NEW ISSUE – BOOK-ENTRY ONLY

RATINGS: Fitch: "AA-"
Moody's: "Aa3"
(See "RATINGS.")

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Authority, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2012A Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, and is exempt from State of California personal income taxes. In the further opinion of Bond Counsel, interest on the 2012A Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the 2012A Bonds. See "TAX MATTERS."

City of San Diego PUBLIC UTILITIES Water & Wastewater

$188,610,000
PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO
SUBORDINATED WATER REVENUE BONDS, REFUNDING SERIES 2012A
(Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund)

Dated: Date of Delivery **Due: August 1, as shown on the inside cover**

The $188,610,000 Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Refunding Series 2012A (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2012A Bonds") are being issued by the Public Facilities Financing Authority of the City of San Diego (the "Authority") pursuant to Article 11 (commencing with Section 53580) of Chapter 3 of Part 1 of Division 2 of Title 5 of the California Government Code, and an Indenture, dated as of January 1, 2009, as amended and supplemented by a First Supplemental Indenture, dated as of June 1, 2009, a Second Supplemental Indenture, dated as of June 1, 2010 and a Third Supplemental Indenture, dated as of April 1, 2012 (collectively, the "Indenture"), each by and between the Authority and Wells Fargo Bank, National Association, as trustee (the "Trustee"). The proceeds of the 2012A Bonds, together with other available funds, will be used to (i) refund certain maturities of the outstanding 2002 Subordinated Bonds, (ii) make a deposit to the Common Subordinated Bonds Reserve Fund to satisfy the Common Subordinated Bonds Reserve Requirement, and (iii) pay costs of issuance with respect to the 2012A Bonds. Capitalized terms used on this cover page and not otherwise defined shall have the meanings ascribed to them elsewhere in this Official Statement. See in particular "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – Indenture" and "– Installment Purchase Agreement."

The 2012A Bonds are limited obligations of the Authority secured by Subordinated Revenues consisting primarily of 2012A Subordinated Installment Payments to be made by the City of San Diego (the "City") to the San Diego Facilities and Equipment Leasing Corporation (the "Corporation") under the 2012A Supplement (as defined herein) and other assets pledged therefore under the Indenture. The 2012A Subordinated Installment Payments will be assigned by the Corporation to the Authority pursuant to the Assignment Agreement. The pledge and right of payment from Net System Revenues securing the 2012A Subordinated Installment Payments will be subordinate to payment of Senior Obligations and on parity with the payment of certain Subordinated Obligations. As of March 1, 2012, the aggregate principal amount of Outstanding Senior Obligations was $643,770,788 and the aggregate principal amount of Outstanding Subordinated Obligations (including the 2002 Subordinated Bonds, certain maturities of which will be refunded with proceeds of the 2012A Bonds) was $243,529,431. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS" and "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – Installment Purchase Agreement."

THE 2012A BONDS ARE LIMITED OBLIGATIONS OF THE AUTHORITY PAYABLE SOLELY FROM AND SECURED SOLELY BY THE SUBORDINATED REVENUES PLEDGED THEREFOR AND AMOUNTS ON DEPOSIT IN THE COMMON SUBORDINATED BONDS RESERVE FUND AND THE SUBORDINATED BONDS PAYMENT FUND ESTABLISHED UNDER THE INDENTURE. THE OBLIGATION OF THE CITY TO MAKE 2012A SUBORDINATED INSTALLMENT PAYMENTS UNDER THE 2012A SUPPLEMENT DOES NOT CONSTITUTE AN OBLIGATION OF THE CITY FOR WHICH THE CITY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE CITY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION. NEITHER THE FULL FAITH AND CREDIT OF THE AUTHORITY, THE CITY, THE COUNTY OF SAN DIEGO (THE "COUNTY"), THE STATE OF CALIFORNIA (THE "STATE"), OR ANY POLITICAL SUBDIVISION OF THE STATE NOR THE TAXING POWER OF THE CITY, THE COUNTY, THE STATE, OR ANY POLITICAL SUBDIVISION OF THE STATE IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF OR INTEREST ON THE 2012A BONDS. THE AUTHORITY HAS NO TAXING POWER. NEITHER THE 2012A BONDS NOR THE OBLIGATION OF THE CITY TO MAKE 2012A SUBORDINATED INSTALLMENT PAYMENTS CONSTITUTES AN INDEBTEDNESS OF THE AUTHORITY, THE CITY, THE COUNTY, THE STATE, OR ANY POLITICAL SUBDIVISION OF THE STATE WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION.

The 2012A Bonds will accrue interest from their date of delivery and interest thereon will be payable on February 1 and August 1 of each year, commencing on August 1, 2012. The 2012A Bonds will bear interest at the respective rates set forth on the inside cover page hereof. See "DESCRIPTION OF THE 2012A BONDS – General" and "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

The 2012A 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 2012A Bonds. Ownership interests in the 2012A Bonds may be purchased in book-entry form only. So long as DTC or its nominee is the Owner of the 2012A Bonds, the principal, the redemption premium, if any, and interest on the 2012A Bonds will be made as described in "APPENDIX E – INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM."

The 2012A Bonds are subject to optional redemption as described herein. See "DESCRIPTION OF THE 2012A BONDS – Redemption of 2012A Bonds."

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 2012A Bonds are offered when, as, and if delivered to and received by the Underwriters, subject to the approval of legality by Orrick, Herrington & Sutcliffe LLP, Bond Counsel. Certain legal matters will be passed upon for the Authority by Orrick, Herrington & Sutcliffe LLP, for the Authority and the City by Jan I. Goldsmith, City Attorney, and for the Underwriters by their counsel, Nixon Peabody LLP, Los Angeles, California. It is anticipated that the 2012A Bonds will be available for delivery through the facilities of DTC in New York, New York on or about May 3, 2012.

Morgan Stanley **De La Rosa & Co.**
RBC Capital Markets **Stone & Youngberg, a Division of Stifel Nicolaus**

Dated: April 3, 2012

MATURITY SCHEDULE

PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO SUBORDINATED WATER REVENUE BONDS, REFUNDING SERIES 2012A

Maturity Date (August 1)	Principal Amount	Interest Rate	Yield	Price	CUSIP †
2013	$17,105,000	2.000%	0.180%	102.261	79730CEG5
2014	6,865,000	3.000	0.480	105.618	79730CEH3
2014	10,730,000	4.000	0.480	107.848	79730CFC3
2015	8,995,000	4.000	0.720	110.498	79730CEJ9
2015	8,945,000	5.000	0.720	113.699	79730CFD1
2016	5,290,000	5.000	1.020	116.489	79730CEK6
2017	5,530,000	4.000	1.230	114.025	79730CEW0
2018	5,790,000	5.000	1.540	120.521	79730CEL4
2019	6,080,000	5.000	1.870	121.111	79730CEM2
2020	6,395,000	5.000	2.150	121.423	79730CEN0
2021	2,445,000	3.000	2.420	104.776	79730CEX8
2021	4,255,000	5.000	2.420	121.252	79730CFE9
2022	7,020,000	5.000	2.670	120.759	79730CEP5
2023	7,375,000	5.000	2.860	118.883*	79730CEY6
2024	7,750,000	5.000	3.030	117.233*	79730CEQ3
2025	910,000	3.000	3.180	98.063	79730CEZ3
2025	7,235,000	5.000	3.180	115.801*	79730CFF6
2026	8,550,000	5.000	3.280	114.858*	79730CER1
2027	8,990,000	5.000	3.400	113.738*	79730CFA7
2028	9,450,000	5.000	3.500	112.815*	79730CES9
2029	9,935,000	5.000	3.580	112.082*	79730CET7
2030	10,445,000	5.000	3.640	111.537*	79730CEU4
2031	10,980,000	5.000	3.700	110.995*	79730CFB5
2032	11,545,000	5.000	3.730	110.725*	79730CEV2

* Price assumes a call at par on August 1, 2022.

No dealer, broker, salesperson, or other person has been authorized by the City, the Authority, or the Corporation to give any information or to make any representations 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, the Authority, or the Corporation. 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 2012A 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 2012A Bonds. Statements contained in this Official Statement that 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 information set forth herein has been furnished by the City and by other sources that are believed to be reliable including, without limitation, the San Diego County Water Authority and The Metropolitan Water District of Southern California. 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.

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, the Corporation, or any other parties described herein since the date hereof. All summaries of the 2012A Bonds, the Indenture, the Master Installment Purchase Agreement, the 2012A Supplement, the Assignment Agreement, and other documents summarized herein are made subject to the provisions of such documents respectively and do not purport to be complete statements of any or all of such provisions.

This Official Statement is submitted in connection with the issuance of the 2012A 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 that includes investor information at http://www.sandiego.gov/investorinformation. However, the information presented at such website 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 2012A Bonds.

THE 2012A BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON AN EXEMPTION CONTAINED IN SUCH ACT. THE 2012A BONDS HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE SECURITIES LAWS OF ANY STATE.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS THAT STABILIZE OR MAINTAIN THE MARKET PRICE OF THE 2012A 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 2012A BONDS TO CERTAIN DEALERS AND DEALER BANKS AND BANKS ACTING AS AGENT AT PRICES LOWER THAN THE PUBLIC OFFERING PRICE STATED ON THE INSIDE COVER PAGE HEREOF AND SAID PUBLIC OFFERING PRICE MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.

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PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO

Joseph W. Craver, *Chair –Public Member*
Halla Razak, *Vice Chair – Public Member*
Gail R. Granewich, *Secretary – City Treasurer*
James Demeaux – *Public Member*
Jay M. Goldstone – *Chief Operating Officer of the City of San Diego*

CITY OF SAN DIEGO

Mayor
Jerry Sanders

City Council

Sherri S. Lightner (District 1)
Kevin Faulconer (District 2)
Todd Gloria (District 3)
Tony Young, Council President (District 4)
Carl DeMaio (District 5)
Lorie Zapf (District 6)
Marti Emerald (District 7)
David Alvarez (District 8)

City Attorney
Jan I. Goldsmith

City Officials

Jay M. Goldstone, *Chief Operating 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

Roger S. Bailey, *Director of Public Utilities*
Alex Ruiz, *Assistant Director of Business Support Branch*
Jim Fisher, *Assistant Director of Water Branch*
Ann Sasaki, *Assistant Director of Wastewater Branch*
Tom Crane, *Assistant Director of Strategic Programs*

Special Services

BOND AND DISCLOSURE COUNSEL
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Westlake Village, California

TRUSTEE
Wells Fargo Bank, National Association
Los Angeles, California

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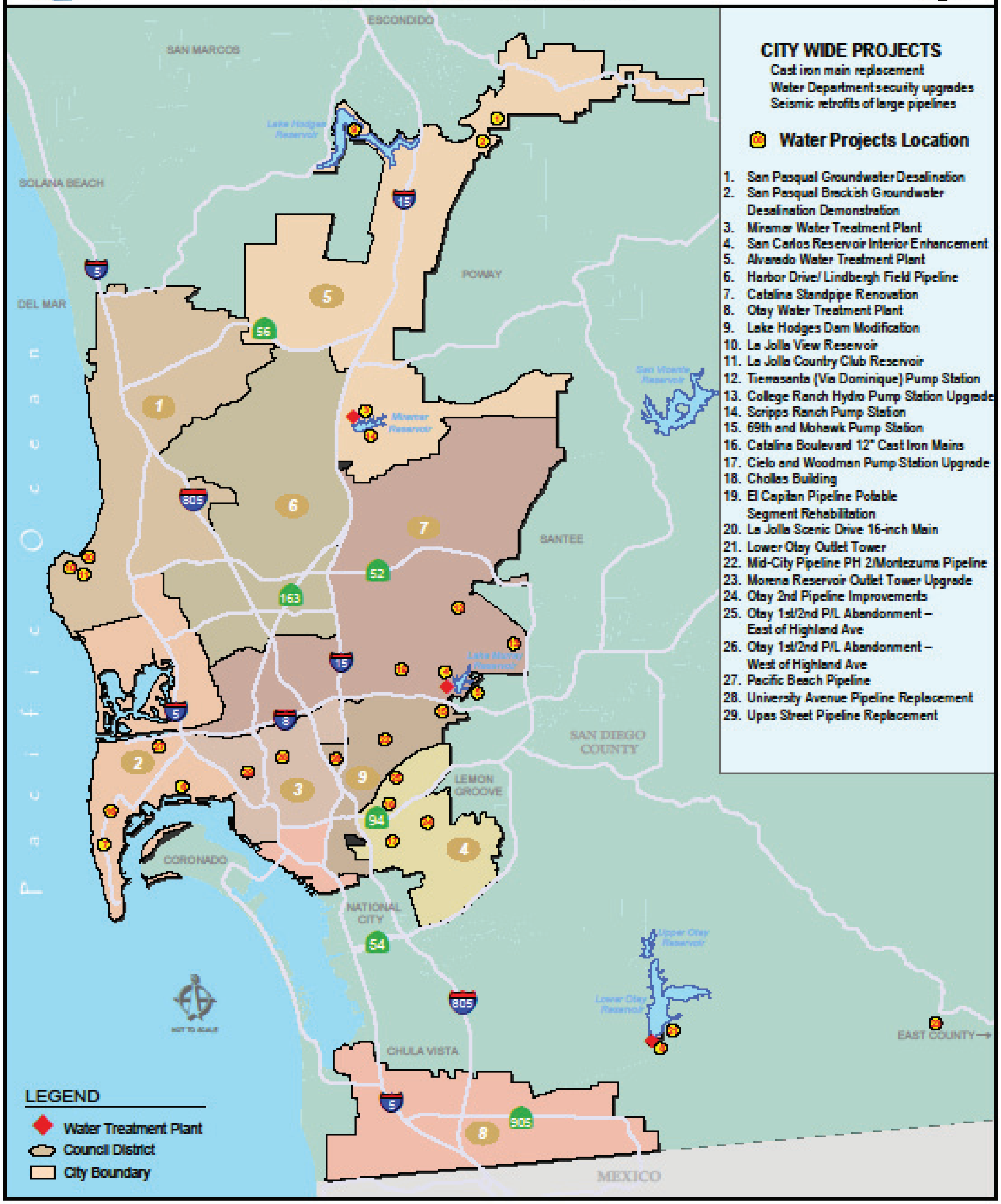
Water Department

WATER CIP PROJECTS



OFFICIAL STATEMENT

$188,610,000
PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO
SUBORDINATED WATER REVENUE BONDS, REFUNDING SERIES 2012A
(Payable Solely From Subordinated Installment Payments
Secured by Net System Revenues of the Water Utility Fund)

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, the 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, reports, and other instruments referred to herein do not purport to be complete and such references are qualified in their entirety by reference to each such law, document, report, or instrument. All capitalized terms used in this Official Statement and not otherwise defined herein have the meanings set forth in the Indenture or the Master Installment Purchase Agreement, each as defined herein. See "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – Indenture" and "– Installment Purchase Agreement."

General

The $188,610,000 Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Refunding Series 2012A (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2012A Bonds") are being issued by the Public Facilities Financing Authority of the City of San Diego (the "Authority") pursuant to Article 11 (commencing with Section 53580) of Chapter 3 of Part 1 of Division 2 of Title 5 of the California Government Code, and an Indenture, dated as of January 1, 2009, as amended and supplemented by a First Supplemental Indenture, dated as of June 1, 2009, a Second Supplemental Indenture, dated as of June 1, 2010 and a Third Supplemental Indenture, dated as of April 1, 2012 (collectively, the "Indenture"), each by and between the Authority and Wells Fargo Bank, National Association, as trustee (the "Trustee"). The proceeds of the 2012A Bonds, together with other available funds, will be used to (i) refund certain maturities of the outstanding 2002 Subordinated Bonds (as defined herein), (ii) make a deposit to the Common Subordinated Bonds Reserve Fund to satisfy the Common Subordinated Bonds Reserve Requirement, and (iii) pay costs of issuance with respect to the 2012A Bonds. The pledge and right of payment from Net System Revenues securing the 2012A Subordinated Installment Payments will be subordinate to payment of Senior Obligations and on parity with the payment of certain Subordinated Obligations. As of March 1, 2012, the aggregate principal amount of Outstanding Senior Obligations was $643,770,788, which includes $49,365,788 in State Revolving Fund loans ("SRF") obtained in 2011; and the aggregate principal amount of Outstanding Subordinated Obligations (including 2002 Subordinated Bonds, certain maturities of which will be refunded with proceeds of the 2012A Bonds and an existing SRF loan with an outstanding principal amount of $15,669,431), was $243,529,431. See "DESCRIPTION OF THE 2012A BONDS," "SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS," and "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

The 2012A Bonds

The 2012A Bonds will accrue interest from their date of delivery and interest thereon will be payable on February 1 and August 1 of each year, commencing on August 1, 2012 (each, an "Interest Payment Date"). The 2012A Bonds will bear interest at the rates set forth on the inside cover page hereof. See "DESCRIPTION OF THE 2012A BONDS – General" and "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

The 2012A Bonds are being 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 2012A Bonds. Ownership interests in the 2012A Bonds may be purchased in book-entry form only. So long as DTC or its nominee is the Owner of the 2012A Bonds, the principal, the redemption premium, if any, and interest on the 2012A Bonds will be made as described in "APPENDIX E – INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM."

Security and Sources of Payment for the 2012A Bonds

The 2012A Bonds are limited obligations of the Authority secured by Subordinated Revenues (as defined herein) and other assets pledged therefore under the Indenture. The Subordinated Revenues will consist primarily of 2012A Subordinated Installment Payments (as defined herein) to be made by the City of San Diego (the "City") to the San Diego Facilities and Equipment Leasing Corporation (the "Corporation") under the 2012A Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of April 1, 2012 (the "2012A Supplement"), supplementing the Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009 (the "Master Installment Purchase Agreement"), as previously supplemented and as supplemented by the 2012A Supplement (the Master Installment Purchase Agreement, together with the 2012A Supplement and all other supplements thereto, the "Installment Purchase Agreement"), each by and between the City and the Corporation. The 2012A Subordinated Installment Payments will be assigned by the Corporation to the Authority pursuant to the Assignment Agreement, dated as of April 1, 2012 (the "Assignment Agreement"), by and between the Corporation and the Authority. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS."

THE BONDS ARE LIMITED OBLIGATIONS OF THE AUTHORITY PAYABLE SOLELY FROM AND SECURED SOLELY BY THE SUBORDINATED REVENUES PLEDGED THEREFOR AND AMOUNTS ON DEPOSIT IN THE COMMON SUBORDINATED BONDS RESERVE FUND AND THE SUBORDINATED BONDS PAYMENT FUND ESTABLISHED UNDER THE INDENTURE. THE OBLIGATION OF THE CITY TO MAKE 2012A SUBORDINATED INSTALLMENT PAYMENTS UNDER THE 2012A SUPPLEMENT DOES NOT CONSTITUTE AN OBLIGATION OF THE CITY FOR WHICH THE CITY IS OBLIGATED TO LEVY OR PLEDGE ANY FORM OF TAXATION OR FOR WHICH THE CITY HAS LEVIED OR PLEDGED ANY FORM OF TAXATION. NEITHER THE FULL FAITH AND CREDIT OF THE AUTHORITY, THE CITY, THE COUNTY OF SAN DIEGO (THE "COUNTY"), THE STATE OF CALIFORNIA (THE "STATE"), OR ANY POLITICAL SUBDIVISION OF THE STATE NOR THE TAXING POWER OF THE CITY, THE COUNTY, THE STATE, OR ANY POLITICAL SUBDIVISION OF THE STATE IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF OR INTEREST ON THE BONDS. THE AUTHORITY HAS NO TAXING POWER. NEITHER THE BONDS NOR THE OBLIGATION OF THE CITY TO MAKE 2012A SUBORDINATED INSTALLMENT PAYMENTS CONSTITUTES AN INDEBTEDNESS OF THE AUTHORITY, THE CITY, THE COUNTY, THE STATE, OR ANY

POLITICAL SUBDIVISION OF THE STATE WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY DEBT LIMITATION OR RESTRICTION.

Redemption of the 2012A Bonds

The 2012A Bonds are subject to optional redemption prior to maturity as described herein. See "DESCRIPTION OF THE 2012A BONDS – Redemption of 2012A Bonds."

Rate Covenant

The City has covenanted in the Master Installment Purchase Agreement to fix, prescribe, and collect rates and charges for the City's water service, as described below (the "Water Service"), which will be at least sufficient to yield the greater of (i) Net System Revenues (as defined herein) sufficient to pay during each Fiscal Year (as defined herein) all Obligations (as defined herein) payable in such Fiscal Year, or (ii) Adjusted Net System Revenues (as defined herein) during each Fiscal Year equal to 120% of the Adjusted Debt Service (as defined herein) for such Fiscal Year. Adjusted Debt Service does **not** include debt service on Subordinated Obligations such as the 2012A Subordinated Installment Payments. The City's fiscal year, which begins on July 1 of each year and ends on June 30 of the following year, is referred to herein as the "Fiscal Year." The Water Service rendered by the City includes the collection, conservation, production, storage, treatment, transmission, furnishing, and distribution services made available or provided by the City's water system (the "Water System"). See "SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS – Rate Covenant" and "WATER SYSTEM FINANCIAL OPERATIONS – Rate Stabilization Fund; Other Funds and Accounts." In addition, for information on the possible limitation on the City's ability to comply with the rate covenant as a consequence of Proposition 218 (as defined herein), see "RISK FACTORS – Rate-Setting Process Under Proposition 218" and "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES – Article XIIIC" and "– Article XIIID."

Common Subordinated Bonds Reserve Fund

In connection with the issuance of the 2012A Bonds, a portion of the amounts in the reserve fund established for the 2002 Subordinated Bonds will be transferred to the Trustee and deposited into the Common Subordinated Bonds Reserve Fund to fully fund the Common Subordinated Bonds Reserve Requirement (as defined herein). See "SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS – Common Subordinated Bonds Reserve Fund."

Obligations to be Refunded

A portion of the proceeds of the sale of the 2012A Bonds, along with other available moneys held under the 2002 Indenture (as hereinafter defined), will be used to refund certain maturities of the outstanding Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Series 2002 (Payable Solely From Subordinated Installment Payments Secured By Net System Revenues of the Water Utility Fund), outstanding in the aggregate principal amount of $227,860,000 as of March 1, 2012 (the "2002 Subordinated Bonds"). The 2002 Subordinated Bonds to be refunded (collectively, the "Refunded 2002 Subordinated Bonds") are described in detail under the caption "THE REFUNDING PLAN."

Outstanding Senior and Subordinated Obligations

The 2012A Subordinated Installment Payments securing payment of the 2012A Bonds are payable from Net System Revenues on a basis that is equal in right of payment by the City of its

Outstanding Subordinated Obligations (as defined herein) under the Installment Purchase Agreement and that is subordinate in right of payment by the City of its Outstanding Senior Obligations (as defined herein) under the Installment Purchase Agreement. As of the date of delivery of the 2012A Bonds, the pledge and right of payment from Net System Revenues securing the 2012A Subordinated Installment Payments (which, in turn, secure the payment of the 2012A Bonds) will be subordinate to payment of Installment Payments securing the payment of $594,405,000 aggregate principal amount Senior Bonds and $49,365,788 in Senior SRF loans. Going forward, any additional SRF loans will be considered senior liens. In addition, as of March 1, 2012, the aggregate principal amount of Outstanding Subordinated Obligations was $243,529,431 (comprised of the 2002 Subordinated Bonds in the amount of $227,860,000, $211,430,000 aggregate principal amount of which will be refunded with proceeds of the 2012A Bonds and one SRF loan in the amount of $15,669,431 (the "Subordinate SRF Loan" herein)) payable from Net System Revenues on parity with the Net System Revenues securing the 2012A Subordinated Installment Payments. As used herein, the term "Subordinated Bonds" means the 2012A Bonds and any other Bonds secured by a pledge of Subordinated Revenues on a parity with such 2012A Bonds. See "THE REFUNDING PLAN," "SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS – Senior Obligations" and "– Subordinated Obligations" and "WATER SYSTEM FINANCIAL OPERATIONS – Outstanding Indebtedness."

Additional Obligations

Pursuant to the Master Installment Purchase Agreement, the City may incur additional Obligations, payments with respect to which will be senior to or on parity with the City's obligation to make 2012A Subordinated Installment Payments, subject to satisfaction of the conditions specified in the Master Installment Purchase Agreement. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS – Issuance of Additional Obligations" and "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM – Financing Plans for the CIP."

The Water System

The City owns the Water System and operates the Water System through its Public Utilities Department (the "Department"). The City has expanded the Water System from time to time to provide safe, reliable water in an efficient, cost-effective, and environmentally responsible manner. See "WATER SYSTEM ORGANIZATION AND MANAGEMENT," "WATER SYSTEM SERVICE AREA AND FACILITIES," "WATER SUPPLY," "WATER SYSTEM REGULATORY REQUIREMENTS," "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM," and "WATER SYSTEM FINANCIAL OPERATIONS."

The Authority

The Authority is a California joint exercise of powers authority established pursuant to a joint exercise of powers agreement by and between the City and the Redevelopment Agency of the City of San Diego (the "Agency"). The Authority was organized, in part, to finance, acquire, construct, maintain, repair, operate, and control certain capital facilities improvements for the City. Due to recent changes in law affecting California redevelopment agencies that were implemented in 2011 with the passage of ABX1 26 as codified in the California Health and Safety Code, the Agency was dissolved as of February 1, 2012 and its operations substantially eliminated but for the continuation of certain enforceable Agency obligations to be administered by a successor agency (in this case the City). The terms of ABX1 26 specify which obligations of the dissolved redevelopment agency remain in place to be administered by the successor agency and which are no longer enforceable. Among the agreements of the dissolved redevelopment agency not deemed invalid by the terms of ABX1 26 are a joint exercise of powers agreement in which the redevelopment agency is a member of the joint powers authority, such as the agreement providing for the establishment and operation of the Authority. Upon the issuance of the 2012A Bonds, Bond Counsel is expected to render its final approving opinion with respect to the 2012A Bonds to the effect that the Third Supplemental Indenture has been duly executed and delivered by, and constitutes a valid and binding limited obligation of, the Authority and the 2012A Bonds will constitute the valid and binding limited obligations of the Authority. See "APPENDIX C – FORM OF BOND COUNSEL OPINION."

Except as provided by the Indenture, the Authority has no liability to the owners or Beneficial Owners of any 2012A Bonds and has pledged none of its moneys, funds or assets as Subordinated Revenues or otherwise toward the payment of any amount due in connection with the 2012A Bonds. The Authority is governed by its own Board of Commissioners. The Authority is dependent upon the officers and employees of the City to administer its program.

The Corporation

The Corporation is a nonprofit charitable corporation duly organized and existing under and by virtue of the laws of the State. The Corporation was organized to acquire, lease, and/or sell to the City real and personal property to be used in the municipal operations of the City. The Corporation was formed at the request of the City to assist in financings such as the installment sale financing described herein. The Corporation has no liability to the owners or Beneficial Owners of any 2012A Bonds, and has pledged none of its moneys, funds or assets to any 2012A Subordinated Installment Payments or any payments under the 2012A Bonds. The Corporation is prohibited from engaging in any business or activities other than those incidental to its sole purpose, and no part of its net earnings may accrue to the benefit of any person or entity other than the City. The Corporation was formed at the request of the City Council of the City (the "City Council"), and is governed by its own Board of Directors.

Forward-Looking Statements

Certain statements contained in this Official Statement reflect not historical facts but forecasts and "forward-looking statements." All forward-looking statements are predictions and are subject to known and unknown risks and uncertainties. No assurance can be given that the future results discussed herein will be achieved, and actual results may differ materially from the forecasts described herein. In this respect, the words "estimate," "project," "anticipate," "expect," "intend," "believe" and similar expressions are intended to identify forward-looking statements. All projections, forecasts, assumptions, expressions of opinions, estimates and other forward-looking statements are expressly qualified in their entirety by the cautionary statements set forth in this Official Statement. The achievement of certain results or other expectations contained in such forward-looking statements involves known and unknown risks, uncertainties, and other factors that may cause the 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. No updates or revisions to these forward-looking statements are expected to be issued if or when the expectations, events, conditions, or circumstances on which such statements are based change. **INVESTORS ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON SUCH FORWARD-LOOKING STATEMENTS, WHICH SPEAK ONLY AS OF THE DATE HEREOF.**

Miscellaneous

Copies of the Indenture, the Installment Purchase Agreement, the Assignment Agreement, and other financing documents may be obtained upon request from the Trustee at Wells Fargo Bank, National Association, 707 Wilshire Boulevard, 17th Floor, Los Angeles, CA 90017.

THE REFUNDING PLAN

The 2002 Subordinated Bonds set forth in the table below will be redeemed on August 1, 2012 at a price equal to the principal amount thereof plus interest accrued thereon in accordance with the terms of that Indenture, dated as of October 1, 2002 (the “2002 Indenture”), by and between the Authority and Wells Fargo Bank, National Association, as trustee for the 2002 Subordinated Bonds. A portion of the proceeds of the 2012A Bonds, along with other available moneys held under the 2002 Indenture, will be used to refund and defease such Refunded 2002 Subordinated Bonds.

Maturity Date	Principal Amount	Interest Rate	CUSIP [(1)]
8/1/2013	$ 575,000	3.400%	79730CAH7
8/1/2013	16,680,000	5.000	79730CBC7
8/1/2014	1,625,000	3.500	79730CAJ3
8/1/2014	16,495,000	5.000	79730CBD5
8/1/2015	1,625,000	3.700	79730CAK0
8/1/2015	17,020,000	5.000	79730CBE3
8/1/2016	1,050,000	3.800	79730CAL8
8/1/2016	5,005,000	5.000	79730CBF0
8/1/2017	1,000,000	3.900	79730CAM6
8/1/2017	5,355,000	5.000	79730CBG8
8/1/2018	1,405,000	4.000	79730CAN4
8/1/2018	5,265,000	5.000	79730CBH6
8/1/2019	7,000,000	5.000	79730CAP9
8/1/2020	100,000	4.200	79730CAQ7
8/1/2020	7,260,000	5.000	79730CBJ2
8/1/2021	850,000	4.250	79730CAR5
8/1/2021	6,885,000	5.000	79730CBK9
8/1/2022	50,000	4.300	79730CAS3
8/1/2022	8,080,000	5.000	79730CBL7
8/1/2023	8,485,000	5.000	79730CBN3
8/1/2024	8,910,000	5.000	79730CBP8
8/1/2026	290,000	4.500	79730CAT1
8/1/2026	19,210,000	5.000	79730CBM5
8/1/2032	71,210,000	5.000	79730CAU8

(1) Copyright 2012, American Bankers Association. CUSIP data are provided by Standard & Poor’s CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. Such CUSIP data are provided only for the convenience of the reader and are not intended to create a database and do not serve in any way as a substitute for the services and information provided by the CUSIP Service Bureau. CUSIP is a registered trademark of the American Bankers Association. The City, the Authority, the Corporation, and the Underwriters do not assume any responsibility for the accuracy of any CUSIP data set forth herein or for any changes or errors in such data.

On the date of issuance of the 2012A Bonds, a portion of the proceeds of the sale of the 2012A Bonds, together with certain moneys currently on deposit in the funds and accounts established under the 2002 Indenture, will be deposited in an account to be established under an Escrow Agreement, dated as of April 1, 2012 (the “Escrow Agreement”), by and between the Authority and Wells Fargo Bank, National Association, as escrow agent (the “Escrow Agent”). Such amounts held under the Escrow Agreement, will be held in escrow and invested in direct obligations of the United States of America (the “Escrow Securities”), the principal of and interest on which will be used to redeem the Refunded 2002 Subordinated Bonds on August 1, 2012. Upon the issuance of the 2012A Bonds and the defeasance of the Refunded 2002 Subordinated Bonds, only the $16,430,000 August 1, 2012 serial maturities of the 2002 Subordinated Bonds will remain outstanding under the 2002 Indenture. At the time of the redemption of the Refunded 2002 Subordinated Bonds, no 2002 Subordinated Bonds will be outstanding under the 2002 Indenture.

PFM Asset Management LLC will verify the accuracy of the mathematical computation concerning the adequacy of the maturing principal amounts of and interest earned on the Escrow Securities to be purchased and held in the Escrow Fund. See "VERIFICATION."

ESTIMATED SOURCES AND USES OF BOND PROCEEDS

The following table details the estimated sources and uses of the proceeds of the sale of the 2012A Bonds and other available funds.

Estimated Sources:

Principal Amount of the 2012A Bonds	$188,610,000.00
Net Original Issue Premium	24,173,090.25
Debt service funds on deposit under the 2002 Indenture	2,675,711.39
Amounts released from the Reserve Fund for the 2002 Subordinated Bonds	19,773,588.66
Total Sources	$235,232,390.30

Estimated Uses:

Escrow Fund	$216,638,388.66
Common Subordinated Bonds Reserve Fund	17,489,748.77
Payment of Costs of Issuance (1)	1,104,252.87
Total Uses	$235,232,390.30

(1) Costs of Issuance for the 2012A Bonds to cover all eligible costs, including underwriters' discount.

DESCRIPTION OF THE 2012A BONDS

General

The 2012A 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 2012A Bonds. Ownership interests in the 2012A Bonds may be purchased in book-entry form only. So long as DTC or its nominee is the Owner of the 2012A Bonds, principal of, redemption premium, if any, and interest on the 2012A Bonds will be made as described in "APPENDIX E – INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM."

The 2012A Bonds will accrue interest from their date of delivery and interest thereon will be payable on February 1 and August 1 of each year, commencing on August 1, 2012. The 2012A Bonds will bear interest at the respective rates set forth on the inside cover page hereof. Interest on the 2012A Bonds shall be calculated on the basis of a 360-day year, comprised of twelve 30-day months. Interest coming due on a date that is not a Business Day shall be payable on the immediately following Business Day.

Redemption of 2012A Bonds

Optional Redemption. The 2012A Bonds maturing on and after August 1, 2023 shall be subject to redemption, in whole or in part, at the option of the Authority (upon the direction of the City), on or after August 1, 2022, at any time, from and to the extent of prepaid 2012A Subordinated Installment Payments paid pursuant to the 2012A Supplement, at a redemption price equal to the principal amount of 2012A Bonds called for redemption, together with interest accrued thereon to the date fixed for redemption, without premium.

Notice of Redemption. So long as DTC is acting as securities depository for the 2012A Bonds, notice of redemption, containing the information required by the Indenture, will be mailed by first class mail, postage prepaid, by the Trustee to DTC (not to the Beneficial Owners of any 2012A Bonds designated for redemption) not more than 60 days nor less than 30 days prior to the redemption date and shall state the date of such notice, the redemption price (including the name and appropriate address of the Trustee), and, in the case of 2012A Bonds to be redeemed in part only, the respective portions of the principal amount thereof to be redeemed. Each such notice shall also state that on said date there will become due and payable on each of said 2012A Bonds the principal amount thereof and, in the case of a 2012A 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 shall cease to accrue, and shall require that such 2012A 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 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.

Selection for Redemption. If less than all of the outstanding 2012A Bonds are to be redeemed prior to maturity, the Authority (at the direction of the City) will select the specific maturity and interest rate (or maturities of bonds and interest rates) of 2012A Bonds, or portions thereof equal to $5,000 or any integral multiple thereof, to be redeemed. If less than all of the 2012A Bonds of like maturity are to be redeemed, the Trustee will select the particular 2012A Bonds or portions of 2012A Bonds to be redeemed at random in such manner as the Trustee in its discretion may deem fair and appropriate.

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 2012A Bonds called for redemption is held by the Trustee, then on the redemption date designated in such notice, the 2012A Bonds shall become due and payable, and from and after the date so designated, interest on the 2012A Bonds so called for redemption shall cease to accrue, and the Owners of such 2012A Bonds shall have no rights in respect thereof except to receive payment of the redemption price thereof. The insufficiency of any such notice shall not affect the sufficiency of the proceedings for redemption. If said moneys are not so available on the redemption date, such 2012A Bonds or portions thereof will continue to bear interest until paid at the same rate as they would have borne had they not been called for redemption. If there is selected for redemption a portion of a 2012A Bond, the Authority will execute and the Trustee for that 2012A Bond will authenticate and deliver, upon the surrender of such 2012A Bond, without charge to the Owner thereof, for the unredeemed balance of the principal amount of the 2012A Bond so surrendered, a 2012A Bond of like maturity and interest rate in any authorized denomination.

SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS

Pledge of Subordinated Revenues; Subordinated Installment Payments

Pursuant to the Indenture, the 2012A Bonds are limited obligations of the Authority payable solely from the Subordinated Revenues and amounts on deposit in the Common Subordinated Bonds Reserve Fund and the Subordinated Bonds Payment Fund established under the Indenture. The term "Subordinated Revenues," as applied to the 2012A Bonds, means all 2012A Subordinated Installment Payments received by or due to be paid to the Corporation pursuant to the 2012A Supplement and the interest or profits from the investment of money in the Common Subordinated Bonds Reserve Fund and the Subordinated Bonds Payment Fund pursuant to the Indenture. The 2012A Subordinated Installment Payments will be assigned by the Corporation to the Authority pursuant to the Assignment Agreement. To secure the pledge of the Subordinated Revenues, the Authority will transfer, convey, and assign to the Trustee, for the benefit of the Owners, all of the Authority's right to receive 2012A Subordinated Installment Payments from the City. See "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – Indenture."

Pledge of Net System Revenues

Pursuant to the Installment Purchase Agreement, the City agrees to make Installment Payments (including the 2012A Subordinated Installment Payments) solely from Net System Revenues. The 2012A Subordinated Installment Payments shall be Subordinated Obligations under the Installment Purchase Agreement and the payment of the 2012A Subordinated Installment Payments shall be on parity in right of payment to the 2002 Subordinated Installment Payments under the Installment Purchase Agreement. No Owner of the Obligations 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 City agrees to make Installment Payments solely from Net System Revenues until such time as the Purchase Price for any Components has been paid in full (or provision for the payment thereof has been made pursuant to the Installment Purchase Agreement), and the City has granted a lien on and pledge of Net System Revenues to secure the payment of such Subordinated Installment Payments (including the 2012A Subordinated Installment Payments) as provided in the Installment Purchase Agreement. The City will not discontinue or suspend any Subordinated Installment Payments (including the 2012A Subordinated Installment Payments) required to be made by the City under the Installment Purchase Agreement, 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, curtailed, or terminated, in whole or in part, and such Subordinated Installment Payments (including the 2012A Subordinated Installment Payments) shall 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 term "Net System Revenues" is defined in the Master Installment Purchase Agreement as, for any Fiscal Year, the System Revenues for such Fiscal Year, less the Maintenance and Operation Costs of the Water System for such Fiscal Year.

The term "System Revenues" is defined in the Master Installment Purchase Agreement as all income, rents, rates, fees, charges, and other moneys derived from the ownership or operation of the Water System, including, without limiting the generality of the foregoing: (a) all income, rents, rates, fees, charges, or other moneys derived by the City from the water services or facilities, and commodities or byproducts, including hydroelectric power, sold, furnished or supplied through the facilities of or in the conduct or operation of the business of the Water System, and including, without limitation, investment earnings on the operating reserves to the extent that the use of such earnings is limited to the Water System by or pursuant to law, and earnings on any Reserve Fund for Obligations, but only to the extent that such earnings may be utilized under the indenture, trust agreement, loan agreement, lease, or installment purchase agreement under which the applicable Obligations are issued (each, an "Issuing Instrument') for the payment of debt service for such Obligations; (b) standby charges and Capacity Charges derived from the services and facilities sold or supplied through the Water System; (c) the proceeds derived by the City directly or indirectly from the lease of a part of the Water System; (d) any amount received from the levy or collection of taxes that are solely available and are earmarked for the support of the operation of the Water System; (e) amounts received under contracts or agreements with governmental or private entities and designated for capital costs for the Water System; and (f) grants for maintenance and operations received from the United States of America or from the State; provided, however, that System Revenues shall not include: (1) 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 (2) 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 Master Installment Purchase Agreement and any amounts transferred from current System Revenues to the Secondary Purchase Fund as permitted by the Master Installment Purchase Agreement. There shall be added to System Revenues any amounts transferred out of such Rate Stabilization Fund or the Secondary Purchase Fund to pay Maintenance and Operation Costs of the Water System. See "WATER SYSTEM FINANCIAL OPERATIONS – Rate Stabilization Fund; Other Funds and Accounts."

The term "Maintenance and Operation Costs of the Water System" is defined in the Master Installment Purchase Agreement as (a) any Qualified Take or Pay Obligation (as defined herein), and (b) the reasonable and necessary costs spent or incurred by the City for maintaining and operating the Water System, calculated in accordance with generally accepted accounting principles, including (among other things) the reasonable expenses of maintenance and repair and other expenses necessary to maintain and preserve the Water System in good repair and working order, and including administrative costs of the City attributable to the Water System, including the Project and the Installment Purchase Agreement, salaries and wages of employees of the Water System, payments to such 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 a Tax Certificate, and fees and expenses payable to any Credit Provider.

All Senior Obligations are of equal rank with each other without preference, priority, or distinction of any Senior Obligations over any other Senior Obligations. The term "Parity Obligations" is defined in the Master Installment Purchase Agreement as (i) Installment Obligations (as defined herein), (ii) Obligations, the principal of and interest on which are payable on a parity with Installment Obligations, and (iii) Reserve Fund Obligations. The term "Installment Obligations" is defined in the Master Installment Purchase Agreement as Obligations consisting of or payable from Installment Payments, which are not subordinated in right of payment to other Installment Payments. The term "Credit Provider" is defined in the Master Installment Purchase Agreement as any municipal bond insurance company, bank, or other financial institution or organization that is performing in all material respects its obligations under any policy of insurance, letter of credit, standby purchase agreement, revolving credit agreement, or other credit arrangement providing credit support or liquidity with respect to Parity Obligations (each, a "Credit Support Instrument") (other than in repayment of a "Credit Provider Reimbursement Obligation" (which term is defined in the Master Installment Purchase Agreement to mean any obligation of the City to repay, from Net System Revenues, amounts advanced by a Credit Provider as credit support or liquidity for Parity Obligations, which obligation shall constitute a Parity Obligation or a Subordinated Obligation, as designated by the City), but excluding in all cases (1) depreciation, replacement, and obsolescence charges or reserves therefor, (2) amortization of intangibles or other bookkeeping entries of a similar nature, (3) costs of capital additions, replacements, betterments, extensions, or improvements to the Water System, which under generally accepted accounting principles are chargeable to a capital account or to a reserve for depreciation, (4) charges for the payment of principal of and interest on any general obligation bond heretofore or hereafter issued for Water System purposes, and (5) charges for the payment of principal of and interest on any debt service on account of any Obligation on a parity with, senior to the Installment Payments.

The term "Qualified Take or Pay Obligation" is defined in the Master Installment Purchase Agreement as 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 the City or 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 rate covenant contained in the Installment Purchase Agreement. As of the date of issuance of the 2012A Bonds, there will be no outstanding Qualified Take or Pay Obligations.

Senior Obligations

As of the date of delivery of the 2012A Bonds, the pledge and right of payment from Net System Revenues securing the 2012A Subordinated Installment Payments (which, in turn, secure the payment of the 2012A Bonds) will be subordinate to the pledge and right of payment from Net System Revenues securing Installment Payments that, in turn, secure the payment of (i) the Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Refunding Series 2009A (Payable Solely From Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2009A Bonds"), which were issued on January 29, 2009, and which will be outstanding, as of May 1, 2012, in the aggregate principal amount of $153,905,000, (ii) the Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Series 2009B (Payable Solely From Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2009B Bonds"), which were issued on June 26, 2009, and which will be outstanding, as of May 1, 2012, in the aggregate principal amount of $317,425,000, and (iii) the Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Refunding Series 2010A (Payable Solely From Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2010A Bonds"), which were issued on June 30, 2010, and which will be outstanding, as of May 1, 2012, in the aggregate principal amount of $123,075,000. Funding agreements for three SRF loans totaling $50,000,000 were obtained in calendar year 2011 as Senior Obligations. Two of the loans, totaling $32 million were funded in calendar year 2011 and their first interest and principal payments were made in February 2012. The third loan for $18 million was partially funded in January 2012 with the balance expected to be funded by April 2012. The total principal amount of these three loans, as of May 1, 2012, is expected to be $49,365,788. As is the case with these three SRF loans, all future additional SRF Loans will be Senior Obligations. The City will continue to apply for additional SRF loans. The Department anticipates that the amount of bonded indebtedness to be issued in the future will be reduced by the amount of the additional SRF Loans received from the California Department of Public Health ("CDPH"), if any.

All Senior Obligations (referred to as "Parity Obligations" in the Master Installment Purchase Agreement) are secured by a first priority lien on and pledge of Net System Revenues. All Senior Obligations are of equal rank with each other without preference, priority, or distinction of any Senior Obligations over any other Senior Obligations. The term "Parity Obligations" is defined in the Master Installment Purchase Agreement as (i) Installment Obligations (as defined herein), (ii) Obligations, the principal of and interest on which are payable on a parity with Installment Obligations, and (iii) Reserve Fund Obligations. The term "Installment Obligations" is defined in the Master Installment Purchase Agreement as Obligations consisting of or payable from Installment Payments, which are not subordinated in right of payment to other Installment Payments.

The term "Obligations" is defined in the Master Installment Purchase Agreement as (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 of 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 cap agreements.

Subordinated Obligations

The 2012A Subordinated Installment Payments shall be Subordinated Obligations under the Installment Purchase Agreement and, as of the date of delivery of the 2012A Bonds, the payment of the 2012A Subordinated Installment Payments will be on parity with the right of payment of $243,529,431 aggregate principal amount of other Outstanding Subordinated Obligations as of March 1, 2012 (certain maturities of which will be refunded with proceeds of the 2012A Bonds) under the Master Installment Purchase Agreement. The Master Installment Purchase Agreement permits the issuance of Obligations secured by a lien on and pledge of Net System Revenues, which lien and pledge is subordinate to the lien on and pledge of Net System Revenues securing Parity Obligations (each, a "Subordinated Obligation"). In addition, nothing contained in the Master Installment Purchase Agreement limits the ability of the City to grant a lien on and pledge of the Net System Revenues that is subordinate to any liens on and pledges of Net System Revenues for the benefit of Subordinated Obligations, subordinate in payment to the 2012A Subordinated Installment Payments. See "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

As of the date of delivery of the 2012A Bonds, the pledge and right of payment from Net System Revenues on parity with the lien and pledge of Net System Revenues to secure the Subordinated Obligations secure the payment of the 2012A Subordinated Installment Payments and, in turn, secure the payment of (i) the 2002 Subordinated Bonds, of which $16,430,000 will then remain outstanding as described herein, and (ii) a loan from the State of California Department of Health Services Safe Drinking Water State Revolving Fund (the "State Revolving Fund"), the aggregate principal amount of $15,669,431 of which was outstanding as of March 1, 2012, payable on a semi-annual basis and matures in 2025 (the "Subordinate SRF Loan") (together with the outstanding 2002 Subordinated Bonds, the "Outstanding Subordinated Obligations"). See "THE REFUNDING PLAN" and "WATER SYSTEM FINANCIAL OPERATIONS – Outstanding Indebtedness." Currently, no SRF Loans are anticipated to be executed as subordinate liens.

The Water Utility Fund

The City accounts for its water operations through an enterprise fund known as the "Water Utility Fund." The Water Utility Fund was established pursuant to an amendment to the City Charter effective February 11, 1963, and is accounted for separately from other funds of the City. The City has agreed and covenanted in the Master Installment Purchase Agreement that all System Revenues shall be received by the City in trust and shall be deposited when and as received in the Water Utility Fund, which fund the City agrees and covenants to maintain so long as any Obligations remain unpaid, and all moneys in the Water Utility Fund shall be so held in trust and applied and used solely as provided in the Master Installment Purchase Agreement. The City further has agreed to pay from the Water Utility Fund: (1) directly or as otherwise required all Maintenance and Operation Costs of the Water System; and

(2) to the Trustee, for deposit in the Payment Fund for Parity Obligations, including Reserve Fund Obligations that are Parity Obligations, the amounts specified in any Issuing Instrument, as payments due on account of Parity Obligations (including any Credit Provider Reimbursement Obligations that are Parity Obligations). In the event there are insufficient Net System Revenues to make all of the payments contemplated by clause (2) 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 the payments described in the preceding paragraph have been made, and in any event not less frequently than January 15 and July 15 of each year, any remaining Net System Revenues shall be used to make up any deficiency in the Reserve Funds for Parity Obligations. Notwithstanding the use of a Reserve Fund Credit Facility in lieu of depositing funds in the related Reserve Fund for Parity Obligations, in the event of any draw on the related Reserve Fund Credit Facility, there shall be deemed a deficiency in such Reserve Fund for Parity Obligations 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 for Parity Obligations, such payments into the Reserve Funds shall be made as nearly as practicable *pro rata* based on the respective unpaid principal amount of all Parity Obligations.

Any amounts thereafter remaining in the Water Utility Fund may from time to time be used to pay the amounts specified in any Issuing Instrument as payments due on account of Subordinated Obligations (including any Reserve Fund Obligations for Subordinated Obligations, any Credit Provider Reimbursement Obligations that are Subordinated Obligations, and any Subordinated Credit Provider Reimbursement Obligations), provided the following conditions are met*:* (1) all Maintenance and Operation Costs of the Water System are being and have been paid and are then current; and (2) all deposits and payments contemplated by clause (2) of the preceding paragraph shall have been made in full and no deficiency in any Reserve Fund for Parity Obligations shall exist, and there shall have been paid, or segregated within the Water Utility Fund, the amounts payable during the current month pursuant to clause (2) of the preceding paragraph.

After deposits described in the preceding paragraphs have been made, any amounts thereafter remaining in the Water Utility Fund may be used for any lawful purpose of the Water System. See "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

Pursuant to the Indenture, on or before each Interest Payment Date, the Trustee shall transfer from the Subordinated Bonds Payment Fund and deposit in the Subordinated Bonds Interest Account that amount of money that, together with any money contained in the Subordinated Bonds Interest Account, equals the aggregate amount of interest becoming due and payable on all Outstanding Subordinated Bonds on such Interest Payment Date. No deposit need be made in the Interest Account if the amount contained in the Subordinated Bonds Interest Account equals at least the Subordinated aggregate amount of interest becoming due and payable on all Outstanding Subordinated Bonds on such Interest Payment Date. All money in the Subordinated Bonds Interest Account shall be used and withdrawn by the Trustee solely for the purpose of paying the interest on the Subordinated Bonds as it shall become due and payable (including accrued interest on any Subordinated Bonds redeemed prior to maturity).

On or before each Principal Payment Date, the Trustee shall transfer from the Subordinated Bonds Payment Fund and deposit in the Subordinated Bonds Principal Account that amount of money that, together with any money contained in the Subordinated Bonds Principal Account, equals the aggregate principal becoming due and payable on all Outstanding Subordinated Bonds. No deposit need be made in the Subordinated Bonds Principal Account if the amount contained therein is at least equal to the aggregate amount of principal become due and payable on Outstanding Subordinated Bonds. All money in the Subordinated Bonds Principal Account shall be used and withdrawn by the Trustee solely for the purpose of paying the principal of the Subordinated Bonds as it shall become due and payable.

In addition to the above accounts, the Trustee shall establish and maintain within the Subordinated Bonds Payment Fund a special account designated the "Subordinated Bonds Redemption Account." All money in the Subordinated Bonds Redemption Account shall be held in trust by the Trustee and shall be applied, used, and withdrawn to redeem Subordinated Bonds.

Any delinquent Subordinated Installment Payments pledged to the Subordinated Bonds shall be applied first to the Subordinated Bonds Interest Account for the immediate payment of interest payments past due and to the Subordinated Bonds Principal Account for immediate payment of principal payments past due on any Subordinated Bond. Any remaining money representing delinquent Subordinated Installment Payments pledged to Subordinated Bonds shall be deposited in the Subordinated Bonds Payment Fund to be applied in the manner provided therein. See "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

Rate Covenant

The City has covenanted in the Master Installment Purchase Agreement to fix, prescribe, and collect rates and charges for the Water Service that will be at least sufficient to yield the greater of (i) Net System Revenues sufficient to pay during each Fiscal Year all Obligations payable in such Fiscal Year or (ii) Adjusted Net System Revenues during each Fiscal Year equal to 120% of the Adjusted 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 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 the Installment Purchase Agreement. The term "Adjusted Net System Revenues" is defined in the Master Installment Purchase Agreement as, for any Fiscal Year, the Net System Revenues for such Fiscal Year, minus an amount equal to earnings from investments in any Reserve Fund securing Obligations for such Fiscal Year. The term "Adjusted Debt Service" is defined in the Master Installment Purchase Agreement as, for any Fiscal Year, Debt Service on Parity Obligations for such Fiscal Year, minus an amount equal to earnings from investments in any Reserve Fund for Parity Obligations for such Fiscal Year. Adjusted Debt Service does **not** include debt service on Subordinated Obligations such as the 2012A Subordinated Installment Payments. Net System Revenues (and, therefore, Adjusted Net System Revenues) may be increased or reduced by transfers in to or out of the Rate Stabilization Fund or the Secondary Purchase Fund. See "– Pledge of Net System Revenues" above. For information on the possible limitation on the City's ability to comply with the rate covenant described above as a consequence of Proposition 218, see "RISK FACTORS – Rate-Setting Process Under Proposition 218" and "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES – Article XIIIC" and "– Article XIIID." For a description of the reserve funds established by the City within the Water Utility Fund, see "WATER SYSTEM FINANCIAL OPERATIONS – Rate Stabilization Fund; Other Funds and Accounts."

Common Subordinated Bonds Reserve Fund

The 2012A Bonds will be secured by amounts on deposit in the Common Subordinated Bonds Reserve Fund within the Subordinated Bonds Reserve Fund held by the Trustee under the Indenture. The 2012A Bonds are Common Subordinated Reserve Fund Bonds. The 2012A Bonds are not secured by any debt service reserve fund other than the Common Subordinated Bonds Reserve Fund and no Obligations other than Common Subordinated Reserve Fund Bonds (the 2012A Bonds and any other Subordinated Bonds so designated in a Supplemental Indenture) will be secured by the Common Subordinated Bonds Reserve Fund. Senior Bonds issued under the Indenture are secured by the Reserve Fund held by the

Trustee under the Indenture. Additional Subordinated Bonds that are not Common Subordinated Reserve Fund Bonds may be secured by a Separate Subordinated Bonds Reserve Fund or by no debt service reserve fund. The Indenture does not permit the funding of the Common Subordinated Bonds Reserve Fund with a surety or similar credit support or insurance policy.

In connection with the issuance of the 2012A Bonds, an amount equal to the Common Subordinated Bonds Reserve Requirement will be deposited into the Common Subordinated Bonds Reserve Fund. See "ESTIMATED SOURCES AND USES OF BOND PROCEEDS." The Indenture defines the "Common Subordinated Bonds Reserve Requirement" as an amount equal to the least of (i) ten percent (10%) of the proceeds (within the meaning of Section 148 of the Code) of the Common Subordinated Bond Reserve Fund Bonds; (ii) 125% of average annual debt service on the Outstanding Common Subordinated Reserve Fund Bonds; or (iii) Common Subordinated Reserve Fund Bonds Maximum Annual Debt Service; provided, however, that, if, upon issuance of a Series of Subordinated Bonds secured by the Common Subordinated Reserve Fund, such amount would require moneys to be credited to the Common Subordinated Reserve Fund from the proceeds of such Series of Subordinated Bonds in an amount in excess of the maximum amount permitted under the Code, the Common Subordinated Bonds Reserve Requirement shall mean an amount equal to the sum of the Common Subordinated Bonds Reserve Requirement immediately preceding issuance of such Subordinated Bonds and the maximum amount permitted under the Code to be deposited therein from the proceeds of such Subordinated Bonds, as certified by the Authority. See "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS." Upon early redemption of any Subordinated Bonds secured by the Common Subordinated Bonds Reserve Fund, the Authority, at the request of the City, may request the Trustee to recalculate and reduce the Common Subordinated Bonds Reserve Requirement, whereupon any excess in the Common Subordinated Bonds Reserve Fund over and above the Common Subordinated Bonds Reserve Requirement shall be transferred to the Subordinated Bonds Payment Fund.

The Subordinated Bonds Reserve Fund will be established as a separate fund held in trust by the Trustee. An amount equal to the Common Subordinated Bonds Reserve Requirement and each Separate Subordinated Bonds Reserve Requirement, if any, shall be maintained in or credited to the Subordinated Bonds Reserve Fund at all times, subject to the provisions of the Indenture described below, and any deficiency therein shall be replenished from the first available Subordinated Revenues as described below.

Moneys in or available from the Common Subordinated Bonds Reserve Fund shall be used solely for the purpose of paying the principal of and interest on the 2012A Bonds (and any other Subordinated Bonds so designated as Common Subordinated Reserve Fund Bonds in a Supplemental Indenture), including the redemption price of the 2012A Bonds coming due and payable by operation of mandatory sinking fund redemption, in the event that the moneys in the Subordinated Bonds Payment Fund are insufficient therefor. In the event that the amount on deposit in the Subordinated Bonds 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 2012A Bonds coming due and payable by operation of mandatory sinking fund redemption, the Trustee shall withdraw the amount of such insufficiency from the Common Subordinated Bonds Reserve Fund in the amount of such insufficiency and transfer such amount to the Subordinated Bonds Payment Fund. Amounts on deposit in the Common Subordinated Bonds Reserve Fund shall not be applied to the payment of Senior Bonds.

In the event that the amount on deposit in the Common Subordinated Bonds Reserve Fund exceeds the Common Subordinated Bonds Reserve Requirement on the fifteenth (15th) calendar day of the month proceeding any Interest Payment Date, the amount of such excess shall be withdrawn therefrom by the Trustee and transferred to (a) the Rebate Fund, to the extent required by the Indenture, or (b) the Subordinated Bonds Payment Fund. The remaining balance in any fund in the Common

Subordinated Bonds Reserve Fund may be applied at the direction of the Authority, to the payment of the final maturing principal payments of Subordinated Bonds secured by such fund.

In the event that the amount on deposit in the Common Subordinated Bonds Reserve Fund at any time falls below the Common Subordinated Bonds Reserve Requirement, the Trustee shall promptly notify the City and the Authority of such fact and the Trustee shall promptly withdraw the amount of such insufficiency from available Subordinated Revenues on deposit in the Subordinated Bonds Payment Fund, and transfer such amount to the Common Subordinated Bonds Reserve Fund.

Issuance of Additional Obligations

Pursuant to the Master Installment Purchase Agreement, the City may incur additional Obligations, payments with respect to which will be senior in priority to, on parity with or subordinated in priority to the City's obligation to make 2012A Subordinated Installment Payments, subject to satisfaction of the conditions specified in the Master Installment Purchase Agreement, as described below.

Issuance of Parity 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 the outstanding Senior Obligations and obligations payable from Net System Revenues on a parity therewith (collectively, the "Parity Obligations"). The City may issue or create any other Parity Obligations, provided that (i) there shall not have occurred and be continuing an Event of Default under the terms of the Installment Purchase Agreement, any Issuing Instrument, or any Credit Support Instrument and (ii) 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 within the 18 consecutive months ending immediately prior to the incurring of such additional Parity Obligations shall have amounted to or exceeded the greater of (i) at least 1.20 times the Maximum Annual Debt Service on all Parity Obligations to be Outstanding immediately after the issuance of the proposed Parity Obligations or (ii) at least 1.00 times the Maximum Annual Debt Service on all Obligations to be Outstanding immediately after the issuance of the proposed Parity 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 Parity Obligations is to be capitalized or, if no interest is to be capitalized, the Fiscal Year in which the Parity Obligations are issued, or (b) the date on which substantially all new Components to be financed with such Parity Obligations are expected to commence operations, will be at least equal to 1.20 times the Maximum Annual Debt Service for all Parity Obligations that will be Outstanding immediately after the issuance of the proposed Parity Obligations.

The certificate or certificates described in clause (2) above will not be required if the Parity Obligations being issued are for the purpose of refunding (A) 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 Adjusted Debt Service on all Parity Obligations Outstanding for all remaining Fiscal Years after the issuance of the refunding Parity Obligations will not exceed the sum of Adjusted Debt Service on all Parity Obligations Outstanding for all remaining Fiscal Years prior to the issuance of such refunding Parity Obligations; or (B) 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 pursuant to 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 Master Installment Purchase Agreement, see "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

Issuance of Subordinated Obligations. Pursuant to the Master Installment Purchase Agreement, if (i) no Event of Default has occurred and is continuing, and (ii) no event of default or termination event attributable to an act of or failure to act by the City under any Credit Support Instrument has occurred and is continuing, the City may issue or incur additional Subordinated Obligations, and such Subordinated Obligations shall be paid in accordance with the provisions of the Master Installment Purchase Agreement, provided that 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 within the 18 consecutive months ending immediately prior to the incurring of such additional Subordinated Obligations shall have amounted to at least 1.00 times the Maximum Annual Debt Service on all Obligations that will be 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 that will be Outstanding immediately after the issuance of the proposed Subordinated Obligations.

The certificate or certificates described in clauses (1) and (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 agreement 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 Master Installment Purchase Agreement, see "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

Issuance of Additional Bonds Under the Indenture

Pursuant to the Indenture, the Trustee may, upon Written Request of the Authority, by a supplement to the Indenture, establish one or more other series of bonds, which may include Additional Senior Bonds and Additional Subordinated Bonds (collectively, the "Additional Bonds"). As defined in the Indenture, the term "Additional Senior Bonds" means those Bonds authorized and issued pursuant to the Indenture on a parity with the 2009A Bonds, the 2009B Bonds and the 2010A Bonds. The term "Additional Subordinated Bonds" means those Bonds authorized and issued pursuant to the Indenture on a parity with the 2012A Bonds.

The issuance of Additional Bonds is conditioned upon satisfaction of the following:

(a) No Event of Default shall have occurred and be then continuing;

(b) The Supplemental Indenture providing for the execution and delivery of such Additional Bonds shall specify the purposes for which such Additional Bonds are then proposed to be delivered, which shall 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 hereunder, 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 Water System. Such Supplemental Indenture may, but shall 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 Supplemental Indenture providing for the execution and delivery of such Additional Bonds shall state whether such Additional Bonds shall be Senior Bonds or Subordinated Bonds;

(d) If such Additional Bonds are Subordinated Bonds, the Supplemental Indenture shall specify whether such Additional Bonds shall be secured by the Common Subordinated Bonds Reserve Fund, a Separate Subordinated Bonds Reserve Bonds or no reserve fund;

(e) If such Additional Bonds are Senior Bonds, the Authority shall 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;

(f) If such Additional Bonds are Common Subordinated Reserve Fund Bonds, the Authority shall deliver or cause to be delivered by the Trustee, from the proceeds of such Additional Bonds or from any other lawfully available source of moneys, an amount sufficient to increase the balance of the Common Subordinated Bonds Reserve Fund to the Common Subordinated Bonds Reserve Fund Requirement;

(g) If such Additional Bonds are Subordinated Bonds to be secured by a Separate Subordinated Bonds Reserve Fund, the Authority shall deliver or cause to be delivered by 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 such Separate Subordinated Bonds Reserve Fund to the Separate Subordinated Bonds Reserve Fund for such Series of Subordinated Bonds;

(h) The Additional Bonds shall be payable as to principal on August 1 and as to interest on February 1 and August 1 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;

(i) Fixed serial maturities or mandatory sinking account payments, or any combination thereof, shall 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;

(j) The aggregate principal amount of Bonds and Additional Bonds executed and delivered hereunder shall not exceed any limitation imposed by law or by any Supplemental Indenture; and

(k) The Trustee shall be the Trustee for the Additional Bonds.

Nothing in the Indenture limits in any way the power and authority of the Authority to incur other obligations payable from other lawful sources. See "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

CITY OF SAN DIEGO

The City of San Diego, with a total population of approximately 1.3 million as of August 1, 2011 and a land area of approximately 324 square miles, is the eighth largest city in the nation and the second largest city in California. The City is the county seat for the County of San Diego. The City offers a wide range of cultural and recreational services to both residents and visitors. Major components of the City's diversified economy include defense, tourism, biotechnology/biosciences, financial and business services, software and telecommunications. 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.

The City was incorporated in 1850. The City operates under and is governed by the laws of the State of California and the City Charter, as periodically amended since its adoption by the electorate in 1931. The City has been operating under a "Strong Mayor" form of government since January 1, 2006. 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, Ethics Commission, City Attorney and City Auditor's departments. The City, with approximately 10,000 current budgeted employees, provides a full range of governmental services which include 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.

WATER SYSTEM ORGANIZATION AND MANAGEMENT

Certain of the information set forth under this caption has been obtained from publicly available sources other than the City and the Department, which the City and the Authority believe to be reliable, including, without limitation, the comprehensive annual financial reports ("CAFRs") and other public financial documents of the San Diego County Water Authority and The Metropolitan Water District of Southern California. As described herein, historically an average of 90% of annual water deliveries are obtained from imported water supplied to the Water System. Accordingly, certain of the information set forth under this caption has been included because it provides additional detail with respect to such sources of supply that may be considered relevant to an informed evaluation and analysis of the 2012A Bonds, the Water System and the Department. However, such information is not guaranteed by the City or the Authority as to its accuracy or completeness and no representation is made as to the absence of material adverse changes in such information subsequent to the date of the respective publicly available source document. Neither the San Diego County Water Authority nor The Metropolitan Water District of Southern California has participated in the preparation of this Official Statement. Neither is obligated in any way to the owners or Beneficial Owners of any 2012A Bonds and neither has pledged any of its moneys, funds or assets toward the payment of any amount due in connection with the 2012A Bonds.

History of Water System

The City has managed and operated the Water System since 1901, when it purchased the privately-owned San Diego Water and Telephone Company, and has expanded the Water System from time to time to satisfy its mission statement, which is to provide safe, reliable water in an efficient, cost-effective, and environmentally responsible manner. In furtherance of its mission, the City and other local retail water distributors formed the San Diego County Water Authority ("CWA") in 1944 for the purpose of purchasing Colorado River water from The Metropolitan Water District of Southern California ("MWD") and conveying such water to local distributors within the County.

The 1.3 million people living in the City used an average of approximately 171 million gallons per day ("MGD") of potable water in Fiscal Year 2011. One MGD for one year is equal to approximately 1,120 acre feet per year ("AFY"). Based on statistics provided by the San Diego Association of Governments ("SANDAG"), the City's population is projected to increase approximately 21% in the next 20 years and the City expects that this projected growth will increase demand for potable water by approximately 18%. The City currently provides water to its customers primarily from two water sources*:* (1) by collecting approximately 10 - 15% of its water needs through local supplies, and (2) by purchasing approximately 85 - 90% of its water from CWA, a wholesale water agency that provided approximately 419,511 acre-feet ("AF") of imported water to its member agencies in the County in Fiscal Year 2011. CWA currently purchases the majority of its imported water from MWD, which is comprised of 26 public water agencies. MWD obtains its water from the Colorado River through the Federal Bureau of Reclamation and from northern California, via the State Water Project (the "SWP"), through the California Department of Water Resources. In Fiscal Year 2011, MWD sold approximately 1.6 million AF of imported water to its customers. Both CWA and MWD are developing storage and additional supplies, such as water transfers, to augment their imported water.

