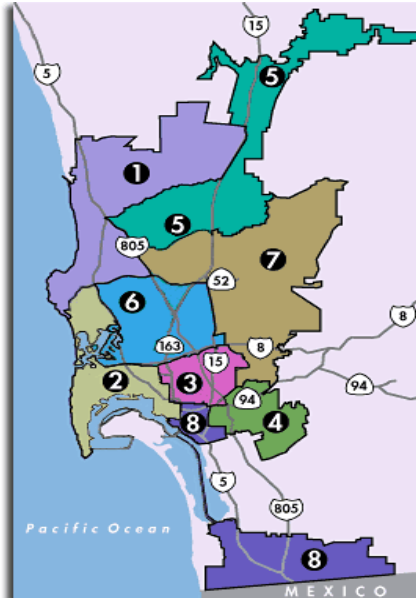
Governing Structure

The City operates under and is governed by the laws of the State of California and its own Charter, as periodically amended since its adoption by the electorate in 1931. The City is currently operating under a Strong-Mayor form of government. The departure, on an interim trial basis, from the City's previous Council-Manager form of government was approved by a vote of the public and became effective January 1, 2006. The Mayor is elected at large to serve a four-year term.

City of San Diego
Full Time and Part Time Employees



City of San Diego Council
District Map



Under the Strong-Mayor form of government, the Mayor is the Chief Executive Officer of the City and has direct oversight over all City functions and services except for the City Council, Personnel, City Clerk, Independent Budget Analyst (IBA), City Attorney, and City Auditor departments. Under this form of government, the City Council is composed of eight members and is presided over by the Council President, who is selected by a majority vote of the City Council. The Mayor presides over City Council in closed session meetings of the Council. The Council retains its legislative authority; however, all City Council resolutions and ordinances are subject to a veto of the Mayor except for certain ordinances including emergency declarations and the City's annual Salary and Appropriations Ordinances. The City Council may override a Mayoral veto with five votes. The City Attorney, who is elected for a four-year term, serves as the chief legal advisor of and attorney for the City and all departments.

During the County's primary election held on June 3, 2008, voters approved Proposition B which requires City Council to place a measure on the June 2010 ballot to allow voters to decide whether the Strong-Mayor form of government should become permanent effective January 1, 2011. Additionally, Proposition B provides for the public to decide whether the number of City Council districts should increase from eight to nine, and therefore, a corresponding increase of City Council votes required to override the Mayor's veto from five to six. Additionally, voters approved Proposition C, which separated the City Auditor's Office from the Comptroller's Office and made the Office of the IBA permanent. Under this amendment, the City Auditor serves a ten-year term and

is supervised by an Audit Committee consisting of two Councilmembers and three members of the public with auditing expertise, who are appointed by the City Council. This amendment also provides that the Mayor will appoint, with City Council confirmation, the Chief Financial Officer. In addition, the Mayor's appointment of the City Treasurer no longer requires City Council confirmation.

Current Elected Officials
(As of the issuance of this report)



Mayor Jerry Sanders

District 1 Councilmember Sherri Lightner			District 5 Councilmember Carl DeMaio
District 2 Council President Pro Tem Kevin Faulconer			District 6 Councilmember Donna Frye
District 3 Councilmember Todd Gloria			District 7 Councilmember Marti Emerald
District 4 Councilmember Tony Young			District 8 Council President Ben Hueso

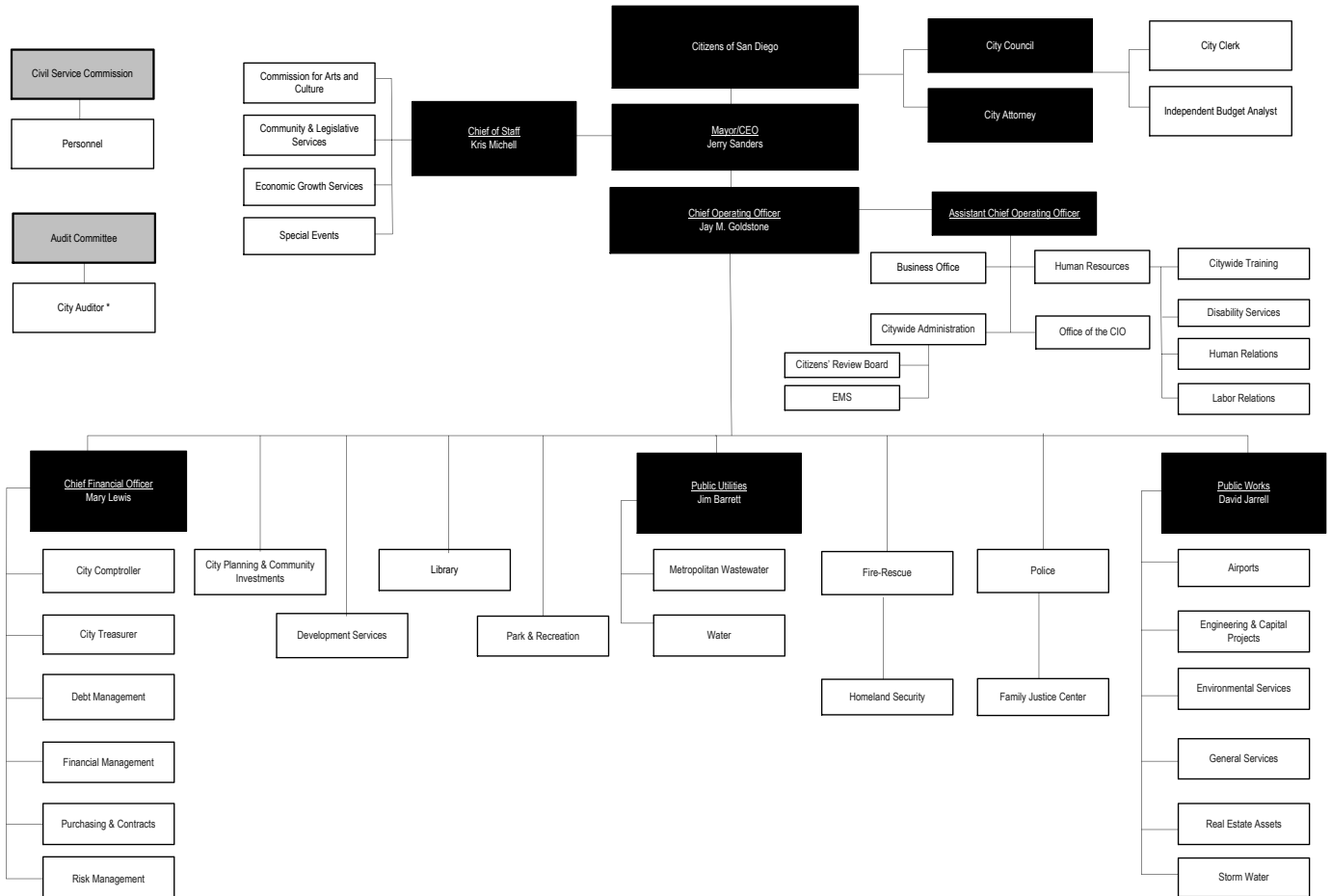


City Attorney
Jan Goldsmith

Other City Officials

- Jay M. Goldstone, Chief Operating Officer
- Mary Lewis, Chief Financial Officer
- Kenton C. Whitfield, City Comptroller
- Gail R. Granewich, City Treasurer
- Elizabeth Maland, City Clerk
- Andrea Tevlin, Independent Budget Analyst
- Eduardo Luna, City Auditor

City of San Diego Organization Chart (As of the issuance of this Report)



* Proposition C, passed in June 2008, provides that the City Auditor shall report to and be accountable to the Audit Committee. To complete the enacting measure for Proposition C, the City Auditor must be appointed by the City Manager (Mayor), in consultation with the Audit Committee, and confirmed by the City Council. This organization chart reflects the reporting structure called for in Proposition C, which will be in effect following that Council action.

Financial Reporting Entity

In accordance with Governmental Accounting Standards Board (GASB) Statement 14, the following component units are incorporated into the accompanying financial statements:

- Centre City Development Corporation (CCDC)
- City of San Diego Metropolitan Transit Development Board Authority (MTDB)
- Redevelopment Agency of the City of San Diego (RDA)
- San Diego Data Processing Corporation (SDDPC)
- San Diego Housing Commission (SDHC)
- San Diego Open Space Park Facilities District #1
- Community Facilities and Other Special Assessment Districts
- Tourism Marketing District
- Convention Center Expansion Financing Authority (CCEFA)
- San Diego City Employees' Retirement System (SDCERS)
- Public Facilities Financing Authority (PFFA)
- San Diego Convention Center Corporation (SDCCC)
- San Diego Facilities and Equipment Leasing Corporation (SDFELC)
- San Diego Industrial Development Authority (SDIDA)
- Southeastern Economic Development Corporation (SEDC)
- Tobacco Settlement Revenue Funding Corporation (TSRFC)

Additionally, the City participates in a joint venture operation with a private company to provide for emergency medical and medical transportation services. This joint venture is a limited liability company named San Diego Medical Services Enterprise, LLC. The financial impact of the joint venture is displayed in the General Fund within the governmental funds statement of revenues, expenditures and changes in fund balance and in the government-wide statement of activities.

Budgetary Process

Pursuant to the City Charter, an annual budget is presented by the Mayor to the City Council for consideration. Set forth in this budget are the anticipated revenues and expenditures of the General Fund, certain special revenue funds, enterprise funds, and certain debt service funds for the ensuing fiscal year. Additionally, project-length financial plans are presented to and adopted by the City Council for the capital projects funds. The legal level of budgetary control for the City's general fund is exercised at the salaries and wages and non-personnel expenditures level. Budgetary control for the other budgeted funds, including those of certain component units, is maintained at the total fund appropriation level. Copies of the City's budgets are available at the Financial Management Office located at 202 C Street, MS8A, San Diego, CA 92101.

The City continues to look for ways to improve the effectiveness and efficiency of its operations. The focus now is on crafting policy that will ensure a continued commitment to strong financial stewardship.

Sincerely,



Jerry Sanders
Mayor


Jay M. Goldstone
Chief Operating Officer
Mary Lewis
Chief Financial Officer
Kenton C. Whitfield
City Comptroller

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FINANCIAL SECTION

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MACIAS GINI & O'CONNELL LLP
Certified Public Accountants & Management Consultants

SAN DIEGO
402 W. Broadway, Suite 400
San Diego, CA 92101
619.573.1112

SACRAMENTO

OAKLAND

WALNUT CREEK

LOS ANGELES

NEWPORT BEACH

INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and Members of the City Council
of the City of San Diego, California

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of San Diego, California (City), as of and for the year ended June 30, 2009, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the San Diego Housing Commission, a discretely presented component unit, which statements reflect 90%, 95% and 85% of the total assets, total net assets and total revenues, respectively, of the aggregate discretely presented component unit totals. Also, we did not audit the Southeastern Economic Development Corporation, a blended component unit, which statements reflect less than 1% in each of the total assets, total net assets and total revenues categories, respectively, of the aggregate remaining fund information. Those financial statements were audited by other auditors whose reports thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the San Diego Housing Commission and the Southeastern Economic Development Corporation is based solely on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City as of June 30, 2009, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the basic financial statements, the City adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, effective July 1, 2008.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2009, on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis, schedules of funding progress and schedule of contributions from employer and other contributing entities, and general fund budgetary information on pages 35 through 48, 168, and 172 through 174, respectively, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The introductory section, supplementary information, and statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplementary information has been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, based on our audit and the report of other auditors, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, accordingly, we express no opinion on them.

 Macias Gini & Connell LLP

Certified Public Accountants

San Diego, California
December 21, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Unaudited)
(In Thousands)
June 30, 2009

As management of the City of San Diego (City), we offer readers of the City financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2009.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements are comprised of three components: (1) government-wide financial statements; (2) fund financial statements; and (3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The focus of the government-wide financial statements is on reporting on the operating results and financial position of the government as an economic entity. These statements are intended to report the entity's operational accountability to its readers, giving information about the probable medium and long-term effects of past decisions on the government's financial position.

The statement of net assets presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The statement of activities presents information showing changes in the City's net assets during the fiscal year 2009. All changes in net assets are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. The focus is on both gross and net costs of City functions, which are supported by general revenues. This Statement also distinguishes functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include: General Government and Support; Public Safety - Police; Public Safety - Fire and Life Safety and Homeland Security; Parks, Recreation, Culture and Leisure; Transportation; Sanitation and Health; and Neighborhood Services. The business-type activities of the City include: Airports; City Store; Development Services; Environmental Services; Golf Course; Recycling; Sewer Utility; and Water Utility.

The government-wide financial statements include the City (known as the primary government) and the following legally separate, discretely presented component units: San Diego Convention Center Corporation (SDCCC); and San Diego Housing Commission (SDHC). Financial information for these component units is reported separately from the financial information presented for the primary government. Blended component units, also legally separate entities, are a part of the government's operations and are combined with the primary government.

Included within the primary government as blended component units:

- Centre City Development Corporation (CCDC)
- City of San Diego Metropolitan Transit Development Board Authority (MTDB Authority)
- City of San Diego Tobacco Settlement Revenue Funding Corporation (TSRFC)
- Community Facilities and Other Special Assessment Districts
- Convention Center Expansion Financing Authority (CCEFA)
- Public Facilities Financing Authority (PFFA)
- Redevelopment Agency of the City of San Diego (RDA)
- San Diego City Employees' Retirement System (SDCERS)
- San Diego Data Processing Corporation (SDDPC)

- San Diego Facilities and Equipment Leasing Corporation (SDFELC)
- San Diego Industrial Development Authority (SDIDA)
- San Diego Open Space Park Facilities District #1
- Southeastern Economic Development Corporation (SEDC)
- Tourism Marketing District (TMD)

The government-wide financial statements can be found beginning on page 52 of this report.

FUND FINANCIAL STATEMENTS

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

GOVERNMENTAL FUNDS

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both of the Governmental Funds Balance Sheet and the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains individual governmental funds. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances for the General Fund, which is a major fund. Data from the other governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the Supplementary Information section of this report.

The City adopts an annual appropriated budget for its General Fund. A budgetary comparison statement has been provided for the General Fund to demonstrate compliance with this budget and is presented as required supplementary information.

The basic governmental funds financial statements can be found beginning on page 56 of this report.

PROPRIETARY FUNDS

The City maintains two different types of proprietary funds, enterprise funds and internal service funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses Enterprise Funds to account for its various business-type activities, such as Sewer and Water Utilities. Internal Service funds, such as Fleet Services, Central Stores, Publishing Services, and Self Insurance, are used to report activities that provide centralized supplies and/or services to the City. All internal service funds, except for the Special Engineering Fund, have been included within governmental activities in the government-wide financial statements since they predominantly benefit governmental functions. The Special Engineering Fund, which services exclusively Sewer and Water activities, has been included within business-type activities in the government-wide financial statements.

Proprietary fund statements provide the same type of information as the government-wide financial statements, only in more detail. The proprietary funds financial statements provide separate information for the Sewer and Water funds, which are considered to be major funds of the City. Data for the nonmajor proprietary funds are combined into a single, aggregated presentation, and the internal service funds are combined into a single, aggregated presentation as well. Included in the Supplementary Information section of this report are individual fund data for the nonmajor proprietary funds and the internal service funds. The basic proprietary funds financial statements can be found beginning on page 60 of this report.

FIDUCIARY FUNDS

Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City's operations. The accounting used for fiduciary funds is much like that used for proprietary funds.

The basic fiduciary funds financial statements can be found beginning on page 63 of this report.

NOTES TO THE FINANCIAL STATEMENTS

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found beginning on page 65 of this report.

OTHER INFORMATION

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the City's progress in funding its obligation to provide pension and postemployment healthcare benefits to its employees, and the General Fund's budgetary comparison schedule. Required supplementary information can be found beginning on page 170 of this report.

The individual fund data referred to earlier in connection with nonmajor governmental funds, nonmajor proprietary funds, internal service funds, and fiduciary funds are presented immediately following the required supplementary information on pensions and the General Fund budgetary comparison schedule, beginning on page 199 of this report.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

CITY OF SAN DIEGO'S SUMMARY OF NET ASSETS
(In Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2009	2008	2009	2008	2009	2008
Capital Assets	\$ 4,455,525	\$ 4,335,317	\$ 4,766,721	\$ 4,634,918	\$ 9,222,246	\$ 8,970,235
Other Assets	2,110,185	2,096,751	1,357,070	1,031,815	3,467,255	3,128,566
Total Assets	6,565,710	6,432,068	6,123,791	5,666,733	12,689,501	12,098,801
Net Long-Term Liabilities	2,164,276	1,965,991	2,413,033	2,068,569	4,577,309	4,034,560
Other Liabilities	143,231	312,696	110,479	108,455	253,710	421,151
Total Liabilities	2,307,507	2,278,687	2,523,512	2,177,024	4,831,019	4,455,711
Net Assets:						
Invested in Capital Assets,						
Net of Related Debt	3,530,937	3,518,704	2,970,351	2,933,012	6,501,288	6,451,716
Restricted	564,605	564,042	42,485	39,436	607,090	603,478
Unrestricted	162,661	70,635	587,443	517,261	750,104	587,896
Total Net Assets	\$ 4,258,203	\$ 4,153,381	\$ 3,600,279	\$ 3,489,709	\$ 7,858,482	\$ 7,643,090

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$7,858,482 at June 30, 2009, an increase of \$215,392 over fiscal year 2008.

\$6,501,288, or approximately 82%, of total Net Assets represent the City's investment in capital assets (e.g., land, structures and improvements, equipment, distribution and collections systems, infrastructure, and construction-in-progress), less any outstanding debt used to acquire these assets. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves generally are not used to liquidate these liabilities.

\$607,090, or approximately 8%, of total Net Assets represent resources that are subject to external restrictions on how they may be used. The remaining balance of \$750,104, or approximately 10%, is available to finance ongoing services and obligations to the City's citizens and creditors.

Unrestricted Net Assets increased by \$162,208, or approximately 28%. Approximately \$70,000 of this increase was in the Business-Type activities, primarily attributed to Council approved rate increases. Governmental activities increased by approximately \$92,000. This was primarily the result of revenues exceeding expenses for RDA by approximately \$70,000. RDA projects are multi-year in nature, and therefore, revenues collected on an annual basis are often budgeted for future larger construction phases of the projects. In addition, RDA experienced increased property tax revenues from fiscal year 2008 to 2009. Another material increase was a \$20,000 increase to debt service reserves not legally restricted but internally set aside.

CITY OF SAN DIEGO'S SUMMARY OF CHANGES IN NET ASSETS
(In Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2009	2008	2009	2008	2009	2008
Revenues:						
Program Revenues						
Charges for Current Services	\$ 345,532	\$ 289,985	\$ 771,725	\$ 772,602	\$ 1,117,257	\$ 1,062,587
Operating Grants and Contributions	93,244	75,126	1,739	2,312	94,983	77,438
Capital Grants and Contributions	110,802	78,347	60,863	58,400	171,665	136,747
General Revenues						
Property Taxes	607,857	576,605	-	-	607,857	576,605
Transient Occupancy Taxes	140,657	159,348	-	-	140,657	159,348
Other Local Taxes	161,485	151,267	-	-	161,485	151,267
Grants and Contributions not Restricted to						
Specific Programs	8,488	6,251	-	-	8,488	6,251
Sales Taxes	229,651	269,757	-	-	229,651	269,757
Investment Income	75,245	96,725	31,004	41,224	106,249	137,949
Other	51,598	85,785	8,257	7,850	59,855	93,635
Total Revenues	1,824,559	1,789,196	873,588	882,388	2,698,147	2,671,584
Expenses:						
General Government and Support	303,581	322,157	-	-	303,581	322,157
Public Safety-Police	418,549	382,907	-	-	418,549	382,907
Public Safety-Fire, Life Safety, Homeland Security	220,787	204,822	-	-	220,787	204,822
Parks, Recreation, Culture and Leisure	258,038	231,955	-	-	258,038	231,955
Transportation	239,305	212,255	-	-	239,305	212,255
Sanitation and Health	77,447	51,772	-	-	77,447	51,772
Neighborhood Services	116,735	91,110	-	-	116,735	91,110
Debt Service:						
Interest on Long-Term Debt	84,070	82,211	-	-	84,070	82,211
Airports	-	-	5,140	4,109	5,140	4,109
City Store	-	-	321	788	321	788
Development Services	-	-	47,260	51,461	47,260	51,461
Environmental Services	-	-	35,718	37,279	35,718	37,279
Golf Course	-	-	11,864	11,142	11,864	11,142
Recycling	-	-	20,067	20,511	20,067	20,511
Sewer Utility	-	-	314,125	322,552	314,125	322,552
Water Utility	-	-	329,748	321,123	329,748	321,123
Total Expenses	1,718,512	1,579,189	764,243	768,965	2,482,755	2,348,154
Change in Net Assets Before Transfers:	106,047	210,007	109,345	113,423	215,392	323,430
Transfers	(1,225)	3,551	1,225	(3,551)	-	-
Net Change in Net Assets	104,822	213,558	110,570	109,872	215,392	323,430
Net Assets - July 1	4,153,381	3,939,823	3,489,709	3,379,837	7,643,090	7,319,660
Net Assets - June 30	\$ 4,258,203	\$ 4,153,381	\$ 3,600,279	\$ 3,489,709	\$ 7,858,482	\$ 7,643,090

GOVERNMENTAL ACTIVITIES

Governmental activities increased the City's net assets by \$104,822 during fiscal year 2009. Variances from fiscal year 2008 of more than 10% are discussed below.

- Charges for Services increased by \$55,547, or approximately 19%. The Special Engineering Fund was closed out during fiscal year 2009, and all Water and Sewer engineering positions were transferred to the General Fund. Charges for Services revenue increased as a result of those engineers billing Water and Sewer capital improvement projects.
- Operating Grants and Contributions increased by \$18,118, or approximately 24%, mainly due to an increase in Community Development Block Grant (CDBG) revenues. This was primarily the result of CDBG funded projects for non-City owned assets for various public improvements.
- Capital Grants and Contributions increased by \$32,455, or approximately 41%, which was caused by several factors. The City was awarded two new grants related to a 2007 landslide in the La Jolla area. The first was a Homeland Security grant for the Desert View Drive Area of La Jolla (\$6,800), and the second was a federal grant for the Mount Soledad Road area (\$11,900). In addition, there were increased revenues recognized for several other Capital Outlay grants including a Seismic Retrofit federal grant (\$5,500), a Prop1B State Grant (\$4,500), and a La Jolla/Pacific Beach/Ocean Beach/Mission Bay Water grant (\$1,200). Donated capital assets increased by \$8,900, which included park land turned over to the City (\$3,200) and land exchanged with the County for open space (\$2,600). These increases were offset by a decrease of approximately \$9,400 in CDBG related capital projects for city-owned public improvements.
- Transient Occupancy Taxes decreased by \$18,691, or approximately 12%, primarily due to the economic downturn in San Diego's tourism industry.
- Grants and Contributions not Restricted to Specific Programs increased by \$2,237, or approximately 36%, primarily due to one-time revenue received by RDA for the sale of downtown condominium units, pursuant to a participation agreement with a developer.
- Sales Taxes decreased by \$40,106, or approximately 15%. The General Fund's sales tax revenue decreased by approximately \$22,700, primarily due to declining retail sales as part of the overall downturn in the economy. TransNet's sales tax revenue decreased by approximately \$15,000. In fiscal year 2008 the City was awarded \$4,900 for the Bike Lanes and Major Corridor Programs, and in fiscal year 2009 the City was not awarded any new funds for these programs. In addition, SANDAG deferred approximately \$5,500 in sales tax disbursements to the City because the City was in violation of a SANDAG Board ruling which states that the City cannot maintain a balance in excess of 30% of the yearly apportionment. SANDAG deferred disbursement until the balance in the fund is reduced to meet the 30% rule.
- Investment Income decreased by \$21,480, or approximately 22%, primarily due to declining interest rates during 2008 and a decrease in interest income from the reinvestment of the investment pool's assets at these record low interest rates.
- Other Revenue decreased by \$34,187, or approximately 40% primarily due to a \$20,200 decrease in Proceeds from Land Sales. Due to the real estate market decline, the City has not sold the remaining parcels that were designated for disposition as part of the portfolio management plan for the City. There were also decreases in developer contributions in the Impact Fees Fund of \$9,300 and the Facilities Benefit Assessment Fund of \$2,400. These decreases were attributed to several communities, mainly Centre City (\$7,000), but also including smaller decreases in Uptown Urban Communities, Pacific Highlands Ranch, and Scripps Miramar Ranch.
- Parks, Recreation, Culture and Leisure expense increased by \$26,083, or approximately 11%, primarily due to the creation of the new Tourism Marketing District (TMD). Fiscal Year 2009 was the first full year for the TMD, causing an increase in expenditures of approximately \$9,500. There were also increases in depreciation of governmental capital assets in the amount of \$6,700 and Net Pension Obligation expense of \$6,900.

- Transportation expense increased by \$27,050, or approximately 13%, primarily due to the Underground Surcharge expenses. Since the underground program is funded by SDG&E franchise revenues, which came in lower than anticipated during fiscal year 2008, expenditures for the undergrounding of utility lines increased by approximately \$17,000 during fiscal year 2009 when revenues came in higher. Expenses related to the addition of the new Right of Way Design Program also increased by approximately \$6,400.
- Sanitation and Health expense increased by \$25,675, or approximately 50%, primarily due to an increase in the General Fund's Storm Water department expenditures. The City's Storm Drain and Street Sweeping programs were transferred to the Storm Water department from the Streets and Public Safety-Police departments, which accounted for an increase of approximately \$20,200. In addition, the Convention Center Fund paid \$5,900 for a one-time capacity fee adjustment for the annual cost of effluent dewatering.
- Neighborhood Services expense increased by \$25,625, or approximately 28%. This increase was primarily the result of a settlement agreement with the County of San Diego regarding the Grantville Redevelopment Project area for \$39,200. This was partially offset by a decrease of approximately \$9,300 which was attributed to a prior year loss on the disposition of an RDA parcel of land in the Centre City Project area, related to the Renaissance Hotel project. The loss was mostly due to timing differences in revenue and expense recognition because advances from the developer were recognized in prior years as the funds were used to acquire the property.

BUSINESS-TYPE ACTIVITIES

Business-type activities increased the City's net assets by \$110,570 during fiscal year 2009. Variances from fiscal year 2008 of more than 10% are discussed below.

- Investment Income decreased by \$10,220, or approximately 25%, primarily due to a bottoming out of declining interest rates around December 2008 and a decrease in interest income from the reinvestment of the Investment Pool's assets at these record low interest rates.
- Airports expense increased by \$1,031, or approximately 25%, primarily due to higher personnel costs. This was the result of filling supervisory positions, as well as emergency repairs and maintenance performed on buildings and runways.
- City Store expense decreased by \$467, or approximately 59%, primarily due to the City Store operations being shut down during fiscal year 2009.

FINANCIAL ANALYSIS OF THE GOVERNMENT'S FUNDS

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

GOVERNMENTAL FUNDS

The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of fiscal year 2009, the City's governmental funds reported combined ending fund balances of \$1,740,792, an increase of \$149,488 from fiscal year 2008. Approximately \$999,926 constitutes unreserved fund balance, which is available for spending at the government's direction. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed (1) to liquidate contracts and purchase orders of the period, (2) to pay debt service, (3) to generate income to pay for the perpetual funding of various programs, or (4) for a variety of other purposes.

The General Fund is the principal operating fund of the City. At the end of fiscal year 2009, undesignated fund balance of the General Fund was \$78,347, while total fund balance was \$114,392. This represents a \$10,389 decrease from the fiscal year 2008 total fund balance.

PROPRIETARY FUNDS

The City's proprietary fund statements provide the same type of information found in the government-wide financial statements, but in more detail.

As of the end of fiscal year 2009, Unrestricted Net Assets of the Sewer Utility Fund are \$292,441. Unrestricted Net Assets increased approximately \$48,724, or approximately 20%, mainly due to increased charges for services as a result of Council approved rate increases.

As of the end of fiscal year 2009, Unrestricted Net Assets of the Water Utility Fund are \$232,899. Unrestricted Net Assets increased by \$21,054, or approximately 10%, mainly due to increased sales of water as a result of Council approved rate increases.

GENERAL FUND BUDGETARY HIGHLIGHTS

The original budget for expenditures and transfers out was \$24,744 higher than the final budget due to increases (decreases) in appropriations primarily attributed to the following:

- (\$10,548) for General Governmental and Support. This variance was mostly attributed to the departments below:
 - (\$11,016) for Citywide Programs. The majority of the budget adjustment (\$7,614) is due to employee leveraged pick up savings being reimbursed to employees out of the UAAL fund instead of the General Fund. City Elections budget decreased by (\$1,975) due to fewer propositions on the November ballot and no run-off elections. The remaining (\$1,427) is made up of a decrease in the amount of Mission Bay revenue transferred to the Park Improvement Fund and other miscellaneous adjustments.
 - \$ 8,377 due to an increase in the General Fund Appropriated Reserve.
 - (\$1,200) for City Treasurer. This decrease was due to the first quarter budget adjustments approved by City Council, which reduced funding for supplies and services, as well as personnel costs.
 - (\$3,853) for City Comptroller, Facilities Maintenance, Field Engineering, and Project Implementation and Technical Services. This decrease was mainly due to the first quarter budget adjustments approved by City Council, which reduced funding for supplies and services, as well as personnel costs.
 - (\$ 2,837) for City Planning and Development, Community Services, Customer Services, Office of Ethics and Integrity, and Public Safety. This decrease was due to the first quarter budget adjustments approved by City Council, which eliminated these four departments.
- (\$7,902) for Public Safety-Police. The majority of the budget reduction was in personnel, which was attributed to vacant positions, the decrease in recruits from the Police Academy, and overtime savings.
- \$10,414 for Public Safety-Fire and Life Services and Homeland Security. The increase in budget was primarily due to over budget expenditures related to overtime Strike Team activities for wildfires and other Federal Emergency Management Agency requirements, unanticipated retirements, and an increase in reimbursable Emergency Medical Services.
- (\$1,560) for Parks, Recreation, Culture and Leisure. This decrease was mainly due to the first quarter budget adjustments approved by City Council.
- (\$4,561) for Transportation. This decrease was due to vacant reimbursable positions in the Streets Department and a budget reduction in supplies and services approved by City Council in December.
- (\$10,273) for Sanitation and Health. The decrease was primarily due to the first quarter budget adjustments approved by City Council, which reduced funding for Storm Drain Repairs, Contracts, Pollution Prevention, and personnel costs.

- \$818 for Principal Retirement. This increase was due to capital lease payments for Police and Parking Enforcement vehicles, as well as equipment, vehicles and helicopters for the Public Safety-Fire and Life Safety and Homeland Security department.
- \$194 for Interest Expense. This increase was due to capital lease payments for Police and Parking Enforcement vehicles, as well as equipment, vehicles and helicopters for the Public Safety-Fire and Life Safety and Homeland Security.

Actual revenues received for the General Fund were \$64,787 less than budgeted. Sales Tax and Transient Occupancy Tax were under budget by \$10,700 and \$8,424, respectively, due to the downturn in the economy. Other Local Taxes were under budget by \$4,545 mainly due to Property Transfer Tax which came in lower than anticipated. This was the result of reduced home sales and shortfalls in SDG&E and Refuse Collection Franchise Fees. Revenue from Use of Money and Property came in \$10,099 under budget, due to declining market values for the City's investment pool. Revenue from Federal Agencies came in \$11,433 under budget. \$2,347 was budgeted to come in during fiscal year 2009 but was actually accrued as fiscal year 2008 revenue. Charges for Current Services came in \$2,101 over budget due to the Engineering Department's work on Water and Sewer capital improvement projects. Other revenue was \$21,562 less than budgeted, which was due to Engineering's charges to Water and Sewer capital projects being received in the Charges for Services category, rather than in Other Revenue, where it was originally budgeted.

Actual expenditures for the General Fund were \$45,464 less than budgeted. \$20,136 was attributed primarily to an increase in the budget of the General Fund Appropriated Reserve without corresponding expenditures, and lower than anticipated allocations from the General Fund Fringe Benefits Reserve. The Fringe Benefits Reserve is used to compensate departments for fringe expenditures in excess of the Revised Budget. In addition, several categories had appropriation savings: Public Safety-Police had personnel and supplies and services savings of \$6,827; Sanitation and Health had savings of \$9,168 mainly due to vacant positions and delays in contractual expenditures for the Storm Water department; Parks, Recreation, Culture, and Leisure had savings of \$3,331 largely due to conservative spending in non-personnel costs. The remaining \$6,002 was primarily due to personnel savings in Neighborhood Services and non-personnel savings in Transportation.

CAPITAL ASSET AND DEBT ADMINISTRATION

CITY OF SAN DIEGO'S CAPITAL ASSETS (Net of Accumulated Depreciation) (In Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2009	2008	2009	2008	2009	2008
Land, Easements, Rights of Way	\$ 1,768,968	\$ 1,755,956	\$ 93,240	\$ 89,988	\$ 1,862,208	\$ 1,845,944
Construction-in-Progress	192,741	165,880	291,283	174,065	484,024	339,945
Structures and Improvements	826,488	827,912	1,253,903	1,422,839	2,080,391	2,250,751
Equipment	169,387	133,317	156,891	102,069	326,278	235,386
Distribution and Collection Systems	-	-	2,971,404	2,845,957	2,971,404	2,845,957
Infrastructure	1,497,941	1,452,252	-	-	1,497,941	1,452,252
Totals	\$ 4,455,525	\$ 4,335,317	\$ 4,766,721	\$ 4,634,918	\$ 9,222,246	\$ 8,970,235

CAPITAL ASSETS

In accordance with GASB Statement No. 34, all major infrastructure assets (such as streets, signals, bridges, and drains) are capitalized by the City in the government-wide statements. While capital assets of both governmental and proprietary funds are capitalized at the government-wide level, only proprietary assets are reported at the fund level. Governmental funds are reported on a modified accrual basis at the fund level. Differences between reporting at the fund level and government-wide level for these governmental assets will be explained in both the reconciliation and the accompanying notes to the financial statements.

The City's investment in capital assets (including infrastructure) for governmental and business-type activities as of June 30, 2009 was \$9,222,246 (net of accumulated depreciation). There was an overall increase in the City's investment in capital assets over fiscal year 2008 of approximately \$252,011. Readers interested in more detailed information on capital asset activity should refer to Note 4 Capital Assets.

HIGHLIGHTS OF FISCAL YEAR 2009 CAPITAL IMPROVEMENT ACTIVITIES

Governmental Activities

- Phase 1 of the Enterprise Resource Planning (ERP) System Core Project to provide a replacement of the legacy software currently used by the Offices of the Chief Financial Officer (CFO) and Business and Support Services was completed and implemented city-wide on July 1, 2009. As identified in the Kroll report, the legacy system was no longer meeting the City's requirement for responsible financial management, efficient human resources management, or IT operational efficiency. The project is being funded primarily through a lease purchase agreement with IBM Credit LLC and cash from SDDPC. The City's fiscal year 2009 capital expenditures for this project were \$19,501.
- Construction continued on the reconstruction of Soledad Mountain Road following the October 2007 landslide that destroyed a large section of the 5700 block of Soledad Mountain Road and Desert View Drive Alley. The project is funded by TransNet, as well as state and federal grants. The City's fiscal year 2009 capital expenditures for this project were \$12,594.
- Construction continues on the North Harbor Drive Bridge over the Navy Estuary. This project will provide for the seismic retrofitting of the bridge as well as stabilization of the existing piers, and joining the paired piers together at the waterline to increase support during seismic events. The City's fiscal year 2009 capital expenditures for this project were \$9,953.
- Construction was completed on the Bird Rock Coastal Traffic Flow Improvements. This project provides traffic calming measures to reduce speed and improve safety and walkability on La Jolla Boulevard. The project provides three modern roundabouts on La Jolla Boulevard, as well as three mini roundabouts on connecting residential streets. La Jolla Boulevard will also be reduced from four to two lanes. The project was funded by SANDAG, TransNet, Developer Impact Fees, and federal and state grants. The City added \$6,207 in capital infrastructure assets related to this project in fiscal year 2009.
- Construction was completed on the widening of Genesee Avenue from Interstate 5 to Campus Point Drive. This project provided for the widening of 2,500 feet of Genesee Avenue to a modified six-lane primary arterial including Class II bicycle lanes. The project was funded by Facility Benefit Assessments. The City added \$6,500 in capital infrastructure assets related to this project in fiscal year 2009.
- Construction continued on Phase II of the Logan Heights Branch Library. This project provides for a new 25,000 square foot library at 28th Street and Ocean Boulevard to serve the Logan Heights Community. The project is funded by various grants and the Library System Improvement Fund. The City's fiscal year 2009 capital expenditures for this project were \$5,540.
- Construction was completed on the Carmel Valley Community Park South. This project provided for the development of a 15 useable acre community park in the Torrey Hills and Carmel Valley Neighborhoods south of State Route 56, located in Carmel Valley Neighborhood 8A. The City added \$8,816 in capital infrastructure assets related to this project in fiscal year 2009.
- Construction began on the First Avenue Bridge Rehabilitation and Retrofit project. This project will provide for seismic retrofits to the abutments, expansion joints and bracing of the First Ave Bridge; as well as extensive hardware restoration

and replacement. The project is part of the Uptown Community Plan. The City's fiscal year 2009 capital expenditures for this project were \$3,714.

- Construction continued on the Bayshore Bikeway. The project provides for construction of a Class I bikeway from the northern end of 13th Street to Main Street at the I-5 interchange at the Southeast corner of San Diego Bay and will complete the missing segment of the planned bike path around San Diego Bay from Point Loma to Coronado. The project is funded by TransNet Major Corridor funds. The City's fiscal year 2009 capital expenditures for this project were \$3,217.

Business-Type Activities

During fiscal year 2009, the Water Utility Fund added approximately \$147,500 in capital improvement projects (CIP). Upgrades and expansion of the Miramar Water Treatment Plant, Otay Water Treatment Plant and the Alvarado Water Treatment Plant continued, along with water main replacements. Capital asset write-offs for fiscal year 2008 were approximately \$8,100, and were primarily related to losses on abandoned projects and retirements of developer contributed assets.

During fiscal year 2009, the Sewer Utility Fund added approximately \$49,500 in CIP, of which the Metropolitan system CIP increased approximately \$4,900. Municipal system CIP increased approximately \$44,600 and included the following major projects: Caltrans/SR-905 Otay Mesa Trunk Sewer, Pipeline Rehabilitation Phase C-1, and the continued replacement of sewer mains and upgrades to the sewer infrastructure. Capital asset write-offs for fiscal year 2008 were approximately \$3,500, and were primarily related to losses on abandoned projects and retirements of developer contributed assets.

HIGHLIGHTS OF APPROVED FISCAL YEAR 2010 CAPITAL IMPROVEMENT PROJECTS (CIP) BUDGET

The Annual Approved Capital Improvements Budget for Fiscal Year 2010 is \$478,400 which is a decrease of \$108,600, or approximately 18.5% from the fiscal year 2009 budget of \$587,000. The decrease in the Fiscal Year 2010 budget is primarily due to one-time financing and Proposition 1B funds which were included in the Fiscal Year 2009 Annual Capital Improvement budget for deferred maintenance needs. Water and Sewer projects comprise over 59.3% of the total CIP budget. Engineering & Capital Projects and General Services projects comprise 25.4%, and 2.5% of the total CIP budget, respectively. Funding for governmental projects include: TransNet funds; Facilities Benefit Assessments; Developer Impact Fees; developer contributions; federal, state, local, and private contributions; land sale proceeds; and deferred maintenance bonds. Highlights of the key budgets by department are as follows:

Governmental Activities

- Engineering and Capital Projects: \$121,500 (25.4% of total CIP budget). Key projects include the undergrounding of City utilities to augment the California Public Utilities Commission (CPUC) Rule 20A funds, and conversion of City-owned street lighting and resurfacing of roadways associated with the undergrounding of utilities. The \$48,900 annual allocation for these projects is entirely funded by the Underground Surcharge Fund. Other significant projects include: \$11,100 for ADA improvements, \$10,200 for Carroll Canyon Road, \$3,500 for North Torrey Pines Road, and \$3,000 for 43rd Street and Logan/National Ave Intersection.
- General Services: \$12,200 (2.5% of total CIP budget). Key budgets include: \$11,800 for deferred maintenance projects.
- Parks and Recreation: \$29,400 (6.1% of total CIP budget). Planned project types for fiscal year 2010 include play area upgrades, joint use fields, accessibility improvements, comfort stations, picnic shelters, sports field and security lighting, new park development, and golf course improvements and upgrades.
- OneSD Support: \$9,900 (2.1% of total CIP budget). This budget is for completion of the Enterprise Resource Planning (ERP) System.
- City Planning and Community Investments: \$5,500 (1.1% of total CIP budget). This budget is for downtown parking improvement projects.

Business-Type Activities

The fiscal year 2010 Water Utility CIP budget is \$149,800. There are no phase funded projects budgeted for fiscal year 2010. Significant projects include: \$43,000 for water main replacements; \$37,900 for the Alvarado Water Treatment Plant–Upgrade and Expansion; \$15,700 for the Miramar Water Treatment Plant–Upgrade and Expansion; \$9,400 for the North City Reclamation System.

The fiscal year 2010 Sewer Utility CIP budget is \$134,100. There are no phase funded projects budgeted for fiscal year 2010. Significant projects include: \$74,300 for pipeline repair, replacement, and rehabilitation; \$39,200 for replacement of trunk sewers; \$8,900 for repair and upgrade of pump stations; and \$7,600 for the repair and upgrade of treatment plants.

CITY OF SAN DIEGO'S OUTSTANDING DEBT
(In Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2009	2008	2009	2008	2009	2008
Capital Lease Obligations	\$ 89,519	\$ 61,262	\$ -	\$ 166	\$ 89,519	\$ 61,428
Contracts Payable	4,715	2,615	-	-	4,715	2,615
Notes Payable	4,786	5,662	-	430,830	4,786	436,492
Loans Payable	44,815	34,777	90,326	95,875	135,141	130,652
Section 108 Loans	33,532	35,896	-	-	33,532	35,896
General Obligation Bonds	6,315	8,580	-	-	6,315	8,580
Revenue Bonds/COP's/ Lease Revenue Bonds	579,500	498,950	2,166,906	1,425,445	2,746,406	1,924,395
Special Assessment/ Special Tax Bonds	152,270	144,805	-	-	152,270	144,805
Tax Allocation Bonds	534,547	548,643	-	-	534,547	548,643
Tobacco Settlement Asset-Backed Bonds	95,380	99,370	-	-	95,380	99,370
Pooled Financing Bonds	33,460	34,115	-	-	33,460	34,115
Totals	<u>\$ 1,578,839</u>	<u>\$ 1,474,675</u>	<u>\$ 2,257,232</u>	<u>\$ 1,952,316</u>	<u>\$ 3,836,071</u>	<u>\$ 3,426,991</u>

LONG-TERM DEBT

At the end of fiscal year 2009, the City, including blended component units, had total debt outstanding of approximately \$3,836,071. Of this amount, \$6,315 is comprised of debt backed by the full faith and credit of the City. The remainder of the City's debt represents revenue bonds, lease revenue bonds, certificates of participation (COPs), special assessment bonds, tax allocation bonds, tobacco settlement asset-backed bonds, pooled financing bonds, contracts payable, notes payable, loans payable, Section 108 loans, SRF loans, and capital lease obligations.

Governmental Activities

- The City issued \$12,365 of Community Facilities District No. 4 (Black Mountain Ranch Villages) Special Tax Bonds, Series 2008 A, to finance public improvements required in connection with the district, to fund the Reserve Fund, and to pay costs of issuance related to the 2008A Bonds. The 2008A bonds were issued pursuant to the Mello-Roos Community Facilities Act of 1982 and are limited obligations of the district.

- The City (PFFA) sold \$103,000 of Lease Revenue Bonds, Series 2009A, on a private placement basis, for the purpose of financing various capital improvement projects. The 2009A bonds are secured from base rental payments and bear interest at a rate of 3.89% through June 1, 2010. Thereafter the rate will be fixed to equal the purchaser's internal cost of funds rate plus a fixed spread of 3.00%, but not to exceed 12% until the final maturity date of December 1, 2018.
- Total principal payments for long-term debt were \$64,542. \$48,356 of this amount was for outstanding bonds, \$2,809 was for loans payable, \$876 was for notes payable, and \$12,501 was for capital leases. Readers interested in more detailed information regarding Governmental Activities Long Term Liabilities should refer to Note 5.

Business-Type Activities

- The City (PFFA) issued \$157,190 of Water Revenue Bonds, Refunding Series 2009A for the following purposes: to prepay \$57,000 of outstanding principal on the Subordinated Water Revenue Notes, Series 2007A; to partially refund \$94,165 of Certificates of Undivided Interest, Series 1998; to fund the reserve; and to pay costs of issuance related to the Series 2009A Bonds. The publicly offered Water 2009A Revenue Refunding Bonds are secured by and payable solely from net system revenues of the Water Utility Fund.
- The City (PFFA) issued \$453,775 of Senior Sewer Revenue Bonds, Series 2009A for the following purposes: to finance capital improvements to the Wastewater System; to pay in full \$223,830 of Subordinate Sewer Revenue Notes, Series 2007; to partially refund \$36,635 of Sewer Revenue Bonds, Series 1997A and \$13,410 of Sewer Revenue Bonds, Series 1997B; to fund the reserve; and to pay costs of issuance related to the Series 2009A Bonds. The publicly offered Sewer 2009A Revenue Bonds are secured by and payable solely from wastewater system net revenues.
- The City (PFFA) issued \$634,940 of Senior Sewer Revenue Refunding Bonds, Series 2009B for the following purposes: to fully refund \$160,220 of outstanding Sewer Revenue Bonds, Series 1993; to partially refund \$211,455 of Sewer Revenue Bonds, Series 1995; to partially refund \$80,255 of Sewer Revenue Bonds, Series 1997A and \$29,385 of Sewer Revenue Bonds, Series 1997B; to partially refund \$97,845 of Sewer Revenue Bonds, Series 1999A and \$54,015 of Sewer Revenue Bonds, Series 1999B; to fund the reserve; and to pay costs of issuance related to the Series 2009A Bonds. The publicly offered Sewer 2009B Revenue Refunding Bonds are secured by and payable solely from wastewater system net revenues.
- The City (PFFA) issued \$328,060 of Water Revenue Bonds, Series 2009B for the following purposes: to finance capital improvements to the Water System; to prepay \$150,000 of outstanding principal on the Subordinated Water Revenue Notes, Series 2008A; to fund the reserve; and to pay costs of issuance related to the series 2009B Bonds. The publicly offered Water 2009B Revenue Bonds are secured by and payable solely from net system revenues of the Water Utility Fund.
- Total principal payments for long-term debt were \$1,269,049, of which \$832,504 was for outstanding bonds, including \$786,910 of bonds refunded or redeemed in advance of scheduled maturity date, and \$45,594 of scheduled bond principal payments. \$430,830 was for outstanding notes prepaid, \$5,549 was for loans payable, and \$166 was for capital leases. Readers interested in more detailed information regarding Business-Type Activities Long Term Liabilities should refer to Note 6.

As of the issuance of this report, the credit ratings on the City of San Diego's outstanding General Obligation Bonds, Revenue Bonds, Lease Revenue Bonds, and COPs are as follows:

	Moody's Investors Service	Fitch Ratings	Standard & Poor's
General Obligation Bonds	A2	A+	A
General Fund Backed Lease Revenue Bonds	Baa1/Baa2	A	A-
Outlook	Stable	Stable	Positive
Wastewater System Bonds	A2	AA-	A+
Outlook	Stable	Stable	Stable
Water System Bonds	A1/A2	AA-/A+	AA-/A+
Outlook	Stable	Stable	Stable

Section 90 of the City Charter provides that the general obligation bonded indebtedness for the development, conservation and furnishings of water shall not exceed 15% of the last preceding assessed valuation of all real and personal property of the City subject to direct taxation, and that the bonded indebtedness for other municipal improvements shall not exceed 10% of such valuation. The City's current outstanding general obligation balances as of June 30, 2009 are significantly less than the current debt limitations for water and other purposes, which are \$5,962,975 and \$3,975,316, respectively (see Statistical Section, Table 12).

It has been the City's practice, as provided for in Section 90.1 of the City Charter, to issue revenue bonds for the purpose of constructing water facilities. Per Section 90.1, revenue bonds do not constitute an indebtedness of the City, but an obligation payable from the revenues received by the utility. Section 90.2 authorizes the issuance of Revenue Bonds for the purpose of constructing improvements to the City's sewer system.

Additional information on the City's long-term debt can be found in the accompanying notes to the financial statements.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the City's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the City Comptroller, 202 C Street, San Diego, California 92101, or e-mailed to comptroller@sandiego.gov. This financial report is also available on the City's website at www.sandiego.gov, under the Office of the City Comptroller. Additional information intended for the investor community is available on the Investor Information web page also located on the City's website listed above.

BASIC FINANCIAL STATEMENTS

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STATEMENT OF NET ASSETS
June 30, 2009
(In Thousands)

	Primary Government			Component Units	
	Governmental Activities	Business-Type Activities	Total	San Diego Convention Center Corporation	San Diego Housing Commission
ASSETS					
Cash and Investments	\$ 1,320,591	\$ 675,673	\$ 1,996,264	\$ 21,756	\$ 94,458
Receivables:					
Taxes - Net	86,059	-	86,059	-	-
Accounts - Net of Allowance for Uncollectibles					
(Governmental \$34,534, Business-Type \$3,019) ..	39,226	79,546	118,772	2,537	6,991
Claims - Net	155	2	157	-	-
Contributions	360	-	360	-	-
Special Assessments - Net	2,993	-	2,993	-	-
Notes	122,948	-	122,948	-	169,532
Accrued Interest	4,421	2,535	6,956	-	18,288
Grants	35,702	3,606	39,308	-	-
Investment in Joint Venture	1,824	-	1,824	-	-
Advances to Other Agencies	5,777	-	5,777	-	-
Internal Balances	(7,929)	7,929	-	-	-
Inventories of Water in Storage	-	36,947	36,947	-	-
Inventories	2,033	622	2,655	15	54
Land Held for Resale	39,413	-	39,413	-	-
Prepaid Expenses	5,313	461	5,774	1,057	1,623
Restricted Cash and Investments	431,547	535,647	967,194	-	699
Deferred Charges	19,752	14,102	33,854	-	-
Capital Assets - Non-Depreciable	1,961,709	384,523	2,346,232	-	36,545
Capital Assets - Depreciable	2,493,816	4,382,198	6,876,014	16,404	60,683
TOTAL ASSETS	<u>6,565,710</u>	<u>6,123,791</u>	<u>12,689,501</u>	<u>41,769</u>	<u>388,873</u>

STATEMENT OF NET ASSETS
June 30, 2009
(In Thousands)

	Primary Government			Component Units	
	Governmental Activities	Business-Type Activities	Total	San Diego Convention Center Corporation	San Diego Housing Commission
LIABILITIES					
Accounts Payable	\$ 46,526	\$ 45,932	\$ 92,458	\$ 5,679	\$ 2,905
Accrued Wages and Benefits	31,314	12,003	43,317	-	415
Other Accrued Liabilities	210	-	210	1,796	2,638
Interest Accrued on Long-Term Debt	24,488	17,761	42,249	-	124
Long-Term Liabilities Due Within One Year	158,140	76,352	234,492	3,077	1,753
Due to Other Agencies	188	11,308	11,496	-	-
Unearned Revenue	34,794	7,494	42,288	9,986	2,342
Contract Deposits	-	8,596	8,596	-	-
Sundry Trust Liabilities	5,711	-	5,711	-	-
Customer Deposits Payable	-	4,566	4,566	-	-
Deposits/Advances from Others	-	2,819	2,819	-	965
Long-Term Liabilities Due After One Year:					
Arbitrage Liability	533	-	533	-	-
Compensated Absences	39,534	6,356	45,890	-	-
Liability Claims	230,316	29,352	259,668	-	-
Capital Lease Obligations	73,556	-	73,556	531	-
Contracts Payable	4,715	-	4,715	-	-
Notes Payable	4,786	-	4,786	500	26,671
Loans Payable	36,107	84,673	120,780	-	-
Section 108 Loans Payable	31,075	-	31,075	-	-
Net Bonds Payable	1,364,345	2,147,103	3,511,448	-	-
Estimated Landfill Closure and Postclosure Care	-	19,336	19,336	-	-
Pollution Remediation Obligation	-	620	620	-	-
Net Other Post Employment Benefit Obligation	73,504	19,767	93,271	-	-
Net Pension Obligation	147,665	29,474	177,139	-	-
TOTAL LIABILITIES	<u>2,307,507</u>	<u>2,523,512</u>	<u>4,831,019</u>	<u>21,569</u>	<u>37,813</u>
NET ASSETS					
Invested in Capital Assets, Net of Related Debt	3,530,937	2,970,351	6,501,288	13,510	69,458
Restricted for:					
Capital Projects	293,284	-	293,284	-	-
Debt Service	-	4,372	4,372	-	-
Low-Moderate Income Housing	135,581	-	135,581	-	-
Nonexpendable Permanent Endowments	13,280	-	13,280	-	-
Other	122,460	38,113	160,573	1,452	128,863
Unrestricted	<u>162,661</u>	<u>587,443</u>	<u>750,104</u>	<u>5,238</u>	<u>152,739</u>
TOTAL NET ASSETS	<u>\$ 4,258,203</u>	<u>\$ 3,600,279</u>	<u>\$ 7,858,482</u>	<u>\$ 20,200</u>	<u>\$ 351,060</u>

The accompanying notes are an integral part of the financial statements.

STATEMENT OF ACTIVITIES
Year Ended June 30, 2009
(In Thousands)

<u>Functions/Programs</u>	<u>Program Revenues</u>			
	<u>Expenses</u>	<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>
Primary Government:				
Governmental Activities:				
General Government and Support	\$ 303,581	\$ 152,630	\$ 13,449	\$ 323
Public Safety - Police	418,549	42,178	14,054	-
Public Safety - Fire and Life Safety and Homeland Security ...	220,787	20,449	16,144	1
Parks, Recreation, Culture and Leisure	258,038	80,795	2,282	19,376
Transportation	239,305	18,360	10,572	77,277
Sanitation and Health	77,447	9,306	2,097	-
Neighborhood Services	116,735	21,814	34,646	13,825
Debt Service:				
Interest	84,070	-	-	-
TOTAL GOVERNMENTAL ACTIVITIES	1,718,512	345,532	93,244	110,802
Business-Type Activities:				
Airports	5,140	4,929	-	1,806
City Store	321	242	-	-
Development Services	47,260	37,310	-	-
Environmental Services	35,718	31,726	83	-
Golf Course	11,864	16,201	-	-
Recycling	20,067	16,027	227	-
Sewer Utility	314,125	322,571	167	28,780
Water Utility	329,748	342,719	1,262	30,277
TOTAL BUSINESS-TYPE ACTIVITIES	764,243	771,725	1,739	60,863
TOTAL PRIMARY GOVERNMENT	\$ 2,482,755	\$ 1,117,257	\$ 94,983	\$ 171,665
Component Units:				
San Diego Convention Center Corporation	\$ 38,365	\$ 30,774	\$ 4,129	\$ 143
San Diego Housing Commission	179,548	26,095	169,456	-
TOTAL COMPONENT UNITS	\$ 217,913	\$ 56,869	\$ 173,585	\$ 143
General Revenues:				
Property Taxes				
Transient Occupancy Taxes				
Other Local Taxes				
Developer Contributions and Fees				
Grants and Contributions not Restricted to Specific Programs				
Sales Taxes				
Investment Income				
Gain on Sale of Capital Assets				
Miscellaneous				
Transfers				
TOTAL GENERAL REVENUES AND TRANSFERS				
CHANGE IN NET ASSETS				
Net Assets at Beginning of Year				
NET ASSETS AT END OF YEAR				

Net Revenue/(Expense) and Changes in Net Assets				
Primary Government			Component Units	
Governmental Activities	Business-Type Activities	Total	San Diego Convention Center Corporation	San Diego Housing Commission
\$ (137,179)	\$ -	\$ (137,179)	\$ -	\$ -
(362,317)	-	(362,317)	-	-
(184,194)	-	(184,194)	-	-
(155,585)	-	(155,585)	-	-
(133,096)	-	(133,096)	-	-
(66,043)	-	(66,043)	-	-
(46,450)	-	(46,450)	-	-
(84,070)	-	(84,070)	-	-
(1,168,934)	-	(1,168,934)	-	-
-	1,595	1,595	-	-
-	(79)	(79)	-	-
-	(9,950)	(9,950)	-	-
-	(3,909)	(3,909)	-	-
-	4,337	4,337	-	-
-	(3,813)	(3,813)	-	-
-	37,393	37,393	-	-
-	44,510	44,510	-	-
-	70,084	70,084	-	-
(1,168,934)	70,084	(1,098,850)	-	-
-	-	-	(3,319)	-
-	-	-	-	16,003
-	-	-	(3,319)	16,003
607,857	-	607,857	-	-
140,657	-	140,657	-	-
161,485	-	161,485	-	-
16,148	-	16,148	-	-
8,488	-	8,488	-	-
229,651	-	229,651	-	-
75,245	31,004	106,249	289	5,543
1,922	-	1,922	-	-
33,528	8,257	41,785	579	-
(1,225)	1,225	-	-	-
1,273,756	40,486	1,314,242	868	5,543
104,822	110,570	215,392	(2,451)	21,546
4,153,381	3,489,709	7,643,090	22,651	329,514
\$ 4,258,203	\$ 3,600,279	\$ 7,858,482	\$ 20,200	\$ 351,060

The accompanying notes are an integral part of the financial statements.

**GOVERNMENTAL FUNDS
BALANCE SHEET
JUNE 30, 2009
(In Thousands)**

	<u>General Fund</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
ASSETS			
Cash and Investments	\$ 86,667	\$ 1,085,808	\$ 1,172,475
Receivables:			
Taxes - Net	69,438	16,621	86,059
Accounts - Net of Allowance for Uncollectibles (General Fund \$7,032, Other Governmental \$26,606)	13,891	24,159	38,050
Claims - Net	130	16	146
Special Assessments	-	2,993	2,993
Notes	-	122,948	122,948
Accrued Interest	906	3,497	4,403
Grants	-	35,702	35,702
From Other Funds	1,500	26	1,526
Interfund Loan Receivable	-	33,460	33,460
Advances to Other Funds	-	7,959	7,959
Advances to Other Agencies	-	5,777	5,777
Land Held for Resale	-	39,413	39,413
Prepaid Items	886	1,351	2,237
Investment in Joint Venture	1,824	-	1,824
Restricted Cash and Investments	-	431,547	431,547
	<u>\$ 175,242</u>	<u>\$ 1,811,277</u>	<u>\$ 1,986,519</u>
TOTAL ASSETS			
LIABILITIES			
Accounts Payable	\$ 3,789	\$ 34,295	\$ 38,084
Accrued Wages and Benefits	27,642	736	28,378
Other Accrued Liabilities	-	210	210
Due to Other Funds	2,095	5,993	8,088
Due to Other Agencies	-	188	188
Unearned Revenue	663	34,054	34,717
Deferred Revenue	26,661	58,784	85,445
Sundry Trust Liabilities	-	5,711	5,711
Advances from Other Funds	-	7,959	7,959
Interfund Loan Payable	-	36,947	36,947
	<u>60,850</u>	<u>184,877</u>	<u>245,727</u>
TOTAL LIABILITIES			

**GOVERNMENTAL FUNDS
BALANCE SHEET
JUNE 30, 2009
(In Thousands)**

	<u>General Fund</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
FUND EQUITY:			
Fund Balances:			
Reserved for Land Held for Resale	-	39,413	39,413
Reserved for Notes Receivable	-	118,907	118,907
Reserved for Encumbrances	32,071	250,665	282,736
Reserved for Advances	-	13,736	13,736
Reserved for Low and Moderate Income Housing	-	95,668	95,668
Reserved for Permanent Endowments	-	13,280	13,280
Reserved for Debt Service	-	175,302	175,302
Reserved for Minority Interest in Joint Venture	1,824	-	1,824
Unreserved, Reported in General Fund:			
Designated for Unrealized Gains	1,943	-	1,943
Designated for Subsequent Years' Expenditures	207	-	207
Undesignated	78,347	-	78,347
Unreserved, Reported in:			
Special Revenue Funds	-	221,089	221,089
Debt Service Funds	-	265,236	265,236
Capital Projects Funds	-	430,479	430,479
Permanent Funds	-	2,625	2,625
TOTAL FUND EQUITY	114,392	1,626,400	1,740,792
TOTAL LIABILITIES AND FUND EQUITY	\$ 175,242	\$ 1,811,277	

Amounts reported for governmental activities in the Statement of Net Assets are different because:

Capital assets used in governmental activities are not financial resources, and therefore, are not reported in the funds.	4,329,571
Other assets and liabilities used in governmental activities are not financial resources, and therefore, are either deferred or not reported in the funds.	105,197
Internal Service funds are used by management to charge the costs of activities such as Fleet Services, Print Shop, Self Insurance, and Central Stores to individual funds. The assets and liabilities of certain Internal Service Funds are included in governmental activities in the Statement of Net Assets.	6,826
Certain liabilities, including bonds payable, are not due and payable in the current period, and therefore, are not reported in the funds.	(1,924,183)
Net Assets of governmental activities	\$ 4,258,203

The accompanying notes are an integral part of the financial statements.

GOVERNMENTAL FUNDS
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
YEAR ENDED JUNE 30, 2009
(In Thousands)

	General Fund	Other Governmental Funds	Total Governmental Funds
REVENUES			
Property Taxes	\$ 398,743	\$ 204,831	\$ 603,574
Special Assessments	-	63,500	63,500
Sales Taxes	212,918	20,222	233,140
Transient Occupancy Taxes	73,765	66,892	140,657
Other Local Taxes	72,432	98,760	171,192
Licenses and Permits	31,249	8,100	39,349
Fines, Forfeitures and Penalties	32,467	1,939	34,406
Revenue from Use of Money and Property	41,461	66,323	107,784
Revenue from Federal Agencies	4,268	66,118	70,386
Revenue from Other Agencies	8,915	43,541	52,456
Revenue from Private Sources	-	21,593	21,593
Charges for Current Services	133,117	70,315	203,432
Other Revenue	5,296	20,415	25,711
TOTAL REVENUES	1,014,631	752,549	1,767,180
EXPENDITURES			
Current:			
General Government and Support	243,057	101,873	344,930
Public Safety - Police	389,390	17,267	406,657
Public Safety - Fire and Life Safety and Homeland Security	195,596	30,100	225,696
Parks, Recreation, Culture and Leisure	116,391	95,368	211,759
Transportation	72,635	90,334	162,969
Sanitation and Health	67,867	10,393	78,260
Neighborhood Services	17,255	56,530	73,785
Capital Projects	-	138,634	138,634
Debt Service:			
Principal Retirement	818	56,391	57,209
Interest	3,106	75,553	78,659
Cost of Issuance	-	1,001	1,001
TOTAL EXPENDITURES	1,106,115	673,444	1,779,559
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(91,484)	79,105	(12,379)
OTHER FINANCING SOURCES (USES)			
Transfers from Proprietary Funds	6,267	1,979	8,246
Transfers from Other Funds	105,059	216,685	321,744
Transfers to Proprietary Funds	(4,043)	(2,547)	(6,590)
Transfers to Other Funds	(26,031)	(295,713)	(321,744)
Net Loss from Joint Venture	(157)	-	(157)
Proceeds from the Sale of Capital Assets	-	2,157	2,157
Capital Leases	-	30,392	30,392
Contracts Issued	-	2,100	2,100
Loans Issued	-	10,483	10,483
Special Tax Bonds Issued	-	12,365	12,365
Revenue Bonds Issued	-	103,000	103,000
Discount on Bonds Issued	-	(129)	(129)
TOTAL OTHER FINANCING SOURCES (USES)	81,095	80,772	161,867
NET CHANGE IN FUND BALANCES	(10,389)	159,877	149,488
Fund Balances at Beginning of Year	124,781	1,466,523	1,591,304
FUND BALANCES AT END OF YEAR	\$ 114,392	\$ 1,626,400	\$ 1,740,792

The accompanying notes are an integral part of the financial statements.