Between 2008 and early 2010, drought conditions in the State triggered the need for both voluntary and mandatory reductions in water use. Dry conditions in the northern Sierra watershed for the SWP and low storage levels in Lake Mead and Lake Powell resulting from a multi-year drought in the Colorado River Basin further affected water deliveries and storage throughout the region. See "WATER SUPPLY."

Governance and Management of Water System

General. The Water 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, depending upon which system benefits from the tasks completed. Though the different branches cover all 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 Assistant Directors.

Prior to the completion of the reorganization of the Water and Wastewater Utilities into a joint Department on July 1, 2009, the City's Water Department and The Metropolitan Wastewater Department had been separately managed since July 1, 1996. Prior to 1996, both enterprise funds were managed as a joint operation as the City's Water Utilities Department. The Water Utility Fund portion of the Department had approximately 719 budgeted full-time equivalent employees as of July 1, 2011. The City Council has the authority to approve the Department's budget, to set rates and charges of the Water System, and to approve execution of certain contracts. For information on how the City sets the rates and charges of the Water System. See "WATER SYSTEM FINANCIAL OPERATIONS – Establishment of Water Service Charges." In accordance with the provisions of the City Municipal Code, the Water Utility Fund and the Sewer Utility Fund are administered in an enterprise account separate from the City's General Fund.

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

Roger S. Bailey. Mr. Roger S. Bailey serves as the City's Director of Public Utilities and oversees the Water, Wastewater and Business Support Branches. Mr. Bailey has Masters of Science and Bachelor of Science degrees in Civil Engineering from Florida A&M University. He also holds a Bachelor of Science degree in Physics and Mathematics from the University of Winnipeg. Canada. Mr. Bailey is a registered professional engineer in Florida and Arizona. He has an extensive background in engineering and public utilities. Prior to joining the City of San Diego in September 2010, he served as the Utilities Director for the City of Glendale, Arizona and the City of Royal Palm Beach, Florida; the Assistant Utilities Director of the City of Valdosta, Georgia; and Senior Engineer with the City of Tallahassee Water Utilities Department.

Alex Ruiz. Mr. Alex Ruiz currently serves as the City's Utilities Business Support Branch Assistant Director. In his capacity as Assistant Director, Mr. Ruiz oversees the day-to-day operations of all Business Support activities. Mr. Ruiz has been with the City since 1988. During the past 12 years, he has served in various management capacities within the City's Public Utilities 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 an 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 since 1990 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 5 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 Water Utility Fund and Sewer Utility Fund and the Engineering and Program Management Division, which provides Capital Project Development and Management to the Water Utility Fund and Sewer Utility Fund. Ms. Sasaki was appointed to the position of Assistant Director in July 2009. Ms. Sasaki began her career with the City 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 Public Utilities Department and oversees, among other things, strategic planning, asset management, and benchmarking activities. 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 started working with the Department in September 2006 and has been in this position since February 2009. 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, contracting, 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 Resource Division. This division provides long-range water resources planning and development, watershed and resources protection, water and wastewater legislation and policy analysis, and management of the City's recycled water and water conservation programs. The Long-Range Planning and Water Resources Division is also charged with management of the Water Purification Demonstration Project currently underway at the North City Water Reclamation Plant.

Financial and Information Technology Division. 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, and contract and grant administration.

Customer Support Division. This division provides high quality customer focused care and service to Public Utility 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, this 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 Quality Assurance Division. This division provides employee, management, and strategic support services, as well as safety, security, training, and quality assurance. The Employee Services and Quality Assurance 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 potable water system. The division maintains approximately 275,000 metered service connections, approximately 25,000 fire hydrants, and more than 47,000 isolation valves. In addition, this 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. This division operates and maintains three water treatment plants with a combined capacity of 298 million gallons per day and a potable water distribution system consisting of 49 water pump stations, 31 reservoirs/standpipes, and more than 950 pressure regulators serving 130 pressure zones. In addition, this division provides corrosion engineering services to the

Water and Wastewater Branches, operational engineering support for the Water Branch, and water supply operation and management for the Department.

The Wastewater Branch is comprised of the following divisions:

Engineering and Program Management Division. This division provides engineering services for the Water, Wastewater, and Reclaimed Water System 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 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 IROC, all of whom are appointed by the Mayor and confirmed by the City Council. The membership of IROC consists of representatives of each ratepayer 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, efforts to achieve high quality, and affordable utility services provided by the Department. IROC's duties and functions include reviewing reports from staff and performing an independent performance review on rate and bond proceeds 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 monthly to review finances, performance and issues for the Department.

On September 20, 2011, IROC issued its "Annual Report on the San Diego Public Utilities Department for the Fiscal Year 2010" (the "2010 IROC Report"). The 2010 IROC Report included a series of recommendations related to the planning for safe, reliable, and cost-effective alternatives to imported water, water conservation, and wastewater reuse. Fiscal Year 2010 key recommendations included: (1) Educating the public on the Advanced Water Purification ("AWP") demonstration project (see "WATER SYSTEM SERVICE AREA AND FACILITIES – Water System Service Area" and "– Existing Water System Facilities" and "WATER SUPPLY – City Planning and Resource Management – Indirect Potable Reuse Demonstration Project (Water Purification Demonstration Project)" and the importance of investing in infrastructure; (2) Evaluate and implement projects to maintain the recycled water program as appropriate; (3) Proactively plan for the "post-AWP demonstration project"; (4) Develop an effective rate structure; (5) Plan for risks associated with natural disasters, sabotage and other emergencies; and (6) Implement a system for investing in capital infrastructure at an optimal level. While IROC recommendations are advisory in nature, the Department incorporates many of IROC's recommendations for its strategic initiatives. IROC's Fiscal Year 2011 Annual Report was released on February 22, 2012.

WATER SYSTEM SERVICE AREA AND FACILITIES

Water System Service Area

The Water System serves the City and certain surrounding areas, including retail, wholesale, and recycled water customers. The Water System's service area covers 404 square miles, including 324 square miles in the City, and a population of approximately 1.3 million people. The map that follows the Table of Contents of this Official Statement shows the boundaries of the service area of the Water System.

Retail Customer Base. The City has six types of retail customer groups, consisting of Single Family Residential ("SFR"), Multi-Family, Commercial, Industrial, Temporary Construction, and Irrigation. For information relating to recycled water customers, see "– *Reclaimed Water Customer Base*" below. For Fiscal Year 2011 retail customers accounted for approximately 94% of total water deliveries and such sales represented approximately 97% of the revenues from total sales of water. Of the Water System's more than 275,000 retail service connections, approximately 91% are SFR and Multi-Family residential accounts, with the balance for Commercial, Industrial, and other users. For Fiscal Year 2011, SFR and Multi-Family residential accounts comprised approximately 64% of total water sales revenue, with the balance for Commercial, Industrial and other users. Some of the SFR, Multi-Family, Commercial, and Industrial accounts have been classified as Irrigation, as described below.

The City's residential users are classified into SFR and Multi-Family classes. As described in the December 14, 2006, Cost of Service Rate Study (as adopted by the City Council in 2007, the "2007 Rate Case"), these residential classes are assumed to be homogenous in water usage and therefore are assigned the same peaking factors. Usage and peaking, however, will vary among the individual customers.

Single Family Residential. SFR refers to individual dwelling units served by a separate meter, and accounted for approximately 43% of total water sales revenues in Fiscal Year 2011.

Multi-Family. Multi-Family encompasses multi-family dwellings such as apartment or condominium complexes, in which two or more dwelling units share the same meter, and accounted for approximately 21% of total water sales revenues in Fiscal Year 2011.

Commercial and Industrial. Commercial and Industrial user classes are comprised of a diverse group of customers and accounted for 21.5% of total water sales revenues in Fiscal Year 2011. These customers are treated equivalently in cost calculations and are assigned the same peaking factors. These customers also typically have lower peaking factors than residential customers due to their relatively consistent usage trend.

Irrigation. Prior to July 2007, the City did not recognize "Irrigation" as a separate customer class. As there is sufficient data to separate these users into such a class, such a class was created by separating the SFR, Multi-Family, Commercial, and Industrial accounts that are used solely for irrigation into a new class. These customers use water primarily to irrigate personal or business landscaping. This diverse group of customers accounted for 10% of total water sales revenue for Fiscal Year 2011.

Temporary Construction. Temporary construction refers to meters that are placed on fire hydrants during construction in order to provide water to the construction site until the installation of a permanent meter. Costs for these customers are usually higher than the average customer because of additional administrative costs associated with transient meters. This group of customers generated less than 0.5% of total water sales revenue for Fiscal Year 2011.

Irrigation and Temporary Construction customers typically have high peak demands characterized by relatively large amounts of water used in short periods of time when compared to average usage. As described in the 2007 Cost of Service Study, peak usage is more costly to deliver than constant usage.

The following table sets forth the historical number of retail connections to the Water System for each year from Fiscal Year 2007 through 2011.

TABLE 1
HISTORICAL NUMBER OF RETAIL CONNECTIONS TO WATER SYSTEM
FISCAL YEAR 2007 THROUGH FISCAL YEAR 2011
(UNAUDITED)

Customer Type	2007	2008	2009	2010	2011
Single Family Residential	219,984	220,519	220,854	221,274	221,863
Multi-Family	29,239	29,208	29,193	29,190	29,167
Commercial	15,604	15,603	15,598	15,605	15,631
Industrial	231	215	205	188	185
Outside City (1)	45	46	45	45	44
Irrigation (2)	7,463	7,462	7,465	7,465	7,480
Temporary Construction	374	345	296	278	308
TOTAL	272,940	273,398	273,656	274,045	274,678
Percent Growth	0.33%	0.17%	0.09%	0.14%	0.23%

(1) Represents retail customers located beyond the City limits that the City has agreed to service. The City's billing system identifies each such account as a separate customer type; due to the small number of such customers, the group is not classified as individual customer class.
(2) Established as a separate customer classification in Fiscal Year 2008; amount for Fiscal Year 2007 was derived from historical reports.
Source: Public Utilities Department, City of San Diego.

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The following table sets forth the 10 largest non-governmental retail customers and the 10 largest governmental customers of the Water System for Fiscal Year 2011, which customers provided approximately 2% and 9% respectively, of the total sales revenues for such Fiscal Year.

TABLE 2
MAJOR NON-GOVERNMENTAL RETAIL CUSTOMERS
AND MAJOR GOVERNMENTAL CUSTOMERS
Fiscal Year 2011
(Unaudited)

Customers	Millions of Cubic Feet	Billings	% of Total Sales Revenues
MAJOR NON-GOVERNMENTAL RETAIL CUSTOMERS			
CP Kelco	47.37	$ 1,733,650	0.49%
San Diego Zoo	24.42	895,645	0.26
Marine Park Corp	24.59	903,765	0.25
Garden Communities	15.46	614,297	0.17
Coca Cola Bottling Co	15.04	545,318	0.15
Sharp Memorial Hospital	13.28	512,041	0.14
H G Fenton Co.	11.37	498,990	0.14
ERP Operating LP	10.55	444,159	0.12
Costa Verde Dev LLC	10.42	427,874	0.12
Marriott Full Service	10.48	402,929	0.11
TOTAL TOP 10 NON-GOVERNMENTAL RETAIL CUSTOMERS	182.98	$ 6,978,668	1.95%
MAJOR GOVERNMENTAL CUSTOMERS			
City of San Diego	292.40	$12,301,035	3.43%
United States Navy	196.11	8,338,801	2.32
University of California at San Diego	87.65	3,322,610	0.93
San Diego Unified School District	42.95	2,198,096	0.61
California Department of Transportation	40.86	1,832,534	0.51
Other Federal Agencies [1]	44.38	1,723,963	0.48
San Diego Port District	19.47	862,976	0.24
San Diego State University	21.06	828,864	0.23
County of San Diego	17.98	701,386	0.20
San Diego Housing Commission	12.65	548,360	0.15
TOTAL TOP 10 GOVERNMENTAL CUSTOMERS	775.51	$32,658,625	9.10%

(1) Includes several Federal agencies, including, but not limited to, the United States Post Office, the Federal Bureau of Investigation and the United States Coast Guard.

Source: Public Utilities Department, City of San Diego.

Wholesale Customer Base. For Fiscal Year 2011, wholesale customers accounted for approximately 6% of total water deliveries and such sales represented approximately 3% of the revenues from total sales and/or treatment of water. The City currently sells and delivers or treats and delivers water on a wholesale basis to four wholesale customers: (1) the California-American Water Company ("Cal-American"), (2) the Santa Fe Irrigation District, (3) the San Dieguito Water District (together with the Santa Fe Irrigation District, the "Water Districts"), and (4) the Otay Water District ("OWD").

Cal-American. Since 1912, the City has been selling and delivering treated water to Cal-American, which in turn provides water to the cities of Coronado and Imperial Beach, as well as a portion of the City. The City's obligation to sell and deliver water to Cal-American and its customers was assumed by the City upon its original acquisition of the Water System. The City's agreement with Cal-American has been subsequently amended to establish minimum and maximum amounts of treated water that may be purchased by Cal-American from the City, an average system delivery and a supply price methodology, which incorporates all of the City's integrated system-wide costs (*i.e.*, the costs associated with treatment, storage and pumping of the treated water supplied to Cal-American), including 60% of the water purchase replacement costs, 17% of the transmission and distribution costs associated with usage of mains that are 16 inches and larger, and a proportionate share of debt service for capital costs of the Water System. For Fiscal Year 2011, the City made approximately 6% of its total water deliveries to Cal-American and such sales represented approximately 2.9% of the revenues from total sales of water. The rates established within the City's agreement with Cal-American are adjusted at the same rate, and for the same period of time as the rate and term set for City rate payers under the current rate case.

Water Districts. Pursuant to an existing contract between the City and the Water Districts, which runs in perpetuity, the City delivers raw water from the Lake Hodges Reservoir. The contract sets the terms and rates pursuant to which the applicable Water Districts may purchase water from the City and provides each Water District with the right to purchase a specified amount of water. The purchase price charged to each Water District is based on a portion of Operation and Maintenance expenditures and capital improvement costs related to the City's provision of water to such Water Districts. For Fiscal Year 2011, these water sales represented less than 1% of total deliveries and revenues from total sales of water. The rates established within the City's contract with the Water Districts are renewed every two years.

OWD. The City's Otay Water Treatment Plant (the "OWTP") is capable of producing treated water in excess of the amounts needed by the Water System customer base traditionally serviced by the OWTP. In 1999, the City entered into an agreement with OWD to deliver up to 10 MGD of surplus treated water, which deliveries began in November 2005. The amounts paid by OWD for such treated water are determined in part by allocating to the City and OWD, based on the amount of treated water produced for each, the projected cost and expenses of all operations, maintenance and overhead, capital improvements, repairs and replacements under $100,000 to be incurred for or at the OWTP. This cost per AF, as determined pursuant to the preceding sentence, is added to the raw water rate, to determine the projected actual cost to OWD for the next succeeding Fiscal Year. Pursuant to the agreement, OWD may elect to pay its proportional share of costs to expand the OWTP to meet its future treated water demands, estimated to be from 10 to 20 MGD. Any expansion would be subject to the City's discretion and the execution of a separate agreement. To date OWD has purchased excess water sparingly. In Fiscal Year 2011, OWD purchased 6.4 AF in August 2010 and 280 AF in January 2011, which represents less than 0.2% of total deliveries.

Reclaimed Water Customer Base. Reclaimed water (also referred to as recycled water) is produced from wastewater processed at water reclamation plants owned and operated by the City as part of the City's Wastewater System. Since 1997, the recycled water produced by the City has been carefully monitored by City and State health officials and water quality-control agencies to ensure that it meets all federal, State, and local water quality standards, including the safety standards applicable to water coming into human contact set forth under Title 22 of the California Code of Regulations, and is suitable for irrigation, industrial, and other non-potable uses. The City began billing OWD and the Olivenhain Municipal Water District for recycled water in Fiscal Year 2007. The City also provides recycled water to the City of Poway under the terms of an agreement entered into in 1998. Wholesale customers of the Wastewater System have asserted a claim to a percentage of the capacity fees and revenues from the sale of recycled water from the South Bay Water Reclamation Plant. The current amount in dispute is approximately \$3.6 million. The capacity fees and revenues from the sale of recycled water are being held by the City pending resolution of this matter. From Fiscal Year 2007 to Fiscal Year 2011, the number of Reclaimed Water System connections increased from 408 to 532. For Fiscal Year 2011, recycled water customers and processing accounted for slightly more than 1% of the revenues from total sales of water.

Existing Water System Facilities

The Water System consists of nine raw water storage reservoirs, three water treatment plants, 29 treated water storage facilities, and over 3,300 miles of water transmission and distribution lines. Water is transported through 49 water-pumping stations and approximately 275,000 metered service connections.

Raw Water Reservoirs. The City has nine reservoirs with a total capacity of 408,593 AF, of which 251,623 AF was in storage as of January 1, 2012. Eight of the raw water storage facilities are directly connected to water treatment plants. One of the nine raw water storage facilities, Lake Hodges Reservoir (30,251 AF total capacity), was connected in 2011 to the Olivenhain Reservoir and will be available for City use via CWA aqueducts and pursuant to an agreement between the City and CWA as part of CWA's Emergency Storage Project (the "Emergency Storage Project"). The Emergency Storage Project was developed to provide approximately 90,100 AF of reservoir storage and supporting distribution facilities to supplement existing emergency water supplies in the County in case of a prolonged interruption of imported water supplies. The City has agreements with the Water Districts to sell local runoff collected at the Lake Hodges Reservoir. The amount of water sold varies from year to year but has historically averaged approximately 7,000 AF on an annual basis. The Lower Otay Reservoir, Barrett Reservoir and Morena Reservoir (135,348 AF total capacity) service the OWTP in south San Diego; the El Capitan Reservoir, San Vicente Reservoir, Sutherland Reservoir and Lake Murray Reservoir (236,311 AF total capacity) service the Alvarado Water Treatment Plant (the "AWTP") in central San Diego; and the Miramar Reservoir (6,682 AF total capacity) services the Miramar Water Treatment Plant (the "MWTP") in north San Diego. Once all components of CWA's Emergency Storage Project are completed (approximately 2013), the City's San Vicente Reservoir will be able to service all three City water treatment plants. According to City Council policy, the City shall have approximately 7.2 months of the annual (rolling 12 months) requirement of the City's demand available in primary water storage facilities. This water is to be used during emergencies, in the event of substantial disruption or interruption of imported water service. This required amount is currently maintained by the City's Water System. As of January 1, 2012, the City held approximately 11.0 months of storage within the City's reservoirs.

In 2006 and 2009 the State Water Resources Control Board listed each of the City's raw water reservoirs as "impaired water bodies" pursuant to Section 303(d) of the Federal Clean Water Act. The "impaired" listings result from the application of drinking water standards to raw source water reservoirs, and do not mean the reservoirs are unsuitable as sources of supply to the City's system. The City currently has a proactive source water protection program for its raw water reservoirs and their catchments.

The following table sets forth the City's raw water reservoirs and their respective storage capacities and storage levels as of January 1, 2012.

TABLE 3
RAW WATER RESERVOIRS
(As of January 1, 2012)

Reservoir	Storage Capacity (AF)	Storage (AF)	Percent Full
Lake Hodges	30,251	23,938	79%
Lower Otay	49,849	41,464	83
Barrett	34,806	28,135	81
Morena	50,694	11,910	23
El Capitan	112,807	83,092	74
San Vicente	89,312	38,802(1)	43
Sutherland	29,508	14,397	49
Lake Murray	4,684	4,293	92
Miramar	6,682	5,592	84
TOTAL	408,593	251,623(2)	62%

(1) Approximately 55% of the raw water stored at the San Vicente Reservoir was drawn down by the end of Fiscal Year 2009 in connection with the ongoing improvements thereto.
(2) Figure includes approximately 2% - 3% of total amount of water in storage that is inaccessible due to reservoir outlets being abandoned, blind flagged, or silted.
Source: Public Utilities Department, City of San Diego.

Water Treatment Plants. The Department maintains and operates three water treatment plants with a combined rated capacity of 298.4 MGD through which potable water is supplied. Supplemental treated supplies from CWA are used to help operate the distribution system reliably and efficiently. All three plants have been mostly upgraded to their Future Rated Capacity of 455 MGD, however they require certification from CDPH before they can be rated as such. The increased capacity will improve the City's ability to treat raw water, thereby further reducing the need to purchase treated water, while providing capacity for customer growth. Of the total of 168,161 AF of water purchased from CWA during Fiscal Year 2011, approximately 19,260 AF was treated water.

Alvarado Water Treatment Plant. The AWTP was originally constructed in 1951 and has a current rated capacity of 120 MGD. Several hydraulic improvements constructed in the mid-1970's and additional upgrades completed recently are expected to be approved by CDPH in late March 2012. This will increase the plant's rated capacity to 200 MGD. The AWTP is located next to Murray Reservoir near Interstate 8 and serves the general area from National City to the San Diego River.

Miramar Water Treatment Plant. The MWTP was originally constructed in 1962 and has a current rated capacity of 144 MGD. The MWTP is located next to Miramar Reservoir off Interstate 15. The MWTP provides drinking water to an estimated 500,000 customers in the general area north of the San Diego River. The various upgrades to the plant have enabled the City to increase the MWTP's capacity, upon further studies and CDPH approval to 215 MGD, to address future demands. The current rated capacity is sufficiently meeting the current demand. Expansion of the raw water aqueducts by CWA will provide the MWTP access to water from San Vicente and Hodges Reservoirs.

Otay Water Treatment Plant. The current OWTP was constructed in 1989 and has a current rated capacity of 34.4 MGD. The OWTP serves the general area along the Mexico border and the southeastern portions of central San Diego. Recent upgrades to the plant, along with further studies and potentially additional improvements based on study results will increase its rated capacity to 40 MGD upon CDPH certification.

The following table summarizes the capacity and demands of the three Water Treatment Plants.

TABLE 4
CAPACITY AND DEMAND OF WATER SYSTEM WATER TREATMENT PLANTS
(In MGD)
As of January 1, 2012

Water Treatment Plant	Original Design Capacity	Current Rated Capacity	Future Rated Capacity [1]	Current Average Demand	Current Peak/Max Demand
Alvarado	66	120	200	81.56	108.30
Miramar	100	144	215	61.02	123.86
Otay	40	34	40	15.28	24.48
Total	206	298	455	157.86	256.64[2]

(1) Although construction at the Miramar plant to bring it up to its Future Rated Capacity is complete, further studies and certification by CDPH is required for it to be officially rated for capacity. The Otay plant may also require additional improvements, based on further studies, to reach its Future Rated Capacity.
(2) Total is not intended to reflect the aggregate peak/maximum demand supported by all water treatment plants, because such plants do not all reach the peak/maximum demand simultaneously.
Source: Public Utilities Department, City of San Diego.

Treated Water Storage Facilities. The Department maintains and operates 29 treated water storage facilities, including steel tanks, standpipes, concrete tanks, and rectangular concrete reservoirs. These facilities have capacities varying from less than 1 million gallons to 35 million gallons and in the aggregate hold a daily total of approximately 250 million gallons.

Delivery System. The Water System consists of approximately 3,300 miles of transmission and distribution pipelines, including transmission lines up to 84 inches in diameter and distribution lines as small as four inches in diameter. Transmission lines are pipelines with larger diameters that convey raw water to the water treatment plants and convey treated water from the water treatment plants to the treated water storage facilities. Distribution lines are pipelines with smaller diameters that directly service the retail users connected to a meter. The Department also maintains and operates 49 water pump stations that deliver treated water from the water treatment plants to approximately 275,000 metered service connections in over 130 different pressure zones. The Department also treats and delivers the water provided by CWA for the City of Del Mar ("Del Mar"). Del Mar pays CWA directly for the untreated water and pays the Department for its treatment and delivery services based on negotiated contract pricing. In addition, the Department maintains several emergency connections to and from neighboring water agencies, including the Santa Fe Irrigation District, the Poway Municipal Water District, Cal-American, the Sweetwater Authority and the Otay Water District.

For Fiscal Year 2011, the City's average daily water use, including Del Mar and Cal-American deliveries, was approximately 171 MGD (which includes 17 MGD of treated water purchased from CWA), with peak day demands as high as 239 MGD. The City's three Water Treatment Plants provided 154 MGD, or 90%, of average demand. Due to current operational limitations with respect to the distribution system, City average and peak daily water demands are met with a combination of City-treated water and treated water supplied by CWA primarily through four metered treated water connections.

Insurance for the Water System

The City, through the statewide joint power authority risk pool, the California State Association of Counties-Excess Insurance Authority ("CSAC-EIA"), maintains an "All Risk" policy that includes Flood and Earthquake coverage for scheduled locations for amounts up to $25,000,000 per occurrence with a $25,000 deductible. The City also maintains an excess liability insurance policy in collaboration with a statewide joint powers authority risk pool, the CSAC-EIA for amounts up to $50,000,000; the City's self-insured retention is $3,000,000.

Utility Costs

The Water System is supplied with electricity and gas by San Diego Gas & Electric Company. The energy and utility services account for approximately 2.8% of the Water System's annual operating budget. On September 8, 2011 much of southern California, from southern Orange County to northern Baja, Mexico and from the coast to Arizona suffered a complete power outage for several hours. The Water System experienced a disruption in service to approximately 8% of the Water System. The Department is currently evaluating the need for additional self-generating power resources to provide water services to domestic customers in the event of the occurrence of significant future power outages. The Department anticipates that any necessary improvements will be funded within the existing operations and maintenance budget of the water fund.

WATER SUPPLY

Current Water Supply

The Water System currently receives approximately 85-90% of its water supply from water imported by CWA, with the balance coming from local runoff. CWA's largest source of imported water is MWD, which obtains its water supply from two primary sources: the Colorado River and the State Water Project. CWA also imports Colorado River water consisting of conserved agricultural water transferred from the Imperial Irrigation District ("IID") and water made available through the lining of the Coachella Canal and the All-American Canal.

Each of these sources of supply suffered from drought conditions throughout the southwestern United States. Calendar year 2009 was a third consecutive year of dry conditions in the northern Sierra watershed for the SWP and there were low storage levels in Lake Mead and Lake Powell resulting from a multi-year drought in the Colorado River Basin. By 2011, however, both the SWP and Colorado River systems enjoyed above average precipitation levels, allowing storage levels to improve significantly. By April 26, 2011, snowpack in the Sierra Nevada had reached 185% of normal. Drier conditions returned in late 2011 and early 2012, with California statewide snowpack at 46% of average as of March 19, 2012. Precipitation in the Colorado River Basin from October 2011 through February 2012 was 85% of normal. Upper Colorado River Basin snowpack measured on February 1, 2012 was 71% of normal.

To satisfy future water supply demands, the City is pursuing the development of groundwater and recycled water resources, although increases in demand are projected to be met primarily through increased water purchases from CWA. CWA has also been working to diversify its water supply sources, including the development of seawater desalination resources, and expects that in the future a significantly smaller percentage of the water it imports will come from MWD and a significantly larger percentage will come from IID transfers.

The City is the largest purchaser of water from CWA, purchasing 40.1% of the total imported water provided by CWA to its member agencies in Fiscal Year 2011. During Fiscal Year 2011, the

Department purchased approximately 168,161 AF of water from CWA at a cost of $143.2 million, including fixed charges. Currently, the City pays CWA, in addition to the fixed charges illustrated in Table 6 below, a variable commodity rate, including transportation of $723 per AF for untreated water and $957 per AF for treated water. Approximately 11% of the City's water purchases are for treated water.

TABLE 5
CWA WATER SUPPLY RATES [(1)]
Calendar Years 2008 through 2012
(Per AF)

Calendar Year	Municipal & Industrial (M&I) Rates		Transportation Rate
	Untreated	Treated	
2008	$390	$554	$60
2009	463	631	64
2010 [(2)]	532	747	67
2011	597	812	75
2012	638	872	85

(1) Rates for volumetric charges. Rates do not include additional charges such as Infrastructure Access Charge, Customer Service Charge, Storage Charge, Capacity Charge, or In-Lieu Charge.
(2) Rates as of September 1, 2009 due to MWD rate increase.
Source: San Diego County Water Authority Invoices.

In addition to the volumetric charges the City pays for imported water, CWA and MWD also levy fixed charges on their member agencies. The following table demonstrates the fixed charges, which are component costs to the City of imported water, paid, or to be paid, by the City to MWD and CWA between calendar years 2008 and 2012.

TABLE 6
MWD and CWA FIXED WATER SUPPLY COSTS
Calendar Years 2008 through 2012
(in thousands)

Calendar Year	2008	2009	2010	2011	2012
MWD Fixed Charges					
Capacity Reservation Charges	$ 2,938	$ 2,797	$ 3,015	$ 3,010	$ 2,718
Readiness-to-Serve Charge[(1)]	5,025	5,493	7,050	8,481	9,808
CWA Fixed Charges					
Customer Service	5,252	5,503	6,259	8,198	9,645
Emergency Storage Charge	8,960	9,234	13,735	17,949	22,310
Infrastructure Access Charge	7,867	8,816	9,405	11,600	12,153
In Lieu Tax Payment	1,695	1,707	1,629	1,583	1,642
Total Fixed Charges	**$31,737**	**$33,550**	**$41,093**	**$50,821**	**$58,276**

(1) Fiscal Year Charge.
Source: San Diego County Water Authority Board Meeting Documents.

The following table sets forth the City's local water production and CWA supplied water for Fiscal Years 2007 through 2011.

TABLE 7
WATER SUPPLIES FOR THE CITY OF SAN DIEGO
Fiscal Years 2007 through 2011
(In AF)

Fiscal Year	Local Supplies	CWA Water Supplies	Total
2007	17,770	222,496	240,266
2008	24,155	215,791	239,946
2009	22,845	202,794	225,639
2010	12,486	187,304	199,790
2011	27,841	161,552	189,393

Source: San Diego County Water Authority CAFRs.

San Diego County Water Authority

The San Diego County Water Authority was organized on June 9, 1944, under the County Water Authority Act (the "CWA Act"). The primary mission of CWA is to provide its member agencies with a safe and reliable supply of imported water for domestic, municipal and agricultural uses. Pursuant to the CWA Act, CWA is authorized to acquire water and water rights within or outside the State of California and to develop, store, and transport such water for beneficial uses and purposes and to provide, sell and deliver water of CWA not needed or required for beneficial purposes of its member agencies to areas outside the boundaries of CWA. The CWA Act also authorizes CWA to exercise the power of eminent domain; to levy and collect taxes; to fix, prescribe, and collect rates or other charges for the delivery of water, use of facilities or property or provisions for service; and to fix in each Fiscal Year a water standby availability charge on land within the boundaries of CWA to which water is made available by CWA.

CWA's 24 member agencies deliver water to approximately 97% of San Diego County's 3.26 million residents throughout a service area that encompasses approximately 952,200 acres (1,488 square miles), covering the foothills and coastal areas of the westerly third of San Diego County. The City of San Diego represents the largest land area (approximately 22%), the largest population (approximately 43%), and the highest assessed property value (approximately 48%) within CWA's service area. When CWA was established in 1944, its service area consisted of 94,707 acres. Growth has primarily resulted from the addition and annexation of additional service areas by member agencies.

The decision-making body of CWA is its 36-member Board of Directors. Each of the 24 member agencies of CWA has at least one representative on the CWA Board of Directors. Member agencies may appoint one additional representative for each additional 5% of total assessed value of property taxable by CWA for purposes within the public agency's boundaries. As a result, the City is entitled to representation by 10 directors (with 48.07% of the assessed property values). Under the CWA Act, a member agency's vote is based on its "total financial contribution" to CWA since CWA's organization in 1944. Total financial contribution includes all amounts paid in taxes, assessments, fees, and charges to or on behalf of CWA or MWD. The CWA Act authorizes each CWA Board of Directors member to cast one vote for each $5,000,000, or major fractional part thereof, of the total financial contribution paid by the member agency. Based on this formula, the City is entitled to 39.99% of the total vote in calendar year 2012. For comparison, the Helix Water District has the second highest voting entitlement, with 7.08% of the vote in calendar year 2012.

Since 1990, CWA has provided an average of 86% of the water supply within its service area. In Fiscal Year 2011, 168,161 AF of water, or approximately 88% of the water supply for the City, was delivered from CWA. The City projects that, with increases in the sale of recycled water and consistent use of local water sources, City purchases of water from CWA could drop to approximately 83% by Fiscal Year 2015.

As a wholesaling entity, CWA has no retail customers, but serves only its member agencies. Water supplies utilized within the CWA service area currently originate from four sources: (1) water imported by CWA from MWD; (2) conserved Colorado River water purchased from the Imperial Irrigation District; (3) conserved Colorado River water achieved as a result of projects to line the All-American and Coachella canals; and, (4) local supplies (such as local runoff, groundwater, reclamation, conservation, and, prospectively, seawater desalination and purified wastewater), with the water imported from MWD currently representing the principal source of water supply. MWD obtains its water supply from two primary sources: the Colorado River, via the MWD's Colorado River Aqueduct, and the State of California Department of Water Resources' SWP, via the Edmund G. Brown California Aqueduct.

The Quantification Settlement Agreement ("QSA") was enacted in October 2003 to provide the State of California the means to implement water transfers and supply programs that will allow the State to live within the State's 4.4 million AF basic annual apportionment of Colorado River water. The QSA and its related water transfers and other agreements were signed by the United States Secretary of the Interior and representatives of various Indian tribes, the United States Bureau of Reclamation, the Coachella Valley Water District, the Imperial Irrigation District (the "IID"), MWD, and CWA. The QSA outlines how the State will reduce its overuse of Colorado River water over a fifteen year period. CWA's Colorado River Program manages the implementation of CWA's agreements under the QSA, including the water transfer agreement with the IID and the concrete lining of portions of the All-American and Coachella Canals. Under the QSA, CWA projects to receive 30% of its water supply from the water transfer and canal lining projects by 2020 while reducing its purchases from MWD to just 30%. The MWD Act provides a preferential right for the purchase of water by each of its constituent agencies. This preferential right is calculated using a formula which establishes CWA's current preferential right to approximately 17.71% of MWD's total supply.

Pursuant to the QSA and its related agreements, CWA is able to purchase up to 200,000 AF per year of conserved water from the IID. The agreement provides that water saved through conservation measures in Imperial Valley will be transferred to CWA. This water is highly reliable because it comes from the IID's Colorado River Water Priority 3 allocation. See the table entitled "Priorities under the 1931 California Seven-Party Agreement" under "– The Metropolitan Water District of Southern California" below. These priorities are higher than MWD's fourth priority allocation of 550,000 AF. This means that water will likely remain available for transfer even during drought periods. Implementation of the water transfer began in calendar year 2003 with a transfer of 10,000 AF of water. The quantities of water transferred will increase according to an agreed-upon delivery schedule, ultimately providing up to 200,000 AF of water in calendar year 2021. This amount will continue to be transferred between 2021 and as late as 2077. In calendar year 2012, CWA is projected to purchase 100,000 AF from the IID as part of the ramped-up schedule of deliveries.

Also pursuant to the QSA, CWA receives approximately 78,000 AF per year of water conserved as a result of recently completed construction projects lining portions of the previously earthen All-American and Coachella Canals. The All-American Canal Lining Project will yield approximately 56,200 AF of Colorado River water transfers per year to CWA and the Coachella Canal Lining Project will yield approximately 21,500 AF per year to CWA. The canal lining projects will reduce the loss of water that occurred through seepage and that conserved water will be delivered to CWA. The Coachella Canal Lining Project was completed in December 2006. The All-American Canal Lining Project began construction in June 2007 and was completed in April 2010, when its full yield of 67,700 AFY was made available to project beneficiaries. The IID has certain limited call rights to a portion of the conserved water, but exercise of call rights would extend the term of the deliveries to CWA. The cost of the canal lining projects was in large part paid by State funds.

QSA related litigation. In November 2003, the IID brought litigation to "validate" 13 of the QSA related contracts as complying with California and federal law. Other lawsuits also were filed contemporaneously, challenging the execution, approval and implementation of the QSA on various grounds. Among other things, the litigation involves a review of the IID environmental impact report for the water transfers and the IID, CWA, MWD, and Coachella Valley Water District (the "CVWD") program environmental impact report for the QSA. In February 2010, Sacramento County Superior Court Judge Roland Candee invalidated the QSA and eleven other agreements because they were inextricably interrelated with the QSA Joint Powers Agreement. On December 7, 2011, California's Third District Court of Appeal issued a ruling reversing the lower court's ruling. See "LITIGATION."

CWA Action on Supply Costs. On June 11, 2010, CWA filed a complaint, *San Diego County Water Authority v. The Metropolitan Water District of Southern California; et al*, alleging that the rates adopted by the MWD Board of Directors on April 13, 2010, misallocate State Water Contract costs to the System Access Rate and the System Power Rate, and thus to charges for transportation of water, and that this results in an overcharge to CWA by at least $24.5 million per year. See "LITIGATION."

Local supply and storage programs. CWA has encouraged development of additional water supply projects such as water recycling and groundwater projects through the award of Local Water Supply Development ("LWSD") incentives of up to $200 per AF for recycled water and groundwater produced and beneficially reused within CWA's service area. The purpose of CWA's LWSD Program is to promote the development of cost-effective water recycling and groundwater projects that prevent or reduce the demand for imported water and improve regional water supply reliability. The LWSD Program reimburses member agencies for all or a portion of the difference between the actual per AF cost of producing recycled water, and the revenue generated by the LWSD participant through the sale of that AF of recycled water (not to exceed $200 per AF). In February 2008, the LWSD Program was expanded to include funding for local brackish groundwater and seawater desalination projects.

The MWD and CWA Local Resources Program ("LRP") incentives are dependent on the City's Project Unit Cost plus the Project Deferred Cost minus the MWD Full Service Treated Water Rate (imported water). The incentive amount received is contingent on the cost difference. As long as the cost difference is greater than MWD's and CWA's LRP incentives ($250 and $200, respectively) the City will continue to receive the full incentive credit. MWD and CWA recalculate the LRP contribution rate every year. As cost for imported water continues to rise, the incentives the City receives will most likely diminish and potentially cease accruing.

CWA's local surface water program is responsible for optimizing the storage of runoff that occurs in the watersheds within CWA's service area with the storage of imported water. On average, local surface water is projected to supply nearly 7% of the region's annual water demands. Expansion of CWA's carryover storage capacity is a key part of local surface supply development. By 2015, CWA expects the San Vicente Dam Raise to raise the San Vicente Dam's height by an additional 117 feet, which is projected to yield an additional 152,500 AFY in local surface storage for imported supplies.

In 2004, CWA adopted a Regional Water Facilities Master Plan, which calls for additional supply diversification, specifically calling for up to 80 MGD of desalinated seawater to meet projected 2030 regional demands. A proposed 50 MGD desalinated seawater project in Carlsbad is fully permitted and preliminary work on the facility has commenced. CWA is currently negotiating long-term contracts with the project owner for the purchase of water produced by the project. Additionally, CWA is exploring potential additional seawater desalination projects in the region and in Mexico, including a proposed 50 –

150 MGD seawater desalination facility to be located on the premises of Camp Pendleton in the northwest part of the region. CWA is currently in the process of updating its 2004 Facilities Master Plan. The updated Plan, developed in collaboration with its member agencies, is expected to be completed in 2012.

The Metropolitan Water District of Southern California

MWD was created in 1928 by a vote of the electorates of several southern California cities. MWD is a wholesale water agency that serves its member agencies, including CWA, and does not have any retail customers. MWD's primary purpose is to provide a supplemental supply of water for domestic and municipal uses and purposes at wholesale rates to its member public agencies. There are 26 member public agencies of MWD, consisting of 14 cities, 11 municipal water districts, and CWA. MWD's service area comprises approximately 5,200 square miles and includes all or portions of the counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura. Of the total population in MWD's six-county service area, almost 19 million people, or 85%, live within MWD's service area. Population projections prepared by SCAG and SANDAG in 2010 and 2011, as part of their planning process to update regional transportation and land use plans, show expected population growth of about 19% in MWD's service area between 2010 and 2035. These preliminary regional agency projections do not reflect a complete analysis of the 2010 Census population estimates and may be revised. MWD is governed by a 37-member Board of Directors, with each member agency having at least one representative on the Board of Directors. Representation and voting rights are based upon the assessed valuation of real property within the jurisdictional boundary of each member agency. CWA has four members on the MWD Board of Directors and 17.89% of the weighted vote in Fiscal Year 2011-12.

MWD imports water from two principal sources, the SWP in Northern California, via the California Aqueduct, and the Colorado River, via the Colorado River Aqueduct. In Fiscal Year 2011, MWD sold approximately 1.5 million AF of imported water to member agencies and expects to sell 1.8 million AF in 2012. During years of normal precipitation, MWD's existing water supplies have been historically sufficient to meet demands within the service area of MWD. In the future, several factors could impact to some extent the availability of both existing and future supplies in normal years.

Local Resources Program. The MWD Board of Directors created the original Joint Participation Agreement for the North City Water Reclamation Plan ("NCWRP") in October 1993. Under this agreement the City would receive a contribution of $154 per AF of tertiary-treated recycled water produced and distributed to end users. The incentive program was designed to encourage the beneficial use of recycled water throughout MWD's service area, thereby reducing the need for imported potable water supplies.

An updated agreement for the NCWRP was executed in December 1996. And two years later on May 26, 1998, MWD's Board of Directors replaced the temporary LRP with a permanent LRP agreement. Under this agreement, the City would receive a sliding scale contribution of $0 to a maximum of $250 per AF of recycled water produced and distributed to end users. Currently the City of San Diego is receiving an incentive of $250 per AF of recycled water distributed to its customers.

Colorado River. The Colorado River was MWD's original source of water after MWD's establishment in 1928. The Colorado River Aqueduct, which is owned and operated by MWD, is 242 miles long, starting at Lake Havasu and terminating at Lake Matthews in Riverside County.

Under applicable laws, agreements, and treaties governing the use of water from the Colorado River, the State is entitled to use 4.4 million AF of Colorado River water annually, plus one-half of any surplus that may be available for use collectively in Arizona, California, and Nevada as declared on an annual basis by the United States Secretary of the Interior. Under the priority system that governs the distribution of Colorado River water made available to California, MWD holds the fourth priority right of 550,000 AFY and a fifth priority right of 662,000 AFY. MWD's fourth priority right is within California's basic annual apportionment of 4.4 million AF; however, the fifth priority right is outside of this entitlement and therefore is not considered a firm supply of water. See the table below, which outlines the water allocation priorities under the governing 1931 California Seven-Party Agreement.

PRIORITIES UNDER THE 1931 CALIFORNIA SEVEN-PARTY AGREEMENT [(1)]

Priority	Description	Acre-Feet Annually
1	Palo Verde Irrigation District gross area of 104,500 acres of land in the Palo Verde Valley	
2	Yuma Project in California not exceeding a gross area of 25,000 acres in California	
3(a)	Imperial Irrigation District and other lands in Imperial and Coachella Valleys [(2)] to be served by All-American Canal	3,850,000
3(b)	Palo Verde Irrigation District – 16,000 acres of land on the Lower Palo Verde Mesa	
4	Metropolitan Water District of Southern California for use on the coastal plain	550,000
	SUBTOTAL	**4,400,000**
5(a)	Metropolitan Water District of Southern California for use on the coastal plain	550,000
5(b)	Metropolitan Water District of Southern California for use on the coastal plain [(3)]	112,000
6(a)	Imperial Irrigation District and other lands in Imperial and Coachella Valleys to be served by the All-American Canal	300,000
6(b)	Palo Verde Irrigation District – 16,000 acres of land on the Lower Palo Verde Mesa	
	TOTAL	**5,362,000**
7	Agricultural use in the Colorado River Basin in California	Remaining surplus

(1) Agreement dated August 18, 1931, among Palo Verde Irrigation District, Imperial Irrigation District, Coachella Valley County Water District, MWD, the City of Los Angeles, the City of San Diego and the County of San Diego. These priorities were memorialized in the agencies' respective water delivery contracts with the Secretary of the Interior.
(2) The Coachella Valley Water District serves Coachella Valley.
(3) In 1946, the City of San Diego, CWA, MWD and the Secretary of the Interior entered into a contract that merged and added the City of San Diego and the County of San Diego's rights to storage and delivery of Colorado River water to the rights of MWD.
Source: MWD.

Until 2003, MWD had been able to take full advantage of its fifth priority right as a result of the availability of surplus water and apportioned but unused water. However, Arizona and Nevada have increased their use of water from the Colorado River, leaving no unused apportionment available for California. In addition, a severe drought in the Colorado River Basin reduced storage in system reservoirs, such that MWD stopped taking surplus deliveries in 2003 in an effort to mitigate the effects of the drought. Prior to 2003, MWD could divert over 1.2 million AF in any year, but since that time, MWD's net diversions of Colorado River water have been limited. MWD has identified a number of programs that could be used to augment Colorado River supplies, including: Conservation Program with IID, a

Crop Rotation Program with Palo Verde Land Management, a Storage and Interstate Release Program with Southern Nevada Water Authority, a Lower Colorado Water Supply Project with the City of Needles, a Storage Program in Lake Mead and a Groundwater Storage Program in east Riverside County.

MWD had expected to divert up to 1.25 million AF of Colorado River water annually under foreseeable runoff and reservoir storage scenarios from 2004 through 2016. However, an extended drought in the Colorado River Basin reduced these initial expectations. From 2000 to 2004, snow pack and runoff in the Colorado River Basin were well below average.

Although runoff was slightly above average in 2005 and 2008, average annual runoff from 2000 through 2010 was 69% of normal, representing the driest eleven-year period on record. In November 2010, Lake Mead's elevation had dropped below 1,081 feet above sea level, the lowest elevation since 1937. Precipitation over the Colorado River Basin from October 2010 through April 2011 was significantly above normal. Upper Colorado River Basin snowpack measured on May 1, 2011 was 150% of normal with accumulations at the highest level on record and the April-July runoff measuring 163% of normal. Although runoff was slightly above average in 2005, the runoff in 2006 and 2007 was again below average, making 2000 through 2007 the driest eight-year period on record. Although 2008 and 2009 runoff was near normal, combined storage in Lake Mead and Lake Powell remains at 50% of capacity. Since 2003, MWD's net diversions of Colorado River water have been limited to a low of approximately 633,000 AF in 2006 and a high of approximately 1,105,232 AF in 2009. Average annual net deliveries for 2003 through 2010 were approximately 849,500 acre-feet, with annual volumes dependent primarily on programs to augment supplies, including transfers of conserved water from agriculture. In 2009, MWD's Colorado River Aqueduct deliveries exceeded 1 million AF for the first time since 2002, including diversions anticipated from new programs and transactions under MWD's Five-Year Supply Plan. As in 2011, MWD has reported that its available Colorado River supply will be about 900,000 AF in 2012.

State Water Project. MWD's other major source of water is the State Water Project (the "SWP"). The SWP is owned by the State and operated by the Department of Water Resources ("DWR"). The SWP transports Feather River water stored in and released from Oroville Dam and unregulated flows diverted directly from the Bay-Delta south via the California Aqueduct to four delivery points near the northern and eastern boundaries of MWD's service area. The total length of the California Aqueduct is 444 miles.

MWD is one of 29 agencies that have long-term contracts for water service from DWR (each a "State Water Contract") and it is the largest agency in terms of the number of people it serves (approximately 19 million), the share of the SWP water for which it is entitled, and the total amount of annual payments made to DWR. MWD's contract with DWR provides for the delivery of 1,911,400 AF (46% of the total SWP entitlement). MWD also retains a "call" on 100,000 AFY on water transferred to the Coachella Valley Water District and the Desert Water Agency, if needed, so long as it pays for the financial obligations associated with the water during the call period.

The SWP was originally intended to meet demands of 4.2 million AF per year. Initial SWP facilities were completed in the early 1970's, and it was envisioned that additional facilities would be constructed as contractor demands increased. Several factors, including increased costs and increased non-SWP demands for limited water supplies, combined to delay the construction of additional facilities. The State Water Contract, under a 100% allocation, provides MWD 1,911,500 AF of water. Water received from the SWP by MWD (between 2002 and 2009), including water from water transfer, groundwater banking and exchange programs varied from a low of 908,000 AF in calendar year 2009 to a high of 1,800,000 AF in 2004. For calendar year 2010, DWR's allocation to SWP contractors was 50% of contracted amounts, reflecting pumping restrictions due to biological opinions for Delta smelt and

Chinook salmon (see "*Environmental Concerns*" below), late spring storms, a return to normal precipitation and reservoir levels and above-normal Sierra snowpack. For calendar year 2011, DWR's initial allocation was 25%, reflecting the then current drought condition. By April 2011, with significantly above normal precipitation over the entire Sierra Nevada range, the allocation was raised to 80% of contracted amounts.

For calendar year 2012, DWR's initial allocation estimate to SWP contractors was set at 60% of contracted amounts, or approximately 1.1 million AF, which is considered to be a high allocation early on in the winter season. This was largely attributable to bountiful precipitation received in 2011, which refilled State and local reservoirs to full or nearly full levels. On February 22, 2012, DWR announced that it had reduced its projected allocation to 50% of contracted amounts, primarily based upon statewide snowpack and precipitation that was then well below average. DWR may revise the allocation estimate if warranted by the year's developing precipitation and water supply conditions. For MWD, the revised 2012 allocation will provide 955,750 acre-feet, or 50% of its 1,911,500-acre-foot contractual amount.

Environmental Concerns. The listing of several fish species as threatened or endangered under the federal or California Endangered Species Acts (respectively, the "Federal ESA" and the "California ESA" and, collectively, the "ESAs") have adversely impacted SWP operations and limited the flexibility of the SWP. Currently, five species (the winter-run and spring-run Chinook salmon, Delta smelt, North American green sturgeon and Central Valley steelhead) are listed under the ESAs. In addition, on June 25, 2009, the California Fish and Game Commission declared the longfin smelt a threatened species under the California ESA. The Federal ESA requires that before any federal agency authorizes funds or carries out an action it must consult with the appropriate federal fishery agency to determine whether the action would jeopardize the continued existence of any threatened or endangered species, or adversely modify habitat critical to the species' needs. The result of the consultation is known as a "biological opinion." In the biological opinion, the federal fishery agency determines whether the action would cause jeopardy to a threatened or endangered species or adverse modification to critical habitat and recommends reasonable and prudent alternatives or measures that would allow the action to proceed without causing jeopardy or adverse modification. The biological opinion also includes an "incidental take statement." The incidental take statement allows the action to go forward even though it will result in some level of "take," including harming or killing some members of the species, incidental to the agency action, provided that the agency action does not jeopardize the continued existence of any threatened or endangered species and complies with reasonable mitigation and minimization measures recommended by the federal fishery agency.

The United States Fish and Wildlife Service and the National Marine Fisheries Service have released new biological opinions with respect to the operations of the Central Valley Project and the SWP, as proposed, are likely to jeopardize the continued existence of the Delta smelt and certain salmonid species and adversely modify critical habitat. MWD has reported that, based on the Water Allocation Analysis released by DWR on December 19, 2008, which analyzed the biological opinion's effects on SWP operations, export restrictions of water from the SWP under median hydrologic conditions could impact deliveries to MWD in the range of 300,000 to 700,000 AF annually. MWD further reports that an additional 10% average water loss, can be expected to begin in 2010, under the most recent biological opinion regarding the salmonid species.

Several legal challenges of completed biological opinions regarding the Delta smelt have been filed and have been consolidated into the Delta Smelt Consolidated Cases. Several legal challenges relating to biological opinions regarding the salmonid species have been filed and have been consolidated into the Consolidated Salmon Cases.

The City is monitoring these developments, as these legal challenges would be a factor that could affect the SWP allocation to MWD, the water deliveries to CWA, and that ultimately could have an adverse effect on the water delivers to the City.

While MWD plans and manages reserve supplies to account for normal occurrences of drought conditions, regulatory restrictions on SWP operations, including but not limited to restrictions under the federal and California Endangered Species Acts, have placed limitations on MWD's ability to provide water to its member agencies, including CWA. MWD continues to urge action to address Bay-Delta water quality concerns which address drinking water quality and aquatic health issues.

Recent CWA and MWD Actions in Response to Drought Conditions

MWD's declared policy is to meet all the supplemental needs of each of its member agencies. However, in late 2007, MWD first notified its member agencies, including CWA, that it expected considerable supply challenges that would result in insufficient core supplies from the Colorado River and SWP to meet demand. MWD announced it would draw from its Water Surplus and Drought Management supplement storage supplies to meet demands. This action triggered the implementation of CWA's Drought Management Plan, which was developed with member agency input and adopted by CWA's Board of Directors in 2006. The CWA Drought Management Plan contains a list of water management actions available to CWA during drought conditions to avoid or reduce impacts due to supply shortages. These actions are organized into three progressive stages that include: voluntary supply management, supply enhancement, and mandatory cutbacks. The declaration by MWD allowed CWA to proceed with the prescribed actions of its Drought Management Plan as necessary.

In February 2008, MWD's Board of Directors adopted a shortage allocation method. The method allows MWD, in the event of shortages, to allocate water based on uniform reduction by class of water service, with adjustments made for growth, loss of local supply, demand hardening due to implementation of water conservation, and the amount a member agency's dependence on MWD for its total water supply, as well as other water supply related factors.

On February 27, 2009, Governor Arnold Schwarzenegger proclaimed a state of emergency related to the ongoing drought and ordered immediate action to manage the crisis. In the proclamation, the Governor used his authority to direct all State government agencies to utilize their resources, implement a State emergency plan, and provide assistance for people, communities, and businesses impacted by the drought.

In response to continuing drought conditions and regulatory restrictions on water supplies from Northern California, the MWD Board of Directors announced on April 14, 2009, that water supply deliveries from MWD to CWA would be reduced by 13%. This reduced supply allocation would be in effective from July 1, 2009, through June 30, 2010. The final 2010 allocation for each member agency was dependent upon its local production during the allocation year and was determined through a formal local supply certification process with the member agencies. On April 13, 2010, the MWD Board of Directors adopted a resolution recognizing the continuing regional water shortage, and sustaining the prior year's regional water use reduction, allowing for the sale of about 1.96 million AF of MWD water in Fiscal Year 2011.

On April 23, 2009, the CWA Board of Directors took actions to ensure the San Diego region does not exceed its reduced water supply allocation from MWD, implementing water supply cutbacks to its 24 member retail water agencies by approximately 8% (on average), effective July 1, 2009. CWA was able to partially mitigate the cutbacks put forth from MWD. Additionally, the CWA Board of Directors declared a Level 2 Drought Alert (the "Level 2 Drought Alert"), the second level of CWA's four-level model drought ordinance. The Level 2 Drought Alert enables CWA's 24 member retail water agencies to adopt mandatory conservation measures for residents and businesses, including use restrictions and tiered water rates that charge more for excessive water use. See also, "Recent Agency Actions in Response to Drought Conditions" below.

Legislation approved in November 2009 sets a statewide conservation target for urban per capita water use of 20% reductions by 2020 (with credits for existing conservation) at the retail level, providing an additional catalyst for conservation by member agencies and retail suppliers.

Based upon an 8% reduction in water allocation from CWA, for Fiscal Year 2010, the City targeted an 8% reduction in overall water usage. Through active messaging and outreach activities explaining the water supply situation and mandatory water use restriction in effect, the City reduced consumption by 11.6% in Fiscal Year 2010 when compared to the previous Fiscal Year. In Fiscal Year 2011, the reduction in usage from Fiscal Year 2009 amounted to 14%.

By March 30, 2011, Governor Jerry Brown declared California's drought over. Significant rainfall and snowpack had dramatically improved water supply conditions, and the State's reservoirs were all at above average levels. Locally, the City Council voted on May 24, 2011 to end Drought Response Level 2 mandatory water use restrictions. Some more permanent water use restrictions remain in effect.

Recent City Actions in Response to Drought Conditions

As the City purchases approximately 85-90% of its water supply from CWA, the City has been proactive in developing methods to mitigate the exposure the City has to water supply restrictions from MWD or CWA. As such, the City has developed and is consistently developing methods to address its need for water supplies.

Adjustment to projections. Because Fiscal Year 2011 had citywide drought restrictions in place, which have since been lifted, and was an above normal precipitation year, the City's financial projections for the Water System for Fiscal Years 2012 through 2016 reflect an approximate 1% growth rate per year from Fiscal Year 2010 in water deliveries. Fiscal Year 2010, itself was a reduction of approximately 12% from Fiscal Year 2009 sales levels. Staff is of the opinion that this level more accurately reflects the new awareness from consumers as to the needs for ongoing conservation.

Drought action responses. The City has been proactive in responding to anticipated water supply issues with the development of voluntary programs and the development of a formal drought response plan. The City's drought response plan includes four levels and culminates in the declaration of drought emergency conditions. Various water conservation practices are encouraged during Drought Response Level 1 and such practices become mandatory upon the declaration of Drought Response Level 2.

In June 2007, the Mayor endorsed the City's participation in CWA's "20 Gallon Challenge," pursuant to which City residents and businesses were asked to voluntarily reduce the region's water use on average by 20 gallons per person, per day. The 20 Gallon Challenge is monitored on an on-going basis and its results have varied over time. The program was not required by law and any failure to meet the challenge did not result in any penalty to the City.

In July 2008, in response to dry weather conditions and uncertainty about future water deliveries, the City declared a Stage 1 Voluntary Compliance Water Watch (the "Stage 1 Voluntary Compliance Water Watch"), which applies during periods when the possibility exists that the Department will not be able to meet all of the water demands of its customers, and called for voluntary conservation measures pursuant to Division 38 of Article 7 of Chapter 6 of the San Diego Municipal Code as then in effect. Subsequent to such declaration and in connection with a region-wide effort coordinated by CWA to achieve greater county-wide consistency in drought response planning, the City Council approved amendments to the drought response plan set forth in the City's Municipal Code. Pursuant to such amendments, the Stage 1 Voluntary Compliance Water Watch was replaced with Drought Response Level 1, which may be declared by the Mayor upon resolution of the City Council when there is a reasonable probability, due to drought, that there will be a water supply shortage and that a consumer demand reduction of up to 10% is required in order to ensure that sufficient supplies will be available to meet anticipated demands.

On May 5, 2009, the City Council, upon recommendation of the Mayor, declared a Drought Response Level 2 Condition, which is also referred to as a Drought Alert Condition (the "Level 2 Drought Alert Condition"). Pursuant to the revisions to the City's Municipal Code referred to above, a Level 2 Drought Alert Condition is triggered when, due to drought, a consumer demand reduction of up to 20% is necessary in order to ensure that sufficient supplies will be available to meet anticipated demands. Voluntary water use restrictions in effect since July 2008 under the Stage 1 Voluntary Compliance Water Watch became mandatory on June 1, 2009. In addition to specific requirements in the City's Emergency Water Regulations, Water System customers are limited to landscape irrigation between the hours of 6:00 p.m. and 10:00 a.m. on no more than three assigned days per week from June through October and between the hours of 4:00 p.m. and 10:00 a.m. during the months of November through May. Furthermore, customers using standard lawn sprinklers for lawn watering and landscape irrigation are limited to no more than ten minutes per water station on an assigned watering day from June through October and no more than seven minutes per water station on an assigned watering day from November through May.

Locally, San Diego received almost 12 inches of rain as of March 29, 2011, compared to the annual average of 10.77 inches. MWD reported that Diamond Valley Lake was almost full, using abundant rain conditions throughout the State to substantially replenish that reservoir. Precipitation in the Colorado River Basin was recorded at 119% of average, which helped replenish reservoir levels at Lake Mead and Lake Powell.

Because of the improved supply conditions, on April 12, 2011, the MWD Board of Directors voted to lift water allocations imposed by Drought Level 2. The CWA Board voted on April 28, 2011, to end water shortage allocations and lift the call for mandatory water use restrictions. Subsequently, on May 24, 2011, the City Council voted to rescind Level 2 Drought, and Mayor Sanders signed and approved the resolution on May 26, 2011.

Conservation. The Water Conservation Program was established by the City Council in 1985 and promotes permanent water savings. The Water Conservation Program accounted for over 34,800 AFY of potable water savings in Fiscal Year 2011. These savings have been achieved by creating a water conservation ethic, adopting programs, policies, and ordinances designed to promote water conservation practices, and implementing comprehensive public information and education campaigns.

The City utilizes a broad range of conservation methods, including: incentive programs for low-flush toilets and water conserving washing machines, survey programs, regulations, efficient landscaping and irrigation management programs, park and recreation partnerships, and public education and outreach.

The Department works closely with the City's Development Services Department to incorporate water conservation requirements into the City's planning and permitting processes to ensure new communities and properties will have water-efficient landscapes. Changes in water conservation technologies may require periodic reassessment of long-range plans and water conservation programs to ensure that savings are realized. The Department continues to work with its proven water conservation programs while implementing new irrigation management programs to maximize water savings.

City Planning and Resource Management

The City has developed and continues to develop strategic plans for the Water System.

1997 Strategic Plan for Water Supply (the "Strategic Plan"). The City's projected water demands and recommended future supplies were developed through the Strategic Plan, which was completed in 1997. The Strategic Plan estimated water demand through 2015 and identified infrastructure requirements necessary to ensure that facilities were in place to store, treat, and distribute required supplies in an efficient and effective manner. In August 1997, the City Council approved a water rate increase to help fund the initial years of the CIP.

The Strategic Plan called for the doubling of water savings from conservation programs, from 13,000 AFY to 26,000 AFY by calendar year 2005. The City achieved its calendar year 2005 goal, with conservation of approximately 29,400 AFY in that year. The City's continued conservation efforts have resulted in approximately 30,350 AFY, 31,500 AFY, 32,250 AFY, 33,070 AFY, 34,317 AFY, and 34,800 AFY of water savings for Fiscal Years 2006, 2007, 2008, 2009, 2010 and 2011, respectively. These efforts, along with proposed projects for cutting edge technologies such as brackish water desalination, are intended to provide the City with a reliable water supply that is less dependent on imports.

2002 Long-Range Water Resources Plan. In 2001, the City, with the assistance of a 12-member citizen's advisory committee, initiated an update of the Strategic Plan, known as the City of San Diego Long-Range Water Resources Plan ("Long-Range Plan"), which was adopted by the City Council on December 9, 2002.

The objectives of the Long-Range Plan were to extend water demand projections through 2030 and to develop a decision-making framework for evaluating water supply options to meet these demands. The water supply options identified in the Long-Range Plan included water conservation, water reclamation, groundwater desalination, groundwater storage, ocean desalination, marine transport, Central Valley water transfers, and imported supply from CWA and MWD. Various portfolios of water supply options were evaluated against a set of planning objectives to determine the appropriate strategic direction for development of these water resources.

The Long-Range Plan concluded that no single supply source will be sufficient to meet the City's future water demand. The water supply options identified in the Long-Range Plan for implementation were conservation, reclamation, groundwater, and transfers of surplus water from the water agencies in the Central Valley under long-term contracts or as spot commodity purchases.

In April of 2011 the City began work on the 2012 Long-Range Water Resources Plan ("2012 Plan"), which will update the 2002 Long-Range Plan. In developing the 2012 Plan, the City has convened an 11-member stakeholder committee who will provide guidance and input on alternative strategies for meeting San Diego's water needs through 2035. The 2012 Plan will address population growth, water resource diversification, climate change and other issue affecting water reliability. The 2012 Plan is anticipated to be completed in the summer of 2012.

2010 Urban Water Management Plan ("2010 UWMP"). The Department is required by the Urban Water Management Planning Act, California Water Code Sections 10610 through 10657, to prepare and adopt a UWMP every five years, in years ending in five and zero. However, because of recent changes in UWMP requirements, State law (SBX7-7) extended the deadline for the 2010 Plans to July 1, 2011.

On June 28, 2011, the City council adopted the 2010 Urban Water Management Plan.

The City is required to submit the adopted UWMP to the California Department of Water Resources ("DWR") in order to be eligible for water management grants or loans administered by DWR, the State Water Resources Control Board or the Delta Stewardship Council [CWC Sec. 10631.5(a)].

The City's 2010 UWMP describes long-term resource planning responsibilities to ensure adequate water supplies are available to meet existing and future demands. In preparation of the UWMP, the Department coordinated with the San Diego County Water Authority and the local water agencies and cities to which the City sells untreated, potable or recycled water. The 2010 UWMP provides assessments for current demands; supplies over a 20-year planning horizon; and details contingency plans and drought response actions for various drought scenarios. The UWMP serves as the foundation document for Water Supply Assessments and Water Supply Verifications.

Groundwater. The City has several groundwater basins within its jurisdiction, including San Pasqual in the north; San Diego River System in the center of the City comprising the Mission Valley Basin and the El Monte/Santee Basin; the Tijuana River Valley Basin in the south; and the San Diego Formation, a large geological water bearing formation, underlying the southwestern portion of San Diego County along the coast, roughly from Mission Valley to the Mexican border.

The groundwater from these basins is predominantly brackish. Improved technologies for processing brackish groundwater have made these basins feasible for consideration as an affordable water supply source. These groundwater supply sources are a viable alternative and are part of the City's planning and investigative efforts. Local water supply projects, particularly groundwater exploration, benefit City rate payers, offer drought protection, and are locally controlled. The City is presently pursuing groundwater feasibility projects in San Pasqual, El Monte/Santee Basin, Tijuana River Valley Basin, and the San Diego Formation.

In the San Pasqual Basin, the completed San Pasqual Brackish Groundwater Desalination Project, which included a small scale demonstration project, examined the feasibility of building a full-scale desalination facility in the lower western end of the San Pasqual basin. In addition, a planning study for San Pasqual Conjunctive Use that investigates the feasibility of storing and recovering raw water in the upper eastern portion of the San Pasqual basin is complete. Identified in the report are percolation basins alternatives and project costs. The project team is currently focused on investigating the synergies between the potential full scale desalination facility and conjunctive use. Finally, continued efforts are in progress to implement basin recommendations and actions from the Council adopted San Pasqual Groundwater Management Plan 2007 ("GMP"). Actions such as establishing a Salt Nutrient Management Plan and formalizing a Ground Water Elevation Monitoring Network will assist to ensure long term groundwater quality and sustainability. The City is executing a feasibility study in the El Monte/Santee Basin and the San Diego Formation known as the Pilot Production Wells Investigation. The goal of this hydro-geological investigation is to install a well in each of the basins to test the sustainable yield or performance of the basin, evaluate water quality, evaluate potential environmental impacts, and assess appropriate treatment technologies for potable water uses over an approximate two year duration. At the end of the testing period, the City will decide to keep the wells in operation, expand the facilities, or shut down operations depending on the outcome of the investigation in each basin.

Separately, in the future the City will examine the feasibility of using the Tijuana Valley alluvial basin for aquifer storage and recovery ("ASR") to seasonally store recycled water during the wet season, and extract the recycled water from the ground and distribute it to meet maximum day demands during the dry season. A number of issues will be addressed including: useable storage capacity of the alluvial aquifer, the injection or spreading of tertiary treated wastewater into a groundwater system, potential lowering or mounding of the groundwater table near environmentally sensitive lands, potential of inducing sea water intrusion, and the mixing native groundwater with recycled water when extracted and distributed in the recycled water distribution, compliance with Basin Plan objectives, and potential impacts to municipal supply wells in Tijuana.

The City provides public outreach to educate citizens on the benefit of groundwater as a potential water supply and related groundwater project efforts and findings. While the City is pursuing several groundwater projects, groundwater does not currently provide a significant source of water for the City.

Indirect Potable Reuse Demonstration Project (Water Purification Demonstration Project). The City is implementing a Water Purification Demonstration Project to evaluate the feasibility of using AWP on recycled wastewater for eventual augmentation of supplies in a local reservoir. Reservoir water would undergo further treatment before being distributed as drinking water. The AWP Demonstration Facility will operate for 18 months. During the first 12 months of operation the advanced purified water will be frequently tested to determine the effectiveness of the treatment equipment in removing contaminants; the equipment will be monitored for flow-and overall performance; operating data will be gathered and analyzed to refine operation and maintenance estimates for a full-scale system; tours will be conducted as part of the public outreach effort; a study of the San Vicente Reservoir will be conducted to establish residence time and short circuiting conditions of the AWP water in the reservoir and all necessary steps will be taken to ensure that the treatment process meet the requirements set by the California Department of Public Health. A Final Project Report for the Demonstration Project, scheduled for December 2012, will be prepared and serve as a single document describing the results of the Demonstration Project for political decision makers, regulators, and the public. The Demonstration Project is an essential step towards full implementation of the indirect Potable Reuse/Reservoir Augmentation program. On November 18, 2008, the City Council approved a temporary rate increase to fund the $11.8 million Demonstration Project. The rate increase was in effect from January 1, 2009 to September 1, 2010. See "WATER SYSTEM FINANCIAL OPERATIONS – Establishment of Water Service Charges" for a description of the commodity charge increase approved by the City Council and the Mayor to fund the IPR Project.

Recycled Water Study. The City undertook the Recycled Water Study (Study) to identify ways to maximize water recycling. Both non-potable reuse ("NPR") and indirect potable reuse ("IPR") options are being analyzed. A market assessment was performed to estimate potential non-potable demands from new retail and wholesale customers. Potential customers have been identified, and those who are serviceable from existing infrastructure will be the primary target. Expanding the non-potable distribution system to serve new areas has not been found to be cost effective; the potential demand is limited while the facility need is significant. This disadvantage associated with NPR led the study team to pursue other options, namely IPR, for maximizing overall reuse. In terms of IPR, groundwater recharge and reservoir augmentation opportunities were assessed. Information about the City's groundwater basins is insufficient at this time to estimate the magnitude of potential groundwater recharge ("GWR"). IPR through reservoir augmentation is expected to yield the greatest amount of recycled water supply, among the options that have been evaluated. The Study was initiated in late 2009 and is expected to be completed in the spring of 2012.

Recycled Water. The majority of expenses relating to the production of recycled water accrue to the City's Wastewater System, while revenues from the sale of recycled water accrue to the Water System primarily because of a $70 million investment that the Water System made in expanding the non-potable recycled water distribution system ("purple pipe") in the late 1990's. The City has made significant capital investments in the recycled water program. To date, approximately $460 million has been spent on two water reclamation plants (consisting of the North City Water Reclamation Plant (the "NCWRP") and the South Bay Water Reclamation Plant (the "SBWRP"), distribution systems and related facilities. Approximately 25% of those costs were covered by State and federal grants.

Located in the Miramar area, the NCWRP has been operational since 1997 and has a permitted design capacity of 30 MGD. The plant operated at an average flow of 22.1 MGD during Fiscal Year 2011. NCWRP produced an average of 4.6 MGD of recycled water each day that is distributed to users through the Department's Northern Water Distribution System. NCWRP limits its production of recycled water (tertiary treatment) to the amount the Department expects to sell. Sewage that is treated at NCWRP for conversion to recycled water flows to the Department's Northern Service Area Distribution System. Sewage that is treated at NCWRP for discharge into the ocean flows to the Point Loma Wastewater Treatment Plant. Approximately 16.3 MGD of return flow to the Wastewater System results from excess secondary effluent from the NCWRP, which is returned to the collection system for disposal via the Point Loma Wastewater Treatment Plant. As of June 30, 2011, the plant currently served 523 retail customers, two wholesale customers, the City of Poway (1 meter), and the Olivenhain Municipal Water District (2 meters).

The SBWRP is located on Dairy Mart Road, near the international border with Mexico. The SBWRP, which commenced delivery of recycled water to customers in the summer of 2006, has a permitted design capacity of 15 MGD. The average influent flows treated during Fiscal Year 2011 were 8.3 MGD, with average outfall flow of 3.5 MGD and average recycled water distributed of 3.3 MGD. The majority of the recycled water is sold to the Otay Water District, a local water agency with more than 600 meter connections. SBWRP provides recycled water to five retail meters including the U.S. International Boundary & Water Commission Treatment Plant, located just to the east of the water reclamation facility and one wholesale customer, Otay Water District (1 meter).

Recycled water usage is seasonal and is primarily used for irrigation. Customers also use the water for dust suppression or soil compaction at construction sites, in cooling towers, ornamental fountains, and for office building toilet and urinal flushing (dual plumbing). During the summer of 2011, the two reclamation plants met a peak production of approximately 11.1 MGD at NCWRP and a peak production of approximately 7.1 MGD at SBWRP. Conversely, during cooler months, production ranges from two to eight MGD for both reclamation plants. Recycled water production continues to increase each year due to the City's marketing efforts to reach "in-fill" customers, who, as identified by the City's Recycled Water Master Plan 2005, are located near existing recycled water distribution lines.

Current recycled water rates were lowered from $1.34 to $0.80 per hundred cubic feet ("HCF") on July 1, 2001. As of March 1, 2012, the recycled water rate was approximately 20% of the equivalent potable water rate charged to irrigation customers. The Department is currently completing an update to a recycled water pricing study. The scope of the study includes development of recommendations for recycled water commodity rates, base fees, capacity charges, alternative rate structures and a recycled water rate model. Factors included in the pricing study include cost of operation and maintenance for production and distribution facilities, capital costs for the most feasible expansion projects, and marketability of recycled water given current potable water use restrictions and potable water pricing. It is anticipated that the recycled water pricing study will be completed in Fiscal Year 2012. See "WATER SYSTEM SERVICE AREA AND FACILITIES – Water System Service Area" for a description of recycled water produced by the City.

Future City Water Demand

Although the City continues to promote water conservation, the demand for water within the City's service area is projected to increase.

TABLE 8
PROJECTED WATER DEMAND
Fiscal Years 2015 through 2035 (AFY)

2015	2020	2025	2030	2035
240,472	260,211	276,375	288,481	298,860

Source: 2010 Urban Water Management Plan, Public Utilities Department, City of San Diego.

The City anticipates meeting a portion of such increased demand through the development of groundwater resources and the expanded use of recycled water, and the balance through increased purchases of imported water from CWA.

WATER SYSTEM REGULATORY REQUIREMENTS

General

Public water supply systems in the State such as the Water System are primarily regulated by CDPH and, in some limited instances, by the EPA, the SWRCB, and California Regional Water Quality Control Boards ("RWQCBs"). Drinking water delivered to retail customers must comply with statutory and regulatory water quality standards designed to protect public health and safety.

As part of routine operations and maintenance activities, the Department transfers treated water between storage facilities and discharges water to the environment. These transfers and discharges are regulated under the Federal Clean Water Act through general and facility-specific National Pollutant Discharge Elimination System ("NPDES") permits issued by the appropriate RWQCB. Such permits contain numerical effluent limitations, monitoring, reporting, and notification requirements for water discharges from the facilities and pipelines of the Water System. The City is generally operating and maintaining the water treatment and transmission facilities in compliance with the NPDES permit requirements.

Federal Requirements

The City's Water System operations are subject to the provisions of the Federal Safe Drinking Water Act (as amended, the "Safe Drinking Water Act"), which sets forth requirements relating to the protection of drinking water and its sources, including rivers, lakes, reservoirs, springs, and ground water wells, against both naturally-occurring and man-made contaminants that may be found in drinking water. The Safe Drinking Water Act is administered by the United States Environmental Protection Agency (the "EPA"), with direct oversight by CDPH and includes, among other things, primary standards for 104 chemical, microbiological, radiological, and physical contaminants in drinking water and requirements for the preparation of consumer confidence reports, water system operator certifications, water distributions system monitoring, treatment plant monitoring and drinking water source assessments. The Safe Drinking Water Act also requires that every five years the EPA establish a list of contaminants that are known or anticipated to occur in public water systems and may require future regulation under the Safe Drinking Water Act. From this contaminant candidate list, the EPA identifies contaminants that are priorities for additional research and data gathering, which information is then used to determine whether or not a regulation is appropriate. This process is repeated for each list every five years. The EPA completed its latest review in 2009 and no additional primary standards were added to the regulations. The EPA is currently evaluating the risks from several additional compounds and organisms including: microbial contaminants; the byproducts of drinking water disinfection; fire retardants; radon; water systems that do not currently disinfect their water but get it from a potentially vulnerable ground water source; and issues related to water treatment and distribution system operational practices impacting distribution system water storage tanks' water quality. The Department currently complies with all applicable standards and regulations of the Safe Drinking Water Act.

The EPA also establishes Secondary Drinking Water Regulations, which are non-enforceable guidelines for contaminants that may cause negative aesthetic (such as taste or odor) or cosmetic effects (such as tooth discoloration). Water systems are not required to adopt these secondary standards, but states may choose to adopt and enforce them. The State has adopted the secondary standards and the City currently meets all such standards.

State Regulations

As an operator of a large municipal water system, the City is responsible for complying with various State requirements, including the California Environmental Quality Act, as amended (Division 13 of the California Public Resources Code) ("CEQA"), with respect to the operational requirements, design and construction standards for dams and reservoirs, distribution systems and pipelines, requirements for control of Cryptosporidium and other water safety issues and training, and other requirements for certification of water treatment and distribution operators. Failure to meet these standards may subject the City to civil or criminal sanctions. The Department is currently in compliance with all applicable State regulations. See "– Compliance Order by the California Department of Public Health" below.

Proposed Regulations

In December 2006, the EPA promulgated the Stage 2 Disinfectants and Disinfection Byproducts Rule ("Stage 2 DBPR") and the Long Term 2 Enhanced Surface Water Treatment Rule ("LT2"), which built upon prior rules to address protection of public water systems against microbial contaminants, especially Cryptosporidium, and at the same time, reduces potential health risks of disinfection byproducts. The Stage 2 DBPR requires operators of public water systems to determine if they exceed permitted disinfection byproduct concentration levels and, if so, identify actions that may be taken to mitigate future high disinfection byproduct levels. The City has complied with the initial phase of the Stage 2 DBPR and has completed its initial distribution system evaluation and complied with its reporting and monitoring requirements by the compliance deadlines set forth in the Stage 2 DBPR. The City has completed all necessary improvements and expects to comply with the LT2 and all remaining requirements of the Stage 2 DBPR.

Other new regulations, including regulations that are in effect but whose compliance are not yet mandated and regulations that are currently proposed, will continue to impact the operation of the Water System and its associated costs. Also, the costs of proposed new regulations, including rules and regulations regarding radon, groundwater and filter backwash, are currently unknown. See "RISK FACTORS – Statutory and Regulatory Compliance."

Compliance Order by the California Department of Public Health

CDPH is the regulatory agency responsible for ensuring that water systems meet the federal regulations outlined above, as well as additional or stricter State regulations. In January 1994, CDPH notified the City that certain deficiencies in the Water System were found during a routine sanitary survey of the Water System conducted by the CDPH Drinking Water Field Operations Branch. The deficiencies primarily related to the future reliability of various components of the Water System. As a result, the City and CDPH entered into a compliance agreement (the "1994 Compliance Agreement") pursuant to which the City agreed to correct operational deficiencies noted during the survey and undertake the required capital improvements to the Water System by the deadlines established in the 1994 Compliance Agreement. The City was notified in January of 1997 that it was not in compliance with the 1994 Compliance Agreement. At that time, the CDPH issued a compliance order (the "1997 Compliance Order"), which has been amended from time to time, including most recently in May 2007 (as amended to date, the "CDPH Compliance Order"), to include additional items that were not in the 1997 Compliance Order. The CDPH Compliance Order will remain in effect until the projects required thereunder are completed.

The Department believes it has made substantial progress in completing the projects set forth in the CDPH Compliance Order and is currently meeting the ongoing requirements thereof, including the obligation to provide CDPH with quarterly progress reports and hold periodic status meetings. In addition, on February 26, 2007, the City authorized rate increases of 6.5% per year for Fiscal Years 2008 through 2011 to finance projects mandated in the CDPH Compliance Order as well as other CIP projects.

CDPH has the authority to impose civil penalties if the City fails to meet CDPH Compliance Order deadlines, although CDPH has not imposed such penalties to date. Violation of the CDPH Compliance Order may be subject to judicial action, including civil penalties specified in California Health and Safety Code Section 116725 ("Section 116725"). Pursuant to Section 116725, a violation of a schedule of compliance for a primary drinking water standard may result in a maximum penalty of $25,000 per day for each violation; and a violation of other standards, such as turbidity, the penalties can reach $5,000 per day. There are a number of additional enforcement tools prescribed by law, including public notification, citations, citations with fines, public hearings, 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 March 1, 2012, the estimated CDPH Compliance Order project costs for Fiscal Years 2012 through 2016 totaled approximately $260.4 million. The Department anticipates financing such costs with existing net assets, present and future revenues, and financing proceeds secured by system revenues provided, however, there can be no assurance that any or all of such financing sources will be available or secured.

Permits and Licenses

The Water System holds a Water Supply Permit from the CDPH for operation of its facilities (the "Water Supply Permit"). The City is required to apply for an amendment to its Water Supply Permit as changes occur within the Water System, including the capacity and process improvements at the water treatment plants. The City works closely with the CDPH during the design, construction and subsequent operations of all improvements that result in amendments to the Water Supply Permit to ensure amendment approval. Various other permits and licenses are required to operate the water treatment plants, water impounding system, water quality lab and distribution system. Such permit requirements address issues such as surface water treatment, disinfection and disinfection byproducts rules, regulations governing groundwater to address waterborne disease and microbial contamination, and rules on the monitoring, reporting and treatment requirements of public water systems associated with lead and copper. The City does not anticipate any problems with continued Water System operation under existing and planned future permits and licenses.

Dam Licensing and Safety Issues

In 1929, the California Legislature enacted legislation providing for supervision over non-federal dams in the State. The statutes place the supervision of the safety of non-federal dams and reservoirs under the jurisdiction of the California Department of Water Resources' Division of Dam Safety ("DSOD"). Dams under jurisdiction are artificial barriers, together with appurtenant work, including outlet towers, which are twenty-five feet or more in height or have an impounding capacity of fifty AF or more. Any artificial barrier not in excess of six feet in height, regardless of storage, or that has a capacity not in excess of fifteen AF, regardless of height, is not considered jurisdictional. The City has thirteen dams under the jurisdiction of the DSOD.

The DSOD reviews plans and specifications for the construction of new dams or for the enlargement, alteration, repair or removal of existing dams, under applications, and must grant written approval before the owner can proceed with construction. The DSOD routinely inspects operating dams to assure that they are adequately maintained. The DSOD also conducts investigations of selected dams and directs the owners to additional investigations and detailed safety evaluations when necessary. DSOD may impose capacity restrictions on dams that may restrict reservoir capacity.

WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM

The Capital Improvement Program

The Water System Capital Improvement Program ("CIP") consists of five fundamental driving forces: replacement of aging infrastructure to reduce pipeline breaks and emergency repairs; increasing treatment capacity; improving process technology; expansion of the Water System to accommodate growth; and compliance with the Federal Safe Drinking Water Act and the CDPH Compliance Order. In February 2007, the City Council adopted rate increases of 6.5% per year for Fiscal Years 2008 through 2011 to help finance capital improvement projects, including projects related to water treatment plants, pipelines, reservoirs and pump stations, projects related to anticipated growth within the City's service area, annual allocation project groups and projects required by or related to applicable State and Federal regulations and orders. The Department has completed approximately $398 million of $585 million of projects projected in the 2007 Rate Case for Fiscal Years 2008 through 2011. Several factors contributed to the lower than anticipated expenditures including: lower construction costs due to the slow economy, lower than anticipated inflation, and the delay in the ramp-up of CIP in 2008. The delayed projects are now on track and are scheduled to be completed by Fiscal Year 2014. This delay has not impacted compliance with CDPH mandates and the Department has met all material requirements to date. Additionally, the Department has exceeded the award of pipeline construction projects, when compared to the 2007 Rate Case. The CIP remains subject to change and is expected to include additional projects for implementation subsequent to 2011, based on the program priorities explained previously.

Description of Major Projects

The Department has developed a comprehensive CIP to address current and future Water System needs. See "– Project Schedule and Costs" below.

The CIP projects can be classified into one of nine categories as they relate to the Water System. The map that follows the Table of Contents of this Official Statement shows the location of the major CIP projects. Brief descriptions of the projects in each of the categories are provided below.

Water Treatment Plants. The Department has completed the rehabilitation and upgrade of the three Water Treatment Plants; Alvarado (AWTP), Miramar (MWTP), and Otay (OWTP). These upgrades, once they have been officially rated by CDPH will increase the capacity for the AWTP from 120 MGD to 200 MGD, the MWTP from 144 MGD to 215 MGD, and the OWTP from 34.2 MGD to 40 MGD to meet future water demands through 2030. These improvements to the water treatment plants will facilitate the City in complying with the requirements of the Federal Safe Drinking Water Act and the CDPH Compliance Order. See "WATER SYSTEM REGULATORY REQUIREMENTS – Federal Requirements" and " – Compliance Order by the California Department of Public Health."

Pipelines. The CIP includes pipeline projects relating to the continued rehabilitation, replacement, and installation of distribution and transmission lines throughout the Water System. The Department continues with the awarding of contracts for the replacement of approximately 20 miles per year of existing cast iron mains and anticipates the awarding process will reach completion by Fiscal Year 2015. The Department is also assessing its transmission pipelines and is scheduling the replacement of these pipelines based on the system needs and available funds.

Pump Stations. The CIP includes projects that will replace, rehabilitate and construct pump stations throughout the Water System.

Raw Water Storage Facilities. The CIP includes projects that will upgrade the raw water outlet structures on three reservoirs and make emergency auxiliary spillway improvements at the Lower Otay Reservoir. Of the three outlet structures, the Barrett outlet structure has been completed, the Morena outlet is in design, and the Otay outlet and auxiliary spillway has been postponed two years, due to ongoing improvements at the San Vicente Dam.

Treated Water Storage Facilities. The rehabilitation and construction projects that were completed through Fiscal Year 2011 have increased the treated water storage capacity by 6% as compared to the amount available on July 1, 1998.

Recycled Water Facilities. The North City Reclamation Distribution System Expansion includes Camino Del Sur – North of SR-56, Carmel Valley Recycled Water (RW) pipeline, Los Penasquitos RW pipeline, Pacific Highlands – Developer Participation Agreement, and Recycled Water System Upgrades. The Carmel Valley pipeline has been installed and awaiting pressure testing before acceptance by the City. Both the Los Penasquitos and Pacific Highlands projects are in construction. The Recycled Water System project is in bid and award phase and the Camino Del Sur project is in design.

Groundwater Projects. See "WATER SUPPLY – Recent City Actions in Response to Drought Conditions – Groundwater" for a description of groundwater feasibility projects being explored by the City in San Pasqual, Mission Valley, and the San Diego Formation.

Security Projects. The water security projects include adding cameras, motion detectors, access control elements, and eight-foot high fences to water facilities. The facilities include nine lakes and dams, three treatment plants, an operations yard, 40 pump stations, 20 water tanks, five regulators and 50 pipeline locations. Communication elements will be installed so that all camera images can be monitored from a security operations center.

Miscellaneous Projects. Miscellaneous CIP projects include air valve adjustments, corrosion control for existing facilities, installation of pressure reducing stations, and installation of flow meters.

Project Schedule and Costs

The Department, in conjunction with the Public Works-Engineering Department ("PWED") (formally known as Engineering & Capital Projects) has recently re-evaluated the Water System's proposed CIP program. This re-evaluation takes into consideration the ongoing trend of lower construction bids and the completion of the majority of the planned treatment plant upgrades, the concerted conservation efforts leading to reduced water demands and treatment capacity needs, re-prioritization of the focus of the CIP program on the maintenance of the distribution system from the treatment plants, and the restructuring of certain City departments. As a result, the priorities of the CIP program are now focused on accelerating the repair and replacement of the water distribution system and the identification and implementation of projects to develop new sources of water. Through diligent efforts, the Water System has completed the majority of the projects listed in the previously described CDPH Compliance Order. The remaining Compliance Order project is awarding contracts for 10 miles of cast iron water main replacement per Fiscal Year.

The current cost estimate of CIP projects for the period from Fiscal Years 2012 through 2016 is approximately $471.1 million, and the cost estimates are subject to change. The budget for each project and program is established and approved by the City Council and adjustments to such budget require approval of the City Council.

The following table shows categories of projects with the estimated cost of expenditures contained in the CIP for the period of Fiscal Years 2012 to 2016. Final CIP project costs will be refined as the CIP progresses.

TABLE 9
SUMMARY OF PROJECTED CIP PROJECTS (1)
Fiscal Years 2012 through 2016

Description	2012	2013	2014	2015	2016	Total
Water Treatment Plants	$ 1,665,810	$ 922,940	$ 0	$ 4,860,253	$24,920,770	$ 32,369,773
Pipelines	65,115,830	65,741,747	71,512,803	78,094,726	62,191,851	342,656,957
Pump Stations	2,918,184	17,713,284	7,668,526	155,891	207,000	28,662,885
Storage Facilities (2)	4,055,489	3,776,762	8,047,960	3,944,293	2,144,520	21,969,024
Reclaimed Water Facility	2,243,907	4,831,296	87,345	0	0	7,162,548
Groundwater	200,000	512,500	515,000	1,030,000	5,175,000	7,432,500
Security	5,074,673	4,565,495	1,442,800	0	0	11,082,968
Miscellaneous	2,650,759	6,192,198	8,550,964	2,327,518	0	19,721,440
Total (3)	$83,924,652	$104,256,222	$97,825,398	$90,412,681	$94,639,141	$471,058,094

(1) Amounts reflect the aggregate costs of all CIP projects required to satisfy the CDPH Compliance Order as well as projects related thereto or necessary for the operation thereof. For Fiscal Years 2012 through 2016, approximately 55% of the capital program is mandated by CDPH.
(2) Storage facilities include treated and untreated water reservoirs.
(3) Totals may not add to total due to independent rounding.
Source: Public Utilities Department, City of San Diego.

Financing Plans for the CIP

The CIP is funded through a combination of System Revenues, bond proceeds, grants, and State Revolving Fund loans. The Department currently expects that approximately 80% of the costs of the CIP through Fiscal Year 2014 will be funded with a combination of existing bond proceeds, grants, and State Revolving Fund loans. The City currently anticipates that in Fiscal Year 2014 a new bond issuance of approximately $111 million will be necessary to fund the CIP in Fiscal Years 2014 and 2015, followed by another issuance of approximately $154 million to fund the CIP in Fiscal Years 2016 and 2017. If the Department is successful in obtaining new grants or SRF loans during this time frame, their proceeds will reduce the amounts of the projected Fiscal Year 2014 and 2016 bond issuances.

Approximately 20% of the remaining costs of the CIP will be paid on a pay-as-you-go-basis, which are supported by currently approved water rates. See "WATER SYSTEM FINANCIAL OPERATIONS – Financial Projections and Modeling Assumptions." These projected costs include an annual inflation range of 2.5% - 3.5% due to anticipated increases in construction costs over time.

The Department has distinguished between repair and replacement and expansion CIP costs to properly apply revenue sources. New customers will benefit from capacity created by expansion projects. These projects will be funded by capacity charges, grants and financing proceeds. Capacity charge revenues are projected to be $6.1 million for Fiscal Year 2012 and $7.0 million per year thereafter through Fiscal Year 2016.

Environmental Compliance

The projects contained in the CIP are generally subject to CEQA. Under CEQA, a project that may have a significant effect on the environment and that 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 that 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 that would result from the project. Approximately 6% of CIP projects reviewed between August 2008 and July 2011 were covered under a previously certified EIR. 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. There were no Negative Declarations prepared for CIP projects reviewed between August 2008 and July 2011. 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. Approximately 44% of CIP projects reviewed between August 2008 and July 2011 were covered by a previously certified MND, or resulted in either the preparation of an MND or Addendum to an MND. Statutory exemptions are activities that are not subject to CEQA. CIP projects can also be exempted if they fit a specific "category" of activities identified by the State Legislature. Between August 2008 and July 2011, approximately 50% of CIP projects qualified for either a statutory or categorical exemption. 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 of the CIP projects and evaluates the projects 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 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 CIP within the contemplated budget or the current timetable.

Project Management for the CIP

Prior to October 2007, the engineering design and construction of CIP projects, as well as their planning and attendant program controls, were all conducted by personnel within the Department. A reorganization of engineering functions for the City as a whole, including the Department's divisions and their respective responsibilities, resulted from recommendations of a steering committee assembled as part of the City's Business Process Reengineering program initiative to enhance the efficiencies and effectiveness of City government by, among other things, reviewing and improving City processes and procedures. The recommendations were presented to the Chief Operating Officer and Mayor and approved by the City Council. Project management, engineering design and construction of all CIP projects, including Water CIP projects, are now managed by CIP project managers in the PWED. Planning of, and program controls for Water CIP projects are conducted and monitored by the Engineering and Program Management Division ("EPM") of the Department. See "WATER SYSTEM ORGANIZATION AND MANAGEMENT – Governance and Management of Water System."

PWED provides a full range of engineering services for the City's capital investment in its various types of infrastructure. PWED is responsible for the planning, design, project management, and construction management of public improvement projects; quality control and inspection of private work permitted in the right-of-way; and surveying and materials testing. PWED's activities include work on various public infrastructure assets to rehabilitate, restore, improve, and add to the City's capital facilities. PWED's activities cover a wide range of City-wide projects including: libraries; fire, lifeguard and police stations; parks and recreation centers; lighting and signals, street improvements, bikeways and other transportation projects; drainage and flood control facilities; rebuilding and expanding water and wastewater pipelines, treatment plants, and pump stations; and dry utilities under-grounding projects. These functions are provided through four of the five divisions within PWED.

Architectural Engineering & Parks Division. This division manages the implementation of non right-of-way and vertical capital improvement projects. This responsibility includes the design and project management of water treatment plants, reservoirs and pump station projects.

Right-of-Way Design Division. This division manages the implementation of right-of-way and related horizontal capital improvement projects, including the design and project management of water pipelines, flood plains and drainage infrastructure, and utilities under-grounding projects.

Field Engineering Division. This division manages construction contracts, materials testing, land surveying services and geological assessment/support. This responsibility includes quality assurance/quality control inspection of CIP projects within the City's jurisdiction.

Project Implementation and Technical Services Division. This division provides centralized technical, operational and project support services to the other divisions within the PWED , as well as to other departments in the City, including the Department. These services include preliminary engineering, project controls, CIP fund management, Americans with Disabilities Act compliance review for CIP projects, quality control and standards, and environmental and permitting assistance.

Contract Disputes

From time to time, the City is engaged in disputes with the contractors and subcontractors working on the CIP. As of January 3, 2012 there is one pending contract dispute claim in the amount of $1.2 million in alleged damages.

Insurance

The City requires the consultant or contractor selected to design or construct a 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.

WATER SYSTEM FINANCIAL OPERATIONS

Establishment of Water Service Charges

The primary sources of moneys deposited in the Water Utility Fund are derived from revenues generated by Water Service charges to City residents and commercial enterprises, capacity charges on new, additional, or larger connections to the Water System within the City, and interest income on fund balances. Water Service charges to City utility customers are collected on a municipal water bill, which also includes sewer charges and storm drain fees. Bills are rendered on a bi-monthly basis for single family and most multi-family dwellings and on a monthly basis for industrial, commercial, and large multi-family 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 meet customer demand for water and pay for required capital improvements. Staff within the Water System and senior management within the City analyze rates and charges to determine the amounts necessary to support the Water 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.

Subsequent to consideration of the recommendations set forth in the 2007 Rate Case, in February 2007 the City Council adopted rate increases of 6.5% per year, effective every July 1, for Fiscal Years 2008 through 2011 in compliance with the requirements of Proposition 218. The rate increases were based on comprehensive forecasted annual Operation and Maintenance expenditures and additional capital costs for the Fiscal Years 2008 through 2011, which were based upon the City's budgeted Fiscal Year 2007 expenditures, adjusted for changes since the budget was developed and for anticipated changes in operations and the effect of inflation in future years. See "WATER SYSTEM FINANCIAL OPERATIONS – Operation and Maintenance Expenditures." Based on the last retail rate increase, which occurred on March 1, 2011 and is still in effect today, the typical single family residence monthly water bill of $72.03 is approximately 1.4% of median household income in the City.

The water fees are composed of two components: a base fee and a commodity charge. The base fee is determined by the size of a customer's meter, and is charged to the customer regardless of whether the customer uses water. The base fee is based upon the assumption that the Department incurs certain costs in order to be in a position to serve the commodity to the water customer upon demand. Those costs are incurred by the Department regardless of whether the customer uses the commodity or not. They include such costs as the general administrative costs of the Department for billing, payment processing, and account management related to the Water System. The size of the customer's connection provides an approximation of the amount of water the customer conceivably could have delivered to his or her property.

The commodity charge is a charge for the amount of water consumed. The commodity charge is set at a rate based upon hundred cubic feet (HCF) of water consumed. Currently, the City has two types of commodity charges: a three-tiered rate for SFR, and a separate single rate for each of the other customer classes, including multi-family residential, commercial/industrial, and temporary construction/irrigation. The three-tiered rate structure for SFRs assesses a higher charge per unit of water as the level of consumption increases.

The City has historically increased water rates to reflect increases in the cost of water purchased from CWA, which increases are generally based on the costs for the infrastructure, operation and maintenance of CWA's water supply system and the cost CWA pays to purchase water from MWD. CWA generally increases the rates it charges on an annual basis with its Board of Directors approving the rates in June to be effective the following January. Following a CWA announcement of higher rates, the City generally calculates the impact to its cost of purchased water and the rate adjustment it would need to make to its customers to recover those increased costs. If a rate increase is proposed, the City would then follow the procedures necessary to satisfy Proposition 218's public notice and hearing requirements and procedures established by the City for receiving and tabulating protests against increases to water rates. The City Council would then act on the proposed rate adjustments for the recovery from the City's water customers of increased costs resulting from CWA's rate increases. The purchased water cost increase typically affects both the base fee and commodity charges within the City's water billing structure.

On April 13, 2010, the MWD Board of Directors approved a 7.5% increase to the cost of purchased water to be effective January 1, 2011, and a 7.5% increase to the cost of purchased water to be effective January 1, 2012 for all of MWD's member agencies, including CWA. On June 24, 2010, the CWA Board of Directors approved passing the increased costs through to its member agencies, with the effective date of January 1, 2011 for the specific rate increases. Based upon projected water usage by the City and the number of water meters within the City's service area, the anticipated increase to the City for calendar year 2011 was projected to be approximately $25.2 million. In determining whether and by what amount to increase its water rates to reflect increases in the cost of water purchased from CWA, City staff calculated that base fees would need to be raised by a range of 2.5% on residential customers to 3.7% on the largest connections, and that the commodity rates would need to be raised by 5.9% on all customer classes. The City was, however, able to offset these increased costs, for a portion of 2011, with approximately $4 million of identified operational savings, and thereby delay passing the related rate increase through to its customers from January 1, 2011 to March 1, 2011. The remaining approximately $21.5 million of costs was passed through by the City to its customers for the 2011 calendar year. For the current year and hereafter, the Department projects that the entire increased cost attributable to the January 1, 2011 CWA rate increases, estimated at approximately $25.2 million per calendar year, will be passed through by the City as increased costs to its customers. The Department has included these costs and corresponding revenue in its operations and maintenance projections.

On June 23, 2011, the CWA Board of Directors approved passing the second round of increased costs through to its member agencies, with the effective date of January 1, 2012 for the specific rate increases. Since that time, the City has taken and is taking a variety of steps to offset this second round of increased costs from CWA, including by absorbing the increased purchase water costs through other cost controls, and has not passed through such increased costs to its customers. The City has identified some operational efficiencies, but the bulk of the savings will need to come from the ability to utilize more of its local water in storage, thereby buying less water from CWA. The amount of CWA's "pass-through" increase attributable to calendar year 2012 (the second half of Fiscal Year 2012 and the first half of Fiscal Year 2013) would be approximately $17.5 million. The City expects similar costs in subsequent calendar years attributable to these January 1, 2012 CWA rate increases and has included these costs in its operations and maintenance projections. The City is aware that MWD has reported that its water rates and charges are currently projected to increase by 7.5% on January 1, 2013, 5.0% on January 1, 2014 and 3.0% annually thereafter. The impacts of these reported rate increases on CWA calendar year 2013 rates, and therefore City water purchase costs, are not known.

As in prior years, the City is taking a variety of steps to offset the increasing price of water from CWA, including reducing its overall operations and maintenance costs, thereby mitigating some or all of the impact of these wholesale cost increases. In the near term, the City expects to utilize more of its local water in storage, thereby buying less water from CWA.

The Department is in the beginning stages of a Cost of Service study ("COSS") that will review the following: revenue requirements for the water and wastewater systems, including capacity fee requirements for Fiscal Years 2014 - 2017; allocation of costs among all customer classes; and a rate design that reflects the true cost of providing service to each class. The study should be complete by the end of calendar year 2012.

The following table sets forth the five-year Water Service charge for each customer class from Fiscal Years 2007 through 2011.

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TABLE 10
FIVE-YEAR WATER SERVICE CHARGE HISTORY FOR SINGLE FAMILY RESIDENTIAL, MULTI-FAMILY, COMMERCIAL, INDUSTRIAL, IRRIGATION, AND TEMPORARY CONSTRUCTION
Fiscal Years 2007 through 2011

Justification for Increase:		Revenue Requirement	Revenue Requirement	Increase in Water Costs from CWA	Revenue Requirement	Increase in Water Costs from CWA and IPR Project	Revenue Requirement	Increase in Water Costs from CWA	Revenue Requirement	Revenue Requirement	Revenue Requirement	Increase in Water Costs from CWA
	Increase amount:	Approx. 9.0%	6.5%	$0.14/EDU	6.5%	$0.20/EDU	6.5%	$0.12/EDU	6.5%	0%	0%	$0.47/EDU
BASE FEES [1]		7/1/06	7/1/07 [3]	1/1/08	7/1/08	1/1/09	7/1/09	1/1/10	7/1/10	9/1/2010	1/1/2011	3/1/2011
Meter Size:	5/8 inch	$15.87	$15.18	$15.32	$16.32	$16.52	$17.59	$17.71	$18.86	$18.86	$18.86	$19.33
	3/4 inch	15.87	15.18	15.32	16.32	16.52	17.59	17.71	18.86	18.86	18.86	19.33
	1 inch	17.11	22.17	22.41	23.86	24.20	25.77	25.97	27.66	27.66	27.66	28.46
	1 1/2 inch	75.41	38.13	38.59	41.10	41.76	44.47	44.87	47.79	47.79	47.79	49.34
	2 inch	116.24	58.09	58.83	62.66	63.72	67.86	68.50	72.95	72.95	72.95	75.44
	3 inch	414.73	104.98	106.38	113.29	115.29	122.78	123.90	132.04	132.04	132.04	136.74
	4 inch	692.00	171.83	174.17	185.49	188.83	201.10	203.10	216.30	216.30	216.30	224.15
	6 inch	1,542.72	337.46	342.12	364.36	371.02	395.14	399.14	425.08	425.08	425.08	440.73
	8 inch	2,081.78	537.01	544.47	579.86	590.52	628.90	635.30	676.59	676.59	676.59	701.64
	10 inch	2,793.63	770.49	781.23	832.01	847.35	902.43	911.63	970.89	970.89	970.89	1,006.94
	12 inch	3,892.44	1,435.00	1,455.06	1,549.64	1,578.30	1,680.89	1,698.09	1,808.47	1,808.47	1,808.47	1,875.82
	16 inch	6,514.14	2,499.62	2,534.62	2,699.37	2,749.37	2,928.08	2,958.08	3,150.36	3,150.36	3,150.36	3,267.86
COMMODITY CHARGE												
Customer Type:	Usage [4]:	7/1/06	7/1/07	1/1/08	7/1/08	1/1/09	7/1/09	1/1/10	7/1/10	9/1/2010	1/1/2011	3/1/2011
	Increase amount:	4.5%	6.5%	$0.09/HCF	6.5%	$8.5% (CWA) and 3.08%(IPR)	6.5%	10.6%	6.5%	-3.86%(IPR Sunset)	-2.16% (CWA)	7.90% (CWA)
Single Family Residential												
Tier 1	0-7 HCF	$1.731	$2.262	$2.352	$2.505	$2.795	$2.977	$3.293	$3.507	$3.410	$3.348	$3.612
Tier 2	8-14 HCF	2.163	2.461	2.551	2.717	3.032	3.229	3.571	3.803	3.698	3.630	3.917
Tier 3	15+ HCF	2.372	2.775	2.865	3.051	3.404	3.625	4.009	4.270	4.152	4.076	4.398
Typical Single Family Monthly Bill Based on 14 HCF/month		43.13	48.24	49.64	52.87	57.31	61.03	65.76	70.03	68.62	67.70	72.03
Multi-Family [2]	per HCF[5]	2.003	2.461	2.551	2.717	3.032	3.229	3.571	3.803	3.698	3.630	3.917
Commercial [2]	per HCF[5]	2.003	2.357	2.447	2.606	2.908	3.097	3.425	3.648	3.547	3.482	3.757
Industrial [2]	per HCF[5]	2.003	2.357	2.447	2.606	2.908	3.097	3.425	3.648	3.547	3.482	3.757
Irrigation [2]	per HCF[5]	-	2.524	2.614	2.784	3.107	3.309	3.660	3.898	3.790	3.721	4.014
Temporary Construction [2]	per HCF[5]	-	2.524	2.614	2.784	3.107	3.309	3.660	3.898	3.790	3.721	4.014

(1) The base fee is dependent on the meter size.
(2) On July 1, 2007, the City established separate categories for Multi-Family, Commercial/Industrial, and Irrigation/Temporary Construction.
(3) Decrease in base fees for 2-inch and smaller meters reflect the 2007 Rate Case and pricing methodologies revised to reflect American Water Work Association methodologies.
(4) HCF (Hundred Cubic Feet) = 748 gallons.
(5) One rate for all usage amounts.

Source: Public Utilities Department, City of San Diego.
Note: No rate increase in January 2007.

Water Service Charges. The Water System's water service charge for all retail user classes includes a fixed base fee and a commodity rate. While the service charge is charged to each water meter and varies with meter size, the commodity rate is applied to a customer's water usage.

The City has a tiered commodity rate structure for SFR customers that is broken down by water usage within each rate block. The remaining retail customers (Multi-Family, Commercial, Industrial, Temporary Construction, and Irrigation) are billed under the same uniform commodity rate for their respective customer classification. See Table 10 for a schedule of commodity rate(s) applicable to each customer class and the base fees for the various water meter sizes in the Water System through Fiscal Year 2011, which were adopted by the City Council and are still in effect for Fiscal Year 2012.

Capacity Charges. In February 2007, the City Council and Mayor approved raising the capacity charge by 19.5% to $3,047 per EDU, which was estimated to provide for full cost recovery for Water System expansion projects planned through Fiscal Year 2015. The City will be undertaking a cost of service study in calendar year 2012 to determine, not only new water rates to be implemented in Fiscal Year 2014, but also the amount of the new capacity charge, if necessary. The water used by a typical SFR is equated to one EDU and equals 500 gallons per day. Non-residential customers are charged based upon calculated usage or an inventory of plumbing components that are assigned a number of "fixture units," which are converted to EDU's using a conversion factor that equates 20 fixture units to one EDU. The minimum capacity assigned to any user is one EDU.

Capacity charges are not treated as operating income for financial reporting purposes but are considered System Revenues and are deposited in the Water Utility Fund. Pursuant to State law, capacity charges can be applied only for the purpose of paying costs associated with capital expansion, bonds, contracts, or other indebtedness of the Water System related to expansion. Because capacity charges are primarily collected on new construction within the City, revenues obtained from such charges vary based upon construction activity.

The following table sets forth the capacity charges for Fiscal Years 2007 through 2012, which have been adopted by the City Council.

TABLE 11
RECENT RATE HISTORY
FOR WATER CAPACITY CHARGES
Fiscal Years 2007 through 2012

Fiscal Year	Water Capacity Charges (Per EDU)	% Increase/ (Decrease) [1]
2007	2,550	0.0
2008	3,047	19.5
2009	3,047	0.0
2010	3,047	0.0
2011	3,047	0.0
2012	3,047	0.0

(1) Figure represents percentage change from prior year.
Source: Public Utilities Department, City of San Diego.

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The following table sets forth the historical capacity charge revenues from Fiscal Years 2007 through 2011. Aggregate capacity charge revenues may not equal the amount derived by multiplying the water capacity rate by the number of units because of individual customer account characteristics. Since capacity charge revenue is dependent on development activity within the City, capacity charge revenues are impacted by the slowdown in residential construction.

TABLE 12
WATER UTILITY FUND
HISTORICAL CAPACITY CHARGE REVENUES
Fiscal Years 2007 through 2011(1)

Fiscal Year	New Equivalent Dwelling Units	Capacity Charge Revenues (1)
2007	5,788	$13,682,238
2008	4,337	9,697,815
2009	1,826	4,232,469
2010	1,567	4,486,143
2011	2,474	7,516,512

(1) Fiscal Year 2007 – 2011 Included with Capital Contributions on Statement of Revenues, Expenses and Changes in Net Assets in the Comprehensive Annual Financial Report of the indicated Fiscal Year.
Source: Office of the Comptroller and Public Utilities Department, City of San Diego.

Collection of Water Service Charges

In order for a person to receive service and be billed by the City for water fees, he or she must contact the Department to have Water Service initiated. The person initiating the service does not have to be the owner of the property to which the water is delivered. Regardless of customer class, the customer has a meter from which the City measures the amount of the water consumed. The meter is read by the Department to calculate the water fees to be charged to the customer based on his or her customer class.

Pursuant to the approved policies and procedures, 100% of the water used is billed, no matter how far back the water usage occurred, and time extensions for payment are granted by Department management under limited conditions, including health and safety-related reasons, legal negotiations, or the negative impact on other ratepayers in the absence of a grant of extension. Such policies and procedures also provide that the Department has the authority to grant a deferred payment in only two circumstances: a customer receiving a bill greater than 200% of the usage on their normal bill (in which case such customer can only receive a deferred payment plan once during the life of the account, and the total payment must be received within one year) and a customer being back-billed for services received but previously unbilled (in which case the total amount due must be paid within one year or referred to City Treasurer if a longer, deferred-payment plan is required). Further, the approved policies provide that a deposit, for those customers requiring one, will be equal to two average billing periods and a fee of $25 will be imposed per returned check.

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 2007 through 2011, accounts receivable amounts outstanding for more than 120 days ranged from approximately $1.9 million to $3.6 million. Water service charges to City utility customers are collected on the municipal water bill, which also includes sewer charges and storm drain fees. Bills are currently invoiced every two months for single family dwellings and most multi-family dwellings and on a monthly basis for all other customers.

The following table sets forth information related to accounts receivable and number of shut-offs.

TABLE 13
WATER CUSTOMER ACCOUNTS RECEIVABLE
AND SHUT-OFFS BY FISCAL YEAR
Fiscal Years 2007 through 2011
(Dollar Amounts in Thousands)
(Unaudited)

	2007	**2008**	**2009**	**2010**	**2011**
Water Sales Revenue [(1)]	$289,127	$297,225	$324,772	$354,543	$358,747
Accounts Receivable [(2)]	$ 28,126	$ 25,995	$ 25,311	$ 29,817	$ 19,359
Accounts Receivable Over 120 Days [(2)]	$ 3,644	$ 2,939	$ 2,190	$ 2,396	$ 1,861
% of Total Water Sales Revenues [(3)]	1.26%	1.00%	0.67%	0.68%	0.52%
Number of Shut-Offs [(4)]	20,451	22,420	23,650	26,875	23,271

(1) Fiscal Years 2007-2011 are audited. All other items are unaudited.
(2) Amounts are as of June 30, and represent the receivable portion of billed customer accounts as of the end of each Fiscal Year. Not included are amounts for unbilled accounts as of June 30.
(3) Percentage of Accounts Receivable over 120 days as compared to Total Water Sales Revenues.
(4) Shut-Offs for non-payment may include multiple shut-offs at the same address throughout the Fiscal Year.

Sources: The City's Comprehensive Annual Financial Reports for the indicated Fiscal Years 2007-2011 with respect to "Water Sales Revenue." Public Utilities Department and Office of the Comptroller, City of San Diego, for all other line items.

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Revenues

The Water Utility Fund's principal source of revenues is Water Service charges to City residents and commercial enterprises. The following table sets forth the historical sources of water sales revenues of the Water Utility Fund for Fiscal Years 2007 through 2011.

TABLE 14
HISTORICAL SOURCES OF WATER SALES REVENUES [(1)]
Fiscal Years 2007 through 2011
(In Thousands)

Sources	2007	2008	2009	2010	2011
Retail					
Single Family Residential	$114,461	$126,373	$132,806	$148,262	$155,958
Multi-Family [(2)]	61,754	62,404	67,529	80,065	81,662
Commercial	93,042	87,465	100,581	104,819	101,200
Industrial	3,091	2,718	3,050	3,723	3,749
Reclaimed	5,528	5,867	7,737	4,488	4,129
Outside City	144	46	52	52	52
Wholesale to Other Retailers					
Other Utilities [(3)]	9,776	9,809	10,238	10,718	9,747
Water Districts	1,331	2,543	2,779	2,416	2,250
TOTAL [(4)]	$289,127	$297,225	$324,772	$354,543	$358,747

(1) Referred to as Historical Sources of Service Revenues in the City's previous continuing disclosure certificates.
(2) Previously listed as "Other Domestic" customer type.
(3) Primarily reflects wholesale revenues from California American Water Company.
(4) Fiscal Years 2007-2011 totals are audited. All other line items unaudited.
Source: The City's Comprehensive Annual Financial Reports for Fiscal Years 2007 through 2011 for Total; Public Utilities Department and Office of the Comptroller, City of San Diego for all other line items.

The four annual water rate increases approved in February 2007 and described previously, along with rate increases related to increased costs for purchased water from CWA, increased Water Service Charge revenues from approximately $289 million in Fiscal Year 2007 to $359 million in Fiscal Year 2011 and included 6.5% annual rate increases in Fiscal Years 2008 through 2011, but do not include revenues generated by purchase water cost increases that were affected as a result of rate increases implemented by CWA. Table 10 herein sets forth the Water System's Water Service rate increases from Fiscal Years 2007 through 2011. Rate increases related to increased costs from CWA are subject to approval by the City Council and Mayor following the required Proposition 218 noticing process on an ad hoc basis as cost increases become effective.

Operation and Maintenance Expenditures

Operation and Maintenance expenditures include the cost of operating and maintaining water supply, treatment, storage, and distribution facilities. Operation and Maintenance expenditures also include the cost of purchasing water, providing technical services such as laboratory services, administrative costs of the Water System including meter reading and billings, human resources administration and general management of the Department (collectively, "Operation and Maintenance expenditures").

Recently, the City developed a comprehensive plan designed to integrate financial information, create streamlined and timely financial reports and adopt internal controls over financial reporting by implementing a new enterprise resource planning ("ERP") system. The first phase was completed in 2009 and 2010 by replacing standalone financial, accounting, procurement, and accounts receivable systems. The finance, logistics and procurement modules became effective on July 1, 2009; the citywide payroll module on January 1, 2010; and the accounts receivable module in April 2010. The following table sets forth the statements of revenues, expenses and changes in fund net assets for the Water Utility Fund for Fiscal Years 2007 through 2011.

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TABLE 15
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS FOR THE WATER UTILITY FUND
Fiscal Years 2007 through 2011 Audited
(In Thousands)

	2007	2008	2009	2010	2011
OPERATING REVENUES [(1)]					
Sales of Water	$ 289,127	$ 297,225	$ 324,772	$ 354,543	$ 358,747
Charges for Services [(2)]	1,147	33	0	14,655	3,789
Revenue from Use of Property	6,162	6,115	5,418	4,431	5,540
Usage Fees	1,594	1,235	1,272	503	33
Other [(2)]	12,262	14,018	11,257	2,329	3,406
TOTAL OPERATING REVENUES	$ 310,292	$ 318,626	$ 342,719	$ 376,461	$ 371,515
OPERATING EXPENSES [(3)]					
Maintenance and Operations [(2)]	$ 97,821	$ 100,360	$ 95,979	$ 70,568	$ 72,027
Cost of Purchased Water Used	124,880	121,186	133,499	148,232	143,155
Taxes [(2)]	163	162	162	1,805	1,755
Administration [(2)]	30,964	36,722	33,258	65,169	65,926
Depreciation	27,644	29,870	39,627	38,525	43,054
TOTAL OPERATING EXPENSES	$ 281,472	$ 288,300	$ 302,525	$ 324,299	$ 325,917
OPERATING INCOME (LOSS)	$ 28,820	$ 30,326	$ 40,194	$ 52,162	$ 45,598
NONOPERATING REVENUES (EXPENSES)					
Earnings on Investments [(4)]	$ 11,461	$ 15,536	$ 12,478	$ 8,914	$ 4,468
Federal Grant Assistance	283	1,427	192	1,351	203
Other Agency Grant Assistance	284	272	1,070	(135)	7,028
Gain (Loss) on Sale/Retirement of Capital Assets	(5,076)	(3,494)	(2,436)	(2,582)	(1,164)
Debt Service Interest Expense	(26,370)	(29,919)	(28,081)	(38,240)	(34,490)
Other [(5)]	175	980	751	3,809	3,552
TOTAL NON OPERATING REVENUES (EXPENSES)	$ (19,243)	$ (15,198)	$ (16,026)	$ (26,883)	$ (20,403)

INCOME (LOSS) BEFORE CONTRIBUTIONS AND TRANSFERS	$ 9,577	$ 15,128	$ 24,168	$ 25,279	$ 25,195
Capital Contributions	$ 80,859	$ 31,526	$ 30,277	$ 23,932	$ 18,011
Transfers from Other Funds	352	578	439	245	113
Transfers from Governmental Funds	84	3,867	3,443	337	142
Transfers to Other Funds	(234)	(93)	(99)	(2)	--
Transfer to Governmental Funds	(1,713)	(834)	(530)	(612)	(222)
CHANGE IN NET ASSETS	$ 88,925	$ 50,172	$ 57,698	$ 49,179	$ 43,239
Net Assets at Beginning of Year	$1,226,423	$1,315,348	$1,365,520	$1,423,218	$1,472,397
NET ASSETS AT END OF YEAR	$1,315,348	$1,365,520	$1,423,218	$1,472,397	$1,515,636

(1) Operating Revenues represent charges to customers for sales and services.
(2) Includes quarterly payments in-lieu of taxes to CWA and annual property tax payments. Variances from Fiscal Year 2009 to Fiscal Year 2011 due to a change in reporting classifications as a result of the City's conversion to a new Enterprise Resource Planning System.
(3) Operating Expenses include cost of sales and services, administrative expenses, and depreciation on capital assets.
(4) Earnings on investments include interest earned on the bond construction funds.
(5) Fiscal Year 2010 revenue includes $2.8 million litigation settlement.
Source: Comprehensive Annual Financial Reports for Fiscal Years 2007 through 2011.

The following table sets forth the debt service coverage for Fiscal Years 2007 through 2011.

TABLE 16
CALCULATION OF HISTORIC DEBT SERVICE COVERAGE
Fiscal Years 2007 through 2011
(Dollar Amounts in Thousands)
(Unaudited)

						Senior Obligations				All Obligations [1]	
Fiscal Year Ended June 30	System Revenues [2]	Total Expenses[3][4]	Net System Revenue	Less: Interest Earnings on Reserve Fund[5]	Adjusted Net System Revenues	Total Debt Service	Less: Interest Earnings[5]	Adjusted Debt Service	Adjusted Debt Service Coverage	Total Debt Service (Senior and Subordinated)	Aggregate Debt Service Coverage
2007	$336,599	$255,486	$ 81,113	$(1,346)	$ 79,767	$21,351	$(1,346)	$20,005	3.99	$40,759	1.99
2008	350,770	258,813	91,957	(1,481)	90,476	21,354	(1,481)	19,873	4.55	43,082	2.13
2009	364,413	263,280	101,133	(2,668)	98,465	21,354	(2,668)	18,686	5.27	49,600	2.04
2010	394,948	287,361	107,587	(3,767)	103,820	28,303	(3,767)	24,536	4.23	56,978	1.89
2011	397,755	285,059	112,696	(1,436)	111,260	34,115	(1,436)	32,679	3.40	62,784	1.79

(1) All Obligations include Outstanding Senior Obligations and the Outstanding Subordinated Obligations (including the 2002 Subordinated Bonds to be refunded), which includes the Senior SRF Loans and the Subordinate SRF Loan.

(2) System Revenues as defined in the Installment Purchase Agreement, including operating and non-operating receipts (*i.e.* interest earnings, capacity charges, other income) as well as transfers and the cash-based components of capital contributions.

(3) Amounts reflect the Maintenance and Operation costs of the Water System.

(4) Amounts under Total Expenses reflect the Maintenance and Operation Costs of the Water System for such Fiscal Year in accordance with the Installment Purchase Agreement and generally includes maintenance and operations, administration, cost of water purchases, transfers to other funds, pension benefits, and retiree health costs. The Water System's projected share of pension payments is based on June 30, 2011 Cheiron Actuarial Valuation.

(5) Interest earnings on the Senior Debt Service Reserve Fund are netted out of both System Revenues and Total Debt Service to calculate Senior Debt Service Coverage Ratios, but are not netted out for Aggregate Debt Service Coverage Ratios.

Source: Statistical Section (Unaudited) of Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2011.

Management's Discussion and Analysis

The following discussion relates to certain items set forth in Table 15. Certain of the following information in connection with the financial condition and results of operations of the Water Utility Fund for Fiscal Year 2011, 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, 2011" and specifically the portion of the basic financial statements relating to the operation of the Water Utility Fund.

Operating Revenues. Total operating revenues for Fiscal Year 2011 were $371.53 million, which represented an decrease of $4.9 million from the previous Fiscal Year. This was primarily due to a decrease in charges for services.

Operating Expenses. Total operating expenses for Fiscal Year 2011 were $325.9 million, an increase of $1.6 million from Fiscal Year 2010. This was primarily the result of an increase in depreciation of $4.5 million.

Operation and Maintenance expenses included the operation of three treatment facilities as well as operation and maintenance of approximately 3,300 miles of distribution mains and associated pump stations. Operation and Maintenance expenditures were 22.1% of operating expenses and totaled $72.0 million for Fiscal Year 2011. This was an increase of $1.5 million or 2.0% more than the corresponding amount for Fiscal Year 2010.

Non-operating Revenues. Non-operating revenues for Fiscal Year 2011 increased by $1.3 million from non-operating revenues received in Fiscal Year 2010. This was primarily due to an increase in other agency grant assistance and a decrease of investment earnings.

Non-operating Expenses. Non-operating expenses decreased by $5.2 million to $35.7 million during Fiscal Year 2011. This was due to a $1.4 million decrease in losses attributable to the retirement of capital assets and a decrease in debt service interest expense of $3.8 million.

Cash Flow from Operations. Net cash provided by operating activities for Fiscal Year 2011 was $67.8 million, a decrease of approximately $31.6 million from the previous year. This change is generally attributable to an increase in payments to suppliers and a decrease in accounts payable.

Reserves. As of June 30, 2011, the Water Utility Fund had total reserves of approximately $157.9 million. This is in compliance with a reserve policy adopted by the City during Fiscal Year 2009.

Outstanding Obligations. As of June 30, 2011, the Water Utility Fund had outstanding debt of approximately $912.9 million. More detailed information about the Water Utility Fund's long-term debt is presented in the notes to the 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, 2011" including certain information regarding the Department's debt service coverage ratio requirements.

Rate Stabilization Fund; Other Funds and Accounts

The City has established within the Water Utility Fund two reserve funds: the Rate Stabilization Fund ("Rate Stabilization Fund") and the Secondary Purchase Fund ("Secondary Purchase Fund"). Amounts in the Rate Stabilization Fund are to be used exclusively for the operation and maintenance of the Water System and such Fund is maintained pursuant to the Master Installment Purchase Agreement. The Rate Stabilization Fund has no associated budgeted amount from year to year and amounts therein are intended to provide a source of funds to mitigate future rate increases. Deposits into the Rate Stabilization Fund are made from current Water System revenues and subject to the discretion of the City Council. Amounts may be deposited into the Rate Stabilization Fund from time to time but such amounts are typically deposited at the end of the Fiscal Year. When deposited in the Rate Stabilization Fund, Net System Revenues for purposes of calculating bond coverage ratios are reduced by the amount of the deposit. Amounts may be withdrawn from the Rate Stabilization Fund through the normal procedures established by the City Comptroller, including approval of the Chief Financial Officer, or by City Council action in the form of an ordinance to appropriate the amounts from the Rate Stabilization Fund into a specific program for expenditure. When withdrawn from the Rate Stabilization Fund, the amounts are deemed System Revenues for purposes of calculating bond coverage requirements. There were no withdraws from this reserve in Fiscal Year 2011. As of June 30, 2011, the Rate Stabilization Fund was funded at $20.5 million. In its current Fiscal Year 2012 projections, the Department has identified operational savings of $14.8 million which are projected to be transferred to the Rate Stabilization Fund, increasing its funding level to $35.3 million by the end of Fiscal Year 2012. As shown in Table 18 below, it is assumed that approximately $11.8 million will be drawn from the Rate Stabilization Fund in Fiscal Year 2013 and an additional $3 million will be drawn in Fiscal Year 2014.

The Secondary Purchase Fund has no associated budgeted amount from year to year and any deposits thereto are subject to the discretion of the City. Amounts in the Secondary Purchase Fund, which may come from any moneys available, are intended to be equal to 6% of the annual budget for the purchase of water and may be used as an emergency reserve for the purchase of water in the event of a drought or other emergency that unexpectedly disrupts the City's normal supply of water or for any operating and maintenance expense. Amounts may be withdrawn from the Secondary Purchase Fund and appropriated for program expenditures through City Council action in the form of an ordinance. There is no requirement to replenish any amounts withdrawn from the Secondary Purchase Fund. To the extent that amounts are deposited in the Secondary Purchase Fund from current Water System Revenues, System Revenues are reduced by the amount of such deposit for purposes of calculating debt service coverage requirements. Amounts withdrawn from the Secondary Purchase Fund are deemed System Revenues. There are currently no expected transfers to or from the Secondary Purchase Fund, other than those necessary to maintain the 6% annual water purchases target. The Fiscal Year 2012 budget includes $12.5 million for the Secondary Purchase Fund.

The City has also established within the Water Utility Fund, the Operating Reserve ("Operating Reserve"), which is funded at an amount necessary to provide for a certain number of days of operations in the event of an emergency or catastrophe that results in loss of revenues. Such amount is calculated based on the annual operating budget for the Fiscal Year (less water purchases and amounts in the Appropriated Reserve (as defined below)). The Operating Reserve is required to be replenished during any Fiscal Year in which amounts were withdrawn. As of June 30, 2011, amounts in the Operating Reserve equaled approximately $29.9 million, which accounts for approximately 65 days of operating costs. The Fiscal Year 2012 budget includes approximately $30.4 million for the Operating Reserve, which represents approximately 65 days of operating costs. The City is in the process of gradually increasing such reserve to a level sufficient for 70 days of operating costs by Fiscal Year 2013.

Other reserves established by the City include SRF Loan Reserves (the "SRF Loan Reserves") for payment of principal and interest on the Senior SRF Loans; two Debt Service Reserve Funds (the "Debt Service Reserve Funds") for payment of principal and interest on its bonds held by the trustees for those bonds; and an Emergency Reserve (the "Emergency Reserve") annually budgeted at $5.0 million to provide for emergency capital expenditures or other unanticipated capital needs. Recent Department budgets have included an amount designated as an Appropriated Reserve (the "Appropriated Reserve"). This budget item has been set in an amount determined by the Department in its discretion and appropriated to provide for unanticipated needs that may arise during the course of the year, including payment of unanticipated operating expenses, which requires the approval of the Department Director, and payment of unanticipated capital needs, which requires approval of the City Council.

In Fiscal Year 2008, the City established a Dedicated Reserve for Efficiencies and Savings (the "DRES") to save funds obtained by increasing efficiencies, changing priorities or other actions related to reducing costs of the CIP or operations and maintenance of the Water System. The funds in the DRES may be used for accelerating 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 offset future rates for the Water System.

The following table sets forth certain reserve funds of the Water Utility Fund as of June 30, 2011.

TABLE 17
WATER UTILITY FUND RESERVES
AS OF 6/30/2011 (1)
(In Thousands)

As Determined by the City's Reserve Policy:	
Secondary Purchase Reserve	$11,263
Emergency Reserve	5,000
Rate Stabilization Reserve	20,500
Appropriated Reserve	3,500
Operating Reserve	29,923
Dedicated Reserve for Efficiencies and Savings ("DRES")	15,127
Total	$85,313
Bonds/Loan Covenants: (2)	
SRF Loan Reserve	$ 4,532
Debt Service Reserve Funds	71,628
Total	$76,160

(1) Source: Public Utilities Department and Debt Management Department, City of San Diego.
(2) As determined by and subject to the terms of respective bond and SRF Loan documents.

For information on the possible limitation on the City's ability to set rates and charges at levels that would permit the City to make deposits into the Rate Stabilization Fund or the Secondary Purchase Fund as a consequence of Proposition 218, see "WATER SYSTEM FINANCIAL OPERATIONS." See also Table 18 under the caption "WATER SYSTEM FINANCIAL OPERATIONS – Financial Projections and Modeling Assumptions" for currently anticipated deposits into and withdrawals from the Rate Stabilization Fund incident to the currently contemplated CIP.

Financial Projections and Modeling Assumptions

The following table sets forth the estimated and projected operating revenues and expenses for Fiscal Years 2012 through 2016. The increase in total operating revenues in Fiscal Year 2012, compared to the Fiscal Year 2011 figure in Table 16 is projected to be $29.5 million. This difference is primarily due to an increase in water sales of $42 million offset by a $12 million decrease to other revenue. The increase in total operating expenses in Fiscal Year 2012, compared to the Fiscal Year 2011 figure in Table 16 is projected to be $53.0 million. This difference is primarily due to an increase in the cost of purchased water of $33 million and an increase in contracts of $20 million. The increase in contracts in Fiscal Year 2012 is primarily due to increased expenditures anticipated for contracts related to cathodic protection retrofit of water mains (categorized as an operating expense), as well as legal costs related to the Mission Valley Terminal and Sweetwater litigation. In addition, there are increased expenditures anticipated for rent and vehicle replacement. The increase in total operating expenses in Fiscal Year 2013, compared to the Fiscal Year 2012 figure in Table 18 is primarily due to the increase in the cost of purchased water. Fiscal Year 2013 reflects a full year of the calendar year 2012 water rate increase from the CWA.

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TABLE 18
ESTIMATED OPERATING REVENUE AND EXPENSES
Fiscal Year 2012 through 2016
(In Thousands)
(Unaudited)

DESCRIPTION	Fiscal Year 2012 Year End Estimate [1]	Fiscal Year 2013 Projected	Fiscal Year 2014 Projected	Fiscal Year 2015 Projected	Fiscal Year 2016 Projected
Total Operating Revenues [2]	$427,344	$428,339	$449,109	$462,340	$475,961
Total Operating Expenses [3]	$338,074	$365,972	$376,892	$377,362	$378,292
Net Operating Revenues	$ 89,270	$ 62,367	$ 72,217	$ 84,978	$ 97,669
Transfer (to)/from Rate Stabilization Fund	(14,800)	11,800	3,000	--	--
Interest Income on Operating Funds	3,213	3,889	3,963	6,169	7,636
Interest Income on Capital Monies	1,268	2,094	2,651	4,417	5,699
Interest Income on Debt Service Reserve Fund	1,230	1,406	1,483	2,361	2,520
Capacity Fee Proceeds	6,100	7,000	7,000	7,000	7,000
Less: Senior Debt Service Reserve Fund Interest [4]	689	858	905	1,440	1,537
Total Adjusted Net System Revenues [5][6]	$ 85,593	$ 87,698	$ 89,409	$103,485	$118,986
Projected Senior Debt Service	$ 37,519	$ 39,879	$ 42,958	$ 47,582	$ 52,712
Less: Senior Debt Service Reserve Fund Interest [4]	689	858	905	1,440	1,537
Adjusted Debt Service [6]	$ 36,830	$ 39,021	$ 42,053	$ 46,142	$ 51,175
Senior Debt Service Coverage [5]	232%	225%	213%	224%	233%
Aggregate Debt Service Coverage					
Net Operating Revenues	$ 89,270	$ 62,367	$ 72,217	$ 84,978	$ 97,669
Transfer (to)/from Rate Stabilization Fund	(14,800)	11,800	3,000	--	--
Interest Income on Operating Funds	3,213	3,889	3,963	6,169	7,636
Interest Income on Capital Monies	1,268	2,094	2,651	4,417	5,699
Capacity Fee Proceeds	6,100	7,000	7,000	7,000	7,000
Debt Service Reserve Fund Interest	1,230	1,406	1,483	2,361	2,520
Total Net System Revenues [7]	$ 86,281	$ 88,555	$ 90,314	$104,925	$120,524
Projected Senior Debt Service	$ 37,519	$ 39,879	$ 42,958	$ 47,582	$ 52,712
Projected Subordinate Debt Service [8]	28,672	24,503	26,770	26,772	26,396
Aggregate Debt Service [9]	$ 66,191	$ 64,382	$ 69,728	$ 74,354	$ 79,108
Aggregate Debt Service Coverage [10]	130%	138%	130%	141%	152%

(1) Based on current year estimated/actual results as of December 31, 2011.
(2) Assumes a 4% rate increase in Fiscal Year 2014 and 2% rate increase in Fiscal Years 2015 and 2016; and water usage has an annual growth projection of 1% for Fiscal Years 2012 through 2016 from actual Fiscal Year 2010 usage.
(3) Includes maintenance and operations, administration, cost of water purchases, pension benefits and retiree health costs. The Water System's projected share of pension payments is based on June 30, 2011 Cheiron Actuarial Valuation.
(4) Includes anticipated bond issuances subsequent to Fiscal Year 2012 ($111 million in or about Fiscal Year 2014 and $154 million in or about Fiscal Year 2016). See "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM – Financing Plans for the CIP." Does not include restricted Debt Service Reserve Fund interest earnings.
(5) As defined in the Installment Purchase Agreement.
(6) Figures may not add to total due to independent rounding.
(7) Does not include restricted interest earnings.
(8) Reflects actual annual debt service savings of approximately $1.5 million in Fiscal Year 2013 and $1.9 million thereafter from the current refunding of the Refunded 2002 Subordinated Bonds. An additional $2.7 million is projected to be recognized in Fiscal Year 2013 as debt service savings. Accrued interest of $2.7 million, which is due on August 1, 2012 (Fiscal Year 2013) on the Refunded 2002 Subordinated Bonds and has already been set aside, is being transferred for deposit into the Escrow Fund. See "THE REFUNDING PLAN."
(9) Not adjusted for Debt Service Reserve Fund earnings.
(10) Ratio of total Net System Revenues to Aggregate Debt Service.
Source: Public Utilities Department, City of San Diego.