City of San Diego
Reconciliation of the Statement of Revenues, Expenditures, and
Changes in Fund Balances of Governmental Funds
to the Statement of Activities
Year Ended June 30, 2009
(In Thousands)

Net change in fund balances - total governmental funds (page 58)	\$ 149,488
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.	121,730
The net effect of various miscellaneous transactions involving capital assets (i.e., donations, retirements, and transfers) is to decrease net assets.	(17,686)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds.	10,410
The issuance of long-term debt (i.e., bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. This amount is the net effect of these differences in the treatment of long-term debt and related items.	(100,854)
Some expenses reported in the Statement of Activities do not require the use of current financial resources (i.e., compensated absences, net pension obligation), and therefore are not accrued as expenses in governmental funds.	(92,248)
Internal Service funds are used by management to charge the costs of activities such as Fleet Services, Publishing Services, Central Stores, Self Insurance, and others to individual funds. The net revenue of certain internal service activities is reported with governmental activities.	<u>33,982</u>
Change in net assets of governmental activities (page 55)	<u>\$ 104,822</u>

The accompanying notes are an integral part of the financial statements.

**PROPRIETARY FUNDS
STATEMENT OF NET ASSETS
JUNE 30, 2009
(In Thousands)**

	<u>Business-Type Activities - Enterprise Funds</u>				
	<u>Sewer Utility</u>	<u>Water Utility</u>	<u>Other Enterprise Funds</u>	<u>Total</u>	<u>Internal Service Funds</u>
ASSETS					
Current Assets:					
Cash and Investments	\$ 345,933	\$ 225,556	\$ 104,184	\$ 675,673	\$ 148,116
Receivables:					
Accounts - Net of Allowance for Uncollectibles (Sewer \$930, Water \$1,749, Other Enterprise \$340, Internal Service \$896)	35,172	43,573	801	79,546	1,176
Claims - Net	-	-	2	2	9
Contributions	-	-	-	-	360
Accrued Interest	1,420	604	511	2,535	18
Grants	-	1,822	1,784	3,606	-
From Other Funds	-	-	3,609	3,609	5,980
Inventories of Water in Storage	-	36,947	-	36,947	-
Inventories	-	620	2	622	2,033
Prepaid Expenses	3	456	2	461	3,076
Total Current Assets	382,528	309,578	110,895	803,001	160,768
Non-Current Assets:					
Restricted Cash and Investments	231,212	263,883	40,552	535,647	-
Deferred Charges	7,114	6,988	-	14,102	-
Interfund Loan Receivable	3,487	-	-	3,487	-
Capital Assets - Non-Depreciable	118,881	240,760	24,882	384,523	1,984
Capital Assets - Depreciable	2,710,102	1,611,573	60,523	4,382,198	123,970
Total Non-Current Assets	3,070,796	2,123,204	125,957	5,319,957	125,954
TOTAL ASSETS	3,453,324	2,432,782	236,852	6,122,958	286,722
LIABILITIES					
Current Liabilities:					
Accounts Payable	11,995	32,367	1,570	45,932	8,442
Accrued Wages and Benefits	7,682	2,145	2,176	12,003	2,936
Interest Accrued on Long-Term Debt	6,162	11,598	1	17,761	269
Long-Term Debt Due Within One Year	54,663	19,705	1,984	76,352	55,267
Due to Other Funds	510	558	147	1,215	1,812
Due to Other Agencies	10,262	1,046	-	11,308	-
Unearned Revenue	-	817	6,677	7,494	77
Contract Deposits	3,503	4,756	337	8,596	-
Current Liabilities Payable from Restricted Assets:					
Customer Deposits Payable	-	4,566	-	4,566	-
Total Current Liabilities	94,777	77,558	12,892	185,227	68,803
Non-Current Liabilities:					
Deposits/Advances from Others	250	-	2,569	2,819	-
Compensated Absences	2,323	2,036	1,997	6,356	3,795
Liability Claims	27,776	1,576	-	29,352	178,126
Capital Lease Obligations	-	-	-	-	21,221
Loans Payable	67,100	17,573	-	84,673	-
Net Revenue Bonds Payable	1,251,957	895,146	-	2,147,103	-
Estimated Landfill Closure and Postclosure Care	-	-	19,336	19,336	-
Pollution Remediation Obligation	-	620	-	620	-
Net Other Post Employment Benefit Obligation	6,916	6,578	6,273	19,767	2,978
Net Pension Obligation	10,785	8,477	10,212	29,474	2,925
Total Non-Current Liabilities	1,367,107	932,006	40,387	2,339,500	209,045
TOTAL LIABILITIES	1,461,884	1,009,564	53,279	2,524,727	277,848
NET ASSETS					
Invested in Capital Assets, Net of Related Debt	1,698,249	1,186,697	85,405	2,970,351	97,195
Restricted for Debt Service	750	3,622	-	4,372	-
Restricted for Closure/Postclosure Maintenance	-	-	38,113	38,113	-
Unrestricted	292,441	232,899	60,055	585,395	(88,321)
TOTAL NET ASSETS	\$ 1,991,440	\$ 1,423,218	\$ 183,573	3,598,231	\$ 8,874

Adjustment to reflect the consolidation of Internal Service Fund activities related to Enterprise Funds..... 2,048

Net assets of Business-Type activities \$ 3,600,279

The accompanying notes are an integral part of the financial statements.

PROPRIETARY FUNDS
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
YEAR ENDED JUNE 30, 2009
(In Thousands)

	Business-Type Activities - Enterprise Funds				Internal Service Funds
	Sewer Utility	Water Utility	Other Enterprise Funds	Total	
OPERATING REVENUES					
Sales of Water	\$ -	\$ 324,772	\$ -	\$ 324,772	\$ -
Charges for Services	318,474	-	58,789	377,263	160,937
Revenue from Use of Property	-	5,418	-	5,418	-
Usage Fees	-	1,272	45,672	46,944	81,001
Other	4,097	11,257	1,974	17,328	883
TOTAL OPERATING REVENUES	322,571	342,719	106,435	771,725	242,821
OPERATING EXPENSES					
Benefit and Claim Payments	-	-	-	-	58,416
Maintenance and Operations	119,470	95,979	81,621	297,070	46,347
Cost of Materials Issued	-	-	-	-	29,149
Cost of Purchased Water Used	-	133,499	-	133,499	-
Taxes	-	162	-	162	-
Administration	71,300	33,258	34,138	138,696	55,715
Depreciation	76,554	39,627	5,797	121,978	26,513
TOTAL OPERATING EXPENSES	267,324	302,525	121,556	691,405	216,140
OPERATING INCOME (LOSS)	55,247	40,194	(15,121)	80,320	26,681
NONOPERATING REVENUES (EXPENSES)					
Earnings on Investments	13,454	12,478	5,075	31,007	5,182
Federal Grant Assistance	-	192	27	219	-
Other Agency Grant Assistance	167	1,070	283	1,520	123
Loss on Sale/Retirement of Capital Assets	(3,525)	(2,436)	(814)	(6,775)	(236)
Debt Service Interest Expense	(46,151)	(28,081)	(3)	(74,235)	(971)
Other	5,244	751	2,262	8,257	10,461
TOTAL NONOPERATING REVENUES (EXPENSES)	(30,811)	(16,026)	6,830	(40,007)	14,559
INCOME BEFORE CONTRIBUTIONS AND TRANSFERS	24,436	24,168	(8,291)	40,313	41,240
Capital Contributions	28,780	30,277	1,806	60,863	198
Transfers from Other Funds	616	439	276	1,331	163
Transfers from Governmental Funds	1,238	3,443	2,617	7,298	5,723
Transfers to Other Funds	(59)	(99)	(63)	(221)	(1,273)
Transfers to Governmental Funds	(3,550)	(530)	(2,464)	(6,544)	(4,539)
CHANGE IN NET ASSETS	51,461	57,698	(6,119)	103,040	41,512
Net Assets at Beginning of Year	1,939,979	1,365,520	189,692		(32,638)
NET ASSETS AT END OF YEAR	\$ 1,991,440	\$ 1,423,218	\$ 183,573		\$ 8,874
Adjustment to reflect the consolidation of Internal Service Fund activities related to Enterprise Funds.				7,530	
Change in net assets of Business-Type activities				<u>\$ 110,570</u>	

The accompanying notes are an integral part of the financial statements.

**PROPRIETARY FUNDS
STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2009
(In Thousands)**

	Business-Type Activities - Enterprise Funds				Internal Service Funds
	Sewer Utility	Water Utility	Other Enterprise Funds	Total	
CASH FLOWS FROM OPERATING ACTIVITIES					
Receipts from Customers and Users	\$ 327,771	\$ 277,717	\$ 90,607	\$ 696,095	\$ 3,182
Receipts from Interfund Services Provided	2,688	65,945	18,305	86,938	250,022
Payments to Suppliers	(120,624)	(262,356)	(41,838)	(424,818)	(104,650)
Payments to Employees	(41,702)	(567)	(61,907)	(104,176)	(90,710)
Payments for Interfund Services Used	(34,733)	(13,779)	(7,609)	(56,121)	(2,739)
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	133,400	66,960	(2,442)	197,918	55,105
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES					
Transfers from Other Funds	616	406	276	1,298	162
Transfers from Governmental Funds	1,238	186	2,617	4,041	2,550
Transfers to Other Funds	(26)	(99)	(62)	(187)	(1,273)
Transfers to Governmental Funds	(998)	(477)	(2,464)	(3,939)	(4,307)
Operating Grants Received.....	167	1,012	238	1,417	123
Proceeds from Advances and Deposits	-	235	2,569	2,804	-
Payments for Advances and Deposits	-	-	(25)	(25)	-
NET CASH PROVIDED (USED FOR) NONCAPITAL FINANCING ACTIVITIES	997	1,263	3,149	5,409	(2,745)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES					
Proceeds from Contracts, Notes and Loans	-	-	-	-	10,362
Proceeds from Revenue Bonds	217,469	179,729	-	397,198	-
Proceeds from Capital Contributions	10,361	7,631	973	18,965	-
Acquisition of Capital Assets	(55,809)	(150,587)	(6,580)	(212,976)	(49,169)
Proceeds from the Sale of Capital Assets	-	5,707	-	5,707	3,358
Principal Payments on Capital Leases	-	-	(166)	(166)	(7,055)
Principal Payments on Contracts, Notes and Loans	(4,654)	(895)	-	(5,549)	-
Principal Payments on Revenue Bonds.....	(31,700)	(13,894)	-	(45,594)	-
Interest Paid on Long-Term Debt.....	(44,670)	(29,625)	(11)	(74,306)	(1,046)
NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES	90,997	(1,934)	(5,784)	83,279	(43,550)
CASH FLOWS FROM INVESTING ACTIVITIES					
Sales of Investments	988,652	1,671,625	-	2,660,277	-
Purchases of Investments	(1,173,015)	(1,759,692)	-	(2,932,707)	-
Interest Received on Investments	13,671	13,914	5,632	33,217	5,202
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	(170,692)	(74,153)	5,632	(239,213)	5,202
Net Increase (Decrease) in Cash and Cash Equivalents	54,702	(7,864)	555	47,393	14,012
Cash and Cash Equivalents at Beginning of Year	291,240	241,215	144,181	676,636	134,104
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 345,942	\$ 233,351	\$ 144,736	\$ 724,029	\$ 148,116
Reconciliation of Cash and Cash Equivalents at End of Year to the Statement of Net Assets:					
Cash and Investments	\$ 345,933	\$ 225,556	\$ 104,184	\$ 675,673	\$ 148,116
Restricted Cash & Investments	231,212	263,883	40,552	535,647	-
Less Investments not meeting the definition of cash equivalents	(231,203)	(256,088)	-	(487,291)	-
Total Cash and Cash Equivalents at End of Year	\$ 345,942	\$ 233,351	\$ 144,736	\$ 724,029	\$ 148,116
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used For) Operating Activities:					
Operating Income (Loss)	\$ 55,247	\$ 40,194	\$ (15,121)	\$ 80,320	\$ 26,681
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided By (Used For) Operating Activities:					
Depreciation	76,554	39,627	5,797	121,978	26,513
(Increase) Decrease in Assets:					
Accounts Receivable - Net	2,455	281	63	2,799	(955)
Claims Receivable - Net	-	-	(2)	(2)	2
Contributions Receivable	-	-	-	-	39
Due from Other Funds	-	-	464	464	-
Inventories	-	(511)	76	(435)	72
Prepaid Expenses	5	(10)	10	5	(710)
Increase (Decrease) in Liabilities:					
Accounts Payable	(3,287)	(9,719)	8	(12,998)	(8,252)
Accrued Wages and Benefits	(2,052)	328	193	(1,531)	(296)
Due to Other Funds	(696)	(684)	(134)	(1,514)	(131)
Due to Other Agencies	7,365	(1,525)	-	5,840	-
Unearned Revenue	-	(326)	(372)	(698)	(49)
Contract Deposits	189	237	62	488	-
Arbitrage Liability	(157)	(429)	-	(586)	-
Compensated Absences	(197)	18	(505)	(684)	(362)
Liability Claims	(11,374)	(6,012)	-	(17,386)	2,331
Estimated Landfill Closure and Postclosure Care.....	-	-	907	907	-
Pollution Remediation Obligation.....	-	620	-	620	-
Net OPEB Obligation	3,878	3,919	3,652	11,449	1,237
Net Pension Obligation	226	201	198	625	(2,401)
Other Nonoperating Revenue	5,244	751	2,262	8,257	11,386
Total Adjustments	76,153	26,766	12,679	117,598	28,424
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	\$ 133,400	\$ 66,960	\$ (2,442)	\$ 197,918	\$ 55,105
Noncash Investing, Capital, and Financing Activities:					
Capital Leases	\$ -	\$ -	\$ -	\$ -	\$ 10,366
Developer Contributed Assets	18,419	22,646	-	41,065	198
Increase (Decrease) in Capital Assets related Accounts Payable	7,632	4,530	(382)	11,780	(6,246)
Noncash Retirement of Capital Assets	(3,525)	(8,142)	(814)	(12,481)	(318)
Contributions of Capital Assets from Governmental Activities	-	3,257	-	3,257	3,174
Proceeds of Refunding Bonds Issued.....	907,050	301,165	-	1,208,215	-
Repayment of Refunding Bonds to Escrow.....	(907,050)	(301,165)	-	(1,208,215)	-
Interest Fund Credits for Debt Service Payments.....	(13,281)	(5,186)	-	(18,467)	-

The accompanying notes are an integral part of the financial statements.

FIDUCIARY FUNDS
STATEMENT OF FIDUCIARY NET ASSETS
June 30, 2009
(In Thousands)

	<u>Pension & Employee Savings Trust</u>	<u>Investment Trust</u>	<u>Agency</u>
ASSETS			
Cash or Equity in Pooled Cash and Investments	\$ 4,616	\$ 4,637	\$ 29,253
Cash with Custodian/Fiscal Agent	371,762	-	-
Investments at Fair Value:			
Short Term Investments	33,311	-	-
Domestic Fixed Income Securities (Bonds)	861,555	-	-
International Fixed Income Securities (Bonds)	143,677	-	-
Domestic Equity Securities (Stocks)	1,444,848	-	-
International Equity Securities (Stocks)	614,246	-	-
Real Estate Equity and Real Estate Securities	350,498	-	-
Defined Contribution Investments	673,922	-	-
Receivables:			
Accounts - Net	-	-	120
Contributions	16,957	-	-
Accrued Interest	13,135	38	15
Loans	32,559	-	-
Securities Sold	81,077	-	-
Prepaid Expenses	73	-	-
Securities Lending Collateral	395,085	-	-
Restricted Cash and Investments	-	-	10,205
Capital Assets - Depreciable	1,275	-	-
TOTAL ASSETS	<u>5,038,596</u>	<u>4,675</u>	<u>\$ 39,593</u>
LIABILITIES			
Accounts Payable	6,113	-	\$ -
Accrued Wages and Benefits	783	-	-
Deposits/Advances from Others	7,200	-	10,977
Sundry Trust Liabilities	-	-	28,616
DROP Liability	360,758	-	-
Net Other Post Employment Benefit Obligation	607	-	-
Net Pension Obligation	628	-	-
Securities Lending Obligations	395,085	-	-
Securities Purchased	203,700	-	-
TOTAL LIABILITIES	<u>974,874</u>	<u>-</u>	<u>\$ 39,593</u>
NET ASSETS			
Held in Trust for Pension Benefits and Other Purposes	<u>\$ 4,063,722</u>	<u>\$ 4,675</u>	

The accompanying notes are an integral part of the financial statements.

FIDUCIARY FUNDS
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
Year Ended June 30, 2009
(In Thousands)

	Pension & Employee Savings Trust	Investment Trust	Total
ADDITIONS			
Employer Contributions	\$ 248,677	\$ -	\$ 248,677
Employee Contributions	95,345	-	95,345
Retiree Contributions	7,483	-	7,483
Contributions to Pooled Investments	-	4,574	4,574
Earnings on Investments:			
Investment Income (Loss)	(1,012,535)	159	(1,012,376)
Investment Expense	(19,661)	-	(19,661)
Net Investment Income (Loss)	(1,032,196)	159	(1,032,037)
Securities Lending Income:			
Gross Earnings	11,607	-	11,607
Borrower Rebates	(4,944)	-	(4,944)
Administrative Expenses (Lending Agent)	(1,754)	-	(1,754)
Net Securities Lending Income	4,909	-	4,909
Other Income:			
Litigation Proceeds	325	-	325
TOTAL OPERATING ADDITIONS	(675,457)	4,733	(670,724)
DEDUCTIONS			
DROP Interest Expense	27,098	-	27,098
Benefit and Claim Payments	373,495	-	373,495
Distributions from Pooled Investments	-	4,484	4,484
Administration	15,057	-	15,057
TOTAL OPERATING DEDUCTIONS	415,650	4,484	420,134
CHANGE IN NET ASSETS	(1,091,107)	249	(1,090,858)
Net Assets at Beginning of Year	5,154,829	4,426	5,159,255
NET ASSETS AT END OF YEAR	\$ 4,063,722	\$ 4,675	\$ 4,068,397

The accompanying notes are an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (In Thousands)

The City of San Diego (the "City") adopted its current charter on April 7, 1931 and operates as a municipality in accordance with State laws. Since adoption, the City Charter has been amended several times. The most recent amendments were added with voter approval of Propositions C and D in the November 4, 2008 election. Proposition C amended the City Charter to designate the use of lease revenues from Mission Bay Park, exceeding certain thresholds, 75% for capital improvements in Mission Bay Park and 25% for capital improvements in other coastal and regional parks. Proposition D amended the Municipal Code section 56.54 to make consumption of alcoholic beverages unlawful at all City parks.

The accounting policies of the City conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. The following is a summary of the City's significant accounting policies:

a. Financial Reporting Entity

As required by GAAP, these financial statements present the primary government and its component units, entities for which the primary government is considered to be financially accountable.

Blended component units, although legally separate entities, are, in substance, part of the primary government's operations and as a result, data from these units are combined with data of the primary government (references within this document to "the City" are referring to the primary government). Component units should be included in the reporting entity financial statements using the blending method if either of the following criteria is met:

- i. The component unit's governing body is substantively the same as the governing body of the primary government (the City).
- ii. The component unit provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government even though it does not provide services directly to it.

Included within the reporting entity as blended component units are the following:

- Centre City Development Corporation
- City of San Diego/Metropolitan Transit Development Board Authority
- Community Facilities and Other Special Assessment Districts
- Convention Center Expansion Financing Authority
- Public Facilities Financing Authority
- Redevelopment Agency of the City of San Diego
- San Diego Data Processing Corporation
- San Diego Facilities and Equipment Leasing Corporation
- San Diego Industrial Development Authority
- San Diego Open Space Park Facilities District #1
- Southeastern Economic Development Corporation
- San Diego City Employees' Retirement System
- Tobacco Settlement Revenue Funding Corporation
- Tourism Marketing District

A brief description of each blended component unit follows:

- Centre City Development Corporation, Inc. (CCDC) is a not-for-profit public benefit corporation established in 1975 to administer certain redevelopment projects in downtown San Diego and to provide redevelopment advisory services to the Redevelopment Agency of the City of San Diego. The City Council elects the Board of Directors. CCDC's budget and governing board are approved by the Redevelopment Agency of the City of San Diego and services are provided exclusively to the primary government. CCDC is reported as a governmental fund. Financial statements can be requested from Centre City Development Corporation, 401 B Street- Fourth Floor, San Diego, California 92101.
- The City of San Diego/Metropolitan Transit Development Board Authority (MTDB Authority) is a financing authority which was established in 1988 to acquire and construct mass transit guide ways, public transit systems, and related transportation facilities primarily benefiting the residents of the City of San Diego. The Mayor appoints, with Council confirmation, two public members and the MTS Board appoints one MTS boardmember to the governing board of the MTDB Authority. The MTDB Authority primarily provides services to the primary government. The MTDB Authority is reported as a governmental fund. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.
- The City maintains various Community Facilities, Maintenance Assessment, and Business Improvement Districts to pay for the construction, maintenance and improvement of community facilities and infrastructure. The governing body of Special Assessment Districts and Community Facilities Districts (special districts) is the City Council. Among its duties, it approves the budgets of special districts, parcel fees, special assessments, and special taxes. The special districts are reported in governmental fund types.
- The Convention Center Expansion Financing Authority (CCEFA) was established in 1996 to acquire and construct the expansion of the existing convention center. During the period reported, the CCEFA was governed by a board consisting of the Mayor [the City Manager] the Director of the Port of San Diego, and a member of the Board of Commissioners for the Port of San Diego. Under the strong mayor form of government, the City Manager position does not exist and therefore is currently vacant. The CCEFA provides services which primarily benefit the primary government. CCEFA is reported as a governmental fund. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.
- The Public Facilities Financing Authority (PFFA) was established in 1991 by the City and the Redevelopment Agency to acquire and construct public capital improvements. PFFA is governed by a board of commissioners composed of the City Treasurer, the assistant executive director of the Redevelopment Agency and three members of the public appointed by the Mayor and confirmed by the Council. PFFA provides services exclusively to the primary government. Financing for governmental funds is reported as a governmental activity and financing for enterprise funds is reported as a business-type activity. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.
- The Redevelopment Agency of the City of San Diego (RDA) was established in 1958 in order to provide a method for revitalizing deteriorating and blighted areas of the City and began functioning in 1969 under the authority granted by the community redevelopment law. The City Council is the governing board sitting as the Board of Directors of the RDA, and the RDA is reported as a governmental fund. Complete stand-alone financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.
- San Diego Data Processing Corporation (SDDPC) was formed in 1979 as a not-for-profit public benefit corporation for the purpose of providing data processing services. SDDPC's budget and governing board are approved by the City Council. SDDPC provides services almost exclusively to the primary government. SDDPC is reported as an Internal Service Fund. Financial statements can be requested from San Diego Data Processing Corporation, 5975 Santa Fe Street, San Diego, California 92109.

- The San Diego Facilities and Equipment Leasing Corporation (SDFELC) is a not-for-profit public benefit corporation established in 1987 for the purpose of acquiring and leasing to the City real and personal property to be used in the municipal operations of the City. The SDFELC is governed by a three member board consisting of the City Attorney, the Chief Financial Officer and the Mayor (as City Manager) and services are provided exclusively to the primary government. Financing for governmental funds is reported as a governmental activity and financing for enterprise funds is reported as a business-type activity. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.
- The San Diego Industrial Development Authority (SDIDA) was established in 1983 by the City for the purpose of providing an alternate method of financing to participating parties for economic development purposes. The City Council is the governing board. SDIDA is reported as a governmental fund. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.
- The San Diego Open Space Park Facilities District #1 (SDOSPF) was established in 1978 by the City for the purpose of acquiring open space properties to implement the Open Space Element of the City's General Plan. The boundaries are contiguous with those of the City. The City Council is the governing board. SDOSPF is reported as a governmental fund. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California 92101.
- Southeastern Economic Development Corporation (SEDC) is a not-for-profit public benefit corporation organized in 1980 by the City to administer certain redevelopment projects in southeast San Diego and to perform economic development services in its area of influence. SEDC's budget and governing board are approved by the Redevelopment Agency and services are provided exclusively to the primary government. SEDC is reported as a governmental fund. Financial statements can be requested from the Southeastern Economic Development Corporation, 995 Gateway Center Way, Suite 300, San Diego, California 92102.
- San Diego City Employees' Retirement System (SDCERS) was established in 1927 by the City and administers retirement, post employment healthcare, disability, and death benefits. Currently, SDCERS also administers the Port of San Diego and the San Diego County Regional Airport Authority defined benefit plans.

SDCERS is a legally separate, blended component unit of the City of San Diego. It is managed by a Board of Administration, the majority of which is appointed by the City of San Diego, and a Pension Administrator who does not report to, or work under the direction of the elected officials or appointed managers of the City of San Diego. SDCERS provides services almost exclusively to the primary government. Additionally, during the period reported, SDCERS utilized legal counsel independent of the City of San Diego. As such, the City does not maintain direct operational oversight of SDCERS or its financial reports.

SDCERS is reported as a pension and employee savings trust fund. Complete stand-alone financial statements can be requested from the San Diego City Employees' Retirement System, 401 West A Street, Suite 400, San Diego, California 92101.

- The Tobacco Settlement Revenue Funding Corporation (TSRFC) is a not-for-profit public benefit corporation established in 2006 for the purpose of acquiring the tobacco settlement revenues allocated to the City from the State of California, pursuant to the Master Settlement Agreement. TSRFC is governed by the Board of Directors which consists of the Chief Operating Officer, the Chief Financial Officer, and one independent director. The independent director shall be appointed by the Mayor or the remaining directors. TSRFC is reported as a governmental fund. Financial statements can be requested from the Office of the City Comptroller, 202 C Street, San Diego, California, 92101.

- The Tourism Marketing District (TMD) is an assessment district created, in fiscal year 2008, by the City on behalf of larger hotel and motel operators within the City. The TMD provides for tourism development, including coordinated joint marketing and promotion of San Diego, in order to maintain and expand the tourism industry. The TMD procedural ordinance establishes a method by which benefited businesses may be assessed for the cost of activities associated with tourism development within their respective area. The governing body of the TMD is the City Council. Among its duties, TMD will initiate proceedings to establish a district upon submission of a written petition, signed by the business owners in the proposed district who will pay more than 50 percent of the assessments proposed to be levied, and will approve the district management plan which includes an annual budget, frequency for levying assessments, and number of years assessments will be levied. The TMD is reported as a governmental fund.

Discretely presented component units, which are also legally separate entities, have financial data reported in a separate column from the financial data of the primary government to demonstrate they are financially and legally separate from the primary government.

There are two entities which are discretely presented component units:

- San Diego Convention Center Corporation (SDCCC)
SDCCC is a not-for-profit public benefit corporation originally organized to market operate and maintain the San Diego Convention Center. San Diego Theaters Inc. is a non-profit subsidiary of SDCCC created in 2003 to operate the San Diego Civic Theater and the restored Balboa Theater. The City is the sole member of SDCCC and acts through the San Diego City Council in accordance with the City Charter and the City's Municipal Code. The City appoints seven voting members out of the nine-member Board of Directors of SDCCC. The City is liable for any operating deficits and would be secondarily liable for any debt issuances of SDCCC. SDCCC is discretely presented because it provides services directly to the citizens. Complete stand-alone financial statements can be requested from San Diego Convention Center Corporation, 111 West Harbor Drive, San Diego, California 92101.
- San Diego Housing Commission (SDHC)
SDHC is a government agency which was formed by the City under Ordinance No. 2515 on December 5, 1978 in accordance with the Housing Authority Law of the State of California. SDHC primarily serves low-income families by providing rental assistance payments, rental housing, loans and grants to individuals and not-for-profit organizations and other services. Members of the Board of Commissioners are appointed by the Mayor and confirmed by the City Council. SDHC is discretely presented because it provides services directly to the citizens. Complete stand-alone financial statements can be requested from San Diego Housing Commission, 1122 Broadway, Suite 300, San Diego, California 92101.

Each blended and discretely presented component unit has a June 30 fiscal year-end.

b. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all of the non-fiduciary activities of the primary government and its component units. 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. Likewise, the primary government is reported discretely from certain legally separate component units for which the primary government is financially accountable.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable as to a specific function or segment. Direct expenses reported include administrative and overhead charges. 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 and contributions.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, the latter of which are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

c. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary and fiduciary funds financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

The business-type activities and proprietary funds financial statements apply all effective pronouncements of the Governmental Accounting Standards Board ("GASB"). In addition, these statements apply all Accounting Principles Board Opinions ("APBO") and Financial Accounting Standards Board ("FASB") Statements and Interpretations issued on or before November 30, 1989, except those that conflict with GASB pronouncements. The City has elected not to apply all FASB Statements and Interpretations issued after November 30, 1989.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of taxes and other charges between the government's water and sewer functions and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

All internal service funds, except for the Special Engineering Fund, have been included within governmental activities in the government-wide financial statements since they predominantly benefit governmental functions. The Special Engineering Fund, which services exclusively water and sewer activities, has been included within business-type activities in the government-wide financial statements.

Amounts reported as program revenues include (1) charges to customers for goods, services, or privileges provided, (2) operating grants and contributions, and (3) capital grants and contributions, including special assessments. General revenues include all taxes and investment income.

Governmental funds financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period.

Revenues which are considered susceptible to accrual include: real and personal property taxes; other local taxes; franchise fees; fines, forfeitures and penalties; motor vehicle license fees; rents and concessions; interest; and state and federal grants and subventions, provided they are received within 60 days from the end of the fiscal year.

Licenses and permits, including parking citations and miscellaneous revenues are recorded as revenues when received in cash because they generally are not measurable until actually received.

Expenditures are recognized when the related fund liability is incurred except for (1) principal and interest of general long-term debt which are recognized when due; and (2) employee annual leave and claims and judgments from litigation which are recorded in the period due and payable since such amounts will not currently be liquidated with expendable available financial resources.

The governmental funds financial statements do not present long-term debt, but the related debt is shown in the reconciliation of the Governmental Funds Balance Sheet to the Government-Wide Statement of Net Assets. Bond premiums, discounts and issuance costs are recognized during the current period.

Permanent Funds, also referred to as Endowment Funds, are governmental funds used to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support City programs. The City has received endowments for the following programs: Mt. Hope Cemetery; Carmel Valley Sewer Maintenance; North Park Branch Library; Jacaranda Tree planting and maintenance in City rights-of-way; Rancho Bernardo Branch Library; La Jolla/Riford Branch Library; Los Penasquitos Canyon Preserve; Montezuma Road Median Maintenance; Southcrest Oak Estates II landscape maintenance; Sycamore Estates property maintenance; and, the Fortuna Mountain Conservation Bank management within Mission Trails Regional Park. The amount of investment earnings available for expenditure is reported as Undesignated Fund Balance in the fund level financial statements. The endowment principal is reported as Restricted for Nonexpendable Permanent Endowments in the Statement of Net Assets. The State law governing the spending of endowment funds investment earnings is California Probate Code Section 18504.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's proprietary funds are charges to customers for sales and services. 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 non-operating revenues and expenses.

Fiduciary funds are used to account for assets held by the City in a trustee capacity or as an agent for individuals, private organizations, and/or other governmental units, and include pension and employee savings trust, investment trust, and agency funds. Pension and Employee Savings Trust Funds are reported using the same measurement focus and basis of accounting as Proprietary Funds. Agency funds are reported using the accrual basis of accounting.

The following is the City's major governmental fund:

General Fund - The General Fund is the principal operating fund of the City. It is used to account for all financial resources, except those required to be accounted for in another fund.

The following are the City's major Enterprise Funds:

Sewer Utility Fund - The sewer utility fund is used to account for the operation, maintenance and development of the City's sewer system. The City's sewer utility fund includes activities related to the performance of services for Participating Agencies.

Water Utility Fund - The water utility fund is used to account for operating and maintenance costs, replacements, betterments, expansion of facilities, and payments necessary in obtaining water from the Colorado River and the State Water Project.

The following are the City's other fund types:

Internal Service Funds - These funds account for vehicle and transportation, printing, engineering, data processing, and storeroom services provided to City departments on a cost-reimbursement basis. Internal service funds also account for self-insurance activities, including workers' compensation and long-term disability programs, which derive revenues from rates charged to benefiting departments. This fund type also accounts for the public liability reserve, which was established for the purpose of paying liability claims.

Pension and Employee Savings Trust Funds - These funds account for the San Diego City Employees' Retirement System, the Supplemental Pension Savings Plan (SPSP), and the 401(k) Plan.

Investment Trust Fund - This fund was established to account for equity that legally separate entities have in the City Treasurer's investment pool. The Automated Regional Justice Information System (ARJIS), the San Diego Graphic Information Source (SanGIS), and the Abandoned Vehicle Abatement (AVA) are all legally separate entities which have cash invested in the City Treasurer's investment pool.

Agency Funds - These funds account for assets held by the City as an agent for individuals, private organizations, and other governments, including federal and state income taxes withheld from employees, parking citation revenues on behalf of other agencies, and certain employee benefit plans.

d. Property Taxes

The County of San Diego (the "County") assesses, bills, and collects property taxes on behalf of numerous special districts and incorporated cities, including the City of San Diego. The City's collections of the current year's taxes are received through periodic apportionments from the County.

The County's tax calendar is from July 1 to June 30. Property taxes attach as a lien on property on January 1. Taxes are levied on July 1 and are payable in two equal installments on November 1 and February 1, and become delinquent after December 10 and April 10, respectively. Since the passage of California's Proposition 13, beginning with fiscal year ended 1979, general property taxes are based either on a flat 1% rate applied to the 1975-76 full value of the property or on 1% of the sales price of any property sold or of the cost of any new construction after the 1975-76 valuation. Taxable values of properties (exclusive of increases related to sales and new construction) can increase by a maximum of 2% per year. The Proposition 13 limitation on general property taxes does not apply to taxes levied to pay the debt service on any indebtedness approved by the voters prior to June 6, 1978 (the date of passage of Proposition 13).

At the government-wide level, property tax revenue is recognized in the fiscal year for which the taxes have been levied. Property taxes received after the fiscal year in which they were levied are not considered available as a resource that can be used to finance the current year operations of the City and, therefore, are recorded as deferred revenue in the governmental funds. The City provides an allowance for uncollected property taxes of approximately 5% of the outstanding current balance which is analyzed each year against most recent data from the County.

Property owners can appeal the assessment value of their property to the County Assessment Appeals Board. If successful, the County Assessor may reduce the taxable value of a property and/or provide a refund to affected property owners. Reductions of taxable property value within the City of San Diego will have a negative impact on future tax collections until assessed valuations increase.

e. Cash and Investments

The City's cash and cash equivalents for Statement of Cash Flows purposes are considered to be cash on hand, demand deposits, restricted cash, and investments held by the City Treasurer in a cash management investment pool and reported at fair value. Cash equivalents reported in the Statement of Cash Flows for the Water and Sewer Utilities do not include restricted investments represented as Restricted Cash and Investments with a maturity date greater than ninety days.

The City's cash resources are combined to form a cash and investment pool managed by the City Treasurer (the pool). The pool is not registered as an investment company with the Securities and Exchange Commission (SEC) nor is it a 2a7-like pool. The investment activities of the Treasurer in managing the pool are governed by California Government Code § 53601 and the City's Investment Policy, which is reviewed by the Investment Advisory Committee and approved annually by the City Council. Interest earned on pooled investments is allocated to participating funds and entities based upon their average daily cash balance during the allocation month. Fair value adjustments to the pool are recorded annually; however, the City Treasury reports on market values monthly. The value of the shares in the pool approximates the fair value of the pool.

The pool participates in the California State Treasurer's Local Agency Investment Fund (LAIF). Investments in LAIF are governed by State statutes and overseen by a five member Local Investment Advisory Board. The fair value of the City's position in LAIF may be greater or less than the value of the shares. Investments in LAIF are valued in these financial statements using a fair value factor provided by LAIF applied to the value of the City's shares in the investment pool.

It has been the City's policy to allow the General Fund to receive interest earned by certain governmental funds, internal service funds and agency funds, unless otherwise expressly stated in the resolutions creating individual funds. During the fiscal year ended June 30, 2009, approximately \$8,887 interest was assigned from various funds to the General Fund. These transactions caused an increase to the "transfers from other funds" amount for the General Fund and caused a like increase to the "transfer to other funds" amount for the fund disbursing the interest. In the case of negative interest, these transactions caused an increase to the "transfers from other funds" amount for the fund transferring the negative interest and caused a like increase to the "transfer to other funds" amount for the General Fund.

Certain governmental funds maintain investments outside of the City's investment pool. These funds are supervised and controlled by a five member Funds Commission which is appointed by the Mayor and confirmed by the City Council. The Funds Commission engages money managers to direct the investments of these funds. Additionally, the City and its component units maintain individual accounts pursuant to bond issuances and major construction contracts which may or may not be related to debt issuances. The investment of these funds is governed by the policies set forth in individual indenture and trustee agreements. Certain component units of the City also participate in LAIF separately from the City Treasurer's investment pool.

All City investments are reported at fair value in accordance with the GASB 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*. Note 3 of the notes to the financial statements contain additional information on permissible investments per the City investment policy and other policies applicable to the cash and investments reported herein.

The discharge of fiduciary duties by SDCERS' Board is governed by Section 144 of the City Charter and Article XVI, Section 17 of the California State Constitution. Investment decisions are made on a risk versus return basis in a total portfolio context. SDCERS' Board has the authority to delegate investment management duties to outside advisors, to seek the advice of outside investment counsel, and to provide oversight and monitoring of the investment managers it hires. Furthermore, under the California State Constitution and other relevant authorities, SDCERS' Board may, at its discretion, and when prudent in the informed opinion of the Board, invest funds in any form or type of investment, financial instrument, or financial transaction, unless otherwise limited by the San Diego City Council. SDCERS' agents, in

SDCERS' name, manage all investments.

SDCERS' investments are reported at fair value in the accompanying Statement of Fiduciary Net Assets. SDCERS' custodian, State Street Bank & Trust Company, provides the market values of exchange traded assets. In the case of debt securities acquired through private placements, SDCERS' contract investment advisors compute fair value based on market yields and average maturity dates of comparable quoted securities. Short-term investments are reported at cost or amortized cost, which approximates fair value. Real estate equity investment fair values are based on either annual valuation estimates provided by SDCERS' contract real estate advisors or by independent certified appraisers. Fair value of investments in commingled funds of publicly traded securities are based on the funds' underlying asset values determined from published market prices and quotations from major investment firms.

f. Inventories

Inventories reported in the government-wide financial statements and the proprietary funds financial statements, which consist of water in storage and supplies, are valued at the lower of cost or market. Such inventories are expensed when consumed using primarily the first-in, first-out (FIFO) and weighted-average methods, respectively. Inventory supplies of governmental funds are recorded as expenditures when purchased.

g. Land Held for Resale

Land Held for Resale, purchased by RDA, is reported in the government-wide and fund financial statements at the lower of cost or net realizable value.

h. Deferred Charges

In the government-wide and proprietary funds financial statements, Deferred Charges represent the unamortized portion of bond issuance costs. These costs will be amortized over the life of the related bonds using a method which approximates the effective interest method.

i. Capital Assets

Non-Depreciable Capital Assets, which include land and construction-in-progress, are reported in the applicable governmental or business-type activities column in the government-wide financial statements, as well as in the Proprietary Funds financial statements.

Depreciable Capital Assets, which include structures and improvements, equipment, distribution and collection systems, and infrastructure, are reported net of accumulated depreciation in the applicable governmental or business-type activities column in the government-wide financial statements, as well as in the proprietary funds financial statements. To meet the criteria for capitalization, an asset must have a useful life in excess of one year and in the case of equipment outlay, must equal or exceed a capitalization threshold of five thousand dollars. All other capital assets such as land, structures, infrastructure, and distribution and collection systems are capitalized regardless of cost. Subsequent improvements are capitalized to the extent that they extend the initial estimated useful life of the capitalized asset, or improve the efficiency or capacity of that asset. Costs for routine maintenance are expensed as incurred. Interest expense incurred during the construction phase of business-type capital assets are reflected in the capitalized value of the asset constructed. During fiscal year 2009, \$18,041 of interest expense incurred was capitalized, which is calculated net of related interest revenue of \$1,835.

Capital assets, when purchased or constructed, are recorded at historical cost or estimated historical cost. Donated capital assets are recorded at the estimated fair value on the date of donation. Depreciation of capital assets is computed using the straight-line method over the estimated useful life of the asset as follows:

Assets	Years
Structures and Improvements	
Buildings	40 - 50
Building Improvements	15 - 40
Equipment	
Automobiles and Light Trucks	5 - 10
Construction and Maintenance Vehicles	5 - 20
General Machinery and Office Equipment	3 - 30
Distribution and Collection Systems	
Sewer Pipes and Water Mains	15 - 150
Reservoirs	100 - 150
Infrastructure	
Pavement and Traffic Signals	12 - 50
Bridges	75
Hardscape	20 - 50
Flood Control Assets	40 - 75

j. Unearned/Deferred Revenue

In the government-wide and all fund level financial statements, unearned revenue represents amounts received which have not been earned. The government-wide financial statements include revenues earned from developer credits, which are not reported in governmental funds because they are non-monetary transactions. In the governmental funds financial statements, deferred revenue represents revenues which have been earned but have not met the recognition criteria based on the modified accrual basis of accounting.

k. Interfund Transactions

The City has the following types of interfund transactions:

Loans – amounts provided with a requirement for repayment. Interfund loans are normally reported as interfund receivables (i.e. Due from Other Funds) in lender funds and interfund payables (i.e. Due to Other Funds) in borrower funds. The non-current portions of long-term interfund loans receivable are reported as advances. There is one interfund loan between the Facilities Benefit Assessments (FBA) Fund and the Sewer Utility Fund, for developer fees owed for the Carmel Valley Trunk sewer project, which is reported as an Interfund Loan Receivable/Payable at the fund level and included with Internal Balances on the government-wide Statement of Net Assets.

Services provided and used – sales and purchases of goods and services between funds for a price approximating their external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as interfund receivables and payables in the fund balance sheets or fund statements of net assets.

Reimbursements – repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Reimbursement is reported as expenditures or expenses in the reimbursing fund and a reduction of expenditures or expenses in the paying fund.

Transfers – flows of assets (such as cash or goods) without equivalent flows of assets in return, and without a requirement for repayment. In governmental funds, transfers are reported as other financing uses in the funds making transfers and as other financing sources in the funds receiving transfers. In proprietary funds, transfers are reported after non-operating revenues and expenses.

l. Long-Term Liabilities

In the government-wide and proprietary funds financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary funds statements of net assets. Capital appreciation bond accretion, bond premiums and discounts, and bond refunding gains and losses are amortized over the life of the bonds using a method which approximates the effective yield method. Net bonds payable reflects amortized bond accretion and unamortized bond discounts, premiums and refunding gains and losses.

m. Sundry Trust Liabilities

Under approval of certain agreements, developers submit to RDA an initial deposit to ensure the developer proceeds diligently and in good faith to negotiate and perform all of the obligations under the agreement. These deposits can normally be used for administrative costs of RDA. In the government-wide financial statements and in the fund financial statements, the unspent portion of these deposits, called Sundry Trust Liabilities, are reported as liabilities of RDA.

n. Compensated Absences

The City provides combined annual leave to cover both vacation and sick leave. It is the City's policy to permit employees to accumulate between 8.75 weeks and 17.5 weeks of earned but unused annual leave, depending on hire date. Accumulation of these earnings will be paid to employees upon separation from service.

The liability for compensated absences reported in the government-wide, proprietary, and fiduciary fund financial statements consists of unpaid, accumulated vacation and sick leave balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary level and includes salary related costs (e.g. Social Security and Medicare Tax). A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

o. Claims and Judgments

The costs of claims and judgments are accrued when incurred and measurable in the government-wide financial statements and both proprietary and fiduciary funds financial statements. In governmental funds, the costs of claims and judgments are recorded as expenditures when payments are due and payable.

p. Non-Monetary Transactions

The City, as part of approving new development in the community planning process, requires that certain public facilities be constructed per the provisions of community financing plans. Historically, the City has agreed to pay a pro rata share of these assets. In lieu of providing direct funding for these assets, the City often provides developers with credits (also referred to as FBA credits) for future permit fees. These credits are earned by the developer upon successful completion of construction phases and when City engineers have accepted the work. The credits are recognized as permit revenue

upon issuance and a corresponding capital asset is recorded in the government-wide financial statements.

q. Net Assets

In the government-wide and proprietary funds financial statements, net assets are categorized as follows:

- Invested in Capital Assets, Net of Related Debt consists of capital assets, net of accumulated depreciation, and reduced by outstanding debt attributed to the acquisition of these assets.
- Restricted Net Assets consist of assets with restrictions imposed on them by external creditors, grantors, contributors, laws and regulations of other governments, or law through constitutional provisions or enabling legislation. It is the City's policy to first apply restricted resources when an expense is incurred for purposes which both restricted and unrestricted net assets are available. As of June 30, 2009, the amount of restricted net assets due to enabling legislation was approximately \$147,994.
- Unrestricted Net Assets consist of net assets that do not meet the definition of Invested in Capital Assets, Net of Related Debt or Restricted Net Assets.

r. Fund Balance

In the fund financial statements, portions of fund equity of governmental funds have been reserved for specific purposes. Reservations are created to either (1) satisfy legal covenants that require a portion of the fund balance to be segregated, or (2) identify the portion of the fund balance that is not appropriable for future expenditures.

Designated fund balance indicates that portion of fund equity for which the City has made tentative plans. Undesignated fund balance indicates that portion of fund equity which is available for appropriation in future periods.

s. Reserves

City Charter Section 91 titled "General Reserve Fund" was approved by the voters on November 6, 1962. This section requires the City Council to create and maintain a General Reserve Fund for the purpose of keeping the payment of running expenses of the City on a cash basis. Section 91 requires the reserve be maintained in an amount sufficient to meet all legal demands against the City Treasury for the first four months or other necessary period of each fiscal year prior to the collection of taxes. This fund may be expended only in the event of a public emergency by the affirmative vote of two-thirds of the City Council. The argument for this charter section given by the Citizens Charter Review Committee, commissioned in 1962, was to "strengthen the financial position of the City through the more efficient utilization of tax monies by reducing the amount of taxes collected and lying idle during a great part of the year, and through focusing responsibility for fiscal policies on the elected City Council."

On February 28, 1984, the City Attorney's Office issued Opinion No. 84-3 which addresses issues in regards to the City's compliance with the funding requirements of Charter Section 91. Such opinion stated, "To the extent that the legislative body approves the issuance of short term notes, commonly referred to as Tax or Revenue Anticipation Notes, pursuant to Section 92 titled "Borrowing Money on Short Term Notes"; or authorizes temporary loans to any tax-supported fund from any other funds in the treasury pursuant to Section 93 titled "Loans and Advances", the General Reserve Fund required under section 91 can be reduced." Therefore, the funding requirements of Charter Section 91 have been satisfied through a combination of the General Fund reserve of \$78,347 reported within the General Fund column of the Governmental Funds Balance Sheet in Undesignated Fund Balance, and the provisions set forth in Charter Sections 92 and 93 for the fiscal year ended June 30, 2009.

In September 2007, the City Attorney's Office issued a new opinion that supersedes, in part, the opinion issued on February 28, 1984. The revised opinion states that the Charter Section 91 General Reserve must be a separate, legal

fund. This fund, separate from the General Fund, must be funded if not at a “four month operating expenditure” level then at a level of such “other necessary funding.” The City Attorney’s Opinion referenced the guidance of the Government Finance Officer’s Association, which recommends a level between 5% and 15% of operating expenditures as the benchmark for interpreting the required funding level that meets the intent of the City’s voters. Per the City Attorney’s opinion, the City created a separate General Reserve in fiscal year 2008, and the General Fund reserve monies were transferred to that separate reserve and reported therein in all future financial statements. The City Council also approved the Mayor’s “City Reserve Policy” with Ordinance 19679 on November 13, 2007. This is a formal fiscal reserve policy that establishes a General Fund Reserve that will be set at a minimum of 8% of annual General Fund Revenues. The policy provides that the City shall reach this level of funding no later than fiscal year 2012. The General Fund Reserve is reported within the General Fund Undesignated Fund Balance as stated above.

The City also has an internal reserve policy in relation to certain governmental long term liabilities which are repaid with Transient Occupancy Tax revenues. When the liabilities are incurred by the City, the City creates policy reserves equal to one half of the annually required lease payments in the form of a rate stabilization reserve for each liability. The purpose of the internal reserve is to make the lease payments when they are due; even if there are unanticipated fluctuations in the Transient Occupancy Tax receipts that could potentially impact the timely payment of lease payments for such liabilities. The City maintains cash funded debt service reserve funds or surety guarantees with trustees in accordance with the bond indentures that exist for these liabilities.

As of June 30, 2009, the following is a schedule of all such internal stabilization reserves (in whole dollars) by fund:

<u>Internal Stabilization Reserve</u>	<u>CAFR Section</u>	<u>CAFR Column</u>	<u>Amount</u>
Convention Center Expansion	Special Revenue	Transient Occupancy Tax	\$ 6,850,531
Petco Park (PFFA-Ballpark)	Special Revenue	Transient Occupancy Tax	5,657,279
Balboa Park (SDFELC)	Special Revenue	Transient Occupancy Tax	3,286,878
Trolley (MTDB)	Special Revenue	Public Transportation	2,043,591
			<u>\$ 17,838,279</u>

These reserve funds were closed and the balances transferred to the General Fund in the FY2010 operating budget.

t. Participating Agencies Revenue Recognition

The Regional Wastewater Disposal Agreement between the City of San Diego (City) and the Participating Agencies (PA) in the Metropolitan Sewerage System allow for quarterly invoicing of local area member municipalities and utility districts to collect and process sewage waste using the City’s facilities. The invoicing is based on an estimated allocation of costs associated with each PA and may not represent that agency’s proportionate allocation of actual maintenance and operating costs of the sewerage system, resulting in an overstatement or understatement of revenue reported in the Sewer Utility Statement of Revenues, Expenses, and Changes in Fund Net Assets.

During fiscal year 2009 the City invoiced approximately \$43,484, net of \$13,966 in credits (expenses) and reimbursements (revenues) as a result of the audits of fiscal year 2006 and 2007 activity. In addition, the City has also recognized and accrued approximately \$4,514 in estimated credits applicable to fiscal year 2008, which has been recorded as a liability on the Sewer Utility Statement of Net Assets. In prior years, credits of \$2,543 and \$8,078 were recorded in the Sewer Utility fund financial statements for fiscal years 2005 and 2004, respectively.

u. Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities, disclosure of contingent assets and liabilities, and the related amounts of revenues and expenses. Actual results could differ from those estimates. Management believes that the estimates are reasonable.

v. New Governmental Accounting Standards Implemented During Fiscal Year Ended June 30, 2009

The requirements for the following accounting standards are effective for the purpose of implementation, for the City, for fiscal year ended June 30, 2009.

In November 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and clean ups. The Statement generally requires the government to estimate the components of expected pollution remediation outlays and determine whether outlays for those components should be accrued as a liability or, if appropriate, capitalized when goods and services are acquired. This would only be required if any one of five obligating events has occurred. If deemed appropriate, the liability will be accrued in the government-wide and proprietary fund financial statements and all required disclosures can be found in Note 18 Contingencies.

In November 2007, GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, which requires endowments to report their land and other real estate investments at fair value. Governments are also required to report changes in fair value as investment income. As of June 30, 2009 the City does not have land or other real estate assets invested in any of the Endowment Funds, which are reported in the Permanent Fund financial statements.

In March 2009, GASB issued Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify the sources of accounting principles and the framework for selecting the principles used in the preparation of the financial statements. The GAAP hierarchy was previously included in the auditing standards of the American Institute of Certified Public Accountants (AICPA). This Statement improves financial reporting by contributing to the GASB's efforts to codify all GAAP for state and local governments so that they derive from a single source.

In March 2009, GASB issued Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statement on Auditing Standards*. The objective of this Statement is to incorporate in the GASB authoritative literature certain accounting and financial reporting guidance presented in the AICPA Statements on Auditing Standards. The three issues addressed are related party transactions, going concern consideration, and subsequent events. This Statement does not establish new accounting standards but rather incorporates existing guidance into the GASB standards.

2. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS (In Thousands)

Certain adjustments are necessary to reconcile governmental funds to governmental activities (which includes all internal service funds except the Special Engineering Fund). The reconciliation of these adjustments is as follows:

- a. Explanation of certain differences between the Governmental Funds Balance Sheet and the Government-wide Statement of Net Assets:

The Governmental Funds Balance Sheet includes a reconciliation between "Total Fund Balances-Governmental Funds" and "Total Net Assets-Governmental Activities" as reported in the Government-wide Statement of Net Assets. One element of the reconciliation states, "Other assets and liabilities used in governmental activities are not financial resources (uses), and therefore, are either deferred or not reported in the funds." The details of this \$105,197 difference are as follows:

Deferred Charges, net, July 1, 2008	\$ 19,875
Issuance Costs	1,001
Amortization Expense	<u>(1,124)</u>
Deferred Charges, net, June 30, 2009	<u>19,752</u>
Deferred Revenue:	
Taxes Receivable	24,783
Notes Receivable	4,041
Motor Vehicle License Receivable	1,032
Special Assessments Receivable	2,077
Grants and Other Receivables	<u>53,512</u>
Deferred Revenue, net, June 30, 2009	<u>85,445</u>
Net Adjustment to increase "Total Fund Balances-Governmental Funds" to arrive at "Total Net Assets-Governmental Activities"	<u>\$ 105,197</u>

Another element of the reconciliation states, "Certain liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds." The details of this (\$1,924,183) difference are as follows:

Interest Accrued on Long-Term Debt	\$ (24,219)
Arbitrage Liability	(533)
Compensated Absences	(66,585)
Liability Claims	(52,190)
Capital Leases Payable	(60,760)
Contracts Payable	(4,715)
Notes Payable	(4,786)
Loans Payable	(44,815)
Section 108 Loans Payable	(33,532)
Net Bonds Payable	(1,402,100)
Accretion of Interest on Capital Appreciation Bonds	(14,682)
Net Pension Obligation	(144,740)
Net OPEB Obligation	<u>(70,526)</u>
Net adjustment to decrease "Total Fund Balances-Governmental Funds" to arrive at "Total Net Assets-Governmental Activities"	<u>\$ (1,924,183)</u>

Another element of the reconciliation states, "Internal Service Funds are used by management to charge the costs of activities such as Fleet Services, Publishing Services, Self Insurance, and Central Stores to individual funds. The assets and liabilities of certain Internal Service Funds are included in the governmental activities in the Statement of Net Assets. The details of this \$6,826 difference are as follows:

Assets:	
Capital Assets - Non Depreciable	\$ 1,984
Capital Assets - Depreciable	123,970
Internal Balances	(2,048)
Other Assets	160,768
Liabilities:	
Compensated Absences	(7,861)
Liability Claims	(221,789)
Capital Lease Obligations	(28,759)
Net Other Post Employment Benefits Obligation	(2,978)
Net Pension Obligation	(2,925)
Other Liabilities	<u>(13,536)</u>
Net adjustment to increase "Total Fund Balances-Governmental Funds" to arrive at "Total Net Assets-Governmental Activities"	<u>\$ 6,826</u>

- b. Explanation of certain differences between the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances and the Government-wide Statement of Activities:

The Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances includes a reconciliation between "Net Change in Fund Balances-Total Governmental Funds" and "Changes in Net Assets of Governmental Activities" as reported in the Government-wide Statement of Activities. One element of that reconciliation explains, "Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense." The details of this \$121,730 difference are as follows:

Capital Projects	\$ 138,634
Other Capital Activities	108,076
Depreciation Expense	<u>(124,980)</u>
Net Adjustment to increase "Net Changes in Fund Balances-Total Governmental Funds" to arrive at "Changes in Net Assets of Governmental Activities"	<u>\$ 121,730</u>

Another element of the reconciliation states "The net effect of various miscellaneous transactions involving capital assets (i.e., donations, retirements, and transfers) is to decrease net assets." The details of this (\$17,686) are as follows:

In the Statement of Activities, only the net gain on the sale of land is reported. However, in the governmental funds, the proceeds from the sale increase financial resources. Thus, the change in net assets differs from the change in fund balances by the net book value of the capital assets sold/retired.	\$ (6,587)
Transfers of capital assets to Business-Type activities decrease net assets in the Statement of Activities, but do not appear in the governmental funds because they are not financial resources.	(3,594)
The Statement of Activities reports losses arising from the retirement of existing depreciable capital assets. Conversely, governmental funds do not report any gain or loss on retirements of capital assets.	<u>(7,505)</u>
Net adjustment to decrease "Net Change in Fund Balances-Total Governmental Funds" to arrive at "Changes in Net Assets of Governmental Activities"	<u>\$ (17,686)</u>

Another element of the reconciliation states, "Internal Service Funds are used by management to charge the costs of activities such as Fleet Services, Publishing Services, Central Stores, Self Insurance, and others to individual funds." The net expense of certain Internal Service activities is reported with governmental activities. The details of this \$33,982 are as follows:

Allocated Operating Profit	\$ 18,508
Nonoperating Revenues (Expenses):	
Loss on Sale/Retirement of Capital Assets	(235)
Other Nonoperating Revenues	14,798
Transfers	713
Capital Contributions	<u>198</u>
Net adjustment to increase "Net Changes in Fund Balances-Total Governmental Funds" to arrive at "Changes in Net Assets of Governmental Activities"	<u>\$ 33,982</u>

Another element of the reconciliation states "The issuance of long-term debt (i.e., bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets." The details of this (\$100,854) difference are as follows:

Debt Issued or Incurred:	
Capital Leases	\$ (30,392)
Contracts Payable	(2,100)
Loans Payable	(10,483)
Special Assessment/Special Tax Bonds	(12,365)
Revenue Bonds	(103,000)
Principal Repayments:	
Capital Leases	5,445
Contracts/Notes Payable	876
Loans Payable	168
Section 108 Loans	2,364
G.O. Bonds	2,265
Revenue Bonds	22,450
Special Assessment Bonds/Special Tax Bonds	4,900
Tax Allocation Bonds	14,096
Tobacco Settlement Asset-Backed Bonds	3,990
Pooled Financing Bonds	655
Loans Payable Modification (See Note 5)	<u>277</u>
Net adjustment to decrease "Net Changes in Fund Balances-Total Governmental Funds" to arrive at "Changes in Net Assets of Governmental Activities"	<u>\$ (100,854)</u>

Another element of the reconciliation states that "Some expenses reported in the Statement of Activities do not require the use of current financial resources (i.e., compensated absences, net pension obligation) and therefore are not accrued as expenses in governmental funds." The details of this (\$92,248) difference are as follows:

Compensated Absences	\$ 16
Liability Claims	(39,200)
Net Pension Obligation/Net OPEB Obligation	(48,630)
Accrued Interest	(2,438)
Current Year Premiums/Discounts and Interest Accretion	
Less Amortization of Bond Premiums	(1,873)
Issuance Costs Less Current Year Amortization	<u>(123)</u>
Net adjustment to decrease "Net Changes in Fund Balances-Total Governmental Funds" to arrive at "Changes in Net Assets of Governmental Activities"	<u>\$ (92,248)</u>

3. CASH AND INVESTMENTS (In Thousands)

The following is a summary of the carrying amount of cash and investments:

	Governmental Activities	Business-Type Activities	Fiduciary Statement of Net Assets other than SDCERS	Subtotal	SDCERS Fiduciary Statement of Net Assets	Grand Total
Cash and Cash or Equity in						
Pooled Cash and Investments	\$ 1,383,731	\$ 723,517	\$ 45,512	\$ 2,152,760	\$ 3,199	\$ 2,155,959
Cash and Investments with Fiscal Agent	156,258	175,593	26	331,877	371,736	703,613
Investments at Fair Value	212,149	312,210	673,922	1,198,281	3,448,135	4,646,416
Securities Lending Collateral	-	-	-	-	395,085	395,085
TOTAL	\$ 1,752,138	\$ 1,211,320	\$ 719,460	\$ 3,682,918	\$ 4,218,155	\$ 7,901,073

a. Cash and Cash or Equity in Pooled Cash and Investments

Cash and Cash or Equity in Pooled Cash and Investments represents petty cash, cash at the bank in demand deposit and/or savings accounts, and cash in escrow for contract retention payables. Furthermore, it represents equity in pooled cash and investments, which is discussed in further detail below.

As provided for by California Government Code, the cash balances of substantially all funds and certain outside entities are pooled and invested by the City Treasurer for the purpose of increasing interest earnings through investment activities. The respective funds' shares of the total pooled cash and investments are included in the table above, under the caption Cash and Cash or Equity in Pooled Cash and Investments.

The following represents a summary of the items included in the Cash and Cash or Equity in Pooled Cash and Investments line item:

Cash on Hand - Petty Cash	\$ 206
Deposits - Held in Escrow Accounts	10,205
Deposits - Cash and Cash Equivalents (Not Pooled)	2,146
Deposits - Cash and Cash Equivalents (Pooled)	1,024
Deposits - Certificates of Deposit (CDARS)	15,000
Pooled Investments in the City Treasury	<u>2,127,378</u>
Total Cash and Cash or Equity in Pooled Cash and Investments	<u>\$ 2,155,959</u>

A summary of the investments held by the City Treasurer's investment pool as of June 30, 2009 is presented in the table below:

Investment	Fair Value	Book Value	Interest Rate		Maturity Range
			%	Range	
U.S. Treasury Bills	\$ 190,408	\$ 188,884	0.29-2.10%	*	7/2/2009-11/27/2009
U.S. Treasury Notes & Bonds	966,025	961,686	0.88-4.88%		11/15/2009-5/15/2012
U.S. Agency Discount Notes	114,889	113,578	0.34-2.55%	*	8/14/2009-3/30/2010
U.S. Agency Notes & Bonds	533,169	529,225	0.50-4.63%		9/28/2009-6/20/2012
Commercial Paper	119,949	119,800	0.12-0.75%	*	7/1/2009-10/16/2009
Corporate Notes & Bonds	151,832	151,520	1.25-6.88%		8/10/2009-6/22/2012
Local Agency Investment Fund (LAIF)	39,718	39,667	1.91%	**	2/21/2010
Repurchase Agreement	11,388	11,388	0.07%		7/1/2009
Certificates of Deposit (CDARS)	15,000	15,000	2.20-2.21%		4/29/2010-5/6/2010
	<u>\$ 2,142,378</u>	<u>\$ 2,130,748</u>			

* Discount Rates

** LAIF - Fair Value is adjusted to account for LAIF factor. Maturity range is based on weighted average maturity of 2.35 days.