The data set forth in Table 18 is based upon various assumptions, including those set forth below, adopted by the Department. The achievement of certain results or other expectations contained in Table 18 involve known and unknown risks, uncertainties, and other factors that may cause actual results, performance, or achievements reflected in Table 18 to be materially different from any future results, performance, or achievements expressed or implied in such Table 18. 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. See also "INTRODUCTION – Forward-Looking Statements."

The Department's operating projections include the expense of improved and expanded Department facilities that will become operational during the projection period. In addition, the projections reflect (one-time) operational savings of $14.8 million in Fiscal Year 2012 from various supply and contractual line items, which will be transferred to the Rate Stabilization Fund by the end of Fiscal Year 2012 and which will reduce Net System Revenues in Fiscal Year 2012. The projections provided in Table 18 assume that approximately $11.8 million will be drawn from the Rate Stabilization Fund in Fiscal Year 2013 and an additional $3 million will be drawn in Fiscal Year 2014. These transfers will be treated as increases to Net System Revenues during the Fiscal Years 2013 and 2014.

The Water System's account growth projections for Fiscal Year 2012 and beyond are based on San Diego Association of Governments ("SANDAG") 2030 Forecasts, which was approved by the Board of SANDAG in November 2003. SANDAG's growth projections from Fiscal Year 2011 and beyond are approximately 1.0% annually. However, adjustments to the Water System's growth projections for Fiscal Years 2012 through 2016 reflect recent growth trends based upon the current economic environment. The Water System's account growth rate for Fiscal Year 2012 through Fiscal Year 2016 is assumed at 0.25% per year. These rates are applied to the number of customer accounts. The Department has based the current number of accounts from the Water Utilities Customers Information System Monthly Rate Code Summary (Actual).

The Department receives both raw and treated water supplies from CWA. The proportion of these two supplies is based on long-term planning criteria designed to minimize the long-term costs for water services. The Water System's Fiscal Year 2010 water deliveries realized an approximate 12% reduction from Fiscal Year 2009 water deliveries due to conservation efforts from the Water System's customers. This conservation effort was assisted by several water use restrictions enacted by the City. Because Fiscal Year 2011 was an above average rain year, the City has since lifted the water use restrictions that were in place, however, the increased rain totals also decreased water demand a further 5%. Usage amounts going forward are projected in the Department's financial model ("model") to be similar to water usage for Fiscal Year 2010, with a slight adjustment for projected customer and population growth. The projected increase in water usage is 1% annually, from Fiscal Year 2010 levels, for Fiscal Year 2012 and beyond.

The Water System has started the process of a cost of service study in Fiscal Year 2012, with an anticipated completion date in late Fiscal Year 2013. The cost of service study will be analyzing the revenue requirements for Fiscal Years 2014 through 2017, including but not limited to, anticipated operational requirements, proposed capital improvement projects and related financing plans, reserve objectives, and anticipated water supply demand. Upon completion of the COSS, the Department will proceed with satisfying any notification and public hearing requirements of Proposition 218, with a goal of additional rate adjustments, if any, becoming effective July 1, 2013 for Fiscal Year 2014 through 2017. The figures in Table 18 reflect the current rates for purchased water, last approved by CWA, effective as of January 1, 2012. See the discussion of the City's prior actions to increase its water rates to reflect increases in the cost of water purchased from CWA under the caption "Establishment of Water Service Charges" above. Table 18 reflects the estimated revenues of the Water System as projected by the Department. The projections assume rate increases of 4% in Fiscal Year 2014 and 2% in Fiscal Years 2015 and 2016. The assumed rate increases are based upon the currently projected future operating, capital, and financing needs of the Water System as shown in Table 18. The assumed rate increases are subject to change based upon the information provided by the completed cost of service study. To date, the City Council has approved all previously proposed rate increases presented by the Department. If rate increases are not approved by the City Council, the Department expects to adjust expenditures to the City's financial projections for the Water System for Fiscal Years 2012 through 2016 shown in Table 18. With respect to the 2012A Bonds and the Rate Covenant under the Indenture, Adjusted Debt Service does not include debt service on Subordinated Obligations such as the 2012A Subordinated Installment Payments.

Recycled water revenues, which are a component of water sales, have averaged nearly $6 million annually since Fiscal Year 2007. Rates for recycled water have remained dramatically below market rates, because they have not changed since Fiscal Year 2002. The Department expects to have its Recycled Water Pricing Study completed in Fiscal Year 2012 and anticipates rates will increase significantly, which will result in similar revenue growth. Recycled revenues will continue to supplant revenues from potable water service charges as existing customers convert from potable to recycled water supplies. Revenues will also be lost as customers convert to recycled water since recycled water will always be priced below potable water. Reduced water purchases will offset a portion of revenue losses of conversion to recycled. However, a large portion of recycled water sales are made on a wholesale basis to other water districts and agencies outside of the City, including the Otay Water District, the City of Poway, and the Olivenhain Water District. These districts comprise approximately 50% of current recycled water sold. Recycled water used by these districts does not offset potable water sales in the City so they do not have a negative revenue impact to the Water Utility Fund.

The Department is actively pursuing Proposition 50 and other grants, as well as applying for additional SRF loans. Such amounts, however, are not included in the model unless grant or SRF agreements have been approved by the Department and the granting agency.

Capital project costs are estimated based on current design, construction management, and construction cost plus a contingency equal to approximately 5% of construction cost. Based upon current trends and information provided by the engineering personnel within the Water System, an escalating annual inflation rate ranging from 2.5 – 3.5% is applied to all capital projects beyond Fiscal Year 2012.

The model reflects capacity charges of $6.1 million for Fiscal Year 2012 and $7.0 million per year thereafter through Fiscal Year 2016.

The model includes the anticipated issuance of additional revenue bonds secured by installment payments pursuant to the Master Installment Purchase Agreement, including bonds in the approximate principal amount of $267 million maturing 30 years from their respective dates of issuance. The Department anticipates that the amount of revenue bonds to be issued in the future will be reduced by the amount of the additional SRF Loans received from CDPH, if any.

Interest rates estimated for projected earnings on fund balance are 1.7% for Fiscal Year 2012 and 2.0% for Fiscal Years 2013 and 2014, 3.0% for Fiscal Year 2015, and 3.50% for Fiscal Year 2016. The interest rate for the projected public financings are reflected in the model to be 5.50%.

For the Operations and Maintenance expenditures, the model reflects assumptions from the City's October 2011 Five Year Financial Outlook. These assumptions include no (0%) increase to salaries and wages, 1.0% escalation in supplies, and 5.0% inflation in energy and utility costs. Based on revised labor agreements, the total of salaries, wages and fringe benefits was decreased by an amount equivalent to 6% of total compensation in Fiscal Years 2010 through 2012. Those amounts are not projected to increase thereafter except for increases to pension benefits and retiree health costs. See "WATER SYSTEM FINANCIAL OPERATIONS – City and Water System Pension Contributions" and "– Postemployment Healthcare Benefits." Actual results may be materially different from the assumptions respecting salary and wage increases included in Table 18. To the extent that actual salary and wage increases are higher than the assumed amounts, the Water System's expenditures may materially increase.

Water purchases are part of Operation and Maintenance expenditures but are projected separately based on historical factors, required emergency storage factors, known supply availability factors, and projected demand. As of January 1, 2012, the City estimates that the projected water purchase costs will vary from \$190 million in Fiscal Year 2012 to \$224 million in Fiscal Year 2016, excluding any additional price adjustments from MWD or CWA after Fiscal Year 2012.

Additional pension costs are reflected in the model based on the Water Utility Fund's proportionate share to fully fund the City's total annual contribution to the Pension System (as defined herein). The Water Utility Fund's proportional share of that contribution was approximately 6.4% (or approximately \$14.7 million) for Fiscal Year 2011 and will be approximately 5.3% (or approximately \$12.3 million budgeted) for Fiscal Year 2012. The Water Utility Fund's proportionate share of the City's total annual OPEB contribution for Fiscal Years 2011 and 2012 is approximately 8.3% (or approximately \$4.9 million) and approximately 7.0% (or approximately \$3.9 million budgeted), respectively. (See "WATER SYSTEM FINANCIAL OPERATIONS – City and Water System Pension Contributions" and "– Post-Retirement Healthcare Benefits.")

Outstanding Indebtedness

As of March 1, 2012, the aggregate principal amount of Outstanding Senior Obligations was \$643,770,788, and the aggregate principal amount of Outstanding Subordinated Obligations (including the 2002 Subordinated Bonds to be refunded) was \$243,529,431. The aggregate principal amount of loans payable from Net System Revenues on parity with the Net System Revenues securing the 2012A Subordinated Installment Payments as of March 1, 2012 was \$15,669,431, consisting of the Subordinate SRF Loan payable to the State of California Water Resources Control Board, included in the amount of Outstanding Subordinated Obligations. The Subordinate SRF Loan is payable on a semi-annual basis, and matures in 2025. Funding agreements for three SRF loans totaling \$50,000,000 were obtained in calendar year 2011 as Senior Obligations. Two of the loans, totaling \$32 million were funded in calendar year 2011 and their first interest and principal payments were made in February 2012. The third loan for \$18 million was partially funded in January 2012 with the balance expected to be funded by April 2012. The total principal amount of these three loans, as of May 1, 2012, is expected to be \$49,365,788. The loans are payable on a semi-annual basis and mature in 2031.

See a description of the Department's long-term debt as of June 30, 2011, as presented in Note 6 to the City's audited financial report for Fiscal Year 2011 attached hereto as APPENDIX A. Except for covenants relating to its continuing disclosure undertakings, the Department was and is in compliance with bond covenants and debt service coverage ratio requirements. See "CONTINUING DISCLOSURE."

The Department has not issued any general obligation debt since March 1, 1991 and has no immediate plans to issue such indebtedness. Pursuant to Section 90 of the City Charter, general obligation bonded indebtedness for the development, conservation, and furnishing 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. See "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM – Financing Plans for the CIP."

The following table sets forth the outstanding indebtedness payable from Net System Revenues as of March 1, 2012. See "THE REFUNDING PLAN" for a description of the refunding and defeasance to be effected with proceeds of the 2012A Bonds.

TABLE 19
OUTSTANDING DEBT
As of March 1, 2012

Series	Final Maturity	Outstanding Principal Amount
Senior Obligations:		
2009A Bonds	August 1, 2038	$153,905,000
2009B Bonds	August 1, 2039	317,425,000
2010A Bonds	August 1, 2028	123,075,000
State Revolving Fund Loans	July 1, 2031	49,365,788
Total Senior Obligations:		$643,770,788
Subordinated Obligations:		
2002 Subordinated Bonds [1]	August 1, 2032	$227,860,000
State Revolving Fund Loan	July 1, 2025	15,669,431
Total Subordinated Obligations:		$243,529,431
Total Outstanding Obligations:		$887,300,219

[1] The City is refunding certain maturities of the outstanding 2002 Subordinated Bonds. Upon the issuance of the 2012A Bonds and the defeasance of the Refunded 2002 Subordinated Bonds, $16,430,000 aggregate principal amount of the 2002 Subordinated Bonds maturing on August 1, 2012 will remain outstanding under the 2002 Indenture. See “THE REFUNDING PLAN.”

Source: Debt Management Department, City of San Diego.

Anticipated Additional Obligations

Pursuant to the Master Installment Purchase Agreement, the City may incur additional Obligations, payments with respect to which will be senior to or on parity with the City’s obligation to make 2012A Subordinated Installment Payments, subject to satisfaction of the conditions specified in the Master Installment Purchase Agreement. See “SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS – Issuance of Additional Obligations” and “WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM – Financing Plans for the CIP.” The City currently has two SRF loan applications pending in an aggregate loan amount of $17.5 million. These are in the early stages of the application process. The City expects to continue to apply for Additional SRF Loans. The Department anticipates that the amount of bonded indebtedness to be issued in the future will be reduced by the amount of the additional SRF Loans received from CDPH, if any.

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Annual Debt Service Requirements

The following table sets forth the amounts required in each Fiscal Year for the payment of principal of and interest on existing Outstanding Obligations payable from the Water Utility Fund after giving effect to the issuance of the 2012A Bonds and the redemption of the 2002 Subordinated Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS."

TABLE 20
DEBT SERVICE ON ALL OUTSTANDING OBLIGATIONS (1)

			2012A Bonds				
Fiscal Year Ending June 30	Total Senior Obligations Debt Service	Outstanding Subordinated Obligations Debt Service (3)	Principal	Interest	Total Principal and Interest	Total Subordinated Obligations Debt Service (3)	Total Debt Service
2012 (2)	$ 37,518,840	$28,672,378	--	--	--	$ 28,672,378	$ 66,191,218
2013	39,879,003	18,204,985	--	$ 6,298,298	$ 6,298,298	24,503,283	64,382,286
2014	39,880,715	1,375,922	$ 17,105,000	8,289,350	25,394,350	26,770,272	66,650,987
2015	39,883,628	1,375,923	17,595,000	7,800,725	25,395,725	26,771,648	66,655,276
2016	40,758,953	1,375,923	17,940,000	7,079,625	25,019,625	26,395,548	67,154,501
2017	53,168,778	1,375,922	5,290,000	6,543,850	11,833,850	13,209,772	66,378,550
2018	53,164,353	1,375,922	5,530,000	6,301,000	11,831,000	13,206,922	66,371,275
2019	53,163,812	1,375,922	5,790,000	6,045,650	11,835,650	13,211,572	66,375,384
2020	53,160,147	1,375,922	6,080,000	5,748,900	11,828,900	13,204,822	66,364,969
2021	53,164,746	1,375,922	6,395,000	5,437,025	11,832,025	13,207,947	66,372,693
2022	53,159,228	1,375,923	6,700,000	5,134,100	11,834,100	13,210,023	66,369,251
2023	47,469,483	1,375,923	7,020,000	4,815,550	11,835,550	13,211,473	60,680,956
2024	47,468,840	1,375,922	7,375,000	4,455,675	11,830,675	13,206,597	60,675,437
2025	49,505,947	1,375,922	7,750,000	4,077,550	11,827,550	13,203,472	62,709,419
2026	51,544,572	687,961	8,145,000	3,689,275	11,834,275	12,522,236	64,066,808
2027	51,536,065	--	8,550,000	3,281,000	11,831,000	11,831,000	63,367,065
2028	51,548,209	--	8,990,000	2,842,500	11,832,500	11,832,500	63,380,709
2029	51,546,690	--	9,450,000	2,381,500	11,831,500	11,831,500	63,378,190
2030	28,960,103	--	9,935,000	1,896,875	11,831,875	11,831,875	40,791,978
2031	28,962,800	--	10,445,000	1,387,375	11,832,375	11,832,375	40,795,175
2032	27,959,812	--	10,980,000	851,750	11,831,750	11,831,750	39,791,562
2033	25,805,488	--	11,545,000	288,625	11,833,625	11,833,625	37,639,113
2034	25,808,931	--	--	--	--	--	25,808,931
2035	25,805,034	--	--	--	--	--	25,805,034
2036	25,808,256	--	--	--	--	--	25,808,256
2037	25,804,888	--	--	--	--	--	25,804,888
2038	25,808,006	--	--	--	--	--	25,808,006
2039	25,808,288	--	--	--	--	--	25,808,288
2040	21,736,763	--	--	--	--	--	21,736,763
Total (4):	$1,118,271,535	$35,404,012	$188,610,000	$94,646,198	$283,256,198	$318,660,209	$1,436,931,748

(1) Includes current debt service on the Senior SRF Loans and the Subordinate SRF Loan; does not include any additional SRF loans discussed herein.
(2) Amounts shown for Fiscal Year 2012 were paid on August 1, 2011 and February 1, 2012 and are not included in Total.
(3) Assumes the refunding and defeasance of the 2002 Subordinated Bonds, but for the August 1, 2012 serial maturities.
(4) Amounts have been rounded; total may not equal the sum of the components.
Source: Debt Management Department, City of San Diego.

Labor Relations

General. The City has five labor organizations which represent classified employees. They are the Municipal Employees Association ("MEA"), the American Federation of State, County, and Municipal Employees Local 127 ("Local 127"), the Police Officers Association ("POA"), the

International Association of Firefighters Local 145 ("Local 145"), and the California Teamsters Local 911 ("Local 911"), who represent lifeguards. A sixth labor organization, the Deputy City Attorneys' Association ("DCAA"), represents unclassified deputy city attorneys. Certain City employees are unrepresented.

As of July 1, 2011, there were 718.9 regular full-time employees of the Department (Water Branch) of which 415.6 are represented by the MEA and 263.7 are represented by the Local 127. The remaining 39.6 employees are unrepresented and unclassified. The two bargaining units represent approximately 94% of the Department (Water Branch employees).

The City is currently involved in negotiations with each of its labor organizations regarding agreements for Fiscal Year 2013.

Contracts for Fiscal Year 2010 – 2012

MEA: On April 14, 2009, the City Council approved the terms of a labor agreement with MEA for Fiscal Years 2010 and 2011. The terms included a general salary freeze and a reduction in overall compensation of approximately 6%. MEA implemented its 6% reduction principally through a 52 hour mandatory furlough and a 3% salary reduction or a waiver of the City's 3% match to the employee's mandatory SPSP contribution. On April 25, 2011, the City Council approved a one year extension that continues the 6% reduction through Fiscal Year 2012.

Local 127: On November 29, 2010, the City Council approved the terms of a labor agreement with Local 127 for Fiscal Years 2011 and 2012. The terms include the continuation of the general salary freeze and a reduction in overall salary of approximately 6% that was imposed on Local 127 in Fiscal Year 2010. Local 127 implemented its 6% reduction principally through the elimination of a 5.4% retirement offset contribution.

Unrepresented: Unrepresented employees took the same general salary freeze and overall compensation reduction of approximately 6% as other employees. The 6% reduction was principally implemented through a mix of reduced or eliminated retirement offset contributions, salary reductions, or a waiver of the City's 3% match to the employee's mandatory SPSP contribution.

Insurance and Liability Claims

The City is self-insured for workers' compensation, long-term disability and public liability claims. For public liability claims, the City self-insures up to $3 million. For liability between $3 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 ("CSAC-EIA"), 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 Water 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 such 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 Water System because such insurance is not commercially available.

The following table reflects the public liability expense and cash payments for liability claims of the Water System for Fiscal Years 2007 through 2011.

TABLE 21
LIABILITY CLAIMS
PUBLIC LIABILITY EXPENSE AND CASH PAYMENTS
Fiscal Years 2007 through 2011
(Unaudited)

Fiscal Year	Public Liability Expense [(1)]	Cash Payments
2007	$4,794,657	$2,483,122
2008	3,251,170	1,676,075
2009	2,408,517	2,012,355
2010	4,560,337	2,539,309
2011	4,356,818	2,587,932

(1) Public Liability Expense includes actual cash payments plus the change in accrued liabilities from the previous Fiscal Year.
Source: Comptroller's Office, City of San Diego.

Investment of Funds

General. Amounts in the funds and accounts of the Water Utility Fund are invested by the City Treasurer in the City 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 City Charter 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 both a monthly and quarterly investment report to the Chief Financial Officer, the City Comptroller and the City Council and annually presents the City Treasurer's Investment Policy to the Chief Financial Officer, the Investment Advisory Committee, the Budget and Finance Committee, and the City Council. All of these documents are promptly posted to the City Treasurer's website. 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 2012A Bonds. 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 Treasurer'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 Treasurer'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 Federal Deposit Insurance Corporation-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 approximately 35% of total funds, the City invests in a variety of debt securities with maturities typically 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 Bank of America 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 unaudited month-end data as of January 31, 2012, approximately 11% of the pool investments mature within 62 days, 14% within 92 days, 24% within 184 days, 40% within 1 year, 79% within 2 years, 99% within 3 years, and 100% within 4 years (on a cumulative basis). As of January 31, 2012, the City Pool had a weighted average maturity of 1.33 years (484 days) and its weighted average yield was 0.62%. 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 0.39 years and the Core portfolio had a duration of 1.71 years as of January 31, 2012. 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 0.39% for every 1% increase in market interest rates while the Core portfolio should decrease in market value by 1.71% 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. See Note 3, "Cash and Investments" to the City's audited financial report for Fiscal Year 2011 attached hereto as APPENDIX A.

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The following table sets forth the City Pool results at January 31, 2012.

TABLE 22
CITY OF SAN DIEGO POOLED INVESTMENT FUND
at January 31, 2012
(in thousands)
(unaudited)

Investment Instrument	Book Value	Fair Value	Percent of Total[1]
U.S. Treasury Notes	$1,041,332	$1,047,163	45.49%
Agency Discount Notes	80,975	81,092	3.54
Agency Notes & Bonds	761,814	764,154	33.27
Commercial Paper	99,764	99,634	4.36
Corporate Notes & Bonds	147,892	147,655	6.46
Local Agency Investment Fund	49,429	49,429	2.16
Repurchase Agreement	45,023	45,023	1.96
Negotiable Certificates of Deposit	25,000	25,010	1.09
Certificates of Deposit (CDARS)	10,000	10,000	0.44
Asset Backed Securities	28,160	28,160	1.23
TOTAL INVESTMENTS	**$2,289,389**	**$2,297,320**	**100.00%**

(1) Based on book value.
Source: Office of the City Treasurer, City of San Diego.

The City Pool is not invested in any structured investment vehicles or mortgage-backed securities. In addition, the City has no outstanding swap arrangements or liquidity facilities.

San Diego City Employees' Retirement System

The following is a description of the City's pension system and its financial condition, which includes an unfunded pension liability of approximately $2.2 billion. While this liability continues to pose a significant challenge to the City as a whole, the Water System's proportionate share of the total City contribution is a small percentage of annual Water System operation and maintenance costs.

San Diego City Employees' Retirement System ("SDCERS") 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 San Diego Unified Port District ("Port") and the San Diego County Regional Airport Authority ("Airport"). The assets of the three separate plans and trusts are pooled in the SDCERS Group Trust for investment purposes. These plans are administered by the SDCERS Board of Administration ("Board") to provide retirement, disability, death and survivor benefits for its members. Amendments to the City's benefit provisions require City Council approval and amendments to retirement benefits require a majority vote by those SDCERS members who are also City employees or retirees. 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 amounts and percentages set forth under this caption relating to SDCERS, 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. Prospective purchasers of the 2012A 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 2012A Bonds are cautioned that such sources and the underlying assumptions speak as of their respective dates, and are subject to change. Prospective purchasers of the 2012A Bonds should also be aware that some of the information presented under this caption contains forward-looking statements and the actual results of the pension system may differ materially from the information presented herein.

The information disclosed under this caption relates solely to the City's participation in SDCERS. City employment classes participating in the City's defined benefit plan are elected officers, general employees and safety employees (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.

TABLE 23
CITY OF SAN DIEGO PLAN MEMBERSHIP
As of June 30, 2011 (actual member count)

	General	Safety	Total by Classification
Active Members	5,498	2,294	7,792
Terminated Members	2,365	529	2,894
Retirees, Disabled and Beneficiaries	4,755	3,147	7,902
Total Members, as of June 30, 2011	12,618	5,970	18,588

Source: Cheiron Actuarial Valuation as of June 30, 2011.

The City is required to make contributions to the pension system as determined by the Board. Pension contributions are authorized and appropriated annually in accordance with the adoption of the City's annual budget. The City Annual Required Contribution ("ARC") is recommended by the SDCERS actuary, Cheiron, Inc. ("Cheiron") and approved by the Board. Cheiron conducts an actuarial analysis for SDCERS annually, the most recent of which is the June 30, 2011 Annual Actuarial Valuation of SDCERS, dated January 6, 2012 ("2011 Valuation"). The 2011 Valuation will serve as the basis for the City's pension contribution for Fiscal Year 2013. The City's actual annual pension contribution may differ from the ARC based on a number of factors discussed below.

Actuarial Assumptions and Methods

Funding Method. Cheiron calculates the City's contribution using the Entry Age Normal ("EAN") method. Under EAN, there are two components to the total contribution: the normal cost and an amortization payment on any unfunded actuarially accrued liability ("UAAL"). The normal cost (associated with active employees only) is computed as the level annual percentage of pay required to fund the retirement benefits between each member's date of hire and assumed retirement.[1] The difference between the EAN actuarial liability and the actuarial value of assets is the UAAL.

Amortization Periods. The UAAL as of June 30, 2011 is amortized over several different closed periods as follows: changes in the UAAL due to assumption changes are amortized over 30 years, changes in the UAAL due to benefit changes are amortized over five years, the outstanding balance of the Fiscal Year 2007 UAAL is amortized over a closed 20 year period (such that, as of Fiscal Year 2013, 16 years of amortization remain), and subsequent yearly experience 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. As of the 2011 Valuation, this resulted in an equivalent single amortization period for the UAAL of 15.789 years.

Actuarial Assumptions. At its September 30, 2011 meeting, the Board approved several actuarial assumption changes resulting from an Experience Study conducted by Cheiron for the period July 1, 2007 through June 30, 2010. The Experience Study compared assumed versus actual experience for various actuarial factors and recommended changes where actual experience differed from the assumptions. The 2011 Valuation reflects the changed assumptions. The following are the principal actuarial assumptions used by Cheiron in preparing the 2011 Valuation with the prior year assumptions shown parenthetically:

1. Investment Return Rate: 7.5% a year, net of both administrative and investment expenses (formerly 7.75%).

2. Inflation Rate: 3.75% a year, compounded annually (formerly 4.00%).

3. Interest Credited to Member Contributions: 7.5% compounded annually.

4. Salary Increase Rates: 3.75% (following a two-year freeze assumption for Fiscal Years 2013 and 2014) (formerly 4.00%).

5. Cost-of-Living Adjustments: 2.00% per year, compounded annually.

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

Actuarial Value of Assets (Asset Smoothing Method). SDCERS uses an actuarial value of assets to calculate the City's pension contribution each year, using an asset smoothing method to dampen the volatility in asset values that could occur because of fluctuations in market conditions. Use of an asset smoothing method is consistent with the long-term nature of the actuarial valuation process. The actuarial value of assets each year is equal to 100% of the expected actuarial value of assets[2] plus 25% of the difference between the current market value of assets and the expected actuarial value of 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. This means that changes in the market value of assets are factored into the actuarial value of assets roughly over a four year period. The actuarial value of assets will also be adjusted, if necessary, to ensure that the actuarial value of assets will never be less than 80% of the

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[1] Prior to Fiscal Year 2009, the City's actuarial liability was calculated using the Projected Unit Credit ("PUC") method.

[2] The expected actuarial value of assets is equal to the prior year's actuarial value of assets increased by actual contributions made, decreased by actual disbursements made, all items further adjusted with the expected investment returns for the year.

market value of assets, nor greater than 120% of the market value of assets. The consequence of the smoothing methodology is that the actuarial value of assets increased by 8.2% while the market value of assets increased by 24.3% from June 30, 2010 to June 30, 2011. As of June 30, 2011, the market value of plan assets was $4.848 billion, and the actuarial value was $4.739 billion.

Funding Status. According to the 2011 Valuation, at June 30, 2011, the City had a UAAL of $2.178 billion and a funded ratio of 68.5%. The UAAL increased by $32.8 million over the UAAL at the 2010 Valuation, which was $2.145 billion, and the funded ratio increased by 1.4%. The primary cause for the increase in the UAAL was the change in actuarial assumptions adopted by the Board at its September 20, 2011 meeting. These changes increased the UAAL by $188.3 million, a significant portion of which was offset by reduced actuarial liabilities and better than expected investment performance, which together decreased the UAAL by $129.8 million. Table 24 below sets forth the City's portion of SDCERS' historical funding progress for Fiscal Years 2002 through 2011:

TABLE 24
CITY OF SAN DIEGO
SCHEDULE OF FUNDING PROGRESS
Fiscal Years 2002 through 2011
($ in thousands)
(unaudited)

Valuation Date (June 30)	Actuarial Value of Assets	Market Value of Assets	AAL	Funded Ratio (Actuarial)	Funded Ratio (Market)	UAAL (Actuarial)	AAL less Market Value of Assets	Covered Payroll [5]	UAAL to Covered Payroll
2002	$2,448,208	$2,609,623	$3,168,921	77.3%	82.4%	$ 720,713	$ 559,298	$535,157	134.7%
2003	2,375,431	2,780,080	3,532,626	67.2	78.7	1,157,195	752,546	533,595	216.9
2004 [1]	2,628,680	2,847,479	3,997,328	65.8	71.2	1,368,648	1,149,849	540,181	253.4
2005	2,983,080	3,205,722	4,377,093	68.2	73.2	1,394,013	1,171,371	557,631	250.0
2006 [2]	3,981,932	3,981,932	4,982,699	79.9	79.9	1,000,767	1,000,767	534,103	187.4
2007 [3]	4,413,411	4,641,341	5,597,653	78.8	82.9	1,184,242	956,312	512,440	231.1
2008 [1]	4,660,346	4,408,719	5,963,550	78.2	73.9	1,303,204	1,554,831	535,774	243.2
2009	4,175,229	3,479,357	6,281,636	66.5	55.4	2,106,408	2,802,279	536,591	392.6
2010	4,382,047	3,900,537	6,527,224	67.1	59.8	2,145,177	2,626,687	530,238	404.6
2011 [4]	4,739,399	4,848,054	6,917,417	68.5	70.1	2,178,018	2,069,363	514,265	423.5

(1) Reflects revised actuarial assumptions.
(2) Reflects revised actuarial methodologies.
(3) Reflects revised actuarial assumptions, including the return to EAN actuarial funding method.
(4) Reflects revised actuarial methodologies and assumptions. Methodologies and assumptions are discussed above.
(5) Covered payroll includes all elements of compensation paid to active City employees on which contributions to the pension plan are based.
Source: SDCERS Comprehensive Annual Financial Report for 2002 through 2010 Valuations; Cheiron Actuarial Valuation as of June 30, 2011; Office of City Comptroller.

Preservation of Benefits Plan

The Preservation of Benefits ("POB") Plan is a qualified governmental excess benefit arrangement ("QEBA") under Internal Revenue Code ("IRC") section 415(m). The POB Plan allows for the payment of promised benefits that exceed IRC section 415(b) limits and therefore cannot be paid from SDCERS assets. The POB Plan is unfunded within the meaning of federal tax law and the City may not prefund the POB Plan to cover future liabilities. Payments related to the POB Plan are funded annually by the City. Depending on whether the City has any retirees whose pension benefits exceed IRC section 415(b) limits in any given year the City may have a POB ARC. The existence of a POB ARC will result in a City pension payment in excess of the ARC.

City and Water System Pension Contributions

The City's total budgeted pension contribution for Fiscal Year 2012, based on the 2010 Valuation, is $232.8 million. This includes a pension plan ARC of $231.2 million and a POB ARC of $1.6 million. The Water Utility Fund's proportionate share of the City's total budgeted pension contribution is $12.3 million, or 5.3%. The City's pension plan ARC for Fiscal Year 2013, based on the 2011 Valuation is $231.3 million. The POB ARC for Fiscal Year 2013 and the City's total pension, contribution have not yet been calculated. While the citywide pension contribution has grown substantially in recent years and poses a significant financial challenge for the City, the Water System's proportionate share of the total City contribution is approximately 2.7% of the Water System's operations and maintenance budgeted costs in Fiscal Year 2012. The following table sets forth the City's pension contributions and the water system's share for Fiscal Years 2006 (the year the City began to fully fund its pension contribution and the first year that Cheiron conducted the actuarial valuation) through 2012.

TABLE 25
CITY OF SAN DIEGO AND WATER UTILITY FUND
PENSION CONTRIBUTION
Fiscal Years 2006 through 2012
($ In Thousands)

Fiscal Year ended (June 30)	Pension Plan ARC	POB Plan ARC	Total ARC [1]	Total Pension Contribution	Additional Contribution (underfunding)	Water System Contribution	Water System Contribution (% of O&M)
2006	$170,071	--	$170,071	$271,349	$101,278	$8,823	3.0%
2007	162,000	--	162,000	169,126	7,126	8,857	3.2
2008	137,700	2,407	140,107	166,581	26,474	8,780	3.1
2009	161,700	4,004	165,704	163,614	(2,090)	6,574	2.2
2010	154,200	1,000	155,200	193,880	38,680	11,339	3.5
2011	229,100	1,817	230,917	230,423	(494)	14,662	4.5
2012 [2]	231,200	N/A	232,800	232,800	N/A	12,346	2.7

(1) Includes core pension ARC and POB Plan ARC. See Note 12 in City's Fiscal Year 2011 CAFR for more information on ARC and POB. Per IRS guidelines, the City may not pre-fund the POB Plan. Therefore, plan contributions may differ from the ARC in any given year. The City did not maintain a QEBA prior to Fiscal Year 2008 and therefore did not calculate a separate ARC.

(2) Data for Fiscal Year 2012 is budgeted. All other data is actual. The total pension contribution assumes a POB Plan ARC of $1,600.

Source: City of San Diego Comprehensive Annual Financial Reports Fiscal Year 2006-2011; SDCERS Actuarial Valuations; Department of Financial Management; Public Utilities Department.

Prospective Funding Status

As part of its actuarial valuations for SDCERS, Cheiron prepares projected financial trends to show the City's expected cost progression. The following table uses the assumed investment return rate of 7.5% adopted by the Board on September 20, 2011. It is critical to note that these projections, while valid as baseline projections, are not likely to occur as experience never conforms exactly to assumptions from year to year.

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TABLE 26
CITY OF SAN DIEGO ACTUARIAL FUNDING PROJECTIONS
(earnings as assumed)
Fiscal Years 2013 through 2023

Fiscal Year Ending June 30	Investment Return Rate	Annual Required Contribution (millions)	ARC as Percentage of Payroll	UAAL (billions)
2013	7.50%	$231.3	46%	$2.18
2014	7.50	236.4	46	2.13
2015	7.50	243.0	46	2.08
2016	7.50	250.2	45	2.02
2017	7.50	258.1	45	1.96
2018	7.50	266.5	44	1.89
2019	7.50	275.5	44	1.81
2020	7.50	285.0	44	1.71
2021	7.50	295.0	44	1.61
2022	7.50	305.5	44	1.49
2023	7.50	316.5	44	1.36

Source: Cheiron 2011 Valuation.

Pension Reform Ballot Initiative

An initiative generally entitled "Comprehensive Pension Reform for San Diego" and designated as Proposition B, "Amendments to the San Diego City Charter Affecting Retirement Benefits," has qualified for the June 5, 2012 ballot. Generally, the amendments would provide all new City employees hired on or after July 1, 2013, except sworn police officers, with a 401(k) plan instead of a defined benefit plan. The initiative also contains other provisions intended to limit pension benefits for existing employees by imposing a six-year freeze on inflationary salary increases from July 1, 2012 to June, 1, 2018 and limiting the compensation used to calculate pension benefits. According to a fiscal analysis prepared by the Independent Budget Analyst, which will be included in the Proposition B ballot materials, and actuarial data compiled by Cheiron, the proposal to change to a 401(k) style plan for all new City employees hired on or after July 1, 2013, except sworn police officers, would have a net cost to the City of approximately $13 million (approximately $56 million in 2012 dollars adjusted for the timing of cost measures and saving measures and assuming inflation at 3.75% per annum) over a thirty year term and the proposal to freeze pay, if fully implemented by the City Council, would save the City approximately $963 million (approximately $581 million in 2012 dollars adjusted for inflation) over a thirty year term.

It is further noted, however that Proposition B, as drafted, is estimated to result in increased costs to the City of $54.1 million for fiscal years 2014 through 2016, largely due to the change in the UAAL payment schedule. These costs will be greater and could continue over a longer period of time if salary freezes are not implemented. Also, Proposition B cannot unilaterally freeze City salaries. Rather, it establishes the City's initial bargaining position with respect to pay increases and pay increases may be authorized with a 2/3 vote of the City Council. If this occurs, the projected savings would be reduced or not achieved. All fiscal analysis regarding Proposition B herein is on a citywide basis and the City has not calculated its potential impact on the Water System.

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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 5,602 retirees, 7,240 active employees, and 759 terminated vested members as of June 30, 2011. This is a closed group because the benefit was eliminated for employees hired after July 1, 2005.

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 prefund future OPEB expenses.

Actuarial Assumptions and Methods

The City commissions an annual actuarial valuation of its OPEB liability for the purpose of determining the City's annual cost in accordance with GASB 45. The valuation as of June 30, 2011 ("2011 OPEB Valuation"), dated November 2, 2011, was performed by Buck Consultants ("Buck"). CalPERS has established minimum valuation assumptions for CERBT participants. The following are the major actuarial assumptions and methods employed by Buck in performing the 2011 OPEB Valuation:

1. Actuarial Cost Method: Entry Age Normal (see description under San Diego Employees' Retirement System for more information).

2. Amortization Rate: Level Dollar.

3. Remaining Amortization Period: 30 years, open.

4. Actuarial Asset Valuation Method: Fair Value.

5. Discount Rate: 6.40% (6.69% in Fiscal Year 2010)

6. Inflation Rate: N/A (benefits are determined based on Health Care Cost Trend Rate, below).

7. Projected Payroll Increase: N/A (benefits are determined based on Health Care Cost Trend Rate, below)

8. Health Care Cost Trend: 9.5% for Fiscal Year 2012 grading down by 0.5% annually to 5% for Fiscal Year 2021 and beyond.

Funding Status

According to the 2011 OPEB Valuation, at June 30, 2011, the City had an OPEB UAAL of $1.132 billion and a funded ratio of 9.34%. The OPEB UAAL increased by approximately $4 million over the OPEB UAAL at the 2010 OPEB Valuation, which was $1.128 billion, and the funded ratio increased by 3.28%.

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The following table shows the City's OPEB funding progress for Fiscal Years 2008 (the year the City began to prefund OPEB expenses) through 2011:

TABLE 27
CITY OF SAN DIEGO
SCHEDULE OF FUNDING PROGRESS (OPEB)
Fiscal Years 2008 through 2011
($ in thousands)
(unaudited)

Fiscal Year ending June 30	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Liability	Funded Ratio	Covered Payroll	UAAL as % of Covered Payroll
2008	$29,637	$1,235,707	$1,206,070	2.40%	$556,857	216.6%
2009	41,497	1,359,377	1,317,880	3.05	549,012	240.0
2010	72,720	1,200,910	1,128,190	6.06	472,561	238.7
2011	116,608	1,248,151	1,131,543	9.34	455,537	248.4

Source: The City of San Diego Comprehensive Annual Financial Report for the Fiscal Years ended June 30, 2008 through June 30, 2011.

City and Water System OPEB Contributions

The City does not fully fund its annual required contribution for OPEB ("OPEB ARC") and does not expect to do so for the foreseeable future. In Fiscal Year 2011, the City paid approximately $33.9 million for annual OPEB pay-as-you-go costs and contributed an additional amount of approximately $25 million to the CERBT. In Fiscal Year 2012, the City has budgeted approximately $37.2 million for annual OPEB pay-as-you-go costs and budgeted an additional amount of approximately $20.6 million for defined contribution payments and to contribute to the CERBT. The total amount the City expects to contribute in Fiscal Year 2012 is $57.8 million.

In Fiscal Year 2011, the Water System's proportionate share of the City's total OPEB contribution was approximately $4.9 million. For Fiscal Year 2012, the Water System has budgeted approximately $3.9 million for its OPEB contribution. The following table sets forth the City's OPEB ARC, City CERBT, pay-as-you-go and total contributions and the Water System's percentage of the total contribution. For additional information, see Note 12 in City's Fiscal Year 2011 CAFR.

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TABLE 28
CITY AND WATER SYSTEM
OPEB CONTRIBUTIONS
Fiscal Years 2008 through 2012
(in Millions)

Fiscal Year ended June 30	OPEB ARC	City CERBT Contribution	City Paygo	City Total Contribution	Water System Total	Water System Contribution (% of O & M)
2008	$ 91.6	$30.1	$23.4	$53.6	$3.9	1.4%
2009	104.5	23.9	25.6	49.5	3.7	1.2
2010	113.4	25.0	31.7	56.7	4.7	1.4
2011	120.3	25.0	33.9	58.9	4.9	1.5
2012 (1)	98.5	20.6	37.2	57.8	3.9	0.9

(1) Data for Fiscal Year 2012 is budgeted. All other information is actual.
Source: The City of San Diego Comprehensive Annual Financial Reports for the Fiscal Years ended June 30, 2008 through June 30, 2011; City of San Diego Financial Management Department and the Public Utilities Department, City of San Diego.

Labor Agreement Related to OPEB

The City has entered into a 15-year single subject memorandum of understanding with each of its labor organizations regarding reforms to the retiree healthcare benefit for health-eligible employees. The agreement, which cannot be changed until Fiscal Year 2015 at the earliest, caps the City's OPEB contribution at $57.8 million for Fiscal Years 2012 through 2015, with annual increases of up to 2.5% after 2015.

RISK FACTORS

Investment in the 2012A Bonds involves risks that may not be appropriate for certain investors. The following is a discussion of certain risk factors that should be considered, in addition to other matters set forth herein, in evaluating the 2012A Bonds for investment. The information set forth below does not purport to be an exhaustive listing of the risks and other considerations that may be relevant to an investment in the 2012A Bonds. In addition, the order in which the following information is presented is not intended to reflect the relative importance of any such risks.

Limited Obligations

The obligation of the City to pay the 2012A Subordinated Installment Payments securing the 2012A 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 2012A Subordinated 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 2012A Supplement to make the 2012A Subordinated 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 2012A Subordinated 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 water to its customers, and the ability of the City to meet its covenant to fix, prescribe, and collect rates and charges for the Water Service in amounts sufficient to timely pay the 2012A Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of or interest on the 2012A Bonds. Such covenant does not include debt service on Subordinated Obligations such as the 2012A Subordinated Installment Payments. See "WATER SYSTEM FINANCIAL OPERATIONS – Establishment of Water Service Charges."

The 2012A Bonds are limited obligations of the Authority payable solely from and secured solely by the Subordinated Revenues pledged therefor and amounts on deposit in the Common Subordinated Bonds Reserve Fund and the Subordinated Bonds Payment Fund established under the Indenture. Funds for the payment of the principal of and the interest on the 2012A Bonds are derived solely from the 2012A Subordinated Installment Payments. The Authority has no other source of revenues from which to pay debt service on the 2012A Bonds. The Authority has no taxing power.

Subordinate Obligations

The 2012A Bonds are limited obligations of the Authority payable solely from and secured by the 2012A Subordinated Installment Payments to be received by the Authority and from the amounts on deposit in certain funds held under the Indenture. The 2012A Subordinated Installment Payments are payable from Net System Revenues on a basis that is equal in right of payment by the City of its Outstanding Subordinated Obligations under the Installment Purchase Agreement but subordinate in right of payment by the City of its Outstanding Senior Obligations under the Installment Purchase Agreement. In the event of a default under the Indenture, the owners of the Senior Obligations have, in certain circumstances, the right to accelerate the entire principal amount of the Senior Obligations. See "Acceleration; Limitations on Remedies" below. In such circumstances, owners of the 2012A Bonds may not receive scheduled payments of principal of and interest on the 2012A Bonds until all holders of Senior Obligations have been paid in full. Further, as concerns the Rate Covenant under the Indenture, Adjusted Debt Service does not include debt service on Subordinated Obligations such as the 2012A Subordinated Installment Payments. See "SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS" and "APPENDIX B – SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

Water System Expenses and Collections

The Operation and Maintenance expenditures related to the Water System are expected to increase in the next five years. See "WATER SYSTEM FINANCIAL OPERATIONS – Financial Projections and Modeling Assumptions." However, there can be no assurance that the City's projected future Maintenance and Operation costs of the Water System will actually be as projected by the Department and described in this Official Statement. In addition, demands on the Water System are expected to increase due to population growth and regulatory requirements in the future. As described herein, the City is in the process of implementing the Long-Range Water Resources Plan and the attendant CIP to provide a framework for meeting future water requirements. Increases in expenses could require a significant increase in rates or charges in order to pay for CIP projects, including those anticipated under the City's Long-Range Water Resources Plan, and to pay the debt service on account of any Obligation senior to or on a parity with the 2012A Subordinated Installment Payments including, without limitation, the 2012A Subordinated Installment Payments securing the 2012A Bonds. Also, any such rate increases could increase the likelihood of nonpayment by purchasers of water from the City and could also decrease demand from such purchasers and may impact the City's ability to pay the 2012A Subordinated Installment Payments and to provide for the payment of the 2012A Bonds as and when due.

Water System Demand

There can be no assurance that the local demand for the services provided by the Water System will be maintained at levels described in this Official Statement. Because of changes in demographics within the boundaries of the City, it is possible for the demand for water services to decline over the term of the 2012A Bonds. A significant decline in demand might create a situation in which the City could not increase rates sufficiently to offset the decrease in subscribers or usage. This would reduce the City's ability to make the 2012A Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of or interest on the 2012A Bonds.

Rate-Setting Process Under Proposition 218

Proposition 218, which added Articles XIIIC and XIIID to the State 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. 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 2012A Supplement to pay the 2012A Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of or interest on the 2012A Bonds. See "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES – Article XIIIC" and "– Article XIIID."

Notwithstanding the foregoing, the City has covenanted to fix, prescribe, and collect rates and charges for Water Service at a level at least sufficient to meet its debt requirements for Senior Bonds, as set forth under "SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS – Rate Covenant," and to use its best efforts to effect Water Service rate increases in compliance with Proposition 218. The current water rates approved by the City Council have been imposed in compliance with Proposition 218. See "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES – Article XIIIC" and "– Article XIIID."

Statutory and Regulatory Compliance

The Water System is subject to a variety of federal and State statutory and regulatory requirements. Laws and regulations governing treatment and delivery of water are enacted and promulgated by federal, state and local government agencies. Compliance with these laws and regulations is and will continue to be costly and, as more stringent standards are developed to ensure safe drinking water standards and the provision of water for other purposes, such costs will likely increase.

The City's failure to comply with applicable laws and regulations could result in significant fines and penalties. Such claims are payable from assets of the Water System or from other legally available sources. In addition to claims by private parties, changes in the scope and standards for public agency water 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 Water Utility Fund. No assurance can be given that the cost of compliance with such laws, regulations, and orders would not adversely affect the ability of the Water System to generate Net System Revenues sufficient to pay the debt service on account of any Obligation senior to or on a parity with the 2012A Subordinated Installment Payments including, without limitation, the 2012A Subordinated Installment Payments. See "WATER SYSTEM REGULATORY REQUIREMENTS – Compliance Order by the California Department of Public Health."

Although the City has covenanted in the Master Installment Purchase Agreement to fix, prescribe, and collect rates and charges for the Water Service in amounts sufficient to timely pay the 2012A Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of or interest on the 2012A Bonds. Such covenant does not include debt service on Subordinated Obligations such as the 2012A Subordinated Installment Payments and no assurance can be given that the cost of compliance with such laws and regulations will not materially adversely affect the ability of the Water System to generate Net System Revenues sufficient to pay the 2012A Subordinated Installment Payments.

Risks Relating to the Water Supply

General. There are a variety of factors that can adversely affect the supply of water available to MWD, CWA and the City. See "WATER SUPPLY." Further, among other factors affecting demand, water use is affected by economic conditions. Economic recession and its associated impacts such as job losses, income losses, and housing foreclosures or vacancies affect aggregate levels of water use and the City's water sales. Among other matters, water supply and demand, general and southern California economic conditions and changes in law and government regulations could adversely affect the amount of operating revenues that the Department receives.

Drought Risks. The ability of the Water 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. If the water supply decreases significantly, whether by operation of mandatory supply restrictions, prohibitively high water costs or otherwise, Water System sales will diminish and Net System Revenues available to pay the 2012A Subordinated Installment Payments may be adversely affected. Suppliers of water to the City, including CWA and MWD, have planned and managed reserve supplies to account for normal occurrences of drought conditions. Between 2008 and early 2011, drought conditions in the State triggered the need for both voluntary and mandatory reductions in water use. Dry conditions in the northern Sierra watershed for the SWP and low storage levels in Lake Mead and Lake Powell resulting from a multi-year drought in the Colorado River Basin further affected water deliveries and storage throughout the region. In 2011, however, above-normal precipitation triggered more than 4 million acre-feet of additional releases from Lake Powell to Lake Mead, the most since 1997. In December 2011, Lake Mead's elevation reached 1,133 feet above sea level, or 56% full, which is approximately 51 feet higher than observed in November 2010, the lowest elevation recorded since the reservoir was first filled. The reservoir peaked in January 2012 at 1,135 feet and is forecasted to drop to an elevation of 1,116 feet by September 2012. Each ten-foot increase in Lake Mead's elevation represents approximately 1 million acre-feet of increased storage. See "WATER SUPPLY."

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 that represent potential safety hazards, including expansive soils and areas of potential liquefaction and landslide. The San Andreas, Rose Canyon, Elsinore, and San Jacinto fault zones are all capable of producing earthquakes in the San Diego area and beyond. Water conveyance and distribution facilities maintained by DWR, MWD and CWA are all subject to the risk of earthquakes and other natural disasters which could interrupt deliveries to the Water System. Earthquakes or other natural disasters could interrupt operation of the Water System or that of its suppliers and thereby interrupt the ability of the City to realize Net System Revenues sufficient to pay the 2012A Subordinated Installment Payments securing the payment of the 2012A Bonds. In anticipation of such potential disasters, the City designs and constructs all facilities of the Water System to the seismic codes in effect at the time of design of the project. The Water System has not experienced any significant losses of facilities or services as a result of earthquakes.

Water conveyance facilities generally consist of pipelines and connections, flow control facilities, and pumping stations, which are not typically vulnerable to damage by wildfires. The above ground facilities within the Water 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 Water System. The Department watches for wildfires that may threaten the facilities of the Water 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 Water System to ensure continuous operation. The Water System did not sustain damage from the October 2007 wildfires in the County.

As described under the caption "WATER SYSTEM SERVICE AREA AND FACILITIES – Existing Water System Facilities – Raw Water Reservoirs," the City is also cooperating with CWA on the Emergency Storage Project, pursuant to which a system of reservoirs, interconnected pipelines and pumping stations is being created to improve the availability of water to the San Diego region in the event of an interruption in imported water deliveries. Currently, the pipelines that carry imported water for CWA, a portion of which is purchased by the Department, extend for hundreds of miles and cross several major fault lines en route to the County. A severe earthquake, drought or other significant disaster could cut off the County's imported water supply for up to six months. As part of the Emergency Storage Project, CWA is increasing the height and storage of San Vicente Reservoir and connecting Lake Hodges to the imported water system, which will increase the amount of water locally available in an emergency.

Although the City has implemented disaster preparedness plans and made improvements to Water 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 Water 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 Master 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 Water System.**

Environmental Considerations. Quagga (dreissena rostriformis bugensis) and Zebra (dreissena polymorpha) mussels are small freshwater bivalve mollusks native to Ukraine. Within the United States and in other areas of the world, they are considered an invasive species with significant adverse impact on the ecosystem. Presence of the invasive Quagga mussel has been verified in water bodies supplied by the lower Colorado River, beginning in January 2007. The first identification of mussel presence in the San Diego region occurred in August 2007. It is suspected that Quagga mussels were transported into the Colorado River basin by recreational vessels traveling from infested waters from the eastern United States. Once introduced into the Colorado River basin, the Quagga mussels have been transported through the imported water supply into the City's reservoirs. Quagga mussels can reproduce quickly and, if left unmanaged, can clog intakes and raw water conveyance systems, alter or destroy fish habitats and affect lakes and beaches. An initial survey of the Colorado River to ascertain the extent of the quagga mussel colonization detected low densities in Lake Mead, Lake Mohave and Lake Havasu and in the intake of the Central Arizona Project. Quagga mussels were also detected at the Colorado River Aqueduct intake pumping plant, Gene Wash and Copper Basin reservoirs, in portions of the Colorado River Aqueduct and in Lake Skinner. Shutdowns of the Colorado River Aqueduct in July 2007, October 2007 and March 2008 permitted additional quagga mussel inspection and facilitated control measures. Once introduced into the Colorado River basin, the Quagga mussels have been transported through the imported water supply into the City's reservoirs. To date, the City has found Quagga mussels in San Vicente, El Capitan, Otay, Murray and Miramar Reservoirs. Quagga mussels pose a significant risk to the aquatic life and ecosystem within reservoirs and to the operation and maintenance of the Water System. At this time, the ultimate impact is unknown; however, it has the potential to generate significant capital and annual operational and maintenance costs. Future quagga mussel control efforts are expected to include infrastructure upgrades and recommendations on boating practices or additional facilities and additional long-term measures.

Security of the Water System. Military conflicts and terrorist activities may adversely impact the operations and finances of the Water System. The Department continually plans and prepares for emergency situations and immediately responds to ensure the quality and service of water is maintained. The Department prepares for emergencies such as earthquake, fire, power failure, or possible water contamination in a variety of ways, including: extensively monitoring the entire water treatment and distribution system on a routine basis throughout the year, in part by taking thousands of water samples; routinely training staff on critical security and safety; conducting disaster drills to improve coordination efforts throughout the region; collaborating with the CDPH, law enforcement and fire-rescue agencies in order to improve multiple agency response to water emergencies; implementing a water quality notification plan to keep customers informed in emergency situations; and implementing additional security measures at all water treatment plants, reservoirs, and other local and remote water facilities. 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 Water System or that costs of security measures will not be greater than presently anticipated. Further, damage to certain components of the Water System could require the City to increase expenditures for repairs to the Water System significantly enough to adversely impact the City's ability to make the 2012A Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of or interest on the 2012A Bonds. The Department's CIP has made use of and is continuing to use Homeland Security grants to enhance security of various facilities throughout the Water System. In addition, the City has established the Operating Reserve, which is currently funded at a minimum 55 days of operating costs which may be used under certain circumstances for repairs to the Water System. The City is in the process of gradually increasing such reserve to a level sufficient for 70 days of operating costs by Fiscal Year 2013. See "WATER SYSTEM FINANCIAL OPERATIONS – Rate Stabilization Fund; Other Funds and Accounts."

Suppliers of water to the City have also taken actions to increase the security of water from the Colorado River Aqueduct and the SWP. MWD conducts ground and air patrols of the Colorado River Aqueduct and monitoring and testing at all treatment plants and along the Colorado River Aqueduct. Similarly, DWR has in place security measures to protect critical facilities of the SWP, including both ground and air patrols of the SWP. Although MWD has constructed redundant systems and other safeguards to ensure its ability to continually deliver water to its customers, and DWR has made similar efforts, a terrorist attack or other security breach against water facilities could materially impair MWD's ability to deliver water to its member agencies, including CWA, from which the Department purchases a substantial portion of its water supplies, through the Colorado River Aqueduct or the SWP, or that costs of security measures will not be greater than presently anticipated, which could adversely impact the City's ability to pay the 2012A Subordinated Installment Payments, which could in turn adversely impact the Authority's ability to make payments of the principal of or interest on the 2012A Bonds.

The safety of the facilities of the Water System is maintained via a combination of regular inspections by City employees, electronic monitoring, and analysis of unusual incident reports. All critical above-ground facilities operated and maintained by the City are controlled access facilities with fencing, gates, closed circuit television systems and security officers at certain points. Smaller, above ground and subterranean pumping stations operated and maintained by the City 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.

Utility Costs. Power outages may cause difficulties in receiving an adequate water supply and thus increase the cost of water. No assurance can be given that any future significant reduction or loss of power would not materially adversely affect the operations of the Water System. Also, the Department cannot guarantee that prices for electricity or gas will not increase, which could adversely affect the Water System's financial condition, although the rate increases previously approved by the City for Fiscal Years 2008 through 2011 allow for 5% inflation in gas and electric costs. The Department also cannot guarantee that additional increases in water rates charged by CWA, the City's wholesale provider, or other charges imposed by CWA or MWD will not be proposed. Such increases in water rates and such other charges as well as increases in electricity and gas costs are eligible to be "passed through" to the City's water customers as increased water rates in accordance with the City's Municipal Code. Such "pass-through" rate increases are subject to Proposition 218 notice requirements. See "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES – Article XIIIC" and "– Article XIIID."

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 Senior Bonds then Outstanding and the interest accrued thereon to be due and payable immediately. So long as any Senior Bonds remain outstanding under the Indenture, no Owners of Subordinated Bonds shall have the right to declare an Event of Default, to declare any Subordinated Bonds immediately due and payable or to direct the Trustee or waive any Event of Default. 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 2012A 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 2012A 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 that 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 2012A 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. The opinions to be delivered by Bond Counsel, concurrently with the issuance of the 2012A Bonds, that the 2012A Bonds constitute valid and binding limited obligations of the City and the Indenture constitutes a valid and binding obligation of the City will be subject to such limitations and the various other legal opinions to be delivered concurrently with the issuance of the 2012A Bonds will be similarly qualified. See "APPENDIX C – FORM OF BOND COUNSEL OPINION."

If the City fails to comply with its covenants under the 2012A Supplement to pay the 2012A Subordinated Installment Payments, there can be no assurance of the availability of remedies adequate to protect the interests of the holders of the 2012A Bonds.

Dam Safety

The DSOD supervises the safety of the thirteen dams under the jurisdiction of the City. DSOD may impose operating restrictions on dams and reservoirs that adversely affect the operation of the Water System. See "WATER SYSTEM REGULATORY REQUIREMENTS – Permits and Licenses."

Future Legislation

The City is subject to various laws, rules and regulations adopted by the local, State and federal governments and their agencies. The City is unable to predict the adoption or amendment of any such laws, rules or regulations, or their effect on the operations of the Water System or financial condition of the Water Utility Fund.

Potential Impact of Climatic Change

The issue of climate change has become an important factor in water resources planning in the State of California, and it is being considered during planning for water supplies and systems. Many studies cite evidence that increasing concentrations of greenhouse gases have caused and will continue to cause a rise in temperatures around the world, which will result in a wide range of changes in climate patterns. Moreover, they cite evidence that a warming trend occurred during the latter part of the 20th century and will likely continue through the 21st century. These changes could have a direct effect on water resources in the State, and numerous studies on climate and water in the State have been conducted to determine the potential impacts. Based on these studies, global warming could result in the following types of water resources impacts in the State, including impacts on water supplies and systems:

- Sea level rise and an increase in saltwater intrusion,

- Changes in the timing, intensity, and variability of precipitation, and an increased amount of precipitation falling as rain instead of as snow,

- Reductions in the average annual snowpack due to a rise in the snowline and a shallower snowpack in the low- and medium-elevation zones, and a shift in snowmelt runoff to earlier in the year,

- Long-term changes in watershed vegetation and increased incidence of wildfires that could affect water quality,

- Increased water temperatures with accompanying adverse effects on some fisheries,

- Increases in evaporation and concomitant increased irrigation need, and

- Changes in urban and agricultural water demand.

However, other than the general trends listed above, there is no clear scientific consensus on exactly how global warming will quantitatively affect State water supplies, and current models of State water systems generally do not reflect the potential effects of global warming.

The Climate Change-Related Impacts in the San Diego Region by 2050 Report, released by California Climate Change Center in August 2009, suggested that due to global climate changes, the mean sea level ("MSL") in the year 2050 will rise by 1.5 feet. A review of historical tide data from the National Oceanic and Atmospheric Administration (NOAA) determined that the average high tide rise for the San Diego Region was 6.55 feet. The projected elevation of the 2050 high tide will be the current high tide elevation (6.55 feet) plus the projected rise in sea level by the year 2050 (1.5 feet), which makes the projected San Diego Region 2050 high tide elevation 8.05 feet above MSL. The City performed an analysis based on these referenced information determining what would be the potential impacts to the City's water and wastewater facilities. Based on the analysis, no water pump stations or treatment plants will be affected by this potential sea level change since these facilities are all situated at higher grounds. The City maintains and operates more than 3,300 miles of water lines; less than 22 miles of these water pipes may be impacted by the projected rise in sea level. The impacts on affected water pipes will be limited by the fact that the water system is under high inner pressure.

Based on these preliminary studies and the results of literature reviews, the potential impacts of global warming on water supplies and systems are going to be limited through 2030. Water system operations may be impacted the most by the need to coordinate local surface and groundwater storage operations and developments with shifting imported water supply availability due to changes in the timing, intensity, and variability of precipitation, and an increased amount of precipitation falling as rain instead of as snow in the watersheds for imported water. City water resource specialists and engineers are involved in ongoing monitoring and research regarding climate change trends and will continue to monitor the changes and predictions, particularly as these changes relate to water system operations and management of water supplies and systems.

Uncertainties of Projections, Forecasts and Assumptions

Compliance with certain of the covenants contained in the Indenture is based upon assumptions and projections including, but not limited to, those described under "WATER SYSTEM FINANCIAL OPERATIONS - FINANCIAL PROJECTIONS AND MODELING ASSUMPTIONS." Projections and assumptions are inherently subject to significant uncertainties. Inevitably, some assumptions will not be realized and unanticipated events and circumstances may occur and actual results are likely to differ, perhaps materially, from those projected. Accordingly, such projections are not necessarily indicative of future performance, and the City assumes no responsibility for the accuracy of such projections. See also "INTRODUCTION - Forward-Looking Statements."

Absence of Market for the 2012A Bonds

There can be no guarantee that there will ever be a secondary market for purchase or sale of the 2012A Bonds or, if a secondary market exists, that the 2012A Bonds can be sold for any particular price. Occasionally, because of general market conditions or because of adverse history or economic prospects connected with a particular issue, secondary marketing practices in connection with a particular issue are suspended or terminated. Additionally, prices of issues for which a market is being made will depend upon then prevailing circumstances. Such prices could be substantially different from the original purchase price.

Loss of Tax Exemption on 2012A Bonds

As discussed under the caption "TAX MATTERS," interest on the 2012A Bonds could become included in gross income for purposes of federal income taxation, retroactive to the date the 2012A Bonds were issued, as a result of future acts or omissions of the City or the Authority in violation of their respective covenants in the Indenture and the Installment Purchase Agreement.

Economic, Political, Social, and Environmental Conditions

Prospective investors are encouraged to evaluate current and prospective economic, political, social, and environmental conditions as part of an informed investment decision. Changes in economic, political, social, or environmental conditions on a local, state, federal, and/or international level may adversely affect investment risk generally. Such conditional changes may include (but are not limited to) fluctuations in business production, consumer prices, or financial markets, unemployment rates, technological advancements, shortages or surpluses in natural resources or energy supplies, changes in law, social unrest, fluctuations in the crime rate, political conflict, acts of war or terrorism, environmental damage, and natural disasters.

CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES

Article XIIIA

Article XIIIA 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 XIIIA 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 XIIIA 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 XIIIA 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 that exceeds the reasonable cost of providing the service for which the fee is charged is a "special tax," which under Article XIIIA must be authorized by a two-thirds vote of the electorate. Under Article XIIID, fees and charges for water, sewer, and refuse collection services are subject to majority protest, but are not subject to the two-third vote requirement of Article XIIIA. The reasonable cost of providing water 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 to date 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 "WATER SYSTEM FINANCIAL OPERATIONS – Revenues."

Article XIIIB

Article XIIIB 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, fees, and charges collected by the City are used to pay the costs of maintaining and operating the Water System and payments due on the Senior Bonds and the 2012A Bonds (including the funding of the Reserve Fund for the Senior Bonds to the Reserve Fund Requirement and the Common Subordinated Bonds Reserve Fund to the Common Subordinated Bonds Reserve Requirement), the City believes as of the date hereof that such moneys should not be subject to the annual appropriations limit of Article XIIIB.

Article XIIIC

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 XIIIC and XIIID 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 XIIIC 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 XIIIC 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 XIIIC 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 XIIIC 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 XIIIC 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 XIIIC and Article XIIID ("SB 919"). Such terms are, however, defined in Article XIIID, discussed below. 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 XIIID and are also fees or charges within the meaning of Section 3 of Article XIIIC. 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 XIIIC.

In the *Bighorn Decision*, the Supreme Court did state that nothing in Section 3 of Article XIIIC 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 that 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 November 5, 1996 (the date of adoption 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 that repeal, reduce or prohibit the future imposition or increase of assessments, fees or charges, including the City's Water Service fees and charges, which are the source of Net System Revenues the 2012A Subordinated Installment Payments and, in turn, payments of the principal of and interest on the 2012A Bonds, and other Outstanding Obligations.

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

Article XIIID

Article XIIID 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." As discussed above, 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 XIIID. Article XIIID 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.

The City's Water Service charges have two components, a base fee based on meter size and a commodity charge based on the volume of water consumed. The City has ratified prior increases in its water rates and charges, and believes it has complied with the applicable and material notice and protest procedures of Article XIIID for its current water rates and charges. As of the date of this Official Statement, there has not been and there is no pending litigation challenging any of the City's water fees and charges approved since the effective date of Proposition 218. While the City Attorney currently believes, based upon the judicial precedent in place during the period of these prior rate increases, that a reviewing court could reasonably uphold the validity of those increases, neither the City nor the City Attorney can provide any assurances as to the outcome of a challenge to the prior increases in the City's water rates and charges that were not approved in accordance with the notice and hearing requirements of Article XIIID if one were brought.

In addition, Article XIIID also includes a number of limitations applicable to existing, new, or increased 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.

Article XIIID 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 XIIID 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-2007-655 in January 2007 establishing additional procedures for submitting protests against proposed increases to water rates, including the provision of notice of a proposed change in water fees to all owners of record on each identified parcel and all water 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 water rates, including guidelines for determining when a valid protest has been submitted.

The City and the City Attorney believe that as of the date of this Official Statement that current water fees and charges that are subject to Proposition 218 materially comply with the provisions thereof. Should it become necessary to increase the water fees and charges above current levels, the City would be required to comply with the requirements of Article XIIID in connection with such proposed increase. To date, there have been no legal challenges to water rate increases implemented by the City pursuant to Proposition 218 or otherwise. As of the date of this Official Statement and under existing standards as of such date, the City and the City Attorney believe that rates and charges may be established at levels that are expected to permit deposits to a Rate Stabilization Fund or maintenance of uncommitted cash reserves. See "WATER SYSTEM FINANCIAL OPERATIONS – Financial Projections and Modeling Assumptions."

The City and the City Attorney believe that current water capacity fees are not subject to Proposition 218. Furthermore, as of the date of this Official Statement, the City and the City Attorney are unaware of any legal challenges to this position.

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.

Proposition 26

Proposition 26, a State ballot initiative aimed at restricting regulatory fees and charges, was approved by the California voters on November 2, 2010. Proposition 26 broadens the definition of "tax" in Article XIIIC of the California Constitution to include levies, charges and exactions imposed by local governments, except for charges imposed for benefits or privileges or for services or products granted to the payor (and not provided to those not charged) that do not exceed their reasonable cost; regulatory fees that do not exceed the cost of regulation; fees for the use of local governmental property; fines and penalties imposed for violations of law; real property development fees; and assessments and property-related fees imposed under Article XIIID of the California Constitution. California local taxes are subject to approval by two-thirds of the voters voting on the ballot measure for authorization. Proposition 26 applies to charges imposed or increased by local governments after the date of its approval. The City believes its water rates and charges are not taxes under Proposition 26. Nevertheless, the City is assessing whether Proposition 26 may affect future water rates and charges.

Initiative, Referendum and Charter Amendments

Under the State Constitution, the voters of the State have the ability to initiate legislation and require a public vote on legislation passed by the State Legislature through the powers of initiative and referendum, respectively. For example, Article XIIIA, Article XIIIB and Articles XIIIC and XIIID and Proposition 26 were adopted pursuant to the State's constitutional initiative process. Under the City Charter, the voters of the City can restrict or revise the powers of the City through the approval of a charter amendment. From time to time, other initiative measures could be adopted or legislative measures could be approved by the Legislature, which may place limitations on the ability of the City to increase revenues or to increase appropriations. Such measures may further affect the City's ability to collect taxes, assessments or fees and charges, which could have an effect on the Department's revenues. The City is unable to predict whether any such initiatives or charter amendments might be submitted to or approved by the voters, the nature of such initiatives or charter amendments, or their potential impact on the City or the Water Utility Fund. See "CONSTITUTIONAL LIMITATIONS ON TAXES AND WATER RATES AND CHARGES - Initiative, Referendum and Charter Amendments."

TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Authority ("Bond Counsel"), based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the 2012A Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "Code"), and is exempt from State of California personal income taxes. Bond Counsel is of the further opinion that interest on the 2012A Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Bond Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. A complete copy of the proposed form of opinion of Bond Counsel is set forth in APPENDIX C attached hereto.

To the extent the issue price of any maturity of the 2012A Bonds is less than the amount to be paid at maturity of such 2012A Bonds (excluding amounts stated to be interest and payable at least annually over the term of such 2012A Bonds), the difference constitutes "original issue discount," the accrual of which, to the extent properly allocable to each Beneficial Owner thereof, is treated as interest on the 2012A Bonds which is excluded from gross income for federal income tax purposes and State of California personal income taxes. For this purpose, the issue price of a particular maturity of the 2012A Bonds is the first price at which a substantial amount of such maturity of the 2012A Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to any maturity of the 2012A Bonds accrues daily over the term to maturity of such 2012A Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such 2012A Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such 2012A Bonds. Beneficial Owners of the 2012A Bonds should consult their own tax advisors with respect to the tax consequences of ownership of 2012A Bonds with original issue discount, including the treatment of Beneficial Owners who do not purchase such 2012A Bonds in the original offering to the public at the first price at which a substantial amount of such 2012A Bonds is sold to the public.

2012A Bonds purchased, whether at original issuance or otherwise, for an amount higher than their principal amount payable at maturity (or, in some cases, at their earlier call date) ("Premium 2012A Bonds") will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of bonds, like the Premium 2012A Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, the amount of tax-exempt interest received, and a Beneficial Owner's basis in a Premium 2012A Bond, will be reduced by the amount of amortizable bond premium properly allocable to such Beneficial Owner. Beneficial Owners of Premium 2012A Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the 2012A Bonds. The Authority has made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the 2012A Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the 2012A Bonds being included in gross income for federal income tax purposes, possibly from the date of original issuance of the 2012A Bonds. The opinion of Bond Counsel assumes the accuracy of these representations and compliance with these covenants. Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken), or events occurring (or not occurring), or any other matters coming to Bond Counsel's attention after the date of issuance of the 2012A Bonds may adversely affect the value of, or the tax status of interest on, the 2012A Bonds. Accordingly, the opinion of Bond Counsel is not intended to, and may not, be relied upon in connection with any such actions, events or matters.

Although Bond Counsel is of the opinion that interest on the 2012A Bonds is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes, the ownership or disposition of, or the accrual or receipt of interest on, the 2012A Bonds may otherwise affect a Beneficial Owner's federal, state or local tax liability. The nature and extent of these other tax consequences depends upon the particular tax status of the Beneficial Owner or the Beneficial Owner's other items of income or deduction. Bond Counsel expresses no opinion regarding any such other tax consequences.

Current and future legislative proposals, if enacted into law, clarification of the Code or court decisions may cause interest on the 2012A Bonds to be subject, directly or indirectly, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent Beneficial Owners from realizing the full current benefit of the tax status of such interest. As one example, the Obama Administration recently announced a legislative proposal, which for tax years beginning on or after January 1, 2013, generally would limit the exclusion from gross income of interest on obligations like the 2012A Bonds to some extent for taxpayers who are individuals and whose income is subject to higher marginal income tax rates. Other proposals have been made that could significantly reduce the benefit of, or otherwise affect, the exclusion from gross income of interest on obligations like the 2012A Bonds. The introduction or enactment of any such legislative proposals, clarification of the Code or court decisions may also affect, perhaps significantly, the market price for, or marketability of, the 2012A Bonds. Prospective purchasers of the 2012A Bonds should consult their own tax advisors regarding any pending or proposed federal or state tax legislation, regulations or litigation, and regarding the impact of future legislation, regulations or litigation, as to which Bond Counsel expresses no opinion.

The opinion of Bond Counsel is based on current legal authority, covers certain matters not directly addressed by such authorities, and represents Bond Counsel's judgment as to the proper treatment of the 2012A Bonds for federal income tax purposes. It is not binding on the Internal Revenue Service ("IRS") or the courts. Furthermore, Bond Counsel cannot give and has not given any opinion or assurance about the future activities of the Authority, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS. The Authority has covenanted, however, to comply with the requirements of the Code.

Bond Counsel's engagement with respect to the 2012A Bonds ends with the issuance of the 2012A Bonds, and, unless separately engaged, Bond Counsel is not obligated to defend the Authority or the Beneficial Owners regarding the tax-exempt status of the 2012A Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the Authority and their appointed counsel, including the Beneficial Owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of IRS positions with which the Authority legitimately disagrees, may not be practicable. Any action of the IRS, including but not limited to selection of the 2012A Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues may affect the market price for, or the marketability of, the 2012A Bonds, and may cause the Authority or the Beneficial Owners to incur significant expense.

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 the Municipal Securities Rulemaking Board in the manner prescribed by the SEC 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 2012, and is to include audited financial statements of the City. See "APPENDIX D – FORM OF CONTINUING DISCLOSURE CERTIFICATE."

The City is party to a number of continuing disclosure undertakings with respect to securities secured by the City's General Fund, the Sewer Utility Fund, and the Water Utility Fund pursuant to Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934. During the last five years, the City failed to provide when due annual reports for Fiscal Years 2006, 2007 and 2010. The audited financial statements for Fiscal Years 2006 and 2007 were delayed in principal part due to restatements of prior financial statements that resulted in the auditors undertaking additional procedures. Annual Reports for Fiscal Years 2006 and 2007 were filed following the release of the audited financial statements for these fiscal years. The delay in releasing the audited financial statements for Fiscal Year 2010 was principally due to the implementation of an enterprise resource planning system for the City. With respect to Fiscal Year 2010, the City provided its audited financial statement on or about August 31, 2011, approximately five months following its respective annual reporting dates under its continuing disclosure undertakings. The City is in compliance with its continuing disclosure undertakings with respect to securities secured by the City's General Fund, the Sewer Utility Fund, and the Water Utility Fund for Fiscal Year 2011.

The City will agree in the Continuing Disclosure Certificate with respect to the 2012A Bonds that, in the event that its audited financial statements are not available for dissemination not later than 270 days after the end of the City's Fiscal Year (which currently ends June 30th), the Annual Report filed with the MSRB shall contain unaudited financial statements in a format similar to the financial statements contained in this Official Statement, and the audited financial statements shall be filed when they become available. See "CONTINUING DISCLOSURE."

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

As of the date of this Official Statement, there is no litigation pending against the City, the Corporation or the Authority or, to the knowledge of its respective executive officers, threatened, seeking to restrain or enjoin the issuance, sale, execution, or delivery of the 2012A Bonds or in any way contesting or affecting the validity of the 2012A Bonds or the authorizations or any proceedings of the City, the Corporation or the Authority 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 2012A Bonds or the use of the proceeds of the 2012A Bonds.

There are no pending lawsuits that, in the opinion of the City Attorney, challenge the validity of the 2012A Bonds, the corporate existence of the City, the Corporation or the Authority, or the title of the executive officers thereof 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 City's Department. The Office of the City Attorney has prepared the following summary, as of the date of this Official Statement, of certain claims and lawsuits for which the estimated loss to the City as of such date exceeds $1 million ("Material Litigation") pending against the Water Utility Fund for construction claims and certain other alleged liabilities arising during the ordinary course of operations of the Water System:

Michael Shames, et al. v. City of San Diego (Cal. Health and Safety Code Sec. 5472 claim). Michael Shames, a local utility rate lawyer, filed a claim on August 25, 2010 against the City alleging that the City illegally charged its recycled water rate customers a lower rate than what it costs to produce recycled water, and that the City has recouped the difference by charging a higher rate for potable water to its potable water customers. Thus, his allegation is that the City's water rate structure violates Water Code Sec. 13580.7 (d) and Proposition 218, which requires, among other things, that rates not exceed the cost of providing the service in question.

Shames alleges the illegal rate structure has been in place since August of 2006 and continues to the date hereof. He seeks an immediate refund of the allegedly illegal fees for himself and the class of all similarly situated ratepayers in the City under Health and Safety Code Sec. 5472 and Revenue and Taxation Code Sec. 5140. He estimates the amount of refundable fees to be approximately $40 million. The City believes there are procedural issues with the claim and that it is also defensible on the merits. In the event of an adverse ruling, damages are estimated to range from: $0 to $40 million exclusive of defense costs. Since filing the claim form, Shames has taken no legal action on this claim nor contacted the City about the claim.

The Office of the City Attorney has also prepared, based upon information available to the City, the following summary as of the date of this Official Statement, of the following additional litigation potentially material to the financial condition of the Water System:

Quantification Settlement Agreement related litigation. In November 2003, the IID brought litigation to "validate" 13 of the QSA related contracts as complying with California and federal law. Other lawsuits also were filed contemporaneously, challenging the execution, approval and implementation of the QSA on various grounds. Among other things, the litigation involves a review of the IID environmental impact report for the water transfers and the IID, CWA, MWD, and Coachella Valley Water District (the "CVWD") program environmental impact report for the QSA. All QSA related litigation has been coordinated in Sacramento County Superior Court.

One of the key issues of the pending QSA litigation is the constitutionality of the Quantification Settlement Agreement Joint Powers Authority Creation and Funding Agreement (the "QSA Funding Agreement"), pursuant to which the IID, the CVWD and CWA agreed to commit $133 million toward certain mitigation costs associated with implementation of the water transfer agreements, and $30 million toward the cost of restoration of and mitigation for the Salton Sea, with the State agreeing to be responsible for any costs exceeding those amounts.

In February 2010, Sacramento County Superior Court Judge Roland Candee invalidated the QSA on grounds that a provision in the contract failed to cap the State's Salton Sea environmental mitigation fees. The court held that the State's commitment was unconditional in nature and, as such, violated the State's debt limitation under the California Constitution. MWD, IID, CVWD, CWA, the State and others appealed various aspects of the court's ruling, and the QSA water transfers continued through the appeal process. On December 7, 2011, the California Court of Appeal for the Third District upheld the State's landmark agreement that helped settle long-standing disputes about the allocation of Colorado River water in California, ruling the QSA did not violate the California Constitution.

In filing the appeal, it was argued that the trial court erred in determining that the QSA Funding Agreement was unconstitutional for obligating the State to pay excess mitigation costs that "were not conditioned upon an appropriation by the Legislature." The appellate court agreed that the QSA Funding Agreement imposes a contractual obligation on the State to pay excess mitigation costs, and ultimately held that the QSA Funding Agreement is constitutional because no party can enforce the obligation and take funds from the Treasury without an appropriation.

In addition, the appellate court rejected other claims of invalidity made by opponents of the QSA, dismissed Clean Air Act and National Environmental Policy Act claims due to lack of jurisdiction and found that the trial court erred in finding the CEQA actions were moot. While project opponents had asked the appellate court to decide the CEQA claims in the first instance, the court found that it could not retain jurisdiction over the CEQA actions without suspending the litigation of the remanded validation action and causing an unjust delay. Accordingly, the court remanded the CEQA issues to the trial court, as well.

San Diego County Water Authority v. The Metropolitan Water District of Southern California. The City depends on CWA for about 90% of the City's water supply. In turn, CWA relies on the MWD for most of its water supply through both the purchase of water from MWD and the wheeling of water through MWD facilities that is transferred from the IID and the All-American & Coachella Canal lining project. A primary driver behind increasing water rates in San Diego is MWD's approval of water rate increases totaling 75% since 2006. CWA is suing MWD to protect San Diego County ratepayers from water rate overcharges that will impact the region's economy and affect statewide water reliability. CWA believes that MWD set rates that overstate the cost of transporting water while undercharging for supply costs.

CWA believes the alleged overcharges will cost CWA ratepayers $31 million in 2011 and as much as $230 million annually by 2021, while providing cost savings to each of the 25 other member agencies of MWD. The case was originally filed on June 11, 2010, in San Francisco County Superior Court as Case No. CPF-10-510830. Further, the complaint alleges MWD is unconstitutionally denying San Diego County ratepayers access to funds for local supply development projects and conservation programs in retaliation for the CWA's lawsuit. CWA also alleges that MWD is under-calculating the CWA's preferential right to water, which could affect the San Diego region's future water supply reliability. MWD has responded and disputes these claims, contending that its rates are reasonable, equitably apportioned among its member agencies and lawful.

On January 6, 2012, San Francisco Superior Court Judge Richard A. Kramer allowed three additional causes of action to be added to the lawsuit and granted motions to allow discovery in CWA's case against MWD. The judge also denied without prejudice MWD's motion to bifurcate the case, saying he will consider how the case should be tried after the parties complete discovery. In addition to three causes of action challenging the 2011 and 2012 rates, CWA's lawsuit claims MWD breached its 2003 contract with CWA in which it pledged to follow applicable law in charging CWA and its ratepayers for transportation of water and unlawfully under-calculated CWA's Preferential Rights to purchase water.

The stakes in the litigation are estimated at between $1.3 billion and $2.1 billion over a 45-year period. As part of the 2003 contract that CWA alleges MWD breached, MWD is required to place all disputed payments made by CWA into an escrow account, which MWD cannot spend during the pendency of the litigation. If CWA wins the case, MWD will be required to return those funds to CWA. By the end of 2012, the escrow account will grow to nearly $80 million. The City is not a party to the lawsuit, is not exposed to any monetary liability and is not funding this litigation.

ADDITIONAL INFORMATION

Civil Grand Jury Recommendations

On June 8, 2010, a San Diego County civil grand jury released a report on the City's financial condition which made a number of findings and recommendations, including that the Mayor and City Council convene a panel of experts to evaluate the legal and financial ramifications of the City declaring bankruptcy. The City is not considering bankruptcy and neither the Mayor nor the City Attorney believes a bankruptcy filing is appropriate. On November 8, 2010, the City Council approved its response to the grand jury report. The City has no obligation to implement any grand jury recommendation.

CERTAIN LEGAL MATTERS

Orrick, Herrington & Sutcliffe LLP, Bond Counsel, will render an opinion with respect to the 2012A Bonds in substantially the form set forth in APPENDIX C hereto. Copies of such opinion will be furnished to the Underwriters at the time of delivery of the 2012A Bonds. Certain legal matters will be passed upon for Authority by Orrick, Herrington & Sutcliffe LLP, for the Authority and the City by Jan I. Goldsmith, City Attorney, and for the Underwriters by their counsel, Nixon Peabody LLP, Los Angeles, California.

VERIFICATION

PFM Asset Management LLC will deliver its report verifying the accuracy of the mathematical computation concerning the adequacy of the maturing principal amounts of and interest earned on the investments, if any, together with other available moneys, to be placed in the Escrow Fund to pay when due, pursuant to a call for redemption, the principal of and interest on the 2002 Subordinated Bonds.

RATINGS

Fitch Ratings ("Fitch") and Moody's Investors Service, Inc. ("Moody's") have assigned their ratings of "AA-," and "Aa3," respectively, to the 2012A Bonds, each with a stable outlook. 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: Fitch Ratings, One State Street Plaza, New York, New York 10004 and 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 2012A Bonds. Neither the City nor the Authority undertakes any obligation to oppose any downward revision, suspension or withdrawal.

UNDERWRITING

The 2012A Bonds are being purchased by the Underwriters named on the cover page to this Official Statement (collectively, the "Underwriters"). Morgan Stanley & Co. LLC is serving as the representative of the Underwriters. The Underwriters have agreed, subject to certain conditions, to purchase the 2012A Bonds at a purchase price of $212,040,958.51 (equal to the original principal amount thereof, plus a net original issue premium of $24,173,090.25, less an underwriters' discount of $742,131.74). The Underwriters may offer and sell the 2012A 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.

The following four sentences have been provided by Morgan Stanley & Co. LLC, one of the underwriters for the 2012A Bonds: Morgan Stanley, parent company of Morgan Stanley & Co. LLC, has entered into a retail brokerage joint venture with Citigroup Inc. As part of the joint venture, Morgan Stanley & Co. LLC will distribute municipal securities to retail investors through the financial advisor network of a new broker-dealer, Morgan Stanley Smith Barney LLC. This distribution arrangement became effective on June 1, 2009. As part of this arrangement, Morgan Stanley & Co. LLC will compensate Morgan Stanley Smith Barney LLC for its selling efforts with respect to the 2012A Bonds.

The following two sentences have been provided by E. J. De La Rosa & Co., Inc., one of the underwriters for the 2012A Bonds: E. J. De La Rosa & Co., Inc. has entered into separate agreements with UnionBanc Investment Services LLC, Credit Suisse Securities USA LLC and City National Securities, Inc. for retail distribution of certain municipal securities offerings, at the original issue prices. Pursuant to said agreements, if applicable to the 2012A Bonds, E. J. De La Rosa & Co., Inc. will share a portion of its underwriting compensation with respect to the 2012A Bonds with UnionBanc Investment Services LLC, Credit Suisse Securities USA LLC or City National Securities, Inc.

FINANCIAL ADVISOR

Montague DeRose and Associates, LLC, Westlake Village, California, has acted as Financial Advisor to the City in conjunction with the issuance of the 2012A Bonds. The Financial Advisor has assisted the City in preparation of this Official Statement and advised in other matters related to the planning, structuring, pricing, execution and delivery of the 2012A Bonds. The Financial Advisor will receive compensation contingent upon the sale and delivery of the 2012A Bonds.

The Financial Advisor has not audited, authenticated or otherwise independently verified the information set forth in the Official Statement, or any other information related to the City with respect to the accuracy or completeness of disclosure of such information.

FINANCIAL STATEMENTS

The City prepares financial statements annually in conformity with generally accepted accounting principles for governmental entities, which are audited by an independent certified public accountant. The City's most recent financial statements, for the Fiscal Year ended June 30, 2011, were audited by Macias Gini & O'Connell LLP (the "Independent Auditor"), independent certified public accountants, as stated in their report. The City's basic financial statements contained in the City's CAFRs include the financial statements of the Water Utility Fund.

Those portions of the City's basic financial statements contained in the CAFR for Fiscal Year 2011 relating to the Water Utility Fund, including all of the City's basic financial statements for Fiscal Year 2011 audited by the Independent Auditor, 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 Water Utility Fund but have been included in APPENDIX A for purposes of context. The unaudited letter of transmittal from the Mayor and unaudited statistical information regarding debt service coverage on and aggregate debt service on all the existing Obligations are also included in APPENDIX A. 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 2012A Bonds. The City's General Fund does not secure payment of debt service on the 2012A Bonds.

The Independent Auditor did not review this Official Statement. 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 CAFR for Fiscal Year 2011, including financial statements of the Water Utility 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.

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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 2012A 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/ Jay M. Goldstone
Chief Operating 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, 2011

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Introductory Section

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THE CITY OF SAN DIEGO

January 31, 2012

Citizens and Interested Parties,

The San Diego economy has shown signs of recovery compared to the low point of the recession; however, economic uncertainties still remain in the San Diego region. Several economic indicators have improved in the past 12 months and some major general revenues such as sales tax and transient occupancy tax have increased. Property tax revenues appear to have stabilized as well. At best, the current national economic projections are for slow growth and limited expansion. State revenues are also coming in lower than projected, adding more pressure on the State's already fragile budget. Efforts by the State to improve its budget picture are already being felt at the local level after the recent court decision to uphold the elimination of redevelopment agencies.

In this challenging economic environment, the City has successfully balanced its annual budgets and adopted them on time, by June 30 each year. In fiscal year 2011, the City again was required to make necessary spending reductions to maintain a balanced budget, which had an impact on services within our communities. The City Council and the Mayor's ability to resolve significant budget issues year after year and adopt annual balanced budgets is an accomplishment that has contributed to the strong results in the General Fund. In fiscal year 2011, General Fund revenues increased by 9% over fiscal year 2010, while at the same time, expenditures increased a modest 2% over the same time period. This resulted in General Fund reserves of 11%, which was in excess of the 8% policy goal that was accomplished in fiscal year 2010.

In these uncertain economic times the City has set challenging goals for its future. The City believes these goals are achievable with continued fiscal discipline and greater government efficiency. The diversity of industry, education and tourism well positions the City for an early economic recovery ahead of other peer cities. We are beginning to see the signs of a sustained economic rebound even though we have several years of recovery ahead to get to pre-recession revenue levels.

Economic Development Activities

The international, national and regional economic condition has adversely affected the City of San Diego's revenues and City services. It has also affected the health of the business community. In November 2011, the unemployment rate in San Diego County stood at 9.2%, which was nearly double from four years earlier. While the unemployment rate has declined from its recent historic highs, the City of San Diego is committed to restoring economic stability and reducing the level of local unemployment. With many advantages, such as its strategic location adjacent to Mexico and the Pacific Rim, desirable industry clusters and a skilled workforce, San Diego can compete for new job-creating public and private-sector investment. The focus of fostering an economic recovery centers on four strategic approaches designed to ensure that investment dollars flow into San Diego:

- Dedicated city staff focused on a business expansion, attraction, and retention (BEAR) effort that highlights the advantages of doing business in San Diego.
- Regulatory streamlining process that eliminates redundant and bureaucratic procedures which do not meaningfully contribute to protecting the public interests.
- Focus on emerging industry clusters, including the Mayor's CleanTech Initiative designed to increase demand for renewable energy (e.g. solar), biofuels, energy efficient solutions, and "green" products.
- Completion of critical path infrastructure facilities which is attractive to base sector industry businesses.

The Mayor's Office of Economic Growth Services (EGS) has redoubled its efforts to retain businesses and make local companies aware of State and Federal programs. The Mayor engages with local businesses through the Economic Development Roundtable, and with personal visits to local manufacturers who have either expanded research & development (R&D) or production operations or are considering expansions. As a result, the City is able to tailor its attraction, expansion and retention efforts as well as educate local companies on government incentives.

Fiscal year 2011 was another financially challenging year for the State of California. One program that was threatened was the California Enterprise Zone Program, a vital economic development tool. Mayor Sanders, a coalition of California Mayors and businesses statewide successfully preserved the Enterprise Zone Program while supporting significant changes to its implementation. Enterprise Zones provide one of the only dependable statewide tax incentives that local areas can use to encourage businesses to locate or stay in-state. By utilizing and improving the Enterprise Zone Program, the City is revitalizing economically-challenged areas, encouraging private investment in blighted communities, creating needed jobs in the region, and assisting workers who face barriers to employment.

The restructuring of San Diego’s Foreign-Trade Zone program was approved by the U.S. Department of Commerce/Foreign-Trade Zone Board at the end of fiscal year 2011. As a result of the restructuring, the City is in a better position to entice new private investments and support international trade opportunities.

The attraction, retention and expansion of local companies are vital in the City’s efforts to create local jobs. To that end, significant new projects were completed this past year throughout the City in the sectors of manufacturing, retail, clean tech, and medical devices. Those EGS-facilitated projects included locating a new concentrated photovoltaic manufacturer called Soitec in northern San Diego; the 300,000 square foot Costco Packaging Center in Otay Mesa which will package and distribute Kirkland merchandise to 157 retail outlets in Mexico and the western United States; the expansion of Chromalloy’s aircraft engine test and repair facility; the expansion of Integrated DNA Technologies, a medical device manufacturer; the expansion of Westfield Shopping Town-UTC; and a new laboratory for DiscovRx, a drug manufacturer.

Regulatory streamlining efforts are ongoing to encourage new private sector investment. The City recently adopted the 7^{th} iteration of the Zoning Code Update which simplifies land use regulations and creates a more predictable approval process for new development. The City also changed its parking regulations to encourage car-share programs and is in the process of updating its policies to encourage sustainable building in San Diego.

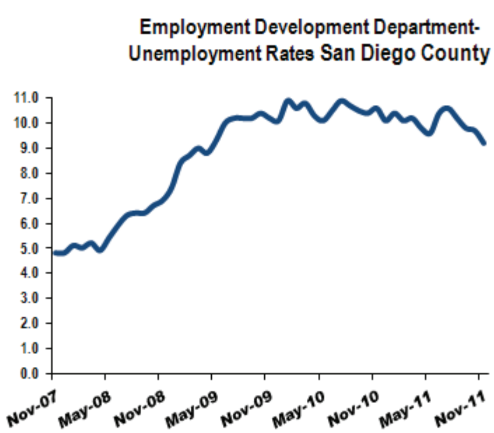
Emerging industry clusters in San Diego are a core focus of EGS support. By partnering with industry cluster organizations such as CleanTECH San Diego, or working directly with companies on their individual needs, EGS provides government aid to help local businesses thrive. Local initiatives that encourage private investment in new clean technology are provided technical and regulatory expertise. During this past year, EGS has assisted ECOtality, Inc. in the installation of electric vehicle charging stations throughout the City. Expanding electric vehicle infrastructure led the City to create an All-Electric Vehicle Car-Share Pilot Program which attracted Car2Go, the first car-share program in North America to exclusively provide all-electric vehicles.

Along the border with Mexico, the City has provided planning, coordination, and advocacy for three major projects. Phase 2 of the 905 Freeway is now under construction with completion expected in 2012. This freeway will accommodate increased international trade within a large industrial area which spans both sides of the border. Two other border infrastructure projects, improvements to the San Ysidro Port of Entry, and construction of a new Cross Border Facility adjacent to Mexico's Rodriguez International Airport, will facilitate increased tourism between San Diego and Mexico.

Fiscal Fundamentals and Our Regional Economy

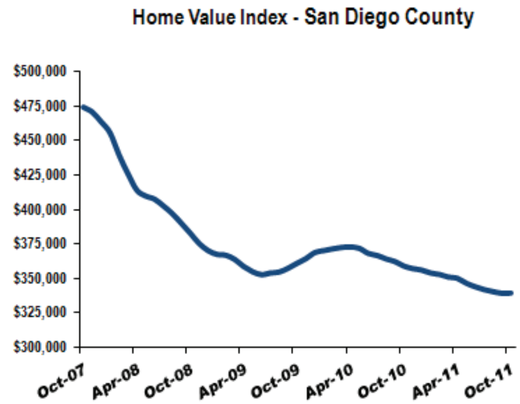
There are currently signs of an economic recovery, but most forecasters predict it will be slow. Retail sales and tourism have improved over the past year. The San Diego region is showing modest but positive signs of decreasing unemployment and stabilization in the housing market. However, the impact of State budgetary actions continue to be challenging. The City continues to closely monitor these areas.

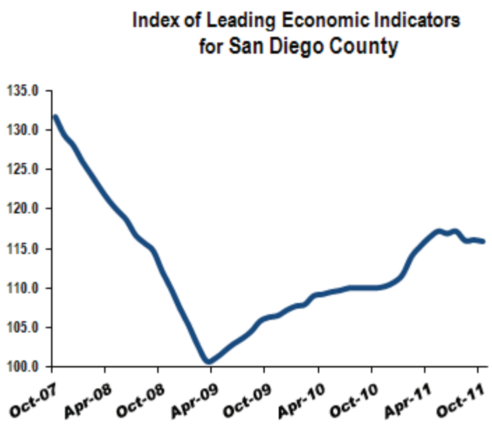
The City has a diversified economy, with the principal employers being government, military, manufacturing, high-tech industries, particularly biotech and telecommunications, and the tourism industry. The City's economic base is also anchored by higher education and major scientific research institutions, including the University of California, San Diego, San Diego State University, Scripps Research Institute, the Salk Institute for Biological Studies, and the Sanford-Burnham Medical Research Institute.



Like all regions around the country, San Diego County's economy has been impacted by the economic recession which has slowed both residential and commercial development within our region. In the past four years unemployment has nearly doubled, rising from 4.8% in November of 2007 to 9.2% in November of 2011. Unemployment hit its peak in July 2010 at 10.9%. Since then we have seen only modest improvement. But we are encouraged to see a 1% improvement in the past four months of the 2011 calendar year.

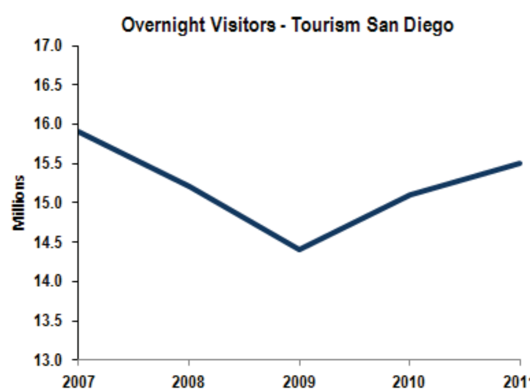
Since the onset of the economic recession in December 2007, significant decreases in median home prices, home sales, and an increase in foreclosures have led to property tax revenue declines which have had a negative impact to the City of San Diego and its citizens. However in fiscal year 2011, a number of factors have led to declines in foreclosure rates and notices of default. While the market is far from pre-recession levels, it is no longer experiencing the large declines in home values recorded in prior fiscal years and we are beginning to see less volatility and some stabilization in countywide median home values.





The index of leading economic indicators for San Diego County improved over the past twelve months from 110.0 to 115.9. This is consistent with the positive growth in taxable sales that the city experienced in fiscal year 2011, with gains reported in all economic sectors, except construction. The City's sales tax consultant, MuniServices LLC, believes that the growth in fiscal year 2011 may be attributed to consumers who kept their jobs throughout the recession and now feel confident spending money on replacement items and new products.

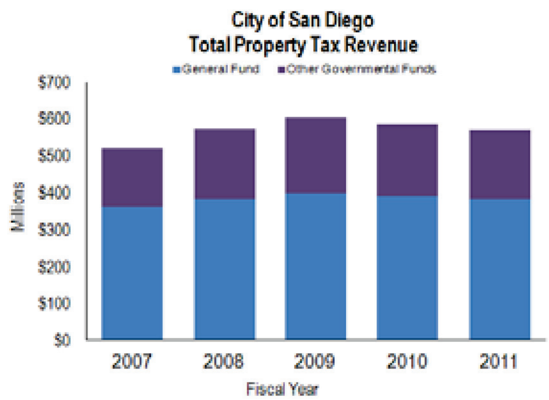
The positive tourism growth trend that started in fiscal year 2010 is projected to continue through fiscal year 2012 according to the San Diego Convention and Visitors Bureau (CONVIS). Per CONVIS, visitor spending in San Diego is projected to grow 4.1% in 2012 due to more regional visitors, improved hotel room demand and sustainable room rates. This growth should result in higher Transient Occupancy Tax revenue for the City.



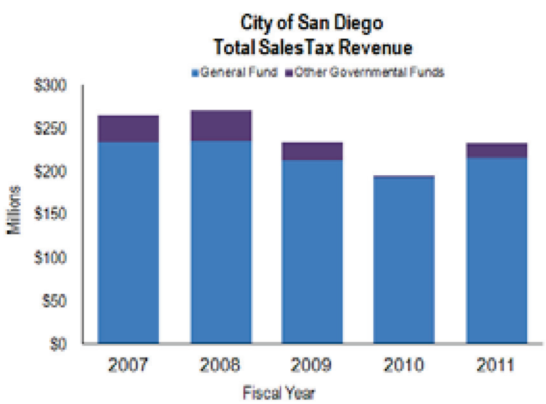
Governmental Funds (Tax Supported Operations)

Governmental Funds account for activities that are principally supported by taxes and intergovernmental revenues. The governmental activities of the City include: General Government and Support; Public Safety – Police; Public Safety – Fire and Life Safety and

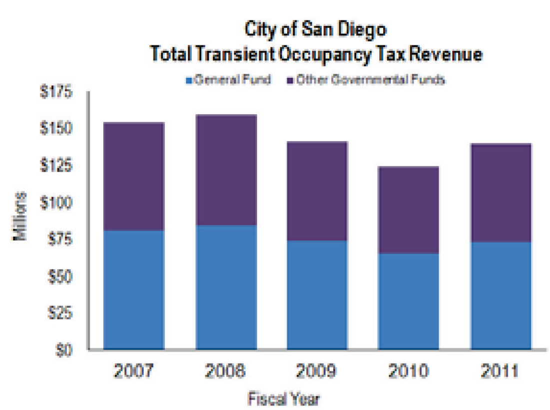
Homeland Security; Parks, Recreation, Culture and Leisure; Transportation; Sanitation and Health; and Neighborhood Services. Governmental Fund revenue in fiscal year 2011 increased by $79 million compared to the prior year. With the exception of property tax revenue, the major Governmental sources of revenue trends indicate a forward movement off of recession lows.



The City's property tax revenue declined for the second consecutive year in fiscal year 2011 by $15.3 million. In fiscal year 2011 total property tax revenues were $569.0 million compared to $584.3 million in fiscal year 2010, representing a 2.6% decline. Property tax revenues for fiscal year 2012 are budgeted to remain about the same as fiscal year 2011. The most recent projection indicates that fiscal year 2012 General Fund property tax revenue is expected to be approximately $385 million, which compares to $384 million in fiscal year 2011. This flattening of the trend is primarily due to a higher collection rate, according to the County Assessor's Office. Property taxes account for approximately 33% of total Governmental Funds revenue.



Improved consumer spending in fiscal year 2011 had a significant positive effect on sales tax revenues. In fiscal year 2011, total sales tax revenue (including safety sales tax) increased $39.4 million or 20.5% over fiscal year 2010. This is the first increase following a two-year downturn in General Fund sales tax revenue. The City's total sales tax revenue budget for fiscal year 2012 is $251.2 million. The General Fund portion of total fiscal year 2012 budgeted sales tax revenue (including safety sales tax) is $218.2 million. Fiscal year 2012 General Fund sales tax revenue growth was budgeted at 4.0%. The most recent projection indicates that fiscal year 2012 sales taxes will exceed the budgeted amount and will mirror improving consumer spending trends. Sales taxes account for approximately 14% of total Governmental Funds revenue.



San Diego remains a top tourist destination due to the region's natural attractions; however, the tourism industry suffered during the recession. 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 approximately 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. In fiscal year 2011, San Diego experienced a resurgence in total TOT revenue, improving

$15.7 million, a 12.6% increase in TOT revenue over fiscal year 2010. The City's total TOT revenue budget for fiscal year 2012 is $142.8 million. The General Fund portion of total fiscal year 2012 budgeted TOT revenue is $74.8 million. Fiscal year 2012 General Fund TOT revenue was budgeted at a 4.0% growth rate. The most recent projection indicates that fiscal year 2012 total TOT revenue will be stronger at $145.3 million. TOT accounts for approximately 8% of total Governmental Funds revenue.

The fiscal year 2011 year end governmental fund expenditures were $20 million less than fiscal year 2010. This is a result of staff reductions, a general salary freeze on controllable wages, and reductions in non-personnel operating expenses. The City managed expenditures so as to absorb the significant increase in the pension Annual Required Contribution (ARC) payment in fiscal year 2011.

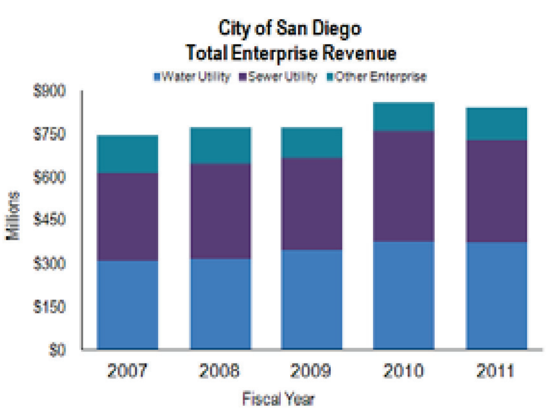
The City privately sold $161 million Tax and Revenue Anticipation Notes (TRAN) on July 1, 2011 and does not foresee the need to issue additional notes to meet any General Fund liquidity needs for the remainder of fiscal year 2012. The City treasury holds approximately $2 billion that is invested primarily in US Treasuries and agencies, and consistent with the City's investment policy, has sufficient liquidity to meet all currently foreseeable cash demands. In April 2011, the City entered into a Qualified Energy Conservation Bonds (QECB) Lease Obligation for the purpose of replacing light fixtures for approximately 28,700 street lights.

The City's capital assets are essential for providing services to its residents and maintaining the quality of its environment. During fiscal year 2011, total capital assets for governmental activities increased by $28 million. This was funded by a combination of developer contributions, grant monies, and city-funded capital improvement programs.

The City's General Fund capital improvement backlog is estimated to be approximately $840 million according to the most recent assessment and cost estimate reported in March 2011. This amount includes the cost of needed repairs to City facilities, streets and storm drains but does not include alleys, sidewalks or related soft costs. The City issued $103 million in bonds during fiscal year 2009 which are currently being used to fund deferred capital improvement projects within the City.

Business-Type Activities (Enterprise Supported Operations)

The majority of the City's business-type activities are related to utilities that provide water and wastewater services. In fiscal year 2011, the Water and Metropolitan Wastewater Departments were consolidated into a single Public Utilities Department and continue to serve San Diego and 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 expenses on behalf of the ratepayers.



Enterprise operating revenue declined by $17 million, or 2%, in fiscal year 2011. Operating revenue from the Water Utility was $372 million in fiscal year 2011 which was a modest reduction of $5 million compared to fiscal year 2010. Sewer Utility operating revenue of $358 million was also down by $24 million from the prior year due to continued water conservation, which led to less wastewater entering the system.

Enterprise operating expenses for fiscal year 2011 were $15 million less than fiscal year 2010, which was a 2% decline. As a result of the Public Utilities Department's continued reduction in operating costs through improved efficiency, and review of processes, both Water Utility expenses and Sewer Utility expenses showed year-over-year reductions which were in line with the reduced revenue for each area. There was also a reduction in water purchase expenses due to reduced water usage and wet weather in fiscal year 2011.

For the year ended June 30, 2011, the City's business-type activities closed with unrestricted net assets totaling $686 million, an increase over fiscal year 2010 of approximately $42 million as a result of City Council approved rate increases in the spring of 2010 and reductions in operating expenses for Sewer and Water Utilities. The unrestricted net assets are expected to be applied to the capital program over the next several years as the department spends capital funds to complete the approved CIP projects.

The City's Water Utility Fund received a State Revolving Fund Loan disbursement from the California Department of Public Health totaling $12 million to assist in financing construction of the Alvarado Water Treatment Plant Ozone Improvement project which will enable the City to meet safe drinking water standards. Net system revenue of the Water Utility Fund has been designated as the dedicated source of funds for repayment of the loan.

The City maintains a network of over 3,000 miles of water pipes and over 3,000 miles of wastewater 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 fiscal year 2011, the City received final approval of its third five-year modified discharge permit from the Environmental Protection Agency (EPA) and the state Regional Water Quality Control Board that became effective on August 1, 2010. This allows the City to continue operating the Point Loma Wastewater Treatment Plant at advanced primary treatment levels, rather than secondary as otherwise required, through July 2015.

The City began implementing mandatory water use restriction in June 2009 as 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 mandatory measures were needed to help San Diego stay within water supply allocations established by the water wholesalers. Within the first year of implementation, the City of San Diego achieved an 11.5% reduction when compared to fiscal year 2009 water usage, and a 14% total reduction through June 2011. Due to abundant precipitation this past winter and improved regional and local water supply conditions, the San Diego City Council ended the Drought Response Level 2 restrictions on May 24, 2011.

In June 2011, the City completed construction and began operations on a demonstration project which intends to verify that highly treated municipal wastewater can be placed in a potable water reservoir and thereby augment local water supplies for the City of San Diego.

Pension Funding

Pension Funding Progress *(Thousands)*			
Actuarial Valuation Date	Actuarial Value of Assets	Unfunded Actuarial Accrued Liability (UAAL)	Funded Ratio
6/30/2007	$4,413,411	$1,184,242	78.8%
6/30/2008	$4,660,346	$1,303,204	78.2%
6/30/2009	$4,175,229	$2,106,407	66.5%
6/30/2010	$4,382,047	$2,145,177	67.1%
6/30/2011	$4,739,399	$2,178,018	68.5%

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 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 most recent June 30, 2011 valuation calculated the unfunded pension liability to be approximately $2.178 billion.

In fiscal year 2009, the Mayor proposed and City Council approved a new pension plan for General Members (effective July 1, 2009). In addition, pension reforms have been implemented for Police Officers hired after June 30, 2009, Lifeguards hired after June 30, 2011, and Firefighters hired on or after January 1, 2012. These changes are expected to achieve savings in the City's pension payments in future years.

Beginning in fiscal year 2012, the City eliminated the employee retirement offset contribution for elected officials, unrepresented employees and most of the represented employees. This is the portion of the individual's retirement system contribution that the City previously paid on the employee's behalf.

In fiscal year 2011, SDCERS investment portfolio returns were strong with final results of 24.2% compared to 13.4% for fiscal year 2010. 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. In fiscal year 2011, the calculated ARC (including Preservation of Benefits Plan-POB) payment increased by $75.7 million to $230.9 million, or 48.8%, as a result of smoothing the large loss in market value of the portfolio experienced in fiscal year 2009. The significant increase of the ARC in fiscal year 2011 put a tremendous strain on City's General Fund operating budget. The City responded by adjusting manageable operating expenses through reductions in personnel and supplies costs.

Retiree Healthcare

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%
6/30/2010	$72,720	$1,128,190	6.1%
6/30/2011	$116,608	$1,131,543	9.3%

The City's actuarial valuation for retiree healthcare costs estimated an unfunded actuarial accrued liability (UAAL) of $1.132 billion as of June 30, 2011. The City is participating in a trust administered by CalPERS to fund this long-term liability. The actuarial value of these assets as of June 30, 2011 was $117 million. The City did not fully fund the ARC for retiree healthcare in fiscal year 2011 which was $120 million. In fiscal year 2011 the City contributed $59 million to the retiree healthcare plan.

The City reached agreement with all six labor organizations on reforms to the retiree healthcare benefit for employees hired before July 1, 2005. Signed Memorandums of

Understanding (MOUs) were approved by City Council on January 24, 2012. These new changes, which were approved by employees in September 2011, will be implemented on April 1, 2012. The MOU for retiree healthcare will establish a $58 million five year maximum cap on the City's obligation. The actuarial analysis of this change in retiree healthcare benefits indicate that the current UAAL will decrease by approximately $330 million and the ARC, as of the June 30, 2010 actuarial valuation, will be reduced by approximately $33 million.

Readers of these financial statements should pay particular attention to Notes 12, 13, 18, and 23, concerning Pension Plans, Other Postemployment 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, 2011.

Financial Reserve Strategies

Adequate financial reserves position the City of San Diego to weather significant economic downturns more effectively, manage the consequences of outside agency actions that may result in revenue reductions, and address unexpected emergencies, such as natural disasters, catastrophic events caused by human activity, or excessive liabilities or legal judgments against the City.

Maintaining, regularly updating, and adhering to an appropriately constructed reserve policy is a best business practice and is among the factors considered by credit rating agencies and the investment community when assessing the credit-worthiness of an organization. The City of San Diego recognizes its Reserve Policy as a cornerstone of its fiscal health and enjoys a strong investment grade rating for its debt issuances. In December 2011, the City Council approved a revised Reserve Policy that includes appropriate financial reserve levels for various reserve categories and maps out a timeframe to fund various reserves to policy levels.

The Reserve Policy stipulates a number of annually budgeted appropriation and capital reserves as well as overflow reserves (DRES and Unassigned). Generally these reserves may be expended only in the event of a public emergency, as determined by a two-thirds vote of the City Council, when such expenditures are necessary to ensure the safety, lives and property of the City and its inhabitants.

General Fund Reserves *(thousands)*				
Name of Reserve	Target	FY 2011 Actual %	FY 2011 Actual $	Policy Goal Met Year
General Fund Reserve	8%	11%	$115,534	2011

The General Fund Reserve Policy set a funding goal of 8.0% of General Fund revenue by the end of fiscal year 2011. With fiscal discipline and a commitment to strong fiscal policies, the City managed limited resources through the recession to grow the General Fund Reserve from 4.8% in fiscal year 2006 to 11% in fiscal year 2011, resulting in a total reserve balance of $115 million. This balance is reported within the General Fund Balance Sheet in both Restricted and Unassigned fund balance categories. The City's goal is to maintain the General Fund Reserves at 8% of revenues.

Citywide Reserves *(thousands)*				
Name of Reserve	Target	FY 2011 Actual %	FY 2011 Actual $	Policy Goal Met Year
Public Liability Fund Reserve	50%	17%	$19,794	2019
Worker's Compensation Fund Reserve	50%	25%	$37,476	2019
Long-Term Disability Fund Reserve	$12,000	77%	$9,184	2014

The City's goal is to maintain dedicated reserves equal to 50% of the value of average annual claims against the City for Public Liability and Worker's

Compensation. The City suspended additional funding into these reserves in fiscal year 2011 and 2012 budgets because of significant budgetary constraints. The revised Reserve Policy sets an annual funding target for the Public Liability and Worker's Compensation fund reserves of $6.1 and $5.9 million, respectively. In fiscal year 2011, the Public Liability Fund Reserve had a balance of $20 million and the Worker's Compensation Fund Reserve had a balance of $37 million. The City expects to meet full policy funding by the year 2019. The Long-Term Disability Fund Reserve has a target of $12 million, and in fiscal year 2011 was 77% funded with a target year of 2014 expected for full funding.

Financial Operating Reserves are also maintained for the City's business type activities which include the Water Utility, Sewer Utility and the Disposal and Refuse Service. These reserves have been established to mitigate financial hardship in any one year in the event of a catastrophe that prevents the utility or service from functioning in its normal capacity. As shown in the chart, for fiscal year 2011, the funding levels as a percentage of the policy target were: Water Operating Reserve 91%; Sewer Operating Reserve 82%; Refuse Disposal Appropriated Fund Reserve 20%; and, Recycling Fund Appropriated Reserve 20%. Each of these reserve funds is identified in the revised Reserve Policy with a target year the City anticipates achieving full funding. Two reserves, the Water Rate Stabilization Reserve and the Sewer Rate Stabilization Reserve, are 100% funded and support existing bond covenant agreements. These reserves are reported as unrestricted net assets in the Statement of Net Assets.

Business Type Activity Reserves *(thousands)*

Name of Reserve	Target	FY 2011 Actual %	FY 2011 Actual $	Policy Goal Met Year
Water Operating Reserve	$32,700	91%	$29,900	2013
Water Rate Stabilization Reserve	$20,500	100%	$20,500	2011*
Water Secondary Purchase Reserve	6%	0%	$0	2013
Sewer Operating Reserve	$41,100	82%	$33,900	2013
Sewer Rate Stabilization Reserve	$21,300	100%	$21,300	2011*
Refuse Disposal Fund App. Reserve	$4,600	20%	$920	2015
Recycling Fund Appropriated Reserve	$2,400	20%	$480	2015

** Supports long term bond covenents*

Budgetary Process and the Five Year Financial Outlook

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.

In June 2011, the City approved a balanced fiscal year 2012 budget through a combination of on-going expenditure reductions, increased revenue projections for sales tax and TOT and some one-time revenue solutions matched to one-time expenditures. Copies of the City's budgets are available at the Financial Management Office located at 202 C Street, MS8A, San Diego, CA 92101 and can be viewed on the City website www.sandiego.gov.

The City publishes a Five Year Financial Outlook (Outlook) annually for the General Fund. The City's most recently published Outlook for fiscal years 2013 – 2017 was released in October 2011. The Outlook incorporated the most recent revenue and expenditure projections based on fiscal year 2012 trends, local and national economic indicators, and known incremental expenditure adjustments over the forecast period. Expenditure projections were adjusted for known increases and revenue projections were updated using more current growth assumptions than the fiscal year 2012 budget. Based on these factors, a $31.8 million deficit in the General Fund was forecast for fiscal year 2013. However, in January 2012, the City received the most recent actuary report which established the fiscal year 2013 ARC payment. Strong investment results, combined with other factors led to a future ARC payment for the General Fund that is $19 million less than projected in the Outlook. This positive news helps the City's forward looking financial position as we move towards achieving a structurally balanced budget in fiscal year 2013.

The City's General Fund Outlook indicates that approximately 65% of the City's major revenues consist of four revenue sources: property tax, sales tax, TOT, and franchise fees. Nearly 72% of the City's General Fund expenditures are personnel expenditures. The regional economy has shown signs of economic stabilization after the extended recession. The Outlook projects strong growth in Sales tax and TOT revenues over the next five years. However, the Outlook also projects that this revenue growth will be tempered by continued high unemployment levels and a stagnant residential and commercial property market. The extended economic recession, combined with the current slow and uncertain pace of recovery, has continued to place fiscal strain on governments, including the City of San Diego. The Outlook discusses 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:

- Eliminate the General Fund structural budget deficit
- Meet contractual obligations and fund mandated programs
- Reduce personnel pension and retiree health care liability and annual City cost through the meet and confer process
- Contribute the full payment of the Annual Required Contribution (ARC) for the City's pension system
- Achieve full cost recovery for programs and services that are intended to be fully cost recoverable
- Maintain or enhance General Fund and other reserves according to the City's Reserve Policy
- Preserve City services to the fullest extent possible
- Develop plans to fund deferred capital infrastructure and maintenance needs

In order to achieve and maintain a structurally balanced budget, the Mayor has indicated that cuts to services and programs may continue even when factoring in projected moderate growth in sales tax and TOT tax revenues and minimal growth in property tax revenues budgeted in fiscal year 2012. Resolving the projected budget deficit in fiscal year 2013 may result in additional workforce reductions combined with expenditure savings from reduced or eliminated programs and services. In light of the General Fund Reserve balance of 11% at the end of fiscal year 2011, the Mayor's Adopted Budget for fiscal year 2012 does not include contributions to fund the General Fund reserve. However, the General Fund budget assumes the projected General Fund reserve level of 8% will be maintained.

Best Practice Operating Improvements

The City continues to implement improvements to the effectiveness and efficiency of its operations and increase transparency to the public. Statistics for many of the key operational metrics can be found in the annual City Budget document listed within each operational department's sub-section.

Since the implementation of the City's new Enterprise Resource Planning (ERP) financial system in 2009, the City has continued to implement additional functional software modules to its ERP system environment. In July 2011, the City converted all of its Utility Customer Billing accounts to the ERP platform. This was a major implementation which successfully transitioned over 274,000 utility customers and set the technical groundwork for a customer billing portal where one day all City billings to a customer can be viewed on the same statement and online customer portal.

With each new module added to the ERP system, the City is able to eliminate 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, reporting capabilities and internal controls for years to come. In November 2011, the City was able to successfully transition all legacy applications off of its mainframe and eliminate $1 million in annual operation costs.

In fiscal year 2011, the City completed an optimization study within its fleet services which was successful in reducing the number of vehicles by approximately 300. This effort is expected to yield an annual cost savings of approximately $2 million.

San Diego continues to restructure its operations through managed competition. In fiscal year 2011, the first managed competition contract for Printing and Reprographic services was awarded, yielding an estimated annual $5 million savings. In October 2011, the Mayor awarded another managed competition contract for Fleet Maintenance Services which is expected save the City approximately $4 million annually.

The City of San Diego is committed to operating a sound, fundamentally sustainable municipal business model. We have addressed pension and retiree health reform and we are structuring ourselves for long-term stability and flexibility. We will continue to balance our annual budgets and look for opportunities to streamline and improve operations and services to our citizens.

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, 2011, 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 improve a comprehensive internal control over financial reporting 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 changes in financial position 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:

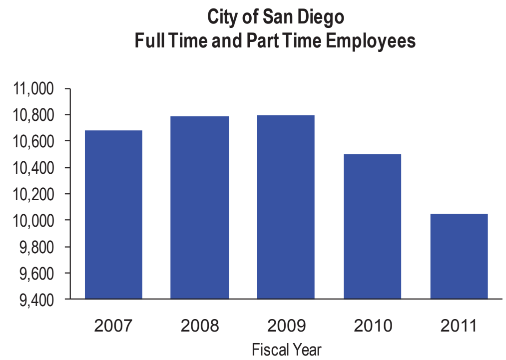
- The introductory section includes information about the organizational structure of the City, the City's economy, and selected other financial information.

- 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

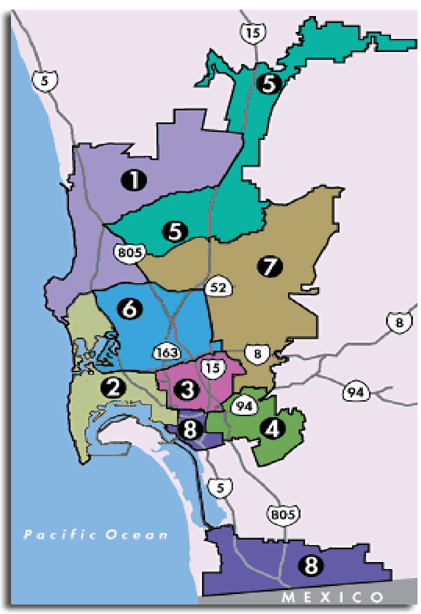
The City of San Diego was incorporated in 1850. The City comprises 324 square miles and, as of January 1, 2011, the California Department of Finance estimates the population to be 1,311,882. The City, with approximately 10,050 employees, provides a full range of governmental services including police 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 has operated under a Strong-Mayor form of government since January 2006. The permanent departure from the City's previous Council-Manager form of government was approved by a vote of the public and became effective January 1, 2011. The Mayor is elected at large to serve a four-year term.

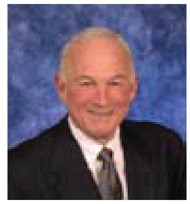
City of San Diego Council District Map



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, Ethics Commission 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 and attorney for the City and all departments.

During the City's primary election held on June 8, 2010, voters approved Measure D which made permanent the Strong-Mayor form of government effective January 1, 2011. Additionally, Measure D increased the number of City Council districts from eight to nine, and therefore, a corresponding increase of City Council votes required to override the Mayor's veto from five to six. The ninth council district will be added in 2012.

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

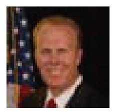


Mayor Jerry Sanders

District 1
Councilmember Sherri Lightner

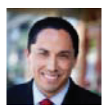
District 5
Councilmember Carl DeMaio

District 2
Council President Pro Tem
Kevin Faulconer



District 6
Councilmember Lorie Zapf

District 3
Councilmember Todd Gloria



District 7
Councilmember Marti Emerald

District 4
Council President Tony Young

District 8
Councilmember David Alvarez

City Attorney
Jan Goldsmith

<u>Other City Officials</u>

Jay M. Goldstone, Chief Operating Officer

Mary Lewis, Chief Financial Officer

Kenton C. Whitfield, City Comptroller

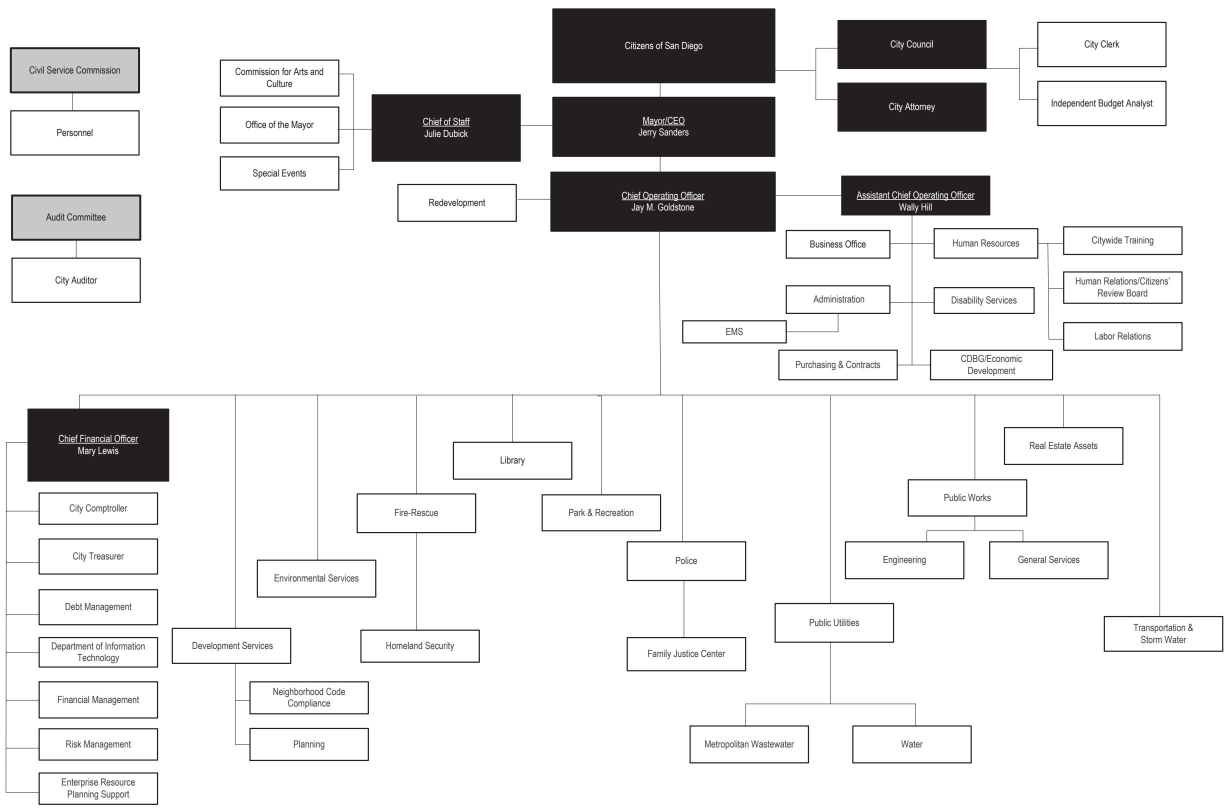
Gail R. Granewich, City Treasurer

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)



Financial Reporting Entities

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 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 Tourism Marketing District
- Tobacco Settlement Revenue Funding Corporation (TSRFC)
- Convention Center Expansion Financing Authority (CCEFA)
- 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)
- Public Facilities Financing Authority (PFFA)
- San Diego City Employees' Retirement System (SDCERS)

Additionally, in fiscal year 2011, the City participated 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. Effective July 1, 2011, the joint venture was dissolved.

Sincerely,

Jerry Sanders
Mayor

Jay M. Goldstone
Chief Operating Officer

Mary Lewis
Chief Financial Officer

Kenton C. Whitfield
City Comptroller

Financial Section

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

INDEPENDENT AUDITOR'S REPORT

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, 2011, 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 financial statements reflect 92%, 95%, and 86% of the total assets, total net assets, and total revenues, respectively, of the aggregate discretely presented component units totals. Also, we did not audit the Southeastern Economic Development Corporation, a blended component unit, which financial statements reflect less than 1% in each of the total assets, total net assets, and total revenues, respectively, of the aggregate remaining fund information. Those financial statements were audited by other auditors whose reports thereon have 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 of America. 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, 2011, 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(w) to the basic financial statements, the City adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* and GASB Statement No. 59, *Financial Instruments Omnibus*.

As discussed in Note 14 to the basic financial statements, the City and the Redevelopment Agency of the City of San Diego (RDA), a component unit of the City, entered into a Cooperation Agreement on February 28, 2011, for the implementation of certain redevelopment projects on behalf of the RDA. In connection with the Cooperation Agreement, the RDA transferred funds to the City of approximately $289 million and transferred ownership to approximately 95 real estate assets.

As described in Note 23 to the basic financial statements, the California State Legislature enacted legislation that was intended to provide for the dissolution of redevelopment agencies in the State of California (Assembly Bill X1 26) unless certain payments are made to the State of California (Assembly Bill X1 27). On December 29, 2011, the California Supreme Court (Court) largely upheld the legislation for the dissolution of redevelopment agencies. Furthermore, the Court invalidated

Assembly Bill X1 27. Accordingly, the RDA is required to dissolve in fiscal year 2011/12 and the guidelines for dissolution are set forth in the legislation. The City's financial statements do not include any adjustments as a result of the dissolution of the RDA.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 31, 2012 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.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, schedules of funding progress and schedule of contributions from employer and other contributing entities, and general fund budgetary information as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's financial statements as a whole. The accompanying introductory section, supplementary information, and statistical section are presented for purposes of additional analysis and are not a required part of the financial statements. The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied by us and the other auditors in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, based on our audit and the reports of other auditors, the information is fairly stated in all material respects in relation to the 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 or provide any assurance on them.

Macias Gini & O'Connell LLP

San Diego, California
January 31, 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Unaudited)
(In Thousands)
Year Ended June 30, 2011

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, 2011. We encourage the reader to consider the information presented here in addition to the information presented in the Letter of Transmittal.

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 City's operational accountability to its readers, giving information about the probable medium and long-term effects of past decisions on the City'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 2011. 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: Sewer Utility; Water Utility; Airports; Development Services; Environmental Services; Golf Course; and Recycling.

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 City'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)
- 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)
- Southeastern Economic Development Corporation (SEDC)
- Tobacco Settlement Revenue Funding Corporation (TSRFC)
- San Diego Tourism Marketing District (TMD)

The government-wide financial statements can be found beginning on page 50 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 54 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.

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 Utility 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 58 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 62 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 64 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 163 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 185 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	
	2011	2010	2011	2010	2011	2010
Capital Assets	$ 4,514,200	$ 4,486,074	$ 4,987,260	$ 4,904,908	$ 9,501,460	$ 9,390,982
Other Assets	2,179,335	2,114,026	1,269,121	1,292,984	3,448,456	3,407,010
Total Assets	6,693,535	6,600,100	6,256,381	6,197,892	12,949,916	12,797,992
Net Long-Term Liabilities	2,121,188	2,052,459	2,273,158	2,325,652	4,394,346	4,378,111
Other Liabilities	202,944	192,596	146,423	140,851	349,367	333,447
Total Liabilities	2,324,132	2,245,055	2,419,581	2,466,503	4,743,713	4,711,558
Net Assets:						
Invested in Capital Assets,						
Net of Related Debt	3,812,560	3,780,474	3,094,788	3,035,924	6,907,348	6,816,398
Restricted	949,227	572,382	56,346	52,190	1,005,573	624,572
Unrestricted	(392,384)	2,189	685,666	643,275	293,282	645,464
Total Net Assets	$ 4,369,403	$ 4,355,045	$ 3,836,800	$ 3,731,389	$ 8,206,203	$ 8,086,434

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 $8,206,203 as of June 30, 2011, an increase of $119,769, or approximately 1%, over fiscal year 2010.

$6,907,348, or approximately 84% 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.

$1,005,573, or approximately 12%, of total Net Assets represent resources that are subject to external restrictions on how they may be used. The remaining balance of $293,282, or approximately 4%, is available to fund ongoing services and obligations to the City's citizens and creditors.

Total Net Assets resulting from Governmental Activities remained fairly stable in fiscal year 2011, with an increase of $14,358, or less than 1%. However, due to the implementation of GASB Statement No. 54 and the related reclassification of fund balances, there was a significant reclassification between Restricted and Unrestricted Net Assets. Restricted Net Assets increased by $376,845, while Unrestricted Net Assets decreased by $394,573.

Total Net Assets resulting from Business-Type Activities increased by $105,411, or approximately 3%. Invested in Capital Assets, Net of Related Debt increased by approximately $58,864, or approximately 2%, while Unrestricted Net Assets increased by $42,391, or approximately 7%. The increase in Unrestricted Net Assets is primarily attributed to Council approved rate increases for Sewer and Water Utilities combined with reductions in operating expenses.