The following represents a condensed statement of net assets and changes in net assets for the City Treasurer's cash and investment pool as of June 30, 2009:

Statement of Net Assets

Deposit - Cash and Cash Equivalents (Pooled)	\$ 1,024
Deposits - Certificates of Deposit (CDARS)	15,000
Investments of Pool Participants	2,127,378
Accrued Interest Receivable of Internal Pool Participants	7,227
Accrued Interest Receivable of External Pool Participants	38
Total Cash, Investments, and Interest Receivable	<u>\$ 2,150,667</u>
Equity of Internal Pool Participants	\$ 2,145,992
Equity of External Pool Participants (SanGIS, ARJIS & AVA) **	4,675
Total Equity	<u>\$ 2,150,667</u>

**Voluntary Participation

Statement of Changes in Net Assets

Net Assets Held for Pool Participants at July 1, 2008	\$ 2,063,901
Net Change in Investments by Pool Participants	86,766
Total Net Assets Held for Pool Participants at June 30, 2009	<u>\$ 2,150,667</u>

b. Cash and Investments with Fiscal Agents

Cash and Investments with Fiscal Agents represents cash and investments held by fiscal agents resulting from bond issuances. More specifically, these funds represent reserves held by fiscal agents or trustees as legally required by bond issuances and liquid investments held by fiscal agents or trustees which are used to pay debt service. Under the Fiduciary Statement of Net Assets, Cash and Investments with Fiscal Agent represents the City's balance for the Preservation of Benefit Plan (POB Plan). The POB Plan is a qualified governmental excess benefit arrangement (QEBA) under Internal Revenue Code (IRC) section 415(m) and is discussed in further detail in Note 12.

The San Diego City Employees' Retirement System (SDCERS) portion of Cash and Investments with Fiscal Agents represents funds held as cash collateral from market neutral portfolios (domestic fixed income investment

strategy). Furthermore, it represents transaction settlements, held in each investment manager's portfolio, which are invested overnight by SDCERS' custodial bank.

c. Investments at Fair Value

Investments at Fair Value represents investments of the City's Supplemental Pension Savings Plan, 401(k) Plan, San Diego City Employees' Retirement System (SDCERS), investments managed by the City Treasurer (which are not part of the pool), investments reported by San Diego Data Processing Corporation (SDDPC), and investments managed by the Funds Commission (e.g. Cemetery Perpetuity, Effie Sergeant, Gladys Edna Peters, Los Penasquitos Canyon, and the Edwin A. Benjamin Library funds).

d. Investment Policy

In accordance with City Charter Section 45 and under authority annually approved by the City Council, the City Treasurer is responsible for the safekeeping and investment of the unexpended cash in the City Treasury according to the City Treasurer's Investment Policy (Policy). This Policy applies to all of the investment activities of the City except for the pension trust funds, the proceeds of certain debt issues, which are managed and invested at the direction of the City Treasurer in accordance with the applicable indenture or by Trustees appointed under indenture agreements or by fiscal agents, and the assets of trust funds, which are placed in the custody of the Funds Commission by Council ordinance.

City staff reviews the Policy annually and may make revisions based upon changes to the California Government Code and the investment environment. These suggested revisions are presented to the Investment Advisory Committee (IAC) for review and comment. The IAC consists of two City representatives and three outside financial professionals with market and portfolio expertise not working for the City of San Diego. The City Council reviews the Policy and considers approval on an annual basis.

The IAC evaluates the horizon returns, risk parameters, security selection, and market assumptions the City's investment staff is using when explaining the City's investment returns. The IAC also meets semi-annually to review the previous two quarters' investment returns and make recommendations to the City Treasurer on proposals presented to the IAC by the Treasurer's staff.

The Policy is governed by the California Government Code (CGC), Sections 53600 et seq. The following table presents the authorized investments, requirements, and restrictions per the CGC and the Policy:

Investment Type	Maximum Maturity (1)		Maximum % of Portfolio		Maximum % with One Issuer		Minimum Rating	
	CGC	City Policy	CGC	City Policy	CGC	City Policy	CGC	City Policy
U.S. Treasury Obligations (bills, bonds, or notes)	5 years	5 years	None	None	None	None	None	None
U.S. Agencies	5 years	5 years	None	(2)	None	(2)	None	None
Bankers' Acceptances (6)	180 days	180 days	40%	40%	30%	10%	None	(3)
Commercial Paper (6)	270 days	270 days	25%	25%	10%	10%	P1	P1
Negotiable Certificates (6)	5 years	5 years	30%	30%	None	10%	None	(3)
Repurchase Agreements	1 year	1 year	None	None	None	None	None	None
Reverse Repurchase Agreements (4)	92 days	92 days	20%	20%	None	None	None	None
Local Agency Investment Fund	N/A	N/A	None	None	None	None	None	None
Non-Negotiable Time Deposits (6)	5 years	5 years	None	25%	None	10%	None	(3)
Medium Term Notes/Bonds (6)	5 years	5 years	30%	30%	None	10%	A	A
Municipal Securities of California Local Agencies (6)	5 years	5 years	None	20%	None	10%	None	A
Mutual Funds	N/A	N/A	20%	5%	10%	None	AAA	AAA
Notes, Bonds, or Other Obligations	5 years	5 years	None	None	None	None	None	AA
Mortgage Pass-Through Securities	5 years	5 years	20%	20%	None	None	AA	AAA
Financial Futures (5)	N/A	None	None	None	None	None	None	None

Footnotes:

- (1) In the absence of a specified maximum, the maximum is 5 years.
- (2) No more than one-third of the cost value of the total portfolio at time of purchase can be invested in the unsecured debt of any one agency.
- (3) Credit and maturity criteria must be in accordance per Section X of the City's Investment Policy.
- (4) Maximum % of portfolio for Reverse Repurchase Agreements is 20% of base value.
- (5) Financial futures transactions would be purchased only to hedge against changes in market conditions for the reinvestment of bond proceeds.
- (6) Investment types with a 10% maximum with one issuer are further restricted per the City's Investment Policy: 5% per issuer and an additional 5% with authorization by City Treasurer.

According to the Policy, the City may enter into repurchase and reverse repurchase agreements only with primary dealers of the Federal Reserve Bank of New York with which the City has entered into a master repurchase agreement.

Additionally, the Policy authorizes investment in other specific types of securities. The City may invest in floating rate notes with coupon resets based upon a single fixed income index (which would be representative of an eligible investment), provided that security is not leveraged. Structured notes issued by U.S. government agencies that contain imbedded calls or options are authorized as long as those securities are not inverse floaters, range notes, or interest only strips derived from a pool of mortgages. A maximum of 8% of the "cost value" of the pooled portfolio may be invested in structured notes.

In fiscal year 2009, the City invested \$15 million as part of the Certificate of Deposit Account Registry Service (CDARS). The CDARS investment was deposited with two institutions, \$5 million with Neighborhood National Bank and \$10 million with First Business Bank. Under the City Treasurer's Investment Policy, this type of investment is subject to a 1% limit of total portfolio value for the City's pooled investments. The CDARS investment program is permissible per California Government Code (CGC) Section 53601.8 and is subject to a 30% limit of total portfolio value.

Ineligible investments prohibited from use in the portfolio include, but are not limited to, common stocks and long-term corporate notes/bonds. A copy of the City Treasurer's Investment Policy can be requested from the City Treasurer, 1200 3rd Avenue, Suite 100, San Diego, CA 92101.

Other Investment Policies

The City currently has a Funds Commission whose role is to supervise and control all trust, perpetuity, and investment funds of the City and such pension funds as shall be placed in its custody. The statutory authority for the Funds Commission is created in City Charter Article V, Section 41(a). While the duties described in the creation document form broad authority for the Funds Commission, in practice, the Funds Commission only oversees investments related to a small number of permanent endowments. The allowable investments for these funds are different than those as prescribed in the City Treasurer's Investment Policy. Each permanent endowment fund has its own separate investment policy. Copies of the individual investment policies can be requested from the City Treasurer, 1200 3rd Avenue, Suite 100, San Diego, CA 92101.

The City and its component units have funds invested in accordance with various bond indenture and trustee agreements. The investment of these bond issuances is in accordance with the Permitted Investments section and applicable account restrictions outlined in the Indenture of each bond issuance. The Permitted Investments section in each Indenture will vary based upon the maturity, cash flow demands, and reserve requirements associated with each issuance. In general, the Permitted Investments section of each Indenture will closely resemble the City Treasurer's Investment Policy, but may include certain investment options not authorized by applicable law for the City Treasurer's Investment Policy (CGC §53601). Copies of the individual bond indentures can be requested from the City Treasurer's Investment Division, 1200 3rd Avenue, Suite 1624, San Diego, CA 92101.

City of San Diego – Disclosures for Specific Risks

e. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Market or interest-rate risk for the City's pooled investments is intended to be mitigated by establishing two portfolios, a liquidity portfolio and a core portfolio. Target durations are based upon the expected short and long-term cash needs of the City. The liquidity portfolio is structured with an adequate mix of highly liquid securities and maturities to meet major cash outflow requirements for at least six months (per CGC Section 53646). The liquidity portfolio uses the Merrill Lynch 3-6 month Treasury Index as a benchmark with a duration of plus or minus 40% of the duration of that benchmark.

The core portfolio uses the Merrill Lynch 1-3 year Treasury Index as a benchmark with a duration of plus or minus 20% of the duration of that benchmark. It consists of high quality liquid securities with a maximum maturity of 5 years and is structured to meet the longer-term cash needs of the City. Information about the sensitivity of the fair value of the City's investments to market interest rate fluctuations is presented in the table below.

As of June 30, 2009, the City's investments (in thousands) by maturity are as follows:

	Years				Fair Value (In Thousands)
	Under 1	1-3	3-5	Over 5	
<u>Pooled Investments with City Treasurer:</u>					
U.S. Treasury Bills	\$ 190,408	\$ -	\$ -	\$ -	\$ 190,408
U.S. Treasury Notes	163,352	802,673	-	-	966,025
U.S. Agencies - Federal Farm Credit Bank	45,014	30,631	-	-	75,645
U.S. Agencies - Federal Home Loan Bank	170,603	111,858	-	-	282,461
U.S. Agencies - Federal Home Loan Mortgage Corporation	59,997	65,361	-	-	125,358
U.S. Agencies - Federal National Mortgage Association	40,000	124,594	-	-	164,594
Commercial Paper	119,949	-	-	-	119,949
Corporate Notes	12,073	139,759	-	-	151,832
Non-Negotiable Certificate of Deposit (CDARS deposit)	15,000	-	-	-	15,000
Repurchase Agreement	11,388	-	-	-	11,388
State Local Agency Investment Fund	39,718	-	-	-	39,718
	<u>867,502</u>	<u>1,274,876</u>	<u>-</u>	<u>-</u>	<u>2,142,378</u>
<u>Non-Pooled Investments with City Treasurer:</u>					
U.S. Treasury Bills	118,574	-	-	-	118,574
U.S. Treasury Notes	11,059	2,756	-	-	13,815
U.S. Agencies - Federal Farm Credit Bank	-	11,186	-	-	11,186
U.S. Agencies - Federal Home Loan Bank	15,031	-	-	-	15,031
U.S. Agencies - Federal Home Loan Mortgage Corporation	37,221	-	-	-	37,221
U.S. Agencies - Federal National Mortgage Association	18,200	10,253	-	-	28,453
Commercial Paper	165,146	-	-	-	165,146
Repurchase Agreements	122,812	-	-	-	122,812
	<u>488,043</u>	<u>24,195</u>	<u>-</u>	<u>-</u>	<u>512,238</u>
<u>Investments with Fiscal Agents, Funds Commission, and Blended Component Units:</u>					
U.S. Treasury Bills	23,595	-	-	-	23,595
U.S. Treasury Bonds and Notes	8,894	38,440	-	425	47,759
U.S. Agencies - Federal Home Loan Bank	94,146	-	-	-	94,146
U.S. Agencies - Federal Home Loan Mortgage Corporation	45,773	-	-	-	45,773
U.S. Agencies - Federal National Mortgage Association	23,077	-	-	-	23,077
Commercial Paper	6,054	-	-	-	6,054
Common Stock	2,429	-	-	-	2,429
Corporate Bonds and Notes	124	1,001	538	3,192	4,855
Guaranteed Investment Contracts	-	-	-	13,716	13,716
Money Market Mutual Funds	78,977	-	-	-	78,977
Mortgage Backed Securities - Commercial	-	-	-	89	89
Mortgage Backed Securities - Government	-	-	-	31	31
Mutual Funds - Equity	279,612	-	-	-	279,612
Mutual Funds - Fixed Income	-	-	396,244	1,537	397,781
Cash (with Fiscal Agents)	26	-	-	-	26
	<u>562,707</u>	<u>39,441</u>	<u>396,782</u>	<u>18,990</u>	<u>1,017,920</u>
Total Investments	<u>\$ 1,918,252</u>	<u>\$ 1,338,512</u>	<u>\$ 396,782</u>	<u>\$ 18,990</u>	3,672,536
Total Deposits					13,375
Total Cash on Hand					206
Total Investments, Deposits, and Cash on Hand (Includes SDCERS Pooled Cash and Investments with the City - \$3,199)					<u>\$ 3,686,117</u>

f. Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. As of June 30, 2009, the City's investments and corresponding credit ratings are as follows:

<u>Pooled Investments with City Treasurer:</u>	<u>Moody's</u>	<u>S&P</u>	<u>Fair Value</u>	<u>Percentage</u>
U.S. Treasury Bills	Exempt	Exempt	\$ 190,408	8.89%
U.S. Treasury Notes	Exempt	Exempt	966,025	45.10%
U.S. Agencies - Federal Farm Credit Bank	Aaa	N/A	75,645	3.53%
U.S. Agencies - Federal Home Loan Bank ¹	Aaa	N/A	262,517	12.25%
U.S. Agencies - Federal Home Loan Bank ¹	P-1	N/A	19,944	0.93%
U.S. Agencies - Federal Home Loan Mortgage Corporation ¹	Aaa	N/A	70,413	3.29%
U.S. Agencies - Federal Home Loan Mortgage Corporation ¹	P-1	N/A	54,945	2.56%
U.S. Agencies - Federal National Mortgage Association ¹	Aaa	N/A	124,594	5.82%
U.S. Agencies - Federal National Mortgage Association ¹	P-1	N/A	40,000	1.87%
Commercial Paper	P-1	N/A	119,949	5.60%
Corporate Notes	Aaa	N/A	123,055	5.74%
Corporate Notes	Aa1	N/A	5,157	0.24%
Corporate Notes	Aa2	N/A	12,073	0.56%
Corporate Notes	A1	N/A	10,544	0.49%
Corporate Notes	A2	N/A	1,003	0.05%
Non-Negotiable Certificates of Deposit (CDARS deposit)	Not Rated	Not Rated	15,000	0.70%
Repurchase Agreements	Not Rated	Not Rated	11,388	0.53%
State Local Agency Investment Fund	Not Rated	Not Rated	39,718	1.85%
Subtotal - Pooled Investments			<u>2,142,378</u>	<u>100.00%</u>
<u>Non-Pooled Investments with City Treasurer:</u>				
U.S. Treasury Bills	Exempt	Exempt	118,574	23.15%
U.S. Treasury Notes	Exempt	Exempt	13,815	2.70%
U.S. Agencies - Federal Farm Credit Bank	Aaa	N/A	11,186	2.18%
U.S. Agencies - Federal Home Loan Bank	P-1	N/A	15,031	2.93%
U.S. Agencies - Federal Home Loan Mortgage Corporation ¹	Aaa	N/A	12,938	2.53%
U.S. Agencies - Federal Home Loan Mortgage Corporation ¹	P-1	N/A	24,283	4.75%
U.S. Agencies - Federal National Mortgage Association ¹	Aaa	N/A	10,253	1.99%
U.S. Agencies - Federal National Mortgage Association ¹	P-1	N/A	18,200	3.55%
Commercial Paper	P-1	N/A	165,146	32.24%
Repurchase Agreements	Not Rated	Not Rated	122,812	23.98%
Subtotal - Non-Pooled Investments			<u>512,238</u>	<u>100.00%</u>

"Exempt" - Per GASB 40, U.S. Treasury Obligations do not require disclosure of credit quality.

"N/A" - S&P rating not applicable, Moody's rating provided.

¹ More than 5% of total investments are with U.S. Agencies whose debt is not backed by full faith and credit of the U.S. Government.

(continued on next page)

<u>Investments with Fiscal Agents, Funds Commission, and Blended Component Units:</u>	<u>Moody's</u>	<u>S&P</u>	<u>Fair Value</u>	<u>Percentage</u>
U.S. Treasury Bills	Exempt	Exempt	\$ 23,595	2.32%
U.S. Treasury Bonds and Notes	Exempt	Exempt	47,759	4.69%
U.S. Agencies - Federal Home Loan Bank ¹	Aaa	N/A	42,977	4.22%
U.S. Agencies - Federal Home Loan Bank ¹	P-1	N/A	51,169	5.03%
U.S. Agencies - Federal Home Loan Mortgage Corporation	P-1	N/A	45,773	4.50%
U.S. Agencies - Federal National Mortgage Association	Aaa	N/A	83	0.01%
U.S. Agencies - Federal National Mortgage Association	P-1	N/A	22,994	2.26%
Commercial Paper	P-1	N/A	6,054	0.59%
Common Stock	Not Rated	Not Rated	2,429	0.24%
Corporate Bonds and Notes	Aa2	N/A	483	0.05%
Corporate Bonds and Notes	Aa3	N/A	169	0.02%
Corporate Bonds and Notes	A1	N/A	954	0.09%
Corporate Bonds and Notes	A2	N/A	2,617	0.26%
Corporate Bonds and Notes	A3	N/A	301	0.03%
Corporate Bonds and Notes	Baa1	N/A	229	0.02%
Corporate Bonds and Notes	Baa2	N/A	102	0.01%
Guaranteed Investment Contracts	Not Rated	Not Rated	13,716	1.35%
Money Market Mutual Funds	Aaa	N/A	78,977	7.76%
Mortgage Backed Securities - Commercial	Aaa	N/A	89	0.01%
Mortgage Backed Securities - Government	Not Rated	Not Rated	31	0.01%
Mutual Funds - Equity	Not Rated	Not Rated	279,612	27.47%
Mutual Funds - Fixed Income	Not Rated	Not Rated	397,781	39.05%
Cash (with Fiscal Agents)	Not Rated	Not Rated	26	0.01%
Subtotal - Other Investments			<u>1,017,920</u>	<u>100.00%</u>
Total Investments			3,672,536	
Total Deposits			13,375	
Total Cash on Hand			206	
Total Investments, Deposits, and Cash on Hand*			<u>\$ 3,686,117</u>	

*(includes SDCERS Pooled Cash and Investments with the City - \$3,199)

"Exempt" - Per GASB 40, US Treasury Obligations do not require disclosure of credit quality.

"N/A" - S&P rating not applicable, Moody's rating provided.

¹ More than 5% of total investments are with U.S. Agencies whose debt is not backed by full faith and credit of the U.S. Government.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the relative size of an investment in a single issuer. As of June 30, 2009, the City exceeded the 5% limit of total investments for issuers of various U.S. Agencies. Investments exceeding the 5% limit are referenced in the credit ratings table above. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are exempt.

g. Custodial Credit Risk*Deposits*

At June 30, 2009, the carrying amount of the City's cash deposits was approximately \$18,170, and the bank balance was approximately \$35,849, the difference of which is substantially due to outstanding checks. For the balance of cash deposits in financial institutions, approximately \$16,008 was covered by federal depository insurance and approximately \$19,841 was uninsured. Pursuant to the California Government Code, California banks and savings and loan associations are required to secure the City's deposits not covered by federal depository insurance by pledging government securities as collateral. As such, \$18,793 of the City's deposits are pledged at 110% and held by a bank acting as the City's agent, in the City's name. The City is exposed to custodial credit risk for the remaining \$1,048, which is uninsured and uncollateralized. The amount subject to custodial credit risk includes approximately \$1,048 in deposits relating to San Diego Data Processing Corporation.

The City also has deposits held in escrow accounts with a carrying amount and bank balance of approximately \$10,205. For the balance of deposits in escrow accounts, approximately \$1,851 was covered by federal depository insurance. The remaining balance of \$8,354 was uninsured. Pursuant to the California Government Code, California banks and savings and loans associations are required to secure the City's deposits in excess of insurance by pledging government securities as collateral. As such, \$8,354 of the City's deposits in escrow accounts are collateralized and pledged at 110%.

Investments

The City's investments at June 30, 2009 are categorized as described below:

- Category 1: Insured or registered, with securities held by the City or its agent in the City's name.
- Category 2: Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the City's name.
- Category 3: Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the City's name.
- Non-Categorized: Includes investments made directly with another party, real estate, direct investments in mortgages and other loans, open-end mutual funds, pools managed by other governments, annuity contracts, and guaranteed investment contracts.

At June 30, 2009, the City had investments exposed to custodial credit risk. Investments within the Cemetery Perpetuity Fund's portfolio were held by Northern Trust Bank, and were not in the City's name. The following summarizes the investment types and amounts that are exposed to custodial credit risk and are classified as Category 3:

<u>Investment Type</u>	<u>Fair Value</u>
U.S. Treasury Bonds and Notes	\$ 494
U.S. Agencies	83
Corporate Bonds and Notes	4,855
Mortgage Backed Securities - Commercial	89
Mortgage Backed Securities - Government	31
Common Stock	2,429
Total	<u>\$ 7,981</u>

h. Restricted Cash and Investments

Cash and investments at June 30, 2009 that are restricted by legal or contractual requirements are comprised of the following:

<u>Nonmajor Governmental Funds</u>	
Reserved for Debt Service	\$ 415,680
Permanent Endowments	15,867
Total Nonmajor Governmental Funds	<u>431,547</u>
<u>Nonmajor Enterprise Funds</u>	
Environmental Services Fund -Funds set aside for landfill site closure and maintenance costs	37,983
Recycling Enterprise Fund - Customer deposits	2,569
Total Nonmajor Enterprise Funds	<u>40,552</u>
<u>Water Utility Enterprise Fund</u>	
Customer deposits	7,317
Interest and redemption funds	256,566
Total Water Utility Enterprise Fund	<u>263,883</u>
<u>Sewer Utility Enterprise Fund</u>	
Interest and redemption funds	231,212
<u>Miscellaneous Agency Funds</u>	
Retention held in escrow	10,205
Total Restricted Cash and Investments	<u>\$ 977,399</u>

Summary of Total Cash and Investments
(In Thousands)

Total Unrestricted Cash and Investments	\$ 6,923,674
Total Restricted Cash and Investments	977,399
Total Cash and Investments	<u>\$ 7,901,073</u>
Total Governmental Activities	\$ 1,752,138
Total Business-Type Activities	1,211,320
Total Fiduciary Activities	4,937,615
Total Cash and Investments	<u>\$ 7,901,073</u>

San Diego City Employees' Retirement System (SDCERS) – Disclosures for Policy and Specific Risks

Summary of Cash and Investments – San Diego City Employees' Retirement System

Cash or Equity in Pooled Cash and Investments with the City of San Diego	\$ 3,199
Cash and Cash Equivalents on Deposit with Custodial Bank and Fiscal Agents	371,736
Investments at Fair Value:	
Short-Term Investments	33,311
Domestic Fixed Income Securities	861,555
International Fixed Income Securities	143,677
Domestic Equity Securities	1,444,848
International Equity Securities	614,246
Directly Owned Real Estate Assets and Real Estate Equity Securities	350,498
Securities Lending Collateral	<u>395,085</u>
Total Cash and Investments for SDCERS	<u><u>\$ 4,218,155</u></u>

Narratives and tables presented in the following sections (i. through r.) are taken directly from the comprehensive annual financial report of the San Diego City Employees' Retirement System, as of June 30, 2009, issued December 8, 2009.

i. Investment Policy

Investments for the pension trust fund are authorized to be made by the Board of Administration of the SDCERS (Board) in accordance with Section 144 of the City Charter and the California State Constitution Article XVI, Section 17. The Board is authorized to invest in any securities that are allowed by general law for savings banks. The Board may also invest in additional investments as approved by resolution of the San Diego City Council. These investments include, but are not limited to, bonds, notes and other obligations, real estate investments, common stock, preferred stock, and pooled vehicles. Additionally, investment policies permit SDCERS' Board to invest in financial futures contracts provided the contracts do not leverage SDCERS' Trust Fund portfolio. Financial futures contracts are recorded at fair value each day and must be settled at expiration date. Changes in the fair value of the contracts will result in the recognition of a gain or loss under GASB Statement No. 25.

Investment earnings from the pension trust fund are accounted for in accordance with GASB Statement No. 25. Net investment income includes the net appreciation/depreciation in the fair value of investments, interest income, dividend income, and other income not included in the change in the fair value of investments, less total investment expenses (including investment management/custodial fees and all other significant investment-related costs). SDCERS had realized losses that totaled \$314,900 for the year ended June 30, 2009. Pursuant to the San Diego Municipal Code, realized gains and losses determine whether contingent benefits will be paid each fiscal year.

SDCERS' investment portfolio includes fixed income strategies to diversify the investment portfolio. The percentage allocated to these strategies is based on efficient model portfolios developed from an annual asset allocation study. The returns of fixed income strategies are in general more consistent than equity returns. SDCERS' target asset allocation policy is reviewed annually to reflect changes in capital market assumptions. As of June 30, 2009, SDCERS' target allocation to fixed income strategies was 29%. The fixed income allocation is externally managed and is comprised as follows: 22% to core-plus domestic fixed income (benchmarked to the Barclays Capital Aggregate Bond Index), 4% to non-U.S. fixed income (benchmarked to the Citigroup Non-U.S. Government Bond Index), and 3% to convertible bond securities (benchmarked to the Merrill Lynch Convertible Index, All Qualities).

SDCERS also has a 5% target allocation to an unsecuritized market neutral strategy which is benchmarked to the Merrill Lynch 1-5 year Government/Corporate Index. The market neutral and convertible bond strategies are

intended to minimize interest rate risk, and duration is not relevant in structuring these portfolios. Convertible securities diversify SDCERS' fixed income portfolio and are expected to provide a higher rate of return than traditional fixed income strategies due to their conversion feature. SDCERS' market neutral strategy was added to SDCERS' fixed income strategy in 1998. This strategy uses equity securities held long and sold short with the cash proceeds of the short sales held in a cash account invested in U.S. Government Federal Funds. Both market neutral strategies have a low correlation to fixed income assets and provide additional diversification to the portfolio's fixed income allocation.

A copy of the SDCERS investment policy and additional details on the results of the system's investment activities are available at 401 West A Street, Suite 400, San Diego, CA 92101.

j. Interest Rate Risk

SDCERS does not have a general investment policy that addresses interest rate risk. Each investment manager's specific investment guidelines places limits on each portfolio to manage interest rate risk. SDCERS uses duration to measure how changes in interest rates will affect the value of its fixed income portfolios. Convertible bonds are typically not subject to interest rate risk as convertible bonds are usually positively correlated to interest rate movements compared to other fixed income securities.

The following table displays the durations for SDCERS' domestic and international fixed income strategies based on portfolio holdings as of June 30, 2009.

**Fixed Income Portfolios (Domestic and International)
Portfolio Duration Analysis as of June 30, 2009**

Type of Security	Effective Duration (in years)	Fair Value ¹ (in thousands)
<u>Collateralized Mortgage Obligations</u>		
Collateralized Mortgage Obligations	7.65	\$ 104,265
<u>Corporates</u>		
Corporate Bonds	4.07	267,080
<u>Government & Agency Obligations</u>		
FHLMC	3.52	61,308
FNMA	2.80	282,624
GNMA I	5.07	15,006
GNMA II	1.29	954
Treasury Strips	18.90	1,762
Government Issues	5.64	118,705
Municipals	11.71	5,545
<u>Asset-Backed Securities</u>		
Other Asset-Backed Securities	1.13	44,281
Total		\$ 901,530

¹ Fair Value does not include convertible bonds, short-term investments, and derivative securities of \$137,013. These securities do not exhibit interest rate risk and duration cannot be calculated.

Source: SDCERS' CAFR as of June 30, 2009

k. Investments Highly Sensitive to Interest Rate Changes

Certain terms in fixed income securities may increase the sensitivity of their fair values to changes in interest rates. The Portfolio Duration Analysis table on the previous page discloses the degree to which SDCERS' investments are sensitive to interest rate changes due to the remaining term of maturity. The total value of securities, as of June 30, 2009, that are highly sensitive to interest rate changes due to factors other than term to maturity are presented in the table below.

	Fair Value (in thousands)	Percent of Fixed Income Portfolio
Adjustable Rate Notes	\$ 11,133	1.1%
Asset Backed Securities	27,238	2.6%
Floating Rate Notes	66,237	6.4%
Interest Only Strips	1,713	0.2%
Inverse Floating Rate Notes	2,970	0.3%
Range Notes	2,626	0.3%

Source: SDCERS' CAFR as of June 30, 2009

Although SDCERS does not have an investment policy that pertains directly to investments that are highly sensitive to interest changes, this risk is mitigated by diversification of issuer, credit quality, maturity, and security selection.

l. Credit Risk

SDCERS employs two core-plus bond managers that invest in a wide variety of fixed income and derivative securities. One of SDCERS' domestic core-plus fixed income managers has tactical discretion to invest in non-U.S. fixed income securities while the other domestic core-plus fixed income manager is limited to U.S. fixed income investments only. The permitted securities and derivatives for the two domestic core-plus fixed income managers include U.S. Government and Agency obligations, collateralized mortgage obligations, U.S. corporate securities, and asset backed securities. Investment guidelines include minimum average portfolio quality of A rating (market value rated); and minimum credit quality at time of purchase of 80% Baa/BBB and 20% B for a domestic core-plus fixed manager; and Ba/BB for core-plus fixed income manager with tactical discretion to invest in non-U.S. fixed income strategies.

The permitted securities for SDCERS' domestic convertible bond portfolio include convertible bonds, convertible preferred stocks, common stocks, and straight debt and synthetic convertibles. SDCERS' domestic convertible bond portfolio will generally maintain an average rating of at least BB+.

The permitted securities for SDCERS' international fixed income portfolio include international corporate securities, sovereign debt instruments, and international asset backed securities. SDCERS' international fixed income portfolio has the following credit and market risk parameters: minimum average portfolio quality of A rating (market value weighted); and a minimum credit quality at time of purchase of BBB- or equivalent rating by at least one of the major rating agencies.

The table on the following page identifies the credit quality for SDCERS' fixed income strategies based on portfolio holdings as of June 30, 2009.

**Credit Quality of SDCERS'
Fixed Income Strategies (Domestic and International)
As of June 30, 2009**

S&P Quality Rating	Total Fair Value (in thousands)	Collateralized Mortgage Obligations	Corporates ¹	Government & Agency Obligations ²	Asset-Backed Securities	Short-Term/ Other
U.S. Treasury	\$ 22,140	\$ -	\$ -	\$ 22,140	\$ -	\$ -
AAA	567,928	83,537	29,611	432,671	22,109	-
AA+	25,931	-	10,046	10,926	4,959	-
AA	28,308	-	19,450	8,121	737	-
AA-	15,950	-	15,950	-	-	-
A+	41,504	-	26,692	2,212	-	12,600
A	58,648	313	57,678	657	-	-
A-	21,786	-	21,786	-	-	-
BBB+	14,733	-	13,581	253	899	-
BBB	10,125	-	4,958	1,384	3,783	-
BBB-	16,460	73	11,896	492	3,999	-
BB+	1,484	528	956	-	-	-
BB	5,529	1,485	4,044	-	-	-
BB-	5,152	1,864	2,143	197	948	-
B+	2,066	-	2,066	-	-	-
B	4,247	-	2,923	-	1,324	-
CCC+	1,849	-	1,849	-	-	-
CCC	2,496	1,541	955	-	-	-
CC	6,239	-	6,239	-	-	-
NR	185,968	14,924	138,737	6,851	5,523	19,933
Totals	<u>\$ 1,038,543</u>	<u>\$ 104,265</u>	<u>\$ 371,560</u>	<u>\$ 485,904</u>	<u>\$ 44,281</u>	<u>\$ 32,533</u>

¹ Corporates include convertible bonds from SDCERS' convertible bond manager.

² Includes municipal holdings as well.

Source: SDCERS' CAFR as of June 30, 2009

m. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the relative size of an investment in a single issuer. As of June 30, 2009, SDCERS had no single issuer that exceeded 5% of total investments, excluding investments issued or explicitly guaranteed by the U.S. Government and investments in mutual funds, external investment pools, and other pooled investments. With respect to the concentration of credit risk by issue, SDCERS' Investment Policy states that not more than 10% of the fixed income portfolio shall be invested in the debt security of any one issue at the time of initial commitment, except for U.S. Government and Agency obligations. While SDCERS does not have a general investment policy on the concentration of credit risk by issuer, each manager's specific investment guidelines place limitations on the maximum holdings in any one issuer.

n. Custodial Credit Risk

Custodial credit risk is the risk that if a financial institution or counterparty fails, SDCERS would not be able to recover the value of its deposits, investments, or securities. SDCERS' exposure to custodial credit risk is further discussed in the following paragraphs.

Deposits

SDCERS' is exposed to custodial credit risk for uncollateralized cash/deposits that are not covered by federal depository insurance. At June 30, 2009, the amount of cash/deposits on deposit with SDCERS' custodial bank totaled \$184,200.

Investments

As of June 30, 2009, 100% of SDCERS' investments were held in SDCERS' name. SDCERS is not exposed to custodial credit risk related to these investments.

Securities Lending Collateral

SDCERS is exposed to custodial credit risk for the securities lending collateral such that certain collateral is received in the form of letters of credit, tri-party collateral or securities collateral. The fair value of securities on loan collateralized by these non-cash vehicles totaled \$35,000 as of June 30, 2009 and are at risk as the collateral for these loaned securities is not held in SDCERS' name and cannot be sold without a borrower default. The cash collateral held by SDCERS' custodian in conjunction with the securities lending program, which totaled \$395,085 as of June 30, 2009, is also at risk as it is invested in a pooled vehicle managed by the custodian. The investment characteristics of the collateral pool are disclosed in the Securities Lending Collateral section.

o. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The following table represents SDCERS' securities (in thousands) held in a foreign currency as of June 30, 2009.

Foreign Currency Risk ¹
As of June 30, 2009
(All values are in U.S. Dollars)

<u>Local Currency Name</u>	<u>Cash</u>	<u>Equity</u>	<u>Fixed income</u>	<u>Total</u>
Australian Dollar	\$ 689	\$ 17,271	\$ 11,717	\$ 29,677
Brazilian Real	-	6,700	-	6,700
Canadian Dollar	97	11,312	2,570	13,979
Swiss Franc	4	34,855	-	34,859
Danish Krone	4	4,707	14,785	19,496
Euro Currency	989	162,934	69,880	233,803
Pound Sterling	356	116,202	3,647	120,205
Hong Kong Dollar	212	48,001	-	48,213
Indonesian Rupiah	-	1,153	-	1,153
Japanese Yen	1,588	124,209	39,826	165,623
South Korean Won	1	729	-	730
Norwegian Krone	128	121	-	249
New Zealand Dollar	-	605	-	605
Philippine Peso	-	140	-	140
Swedish Krona	103	7,357	4,437	11,897
Singapore Dollar	5	6,953	-	6,958
Taiwan Dollar	37	3,360	-	3,397
South African Rand	-	2,093	-	2,093
Totals	\$ 4,213	\$ 548,702	\$ 146,862	\$ 699,777

¹ The foreign exchange exposure in SDCERS' international equity small cap value portfolio (an institutional mutual fund investment) is not included in this disclosure.

Source: SDCERS' CAFR as of June 30, 2009

Foreign currency is comprised of international investment proceeds and income to be repatriated into U.S. dollars and funds available to purchase international securities. Foreign currency is not held by SDCERS as an investment. Foreign currency is held temporarily in foreign accounts until it is able to be repatriated or expended to settle trades. A significant component of the diversification benefit of non-domestic investments comes from foreign currency exposure. As such, SDCERS does not have a policy to hedge against fluctuations in foreign exchange rates. SDCERS' investment managers may hedge currencies at their discretion pursuant to specific guidelines included in their investment management agreements.

p. Derivative Instruments

SDCERS' investment managers, as permitted by specific investment guidelines, may enter into transactions involving derivative financial instruments, consistent with the objectives established by the Board's Investment Policy Statement. These instruments include futures, options and swaps. By Board policy these investment vehicles may not be used to leverage SDCERS' portfolio. These instruments are used primarily to enhance a portfolio's performance and to reduce its risk or volatility. The notional or contractual amount (in thousands) of

futures contracts as of June 30, 2009 was \$350,600. The fair value (in thousands) of options and swaps included in the short-term investments line on the SDCERS Statement of Plan Net Assets was \$7,900 as of June 30, 2009.

Futures contracts are contracts in which the buyer agrees to purchase and the seller agrees to make delivery on a specific financial instrument on a predetermined date and price. Gains and losses on futures contracts are settled daily based on a notional principal value and do not involve an actual transfer of the specific instrument. Futures contracts are standardized and are traded on exchanges. The exchange assumes the risk that counterparty will not pay and generally requires margin payments to minimize such risk.

Option contracts provide the option purchaser with the right, but not the obligation, to buy or sell the underlying security at a set price during a period or at a specified date. The option writer is obligated to buy or sell the underlying security if the option purchaser chooses to exercise the option. SDCERS uses exchange-traded and over-the-counter options. Options are sold and proceeds are received to enhance fixed income portfolio performance. Option contracts sold were predominantly on money market and short-term instruments of less than one-year to maturity. In call option contracts, if interest rates remained steady or declined during the option contract periods, the contracts would expire unexercised. By contrast, in put option contracts, if interest rates rose sufficiently to result in the purchase of the securities on or before the end of the option periods, this would occur at prices attractive to the portfolio manager.

Swap agreements are used to modify investment returns or interest rates on investments. Swap transactions involve the exchange of investment returns or interest rate payments without the exchange of the underlying principal amounts. These swaps could expose investors entering into these types of arrangements to credit risk in the event of non-performance by counterparties.

In January 2009, SDCERS implemented a cash overlay program with the objective of keeping the portfolio performing more closely to its target asset allocations. SDCERS does not have an allocation to cash, but the portfolio will have cash balances held at the investment manager level to settle trades. The overlay program utilizes futures contracts as an inexpensive, highly liquid method of maintaining the portfolio's exposures to the target allocation.

q. Real Estate

SDCERS' target allocation to real estate is 11%. SDCERS' Board established the following portfolio composition target: a minimum of 30% in stable core real estate and a maximum of 70% to enhanced, high return and opportunistic real estate opportunities. No more than 40% of SDCERS' real estate portfolio is allocated to non-U.S. real estate investment opportunities pursuant to a policy adopted by the Board in FY 2007. As of June 30, 2009, unfunded capital commitments totaled \$111,300 and real estate investments totaled \$350,498.

r. Securities Lending Collateral

SDCERS has entered into an agreement with its custodial bank, State Street, to lend domestic and international equity and fixed income securities to broker-dealers and banks in exchange for pledged collateral that will be returned for the same securities plus a fee in the future. All securities loans can be terminated on demand by either the lender or the borrower.

State Street manages the securities lending program and receives cash and/or securities as collateral. Borrowers are required to deliver collateral equal to 102% of the market value of domestic securities on loan and 105% of the market value of international securities on loan. State Street does not have the ability to pledge or sell collateral securities delivered absent a borrower default.

SDCERS had no credit risk exposure to borrowers because the amounts provided to State Street on behalf of SDCERS, in the form of collateral plus accrued interest, exceeded the amounts broker-dealers and banks owed to the State Street on behalf of SDCERS for securities borrowed. State Street has indemnified SDCERS by agreeing to purchase replacement securities or return cash collateral in the event a borrower fails to return or pay distributions on a loaned security. SDCERS incurred no losses during the fiscal year resulting from a default of

the borrowers or State Street. Non-cash collateral (securities and letters of credit) cannot be pledged or sold without a borrower default and are therefore not reported as an asset of SDCERS for financial reporting purposes.

Despite lending securities on a fully collateralized basis, SDCERS may encounter various risks related to securities lending agreements. These risks include operational risk, borrower or counterparty default risk, and collateral reinvestment risk. During the fiscal year, the two collateral pools that SDCERS was invested in and managed by State Street were impacted by market events and the credit crunch. Market values of securities held in collateral pools declined as liquidity evaporated. However, SDCERS' investments in the collateral pools did not realize any losses. State Street is required to maintain its securities lending program in compliance with applicable laws of the United States and all countries in which lending activities take place, and all rules, regulations, and exemptions from time to time promulgated and issued under the authority of those laws.

The SDCERS securities lending transactions, collateralized by cash as of June 30, 2009 had a fair value of \$382,500 and a collateral value of \$395,085, which were reported in the assets and liabilities in the accompanying Statements of Plan Net Assets for the Group Trust in accordance with GASB Statement No. 28. As of June 30, 2009, the securities lending transactions collateralized by securities, irrevocable letters of credit, or tri-party collateral had a fair value of \$35,000 and a collateral value of \$36,800, which were not reported in the assets or liabilities in the accompanying Statements of Plan Net Assets for the Group Trust per GASB Statement No. 28. The total collateral pledged to SDCERS at fiscal year end for its securities lending activities was \$395,085.

The cash collateral received on lent securities was invested by State Street, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. Because the securities loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. As of June 30, 2009, the investment pool had an average duration of 42.64 days and an average weighted maturity of 317.62 days for U.S. Dollar (USD) denominated collateral. Beginning in fiscal year 2007, the securities lending program was expanded to allow the acceptance of Euro (EUR) denominated collateral. As of June 30, 2008, the Euro collateral pool had an average duration of 35 days and an average weighted maturity of 508 days.

As of June 30, 2009, SDCERS has lent \$417,500 in securities and received collateral of \$36,759 and \$395,085 in securities and cash, respectively from borrowers. SDCERS' securities lending transactions as of June 30, 2009, are summarized in the following table.

Securities Lending as of June 30, 2009

Security Type	Fair Value of Loaned Securities	Cash Collateral	Fair Value of Securities Collateral
Securities Loaned for Cash Collateral			
US Corporate Bond and Equity (USD)	\$ 255,040	\$ 263,150	\$ -
US Government Agencies (USD)	39,839	40,672	-
Non-US Fixed Income (EUR)	38,307	38,924	-
Non-US Fixed Income (USD)	2,754	2,765	-
Non-US Equity (USD)	46,550	49,574	-
Securities Loaned with Non-Cash Collateral			
US Government Agencies (USD)	11,422	-	11,795
US Corporate Bond and Equity (USD)	124	-	3,011
Non-US Equity (EUR)	-	-	1
Non-US Equity (USD)	23,464	-	21,952
Total	\$ 417,500	\$ 395,085	\$ 36,759

Source: SDCERS' as of June 30, 2009

Discretely Presented Component Units – Disclosures for Policy and Specific Risks

Narratives and tables presented in the following sections (s. through t.) are taken directly from the comprehensive annual financial reports of the San Diego Convention Center Corporation and the San Diego Housing Commission, as of June 30, 2009, respectively.

s. San Diego Convention Center Corporation

Cash deposits and investments for SDCCC were categorized as follows at June 30, 2009:

Cash on hand	\$ 59
Deposits	1,449
Certificates of deposit	1,452
Money market account deposits	1,010
Money market mutual funds	<u>17,786</u>
Total cash and investments	<u>\$ 21,756</u>

Deposits (In Thousands)

On June 30, 2009, the carrying amount of the San Diego Convention Center Corporation's (SDCCC) cash on hand, deposits, certificates of deposit, and money market account deposits was \$3,970 and the bank balance was \$4,029. Of the bank balance, \$2,317 was covered by federal depository insurance. The remaining uninsured balance of \$1,712 was collateralized with the collateral held by an affiliate of the counterparty's financial institution. Neither the money market account deposits nor the certificates of deposit are rated by credit rating agencies. The \$1,452 invested in certificates of deposit bear interest rates from 1.3% to 1.6%, and have maturities of less than one year. SDCCC does not have a formal deposit and investment policy that addresses custodial credit risk.

Investments (In Thousands)

At June 30, 2009, SDCCC had a total investment balance of \$17,786. The total investment balance includes \$17,786 in money market mutual funds. Of the amount invested in money market funds and accounts, \$13,634 was covered by the U.S. Treasury Department's temporary Money Market Fund Guarantee Program. The money market mutual funds are not rated by credit rating agencies. SDCCC does not have a formal deposit and investment policy that addresses credit quality risk and places no limit on the amount that may be invested in any one account or fund. Of the total investments not covered by the Guarantee Program or Federal depository insurance, 16.5% were invested in a Dreyfus money market mutual fund. There were no other investment amounts in any single account or fund that exceeded 5% of total uninsured investments.

t. San Diego Housing Commission

Cash, cash equivalents, and investments at June 30, 2009 consisted of the following:

Deposits	\$ 4,261
Petty cash	12
Certificates of deposit	2,259
Agency Bonds	49,494
Corporate Bonds	7,103
Investment - Other	1
Local agency investment fund	<u>31,328</u>
Total cash and investments	94,458
Restricted cash and cash equivalents	<u>699</u>
Total	<u>\$ 95,157</u>

Deposits (In Thousands)

The carrying amount of the San Diego Housing Commission's (SDHC) deposits and petty cash was \$4,273 and the bank balance was \$4,737 at June 30, 2009. The bank balances were fully insured and/or collateralized with securities held by the pledging financial institutions in SDHC's name. The California Government Code requires California banks and savings and loan associations to secure SDHC's deposits by pledging securities as collateral. This Code states that collateral pledged in this manner shall have the effect of perfecting a security interest in such collateral superior to those of a general creditor. Thus, collateral for cash deposits is considered to be held in SDHC's name.

At June 30, 2009, SDHC had a carrying amount and bank balance of \$2,259 in non-negotiable certificates of deposit. The certificates of deposit were either covered by FDIC insurance or 100% collateralized with securities held by pledging financial institutions.

Investments (In Thousands)

As of June 30, 2009, SDHC's investments included corporate bonds, agency bonds, and California Local Agency Investment Fund (LAIF). SDHC had \$7,103 in corporate bonds, which represent an investment in FDIC-guaranteed floating rate corporate debt securities (floaters) explicitly backed by the U.S. government. Unlike fixed rate instruments, the coupon rate on these floating-rate securities resets every 3 months based on the 90 day London Inter-Bank Offer Rate (LIBOR) index plus a margin or basis points. All of SDHC's corporate bonds were rated AAA by Standard & Poor's as of June 30, 2009.

Agency bonds represent the SDHC's investment in Government-Sponsored Enterprises (GSE) Senior Debt bonds and Mortgage-backed Security (MBS) bonds traded on an active secondary market. As of June 30, 2009, SDHC had \$49,494 invested in these AAA rated securities, with a weighted average maturity of 791 days.

SDHC participates in the Local Agency Investment Fund (LAIF). As of June 30, 2009, SDHC had \$31,328 invested with LAIF. The investment in LAIF represents SDHC's equity in the pooled investments of that fund. The average maturity of LAIF investments was 235 days as of June 30, 2009. LAIF had 14.71% of the pool investment funds in structured notes and asset-backed securities.

Policy

In accordance with state statutes and HUD regulations, SDHC has authorized the CFO or their designee to invest in obligations of the U.S. Treasury, U.S. Government agencies or other investments as outlined in the

Commission Investment Policy. An Investment Committee, consisting of two Commission Board members, monitors the management of funds and compliance with the Commission Investment Policy. There are many factors that can affect the value of investments. Some factors, such as credit risk, custodial risk, concentration of credit risk, and interest rate risk, may affect both equity and fixed income securities. It is the investment policy of SDHC to invest substantially all of its funds in fixed income securities which limits SDHC's exposure to most types of risk.

Interest Rate Risk

In accordance with its investment policy, SDHC manages its interest rate risk by limiting the weighted average maturity of its investment portfolio. This is accomplished by matching portfolio maturities to projected liabilities and by continuously investing a portion of the portfolio in readily available funds to ensure that appropriate liquidity is maintained in order to meet ongoing operations.

Credit Risk

SDHC will minimize credit risk by limiting investments to those listed in the investment policy. In addition, SDHC will pre-qualify the financial institutions, broker/dealers, intermediaries, and advisors with which SDHC will do business in accordance with the investment policy. SDHC will diversify the portion of the investment portfolio not invested in U.S. Treasury Bills, Notes, Bonds, and Collateralized Certificates of Deposit to minimize potential losses from any one type of security or issuer.

Concentration of Credit Risk

Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers. Investments issued or guaranteed by the U.S. government and investments in external investment pools such as LAIF are not considered subject to concentration of credit risk. SDHC may choose to maintain 100% of its investment portfolio in U.S. Treasury Bills, Notes, Bonds, and Collateralized Certificates of Deposit.

Custodial Credit Risk

At June 30, 2009, SDHC did not have any investments exposed to custodial risk. Bonds are purchased through a Merrill Lynch account in SDHC's name. All securities are held in safekeeping by Merrill Lynch and are covered by Securities Investor Protection Corporation (SIPC) and a separate Lloyd's of London policy for a combined aggregate limit of \$600 million.

4. CAPITAL ASSETS (In Thousands)

Capital asset activity for the year ended June 30, 2009 was as follows:

	Primary Government				Ending Balance
	Beginning Balance	Increases	Decreases/ Adjustments	Transfers	
GOVERNMENTAL ACTIVITIES:					
Non-Depreciable Capital Assets:					
Land, Easements, Rights of Way	\$ 1,755,956	\$ 20,081	\$ (6,587)	\$ (482)	\$ 1,768,968
Construction in Progress	165,880	125,367	(4,149)	(94,357)	192,741
Total Non-Depreciable Capital Assets	1,921,836	145,448	(10,736)	(94,839)	1,961,709
Depreciable Capital Assets:					
Structures and Improvements	1,143,383	13,231	(1,426)	14,600	1,169,788
Equipment	367,004	65,087	(64,151)	2,513	370,453
Infrastructure	3,007,785	56,086	(3,066)	79,746	3,140,551
Total Depreciable Capital Assets	4,518,172	134,404	(68,643)	96,859	4,680,792
Less Accumulated Depreciation For:					
Structures and Improvements	(315,471)	(29,158)	1,426	(97)	(343,300)
Equipment	(233,687)	(34,940)	69,863	(2,302)	(201,066)
Infrastructure	(1,555,533)	(87,395)	383	(65)	(1,642,610)
Total Accumulated Depreciation	(2,104,691)	(151,493)	71,672	(2,464)	(2,186,976)
Total Depreciable Capital Assets - Net of Depreciation	2,413,481	(17,089)	3,029	94,395	2,493,816
Governmental Activities Capital Assets, Net	\$ 4,335,317	\$ 128,359	\$ (7,707)	\$ (444)	\$ 4,455,525
BUSINESS-TYPE ACTIVITIES:					
Non-Depreciable Capital Assets:					
Land, Easements, Rights of Way	\$ 89,988	\$ -	\$ (5)	\$ 3,257	\$ 93,240
Construction in Progress	174,065	202,630	(4,772)	(80,640)	291,283
Total Non-Depreciable Capital Assets	264,053	202,630	(4,777)	(77,383)	384,523
Depreciable Capital Assets:					
Structures and Improvements	1,785,713	5,144	(199,367)	18,871	1,610,361
Equipment	342,574	3,100	56,206	2,111	403,991
Distribution & Collection Systems and Other Infrastructure	3,481,401	54,946	119,275	54,381	3,710,003
Total Depreciable Capital Assets	5,609,688	63,190	(23,886)	75,363	5,724,355
Less Accumulated Depreciation For:					
Structures and Improvements	(362,874)	(36,641)	42,954	103	(356,458)
Equipment	(240,505)	(22,918)	14,027	2,296	(247,100)
Distribution & Collection Systems and Other Infrastructure	(635,444)	(62,419)	(40,801)	65	(738,599)
Total Accumulated Depreciation	(1,238,823)	(121,978)	16,180	2,464	(1,342,157)
Total Depreciable Capital Assets - Net of Depreciation	4,370,865	(58,788)	(7,706)	77,827	4,382,198
Business-Type Activities Capital Assets, Net	\$ 4,634,918	\$ 143,842	\$ (12,483)	\$ 444	\$ 4,766,721

Governmental Activities capital assets net of accumulated depreciation at June 30, 2009 are comprised of the following:

General Capital Assets, Net	\$ 4,329,571
Internal Service Funds Capital Assets, Net	125,954
Total	<u>\$ 4,455,525</u>

Business-Type Activities capital assets net of accumulated depreciation at June 30, 2009 are comprised of the following:

Enterprise Funds Capital Assets, Net	<u>\$ 4,766,721</u>
--------------------------------------	---------------------

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental Activities:

General Government and Support	\$ 5,914
Public Safety - Police	4,904
Public Safety - Fire and Life Safety	2,892
Parks, Recreation, Culture and Leisure	35,067
Transportation	73,761
Sanitation and Health	290
Neighborhood Services	<u>2,152</u>
Subtotal	124,980
Internal Service	<u>26,513</u>
Total Depreciation Expense	<u>\$ 151,493</u>

Business-Type Activities:

Airports	\$ 520
City Store	1
Development Services	267
Environmental Services	3,140
Golf Course	817
Recycling	1,052
Sewer Utility	76,554
Water Utility	<u>39,627</u>
Total Depreciation Expense	<u>\$ 121,978</u>

Discretely Presented Component Units

Capital asset activities for the City's Discretely Presented Component Units for the year ended June 30, 2009 are as follows:

	Discretely Presented Component Unit - San Diego Convention Center Corp.			
	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases/ Adjustments</u>	<u>Ending Balance</u>
Depreciable Capital Assets:				
Structures and Improvements	\$ 25,329	\$ 1,097	\$ (160)	\$ 26,266
Equipment	9,317	627	(214)	9,730
Total Depreciable Capital Assets	<u>34,646</u>	<u>1,724</u>	<u>(374)</u>	<u>35,996</u>
Less Accumulated Depreciation For:				
Structures and Improvements	(10,626)	(1,691)	96	(12,221)
Equipment	(6,843)	(735)	207	(7,371)
Total Accumulated Depreciation	<u>(17,469)</u>	<u>(2,426)</u>	<u>303</u>	<u>(19,592)</u>
Capital Assets, Net	<u>\$ 17,177</u>	<u>\$ (702)</u>	<u>\$ (71)</u>	<u>\$ 16,404</u>

	Discretely Presented Component Unit - San Diego Housing Commission			
	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases/ Adjustments</u>	<u>Ending Balance</u>
Non-Depreciable Capital Assets:				
Land, Easements, Rights of Way	\$ 29,544	\$ -	\$ -	\$ 29,544
Construction in Progress	11,720	-	(4,719)	7,001
Total Non-Depreciable Capital Assets	<u>41,264</u>	<u>-</u>	<u>(4,719)</u>	<u>36,545</u>
Depreciable Capital Assets:				
Structures and Improvements	64,273	-	4,499	68,772
Equipment	2,463	162	220	2,845
Total Depreciable Capital Assets	<u>66,736</u>	<u>162</u>	<u>4,719</u>	<u>71,617</u>
Less Accumulated Depreciation For:				
Structures and Improvements	(7,628)	(1,942)	-	(9,570)
Equipment	(939)	(425)	-	(1,364)
Total Accumulated Depreciation	<u>(8,567)</u>	<u>(2,367)</u>	<u>-</u>	<u>(10,934)</u>
Total Depreciable Capital Assets - Net of Depreciation	<u>58,169</u>	<u>(2,205)</u>	<u>4,719</u>	<u>60,683</u>
Capital Assets, Net	<u>\$ 99,433</u>	<u>\$ (2,205)</u>	<u>\$ -</u>	<u>\$ 97,228</u>

5. GOVERNMENTAL ACTIVITIES LONG-TERM LIABILITIES (IN THOUSANDS)

a. Long-Term Liabilities

Governmental long-term liabilities as of June 30, 2009 are comprised of the following:

Type of Obligation	Interest Rates	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2009
Arbitrage Liability				\$ 533
Compensated Absences				74,446
Liability Claims				273,979
Capital Lease Obligations				89,519
<u>Contracts Payable:</u>				
Contract Payable to SDSU Foundation, dated December 1991	variable*	---	\$ 1,598	1,598
Amendment to Contract Payable to SDSU Foundation, dated January 1995	variable*	---	117	117
Contract Payable to Western Pacific Housing, Inc., dated April 2004	5.0%	---	3,000	<u>3,000</u>
Total Contracts Payable				<u>4,715</u>
<u>Notes Payable:</u>				
Note Payable to Price Charities, dated April 2001	5.0	2032	5,115	2,506
Note Payable to Price Charities, dated May 2005	8.0	2025	2,100	2,100
Amendment to Note Payable to Price Charities, dated February 2006	8.0	2025	180	<u>180</u>
Total Notes Payable				<u>4,786</u>
<u>Loans Payable:</u>				
International Gateway Associates, LLC, dated October 2001	10.0	2032	1,876	1,788
PCCP/SB Las America, LLC, dated August 2005	10.0	2036	1,247	1,222
Centerpoint, LLC, dated April 2006	5.5	2021	5,246	4,969
Bank of America, N.A. Line of Credit, dated October 2006	variable*	2009	8,530	8,530
California Housing Finance Agency dated October, 2006	3.0	2017	1,250	1,250
California Energy Resources Conservation and Development Commission, dated January 2007	4.5	2021	302	302
California Energy Resources Conservation and Development Commission, dated March 2007	3.95	2019	2,154	1,760
San Diego National Bank, Line of Credit, dated July 2007 City Heights Housing Area	4.05	2011	1,298	1,298
San Diego National Bank, Line of Credit, dated July 2007 City Heights Non-Housing Area	6.42	2011	2,011	2,011
San Diego National Bank, Line of Credit, dated July 2007 Naval Training Center Housing Area	2.58	2011	2,635	2,635
San Diego National Bank, Line of Credit, dated July 2007 Naval Training Center Non-Housing Area	1.0 - 5.49	2011	6,804	11,100
San Diego National Bank, Line of Credit, dated July 2007 North Bay Housing Area	4.05	2011	2,255	2,255
San Diego National Bank, Line of Credit, dated July 2007 North Park Non-Housing Area	1.42 - 4.05	2011	3,695	<u>5,695</u>
Total Loans Payable				<u>44,815</u>
Section 108 Loans Payable				<u>33,532</u>

<u>Type of Obligation</u>	<u>Interest Rates</u>	<u>Fiscal Year Maturity Date</u>	<u>Original Amount</u>	<u>Balance Outstanding June 30, 2009</u>
General Obligation Bonds:				
Public Safety Communications Project, Series 1991	5.0 - 8.0**	2012	\$ 25,500	\$ 6,315
Total General Obligation Bonds				<u>6,315</u>
Revenue Bonds / Lease Revenue Bonds / COPs:				
MTDB Authority Lease Revenue Refunding Bonds, Series 1994	4.25 - 5.625**	2010	66,570	2,770
Public Facilities Financing Authority Stadium Lease Revenue Bonds, Series 1996 A	6.2 - 7.45**	2027	68,425	56,275
San Diego Facilities and Equipment Leasing Corp. Certificates of Participation, Series 1996 A	4.0 - 5.6**	2011	33,430	6,685
San Diego Facilities and Equipment Leasing Corp. Certificates of Participation Refunding, Series 1996 B	4.0 - 6.0**	2022	11,720	8,050
Convention Center Expansion Financing Authority Lease Revenue Bonds, Series 1998 A	3.8 - 5.25**	2028	205,000	168,065
Centre City Parking Revenue Bonds, Series 1999 A	4.5 - 6.49**	2026	12,105	9,860
Public Facilities Financing Authority Reassessment District Refunding Revenue Bonds, Series 1999 A	2.75 - 4.75**	2018	30,515	11,850
Public Facilities Financing Authority Reassessment District Refunding Revenue Bonds, Series 1999 B	3.5 - 5.10**	2018	7,630	2,930
Public Facilities Financing Authority Fire and Life Safety Lease Revenue Bonds, Series 2002 B	3.55 - 7.0**	2032	25,070	22,280
Centre City Parking Revenue Bonds, Series 2003 B	3.0 - 5.30**	2027	20,515	17,570
MTDB Authority Lease Revenue Refunding Bonds, Series 2003	2.0 - 4.375**	2023	15,255	12,120
San Diego Facilities Equipment Leasing Corp. Certificates of Participation Refunding, Series 2003	1.0 - 4.0**	2024	17,425	8,655
Public Facilities Financing Authority Ballpark Lease Revenue Refunding Bonds, Series 2007 A	5.0 - 5.25**	2032	156,560	149,390
Public Facilities Financing Authority Lease Revenue Bonds, Series 2009 A	variable*	2019	103,000	103,000
Total Revenue Bonds / Lease Revenue Bonds / COPs				<u>579,500</u>
Special Assessment / Special Tax Bonds:				
Otay Mesa Industrial Park Limited Obligation Improvement Bonds, Issued May 1992	5.5 - 7.95**	2013	2,235	250
Miramar Ranch North Special Tax Refunding Bonds, Series 1998	3.75 - 5.375**	2021	59,465	39,650
Santaluz Special Tax Bonds, Improvement Area No.1, Series 2000 A	4.75 - 6.375**	2031	56,020	52,000
Santaluz Special Tax Bonds, Improvement Area No.3, Series 2000 B	4.5 - 6.2**	2031	4,350	4,020
City of San Diego Reassessment District No. 2003-1 Limited Obligation Refunding Bonds	4.25 - 5.8**	2018	8,850	6,210
Piper Ranch Limited Obligation Improvement Bonds, Issued January 2004	2.5 - 6.2**	2034	5,430	4,310
Santaluz Special Tax Bonds, Improvement Area No.1, Series 2004 A	1.7 - 5.5**	2031	5,000	4,500
Santaluz Special Tax Bonds, Improvement Area No.4, Series 2004 A	1.65 - 5.5**	2034	9,965	9,450
Liberty Station Special Tax Bonds, Series 2006 A	5.0 - 5.75**	2037	16,000	15,630
Liberty Station Special Tax Bonds, Series 2008 A	3.74 - 6.3**	2037	3,950	3,885
Black Mountain Ranch Villages Special Tax Bonds Series 2008 A	3.125-6.0**	2038	12,365	12,365
Total Special Assessment / Special Tax Bonds				<u>152,270</u>

(continued on next page)

<u>Type of Obligation</u>	<u>Interest Rates</u>	<u>Fiscal Year Maturity Date</u>	<u>Original Amount</u>	<u>Balance Outstanding June 30, 2009</u>
<u>Tax Allocation Bonds:</u>				
Gateway Center West Redevelopment Project Tax Allocation Bonds, Series 1995	7.8 - 9.75**	2014	\$ 1,400	\$ 580
Mount Hope Redevelopment Project Tax Allocation Bonds, Series 1995 A	4.4 - 6.0**	2020	1,200	750
Horton Plaza Redevelopment Project Tax Allocation Refunding Bonds, Series 1996 A	3.8 - 6.0**	2016	12,970	6,355
Centre City Redevelopment Tax Allocation Bonds, Series 1999 A	3.0 - 5.125**	2019	25,680	25,200
Centre City Redevelopment Tax Allocation Bonds, Series 1999 B	6.25**	2014	11,360	11,360
Centre City Redevelopment Tax Allocation Bonds, Series 1999 C	3.1 - 4.75**	2025	13,610	11,705
City Heights Redevelopment Tax Allocation Bonds, Series 1999 A	4.5 - 5.8**	2029	5,690	5,060
City Heights Redevelopment Tax Allocation Bonds, Series 1999 B	5.75 - 6.4***	2029	10,141	8,982
Centre City Redevelopment Project Tax Allocation Bonds, Series 2000 A	4.0 - 5.6**	2025	6,100	4,810
Centre City Redevelopment Project Tax Allocation Bonds, Series 2000 B	3.95 - 5.35**	2025	21,390	18,190
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2000	4.25 - 5.8**	2022	15,025	13,110
North Bay Redevelopment Project Tax Allocation Bonds, Series 2000	4.25 - 5.875**	2031	13,000	11,200
North Park Redevelopment Project Tax Allocation Bonds, Series 2000	4.1 - 5.9**	2031	7,000	6,035
Centre City Redevelopment Tax Allocation Bonds, Series 2001 A	4.93 - 5.55****	2027	58,425	55,795
Mount Hope Redevelopment Project Tax Allocation Bonds, Series 2002 A	5.0**	2027	3,055	3,055
Centre City Redevelopment Project Tax Allocation Bonds, Series 2003 A	2.5 - 5.0**	2029	31,000	11,980
City Heights Redevelopment Project Tax Allocation Bonds, Series 2003 A	5.875 - 6.5**	2034	4,955	4,955
City Heights Redevelopment Project Tax Allocation Bonds, Series 2003 B	2.5 - 4.25**	2014	865	410
North Park Redevelopment Project Tax Allocation Bonds, Series 2003 A	1.5 - 6.125**	2028	7,145	6,045
North Park Redevelopment Project Tax Allocation Bonds, Series 2003 B	4.75 - 5.0**	2034	5,360	5,360
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 A	4.65 - 5.1**	2022	6,325	6,325
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 B	3.25 - 5.45**	2022	4,530	4,300
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 C	3.49 - 7.74**	2022	8,000	6,565
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 A	3.5 - 5.25**	2030	101,180	93,410
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 B	2.26 - 4.58**	2011	9,855	3,035
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 C	2.26 - 6.18**	2030	27,785	25,035

<u>Type of Obligation</u>	<u>Interest Rates</u>	<u>Fiscal Year Maturity Date</u>	<u>Original Amount</u>	<u>Balance Outstanding June 30, 2009</u>
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 D	2.26 - 6.28**	2030	\$ 8,905	\$ 8,035
Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 A	4.25 - 5.25**	2033	76,225	75,025
Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 B	5.66 - 6.2**	2032	33,760	32,880
Centre City Redevelopment Project Tax Allocation Bonds, Series 2008 A	3.74 - 6.3**	2021	69,000	69,000
Total Tax Allocation Bonds				<u>534,547</u>
<u>Tobacco Settlement Asset-Backed Bonds:</u>				
Tobacco Settlement Revenue Funding Corporation Asset-Backed Bonds, Series 2006	7.125**	2023	105,400	<u>95,380</u>
<u>Pooled Financing Bonds:</u>				
Public Facilities Financing Authority Pooled Financing Bonds, Series 2007 A	5.95 - 6.65**	2038	17,230	16,340
Public Facilities Financing Authority Pooled Financing Bonds, Series 2007 B	4.0 - 5.25**	2038	17,755	<u>17,120</u>
Total Pooled Financing Bonds				<u>33,460</u>
Total Bonds Payable				<u>1,401,472</u>
Net Other Postemployment Benefits Obligation				73,504
Net Pension Obligation				<u>147,665</u>
Total Governmental Activities Long-Term Liabilities				<u>\$ 2,148,966</u>

* Additional information on the variable rate contracts payable with the SDSU Foundation, the loan payable line of credit from Bank of America, and the PFFA Lease Revenue Bonds, Series 2009 A are discussed further on the following page.