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

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2011	2010	2011	2010	2011	2010
Revenues:						
Program Revenues						
Charges for Services	$ 392,364	$ 369,740	$ 842,291	$ 859,732	$ 1,234,655	$ 1,229,472
Operating Grants and Contributions	81,159	71,829	8,355	3,289	89,514	75,118
Capital Grants and Contributions	51,674	60,139	30,692	45,738	82,366	105,877
General Revenues						
Property Taxes	560,577	579,410	-	-	560,577	579,410
Transient Occupancy Taxes	140,752	123,332	-	-	140,752	123,332
Sales Taxes	246,452	244,406	-	-	246,452	244,406
Other Local Taxes	158,797	183,694	-	-	158,797	183,694
Grants and Contributions not Restricted to Specific Programs	10,320	18,065	-	-	10,320	18,065
Investment Income	25,488	30,472	13,717	22,332	39,205	52,804
Other	30,471	43,334	12,684	13,321	43,155	56,655
Total Revenues	1,698,054	1,724,421	907,739	944,412	2,605,793	2,668,833
Expenses:						
General Government and Support	361,098	395,344	-	-	361,098	395,344
Public Safety-Police	427,724	402,222	-	-	427,724	402,222
Public Safety-Fire, Life Safety, Homeland Security	223,174	214,975	-	-	223,174	214,975
Parks, Recreation, Culture and Leisure	248,668	266,343	-	-	248,668	266,343
Transportation	191,402	190,054	-	-	191,402	190,054
Sanitation and Health	74,639	78,171	-	-	74,639	78,171
Neighborhood Services	85,588	137,971	-	-	85,588	137,971
Debt Service:						
Interest on Long-Term Debt	77,443	72,672	-	-	77,443	72,672
Sewer Utility	-	-	315,591	338,688	315,591	338,688
Water Utility	-	-	362,830	365,683	362,830	365,683
Airports	-	-	4,297	5,671	4,297	5,671
Development Services	-	-	43,552	36,640	43,552	36,640
Environmental Services	-	-	34,904	33,955	34,904	33,955
Golf Course	-	-	15,503	14,618	15,503	14,618
Recycling	-	-	19,611	19,265	19,611	19,265
Total Expenses	1,689,736	1,757,752	796,288	814,520	2,486,024	2,572,272
Change in Net Assets Before Transfers:	8,318	(33,331)	111,451	129,892	119,769	96,561
Transfers	6,040	(1,218)	(6,040)	1,218	-	-
Net Change in Net Assets	14,358	(34,549)	105,411	131,110	119,769	96,561
Net Assets - July 1	4,355,045	4,389,594	3,731,389	3,600,279	8,086,434	7,989,873
Net Assets - June 30	$ 4,369,403	$ 4,355,045	$ 3,836,800	$ 3,731,389	$ 8,206,203	$ 8,086,434

GOVERNMENTAL ACTIVITIES

Governmental activities increased the City's net assets by $14,358 during fiscal year 2011. Variances from fiscal year 2010 of more than 10% are discussed below.

- Operating Grants and Contributions increased by $9,330, or approximately 13%, primarily due to an increase in federal awards from the Office of Homeland Security.

- Capital Grants and Contributions decreased by $8,465, or approximately 14%, primarily due to a large land donation of approximately $9,700 in the prior fiscal year.

- Transient Occupancy Taxes increased by $17,420, or approximately 14%, primarily due to an improvement in the local tourism industry.

- Other Local Taxes decreased by $24,897, or approximately 14%. Approximately $16,000 of this variance is due to a decrease in accrued SDG&E franchise revenues for the Underground Surcharge Program resulting from a one-time accrual in the previous fiscal year. The remaining amount was due to an overall decrease in franchise revenues received from SDG&E by the Underground Surcharge Fund as well as the General Fund.

- Grants and Contributions not Restricted to Specific Programs decreased by $7,745, or approximately 43%, primarily due to a one-time revenue recorded in the prior fiscal year as a result of RDA's negotiations with various developers to reduce outstanding long-term debt obligations.

- Investment Income decreased by $4,984, or approximately 16%, primarily due to the prolonged period of low interest rates.

- Other Revenue decreased by $12,863, or approximately 30%. This variance is due to the recognition of a $24,419 contract payable which was previously recorded as developer contributions revenue. This decrease was partially offset by an increase in developer contributions for both Impact Fees and Facilities Benefit Assessments primarily related to the communities of Otay Mesa West, North University City and the Mission Valley Urban Community.

- Neighborhood Services expense decreased by $52,383, or approximately 38%. This variance was primarily attributed to a decrease in accrued liability claims related to RDA of $58,500. In the prior fiscal year, this accrual was recorded as the result of an audit of the City's CDBG Program by the Office of the Inspector General. During fiscal year 2011, RDA experienced an offsetting increase of approximately $5,500 due to one-time expenses for the Quiet Zone Project in the downtown area.

BUSINESS-TYPE ACTIVITIES

Business-type activities increased the City's net assets by $105,411 during fiscal year 2011. Variances from fiscal year 2010 of more than 10% are discussed below.

- Operating Grants and Contributions increased by $5,066, or approximately 154%, primarily due to a Proposition 50 grant received by Water Utilities.

- Capital Grants and Contributions decreased by $15,046, or approximately 33%, primarily due to a reduction in developer contributed assets of approximately $25,000 for Water and Sewer Utilities. This was partially offset by increased capacity charges.

- Investment Income decreased by $8,615, or approximately 39%, primarily due to the prolonged period of low interest rates.

- Airports expense decreased by $1,374, or approximately 24%, primarily due to a reduction of expenses for gypsum waste removal.

- Development Services expense increased by $6,912, or approximately 19%, primarily due to the inclusion of the Subdivision Deposit Trust Fund in fiscal year 2011, which was previously classified as a Special Revenue fund.

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, governmental fund balance classifications comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported.

As of the end of fiscal year 2011, the City's governmental funds reported combined ending fund balances of $1,708,239, an increase of $68,899 over fiscal year 2010. Approximately $30,963 constitutes unassigned fund balance, which is available for spending at the government's direction. The remainder of fund balance is not available for new spending because it has been restricted, committed, or assigned (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. Total Fund Balance for the General Fund was $245,748, an increase of $87,173 over fiscal year 2010. This increase is primarily due to the transfer of $85,019 of RDA fund balance to the General Fund resulting from the Cooperation Agreement entered into on February 28, 2011. RDA funds are classified as Restricted 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 2011, Unrestricted Net Assets of the Sewer Utility Fund were $388,421, an increase of $36,080, or approximately 10% over fiscal year 2010. The Unrestricted Net Assets of the Water Utility Fund were $245,966, an increase of $12,701, or approximately 5% over fiscal year 2010. Both increases were primarily due to Council approved rate increases as well as reductions in operating expenses.

GENERAL FUND BUDGETARY HIGHLIGHTS

The original budget for expenditures and transfers out was $1,671 lower than the final budget due to increases (decreases) in appropriations primarily attributed to the following:

- $9,100 for Public Safety-Police. This increase was primarily due to higher than anticipated personnel costs associated with overtime and pay in-lieu of annual leave.

- $7,631 for Public Safety-Fire and Life Safety and Homeland Security. This increase was due to higher than anticipated personnel costs associated with overtime and pay in-lieu of annual leave.

- ($14,638) for Transportation. This decrease was primarily due to a reclassification of Proposition 42 transportation expenditures from the General Fund to the Special Revenue Fund.

- $1,312 for Sanitation and Health. This increase was primarily due to expenditures related to the Miramar Landfill.

Actual revenues received for the General Fund were $11,654 less than budgeted. Property Tax revenues were under budget by $6,038 primarily due to a decrease in assessed valuations. Sales Tax and Transient Occupancy Tax were over budget by $12,014 and $7,284, respectively, primarily due to an improvement in consumer spending and tourism. Licenses and Permits revenue was under budget by $2,975 due to lower than anticipated Parking Meter revenue. Revenue from Other Agencies was over budget by $4,916 primarily due to higher than expected Motor Vehicle License renewals. Charges for Current Services came in $23,083 under budget due to revenue shortfalls in the General Services and Parks and Recreation departments.

Actual expenditures for the General Fund were $12,790 under budget. General Government and Support had appropriation savings of $7,709 due to the allocation of fringe benefit expenditures which was lower than budgeted. Parks, Recreation, Culture and Leisure had appropriation savings of $2,895 due to the department's water conservation efforts accompanied by increased rainfall during the year. Additionally, Neighborhood Services had appropriation savings of $1,291 primarily due to lower than anticipated contractual obligations.

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	
	2011	2010	2011	2010	2011	2010
Land & Rights of Way	$ 1,811,971	$ 1,798,345	$ 95,442	$ 95,428	$ 1,907,413	$ 1,893,773
Easements	277	5	44	19	321	24
Construction-in-Progress	221,796	191,743	215,929	288,869	437,725	480,612
Structures and Improvements	787,859	811,904	1,340,061	1,305,899	2,127,920	2,117,803
Equipment	142,020	153,279	154,080	147,086	296,100	300,365
Intangible Equipment	34,314	37,619	-	-	34,314	37,619
Distribution and Collection Systems	-	-	3,181,704	3,067,607	3,181,704	3,067,607
Infrastructure	1,515,963	1,493,179	-	-	1,515,963	1,493,179
Totals	$ 4,514,200	$ 4,486,074	$ 4,987,260	$ 4,904,908	$ 9,501,460	$ 9,390,982

CAPITAL ASSETS

In accordance with GASB Statement Nos. 34 and 51, all major assets such as streets, signals, bridges, drains and intangible assets 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, 2011 was $9,501,460 (net of accumulated depreciation/amortization). There was an overall increase in the City's investment in capital assets over fiscal year 2010 of approximately $110,478. Readers interested in more detailed information on capital asset activity should refer to Note 4 - Capital Assets.

HIGHLIGHTS OF FISCAL YEAR 2011 CAPITAL IMPROVEMENT ACTIVITIES

Governmental Activities

- Construction on San Diego's New Main Library began in fiscal year 2011. Once completed, the project will provide for a new multi-story, multi-use facility that will include a Charter High School, auditorium, art gallery and multiple public meeting spaces. The 500,000 square foot building will meet current library needs as well as provide room for growth. The new library is expected to be open for use in June 2013. The project is being funded by multiple sources including redevelopment funding, grant funds and private donations. The City's fiscal year 2011 capital expenditures for this project were $38,588.

- Construction began on the La Jolla Village Drive/I-805 interchange project during fiscal year 2011. The project will provide for a reconfiguration of the freeway interchanges as well as widening the road and overpass structures. New bike lanes will also be constructed as part of the improvements. Once complete in 2012, traffic circulation and safety in the University City community area is designed to be significantly improved. The project is being funded by the North City Facilities Benefit Assessment (FBA). The City's fiscal year 2011 capital expenditures for this project were $3,838.

- Otay Mesa Truck Route Phase 3 completed construction at the end of fiscal year 2011. This phase of the project provided for the addition of an emergency lane and paved shoulder from Drucker Lane to the international port of entry. This addition will provide a dedicated emergency lane for Border Patrol, Police, and other emergency vehicle use. This project was partially funded by TransNet funds and grant funds. The City's fiscal year 2011 capital expenditures for this project were $2,257.

- Property acquisition for the Olive Street Park Acquisition and Development project was completed early in fiscal year 2011. The project will ultimately provide for the expansion of useable park acreage in the Uptown Community at the south end of the existing Olive Street Park. Final improvements may include multi-purpose turf areas, children's play area, seating, ADA compliant walkways, landscaping and security lighting. The City's fiscal year 2011 capital expenditures for this project were $1,425.

- The asphalt overlay of approximately 52 miles of roads Citywide, and the installation of approximately 1,147 new curb ramps was completed during fiscal year 2011. This project was one of several that will result in improved surface street conditions. Funded by the Deferred Capital Bond of 2009, the City's fiscal year 2011 expenditures for this project were $15,498.

- The replacement of approximately 12,600 linear feet of sidewalks as well as the installation of an additional 88 curb ramps was completed during fiscal year 2011. The Deferred Capital Bond of 2009 was the major funding source for these infrastructure improvements. The City's fiscal year 2011 expenditures for this project were $1,702.

- The undergrounding of utility lines within the Old Town San Diego community began early in fiscal year 2011 and will continue through fiscal year 2012. When complete, all utilities within residential block 2-E will be underground. This project is completely funded by the Utility Underground Fund and contributions from SDG&E. In fiscal year 2011, $2,682 was expended toward the initiation of the project.

- Installation of a new irrigation system continued at the Balboa Park Golf Course and is expected to be complete in fiscal year 2012. This project will provide for new irrigation systems at both the 18-hole and 9-hole golf courses at Balboa Park. The City's fiscal year 2011 capital expenditures for this project were $2,394.

- Property acquisition was completed for the Gonzales Canyon Neighborhood Park project. When complete, this project will provide for a five acre park adjacent to a future planned elementary school. Park amenities will include a multi-purpose turf sports field, lighted ball fields, comfort stations, children's play areas and other improvements. Project expenditures towards land acquisition totaled $2,850 during fiscal year 2011.

Business-Type Activities

During fiscal year 2011, the Water Utility Fund added approximately $39,598 in capital improvement projects (CIP). CIS ERP Implementation, Water Group Job 915, Advanced Water Demonstration Plant, Water Group Job 790, and the Alvarado Water Treatment Plant Upgrade and Expansion continued, along with water main replacements. Capital asset write-offs for fiscal year 2011 were approximately $1,387, and were primarily related to losses on abandoned projects and retirements of developer contributed assets**.**

During fiscal year 2011, the Sewer Utility Fund added approximately $66,004 in CIP, of which the Metropolitan system CIP increased approximately $5,455. Municipal system CIP increased approximately $60,549 and included the following major projects: South Mission Valley Trunk Sewer, CIS ERP Implementation, Lake Murray Trunk Sewer, and the continued replacement of sewer mains and upgrades to the sewer infrastructure. Capital asset write-offs for fiscal year 2011 were approximately $1,971 and were primarily related to losses on abandoned projects and retirements of developer contributed assets

HIGHLIGHTS OF THE APPROVED FISCAL YEAR 2012 CAPITAL IMPROVEMENT PROJECTS (CIP) BUDGET

The Annual Approved Capital Improvements Budget for Fiscal Year 2012 is $208,100 which is a decrease of $91,500 or approximately 30.6% from the fiscal year 2011 budget of $299,600. The decrease in the fiscal year 2012 budget is primarily due to a reprioritization of public utilities projects. Water and Sewer projects comprise over 52.5% of the total CIP budget, Transportation related projects represent 17.4% of the total CIP Budget, and building improvements make up 22.4% of the overall program budget. Funding for governmental projects includes: TransNet funds; Facilities Benefit Assessments; Developer Impact Fees; developer contributions; federal, state, local, and private contributions; land sale proceeds; and deferred capital projects bonds. Highlights of the key budgets by department are as follows:

Governmental Activities

- Transportation & Storm Water: $37,200. 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 estimated $15,000 annual allocation funding for these projects is funded entirely by the Underground Surcharge Fund. Other significant projects include $2,300 for Palm Avenue Roadway Improvements, $1,500 for Juan Street Concrete Street and $10,500 for improvements at State Route 163 & Friars Road.

- Fire-Rescue: $4,700. Projects during the 2012 fiscal year include the installation of a new department wide In-Station Alerting system as well as the construction of a new East Mission Valley Fire Station.

- Parks and Recreation: $5,900. Planned project types for fiscal year 2012 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.

Business-Type Activities

The fiscal year 2012 Public Utilities CIP budget is $145,400. Significant projects include: $55,100 for water main replacements; $30,000 for sewer main replacements; $17,000 for the replacement of trunk sewers; $8,800 for water pump station restorations; $5,300 for Metro Biosolids Center (MBC) – Bio Solids Storage Silos; and $4,500 for standpipe and reservoir rehabilitations.

LONG-TERM DEBT

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

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2011	2010	2011	2010	2011	2010
Capital Lease Obligations	$ 68,018	$ 84,561	$ -	$ -	$ 68,018	$ 84,561
QECB Lease Obligations	13,142	-	-	-	13,142	-
Contracts Payable	24,419	1,018	-	-	24,419	1,018
Notes Payable	-	3,301	-	-	-	3,301
Loans Payable	36,621	79,395	91,025	84,673	127,646	164,068
Section 108 Loans	16,342	31,496	-	-	16,342	31,496
General Obligation Bonds	2,240	4,340	-	-	2,240	4,340
Revenue Bonds/COP's/ Lease Revenue Bonds	531,550	547,260	2,009,160	2,073,075	2,540,710	2,620,335
Tax Allocation Bonds	615,495	529,423	-	-	615,495	529,423
Tobacco Settlement Asset-Backed Bonds	89,600	92,350	-	-	89,600	92,350
Pooled Financing Bonds	32,010	32,780	-	-	32,010	32,780
Totals	$ 1,429,437	$ 1,405,924	$ 2,100,185	$ 2,157,748	$ 3,529,622	$ 3,563,672

At the end of fiscal year 2011, the City, including blended component units, had total debt outstanding of approximately $3,529,622. Of this amount, $2,240 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), tax allocation bonds, tobacco settlement asset-backed bonds, pooled financing bonds, contracts payable, loans payable, Section 108 loans, SRF loans, Taxable Qualified Energy Conservation Bonds (QECBs) and capital lease obligations.

Governmental Activities

- The City (RDA) issued $58,565 of Housing Set-Aside Tax Allocation Bonds for the purpose of repaying long-term debt and to finance a portion of the costs of low and moderate income housing projects within the City Heights, North Bay, and North Park, Crossroads, Naval Training Center and San Ysidro Redevelopment Project areas. The Series 2010A taxable bonds are payable solely from, and secured by, a pledge of tax revenues derived from the 20% of tax increment allocated to RDA from the Redevelopment Project Areas that RDA is obligated to deposit into its Low and Moderate Income Housing Fund. Bond proceeds were used to repay $25,634 of the San Diego National Bank line of credit outstanding principal, $1,018 to repay the Western Pacific Housing Contract Payable and $1,607 to repay the Price Charities Note Payable dated April 2001.

- The City (RDA) issued $19,765 of Tax Allocation Bonds for the purpose of repaying long-term debt and financing a portion of the costs of redevelopment activities within the Naval Training Center Redevelopment Project. The Series A bonds are payable solely from, and secured by, a pledge of tax revenues allocated to RDA from the Naval Training Center Redevelopment Project, excluding those monies that RDA is obligated to deposit into its Low and Moderate Income Housing Fund and monies allocable to other taking agencies under the Redevelopment Law. Bond proceeds were used to repay $12,211 of the San Diego National Bank line of credit outstanding principal.

- The City (RDA) issued $4,915 of Tax Allocation Bonds for the purpose of financing certain redevelopment activities within, or of benefit to, the Crossroads Redevelopment Project. The Series A bonds are payable solely from, and secured by, a pledge of tax revenues allocated to RDA from the Crossroads Redevelopment Project, excluding those monies that RDA is obligated to deposit into its Low and Moderate Income Housing Fund and excluding monies which are allocable to other taking agencies under the Redevelopment Law.

- The City (RDA) issued $5,635 of 2010 Series A tax-exempt and $9,590 of 2010 Series B taxable City Heights Redevelopment Project Tax Allocation Bonds. The Series A bonds were issued to fund redevelopment projects within the City Heights Redevelopment Project and the Series B bonds were issued for the purpose of repaying long-term debt and to finance redevelopment activities in the City Heights Redevelopment Project. The 2010 Series A and B bonds are payable solely from, and secured by, pledged tax revenues allocated to RDA from the City Heights Redevelopment Project, excluding amounts payable to RDA's Low and Moderate Income Housing Fund, and amounts payable to other taxing agencies pursuant to tax sharing agreements. Bond proceeds were used to repay $2,010 of the San Diego National Bank line of credit outstanding principal and $1,827 to repay the Price Charities Note Payable dated May 2005.

- The City (RDA) issued $2,900 of 2010 Series A tax-exempt and $5,030 Series B taxable San Ysidro Redevelopment Project Tax Allocation Bonds. The Series A bonds were issued to repay certain redevelopment activities within or of benefit to the San Ysidro Redevelopment Project and the Series B bonds were issued for the purpose of repaying a loan with a developer and fund certain redevelopment activities in the Redevelopment Project. The 2010 Series A and B bonds are payable solely from, and secured by, tax revenues allocated to RDA from the San Ysidro Redevelopment Project, excluding those monies that RDA is obligated to deposit into its Low and Moderate Income Housing Fund and excluding monies which are allocable to other taxing agencies under the Redevelopment Law. Proceeds from the

Series B bonds were used to repay $1,768 of the International Gateway Associates, LLC loan payable dated October 2001 and $1,212 to repay the PCCP/SB Las Americas, LLC loan payable dated August 2005.

- The City issued $13,142 of taxable QECBs pursuant to the America Recovery and Reinvestment Act of 2009. The QECB financing is eligible for the direct interest subsidy payment from the U.S. Department of the Treasury within the meaning of Section 54D(a) of the Internal Revenue Code of 1986, as amended. The QECBs were issued to fund the Broad Spectrum Street Lighting Conversion Program and will be paid from annual appropriations payable out of any source of legally available funds.

- Total principal payments or reductions of long-term debt were $121,292. Of this amount, $41,658 was for scheduled bond principal payments on outstanding bonds, $58,273 for loans payable, $3,434 for notes payable, $1,018 for contracts payable and $16,909 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 received a State Revolving Fund Loan disbursement from the State of California Department of Public Health totaling $12,000 to assist in financing the construction of the Alvarado Water Treatment Plant Ozone Improvement project which will enable the City to meet safe drinking water standards.

- Total principal payments for long-term debt were $69,680, $63,915 of which was for principal payments on outstanding bonds and $5,765 on loans payable. 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 Lease Revenue Bonds and Revenue Bonds are as follows:

	Moody's Investors Service	**Fitch Ratings**	**Standard & Poor's**
General Fund Backed Lease Revenue Bonds	A2	A+	A-
Outlook	Stable	Stable	Stable
Wastewater System Bonds	Aa3	AA	A+
Outlook	Stable	Stable	Stable
Water System Bonds	Aa2/Aa3	AA/AA-	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 outstanding general obligation balance of $2,240 as of June 30, 2011 is significantly less than the current debt limitations for water and other purposes, which are $5,972,443 and $3,981,629 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. They are special obligations payable from the revenues received by the utility. Similarly, Section 90.2 authorizes the issuance of revenue bonds for the purpose of constructing improvements to the City's sewer utility.

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 sent to the Office of the City Comptroller at 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, 2011
(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	$ 1,482,248	$ 754,367	$ 2,236,615	$ 10,319	$ 129,471
Receivables:					
Taxes - Net of Allowance for Uncollectibles (Governmental $5,821)	93,749	-	93,749	-	-
Accounts - Net of Allowance for Uncollectibles (Governmental $26,090, Business-Type $6,194)	120,142	114,487	234,629	3,632	6,177
Claims	222	434	656	-	-
Special Assessments	2,061	-	2,061	-	-
Notes	180,317	-	180,317	-	222,271
Accrued Interest	2,264	2,317	4,581	-	24,733
Grants	53,406	3,328	56,734	-	-
Investment in Joint Venture	2,055	-	2,055	-	-
Advances to Other Agencies	5,268	-	5,268	-	-
Internal Balances	(3,080)	3,080	-	-	-
Inventories of Water in Storage	-	50,186	50,186	-	-
Inventories	2,764	541	3,305	16	-
Land Held for Resale	44,664	-	44,664	-	-
Prepaid Expenses	4,280	-	4,280	975	567
Restricted Cash and Investments	171,548	327,470	499,018	3,107	4,425
Deferred Charges	17,427	12,911	30,338	-	2,057
Capital Assets - Non-Depreciable	2,034,044	311,415	2,345,459	16,594	60,907
Capital Assets - Depreciable	2,480,156	4,675,845	7,156,001	14,888	91,106
TOTAL ASSETS	6,693,535	6,256,381	12,949,916	49,531	541,714

STATEMENT OF NET ASSETS
June 30, 2011
(In Thousands)

	Primary Government			Component Units	
	Governmental Activities	Business-Type Activities	Total	San Diego Convention Center Corporation	San Diego Housing Commission
LIABILITIES					
Accounts Payable	$ 94,260	$ 52,403	$ 146,663	$ 1,747	$ 2,782
Accrued Wages and Benefits	39,493	25,554	65,047	-	742
Other Accrued Liabilities	67	-	67	2,376	1,470
Interest Accrued on Long-Term Debt	21,850	25,345	47,195	-	574
Long-Term Liabilities Due Within One Year	143,883	85,690	229,573	1,475	25,226
Due to Other Agencies	3,379	2,218	5,597	-	-
Unearned Revenue	39,728	15,171	54,899	7,642	3,459
Contract Deposits	502	8,103	8,605	-	-
Sundry Trust Liabilities	3,665	-	3,665	-	-
Liabilities Payable from Restricted Assets:					
Customer Deposits Payable	-	11,519	11,519	-	-
Deposits/Advances from Others	-	6,110	6,110	-	1,321
Long-Term Liabilities Due After One Year:					
Arbitrage Liability	3	25	28	-	-
Compensated Absences	42,112	7,433	49,545	49	-
Liability Claims	277,333	11,750	289,083	-	-
Capital Lease Obligations	50,742	-	50,742	-	-
QECB Lease Obligations	12,392	-	12,392	-	-
Contracts Payable	19,720	-	19,720	-	-
Notes Payable	-	-	-	15,669	101,625
Loans Payable	28,560	84,692	113,252	-	-
Section 108 Loans Payable	15,188	-	15,188	-	-
Net Bonds Payable	1,246,217	1,991,171	3,237,388	-	-
Estimated Landfill Closure and Postclosure Care	-	20,845	20,845	-	-
Net Other Post Employment Benefit Obligation	167,819	48,161	215,980	-	-
Net Pension Obligation	117,219	23,391	140,610	-	-
TOTAL LIABILITIES	2,324,132	2,419,581	4,743,713	28,958	137,199
NET ASSETS					
Invested in Capital Assets, Net of Related Debt	3,812,560	3,094,788	6,907,348	17,361	43,092
Restricted for:					
Capital Projects	654,126	-	654,126	1,733	-
Debt Service	-	11,129	11,129	-	-
Low-Moderate Income Housing	84,260	-	84,260	-	-
Nonexpendable Permanent Endowments	15,670	-	15,670	-	-
Other	195,171	45,217	240,388	1,375	137,162
Unrestricted	(392,384)	685,666	293,282	104	224,261
TOTAL NET ASSETS	$ 4,369,403	$ 3,836,800	$ 8,206,203	$ 20,573	$ 404,515

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

STATEMENT OF ACTIVITIES
Year Ended June 30, 2011
(In Thousands)

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions
Primary Government:				
Governmental Activities:				
General Government and Support	$ 361,098	$ 185,696	$ 9,029	$ 296
Public Safety - Police	427,724	44,879	4,772	449
Public Safety - Fire and Life Safety and Homeland Security	223,174	30,655	27,607	220
Parks, Recreation, Culture and Leisure	248,668	65,033	7,037	14,960
Transportation	191,402	27,304	-	34,565
Sanitation and Health	74,639	11,784	2,795	395
Neighborhood Services	85,588	27,013	29,919	789
Debt Service:				
Interest	77,443	-	-	-
TOTAL GOVERNMENTAL ACTIVITIES	1,689,736	392,364	81,159	51,674
Business-Type Activities:				
Sewer Utility	315,591	357,731	380	12,345
Water Utility	362,830	371,515	7,231	18,011
Airports	4,297	4,749	9	336
Development Services	43,552	45,743	-	-
Environmental Services	34,904	28,246	-	-
Golf Course	15,503	15,715	-	-
Recycling	19,611	18,592	735	-
TOTAL BUSINESS-TYPE ACTIVITIES	796,288	842,291	8,355	30,692
TOTAL PRIMARY GOVERNMENT	$ 2,486,024	$ 1,234,655	$ 89,514	$ 82,366
Component Units:				
San Diego Convention Center Corporation	$ 36,417	$ 31,418	$ 3,656	$ 143
San Diego Housing Commission	202,290	29,307	184,750	-
TOTAL COMPONENT UNITS	$ 238,707	$ 60,725	$ 188,406	$ 143

General Revenues:

- Property Taxes
- Transient Occupancy Taxes
- Sales Taxes
- Other Local Taxes
- Developer Contributions and Fees
- Grants and Contributions not Restricted to Specific Programs
- 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
$ (166,077)	$ -	$ (166,077)	$ -	$ -
(377,624)	-	(377,624)	-	-
(164,692)	-	(164,692)	-	-
(161,638)	-	(161,638)	-	-
(129,533)	-	(129,533)	-	-
(59,665)	-	(59,665)	-	-
(27,867)	-	(27,867)	-	-
(77,443)	-	(77,443)	-	-
(1,164,539)	-	(1,164,539)	-	-
-	54,865	54,865	-	-
-	33,927	33,927	-	-
-	797	797	-	-
-	2,191	2,191	-	-
-	(6,658)	(6,658)	-	-
-	212	212	-	-
-	(284)	(284)	-	-
-	85,050	85,050	-	-
(1,164,539)	85,050	(1,079,489)	-	-
-	-	-	(1,200)	-
-	-	-	-	11,767
-	-	-	(1,200)	11,767
560,577	-	560,577	-	-
140,752	-	140,752	-	-
246,452	-	246,452	-	-
158,797	-	158,797	-	-
14,131	-	14,131	-	-
10,320	-	10,320	-	-
25,488	13,717	39,205	48	7,834
133	-	133	-	-
16,207	12,684	28,891	811	2,076
6,040	(6,040)	-	-	-
1,178,897	20,361	1,199,258	859	9,910
14,358	105,411	119,769	(341)	21,677
4,355,045	3,731,389	8,086,434	20,914	382,838
$ 4,369,403	$ 3,836,800	$ 8,206,203	$ 20,573	$ 404,515

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

GOVERNMENTAL FUNDS
BALANCE SHEET
JUNE 30, 2011
(In Thousands)

	General Fund	Other Governmental Funds	Total Governmental Funds
ASSETS			
Cash and Investments	$ 222,352	$ 1,112,812	$ 1,335,164
Receivables:			
Taxes - Net of Allowance for Uncollectibles (General Fund $5,589, Other Governmental $232)	66,170	27,579	93,749
Accounts - Net of Allowance for Uncollectibles (General Fund $5,615, Other Governmental $19,740)	12,359	97,816	110,175
Claims	214	8	222
Special Assessments	-	2,061	2,061
Notes	-	180,317	180,317
Accrued Interest	498	1,754	2,252
Grants	1	53,405	53,406
From Other Funds	6,510	748	7,258
Interfund Loan Receivable	-	32,010	32,010
Advances to Other Funds	-	8,784	8,784
Advances to Other Agencies	45	5,223	5,268
Land Held for Resale	9,403	35,261	44,664
Prepaid Items	-	2,744	2,744
Investment in Joint Venture	2,055	-	2,055
Restricted Cash and Investments	-	171,548	171,548
TOTAL ASSETS	$ 319,607	$ 1,732,070	$ 2,051,677
LIABILITIES			
Accounts Payable	$ 16,765	$ 62,678	$ 79,443
Accrued Wages and Benefits	36,475	638	37,113
Other Accrued Liabilities	-	67	67
Due to Other Funds	-	7,258	7,258
Due to Other Agencies	26	3,353	3,379
Unearned Revenue	2,563	36,647	39,210
Deferred Revenue	17,661	110,989	128,650
Sundry Trust Liabilities	-	3,665	3,665
Advances from Other Funds	-	8,784	8,784
Interfund Loan Payable	-	35,497	35,497
Contract Deposits	369	3	372
TOTAL LIABILITIES	73,859	269,579	343,438

GOVERNMENTAL FUNDS
BALANCE SHEET
JUNE 30, 2011
(In Thousands)

	General Fund	Other Governmental Funds	Total Governmental Funds
FUND EQUITY			
Fund Balances:			
Nonspendable	-	21,093	21,093
Restricted	145,880	1,378,184	1,524,064
Committed	1,183	92,783	93,966
Assigned	38,153	-	38,153
Unassigned	60,532	(29,569)	30,963
TOTAL FUND EQUITY	245,748	1,462,491	1,708,239
TOTAL LIABILITIES AND FUND EQUITY	$ 319,607	$ 1,732,070	

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.	4,395,436
Other assets and liabilities used in governmental activities are not financial resources (uses), and therefore, are either deferred or not reported in the funds.	146,077
Internal Service funds are used by management to charge the costs of activities such as Fleet Services, Central Stores, Publishing Services, and Self Insurance to individual funds. The assets and liabilities of certain Internal Service Funds are included in governmental activities in the Statement of Net Assets.	23,594
Certain liabilities, including bonds payable, are not due and payable in the current period, and therefore, are not reported in the funds.	(1,903,943)
Net Assets of governmental activities	$ 4,369,403

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, 2011
(In Thousands)

	General Fund	Other Governmental Funds	Total Governmental Funds
REVENUES			
Property Taxes	$ 384,023	$ 184,986	$ 569,009
Special Assessments	-	42,823	42,823
Sales Taxes	215,873	16,204	232,077
Transient Occupancy Taxes	73,399	66,146	139,545
Other Local Taxes	70,994	87,803	158,797
Licenses and Permits	28,621	14,047	42,668
Fines, Forfeitures and Penalties	31,598	1,758	33,356
Revenue from Use of Money and Property	49,923	36,797	86,720
Revenue from Federal Agencies	1,431	84,682	86,113
Revenue from Other Agencies	8,773	45,855	54,628
Revenue from Private Sources	1,016	28,110	29,126
Charges for Current Services	181,006	23,776	204,782
Other Revenue	4,505	28,302	32,807
TOTAL REVENUES	1,051,162	661,289	1,712,451
EXPENDITURES			
Current:			
General Government and Support	259,782	80,000	339,782
Public Safety - Police	389,811	12,517	402,328
Public Safety - Fire and Life Safety and Homeland Security	184,437	26,102	210,539
Parks, Recreation, Culture and Leisure	114,375	90,844	205,219
Transportation	42,704	72,464	115,168
Sanitation and Health	66,320	3,954	70,274
Neighborhood Services	25,767	63,059	88,826
Capital Outlay	776	141,360	142,136
Debt Service:			
Principal Retirement	10,391	104,383	114,774
Cost of Issuance	-	1,552	1,552
Interest	5,030	68,063	73,093
TOTAL EXPENDITURES	1,099,393	664,298	1,763,691
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	(48,231)	(3,009)	(51,240)
OTHER FINANCING SOURCES (USES)			
Transfers from Proprietary Funds	1,983	5,461	7,444
Transfers from Other Funds	158,874	674,265	833,139
Transfers to Proprietary Funds	(2,852)	(3,712)	(6,564)
Transfers to Other Funds	(22,601)	(810,538)	(833,139)
Proceeds from the Sale of Capital Assets	-	782	782
QECB Lease Issued	-	13,142	13,142
Notes Issued	-	133	133
Loans Issued	-	345	345
Tax Allocation Bonds Issued	-	106,400	106,400
Discount on Bonds Issued	-	(1,585)	(1,585)
Premium on Bonds Issued	-	42	42
TOTAL OTHER FINANCING SOURCES (USES)	135,404	(15,265)	120,139
NET CHANGE IN FUND BALANCES	87,173	(18,274)	68,899
Fund Balances at Beginning of Year	158,575	1,480,765	1,639,340
FUND BALANCES AT END OF YEAR	$ 245,748	$ 1,462,491	$ 1,708,239

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

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2011
(In Thousands)

Net change in fund balances - total governmental funds (page 56)	$ 68,899
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.	30,885
The net effect of various miscellaneous transactions involving capital assets (i.e., donations, retirements, and transfers) is to decrease net assets.	(959)
Deferred revenue available to liquidate liabilities of the current period were recognized in the governmental funds during the year; however, such amounts were recognized in the statement of activities in the prior year.	(6,251)
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.	(29,665)
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 expenditures in governmental funds.	(45,215)
Internal Service funds are used by management to charge the costs of activities such as Fleet Services, Central Stores, Publishing Services, Self Insurance, and others to individual funds. The net expense of certain internal service activities is reported with governmental activities.	(3,336)
Change in net assets of governmental activities (page 53)	$ 14,358

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

PROPRIETARY FUNDS
STATEMENT OF NET ASSETS
JUNE 30, 2011
(In Thousands)

	Business-Type Activities - Enterprise Funds				
	Sewer Utility	Water Utility	Other Enterprise Funds	Total	Internal Service Funds
ASSETS					
Current Assets:					
Cash and Investments	$ 419,209	$ 214,550	$ 120,608	$ 754,367	$ 147,084
Receivables:					
Accounts - Net of Allowance for Uncollectibles (Sewer $872, Water $1,780, Other Enterprise $3,542, Internal Service $735)	43,571	66,133	4,783	114,487	9,967
Claims	212	222	-	434	-
Accrued Interest	1,164	868	285	2,317	12
Grants	181	2,596	551	3,328	-
Inventories of Water in Storage	-	50,186	-	50,186	-
Inventories	-	540	1	541	2,764
Prepaid Expenses	-	-	-	-	1,536
Total Current Assets	464,337	335,095	126,228	925,660	161,363
Non-Current Assets:					
Restricted Cash and Investments	114,499	161,687	51,284	327,470	-
Deferred Charges	6,275	6,636	-	12,911	-
Interfund Loan Receivable	3,487	-	-	3,487	-
Capital Assets - Non-Depreciable	168,524	119,956	22,935	311,415	11,855
Capital Assets - Depreciable	2,738,317	1,879,721	57,807	4,675,845	106,909
Total Non-Current Assets	3,031,102	2,168,000	132,026	5,331,128	118,764
TOTAL ASSETS	3,495,439	2,503,095	258,254	6,256,788	280,127
LIABILITIES					
Current Liabilities:					
Accounts Payable	22,135	26,350	3,918	52,403	14,817
Accrued Wages and Benefits	13,238	9,645	2,671	25,554	2,380
Interest Accrued on Long-Term Debt	7,728	17,617	-	25,345	164
Long-Term Debt Due Within One Year	56,594	27,298	1,798	85,690	46,419
Due to Other Agencies	698	1,520	-	2,218	-
Unearned Revenue	-	539	14,632	15,171	518
Contract Deposits	3,722	4,365	16	8,103	130
Current Liabilities Payable from Restricted Assets:					
Customer Deposits Payable	-	5,384	6,135	11,519	-
Total Current Liabilities	104,115	92,718	29,170	226,003	64,428
Non-Current Liabilities:					
Deposits/Advances from Others	497	-	5,613	6,110	-
Arbitrage Liability	-	25	-	25	-
Compensated Absences	2,805	2,426	2,202	7,433	3,771
Liability Claims	8,662	3,088	-	11,750	169,569
Capital Lease Obligations	-	-	-	-	9,422
Loans Payable	57,260	27,432	-	84,692	-
Net Revenue Bonds Payable	1,152,334	838,837	-	1,991,171	-
Estimated Landfill Closure and Postclosure Care	-	-	20,845	20,845	-
Net Other Post Employment Benefit Obligation	17,201	16,423	14,537	48,161	7,738
Net Pension Obligation	8,639	6,510	8,242	23,391	2,012
Total Non-Current Liabilities	1,247,398	894,741	51,439	2,193,578	192,512
TOTAL LIABILITIES	1,351,513	987,459	80,609	2,419,581	256,940
NET ASSETS					
Invested in Capital Assets, Net of Related Debt	1,749,107	1,264,939	80,742	3,094,788	102,896
Restricted for Debt Service	6,398	4,731	-	11,129	-
Restricted for Closure/Postclosure Maintenance	-	-	45,217	45,217	-
Unrestricted	388,421	245,966	51,686	686,073	(79,709)
TOTAL NET ASSETS	$ 2,143,926	$ 1,515,636	$ 177,645	3,837,207	$ 23,187
Adjustment to reflect the consolidation of Internal Service Fund activities related to Enterprise Funds.				(407)	
Net assets of Business-Type activities				$ 3,836,800	

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, 2011
(In Thousands)

	Business-Type Activities - Enterprise Funds				
	Sewer Utility	Water Utility	Other Enterprise Funds	Total	Internal Service Funds
OPERATING REVENUES					
Sales of Water	$ -	$ 358,747	$ -	$ 358,747	$ -
Charges for Services	354,083	3,789	65,016	422,888	139,438
Revenue from Use of Property	181	5,540	-	5,721	-
Usage Fees	-	33	44,715	44,748	62,938
Other	3,467	3,406	3,314	10,187	1,494
TOTAL OPERATING REVENUES	357,731	371,515	113,045	842,291	203,870
OPERATING EXPENSES					
Benefit and Claim Payments	-	-	-	-	48,907
Maintenance and Operations	134,696	72,027	78,348	285,071	59,941
Cost of Materials Issued	-	-	-	-	27,546
Cost of Purchased Water Used	-	143,155	-	143,155	-
Taxes	-	1,755	-	1,755	-
Administration	63,875	65,926	32,600	162,401	54,972
Depreciation	63,488	43,054	5,759	112,301	25,981
TOTAL OPERATING EXPENSES	262,059	325,917	116,707	704,683	217,347
OPERATING INCOME (LOSS)	95,672	45,598	(3,662)	137,608	(13,477)
NONOPERATING REVENUES (EXPENSES)					
Earnings on Investments	7,454	4,468	1,795	13,717	1,707
Federal Grant Assistance	380	203	9	592	-
Other Agency Grant Assistance	-	7,028	735	7,763	-
Gain (Loss) on Sale/Retirement of Capital Assets	(1,961)	(1,164)	(122)	(3,247)	310
Debt Service Interest Expense	(51,112)	(34,490)	-	(85,602)	(844)
Other	6,404	3,552	2,728	12,684	758
TOTAL NONOPERATING REVENUES (EXPENSES)	(38,835)	(20,403)	5,145	(54,093)	1,931
INCOME (LOSS) BEFORE CONTRIBUTIONS AND TRANSFERS	56,837	25,195	1,483	83,515	(11,546)
Capital Contributions	12,345	18,011	336	30,692	294
Transfers from Other Funds	147	113	77	337	768
Transfers from Governmental Funds	-	142	307	449	6,115
Transfers to Other Funds	(10)	-	(750)	(760)	(345)
Transfers to Governmental Funds	(192)	(222)	(5,652)	(6,066)	(1,378)
CHANGE IN NET ASSETS	69,127	43,239	(4,199)	108,167	(6,092)
Net Assets at Beginning of Year	2,074,799	1,472,397	181,844		29,279
NET ASSETS AT END OF YEAR	$ 2,143,926	$ 1,515,636	$ 177,645		$ 23,187
Adjustment to reflect the consolidation of Internal Service Fund activities related to Enterprise Funds.				(2,756)	
Change in net assets of Business-Type activities				$ 105,411	

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

PROPRIETARY FUNDS
STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2011
(In Thousands)

	Business-Type Activities - Enterprise Funds				
	Sewer Utility	Water Utility	Other Enterprise Funds	Total	Internal Service Funds
CASH FLOWS FROM OPERATING ACTIVITIES					
Receipts from Customers and Users	$ 366,503	$ 364,110	$ 123,196	$ 853,809	$ 41,268
Receipts from Interfund Services Provided	3,007	6,503	4,800	14,310	162,542
Payments to Suppliers	(110,160)	(224,942)	(44,032)	(379,134)	(102,782)
Payments to Employees	(81,615)	(72,015)	(54,145)	(207,775)	(89,818)
Payments for Interfund Services Used	(6,549)	(5,883)	(6,136)	(18,568)	(1,493)
NET CASH PROVIDED BY OPERATING ACTIVITIES	171,186	67,773	23,683	262,642	9,717
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES					
Transfers from Other Funds	147	113	77	337	768
Transfers from Governmental Funds	-	142	307	449	6,115
Transfers to Other Funds	(10)	-	(750)	(760)	(345)
Transfers to Governmental Funds	(192)	(222)	(5,652)	(6,066)	(1,378)
Operating Grants Received	336	5,797	781	6,914	-
Proceeds from Advances and Deposits	-	454	1,481	1,935	-
Payments for Advances and Deposits	(33)	-	(1,159)	(1,192)	-
NET CASH PROVIDED BY (USED FOR) NONCAPITAL FINANCING ACTIVITIES	248	6,284	(4,915)	1,617	5,160
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES					
Proceeds from Loans	117	12,960	-	13,077	-
Proceeds from Capital Contributions	9,611	11,752	493	21,856	-
Acquisition of Capital Assets	(93,590)	(75,294)	(4,023)	(172,907)	(25,021)
Proceeds from the Sale of Capital Assets	10	231	-	241	1,807
Principal Payments on Capital Leases	-	-	-	-	(6,517)
Principal Payments on Loans	(4,825)	(940)	-	(5,765)	-
Principal Payments on Revenue Bonds	(42,620)	(21,295)	-	(63,915)	-
Interest Paid on Long-Term Debt	(61,104)	(40,328)	-	(101,432)	(772)
NET CASH (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES	(192,401)	(112,914)	(3,530)	(308,845)	(30,503)
CASH FLOWS FROM INVESTING ACTIVITIES					
Sales of Investments	274,380	659,699	-	934,079	-
Purchases of Investments	(218,425)	(630,101)	-	(848,526)	-
Interest and Dividends Received on Investments	6,506	4,114	1,790	12,410	1,702
NET CASH PROVIDED BY INVESTING ACTIVITIES	62,461	33,712	1,790	97,963	1,702
Net Increase (Decrease) in Cash and Cash Equivalents	41,494	(5,145)	17,028	53,377	(13,924)
Cash and Cash Equivalents at Beginning of Year	380,516	226,975	154,864	762,355	161,008
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 422,010	$ 221,831	$ 171,892	$ 815,733	$ 147,084
Reconciliation of Cash and Cash Equivalents at End of Year to the Statement of Net Assets:					
Cash and Investments	$ 419,209	$ 214,550	$ 120,608	$ 754,367	$ 147,084
Restricted Cash and Investments	114,499	161,687	51,284	327,470	-
Less Investments not meeting the definition of cash equivalents	(111,698)	(154,406)	-	(266,104)	-
Total Cash and Cash Equivalents at End of Year	$ 422,010	$ 221,831	$ 171,892	$ 815,733	$ 147,084

PROPRIETARY FUNDS
STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2011
(In Thousands)

	Business-Type Activities - Enterprise Funds				
	Sewer Utility	Water Utility	Other Enterprise Funds	Total	Internal Service Funds
Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities:					
Operating Income (Loss)	$ 95,672	$ 45,598	$ (3,662)	$ 137,608	$ (13,477)
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided By Operating Activities:					
Depreciation	63,488	43,054	5,759	112,301	25,981
Other Nonoperating Revenue	6,404	3,552	2,728	12,684	758
(Increase) Decrease in Assets:					
Accounts Receivable - Net	5,192	(4,085)	(4,280)	(3,173)	(1,837)
Claims Receivable - Net	93	62	-	155	-
Due from Other Funds	-	-	5,385	5,385	372
Inventories	-	(11,723)	2	(11,721)	(213)
Prepaid Expenses	-	467	-	467	4
Increase (Decrease) in Liabilities:					
Accounts Payable	2,448	(16,247)	934	(12,865)	(2,849)
Accrued Wages and Benefits	330	3,392	488	4,210	214
Due to Other Funds	(24)	(99)	(29)	(152)	(1,000)
Due to Other Agencies	-	(2)	-	(2)	-
Unearned Revenue	-	(126)	11,525	11,399	516
Contract Deposits	89	(305)	(407)	(623)	130
Arbitrage Liability	-	25	-	25	-
Compensated Absences	(123)	178	119	174	(280)
Liability Claims	(7,829)	(1,245)	-	(9,074)	(1,136)
Estimated Landfill Closure and Postclosure Care	-	-	719	719	-
Net OPEB Obligation	5,371	5,208	4,343	14,922	2,012
Net Pension Obligation	75	69	59	203	522
Total Adjustments	75,514	22,175	27,345	125,034	23,194
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 171,186	$ 67,773	$ 23,683	$ 262,642	$ 9,717
Noncash Investing, Capital, and Financing Activites:					
Capital Leases	$ -	$ -	$ -	$ -	$ 366
Developer Contributed Assets	2,734	6,259	-	8,993	294
Increase (Decrease) in Capital Assets related Accounts Payable	1,687	(1,113)	(177)	397	-
Noncash Retirement of Capital Assets	(1,972)	(1,387)	(122)	(3,481)	(1,497)
Capitalized Interest and Related Amounts	7,928	7,918	-	15,846	-
Change in Fair Value of Investments	(748)	(246)	-	(994)	-
Interest Fund Credits for Debt Service Payments	(2,487)	(518)	-	(3,005)	-

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

FIDUCIARY FUNDS
STATEMENT OF FIDUCIARY NET ASSETS
June 30, 2011
(In Thousands)

	Pension & Employee Savings Trust	Investment Trust	Agency
ASSETS			
Cash and Investments	$ 1,894	$ 5,541	$ 12,522
Cash with Custodian/Fiscal Agent	385,726	-	-
Investments at Fair Value:			
Domestic Fixed Income Securities (Bonds)	1,330,134	-	-
International Fixed Income Securities (Bonds)	252,934	-	-
Domestic Equity Securities (Stocks)	1,673,462	-	-
International Equity Securities (Stocks)	1,057,038	-	-
Real Estate Equity and Real Estate Securities	519,754	-	-
Equity Mutual Funds	416,612	-	-
Fixed Income Mutual Funds	399,517	-	-
Private Equity	87,004	-	-
Receivables:			
Accounts - Net	-	-	1,709
Special Assessments	-	-	642
Contributions	44,812	-	-
Accrued Interest	12,304	9	14
Loans	36,885	-	-
Securities Sold	28,365	-	-
Prepaid Expenses	265	-	-
Securities Lending Collateral	326,600	-	-
Restricted Cash and Investments	-	-	39,308
Capital Assets - Depreciable	2,048	-	-
TOTAL ASSETS	6,575,354	5,550	$ 54,195
LIABILITIES			
Accounts Payable	35,699	-	$ 725
Accrued Wages and Benefits	858	-	-
Deposits/Advances from Others	-	-	129
Sundry Agency Liabilities	-	-	20,054
Due to Bondholders	-	-	33,287
DROP Liability	434,547	-	-
Net Other Post Employment Benefit Obligation	1,317	-	-
Net Pension Obligation	632	-	-
Securities Lending Obligations	326,600	-	-
Securities Purchased	151,932	-	-
TOTAL LIABILITIES	951,585	-	$ 54,195
NET ASSETS			
Held in Trust for Pension Benefits and Other Purposes	$ 5,623,769	$ 5,550	

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

FIDUCIARY FUNDS
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
Year Ended June 30, 2011
(In Thousands)

	Pension & Employee Savings Trust	Investment Trust	Total
ADDITIONS			
Employer Contributions	$ 295,908	$ -	$ 295,908
Employee Contributions	144,419	-	144,419
Retiree Contributions	7,694	-	7,694
Contributions to Pooled Investments	-	2,776	2,776
Earnings on Investments:			
Investment Income	1,166,301	9	1,166,310
Investment Expense	(26,015)	-	(26,015)
Net Investment Income	1,140,286	9	1,140,295
Securities Lending Income:			
Gross Earnings	2,868	-	2,868
Borrower Rebates	(1,273)	-	(1,273)
Net Securities Lending Income	1,595	-	1,595
Other Income:			
Litigation Proceeds	1,507	-	1,507
TOTAL OPERATING ADDITIONS	1,591,409	2,785	1,594,194
DEDUCTIONS			
DROP Interest Expense	24,878	-	24,878
Benefit and Claim Payments	472,845	-	472,845
Distributions from Pooled Investments	-	2,040	2,040
Administration	15,880	-	15,880
TOTAL OPERATING DEDUCTIONS	513,603	2,040	515,643
CHANGE IN NET ASSETS	1,077,806	745	1,078,551
Net Assets at Beginning of Year	4,545,963	4,805	4,550,768
NET ASSETS AT END OF YEAR	$ 5,623,769	$ 5,550	$ 5,629,319

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

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2011

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. Most recently, changes were made to the City Charter in the municipal primary election on June 8, 2010 and the municipal general election on November 2, 2010. During the primary election, voters approved Proposition C, which expanded the eligibility for veterans preference points for City employment to veterans who have served in any war, major military action or peacekeeping mission, and Proposition D, which made permanent the Strong Mayor form of government, created a ninth City Council district and increased the number of Council votes needed to override a mayoral veto from five to six. During the general election, voters approved Proposition B, which established a good cause requirement for the termination or suspension of Deputy City Attorneys.

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. <u>Financial Reporting Entity</u>

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
- 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
- Southeastern Economic Development Corporation
- San Diego City Employees' Retirement System
- Tobacco Settlement Revenue Funding Corporation
- San Diego 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 (RDA) 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 are available at www.ccdc.com.

- The City of San Diego/Metropolitan Transit Development Board Authority (MTDB Authority) is a financing authority which was established in 1988 by the City and the Metropolitan Transit Development Board (now the Metropolitan Transit System or MTS) 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 City Council confirmation, two public members and the MTS Board appoints one MTS board member 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.

- The Convention Center Expansion Financing Authority (CCEFA) was established in 1996 by the City and the Port of San Diego to acquire and construct the expansion of the existing convention center. The CCEFA is 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 Mayor may appoint a City Manager and the Chief Operating Officer has been confirmed in this position by the City Council. The CCEFA provides services which primarily benefit the primary government. CCEFA is reported as a governmental fund.

- The Public Facilities Financing Authority (PFFA) was established in 1991 by the City and the RDA 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 RDA and three members of the public appointed by the Mayor and confirmed by the City 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.

- 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 are available at www.sandiego.gov.

- 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 are available at www.sddpc.org.

- 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.

- 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.

- 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. The City Council elects the Board of Directors. SEDC's budget and governing board are approved by the RDA and services are provided exclusively to the primary government. SEDC is reported as a governmental fund. Financial statements are available at www.sedcinc.org.

- 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 San Diego Unified Port District (Port) and the San Diego County Regional Airport Authority (Airport) 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. As such, the City does not maintain direct operational oversight of SDCERS or its financial reports. SDCERS provides services almost exclusively to the primary government.

  SDCERS is reported as a pension and employee savings trust fund. Complete stand-alone financial statements are available at www.sdcers.org.

- 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 purchased from the City the rights to receive future tobacco settlement revenues due to the City. 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.

- The San Diego 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. The TMD is reported as a component of the Acquisition, Improvement and Operations nonmajor 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 subsidizes the annual operations of the SDCCC. SDCCC is discretely presented because it provides services directly to the citizens. Complete stand-alone financial statements are available at www.sdccc.org.

- 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. SDHC is discretely presented because it provides services directly to the citizens. SDHC is governed by the San Diego Housing Authority, which is composed of the eight members of the San Diego City Council. The Housing Authority has final authority over the SDHC's budget and major policy changes. SDHC has three blended component units which are Belden SDHC FNMA LLC, Central SDHC FNMA LLC and Northern SDHC FNMA LLC together and collectively referred to as the "LLCs". The LLCs were created as a requirement of Fannie Mae to obtain financing on the former public housing units and are wholly owned by the San Diego Housing Commission. A portion of the Commission's larger properties were recently leveraged with Federal National Mortgage Association (FNMA) and Federal Housing Association (FHA) loans and are the obligation of the LLCs, not SDHC. Each one of these loans are nonrecourse obligations of the LLCs. Complete stand-alone financial statements are available at www.sdhc.org.

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 normally are supported by taxes and intergovernmental revenues and are reported separately from business-type activities, which rely to a significant extent on user 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.

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 imposed by the provider 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 City's water and sewer functions and various other functions of the City. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Amounts reported as program revenues include (1) charges 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 associated with debt issued or refunded during the year 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: Carmel Valley Sewer Maintenance; Mt. Hope Cemetery; 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; Southcrest Oak Estates II landscape maintenance; Sycamore Estates property maintenance; Fortuna Mountain Conservation Bank management within Mission Trails Regional Park; and, the Environmental Trust Bankruptcy Endowment. The corpus of permanent funds is reported as Nonspendable Fund Balance and investment earnings available for expenditure is reported as Restricted 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 and only report assets and liabilities, and therefore, do not have a measurement focus.

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 Preservation of Benefits Plan, the Post-Employment Healthcare Benefit Plan, the Supplemental Pension Savings Plan (SPSP), the 401(a) Plan 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 Abandoned Vehicle Abatement (AVA) is the only legally separate entity which has 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, certain employee benefit plans and special assessments.

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 and which do not meet the 60 day availability criterion 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 3% of the outstanding current balance which is analyzed each year against the most recent data from the County. For fiscal year 2011, the allowance amount was $5,821.

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 from the time of purchase.

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 City Treasurer in managing the pool are governed by California Government Code § 53601 and the City of San Diego City Treasurer's Investment Policy, which is reviewed by the Investment Advisory Committee and presented annually to 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 the individual funds. During the year ended June 30, 2011, approximately $2,238 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 the 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 contains additional information on permissible investments per the City of San Diego City Treasurer's 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 consists primarily of water in storage, 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 for inventories of water in storage and supplies, respectively. Inventory supplies of governmental funds are recorded as expenditures when purchased.

g. Land Held for Resale

Land Held for Resale, purchased by the RDA, is reported in the government-wide and fund financial statements at the lower of cost or net realizable value. In the governmental funds financial statements, fund balances associated with properties held for resale is reported as restricted fund balance since the proceeds from the sale of such properties is restricted for the purpose of affordable housing or redevelopment activities as codified in the California Health and Safety Code.

Land is originally recorded at historical cost and adjusted to net realizable value when the RDA enters into disposition and development agreements whereby the property will be sold for less than its historical cost, when a property is impaired or when property values decrease due to market conditions.

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. Notes Receivable

The City's notes receivable are primarily comprised of notes held by the RDA, which provides cash or conveys land to developers in exchange for promissory notes to facilitate the financing of affordable housing and redevelopment projects. Some of the notes are forgivable after a specified period of time if certain requirements are met. These requirements typically relate to income restrictions on affordable housing projects. Other notes are non-forgivable and require repayment in accordance with its corresponding promissory note.

In the case of forgivable notes, the RDA assumes that the developer will comply with the affordable housing covenants, or other restrictions, and that the note will be forgiven. Hence, forgivable notes are expensed/expended at the time the cash is disbursed by the RDA or at the time land is conveyed to the developer. In the event the developer does not meet the restriction requirements, the RDA records a note receivable and recognizes revenue equal to the estimated collectable amount.

Non-forgivable notes receivable are reported as an asset transaction in which cash or land is provided in exchange for a promissory note. As payments on each note are collected, the RDA recognizes revenue for the interest component of each payment, reduces the receivable balance of the note and increases cash for the principal component of the payment. Unless information is available on the uncollectability of a specific note, there is no allowance for uncollectable amounts on non-forgivable notes receivable since these notes are typically secured by real property.

j. Capital Assets

Non-Depreciable Capital Assets, which include land, rights of way, easements, 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/amortization 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 2011, $15,846 of interest expense incurred was capitalized which is calculated net of related interest revenue of $1,584.

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/amortization 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
Intangible Assets	5 - 20
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

k. 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 the 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.

l. 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.

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. The reimbursement is reported as expenditures or expenses in the reimbursing fund and a reduction of expenditures or expenses in the fund that initially incurred the expense.

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.

m. 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 are amortized over the life of the bonds using a method which approximates the effective interest method and deferred amounts on refunding are amortized over the shorter of the life of the refunded or refunding bonds. Net bonds payable reflects amortized bond accretion and unamortized bond discounts, premiums and deferred amounts on refunding.

n. Sundry Trust Liabilities

Under approval of certain agreements, developers submit to the 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 incurred by the 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 the RDA.

o. 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 and proprietary 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. 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.

p. 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.

q. 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.

r. 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, 2011, the amount of restricted net assets due to enabling legislation was approximately $150,847.
- 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.

s. Fund Balances

In the fund financial statements, governmental funds report fund balances as nonspendable, restricted, committed, assigned or unassigned based on the extent to which the City is bound to honor constraints on how resources can be spent.

- Nonspendable fund balance – amounts that cannot be spent because they are either (a) not spendable in form or (b) legally or contractually required to be maintained intact.
- Restricted fund balance – amounts with constraints placed on their use that are either (a) externally imposed by creditors, grantors, contributors or laws or regulations of other governments, or (b) imposed by law through constitutional provisions or enabling legislation.
- Committed fund balance – amounts that can only be used for specific purposes determined by formal action of the City's highest level of decision making authority (City Council) and that remain binding unless removed in the same manner. The underlying action that imposed the limitation must occur prior to the close of the reporting period; however, the amount which will be subject to the constraint may be determined in a subsequent period.
- Assigned fund balance – amounts that are constrained by the City's intent to be used for specific purposes. The intent can be established at either the highest level of decision making authority or by a body or an official designated for that purpose. This fund balance classification also represents the residual balance for all funds other than the General Fund.
- Unassigned fund balance – the residual classification for the City's General Fund that includes amounts not included in other classifications. In funds other than the General Fund, the unassigned classification is used only if expenditures incurred for specific purposes exceed the amounts restricted, committed or assigned to those purposes.

The City Council establishes, modifies or rescinds fund balance commitments and assignments by passage of an ordinance or resolution. This is done through adoption of the budget and subsequent budget amendments that occur throughout the year.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, followed by committed, assigned and unassigned as they are needed.

t. Reserves

City Charter Section 91 requires the City Council to maintain a General Reserve Fund 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 City's formal reserve policy, which was adopted in fiscal year 2008 and subsequently amended in December 2011, was created in accordance with Charter Section 91 and defines the General Fund Reserve. The General Fund Reserve includes the General Reserve Fund (or Emergency Reserve), the appropriated reserve and the General Fund unassigned fund balance. The reserve policy defines a goal of having a minimum of 8% of annual General Fund revenues held in the General Fund Reserve by fiscal year 2012. This reserve level was achieved in fiscal year 2010 and maintained through fiscal year 2011.

u. Participating Agencies Revenue Recognition

The Regional Wastewater Disposal Agreement between the 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 each PA's proportionate allocation of actual maintenance and operating costs of the sewage system, resulting in an overstatement or understatement of revenue reported in the Sewer Utility Statement of Revenues, Expenses, and Changes in Fund Net Assets.

v. 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.

w. New Governmental Accounting Standards Implemented During Year Ended June 30, 2011

The requirements for the following accounting standards are effective for the purpose of implementation, if applicable to the City, for the year ended June 30, 2011.

In February 2009, GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which enhances the usefulness of fund balance information by providing clearer direction for fund balance classification through the use of a universal hierarchy based on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. This universal hierarchy allows for greater consistency when identifying fund balance classifications. Additionally, this statement clarifies existing governmental fund type definitions.

In June 2010, GASB issued Statement No. 59, *Financial Instruments Omnibus*, which updates and improves existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools by providing more complete and consistent information.

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). 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 $146,077 difference are as follows:

Deferred Charges, July 1, 2010	$ 16,909
Issuance Costs	1,552
Amortization Expense	(1,034)
Deferred Charges, June 30, 2011	17,427
Deferred Revenue:	
Taxes Receivable	77,535
Notes Receivable	3,420
Motor Vehicle License Receivable	681
Special Assessments Receivable	402
Grants and Other Receivables	46,612
Deferred Revenue, June 30, 2011	128,650
Net Adjustment to increase "Total Fund Balances-Governmental Funds" to arrive at "Total Net Assets-Governmental Activities"	$ 146,077

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 ($1,903,943) difference are as follows:

Interest Accrued on Long-Term Debt	$ (21,686)
Arbitrage Liability	(3)
Compensated Absences	(65,967)
Liability Claims	(107,764)
Capital Lease Obligations	(52,150)
QECB Lease Obligation	(13,142)
Contracts Payable	(24,419)
Loans Payable	(36,621)
Section 108 Loans Payable	(16,342)
Net Bonds Payable	(1,272,175)
Accretion of Interest on Capital Appreciation Bonds	(18,386)
Net Other Post Employment Benefits Obligation	(160,081)
Net Pension Obligation	(115,207)
Net adjustment to decrease "Total Fund Balances-Governmental Funds" to arrive at "Total Net Assets-Governmental Activities"	$ (1,903,943)

Another element of the reconciliation states: "Internal Service Funds are used by management to charge the costs of activities such as Fleet Services, Central Stores, Publishing Services and Self Insurance 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 $23,594 difference are as follows:

Assets:	
Capital Assets - Non Depreciable	$ 11,855
Capital Assets - Depreciable	106,909
Internal Balances	407
Current Assets	161,363
Liabilities:	
Compensated Absences	(7,485)
Liability Claims	(205,828)
Capital Lease Obligations	(15,868)
Net Other Post Employment Benefits Obligation	(7,738)
Net Pension Obligation	(2,012)
Other Liabilities	(18,009)
Net adjustment to increase "Total Fund Balances-Governmental Funds" to arrive at "Total Net Assets-Governmental Activities"	$ 23,594

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 $30,885 difference are as follows:

Capital Outlay	$ 142,136
Other Capital Activities	16,091
Depreciation Expense	(127,342)
Net Adjustment to increase "Net Changes in Fund Balances-Total Governmental Funds" to arrive at "Changes in Net Assets of Governmental Activities"	$ 30,885

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 ($959) 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.	$ (303)
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.	(656)
Net adjustment to decrease "Net Change in Fund Balances-Total Governmental Funds" to arrive at "Changes in Net Assets of Governmental Activities"	$ (959)

Another element of the reconciliation states: “Internal Service Funds are used by management to charge the costs of activities such as Fleet Services, Central Stores, Publishing Services, Self Insurance, and others to individual funds. The net expense of certain Internal Service activities is reported with governmental activities.” The details of this ($3,336) are as follows:

Allocated Operating Profit	$ (10,721)
Nonoperating Revenues (Expenses):	
Other Nonoperating Revenues	1,931
Transfers	5,160
Capital Contributions	294
Net adjustment to decrease "Net Changes in Fund Balances-Total Governmental Funds" to arrive at "Changes in Net Assets of Governmental Activities"	$ (3,336)

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 of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets." The details of this ($29,665) difference are as follows:

Debt Issued or Incurred:	
QECB Lease Obligation	$ (13,142)
Contracts/Notes Payable	(24,552)
Loans Payable	(345)
Tax Allocation Bonds	(106,400)
Principal Repayments:	
Capital Lease Obligations	10,391
Contracts/Notes Payable	4,452
Loans Payable	43,119
Section 108 Loans	15,154
General Obligation Bonds	2,100
Revenue Bonds	15,710
Tax Allocation Bonds	20,328
Tobacco Settlement Asset-Backed Bonds	2,750
Pooled Financing Bonds	770
Net adjustment to decrease "Net Changes in Fund Balances-Total Governmental Funds" to arrive at "Changes in Net Assets of Governmental Activities"	$ (29,665)

Another element of the reconciliation states: "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 expenditures in governmental funds." The details of this ($45,215) difference are as follows:

Compensated Absences	$ (300)
Liability Claims	4,185
Net Pension Obligation/Net OPEB Obligation	(47,655)
Accrued Interest	(1,635)
Current Year Premiums/Discounts and Interest Accretion Less Amortization of Bond Premiums	(328)
Issuance Costs Less Current Year Amortization	518
Net adjustment to decrease "Net Changes in Fund Balances-Total Governmental Funds" to arrive at "Changes in Net Assets of Governmental Activities"	$ (45,215)

3. CASH AND INVESTMENTS (In Thousands)

The following is a summary of the carrying amount of cash and investments as of June 30, 2011:

	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	$ 1,377,518	$ 815,727	$ 28,731	$ 2,221,976	$ 944	$ 2,222,920
Cash and Investments with Fiscal Agents	156,529	163,305	29,592	349,426	385,723	735,149
Investments at Fair Value	119,749	102,805	816,130	1,038,684	4,920,326	5,959,010
Securities Lending Collateral	-	-	-	-	326,600	326,600
Total	$ 1,653,796	$ 1,081,837	$ 874,453	$ 3,610,086	$ 5,633,593	$ 9,243,679

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	$ 203
Deposits - Held in Escrow Accounts	6,676
Deposits - Cash and Cash Equivalents (Not Pooled)	1,874
Deposits - Cash, Cash Equivalents, and Certificates of Deposit (Pooled)	11,600
Pooled Investments in the City Treasury	2,201,623
Total Cash and Cash or Equity in Pooled Cash and Investments	$ 2,221,976

A summary of the deposits and investments held by the City Treasurer's investment pool as of June 30, 2011 is presented in the table below:

Investment	Fair Value	Book Value	Interest Rate % Range		Maturity Range
U.S. Treasury Notes	$ 1,002,272	$ 995,166	0.375-1.875%		3/15/2012-6/15/2014
U.S. Agency Discount Notes	56,055	56,021	0.18-0.20%	*	7/18/2011-5/25/2012
U.S. Agency Notes & Bonds	651,266	648,632	0.15-2.25%		8/4/2011-7/30/2014
Commercial Paper	169,922	169,881	0.04-0.29%		7/1/2011-11/25/2011
Corporate Notes & Bonds	222,798	222,165	0.75-6.375%		7/12/2011-5/19/2014
Local Agency Investment Fund (LAIF)	49,353	49,276	0.51%	**	2/23/2012
Negotiable Certificates of Deposit	49,957	50,000	0.262-0.38%		7/8/2011-6/7/2012
Certificates of Deposit (CDARS)	10,000	10,000	1.25%		2/16/2012
	$ 2,211,623	$ 2,201,141			

* Discount Rates

** LAIF - Fair Value is adjusted to account for LAIF factor. Maturity range is based on weighted average maturity of 238 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, 2011:

Statement of Net Assets	
Deposit - Cash, Cash Equivalents, and Certificates of Deposit (Pooled)	$ 11,600
Investments of Pool Participants	2,201,623
Accrued Interest Receivable of Internal Pool Participants	3,371
Accrued Interest Receivable of External Pool Participants	9
Total Cash, Investments, and Interest Receivable	$ 2,216,603
Equity of Internal Pool Participants	$ 2,211,053
Equity of External Pool Participants (Abandoned Vehicle Abatement) ***	5,550
Total Equity	$ 2,216,603

***Voluntary Participation

Statement of Changes in Net Assets	
Net Assets Held for Pool Participants at July 1, 2010	$ 2,128,638
Net Change in Investments by Pool Participants	87,965
Total Net Assets Held for Pool Participants at June 30, 2011	$ 2,216,603

b. Cash and Investments with Fiscal Agents

Cash and Investments with Fiscal Agents include 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 Agents include 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. Additionally, Cash and Investments with Fiscal Agents include the San Diego City Employees' Retirement System (SDCERS) portion of 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, 401(a) Plan, San Diego City Employees' Retirement System (SDCERS), investments managed by the City Treasurer (which are not part of the pool) and investments managed by the Funds Commission (e.g. Cemetery Perpetuity Fund, Los Penasquitos Canyon Preserve Fund, and the Edwin A. Benjamin, Jane Cameron, Gladys Edna Peters, and Effie Sergeant Library Funds).

d. Investment Policy

In accordance with City Charter Section 45, the City Treasurer is responsible for the safekeeping and investment of the unexpended cash in the City Treasury. The City Treasurer is also responsible for maintaining the City of San Diego City Treasurer's Investment Policy (Policy) which is presented to Council annually. 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 City Treasurer's 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 acceptance on an annual basis.

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 (7)	
	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	30%	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%	20%	10%	5%	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 with 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 the City Treasurer.

(7) Minimum credit rating categories include modifications (+/-).

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.

Ineligible investments prohibited from use in the portfolio include, but are not limited to, common stocks and long-term corporate notes/bonds. The City of San Diego City Treasurer's Investment Policy is available at www.sandiego.gov/treasurer/investments/invpolicy.shtml.

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 of San Diego City Treasurer's Investment Policy. Each permanent endowment fund has its own separate investment policy.

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 of San Diego City Treasurer's Investment Policy, but may include certain investment options not authorized by applicable law for the City of San Diego City Treasurer's Policy (CGC §53601). Individual bond indentures are available at www.sandiego.gov/investorinformation/terms.shtml.

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 Bank of America 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 Bank of America 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 on the next page.

As of June 30, 2011, the City's investments (in thousands) by maturity are as follows:

	Years				Fair Value
Pooled Investments with City Treasurer:	Under 1	1-3	3-5	Over 5	(In Thousands)
U.S. Treasury Notes	$ 136,061	$ 866,211	$ -	$ -	$ 1,002,272
U.S. Agencies - Federal Farm Credit Bank	72,640	71,058	-	-	143,698
U.S. Agencies - Federal Home Loan Bank	190,299	55,323	-	-	245,622
U.S. Agencies - Federal Home Loan Mortgage Corporation	74,033	80,028	24,969	-	179,030
U.S. Agencies - Federal National Mortgage Association	58,805	60,166	-	-	118,971
U.S. Agencies - National Credit Union Association Notes	-	20,000	-	-	20,000
Commercial Paper	169,922	-	-	-	169,922
Corporate Notes	163,248	59,550	-	-	222,798
Negotiable Certificates of Deposit	49,957	-	-	-	49,957
Non-Negotiable Certificate of Deposit (CDARS deposit)	10,000	-	-	-	10,000
State Local Agency Investment Fund	49,353	-	-	-	49,353
	974,318	1,212,336	24,969	-	2,211,623
Non-Pooled Investments with City Treasurer:					
U.S. Treasury Bills	26,078	-	-	-	26,078
U.S. Treasury Notes	60,282	-	-	-	60,282
U.S. Agencies - Federal Home Loan Bank	15,348	-	-	-	15,348
U.S. Agencies - Federal Home Loan Mortgage Corporation	29,609	-	-	-	29,609
U.S. Agencies - Federal National Mortgage Association	51,120	-	-	-	51,120
Commerical Paper	17,998	-	-	-	17,998
Corporate Notes	1,665	-	-	-	1,665
	202,100	-	-	-	202,100
Investments with Fiscal Agents, Funds Commission, and Blended Component Units:					
U.S. Treasury Bills	14,518	-	-	-	14,518
U.S. Treasury Bonds and Notes	36,811	7,396	49,171	29,730	123,108
U.S. Agencies - Federal Home Loan Bank	1,707	-	-	-	1,707
U.S. Agencies - Federal Home Loan Mortgage Corporation	11,754	-	-	-	11,754
U.S. Agencies - Federal National Mortgage Association	10,769	6,527	-	-	17,296
Commercial Paper	8,236	-	-	-	8,236
Common Stock [1]	3,186	-	-	-	3,186
Corporate Bonds and Notes	29,150	38,870	555	3,005	71,580
Exchange Traded Funds [1]	806	-	-	-	806
Government Mortgage Backed Securities	-	-	-	19	19
Guaranteed Investment Contracts	-	-	-	13,703	13,703
Money Market Mutual Funds	92,975	-	-	-	92,975
Mutual Funds - Equity [1]	421,686	-	-	-	421,686
Mutual Funds - Fixed Income	-	399,079	-	3,223	402,302
Repurchase Agreements	2,550	-	-	-	2,550
Cash (with Fiscal Agents)	584	-	-	-	584
	634,732	451,872	49,726	49,680	1,186,010
Total Investments	$ 1,811,150	$ 1,664,208	$ 74,695	$ 49,680	3,599,733
Total Deposits					10,150
Total Cash on Hand					203
Total Investments, Deposits, and Cash on Hand					$ 3,610,086

[1] Common stock, exchange traded funds, and equity mutual funds do not have maturities.

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, 2011, the City's investments and corresponding credit ratings are as follows:

Pooled Investments with City Treasurer:	Moody's	S&P	Fair Value	Percentage
U.S. Treasury Notes	Exempt	Exempt	$ 1,002,272	45.33%
U.S. Agencies - Federal Farm Credit Bank [1]	Aaa	N/A	131,214	5.93%
U.S. Agencies - Federal Farm Credit Bank [1]	P-1	N/A	12,484	0.56%
U.S. Agencies - Federal Home Loan Bank [1]	Aaa	N/A	245,622	11.11%
U.S. Agencies - Federal Home Loan Mortgage Corporation [1]	Aaa	N/A	154,030	6.96%
U.S. Agencies - Federal Home Loan Mortgage Corporation [1]	P-1	N/A	25,000	1.13%
U.S. Agencies - Federal National Mortgage Association [1]	Aaa	N/A	100,400	4.54%
U.S. Agencies - Federal National Mortgage Association [1]	P-1	N/A	18,571	0.84%
U.S. Agencies - National Credit Union Association Notes	Aaa	N/A	20,000	0.90%
Commercial Paper	P-1	N/A	169,922	7.68%
Corporate Notes	Aaa	N/A	111,237	5.03%
Corporate Notes	Aa1	N/A	5,105	0.23%
Corporate Notes	Aa2	N/A	55,660	2.52%
Corporate Notes	Aa3	N/A	25,362	1.15%
Corporate Notes	A1	N/A	5,036	0.23%
Corporate Notes	A2	N/A	20,398	0.92%
Negotiable Certificates of Deposit	P-1	N/A	25,002	1.13%
Negotiable Certificates of Deposit	Aa1	N/A	24,955	1.13%
Non-Negotiable Certificates of Deposit (CDARS deposit)	Not Rated	Not Rated	10,000	0.45%
State Local Agency Investment Fund	Not Rated	Not Rated	49,353	2.23%
Subtotal - Pooled Investments			2,211,623	100.00%
Non-Pooled Investments with City Treasurer:				
U.S. Treasury Bills	Exempt	Exempt	26,078	12.89%
U.S. Treasury Notes	Exempt	Exempt	60,282	29.84%
U.S. Agencies - Federal Home Loan Bank [1]	Aaa	N/A	4,843	2.40%
U.S. Agencies - Federal Home Loan Bank [1]	P-1	N/A	10,505	5.19%
U.S. Agencies - Federal Home Loan Mortgage Corporation [1]	Aaa	N/A	2,291	1.14%
U.S. Agencies - Federal Home Loan Mortgage Corporation [1]	P-1	N/A	27,318	13.52%
U.S. Agencies - Federal National Mortgage Association [1]	Aaa	N/A	1,151	0.57%
U.S. Agencies - Federal National Mortgage Association [1]	P-1	N/A	49,969	24.72%
Commerical Paper	P-1	N/A	17,998	8.91%
Corporate Notes	Aaa	AAA	1,665	0.82%
Subtotal - Non-Pooled Investments			202,100	100.00%

"Exempt" - Per GASB Statement No. 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 the full faith and credit of the U.S. Government.

Investments with Fiscal Agents, Funds Commission, and Blended Component Units:	Moody's	S&P	Fair Value	Percentage
U.S. Treasury Bills	Exempt	Exempt	$ 14,518	1.22%
U.S. Treasury Bonds and Notes	Exempt	Exempt	123,108	10.38%
U.S. Agencies - Federal Home Loan Bank	P-1	N/A	1,707	0.14%
U.S. Agencies - Federal Home Loan Mortgage Corporation	P-1	N/A	11,754	0.99%
U.S. Agencies - Federal National Mortgage Association	Aaa	N/A	6,527	0.55%
U.S. Agencies - Federal National Mortgage Association	P-1	N/A	10,769	0.91%
Commercial Paper	P-1	N/A	8,236	0.69%
Common Stock	N/A	N/A	3,186	0.27%
Corporate Bonds and Notes	Aaa	N/A	66,853	5.63%
Corporate Bonds and Notes	Aa1	N/A	210	0.02%
Corporate Bonds and Notes	Aa2	N/A	342	0.03%
Corporate Bonds and Notes	Aa3	N/A	226	0.02%
Corporate Bonds and Notes	A1	N/A	685	0.06%
Corporate Bonds and Notes	A2	N/A	3,054	0.26%
Corporate Bonds and Notes	A3	N/A	107	0.01%
Corporate Bonds and Notes	WR[2]	A-	103	0.01%
Exchange Traded Funds	N/A	N/A	806	0.07%
Government Mortgage Backed Securities	Not Rated	Not Rated	19	0.01%
Guaranteed Investment Contracts	Not Rated	Not Rated	13,703	1.16%
Money Market Mutual Funds	Aaa	N/A	92,975	7.84%
Mutual Funds - Equity	N/A	N/A	421,686	35.54%
Mutual Funds - Fixed Income	Not Rated	Not Rated	402,302	33.92%
Repurchase Agreements	Not Rated	Not Rated	2,550	0.22%
Cash (with Fiscal Agents)	Not Rated	Not Rated	584	0.05%
Subtotal - Other Investments			1,186,010	100.00%
Total Investments			3,599,733	
Total Deposits			10,150	
Total Cash on Hand			203	
Total Investments, Deposits, and Cash on Hand			$ 3,610,086	

"Exempt" - Per GASB Statement No. 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 the full faith and credit of the U.S. Government.

[2] Rating withdrawn for reasons including: debt maturity, calls, puts, conversions, etc.

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, 2011, 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, 2011, the carrying amount of the City's cash deposits was approximately $13,474, and the bank balance was approximately $26,636; the difference is substantially due to outstanding checks. For the balance of cash deposits in financial institutions, approximately $10,893 was covered by federal depository insurance and approximately $15,743 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, $14,683 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 $1,060, which is uninsured and uncollateralized. The amount subject to custodial credit risk represents $1,060 in deposits with the San Diego Data Processing Corporation.

The City also has deposits held in escrow accounts with a carrying amount and bank balance of approximately $6,676. For the balance of deposits in escrow accounts, approximately $1,813 was covered by federal depository insurance. The remaining balance of $4,863 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, $4,863 of the City's deposits in escrow accounts are collateralized and pledged at 110%.

Investments

The City's investments at June 30, 2011 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, 2011, 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:

Investment Type	Fair Value
Common Stock	$ 3,098
Corporate Bonds and Notes	4,727
Exchange Traded Funds	806
Government Mortgage Backed Securities	19
U.S. Treasury Bonds and Notes	926
Total	$ 9,576

h. Restricted Cash and Investments

Cash and investments at June 30, 2011 that are restricted by legal or contractual requirements are comprised of the following:

Nonmajor Governmental Funds		
Debt Service	$	152,575
Permanent Endowments		18,973
Total Nonmajor Governmental Funds		171,548
Nonmajor Enterprise Funds		
Environmental Services Fund - Funds set aside for landfill site closure and maintenance costs		45,149
Recycling Enterprise Fund - Customer deposits		6,135
Total Nonmajor Enterprise Funds		51,284
Water Utility Enterprise Fund		
Customer Deposits		5,553
Interest and Redemption Funds		156,134
Total Water Utility Enterprise Fund		161,687
Sewer Utility Enterprise Fund		
Interest and Redemption Funds		114,499
Miscellaneous Agency Funds		
Special Assessment Funds and Retention Held in Escrow Accounts		39,308
Total Restricted Cash and Investments	$	538,326

Summary of Total Cash and Investments

Total Unrestricted Cash and Investments	$	8,705,353
Total Restricted Cash and Investments		538,326
Total Cash and Investments	$	9,243,679
Total Governmental Activities	$	1,653,796
Total Business-Type Activities		1,081,837
Total Fiduciary Activities		6,508,046
Total Cash and Investments	$	9,243,679

San Diego City Employees' Retirement System (SDCERS) – Disclosures for Policy and Specific Risks

Narratives and tables presented in the following sections (i. through s.) are taken directly from the comprehensive annual financial report of the San Diego City Employees' Retirement System, as of June 30, 2011, issued December 5, 2011.

Summary of Cash and Investments – San Diego City Employees' Retirement System

Cash or Deposit with Wells Fargo Bank	$ 944
Cash and Cash Equivalents on Deposit with Custodial Bank and Fiscal Agents	385,723
Investments at Fair Value:	
Domestic Fixed Income Securities	1,330,134
International Fixed Income Securities	252,934
Domestic Equity Securities	1,673,462
International Equity Securities	1,057,038
Real Estate	519,754
Private Equity	87,004
Securities Lending Cash Collateral	326,600
Total Cash and Investments for SDCERS	$ 5,633,593

i. Investment Policy and Portfolio Risk

The Board of Administration of SDCERS (Board) has exclusive authority over the administration and investment of SDCERS' Trust Fund assets pursuant to 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 bonds, notes or other obligations, real estate investments, common stock, preferred stock, private equity and pooled vehicles. The risks and correlations of each asset class and investment manager are considered relative to an entire portfolio. Investment policies permit the Board to invest in financial futures contracts provided the contracts do not hedge SDCERS' Trust Fund portfolio. Financial futures contracts are recorded at market value each day and must be settled at expiration date. Changes in the market value of the contracts results in the recognition of a gain or loss under GASB Statement No. 25.

Investment earnings are recorded 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 appreciation/depreciation in the fair value of investments, less total investment expenses (including investment management/custodial fees and all other significant investment-related costs). SDCERS had current year realized gains that totaled $685,100 for the year ended June 30, 2011. Pursuant to the San Diego Municipal Code, realized gains and losses determine whether certain contingent benefits will be paid each fiscal year.

Through its investment objectives and policies, the Board has placed considerable importance on both generating a reasonable rate of return above inflation and on the preservation of capital. Investments are made only after the risk/reward trade-offs are clearly understood.

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 vary less than equity returns. SDCERS' target asset allocation policy is reviewed each year to reflect changes in capital market assumptions. SDCERS' long term target allocation to fixed income strategies as of June 30, 2011 was 25%, which includes domestic fixed income and emerging market debt. As of June 30, 2011, SDCERS' target allocation to fixed income was 29%, as it included a 4% allocation to non-U.S. fixed income, which was subsequently terminated. The fixed income allocation is externally managed and is comprised as follows: 22% to core 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 emerging market debt (benchmarked to the 50% JP Morgan Emerging Market Bond Index Global Diversified and 50% JP Morgan Global Bond Index-Emerging Global Diversified). A 3% target allocation to convertible bond securities (benchmarked to the Merrill Lynch Convertible Index, All Qualities) is not included in the fixed income allocation, but instead is included in the domestic equity allocation. However, given that these convertible securities have fixed income attributes, the convertible bond allocation is included in the Portfolio Risk analysis. SDCERS' overall portfolio diversification limits the fixed income invested in the debt security of any one issuer to 10% of the portfolio at the time of the initial commitment, except for U.S. Government obligations (or agencies and instruments of the U.S. Government) to minimize overall market and credit risk.

A copy of the SDCERS investment policy and additional details on the results of SDCERS' 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. Fixed income portfolios use duration to measure how a change in interest rates will affect the value of the portfolio.

Convertible bonds are generally less sensitive to changes in interest rates and more sensitive to the profitability of the underlying issuer. Company fundamentals are the overriding factor in the bond's return, while fluctuations in interest rates have significantly less impact.

The following table identifies the durations of SDCERS' domestic and international fixed income strategies based on portfolio holdings as of June 30, 2011.

Type of Security	Effective Duration (in years)	Fair Value [1]
Asset-Backed Securities		
Asset-Backed Securities	1.44	$ 28,524
Adjustable Rate Mortgages		
Adjustable Rate Mortgages	1.20	3,827
Commercial Mortgage-Backed Securities		
Commercial Mortgage-Backed Securities	2.90	38,419
Collateralized Mortgage Obligations		
Collateralized Mortgage Obligations	3.42	44,820
Corporate Bonds		
Corporate Bonds [2]	3.76	249,258
Government & Agency Obligations		
Agency Securities	2.16	67,417
Municipals	11.40	26,400
Other Government Securities	3.84	11,322
Pass-Thru Securities	4.74	120,021
Sovereign Debt Securities	6.54	152,922
Supranational Debt Securities	7.17	10,538
Treasury Securities	8.77	62,550
Mortgage-Backed Securities		
Mortgage-Backed Securities	5.53	2,186
Short-Term/Other [3]		
Foreign Currency [4]	0.09	13,437
Money Market Securities	0.24	17,166
Total		$ 848,807

Footnotes:

[1] Fair Value does not include convertible bonds of $140,652, fixed income mutual funds of $604,645, and derivative instruments of ($11,036). Convertible bonds and derivatives do not exhibit interest rate risk and duration cannot be calculated. The table below shows the effective duration for each of SDCERS' fixed income mutual funds.

[2] Corporates do not include convertible securities of $140,652.

[3] Short Term/Other does not include derivative instruments, short term instruments, and mutual funds of $593,609.

[4] Foreign Currency of $13,437 has been added to this schedule as the duration was avalable.

Name of Institutional Mutual Fund	Effective Duration	Fair Value
BlackRock U.S. Debt NL Fund	4.56	$ 278,690
MetWest Enhanced TALF Strategy	0.40	32,865
MetWest High Yield Fund B	3.20	19,096
PIMCO PAPS High Yield Portfolio	4.50	15,621
PIMCO PAPS International Portfolio	9.99	16,379
PIMCO PAPS Short-Term Floating NAV II Portfolio	0.20	166,626
Wellington Trust Company CIF II Opportunistic Emerging Markets Debt Portfolio	5.95	75,368
Total		$ 604,645

Source: SDCERS' CAFR as of June 30, 2011

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 simply to the remaining term of maturity. The total value of securities, as of June 30, 2011, that are highly sensitive to interest rate changes due to factors other than term to maturity are shown in the following table.

Type of Security	Fair Value	Percent of Fixed Income Portfolio
Adjustable Rate Notes	$ 9,788	0.9%
Asset-Backed Securities	9,235	0.9%
Floating Rate Notes	131,198	12.5%
Range Notes	9,091	0.9%
Total	$ 159,312	15.2%

Source: SDCERS' CAFR as of June 30, 2011

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 bond managers and an emerging market debt manager that invest in a wide variety of U.S. and non-U.S. fixed income and derivative securities, fixed income mutual funds, and one passive core fixed income index fund. The investment management agreements between SDCERS and its two core bond managers contain specific investment guidelines that identify permitted fixed income investments. One of SDCERS' domestic core fixed income managers has tactical discretion to invest in non-U.S. fixed income securities while the other domestic core fixed income manager is limited to U.S. fixed income investments only.

The permitted securities and derivatives for the two domestic core fixed income managers include U.S. Government and agency obligations, collateralized mortgage obligations, U.S. corporate securities, commercial mortgage backed securities, asset backed securities, futures, forwards, options, interest rate swaps and credit default swaps. Investment guidelines include minimum average portfolio quality of AA- rating (market value weighted) and minimum credit quality at time of purchase of BB+ for the two domestic fixed income managers.

The permitted securities for SDCERS' domestic convertible bond portfolio include convertible bonds, convertible preferred stocks, common stocks (due to forced conversions) and synthetic convertibles. SDCERS' domestic convertible bond portfolio will generally maintain an average quality rating of at least B.

The permitted securities and derivatives for SDCERS' international fixed income portfolio include investments in developed and emerging markets and derivatives. In developed markets, investments may be made in sovereign and supranationals, Eurodollar bonds, corporates and mortgages. Emerging market investments are defined as sovereign and corporate debt outside the index of the Citi World Government Bond Index ex-US. Derivative instruments may include interest rate futures, options, swaps, FX forward contracts and spot transactions. 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, e.g. Moody's, S&P, Fitch.

The following table identifies the credit quality for SDCERS' fixed income strategies based on portfolio holdings as of June 30, 2011.

S&P Quality Rating	Total Fair Value	Commerical Mortgage-Backed Securities	Mortgage-Backed Securities	Adjustable-Rate Mortgages	Collateralized Mortgage Obligations	Corporates [1]	Government & Agency Obligations [2]	Asset-Backed Securities	Short-Term/ Other [3]
US Treasury	$ 62,550	$ -	$ -	$ -	$ -	$ -	$ 62,550	$ -	$ -
AAA	297,925	18,437	879	3,827	37,529	12,707	214,115	10,431	-
AA+	9,961	1,622	-	-	-	7,042	1,297	-	-
AA	41,591	-	-	-	-	18,650	17,241	-	5,700
AA-	19,282	-	-	-	127	12,181	6,974	-	-
A+	50,605	7,238	-	-	-	28,833	14,534	-	-
A	67,011	1,748	-	-	-	51,319	13,105	839	-
A-	38,544	3,410	-	-	-	28,662	6,472	-	-
BBB+	17,316	105	-	-	70	17,141	-	-	-
BBB	18,292	-	-	-	882	15,960	1,450	-	-
BBB-	27,311	-	-	-	-	25,131	2,180	-	-
BB+	3,501	-	-	-	-	3,501	-	-	-
BB	2,736	-	-	-	-	2,736	-	-	-
BB-	7,888	-	-	-	-	6,287	1,601	-	-
B+	3,314	-	-	-	-	3,314	-	-	-
B	2,608	-	-	-	-	2,608	-	-	-
NR	907,770	5,859	1,307	-	6,212	153,838	109,651	17,254	613,649
A-1+	2,595	-	-	-	-	-	-	-	2,595
A-1	2,268	-	-	-	-	-	-	-	2,268
Totals	$ 1,583,068	$ 38,419	$ 2,186	$ 3,827	$ 44,820	$ 389,910	$ 451,170	$ 28,524	$ 624,212

Footnotes:

[1] Corporates include convertible bonds from SDCERS' convertible bond manager.

[2] Includes international and municipal holdings.

[3] Includes fixed income mutual fund investments of $604,645. These institutional quality fund investments are not directly rated by major credit rating agencies such as S&P. Instead, these fund investments are managed to an average credit rating for the entire fund. The following table depicts the average credit rating for each fund.

Name of Institutional Mutual Fund	Fair Value	Average Credit Rating
BlackRock U.S. Debt NL Fund	$ 278,690	AA
MetWest Enhanced TALF Strategy	32,865	AAA
MetWest High Yield Fund B	19,096	B+
PIMCO PAPS High Yield Portfolio	15,621	BB-
PIMCO PAPS International Portfolio	16,379	AA
PIMCO PAPS Short-Term Floating NAV II Portfolio	166,626	AA+
Wellington Trust Company CIF II Opportunistic Emerging Markets Debt Portfolio	75,368	BBB-
Total	$ 604,645	

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, 2011, 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 U.S. 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 does not have a specific policy relating to custodial credit risk. SDCERS' exposure to custodial credit risk is further discussed in the following paragraphs.

Deposits

SDCERS' is exposed to custodial credit risk for uncollateralized cash and cash equivalents that are not covered by Federal Depository Insurance Corporation (FDIC). Cash and cash equivalents on deposit with SDCERS' custodial bank totaled $385,700 as of June 30, 2011.

Investments

As of June 30, 2011, 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' custodial bank acts as its securities lending agent. 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 $82,300 as of June 30, 2011 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 $326,600 as of June 30, 2011, 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 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 held in a foreign currency as of June 30, 2011.

Local Currency Name	Cash	Equity	Fixed income	Total
Australian Dollar	$ 360	$ 16,692	$ 12,779	$ 29,831
Brazilian Real	-	443	27	470
Canadian Dollar	570	22,896	24,501	47,967
Chinese Renminbi	(168)	-	-	(168)
Chinese Yuan	169	117	-	286
Danish Krone	59	3,842	2,760	6,661
Euro Currency	5,669	166,212	129,510	301,391
Hong Kong Dollar	360	34,080	-	34,440
Indonesian Rupiah	-	902	-	902
Israel Shekel	10	1,795	-	1,805
Japanese Yen	1,425	114,635	15,483	131,543
Malaysian Ringgit	-	1,977	-	1,977
Mexican Peso	-	374	8,464	8,838
New Zealand Dollar	19	1,281	-	1,300
Norwegian Krone	233	4,702	-	4,935
Philippine Peso	-	245	-	245
Polish Zloty	-	-	721	721
Singapore Dollar	227	5,116	-	5,343
South African Rand	2	2,590	-	2,592
South Korean Won	-	15,856	5,118	20,974
Swedish Krona	244	13,852	919	15,015
Swiss Franc	548	30,626	-	31,174
Taiwan Dollar	515	5,118	-	5,633
Thailand Baht	-	2,613	-	2,613
Turkish Lira	-	-	-	-
United Kingdom Pound	336	95,178	13,108	108,622
Totals	$ 10,578	$ 541,142	$ 213,390	$ 765,110

This schedule does not include foreign currency exposure to four international equity and one international fixed income institutional mutual fund investments.

Source: SDCERS' CAFR as of June 30, 2011

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. SDCERS does not have a general investment policy in place to manage foreign currency risk or to hedge against fluctuations in foreign currency exposure. Instead, SDCERS' investment managers may hedge currencies at their discretion pursuant to their specific investment guidelines included in each of their investment management agreements.

p. Derivative Instruments

In June 2008, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which became effective for financial statements for periods beginning after June 15, 2009. Pursuant to the requirements of this statement, SDCERS has provided a summary of derivative instrument activities during the reporting period and the related risks. As of June 30, 2011, the derivative instruments held by SDCERS are considered investments and not hedges for accounting purposes. The gains and losses arising from this activity are recognized in the SDCERS Statement of Changes in Plan Net Assets.

SDCERS' investment managers, as permitted by their specific investment guidelines, may enter into transactions involving derivative financial instruments, consistent with the objectives established by the SDCERS' Investment Policy Statement. These instruments include futures, options, swaps, forwards, warrants and rights. By Board policy, these investment vehicles may not be used to leverage SDCERS' portfolio, i.e., use derivatives to increase the portfolio's notional exposure to any given asset class. These instruments are used in an attempt to enhance a portfolio's performance and/or reduce the portfolio's risk.

All investment derivatives discussed below are addressed in the Investment Policy and Portfolio Risk discussion (section i). Investment derivative instruments are disclosed separately to provide a comprehensive and distinct view of this activity and its impact on the overall investment portfolio.

The following table provides a summary of the derivative instruments outstanding as of June 30, 2011.

Investment Derivative Disclosure

	Changes in Fair Value		Fair Value at June 30, 2011		
Investment Derivative Instruments	Classification	Amount	Classification	Amount	Notional
Credit Default Swaps	Investment Income / (Loss)	$ (75)	Swaps	$ (567)	$ 66,603
Fixed Income Futures	Investment Income / (Loss)	7,455	Futures	-	579,543
Fixed Income Options	Investment Income / (Loss)	1,939	Options	(1,201)	(298,700)
Foreign Currency Futures	Investment Income / (Loss)	1,237	Futures	-	10,400
Futures Options Written	Investment Income / (Loss)	611	Options	(150)	(586)
Foreign Currency Forwards	Investment Income / (Loss)	(5,286)	Long Term Instruments	(252)	176,107
Index Futures	Investment Income / (Loss)	65,687	Futures	-	173
Interest Rate Swaps	Investment Income / (Loss)	(3,443)	Swaps	(734)	97,375
Rights	Investment Income / (Loss)	382	Common Stock	7	49
Warrants	Investment Income / (Loss)	9	Common Stock	-	-
Total Derivative Instruments		$ 68,516		$ (2,897)	$ 630,964

Source: SDCERS' CAFR as of June 30, 2011

Some derivative instruments, such as credit default swaps and interest rate swaps, are not exchange traded and are priced using quarterly Over-the-Counter trading data.

Futures contracts are financial instruments that derive their value from underlying indices or reference rates and are marked-to-market at the end of each trading day. Daily settlement of gains and losses occur on the following business day. As a result, the futures contracts do not have a fair value as of June 30, 2011. Daily settlement of gains and losses is a risk control measure to limit counterparty credit risk. Futures variation margin amounts are settled each trading day and recognized in the financial statements under net appreciation (depreciation) in fair value of investments as they are incurred.

Foreign currency forward contracts are obligations to buy or sell a currency at a specified exchange rate and quantity on a specific future date. The fair value of the foreign currency forwards is the unrealized gain or loss calculated based on the difference between the specified exchange rate and the closing exchange rate at June 30, 2011.

Counterparty Credit Risk

The following table illustrates the counterparty credit ratings of SDCERS' non-exchange traded investment derivative instruments outstanding and subject to loss at June 30, 2011:

Counterparty Name	Fair Value	S&P Rating
Deutsche Bank AG London	$ 182	A+
Citibank N.A.	124	A+
UBS AG	69	A+
BNP Paribas SA	60	AA
Credit Suisse London Branch (GFX)	57	A+
Bank of America N.A.	52	A+
Morgan Stanley Capital Services Inc.	52	A
Royal Bank of Canada	52	AA-
JPMorgan Chase Bank	51	AA-
Credit Suisse Securities (USA) LLC	30	A+
Credit Suisse Financial Products	20	A+
Merrill Lynch Pierce Fenner & Smith Inc.	15	A
HSBC Bank USA	11	AA
Morgan Stanley and Co. International PLC	8	A
JPMorgan Chase Bank N.A.	7	AA-
Barclays Capital	7	AA-
UBS AG London	5	A+
Goldman Sachs International	3	A
Barclays Bank PLC Wholesale	3	AA-
Total	$ 808	

Source: SDCERS' CAFR as of June 30, 2011

The aggregate fair value of investment derivative instruments in an asset position subject to counterparty credit risk at June 30, 2011 was $808. This represents the maximum loss that would be recognized at the reporting date if all counterparties failed to perform as contracted. At June 30, 2011, SDCERS did not have any significant exposure to counterparty credit risk with any single party. SDCERS does not have any specific policies relating to the posting of collateral or master netting agreements.

Custodial Credit Risk

The custodial credit risk disclosure for exchange traded derivative instruments is made in accordance with the custodial credit risk disclosure requirements of GASB Statement No. 40. At June 30, 2011, all of SDCERS' investments in derivative instruments were held in SDCERS' name and were not exposed to custodial credit risk.

Interest Rate Risk

At June 30, 2011 SDCERS was exposed to interest rate risk on its investments in interest rate swaps, options, and credit default swaps. The table below illustrates the maturity periods of these derivative instruments.

		Investment Maturities (in years)			
Investment Type	Fair Value	Less Than 1	1 - 5	6 - 10	More Than 10
Credit Default Swaps	$ (567)	$ 4	$ (412)	$ (159)	$ -
Fixed Income Options	(1,201)	(762)	(365)	(74)	-
Interest Rate Swaps	(734)	3	12	(223)	(526)
Total	$ (2,502)	$ (755)	$ (765)	$ (456)	$ (526)

Source: SDCERS' CAFR as of June 30, 2011

Derivative Instruments Highly Sensitive to Interest Rate Changes

Credit default swaps, fixed income futures, options and interest rate swaps are highly sensitive to changes in interest rates. The table below reflects the fair value and notional amount of these derivative instruments as of June 30, 2011.

Investment Type	Fair Value	Notional
Credit Default Swaps	$ (567)	$ 66,603
Fixed Income Futures	-	579,543
Fixed Income Options	(1,201)	(298,700)
Interest Rate Swaps	(734)	97,375
Total	$ (2,502)	$ 444,821

Source: SDCERS' CAFR as of June 30, 2011

Foreign Currency Risk

At June 30, 2011, SDCERS was exposed to foreign currency risk on its investments in options, currency forward contracts and interest rate swaps denominated in foreign currencies.

		Forward Contracts			
Currency Name	Fixed Income Options	Net Receivables	Net Payables	Interest Rate Swaps	Total
Australian Dollar	$ -	$ -	$ (86,254)	$ -	$ (86,254)
Brazilian Real	-	-	-	26,625	26,625
Canadian Dollar	-	13,566	(152,732)	-	(139,166)
Swiss Franc	-	954	-	-	954
Chilean Peso	-	(461)	-	-	(461)
Yuan Renminbi	-	509	-	-	509
Danish Krone	-	(3,782)	(2,653)	-	(6,435)
Euro Currency	7,104	64,377	(239,812)	(32,946)	(201,277)
Pound Sterling	-	(1,761)	225,432	-	223,671
Japanese Yen	-	(21,238)	-	-	(21,238)
South Korean Won	-	-	(21,045)	-	(21,045)
Mexican Peso	-	3,433	(22,656)	-	(19,223)
Malaysian Ringgit	-	6,743	-	-	6,743
Norwegian Krone	-	30,690	-	-	30,690
Peruvian Nouveau Sol	-	990	(1,803)	-	(813)
Philippine Peso	-	(36,919)	-	-	(36,919)
Polish Zloty	-	(4,680)	3,322	-	(1,358)
Swedish Krona	-	(9,424)	-	-	(9,424)
Singapore Dollar	-	2,728	-	-	2,728
Total	$ 7,104	$ 45,725	$ (298,201)	$ (6,321)	$ (251,693)

Source: SDCERS' CAFR as of June 30, 2011

In addition to the investments listed in the above table, SDCERS has investments in foreign futures contracts with a total notional value of $3,700. As indicated previously, futures variation margin amounts are settled each trading day and recognized as realized gains/losses as they are incurred. As a result, the foreign futures contracts have no fair value at June 30, 2011.

Contingent Features

At June 30, 2011, SDCERS did not hold any positions in derivatives containing contingent features.

q. Private Equity

SDCERS' target allocation to private equity is 5%. The Board has approved an opportunistic portfolio composition with a focus on value and current income-producing strategies. As of June 30, 2011, unfunded capital commitments totaled $220,200 and private equity investments totaled $87,004.

r. Real Estate

SDCERS' target allocation to real estate is 11%. The Board has established the following portfolio composition targets: 25% in public real estate securities and 75% in private real estate investments. The private portfolio is further diversified with a target of 60% in core real estate and 40% in value-add and opportunistic real estate. 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, 2011, unfunded capital commitments totaled $116,400 and real estate investments totaled $519,754.

s. Securities Lending

SDCERS has entered into an agreement with State Street Bank and Trust Company (State Street), its custodial bank, 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 SDCERS' securities lending program and receives cash and/or securities as collateral. Borrowers are required to deliver collateral for each loan equal to at least 100% of the market value of the loaned securities. 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 State Street on behalf of SDCERS for securities borrowed. State Street has indemnified SDCERS by agreeing to purchase replacement securities or return cash collateral if 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.

When lending its 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. 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, as well as all rules, regulations, and exemptions from time to time promulgated and issued under the authority of those laws.

As of June 30, 2011, securities on loan collateralized by cash had a fair value of $319,200 and a collateral value of $326,600, which was reported in the assets and liabilities in the accompanying Statement of Plan Net Assets for the Group Trust in accordance with GASB Statement No. 28. The collateral value exceeds the fair value of the securities on loan because borrowers are required to deliver collateral for each loan up to 102% for domestic loans and 105% for international loans. As of June 30, 2011, securities on loan collateralized by securities, irrevocable letters of credit, or tri-party collateral had a fair value of $78,800 and a collateral value of $82,300, which were not reported in the assets or liabilities in the accompanying Statement of Plan Net Assets for the

Group Trust per GASB Statement No. 28. The total collateral pledged to SDCERS at fiscal year end June 30, 2011 for its securities lending activities was $408,900.

During the fiscal year, SDCERS and the borrowers maintained the right to terminate securities lending transactions upon notice. The cash collateral received for lent securities was invested by State Street, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment fund, or collateral pool. In July 2010, State Street announced a restructuring of the securities lending collateral funds. Each fund was separated into two pools, a liquidity pool and a duration pool. The split allows SDCERS greater flexibility in managing the available liquidity in the investments in the collateral funds and the outstanding balance of securities on loan. SDCERS invests in two collateral funds, the Quality D Short-Term Investment Fund (Quality D) and the State Street Global Securities Lending Euro Trust (Euro Trust).

The restructuring of the Quality D and Euro Trust was completed in December 2010. At the time of the restructuring, the liquidity pool consisted solely of assets whose amortized values approximated their fair market values and that had a final maturity of 90 days or less from the date of restructuring. Due to the inherent extension risk, any asset-backed securities were not included in the liquidity pool even if they had a final maturity date of less than 90 days from the date of restructuring. These assets were held in the duration pool. As these asset-backed securities pay down and mature, the cash generated will be transferred from the duration pool to the liquidity pool. The duration pool will consist primarily of investments with expected maturities of greater than 90 days at the time of restructuring and will not accept new investments of cash collateral. SDCERS will have its own specified percentage interest in each security held in the duration pool, and such percentage interest will not vary over time unless one or more other participants in the pool withdraw their interests in kind. The duration pool does not permit cash redemptions, but rather withdrawals on an in-kind basis. The duration funds continue to receive payments and have not realized any defaults.

As of June 30, 2011, SDCERS had $220,500 invested in the Quality D liquidity collateral pool, which had an average duration of 31.67 days and an average weighted final maturity of 61.80 days. SDCERS had $84,500 invested in the Quality D duration pool, which had an average duration of 35.97 days and an average weighted final maturity of 484.43 days. As of June 30, 2011, SDCERS had $5,500 invested in the Euro Trust liquidity pool, which had an average duration of 11 days and an average weighted final maturity of 30 days. SDCERS had $16,100 invested in the Euro Trust duration pool, which had an average duration of 41 days and an average weighted final maturity of 1,149 days.

Duration is a measure of time based on the weighted average of all cash flows for the securities in the collateral pools. Alternatively, the weighted average final maturity measures when all final maturities in the portfolio will occur. The duration of the investments made with cash collateral does not generally match the duration of the loans. This is because the loans are terminable at any time by SDCERS or the borrower.

Discretely Presented Component Units – Disclosures for Policy and Specific Risks

Narratives and tables presented in the following sections (t. through u.) are taken directly from the audited financial statements of the San Diego Convention Center Corporation and the comprehensive annual financial report of the San Diego Housing Commission as of June 30, 2011, issued December 5, 2011 and November 30, 2011, respectively.

t. San Diego Convention Center Corporation

Cash deposits and investments for SDCCC were categorized as follows at June 30, 2011:

Cash on hand	$	65
Deposits		110
Certificates of deposit (non-negotiable)		1,207
Bank money market account deposits		9,125
Government money market mutual funds		2,919
Total cash and investments	$	13,426

Deposits

On June 30, 2011, the carrying amount of the San Diego Convention Center Corporation's (SDCCC) cash on hand, deposits, non-negotiable certificates of deposit and bank money market account deposits was $10,507 and the bank balance was $10,441. Of the bank balance, $610 was covered by federal depository insurance. The remaining uninsured balance of $9,831 was collateralized with the collateral held by an affiliate of the counterparty's financial institution. Neither the bank money market account deposits nor the certificates of deposit are rated by credit rating agencies. The $1,207 invested in non-negotiable certificates of deposit bear interest rates of 0.4% and have maturities greater than three months and less than one year. SDCCC developed a formal deposit and investment policy that was approved in August 2010 which addresses custodial credit risk.

Investments

At June 30, 2011, SDCCC had total investments of $2,919 which were invested in government money market mutual funds. The government money market mutual funds have a "AAA" rating with a weighted average maturity of 48 days. The carrying value of the money market mutual funds is determined at the book value of the portfolio. SDCCC developed a formal deposit and investment policy in August 2010 which addresses credit quality risk and allowable investments. SDCCC places no limit on the amount that may be invested in any one account or fund. SDCCC's allowable investments include: obligations of the U.S. government, its agencies and instrumentalities; investment grade state and local government securities; certificates of deposit, bankers' acceptances; repurchase agreements; and money market mutual funds whose portfolios consist of only domestic securities.

u. San Diego Housing Commission

Cash, cash equivalents, and investments at June 30, 2011 consisted of the following:

Deposits	$ 4,453
Petty cash	14
Cash held in investment account	1
Certificates of deposit (non-negotiable)	87
Agency Bonds	58,868
Corporate Bonds	9,036
Local Agency Investment Fund	34,792
San Diego County Investment Pool	22,220
Total cash and investments	129,471
Restricted cash and cash equivalents	4,425
Total	$ 133,896

Deposits

The carrying amount of the San Diego Housing Commission's (SDHC) deposits and petty cash was $4,467. 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, 2011, SDHC had a carrying amount and bank balance of $87 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

As of June 30, 2011, SDHC's investments included agency bonds, corporate bonds, California Local Agency Investment Fund (LAIF) and San Diego County Investment Pool (SDCIP). Agency bonds represent SDHC's investment in Government-Sponsored Enterprises (GSE), such as Fannie Mae (FNMA) and Freddie Mac (FDMC), Senior Debt and Mortgage-Backed Security (MBS) bonds traded on an active secondary market. As of June 30, 2010, SDHC had $58,868 invested in U.S. Government Agency bonds, with $1,000 invested in GSE Senior Debt and the remaining $57,868 invested in Agency MBS. The GSE Senior Debt securities hold a Standard & Poor's AAA rating.

SDHC's investment in corporate bonds 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. As of June 30, 2011, SDHC had $9,036 invested in corporate bonds which were all rated AAA by Standard & Poor's.

SDHC participates in the Local Agency Investment Fund (LAIF). As of June 30, 2011, SDHC had $34,792 invested with LAIF. The investment in LAIF represents SDHC's equity in the pooled investments of that fund. The average maturity of Pooled Money Investment Account (PMIA) investments was 237 days as of June 30, 2011. LAIF had 5.01% of the pool investment funds in structured notes and asset-backed securities.

In addition to LAIF, SDHC also participates in the San Diego County Investment Pool (SDCIP). SDCIP is a Standard & Poor's AAA rated fund managed by the San Diego County Treasurer-Tax Collector. The market value of SDCIP's investment portfolio at June 30, 2011 was $5,856,000. The investment portfolio had a weighted average yield to maturity of 0.84%, weighted days to maturity of 425 days and an effective duration of 0.670 years. SDHC is a voluntary participant in the County pool and as of June 30, 2011, SDHC has $22,220 invested in SDCIP.

Policy

In accordance with state statutes and HUD regulations, SDHC has authorized the Chief Financial Officer (CFO) or 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, 2011, 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, 2011 was as follows:

	Primary Government				
	Beginning Balance	Increases	Decreases/ Adjustments	Transfers	Ending Balance
GOVERNMENTAL ACTIVITIES:					
Non-Depreciable Capital Assets:					
Land & Rights of Way	$ 1,798,345	$ 13,926	$ (303)	$ 3	$ 1,811,971
Easements	5	272	-	-	277
Construction in Progress	191,743	89,648	(194)	(59,401)	221,796
Total Non-Depreciable Capital Assets	1,990,093	103,846	(497)	(59,398)	2,034,044
Depreciable Capital Assets:					
Structures and Improvements	1,185,245	3,649	(25)	2,713	1,191,582
Equipment	356,791	17,517	(23,176)	5,256	356,388
Equipment (Intangible)	37,619	508	-	-	38,127
Infrastructure	3,220,833	58,385	-	51,429	3,330,647
Total Depreciable Capital Assets	4,800,488	80,059	(23,201)	59,398	4,916,744
Less Accumulated Depreciation/Amortization For:					
Structures and Improvements	(373,341)	(30,401)	19	-	(403,723)
Equipment	(203,512)	(32,079)	21,223	-	(214,368)
Equipment (Intangible)	-	(3,813)	-	-	(3,813)
Infrastructure	(1,727,654)	(87,030)	-	-	(1,814,684)
Total Accumulated Depreciation/Amortization	(2,304,507)	(153,323)	21,242	-	(2,436,588)
Total Depreciable Capital Assets - Net of Depreciation	2,495,981	(73,264)	(1,959)	59,398	2,480,156
Governmental Activities Capital Assets, Net	$ 4,486,074	$ 30,582	$ (2,456)	$ -	$ 4,514,200
BUSINESS-TYPE ACTIVITIES:					
Non-Depreciable Capital Assets:					
Land & Rights of Way	$ 95,428	$ 14	$ -	$ -	$ 95,442
Easements	19	25	-	-	44
Construction in Progress	288,869	108,820	(1,820)	(179,940)	215,929
Total Non-Depreciable Capital Assets	384,316	108,859	(1,820)	(179,940)	311,415
Depreciable Capital Assets:					
Structures and Improvements	1,697,724	17,690	(30)	51,734	1,767,118
Equipment	413,652	7,556	(1,092)	15,742	435,858
Distribution & Collection Systems and Other Infrastructure	3,859,930	64,029	(2,126)	112,464	4,034,297
Total Depreciable Capital Assets	5,971,306	89,275	(3,248)	179,940	6,237,273
Less Accumulated Depreciation/Amortization For:					
Structures and Improvements	(391,825)	(37,484)	30	2,222	(427,057)
Equipment	(266,566)	(16,122)	880	30	(281,778)
Distribution & Collection Systems and Other Infrastructure	(792,323)	(58,695)	677	(2,252)	(852,593)
Total Accumulated Depreciation/Amortization	(1,450,714)	(112,301)	1,587	-	(1,561,428)
Total Depreciable Capital Assets - Net of Depreciation	4,520,592	(23,026)	(1,661)	179,940	4,675,845
Business-Type Activities Capital Assets, Net	$ 4,904,908	$ 85,833	$ (3,481)	$ -	$ 4,987,260

Governmental Activities capital assets net of accumulated depreciation at June 30, 2011 are comprised of the following:

General Capital Assets, Net	$	4,395,436
Internal Service Funds Capital Assets, Net		118,764
Total	$	4,514,200

Business-Type Activities capital assets net of accumulated depreciation at June 30, 2011 are comprised of the following:

Enterprise Funds Capital Assets, Net	$	4,987,260

Depreciation/amortization expense was charged to functions/programs of the primary government as follows:

Governmental Activities:

General Government and Support	$	7,002
Public Safety - Police		4,367
Public Safety - Fire and Life Safety and Homeland Security		3,723
Parks, Recreation, Culture and Leisure		35,334
Transportation		74,308
Sanitation and Health		450
Neighborhood Services		2,158
Subtotal		127,342
Internal Service		25,981
Total Depreciation/Amortization Expense	$	153,323

Business-Type Activities:

Sewer Utility	$	63,488
Water Utility		43,054
Airports		652
Development Services		66
Environmental Services		3,470
Golf Course		1,095
Recycling		476
Total Depreciation/Amortization Expense	$	112,301

Discretely Presented Component Units

Capital asset activities for the City's Discretely Presented Component Units for the year ended June 30, 2011 are as follows:

	Discretely Presented Component Unit - San Diego Convention Center Corporation			
	Beginning Balance	Increases	Decreases/ Adjustments	Ending Balance
Non-Depreciable Capital Assets:				
Land, Easements, Rights of Way	$ 13,661	$ 2,933	$ -	$ 16,594
Depreciable Capital Assets:				
Structures and Improvements	27,098	2,408	(5)	29,501
Equipment	9,570	67	(514)	9,123
Total Depreciable Capital Assets	36,668	2,475	(519)	38,624
Less Accumulated Depreciation/Amortization For:				
Structures and Improvements	(13,963)	(1,871)	5	(15,829)
Equipment	(7,845)	(552)	490	(7,907)
Total Accumulated Depreciation/Amortization	(21,808)	(2,423)	495	(23,736)
Total Depreciable Capital Assets - Net of Depreciation/Amortization	14,860	52	(24)	14,888
Capital Assets, Net	$ 28,521	$ 2,985	$ (24)	$ 31,482

	Discretely Presented Component Unit - San Diego Housing Commission			
	Beginning Balance	Increases	Decreases/ Adjustments	Ending Balance
Non-Depreciable Capital Assets:				
Land, Easements, Rights of Way	$ 39,023	$ 21,634	$ (216)	$ 60,441
Construction in Progress	4,319	126	(3,979)	466
Total Non-Depreciable Capital Assets	43,342	21,760	(4,195)	60,907
Depreciable Capital Assets:				
Structures and Improvements	73,182	26,758	2,502	102,442
Equipment	2,931	287	(5)	3,213
Total Depreciable Capital Assets	76,113	27,045	2,497	105,655
Less Accumulated Depreciation/Amortization For:				
Structures and Improvements	(10,293)	(3,489)	1,543	(12,239)
Equipment	(1,905)	(559)	154	(2,310)
Total Accumulated Depreciation/Amortization	(12,198)	(4,048)	1,697	(14,549)
Total Depreciable Capital Assets - Net of Depreciation/Amortization	63,915	22,997	4,194	91,106
Capital Assets, Net	$ 107,257	$ 44,757	$ (1)	$ 152,013

5. GOVERNMENTAL ACTIVITIES LONG-TERM LIABILITIES (IN THOUSANDS)

a. Long-Term Liabilities

Governmental long-term liabilities as of June 30, 2011 are comprised of the following:

Type of Obligation	Interest Rates	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2011
Arbitrage Liability				$ 3
Compensated Absences				73,452
Liability Claims				313,592
Capital Lease Obligations				68,018
Qualified Energy Conservation Bonds Lease Obligation		2026	$ 13,142	13,142
Contracts Payable:				
Facilities Financing Reimbursement Agreement Obligations				24,419
Loans Payable:				
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	1,280	1,148
California Energy Resources Conservation and Development Commission, dated March 2007	3.95	2019	2,154	1,461
Bank of America, N.A. McGuigan Judgment, dated June 2010	3.79*	2015	32,762	32,762
Total Loans Payable				36,621
Section 108 Loans Payable				16,342
General Obligation Bonds:				
Public Safety Communications Project, Series 1991	5.0 - 8.0**	2012	25,500	2,240
Revenue Bonds / Lease Revenue Bonds / COPs:				
Convention Center Expansion Financing Authority Lease Revenue Bonds, Series 1998 A	3.8 - 5.25**	2028	205,000	156,785
Centre City Parking Revenue Bonds, Series 1999 A	4.5 - 6.4**	2026	12,105	9,140
Public Facilities Financing Authority Fire and Life Safety Lease Revenue Bonds, Series 2002 B	3.55 - 7.0**	2032	25,070	21,150
Centre City Parking Revenue Bonds, Series 2003 B	3.0 - 5.3**	2027	20,515	16,255
MTDB Authority Lease Revenue Refunding Bonds, Series 2003	2.0 - 4.375**	2023	15,255	10,745
San Diego Facilities Equipment Leasing Corp. Certificates of Participation Refunding, Series 2003	1.0 - 4.0**	2024	17,425	7,725
Public Facilities Financing Authority Ballpark Lease Revenue Refunding Bonds, Series 2007 A	5.0 - 5.25**	2032	156,560	142,115
Public Facilities Financing Authority Lease Revenue Refunding Bonds, Series 2010 A	3.0-5.25**	2040	167,635	167,635
Total Revenue Bonds / Lease Revenue Bonds / COPs				531,550

(continued on next page)

Type of Obligation	Interest Rates	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2011
Tax Allocation Bonds:				
Mount Hope Redevelopment Project Tax Allocation Bonds, Series 1995 A	4.4 - 6.0**	2020	$ 1,200	$ 645
Horton Plaza Redevelopment Project Tax Allocation Refunding Bonds, Series 1996 A	3.8 - 6.0**	2016	12,970	4,795
Centre City Redevelopment Tax Allocation Bonds, Series 1999 A	3.0 - 5.125**	2019	25,680	22,295
Centre City Redevelopment Tax Allocation Bonds, Series 1999 B	6.25**	2014	11,360	6,885
Centre City Redevelopment Tax Allocation Bonds, Series 1999 C	3.1 - 4.75**	2025	13,610	11,190
City Heights Redevelopment Tax Allocation Bonds, Series 1999 A	4.5 - 5.8**	2029	5,690	4,765
City Heights Redevelopment Tax Allocation Bonds, Series 1999 B	5.75 - 6.4***	2029	10,141	8,160
Centre City Redevelopment Project Tax Allocation Bonds, Series 2000 A	4.0 - 5.6**	2025	6,100	4,410
Centre City Redevelopment Project Tax Allocation Bonds, Series 2000 B	3.95 - 5.35**	2025	21,390	17,095
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2000	4.25 - 5.8**	2022	15,025	11,815
North Bay Redevelopment Project Tax Allocation Bonds, Series 2000	4.25 - 5.875**	2031	13,000	10,655
North Park Redevelopment Project Tax Allocation Bonds, Series 2000	4.1 - 5.9**	2031	7,000	5,740
Centre City Redevelopment Project Tax Allocation Bonds, Series 2001 A	4.93 - 5.55****	2027	58,425	54,795
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	255
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	4,115
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 C	3.49 - 7.74**	2022	8,000	5,890
North Park Redevelopment Project Tax Allocation Bonds, Series 2003 A	1.5 - 6.125**	2028	7,145	5,635
North Park Redevelopment Project Tax Allocation Bonds, Series 2003 B	4.75 - 5.0**	2034	5,360	5,360
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 A	3.5 - 5.25**	2030	101,180	88,260

Type of Obligation	Interest Rates	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2011
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 C	2.26 - 6.18**	2030	$ 27,785	$ 23,425
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 D	2.26 - 6.28**	2030	8,905	7,525
Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 A	4.25 - 5.25**	2033	76,225	73,530
Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 B	5.66 - 6.2**	2032	33,760	31,490
Centre City Redevelopment Project Tax Allocation Bonds, Series 2008 A	3.74 - 6.3**	2021	69,000	60,120
North Park Redevelopment Project Tax Allocation Bonds, Series 2009 A	6.0-7.0**	2040	13,930	13,930
City Heights Redevelopment Project Tax Allocation Bonds, Series 2010 A	5.625**	2041	5,635	5,635
City Heights Redevelopment Project Tax Allocation Bonds, Series 2010 B	7.375**	2038	9,590	9,590
Crossroads Redevelopment Project Tax Allocation Bonds, Series 2010 A	3.0-6.0**	2041	4,915	4,915
Housing Set-Aside Tax Allocation Bonds, Series 2010 A	4.375-7.75**	2041	58,565	58,565
Naval Training Center Redevelopment Project Tax Allocation Bonds, Series 2010 A	3.0-5.75**	2041	19,765	19,765
San Ysidro Redevelopment Project Tax Allocation Bonds, Series 2010 A	5.75**	2041	2,900	2,900
San Ysidro Redevelopment Project Tax Allocation Bonds, Series 2010 B	4.375-7.750**	2036	5,030	5,030
Total Tax Allocation Bonds				615,495
Tobacco Settlement Asset-Backed Bonds:				
Tobacco Settlement Revenue Funding Corporation Asset-Backed Bonds, Series 2006	7.125**	2023	105,400	89,600
Pooled Financing Bonds:				
Public Facilities Financing Authority Pooled Financing Bonds, Series 2007 A	5.95 - 6.65**	2038	17,230	15,580
Public Facilities Financing Authority Pooled Financing Bonds, Series 2007 B	4.0 - 5.25**	2038	17,755	16,430
Total Pooled Financing Bonds				32,010
Total Bonds Payable				1,270,895
Net Other Postemployment Benefits Obligation				167,819
Net Pension Obligation				117,219
Total Governmental Activities Long-Term Liabilities				$ 2,101,522

* McGuigan Judgment loan payable has a 3.79% fixed rate for term of borrowing subject to increase if there is a rating downgrade or an Event of Default.

** 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, 2011 does not include accreted interest of $9,030.

**** 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, 2011 does not include accreted interest of $9,356.

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, enterprise funds, and certain internal service funds. Pension liabilities are paid out of the operating funds based on a percentage of payroll.

Taxable QECBs were issued pursuant to the America Recovery and Reinvestment Act of 2009. The QECB financing is eligible for the direct interest subsidy payment from the U.S. Department of the Treasury within the meaning of Section 54D(a) of the Internal Revenue Code of 1986, as amended. The QECBs were issued to fund the Broad Spectrum Street Lighting Conversion Program and will be paid from annual appropriations payable out of any source of legally available funds. The nominal interest rate of the lease financing is 6.16% with a net effective rate of 2.40% including the QECB federal subsidy.

A Contract Payable to Western Pacific Housing of $3,000 was reduced in the prior fiscal year by $1,872, pursuant to the Disposition and Development Agreement between RDA and Western Pacific Housing. The Affordability Component of the obligation, which is subject to an adjustment based on the actual project sales revenue proceeds received by Western Pacific Housing, resulted in a reduction of $972. Additionally, due to the fact that Western Pacific Housing did not comply with prevailing wage requirements of the DDA, the Public Improvement Component of the obligation of $900 was eliminated. The remaining balance was paid in full by the end of fiscal year 2011.

Loans Payable also included 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. The remaining balances were refunded within the fiscal year.

On June 30, 2010, the City entered into an Agreement Regarding Purchase of McGuigan Judgment with Bank of America, N.A. (BANA). The Agreement is related to the Settlement Agreement and Judgment between William J. McGuigan (Class Representative) and the City of San Diego, under which the City agreed to pay SDCERS $173,000 in excess of the ARC no later than June 8, 2011. As of June 30, 2010, a balance of $32,762 was owed to SDCERS. Under the terms of the Agreement, the outstanding balance on the McGuigan Judgment was transferred to BANA as a loan payable of the City and will be repaid in four annual payments beginning in fiscal year 2012. The Judgment Installment Payments to BANA have a fixed rate of 3.79% unless the City's long-term general obligation indebtedness rating is lowered, withdrawn, suspended or upon the occurrence of an Event of Default.

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.

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.

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.

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. TSRFC 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, 2011, including interest payments to maturity, are as follows:

Year Ended June 30,	Capital Lease Obligations		Qualified Energy Conservation Bonds Lease Obligation		Contracts Payable		Loans Payable	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2012	$ 17,276	$ 2,521	$ 750	$ 776	$ -	$ -	$ 8,061	$ 1,369
2013	15,930	1,844	755	763	-	-	8,373	1,056
2014	11,861	1,266	773	717	-	-	8,699	730
2015	8,487	858	792	669	-	-	9,034	395
2016	5,801	563	811	620	-	-	389	46
2017-2021	6,159	1,239	4,356	2,328	-	-	815	49
2022-2026	2,504	182	4,905	921	-	-	-	-
Unscheduled*	-	-	-	-	24,419	-	1,250	76
Total	$ 68,018	$ 8,473	$ 13,142	$ 6,794	$ 24,419	$ -	$ 36,621	$ 3,721

** The contracts payable for the Facilities Financing Reimbursement Agreements in the amount of $24,419, and the loan payable to the California Housing Finance Agency in the amount of $1,250 do not have an annual repayment schedule. Annual Payments to the Facilities Financing Reimbursement Agreements are based on availability of Facilities Benefit Assessment (FBA) and Development Impact Fee (DIF) revenue. Annual payments to the California Housing Finance Agency are deferred for the term of the loan.*

Year Ended June 30,	Section 108 Loans Payable Principal	Section 108 Loans Payable Interest	General Obligation Bonds Principal	General Obligation Bonds Interest	Revenue Bonds / COPs Principal	Revenue Bonds / COPs Interest
2012	$ 1,154	$ 814	$ 2,240	$ 74	15,330	26,362
2013	1,171	765	-	-	18,400	25,596
2014	1,221	712	-	-	19,260	24,731
2015	1,282	656	-	-	20,180	23,818
2016	1,304	595	-	-	21,135	22,857
2017-2021	6,697	1,942	-	-	122,060	97,917
2022-2026	3,513	382	-	-	146,190	65,050
2027-2031	-	-	-	-	104,720	30,342
2032-2036	-	-	-	-	38,190	11,363
2037-2041	-	-	-	-	26,085	3,170
Total	$ 16,342	$ 5,866	$ 2,240	$ 74	$ 531,550	$ 331,206

Year Ended June 30,	Tax Allocation Bonds Principal	Tax Allocation Bonds Unaccreted Appreciation*	Tax Allocation Bonds Interest	Tobacco Settlement Asset-Backed Bonds Principal**	Tobacco Settlement Asset-Backed Bonds Interest	Pooled Financing Bonds Principal	Pooled Financing Bonds Interest
2012	$ 21,569	$ 2,317	$ 32,914	$ 4,400	$ 6,384	$ 825	$ 1,805
2013	24,688	2,388	31,762	4,600	6,071	860	1,762
2014	26,249	2,455	30,465	5,000	5,743	900	1,718
2015	27,103	2,459	29,122	5,400	5,386	950	1,671
2016	28,502	2,440	27,724	5,700	5,002	1,000	1,621
2017-2021	161,353	11,280	114,627	35,500	18,261	5,775	7,223
2022-2026	129,279	6,394	76,727	29,000	3,513	5,795	5,582
2027-2031	93,047	447	46,072	-	-	7,720	3,610
2032-2036	53,870	-	25,081	-	-	6,260	1,317
2037-2041	49,835	-	8,813	-	-	1,925	115
Subtotal	615,495	30,180	423,307	89,600	50,360	32,010	26,424
Add:							
Accreted Appreciation through June 30, 2011	18,386	-	-	-	-	-	-
Total	$ 633,881	$ 30,180	$ 423,307	$ 89,600	$ 50,360	$ 32,010	$ 26,424

** Unaccreted Appreciation represents the amount to be accreted in future years regardless of the timing of cash flows.*

*** 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, 2011. The effect of bond accretion, bond premiums, discounts, and deferred amounts on refunding are amortized as adjustments to long-term liabilities.