** Interest rates are fixed, and reflect the range of rates for various maturities from the date of issuance to maturity.

*** The City Heights Redevelopment Tax Allocation Bonds, Series 1999 B, are capital appreciation bonds, which mature from fiscal year 2011 through 2029. The balance outstanding at June 30, 2009 does not include accreted interest of \$7,695.

**** The Centre City Redevelopment Tax Allocation Bonds, Series 2001 A, partially include capital appreciation bonds, which mature from fiscal year 2015 through 2027. The balance outstanding at June 30, 2009 does not include accreted interest of \$6,987.

Arbitrage Rebate Liability is calculated via third party providers in accordance with the provisions of the Internal Revenue Code of 1986, as amended, and the United States Treasury Regulations effective as of July 1, 1993, as amended.

Liability claims are primarily liquidated by the Self Insurance (Internal Service) Fund and Enterprise Funds. Compensated absences are generally liquidated by the general fund and certain internal service funds. Pension liabilities are paid out of the operating funds based on a percentage of payroll.

Public safety general obligation bonds are secured by a pledge of the full faith and credit of the City or by a pledge of the City to levy ad valorem property taxes without limitation. Open space general obligation bonds are backed by Environmental Growth Fund 2/3 franchise fees.

Revenue bonds are secured by a pledge of specific revenue generally derived from fees or service charges related to the operation of the project being financed. Certificates of Participation (COPs) and lease revenue bonds provide long-term financing through a lease agreement, installment sales agreement, or loan agreement that does not constitute indebtedness under the state constitutional debt limitation and is not subject to other statutory requirements applicable to bonds.

Special assessment/special tax bonds are issued by the City to provide funds for public improvements in/and or serving special assessment and Mello-Roos districts created by the City. The bonds are secured by assessments and special taxes levied on the properties located within the assessment districts and the community facilities districts, and are payable solely from the assessments and special taxes collected. The assessments and the special taxes, and any bonds payable from them, are secured by a lien on the properties upon which the assessments and the special taxes are levied. Neither the faith and credit nor the taxing power of the City is pledged to the payment of the bonds.

Section 108 loans are the loan guarantee provisions of the Community Development Block Grant (CDBG) program. Section 108 loans provide the community with a source of financing for economic development, housing rehabilitation, public facilities, and capital improvement and infrastructure projects.

San Diego State University Foundation executed an Agreement for Processing a Redevelopment Plan and Land Use Entitlements with RDA which allows for reimbursement of expenses incurred by the Foundation, in assisting in the preparation and processing of the Redevelopment Plan and Land Use Entitlements in the College Area. The agreement is a variable rate obligation of RDA. The unpaid principal bears interest at the prime rate and is fixed on a quarterly basis, using the prime rate established on the first banking day of each calendar quarter. Interest calculations are made on the quarterly weighted average of the principal balance and are made at the end of the quarter based upon the rate fixed for that quarter. The effective interest rate as of June 30, 2009 is 3.25 percent.

Loans Payable includes a loan agreement with Centerpoint, LLC that was for the purpose of constructing affordable housing and retail space pursuant to the terms of a Disposition and Development Agreement and the first and second implementation agreements. On December 29, 2008 a third implementation agreement was executed that converted the project from the sale of residential dwelling units to rental residential dwelling units. Due to the modification of the size of the dwelling units to be developed and the corresponding reduction in the development costs, the amount of the loan was reduced from \$5,245 to \$4,969. The corresponding liability has been reduced in the Statement of Net Assets.

Loans Payable includes a line of credit executed by RDA with Bank of America, N.A. on October 31, 2006. The line of credit is to be used to refinance the North Park Theatre, to pay sums of settlement of eminent domain actions relating to the North Park Redevelopment Area and for other redevelopment activities in the North Park Redevelopment Area. The tax-exempt portion of the line of credit has an effective interest rate of 3.23 percent, the taxable portion has an effective interest rate of 4.75 percent as of June 30, 2009, and the effective interest rate will reset on October 31, annually.

Loans Payable also includes six separate non-revolving secured three-year term lines of credit executed by RDA with San Diego National Bank dated July 26, 2007. Four lines of credit are for affordable housing in North Park, City Heights, North Bay and Naval Training Center (NTC) Redevelopment Project Areas. Two lines of credit are for non-housing or general purposes for City Heights and NTC Redevelopment Project Areas. Each advance taken from the lines of credit has a fixed rate that is set on the day of the advance to be equal to either the United States Three-Year Treasury Constant Maturities Index plus one and nine-tenths percentage point or the One-Month LIBOR Rate plus one and one-tenth percentage point and that rate remains constant during the entire period such advance is outstanding.

PFFA Lease Revenue Bonds, Series 2009A were issued for the purpose of financing various capital improvement projects. The Series 2009A bonds are secured from base rental payments and bear interest at a rate of 3.89 percent through June 1, 2010. Thereafter the interest rate will be fixed to equal the purchaser's internal cost of funds rate plus a fixed spread of 3.0 percent, provided that in no event will the interest rate exceed 12 percent, and the new rate will remain constant until the final maturity date of December 1, 2018.

Tobacco Settlement Asset-Backed Bonds are limited obligations of the Tobacco Settlement Revenue Funding Corporation, which is a separate legal California nonprofit public benefit corporation established by the City of San Diego. The Corporation purchased from the City the rights to receive future tobacco settlement revenues due to the City. The Tobacco Settlement Asset-Backed Bonds are payable from and secured solely by pledged tobacco settlement revenues.

b. Amortization Requirements

The annual requirements to amortize such long-term debt outstanding as of June 30, 2009, including interest payments to maturity, are as follows:

Year Ended June 30,	Capital Lease Obligations		Contracts Payable		Notes Payable		Loans Payable	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2010	\$ 15,963	\$ 3,551	\$ -	\$ -	\$ -	\$ -	\$ 8,708	\$ 1,616
2011	15,475	2,661	-	-	-	-	25,180	650
2012	15,915	2,056	-	-	-	-	195	351
2013	14,294	1,438	-	-	-	-	205	341
2014	10,152	933	-	-	-	-	216	330
2015-2019	13,413	1,827	-	-	-	-	1,264	1,467
2020-2024	4,307	531	-	-	-	-	480	1,177
2025-2029	-	-	-	-	-	-	772	884
2030-2034	-	-	-	-	-	-	1,045	412
2035-2039	-	-	-	-	-	-	229	35
Unscheduled*	-	-	4,715	1,868	4,786	1,767	6,521	-
Total	<u>\$ 89,519</u>	<u>\$ 12,997</u>	<u>\$ 4,715</u>	<u>\$ 1,868</u>	<u>\$ 4,786</u>	<u>\$ 1,767</u>	<u>\$ 44,815</u>	<u>\$ 7,263</u>

* The contracts payable to SDSU Foundation in the amount of \$1,715, the contract payable to Western Pacific Housing, Inc. in the amount of \$3,000, the notes payable to Price Charities of \$4,786, the loan payable to Centerpoint, LLC in the amount of \$4,969, the loan payable to California Housing Finance Agency in the amount of \$1,250, and the loan payable to the California Energy Resources Conservation and Development Commission in the amount of \$302 do not have repayment schedules. Annual payments on the San Diego State University debt is based on the availability of tax increment, net of the low-moderate and taxing agency set-asides, as well as project area administration costs. Annual payments on the Western Pacific Housing, Inc., and Price Charities debt are based on available tax increment. Annual payments on the Centerpoint, LLC debt are based upon future receipts of unallocated tax increment or other available sources. Annual payments on the California Housing Agency are deferred for the term of the loan. Annual payments on the California Energy and Resources Conservation and Development Commission will not begin until project completion.

Year Ended June 30,	Section 108 Loans		General Obligation Bonds		Revenue Bonds / COPs		Special Assessment / Special Tax Bonds	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
	2010	\$ 2,457	\$ 1,685	\$ 1,975	\$ 353	\$ 21,955	\$ 29,735	\$ 5,130
2011	2,595	1,579	2,100	219	29,776	27,720	5,490	8,152
2012	2,724	1,460	2,240	74	27,567	26,402	5,860	7,870
2013	2,863	1,329	-	-	28,870	25,094	6,155	7,561
2014	3,016	1,186	-	-	30,227	23,719	6,430	7,224
2015-2019	13,023	3,659	-	-	163,510	96,248	36,755	30,530
2020-2024	6,158	1,036	-	-	124,740	60,620	29,515	20,969
2025-2029	696	21	-	-	117,650	25,611	28,415	13,088
2030-2034	-	-	-	-	35,205	3,736	21,765	4,470
2035-2039	-	-	-	-	-	-	6,755	707
Total	<u>\$ 33,532</u>	<u>\$ 11,955</u>	<u>\$ 6,315</u>	<u>\$ 646</u>	<u>\$ 579,500</u>	<u>\$ 318,885</u>	<u>\$ 152,270</u>	<u>\$ 108,979</u>

Year Ended June 30,	Tax Allocation Bonds			Tobacco Asset-Backed Bonds		Pooled Financing Bonds	
	Principal	Unaccrued		Principal	Interest	Principal	Interest
		Appreciation	Interest				
2010	\$ 19,054	\$ 2,163	\$ 26,620	\$ 3,800	\$ 6,796	\$ 680	\$ 1,883
2011	19,948	2,243	25,727	4,000	6,525	770	1,846
2012	20,884	2,317	24,749	4,400	6,240	825	1,805
2013	24,143	2,388	23,612	4,600	5,927	860	1,762
2014	25,704	2,455	22,327	5,000	5,599	900	1,718
2015-2019	144,897	12,014	90,577	30,900	22,101	5,280	7,821
2020-2024	134,019	8,824	52,561	42,680	8,765	5,725	6,247
2025-2029	102,468	2,181	22,801	-	-	6,880	4,470
2030-2034	43,430	-	4,500	-	-	7,895	2,155
2035-2039	-	-	-	-	-	3,645	445
Subtotal	534,547	34,585	293,474	95,380	61,953	33,460	30,152
Add:							
Accrued Appreciation through June 30, 2009	14,682	-	-	-	-	-	-
Total	<u>\$ 549,229</u>	<u>\$ 34,585</u>	<u>\$ 293,474</u>	<u>\$ 95,380</u>	<u>\$ 61,953</u>	<u>\$ 33,460</u>	<u>\$ 30,152</u>

* The Tobacco Asset-Backed Bond Principal Debt Service requirements are based upon expected Turbo Principal payments.

c. Change in Long-Term Liabilities

Additions to governmental activities long-term debt for contracts, notes and loans payable may differ from proceeds reported on the Statement of Revenues, Expenditures, and Changes in Fund Balances, due to funding received in prior fiscal years being converted from short-term to long-term debt as a result of developers extending the terms of the obligation.

The following is a summary of changes in governmental activities long-term liabilities for the year ended June 30, 2009. The effect of bond accretion, bond premiums, discounts, and deferred amounts on bond refunds are amortized as adjustments to long-term liabilities.

	Governmental Activities				
	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Arbitrage Liability	\$ -	\$ 533	\$ -	\$ 533	\$ -
Compensated Absences	74,825	62,642	(63,021)	74,446	34,912
Liability Claims	232,448	84,863	(43,332)	273,979	43,663
Capital Lease Obligations	61,262	40,758	(12,501)	89,519	15,963
Contracts Payable	2,615	2,100	-	4,715	-
Notes Payable	5,662	-	(876)	4,786	-
Loans Payable	34,777	10,483	(445)	44,815	8,708
Section 108 Loans Payable	35,896	-	(2,364)	33,532	2,457
General Obligation Bonds	8,580	-	(2,265)	6,315	1,975
Revenue Bonds / COPs	498,950	103,000	(22,450)	579,500	21,955
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	(4,235)	-	203	(4,032)	(203)
Net Revenue Bonds/COP's	494,715	103,000	(22,247)	575,468	21,752
Special Assessment / Special					
Tax Bonds	144,805	12,365	(4,900)	152,270	5,130
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	(534)	(129)	53	(610)	(53)
Net Special Assessment Bonds	144,271	12,236	(4,847)	151,660	5,077
Tax Allocation Bonds	548,643	-	(14,096)	534,547	19,054
Interest Accretion	12,837	2,080	(235)	14,682	-
Balance with Accretion	561,480	2,080	(14,331)	549,229	19,054
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	5,494	-	(116)	5,378	116
Net Tax Allocation Bonds	566,974	2,080	(14,447)	554,607	19,170
Tobacco Settlement Asset-Backed Bonds	99,370	-	(3,990)	95,380	3,800
Pooled Financing Bonds	34,115	-	(655)	33,460	680
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	(125)	-	17	(108)	(17)
Net Pooled Financing Bonds	33,990	-	(638)	33,352	663
Net Other Postemployment Benefits Obligation	28,872	44,632	-	73,504	-
Net Pension Obligation	141,734	5,931	-	147,665	-
Total	\$ 1,965,991	\$ 369,258	\$ (170,973)	\$ 2,164,276	\$ 158,140

d. Defeasance and Redemption of Debt

As of June 30, 2009, principal amounts payable from escrow funds established for defeased bonds are as follows:

<u>Defeased Bonds</u>	<u>Amount</u>
Central Imperial Redevelopment Project Tax Allocation Bonds, Series 2000	\$ 2,975
Southcrest Redevelopment Project Tax Allocation Bonds, Series 2000	<u>1,520</u>
Total Defeased Bonds Outstanding	<u>\$ 4,495</u>

e. Long-Term Pledged Liabilities

Governmental long-term pledged liabilities as of June 30, 2009 are comprised of the following:

<u>Type of Pledged Revenue</u>	<u>Fiscal Year Maturity Date</u>	<u>Pledged Revenue to Maturity</u>	<u>Debt Principal & Interest Paid</u>	<u>Pledged Revenue Recognized</u>
<u>Pledged CDBG Revenue:</u>				
Section 108 Loans Payable		\$ 34,763	\$ 3,534	\$ 3,534
Total Pledged CDBG Revenue		<u>34,763</u>	<u>3,534</u>	<u>3,534</u>
<u>Pledged Developer Revenue:</u>				
Regional Transportation Center Redevelopment Project (Section 108)	2021	<u>2,663</u>	<u>285</u>	<u>285</u>
Total Pledged Developer Revenue		<u>2,663</u>	<u>285</u>	<u>285</u>
<u>Pledged Net Operating Revenue (Parking):</u>				
Centre City Parking Revenue Bonds, Series 1999 A	2026	<u>16,065</u>	<u>957</u>	<u>953</u>
Centre City Parking Revenue Bonds, Series 2003 B	2027	<u>26,879</u>	<u>1,508</u>	<u>1,390</u>
Total Pledged Net Operating Revenue (Parking)		<u>42,944</u>	<u>2,465</u>	<u>2,343</u>
<u>Pledged Special Assessment / Special Tax Revenue:</u>				
Otay Mesa Industrial Park Limited Obligation Improvement Bonds, Issued May 1992	2013	<u>292</u>	<u>72</u>	<u>71</u>
Miramar Ranch North Special Tax Refunding Bonds, Series 1998	2021	<u>52,117</u>	<u>4,371</u>	<u>4,147</u>
Public Facilities Financing Authority Reassessment District Refunding Revenue Bonds, Series 1999 A	2018	<u>13,651</u>	<u>2,330</u>	<u>1,882</u>
Public Facilities Financing Authority Reassessment District Refunding Revenue Bonds, Series 1999 B	2018	<u>3,424</u>	<u>599</u>	<u>470</u>
Santaluz Special Tax Bonds, Improvement Area No.1, Series 2000 A	2031	<u>96,349</u>	<u>4,368</u>	<u>4,287</u>
Santaluz Special Tax Bonds, Improvement Area No.3, Series 2000 B	2031	<u>7,325</u>	<u>316</u>	<u>337</u>
City of San Diego Reassessment District No. 2003-1 Limited Obligation Refunding Bonds	2018	<u>7,899</u>	<u>966</u>	<u>732</u>
Piper Ranch Limited Obligation Improvement Bonds, Issued January 2004	2034	<u>8,311</u>	<u>345</u>	<u>317</u>
Santaluz Special Tax Bonds, Improvement Area No.1, Series 2004 A	2031	<u>7,615</u>	<u>377</u>	<u>370</u>
Santaluz Special Tax Bonds, Improvement Area No.4, Series 2004 A	2034	<u>17,221</u>	<u>625</u>	<u>692</u>
Liberty Station Special Tax Bonds, Series 2006 A	2037	<u>31,193</u>	<u>1,149</u>	<u>1,554</u>
Liberty Station Special Tax Bonds, Series 2008 A	2037	<u>7,760</u>	<u>256</u>	<u>347</u>
Black Mountain Ranch Villages Special Tax Bonds Series 2008 A	2038	<u>25,169</u>	<u>358</u>	<u>986</u>
Total Pledged Special Assessment / Special Tax Revenue		<u>278,326</u>	<u>16,132</u>	<u>16,192</u>

(continued on next page)

<u>Type of Pledged Revenue</u>	<u>Fiscal Year Maturity Date</u>	<u>Pledged Revenue to Maturity</u>	<u>Debt Principal & Interest Paid</u>	<u>Pledged Revenue Recognized</u>
<u>Pledged Tax Increment Revenue:</u>				
<u>Contracts</u>				
Contract Payable to SDSU Foundation, dated December 1991	---	\$ 3,095	-	\$ -
Amendment to Contract Payable to SDSU Foundation, dated January 1995	---	233	-	-
Contract Payable to Western Pacific Housing, Inc., dated April 2004	---	3,476	-	-
<u>Notes</u>				
Note Payable to Price Charities, dated April 2001	2032	4,274	1,045	1,045
Note Payable to Price Charities, dated May 2005	2025	2,100	-	-
Amendment to Note Payable to Price Charities, dated February 2006	2025	180	-	-
<u>Loans</u>				
International Gateway Associates, LLC, dated October 2001	2032	4,776	199	199
PCCP/SB Las America, LLC, dated August 2005	2036	3,571	132	132
Centerpoint, LLC, dated April 2006	2021	4,969	-	-
Bank of America, N.A. Line of Credit, dated October 2006	2009	8,626	330	330
San Diego National Bank, Line of Credit, dated July 2007 City Heights Housing Area	2011	1,419	74	74
San Diego National Bank, Line of Credit, dated July 2007 City Heights Non-Housing Area	2011	2,255	163	163
San Diego National Bank, Line of Credit, dated July 2007 Naval Training Center Housing Area	2011	2,748	55	55
San Diego National Bank, Line of Credit, dated July 2007 Naval Training Center Non-Housing Area	2011	11,651	317	317
San Diego National Bank, Line of Credit, dated July 2007 North Bay Housing Area	2011	2,407	93	93
San Diego National Bank, Line of Credit, dated July 2007 North Park Non-Housing Area	2011	5,952	140	140
Naval Training Center Civic, Arts, and Cultural Center (Section 108)	2025	8,062	509	509

<u>Type of Pledged Revenue</u>	<u>Fiscal Year Maturity Date</u>	<u>Pledged Revenue to Maturity</u>	<u>Debt Principal & Interest Paid</u>	<u>Pledged Revenue Recognized</u>
Bonds				
Gateway Center West Redevelopment Project Tax Allocation Bonds, Series 1995	2014	\$ 732	\$ 145	\$ 145
Mount Hope Redevelopment Project Tax Allocation Bonds, Series 1995 A	2020	1,018	91	91
Horton Plaza Redevelopment Project Tax Allocation Refunding Bonds, Series 1996 A	2016	7,778	1,116	1,110
Centre City Redevelopment Tax Allocation Bonds, Series 1999 A	2019	32,987	1,276	1,209
Centre City Redevelopment Tax Allocation Bonds, Series 1999 B	2014	13,154	710	3,083
Centre City Redevelopment Tax Allocation Bonds, Series 1999 C	2025	17,179	794	780
City Heights Redevelopment Tax Allocation Bonds, Series 1999 A	2029	8,497	430	418
City Heights Redevelopment Tax Allocation Bonds, Series 1999 B	2029	31,130	571	543
Centre City Redevelopment Project Tax Allocation Bonds, Series 2000 A	2025	7,215	445	441
Centre City Redevelopment Project Tax Allocation Bonds, Series 2000 B	2025	27,376	1,458	1,406
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2000	2022	18,806	1,353	1,340
North Bay Redevelopment Project Tax Allocation Bonds, Series 2000	2031	19,804	893	834
North Park Redevelopment Project Tax Allocation Bonds, Series 2000	2031	10,676	479	448
Centre City Redevelopment Tax Allocation Bonds, Series 2001 A	2027	109,162	2,567	2,473
Mount Hope Redevelopment Project Tax Allocation Bonds, Series 2002 A	2027	5,355	153	153
Centre City Redevelopment Project Tax Allocation Bonds, Series 2003 A	2029	21,107	3,971	3,886
City Heights Redevelopment Project Tax Allocation Bonds, Series 2003 A	2034	10,371	316	316
City Heights Redevelopment Project Tax Allocation Bonds, Series 2003 B	2014	452	92	92
North Park Redevelopment Project Tax Allocation Bonds, Series 2003 A	2028	9,975	546	546
North Park Redevelopment Project Tax Allocation Bonds, Series 2003 B	2034	11,189	259	259

(continued on next page)

<u>Type of Pledged Revenue</u>	<u>Fiscal Year Maturity Date</u>	<u>Pledged Revenue to Maturity</u>	<u>Debt Principal & Interest Paid</u>	<u>Pledged Revenue Recognized</u>
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 A	2022	\$ 9,487	\$ 310	\$ 306
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 B	2022	6,135	327	309
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 C	2022	10,252	798	770
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 A	2030	146,086	6,855	6,855
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 B	2011	3,155	1,965	1,965
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 C	2030	41,891	2,230	2,152
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 D	2030	13,570	723	698
Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 A	2033	125,477	4,356	4,268
Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 B	2032	61,393	2,642	2,617
Public Facilities Financing Authority Pooled Financing Bonds, Series 2007 A	2038	32,499	1,409	1,409
Public Facilities Financing Authority Pooled Financing Bonds, Series 2007 B	2038	31,113	1,164	1,164
Centre City Redevelopment Project Tax Allocation Bonds, Series 2008 A	2021	95,878	2,800	9,927
Total Pledged Tax Increment Revenue		<u>1,010,693</u>	<u>46,301</u>	<u>55,070</u>
<u>Pledged Tobacco Settlement Revenue:</u>				
Tobacco Settlement Revenue Funding Corporation Asset-Backed Bonds, Series 2006	2023	\$ 157,333	\$ 11,056	\$ 10,100
Total Pledged Tobacco Settlement Revenue		<u>157,333</u>	<u>11,056</u>	<u>10,100</u>
Total Pledged Revenue		<u>\$ 1,526,722</u>	<u>\$ 79,773</u>	<u>\$ 87,524</u>

6. BUSINESS-TYPE ACTIVITIES LONG-TERM LIABILITIES (In Thousands)

a. Long-Term Liabilities

Business-type activities long-term liabilities as of June 30, 2009 are comprised of the following:

<u>Type of Obligation</u>	<u>Interest Rates</u>	<u>Fiscal Year Maturity Date</u>	<u>Original Amount</u>	<u>Balance Outstanding June 30, 2009</u>
Compensated Absences				\$ 12,671
Liability Claims				32,853
<u>Loans Payable:</u>				
Loans Payable to San Diego County Water Authority	-	-	\$ 100	100
Loans Payable to State Water Resources Control Board, issued February 9, 2000	1.80%**	2020	10,606	6,301
Loans Payable to State Water Resources Control Board, issued February 9, 2000	1.80**	2022	6,684	4,613
Loans Payable to State Water Resources Control Board, issued March 30, 2001	1.80**	2022	33,720	23,262
Loans Payable to State Water Resources Control Board, issued May 17, 2001	1.80**	2022	7,742	5,340
Loans Payable to State Water Resources Control Board, issued May 17, 2001	1.80**	2021	860	553
Loans Payable to State Water Resources Control Board, issued June 11, 2001	1.80**	2021	2,525	1,623
Loans Payable to State Water Resources Control Board, issued October 3, 2002	1.99**	2020	3,767	2,459
Loans Payable to State Water Resources Control Board, issued October 3, 2002	1.80**	2023	8,068	5,942
Loans Payable to State Water Resources Control Board, issued December 14, 2005	1.89**	2024	10,093	8,257
Loans Payable to Department of Health Services, issued July 6, 2005	2.51**	2026	21,525	18,491
Loans Payable to State Water Resources Control Board, issued October 15, 2006	1.99**	2024	3,858	3,306
Loans Payable to State Water Resources Control Board, issued February 28, 2007	1.89**	2026	11,068	10,079
Total Loans Payable				<u>90,326</u>

(continued on next page)

<u>Type of Obligation</u>	<u>Interest Rates</u>	<u>Fiscal Year Maturity Date</u>	<u>Original Amount</u>	<u>Balance Outstanding June 30, 2009</u>
<u>Bonds Payable:</u>				
Sewer Revenue Bonds, Series 1995	3.9 - 6.0*	2025	\$ 350,000	\$ 43,850
Sewer Revenue Bonds, Series 1997 A	3.7 - 5.375*	2027	183,000	22,565
Sewer Revenue Bonds, Series 1997 B	3.7 - 5.375*	2027	67,000	8,260
Water Certificate of Undivided Interest, Series 1998	4.0 - 5.375*	2029	385,000	141,320
Sewer Revenue Bonds, Series 1999 A	3.5 - 5.125*	2029	203,350	67,020
Sewer Revenue Bonds, Series 1999 B	3.5 - 5.125*	2029	112,060	37,080
Subordinated Water Revenue Bonds, Series 2002	2.0 - 5.0*	2033	286,945	272,846
Senior Sewer Revenue Bonds, Series 2009 A	2.0-5.375*	2039	453,775	453,775
Senior Sewer Revenue Refunding Bonds Series 2009 B	3.0-5.5*	2025	634,940	634,940
Water Revenue Refunding Bonds, Series 2009 A	2.5-5.25*	2039	157,190	157,190
Water Revenue Bonds, Series 2009 B	2.5-5.75*	2040	328,060	328,060
Total Bonds Payable				<u>2,166,906</u>
Estimated Landfill Closure and Postclosure Care				19,336
Net Other Postemployment Benefits Obligation				19,767
Net Pension Obligation				29,474
Pollution Remediation Obligation				<u>620</u>
Total Business-Type Activities Long-Term Liabilities				<u>\$ 2,371,953</u>

* Interest rates are fixed, and reflect the range of rates for various maturities from the date of issuance to maturity.

** Effective rate

b. Amortization Requirements

Annual requirements to amortize long-term debt as of June 30, 2009, including interest payments to maturity, are as follows:

Year Ended June 30	Loans Payable		Revenue Bonds Payable	
	Principal	Interest	Principal	Interest
2010	\$ 5,653	\$ 1,780	\$ 58,741	\$ 97,033
2011	5,765	1,670	63,915	103,683
2012	5,878	1,557	66,420	101,173
2013	5,992	1,443	69,275	98,325
2014	6,109	1,326	72,485	95,112
2015-2019	32,384	4,792	417,635	420,395
2020-2024	25,072	1,677	485,090	307,757
2025-2029	3,373	89	470,265	183,672
2030-2034	-	-	220,205	96,243
2035-2039	-	-	221,720	39,781
2040-2044	-	-	21,155	582
Unscheduled*	100	-	-	-
Total	<u>\$ 90,326</u>	<u>\$ 14,334</u>	<u>\$ 2,166,906</u>	<u>\$ 1,543,756</u>

* The loan payable to the San Diego County Water Authority in the amount of \$100 does not have an annual repayment schedule. The payment is due if funding for the projects for which the loan was received becomes available from other sources.

c. Change in Long-Term Liabilities

The following is a summary of changes in long-term liabilities for the year ended June 30, 2009. The effect of bond premiums, discounts and deferred amounts on refunding are reflected as adjustments to long-term liabilities.

	Business-Type Activities				
	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Arbitrage Liability	\$ 586	\$ -	\$ (586)	\$ -	\$ -
Compensated Absences	13,355	11,949	(12,633)	12,671	6,315
Liability Claims	50,239	(13,794)	(3,592)	32,853	3,501
Capital Lease Obligations	166	-	(166)	-	-
Revenue Notes Payable	430,830	-	(430,830)	-	-
Loans Payable	95,875	-	(5,549)	90,326	5,653
Revenue Bonds Payable	1,425,445	1,573,965	(832,504)	2,166,906	58,741
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	(6,619)	39,748	7,951	41,080	2,142
Net Revenue Bonds Payable	1,418,826	1,613,713	(824,553)	2,207,986	60,883
Estimated Landfill Closure/Postclosure Care	18,429	907	-	19,336	-
Net Other Postemployment Benefits Obligation	8,921	10,846	-	19,767	-
Net Pension Obligation	31,342	-	(1,868)	29,474	-
Pollution Remediation Obligation	-	620	-	620	-
Totals	\$ 2,068,569	\$ 1,624,241	\$ (1,279,777)	\$ 2,413,033	\$ 76,352

d. Defeasance and Redemption of Debt

PFFA issued Water Revenue Bonds, Series 2009A in the amount of \$157,190 and Series 2009B in the amount of \$328,060. The bond proceeds were used to fully redeem outstanding Subordinated Water Notes, Series 2007A and Subordinated Water Notes, Series 2008A and for partial redemption of the Water Certificates of Undivided Interest, Series 1998. The Water 2007A and 2008A Notes have been redeemed and the corresponding liabilities have been removed from the Statement of Net Assets. The redemption transaction for the Water 2007A Notes resulted in a total economic loss of approximately \$11,161 and a cash flow cost of approximately \$21,558. The redemption transaction for the Water 2008A Notes resulted in a total economic loss of approximately \$40,412 and a cash flow cost of approximately \$92,955. The partial refunding of \$94,165 from the remaining outstanding Water Certificates of Undivided Interest, Series 1998 resulted in a total economic gain of approximately \$5,580 and a cash flow savings of approximately \$8,741. All of the Notes and Certificates that were redeemed or refunded from the Water Revenue Bonds, Series 2009A and 2009B were called or redeemed at a date prior to the end of the fiscal year, and accordingly, there is no defeased debt balance outstanding as of June 30, 2009.

PFFA issued Senior Sewer Revenue Bonds, Series 2009A in the amount of \$453,775 and Series 2009B in the amount of \$634,940. The bond proceeds were used to fully redeem and refund outstanding Subordinated Sewer Revenue Notes, Series 2007 and Sewer Revenue Bonds, Series 1993. The bond proceeds were also used for a partial redemption of the Sewer Revenue Bonds, Series 1995, Series 1997A, Series 1997B, Series 1999A and Series 1999B. The Subordinated Sewer Notes, Series 2007 were fully redeemed while the Sewer Revenue Bonds, Series 1993, carry a defeased balance in an escrow fund, listed below. Both liabilities have been removed

from the Statement of Net Assets. The redemption transaction for the Sewer 2007 Notes resulted in a total economic loss of approximately \$23,013 and a cash flow cost of approximately \$44,084. The redemption transaction for the Sewer Revenue Bonds, Series 1993 resulted in a total economic gain of approximately \$8,457 and a cash flow savings of approximately \$13,951. The partial redemption of the Sewer Revenue Bonds, Series 1995 resulted in a total economic gain of approximately \$11,086 and a cash flow savings of approximately \$18,287. The partial redemption of the Sewer Revenue Bonds, Series 1997A and Series 1997B resulted in a total economic gain of approximately \$10,954 and a cash flow savings of approximately \$18,190. The partial redemption of the Sewer Revenue Bonds, Series 1999A and Series 1999B resulted in a total economic gain of approximately \$7,933 and a cash flow savings of approximately \$13,085. The 2007 Notes were fully redeemed and the partial refunding of the Series 1995, 1997 and 1999 bonds, from the Sewer Revenue Bonds, Series 2009A and Series 2009B, were all called or redeemed at a date prior to the end of the fiscal year, and accordingly, there is no defeased debt balance outstanding as of June 30, 2009.

As of June 30, 2009, principal amount payable from the escrow fund established for the defeased bond is as follows:

<u>Defeased Bonds</u>	<u>Balance</u>
Sewer Revenue Bonds, Series 1993	<u>\$ 160,220</u>

e. Long-Term Pledged Liabilities

Business-type activities long-term pledged liabilities as of June 30, 2009 are comprised of the following:

Type of Pledged Revenue	Fiscal Year Maturity Date	Pledged Revenue to Maturity	Debt Principal & Interest Paid	Pledged Revenue Recognized
<u>Pledged Net Sewer Systems Revenue:</u>				
<u>Loans</u>				
Loans Payable to State Water Resources Control Board, issued February 9, 2000	2020	\$ 7,004	\$ 637	\$ 637
Loans Payable to State Water Resources Control Board, issued February 9, 2000	2022	5,216	401	401
Loans Payable to State Water Resources Control Board, issued March 30, 2001	2022	26,320	2,025	2,025
Loans Payable to State Water Resources Control Board, issued May 17, 2001	2022	6,038	465	465
Loans Payable to State Water Resources Control Board, issued May 17, 2001	2021	619	52	52
Loans Payable to State Water Resources Control Board, issued June 11, 2001	2021	1,819	151	151
Loans Payable to State Water Resources Control Board, issued October 3, 2002	2020	2,763	251	251
Loans Payable to State Water Resources Control Board, issued October 3, 2002	2023	6,777	484	484
Loans Payable to State Water Resources Control Board, issued December 14, 2005	2024	9,561	637	637
Loans Payable to State Water Resources Control Board, issued October 15, 2006	2024	3,858	258	258
Loans Payable to State Water Resources Control Board, issued February 28, 2007	2026	11,883	699	699

<u>Type of Pledged Revenue</u>	<u>Fiscal Year Maturity Date</u>	<u>Pledged Revenue to Maturity</u>	<u>Debt Principal & Interest Paid</u>	<u>Pledged Revenue Recognized</u>
<u>Bonds and Notes</u>				
Sewer Revenue Bonds, Series 1993	2023	\$ -	\$ 16,319	\$ 16,316
Sewer Revenue Bonds, Series 1995	2025	78,930	23,585	23,581
Sewer Revenue Bonds, Series 1997 A	2027	43,889	12,179	12,177
Sewer Revenue Bonds, Series 1997 B	2027	16,066	4,458	4,457
Sewer Revenue Bonds, Series 1999 A	2029	126,138	13,207	12,352
Sewer Revenue Bonds, Series 1999 B	2029	69,789	7,308	7,118
Subordinated Sewer Revenue Notes, Series 2007	2009	-	11,192	11,190
Senior Sewer Revenue Bonds, Series 2009 A	2039	858,509	-	-
Senior Sewer Revenue Refunding Bonds Series 2009 B	2025	911,622	-	-
Total Pledged Net Sewer Systems Revenue		<u>2,186,801</u>	<u>94,308</u>	<u>93,251</u>
<u>Pledged Net Water Systems Revenue:</u>				
<u>Loans</u>				
Loans Payable to Department of Health Services, issued July 6, 2005	2026	22,703	1,376	1,376
<u>Bonds and Notes</u>				
Water Certificate of Undivided Interest, Series 1998	2029	256,934	21,354	20,002
Subordinated Water Revenue Bonds, Series 2002	2033	424,199	18,037	17,200
Subordinated Water Revenue Notes, Series 2007 A	2009	-	2,301	2,301
Subordinated Water Revenue Notes, Series 2008 A	2010	-	4,551	6,532
Water Revenue Refunding Bonds, Series 2009 A	2039	262,608	-	-
Water Revenue Bonds, Series 2009 B	2040	661,977	-	-
Total Pledged Net Water Systems Revenue		<u>1,628,421</u>	<u>47,619</u>	<u>47,411</u>
Total Pledged Revenues		<u>\$ 3,815,222</u>	<u>\$ 141,927</u>	<u>\$ 140,662</u>

7. DISCRETELY PRESENTED COMPONENT UNITS LONG-TERM DEBT (In Thousands)

Discretely presented component units long-term debt as of June 30, 2009 is comprised as follows:

San Diego Convention Center Corporation

Type of Obligation	Interest Rate	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2009	Due Within One Year
Compensated Absences				\$ 1,214	\$ 1,214
Capital Leases			\$ 3,942	1,394	863
Note Payable to San Diego					
Unified Port District, dated 1999	0.00%	2011	10,000	1,500	1,000
Total Long-Term Liabilities				<u>\$ 4,108</u>	<u>\$ 3,077</u>

Annual requirements to amortize long-term debt as of June 30, 2009, are as follows:

Capital Lease		Note Payable	
Fiscal Year	Amount	Fiscal Year	Amount
2010	\$ 931	2010	\$ 1,000
2011	543	2011	500
Total minimum lease payments	1,474	Total	<u>\$ 1,500</u>
Less: amount representing interest	(80)		
Present value of minimum lease payments	<u>\$ 1,394</u>		

San Diego Housing Commission

Type of Obligation	Interest Rate	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2009	Due Within One Year
Compensated Absences				\$ 1,351	\$ 1,351
Note Payable to Chase, dated June 1995	Variable	2012	\$ 4,725	3,274	161
Note Payable to State of California (RHCP)	0.0	2014	1,405	1,405	-
Note Payable to State of California (RHCP)	0.0	2015	3,149	3,149	-
Note Payable to US Bank, dated November 2006	Variable	2012	20,550	19,245	241
Total Notes Payable				<u>27,073</u>	<u>402</u>
Total Long-Term Liabilities				<u>\$ 28,424</u>	<u>\$ 1,753</u>

The interest rate for the Chase obligation as of June 30, 2009 was 3.01%. The variable rate in accordance with the loan agreement is equal to .65 times the sum of the Variable Index Rate plus 3%. The Variable Index Rate is defined as the most recently available monthly weighted average cost of funds for 11th District Savings Institutions published by the Federal Home Loan Bank of San Francisco.

The interest rate for the US Bank obligation as of June 30, 2009 was 7.54%. The variable interest rate in accordance with the loan agreement is 2.25% plus LIBOR.

The Commission entered into an Interest Rate Swap Agreement with US Bank (the Swap Provider) to reduce the impact of changes in interest rate. Under the terms of the Swap Agreement, the Commission has agreed to pay interest to the Swap Provider at a fixed rate of 5.29% plus 2.25% exclusive of any fees, add-ons or other trustee or bank charges, while the Swap Provider has agreed to make the Commission's required monthly mortgage payment. The notional amount of the Swap Agreement is \$20,006. The Swap Agreement expires at maturity of the mortgage in 2011.

Pursuant to SFAS No. 133, derivative instruments not meeting the criteria for hedge accounting are recorded at fair value on the statement of net assets with any change in fair value reflected in the statement of activities in the period of change. The Commission recorded a liability for the fair value of the interest rate swap as of June 30, 2009 in the amount of \$1,736. During the year ended June 30, 2009, a loss in fair value of \$831 has been realized and is included in the statement of activities.

Annual requirements to amortize such long-term debt as of June 30, 2009 to maturity are as follows:

Year Ending June 30	Principal	Interest
2010	\$ 402	\$ 1,563
2011	416	1,540
2012	21,701	488
2013	-	-
2014	1,405	-
2015-2019	3,149	-
Total	<u>\$ 27,073</u>	<u>\$ 3,591</u>

8. SHORT-TERM NOTES PAYABLE (In Thousands)

The City issues Tax and Revenue Anticipation Notes (TRANs) in advance of property tax collections, depositing the proceeds into the General Fund. These notes are necessary to meet the cash requirements of the City prior to the receipt of property taxes.

Short-term debt activity for the year ended June 30, 2009, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Tax and Revenue Anticipation Notes	<u>\$ 116,000</u>	<u>\$ 135,000</u>	<u>\$ (251,000)</u>	<u>\$ -</u>

The \$116,000 (FY08) TRANs issue, which was a 13 month note obligation, had an interest rate of 3.90% and was repaid on August 1, 2008.

The \$135,000 (FY09) TRANs issue had an average effective interest rate of 2.68% and was repaid on April 30, 2009.

9. JOINT VENTURE and JOINTLY GOVERNED ORGANIZATIONS (In Thousands)San Diego Medical Services Enterprise, LLC

A joint venture is a legal entity or other organization that results from a contractual arrangement and that is owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control. San Diego Medical Services Enterprise, LLC (SDMSE) is a joint venture that is reported within the General Fund, in accordance with GASB 14.

SDMSE was organized on May 2, 1997 to provide emergency medical services and medical transportation services to the citizens of San Diego. Operations began July 1, 1997 under an initial 5 year agreement that was extended on July 1, 2002 and again on July 1, 2005 for an additional three year period. On July 1, 2008 operations were extended until December 31, 2009 under a separate extension agreement and may be extended an additional six months if necessary. In addition, the City Council has authorized the Mayor to re-negotiate and execute a new five year agreement with SDMSE for ambulance services. The San Diego City Attorney is currently reviewing the proposed extension agreement and related SDMSE agreements to determine whether any changes to these agreements may be appropriate.

The SDMSE partners are the City of San Diego and Rural Metro of San Diego, Inc., a wholly owned subsidiary of Rural Metro Corporation (a publicly traded corporation). The SDMSE governing board of managers is comprised of five members, three of whom are appointed by the City; currently one of the City appointments is vacant.

The maximum funds which the City is required to contribute to the costs of SDMSE operations are limited to an aggregate of \$8,450 during the term of the third amended agreement. This aggregate includes a \$650 annual subsidy and any other amounts to be paid to the City since 1997 under the original contract, and any losses the City is required to cover under the extended contract, excluding any amount the City contributes for Medicare fee reimbursements. Cumulatively, the City has paid annual subsidies totaling \$5,700 as of June 30, 2009. Effective in fiscal year 2006, the City was no longer required to pay the \$650 annual subsidy and the Medicare fee reimbursements shall not exceed \$250 per fiscal year. Net assets of SDMSE are pro-rated to each partner based on a 50/50 split. In accordance with the operating agreement, profit and loss for each fiscal year is allocated equally to the members, subject to an aggregate limitation on loss to the City of \$8,450 (equal to the amount of subsidies discussed above). For the fiscal year ended June 30, 2009, SDMSE reported a net income of \$3,185, a member distribution of \$3,500, and ending net assets of \$3,647.

Under the terms of an operating agreement between Rural/Metro of San Diego, Inc. and SDMSE, Rural/Metro of San Diego, Inc. has made available a line-of-credit in the initial amount of \$3,500 bearing an interest rate of 9.5%. SDMSE did not have an outstanding balance, nor did it borrow on the line-of-credit at June 30, 2009.

Complete financial statements can be requested from San Diego Medical Services Enterprise, LLC, 8401 East Indian School Road, Scottsdale, Arizona 85251.

San Diego Workforce Partnership

The City of San Diego and the County of San Diego jointly govern the San Diego Workforce Partnership (Consortium). The Consortium's Board of Directors consists of two members of the City Council, two members from the County Board of Supervisors, and one member of a charitable organization. The purpose of the Consortium is to provide regional employment and training services in order to develop and create job opportunities throughout San Diego County. The Consortium is empowered to make applications for and receive grants from governmental or private

sources. The City does not appoint a majority of the Board, is not able to impose its will on the Consortium, and the Consortium is not fiscally dependent on the City. Therefore, it is the City's conclusion that the Consortium is a Governmental Organization with a jointly appointed board and not a component unit of the City. However, in the event the Consortium incurs a liability it cannot financially handle, the City and the County have agreed to share in the payment of those obligations.

Complete financial statements can be requested from San Diego Workforce Partnership, Inc. 3910 University Avenue, Suite 400, San Diego, CA 92105.

San Diego Geographic Information Source (SanGIS)

SanGIS was created in July 1997 as a joint powers agreement between the City of San Diego and the County of San Diego. SanGIS objectives are: to create and maintain a geographic information system; to market and license digital geographic data and software; to provide technical services; and to publish geographical and land-related information.

Complete financial statements can be requested from SanGIS, 5469 Kearny Villa Road, Suite 102, San Diego, CA 92123.

10. LEASE COMMITMENTS (In Thousands)

The City leases various properties and equipment. Leased property having elements of ownership are recorded as capital leases and reported as capital assets in the government-wide financial statements, along with a corresponding capital lease obligation. Leased property that does not have elements of ownership is reported as an operating lease and is expensed when paid.

Operating Leases

The City's operating leases consist primarily of rental property occupied by City departments. The following is a schedule of future minimum rental payments required under operating leases entered into by the City for property that has initial or remaining non-cancelable lease terms in excess of one year as of June 30, 2009:

Year Ended June 30	Amount
2010	\$ 12,642
2011	12,122
2012	12,332
2013	12,189
2014	7,617
2015-2019	4,818
2020-2024	245
Total	<u>\$ 61,965</u>

Rent expense as related to operating leases was \$12,719 for the year ended June 30, 2009.

Capital Leases

The City has entered into various capital leases for equipment and structures. These capital leases have maturity dates ranging from August 1, 2008 through October 1, 2023, and interest rates ranging from 2.63% to 7.94%. A schedule of future minimum lease payments under capital leases as of June 30, 2009 is provided in Notes 5 and 6. The value of all capital leased assets as of June 30, 2009 for governmental assets is \$109,792 net of accumulated depreciation of \$58,551, and business-type assets of \$1,357, net of accumulated depreciation of \$9,684. These amounts are categorized by major asset class in the table below.

	Gross Value	Depreciation	Net Book Value
<u>Governmental</u>			
Equipment	\$ 134,184	\$ (56,708)	\$ 77,476
Structures & Improvement	4,889	(1,843)	3,046
Construction in Progress	29,270	-	29,270
Total Governmental	<u>\$ 168,343</u>	<u>\$ (58,551)</u>	<u>\$ 109,792</u>
<u>Business-Type</u>			
Equipment	\$ 11,041	\$ (9,684)	\$ 1,357
Total Business-Type	<u>\$ 11,041</u>	<u>\$ (9,684)</u>	<u>\$ 1,357</u>

Lease Revenues

The City has operating leases for certain land, buildings, and facilities with tenants and concessionaires. Leased capital asset carrying values of approximately \$76,591, as well as depreciation, are reported in Note 4 and are consolidated with non-leased assets. Minimum annual lease revenues are reported in the following schedule:

Year Ended June 30	Amount
2010	\$ 33,813
2011	33,027
2012	32,128
2013	30,975
2014	30,062
2015-2019	138,749
2020-2024	124,203
2025-2029	118,584
2030-2034	110,230
2035-2039	100,732
2040-2044	93,506
2045-2049	66,178
2050-2054	12,334
2055-2059	4,840
2060-2064	1,100
Total	<u>\$ 930,461</u>

This amount does not include contingent rentals, which may be received under certain leases of property on the basis of percentage returns. Rental income as related to operating leases was \$81,301 for the year ended June 30, 2009, which includes contingent rentals of \$46,748.

11. DEFERRED COMPENSATION PLAN (In Thousands)

The City, San Diego Convention Center Corporation (SDCCC), San Diego Data Processing Corporation (SDDPC), and San Diego Housing Commission (SDHC) each offer their employees a deferred compensation plan, created in accordance with Internal Revenue Service Code Section 457, State and Local Government Deferred Compensation Plans. These plans, available to eligible employees, permit them to defer, pre-tax, a portion of their salary until future years. Deferred compensation is not available to employees until termination, retirement, death, disability, or an unforeseeable emergency. All assets and income of the deferred compensation plan are held in trust for the exclusive benefit of plan participants and their beneficiaries. The deferred compensation plans are not considered part of the City of San Diego's financial reporting entity.

12. PENSION PLANS (In Thousands)

The City has a defined benefit pension plan and various defined contribution pension plans covering substantially all of its employees.

DEFINED BENEFIT PLAN**a. Plan Description**

San Diego City Employees' Retirement System ("SDCERS"), as authorized by Article IX of the City Charter, is a public employee retirement system established in fiscal year 1927 by the City. SDCERS administers independent, qualified, single employer governmental defined benefit plans and trusts for the City, the Port of San Diego (the "Port"), and the San Diego County Regional Airport Authority (the "Airport"). As of July 1, 2007, the assets of the three separate plans and trusts are pooled in the SDCERS Group Trust. These plans are administered by the SDCERS Board (the "Board") to provide retirement, disability, death and survivor benefits for its members. Amendments to the City's benefit provisions require City Council approval as well as a majority vote by members. As of January 1, 2007, benefit increases also require a majority vote of the public. All approved benefit changes are codified in the City's Municipal Code.

The plans cover all eligible employees of the City, the Port, and the Airport. All City employees working half-time or greater and full-time employees of the Port and the Airport are eligible for membership and are required to join SDCERS. The Port and Airport are not component units of the City CAFR per GASB 14; however, the financial statements of SDCERS Pension trust do include the Port and Airport activity and are reported in the trust and agency section of the CAFR. The information disclosed in this note however, relates solely to the City's participation in SDCERS. City employment classes participating in the Plan are elected officers, general and safety (including police, fire and lifeguard members). These classes are represented by various unions depending on the type and nature of work performed, except for elected officials, unclassified and unrepresented employees.

City of San Diego Plan Membership as of June 30, 2009 (actual member count)

	General	Safety	Total by Classification
Active Members	5,825	2,449	8,274
Terminated Members	2,298	528	2,826
Retirees, Disabled and Beneficiaries	4,428	2,943	7,371
Total Members, as of June 30, 2009	12,551	5,920	18,471

Source: SDCERS' CAFR as of June 30, 2009

As a defined benefit Plan, retirement benefits are determined primarily by a member's class, age at retirement, number of years of creditable service, and the member's final compensation based on the highest salary earned over a consecutive one-year period. The Plan provides cost of living adjustments of 2% to retirees, which is factored into the actuarial assumptions. Increases in retirement benefits due to cost of living adjustments do not require voter approval. The Plan requires ten years of service at age 62, or 20 years of service at age 55 for general members (50 for safety members), which could include certain service purchased or service earned at a reciprocating government entity, to vest for a benefit. Typically, retirement benefits are awarded at a rate of 2.5%

of the employee's one-year high annual salary per year of service at age 55 for general members, and 3% for Safety members starting at the age of 50. The actual percentage of final average salary per year served component of the calculation rises as the employee's retirement age increases and depends on the retirement option selected by the employee. General Plan percentage of final average salary per year served is a maximum of 2.8% for general members and 3% for safety members.

On July 28, 2008, the City Council approved R-303977 which presents modified defined contribution and defined benefit Plans for all non-safety City employees hired on or after July 1, 2009 (these changes were subsequently codified into the Municipal Code on June 25, 2009 with Council's approval of O-19874). The new defined benefit Plan includes modified percentages used to determine annual retirement allowance (depending on employees' age at retirement), a pensionable salary calculation used to determine retirement allowances based on a 3-year average, and a maximum annual retiree benefit of 80% of employees' pensionable salary. Additionally, the new defined contribution Plan includes mandatory employee contributions to SPSP (as well as City match) of 1% and the introduction of mandatory employee contribution to a retiree medical trust Plan (as well as City match) of 0.25%. See SDMC Section 24.04 for additional information.

Deferred Retirement Option Program (DROP)

The City also has a Deferred Retirement Option Program (DROP) where participants continue to work for the City and receive a regular paycheck. SDCERS' members electing to participate in DROP must agree to participate in the program for a specific period, up to a maximum of five years. A DROP participant must agree to end employment with the City on or before the end of the selected DROP participation period. A SDCERS member's decision to enter DROP is irrevocable.

Upon entering the program, the DROP participant stops making contributions to SDCERS and stops earning creditable service. Instead, amounts equivalent to the participant's retirement benefit plus earnings and additional contributions are credited to an interest bearing individual account held in the participant's name. On November 21, 2008, the SDCERS Board changed the DROP interest credit rate to 7.75% from 8% to mirror the newly adopted investment return assumption adopted by the Board on September 19, 2008. On February 20, 2009 the Board changed the DROP interest rate again. Effective July 1, 2009, DROP participation interest will be 3.54% and DROP annuity interest will be 5.0%. The DROP benefit is the value of a DROP participant's account at the end of the DROP participation period. Participants select the form of the distribution of the DROP account when they leave employment and begin retirement. The distribution is made as a single lump sum or in 240 equal monthly payments, or as otherwise allowed by applicable provisions of the Internal Revenue Code. Outstanding liabilities for DROP are shown on the Statement of Fiduciary Net Assets in the basic financial statements. During the period of participation, the participant continues to receive most of the employer offered benefits available to regular employees with exception to earning creditable service, as previously discussed.

SDCERS' members who were hired on or after July 1, 2005 are ineligible to participate in the DROP program due to the benefit changes negotiated with the July 1, 2005 Memoranda of Understanding (MOU). However, SDCERS has asserted that due to delays in codification of benefit changes into the Municipal Code, the effective cut off date would instead be February 16, 2007, which is when the Ordinance O-19567 was officially codified in the Municipal Code. As of the issuance of this report, there has been no change in the status of this case [refer to Note 18 for additional information]. Notwithstanding amendments to the municipal code, SDCERS' members who were hired prior to July 1, 2005 are eligible to participate in DROP when they are eligible for a service retirement.

Purchase of Service Credits

Article 4 Division 13 of the City's Municipal Code allows Plan members to purchase years of Creditable Service for use in determining retirement allowances. To purchase Creditable Service, a Member must elect to pay and thereafter pay, in accordance with such election before retirement, into the Retirement Fund an amount, including interest, determined by the Board. No Member will receive Creditable Service under this Division for any service for which payment has not been completed pursuant to this Division before the effective date of the Member's retirement. After review of the purchase of service program, SDCERS' actuary concluded that the service credit pricing structure that was in place prior to November 2003 did not reflect the full cost in the price then charged to SDCERS members. The pricing shortfall of approximately \$146,000, which is included in the Unfunded Actuarial Accrued Liability (UAAL), is reported in this note as of the most recent valuation date and in the RSI of these financial statements for the two years prior to the most recent valuation date. On November 13, 2008, a court ruling stated that the Board's decision to amortize the underpaid purchase of service credits, for certain employees who had yet to retire as of November 20, 2007, through the City's existing unfunded actuarial liability is unlawful and contrary to the Municipal Code and City Charter. Judgment was entered in favor of the City on December 12, 2008 which finalized the November 13, 2008 ruling. However, SDCERS submitted an appeal to this ruling which is currently pending. The amount of the potential benefit to the City is not known as of the issuance of this report. Additionally, the service credit pricing structure used after November 2003 does cover the full projected cost to the System when members purchased the service credits.

SDCERS' members who were hired on or after July 1, 2005 are ineligible to participate in the Purchase of Service Credit program due to the benefit changes negotiated with the July 1, 2005 MOU. However, SDCERS has asserted that due to delays in codification of benefit changes into the municipal code, the effective cut off date would instead be February 16, 2007, which is when the Ordinance O-19567 was officially codified in the Municipal Code. As of the issuance of this report, there has been no change in the status of this case [refer to Note 18 for additional information]. Notwithstanding amendments to the municipal code, SDCERS' members who were hired prior to July 1, 2005 are eligible to participate the Purchase of Service Credit Program at the full cost to the participant.

Corbett Settlement Benefits and Retirement Factors

In 1998, a lawsuit was filed by retired employees who alleged that the City's definition of compensation subject to the computation of retirement benefits improperly excluded the value of certain earnings. The City and SDCERS settled in May of 2000, which is known as the Corbett Settlement. This settlement provided for a flat increase of 7% in benefits payable to eligible members who retired prior to July 1, 2000, payable annually. The settlement also provided a 10% benefit increase and allows for two options in calculating the service retirement allowance for employees active at the time of the settlement and who joined the Retirement System before July 1, 2000 and who retired after July 1, 2000.

The options for calculating the service retirement allowance are outlined in the San Diego Municipal Code sections 24.0402 and 24.0403 which can be obtained at City of San Diego City Clerks Office 202 C Street, San Diego, CA 92101 or online at www.sandiego.gov.

On July 1, 2002, the City Council increased the retirement factors used for calculating retirement allowances; this action was related to MP-2 (as discussed later in this note). As a result of the Corbett Settlement and other benefit actions taken by the City Council, the service retirement factors for general members (non-safety and non-legislative) range from 2.0% at age 55 to 2.8% at age 65. The service retirement factors for Safety Members (Fire, Police and Lifeguard) range from 2.2% at age 50 to 3.0% at age 50 depending on the Corbett Settlement

option selected. Finally, the City also maintains an Elected Officer's Retirement Plan where members are eligible to receive 3.5% of their final average salary per year of creditable service. Depending on the number of years of service, participants of the Elected Officer's Retirement Plan can retire earlier than the age of 55; however, their retirement allowance is reduced by 2.0% for each year under the age of 55.

Preservation of Benefit Arrangement

On March 19, 2001, the City Council adopted Ordinance O-18930, adding SDMC sections 24.1601 through 24.1608, establishing the Preservation of Benefit (POB) arrangement. The POB arrangement is a qualified governmental excess benefit arrangement (QEBA) under Internal Revenue Code (IRC) section 415(m), which was created by Congress to allow the payment of promised pension benefits that exceed the IRC section 415(b) limits (and therefore cannot be paid from a qualified retirement plan). On October 28, 2008, the IRS issued a private letter ruling to SDCERS approving the qualified status of the QEBA. No additional payments or repayments are required as a result of the Compliance Statement. As provided in SDMC section 24.1606 and required by federal tax law, the POB arrangement is unfunded within the meaning of the federal tax laws. The City may not pre-fund the POB arrangement to cover future liabilities beyond the current year as it can with an IRC section 401(a) pension plan. SDCERS has established procedures to pay for these benefits on a pay-as-you-go basis. As of issuance of this report, actuarial liabilities related to retired member benefits that exceeded §415 limits are included in the RSI for the City's core pension Plan for valuation years up to and including fiscal year 2005. In the fiscal year 2006 actuarial valuation, the estimated actuarial accrued liability related to excess benefits for eligible active members of the system, amounting to approximately \$22,800, was removed from the Plan's Actuarial Liabilities (this liability is estimated to be approximately \$30,400 in the fiscal year 2007 actuarial valuation). Additionally, the liability for retired members of the POB arrangement, amounting to approximately \$6,400, has been excluded from the fiscal year 2007 actuarial valuation. Estimates related to the actuarial liability for benefits that exceed IRS §415 limits were calculated using actuarial assumptions consistent with those used to perform actuarial valuations for the City's core pension Plan and also pursuant to the Compliance Statement, dated December 20, 2007, and Tax Determination Letter provided by the IRS during Voluntary Correction Program discussions.

In Fiscal Year 2009, approximately \$1,300 in benefits were paid by the City for the POB arrangement. The number of participants in any given year for the POB arrangement is determined by the number of Plan participants who exceed the current year's IRS §415(b) limitations as calculated by SDCERS' actuary. The maximum annual payment for the calendar year 2009 was \$195 and is adjusted downward depending on the age of the participant when benefits began. In fiscal year 2009, the City's ARC was approximately \$4,004; however, the City contributed approximately \$1,210 to the POB arrangement, and therefore, the remaining \$2,794, which represents future liabilities, is included in the City's Net Pension Obligation (NPO). According to the valuation for the fiscal year ended June 30, 2009, the AAL related to the POB arrangement is approximately \$7,400, all of which is unfunded. Additionally, financial statements for the Preservation of Benefits arrangement are included in the Trust & Agency section of this report.

b. Summary of Significant Accounting Policies – Pension

Basis of Accounting - The pension trust fund uses the economic resources measurement focus and the accrual basis of accounting. Contributions are recognized as additions in the period in which the contributions are due and a formal commitment to provide the contributions has been made. Benefits and refunds are recognized when due and payable in accordance with the Plan.

Method Used to Value Investments - SDCERS investments are stated at fair value. The SDCERS custodial agent

provides market values of invested assets with the exception of the fair value of directly owned real estate assets which are provided by the responsible investment manager and independent third party appraisal firms. Investment income is recognized in accordance with GASB 25 and is stated net of investment management fees and related expenses.

c. **Contributions and Reserves - Disclosure Related to Long - Term Contracts and Other Agreements**

Funding Contracts: Union Agreements

The City has historically picked up a portion of the employee's retirement contributions. The fiscal year 2006 MOUs and the changes to current and future employee benefits therein were introduced to the City Council in June 2005, and the changes in benefit eligibility were approved by Council Resolution 300600.

The agreement in the MOUs (agreements with the police union were not reached) was to reduce the amount of individual employees' pension contributions which are paid for by the City, effective fiscal year 2006. The agreements with labor unions resulted in the reduction of City offset of the employee pension contribution by 3% for the Municipal Employees' Association (MEA), the International Association of Fire Fighters Local 145, and the Deputy City Attorney Association (DCAA) and a unilaterally imposed reduction of 3.2% for the San Diego Police Officers Association (POA). In addition, the American Federation of State and County Municipal Employees (AFSCME) Local 127 negotiated a 1.9% salary reduction in lieu of a City "pick up" contribution reduction and a benefit freeze.

The agreements with the bargaining units explicitly indicate that savings to the City must be used to help address its UAAL within the timeframe of the respective contracts. The labor contract with Local 127 states that "By June 30, 2008, if the City has not dedicated a total of \$600,000,000 or more to the UAAL reduction, including the amount received by leveraging employee salary reduction and pension contribution monies, the AFSCME salary reduction monies with interest will revert to SDCERS Employee Contribution Rate Reserve for benefit of Local 127 unit members to defray employee pension contributions."

Upon the conclusion of the fiscal year ended June 30, 2008, the City had contributed approximately \$143,300 through contributions in excess of the ARC for fiscal years 2006 through 2008, and therefore, was not able to meet the outstanding commitment in its entirety. As such, the City reached agreements with both MEA and Local 127. The MEA settlement required the City to return prior year savings to MEA members of approximately \$6,078 and eliminated 2% of the employee pick-up. The Local 127 settlement required the City to return prior year savings to Local 127 members of approximately \$4,786 as well as eliminate the 1.9% salary reduction.

Funding Commitments Related to Legal Settlements

The City employer contributions for fiscal years 1996 – 2003 were not based on the full actuarial rates. Instead, employer contributions were less than the full actuarial rates in accordance with agreements between the City and SDCERS, commonly referred to as Manager's Proposal 1 (MP-1) and Manager's Proposal 2 (MP-2). In September 2006, the City entered into a settlement of McGuigan v. City of San Diego (the "McGuigan Settlement") related to the underfunding by the City of the pension system. Under the McGuigan Settlement, the City is obligated to pay into SDCERS \$173,000 no later than June 8, 2011. An additional requirement of the McGuigan Settlement is that the City provides SDCERS real property collateral totaling \$100,000 (Non-Depreciable Capital Assets – Land). These amounts are to be returned upon the full payment of the settlement. The City provided the real property collateral at the time of the settlement; subsequently, the City provided a

cumulative amount of approximately \$144,000¹ of additional payments to SDCERS in an attempt to meet the terms of the McGuigan Settlement. This leaves an outstanding obligation resulting from the McGuigan Settlement of approximately \$35,722, including interest as of June 30, 2009. The McGuigan Settlement was partially funded through the securitization of future tobacco revenue, transfers of actual tobacco revenue receipts, additional employee "pick up" savings, and City contributions made in addition to the ARC.

d. **Funding Policy and Contribution Rates**

City Charter Article IX Section 143 requires employees and employers to contribute to the retirement Plan. The Charter section, which was amended in fiscal year 2005, stipulates that funding obligations of the City shall be determined by the Board of SDCERS and are not subject to modification by the City. The section also stipulates that under no circumstances may the City and Board enter into any multi-year funding agreements that delay full funding of the retirement Plan. The Charter requires that employer contributions be substantially equal to employee contributions (SDCERS' legal counsel has opined that this requirement applies to the normal cost contribution only). Pursuant to the Charter, City employer contribution rates, adjusted for payment at the beginning of the year, are actuarially determined rates and are expressed as a fixed annual required contribution as well as percentages of annual covered payroll. The entire expense of SDCERS' administration is charged against the earnings and Plan assets of SDCERS.

The following table shows the City's contribution rates (weighted average of each employee group) for fiscal year 2009, based on the valuation ended June 30, 2007, expressed as percentages of active payroll:

	Employer Contribution Rates	
	General Members	Safety Members
Normal Cost*	9.89%	18.41%
Amortization Payment*	13.86%	24.23%
Normal Cost Adjusted for Amortization Payment*	23.75%	42.64%
City Contribution Rates Adjusted for Payment at the Beginning of the Year	22.85%	41.03%

* Rates assume that contributions are made uniformly during the Plan year.

Normal Cost = The actuarial present value of pension plan benefits allocated to the current year by the actuarial cost method.

Amortization Payment = The portion of the pension plan contribution which is designed to pay interest on and to amortize the unfunded actuarial accrued liability.

Members are required to contribute a percentage of their annual salary to the Plan on a biweekly basis. Rates vary according to entry age. For fiscal year 2009, the City employee contribution rates as a percentage of annual covered payroll averaged 10.06% for general members and 12.69% for safety members. A portion of the employee's share, depending on the employee's member class, is paid by the City (commonly referred to as the Employee Offset). In fiscal year 2009, the amount paid by the City ranges from 1.4% to 5.89% of covered payroll for general members and the rate for safety Plan members ranges from 2.4% to 4.3%. Employee contributions paid by the City, amounting to approximately \$20,317 in fiscal year 2009, are made from the City's operating budget. The amount paid on behalf of the employees has been renegotiated through the meet and confer process which ultimately reduced the amount of the employee contribution paid by the City.

¹ This amount includes a contribution in addition to the ARC of approximately \$700 in fiscal year 2009.

On September 2, 2008, Council approved O-19781 which amended Chapter 2, Article 4, Division 15 of the San Diego Municipal Code. The intent of the amendment was to eliminate the concept of “Surplus Earnings” (earnings in excess of those earned using the assumed actuarial rate of return) which was the historical term for the funds used to pay for supplemental and contingent benefits. In accordance with these revised SDMC sections, annual distributions of these benefits are paid from Plan assets and take place in priority order. The Plan assets are distributed to various SDCERS system reserves, SDCERS budget, and contingent benefits. The order of distribution and a more detailed discussion of each distribution follows: First, Plan assets are used to credit interest, at a rate determined by the SDCERS Board, which is currently 7.75%, to the Employer and Employee Contribution Reserves and 3.54% to DROP member accounts. Second, Plan assets are used to fund the SDCERS Annual Budget. Third, Plan assets are distributed for supplemental or contingent payments or transfers to reserves. These items include in a priority order: 1) Annual Supplement Benefit Payment (“13th Check”) paid to retirees generally equal to approximately \$30 (whole dollars) times the number of years of employment. 2) Corbett Settlement Payment paid to retirees who terminated employment prior to July 1, 2000 (Corbett Settlement payments not paid in any one year accrue to the next year and remain an obligation of SDCERS until paid). 3) Crediting interest to the Reserve for Supplemental Cost of Living Adjustment (“COLA”).

e. **Funded Status and Funding Progress**

The following table summarizes the Plan’s funding status as of the most recent valuation date:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	UAAL (b - a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a)/c)
6/30/2008	\$ 4,660,346	\$ 5,963,550	\$ 1,303,204	78.15%	\$ 535,774	243.24%

The actuarial assumptions used for the fiscal year 2008 valuation include an Entry Age Normal actuarial funding method, an Expected Value of Assets smoothing method, a UAL that is amortized over several different periods, a 7.75% earnings assumption, a 4.0% projected salary increase rate with an additional merit component based on member class and years of service, a 2% annual cost-of-living adjustment and a 4% inflation rate. The required schedule of funding progress immediately following the notes to the financial statements presents multiyear trend information about whether the actuarial value of Plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

f. **Annual Pension Cost and Net Pension Obligation**

Annual Pension Costs

Beginning with the valuation dated June 30, 2007, the normal cost (i.e. the actuarial present value of pension Plan benefits allocated to the current year) and the UAAL amortization cost (i.e. the portion of the pension Plan payment designed to amortize the UAAL) were determined using the Entry Age Normal (EAN) actuarial cost method (as opposed to the previously used Projected Unit Credit method), the result of which caused the UAAL used in the determination of the fiscal year 2009 ARC to increase by approximately \$252,200. The following are the principal actuarial assumptions used for the fiscal year 2007 valuation (additional assumptions were used regarding a variety of other factors):

- a) An 8.0% investment rate of return, net of administrative expenses.**

- b) Projected salary increases of at least 4.25% per year.**
- c) An assumed annual cost-of-living adjustment that is generally 2% per annum and compounded. In addition, there is a closed group of special safety officers whose annual adjustment is equal to inflation (4.25% per year).

**Both (a) and (b) included an inflation rate of 4.25%.

The actuarial value of assets was determined using a methodology that smoothes the effects of short-term volatility in the market value of investments over a five-year period. In fiscal year 2007, the SDCERS Board approved a different asset smoothing method by marking the actuarial value of assets to market value in the fiscal year 2006 actuarial valuation, the result of which caused the UAAL to decrease by approximately \$183,800. The method used by the actuary in fiscal year 2005 was not a commonly used method. The expected actuarial value asset smoothing method commenced with the fiscal year 2007 valuation. Additionally, pursuant to the Gleason Settlement, the UAAL was being amortized over a fixed 30-year closed period for the fiscal years 2006, 2007, and 2008. However, for valuations effective June 30 2007, SDCERS' Board of Administration decided to use a 20-year closed amortization schedule with no negative amortization.

The following table shows the City's annual pension cost ("APC") and the percentage of APC contributed for the fiscal year ended June 30, 2009 and two preceding years (in thousands):

Fiscal Year Ended June 30	APC	Percentage Contributed	Net Pension Obligation
2007	\$ 169,762	99.63%	\$ 195,356
2008	145,077	114.82%	173,852
2009	167,529	97.66%	177,767

Net Pension Obligation

Net Pension Obligation (NPO) is the cumulative difference, since the effective date of GASB 27 (fiscal year 1998, with a 10-year look back), between the annual pension cost and the employer's contributions to the Plan. This includes the pension liability at transition (beginning pension liability) and excludes short term differences and unpaid contributions that have been converted to pension-related debt. As of June 30, 2009, the City's NPO is approximately \$177,767 and is reported in accordance with GASB 27. See table above.

The change to NPO is derived by first calculating the City's Annual Required Contribution ("ARC"). The ARC is calculated by actuarially determining the cost of pension benefits accrued during the year (normal cost) as well as the annual amount needed to amortize the UAAL (amortization cost) as reported by the actuary, in accordance with the amortization period and method selected. The ARC is then increased by interest accruing on any outstanding NPO (NPO Interest) and then reduced by the amortization of the UAAL that is related to the NPO (ARC Adjustment).

The following shows the calculation for NPO based on the actuarial information provided to the City (in thousands):

ARC [Fiscal Year 2009]	\$ 165,704
Interest on NPO	13,895
ARC Adjustment	<u>(12,070)</u>
Annual Pension Cost	167,529
Contributions [Fiscal Year 2009]	<u>(163,614)</u>
Change in NPO	3,915
NPO Beginning of Year [July 1, 2008]	173,852
NPO End of Year [June 30, 2009]	<u><u>\$ 177,767</u></u>

Components of the NPO and actions taken to address the Pension Liability

Multiple components have contributed to the City's NPO dating back to fiscal year 1988, including the use of pension assets to pay for costs related to retiree healthcare and employee contribution offset liabilities. Additionally, benefit increases resulting from the Corbett Settlement, which were initially considered contingent, were excluded from the actuarially determined ARC and the City's contributions for the fiscal years 1996-2003 were less than the ARC as a result of MP-1 and MP-2.

As part of the agreements with the labor unions, several benefits were altered or eliminated for all employees hired on or after July 1, 2005, including the Deferred Retirement Option Plan (DROP), the 13th Check, the option to purchase years of service credits ("air-time"), and retiree healthcare benefits; however, the retirement formula generally remains 2.5% at 55 for general members and 3.0% at 50 for safety members.

DEFINED CONTRIBUTION PLANS

a. Supplemental Pension Savings Plan - City

Pursuant to the City's withdrawal from the Federal Social Security System effective January 8, 1982, the City established the Supplemental Pension Savings Plan ("SPSP"). Pursuant to the Federal Government's mandate of a Social Security Medicare tax for all employees not covered by Social Security hired on or after April 1, 1986, the City established the Supplemental Pension Savings Plan-Medicare ("SPSP-M"). The SPSP and SPSP-M Plans were merged into a single plan ("SPSP") on November 12, 2004 for administrative simplification, without a change in benefits. Pursuant to the requirements of the Omnibus Budget Reconciliation Act of 1990 ("OBRA-90") requiring employee coverage under a retirement system in lieu of coverage under the Federal Insurance Contributions Act ("FICA") effective July 1, 1991, the City established the Supplemental Pension Savings Plan-Hourly ("SPSP-H"). These supplemental plans are defined contribution plans administered by Wachovia Corporation to provide pension benefits for eligible employees. There are no plan members who belong to an entity other than the City. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings, less investment losses. The City's general retirement members and lifeguard members of the City's safety retirement members participate in the plan. Eligible employees may participate from the date of employment.

The following table details plan participation as of June 30, 2009:

<u>Plan</u>	<u>Participants</u>
SPSP	8,323
SPSP – H	4,355

The SPSP Plan requires that both the employee and the City contribute an amount equal to 3% of the employee's total salary each pay period. Participants in the Plan hired before July 1, 1986 may voluntarily contribute up to an additional 4.5% and participants hired on or after July 1, 1986 may voluntarily contribute up to an additional 3.05% of total salary, with the City matching each. Hourly employees contribute 3.75% on a mandatory basis which is also matched by City contributions.

Under the SPSP Plan, the City's contributions for each employee (and interest allocated to the employee's account) are fully vested after five years of continuous service at a rate of 20% for each year of service. Hourly employees are immediately 100% vested. The unvested portion of City contributions and interest forfeited by employees who leave employment before five years of service are used to reduce the City's cost.

In fiscal year 2009, the City and the covered employees contributed approximately \$23,746 and \$22,643, respectively. As of June 30, 2009, the fair value of plan assets totaled approximately \$489,344. SPSP is considered part of the City of San Diego's financial reporting entity and is reported as a pension and employee savings trust fund.

b. **401(k) Plan - City**

The City established a 401(k) Plan effective July 1, 1985. The 401(k) Plan is a defined contribution plan administered by Wachovia Corporation to provide pension benefits for eligible employees. Employees are eligible to participate from date of employment. Employees make contributions to their 401(k) Plan accounts through payroll deductions, and may also elect to contribute to their 401(k) account through the City's Employees' Flexible Benefits Program.

The employees' 401(k) contributions are based on IRS calendar year limits. Employees contributed approximately \$22,246 during the fiscal year ended June 30, 2009. There is no City contribution towards the 401(k) Plan.

As of June 30, 2009, the fair value of plan assets totaled approximately \$220,022. The 401(k) Plan is considered part of the City's financial reporting entity and is reported as a pension and employee savings trust fund.

c. **Pension Plan - Centre City Development Corporation (CCDC)**

CCDC has a Money Purchase Pension Plan covering all full-time permanent employees (the "CCDC Plan"). The CCDC Plan is a defined contribution plan under which benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate on the first day of the month following 90 days after their date of employment. During each year, CCDC contributes semi-monthly an amount equal to 8% of the total quarterly compensation for all employees. CCDC's contributions for each employee are fully vested after six years of continuous service. CCDC's total payroll (excluding benefits) in fiscal year 2009 was approximately \$3,964. CCDC contributions were calculated using the base salary amount of approximately \$3,784. CCDC made the required 8% contribution amounting to approximately \$278 (net of forfeitures) for fiscal year 2009.

In addition, CCDC has a Tax Deferred Annuity Plan covering all full-time permanent employees. The CCDC Plan is a defined contribution plan under which benefits depend solely on amounts contributed to the plan by the employer and the employees, plus investment earnings. Employees are eligible to participate on the first day of the month following 90 days after their date of employment. During each plan year, CCDC contributes semi-monthly an amount equal to 16% of the total semi-monthly compensation for eligible employees. CCDC's contributions for each employee are fully vested at time of contribution. The Tax Deferred Annuity Plan includes

amounts deposited by employees prior to CCDC becoming a contributor to the CCDC Plan. CCDC made the required 16% contribution amounting to approximately \$610 for fiscal year 2009.

The fiduciary responsibilities of CCDC consist of making contributions and remitting deposits collected. The City does not hold these assets in a trustee or agency capacity for CCDC; therefore, these assets are not reported within the City's basic financial statements.

d. **Pension Plan - San Diego Convention Center Corporation (SDCCC)**

SDCCC's Money Purchase Pension Plan (the "SDCCC Plan") became effective January 1, 1986. The SDCCC Plan is a qualified defined contribution plan and as such, benefits depend on amounts contributed to the SDCCC Plan plus investment earnings less allowable plan expenses. The SDCCC Plan covers employees not otherwise entitled to a retirement/pension plan provided through a collective bargaining unit agreement. Employees are eligible at the earlier of the date on which they complete six months of continuous full-time service, or the twelve-month period beginning on the hire date (or any subsequent Plan year) during which they complete 1,000 hours of service.

A plan year is defined as a calendar year. SDCCC's balance for each eligible employee is vested gradually over five years of continuing service with an eligible employee becoming fully vested after five years. Forfeitures and SDCCC Plan expenses are allocated in accordance with Plan provisions. A trustee bank holds the SDCCC Plan assets. The City does not act in a trustee or agency capacity for the SDCCC plan; therefore, these assets are not reported within the City's basic financial statements.

For the year ended June 30, 2009, pension expenditures for the SDCCC Plan amounted to \$1,378. SDCCC records pension expenditures during the fiscal year based upon estimated covered compensation.

e. **Pension Plan - San Diego Data Processing Corporation (SDDPC)**

SDDPC administers a Money Purchase Pension Plan (the "SDDPC Plan") covering substantially all employees. The SDDPC Plan is a defined contribution plan, wherein benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate from the date of employment. During each plan year, SDDPC contributes monthly an amount equal to 20% of the total monthly compensation for all employees. SDDPC contributions for each employee are fully vested after four years of continuing service. The City does not act in a trustee or agency capacity for the SDDPC Plan; therefore, these assets are not reported within the City's basic financial statements. In fiscal year 2009, SDDPC made the required 20% contribution, amounting to approximately \$4,023.

SDDPC also administers a Tax Sheltered Annuity Plan, a voluntary defined contribution plan covering all employees of SDDPC who are eligible for membership as defined by the plan document. There are no employer contributions to this plan.

f. **Pension Plan - San Diego Housing Commission (SDHC)**

SDHC provides pension benefits for all its full-time employees through a defined contribution plan (the "SDHC Plan"). In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate on the first day of their employment. SDHC's contributions for each employee (and interest allocated to the employee's account) are fully vested after four years of continuous service. SDHC's contributions for, and interest forfeited by, employees who leave employment before four years of service are used to reduce the SDHC's current-period contribution requirement. SDHC's covered payroll in

fiscal year 2009 was approximately \$12,166. SDHC made the required 14% contribution, amounting to approximately \$1,703 and plan members contributed \$67 for fiscal year 2009. The City does not act in a trustee or agency capacity for the SDHC Plan; therefore, these assets are not reported within the City's basic financial statements.

g. **Pension Plan - Southeastern Economic Development Corporation (SEDC)**

SEDC has a 403(b) Tax Sheltered Annuity Plan (Defined Contribution Plan) covering all full-time permanent employees (the "SEDC Plan"). The first six months of the current fiscal year, July 1, 2008 to December 31, 2008, the plan was administered by James Kerr & Associates, Inc with Morgan Stanley Dean Witter as the investment advisor. Under this plan, SEDC contributed a monthly amount equal to 12% of the employees' base salary, or 15% of management employees' base salary. This plan terminated on December 31, 2008. All assets of the plan were transferred to a new 403(b) Tax Sheltered Annuity Plan, effective January 1, 2009. This plan is currently administered by VLP Corporate Services, LLP with Merrill Lynch as the investment advisor. Employees are eligible on their date of employment, and SEDC contributes an amount equal to 12% of all employees' salaries. SEDC's total payroll in fiscal year 2009 was approximately \$813 and SEDC made the required 403(b) contribution totaling \$96 for fiscal year 2009. SEDC Plan members contributed an additional \$14.

13. OTHER POSTEMPLOYMENT BENEFITS (In Thousands)

a. Plan Description

The City provides postemployment healthcare benefits to qualifying general, safety and legislative members, as provided for in San Diego Municipal Code (SDMC) Sections 24.1201 through 24.1204. The Other Postemployment Benefit Plan (the "OPEB Plan") is a single-employer plan, administered by SDCERS, and includes approximately 5,400¹ retirees, 8,900¹ active employees and 600¹ terminated vested members as of June 30, 2009. Postemployment healthcare benefits are primarily for health eligible retirees who were actively employed on or after October 5, 1980 and were otherwise entitled to retirement allowances. Health eligible retirees can obtain health insurance coverage with the plan of their choice, including any City sponsored, union sponsored, or privately secured health plan. In fiscal year 2009, health eligible retirees who were also eligible for Medicare are entitled to receive reimbursement/payment of healthcare premiums, limited to approximately \$8.4 per year, in addition to reimbursement/payment for Medicare Part B premiums, limited to approximately \$1.2 per year. Health eligible retirees who are not eligible for Medicare are entitled to receive reimbursement/payment of healthcare premiums, limited to approximately \$8.9 per year. Reimbursements for health eligible retirees are adjusted annually based upon the projected increase for National Health Expenditures by the Centers for Medicare and Medicaid Services. Annual adjustments may not exceed 10% for any plan year. Non-health eligible employees who retired or terminated prior to October 6, 1980 and who are otherwise eligible for retirement allowances are also eligible for reimbursement/payment of healthcare benefits limited to a total of \$1.2 per year. Reimbursements for non-health eligible retirees are not subject to annual adjustments.

As of July 1, 2005, the City's postemployment healthcare benefit plan is closed to new entrants. However, SDCERS has asserted that due to delays in codification of benefit changes into the Municipal Code, the effective cut off date would instead be February 16, 2007, which is when the Ordinance O-19567 was officially codified in the Municipal Code. As of the issuance of this report, there has been no change in the status of this case [refer to Note 18 for additional information].

Effective July 1, 2009, the City has agreed to establish a trust vehicle for a defined contribution plan to fund retiree medical benefits for employees who are excluded from the current plan. This defined contribution plan requires a mandatory employee contribution of 0.25% of gross salary with a corresponding 0.25% match by the City. Legislative and Safety members are ineligible for this plan. Additionally, as part of the agreements with the labor unions, the new definition of "health-eligible retiree" states that employees must have 10 years of service with the City to receive 100% of the retiree health benefit and five years of service to receive 50% of the retiree health benefit.

b. Summary of Significant Accounting Policies

Basis of Accounting - The postemployment healthcare trust funds use the economic resources measurement focus and the accrual basis of accounting. Contributions are recognized as additions in the period in which the contributions are due and a formal commitment to provide the contributions has been made. Benefits and refunds are recognized when due and payable in accordance with the OPEB Plan.

Method Used to Value Investments - CalPERS investments are stated at fair value. Certain construction projects and alternative investments are reported at cost, which approximates market value. Mortgages are valued on the basis of their future principal and interest payments discounted at prevailing interest rates for similar instruments. The fair value of real estate investments, principally rental property subject to long-term net leases, is estimated based on independent appraisals.

¹ Reported as a whole number.

c. Contributions and Reserves

In accordance with SDMC Section 24.1204, postemployment healthcare benefits are to be paid by the City, directly, from any source available to it other than the Pension Plan. Members of the OPEB Plan do not have contribution requirements related to their own coverage; however, retirees are required to pay for the benefits of their beneficiaries (amounts vary based on coverage elections). In fiscal year 2009, the City contributed \$25,587 to the Post-Employment Healthcare Benefit Plan, which is administered by SDCERS.

In addition to current retirees and beneficiaries, the OPEB Plan includes active and terminated vested members, and therefore, the City also pre-funds future expenses related to postemployment healthcare benefits through an investment trust administered by CalPERS. The CalPERS Employers Retirement Benefits Trust (CERBT) requires the City to pre-fund in an amount not less than \$5 annually. An ARC for the OPEB Plan is calculated by the City's actuary on an annual basis. City management plans to continue funding current year postemployment healthcare benefits from the pay-as-you-go trust established with SDCERS until the City is able to pay the ARC in full. Additionally, City management intends to pre-fund the CERBT with up to \$25,000 on an annual basis, which is also outlined in the City's Five Year Financial Outlook. All contributions to the CERBT become trust assets.

The City contributed approximately \$23,911 to the CERBT in fiscal year 2009. As of June 30, 2009, the balance in the CERBT was approximately \$41,497. This balance is inclusive of all contributions to the plan as well as investment losses and administrative expenses amounting to approximately \$12,499 and \$45, respectively.

d. Funded Status and Funding Progress

The following table summarizes the OPEB Plan's funding status as of the most recent valuation date:

Schedule of Funded Status						
Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as % of Covered Payroll ((b-a)/c)
06/30/09	\$ 41,497	\$ 1,359,377	\$ 1,317,880	3.05%	\$ 549,012	240.05%

The schedules presented as required supplementary information following the notes to the financial statements present information regarding the funding status and employer contributions for the current and preceding fiscal years. The Schedule of Funding Progress is intended to present information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. The Schedule of Employer Contributions is intended to present trend information about the amounts contributed to the OPEB Plan by employers in comparison to the ARC determined in accordance with the parameters of GASB 43. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Actuarial calculations are based on the benefits provided under the terms of the substantive plan in effect at the time of each valuation. Additionally, actuarial calculations reflect a long-term perspective and include methods and assumptions that are designed to reduce short-term volatility of actuarial accrued liabilities and the actuarial value of assets. The following table summarizes the more significant actuarial methods and assumptions used to calculate the ARC for the fiscal year 2009 (actuarial valuation for the fiscal year ended June 30, 2007) as well as for the most current actuarial valuation (ended June 30, 2009):

<i>Description</i>	<i>Method/Assumption</i>
Actuarial Cost Method	Entry Age Normal
Amortization Method	Level Dollar
Remaining Amortization Period	30 years, open
Actuarial Asset Valuation Method	Fair Value
Discount Rate	6.69%*
Inflation Rate	N/A**
Projected Payroll Increases	N/A**
Health Care Cost Trend Rate	10% grading down 0.5% each year to 5%

* Determined as a blended rate based on the City's partial contributions to the Plan.

** Postemployment healthcare benefits are not based on inflation or payroll, but rather are determined based on the Health Care Cost Trend Rate.

Source: Buck Consultants

e. Other Postemployment Benefit Cost and Net OPEB Obligation (NOPEBO)

The following table presents the annual OPEB cost, the percentage of annual OPEB cost contributed during the fiscal year, and the net OPEB obligation at the end of fiscal year 2009 as well as for the preceding fiscal year:

Fiscal Year Ended	Annual OPEB Cost	Percentage Contributed	Net OPEB Obligation
06/30/08	\$ 91,346	58.63%	\$ 37,793
06/30/09	105,583	46.88%	93,878

As the administrator of the OPEB Plan, the City implemented GASB Statements 43 and 45 in fiscal year 2008 and elected to report a zero net OPEB obligation at the beginning of the transition year. The following table shows the calculation of the City's net OPEB obligation of the OPEB Plan for the fiscal year ended June 30, 2009 (based on the valuation ended June 30, 2007):

ARC [Fiscal Year 2009]	\$ 104,475
Interest on NOPEBO	2,548
ARC Adjustment	(1,440)
Annual OPEB Cost	105,583
Contributions [Fiscal Year 2009]	(49,498)
Change in NOPEBO	56,085
NOPEBO Beginning of Year [July 1, 2008]	37,793
NOPEBO End of Year [June 30, 2009]	\$ 93,878

14. INTERFUND RECEIVABLES, PAYABLES, AND TRANSFERS (In Thousands)

Interfund Working Capital Advance (WCA) balances are the result of loans between funds that are expected to be repaid in excess of one year. The majority of the advances, approximately \$7,359, are advances from the Housing and Urban Development (HUD) Section 108 grant funds to RDA. Interfund WCA balances at June 30, 2009 are as follows:

Contributing Fund (Receivable)	Benefitting Fund (Payable)	
	NonMajor Governmental	
NonMajor Governmental	\$	7,959

Interfund receivable and payable balances are the result of loans between funds that are expected to be repaid during the next fiscal year, as well as amounts due for services provided. \$5,980 represents amounts owed to SDDPC for data processing services provided to the City but not paid for until July 2009, and \$3,604 represents a deficit in the Subdivision Fund which is covered by Development Services. Interfund receivable/payable balances at June 30, 2009 are as follows:

Contributing Fund (Receivable)	Benefitting Fund (Payable)						Total
	General Fund	Non Major Governmental	Internal Service	Sewer Utility	Water Utility	Non major Enterprise	
General Fund	\$ -	\$ -	\$ 1,500	\$ -	\$ -	\$ -	\$ 1,500
Nonmajor Governmental	-	-	26	-	-	-	26
Nonmajor Enterprise	-	3,604	5	-	-	-	3,609
Internal Service	2,095	2,389	281	510	558	147	5,980
Total	\$ 2,095	\$ 5,993	\$ 1,812	\$ 510	\$ 558	\$ 147	\$ 11,115

The Sewer Utility Fund has an interfund loan receivable of \$3,487, and the Black Mountain Ranch FBA Fund, a capital projects fund, has a corresponding interfund payable of \$3,487 for advanced FBA project funding. The Sewer Fund agreed to finance the Carmel Valley Trunk Sewer project to facilitate earlier construction, of which a portion was deemed the responsibility of the Carmel Valley area developers and is intended to be reimbursed in fiscal year 2010 from FBA Fund assessment revenue.

PFFA issued pooled financing bonds, Series 2007 A and B for the purpose of making loans to RDA to be used for financing and refinancing redevelopment activities in the Southcrest, Central Imperial, and Mount Hope Redevelopment Project Areas. The PFFA debt service fund has an interfund loan receivable of \$33,460 and the Redevelopment Agency Fund has an aggregate interfund loan payable of \$33,460. Since these loans are between governmental funds, the interfund receivable and payable are eliminated through the government-wide conversion.

Interfund transfers result from the transfer of assets without the expectation of repayment. Transfers are most commonly used to (1) move revenues from the fund in which it is legally required to collect them into the fund which is legally required to expend them, including TOT, Storm Drain, and TransNet funds collected in said funds but legally spent within the General Fund, (2) utilize unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds, in accordance with budgetary authorizations, and (3) move tax revenues collected in the special revenue funds to capital projects and debt service funds to pay for the capital projects and debt service needs during the fiscal year.

Interfund transfer balances for the year ended June 30, 2009 are as follows:

Contributing Fund	Benefiting Fund							Total
	General Fund	Nonmajor Governmental	Sewer Utility	Water Utility	Nonmajor Enterprise	Internal Service	Governmental Capital Asset Transfers	
General Fund	\$ -	\$ 26,031	\$ -	\$ -	\$ 2,196	\$ 1,847	\$ -	\$ 30,074
Nonmajor Governmental	105,059	190,654	1,238	186	421	702	-	298,260
Sewer Utility	-	998	-	33	-	26	2,552	3,609
Water Utility	-	477	-	-	-	99	53	629
Nonmajor Enterprise	2,131	333	-	-	30	33	-	2,527
Internal Service	4,136	171	616	406	246	5	232	5,812
Governmental Capital Asset Transfers	-	-	-	3,257	-	3,174	-	6,431
Total	\$ 111,326	\$ 218,664	\$ 1,854	\$ 3,882	\$ 2,893	\$ 5,886	\$ 2,837	\$ 347,342

15. RISK MANAGEMENT (In Thousands)

The City is exposed to various risks of loss related to torts, including theft of, damage to, and destruction of assets, errors and omissions, injuries to employees, and natural disasters. The City has established various self-insurance programs and maintains contracts with various insurance companies to manage excessive risks.

The City maintains an excess liability insurance policy in collaboration with a statewide joint powers authority risk pool, the California State Association of Counties-Excess Insurance Authority (CSAC-EIA) for amounts up to \$50,000. The City's self-insurance retention amount is \$4,000.

The City offers a cafeteria-style flexible benefits plan. For Municipal Employees' Association (MEA) and Local-127 represented employees, this plan requires employees to choose a health plan unless covered elsewhere, and also a life insurance plan. It also gives employees the option of obtaining dental insurance, vision insurance, or catastrophic care insurance. For all other employees, the benefits plan is the same, with the exception that \$50 of City-paid life insurance is automatically provided outside of the flexible benefit credit. Employees can place remaining flexible benefit dollars into IRS qualified dental/medical/vision and childcare reimbursement accounts, into their 401(k), and/or take as cash.

The City is self-insured for workers' compensation and long-term disability (LTD). All operating funds of the City participate in both these programs and make payments to the Self Insurance Fund. Each fund contributes an amount equal to a specified rate multiplied by the gross salaries of the fund. These payments are treated as operating expenditures in the contributing funds and operating revenues in the Self Insurance Fund.

Public liability, workers' compensation, and long-term disability estimated liabilities as of June 30, 2009 are determined based on results of independent actuarial evaluations and include amounts for claims incurred but not reported and adjustment expenses. Claims liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amount of payouts, and other economic and social factors. Estimated liabilities for public liability claims have been recorded in the Self Insurance Fund, Sewer Utility Fund, and Water Utility Fund.

A reconciliation of total liability claims, for all three funds, showing current and prior year activity is presented below:

	Public Liability	Workers' Comp & Long- Term Disability	Total
Balance, July 1, 2007	\$ 104,244	\$ 175,798	\$ 280,042
Claims and Changes in Estimates	35,902	17,167	53,069
Claim Payments	(28,043)	(22,381)	(50,424)
Balance, June 30, 2008	112,103	170,584	282,687
Claims and Changes in Estimates	57,357	13,711	71,069
Claim Payments	(25,588)	(21,336)	(46,924)
Balance, June 30, 2009	<u>\$ 143,873</u>	<u>\$ 162,959</u>	<u>\$ 306,832</u>

The City, in collaboration with CSAC-EIA, maintains an "All Risk" policy which includes flood and earthquake coverage for scheduled locations for amounts up to \$25,000 per occurrence under the primary policy, with a \$25 deductible. Limits include coverage for business interruption losses for designated lease-financed locations. There is no sharing of limits among the City and member counties of the CSAC-EIA pool, unless the City and member are mutually subject to the same loss. Limits and coverage may be adjusted periodically in response to the requirements of bond financed projects, acquisitions, and in response to changes in the insurance marketplace.

Earthquake coverage is provided for designated buildings/structures and certain designated City lease-financed locations in the amount of \$60,000, including coverage for business interruption caused by earthquake at certain designated locations. Earthquake coverage is subject to a deductible of 5% of total values per unit per occurrence, subject to a \$100 minimum. The City's earthquake coverage is purchased jointly and shared with the member counties in the CSAC-EIA pool. Due to the potential for geographically concentrated earthquake losses, the CSAC-EIA pool is geographically diverse to minimize any potential sharing of coverage in the case of an individual earthquake occurrence. Depending upon the availability and affordability of such earthquake insurance, the City may elect not to purchase such coverage in the future, or the City may elect to increase the deductible or reduce the coverage from present levels.

The City is a public agency subject to liability for the dishonest and negligent acts or omissions of its officers and employees acting within the scope of their duty ("employee dishonesty" and "faithful performance"). The City participates in the joint purchase of insurance covering employee dishonesty and faithful performance through the CSAC-EIA pool. Coverage is provided in the amount of \$10,000 per occurrence, subject to a \$25 deductible.

During fiscal year 2009, there were no significant reductions in insurance coverage from the prior year. For each of the past three fiscal years, the settlements have not exceeded insurance coverage.

See Contingencies, Note 18, for additional information.

16. FUND BALANCE / NET ASSETS (DEFICIT) (In Thousands)

Development Services (Enterprise) has a net deficit of approximately (\$8,785), due to a drop in workload activity caused by the deteriorating economy. The department reduced their work force by 27 full time equivalents (FTE) in the three months prior to the end of fiscal year 2009, but the adjustment did not correct the structural deficit between revenues and expenditures. A user fee increase was approved by the City Council on October 27, 2009 per Resolution R-305326. Based upon the projected workload decline for the current fiscal year, the Development Services Department has reduced an additional 48 FTEs to correct the revenue/expenditure deficit. Further reductions will be made as required to respond to revenue deficits.

The Self Insurance Fund (Internal Service) has a net deficit of approximately (\$164,372), which represents unfunded estimated claims and claim settlements related to Public Liability, Workers' Compensation, and Long-Term Disability. It is anticipated that individual claim settlements will be funded through future user charges, subsequent to the filing of a claim and prior to its settlement. In addition to user charges, in January 2008 the Mayor's office presented a five-year financial outlook to the City Council, including a proposal to fund the Self Insurance Fund. As part of this proposal, during fiscal year 2009, \$10,000 was contributed to the Public Liability Fund and \$5,000 to the Workers' Compensation Fund. On November 13, 2007, the City Council also approved the formal City Reserve Policy. This policy contains a "Risk Management Reserve Policy" for the self insurance funds. Both the Public Liability and Worker's Compensation funds shall maintain dedicated reserves equal to 50% of the outstanding claims. This is to be achieved no later than fiscal year 2014. However, due to the continued decline in the economy, and a reduction in General Fund revenues, the City may reassess this reserve policy during fiscal year 2010. The Long-Term Disability fund reserve was set to be \$12,000 by fiscal year 2012 as recommended in the actuarial valuation report.

Publishing Services (Internal Service) has a net deficit of (\$674), due to a decline in work production and outdated pricing for services which are not fully cost recoverable. Publishing Services has restructured their rates to ensure full cost recovery. In Fiscal Year 2009, after the implementation of the revised rates, the net deficit decreased by \$76.

17. COMMITMENTS (In Thousands)

As of June 30, 2009, the City's business-type activities contractual commitments are as follows:

Airports	\$ 1,849
Environmental Services	5,205
Sewer Utility	91,639
Water Utility	92,938
Other	<u>2,051</u>
Total Contractual Commitments	<u>\$ 193,682</u>

These contractual commitments are to be financed with existing reserves and future service charges. The Sewer and Water Utility Funds intend to finance their contractual commitments with financing proceeds secured by system revenues, in addition to existing reserves and future service charges.

Consent Decree

On April 2, 2001, two environmental groups filed suit against the City alleging that the Municipal System's collection system was deficient as a result of sewer spills from December 1996 to the time of the filing. The complaint sought injunctive relief to prevent illegal discharges, a compliance schedule to upgrade the Municipal System's collection system, and civil penalties of \$27.5 per day for each day of violation. The City contested the plaintiffs' claims.

The U.S. Environmental Protection Agency (EPA) and the State also filed suits against the City alleging the same collection system violations, seeking unspecified penalties and injunctive relief for collection system improvements. All three cases were consolidated. On March 16, 2005, the City settled the State lawsuit for \$1,200. Of this total, \$1,000 funded three supplemental environmental projects to benefit the local environment, and \$200 was deposited in the State's Cleanup and Abatement Account.

The EPA, the City, and the environmental groups reached an agreement on additional requirements to reduce sewer spills, which are set forth in a Consent Decree (the "Consent Decree"). The Consent Decree requires increased sewer spill response and tracking, increased root control, replacement or rehabilitation of 250 miles of pipeline, a canyon economic and environmental analysis, pump station and force main upgrades, and entails court supervision of these upgrades at least through June 2013. The estimated average annual cost of this commitment is \$117,000 per year in capital projects and \$48,700 per year in operational maintenance to the sewer system (based on the projected expenditures for wastewater collections for fiscal year 2009); however, the costs for bidding, constructing and completing the required work will fluctuate depending on variables such as changes in the cost of materials and labor. No civil penalty payment was required, though stipulated penalties ranging from \$375 (in whole dollars) to \$20,000 (in whole dollars) per occurrence are included for subsequent violations of the Consent Decree. The Consent Decree was approved by the Court on October 9, 2007, settling all remaining issues in the case.

Four sewer rate increases were approved for fiscal year 2007 through fiscal year 2010 to partially fund the obligations of the Consent Decree. However, additional rate increases will be necessary (likely beginning in year 2011) to completely fund the Consent Decree. The City funds the Capital Projects in the Consent Decree through the issuance of notes and bonds which are repaid with sewer system revenues.

Agreement Relative to Modified Permit for the Point Loma Wastewater Treatment

In December 2008, the Environmental Protection Agency (EPA) released its tentative decision to approve the City's request to renew a modified permit for the Point Loma Wastewater Treatment Plant. Point Loma initially received a modified permit (also known as a waiver) in 1995, which was renewed in 2002. The City entered into an agreement with the environmental organizations to support the waiver and the City promised to conduct a study to identify opportunities to maximize recycling wastewater for non-potable and potable uses for an amount not to exceed \$2,000,000 (in whole dollars). This request is the City's second renewal. In June 2009, the State of California's Regional Water Quality Control Board concurred with the EPA and concluded the public hearing process by unanimously approving the modified permit. On October 7, 2009 the California Coastal Commission voted 8 to 4 to approve the modified permit with the condition that the City come back in 2 years with the Recycled Water Study. The City is evaluating the specifics of the condition and will return to the California Coastal Commission in February 2010 for further discussion and adoption of findings. During this time, the present modified permit will be administratively continued. Point Loma will continue to operate under the provisions of the modified permit that was adopted in 2002, in full compliance with the Clean Water Act section 301(h), as modified by the Ocean Pollution Reduction Act.

California Department of Public Health Compliance Order

In 1994, the City of San Diego entered into a compliance agreement with the State of California Department of Public Health (DPH) with the approval of City Council, after the DPH Drinking Water Field Operations Branch conducted a sanitary survey of the City's water system. This agreement required the City to correct operational deficiencies and begin necessary capital improvements. The City was notified in January of 1997 that it was not in compliance with this agreement. At that time, the DPH issued a compliance order. The January 1997 Compliance Order was last amended in May of 2007 (Amendment 11), and included additional items that were not in the original Compliance Order. The DPH Compliance Order will remain in effect until the required projects are completed.

Presently, the Water Department is meeting all of the requirements of the DPH Compliance Order, including the ongoing obligation to provide DPH with quarterly progress reports. On February 26, 2007, the City authorized an increase in water rates and charges to continue funding projects mandated in the DPH Compliance Order as well as other Capital Improvement Program projects. In addition, on October 8, 2007, November 17, 2008, and November 17, 2009, the City authorized "pass-through" rate increases to account for the higher cost of water purchased from the San Diego County Water Authority. The 2007 and 2008 pass-through rate increases took effect on January 1, 2008 and January 1, 2009, respectively. The November 2009 pass-through increase is scheduled to take effect on January 1, 2010. All three pass-through rate increases will help preserve the funds previously committed to DPH Compliance Order projects. In conjunction with the November 17, 2008 approval of the January 1, 2009 pass-through rate increase, the City also approved a rate increase to cover the cost of an indirect potable reuse demonstration project. This increase also took effect January 1, 2009 and is anticipated to sunset on July 1, 2010 at which time sufficient revenue is expected to have been generated to offset the costs of the project.

The DPH has authority to impose civil penalties if the City fails to meet Compliance Order deadlines, although DPH has not imposed such penalties to date. Violation of the DPH Compliance Order may be subject to judicial action, including civil penalties specified in the California Health and Safety Code, Section 116725. Section 116725 penalties for violating a schedule of compliance for a primary drinking water standard can go as high as \$25,000 (in whole dollars) per day for each violation. For violations of other standards, such as turbidity, the penalties can reach \$5,000 (in whole dollars) per day. There are a number of additional enforcement tools prescribed by law, including mandatory water conservation, litigation and service connection moratoriums.

The costs for bidding, constructing and completing the required work will fluctuate depending on variables such as changes in the cost of materials and labor. As of June 2009, the Water Department's DPH Compliance Order project and DPH related project costs approximate:

Total Projects	FY09 Actuals	FY10 - FY11	FY12 - FY19	TOTAL
DPH & EPA Requirements	\$ 126,355	\$ 131,212	\$ 216,279	\$ 473,846
DPH Related Projects	19,150	98,633	296,286	414,069

These commitments are to be financed with existing net assets, present and future revenues, and financing proceeds secured by system revenues.

Convention Center Dewatering

The City is responsible for the disposition and monitoring of the quality of groundwater from the parking structure at the San Diego Convention Center located adjacent to San Diego Bay. The Convention Center includes a subterranean parking garage, which is subject to infiltration of groundwater, much of which originates from the bay. This groundwater must be continually pumped from the parking structure to prevent it from being inundated. Approximately 500,000 gallons of groundwater is pumped daily from the parking structure. Until March 26, 2008, this water was discharged into San Diego Bay. The City held a National Pollutant Discharge Elimination System (NPDES) permit for the discharge, issued by the Regional Water Quality Control Board (RWQCB). Monthly groundwater discharge sample results have not met the standards dictated by the NPDES permit since the end of calendar year 2005. This triggered the implementation of work to cease effluent violations within 27 months (from the end of March 2008), pursuant to an order of the RWQCB.

To achieve compliance with groundwater discharge requirements, the City retained an engineering consultant in fiscal year 2006 to review all previous work and develop the most cost-effective engineering solution to achieve compliance. The consultant's final report was received in August 2007. This report determined that the most cost effective method to comply with the RWQCB Order in the near term was to divert the discharge from the bay to the sewer system.

The City of San Diego established the diversion to the sewer effective March 26, 2008 in compliance with the RWQCB Order. The City requested permission from the EPA to make diversion of the groundwater into the sewer system permanent. The EPA granted the City's request on December 3, 2009. The City is now requesting concurrence from the State Water Resources Control Board ("SWRCB"), which must also approve the permanent diversion as a condition of funding it received from the EPA and passed through to the City.

18. CONTINGENCIES (In Thousands)**FEDERAL AND STATE GRANTS**

The City recognizes as revenue grant monies received as reimbursement for costs incurred in certain Federal and State programs it administers. Although the City's Federal grant programs are audited in accordance with the requirements of the Federal Single Audit Act of 1984, the Single Audit Act Amendments of 1996 and the related U.S. Office of Management and Budget Circular A-133, these programs may be subject to financial and compliance audits by the reimbursing agencies. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time. The Single Audit for fiscal year 2008 was completed by Macias Gini & O'Connell LLP. The Single Audit for fiscal year 2009 is in process.

The Office of the Inspector General (OIG) audited the City's Community Development Block Grant (CDBG) program, specifically CDBG loans to RDA, and on December 30, 2008, OIG issued its audit report to HUD, Office of Community Planning and Development (OPD). In addition to other findings, OIG determined that the City failed to execute loan agreements and repayment schedules for the CDBG loans issued to RDA that include a principal balance of \$63,000 and an accumulated interest of approximately \$76,000 totaling \$139,202 in loans outstanding. The OIG audit report recommended that HUD require the City to execute written interagency agreements and loan agreements with RDA for these outstanding loan amounts. The City is currently in discussions with HUD on the audit findings and any actions HUD may require of the City, including the possible repayment by the City of certain CDBG funds and that HUD could forgive a portion of the accumulated interest so that repayment of the loans would not adversely impact RDA project areas. Depending on the outcome of the City's negotiations with HUD, repayment of the loans by RDA could impact RDA's liquidity. These loans are reported as a component of loans payable and accrued interest payable to the City in the long-term liabilities footnote of the Redevelopment Agency Financial Statements with an "unscheduled" maturity date. These loans do not appear in the City's CAFR as they represent interfund loans between two governmental funds in which repayment is not expected in a reasonable amount of time. Therefore, these loans are reported as interfund transfers in the fund level statements, and then eliminated as interfund activity in the government wide statements per GASB 34.

CONTINUING DISCLOSURE OBLIGATIONS

The City, in connection with all bond offerings since the effective date (July 1995) of the continuing disclosure requirements of SEC Rule 15c2-12, has contractually obligated itself to provide annual financial information, including audited financial statements, within certain specified time periods (generally nine months) after the end of each fiscal year. During fiscal year 2009, the City has met its contractual obligations to provide to the national repositories the audited financial statement for the fiscal year ended 2008 and certain annual financial information and operating data for fiscal year ended 2008 on a timely basis. Previously, the City failed to file required annual reports and the audited financial statements by the filing dates for the fiscal years ended 2003 through 2007. Each required annual report and the audited financial statements were subsequently filed. As of fiscal year 2009, there are no annual reports pending to be filed.

SEC ACTIONS

In November 2006, the Securities and Exchange Commission (SEC) entered an Order sanctioning the City of San Diego for committing securities fraud by failing to disclose, in 2002 and 2003, material information about its pension and retiree health care obligations in connection with disclosures relating to the sale of its municipal bonds. To settle the action, the City agreed to cease and desist from future securities fraud violations and to retain an independent

consultant for three years to foster compliance with its disclosure obligations under the federal securities laws. The SEC's investigation with respect to the City's misleading disclosures may be ongoing as to individuals and other entities that may have violated the federal securities laws.

The SEC Order sanctioning the City of San Diego for committing securities fraud is available at: www.sec.gov

Changes to the City Charter to enhance the independence of both the City Auditor and the Audit Committee were approved with the passage of Proposition C (Prop C) in the June 3, 2008 election. These amendments included a restructured Audit Committee consisting of two Councilmembers, one being chair, and three public members. The public members must have at least ten years of professional auditing or accounting experience, and are appointed by the City Council.

INDEPENDENT CONSULTANT'S REPORTS

The Independent Consultant required by the SEC Order has several specific mandates. Among these are annual reviews, for a three year period, of the City's policies, procedures and internal controls regarding financial disclosures. The Independent Consultant is also required to make recommendations concerning the City's policies, procedures and internal controls and to assess the City's adoption and implementation of these recommendations

On April 24, 2009 the Independent Consultant issued his second annual report to the City of San Diego which was presented to the City Council on July 20, 2009. This report described his review and assessment of the City's policies, procedures and internal controls regarding the City's financial and other disclosures; the hiring of internal personnel and external experts for disclosure functions and; training programs focused on compliance and disclosure obligations. His complete report and recommendations is available at: www.sandiego.gov (included with the July 20, 2009 Audit Committee materials.)

On September 30, 2009 the Mayor sent a response to the Independent Consultant's second annual report to the Securities and Exchange Commission. This response is available at: www.sandiego.gov.

STATUS OF INTERNAL CONTROLS OVER FINANCIAL REPORTING

The plan to improve the City's internal controls over financial reporting includes the implementation of an enterprise resource planning (ERP) system during fiscal year 2010 to improve the way the City manages finances and the processes and internal controls involved in the City's accounting and human resources functions. As of June 30, 2009, setup work for the internal controls module called Governance, Risk and Compliance (GRC) has been completed within our ERP system. The GRC system for monitoring and testing access and process controls was activated with the new ERP system on July 1, 2009. The City has an 18 month internal controls plan in place that addresses the remediation of internal control weaknesses over financial reporting through more robust process documentation, further access and process control development within GRC, internal control testing, and employee training.

LITIGATION AND REGULATORY ACTIONS

The City is a defendant in lawsuits pertaining to material matters, including claims asserted which are incidental to performing routine governmental and other functions. This litigation includes but is not limited to: actions commenced and claims asserted against the City arising out of alleged torts; alleged breaches of contracts; alleged violations of law; and condemnation proceedings. The City has received approximately 2,300 notices of claims in fiscal year 2009.

The estimate of the liability for unsettled claims has been reported in the Government-wide Statement of Net Assets and the proprietary funds financial statements. The liability was estimated by categorizing the various claims and supplemented by information provided by the City Attorney with respect to certain large individual claims and proceedings. The recorded liability is the City's best estimate based on available information.

Significant individual lawsuits are described below.

SDCERS v. City of San Diego

In 1996 and 2002, SDCERS, the City, and various labor unions entered into agreements wherein the City's contribution to the pension system was less than the actuarially required contribution, while also increasing pension benefits. SDCERS has filed a complaint claiming the benefits are legal and should continue to be paid by the City. The City Attorney filed a cross-complaint alleging the benefits were not legal; however, that case was dismissed in January 2007. SDCERS filed a compulsory cross-complaint against the City, seeking damages in an amount equivalent to what the City should have contributed to the pension system in the absence of the funding relief granted by earlier management agreements MP-1 and MP-2. The City does not currently have an estimate of the range, if any, potential loss in the event of an adverse ruling.

City v. SDCERS

On October 15, 2007, the City filed a lawsuit concerning the effective date of certain benefit changes arising from the 2005 MOU entered into between the City and four of its collective bargaining units. The City contends the effective date of the benefit changes is July 1, 2005; however, the defendants contend the effective date is February 16, 2007 when the Municipal Code change was codified by O-19567. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of \$0 - \$5,000.

Ernest Abbit, etc. v. City of San Diego

Residents of the De Anza Mobilehome Park filed a lawsuit alleging violations of the California Mobilehome Residency laws for management abuses and individual tort claims. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of \$0 - \$19,000.

Joseph Aglio, etc v. City of San Diego

This complaint was filed by the firm Tatro & Zamoyski, representing a separate class of residents of the De Anza Mobilehome Park that were previously excluded from the Ernest Abbit case above due to settlements entered into with the City or because they were evicted. The claims are identical to the Ernest Abbit case. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of \$0 - \$16,000.

Colony Hills Homeowners Association, Wayne Akeson, et al. v. City of San Diego

On August 6, 2006, a lawsuit arose following a water main break which caused flooding along a private street in the Colony Hills Homeowners Association in La Jolla. Claimants allege the water main failure caused soil subsidence, hillside failure, road failure and diminished property values of forty homes. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of \$0 - \$45,000.

Janet Wood v. City of San Diego

This case against the City claims that women and unmarried retirees receive less benefits than others. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of \$0 - \$2,000.

Frazier, Patricia, et al v. City of San Diego

This is an action by former City employees who are now defendants to a civil action by the SEC. Plaintiffs seek a declaratory judgment in the form of an order from the courts for the City to defend and indemnify Plaintiffs. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of \$0 - \$3,000.

San Diego Police Tow operators v. City of San Diego

This case was brought by the towing companies under contract with the City, and alleges that the City is charging them "franchise fees" that exceed the amount permitted to be charged under the California Vehicle Code. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of \$0 - \$14,000.

California Restaurant Management System Inc. v. City of San Diego

The California Restaurant Management System filed a class action lawsuit seeking refunds of sewer collection fees paid by "Food Service Establishments" as defined by the City's wastewater department. The Plaintiff alleges that the City failed to properly calculate the proportional impact of Food Service Establishments' use of the sewer system in determining sewer rates from 1994-2004. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of \$0 - \$5,000.

Richard S. Pearson v. Mission and PB Drive, LLP and City of San Diego

Mission and PB Drive, LLP (MPB) is currently building a mixed-use, residential-commercial development on property which shares a common border with Pearson's residential property in Pacific Beach. The City owns a six foot drainage easement along the common border of the Pearson and MPB properties. MPB sued Pearson for trespass and nuisance. Pearson then filed a cross-complaint against MPB for nuisance, trespass and to quiet title to easement/declaratory relief/prescriptive easement. Pearson then amended his cross-complaint to bring the City into the lawsuit claiming nuisance, breach of contract, implied contractual indemnity, invasion of privacy and quiet title to easement/declaratory relief/prescriptive easement. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of \$0 - \$2,500.

Betty Jones v. City of San Diego

This case concerns an allegation of personal injury due to a trip and fall in a City park. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of \$0 - \$2,000.

Grande North at Santa Fe Place Home Owner's Association v. BOSA Development; City of San Diego

This case alleges property damage from hydrogen sulfide gas escaping from sewer lines. The damage includes the venting and plumbing throughout the multiple unit high rise condominium project. In the event of an adverse ruling, the liability facing the City is estimated to be in the range of \$0 - \$10,000.

Significant regulatory actions are described below (Other regulatory actions are described in Note 17 Commitments).

POLLUTION REMEDIATION OBLIGATIONS

In November 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and clean ups. This Statement is effective for this fiscal year ended June 30, 2009.

Significant Pollution Remediation Events are discussed below:

California Regional Water Quality Board Administrative Proceeding

This matter involves a tentative cleanup and abatement order by the Regional Water Quality Control Board (RWQCB) which when made effective will require remediation of polluted bay sediments near historic shipyards on San Diego Bay. The City has been named as a "Discharger" in the tentative order along with other entities which include shipyard operators, the local electric utility SDG&E, and the U.S. Navy. The basis for the City being named is pollution flowing from its storm water conveyance system into the bay and Chollas Creek, which empties into the bay at the site. The discharges causing the polluted sediment are alleged to have occurred from 1915 to present. The order was originally issued in 2005 and was stayed by the Board in 2006; the stay was lifted in April 2008 after the RWQCB staff revised and reissued the tentative order. The proceeding was then stayed again in June 2008 while the parties pursued mediation. The Board has extended the mediation stay several times, at this time indefinitely, as the parties continue to actively pursue a settlement in confidential mediation. It is anticipated that a mediated settlement will be presented for public consideration and adoption by the RWQCB in late 2009 or early 2010, and that the RWQCB staff and Dischargers will be in accord with this possible settlement proposal. It is uncertain whether intervening environmental groups will subscribe to a proposed settlement and a contested hearing before the RWQCB and litigation remain possible results. The total cost of the cleanup is estimated to be between \$900 and \$122,000 (industrial shipbuilders urge the low end, environmental groups urge cleanup levels that would cost at the high end) – but those are the far ends of the spectrum and the cost of the actual total cleanup will likely be in the \$40,000 to \$80,000 range, subject to post-remedial monitoring, plus an additional \$6,000 to \$9,000 in site investigation, assessment costs, and RWQCB oversight costs. The order will include post-remedial monitoring requirements which, depending on monitoring results and trends, may lead to further cleanup orders. The parties will address allocation of all of these costs in mediation; however there exist many variables which make accurate estimation of the City's likely share of the total costs impossible at this time. Issues of allocation among the parties will be determined using principles established in the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), as interpreted in existing case law. CERCLA principles will be the basis of discussion in further mediation, and absent a settlement on allocation, those principles will be at issue in litigation. In this case there are a myriad of factual inputs relative to the CERCLA principles of allocation. Disputes over those facts and the weight they should be given, the number of Discharger parties, the confidential nature of the mediation, and the exposure to the possibility of litigation all preclude the City from publishing more a specific projected outcome in this matter at this time.

California Regional Water Quality Board (Board) Administrative Civil Liability Complaint

This matter involves a sewage spill into Lake Hodges in August 2007. The allegation from the Board is that the City violated the Clean Water Act and its NPDES permit. The penalty approved by the Board's staff, on 11/18/09, is \$620 with an additional amount also due Santa Fe Irrigation for \$60 as a result of the same spill. The \$620 liability has been accrued in the Water Utility fund level financial statements.

County Department of Environmental Health (DEH) Unauthorized Release Cases

The City owns Underground Storage Tank Systems (UST) at various locations, including but not limited to: Airports, Fleet Division, and Fire and Rescue Divisions. The City has been named as a responsible party by the DEH in 23 cases located at 11 UST sites. The nature of the pollution involves soil and groundwater contamination by the UST's. The City has been able to utilize the State's UST Cleanup Fund to obtain reimbursement for a vast majority of the site assessment and mitigation costs. An estimate of the City's Pollution Liability has been calculated using a variety of methods and assumptions including but not limited to: soil borings; monitoring wells; lateral and vertical extent of impacts being defined; treatment; attenuation monitoring; and, soil and vapor sampling. The liability for each site ranges from \$0 to \$1,000, all but two estimates are under \$300. Given that the vast majority of all costs are paid out of the State's UST Cleanup Fund, and the majority of the estimates are of relatively small amounts, the estimates are expensed when incurred throughout the year in the responsible fund and no liability is accrued in the financial statements.

19. THIRD PARTY DEBT (In Thousands)

The City has authorized the issuance of certain conduit revenue private activity bonds, in its name, to provide tax exempt status because it believes a substantial public benefit will be achieved through the use of the proceeds. Aside from the fact that these bonds have been issued in the City's name, the City has no legal obligation to make payment on these bonds and has not pledged any City assets as a guarantee to the bondholders. The following describes the outstanding third party debt:

Mortgage and Revenue Bonds

Single family mortgage revenue bonds have been issued to provide funds to purchase mortgage loans secured by first trust deeds on newly constructed and existing single-family residences. The purpose of this program is to provide low interest rate home mortgage loans to persons of low or moderate income who are unable to qualify for conventional mortgages at market rates. Multi-family housing revenue bonds are issued to provide construction and permanent financing to developers of multi-family residential rental projects located in the City to be partially occupied by persons of low income.

As of June 30, 2009, the status of all third party bonds issued is as follows (in thousands):

	Original Amount	Balance June 30, 2009
Mortgage Revenue	<u>\$ 15,700</u>	<u>\$ 7,320</u>

These bonds do not constitute an indebtedness of the City. The bonds are payable solely from payments made on and secured by a pledge of the acquired mortgage loans, certain funds and other monies held for the benefit of the bondholders pursuant to the bond indentures, property liens and other loans. In reliance upon the opinion of bond counsel, City officials have determined that these bonds are not payable from any revenues or assets of the City, and neither the full faith nor credit of the taxing authority of the City, the state, or any political subdivision thereof is obligated to the payment of principal or interest on the bonds. In essence, the City is acting as a conduit for the private property owners/bondholders in collecting and forwarding the funds. Accordingly, no liability has been recorded in the City's government-wide statement of net assets.

20. CLOSURE AND POST CLOSURE CARE COST (In Thousands)

State and federal laws and regulations require that the City of San Diego place a final cover on its Miramar Landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for thirty years after closure. Although closure and post closure care costs will be paid only near or after the date that the landfill stops accepting waste, the City reports a portion of these closure and post closure care costs as an operating expense in each period based on landfill capacity used as of each financial statement date.

The \$19,336 reported as landfill closure and post closure care liability at June 30, 2009 represents the cumulative amount reported to date based on the use of 76% of the estimated capacity of the landfill. The remaining life of the landfill is approximately eight years, based on the estimated closing date of 2017.

The City will recognize the remaining estimated cost of closure and post closure care of \$6,112 as the remaining estimated capacity is filled. These amounts are based on what it would cost to perform all closure and post-closure care at June 30, 2009. Actual costs may be higher due to inflation, changes in technology, or changes in regulations.

The City is required by state and federal laws and regulations to make annual contributions to finance closure and post-closure care. The City is in compliance with these requirements and at June 30, 2009, cash or equity in pooled cash and investments of \$37,983 was held for this purpose. This is reported as restricted assets on the statement of net assets in the Environmental Services Fund. The City expects that future inflation costs will be paid from interest earnings on these annual contributions. However, if interest earnings are inadequate or additional post-closure care requirements are determined (due to changes in technology or applicable laws or regulations, for example), these costs may need to be paid by charges to future landfill users or from other sources.

21. OPERATING AGREEMENTS (In Thousands)San Diego Data Processing Corporation and Automated Regional Justice Information System

SDDPC has a yearly information technology services contract agreement with a joint powers agency known as the Automated Regional Justice Information System ("ARJIS") whose main purpose is to pursue development of computerized law enforcement systems in the region.

Under the agreement, SDDPC provides information technology services to ARJIS at rates which, on an annual basis, are equivalent to those charged to other governmental agency clients. Included in SDDPC's services revenue is approximately \$3,689 related to ARJIS for the year ended June 30, 2009.

City of San Diego and Padres L.P.

On February 1, 2000, the City entered into a Joint Use and Management Agreement (Agreement) with the San Diego Padres baseball team (Padres) governing the rights and duties of the City and Padres with respect to the use and operation of the new Petco Park Ballpark Facility (Facility). The Facility was completed and operational in April 2004 and the City and Padres jointly own the facility. The Padres have a 30% divided interest based upon the original Facility cost estimate of \$267,500 (or \$80,250), and the City owns 70%, which is capitalized on the City's books. The City and the Padres have agreed upon the schedule of items and components that constitute the Padres' divided ownership, and the value of that divided ownership may vary from (but does not exceed) 30% due to the calculation of cost overruns for the Facility. Following termination of any occupancy agreement for the Facility, the Padres' ownership interest will automatically transfer to the City. Under the terms of the Agreement, the Padres are responsible for Facility operation and management, including maintenance, repairs and security required to preserve its condition. The City is responsible for paying certain expenses associated with the operation and maintenance of the Facility, up to a maximum of \$3,500 per year, subject to certain inflationary adjustments.

For information pertaining to the operating agreement with San Diego Medical Services Enterprises, LLC please refer to Note 9, Joint Ventures and Jointly Governed Organizations.

22. SUBSEQUENT EVENTS (In Thousands)

On July 1, 2009, the City issued the fiscal year 2009-2010 Tax and Revenue Anticipation Notes in the amount of \$125,000 to meet the annual general fund cash flow needs of the City. The fiscal year 2008-2009 Tax Revenue Anticipation Note was repaid on April 1, 2009.

On July 24, 2009, the State Legislature passed Assembly Bill (AB) 26 4x, which requires redevelopment agencies statewide to deposit a total of \$2.05 billion of property tax increment in county "Supplemental" Educational Revenue Augmentation Funds (SERAF) to be distributed to meet the State's Proposition 98 obligations to schools. The SERAF revenue shift of \$2.05 billion will be made over two years, \$1.7 billion in fiscal year 2010 and \$350 million in fiscal year 2011. The SERAF would then be paid to school districts and the county offices of education which have students residing in redevelopment project areas, or residing in affordable housing projects financially assisted by a redevelopment agency, thereby relieving the State of payments to those schools. RDA's share of this revenue shift is approximately \$55,649 in fiscal year 2010 and \$11,457 in fiscal year 2011. Payments are to be made by May 10 of each respective fiscal year. RDA intends to fund these payments with a combination of tax increment to be collected in fiscal year 2010 and 2011 and carryover funds from the current year.

On July 28, 2009 the State passed its 2009-2010 budget. This budget and related legislation contained provisions requiring California cities, counties, and special districts to lend property tax revenues to the State. The State is not required to repay the borrowed amounts until June 30, 2013. For the City, the borrowed amount totals \$35,815. As part of the State budget actions, local agencies were provided the opportunity to receive the monies being borrowed by the State up front through a securitization program offered by the California Statewide Communities Development Authority ("CSCDA"), a joint powers authority. The City elected to participate in the program offered by CSCDA, and on October 19, 2009 the City Council approved Resolution R-305333, authorizing the applicable participation documents. The securitization was executed on November 19, 2009, and payments to the City will be made in two equal installments on January 15, 2010 and May 3, 2010. Under the program, there is no impact to the City's Fiscal Year 2009-2010 budget.

On July 30, 2009, RDA issued \$13,930 of Subordinate Tax Allocation Bonds for the purpose of repaying certain outstanding obligations and to finance redevelopment activities relating to the North Park Redevelopment Project area. The Series 2009A bonds are payable solely from and secured by a pledge of tax revenues and are subordinate to the prior liens of the outstanding North Park Redevelopment Project Tax Allocation Bonds, Series 2000, Series 2003A and Series 2003B. The bond issuance is structured as term bonds and has an interest rate that ranges from 6.0% to 7.0%, with a final maturity date of November 1, 2039.

On September 11, 2009 the City Council approved the "*Improper Influence of Outside Professionals and Obstruction of the City Auditor*" Ordinance #19895. This ordinance makes it unlawful for any elected official, officer or employee of the City, or anyone acting under their direction, to take any action to coerce or fraudulently influence, manipulate or mislead the City Auditor or any member of his or her staff in the conduct of an audit with the specific intent of obstructing such audit or rendering any report materially misleading. Municipal Code Section 22.0711 has been updated with this new ordinance language and can be accessed at sandiego.gov.

On September 25, 2009, the Related Companies (Plaintiffs) filed a lawsuit against RDA, the City, and CCDC, contending they breached a negotiating agreement entered into with Plaintiffs. Plaintiffs claim a development agreement acceptable to Plaintiffs wrongfully failed to be executed by RDA, the City, and CCDC under the pretext that CCDC's president had a financial interest in Plaintiffs' sister company while CCDC's president resided in Florida. Plaintiffs claim they lost millions of dollars in pre-development investment expenditures as a result of the breach of the negotiating agreement. No estimate of the amount or range of potential loss may be made at this time.

The California Redevelopment Association (CRA) is the lead petitioner on a lawsuit to invalidate AB 26 4x, similar to last year's successful lawsuit challenging the constitutionality of AB 1389. The CRA filed the lawsuit on October 20, 2009. The lawsuit asserts that the transfer of property tax increment to the SERAF is not permitted under Article XVI, Section 16 of the California Constitution. The complaint also asserts impairment of contract and gift of public funds arguments. While the State made adjustments in AB 26 4x to address the constitutional issues raised by the Superior Court over last year's lawsuit challenging AB 1389, the Agency, along with the CRA and other California redevelopment agencies, believe that the SERAF remains unconstitutional.

On November 30, 2009, RDA terminated its Disposition and Development Agreement (DDA) with CentrePoint LLC for the development of a mixed-use development project within the Crossroads Project Area. Pursuant to the DDA, RDA's contribution was in the form of a developer loan of \$5,245 to be repaid from the Crossroads Low and Moderate Income Housing Fund to subsidize 47 affordable units. The loan amount was later reduced to \$4,969 pursuant to the third implementation agreement with CentrePoint LLC. Termination of the agreement will result in recognition of revenue for the loan payable balance of \$4,969 and removal of the long term liability in the government-wide financial statements.

On December 9, 2009, the RDA Board approved the principal terms of a settlement agreement with San Diego State University Foundation (Foundation) on a complaint for specific performance alleging that the RDA breached an agreement requiring them to sell certain property to the plaintiff. The settlement provides that the RDA contractual obligation of \$1,715 and accrued interest of \$1,613 payable to the Foundation will be reduced to the sum of \$750. Additionally, RDA will transfer fee title of the property to the Foundation by Grant Deed.

Required Supplementary Information (Unaudited)
June 30, 2009

PENSION TRUST FUNDS

Schedule of Funding Progress

The following table shows the funding progress of the City's pension trust funds for the last three fiscal years (in thousands):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	UAAL (b - a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a)/c)
6/30/2006	\$ 3,981,932	\$ 4,982,700	\$ 1,000,768	79.92%	\$ 534,103	187.37%
6/30/2007 *	4,413,411	5,597,653	1,184,242	78.84%	512,440	231.10%
6/30/2008	4,660,346	5,963,550	1,303,204	78.15%	535,774	243.24%

Source: Cheiron, Inc.

* The actuarial accrued liability was calculated using the Entry Age Normal (EAN) method beginning in fiscal year 2007. Prior to fiscal year 2007, the Projected Unit Credit (PUC) method was used.

OPEB TRUST FUND

Schedule of Funding Progress

The following table shows the funding progress of the City's OPEB trust fund for the last two fiscal years (in thousands):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	UAAL (b - a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a)/c)
6/30/2008	\$ 29,637	\$ 1,235,707	\$ 1,206,070	2.40%	\$ 556,857	216.59%
6/30/2009	41,497	1,359,377	1,317,880	3.05%	549,012	240.05%

Schedule of Contributions from Employer and Other Contributing Entities

The following table shows contributions to the City's OPEB trust fund for the last two fiscal years (in thousands):

Fiscal Year	Annual Required Contribution	Actual Contribution	Percentage Contributed
6/30/2008	\$ 91,645	\$ 53,553	58.44%
6/30/2009	104,475	49,498	47.38%

Source: Buck Consultants

REQUIRED SUPPLEMENTARY INFORMATION - GENERAL FUND

GENERAL FUND

The general fund is the chief operating fund of the City. It is used to account for all financial resources except those required to be accounted for in another fund.

General fund revenues are derived from such sources as: Taxes; Licenses and Permits; Fines, Forfeitures, and Penalties; Use of Money and Property; Aid from Other Governmental Agencies; Charges for Current Services; and Other Revenue.

Current expenditures and encumbrances are classified by the functions of: General Government and Support; Public Safety–Police; Public Safety–Fire and Life Safety and Homeland Security; Parks, Recreation, Culture and Leisure; Transportation; Sanitation and Health; Neighborhood Services; and Debt Service Principal and Interest. Appropriations are made from the fund annually.

GENERAL FUND
SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL (BUDGETARY BASIS)
YEAR ENDED JUNE 30, 2009
(In Thousands)

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Amounts</u>	<u>Variance with Final Budget Positive (Negative)</u>
REVENUES				
Property Tax	\$ 411,142	\$ 396,620	\$ 398,743	\$ 2,123
Sales Tax	230,196	223,618	212,918	(10,700)
Transient Occupancy Tax	90,629	82,189	73,765	(8,424)
Other Local Taxes	78,537	76,977	72,432	(4,545)
Licenses and Permits	32,687	32,240	31,249	(991)
Fines, Forfeitures and Penalties	34,215	34,216	32,467	(1,749)
Revenue from Use of Money and Property	54,019	52,351	42,252	(10,099)
Revenue from Federal Agencies	15,724	15,701	4,268	(11,433)
Revenue from Other Agencies	9,283	8,423	8,915	492
Charges for Current Services	135,582	131,016	133,117	2,101
Other Revenue	29,334	26,858	5,296	(21,562)
TOTAL REVENUES	1,121,348	1,080,209	1,015,422	(64,787)
EXPENDITURES				
Current:				
General Government and Support	279,818	269,270	249,134	20,136
Public Safety - Police	406,503	398,601	391,774	6,827
Public Safety - Fire and Life Safety and Homeland Security	186,752	197,166	196,329	837
Parks, Recreation, Culture and Leisure	125,464	123,904	120,573	3,331
Transportation	83,016	78,455	75,562	2,893
Sanitation and Health	100,903	90,630	81,462	9,168
Neighborhood Services	22,183	21,621	19,416	2,205
Debt Service:				
Principal Retirement	-	818	818	-
Interest	2,979	3,173	3,106	67
TOTAL EXPENDITURES	1,207,618	1,183,638	1,138,174	45,464
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	(86,270)	(103,429)	(122,752)	(19,323)
OTHER FINANCING SOURCES (USES)				
Transfers from Proprietary Funds	2,746	2,746	6,267	3,521
Transfers from Other Funds	69,347	71,334	105,059	33,725
Transfers to Proprietary Funds	(6,150)	(4,043)	(4,043)	-
Transfers to Other Funds	(24,688)	(26,031)	(26,031)	-
Net Loss from Joint Venture	-	-	(157)	(157)
TOTAL OTHER FINANCING SOURCES (USES)	41,255	44,006	81,095	37,089
NET CHANGE IN FUND BALANCE	(45,015)	(59,423)	(41,657)	17,766
Fund Balance Undesignated at July 1, 2008.....	75,339	75,339	75,339	-
Reserved for Encumbrances at July 1, 2008.....	43,853	43,853	43,853	-
Reserved for Minority Interest in Joint Venture at July 1, 2008	-	-	1,981	1,981
Reserved for Minority Interest in Joint Venture at June 30, 2009	-	-	(1,824)	(1,824)
Designated for Subsequent Years' Expenditures at July 1, 2008.....	862	862	862	-
Designated for Subsequent Years' Expenditures at June 30, 2009	-	-	(207)	(207)
FUND BALANCE UNDESIGNATED AT JUNE 30, 2009.....	\$ 75,039	\$ 60,631	\$ 78,347	\$ 17,716

The accompanying note is an integral part of the Required Supplementary Information

Note to Required Supplementary Information Year Ended June 30, 2009

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Budgetary Data

On or before the first meeting in May of each year, the City Manager submits to the City Council a proposed operating and capital improvements budget for the fiscal year commencing July 1. This budget includes annual budgets for the following funds:

- **General Fund**
- **Special Revenue Funds:**
 - City of San Diego:
 - Acquisition, Improvement and Operation
 - Environmental Growth Funds:
 - Two-Thirds Requirement
 - One-Third Requirement
 - Police Decentralization
 - Public Transportation
 - Qualcomm Stadium Operations
 - Special Gas Tax Street Improvement
 - Street Division Operations
 - Transient Occupancy Tax
 - Underground Surcharge
 - Zoological Exhibits
 - Other Special Revenue
 - Centre City Development Corporation
 - Southeastern Economic Development Corporation
- **Debt Service Funds:**
 - City of San Diego:
 - Public Safety Communications Project
 - San Diego Open Space Park Facilities District #1
- **Capital Projects Funds:**
 - City of San Diego:
 - TransNet

Public hearings are then conducted to obtain citizen comments on the proposed budget. During the month of July the budget is legally adopted through passage of an appropriation ordinance by the City Council. Budgets are prepared on the modified accrual basis of accounting except that (1) encumbrances outstanding at year-end are considered expenditures and (2) the increase/decrease in reserve for advances and deposits to other funds and agencies are considered as additions/deductions of expenditures. The City budget is prepared excluding unrealized gains or losses resulting from the change in fair value of investments, proceeds from capital leases, and net income from joint venture.

The legal level of budgetary control for the City's general fund is exercised at the salaries and wages and non-personnel expenditures level. Budgetary control for the other budgeted funds, including those of certain component units, is maintained at the total fund appropriation level. All amendments to the adopted budget require City Council approval except as delegated in the Annual Appropriation Ordinance.

Reported budget figures are as originally adopted or subsequently amended plus prior year continuing appropriations. Such budget amendments during the year, including those related to supplemental appropriations, did not cause these reported budget amounts to be significantly different than the originally adopted budget amounts. Appropriations lapse at year-end to the extent that they have not been expended or encumbered, except for those of a capital nature, which continue to subsequent years.

The following is a reconciliation of the net change in fund balance prepared on a GAAP basis to that prepared on the budgetary basis for the year ended June 30, 2009 (in thousands):

	General Fund
Net Change in Fund Balances - GAAP Basis	\$ (10,389)
Add (Deduct):	
Encumbrances Outstanding, June 30, 2009	(32,071)
Reserved for Advances, June 30, 2009	-
Designated for Unrealized Gains, June 30, 2009	(1,943)
Reserved for Advances, June 30, 2008	9
Designated for Unrealized Gains, June 30, 2008	<u>2,737</u>
Net Change in Fund Balances - Budgetary Basis	<u>\$ (41,657)</u>

b. Encumbrances

Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary control in the budgeted governmental funds.

Encumbrances outstanding at year-end are reported as reservations of fund balances, since the commitments will be honored through subsequent years' continuing appropriations. Encumbrances do not constitute expenditures or liabilities for GAAP reporting purposes.

SUPPLEMENTARY INFORMATION

City of San Diego
Pledged-Revenue Coverage - Sewer Bonds (Unaudited)
Last Ten Fiscal Years (In Thousands)

Fiscal Year Ended June 30	Total System Revenues ¹	Total Maintenance and Operation Costs (Excludes Depreciation)	Net System Revenues ²	Senior Debt Service		
				Principal	Interest	Total
2000	\$ 291,238	\$ 137,007	\$ 154,231	\$ 18,300	\$ 58,755	77,055
2001	283,228	168,853	114,375	22,150	54,905	77,055
2002	310,392	170,022	140,370	23,045	54,009	77,054
2003	334,551	241,822	92,729	24,000	53,046	77,046
2004	296,169	196,823	99,346	25,030	52,020	77,050
2005	322,542	204,163	118,379	26,120	50,935	77,055
2006	320,288	202,111	118,177	27,390	49,662	77,052
2007 ⁴	343,921	202,632	141,289	28,760	48,291	77,051
2008	361,511	211,449	150,062	30,250	46,805	77,055
2009	353,446	197,379	156,067	31,700	45,356	77,056

¹ Beginning in Fiscal Year 2004, the City's methodology for reporting Net System Revenues was changed to exclude interest earnings on Acquisition Bond Proceeds from Total Income. The data presented in this Table has been restated to reflect this change.

² Net System Revenues is defined as "System Revenues" less "Maintenance and Operation Costs" of the Wastewater System for the fiscal year.

³ All Obligations include Senior, Subordinate and State Revolving Fund (SRF) Loans.

⁴ Senior Debt Service principal and interest amounts for FY 2007 were updated for correct amounts.

Source: Comprehensive Annual Financial Reports

Table 14

Senior Debt Service Coverage	All Obligations ³	
	Total Debt Service	Aggregate Debt Service Coverage
2.00	\$ 77,055	2.00
1.48	77,688	1.47
1.82	77,888	1.80
1.20	80,995	1.14
1.29	81,516	1.22
1.54	84,789	1.40
1.53	86,802	1.36
1.83	96,408	1.47
1.95	94,555	1.59
2.03	94,305	1.65

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APPENDIX B

SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

The following is a summary of certain definitions and provisions set forth in the Indenture and the Installment Purchase Agreement. The Series 2010A Bonds are described in this summary as the "2010A Bonds." This summary does not purport to be comprehensive, and reference should be made to the Indenture and the Installment Purchase Agreement for a full and complete statement of the definitions and provisions contained in such documents. Copies of these documents are available from the Trustee. See "INTRODUCTION—Miscellaneous" in the body of this Official Statement.

INDENTURE

The Indenture sets forth certain terms of the Bonds, the nature and extent of the security for the Bonds, the rights of the Owners of the Bonds, rights, duties and immunities of the Trustee and the rights and obligations of the Authority with respect to the Bonds. Certain provisions of the Indenture are summarized below. Other provisions are summarized in the body of this Official Statement under the captions "DESCRIPTION OF THE SERIES 2010A BONDS" and "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS." Capitalized terms used in connection with the Indenture but not defined below have the meanings ascribed thereto in the body of this Official Statement; certain capitalized terms are defined herein following the description of the Indenture, in connection with the description of the Installment Purchase Agreement.

Selected Definitions

The term "Additional Bonds" means those Bonds authorized and issued under the Indenture on a parity with the 2010A Bonds, in accordance with Indenture.

The term "Agreement" means the Master Installment Purchase Agreement, dated as of September 1, 1993, as supplemented by a 1993-1 Supplement dated as of September 1, 1993, a 1994-1 Supplement dated October 3, 1994, a 1995-1 Supplement dated as of December 1, 1995, a 1997-1 Supplement dated as of February 1, 1997, a 1999-1 Supplement dated as of March 1, 1999, a First Amendatory Supplement dated as of August 15, 2003, a 2004 Supplement dated as of June 1, 2004 (as amended), a 2009-1 Supplement dated as of May 1, 2009, a 2009-2 Supplement, dated as of June 1, 2009, and the 2010-1 Supplement, each by and between the City and the Authority.

The term "Authority" means the Public Facilities Financing Authority of the City of San Diego, a California joint exercise of powers entity.

The term "Authorized Denominations" means, with respect to the Bonds, \$5,000 and any integral multiple thereof and with respect to any Additional Bonds, the authorized denominations specified in a Supplemental Indenture related to such Additional Bonds.

The term "Beneficial Owners" means those individuals; partnerships, corporations or other entities for whom the Participants have caused the Depository to hold Book-Entry Bonds.

The term "Board" means the Board of Commissioners of the Authority.

The term "Bond or Bonds" means the 2009A Bonds, the 2009B Bonds, the 2010A Bonds and any Additional Bonds authorized and issued under the Indenture on a parity with the 2009A Bonds, the 2009B Bonds and the 2010A Bonds, in accordance with Indenture.

The term "Bond Counsel" means a firm of attorneys that are nationally recognized as experts in the laws governing and relating to municipal finance.

The term "Bond Law" means the Marks-Roos Local Bond Pooling Act of 1985, as amended, being Section 6584 et seq. of the Government Code of the State.

The term “Book-Entry Bonds” means Bonds executed and delivered under the book-entry system described in the Indenture.

The term “Business Day” means a day of the year other than Saturday or Sunday, or a day on which banking institutions located in California are required or authorized to remain closed, or an which the New York Stock Exchange is closed. If the date for making any payment or the last date for performance of any act or the exercising of any right, as provided in the Indenture, is not a Business Day, such payment may be made or act performed or right exercised on the next succeeding Business Day, with the same force and effect as if done on the nominal date provided in the Indenture, and, unless otherwise specifically provided in the Indenture, no interest will accrue for the period from and after such nominal date.

The term “Certificate of the Authority” means an instrument in writing signed by the Chair, the Vice Chair or the Secretary of the Authority, or by any other officer of the Authority duly authorized by the Authority for that purpose. If and to the extent required by the provisions of the Indenture, each Certificate of Authority will include the statements provided for in the Indenture.

The term “Certificate of the City” means an instrument in writing signed by the Chief Financial Officer, the Chief Operating Officer or any of their respective designees.

The term “Charter” means the Charter of the City as it now exists or may be amended, and any new or successor Charter.

The term “City” means the City of San Diego, a municipal corporation and a charter city duly organized and existing under the Charter and the Constitution of the State.

The term “Closing Date” means any date upon which a Series of Bonds is purchased.

The term “Code” means the Internal Revenue Code of 1986, as amended, and the regulations thereunder, and any successor laws or regulations.

The term “Components” means components of the Project for which the City makes Installment Payments or Subordinated Installment Payments pursuant to any Supplement. The term “Refunded Components” means the Components originally financed with the proceeds of the Refunded Bonds, which are being refunded with the proceeds of sale of the 2010A Bonds.

The term “Comptroller” means the Comptroller of the City.

The term “Corporate Trust Office of the Trustee” means the corporate trust office of the Trustee at the address set forth in the Indenture or such other or additional offices as may be specified to the Authority by the Trustee in writing, except that with respect to presentation of Bonds for payment or for registration of transfer and exchange such term shall mean the office or agency of the Trustee at which, at any particular time its corporate trust agency business shall be conducted.

The term “Costs of Issuance” means all items of expense directly or indirectly payable by or reimbursable to the City or the Authority relating to the issuance, sale and delivery of any Bonds under the Indenture, including but not limited to, costs of preparation and reproduction of documents; fees and expenses of the Feasibility Consultant; fees and expenses of the Authority (including its counsel); expenses of City and Authority staff; fees of the City’s Financial Advisor; initial fees, expenses and charges of the Trustee (including its counsel); Rating Agency fees; Underwriters’ discount; legal fees and charges of Bond Counsel, Disclosure Counsel, Underwriters’ counsel, and the City Attorney; and any other cost, charge or fee in connection with the issuance and delivery of the Bonds.

The term “Costs of Issuance Account” means, with respect to the 2010A Bonds, the City of San Diego Wastewater System Improvement Project Costs of Issuance Account—2010A Bonds established under the Indenture for the payment of Costs of Issuance related to the 2010A Bonds.

The term “Depository” means the securities depository acting as Depository pursuant to the Indenture.

The term "DTC" means The Depository Trust Company, New York, New York, and its successors.

The term "Event of Default" will have the meaning set forth in the Indenture, as described below.

The term "Feasibility Consultant" means the consultant who, or whose firm, provides services to the City respecting the future ability of Project components being acquired, installed or constructed with proceeds of sale of the Bonds to generate sufficient Net System Revenues to permit the City to incur Additional Obligations, as set forth in the Agreement.

The term "Federal Securities" means the following securities:

(1) United States Treasury Bills, bonds, and notes for which the full faith and credit of the United States are pledged for payment of principal and interest;

(2) Direct senior obligations issued by the following agencies of the United States Government: the Federal Farm Credit Bank System, the Federal Home Loan Bank System, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Tennessee Valley Authority;

(3) Mortgage Backed Securities (except stripped mortgage securities) issued by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Government National Mortgage Association; and

(4) United States Treasury Obligations, State and Local Government Series.

The term "Fiscal Year" means the fiscal year of the Authority which, as of the date of the Indenture, is the period from July 1 to and including the following June 30.

The term "Fitch" means Fitch Ratings and its successors, and if such company will for any reason no longer perform the functions of a securities rating agency, "Fitch" will be deemed to refer to any nationally recognized securities rating agency designated by the Authority and the City.

The term "Indenture" means the Indenture, dated as of May 1, 2009, as amended by a First Supplemental Indenture, dated as of June 1, 2009, and by a Second Supplemental Indenture, dated as of April 1, 2010, by and between the Authority and the Trustee.

The term "Information Services" means Financial Information, Inc.'s "Daily Called Bond Service," 30 Montgomery Street, 10th Floor, Jersey City, New Jersey 07302, Attention: Editor; Moody's "Municipal and Government," 99 Church Street, 8th Floor, New York, New York 10007, Attention: Municipal News Reports; and Xcitek's "Called Bond Service," 5 Hanover Square, New York, New York 10004, Attention: Bond Redemption Group; provided, however, in accordance with then current guidelines of the Securities and Exchange Commission, Information Services means such other organizations providing information with respect to called bonds as the Authority may designate in writing to the Trustee.

The term "Interest Account" means the account by that name established under the Indenture.

The term "Interest Payment Date" means, with respect to the 2010A Bonds, each May 15 and November 15, commencing May 15, 2010, until the 2010A Bonds are paid or redeemed in full.

The term "Letter of Representations" means the letter of the Authority delivered to and accepted by the Depository on or prior to the delivery of any Book-Entry Bonds setting forth the basis on which the Depository serves as depository for such Book-Entry Bonds, as originally executed or as it may be supplemented or revised or replaced by a letter to a substitute Depository.

The term "Moody's" means Moody's Investors Service, a corporation organized and existing under the laws of the State of Delaware, and its successors, and if such corporation will for any reason no

longer perform the functions of a securities rating agency, "Moody's" will be deemed to refer to any other nationally recognized securities rating agency designated by the Authority and the City.

The term "1997 Supplemental Indenture" means that certain Third Supplemental Indenture, dated as of February 1, 1997, by and between the Authority and the 1997 Trustee supplementing the 1993 Indenture pursuant to which the Refunded Bonds were issued.

The term "1997 Trustee" means The Bank of New York Mellon Trust Company, N.A. as successor trustee under the 1993 Indenture and the 1997 Supplemental Indenture .

The term "1993 Indenture" means that certain Indenture, dated as of September 1, 1993, by and between the Authority and the Trustee, as supplemented and amended by a First Supplemental Indenture, a Second Supplemental Indenture, a Third Supplemental Indenture, a Fourth Supplemental Indenture, and a Fifth Supplemental Indenture.

The term "1993 Trustee" means The Bank of New York Mellon Trust Company, N.A., as successor trustee under the 1993 Indenture, as supplemented and amended, and as such the trustee for the Outstanding Parity Bonds.

The term "Nominee" means the nominee of the Depository, which may be the Depository, as determined from time to time pursuant to the Indenture.

The term "Original Indenture" means the Indenture dated as of May 1, 2009 by and between the Authority and the Trustee.

The term "Outstanding," when used as of any particular time with reference to Bonds, means (subject to the provisions of the Indenture) all Bonds theretofore or thereupon executed by the Authority and authenticated and delivered by the Trustee pursuant to the terms of the Indenture, except:

- (1) Bonds theretofore cancelled by the Trustee or surrendered to the Trustee for cancellation;
- (2) Bonds paid or deemed to have been paid within the meaning of the Indenture;
- (3) Bonds beneficially owned by the City or the Authority; and
- (4) Bonds in lieu of or in substitution for which other Bonds will have been executed by the Authority and authenticated and delivered pursuant to the terms of the Indenture.

The term "Outstanding Parity Bonds" means the outstanding principal amount of the Public Facilities Financing Authority of the City of San Diego Sewer Revenue Bonds, Series 1995, Series 1997A and 1997B, Series 1999A, and Series 1999B (to the extent any of such securities are outstanding after the issuance of the 2010A Bonds and the refunding described in the 2010-1 Supplement), the Public Facilities Financing Authority of the City of San Diego Senior Sewer Revenue Bonds, Series 2009A and the Public Facilities Financing Authority of the City of San Diego Senior Sewer Revenue Refunding Bonds, Series 2009B.

The term "Owner" means any Person who will be the registered owner of any Outstanding Bond, as shown on the registration books required to be maintained by the Trustee pursuant to the Indenture.

The term "Parity Installment Payments" means Installment Payments that are Parity Obligations (as defined in the Agreement), scheduled to be paid by the City under and pursuant to any Supplement that has been assigned to the Trustee (as assignee of the Authority) to secure any Senior Bonds or Notes.

The term "Parity Obligations" means any Obligations payable from Net System Revenues that are secured by a first priority lien on Net System Revenues and are senior in, priority to payment of Subordinated Obligations, including Subordinated Installment Payments.

The term "Participants" means those broker-dealers, banks and other financial institutions from time to time for which the Depository holds Book-Entry Bonds as securities depository.

The term "Payment Fund" means the fund by that name established under the Indenture.

The term "Permitted Investments" means any of the following to the extent then permitted by law and the Indenture:

(1) Federal Securities;

(2) Obligations of any state, territory or commonwealth of the United States of America or any political subdivision thereof or any agency or department of the foregoing; provided, that at the time of their purchase such obligations are rated "AAA" by two Rating Agencies;

(3) Bonds, notes, debentures or other evidences of indebtedness issued or guaranteed by any corporation which are, at the time of purchase, rated by each Rating Agency in their respective highest short-term rating categories, or, if the term of such indebtedness is longer than three years, rated "AAA" by two Rating Agencies;

(4) Taxable commercial paper or tax-exempt commercial paper with a maturity of not more than 270 days, rated "A1/P1/F1" by two Rating Agencies;

(5) Deposit accounts or certificates of deposit, whether negotiable or non-negotiable, issued by a state or national bank (including the Trustee) or a state or federal savings and loan association or a state-licensed branch of a foreign bank; provided, however, that such certificates of deposit or deposit accounts will be either (a) continuously and fully insured by the Federal Deposit Insurance Corporation; or (b) have maturities of not more than 365 days (including certificates of deposit) and are issued by any state or national bank or a state or federal savings and loan association, the short-term obligations of which are rated in the highest short term letter and numerical rating category by two Rating Agencies;

(6) Bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as bankers acceptances, which bank has short-term obligations outstanding which are rated by two Rating Agencies in their respective highest short-term rating categories, and which bankers acceptances mature not later than 180 days from the date of purchase;

(7) Any repurchase agreement with any bank or trust company organized under the laws of any state of the United States or any national banking association (including the Trustee), or a state-licensed branch of a foreign bank, having a minimum permanent capital of one hundred million dollars (\$100,000,000) and with short-term debt rated by two Rating Agencies in their respective three highest short-term rating categories or any government bond dealer reporting to, trading with, and recognized as a primary dealer by, the Federal Reserve Bank of New York, which agreement is secured by anyone or more of the securities and obligations described in clause (1) of this definition, which will have a market value (valued at least weekly) not less than 102% of the principal amount of such investment and will be lodged with the Trustee, the Treasurer or other fiduciary, as custodian for the Trustee, by the bank, trust company, national banking association or bond dealer executing such repurchase agreement. The entity executing each such repurchase agreement required to be so secured will furnish the Trustee with an undertaking satisfactory to it that the aggregate market value of all such obligations securing each such repurchase agreement (as valued at least weekly) will be an amount equal to 102% the principal amount of such repurchase agreement and the Trustee will be entitled to rely on each such undertaking;

(8) Any cash sweep or similar account arrangement of or available to the Trustee, the investments of which are limited to investments described in clauses (1), (2) and (7) of this definition and any money market fund, the entire investments of which are limited, to investments described in clauses (1), (2) and (7) of this definition and which money market fund is rated in their respective highest rating categories by two Rating Agencies and which may

include funds for which the Trustee, its parent holding company, if any, or any affiliates or subsidiaries of the Trustee provide investment advisory or other management services;

(9) Any guaranteed investment contract, including forward delivery agreements (“FDAs”) and forward purchase agreements (“FPAs”), with a financial institution or insurance company which has at the date of execution thereof an outstanding issue of unsecured, uninsured and unguaranteed debt obligations or a claims-paying ability rated within the two highest rating categories of two or more Rating Agencies. Only Permitted Investments described in clause (1) above and having maturities equal to or less than 30 years from their date of delivery will be considered eligible for any collateralization/delivery purposes for guaranteed investment contracts, FDAs or FPAs;

(10) Certificates, notes, warrants, bonds or other evidence of indebtedness of the State or of any political subdivision or public agency thereof which are rated in the highest short-term rating category or within one of the three highest long-term rating categories of two Rating Agencies (excluding securities that do not have a fixed par value and/or whose terms do not promise a fixed dollar amount at maturity or call date);

(11) For amounts less than \$10,000, interest-bearing demand or time deposits (including certificates of deposit) in a nationally or state-chartered bank, or a state or federal savings and loan association in the State, fully insured by the Federal Deposit Insurance Corporation, including the Trustee or any affiliate thereof;

(12) Investments in taxable money market funds or portfolios restricted to obligations with an average maturity of one year or less and which funds or portfolios are rated in either of the two highest rating categories by two Rating Agencies or have or are portfolios guaranteed as to payment of principal and interest by the full faith and credit of the United States of America and which may include funds for which the Trustee, its parent holding company, if any, or any affiliates or subsidiaries of the Trustee provide investment advisory or other management services;

(13) Investments in the City’s pooled investment fund;

(14) Investments in the Local Agency Investment Fund created pursuant to Section 16429.1 of the Government Code of the State;

(15) Shares of beneficial interest in diversified management companies investing exclusively in securities and obligations described in clauses (1) through (12) of this definition and which companies are rated in their respective highest rating categories by two Rating Agencies or have an investment advisor registered with the Securities and Exchange Commission with not less than five years’ experience investing in such securities and obligations and with assets under management in excess of five hundred million dollars (\$500,000,000); and

(16) Shares in a California common law trust established pursuant to Title 1, Division 7, Chapter 5 of the Government Code of the State which consists exclusively of investments permitted by Section 53601 of Title 5, Division 2, Chapter 4 of the Government Code of the State, as it may be amended.

The term “Person” means any legal entity or natural person, as the context may require.

The term “Pre-Refunded Municipals” means any bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state which are not callable at the option of the obligor prior to maturity or as to which irrevocable instructions have been given by the obligor to call on the date specified in the notice.

The term “Principal Account” means the account of that name established under the Indenture.

The term “Principal Payment Date” means each May 15, commencing May 15, 2010, until the 2010A Bonds are paid or redeemed in full.

The term "Project" means the acquisition, construction, installation and improvements to the Wastewater System described in Exhibit A to the Agreement and as modified with respect to Components in conformance with the Agreement.

The term "Project Costs" means the costs of the Project disbursed from time to time by the Comptroller from the Acquisition Fund pursuant to the Indenture.

The term "Purchase Price" means the principal amount plus interest thereon owed by the City under the terms of the Agreement as provided in the Indenture thereof and as specified in a Supplement.

The term "Rating Agency" means Fitch, Moody's or S&P.

The term "Rebate Fund" means the fund by that name created under the Indenture and any other accounts thereunder.

The term "Record Date" means the fifteenth day of the calendar month immediately preceding an Interest Payment Date, whether or not such day is a Business Day.

The term "Redemption Account" means the account by that name established under the Indenture.

The term "Refunded Bonds" means the Outstanding Parity Bonds to be refunded with a portion of the proceeds of the 2010A Bonds.

The term "Representative" means Citigroup Global Markets, Inc., as representative of the Underwriters.

The term "Reserve Fund" means the fund by that name established under the Indenture, in which the Reserve Requirement will be held and invested.

The term "Reserve Requirement" means, as of any date of calculation, the least of (i) ten percent (10%) of the proceeds (within the meaning of section 148 of the Code) of the Bonds; (ii) 125% of average annual debt service on the then-Outstanding Bonds; or (iii) the Maximum Annual Debt Service for that and any subsequent year. Upon early redemption of any of the Bonds, the Authority, at the request of the City, may request the Trustee to recalculate and reduce any Reserve Requirement, whereupon any excess in the Reserve Fund over and above such Reserve Requirement will be transferred to the Payment Fund.

The term "Revenues" means all Installment Payments received by or due to be paid to the Authority pursuant to all Supplements executed and delivered by the Authority to secure payment of principal of and interest on Bonds issued under the Indenture, and the interest or profits from the investment of money in any account or fund (other than the Rebate Fund) pursuant to the investment provisions of the Original Indenture.

The term "S&P" means Standard & Poor's Ratings Group, a division of The McGraw-Hill Companies, Inc., a corporation organized and existing under the laws of the State of New York, and its successors, and if such corporation will for any reason no longer perform the functions of a securities rating agency, "S&P" will be deemed to refer to any other nationally recognized securities rating agency designated by the Authority and the City.

The term "Securities Depository" means The Depository Trust Company, 55 Water Street, 50th Floor, New York, N.Y. 10041-0099 Attn: Call Notification Department, Fax (212) 855-7232, or, in accordance with then-current guidelines of the Securities and Exchange Commission, such other securities depositories, or no such depositories, as the Authority may indicate in a Written Request of the Authority delivered to the Trustee.

The term "State" means the State of California.

The term “Subordinated Installment Payments” means Installment Payments that are Subordinated Obligations (as defined in the Agreement), scheduled to be paid by the City under and pursuant to any Supplement that has been assigned to the Trustee (as assignee of the Authority) to secure any Subordinated Bonds or Notes.

The term “Subordinated Obligations” means any Obligations payable from Net System Revenues that are secured by a second priority lien on Net System Revenues and are subordinate in priority to payment of Parity Obligations, including the Parity Installment Payments.

The term “Supplement” means a supplement to the Agreement providing for the payment of specific Installment Payments as the Purchase Price for Components of the Project, executed and delivered by the City and the Authority.

The term “Supplemental Indenture” means any indenture supplemental to the Indenture or amendatory hereof duly executed and delivered by the Authority and the Trustee as authorized under the Indenture.

The term “Surety Bond” means a reserve surety bond, insurance policy, letter of credit or other similar instrument providing, by its terms, a stated amount as a credit towards or in satisfaction of all or part of the Reserve Requirement, which will be held by the Trustee in trust, pursuant to the Indenture.

The term “Tax Certificate” means the Tax and Nonarbitrage Certificate delivered with respect to Tax-Exempt Bonds on their Closing Date.

The term “Tax Code” means the Internal Revenue Code of 1986, as amended, and the Regulations promulgated by the Internal Revenue Service pursuant thereto.

The term “Tax-Exempt Bonds” means those Bonds which, by their terms, bear interest that is excluded from gross income for federal income tax purposes, pursuant to the Tax Code.

The term “Treasurer” means the Office of the City Treasurer of the City of San Diego.

The term “Trustee” means The Bank of New York Mellon Trust Company, N.A., a national banking association existing under and by virtue of the laws of the United States, or any other bank or trust company which may at any time be substituted in its place as provided in the Indenture.

The term “2009A Bonds” means the Public Facilities Financing Authority of the City of San Diego Senior Sewer Revenue Bonds, Series 2009A (payable Solely From Installment Payments Secured By Wastewater System Net Revenues) issued under the Indenture.

The term “2009B Bonds” means the Public Facilities Financing Authority of the City of San Diego Senior Sewer Revenue Bonds, Series 2009B (Payable Solely From Installment Payments Secured By Wastewater System Net Revenues) issued under the Indenture.

The term “2009-1 Installment Payments” means those Installment Payments scheduled to be paid by the City under the 2009-1 Supplement.

The term “2009-1 Supplement” means the 2009-1 Supplement to the Agreement, by and between the City and the Authority, dated as of May 1, 2009, with respect to the 2009A Bonds.

The term “2009-2 Installment Payments” means those Installment Payments scheduled to be paid by the City under the 2009-2 Supplement.

The term “2009-2 Supplement” means the 2009-2 Supplement to the Agreement, by and between the City and the Authority, dated as of June 1, 2009, with respect to the 2009B Bonds.

The term “2007 Trustee” means Wells Fargo Bank, National Association, as trustee under the Subordinate Indenture of Trust dated as of May 1, 2007 by and between the Authority and the 2007 Trustee.

The term "2010A Bonds" means the Public Financing Authority of the City of San Diego Senior Sewer Revenue Refunding Bonds, Series 2010A (Payable Solely From Installment Payments Secured By Wastewater System Net Revenues) issued under the Indenture.

The term "2010A Closing Date" means the date identified as such in the 2010-1 Supplement.

The term "2010-1 Installment Payments" means those Installment Payments scheduled to be paid by the City under the 2010-1 Supplement.

The term "2010-1 Supplement" means the 2010-1 Supplement to the Agreement, by and between the City and the Authority, dated as of April 1, 2010.

The term "Underwriters" means, collectively, the underwriters listed in the purchase contract pursuant to which the 2010A Bonds are sold.

The term "Wastewater System" means any and all facilities, properties, and improvements at any time owned, controlled or operated by the City as part of the Sewer Revenue Fund (defined in the Agreement) for collection, treatment, distribution, administration, disposal or reclamation of waste.

The term "Written Request of the Authority" means an instrument in writing signed by the Chair, the Vice Chair, or the Secretary of the Authority, or by any other officer or Commissioner of the Board duly authorized by the Authority for that purpose.

The term "Written Request of the City" means an instrument in writing signed by the Chief Operating Officer, the Chief Financial Officer or any of their respective designees, or by any other official of the applicable administrative departments of the City duly authorized by the City for that purpose.

Establishment of Funds; Deposit and Application

Establishment of Funds and Accounts.

(a) The Trustee will establish and maintain the Costs of Issuance Account.

(b) The Trustee will maintain the Payment Fund, including the Interest Account, the Principal Account, and the Redemption Account.

(c) The Trustee will maintain the Reserve Fund.

Use of moneys in Costs of Issuance Account. (a) The Trustee shall make disbursements from the Costs of Issuance Account from time to time upon receipt of a written request of the City on behalf of the Authority signed by an authorized representative of the Debt Management Department and an authorized representative of the Comptroller. Such written request shall be substantially in the form of Exhibit B to the 2010-1 Supplement and shall: (i) state with respect to each disbursement to be made: (A) the requisition number, (B) the name and address of the person, firm or authority to whom payment is due, (C) the amount to be disbursed, and (D) that each obligation therein has been properly incurred and is a proper charge against the Costs of Issuance Account and has not been the basis of any previous disbursement; (ii) specifies in reasonable detail the nature of the obligation; and (iii) is accompanied by a bill or statement of account for each obligation.

(b) On the 181st day after the Closing Date, or such earlier date on which the City informs the Trustee in writing that all Costs of Issuance of the 2010A Bonds have been paid, the Trustee shall transfer any remaining balance in the Costs of Issuance Account first to the Reserve Fund to the extent necessary to make the amount on deposit therein equal to the then Reserve Requirement and thereafter to the account or accounts of the Payment Fund as directed by the City on behalf of the Authority.

Reserve Fund. (a) The Reserve Fund is a separate fund held in trust by the Trustee. The Trustee will receive on the 2010A Closing Date for deposit into the Reserve Fund a portion of the proceeds of the 2010A Bonds specified in the 2010-1 Supplement in satisfaction of the 2010A Reserve Requirement. An

amount equal to the Reserve Requirement will be maintained in or credited to the Reserve Fund at all times, subject to the provisions of the Indenture, and any deficiency therein will be replenished from the first available Revenues pursuant to the Indenture.

(b) Moneys in or available from the Reserve Fund will be used solely for the purpose of paying the principal of and interest on the Bonds, including the redemption price of the Bonds coming due and payable by operation of mandatory sinking fund redemption pursuant to the Indenture, in the event that the moneys in the Payment Fund are insufficient therefor. If and during such time as a Surety Bond is in effect, not less than two Business Days prior to each Interest Payment Date, the Trustee will ascertain the necessity for a draw upon the Surety Bond and, if a draw is necessary, will provide notice thereof to the provider of the Surety Bond in accordance with the terms of the Surety Bond at least two Business Days prior to each Interest Payment Date. In the event that the amount on deposit in the Payment Fund on any date is insufficient to enable the Trustee to pay in full the aggregate amount of principal of and interest on the Bonds coming due and payable, including the redemption price of the Bonds coming due and payable by operation of mandatory sinking fund redemption pursuant to the Indenture, the Trustee will withdraw the amount of such insufficiency from the Reserve Fund or make a draw upon the Surety Bond in the amount of such insufficiency and transfer such amount to the Payment Fund.

(c) Investment earnings on amounts held in the Reserve Fund shall remain therein, except as follows. In the event that the amount on deposit in the Reserve Fund exceeds the Reserve Requirement on the fifteenth (15th) calendar day of the month preceding any Interest Payment Date, the amount of such excess will be withdrawn therefrom by the Trustee and transferred to (a) the Rebate Fund, to the extent required under the Indenture, or (b) the accounts of the Payment Fund as directed by the City on behalf of the Authority. The remaining balance in the Reserve Fund may be applied, at the direction of the Authority, or the City on behalf of the Authority, to the payment of the final maturing principal payments of the Bonds.

(d) Notwithstanding anything in the Indenture to the contrary, at the option of the City, amounts required to be held in the Reserve Fund may be withdrawn, in whole or in part, upon the deposit of a Surety Bond with the Trustee, in a stated amount equal to the amounts so withdrawn; provided, that at the time of such deposit each of the Rating Agencies then rating the Bonds will be notified of such proposed withdrawal and the deposit of such Surety Bond will not result in a withdrawal or downgrading of any rating of the Bonds then in effect by each of the Rating Agencies then rating the Bonds. Any such withdrawn moneys will be transferred, at the election of the City, to the Acquisition Fund, to the Redemption Account in the Payment Fund, to the Principal Account of the Payment Fund or to a special account to be established for the payment of any fees in connection with obtaining such Surety Bond.

To the extent that the Reserve Fund is comprised of both funds on deposits and a Surety Bond, withdrawals from the Reserve Fund will be made first from funds on deposit and then from the Surety Bond. To the extent that the Reserve Fund is replenished by the City, the amount so replenished will be credited first to any Surety Bond and then to funds on deposit in the Reserve Fund. To the extent that replenishment funds are credited to the Surety Bond, the Trustee will pay the same to the provider of the Surety Bond in lieu of retaining such funds in the Reserve Fund, conditioned upon reinstatement of the Surety Bond for the amount so paid.

In the event the provider of it Surety Bond makes payments to the Trustee as part of the Reserve Requirement, the provider shall become subrogated to the rights of the recipients of such payments, but such right of subrogation shall be subordinate to the rights of the provider of any policy of municipal bond insurance which has been drawn upon for payment of principal or interest on Bonds.

In no event will the City or the Authority be required to replace any Surety Bond initially delivered under the Indenture with a similar instrument or with cash.

(e) In the event that the amount on deposit in the Reserve Fund at any time falls below the Reserve Requirement or in the event of a draw on the Surety Bond deposited therein, the Trustee will promptly notify the City and the Authority of such fact. Upon receipt of written notice from the Trustee of a shortfall in the Reserve Fund, the City will transfer to the Trustee from Net System Revenues in accordance with the Agreement an amount sufficient to restore the balance on deposit in or credited to

the Reserve Fund to the Reserve Requirement and to repay any amounts then due to the provider of the Surety Bond, if any. No deposit need be made in the Reserve Fund so long as the balance therein, taken together with amounts available under any Surety Bond, at least equals the Reserve Requirement.

Revenues

Pledge of Revenues.

(a) All Revenues and amounts on deposit in the funds and accounts established under the Indenture (other than amounts on deposit in the Rebate Fund) are irrevocably pledged to the payment of the interest on and principal of the Bonds, but only as provided in the Indenture, and the Revenues will not be used for any other purpose while any of the Bonds remain Outstanding; provided, that out of the Revenues there may be allocated such sums for such purposes as are expressly permitted by the Indenture.

(b) To secure the pledge of the Revenues contained in the Indenture, the Authority transfers, conveys and assigns to the Trustee, for the benefit of the Owners, all of the Authority's rights under the 2009-1 Supplement, the 2010-1 Supplement and, in connection with any Additional Bonds issued under the Indenture, the Authority's rights under the Supplement(s) hereinafter executed by the City and the Authority to secure payment of principal of and interest on such Additional Bonds, including the right to receive Parity Installment Payments from the City, the right to receive any proceeds of insurance maintained thereunder or any condemnation award rendered with respect to the Components and the right to exercise any remedies provided therein in the event of a default by the City thereunder. The Trustee accepts said assignment for the benefit of the Owners subject to the provisions of the Indenture.

(c) The Trustee will be entitled to and will receive all of the 2009-1 Installment Payments and 2010-1 Installment Payments, and, in connection with any Additional Bonds issued under the Indenture, the Installment Payments made by the City pursuant to the Supplement(s) hereinafter executed by the City and the Authority to secure payment of principal of and interest on such Additional Bonds, and any such 2009-1 Installment Payments, 2010-1 Installment Payments and additional Installment Payments collected or received by the Authority will be deemed to be held, and to have been collected or received, by the Authority as agent of the Trustee and will forthwith be paid by the Authority to the Trustee.

Receipt and Deposit of Revenues in the Payment Fund. To carry out and effectuate the pledge contained in the Indenture, the Authority agrees and covenants that all Revenues when and as received will be received in trust under the Indenture for the benefit of the Owners and will be deposited when and as received in the Payment Fund. All Revenues will be accounted for through and held in trust in the Payment Fund, and the Authority will have no beneficial right or interest in any of the Revenues except only as provided in the Indenture. All Revenues, whether received by the Authority in trust or deposited with the Trustee as provided in the Indenture, will nevertheless be allocated, applied and disbursed solely to the purposes and uses set forth in the Indenture, and will be accounted for separately and apart from all other accounts, funds, money or other assets of the Authority.

Maintenance of Accounts for Use of Money in the Payment Fund.

(a) Except as otherwise provided in the Indenture, all monies in the Payment Fund will be deposited by the Trustee in the following respective special accounts within the Payment Fund in the following order of priority:

- (i) Interest Account,
- (ii) Principal Account, and
- (iii) Redemption Account.

All monies in each of such Accounts will be held in trust by the Trustee and will be applied, used and withdrawn only for the purposes authorized in the Indenture.

(b) On or before each Interest Payment Date, the Trustee will transfer from the Payment Fund and deposit in the Interest Account that amount of money that, together with any money contained in the Interest Account, equals the aggregate amount of interest becoming due and payable on all Outstanding Bonds on such Interest Payment Date. No deposit need be made in the Interest Account if the amount contained in the Interest Account equals at least the aggregate amount of interest becoming due and payable on all Outstanding Bonds on such Interest Payment Date. All money in the Interest Account will be used and withdrawn by the Trustee solely for the purpose of paying the interest on the Bonds as it will become due and payable (including accrued interest on any Bonds redeemed prior to maturity).

(c) On or before each Principal Payment Date, the Trustee will transfer from the Payment Fund and deposit in the Principal Account that amount of money that, together with any money contained in the Principal Account, equals the aggregate principal becoming due and payable on all Outstanding Bonds. No deposit need be made in the Principal Account if the amount contained therein is at least equal to the aggregate amount of principal become due and payable on all Outstanding Bonds. All money in the Principal Account will be used and withdrawn by the Trustee solely for the purpose of paying the principal of the Bonds as it will become due and payable.

(d) In addition to the above accounts, the Trustee shall establish and maintain within the Payment Fund a special account designated the "Redemption Account." All money in the Redemption Account will be held in trust by the Trustee and will be applied, used, and withdrawn either to redeem the Bonds pursuant to the Indenture. Any moneys that, pursuant to the Agreement and the related provisions of any Supplements, are to be used to redeem Bonds will be deposited by the Trustee in the Redemption Account. The Trustee will, on the scheduled redemption date, withdraw from the Redemption Account and pay to the Owners entitled thereto an amount equal to the redemption price of the Bonds to be redeemed on such date.

(e) Any delinquent Installment Payments pledged to the Bonds will be applied first to the Interest Account for the immediate payment of interest payments past due and then to the Principal Account for immediate payment of principal payments past due on any Bond. Any remaining money representing delinquent Installment Payments pledged to Bonds will be deposited in the Payment Fund to be applied in the manner provided therein.

Investment of Moneys in Funds and Accounts. Moneys in the Acquisition Fund will be accounted for by the Comptroller and invested by the Treasurer in any legally permitted investment, including but not limited to the pooled investment fund of the City. In the absence of a Written Request of the City, the Trustee may invest moneys in the funds and accounts held by the Trustee in Permitted Investments, as set forth in the letter of authorization and direction executed by the City and delivered to the Trustee. The obligations in which moneys in the said funds and accounts are invested will mature prior to the date on which such moneys are estimated to be required to be paid out under the Indenture. For purposes of determining the amount of deposit in any fund or account, all investments credited to such fund or account will be valued at the lesser of market value or the cost thereof. The Trustee will semiannually, on or before April 15 and October 15 of each year, and at such times as the Authority will deem appropriate, value the investments in the funds and accounts established under the Indenture on the basis of the lesser of market value or the cost thereof. Except as otherwise provided in the Indenture, Permitted Investments representing an investment of moneys attributable to any fund or account established under the Indenture and all investment profits or losses thereon will be deemed at all times to be a part of said fund or account. The Trustee shall not be liable for any losses resulting from any investments made pursuant to the Indenture.

Additional Bonds

Execution and Delivery of Additional Bonds. In addition to the 2009A Bonds, the 2009B Bonds and the 2010A Bonds, the Trustee will, upon Written Request of the Authority, by a supplement to the Indenture, establish one or more other series of Bonds secured by the pledge made under the Indenture equally and ratably with any Bonds previously issued and delivered, in such principal amount as will be determined by the Authority, but only upon compliance with the provisions of the Indenture, the requirements of the Agreement applicable to the incurrence of Subordinated Obligations and any additional requirements set forth in the applicable Supplemental Indenture, which are made conditions precedent to the execution and delivery of Additional Bonds:

(a) No Event of Default will have occurred and be then continuing;

(b) The Supplemental Indenture providing for the execution and delivery of such Additional Bonds will specify the purposes for which such Additional Bonds are then proposed to be delivered, which will be one or more of the following: (i) to provide moneys needed to provide for Project Costs by depositing into the Acquisition Fund the proceeds of such Additional Bonds to be so applied; (ii) to provide for the payment or redemption of Bonds then Outstanding under the Indenture, by depositing with the Trustee moneys and/or investments required for such purpose under the defeasance provisions set forth in the Indenture; or (iii) to provide moneys needed to refund or refinance all or part of any other current or future obligations of the City with respect to the funding of the Wastewater System. Such Supplemental Indenture may, but will not be required to, provide for the payment of expenses incidental to such purposes, including the Costs of Issuance of such Additional Bonds, capitalized interest with respect thereto for any period authorized under the Code (in the case of Tax-Exempt Bonds) and, in the case of any Additional Bonds intended to provide for the payment or redemption of existing Bonds, or other Obligations of the City, expenses incident to calling, redeeming, paying or otherwise discharging the Obligations to be paid with the proceeds of the Additional Bonds;

(c) The Authority will deliver or cause to be delivered to the Trustee, from the proceeds of such Additional Bonds or from any other lawfully available source of moneys, an amount (or a Surety Bond in an amount) sufficient to increase the balance in the Reserve Fund to the Reserve Fund Requirement for all Bonds and Additional Bonds to be then Outstanding;

(d) The Additional Bonds will be payable as to principal on May 15 and as to interest on May 15 and November 15 of each year during their term, except that the first interest payment due with respect thereto may be for a period of not longer than twelve (12) months;

(e) Fixed serial maturities or mandatory sinking account payments, or any combination thereof, will be established in amounts sufficient to provide for the retirement of all of the Additional Bonds of such Series on or before their respective maturity dates;

(f) The aggregate principal amount of Bonds and Additional Bonds executed and delivered under the Indenture will not exceed any limitation imposed by, law or by any Supplemental Indenture; and

(g) The Trustee will be the Trustee for the Additional Bonds.

Nothing in the Indenture will limit in any way the power and authority of the Authority to incur other obligations payable from other lawful sources.

Proceedings for Execution and Delivery of Additional Bonds. Whenever the Authority will determine to file its Written Request with the Trustee for the execution and delivery of Additional Bonds, the Authority will authorize the execution and delivery of a Supplemental Indenture, specifying the aggregate principal amount and describing the forms of Bonds and providing the terms, conditions, distinctive designation, denominations, date, maturity date or dates, interest rate or rates (or the manner of determining same), Interest Payments and payment dates, redemption provisions and place or places of payment of principal or redemption price, if any, and interest represented by such Additional Bonds not inconsistent with the terms of the Indenture.

Before any series of Additional Bonds may be executed and delivered by the Trustee, the Authority will file the following documents with the Trustee:

(a) An executed copy of the applicable Supplemental Indenture;

(b) A statement of the Authority to the effect that the requirements set forth in the Indenture have been met;

(c) In the case of a Series of Additional Bonds delivered for the purpose described in the Indenture, irrevocable instructions to the Trustee to give notice as provided in the Indenture of redemption of all Bonds to be redeemed in connection therewith; and

(d) An opinion or opinions of Bond Counsel, to the effect that the execution and delivery of the Additional Bonds, the supplement to the Indenture and related supplements or amendments have been duly authorized by the Authority and meet the requirements of the Indenture; and that the execution and delivery of such Additional Bonds will not, in and of themselves, cause the interest on the Tax-Exempt Bonds to become included within the gross income for purposes of federal income taxation.

Covenants of Authority

Punctual Payment and Performance. The Authority will punctually pay the interest and the principal to become due on every Bond issued under the Indenture in strict conformity with the terms of the Indenture and of the Bonds, and will faithfully observe and perform all the agreements and covenants contained therein.

Rebate Fund.

(a) The Trustee will maintain such accounts within the Rebate Fund as it is instructed by the Authority as will be necessary in order to comply with the applicable Tax Certificate (which is incorporated herein by reference). The Trustee will deposit moneys in the Rebate Fund made available by the Authority and/or the City pursuant to a Written Request of the City. All money at any time deposited in the Rebate Fund will be governed by the Indenture and the Tax Certificate and will be held by the Trustee in trust, to the extent required to satisfy the amount required to be rebated to the United States under the Code, and none of the City, the Authority, the Trustee nor the Owners will have any rights in or claims to such money. The Trustee will make information regarding the investments available to the City, will invest the Rebate Fund in Permitted Investments pursuant to a Written Request of the City that is in conformity with the restrictions set forth in the Tax Certificate and will deposit income from such Permitted Investments immediately upon receipt thereof into the Rebate Fund. The Trustee agrees to comply with all Written Requests of the City given in accordance with the Tax Certificate.

(b) The City and the Authority will make or cause to be made the rebate computations respecting all Outstanding Bonds in accordance with the Tax Certificate, as required by the Code, and will provide to the Trustee written evidence that the computation of the rebate requirement has been made along with a letter from an independent certified public accountant or arbitrage consultant verifying the accuracy of such calculations. Upon a Written Request of the City, the Trustee will make deposits into the Rebate Fund from deposits by the City so that the balance of the amount on deposit will be equal to the rebate requirement. The Trustee will have no obligation to rebate any amounts required to be rebated pursuant to the Indenture, other than from moneys held in the Rebate Fund or from other moneys provided to it by the City on behalf of itself or the Authority. Records of the actions required by the Indenture will be retained by the Trustee, the City and the Authority until the date which is six (6) years after the date on which the Bonds are no longer Outstanding.

(c) Not later than sixty (60) days after the end of the fifth Bond Year as defined in the Tax Certificate and every five (5) years thereafter, the Trustee, upon receipt of a Written Request of the City, will pay to the United States part or all of the amounts in the Rebate Fund, as so directed. Each payment will be accompanied by a statement summarizing the determination of the amount to be paid to the United States, as provided by the City. In addition, if the City so directs, then the Trustee will deposit moneys into or transfer moneys out of the Rebate Fund from or into such accounts or funds as directed by the Written Request of the City. Any amounts remaining in the Rebate Fund following the final payment of the rebate requirement will be paid to the City. Money, including investment earnings, will not be transferred from the Rebate Fund except as provided in the Indenture.

(d) The Trustee shall have no obligation to rebate any amounts required to be rebated pursuant to this Section, other than from moneys held in the funds and accounts created hereunder or from other moneys provided to it by the City on behalf of itself or the Authority.

(e) The Trustee shall invest all amounts held in the Rebate Fund in Permitted Investments as directed by a Written Request of the City, which directions shall be subject to the restrictions set forth in the Tax Certificate. Money, including investment-earnings, shall not be transferred from the Rebate Fund except as provided in paragraphs (f) and (g) below.

(f) Upon receipt of a Written Request of the City, the Trustee shall remit part or all of the amounts in the Rebate Fund to the United States of America, as so directed. In addition, if the City so directs, then the Trustee shall deposit moneys into or transfer moneys out of the Rebate Fund from or to such accounts or fund as directed by the Written Request of the City.

(g) After payment and satisfaction of any rebate requirement applicable to the Bonds (or if provisions for payment and satisfaction have been made therefor that are acceptable to the Trustee), any funds remaining in the Rebate Fund shall be withdrawn by the Trustee and remitted to the City.

(h) Notwithstanding any other provision of the Indenture, including in particular Article XI thereof, the obligation to remit the rebate requirement to the United States and to comply with all other requirements of this Section and the Tax Certificate shall survive the defeasance or payment in full of the Tax-Exempt Bonds.

(i) The Authority shall not use or permit any proceeds of the Tax-Exempt Bonds or any funds of the Authority, directly or indirectly, to acquire any securities or obligations, and shall not take or permit to be taken any other action or actions, that would cause any Tax-Exempt Bonds to be an "arbitrage bond" within the meaning of the Code or "federally guaranteed" within the meaning of Section 149(b) of the Code and any applicable regulations promulgated from time to time thereunder and under Section 103(c) of the Code. The Authority shall observe and not violate the requirements of Section 148 of the Code and any such applicable regulations. The Authority shall comply with all requirements of Sections 148 and 149(b) of the Code to the extent applicable to the Tax-Exempt Bonds.

(j) The Authority specifically covenants in the Indenture to comply with the provisions and procedures of the Tax Certificate.

(k) The Authority shall not use or permit the use of any proceeds of the Bonds or any funds of the Authority, directly or indirectly, in any manner, and shall not take or omit to take any action that would cause any Tax-Exempt Bonds to be treated as an obligation not described in Section 103(a) of the Code.

(l) Notwithstanding any of the foregoing Rebate Fund provisions, if the Authority and the City provide to the Trustee an opinion of Bond Counsel to the effect that any specified action required under the Rebate Fund provisions is no longer required or that some further or different action is required to maintain the exclusion from gross income for federal income tax purposes of interest with respect to the Tax-Exempt Bonds, the Trustee, the Authority and the City may conclusively rely on such opinion in complying with the requirements of the Indenture and the covenants under the Indenture will be deemed to be modified to that extent.

Eminent Domain. If the whole of the Components or so much thereof as to render the remainder unusable for the purposes for which it was used or intended to be used by the City will be taken under the power of eminent domain, the term of the Agreement will cease as of the day that possession will be so taken. In such case, the Authority will take or cause to be taken such action as is reasonably necessary to obtain compensation at least equal to the value of the Components or portion thereof taken by eminent domain. If less than the whole of the Components will be taken under the power of eminent domain and the remainder is usable for the purposes for which it was used by the City at the time of such taking, then the Agreement will continue in full force and effect as to such remainder, and the parties thereto waive the benefits of any law to the contrary. So long as any of the Bonds are Outstanding, the net proceeds of any award made in eminent domain proceedings for taking the Components or any portion thereof will be transferred to the Payment Fund. Any such award made after all of the Bonds have been fully paid and retired and all fees and expenses of the Trustee have been fully paid will be paid to the City.

Accounting Records and Reports. The Authority, or the City on behalf of the Authority, will keep or cause to be kept proper books of record and accounts in which complete and correct entries will be made of all transactions relating to the receipts, disbursements, allocation and application of the

Revenues, and such books will be available for inspection by the Trustee, at reasonable hours and under reasonable conditions. Not more than 270 days after the close of each Fiscal Year, the Authority, or the City on behalf of the Authority, will furnish or cause to be furnished to the Trustee financial statements that include the Sewer Revenue Fund for the preceding Fiscal Year, prepared in accordance with generally accepted accounting principles, together with a report of an Independent Certified Public Accountant thereon. For purposes of the Indenture, "financial statement" will mean audited financial statements, if available, or unaudited financial statements, if audited financial statements are not available and Unaudited financial statements are available. The Authority, or the City on behalf of the Authority, will also keep or cause to be kept such other information as is required under the Tax Certificate.

The City's Budgets. The Authority, or the City on behalf of the Authority, will supply to the Trustee, as soon as practicable after the beginning of each Fiscal Year following the effectiveness of the applicable City ordinance but in no event later than six months from the date of effectiveness of such ordinance, a Certificate of the City certifying that the City has made adequate provision in its annual budget for such Fiscal Year for the payment of all Parity Installment Payments, Subordinated Installment Payments and all other Obligations due under the 2010-1 Supplement and the Agreement in such Fiscal Year. If the amounts so budgeted are not adequate for the payment of all Parity Installment Payments, Subordinated Installment Payments and all other Obligations due under the Agreement in such Fiscal Year, the Authority, or the City on behalf of the Authority, will take such action as may be necessary and within its power to request such annual budget to be amended, corrected or augmented by the City so as to include therein the amounts required to be paid by the City from Net System Revenues in such Fiscal Year, and will notify the Trustee of the proceedings then taken or proposed to be by the Authority.

Continuing Disclosure. The City has undertaken all responsibility for compliance with continuing disclosure requirements, and accordingly the Authority will have no liability to the Owners of the Bonds or any other person with respect to S.E.C. Rule 15c2-12, and the City will comply with and carry out all of the provisions of each continuing disclosure certificate, each dated the date of the execution and delivery of each Series of Bonds. See the caption in this Official Statement, "CONTINUING DISCLOSURE." Notwithstanding any other provision the Indenture, failure of the City to comply with a Continuing Disclosure Certificate will not be considered an Event of Default under the Indenture or under the Installment Purchase Agreement; provided, that the Trustee may and, at the request of any participating underwriter or the Owners of at least twenty-five percent (25%) in aggregate principal amount of the Outstanding Bonds of any series and upon receiving indemnification reasonably satisfactory to the Trustee, will, or any Owner or Beneficial Owner of any of the Bonds may, take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City to comply with its obligations under the related Continuing Disclosure Certificate.

Amendment of Indenture

Amendment of Indenture.

(a) The Indenture and the rights and obligations of the Authority and of the all Owners of the Bonds may be amended at any time by a Supplemental Indenture, which will become binding when the written consents of the Owners of 51% in aggregate principal amount of the Bonds then Outstanding, exclusive of Bonds disqualified as provided in the Indenture, are filed with the Trustee. No such amendment will (i) permit the creation by the Authority of any pledge of the Revenues as provided herein superior to or on a parity with the pledge created pursuant to the Indenture for the benefit of any Bond without the written consent of the Owner thereof; (ii) modify any rights or obligations of the Trustee without its prior written assent thereto; or (iii) modify provisions respecting the time or amount of payments on any Bond, without the written consent of the Owner thereof.

(b) The Indenture and the rights and obligations of the Authority and of the Owners may also be amended at any time by a Supplemental Indenture which will become binding without the consent of any Owners of Bonds for anyone or more of the following purposes:

(i) to make such provisions for the purpose of curing any ambiguity or of correcting, curing or supplementing any defective provision contained herein in regard to questions arising

under the Indenture that the Authority may deem desirable or necessary and not inconsistent with the Indenture and that will not adversely affect the interests of the Owners; or

(ii) to make any other change or addition thereto that will not materially adversely affect the interests of the Owners, or to surrender any right or power reserved herein to or conferred herein on the Authority; provided, however, that the Owners will be given prompt notice of any such amendment and will receive a copy of the final executed Supplemental Indenture making such changes.

Disqualified Bonds. Bonds owned or held by or for the account of the Authority or the City will not be deemed Outstanding for the purpose of any consent or other action or any calculation of Outstanding Bonds provided in the Indenture, and will not be entitled to consent to or take any other action provided therein. Upon request of the Trustee, the Authority and the City shall specify in a certificate to the Trustee those Bonds disqualified pursuant to the Indenture and the Trustee may conclusively rely on such certificate.

Endorsement or Replacement of Bonds After Amendment. After the effective date of any action taken as described in the Indenture, the Authority may determine that the Bonds may bear a notation by endorsement in form approved by the Authority as to such action, and in that case upon demand of the Owner of any Outstanding Bond and presentation of its Bond for such purpose at the Corporate Trust Office of the Trustee, a suitable notation as to such action will be made on such Bond. If the Authority will determine that a Bond will bear such a notation by endorsement pursuant to the Indenture, a new Bond so modified will be prepared and executed, and upon demand of the Owner of any Outstanding Bond, such new Bond will be exchanged at the Corporate Trust Office of the Trustee without cost to such Owner upon surrender of such Bond.

Amendment by Mutual Consent. The provisions of the Indenture will not prevent any Owner from accepting any amendment as to the particular Bonds owned by him, provided that due notation thereof is made on such Bonds.

Events of Default and Remedies of Holders

Events of Default and Acceleration of Maturities.

(a) The following events will constitute events of default under the Indenture:

(i) failure in the due and punctual payment of the interest on the Bonds when and as the same will become due and payable;

(ii) failure in the due and punctual payment of the principal of the Bonds when and as the same will become due and payable, whether at maturity as therein expressed or by proceedings for redemption;

(iii) failure by the Authority in the performance of any of the other agreements or covenants required in the Indenture to be performed by the Authority, as set forth in the Indenture, and such default will have continued for a period of 30 days after the Authority and the City will have been given notice in writing of such default by the Trustee or to the Authority, the City and the Trustee by Owners of 25% or more of the aggregate principal amount of the Bonds then Outstanding; or

(iv) if any event of default will have occurred and be continuing under Section 8.01 of the Agreement; or

(v) if the Authority will file a petition or answer seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if under the provisions of any other law for the relief or aid of debtors any court of competent jurisdiction will assume custody or control of the Authority or of the whole or any substantial part of its property.

(b) If one or more Events of Default will occur, then and in each and every such case during the continuance of such Event of Default, the Trustee may by notice in writing to the Authority and the City, declare the principal of all Bonds then Outstanding and the interest accrued thereon to be due and payable immediately. Upon any such declaration, the same will become due and payable, anything contained in the Indenture or in the Bonds to the contrary notwithstanding. These provisions are subject to the condition that if at any time after the entire principal amount of the unpaid Bonds and the accrued interest thereon will have been so declared due and payable and before any judgment or decree for the payment of the moneys due will have been obtained or entered, there will be deposited with the Trustee a sum sufficient to pay the unpaid principal amount of the Bonds due prior to such declaration and the accrued interest thereon, with interest on such overdue installments at the rate or rates applicable thereto in accordance with their terms, and the reasonable fees and expenses of the Trustee, and any and all other defaults known to the Trustee (other than in the payment the entire principal amount of the unpaid Bonds and the accrued interest thereon due and payable solely by reason of such declaration) will have been made good or cured to the satisfaction of the Trustee or provision deemed by the Trustee to be adequate will have been made therefor, then and in every such case the Trustee, by written notice to the City and the Authority, may rescind and annul such declaration and its consequences; but no such rescission and annulment will extend to or will affect any subsequent default or will impair or exhaust any right or power consequent thereon.

Proceedings by Trustee. Upon the occurrence and continuance of any Event of Default, the Trustee in its discretion may, and at the written request of Owners of 51% or more in aggregate principal amount of Bonds Outstanding will (but only to the extent indemnified to its satisfaction from fees and expenses, including attorneys' fees), do the following:

(a) by mandamus, or other suit, action or proceeding at law or in equity, enforce all rights of the Owners and require the Authority to enforce all rights of the Owners of the Bonds, including the right to require the Authority to receive and collect Revenues and to enforce its rights under the Agreement and to require the Authority to carry out any other covenant or agreement with Owners of Bonds and to perform its duties under the Indenture;

(b) bring suit upon the Bonds;

(c) by action or suit in equity enjoin any acts or things that may be unlawful or in violation of the rights of the Owners; and

(d) as a matter of right, have receivers appointed for the Revenues and the issues, earnings, income, products and profits thereof, pending such proceedings, with such powers as the court making such appointment will confer.

Effect of Discontinuance or Abandonment. In case any proceeding taken by the Trustee on account of any default or Event of Default will have been discontinued or abandoned for any reason, or will have been determined -adversely to the Trustee, then and in every such case, the Authority, the Trustee and the Owners will be restored to their former positions and rights under the Indenture, respectively, and all rights, remedies and powers of the Trustee will continue as though no such proceeding had been taken.

Rights of Owners.

(a) Anything in the Indenture to the contrary notwithstanding and subject to the limitations and restrictions as to the rights of the Owners in the Indenture, upon the occurrence and continuance of any Event of Default or the Owners of 51% or more in aggregate principal amount of the Bonds then Outstanding will have the right upon providing the Trustee security and indemnity reasonably satisfactory to it against the costs, expenses, and liabilities to be incurred therein or thereby, by an instrument in writing executed and delivered to the Trustee, to direct the method and place of conducting all remedial proceedings to be taken by the Trustee under the Indenture.

(b) The Trustee may refuse to follow any direction that conflicts with law or the Indenture or that the Trustee determines is prejudicial to rights of other Owners or would subject the Trustee to personal liability.

Restrictions on Owners' Actions.

(a) In addition to the other restrictions on the rights of Owners to request action upon the occurrence of an Event of Default and to enforce remedies set forth in the Indenture, no Owner of any of the Bonds will have any right to institute any suit, action or proceeding in equity or at law for the enforcement of any trust under the Indenture, or any other remedy under the Indenture or on said Bonds, unless:

(i) such Owner previously will have given to the Trustee written notice of an Event of Default as provided in the Indenture; and

(ii) the Owners of 51% or more in aggregate principal amount of the Bonds then Outstanding will have made written request of the Trustee to institute any such suit, action, proceeding or other remedy, after the right to exercise such powers or rights of action, as the case may be, will have accrued, and will have afforded the Trustee a reasonable opportunity either to proceed to exercise the powers granted in the Indenture, or to institute such action, suit or proceeding in its or their name; and

(iii) there will have been offered to the Trustee security and indemnity satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby; and

(iv) the Trustee will not have complied with such request within a reasonable time.

(b) Such notification, request and offer of indemnity are declared in every such case, at the option of the Trustee, to be conditions precedent to the execution of the trusts of the Indenture or for any other remedy under the Indenture. It is understood and intended, subject to the Indenture, that no one or more Owners of the Bonds secured by the Indenture will have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of the Indenture, or to enforce any right under the Indenture or under the Bonds, except in the manner therein provided, and that all proceedings at law or in equity will be instituted, and maintained in the manner therein provided, and for the equal benefit of all Owners of Outstanding Bonds.

Power of Trustee to Enforce. All rights of action under the Indenture or under any of the Bonds secured by the Indenture which are enforceable by the Trustee may be enforced by it without the possession of any of the Bonds, or the production thereof at the trial or other proceedings relative thereto. Any such suit, action or proceedings instituted by the Trustee will be brought in its own name, as Trustee, for the equal and ratable benefit of the Owners of the Bonds, subject to the provisions of the Indenture.

Remedies Not Exclusive. No remedy in the Indenture conferred upon or reserved to the Trustee or to the Owners of the Bonds is intended to be exclusive of any other remedy or remedies, and each and every such remedy will be cumulative, and will be in addition to every other remedy given under the Indenture or now or hereafter existing at law or in equity or by statute.

Waiver of Events of Default; Effect of Waiver.

(a) The Trustee will waive any Event of Default under the Indenture and its consequences and rescind any declaration of acceleration, upon the written request of the Owners of 67% or more of the Outstanding Bonds. If any Event of Default will have been waived as provided in the Indenture, the Trustee will promptly give written notice of such waiver to the Authority and will give notice thereof by first class mail, postage prepaid to all Owners of Outstanding Bonds if such Owners had previously been given notices of such Event of Default. No such waiver, rescission and annulment will extend to or affect any subsequent Event of Default, or impair any right or remedy consequent thereon.

(b) No delay or omission of the Trustee or any Owner of the Bonds to exercise any right or power accruing upon any default or Event of Default will impair any such right or power or will be construed to be a waiver of any such default or Event of Default or an acquiescence therein. Every power and remedy

given by the Indenture to the Trustee or the Owners of the Bonds, respectively, may be exercised from time to time and as often as may be deemed expedient.

Application of Moneys.

(a) Any moneys received by the Trustee pursuant to the Indenture, together with any moneys that upon the occurrence of an Event of Default are held by the Trustee in any of the funds and accounts established under the Indenture (other than the Rebate Fund and other than moneys held for Bonds not presented for payment) will, after payment of all fees and expenses of the Trustee, and the fees and expenses of its counsel, be applied as follows:

(i) Unless the principal of all of the Outstanding Bonds will be due and payable:

(A) First—To the payment of the Owners of all installments of interest then due on the Bonds, in the order of the maturity of the installments of such interest and, if the amount available will not be sufficient to pay in full any particular installment, then to the payment ratably, according to the amounts due on such installment, to the Owners, without any discrimination or privilege;

(B) Second—To the payment of the Owners of the unpaid principal of any of the Bonds that will have become due (other than Bonds matured or called for redemption for the payment of which moneys are held pursuant to the provisions of the Indenture), in the order of their due dates and, if the amount available will not be sufficient to pay in full the principal of and premium, if any, on such Bonds due on any particular date, then to the payment ratably, according to the amount due on such date, to the Owners without any discrimination; and

(C) Third—To be held for the payment to the Owners as the same will become due of the principal of and interest on the Bonds, that may thereafter become due either at maturity or upon call for redemption prior to maturity and, if the amount available will not be sufficient to pay in full such principal and premium, if any, due on any particular date, together with interest then due and owing thereon, payment will be made in accordance with the Indenture.

(ii) If the principal of all of the Outstanding Bonds will be due and payable, to the payment of the principal and interest then due and unpaid upon the Outstanding Bonds without preference or priority of any of principal, or interest over the others or of any installment of interest, or of any Outstanding Bond over any other Outstanding Bond, ratably, according to the amounts due respectively for principal and interest, to the Owners without any discrimination or preference except as to any difference in the respective amounts of interest specified in the Outstanding Bonds.

(b) Whenever moneys are to be applied pursuant to the provisions of the Indenture, such moneys will be applied at such times, and from time to time, as the Trustee will determine, having due regard to the amount of such moneys available for application and the likelihood of additional moneys becoming available for such application in the future. The Trustee will give, by mailing by first-class mail as it may deem appropriate, such notice of the deposit with it of any such moneys.

Defeasance

If the Authority will pay or cause to be paid to the Owners of all Outstanding Bonds the interest thereon and the principal thereof and the premiums, if any, thereon at the times and in the manner stipulated therein and in the Indenture, then the Owners of such Bonds will cease to be entitled to the pledge of the Revenues as provided in the Indenture, and all agreements, covenants and other obligations of the Authority to the Owners of such Bonds will cease, terminate and become void and be discharged and satisfied. In such event, the Trustee will execute and deliver to the Authority all such instruments as may be necessary or desirable to evidence such discharge and satisfaction, and the Trustee will pay over or deliver to the Authority all money or securities or other property held by it pursuant to the Indenture

that are not required for the payment of the interest on and principal of and redemption premiums, if any, on such Bonds.

Subject to the provisions of the above paragraph, when any of the Bonds will have been paid and if, at the time of such payment, the Authority will have kept, performed and observed all the covenants and promises in such Bonds and in the Indenture required or contemplated to be kept, performed and observed by the Authority or on its part on or prior to that time, then the Indenture will be considered to have been discharged in respect of such Bonds and such Bonds will cease to be entitled to the lien of the Indenture and such lien and all agreements, covenants, and other obligations of the Authority therein will cease, terminate and become void and be discharged and satisfied as to such Bonds.

Notwithstanding the satisfaction and discharge of the Indenture or the discharge of the Indenture in respect of any Bonds, those provisions of the Indenture relating to the maturity of the Bonds, interest payments and dates thereof, exchange and transfer of Bonds, replacement of mutilated, destroyed, lost or stolen Bonds, the safekeeping and cancellation of Bonds, nonpresentment of Bonds, and the duties of the Trustee in connection with all of the foregoing, remain in effect and will be binding upon the Trustee and the Owners of the Bonds and the Trustee will continue to be obligated to hold in trust any moneys or investments then held by the Trustee for the payment of the principal of, redemption premium, if any, and interest on the Bonds, to pay to the Owners of Bonds the funds so held by the Trustee as and when such payment becomes due. Notwithstanding the satisfaction and discharge of the Indenture or the discharge thereof in respect of any Bonds, those provisions of the Indenture relating to the compensation of the Trustee will remain in effect and will be binding upon the Trustee and the Authority. Any Outstanding Bonds will prior to the maturity date or redemption date thereof be deemed to have been paid for purposes of the Indenture if: (i) in case any of such Bonds are to be redeemed on any date prior to their maturity date, the Authority will have given to the Trustee in form satisfactory to it irrevocable instructions to mail, on a date in accordance with the provisions of the Indenture, notice of redemption of such Bonds on said redemption date, said notice to be given in accordance with the Indenture; (ii) there will have been deposited with the Trustee either (A) money in an amount which will be sufficient; or (B) Federal Securities of which are not subject to redemption prior to maturity except by the holder thereof (including any such Permitted Investments issued or held in book-entry form on the books of the Department of the Treasury of the United States of America) and/or Pre-Refunded Municipals, the interest on and principal of which when due, and without any reinvestment thereof, will provide money that, together with the money, if any, deposited with the Trustee at the same time, will, as verified by an independent certified public accountant or other independent financial consultant acceptable to the Trustee, be sufficient, to pay when due the interest to become due on such Bonds on and prior to the maturity date or redemption date thereof, as the case may be, and the principal of and interest on such Bonds; and; (iii) in the event such Bonds are not by their terms subject to redemption within the next succeeding 60 days, the Authority will have given the Trustee in form satisfactory to it irrevocable instructions to mail as soon as practicable, a notice to the Owners of such Bonds and to the Securities Depositories and the Information Services that the deposit required by clause (ii) above has been made with the Trustee and that such Bonds are deemed to have been paid in accordance with the Indenture and stating the maturity date or redemption date upon which money is to be available for the payment of the principal of and interest on such Bonds.

INSTALLMENT PURCHASE AGREEMENT

The Installment Purchase Agreement sets forth certain terms and conditions of the purchase of the Project by the City. Certain definitions and provisions of the Installment Purchase Agreement are set forth or summarized below. Other provisions of the Installment Purchase Agreement are summarized in the body of the Official Statement under the caption "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS."

Selected Definitions

The term "Accountant's Report" means a report signed by an Independent Certified Public Accountant.

The term "Acquisition Fund" means the fund by that name established pursuant to any Issuing Instrument.

The term "Authority" means the Public Facilities Financing Authority of the City of San Diego, a joint powers authority duly organized and existing under and by virtue of the laws of the State of California.

The term "Authorized City Representative" means the Mayor, the City Manager or the Treasurer of the City or such other officer or employee of the City or other person who has been designated as such representative by resolution of the City Council of the City.

The term "Authorizing Ordinance" means the ordinance pursuant to which the Installment Purchase Agreement was authorized and any additional Ordinance or official authorizing act of the Council of the City approving execution and delivery of any Supplement to the Installment Purchase Agreement or any Issuing Instrument.

The term "Balloon Indebtedness" means, with respect to any Series of Obligations twenty-five percent (25%) or more of the principal of which matures on the same date or within a 12-month period (with sinking fund payments on Term Obligations deemed to be payments of matured principal), that portion of such Series of Obligations which matures on such date, or within such 12-month period; provided, however, that to constitute Balloon Indebtedness the amount of indebtedness maturing on a single date or over a 12-month period must equal or exceed 150% of the amount of such Series Obligations which matures during any preceding 12-month period. For purposes of this definition, the principal amount maturing on any date shall be reduced by the amount of such indebtedness which is required, by the documents governing such indebtedness, to be amortized by prepayment or redemption prior to its stated maturity date.

The term "Bond Counsel" means a firm of attorneys which are nationally recognized as experts in the area of municipal finance.

The term "Charter" means the Charter of the City as it now exists or may hereafter be amended, and any new or successor Charter.

The term "City" means the City of San Diego, a municipal authority organized and existing under the Charter, and any successor to the City as a result of a transfer authorized under the Installment Purchase Agreement.

The term "Code" means the Internal Revenue Code of 1986, and the regulations thereunder, as amended, and any successor provisions of law.

The term "Components" means components of the Project specified in a Supplement.

The term "Consultant" means the consultant, consulting firm, engineer, architect, engineering firm, architectural firm, accountant or accounting firm retained by the City to perform acts or carry out the duties provided for such consultant in the Installment Purchase Agreement. Such consultant, consulting firm, engineer, architect, engineering firm or architectural firm shall be nationally recognized

within its profession for work of the character required. Such accountants or accounting firm shall be independent certified public accountants licensed to practice in the State of California..

The term "Contracts" means any contract or lease of the City (including the Installment Purchase Agreement) authorized and executed by the City, the installment or lease payments of which are payable from the Net System Revenues and which are on a parity with Installment Payments.

The term "Credit Provider" means any municipal bond insurance company, bank or other financial institution or organization which is performing in all material respects its obligations under any Credit Support arrangements for some or all of the Parity Obligations.

The term "Credit Provider Reimbursement Obligations" means obligations of the City to repay, from Net System Revenues, amounts advanced by a Credit Provider as credit support or liquidity for Parity Obligations, which obligations shall be Parity Obligations or Subordinated Obligations, as designated by the City.

The term "Credit Support" means a policy of insurance, a letter of credit, a stand-by purchase agreement, revolving credit agreement or other credit arrangement pursuant to which a Credit Provider provides credit or liquidity support with respect to the payment of interest, principal or the purchase price of any Parity Obligations.

Except as otherwise provided in the next sentence, the term "Debt Service" means, for any Fiscal Year, the sum of (1) the interest payable during such Fiscal Year on all outstanding Parity Obligations, assuming that all outstanding Serial Parity Obligations are retired as scheduled and that all outstanding Term Parity Obligations are redeemed or paid from sinking fund payments as scheduled (except to the extent that such interest is to be paid from the proceeds of sale of any Parity Obligations), (2) that portion of the principal amount of all outstanding Serial Parity Obligations maturing on the next succeeding principal payment date which falls in such Fiscal Year (excluding Serial Obligations which at the time of issuance are intended to be paid from the sale of a corresponding amount of Parity Obligations), (3) that portion of the principal amount of all outstanding Term Parity Obligations required to be redeemed or paid on any redemption date which falls in such Fiscal Year (together with the redemption premiums, if any, thereon); provided that, (1) as to any Balloon Indebtedness, Tender Indebtedness and Variable Rate Indebtedness, interest thereon shall be calculated as provided in the definition of Maximum Annual Debt Service and principal shall be deemed due at the nominal maturity dates thereof; (2) the amount on deposit in a debt service reserve fund on any date of calculation of Debt Service shall be deducted from the amount of principal due at the final maturity of the Parity Obligations for which such debt service reserve fund was established and in each preceding year until such amount is exhausted; (3) the amount of any interest payable on any Parity Obligation for which there exists a Qualified Swap Agreement shall be the net amount payable by the City as provided in paragraph (iv) or paragraph (viii), as applicable, of the definition of Maximum Annual Debt Service; and (4) the amount of payments on account of Parity Obligations which are redeemed, retired or repaid on the basis of the accreted value due on the scheduled redemption, retirement or repayment date shall be deemed principal payments, and interest that is compounded and paid as part of the accreted value shall be deemed payable on the scheduled redemption, retirement or repayment date but not before.

The term "Defaulted Obligations" means Obligations in respect of which an Event of Default has occurred and is continuing.

The term "District" shall mean the San Diego Wastewater Management District created under Chapter 803 of 1992 Session Laws.

The term "Engineer's Report" means a report signed by an Independent Engineer.

The term "Event of Default" means an event described in the Installment Purchase Agreement, as described below.

The term "Fiscal Year" means the period beginning on July 1 of each year and ending on the next succeeding June 30, or any other twelve-month period selected and designated as the official Fiscal Year of the City.

The term "Independent Certified Public Accountant" means any firm of certified public accountants appointed by the City, and each of whom is independent pursuant to the Statement on Auditing Standards No.1 of the American Institute of Certified Public Accountants.

The term "Independent Engineer" means any registered engineer or firm of registered engineers of national reputation generally recognized to be well qualified in engineering matters relating to wastewater systems, appointed and paid by the City.

The term "Installment Payment Date" means any date on which an Installment Payment is due as specified in or determined pursuant to a Supplement.

The term "Installment Payments" means the Installment Payments scheduled to be paid by the City under and pursuant to the Installment Purchase Agreement and any Supplement.

The term "Installment Payment Obligations" means Obligations consisting of or which are supported in whole by Installment Payments.

The term "Installment Purchase Agreement" means the Master Installment Purchase Agreement by and between the City and the Authority, dated as of September 1, 1993, as originally executed and as it is from time to time amended or supplemented in accordance with its terms.

The term "Issuing Instrument" shall mean any indenture, trust agreement, loan agreement, lease Installment Purchase Agreement or other instrument, including any Supplement, under which Obligations are issued or created.

The term "Law" means the Charter and all laws of the State supplemental thereto.

The term "Maintenance and Operation Costs of the Metropolitan System" means (a) a Qualified Take or Pay Obligation related to the Metropolitan System and (b) reasonable and necessary costs spent or incurred by the City for maintaining and operating the Metropolitan System, calculated in accordance with generally accepted accounting principles, including (among other things) the reasonable expenses of management and repair and other expenses necessary to maintain and preserve the Metropolitan System in good repair and working order, and including administrative costs of the City attributable to the Components which are part of the Metropolitan System, salaries and wages of employees, payments to employees retirement systems (to the extent paid from Metropolitan System Revenues), overhead, taxes (if any), fees of auditors, accountants, attorneys or engineers and insurance premiums, and including all other reasonable and necessary costs of the City or charges required to be paid by it to comply with the terms of the Obligations the proceeds of which are used to acquire Components which are part of the Metropolitan System, including any amounts required to be deposited in the Rebate Fund pursuant to the Tax Certificate relating to the financing of Components which are part of the Metropolitan System, fees and expenses payable to any Credit Provider (other than in repayment of a Credit Provider Reimbursement Obligation), and including expenses incurred or accrued incident to the formation of an entity to which the City may transfer substantially all of the Metropolitan System pursuant to the Installment Purchase Agreement, but excluding in all cases (i) depreciation, replacement and obsolescence charges or reserves therefor, (ii) amortization of intangibles or other bookkeeping entries of a similar nature, (iii) costs of capital additions, replacements, betterments, extensions or improvements to the Metropolitan System, which under generally accepted accounting principles are chargeable to a capital account or to a reserve for depreciation, (iv) charges for the payment of principal and interest on any general obligation bond heretofore or hereafter issued for Metropolitan System purposes, and (v) charges for the payment of principal and interest on account of any Obligation.

The term "Maintenance and Operation Costs of the Municipal System" means (a) a Qualified Take or Pay Obligation related to the Municipal System and (b) the reasonable and necessary costs spent or incurred by the City for maintaining and operating the Municipal System, calculated in accordance with generally accepted accounting principles, including (among other things) the reasonable expenses of management and repair and other expenses necessary to maintain and preserve the Municipal System in good repair and working order, and including administrative costs of the City attributable to the Components which are part of the Municipal System, salaries and wages of employees, payments to

employees retirement systems (to the extent paid from Municipal System Revenues), overhead, taxes (if any), fees of auditors, accountants, attorneys or engineers and insurance premiums, and including all other reasonable and necessary costs of the City or charges required to be paid by it to comply with the terms of the Obligations the proceeds of which are used to acquire Components which are part of the Municipal System, including any amounts required to be deposited in the Rebate Fund pursuant to the Tax Certificate relating to the financing of Components which are part of the Municipal System, fees and expenses payable to any Credit Provider (other than in repayment of a Credit Provider Reimbursement Obligation), but excluding in all cases (i) depreciation, replacement and obsolescence charges or reserves therefor, (ii) amortization of intangibles or other bookkeeping entries of a similar nature, (iii) costs of capital additions, replacements, betterments, extensions or improvements to the Municipal System, which under generally accepted accounting principles are chargeable to a capital account or to a reserve for depreciation, (iv) charges for the payment of principal and interest on any general obligation bond heretofore or hereafter issued for Municipal System purposes, and (v) charges for the payment of principal and interest on account of any Obligation.

The term "Maintenance and Operation Costs of the Wastewater System" means (a) a Qualified Take or Pay Obligation and (b) the reasonable and necessary costs spent or incurred by the City for maintaining and operating the Wastewater System, calculated in accordance with generally accepted accounting principles, including (among other things) the reasonable expenses of management and repair and other expenses necessary to maintain and preserve the Wastewater System in good repair and working order, and including administrative costs of the City attributable to the Project and the Installment Purchase Agreement, salaries and wages of employees, payments to employees retirement systems (to the extent paid from System Revenues), overhead, taxes (if any), fees of auditors, accountants, attorneys or engineers and insurance premiums, and including all other reasonable and necessary costs of the City or charges required to be paid by it to comply with the terms of the Obligations, including the Installment Purchase Agreement, including any amounts required to be deposited in the Rebate Fund pursuant to the Tax Certificate, fees and expenses payable to any Credit Provider (other than in repayment of a Credit Provider Reimbursement Obligation), and expenses incurred or accrued incident to the formation of an entity to which the City may transfer substantially all of the Metropolitan System pursuant to the Installment Purchase Agreement, but excluding in all cases (i) depreciation, replacement and obsolescence charges or reserves therefor, (ii) amortization of intangibles or other bookkeeping entries of a similar nature, (iii) costs of capital additions, replacements, betterments, extensions or improvements to the Wastewater System which under generally accepted accounting principles are chargeable to a capital account or to a reserve for depreciation, (iv) charges for the payment of principal and interest on any general obligation bond heretofore or hereafter issued for Wastewater System purposes, and (v) charges for the payment of principal and interest on any debt service on account of any obligation on a parity with or subordinate to the Installment Payments.

The term "Maximum Annual Debt Service" means, at any point in time, with respect to Parity Obligations then Outstanding, the maximum amount of principal and interest becoming due on the Parity Obligations in the then current or any future Fiscal Year, calculated by the City or by an Independent Certified Public Accountant as provided in this definition and provided to the Trustee. For purposes of calculating Maximum Annual Debt Service, the following assumptions shall be used to calculate the principal and interest becoming due in any Fiscal Year:

(i) in determining the principal amount due in each year, payments shall (except to the extent a different subsection of this definition applies for purposes of determining principal maturities or amortization) be assumed to be made in accordance with any amortization schedule established for such debt, including the amount of any Parity Obligations which are or have the characteristics of commercial paper and which are not intended at the time of issuance to be retired from the sale of a corresponding amount of Parity Obligations, and including any scheduled mandatory redemption or prepayment of Parity Obligations on the basis of accreted value due upon such redemption or prepayment, and for such purpose, the redemption payment or prepayment shall be deemed a principal payment; in determining the interest due in each year, interest payable at a fixed rate shall (except to the extent subsection (ii) or (iii) of this definition applies) be assumed to be made at such fixed rate and on the required payment dates;

(ii) if all or any portion or portions of an Outstanding Series of Parity Obligations constitutes Balloon Indebtedness or if all or any portion or portions of a Series of Parity

Obligations or such payments then proposed to be issued would constitute Balloon Indebtedness, then, for purposes of determining Maximum Annual Debt Service, each maturity which constitutes Balloon Indebtedness shall be treated as if it were to be amortized in substantially equal annual installments of principal and interest over a term of 25 years commencing in the year the stated maturity of such Balloon Indebtedness occurs, the interest rate used for such computation shall be determined as provided in (iv) or (v) below, as appropriate, and all payments of principal and interest becoming due prior to the year of the stated maturity of the Balloon Indebtedness shall be treated as described in (i) above;

(iii) if any of the Outstanding Series of Parity Obligations constitutes Tender Indebtedness or if Parity Obligations proposed to be issued would constitute Tender Indebtedness, then for purposes of determining Maximum Annual Debt Service, Tender Indebtedness shall be treated as if the principal amount of such Parity Obligations were to be amortized in accordance with the amortization schedule set forth in such Tender Indebtedness or in the standby purchase or liquidity facility established with respect to such Tender Indebtedness, or if no such amortization schedule is set forth, then such Tender Indebtedness shall be deemed to be amortized in substantially equal annual installments of principal and interest over a term of 25 years commencing in the year in which such Series first subject to tender, the interest rate used for such computation shall be determined as provided in (iv) or (v) below, as appropriate;

(iv) if any Outstanding Parity Obligations constitute Variable Rate Indebtedness (except to the extent paragraph (ii) relating to Balloon Indebtedness or paragraph (iii) relating to Tender Indebtedness applies), the interest rate on such Obligation shall be assumed to be 110% of the daily average interest rate on such Parity Obligations during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Parity Obligations shall have been Outstanding; provided that in the event that such Variable Rate Indebtedness has been issued in connection with a Qualified Swap Agreement, the interest rate for purposes of computing Maximum Annual Debt Service shall be determined by (x) calculating the annualized net amount paid by the City under such Variable Rate Indebtedness and Qualified Swap Agreement (after giving effect to payments made under the Variable Rate Indebtedness and made and received by the City under the Qualified Swap Agreement) during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Qualified Swap Agreement has been in effect, and (y) dividing the amount calculated in clause (x) by the average daily balance of the related Parity Obligations Outstanding during the 12 month period contemplated by clause (x);

(v) if Parity Obligations proposed to be issued will be Variable Rate Indebtedness (except to the extent subsection (ii) relating to Balloon Indebtedness or subsection (iii) relating to Tender Indebtedness applies), then such Parity Obligations shall be assumed to bear interest at 110% of the average of the J.J. Kenny High Grade Index during the prior 12 months ending with the month preceding the date of sale of such additional Parity Obligations, or if that index is no longer published, another similar index selected by the City, or if the City fails to select a replacement index, an interest rate equal to 80% of the yield for outstanding United States Treasury bonds having an equivalent maturity, or if there are no such Treasury bonds having such maturities, 100% of the lowest prevailing prime rate of any of the five largest commercial banks in the United States ranked by assets; provided that in the event that such Variable Rate Indebtedness will be issued in connection with a Qualified Swap Agreement, the interest rate for purposes of computing Maximum Annual Debt Service shall be determined by (a) calculating the net amount to be paid by the City under such Variable Rate Indebtedness and Qualified Swap Agreement after giving effect to payments to be made under the Variable Rate Indebtedness and to be made and received by the City under the Qualified Swap Agreement) for the period during which the Qualified Swap Agreement is to be in effect and for this purpose any variable rate of interest agreed to be paid thereunder shall be deemed to be the rate at which the related Parity Obligation shall be assumed to bear interest, and (b) dividing the amount calculated in clause (a) by the average principal amount of the related Parity Obligation to be Outstanding during the first year after the issuance of such Parity Obligation;

(vi) if moneys or Permitted Investments have been deposited by the City into a separate fund or account or are otherwise held by the City or by a fiduciary to be used to pay principal and/or interest on specified Parity Obligations, then the principal and/or interest to be paid from such moneys, Permitted Investments or from the earnings thereon shall be disregarded and not included in calculating Maximum Annual Debt Service;

(vii) if Parity Obligations are Paired Obligations, the interest thereon shall be the resulting linked rate or effective fixed rate to be paid with respect to such Paired Obligations; and

(viii) in the event that an agreement or commitment which, at the time of calculation is a Qualified Swap Agreement is or is to be in effect with respect to a Parity Obligation which is not Variable Rate Indebtedness, the interest rate of such Parity Obligation for purposes of calculating Maximum Annual Debt Service shall be calculated as follows:

(a) for such a Qualified Swap Agreement which is in effect on the date of calculation, the interest rate shall be calculated in the same manner as is specified in paragraph (iv) for a Qualified Swap Agreement issued in connection with Variable Rate Indebtedness which is Outstanding on the date of calculation; and

(b) for such a Qualified Swap Agreement which is not in effect on the date of calculation, the interest rate shall be calculated in the same manner as is specified in paragraph (v) for a Qualified Swap Agreement to be issued in connection with Variable Rate Indebtedness to be Outstanding after the date of calculation, and for this purpose any variable rate of interest agreed to be paid thereunder shall be assumed to be the rate assumed for Variable Rate Indebtedness described in paragraph (v).

The term "Maximum Rate" means, on any day, the maximum interest rate allowed by law.

The term "Metropolitan System" means any and all facilities, properties and improvements designated by the City in its sole discretion as part of the Metropolitan System, and used for the conveyance from the Municipal System and treatment of sewage collected by the City through its Municipal System or by any of the Participating Agencies.

The term "Metropolitan System Revenues" means all income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Metropolitan System, including, without limiting the generality of the foregoing, (1) all income, rents, rates, fees, charges (including standby and capacity charges), or other moneys derived by the City from the wastewater services, facilities, and commodities or byproducts sold, furnished or supplied through the facilities of or in the conduct or operation of the business of the Metropolitan System, and including, without limitation, investment earnings on the operating reserves to the extent that the use of such earnings is limited to the Metropolitan System by or pursuant to law, earnings on any Reserve Fund for Obligations the proceeds of which were used to finance improvements which are part of the Metropolitan System, or to fund or refund any such Obligations, but only to the extent that such earnings may be utilized under the Issuing Instrument for the payment of debt service for such Obligations; (2) the proceeds derived by the City directly or indirectly from the sale, lease or other disposition of a part of the Metropolitan System; (3) any amount received from the levy or collection of taxes which are solely available and are earmarked for the support of the operation of the Metropolitan System; (4) amounts received under contracts or agreements with governmental or private entities and designated for capital costs for Components which are to be part of the Metropolitan System; and (5) grants received from the United States of America or from the State of California for Components which are to be part of the Metropolitan System; provided, however, that Metropolitan System Revenues shall not include: (a) in all cases, customers' deposits or any other deposits or advances subject to refund until such deposits or advances have become the property of the City; and (b) the proceeds of borrowings. Notwithstanding the foregoing, there shall be deducted from Metropolitan System Revenues any amounts transferred into a Rate Stabilization Fund as contemplated by the Installment Purchase Agreement, and there shall be added to Metropolitan System Revenues any amounts transferred out of such Rate Stabilization Fund to pay Maintenance and Operation Costs of the Metropolitan System.

The term “Moody’s” means Moody’s Investors Service, Inc., a Delaware corporation, and its successors, and if such corporation shall for any reason no longer perform the functions of a securities rating agency, “Moody’s” shall be deemed to refer to any other nationally recognized securities rating agency designated by the City.

The term “Municipal System” means any and all facilities, properties and improvements at any time owned, controlled or operated by the City, and designated by the City in its sole discretion as part of the Municipal System, for the collection of sewage from the points of origination thereof and the conveyance thereof to the Metropolitan System.

The term “Municipal System Revenues” means all income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Municipal System, including, without limiting the generality of the foregoing, (1) all income, rents, rates, fees, charges (including standby and capacity charges), or other moneys derived by the City from the wastewater services, facilities, and commodities or byproducts sold, furnished or supplied through the facilities of or in the conduct or operation of the business of the Municipal System, and including, without limitation, investment earnings on the operating reserves to the extent that the use of such earnings is limited to the Municipal System by or pursuant to law, earnings on any Reserve Fund for Obligations the proceeds of which were used to finance improvements which are part of the Municipal System, or to fund or refund any such Obligations, but only to the extent that such earnings may be utilized under the Issuing Instrument for debt service for such Obligations; (2) the proceeds derived by the City directly or indirectly from the sale, lease or other disposition of a part of the Municipal System; (3) any amount received from the levy or collection of taxes which are solely available and are earmarked for the support of the operation of the Municipal System; (4) amounts received under contracts or agreements with governmental or private entities and designated for capital costs for Components which are to be part of the Municipal System; and (5) grants received from the United States of America or from the State of California for Components which are to be part of the Municipal System; provided, however, that Municipal System Revenues shall not include: (a) in all cases, customers’ deposits or any other deposits or advances subject to refund until such deposits or advances have become the property of the City; and (b) the proceeds of borrowings. Notwithstanding the foregoing, there shall be deducted from Municipal System Revenues any amounts transferred into a Rate Stabilization Fund as contemplated by the Installment Purchase Agreement, and there shall be added to Municipal System Revenues any amounts transferred out of such Rate Stabilization Fund to pay Maintenance and Operation Costs of the Municipal System.

The term “Net Proceeds” means, when used with respect to any insurance, self insurance or condemnation award, the proceeds from such award remaining after payment of all expenses (including attorneys’ fees) incurred in the collection of such proceeds.

The term “Net Metropolitan System Revenues” means, for any Fiscal Year, the Metropolitan System Revenues for such Fiscal Year less the Maintenance and Operation Costs of the Metropolitan System for such Fiscal Year.

The term “Net Municipal System Revenues” means, for any Fiscal Year, the Municipal System Revenues for such Fiscal Year less the Maintenance and Operation Costs of the Municipal System for such Fiscal Year.

The term “Net System Revenues” means, for any Fiscal Year, the System Revenues for such Fiscal Year less the Maintenance and Operation Costs of the Wastewater System for such Fiscal Year.

The term “Obligations” means (i) obligations of the City for money borrowed (such as bonds, notes or other evidences of indebtedness) or as installment purchase payments under any contract (including Installment Payments), or as lease payments under any financing lease (determined to be such in accordance with generally accepted accounting principles), the principal and interest on which are payable from Net System Revenues; (ii) obligations to replenish any debt service reserve funds with respect to such obligations of the City; (iii) obligations secured by or payable from any of such obligations of the City; and (iv) obligations of the City payable from Net System Revenues under (a) any contract providing for payments based on levels of, or changes in, interest rates, currency exchange rates, stock or other indices, (b) any contract to exchange cash flows or a series of payments or (c) any contract

to hedge payment, currency, rate spread or similar exposure, including but not limited to interest rate swap agreements and interest rate cap agreements.

The term "Outstanding," when used as of any particular time with respect to Obligations, means all Obligations theretofore or thereupon executed, authenticated and delivered by the City or any trustee or other fiduciary, except (i) Obligations theretofore cancelled or surrendered for cancellation; (ii) Obligations paid or deemed to be paid within the meaning of any defeasance provisions thereof; (iii) Obligations owned by the City or the Authority; (iv) Obligations in lieu of or in substitution for which other Obligations have been executed and delivered; and (v) Obligations assumed by the District or other successor in accordance with the Installment Purchase Agreement.

The term "Owner" means any person who shall be the registered owner of any outstanding Obligation certificate or other evidence of a right to receive Installment Payments directly or as security for payment of the Obligation.

The term "Paired Obligations" shall mean any Series (or portion thereof) of Parity Obligations designated as Paired Obligations in a Supplement or related Issuing Instrument or other document authorizing the issuance or incurrence thereof, which are simultaneously issued or incurred (i) the principal of which is of equal amount maturing and to be redeemed (or cancelled after acquisition thereof) on the same dates and in the same amounts, and (ii) the interest rates which, taken together, result in an irrevocably fixed interest rate obligation of the City for the terms of such Paired Obligations.

The term "Parity Installment Obligation" means Obligations consisting of or payable from Installment Payments which are not subordinated in right of payment to other Installment Payments.

The term "Parity Obligations" means (i) Parity Installment Obligations, (ii) Obligations the principal and interest of which are payable on a parity with Parity Installment Obligations, (iii) Qualified Take or Pay Obligations and (iv) Qualified Swap Agreements. Notwithstanding the foregoing, any amounts payable with respect to a Qualified Swap Agreement which represent termination payments or unwinding payments shall not be deemed to be Parity Obligations unless (a) such Qualified Swap Agreement expressly states that such termination payments or unwinding payments are to be considered Parity Obligations and (b) each Rating Agency which currently maintains a rating with respect to any Parity Obligation confirms in Writing to the City that the inclusion of such termination payments or unwinding payments as Parity Obligations will not result in a downgrading, withdrawal or suspension of such rating.

The term "Participating Agencies" shall mean the cities and other agencies providing local sewage collection services within their respective areas and which (a) have entered into contracts with the City pursuant to which the City is providing sewage collection, transportation, treatment or disposal services or (b) are having such services provided by the District or other successor to the City to which the Metropolitan System has been transferred pursuant to the Installment Purchase Agreement.

The term "Paying Agent" or "Paying Agents" means, with respect to an Installment Payment Obligation or Series of Installment Payment Obligations, the bank, trust company or other financial institution, if any, or other entities designated as the place or entity which shall make payment on such Installment Payment Obligation or a Series of Installment Payment Obligations and/or the interest thereon instead of or in addition to the City Treasurer's office.

The term "Payment Fund" means the fund designated in the Issuing Instrument as the fund into which Installment Payments are to be deposited for the purposes of paying principal or interest on related Obligations.

The term "Permitted Investments" means investments which pursuant to an Issuing Instrument are permissible for the investment of funds received from the sale of Obligations pursuant to the Issuing Document or from other funds held pursuant to the Issuing Document.

The term "Project" means the construction, replacement and improvements to the Wastewater System described in Exhibit A to the Installment Purchase Agreement and as modified with respect to Components in conformance with the Installment Purchase Agreement.

The term "Purchase Price" means the principal amount plus interest thereon owed by the City to the Authority under the terms hereof as provided in the Installment Purchase Agreement and as specified in a Supplement.

The term "Qualified Swap Agreement" means a contract or agreement, payable from Net System Revenues on a parity with Parity Obligations, intended to place Obligations on the interest rate, currency, cash flow or other basis desired by the City, including, without limitation, any interest rate swap agreement, currency swap agreement, forward payment conversion agreement or futures contract, any contract providing for payments based on levels of, or changes in, interest rates, currency exchange rates, stock or other indices, any contract to exchange cash flows or a series of payments, or any contract, including, without limitation, an interest rate floor or cap, or an option, put or call, to hedge payment, currency, rate, spread or similar exposure, between the City and the counterparty; provided that not less than 30 days prior to the City's execution of such contract or agreement, each Rating Agency which maintains a rating with respect to any Parity Obligation receives notice in writing of the City's pending execution thereof; provided further that at the time of origination each Rating Agency which maintains a rating with respect to any Parity Obligation confirms in writing to the City that the City's execution and delivery of such contract will not result in a downgrading, withdrawal or suspension of such rating; and provided further, that the following requirements shall also be applicable, to the extent they are more restrictive than the foregoing conditions and so long as the Bond Insurer is insuring the payment of principal of and interest on any 1995 Bonds:

1. The provider of such contract or agreement must be rated at least A-/A3 or better by S&P and Moody's (the "Initial Rating Requirement").
2. After satisfaction of the Initial Rating Requirement, the long term indebtedness of such provider or the claims paying ability of such provider shall not fall below Baa2 or BBB by either S&P or Moody's.

The term "Qualified Take or Pay Obligation" means the obligation of the City to make use of any facility, property or services, or some portion of the capacity thereof, or to pay therefor from System Revenues, or both, whether or not such facilities, properties or services are ever made available to the City for use, and there is provided to the City a certificate of an Independent Engineer to the effect that the incurrence of such obligation will not adversely affect the ability of the City to comply with the provisions of the Installment Purchase Agreement.

The term "Rating Agencies" means Moody's and S&P, or whichever of them is rating any Parity Obligations or any Subordinated Obligations, as applicable.

The term "Rebate Fund" means the fund by that name established pursuant to any Issuing Instrument.

The term "Rebate Requirement" shall have the meaning specified in any Tax Certificate.

The term "Reserve Fund Credit Facility" shall mean a letter of credit, line of credit, surety bond, insurance policy or similar facility deposited in a Reserve Fund or Reserve Account in lieu of or in partial substitution for cash or securities on deposit therein.

The terms "Reserve Fund" and "Reserve Account" shall have the meanings given to such terms in any Issuing Instrument or Supplement.

The term "Reserve Requirement" shall have the meaning given to such term in any Issuing Instrument or Supplement.

The term "S&P" means Standard & Poor's Corporation, a New York corporation, and its successors, and if such corporation shall for any reason no longer perform the functions of a securities rating agency, "S&P" shall be deemed to refer to any other nationally recognized securities rating agency designated by the City.

The term “Serial Parity Obligations” means Serial Obligations which are Installment Payments or are payable on a parity with Parity Installment Obligations.

The term “Serial Obligations” means Obligations for which no sinking fund payments are provided.

The term “Series” means Obligations issued at the same time or sharing some other, common term or characteristic and designated as a separate Series.

The term “Sewer Revenue Fund” has the meaning ascribed thereto in the Installment Purchase Agreement.

The term “Subordinated Credit Provider” means any municipal bond insurance company, bank or other financial institution or organization which is performing in all material respects its obligations under any Subordinated Credit Support arrangements for some or all of the Subordinated Obligations.

The term “Subordinated Credit Provider Expenses” means the fees and expenses payable to any Subordinated Credit Provider in connection with the provision of Subordinated Credit Support; provided, that the term “Subordinated Credit Provider Expenses” shall not include any Subordinated Credit Provider Reimbursement Obligations.

The term “Subordinated Credit Provider Reimbursement Obligations” means obligations of the City to repay, from Net System Revenues, amounts advanced by a Subordinated Credit Provider as credit support or liquidity for Subordinated Obligations, which obligation shall be a Subordinated Obligation.

The term “Subordinated Credit Support” means a policy of insurance, a letter of credit, a stand-by purchase agreement, revolving credit agreement or other credit arrangement pursuant to which a Subordinated Credit Provider provides credit or liquidity support with respect to the payment of interest, principal or the purchase price of any Subordinated Obligations.

The term “Subordinated Obligations” means any Obligation (1) that is designated as a Subordinated Obligation in the Issuing Instrument creating such Obligation, (2) the payment of which is subordinated in right of payment to Parity Obligations and (3) that in the Issuing Instrument creating such Obligation there is an express statement that no Owner of such Obligation shall have any right to take any action or enforce any right that has a materially adverse effect on the interests of the Owners of the Installment Payment Obligations.

The term “Supplement” means a Supplement, substantially in the form of Exhibit B to the Installment Purchase Agreement, providing for the payment of specific Installment Payments as the Purchase Price for Components of the Project, executed and delivered by the City and the Authority.

The term “System Revenues” means all income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Wastewater System, including, without limiting the generality of the foregoing, (i) all income, rents, rates, fees, charges (including standby and capacity charges), or other moneys derived by the City from the wastewater services, facilities, and commodities or byproducts sold, furnished or supplied through the facilities of or in the conduct or operation of the business of the Wastewater System, but including, without limitation, investment earnings on the operating reserves to the extent that the use of such earnings is limited to the Wastewater System by or pursuant to law, earnings on any Reserve Fund for Obligations but only to the extent that such earnings may be utilized under the Issuing Instrument for the payment of debt service for such Obligations; (ii) the proceeds derived by the City directly or indirectly from the lease of a part of the Wastewater System; (iii) any amount received from the levy or collection of taxes which are solely available and are earmarked for the support of the operation of the Wastewater System; (iv) amounts received under contracts or agreements with governmental or private entities and designated for capital costs; and (v) grants received from the United States of America or from the State of California; provided, however, that System Revenues shall not include: (a) in all cases, customers deposits or any other deposits or advances subject to refund until such deposits or advances have become the property of the City; and (b) the proceeds of borrowings. Notwithstanding the foregoing, there shall be deducted from System Revenues any amounts transferred, into a Rate Stabilization Fund as contemplated by the Installment Purchase Agreement, and

there shall be added to System Revenues any amounts transferred out of such Rate Stabilization Fund to pay Maintenance and Operation Costs of the Wastewater System.

The term "Tax Certificate" shall mean any certificate delivered with respect to the maintenance of the tax-exempt status of Tax-Exempt Installment Payment Obligations.

The term "Tax-Exempt Installment Payment Obligations" means Installment Payment Obligations in respect of which it is intended that the interest component thereof will be excluded from gross income pursuant to Section 103 of the Code.

The term "Tender Indebtedness" means any Parity Obligations or portions of Parity Obligations, a feature of which is an option, on the part of the holders thereof, or an obligation, under the terms of such Parity Obligations, to tender all or a portion of such Parity Obligations to the City, a Paying Agent or other fiduciary or agent for payment or purchase and requiring that such Bonds or portions of Bonds or that such rights to payments or portions of payments be purchased if properly presented.

The term "Term Parity Obligations" means Term Obligations which are Parity Installment Obligations or are payable on a parity with Parity Installment Obligations.

The term "Term Obligations" means Obligations which are payable on or before their specified maturity dates from sinking fund payments established for that purpose and calculated to retire such Obligations on or before their specified maturity dates.

The term "Trustee" means a financial institution acting in its capacity as Trustee under and pursuant to the any Issuing Instrument, and its successors and assigns.

The term "Variable Rate Indebtedness" means any portion of indebtedness evidenced by Parity Obligations the interest rate on which is not established at the time of incurrence of such indebtedness and has not, at some subsequent date, been established at a rate which is not subject to fluctuation or subsequent adjustment, excluding Paired Obligations.

The term "Wastewater Service" means the wastewater collection and treatment services made available or provided by the Wastewater System.

The term "Wastewater System" means any and all facilities, properties and improvements at any time owned, controlled or operated by the City as part of the Sewer Revenue Fund for the collection, treatment, distribution, administration, disposal or reclamation of waste, including the Municipal System and the Metropolitan System. After any transfer of the Metropolitan System permitted by the Installment Purchase Agreement, the term "Wastewater System" shall mean the Municipal System with respect to the City and the Metropolitan System with respect to the transferee.

General

The Installment Purchase Agreement provides the terms and conditions of the purchase of the Project by the City. Certain provisions of the Installment Purchase Agreement are summarized below. These summaries do not purport to be complete or definitive and are qualified in their entirety by reference to the full terms of the Installment Purchase Agreement.

Acquisition and Construction of the Project. The Authority has agreed to cause the Project to be constructed, acquired and installed by the City, as agent of the Authority. The City will enter into contracts and provide for, as agent of the Authority, the complete construction, acquisition and installment of the Project. The City has agreed that it will cause the construction, acquisition and installation of the Project to be diligently performed. Except to the extent of proceeds of the Obligations which are deposited in the Acquisition Fund, the Authority will be under no liability of any kind or character whatsoever for the payment of any cost of any Components. In the event the proceeds of the Obligations deposited in the Acquisition Fund are insufficient to complete the construction, acquisition and installation of Components, the City will cause to be deposited in the Acquisition Fund (or otherwise appropriate and encumber) from and to the extent of available amounts on deposit in the Sewer Revenue

Fund (or other lawfully available moneys) an amount equal to that necessary to complete the construction, acquisition and installation of such Components.

The Authority will not undertake to cause any Component of the Project to be constructed, acquired or installed unless and until the City and the Authority have entered into a Supplement specifying the components of the Project to be installed, the date of completion, the Purchase Price to be paid by the City under the Installment Purchase Agreement for that Component of the Project, and the Installment Payments or the method of calculating Installment Payments.

Changes to the Project. From time to time and at any time, the City may modify or amend the description of the Project, to eliminate any part thereof and/or to substitute another Project or Projects, all without obtaining any consent, by filing such modification or amendment with the Authority and the Trustee; provided however, that no such amendment will substitute a Project or Projects which are not to be owned by the Sewer Revenue Fund or will in any way impair the obligations of the City contained in any Supplement executed prior to such amendment. The City may substitute other improvements for those listed as Components in any Supplement, but only if the City first files with the Authority and the Trustee a certificate of an Authorized City Representative: (a) identifying the Components to be substituted and the Components they replace; (b) stating that the substituted Components will be owned by the Sewer Revenue Fund; and (c) stating that with respect to Components financed with Tax-Exempt Installment Obligations, the estimated costs of construction, acquisition and installation of the substituted improvements are not less than such costs for the improvements previously planned.

Substituted Components may include or consist of an undivided interest in such Components, in which event the costs associated with the substituted Components over and above the undivided interest need not be deposited in the Acquisition Fund (or otherwise appropriated and encumbered); provided that the certificate of an Authorized City Representative specifies that the funds necessary to complete the substituted Components are on deposit in the Acquisition Fund or otherwise appropriated and encumbered.

Installment Payments

Purchase Price. The City will pay the Purchase Price for any Components being purchased as provided in a Supplement. The Purchase Price to be paid by the City to the Authority under any Supplement to the Installment Purchase Agreement, solely from Net System Revenues and from no other sources, is the sum of the principal amount of the City's obligations under any Supplement plus the interest to accrue on the unpaid balance of such principal amount from the effective date and over the term of the Supplement, subject to prepayment provisions as provided therein.

The principal amount of the Installment Payments to be made by the City under a Supplement will be paid at least five days prior to the date such Installment Payments are payable as specified in such Supplement or at such other earlier time or times and in the manner or manners as specified in such Supplement. In the event the principal amount of an Installment Payment is not paid by the date the same is due and payable as specified in such Supplement, the same shall bear interest at the Default Rate, commencing on the day the same is due, to, but not including, the payment date.

The interest to accrue on the unpaid balance of such principal amount shall be paid at least five days prior to the date such interest is payable as specified in a Supplement or at such other earlier time or times as specified in such Supplement, and shall be paid by the City as and constitute interest paid on the principal amount of the City's obligations thereunder. Interest shall be payable in an amount not exceeding the Maximum Rate, at such intervals and according to such interest rate formulas as shall be specified in a Supplement or by reference to any Issuing Instrument to which such Supplement relates, and shall be payable with such frequency as shall be specified therein. In the event that interest is not paid by the date such interest is payable, to the extent permitted by applicable law, such interest shall thereafter bear interest at the Default Rate, commencing on the day the same is due, to, but not including, the payment date.

Installment Payments; Reserve Fund Payments. The City may, subject to any rights of prepayment provided in a Supplement, pay to the Authority, solely from Net System Revenues and from

no other sources, the Purchase Price in Installment Payments over a period not to exceed the maximum period permitted by law, as provided in a Supplement.

Subject to the allocation of Net System Revenues contained in Section 5.02 of the Installment Purchase Agreement, in the event that a Trustee notifies the City that the amount on deposit in a Reserve Fund or Reserve Account is less than the Reserve Requirement, the City will deposit or cause to be deposited, solely from Net System Revenues, in such Reserve Fund or Reserve Account such amounts on a monthly basis as are necessary to increase the amount on deposit therein to the Reserve Requirement in the ensuing six months.

The obligation of the City to make the Installment Payments solely from Net System Revenues is absolute and unconditional, and until such time as the Purchase Price has been paid in full (or provision for the payment thereof has been made), the City will not discontinue or suspend any Installment Payments required to be made by it when due, whether or not the Project or any part thereof is operating or operable or has been completed, or its use is suspended, interfered with, reduced or curtailed or terminated in whole or in part, and such Installment Payments will not be subject to reduction whether by offset or otherwise and will not be conditioned upon the performance or nonperformance by any party of any agreement for any cause whatsoever.

The City agrees and covenants under the Installment Purchase Agreement that all System Revenues will be received by the City in trust and will be deposited when and as received in the Sewer Revenue Fund. The City agrees and covenants to maintain the Sewer Revenue Fund so long as any Installment Payments or payments due by the City under any Qualified Swap Agreement remain unpaid, and all moneys in the Sewer Revenue Fund will be so held in trust and applied and used solely as provided in the Installment Purchase Agreement.

Commitment of the Net System Revenues

All Parity Obligations, including Parity Installment Payment Obligations, shall be secured by a first priority lien on and pledge of Net System Revenues. The City in the Installment Purchase Agreement does grant such first priority lien on and pledge of Net System Revenues to secure Parity Obligations. Such lien and pledge shall constitute a first priority lien on Net System Revenues. All Parity Obligations shall be of equal rank with each other without preference, priority or distinction of any Parity Obligations over any other Parity Obligations.

All Subordinated Obligations shall be secured by a second priority lien on and pledge of Net System Revenues that is junior and subordinate to the lien on and pledge of Net System Revenues security Parity Obligations. The City in the Installment Purchase Agreement does grant such second priority lien on and pledge of Net System Revenues to secure Subordinated Obligations. Such lien and pledge shall constitute a second priority lien on Net System Revenues. All Subordinated Obligations shall be of equal rank with each other without preference, priority or distinction of any Subordinated Obligations over any other Subordinated Obligations.

The City represents and states in the Installment Purchase Agreement that it has not previously granted any lien or charge on any of the Net System Revenues except as provided in the Installment Purchase Agreement; provided, however, that out of Net System Revenues there may be apportioned such sums for such purposes as are expressly permitted by the Installment Purchase Agreement.

Nothing contained in the Installment Purchase Agreement shall limit the right and ability of the City to grant liens on and pledges of Net System Revenues that are subordinate to the liens on and pledges of Net System Revenues for the benefit of Parity Obligations or Subordinated Obligations contained in the Installment Purchase Agreement.

Allocation of System Revenues

Payment of Parity Obligations. In order to carry out and effectuate the commitment and pledge contained in the Installment Purchase Agreement, the City agrees and covenants that all System Revenues shall be received by the City in trust and shall be deposited when and as received in the City of San Diego Sewer Revenue Fund, which fund was established pursuant to the Ordinances of the City

Council of the City (the "Sewer Revenue Fund") and which fund the City agrees and covenants to maintain so long as any Installment Payments or payments due by the City under any Qualified Swap Agreement related thereto remain unpaid, and all moneys in the Sewer Revenue Fund shall be so held in trust and applied and used solely as provided herein. The City shall pay: (i) directly or as otherwise required all Maintenance and Operation Costs of the Wastewater System; (ii) to the Trustee of the Parity Installment Obligations for deposit in the Payment Fund for Parity Installment Obligations, the amounts specified in any Issuing Instrument, as payments due on account of Parity Installment Obligations; (iii) to the obligee specified therein, any payment due as to any Parity Obligation that is not a Parity Installment Obligation (including any Credit Provider Reimbursement Obligations designated as Parity Obligations), other than (A) payments due on account of Qualified Take or Pay Obligations and (B) payments due by the City under a Qualified Swap Agreement; (iv) to the obligee specified therein, any payment due as to Qualified Take or Pay Obligations; and (v) to the counterparty specified in any Qualified Swap Agreement, the amounts or payments due under such Qualified Swap Agreement as Parity Obligations. In the event there are insufficient Net System Revenues to make all of the payments contemplated by the foregoing clauses (ii), (iii), (iv) and (v), then said payments shall be made as nearly as practicable, pro rata, based upon the respective unpaid principal amounts of said Parity Obligations.

Funding of Reserve Funds and Reserve Accounts for Parity Obligations. After the payments contemplated by the foregoing paragraph have been made, and in any event not less frequently than May 15 and November 15 of each year or any date on which payments in respect of any Subordinated Obligations are due, any remaining Net System Revenues shall be used to make up any deficiency in the Reserve Funds and Reserve Accounts for Parity Obligations. Notwithstanding the use of a Reserve Fund Credit Facility, in lieu of depositing funds in the Reserve Fund and Reserve Accounts for Parity Obligations, in the event of any draw on the Reserve Fund Credit Facility, there shall be deemed a deficiency in such Reserve Funds and Reserve Accounts until the amount of the Reserve Fund Credit Facility is restored to its pre-draw amount. In the event there are insufficient Net System Revenues to make up all deficiencies in all Reserve Funds and Reserve Accounts for Parity Obligations, such payments into Reserve Funds and Reserve Accounts shall be made as nearly as practicable pro rata based on the respective unpaid principal amount of all Parity Obligations.

Payment of Subordinated Obligations. (1) Notwithstanding anything in the Installment Purchase Agreement to the contrary, no payments from the Sewer Revenue Fund shall be made in respect of any Subordinated Obligations unless the following conditions are met: (A) all Maintenance and Operation Costs of the Wastewater System are being and have been paid and are then current; and (B) all deposits and payments contemplated by clauses (ii), (iii), (iv) and (v) of the second preceding paragraph shall have been made in full and no deficiency in any Reserve Fund or Reserve Account for Parity Obligations shall exist, and there shall have been paid, or segregated within the Sewer Revenue Fund, the amounts payable during the current month pursuant to clauses (ii), (iii), (iv) and (v) of the second preceding paragraph; provided, however, that if the amounts payable during any month pursuant to clauses (ii), (iii), (iv) or (v) of the second preceding paragraph are not able to be determined at the time of the payment of any Subordinated Obligation due to periods in which the actual interest rate accruing in respect of any Parity Obligations cannot yet be determined, then no payments from the Sewer Revenue Fund shall be made in respect of any Subordinated Obligations unless there shall have been segregated within the Sewer Revenue Fund the maximum amount that may be payable in that month under clauses (ii), (iii), (iv) and (v) of the second preceding paragraph as specified in the Issuing Instruments of the Parity Obligations and in accordance with applicable law; and

(2) Subject to subsection (1) above, the City shall apply any amounts thereafter remaining in the Sewer Revenue Fund (A) to the payment of Subordinated Credit Provider Expenses and (B) to the obligee specified therein, any payment due as to any Subordinated Obligations. In the event that there are insufficient Net System Revenues remaining in the Sewer Revenue Fund after the payments described in subsection (1) to make all of the payments contemplated by clause (B) of the immediately preceding sentence, then said payments shall be made as nearly as practicable, pro rata, based on the respective unpaid principal amounts of said Subordinated Obligations.

Funding of Reserve Funds and Reserve Accounts for Subordinated Obligations. After the payments contemplated by the preceding paragraphs have been made, and in any event (subject to the payments required pursuant to the preceding paragraphs) not later than those times specified in the Issuing Instruments of any Subordinated Obligations or the dates on which any payments in respect of

any Obligations that are neither Parity Obligations nor Subordinated Obligations are due, any remaining Net System Revenues in the Sewer Revenue Fund shall be used (A) to fund or to contribute to any Reserve Funds and Reserve Accounts for Subordinated Obligations and (B) to make up any deficiency in the Reserve Funds and Reserve Accounts for Subordinated Obligations, in such amounts as are specified in the Issuing Instruments of the Subordinated Obligations. Notwithstanding the use of a Reserve Fund Credit Facility in lieu of depositing funds in the Reserve Funds and Reserve Accounts for Subordinated Obligations, in the event of any draw on the Reserve Fund Credit Facility, there shall be deemed a deficiency in such Reserve Funds and Reserve Accounts until the amount of the Reserve Fund Credit Facility is restored to its pre-draw amount. In the event there are insufficient Net System Revenues to make up all deficiencies in all Reserve Funds and Reserve Accounts for Subordinated Obligations, such payments into Reserve Funds and Reserve Accounts for Subordinated Obligations shall be made as nearly as practicable, pro rata, based on the respective unpaid principal amount of all Subordinated Obligations.

Remaining Funds. Any amounts thereafter remaining in the Sewer Revenue Fund after the payments made pursuant to the preceding paragraphs may from time to time be used to pay for capital expenditures for the Wastewater System or any other Wastewater System purpose, provided, all deposits and payments contemplated by Section 5.02(c)(2) of the Installment Purchase Agreement shall have been made in full and no deficiency in any Reserve Fund or Reserve Account for Subordinated Obligations shall exist, and there shall have been paid, or segregated within the Sewer Revenue Fund, the amounts payable during the current month pursuant to said Section 5.02(c)(2); provided, further, that if the amounts payable during any month pursuant to said Section 5.02(c)(2) are not able to be determined at the time of the payment of any Obligation that is neither a Parity Obligation nor a Subordinated Obligation due to periods in which the actual interest rate accruing in respect of any Subordinated Obligations cannot yet be determined, then no payments from the Sewer Revenue Fund shall be made in respect of any such Obligations unless there shall have been segregated within the Sewer Revenue Fund the maximum amount that may be payable in that month under said Section 5.02(c)(2) as specified in the Issuing Instruments of the Subordinated Obligations and in accordance with applicable law.

The obligations of the City under the Installment Purchase Agreement to make deposits into Reserve Funds and Reserve Accounts shall have the priorities as to Net System Revenues as described above.

Additional Obligations

The City may not create any Obligations the payments of which are senior or prior in right to the payment by the City of Parity Obligations.

Without regard to the provisions in the next paragraph, the City may at any time enter into or create an obligation or commitment which is a Credit Provider Reimbursement Obligation or a Qualified Swap provided the Obligation to which the Qualified Swap Agreement relates is a Parity Obligation.

The City may at any time and from time to time issue or create any other Parity Obligations, provided: (1) There shall not have occurred and be continuing (i) an Event of Default under the terms of the Installment Purchase Agreement or any Issuing Instrument or (ii) Event of Default or Termination Event (as defined in any Qualified Swap Agreement) under any Qualified Swap Agreement; and (2) The City obtains or provides a certificate or certificates, prepared by the City or at the City's option by a Consultant, showing that:

(A) the Net System Revenues as shown by the books of the City for any 12 consecutive month period out of the 18 consecutive months ending immediately prior to the incurring of such additional other Parity Obligations shall have amounted to at least 1.20 times the Maximum Annual Debt Service on all Parity Obligations Outstanding during such period. For purposes of preparing the certificate or certificates described above, the Consultant or Consultants may rely upon financial statements prepared by the City, which have not been subject to audit by an independent certified public accountant if audited financial statements for the period are not available; and

(B) the estimated Net System Revenues for the next 12 months following the date of issuance of such other Parity Obligations will be at least equal to 1.20 times the Maximum Annual Debt Service for all Parity Obligations which will be Outstanding immediately after the issuance of the proposed Parity Obligations.

For purposes of the computations to be made as described in clause (B) above, the determination of Net System Revenues:

(i) may take into account any increases in rates and charges which relate to the Wastewater System and shall take into account any reduction in such rates and charges, which will, for purposes of the test described in clause (B), be effective during the fiscal year ending within the 12-month period for which such estimate is made; and

(ii) may take into account an allowance for any estimated increase in such Net System Revenues from any revenue producing additions or improvements to or extensions of the Wastewater System, to be made with the proceeds of such additional indebtedness or with the proceeds at Parity Obligations previously issued, all in an amount equal to the estimated additional average annual Net System Revenues to be derived from such additions, improvements and extensions for the first 36-month period in which each addition, improvement or extension is respectively to be in operation, all as shown by such certificate of the City or a Consultant, as applicable; and

(iii) for the period contemplated by clause (B) Maintenance and Operation Costs of the Wastewater System shall be deemed to be equal to such costs for the 12 consecutive months immediately prior to incurring such other Parity Obligations, but adjusted if deemed necessary, by the City or a Consultant, as applicable, for any increased Maintenance and Operations Costs of the Wastewater System which are, in the judgment of the City or a Consultant, as applicable, essential to maintaining and operating the Wastewater System and which will occur during the Fiscal Year ending within the period contemplated by clause (B).

The certificate or certificates described above in clause (B) shall not be required if the Parity Obligations being issued are for the purpose of (i) issuing the Parity Obligations initially issued under this Agreement or (ii) refunding (x) then Outstanding Parity Obligations if at the time of the issuance of such Parity Obligations a certificate of an Authorized City Representative shall be delivered showing that Debt Service in each Fiscal Year on all Parity Obligations Outstanding after the issuance of the refunding Parity Obligations will not exceed Debt Service in each corresponding Fiscal Year on all Parity Obligations Outstanding prior to the issuance of such Parity Obligations; or (y) then Outstanding Balloon Indebtedness, Tender Indebtedness or Variable Rate Indebtedness, but only to the extent that the principal amount of such indebtedness has been put, tendered to or otherwise purchased by a standby purchase or other liquidity facility relating to such indebtedness.

Without regard to the preceding paragraphs, if (i) no Event of Default has occurred and is continuing and (ii) no Event of Default or Termination Event (as defined in any Qualified Swap Agreement) under any Qualified Swap Agreement has occurred and is continuing, the City may issue or incur Subordinated Obligations, and such Subordinated Obligations may be paid only in accordance with the provisions of Section 5.02(c) and 5.02(d) of the Installment Purchase Agreement which are described under the subheading "Allocation of System Revenues" above.

Selected Covenants of the City

Compliance with Installment Purchase Agreement; Ancillary Agreements. The City will punctually pay Parity Obligations in strict conformity with the terms thereof and with the terms of the Installment Purchase Agreement, and will faithfully observe and perform all the agreements, conditions, covenants and terms contained in the Installment Purchase Agreement, and will not terminate the Installment Purchase Agreement for any cause including, without limiting the generality of the foregoing, any acts or circumstances that may constitute failure of consideration, destruction of or damage to the Project, commercial frustration of purpose, any change in the tax or other laws of the United States of America or of the State or any political subdivision of either or any failure of the Authority to observe or perform any agreement, condition, covenant or term contained in the Installment Purchase Agreement,

whether express or implied, or any duty, liability or obligation arising out of or connected therewith of the insolvency, or deemed insolvency, or bankruptcy, or liquidation of the Authority, or any force majeure, including, acts of God, tempest, storm, earthquake, war, rebellion, riot, civil disorder, acts of public enemies, blockade or embargo, strikes, industrial disputes, lack of transportation facilities, fire, explosion, or acts or regulations of governmental authorities.

The City will faithfully observe and perform all the agreements, conditions, covenants and terms contained in the Installment Purchase Agreement, including Supplements, and any Issuing Instrument or Qualified Swap Agreement relating to Parity Obligations required to be observed and performed by it and, except as otherwise provided in the Installment Purchase Agreement, each of the agreements, conditions, covenants and terms contained in each such contract and agreement is an essential and material term of the purchase of and payment for each Component by the City pursuant to, in accordance with, and as authorized under the Law.

The City will faithfully observe and perform all of the agreements and covenants of the City contained in each Authorizing Ordinance and will not permit the same to be amended or modified so as to adversely affect the Owners of Installment Payment Obligations or the counterparty to any Qualified Swap Agreement that is in effect.

The City will be unconditionally and irrevocably obligated, as long as any Installment Payment Obligations remain outstanding and unpaid, to take all lawful action necessary or required to continue to entitle the City to collect and deposit such System Revenues in the Sewer Revenue Fund for use as provided in this Installment Purchase Agreement, provided however, such obligation does not, in any way, limit the City's ability to undertake any and all legal acts, including any appeals, in the defense of a federal court order dictating a wastewater system configuration other than that approved and adopted by the City.

Against Encumbrances, Sale or Competitive Facilities. The City will not make any pledge of or place any lien on the Net System Revenues except as otherwise provided in the Installment Purchase Agreement. The City will not sell, lease or otherwise dispose of the Wastewater System or any part thereof essential to the proper operation of the Wastewater System or to the maintenance of the System Revenues, except as provided in the Installment Purchase Agreement. Further, the City will not, except as otherwise provided in the Installment Purchase Agreement, enter into any agreement or lease which impairs the operation of the Wastewater System or any part thereof necessary to secure adequate Net System Revenues for the payment of the Parity Obligations or which would otherwise impair the rights of the Authority with respect to the System Revenues or which has become nonoperative or which is not needed for the efficient and proper operation of the Wastewater System, or any material or equipment which has become worn out, may be sold if such sale will not materially reduce the Net System Revenues and if the proceeds of such sale are deposited in the Sewer Revenue Fund.

Except as permitted under the Installment Purchase Agreement, the City will not, to the extent permitted by existing law, construct, acquire, maintain or operate and will not, to the extent permitted by existing law and within the scope of its powers, permit any other public or private agency, authority, district or political subdivision or any person whomsoever to acquire, construct, maintain or operate within the City any wastewater system competitive with the Wastewater System.

Transfer of Metropolitan System Components. Notwithstanding anything to the contrary in the Installment Purchase Agreement, the City may transfer ownership of substantially all of the Metropolitan System, including amounts in the Sewer Revenue Fund attributable to the Metropolitan System, and any amounts in the Rate Stabilization Fund agreed upon by the City and the transferee as being attributable to the Metropolitan System, to the District or any other governmental agency whose primary purpose is to provide wastewater treatment and disposal service; provided such entity agrees to assume all Obligations the proceeds of which were used to acquire Components which are part of the Metropolitan System and all other obligations relating to the Metropolitan System which are payable from Metropolitan System Revenues, Net Metropolitan System Revenues, System Revenues or Net System Revenues, including but not limited to salaries and benefits payable to employees who are to become employees of such entity, all accounts payable, Qualified Swap Agreements, Credit Provider Reimbursement Obligations and all other obligations with respect thereto such as capital improvement expenditure obligations and tort claims, and the obligation to pay fines, penalties or damages arising out

of or relating to violation of federal, state or local laws or regulations which are applicable or purported to be applicable to the operation of the Metropolitan System, and provided that the following conditions are met:

(a) there will not have occurred and be continuing an Event of Default under the terms of the Installment Purchase Agreement, or any other Issuing Instrument or Qualified Swap Agreement or any Termination Event (as defined in a Qualified Swap Agreement) under any Qualified Swap Agreement;

(b) there will have been delivered to the Trustee an opinion of Bond Counsel to the effect that the proposed transfer will not have an adverse effect on the exclusion from gross income for federal income tax purposes of the interest component of Tax-Exempt Installment Payment Obligations;

(c) the entity will have obtained all necessary licenses, permits and consents from all governmental agencies or authorities having or asserting jurisdiction over the activities of the Metropolitan System;

(d) there will be delivered to all trustees for any Obligations and to any Qualified Swap Provider an opinion of counsel, who may be the City Attorney of the City, to the effect that the Supplements referred to in clauses (h)(1) and (h)(2) below are valid, binding and enforceable against the transferee in the case of a Supplement referred to in clause (h)(1) below and against the City in the case of a Supplement referred to in a clause (h)(2) below;

(e) the City obtains or provides a certificate prepared by a Consultant showing that (i) the estimated Net Metropolitan System Revenues for the next 12 months following the date of transfer will be at least equal to 1.20 times the Maximum Annual Debt Service for all Outstanding Parity Obligations to be assumed by the transferee, assuming for this purpose that the Outstanding Parity Obligations to be assumed by the transferee will include all such Obligations; and (ii) the estimated Net Municipal System Revenues for the next 12 months following the date of transfer will be at least equal to 1.20 times the Maximum Annual Debt Service for all Outstanding Parity Obligations not to be assumed by the transferee, assuming for this purpose that the Outstanding Parity Obligations not to be assumed by the transferee will include all such Obligations;

(f) there will be delivered to the Trustee a notice of each of the Rating Agencies then providing ratings on all Obligations to be outstanding immediately after the transfer, reconfirming the ratings on all such Obligations in effect immediately prior to such transfer, without giving effect to any bond insurance, letter of credit, guarantee or other credit support for such Obligations, or alternatively, all such Obligations will be defeased or paid in full prior to such transfer;

(g) there will be delivered to each Owner notice of the intended transfer of Metropolitan System Components not less than 30 nor more than 60 days prior to the expected transfer date; and

(h) incident to a transfer of the Metropolitan System permitted by the Installment Purchase Agreement:

(1) the transferee will execute and deliver to the Trustee a Supplement which will contain the following:

(A) the assumption and indemnification by the transferee of all obligations of the City under the Installment Purchase Agreement, but only as they relate to the Metropolitan System, including Obligations the proceeds of which were used to acquire Components for the Metropolitan System;

(B) a pledge by the transferee of Net Metropolitan System Revenues for the payment of assumed Parity Obligations which will be in substantially the

same form as the pledge of the City under the Installment Purchase Agreement of Net System Revenues to secure the payment of all Parity Obligations;

(C) representations of the transferee substantially in the form provided by the City under the Installment Purchase Agreement, but only as to the Obligations assumed by the transferee and the covenants to be contained in such Supplement;

(D) covenants of the transferee relating to the acquisition, construction and changes to the Project, but only as to the Components which are or are to be part of the Metropolitan System;

(E) covenants of the transferee relating to Purchase Payments and Installment Payments, but only as they relate to Parity Obligations being assumed by the transferee and the Net Metropolitan System Revenues;

(F) covenants of the transferee relating to the allocation of System Revenues, but limited only to Parity Obligations assumed by the transferee and moneys deposited from Metropolitan System Revenues and Net Metropolitan System Revenues;

(G) covenants of the transferee relating to Additional Obligations, but only within respect to Parity Obligations payable from Net Metropolitan System Revenues (for this purpose the calculations and coverages contemplated thereby will relate only to Metropolitan System Revenues, Maintenance and Operations Costs of the Metropolitan System and Net Metropolitan System Revenues);

(H) covenants of the transferee substantially in the form provided by the City under the Installment Purchase Agreement, (exclusive of covenants relating to the transfer of the Metropolitan System and subcontracting), but only to the extent of the Metropolitan System and Installment Payment Obligations payable from Metropolitan System Revenues and Net Metropolitan System Revenues and Installment Payment Obligations assumed by or of the transferee.

(I) Events of Default and remedies substantially in the form set forth in the Installment Purchase Agreement, but only relating to Parity Obligations assumed by the transferee; and

(J) covenants of the transferee relating to benefits of the Installment Purchase Agreement amendments of the Installment Purchase Agreement and the effective date, but only with respect to Parity Obligations assumed by the transferee;

(2) the City will execute and deliver a Supplement which will reaffirm all of the City's representations and warranties under the Installment Purchase Agreement and each Supplement, the pledge provided for in, and each of the covenants of the City contained in the Installment Purchase Agreement or any Supplement, provided that such representations, warranties, pledges and covenants will be limited solely and exclusively to the Municipal System, Municipal System Revenues, Maintenance and Operations Costs of the Municipal System and Net Municipal System Revenues, as the case may be.

Upon execution and delivery of such Supplements and upon satisfaction of the conditions specified above, the City will be relieved and discharged from any and all Installment Payment Obligations payable from Net System Metropolitan Revenues and which have been assumed by a transferee.

Maintenance and Operation of the Wastewater System; Budgets. The City will maintain and preserve the Wastewater System in good repair and working order at all times and will operate the Wastewater System in an efficient and economical manner and will pay all Maintenance and Operation

Costs of the Wastewater System as they become due and payable. The City will adopt and file with the Authority, on or before the effective date of the Installment Purchase Agreement, a budget approved by the City Council of the City setting forth the estimated Maintenance and Operation Costs of the Wastewater System for the period from such date until the close of the then current Fiscal Year. On or before August 1, of each Fiscal Year, the City will adopt, and on or before 120 days after the beginning of the Fiscal Year, file with the Authority a budget approved by the City Council of the City setting forth the estimated Maintenance and Operation Costs of the Wastewater System for such Fiscal Year. Any budget may be amended at any time during any Fiscal Year and such amended budget will be filed by the City with the Authority.

Amount of Rates and Charges; Rate Stabilization Fund. The City will fix, prescribe and collect rates and charges for the Wastewater Service which will be at least sufficient (a) to pay during each Fiscal Year all Obligations, (other than Parity Obligations) payable in such Fiscal Year, and (b) to yield during each Fiscal Year Net System Revenues equal to one hundred twenty percent (120%) of the Debt Service for such Fiscal Year. The City may make adjustments from time to time in such rates and charges and may make such classification thereof as it deems necessary, but will not reduce the rates and charges then in effect unless the Net System Revenues from such reduced rates and charges will at all times be sufficient to meet the requirements of the Installment Purchase Agreement.

The City may establish, as a fund within the Sewer Revenue Fund, a fund denominated the Rate Stabilization Fund. From time to time the City may deposit into the Rate Stabilization Fund, from current System Revenues, such amounts as the City will determine and the amount of available current System Revenues will be reduced by the amount so transferred. Amounts may be transferred from the Rate Stabilization Fund solely and exclusively to pay Maintenance and Operation Costs of the Wastewater System, and any amounts so transferred will be deemed System Revenues when so transferred. All interest or other earnings upon amounts in the Rate Stabilization Fund may be withdrawn therefrom and accounted for as System Revenues.

Insurance. The City will procure and maintain or cause to be procured and maintained insurance on the Wastewater System with responsible insurers, or provide self insurance reserves, in such amounts and against such risks (including accident to or destruction of the Wastewater System) as are usually covered in connection with wastewater systems similar to the Wastewater System. In the event of any damage to or destruction of the Wastewater System caused by the perils covered by such insurance or self insurance, the Net Proceeds thereof will be applied to the reconstruction, repair or replacement of the damaged or destroyed portion of the Wastewater System. The City will begin such reconstruction, repair, or replacement promptly, after such reconstruction, repair or replacement as expeditiously as possible, and will payout of such Net Proceeds all costs and expenses in connection with such reconstruction, repair or replacement so that the same will be completed and the Wastewater System will be free and clear of all claims and liens unless the City determines that such property or facility is not necessary to the efficient operation of the Wastewater System and therefore determines not to reconstruct, repair or replace such project or facility. If such Net Proceeds exceed the costs of such reconstruction, repair or replacement, then the excess Net Proceeds will be deposited in the Sewer Revenue Fund and be available for other proper uses of Funds deposited in the Sewer Revenue Fund.

The City will procure and maintain such other insurance which it will deem advisable or necessary to protect its interests and the interests of the Authority, which insurance will afford protection in such amounts and against such risks as are usually covered in connection with wastewater systems similar to the Wastewater System; provided that any such insurance may be maintained under a self-insurance program so long as such self-insurance is maintained in the amounts and manner usually maintained in connection with wastewater systems similar to the Wastewater System and is, in the opinion of an accredited actuary, actuarially sound.

All policies of insurance required to be maintained in the Installment Purchase Agreement will, to the extent reasonably Obtainable, provide that the Authority and the Trustee will be given 30 days' written notice of any intended cancellation thereof or reduction of coverage provided thereby. The City will certify to the Authority and Trustee annually or on or before August 31 that it is in compliance with the insurance requirements provided in the Installment Purchase Agreement.

Accounting Records, Financial Statements and Other Reports. The City will keep appropriate accounting records in which complete and correct entries will be made of all transactions relating to the Wastewater System, which records will be available for inspection by the Authority and the Trustee at reasonable hours and under reasonable conditions.

The City will prepare and file with the Authority and the Trustee, annually after the close of each Fiscal Year, the following:

(1) within 270 days financial statements of the Sewer Revenue Fund for the preceding Fiscal Year prepared in accordance with generally accepted accounting principles, together with an Accountant's Report thereon;

(2) within 45 days, a detailed report as to all insurance policies maintained and self-insurance programs maintained by the City with respect to the Wastewater System as of the close of such Fiscal Year, including the names of the insurers which have issued the policies and the amounts thereof and the property or risks covered thereby; and

(3) the City will furnish a copy of the financial statements referred to above to any Owner of the Bonds requesting a copy thereof.

Payment of Taxes and Compliance with Governmental Regulations. The City will pay and discharge all taxes, assessments and other governmental charges which may be lawfully imposed upon the Wastewater System or any part thereof or upon the System Revenues when the same will become due. The City will duly observe and conform with all valid regulations and requirements of any governmental authority relative to the operation of the Wastewater System or any part thereof, but the City will not be required to comply with any regulations or requirements so long as the validity or application thereof will be contested in good faith.

Collection of Rates and Charges; No Free Service. The City will have in effect at all times rules and regulations for the payment of bills for Wastewater Services, and that such regulations will provide that where the City furnishes water to the property receiving Wastewater Service, the Wastewater Service charges will be collected together with the water rates upon the same bill providing for a due date and a delinquency date for each bill. In each case where such bill remains unpaid in whole or in part after it becomes delinquent, the City may disconnect such premises from the water service, and such premises will not thereafter be reconnected to the water service except in accordance with City operating rules and regulations governing such situations of delinquency. The City will not permit any part of the Wastewater System or any facility thereof to be used or taken advantage of free of charge by any authority, firm or person, or by any public agency (including the United States of America, the State and any city, county, district, political subdivision, public corporation or agency of any thereof).

Eminent Domain Proceeds. If all or any part of the Wastewater System will be taken by eminent domain proceedings, then subject to the provisions of any Authorizing Ordinance, the Net Proceeds thereof will be applied to the replacement of the property or facilities so taken, unless the City determines that such property or facility is not necessary to the efficient or proper operation of the Wastewater System and therefore determines not to replace such property or facilities. Any Net Proceeds of such award not applied to replacement or remaining after such work has been completed will be deposited in the Sewer Revenue Fund and be available for other proper uses of funds deposited in the Sewer Revenue Fund.

Tax Covenants. There will be included in each Supplement relating to Tax-Exempt Installment Payment Obligations such covenants as are deemed necessary or appropriate by Bond Counsel for the purpose of assuring that interest on such Installment Payment Obligations will be excluded from gross income under Section 103 of the Code. The 2010-1 Supplement sets forth certain tax covenants as specified therein.

Operate Wastewater System. The City will operate the Wastewater System in an efficient and economical manner, provided that the City may remove from the service on a temporary or permanent basis such part or parts of the Wastewater System so long as (a) Net System Revenues are equal to 120% of the Debt Service for the then current Fiscal Year and for each Fiscal Year thereafter to and including the

Fiscal Year during which the last Installment Payment is due as evidenced by an Engineer's Report on file with the City, and (b) the City will have filed with the Trustee an opinion of nationally recognized Bond Counsel to the effect that the removal of such part or parts of the Wastewater System will not adversely affect the exclusion from gross income for federal income tax purposes of the interest on Tax-Exempt Installment Payment Obligations.

Additional Covenants. The City may provide additional covenants pursuant to any Supplement, including covenants relating to any Credit Support obtained for Installment Payment Obligations; provided, however, that such additional covenants do not materially and adversely affect the right of Owners of Outstanding Obligations issued prior to any such Supplement.

Prepayment of Installment Payments

Provisions may be made in any Supplement for the prepayment of Installment Payments, in whole or in part, in such multiples and in such order of maturity and from funds of any source, and with such prepayment premiums and other terms as are specified in the Supplement. Said Supplement will also provide for any notices to be given relating to such prepayment. The 2010-1 Supplement contains provisions for the prepayment, at the option of the City, of the Principal Portion of the Component Installment Payments, as specified therein.

Events of Default and Remedies of the Authority

The following will be "events of default" under the Installment Purchase Agreement:

(a) failure in the due and punctual payment of or on account of any Parity Obligation as the same will become due and payable;

(b) failure by the City in the performance of any of the agreements or covenants required to be performed by it under the Installment Purchase Agreement (other than as specified in (a) above), and such default will have continued for 60 days after the City has been given notice in writing of such default by the Authority;

(c) if any Event of Default specified in any Supplement, Authorizing Ordinance or Issuing Instrument will have occurred and be continuing; or

(d) if the City files a petition or answer seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if a court of competent jurisdiction will approve a petition filed with or without the consent of the City seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if under the provisions of any other law for the relief or aid of debtors any court of competent jurisdiction will assume custody or control of the City or of the whole or any substantial part of its property;

then and in each case during the continuance of such event of default, the Authority will upon the written request of the Owners of 25% or more of the aggregate principal amount of all Series of Parity Installment Obligations Outstanding, voting collectively as a single class; by written notice to the City, declare the entire unpaid principal amount thereof and the accrued interest thereon to be due and payable immediately, and upon any such declaration the same will become immediately due and payable; anything to the contrary contained in the Installment Purchase Agreement notwithstanding, provided, that with respect to a Series of Parity Installment Obligations which is credit enhanced by Credit Support, acceleration will not be effective unless the declaration is consented to by the related Credit Provider and, provided further, that nothing in the Installment Purchase Agreement will affect the rights of the parties to a Qualified Swap Agreement to terminate such Qualified Swap Agreement. If at any time after the entire principal amount of all Series of Parity Installment Obligations and the accrued interest thereon have been so declared due and payable and before any judgment or decree for the payment of the moneys due will have been obtained or entered, the City will deposit with the Authority a sum sufficient to pay the unpaid principal amount of all such Series of Parity Installment Obligations and the unpaid payments of any other Parity Obligations referred to in clause (a) above due prior to such declaration and the accrued interest thereon, with interest on such overdue installments at the rate or rates applicable

thereto in accordance with their terms, and the reasonable expenses of the Authority, and any and all other defaults known to the Authority (other than in the payment of the entire principal amount of the unpaid Parity Installment Obligations and the accrued interest thereon due and payable solely by reason of such declaration), will have been made good or cured to the satisfaction of the Authority or provision deemed by the Authority to be adequate will have been made therefor, then the Authority, by written notice to the City, may rescind and annul such declaration and its consequences; but no such rescission and annulment will extend to or will affect any subsequent default or will impair or exhaust any right or power consequent thereon.

Subject to the Installment Purchase Agreement and, with respect to any Subordinated Obligation, the Issuing Instrument creating that Subordinated Obligation, the Owners of Subordinated Obligations may enforce the provisions of the Installment Purchase Agreement for their benefit by appropriate legal proceedings. Notwithstanding anything to the contrary in the Installment Purchase Agreement, no Owner of Subordinated Obligations will have any right to take any action or enforce any right that has, a materially adverse effect on the interests of the Owners of the Installment Payment Obligations and the Authority will not take any action to enforce, on behalf of any Owner of Subordinated Obligations, any such right.

The payment of Subordinated Obligations will be subordinated in right of payment to payments of the Parity Obligations (except for any payment in respect to the Subordinated Obligations from the Reserve Funds or Reserve Accounts securing such Subordinated Obligations). In any Event of Default, Owners of Parity Obligations will be entitled to receive payment thereof in full before the Owners of Subordinated Obligations are entitled to receive payment thereof (except for any payment in respect of the Subordinated Obligations from Reserve Funds or Reserve Accounts securing such Subordinated Obligations) and the Owners of the Subordinated Obligations will become subrogated to the rights of such Owners of Parity Obligations to receive payments with respect thereto.

Application of Net System Revenues Upon Acceleration

All Net System Revenues received after the date of the declaration of acceleration by the Authority as provided in the Installment Purchase Agreement will be applied in the following order:

(a) First, to the payment of the costs and expenses of the Authority if any, in carrying out the provisions of the Installment Purchase Agreement, including reasonable compensation to its accountants and counsel;

(b) Second, to the payment of the entire principal amount of the unpaid Parity Installment Obligations and the unpaid principal amount of all other Parity Obligations and the unpaid principal thereon, with interest on the overdue installments at the rate or rates of interest applicable thereto in accordance with their respective terms. In the event there are insufficient Net System Revenues to pay the entire principal amount and accrued interest on all Parity Obligations, then accrued interest (and payments due to the counterparty to a Qualified Swap Agreement) will first be paid and any remaining amount will be paid on account of principal, and in the event there are insufficient Net System Revenues to fully pay either interest or principal in accordance with the foregoing, then payment will be protected with a priority based upon the total amounts due in the priority; and

(c) Third, to the payment of the entire principal amount of the unpaid Subordinated Obligations and the accrued interest thereon, with interest on the overdue installments at the rate or rates of interest applicable thereto in accordance with their respective terms. In the event there are insufficient Net System Revenues to pay the entire principal amount and accrued interest on all Subordinated Obligations, then accrued interest will first be paid and any remaining amount will be paid on account of principal, and in the event there are insufficient Net System Revenues to fully pay either interest or principal in accordance with the foregoing, then payment will be prorated within a priority based upon the total amounts due in the priority.

Other Remedies of the Authority

The Authority will have the right, subject to receipt of consent from any Credit Provider with respect to a particular Series of Parity Installment Obligations: (a) by mandamus or other action or

proceeding or suit at law or in equity to enforce its rights against the City or any councilmember, officer or employee thereof, and to compel the City or any such councilmember or officer or employee to perform and carry out its or his duties under the Law and the agreements and covenants required to be performed by it or him contained in the Installment Purchase Agreement; (b) by suit in equity to enjoin any acts or things which are unlawful or violate the rights of the Authority; or (c) by suit in equity upon the happening of an Event of Default to require the City and its councilmembers, officers and employees to account as the trustee of an express trust.

Discharge of Obligations

If (a) the City will pay or cause to be paid or there will otherwise be paid to the Owners all Outstanding Installment Payment Obligations of a Series the interest thereon and the principal thereof and the redemption premiums, if any, thereon or if all Outstanding Obligations will be deemed to have been paid at the times and in the manner stipulated in the applicable Issuing Instrument, or (b) the transfer of ownership of substantially all of the Metropolitan System, as contemplated by the Installment Purchase Agreement will have occurred, then all agreements, covenants and other obligations of the City under the Installment Purchase Agreement will thereupon cease, terminate and become void and be discharged and satisfied (but only as to such Series in the case of any event described in (a) and only as provided in the Installment Purchase Agreement in the case of a transfer of the Metropolitan System) except for the obligation of the City to pay or cause to be paid all sums due thereunder.

Amendments

The Installment Purchase Agreement may be amended with respect to a Series of Installment Payment Obligations in writing as may be mutually agreed by the City and the Authority, with the written consent of any Credit Provider which is providing insurance until the final maturity or payment in full of one or more maturities of such Installment Payment Obligations, or any other Credit Provider for such Installment Payment Obligations and the Owners of a majority in aggregate principal amount of such Installment Payment Obligations then Outstanding, provided that no such amendment will (a) extend the payment date of any Installment Payment, or reduce the amount of any Installment Payment without the prior written consent of the Owner of each Obligation so affected, (b) reduce the percentage of Installment Payment Obligations the consent of the Owners of which is required for the execution of any amendment of the Installment Purchase Agreement, or (c) amend the provisions of transfer of the Metropolitan System Components without an unqualified opinion of nationally recognized Bond Counsel to the effect that such amendment does not adversely affect the exclusion of the interest portion of the Installment Payments received by the Owners of Tax-Exempt Installment Payment Obligations from gross income under Section 103 of the Code. Notwithstanding the foregoing, so long as the City has any obligations under a Qualified Swap Agreement, it will not amend or modify, or consent to the amendment or modification of, the Installment Purchase Agreement that would in any way adversely affect (i) the rights of a counterparty to a Qualified Swap Agreement under the Installment Purchase Agreement, or (ii) the obligations of the City under the Installment Purchase Agreement to such a counterparty without the prior written consent of such Qualified Swap Provider.

With the written consent of any Credit Provider, the Installment Purchase Agreement and the rights and obligations of the City and the Authority thereunder may also be amended or supplemented at any time by an amendment or supplement to the Installment Purchase Agreement which will be come binding upon the execution by the City and the Authority, without the written consent of any Owner of Installment Obligations, but only to the extent permitted by law and only upon receipt of an unqualified opinion of nationally recognized Bond Counsel selected by the City and approved by the Authority to the effect that such amendment or supplement is permitted by the provisions of the Installment Purchase Agreement and is not inconsistent therewith and does not adversely affect the exclusion of the interest portion of the Installment Payments received by the Owners from gross income for federal tax purposes, and only (a) to add to the covenants and agreements of the Authority or the City or to surrender any right or power reserved to or conferred upon the Authority or the City, and which will not adversely affect the interests of the Owners of the Installment Payment Obligations; (b) to cure, correct or supplement any ambiguous or defective provision contained in the Installment Purchase Agreement or in regard to questions arising thereunder, as the Authority or the City may deem necessary or desirable and which will not adversely affect the interests of the Owners of the Installment Payment Obligations; and (c) to

make such other amendments or modifications which will not materially adversely affect the interests of the Owners of the Installment Payment Obligations.

Consent of Ambac. No provision in the Installment Purchase Agreement, as amended from time to time, which expressly recognizes or grants rights in or to Ambac may be amended in any manner which adversely affects the rights of Ambac thereunder, without the prior written consent of Ambac.

2010-1 SUPPLEMENT

The term “2010-1 Supplement” means the 2010-1 Supplement to the Master Installment Purchase Agreement by and between the City of San Diego and the Public Facilities Financing Authority of the City of San Diego, supplementing and amending the Installment Purchase Agreement. The 2010-1 Supplement sets for the certain terms and conditions of the purchase of the Refunded Components of the Project by the City. Certain provisions of the 2010-1 Supplement are summarized below.

Installment Payments. Pursuant to the 2010-1 Supplement, the City agrees to purchase the Components identified therein from the Authority by making Installment Payments comprised of a principal portion and interest portion which equal the debt service payments payable on the Series 2010A Bonds. See the caption “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2010A BONDS” in the body of the Official Statement.

Tax Exemption. The City covenants in the 2010-1 Supplement as follows:

(a) The City will not directly or indirectly use or permit the use of any proceeds of the Component Obligation Series 2010A or any other funds of the City or of the Project, or the 1995 Components, the 1997 Components or the 1999 Components, or take or omit to take any action that would cause the Series 2010A Bonds to be “private activity bonds” within the meaning of Section 141 of the Code, or obligations which are “federally guaranteed” within the meaning of Section 149(b) of the Code.

(b) The City covenants that it will not take any action, or fail to take any action, if such action or failure to take action would adversely affect the exclusion from gross income of the interest represented by the Series 2010A Bonds under Section 103 of the Code. The City will not directly or indirectly use or permit the use of any proceeds of the Series 2010A Bonds or any other funds of the City, or take or omit to take any action, that would cause the Series 2010A Bonds to be “arbitrage bonds” within the meaning of Section 148(a) of the Code. To that end, the City will comply with all requirements of Section 148 of the Code to the extent applicable to the Series 2010A Bonds. In the event that at any time the City is of the opinion that for purposes of the Installment Purchase Agreement it is necessary to restrict or limit the yield on the investment of any moneys held by the Trustee under the Indenture or otherwise, the City will so instruct the Trustee in writing, and will cause the Trustee to take such action as may be necessary in accordance with such instructions.

(c) Without limiting the generality of the foregoing, the City agrees that there will be paid from time to time all amounts required to be rebated to the United States of America pursuant to Section 148(f) of the Code and any temporary, proposed or final Treasury Regulations as may be applicable to the Series 2010A Bonds from time to time. This covenant will survive payment in full or defeasance of the Series 2010A Bonds. The City specifically covenants to payor cause to be paid to the United States of America at the times and in the amounts determined under the 2010-1 Supplement the Rebate Requirement, as described in the Tax Certificate, and to otherwise comply with the provisions of the Tax Certificate executed by the City in connection with the execution and delivery of the Series 2010A Bonds.

(d) Notwithstanding any provision of the tax covenants of the 2010-1 Supplement, if the City provides to the Trustee an opinion of nationally recognized Bond Counsel to the effect that any action required under the tax covenants contained in the 2010-1 Supplement is no longer required, or to the effect that some further action is required, to maintain the exclusion from gross income of the interest on the Series 2010A Bonds pursuant to Section 103 of the Code, the City may rely conclusively on such opinion in complying with the provisions thereof, and the covenants under the 2010-1 Supplement will be deemed to be modified to that extent.

Continuing Disclosure. The City covenants and agrees in the 2010-1 Supplement that it will comply with and carry out all of the provisions of the Continuing Disclosure Certificate. Notwithstanding any other provision of the 2010-1 Supplement, failure of the City to comply with the Continuing Disclosure Certificate will not be considered a default of any kind under the 2010-1 Supplement or the Installment Purchase Agreement; however, the Trustee may (and, at the request of any Participating Underwriter or the Owners of at least 25% in aggregate principal amount of the Series 2010A Bonds, will) or any Owner or Beneficial Owner may take such actions as may be necessary and appropriate, including seeking specific performance by court order, to cause the City to comply with its obligations under the foregoing covenant and agreement in the 2010-1 Supplement. For purposes of the 2010-1 Supplement, "Beneficial Owner" means any person who has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Series 2010A Bonds (including persons holding Series 2010A Bonds through nominees, depositories or other intermediaries).

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APPENDIX C

FORM OF BOND COUNSEL OPINION

[Letterhead of Quint & Thimmig LLP]

[Closing Date]

Public Facilities Financing Authority
of the City of San Diego
202 C Street
San Diego, California 92101

City of San Diego
202 C Street
San Diego, California 92101

Re: \$161,930,000 Public Facilities Financing Authority of the City of San Diego Senior Sewer Revenue Bonds, Series 2010A

Members of the Board of Directors:

We have acted as bond counsel in connection with the delivery by the Public Facilities Financing Authority of the City of San Diego (the "Authority") of \$161,930,000 aggregate principal amount of the bonds of the Authority designated the "Public Facilities Financing Authority of the City of San Diego Senior Sewer Revenue Refunding Bonds, Series 2010" (the "Bonds"), pursuant to the provisions of Article 4 (commencing with section 6584) of Chapter 5 of Division 7 of Title 1 of the California Government Code (the "Law"), and pursuant to an Indenture, dated as of May 1, 2009 (the "Original Indenture"), as supplemented by a First Supplemental Indenture dated as of June 1, 2009, and as further supplemented by a Second Supplemental Indenture dated as of April 1, 2010 (the Original Indenture, as so supplemented, is referred to herein as the "Indenture"), each by and between the Authority and The Bank of New York Mellon Trust Company, N.A., as trustee (the "Trustee"), and a resolution of the Board of Commissioners of the Authority adopted on March 26, 2010. The Bonds are secured by Revenues as defined in the Indenture, including installment payments (the "Installment Payments") made by the City of San Diego (the "City"), under the Master Installment Purchase Agreement, dated as of September 1, 1993, by and between the City and the Authority, as amended and supplemented, including as supplemented by the 2010-1 Supplement, dated as of April 1, 2010 (collectively, the "Installment Purchase Agreement"). We have examined the Law and such certified proceedings and other papers as we deem necessary to render this opinion.

As to questions of fact material to our opinion, we have relied upon representations of the Authority and the City contained in the Indenture and the Installment Purchase Agreement and in the certified proceedings, and upon other certifications furnished to us, without undertaking to verify the same by independent investigation.

Based upon our examination we are of the opinion, under existing law, that:

1. The Authority is a joint exercise of powers agency and public entity duly organized and existing under the laws of the State of California, with power to enter into the Indenture, to perform the agreements on its part contained therein and to issue the Bonds.

2. The Bonds constitute legal, valid and binding special obligations of the Authority enforceable in accordance with their terms and payable solely from the sources provided therefor in the Indenture.

3. The Indenture has been duly authorized, executed and delivered by the Authority and constitutes a legal, valid and binding obligation of the Authority enforceable against the Authority in accordance with its terms.

4. The Indenture establishes a valid first and exclusive lien on and pledge of the Revenues (as such term is defined in the Indenture) and other funds pledged thereby for the security of the Bonds, in accordance with the terms of the Indenture.

5. The Installment Purchase Agreement has been duly approved by the Authority and constitutes a legal, valid and binding obligation of the Authority enforceable against the Authority in accordance with its terms.

6. The City is a municipal corporation duly organized and existing under the laws of the State of California, with power to enter into the Installment Purchase Agreement and to perform the agreements on its part contained therein.

7. The Installment Purchase Agreement has been duly approved by the City and constitutes a legal, valid and binding obligation of the City enforceable against the City in accordance with its terms. The obligation of the City to make the Installment Payments is a special obligation of the City payable solely from Net System Revenues (as such term is defined in the Installment Purchase Agreement) of the City's wastewater enterprise (the "Wastewater System"). The general fund of the City is not liable, and neither the credit nor taxing power of the City is pledged, for the payment of the Installment Payments under the Installment Purchase Agreement.

8. Subject to the Authority's and the City's compliance with certain covenants, interest on the Bonds (i) is excludable from gross income of the owners thereof for federal income tax purposes and (ii) is not included as an item of tax preference in computing the alternative minimum tax for individuals and corporations under the Internal Revenue Code of 1986, as amended (the "Code"), but is taken into account in computing an adjustment used in determining the federal alternative minimum tax for certain corporations. Failure by the Authority or the City to comply with one or more of such covenants could cause interest on the Bonds to not be excludable from gross income under section 103 of the Code for federal income tax purposes retroactively to the date of issuance of the Bonds.

9. Interest on the Bonds is exempt from personal income taxation imposed by the State of California.

Ownership of the Bonds may result in other tax consequences to certain taxpayers, and we express no opinion regarding any such collateral consequences arising with respect to the Bonds.

With respect to the opinions expressed herein, the enforceability of the Installment Purchase Agreement is subject to the limitations on the imposition of certain fees and charges by the City related to the Wastewater System under Articles XIII C and XIII D of the California Constitution. In addition, the rights of the owners of the Bonds and the enforceability of the Bonds and the Indenture may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights heretofore or hereafter enacted and also may be subject to the exercise of judicial discretion in accordance with general principles of equity.

In rendering this opinion, we have relied upon certifications of the Authority, the City and others with respect to certain material facts. Our opinion represents our legal judgment based upon such review of the law and the facts that we deem relevant to render our opinion and is not a guarantee of a result. This opinion is given as of the date hereof and we assume no obligation to revise or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention or any changes in law that may hereafter occur.

Respectfully submitted,

APPENDIX D

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This CONTINUING DISCLOSURE CERTIFICATE, (the "Disclosure Certificate") is executed and delivered by THE CITY OF SAN DIEGO (the "City") in connection with the issuance of \$161,930,000 Public Facilities Financing Authority of the City of San Diego Senior Sewer Revenue Refunding Bonds, Series 2010A (Payable Solely From Installment Payments Secured By Wastewater System Net Revenues) (the "Series 2010A Bonds"). The Series 2010A Bonds are being issued by the Public Facilities Financing Authority of the City of San Diego (the "Authority") pursuant to the provisions of the Joint Exercise of Powers Act (commencing with Section 6500) of the Government Code of the State of California and an Indenture, dated as of May 1, 2009 (as supplemented, the "Indenture"), by and between the Authority and The Bank of New York Mellon Trust Company, N.A., as trustee (the "Trustee"). The proceeds of the Series 2010A Bonds will be used to refund the refunded Bonds (as defined in the Indenture), fund the Reserve Fund and pay costs of issuance with respect to the Series 2010A Bonds. In connection therewith, the City, as an "obligated person" with respect to the Series 2010A Bonds (within the meaning of the Rule, as defined herein), covenants and agrees as follows:

Section 1. Purpose of the Disclosure Certificate. This Disclosure Certificate is being executed and delivered by the City for the benefit of the holders and beneficial owners of the Bonds and in order to assist the Participating Underwriter in complying with S.E.C. Rule 15c2-12(b)(5).

Section 2. Definitions. In addition to the definitions set forth in the Indenture, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section 2, the following capitalized terms shall have the following meanings:

"Annual Report" shall mean any Annual Report provided by the City pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

"Beneficial Owner" shall mean any person which (a) has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries), or (b) is treated as the owner of any Bonds for federal income tax purposes.

"Dissemination Agent" shall mean the City or any successor Dissemination Agent designated in writing by the City and which has filed with the City a written acceptance of such designation. In the absence of such a designation, the City shall act as the Dissemination Agent.

"EMMA" or *"Electronic Municipal Market Access"* means the centralized on-line repository for documents filed with the MSRB, such as official statements and disclosure information relating to municipal bonds, notes and other securities as issued by state and local governments.

"Listed Events" shall mean any of the events listed in Section 5(a) of this Disclosure Certificate.

"MSRB" means the Municipal Securities Rulemaking Board, which has been designated by the Securities and Exchange Commission as the sole repository of disclosure information for purposes of the Rule, or any other repository of disclosure information which may be designated by the Securities and Exchange Commission as such for purposes of the Rule in the future.

"Participating Underwriter" shall mean any of the original underwriters of the Bonds required to comply with the Rule in connection with offering of the Bonds.

"Rule" shall mean Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

Section 3. Provision of Annual Reports.

(a) *Delivery of Annual Report to MSRB.* The City shall, or upon written direction shall cause the Dissemination Agent to, not later than 270 days after the end of the City's fiscal year (which currently ends June 30th), commencing with the report for the Fiscal Year 2010, provide to the Participating Underwriter and to file with EMMA, in a readable pdf or other electronic format as prescribed by the MSRB, an Annual Report that is consistent with the requirements of Section 4 of this Disclosure Certificate. The Annual Report may be submitted as a single document or as separate documents comprising a package, and may cross-reference other information as provided in Section 4 of this Disclosure Certificate; provided that the audited financial statements of the City may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date.

(b) *Change of Fiscal Year.* If the City's fiscal year changes, it shall give notice of such change in the same manner as for a Listed Event under Section 5(d).

(c) *Delivery of Annual Report to Dissemination Agent.* Not later than fifteen (15) Business Days prior to the date specified in subsection (a) for providing the Annual Report to EMMA, the City shall provide the Annual Report to the Dissemination Agent (if other than the City). If by such date, the Dissemination Agent has not received a copy of the Annual Report, the Dissemination Agent shall notify the City.

(d) *Report of Non-Compliance.* If the City is unable to provide an Annual Report by the date required in subsection (a), the Dissemination Agent shall send a notice to EMMA in substantially the form attached as Exhibit A.

(e) *Annual Compliance Certification.* The Dissemination Agent shall, if the Dissemination Agent is other than the City, file a report with the City certifying that the Annual Report has been provided pursuant to this Disclosure Certificate, stating the date it was provided.

Section 4. **Content of Annual Reports.** The Annual Report shall contain or incorporate by reference the following:

(a) Audited financial statements of the City for the preceding fiscal year, prepared in accordance with the laws of the State and including all statements and information prescribed for inclusion therein by the Controller of the State. If the City's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to Section 3(a), the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(b) To the extent not included in the audited final statement or the Comprehensive Annual Financial Report (CAFR) of the City, the Annual Report shall also include financial information and operating data with respect to the City, as such information and data relate to the City's Public Utilities Department and the Sewer Revenue Fund, for the most recently completed fiscal year of the type included in the Official Statement, if any, in the following categories (to the extent not included in the City's audited financial statements):

(i) An update of the information contained in the table of the Official Statement entitled "Metropolitan Sub-System City and Participating Agencies Flow and Capacity Rights" of the Official Statement (exclusive of the information contained under the column heading "Estimated Population");

(ii) An update of the information contained in the table of the Official Statement entitled "Wastewater System Total Annual Flow;"

(iii) An update of the information contained in the table of the Official Statement entitled "Wastewater System Historical Sources of Sewer Service Charge Revenues;"

(iv) An update of the information contained in the table of the Official Statement entitled "Municipal Sub-System Ten Largest Customers;"

(v) An update of the information contained in the table of the Official Statement entitled "Approved Rate Increases for Single Family Residential, Multifamily and Commercial and Industrial Customers," including rate(s) approved by the City Council for the most recently completed fiscal year that will become effective in a future fiscal year;

(vi) An update of the information contained in the table of the Official Statement entitled "Sewer Customer Accounts Receivable and Shut-Offs;"

(vii) An update of the information contained in the table of the Official Statement entitled "Municipal Sub-System Sewer Revenue Fund Historical Capacity Charge Revenues;"

(viii) An update of the information contained in the table of the Official Statement entitled "Rate History for Sewer Capacity Charges;"

(ix) Information contained in the table of the Official Statement entitled "Statements of Revenues, Expenses and Changes in Fund Net Assets" will be available in the City's comprehensive annual financial report for the most recently completed fiscal year or updated information will be presented in tabular form comparable to the referenced table;

(x) An update of the information contained in the table of the Official Statement entitled "Sewer Revenue Fund Reserves" for the most recently completed fiscal year;

(xi) Information contained in the table of the Official Statement entitled "Calculation of Historic Parity Debt Service Coverage" will be available in the City's comprehensive annual financial report for the most recently completed fiscal year or updated information will be presented in tabular format comparable to referenced table;

(xii) An update of the information contained in the Official Statement under the heading "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Labor Relations" for the most recently completed fiscal year.

(xiii) An update of the information contained under the heading "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Insurance and Liability Claims" and the table of the Official Statement entitled "Liability Claims Budgeted and Expenditures;"

(xiv) An update of the information contained under the heading "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Investment of Funds" and information in the table of the Official Statement entitled "City of San Diego Pooled Investment Fund;"

(xv) Information contained in the table of the Official Statement entitled "City of San Diego Schedule of Funding Progress;"

(xvi) An update of the information contained under the heading "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Wastewater System Share of Contribution to Pension System and NPO;" and

(xvii) An update of the information contained under the heading "WASTEWATER SYSTEM FINANCIAL OPERATIONS—Postemployment Healthcare Benefits."

(c) Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the City or related public entities, which are available to the public on the MSRB's Internet web site or filed with the Securities and Exchange Commission. The City shall clearly identify each such other document so included by reference.

If the document included by reference is a final official statement, it must be available from EMMA.

(d) In addition to any of the information expressly required to be provided under paragraph (b) of this Section 4, the City shall provide such further information, if any, as may be necessary to make the specifically required statements, in the light of the circumstances under which they are made, not misleading.

Section 5. **Reporting of Significant Events.**

(a) *Listed Events.* Pursuant to the provisions of this Section 5, the City shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material:

- (i) Principal and interest payment delinquencies.
- (ii) Non-payment related defaults.
- (iii) Unscheduled draws on debt service reserves reflecting financial difficulties.
- (iv) Unscheduled draws on credit enhancements reflecting financial difficulties.
- (v) Substitution of credit or liquidity providers, or their failure to perform.
- (vi) Adverse tax opinions or events affecting the tax-exempt status of the security.
- (vii) Modifications to rights of security holders.
- (viii) Contingent or unscheduled bond calls.
- (ix) Defeasances.
- (x) Release, substitution, or sale of property securing repayment of the securities.
- (xi) Rating changes.

(b) *Determination of Materiality of Listed Events.* Whenever the City obtains knowledge of the occurrence of a Listed Event, the City shall as soon as possible determine if such event would be material under applicable federal securities laws.

(c) *Notice to Dissemination Agent.* If the City has determined that knowledge of the occurrence of a Listed Event would be material under applicable federal securities laws, the City shall promptly notify the Dissemination Agent (if other than the City) in writing. Such notice shall instruct the Dissemination Agent to report the occurrence pursuant to subsection (d).

(d) *Notice of Listed Events.* The City shall file, or cause the Dissemination Agent to file, a notice of the occurrence of a Listed Event, if material, with EMMA, in a readable PDF or other electronic format as prescribed by EMMA, with a copy to the Participating Underwriter. Notwithstanding the foregoing, notice of Listed Events described in subsections (a)(viii) and (ix) (defeasances) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to Bondholders of affected Bonds.

Section 6. Identifying Information for Filings with EMMA. All documents provided to EMMA under this Disclosure Certificate shall be accompanied by identifying information as prescribed by the MSRB.

Section 7. Termination of Reporting Obligation. The City's obligations under this Disclosure Certificate shall terminate upon the defeasance, prior redemption or payment in full of all of the Bonds. If such termination occurs prior to the final maturity of the Bonds, the City shall give notice of such termination in the same manner as for a Listed Event under Section 5.

Section 8. **Dissemination Agent.**

(a) *Appointment of Dissemination Agent.* The City may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Certificate, and may discharge any such agent, with or without appointing a successor Dissemination Agent. If the Dissemination Agent is not the City, the Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the City pursuant to this Disclosure Certificate. The initial Dissemination Agent shall be the City.

(b) *Compensation of Dissemination Agent.* The Dissemination Agent shall be paid compensation by the City for its services provided hereunder in accordance with its schedule of fees as agreed to between

the Dissemination Agent and the City from time to time and all expenses, legal fees and advances made or incurred by the Dissemination Agent in the performance of its duties hereunder. The Dissemination Agent shall not be deemed to be acting in any fiduciary capacity for the City, Holders or Beneficial Owners, or any other party. The Dissemination Agent may rely and shall be protected in acting or refraining from acting upon any direction from the City or an opinion of nationally recognized bond counsel. The Dissemination Agent may at any time resign by giving written notice of such resignation to the City.

Section 9. **Amendment; Waiver.** Notwithstanding any other provision of this Disclosure Certificate, the City may amend this Disclosure Certificate (and the Dissemination Agent shall agree to any amendment so requested by the City that does not impose any greater duties or risk of liability on the Dissemination Agent), and any provision of this Disclosure Certificate may be waived, provided that the following conditions are satisfied:

(a) *Change in Circumstances.* If the amendment or waiver relates to the provisions of Sections 3(a), 4 or 5(a), it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of an obligated person with respect to the Bonds, or the type of business conducted;

(b) *Compliance as of Issue Date.* The undertaking, as amended or taking into account such waiver, would, in the opinion of a nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) *Consent of Holders; Non-impairment Opinion.* The amendment or waiver either (i) is approved by the Bondholders in the same manner as provided in the Indenture for amendments to the Indenture with the consent of Bondholders, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Bondholders or Beneficial Owners.

If this Disclosure Certificate is amended or any provision of this Disclosure Certificate is waived, the City shall describe such amendment or waiver in the next following Annual Report and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the City. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(d), and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

Section 10. **Additional Information.** Nothing in this Disclosure Certificate shall be deemed to prevent the City from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the City chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the City shall have no obligation under this Disclosure Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Section 11. **Default.** In the event of a failure of the City to comply with any provision of this Disclosure Certificate, any Bondholder or Beneficial Owner may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City to comply with its obligations under this Disclosure Certificate. The sole remedy under this Disclosure Certificate in the event of any failure of the City to comply with this Disclosure Certificate shall be an action to compel performance.

Section 12. **Duties, Immunities and Liabilities of Dissemination Agent.** The Dissemination Agent shall have only such duties as are specifically set forth in this Disclosure Certificate, and the City agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents,

harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The obligations of the City under this Section shall survive resignation or removal of the Dissemination Agent and payment of the Bonds.

Section 13. **Beneficiaries.** This Disclosure Certificate shall inure solely to the benefit of the City, the Dissemination Agent, the Participating Underwriters and Holders and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity.

Date: [Closing Date]

THE CITY OF SAN DIEGO

By _____
Authorized Signatory

Attest:

City Clerk

APPROVED AS TO FORM:
JAN I. GOLDSMITH, City Attorney

By _____
Deputy City Attorney

EXHIBIT A

**NOTICE TO MUNICIPAL SECURITIES RULEMAKING BOARD
OF FAILURE TO FILE ANNUAL REPORT**

Name of Obligor: The City of San Diego

Name of Issue: Public Facilities Financing Authority of the City of San Diego Senior Sewer Revenue Refunding Bonds, Series 2010A (Payable Solely From Installment Payments Secured By Wastewater System Net Revenues) (the "Bonds")

Date of Issuance: [Closing Date]

NOTICE IS HEREBY GIVEN that the City of San Diego has not provided an Annual Report with respect to the above-named Bonds as required by Section 3 of the Continuing Disclosure Certificate dated [Closing Date] executed and delivered by the City. The City anticipates that the Annual Report will be filed by _____.

Dated: _____

THE CITY OF SAN DIEGO

By: _____
Title: _____

cc: Trustee

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APPENDIX E

INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM

THE INFORMATION IN THIS APPENDIX E CONCERNING THE DEPOSITORY TRUST COMPANY, NEW YORK, NEW YORK AND ITS BOOK-ENTRY SYSTEM HAS BEEN OBTAINED FROM SOURCES THAT THE CITY, THE AUTHORITY AND THE UNDERWRITERS BELIEVE TO BE RELIABLE, BUT THE CITY, THE AUTHORITY AND THE UNDERWRITERS TAKE NO RESPONSIBILITY FOR THE ACCURACY THEREOF.

The Depository Trust Company ("DTC"), New York, New York, will act as securities depository for the Public Facilities Financing Authority of the City of San Diego Senior Sewer Revenue Refunding Bonds, Series 2010A (Payable Solely From Installment Payments Secured by Wastewater System Net Revenues) (the "Series 2010A Bonds"). The Series 2010A Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered bond certificate will be issued for each maturity of each Series of the Series 2010A Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of the Series 2010A Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2010A Bonds on DTC's records. The ownership interest of each actual purchaser of each Series 2010A Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2010A Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2010A Bonds, except in the event that use of the book-entry system for the Series 2010A Bonds is discontinued.

To facilitate subsequent transfers, all Series 2010A Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Series 2010A Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not affect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2010A Bonds;

DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2010A Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. The City and the Authority will not have any responsibility or obligation to such Direct Participants and Indirect Participants or the persons for whom they act as nominees with respect to the Series 2010A Bonds. Beneficial Owners of the Series 2010A Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2010A Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Series 2010A Bond documents. For example, Beneficial Owners of the Series 2010A Bonds may wish to ascertain that the nominee holding the Series 2010A Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. The conveyance of notices and other communications by DTC to DTC Participants, by DTC Participants to Indirect Participants and by DTC Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Any failure of DTC to advise any DTC Participant, or of any DTC Participant or Indirect Participant to notify a Beneficial Owner, of any such notice and its content or effect will not affect the validity of the redemption of the Series 2010A Bonds called for redemption or of any other action premised on such notice. Redemption of portions of the Series 2010A Bonds by the Authority will reduce the outstanding principal amount of Series 2010A Bonds held by DTC. In such event, DTC will implement, through its book-entry system, a redemption by lot of interests in the Series 2010A Bonds held for the account of DTC Participants in accordance with its own rules or other agreements with DTC Participants and then DTC Participants and Indirect Participants will implement a redemption of the Series 2010A Bonds for the Beneficial Owners.

Redemption notices shall be sent to DTC. If less than all of the Series 2010A Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2010A Bonds unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Trustee as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 2010A Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments of principal of, premium, if any, and interest on the Series 2010A Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Trustee, on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, or the Trustee, subject to any statutory, or regulatory requirements as may be in effect from time to time. Payments of principal of, premium, if any, and interest on the Series 2010A Bonds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

NONE OF THE CITY, THE AUTHORITY OR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS WITH RESPECT TO THE PAYMENTS OR THE PROVIDING OF NOTICE TO

DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS OR THE SELECTION OF BONDS FOR PREPAYMENT.

DTC may discontinue providing its services as depository with respect to the Series 2010A Bonds at any time by giving reasonable notice to the City, the Authority or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, bond certificates are required to be printed and delivered.

The City and the Authority may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, bond certificates will be printed and delivered to DTC.

In the event that the book-entry system is discontinued as described above, the requirements of the Indenture will apply. The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the Authority believes to be reliable, but the Authority takes no responsibility for the accuracy thereof.

None of the City, the Authority, the Trustee or the Underwriters can and do not give any assurances that DTC, the Participants or others will distribute payments of principal of, premium, if any, and interest on the Series 2010A Bonds paid to DTC or its nominee as the registered owner, or will distribute any prepayment notices or other notices, to the Beneficial Owners, or that they will do so on a timely basis or will serve and act in the manner described in this Official Statement. None of the City, the Authority, the Trustee or the Underwriters are responsible or liable for the failure of DTC or any Participant to make any payment or give any notice to a Beneficial Owner with respect to the Series 2010A Bonds or an error or delay relating thereto.

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