	Governmental Activities				
	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Arbitrage Liability	$ 3	$ -	$ -	$ 3	$ -
Compensated Absences	73,431	53,427	(53,406)	73,452	31,340
Liability Claims	318,914	29,944	(35,266)	313,592	36,259
Capital Lease Obligations	84,561	366	(16,909)	68,018	17,276
Qualified Energy Conservation Bonds					
Lease Obligation	-	13,142	-	13,142	750
Contracts Payable	1,018	24,419	(1,018)	24,419	4,699
Notes Payable	3,301	133	(3,434)	-	-
Loans Payable	79,395	345	(43,119)	36,621	8,061
Section 108 Loans Payable	31,496	-	(15,154)	16,342	1,154
General Obligation Bonds	4,340	-	(2,100)	2,240	2,240
Revenue Bonds / COPs	547,260	-	(15,710)	531,550	15,330
Unamortized Bond Premiums, Discounts					
and Deferred Amounts on Refunding	(2,178)	-	164	(2,014)	(164)
Net Revenue Bonds/COP's	545,082	-	(15,546)	529,536	15,166
Tax Allocation Bonds	529,423	106,400	(20,328)	615,495	21,569
Interest Accretion	16,535	2,243	(392)	18,386	-
Balance with Accretion	545,958	108,643	(20,720)	633,881	21,569
Unamortized Bond Premiums, Discounts					
and Deferred Amounts on Refunding	5,071	(1,543)	(162)	3,366	162
Net Tax Allocation Bonds	551,029	107,100	(20,882)	637,247	21,731
Tobacco Settlement Asset-Backed Bonds	92,350	-	(2,750)	89,600	4,400
Pooled Financing Bonds	32,780	-	(770)	32,010	825
Unamortized Bond Premiums, Discounts					
and Deferred Amounts on Refunding	(90)	-	18	(72)	(18)
Net Pooled Financing Bonds	32,690	-	(752)	31,938	807
Net Other Postemployment Benefits Obligation	118,431	49,388	-	167,819	-
Net Pension Obligation	116,418	801	-	117,219	-
Total	$ 2,052,459	$ 279,065	$ (210,336)	$ 2,121,188	$ 143,883

d. Long-Term Pledged Liabilities

Governmental long-term pledged liabilities as of June 30, 2011 are comprised of the following:

Type of Pledged Revenue	Fiscal Year Maturity Date	Pledged Revenue to Maturity	Debt Principal & Interest Paid	Pledged Revenue Recognized
Pledged CDBG Revenue:				
Section 108 Loans Payable		$ 13,040	$ 16,916	$ 16,839
Total Pledged CDBG Revenue		13,040	16,916	16,839
Pledged Developer Revenue:				
Regional Transportation Center Redevelopment Project (Section 108)	2021	2,121	266	266
Total Pledged Developer Revenue		2,121	266	266
Pledged Development Impact Fee (DIF) Revenue:				
Kearny Mesa Reimbursement Agreement, dated June 2005		3,644	-	-
Total Pledged Development Impact Fee (DIF) Revenue:		3,644	-	-
Pledged Facilities Benefit Assessment (FBA) Revenue:				
Facilities Financing Reimbursement Agreement Obligations		20,775	-	-
Total Pledged Facilities Benefit Assessment (FBA) Revenue		20,775	-	-
Pledged Net Operating Revenue (Parking):				
Centre City Parking Revenue Bonds, Series 1999 A	2026	14,157	954	964
Centre City Parking Revenue Bonds, Series 2003 B	2027	23,870	1,504	1,516
Total Pledged Net Operating Revenue (Parking)		38,027	2,458	2,480
Pledged Tax Increment Revenue:				
Contracts				
Contract Payable to Western Pacific Housing, Inc., dated April 2004	2011	-	1,042	1,042
Notes				
Note Payable to Price Charities, dated April 2001	2011	-	1,675	-
Note Payable to Price Charities, dated May 2005	2011	-	1,715	-
Amendment to Note Payable to Price Charities, dated February 2006	2011	-	188	-
Loans				
International Gateway Associates, LLC, dated October 2001	2011	-	1,945	-
PCCP/SB Las America, LLC, dated August 2005	2011	-	1,333	-
San Diego National Bank, Line of Credit, dated July 2007 City Heights Housing Area	2011	-	4,192	-
San Diego National Bank, Line of Credit, dated July 2007 City Heights Non-Housing Area	2011	-	2,067	-
San Diego National Bank, Line of Credit, dated July 2007 Naval Training Center Housing Area	2011	-	5,641	-

Type of Pledged Revenue	Fiscal Year Maturity Date	Pledged Revenue to Maturity	Debt Principal & Interest Paid	Pledged Revenue Recognized
San Diego National Bank, Line of Credit, dated July 2007 Naval Training Center Non-Housing Area	2011	$ -	$ 12,339	$ -
San Diego National Bank, Line of Credit, dated July 2007 North Bay Housing Area	2011	-	8,639	-
San Diego National Bank, Line of Credit, dated July 2007 North Park Housing Area	2011	-	7,371	-
Naval Training Center Civic, Arts, and Cultural Center (Section 108)	2025	7,047	507	507
Bonds				
Gateway Center West Redevelopment Project Tax Allocation Bonds, Series 1995	2011	-	508	391
Mount Hope Redevelopment Project Tax Allocation Bonds, Series 1995 A	2020	831	95	169
Horton Plaza Redevelopment Project Tax Allocation Refunding Bonds, Series 1996 A	2016	5,548	1,117	1,113
Centre City Redevelopment Tax Allocation Bonds, Series 1999 A	2019	27,748	2,835	2,850
Centre City Redevelopment Tax Allocation Bonds, Series 1999 B	2014	7,548	2,586	2,584
Centre City Redevelopment Tax Allocation Bonds, Series 1999 C	2025	15,585	794	760
City Heights Redevelopment Tax Allocation Bonds, Series 1999 A	2029	7,643	426	426
City Heights Redevelopment Tax Allocation Bonds, Series 1999 B	2029	29,606	825	825
Centre City Redevelopment Project Tax Allocation Bonds, Series 2000 A	2025	6,322	447	438
Centre City Redevelopment Project Tax Allocation Bonds, Series 2000 B	2025	24,464	1,456	1,414
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2000	2022	16,110	1,344	1,341
North Bay Redevelopment Project Tax Allocation Bonds, Series 2000	2031	18,011	897	868
North Park Redevelopment Project Tax Allocation Bonds, Series 2000	2031	9,713	481	465
Centre City Redevelopment Tax Allocation Bonds, Series 2001 A	2027	104,035	2,564	2,532
Mount Hope Redevelopment Project Tax Allocation Bonds, Series 2002 A	2027	5,049	153	229
Centre City Redevelopment Project Tax Allocation Bonds, Series 2003 A	2029	19,936	585	-
City Heights Redevelopment Project Tax Allocation Bonds, Series 2003 A	2034	9,740	315	315
City Heights Redevelopment Project Tax Allocation Bonds, Series 2003 B	2014	271	92	92

(continued on next page)

Type of Pledged Revenue	Fiscal Year Maturity Date	Pledged Revenue to Maturity	Debt Principal & Interest Paid	Pledged Revenue Recognized
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 A	2022	$ 8,866	$ 310	$ 301
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 B	2022	5,527	295	274
Horton Plaza Redevelopment Project Tax Allocation Bonds, Series 2003 C	2022	8,661	797	784
North Park Redevelopment Project Tax Allocation Bonds, Series 2003 A	2028	8,888	544	544
North Park Redevelopment Project Tax Allocation Bonds, Series 2003 B	2034	10,670	259	259
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 A	2030	131,832	7,510	5,591
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 B	2011	-	1,197	1,197
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 C	2030	37,434	2,224	2,234
Centre City Redevelopment Project Tax Allocation Bonds, Series 2004 D	2030	12,126	721	708
Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 A	2033	116,763	4,358	4,165
Centre City Redevelopment Project Tax Allocation Bonds, Series 2006 B	2032	56,115	2,640	3,624
Public Facilities Financing Authority Pooled Financing Bonds, Series 2007 A	2038	29,688	1,399	2,321
Public Facilities Financing Authority Pooled Financing Bonds, Series 2007 B	2038	28,746	1,216	1,717
Centre City Redevelopment Project Tax Allocation Bonds, Series 2008 A	2021	79,757	8,053	9,014
North Park Redevelopment Project Tax Allocation Bonds, Series 2009 A	2040	36,598	954	628
City Heights Redevelopment Project Tax Allocation Bonds, Series 2010 A	2041	14,609	163	163
City Heights Redevelopment Project Tax Allocation Bonds, Series 2010 B	2038	25,676	363	363
Crossroads Redevelopment Project Tax Allocation Bonds, Series 2010 A	2041	11,022	142	142
Housing Set-Aside Tax Allocation Bonds, Series 2010 A	2041	156,124	2,261	2,261
Naval Training Center Redevelopment Project Tax Allocation Bonds, Series 2010 A	2041	40,176	530	530
San Ysidro Redevelopment Project Tax Allocation Bonds, Series 2010 A	2041	7,458	86	86
San Ysidro Redevelopment Project Tax Allocation Bonds, Series 2010 B	2036	10,906	185	185
Total Pledged Tax Increment Revenue		1,152,849	102,381	55,452
Pledged Tobacco Settlement Revenue:				
Tobacco Settlement Revenue Funding Corporation Asset-Backed Bonds, Series 2006	2023	139,960	9,330	9,019
Total Pledged Tobacco Settlement Revenue		139,960	9,330	9,019
Total Pledged Revenue		$ 1,370,416	$ 131,351	$ 84,056

6. BUSINESS-TYPE ACTIVITIES LONG-TERM LIABILITIES (IN THOUSANDS)

a. Long-Term Liabilities

Business-type activities long-term liabilities as of June 30, 2011 are comprised of the following:

Type of Obligation	Interest Rates	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2011
Arbitrage Liability				$ 25
Compensated Absences				13,502
Liability Claims				15,680
Loans Payable:				
Loans Payable to San Diego County Water Authority	-	-	$ 217	217
Loans Payable to State Water Resources Control Board, issued February 9, 2000	1.80%**	2020	10,606	5,246
Loans Payable to State Water Resources Control Board, issued February 9, 2000	1.80**	2022	6,684	3,971
Loans Payable to State Water Resources Control Board, issued March 30, 2001	1.80**	2022	33,720	20,026
Loans Payable to State Water Resources Control Board, issued May 17, 2001	1.80**	2022	7,742	4,597
Loans Payable to State Water Resources Control Board, issued May 17, 2001	1.80**	2021	860	469
Loans Payable to State Water Resources Control Board, issued June 11, 2001	1.80**	2021	2,525	1,375
Loans Payable to State Water Resources Control Board, issued October 3, 2002	1.99**	2020	3,767	2,051
Loans Payable to State Water Resources Control Board, issued October 3, 2002	1.80**	2023	8,068	5,181
Loans Payable to State Water Resources Control Board, issued December 14, 2005	1.89**	2024	10,093	7,285
Loans Payable to Department of Health Services, issued July 6, 2005	2.51**	2026	21,525	16,634
Loans Payable to State Water Resources Control Board, issued October 15, 2006	1.99**	2024	3,858	2,920
Loans Payable to State Water Resources Control Board, issued February 28, 2007	1.89**	2026	11,068	9,053
Loans Payable to Department of Health Services, issued May 30, 2011	2.31**	2032	12,000	12,000
Total Loans Payable				91,025

Type of Obligation	Interest Rates	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2011
Bonds Payable:				
Subordinated Water Revenue Bonds, Series 2002	2.0 - 5.0*	2033	$ 286,945	$ 243,520
Senior Sewer Revenue Bonds, Series 2009 A	2.0-5.375*	2039	453,775	439,890
Senior Sewer Revenue Refunding Bonds Series 2009 B	3.0-5.5*	2025	634,940	562,885
Water Revenue Refunding Bonds, Series 2009 A	2.5-5.25*	2039	157,190	155,045
Water Revenue Bonds, Series 2009 B	2.5-5.75*	2040	328,060	322,815
Senior Sewer Revenue Refunding Bonds Series 2010 A	5.25*	2029	161,930	161,930
Water Revenue Refunding Bonds, Series 2010 A	5.0-5.25*	2029	123,075	123,075
Total Bonds Payable				2,009,160
Estimated Landfill Closure and Postclosure Care				20,845
Net Other Postemployment Benefits Obligation				48,161
Net Pension Obligation				23,391
Total Business-Type Activities Long-Term Liabilities				$ 2,221,789

* *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, 2011, including interest payments to maturity, are as follows:

Year Ended June 30	Loans Payable Principal	Loans Payable Interest	Revenue Bonds Payable Principal	Revenue Bonds Payable Interest
2012	$ 6,333	$ 1,787	$ 66,420	$ 100,084
2013	6,476	1,711	69,275	97,235
2014	6,604	1,583	72,485	94,022
2015	6,735	1,453	75,895	90,615
2016	6,868	1,319	79,960	87,047
2017-2021	35,552	4,498	458,355	373,524
2022-2026	18,590	1,403	483,630	251,690
2027-2031	3,495	269	326,590	140,042
2032-2036	372	4	215,375	73,600
2037-2041	-	-	161,175	17,462
Total	$ 91,025	$ 14,027	$ 2,009,160	$ 1,325,321

c. Change in Long-Term Liabilities

The following is a summary of changes in long-term liabilities for the year ended June 30, 2011. 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	$ -	$ 25	$ -	$ 25	$ -
Compensated Absences	13,327	11,200	(11,025)	13,502	6,069
Liability Claims	23,715	6,895	(14,930)	15,680	3,930
Loans Payable	84,673	12,117	(5,765)	91,025	6,333
Revenue Bonds Payable	2,073,075	-	(63,915)	2,009,160	66,420
Unamortized Bond Premiums, Discounts and Deferred Amounts on Refunding	54,307	-	(2,938)	51,369	2,938
Net Revenue Bonds Payable	2,127,382	-	(66,853)	2,060,529	69,358
Estimated Landfill Closure/Postclosure Care	20,126	719	-	20,845	-
Net Other Postemployment Benefits Obligation	33,239	14,922	-	48,161	-
Net Pension Obligation	23,190	201	-	23,391	-
Totals	$ 2,325,652	$ 46,079	$ (98,573)	$ 2,273,158	$ 85,690

d. Long-Term Pledged Liabilities

Business-type activities long-term pledged liabilities as of June 30, 2011 are comprised of the following:

Type of Pledged Revenue	Fiscal Year Maturity Date	Pledged Revenue to Maturity	Debt Principal & Interest Paid	Pledged Revenue Recognized
Pledged Net Sewer Systems Revenue:				
Loans				
Loans Payable to State Water Resources Control Board, issued February 9, 2000	2020	$ 5,731	$ 637	$ 637
Loans Payable to State Water Resources Control Board, issued February 9, 2000	2022	4,413	401	401
Loans Payable to State Water Resources Control Board, issued March 30, 2001	2022	22,272	2,025	2,025
Loans Payable to State Water Resources Control Board, issued May 17, 2001	2022	5,109	464	464
Loans Payable to State Water Resources Control Board, issued May 17, 2001	2021	516	52	52
Loans Payable to State Water Resources Control Board, issued June 11, 2001	2021	1,516	152	152
Loans Payable to State Water Resources Control Board, issued October 3, 2002	2020	2,260	251	251
Loans Payable to State Water Resources Control Board, issued October 3, 2002	2023	5,809	484	484
Loans Payable to State Water Resources Control Board, issued December 14, 2005	2024	8,287	637	637
Loans Payable to State Water Resources Control Board, issued October 15, 2006	2024	3,344	257	257
Loans Payable to State Water Resources Control Board, issued February 28, 2007	2026	10,485	699	699
Bonds and Notes				
Senior Sewer Revenue Bonds, Series 2009 A	2039	800,546	28,984	28,081
Senior Sewer Revenue Refunding Bonds, Series 2009 B	2025	781,592	65,003	63,783
Senior Sewer Revenue Refunding Bonds, Series 2010 A	2029	289,846	8,501	8,138
Total Pledged Net Sewer Systems Revenue		1,941,726	108,547	106,061
Pledged Net Water Systems Revenue:				
Loans				
Loans Payable to Department of Health Services, issued July 6, 2005	2026	19,951	1,376	1,376
Loans Payable to Department of Health Services, issued May 30, 2011	2032	15,051	-	-
Bonds and Notes				
Subordinated Water Revenue Bonds, Series 2002	2033	369,608	27,293	27,028
Water Revenue Refunding Bonds, Series 2009 A	2039	245,249	8,680	8,673
Water Revenue Bonds, Series 2009 B	2040	630,352	21,736	21,590
Water Revenue Refunding Bonds, Series 2010 A	2029	217,288	3,699	3,598
Total Pledged Net Water Systems Revenue		1,497,499	62,784	62,265
Total Pledged Revenues		$ 3,439,225	$ 171,331	$ 168,326

7. DISCRETELY PRESENTED COMPONENT UNITS LONG-TERM DEBT (In Thousands)

Narratives and tables presented in the following sections are taken from the audited financial statements of the San Diego Convention Center Corporation and the comprehensive annual financial report of the San Diego Housing Commission as of June 30, 2011.

San Diego Convention Center Corporation

Type of Obligation	Interest Rate	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2011	Due Within One Year
Compensated Absences				$ 1,340	$ 1,291
Notes Payable:					
Fifth Avenue Landing LLC	5.27%	2015	12,500	12,500	-
San Diego Gas and Electric Sustainable Energy	0.00%	2012	353	353	184
Redevelopment Agency of the City of San Diego	3.00%	2018	3,000	3,000	-
Total Notes Payable				15,853	184
Total Long-Term Liabilities				$ 17,193	$ 1,475

Effective February 24, 1999, SDCCC entered into a Note Purchase Contract with the Port for $10,000, the proceeds of which were used to pay for the direct and incidental costs of the Sails Pavilion Enhancement project completed in July 2000. SDCCC repays the note at zero percent per annum rate to the Port. During the year ended June 30, 2011, SDCCC made the final payment in the amount of $500 to the Port.

SDCCC entered into a Note Purchase Contract on May 6, 2010 for $12,500 with Fifth Avenue Landing, LLC, the proceeds of which were used for the Phase III expansion site ground lease purchase. The Fifth Avenue Landing LLC note payable is repaid at the rate of 5.27% per annum with a $12,500 principal payment due by May 6, 2015. SDCCC is required to pay an annual interest payment of $500, while the remaining accrued interest owed in any one year is payable at the date of final maturity.

On December 6, 2010, SDCCC entered into a Financing Loan Agreement with San Diego Gas & Electric (SDG&E) for $353, the proceeds of which were used to retrofit energy efficient/demand lighting equipment in the Convention Center exhibit halls. SDG&E contracted with a third party to perform the installation work and extend financing to SDCCC at a zero percent per annum rate. Upon final inspection of the completed project, SDG&E paid the third party contractor for the work performed and will collect the balance of the note payable through an on-bill financing arrangement set forth in 23 equal installments through SDCCC's monthly utility bill.

SDCCC entered into a Note Purchase Contract with the Redevelopment Agency of the City of San Diego on March 16, 2011 for $3,000, the proceeds of which were earmarked for certain design and planning costs for the Phase III expansion project. The note payable to the RDA is repaid at a rate of 3% per annum, simple interest. The $3,000 principal payment, plus any accrued interest, is due by June 30, 2018.

Annual requirements to amortize long-term debt as of June 30, 2011, are as follows:

Notes Payable		
Fiscal Year Ended June 30	Principal	Interest
2012	$ 184	$ 500
2013	169	500
2014	-	500
2015	12,500	1,297
2016	-	-
2017-2018	3,000	637
Total	$ 15,853	$ 3,434

San Diego Housing Commission (SDHC)

Type of Obligation	Interest Rate	Fiscal Year Maturity Date	Original Amount	Balance Outstanding June 30, 2011	Due Within One Year
Compensated Absences				$ 1,529	$ 1,529
Notes Payable:					
Debts of SDHC					
JPMorgan Chase, dated June 1995	Variable	2012	$ 4,725	2,949	2,949
State of California (RHCP)	0.00%	2015	3,149	3,149	-
State of California (RHCP)	0.00%	2014	1,405	1,405	-
US Bank, dated November 2006	Variable	2012	20,550	19,508	19,508
Redevelopment Agency, dated March 1992	0.00% forgivable	2022	696	696	-
Redevelopment Agency, dated March 18, 2010	1.00% forgivable	2065	3,099	3,338	-
Debts of the LLCs					
Greystone Servicing Corp, Inc. Fannie Mae (Belden)	7.32%	2040	12,320	12,151	130
Greystone Servicing Corp, Inc. Fannie Mae (Northern)	7.32%	2040	10,810	10,662	115
Greystone Servicing Corp, Inc. Fannie Mae (Central)	7.32%	2040	14,010	13,817	148
PNC Bank, NA FHA (Southern)	3.76%	2046	25,017	24,754	362
PNC Bank, NA FHA (Northern)	3.76%	2046	17,500	17,317	253
PNC Bank, NA FHA (Central)	3.65%	2046	15,726	15,576	232
Total Notes Payable				125,322	23,697
Total Long-Term Liabilities				$ 126,851	$ 25,226

The interest rate for the JP Morgan Chase obligation as of June 30, 2011 was 3.0%. The variable rate in accordance with the loan agreement is equal to .65 times the sum of the Variable Index Rate plus 3.0%. 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, 2011 was 2.441%. The variable interest rate in accordance with the loan agreement is 2.6% plus LIBOR.

SDHC entered into an Interest Rate Swap Agreement with US Bank (the Swap Provider) to reduce the impact of changes in interest rates. Under the terms of the Swap Agreement, SDHC has agreed to pay interest to the Swap

Provider at a fixed rate of 5.29% plus 2.6% exclusive of any fees, add-ons or other trustee or bank charges, while the Swap Provider has agreed to make SDHC's required monthly mortgage payment. The notional amount of the Swap Agreement is $19,766. The Swap Agreement expired at maturity of the mortgage in 2011.

Pursuant to GASB No. 53, 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. SDHC recorded a liability for the fair value of the interest rate swap as of June 30, 2011 in the amount of $417. During the year ended June 30, 2011, a gain in fair value of $859 was realized and is included in the Statement of Activities.

The US Bank loan represents the loan for the Smart Corner Building which houses the administrative offices of SDHC, which was due October 31, 2011.

SDHC entered into a loan agreement with the RDA as of March 18, 2010, for the acquisition and rehabilitation of the Sandford Hotel. The loan from the RDA is a forgivable loan, with a term of 55 years and 1% simple interest. The total approved loan amount is $6,095 with $3,338 having been disbursed as of June 30, 2011.

On December 30, 2009, Belden SDHC FNMA LLC, Central SDHC FNMA LLC and Northern SDHC FNMA LLC (blended component units of the SDHC) entered into debt agreements with Greystone Servicing Corp. Inc. in the amount of $37.1 million. The debt agreement is to obtain financing towards acquiring over 350 affordable housing units in the City. The FNMA loans were nonrecourse obligations of the LLCs and not of the SDHC. Under the terms of the loan agreements, the LLCs agreed to pay a fixed interest rate of 7.32% on the life of the loan through maturity on January 1, 2040.

On August 31, 2010, Northern SDHC FHA LLC and Southern SDHC FHA LLC (blended component units of the SDHC) entered into debt agreements with PNC Bank, N.A. for the combined total amount of $58,300. The debt agreements are to obtain financing to acquire additional affordable housing units in the City. The FHA loans are nonrecourse obligations of the LLCs and not of the SDHC. Under the terms of the loan agreements, the LLCs agreed to pay a fixed interest rate not to exceed 4% on the life of the loan through maturity on September 1, 2045 and October 1, 2045 respectively.

The American Recovery and Reinvestment Act of 2009 created the new Build America Bond (BABs) program. Under this program, state and local governments receive directly from the U.S. Treasury subsidy payments for a portion of their borrowing costs on BABs equal to 35 percent of the total coupon interest paid. The subsidy stream is paid for the full term of the bonds. The Belden SDHC FNMA LLC, Northern SDHC FHA LLC and the Southern SDHC FHA LLC loans have been approved as qualified direct subsidy BABs. SDHC has received $781 in fiscal year 2011 subsidy payments.

The annual requirements to amortize such long-term liabilities as of June 30, 2011 are as follows:

Notes Payable

Fiscal Year Ended June 30	Principal	Interest
2012	$ 23,697	$ 5,318
2013	1,302	4,743
2014	2,772	4,677
2015	4,585	4,608
2016	1,509	4,535
2017-2021	8,796	21,425
2022-2026	12,068	18,848
2027-2031	14,819	15,402
2032-2036	19,463	10,758
2037-2041	21,211	4,672
2042-2046	11,762	980
2065	3,338	3,318
Total	$ 125,322	$ 99,284

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, 2011, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Tax and Revenue Anticipation Notes	$ -	$ 163,165	$ (163,165)	$ -

The $163,165 (FY11) TRANs issue had an interest rate of 2.0% and the final note was repaid on May 27, 2011.

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 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 Statement No. 14.

Prior to July 1, 2011, the SDMSE partners were the City of San Diego and Rural/Metro of San Diego, Inc., a wholly owned subsidiary of Rural/Metro Corporation. The SDMSE governing board of managers was comprised of five members, three of whom were appointed by the City.

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, and continued until June 30, 2011. On July 1, 2011, the City sold its interest in SDMSE to Rural/Metro of San Diego, Inc. and Rural/Metro of Southern California, Inc. The City no longer has any partnership interest in SDMSE. As of July 1, 2011, the City has an agreement with Rural/Metro of San Diego, Inc. to provide emergency medical services and medical transportation services within the City through June 30, 2013.

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 Consortium 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 sustain, the City and the County have agreed to share in the payment of such an obligation.

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.

Capital Leases

The City has entered into various capital leases for equipment and structures. These capital leases have maturity dates ranging from July 1, 2011 through October 1, 2023 and interest rates ranging from 1.89% to 4.88%. A schedule of future minimum lease payments under capital leases as of June 30, 2011 is provided in Note 5. The value of all governmental capital leased assets as of June 30, 2011 is $90,580 net of accumulated depreciation of $116,563. These amounts are categorized by major asset class in the table below.

Values of Capital Leased Assets by Major Asset Class

	Gross Value	Depreciation	Net Book Value
Governmental			
Equipment	$ 158,916	$ (70,908)	$ 88,008
Structures & Improvement	48,227	(45,655)	2,572
Total Governmental	$ 207,143	$ (116,563)	$ 90,580

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, 2011:

Year Ended June 30	Amount
2012	$ 11,856
2013	11,721
2014	7,397
2015	782
2016	529
2017-2021	2,459
Total	$ 34,744

Rent expense as related to operating leases was $11,716 for the year ended June 30, 2011.

Lease Revenues

The City has operating leases for certain land, buildings, and facilities with tenants and concessionaires. Leased capital asset carrying values of approximately $81,644, 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
2012	$ 37,469
2013	36,251
2014	35,022
2015	34,319
2016	33,672
2017-2021	152,395
2022-2026	138,270
2027-2031	130,307
2032-2036	117,818
2037-2041	111,356
2042-2046	99,297
2047-2051	52,663
2052-2056	18,087
2057-2061	8,991
Total	$ 1,005,917

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 $77,183 for the year ended June 30, 2011, which includes contingent rentals of $39,918.

11. DEFERRED COMPENSATION PLAN (In Thousands)

The City, SDCCC, SDDPC and 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 permit eligible employees 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'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 and the Airport. The assets of the three separate plans and trusts are pooled in the SDCERS Group Trust. These plans are administered by the SDCERS Board (Board) to provide retirement, disability, death and survivor benefits for its members. Amendments to the City's benefit provisions require City Council approval and amendments to retirement benefits require a majority vote by those SDCERS members who are also City employees or retirees. 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 per GASB Statement No. 14; however, the financial statements of SDCERS Pension Trust do include the Port and the Airport activity and are reported in the trust and agency section of the CAFR.

The information disclosed in this note relates solely to the City's participation in SDCERS. City employment classes participating in the City's defined benefit plan (Plan) are elected officers, general employees and safety employees (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, 2011 (actual member count)

	General	Safety	Total by Classification
Active Members	5,498	2,294	7,792
Terminated Members	2,365	529	2,894
Retirees, Disabled and Beneficiaries	4,755	3,147	7,902
Total Members, as of June 30, 2011	12,618	5,970	18,588

Source: Cheiron Actuarial Valuation as of June 30, 2011

As a defined benefit plan, retirement benefits are determined under the Plan primarily by a member's class, hire date, age at retirement, number of years of creditable service, and the member's final compensation. The Plan provides annual cost of living adjustments not to exceed 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.

Final compensation is based upon either the highest salary earned over a consecutive twelve month period or the highest average salary earned over three one-year periods, depending on the member's hire date. To qualify for a service retirement benefit, the Plan requires ten years of service at age 62 for general members (55 for safety members) 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. Retirement benefits are awarded at various rates ranging from 1.0% to 3.5% per year of service multiplied by final compensation depending on the member's plan and hiring date. The actual percentage of final compensation 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. The maximum percentage of final compensation per year served is 2.8% for general members, 3% for safety members and 3.5% for elected officers. 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.

Deferred Retirement Option Plan (DROP)

The Deferred Retirement Option Plan (DROP) is a program designed to allow members an alternate method of accruing additional retirement benefits from the Plan while they continue to work for the City. Only members hired before July 1, 2005 are eligible to participate in DROP. A member must be eligible for a service retirement to enter DROP. In addition, the member 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. The member's decision to enter DROP is irrevocable.

Upon entering DROP, the participant stops making pension contributions to SDCERS and stops earning service credit. Instead, amounts equivalent to the participant's retirement benefit plus additional DROP contributions are credited to an interest bearing individual account held in the participant's name. Effective January 1, 2011, the annual interest credited to DROP participant accounts is 2.3% while the participant is employed by the City. When the participant leaves DROP and retires from City service, the participant's DROP account balance may be paid in a lump sum, rolled over to another plan, or converted to monthly payments over either 240 months or the participant's life expectancy. The DROP annuity factor used to calculate the monthly payments is 4.8% effective January 1, 2011. 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 service credit, as previously discussed.

Purchase of Service Credits

Plan members hired prior to July 1, 2005 are permitted to purchase service credits to be used in determining retirement allowances. The cost of purchased service credits is determined by the Board consistent with the requirements of the San Diego Municipal Code (SDMC).

Prior to August 15, 2003, the cost of purchased service credits to employees was priced below actual cost. On August 15, 2003, the Board became aware of and corrected the under-pricing; however, the Board continued to allow employees to purchase service credits at the below-cost rate until November 1, 2003, in violation of the Municipal Code. In November 2007, the City challenged this action in court and in November 2008, the trial court ruled, and in June 2010 an appellate court later affirmed, that the employees had underpaid for the purchased service credits and that the Board was prohibited from requiring the City make up the underfunded amount by including it in the UAAL. The Board has determined not to further appeal this ruling and the costs associated with the under-priced purchased service credits will not be borne by the City. SDCERS has implemented corrections for the under-priced purchased service credits, which include refunding purchased amounts, requiring additional payments from employees, or reducing credits purchased to the amount of the actual payments received. According to the June 30, 2011 actuarial valuation, the City's UAAL has been reduced by approximately $64,800 as a result of the purchased service credit cost recovery process.

Preservation of Benefits Plan

The POB Plan 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). As provided in San Diego Municipal Code section 24.1606 and required by federal tax law, the POB Plan is unfunded within the meaning of the federal tax laws. The City may not pre-fund the POB Plan 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 which is funded by the City.

In Fiscal Year 2011, approximately $1,300 in benefits above 415(b) limits were paid by the City for the POB Plan. The number of participants in any given year for the POB Plan is determined by the number of Plan participants who exceed the current year's section 415(b) limitations as calculated by SDCERS' actuary. The maximum annual participant payment from a defined benefit plan for the calendar year 2011 was $195 and, for non-safety members, is adjusted downward depending on the age of the participant when benefits began. In fiscal year 2011, the City's POB ARC was approximately $1,800; however, the City contributed approximately $1,300 to the POB Plan, and therefore, the $500 difference increased the City's Net Pension Obligation (NPO). Additionally, the Actuarial Accrued Liability (AAL) related to the POB Plan is approximately $9,144 as of July 1, 2010 which is required to be paid on a pay-as-you-go basis. Financial statements for the Preservation of Benefits Plan 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. Additionally, private equity assets are valued by the private equity managers giving consideration to the financial condition and operating results of the portfolio companies, and other factors deemed relevant. 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**

Offset Agreements

The City has historically negotiated employee retirement contribution offsets with certain employee groups meaning the City has paid a portion of the employees' retirement contributions. For instance, in fiscal year 2009, the City made offset payments of employee retirement contributions ranging from 5.89 percent for elected officials and 1.4 percent for employees represented by the Municipal Employees Association (MEA), which represents white-collar workers. All eligible employees received some level of contribution offset. In recent years, such offsets have been reduced and for fiscal year 2012, the City has only two such arrangements. The City currently pays retirement contribution offsets of 2.3% for members of Teamsters Local 911, which represents employees in the lifeguard service, and 0.4% for members of MEA.

Funding Commitments Related to Legal Settlements—McGuigan Settlement

The City employer contributions for fiscal years 1996 – 2005 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). The underfunding of the pension system resulted in numerous lawsuits, most of which have been settled by the City.

In September 2006, the City entered into a settlement of McGuigan v. City of San Diego (McGuigan Settlement) related to the underfunding by the City of the pension system. Under the McGuigan Settlement, the City was obligated to pay into SDCERS approximately $173,000 in excess of its required contributions no later than June 8, 2011. Prior to fiscal year 2010, the City made approximately $144,000 in additional payments to SDCERS to meet, in part, the terms of the McGuigan Settlement and, on June 30, 2010, entered into an agreement with Bank of America to satisfy the remaining obligation. Under the terms of the agreement, the bank made payment to SDCERS on behalf of the City in an amount of approximately $32,800. The City is required to repay the bank in four annual payments of approximately $9,000 commencing July 1, 2011. In addition to the payment made to SDCERS by the bank on behalf of the City, the City contributed an additional $5,600 of accrued interest to SDCERS. The McGuigan Settlement was fully funded by the arrangement with Bank of America described above, the securitization of future tobacco revenue, transfers of actual tobacco revenue receipts, additional employee "pick up" savings, and City contributions made in excess of the ARC.

d. **Funding Policy and Contribution Rates**

City Charter Article IX Section 143 requires employees and employers to contribute to the Plan. The Charter section 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 Plan. The Charter requires that employer contributions for normal retirement allowances be substantially equal to employee contributions. SDCERS' legal counsel has opined that this requirement applies to the current normal cost contribution only and not to changes in unfunded liabilities resulting from market or actuarial gains or losses. This matter is currently being litigated between SDCERS and the City.

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 2011, based on the valuation ended June 30, 2009, expressed as percentages of active payroll:

	Employer Contribution Rates		
	General Members	Elected Members	Safety Members
Normal Cost*	9.15%	30.53%	14.44%
Amortization Payment*	25.82%	39.15%	38.46%
Normal Cost Adjusted for Amortization Payment*	34.97%	69.68%	52.90%
City Contribution Rates Adjusted for Payment at the Beginning of the Year	33.70%	69.68%	50.98%

** 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 2011, the City employee contribution rates as a percentage of annual covered payroll averaged 9.89% for general members and 15.79% for safety members. A portion of an employee's share, depending on that employee's member class, may be paid by the City as a retirement offset. In fiscal year 2011, the amount paid by the City ranges from 0.00% to 3.4% of covered payroll for general members and the rate for safety Plan members ranges from 0.00% to 5.30%. Employee contribution offsets paid by the City, amounting to approximately $6,482 in fiscal year 2011, 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 reduced the amount of the employee contribution paid by the City.

On September 2, 2008, City Council approved O-19781 which amended Chapter 2, Article 4, Division 15 of the SDMC. 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, these benefits 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 2.3% 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 which ranges from $30 to $75 (whole dollars) times the number of years of service credit. 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 (SCOLA).

e. **Funded Status and Funding Progress**

The following table summarizes the Plan's funding status as reported in the fiscal year 2011 valuation:

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)
6/30/2011	$ 4,739,399	$ 6,917,417	$ 2,178,018	68.51%	$ 514,265	423.52%

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 Cost

The City's annual pension cost for fiscal year 2011 is based on the SDCERS June 30, 2009 Actuarial Valuation. The following table summarizes the principal actuarial methods and assumptions used in the June 30, 2009 and June 30, 2011 actuarial valuations:

	Method/Assumption for the Valuation Ended	
Description	June 30, 2009	June 30, 2011
Actuarial Method	Entry Age Normal (EAN) [1]	Entry Age Normal (EAN)
Amortization Method	Level Percent Closed	Level Percent Closed
Equivalent Single Amortization Period	16.209 years [2]	15.789 years [3]
Asset Smoothing Method	Expected Value Method	Expected Value Method
Annual Rate of Return on Investments	7.75%, net of administrative expenses	7.50%, net of administrative expenses
Inflation Rate	4.00% per year, compounded annually	3.75% per year, compounded annually
Cost of Living Adjustment	2.00% per year, compounded annually	2.00% per year, compounded annually
Projected Salary Increases Due to Inflation	4.00% per year	0% for the next 2 years, 3.75% thereafter

The actuarial value of assets was determined using a methodology that smoothes the effects of short-term volatility in the market value of investments. The valuations performed prior to fiscal year 2008 assumed an 8% annual rate of return. Additionally, the valuations performed prior to fiscal year 2007 amortized the UAAL over a fixed 30-year closed period. For valuations effective June 30 2007, the Board adopted a 20-year closed

[1] The entry age normal actuarial cost method is designed to fund a member's total plan benefit over the course of his or her career and to produce stable employer contributions in amounts that increase at the same rate as the employer's payroll (ie., level % of payroll). SDCERS adopted this actuarial cost method as of the June 30, 2007 Actuarial Valuation.
[2] 18 years for the outstanding balance of the 2007 unfunded actuarial liability, 15 years for experience gains and losses, 30 years for changes in methods and assumptions, 5 years for benefit changes.
[3] 16 years for the outstanding balance of the 2007 unfunded actuarial liability, 15 years for experience gains and losses, 30 years for changes in methods and assumptions, 5 years for benefit changes.

amortization schedule with no negative amortization and a 15-year closed amortization schedule for gains and losses beginning in fiscal year 2008.

The following table shows the City's annual pension cost (APC) and the percentage of APC contributed for the fiscal year ended June 30, 2011 and two preceding years (in thousands):

Fiscal Year Ended June 30	APC	Percentage Contributed	Net Pension Obligation
2009	$ 167,529	97.66%	$ 177,767
2010	156,346	124.01%	140,233
2011	231,432	99.56%	141,242

Net Pension Obligation

Net Pension Obligation (NPO) is the cumulative difference, since the effective date of GASB Statement No. 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, 2011, the City's NPO is approximately $141,242 and is reported in accordance with GASB Statement No. 27. See table below.

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 2011]	$ 230,917
Interest on NPO	10,868
ARC Adjustment	(10,353)
Annual Pension Cost	231,432
Contributions [Fiscal Year 2011]	(230,423)
Change in NPO	1,009
NPO Beginning of Year [July 1, 2010]	140,233
NPO End of Year [June 30, 2011]	$ 141,242

DEFINED CONTRIBUTION PLANS

a. **<u>Supplemental Pension Savings Plan - City</u>**

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 Wells Fargo 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 members, lifeguard members and elected officers participate in the plan. Eligible employees may participate from the date of employment; however, the plan was closed to general and lifeguard members hired on or after July 1, 2009 and January 1, 2011, respectively.

The following table details plan participation as of June 30, 2011:

Plan	Participants
SPSP	7,601
SPSP – H	4,293

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 2011, the City and the covered employees contributed $15,457 and $19,555, respectively. As of June 30, 2011, the fair value of plan assets totaled $573,604. 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(a) Plan - City**

The City established a 401(a) Plan for all General Member employees hired on or after July 1, 2009. The 401(a) Plan is a defined contribution plan administered by Wells Fargo to provide pension benefits for eligible employees. Employees are eligible to participate from the date of employment and are immediately 100% vested. Employees contribute 1% on a mandatory basis which is matched by City contributions. Additionally, employees can make voluntary contributions to their 401(a) Plan accounts through payroll deductions not to exceed IRS limits. Voluntary contributions to the plan are not matched by the City.

The City and employees contributed $90 and $107, respectively, during the fiscal year ended June 30, 2011. As of June 30, 2011, the fair value of plan assets totaled $349. The 401(a) Plan is considered part of the City's financial reporting entity and is reported as a pension and employee savings trust fund.

c. **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 Wells Fargo to provide pension benefits for eligible employees. Employees are eligible to participate from the date of employment. Employees make contributions to their 401(k) Plan accounts through payroll deductions.

The employees' 401(k) contributions are based on IRS calendar year limits. Employees contributed $14,481 during the fiscal year ended June 30, 2011. There is no City contribution towards the 401(k) Plan.

As of June 30, 2011, the fair value of plan assets totaled $279,643. 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.

d. **Pension Plan - Centre City Development Corporation (CCDC)**

CCDC has a Money Purchase Pension Plan covering all full-time permanent employees (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 the fiscal year, CCDC contributes semi-monthly an amount equal to 8% of the total semi-monthly compensation for all full-time permanent 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 2011 was $3,371. CCDC's contributions were calculated using the base salary amount of all full-time permanent employees of $3,280. CCDC made the required 8% contribution amounting to $223 (net of forfeitures) for fiscal year 2011.

In addition, CCDC has a Tax Deferred Annuity Plan under IRC section 403(b) (403(b) Plan) covering all full-time permanent employees. The 403(b) 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 403(b) Plan includes amounts deposited by employees prior to CCDC becoming a contributor to the 403(b) Plan. CCDC made the required 16% contribution amounting to approximately $525 for fiscal year 2011.

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.

e. **Pension Plan - San Diego Convention Center Corporation (SDCCC)**

SDCCC's Money Purchase Pension Plan (SDCCC Plan) is a governmental plan under IRC section 414(d) and 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 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. Effective January 1, 2009, employees are eligible to participate in the Plan on the first day of the month after completion of 1,000 hours of service during the twelve-month period beginning on the employees' hire date (or during any subsequent Plan years).

A plan year is defined as a calendar year. The SDCCC Plan'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 the 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, 2011, pension expenses for the SDCCC Plan amounted to $1,380. SDCCC records pension expenses during the fiscal year based upon employee compensation that is included in gross income covered compensation.

f. **Pension Plan - San Diego Data Processing Corporation (SDDPC)**

SDDPC administers a Money Purchase Pension Plan (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 their date of employment. During each plan year, SDDPC contributes monthly an amount equal to 20% of the total defined eligible monthly compensation for all employees. SDDPC contributions for each employee are fully vested after four years of continuous 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 2011, SDDPC made the required 20% contribution, amounting to approximately $4,013.

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 and who elect to participate. There are no employer contributions to this plan.

g. **Pension Plan - San Diego Housing Commission (SDHC)**

SDHC provides pension benefits for all its full-time employees through a defined contribution plan (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 2011 was approximately $14,351. SDHC made the required 14% contribution, amounting to approximately $2,009 and plan members contributed $85 for fiscal year 2011. 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.

h. **Pension Plan - Southeastern Economic Development Corporation (SEDC)**

SEDC has a 403(b) Tax Sheltered Annuity Plan (Defined Contribution Plan) covering all employees (SEDC Plan). The 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 2011 was approximately $664 and SEDC made the required 403(b) contribution totaling $83. SEDC Plan members contributed an additional $36. The City does not act in a trustee or agency capacity for the SEDC Plan; therefore, these assets are not reported within the City's basic financial statements.

13. OTHER POSTEMPLOYMENT BENEFITS (In Thousands)

a. Plan Description

The City provides postemployment healthcare benefits to qualifying general, safety and elected members, as provided for in SDMC Sections 24.1201 through 24.1204. The Other Postemployment Benefit Plan (the "OPEB Plan") is a single-employer plan, managed by SDCERS, and includes approximately 5,600[1] retirees, 7,200[1] active employees and 800[1] terminated vested members as of June 30, 2011. Postemployment healthcare benefits are primarily for health eligible retirees, not inclusive of dependents, who were actively employed on or after October 5, 1980 and were otherwise entitled to retirement allowances. Additionally, employees must have 10 years of service with the City to receive 50% of the retiree health benefit and receive an additional 5% per year of service in excess of 10 years, resulting in a maximum benefit of 100% at 20 years of service. 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. Health eligible retirees who are also eligible for Medicare are entitled to receive reimbursement/payment of healthcare premiums, ranging from approximately $8,400[1] to $9,300[1] per year depending on retirement date, in addition to reimbursement/payment for Medicare Part B premiums, which ranges from $1,200[1] to $1,300[1] per year. Health eligible retirees who are not eligible for Medicare are entitled to receive reimbursement/payment of healthcare premiums, ranging from approximately $8,900[1] to $9,900[1] per year depending on retirement date. 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 Inflator). 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 $1,200[1] per year. Reimbursements for non-health eligible retirees are not subject to annual adjustments.

The City's postemployment healthcare benefit plan is closed to employees hired on or after July 1, 2005; however, this is being challenged in court by certain employee groups who contend that due to delays in codification of benefit changes into the Municipal Code, the effective cutoff date would instead be February 16, 2007, which is when the Ordinance O-19567 was officially codified in the Municipal Code. The court ruled in favor of the City but the matter is currently on appeal.

In addition, the Annual Inflator associated with the benefit was frozen for active employees, effective July 1, 2009 and continued until June 30, 2011, pending further negotiation. Employees retiring during that period were not entitled to the Annual Inflator. However, employees retiring after June 30, 2011 are entitled to the Annual Inflator with exception of Police Officers Association (POA) and Local 127 members.

In fiscal year 2010, the City established a trust vehicle for a defined contribution plan to fund retiree medical benefits for general members hired after July 1, 2009 who are excluded from the OPEB 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. Elected and safety members are ineligible for this plan.

b. Summary of Significant Accounting Policies

Basis of Accounting - The postemployment healthcare 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 OPEB Plan.

Method Used to Value Investments – CalPERS, which administers the retirement benefits trust described below, states

[1] Reported as a whole number.

investments 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.

c. Contributions and Reserves

In accordance with SDMC Section 24.1204, postemployment healthcare benefits are to be paid directly by the City 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, they are required to pay for the benefits of their beneficiaries (amounts vary based on coverage elections). In fiscal year 2011, the City contributed $33,868 to the Post-Employment Healthcare Benefit Plan.

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. The ARC for the OPEB Plan is calculated by the City's actuary on an annual basis.

The City plans to continue funding current year postemployment healthcare benefits from the pay-as-you-go trust fund (Post-Employment Healthcare Benefit Plan) until it is able to pay the ARC in full. Additionally, the City plans to contribute approximately $10,000 to $15,000 per year to the CERBT, not to exceed $25,000, for Fiscal Years 2012 through 2015 to pre-fund future Other Postemployment Benefits. All contributions to the CERBT become trust assets.

The City contributed approximately $25,000 to the CERBT in fiscal year 2011. As of June 30, 2011, the market value of the CERBT was approximately $116,608. This balance is net of all contributions to the plan as well as Fiscal Year 2011 annual investment gains and administrative expenses amounting to approximately $19,006 and $118, 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)
06/30/11	$ 116,608	$ 1,248,151	$ 1,131,543	9.34%	$ 455,537	248.40%

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 value of plan assets is 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 Statement No. 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 2011 (actuarial valuation for the fiscal year ended June 30, 2009), as well as for the most current actuarial valuation (ended June 30, 2011):

Description	Method/Assumption
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%* (FY09), 6.40%* (FY11)
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 2011, as well as for the two preceding fiscal years:

Fiscal Year Ended	Annual OPEB Cost	Percentage Contributed	Net OPEB Obligation
06/30/09	$ 105,583	46.88%	$ 93,878
06/30/10	115,442	49.11%	152,631
06/30/11	123,534	47.65%	217,297

As the administrator of the OPEB Plan, the City implemented GASB Statement Nos. 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, 2011 (based on the valuation for the fiscal year ended June 30, 2009):

ARC [Fiscal Year 2011]	$ 120,324
Interest on NOPEBO	10,209
ARC Adjustment	(6,999)
Annual OPEB Cost	123,534
Contributions [Fiscal Year 2011]	(58,868)
Change in NOPEBO	64,666
NOPEBO Beginning of Year [July 1, 2010]	152,631
NOPEBO End of Year [June 30, 2011]	$ 217,297

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 $6,446, are advances from the Housing and Urban Development (HUD) Section 108 grant funds to RDA. Interfund WCA balances at June 30, 2011 are as follows:

	Benefitting Fund (Payable)
Contributing Fund (Receivable)	NonMajor Governmental
NonMajor Governmental	$ 8,784

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. $6,510 represents a loan from the General Fund to the TransNet fund to cover a cash deficit and $748 represents payables from RDA to CCDC and SEDC for reimbursable operating costs. Interfund receivable/payable balances at June 30, 2011 are as follows:

	Benefitting Fund (Payable)
Contributing Fund (Receivable)	NonMajor Governmental
General Fund	$ 6,510
Nonmajor Governmental	748
Total	$ 7,258

The Sewer Utility Fund has an interfund loan receivable of $3,487, and the Black Mountain Ranch Facilities Benefit Assessments (FBA) Fund, a capital projects fund, has a corresponding interfund payable for advanced FBA project funding. In order to expedite construction, the Sewer Utility Fund agreed to finance the Carmel Valley Trunk Sewer project. A portion of this project was deemed the responsibility of the Carmel Valley area developers and is intended to be reimbursed during fiscal year 2012 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 $32,010 and RDA has an aggregate interfund loan payable of $32,010. 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.

On February 28, 2011, the City and RDA entered into a cooperation agreement for the payment of costs associated with certain RDA funded projects (Projects Implementation Agreement). Pursuant to the agreement, the RDA transferred approximately $289,000 to the City in anticipation of work to be performed in future years. In addition, the City and RDA authorized the transfer of approximately 95 real estate assets from the RDA to the City for the implementation of projects pursuant to the Projects Implementation Agreement. These transfers are included in the General Fund and Nonmajor Governmental categories listed below.

Interfund transfer balances for the year ended June 30, 2011 are as follows:

	Benefiting Fund						
Contributing Fund	General Fund	Nonmajor Governmental	Sewer Utility	Water Utility	Nonmajor Enterprise	Internal Service	Total
General Fund	$ -	$ 22,601	$ -	$ -	$ -	$ 2,852	$ 25,453
Nonmajor Governmental	158,874	651,664	-	142	307	3,263	814,250
Sewer Utility	192	-	-	-	-	10	202
Water Utility	181	41	-	-	-	-	222
Nonmajor Enterprise	243	5,409	-	-	-	750	6,402
Internal Service	1,367	11	147	113	77	8	1,723
Total	$ 160,857	$ 679,726	$ 147	$ 255	$ 384	$ 6,883	$ 848,252

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 and/or vision 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 receive flexible benefit dollars as taxable earnings and may use those dollars for medical/dental/vision and childcare reimbursement accounts.

The City is self-insured for workers' compensation and long-term disability (LTD). All operating funds of the City participate in both of 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 expenses 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, 2011 were determined based on results of independent actuarial evaluations and include amounts for claims incurred but not reported and adjustment expenses. Claims liabilities were 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, 2009	$ 143,873	$ 162,959	$ 306,832
Claims and Changes in Estimates	50,720	29,605	80,325
Claim Payments	(20,498)	(24,030)	(44,528)
Balance, June 30, 2010	174,095	168,534	342,629
Claims and Changes in Estimates	10,325	26,514	36,839
Claim Payments	(26,797)	(23,399)	(50,196)
Balance, June 30, 2011	$ 157,623	$ 171,649	$ 329,272

The City, in collaboration with CSAC-EIA, maintains an "All Risk" policy which includes flood 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, as required, 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 insured 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 2011, there were no significant reductions in insurance coverage from the prior year. For each of the past three fiscal years, settlements have not exceeded insurance coverage.

See Contingencies, Note 18, for additional information.

16. FUND BALANCE / NET ASSETS (DEFICIT) (In Thousands)

The Development Services Enterprise fund has a net assets deficit of $11,303 primarily due to the accumulation of unfunded expenses related to long-term liabilities such as the NPO, NOPEBO and Compensated Absences and is in the process of identifying a solution to correct future net asset deficits.

The Publishing Services Internal Service fund has a net assets deficit of $653 primarily due to the accumulation of unfunded expenses related to long-term liabilities such as the NPO, NOPEBO and Compensated Absences and is in the process of identifying a solution to correct future net asset deficits.

The Self Insurance Internal Service fund has a net assets deficit of $139,494, 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. Even though the City suspended funding the Public Liability and Workers' Compensation reserves in fiscal years 2011 and 2012, the City funded the current year's claim settlements through the department's operating budget. Additionally, the City's Reserve Policy calls for a reserve goal of 50% of outstanding claims to be achieved no later than fiscal year 2019. Additionally, the Long-Term Disability fund reserve was set to be $12,000 by fiscal year 2013 as recommended in the actuarial valuation report.

The Miscellaneous Internal Service Fund has a net assets deficit of $76 and is primarily due to unemployment expenses in excess of revenues and an increase in the annual OPEB obligation. In fiscal year 2012, the rates for the unemployment insurance reserve were adjusted upward to help mitigate this deficit. Additionally, the Risk Management Department is in the process of identifying a solution to correct future net asset deficits within the fund resulting from pension and OPEB obligations.

17. COMMITMENTS (In Thousands)

As of June 30, 2011, the City's contractual commitments are as follows:

General Fund	$	7,303
Other Governmental Funds		389,771
Sewer Utility		87,219
Water Utility		45,732
Other Enterprise Funds		1,860
Total Contractual Commitments	$	531,885

Consent Decree

In October 2007, the City settled litigation filed by the U.S. Environmental Protection Agency (EPA) and two environmental groups by agreeing to additional requirements to reduce sewer spills, which are set forth in a court approved Consent Decree (Consent Decree). The Consent Decree requires, among other things, increased maintenance and infrastructure improvements, including the replacement or rehabilitation of 250 miles of pipeline and trunk sewer, pump station and force main upgrades, and entails court supervision of these upgrades at least through June 2013. The average annual cost of this future commitment is estimated at $79,000 per year in capital projects and $40,600 per year in operational maintenance to the sewer system in fiscal years 2012 and 2013. Sewer Utility expects to fund these commitments through a combination of existing net assets, system revenues, and financing proceeds. Sewer Utility is currently in compliance with the Consent Decree requirements and expects to substantially fulfill all the terms of the Consent Decree by the end of fiscal year 2013.

Agreement Relative to Modified Permit for the Point Loma Wastewater Treatment

In December 2008, the City received a second renewal of a modified permit for the Point Loma Wastewater Treatment Plant and agreed to identify opportunities to maximize recycling wastewater for potable and non potable uses. In August 2010, the EPA issued another waiver and renewed the modified permit for 5 more years. There is no assurance that additional waivers will be approved. If the City cannot operate under a modified permit, there could be significant future obligations to fund the secondary treatment requirements. In October 2009, in conjunction with the approval of the waiver, the California Coastal Commission required the City to complete a Recycled Water Study in two years. The City expects to submit the Recycled Water Study by July 2012.

California Department of Public Health Compliance Order

In 1997, the State of California Department of Public Health (DPH) issued a compliance order requiring the City to correct operational deficiencies and begin necessary capital improvements related to the City's water system. This 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 City is meeting all of the requirements of the DPH Compliance Order, including the progress of mandated projects and the ongoing obligation to provide DPH with quarterly progress reports.

For fiscal years 2012 to 2016, the City's DPH Compliance Order project costs are estimated to be a combined total of $229,000. Water Utility expects to fund these commitments through a combination of existing net assets, system revenues, and financing proceeds. Water Utility expects to substantially fulfill all the terms of the Compliance Order by the end of fiscal year 2016.

18. CONTINGENCIES (In Thousands)

FEDERAL AND STATE GRANTS

The City recognizes as revenue grant monies received as reimbursement for costs incurred related to 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 2011 is in process.

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 received 2,088 notices of claims in fiscal year 2011.

As of June 30, 2011, the City estimates the amount of tort and non-tort liabilities to be approximately $157,600, which has been reported in the Government-wide Statement of Net Assets and the proprietary funds financial statements. The liability was actuarially determined and was supplemented by information provided by the City Attorney with respect to certain large individual claims and proceedings. The liability recorded is the City’s best estimate based on information available as of the issuance of this report. The City Attorney also estimates that in the event of an adverse ruling, certain pending lawsuits and claims have a reasonable possibility of resulting in an additional liability, in the aggregate, ranging from $0 - $231,000. However, the potential liabilities related to these claims are not individually accrued because it is not probable that a loss has been incurred as of June 30, 2011.

Significant regulatory actions are described below (Other regulatory actions are described in Note 17 Commitments).

POLLUTION REMEDIATION OBLIGATIONS

<u>California Regional Water Quality Board Administrative Proceeding</u>

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 RWQCB issued the original order in fiscal year 2005, and in December 2010, the RWQCB released the revised proposed cleanup order which, if adopted, would mandate a project with an estimated cost of $60,000 to $100,000, plus an additional $6,000 to $9,000 of costs related to site investigation, assessment and RWQCB oversight. The order includes post-remedial monitoring requirements which, depending on monitoring results and trends, may lead to further cleanup orders. The parties are addressing allocation of these costs in mediation and if necessary, in litigation which has been commenced and which is proceeding in parallel with mediation efforts. Many variables exist which make accurate estimation of the City’s share of the total costs impossible at this time. A conservative, high-range estimate of the City’s exposure is 25% of cleanup costs; however, a lesser percentage is possible. The City has tendered claims on insurance policies in regard to this order which remain pending.

Additionally, the RWQCB prepared an environmental impact report for the proposed cleanup level project which has been released for public review and comment. Multiple hearings were held by RWQCB in November 2011 and intervening environmental groups have filed testimony and objections at the hearings to the proposed cleanup levels and were seeking a more costly remedial project. This matter is currently under review by the RWQCB.

County Department of Environmental Health (DEH) Unauthorized Release Cases

The City owns/owned Underground Storage Tank (UST) Systems at various locations including, but not limited to: Airports, Fleet Operations Yards, Police Substations, and Fire-Rescue Facilities. 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 USTs. 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 established using a variety of methods and assumptions including, but not limited to: soil borings and groundwater monitoring wells to determine lateral and vertical extent of impacts; soil vapor assessment studies; corrective action planning; active soil and groundwater treatment; and attenuation monitoring. The liability for each site ranges from $0 to $1,000, and 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.

Sewage Spill at Pump Station 64

On September 8, 2011, during a regional countywide electrical power outage, all power was lost at Sewer Pump Station 64. As a result of the power outage, 2.4 million gallons of sewage was spilled into the Penasquitos Creek and ultimately the Los Penasquitos Lagoon. For six days following the event, the City posted notification on the beaches five miles north and south of the mouth of the lagoon warning of contaminated water. The City also pumped a mixture of sewage and creek water from the Penasquitos Creek, recovering approximately 931,550 gallons of sewage.

The discharge of untreated sewage is a violation of State Water Board Order No. 2006-0003-DWQ, Statewide General Waste Discharge Requirements for Sanitary Sewer Systems and San Diego Water Board Order No. R9-2007-0005, Waste Discharge Requirements for Sewage Collection Agencies in the San Diego Region. The City received an Investigative Order from the California RWQCB pertaining to the sewage spill. The City submitted a technical report to the RWQCB on October 14, 2011 and was required to submit a final monitoring report by January 13, 2012. The City expects to submit the final monitoring report by February 17, 2012 and does not anticipate the RWQCB to assess any penalties or violations due to the late submittal. These reports provided information to the RWQCB to evaluate the nature, circumstances, extent and impacts of the discharge of untreated sewage. A final decision has not been rendered.

The California Water Code provides for various enforcement options, including civil monetary remedies for violations of Order No. 2006-0003-DWQ. Water Code section 13350 provides that any person who violates any waste discharge requirement issued by a Regional Board shall be civilly liable. Water Code section 13350(e)(2) provides that civil liability may be assessed on a per gallon basis, and may not exceed $10 (whole dollars) for each gallon of waste discharged.

19. DEBT WITHOUT GOVERNMENT COMMITMENT (In Thousands)

The City has authorized the issuance of certain conduit Mortgage Revenue Bonds and Special Assessment/Special Tax Bonds. 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. These bonds do not constitute 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. Accordingly, no liability has been recorded in the City's government-wide statement of net assets.

The following describes the outstanding debt without government commitment:

Mortgage 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, 2011, the status of mortgage revenue bonds issued is as follows:

	Original Amount	Balance June 30, 2011
Mortgage Revenue	$ 15,700	$ 5,595

Special Assessment/Special Tax Bonds

The special assessment districts, including Community Facilities Districts in various parts of the City, have issued debt to finance infrastructure improvements and facilities within their respective districts. The special assessment bonds are secured by special tax liens and assessments on the real property within the special assessment district and are not direct liabilities of the City. The City has no obligation beyond the balances in the designated agency funds for any delinquent assessment district bond payments. If delinquencies occur beyond the amounts held in the reserve funds created from bond proceeds, the City has no duty to pay the delinquency out of any available funds of the City. The City acts as the agent in the collection and remittance of the special taxes and assessments for these Districts and initiates foreclosure proceedings as required under the bond covenants.

As of June 30, 2011, the status of each of the special assessment bonds issued is as follows:

	Original Amount	Balance June 30, 2011
Assessment District No.4030 (Otay Mesa Industrial Park), Issued May 1992	$ 2,235	$ 135
Communities Facilities District No.1 (Miramar Ranch North), Series 1998	59,465	34,495
Reassessment District No. 1999-1, Issued February 1999	38,145	12,171
Communities Facilities District No.2 (Santaluz), Improvement Area No. 1, Series 2000 A	56,020	48,515
Communities Facilities District No.2 (Santaluz), Improvement Area No. 3, Series 2000 B	4,350	3,805
Reassessment District No. 2003-1, Issued August 2003	8,850	5,060
Assessment District No. 4096 (Piper Ranch), Issued December 2003	5,430	4,135
Communities Facilities District No.2 (Santaluz), Improvement Area No. 1, Series 2004 A	5,000	4,100
Communities Facilities District No.2 (Santaluz), Improvement Area No. 4, Series 2004 A	9,965	8,070
Communities Facilities District No.3 (Liberty Station), Series 2006 A	16,000	15,120
Communities Facilities District No.3 (Liberty Station), Series 2008 A	3,950	3,745
Communities Facilities District No.4 (Black Mountain Ranch Villages), Series 2008 A	12,365	11,940
Total Special Assessment / Special Tax Bonds:	$ 221,775	$ 151,291

Refunding Revenue Bonds

The Public Facilities Financing Authority of the City of San Diego issued Refunding Revenue Bonds in February 1999 for the purpose of acquiring the Limited Obligation Refunding Bonds issued by the City of San Diego Reassessment District No.1999-1 and sold to the Authority for the purpose of refunding certain outstanding prior assessment district bonds of the City. The Bonds are special obligations of the Authority payable solely from and secured by amounts received from the acquired Limited Obligations, investment income with respect to any monies held by the Trustee in the funds and accounts established under the indenture and any amounts, including proceeds of the sale of the Bonds, held in any fund or account established pursuant to the Indenture.

As of June 30, 2011, the status of each of the refunding revenue bonds issued is as follows:

	Original Amount	Balance June 30, 2011
Reassessment District No. 1999-1, Series 1999 A Senior Lien Bonds	$ 30,515	$ 8,270
Reassessment District No. 1999-1, Series 1999 B Subordinate Lien Bonds	7,630	2,045
Total Refunding Revenue Bonds	$ 38,145	$ 10,315

20. CLOSURE AND POST-CLOSURE CARE COST (In Thousands)

State and federal laws and regulations require that the City 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 $20,845 reported as landfill closure and post-closure care liability as of June 30, 2011 represents the cumulative amount reported to date based on the use of 80% of the estimated capacity of the landfill.

The City will recognize the remaining estimated cost of closure and post-closure care of $5,165 as the remaining estimated capacity is filled. These amounts are based on what it would cost to perform all closure and post-closure care as of June 30, 2011. The City expects to close the landfill in fiscal year 2022. 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 as of June 30, 2011, cash or equity in pooled cash and investments of $43,611 was held for this purpose. This amount 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 imposed (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.

The City is required by state and federal laws and regulations to demonstrate financial resources sufficient to conduct corrective action for all known or reasonably foreseeable releases from the Miramar Landfill site to meet the current corrective action cost estimate approved by the San Diego Regional Water Quality Control Board. The City is in compliance with these requirements and as of June 30, 2011, cash or equity in pooled cash and investments of $1,538 was held for this purpose. This amount 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 imposed (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 $4,193 related to ARJIS for the year ended June 30, 2011.

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 Padres have a 30% divided interest and the City owns 70%, which is shown as a capital asset in the City's statement of net assets. The occupancy agreement expires on December 14, 2033 and includes the right to exercise two 5-year extensions. Upon expiration, 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. In fiscal year 2011, the City paid approximately $4,158 related to the operation and maintenance of the Facility.

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. FUND BALANCES (In Thousands)

The following table provides additional detail regarding the City's governmental fund balances:

	General Fund	Other Governmental Funds	Total Governmental Funds
NONSPENDABLE			
Not in Spendable Form	$ -	$ 5,423	$ 5,423
Legally/Contractually Required to be Maintained Intact	-	15,670	15,670
Total Nonspendable	-	21,093	21,093
RESTRICTED			
Redevelopment	85,019	799,875	884,894
Facilities Benefit Assessments	-	135,972	135,972
Public Facilities Financing Authority	-	106,876	106,876
Impact Fees	-	57,880	57,880
Other Construction	-	55,356	55,356
Emergency Reserve	55,000	-	55,000
Underground Surcharge	-	40,032	40,032
Acquisition, Improvement and Operations	-	36,089	36,089
Capital Outlay	-	21,103	21,103
Grants	-	14,607	14,607
Traffic Congestion Relief (Prop 42)	-	14,580	14,580
Tobbacco Settlement Revenue Funding Corporation	-	12,832	12,832
Special Gas Tax Street Improvement	-	11,993	11,993
TransNet	-	7,176	7,176
Fiesta Island Sludge	-	7,168	7,168
Naval Training Center Public Arts Center	-	5,156	5,156
Special Assessment/Special Tax Bonds	-	4,425	4,425
Environmental Growth	-	3,718	3,718
Interest Earned - Endowments	-	3,317	3,317
Public Safety Communications Project	-	2,750	2,750
Zoological Exhibits	-	183	183
Qualified Energy Conservation Bonds	-	31	31
City of San Diego MTDB Authority	-	20	20
Other	5,861	37,045	42,906
Total Restricted	145,880	1,378,184	1,524,064

	General Fund	Other Governmental Funds	Total Governmental Funds
COMMITTED			
Other Construction	$ -	$ 13,743	$ 13,743
Sea World Traffic Mitigation	-	11,844	11,844
Medical Services	-	11,615	11,615
Transient Occupancy Tax	-	11,538	11,538
Park & Recreation Districts	-	6,469	6,469
Regional Parks	-	5,718	5,718
Qualcomm Stadium Operations	-	4,738	4,738
Centre City Development Corporation	-	1,345	1,345
Information Technology	902	-	902
Public Transportation	-	668	668
Acquisition, Improvement and Operations	-	522	522
Street Division Operations	-	350	350
Southeastern Economic Development Corporation	-	227	227
San Diego Industrial Development Authority	-	66	66
Other	281	23,940	24,221
Total Committed	1,183	92,783	93,966
ASSIGNED			
Parking Meter Districts	18,347	-	18,347
Police Decentralization	5,709	-	5,709
De Anza Operating/Settlement	4,881	-	4,881
Library Improvement	3,263	-	3,263
Wireless Communication Technology	2,366	-	2,366
Other	3,587	-	3,587
Total Assigned	38,153	-	38,153
UNASSIGNED	60,532	(29,569)	30,963
GRAND TOTAL	$ 245,748	$ 1,462,491	$ 1,708,239

The amounts reported in the Restricted, Committed and Assigned categories as “Other” are composed of a variety of small restrictions/commitments/assignments, none of which are significant enough to be identified separately in this schedule.

23. SUBSEQUENT EVENTS (In Thousands)

On July 1, 2011, the City issued the fiscal year 2012 Tax and Revenue Anticipation Notes as a private placement in the amount of $161,000 to meet the annual General Fund cash flow needs of the City. The final maturity date of the fiscal year 2012 Tax Revenue Anticipation Notes is May 31, 2012.

Long-Term Liabilities

On September 29, 2011 and October 11, 2011, the City received $11,656 and $8,344, respectively from the State Department of Public Health, State Revolving Fund Loan, totaling $20,000 of additional financing for the Miramar Water Treatment Plant Upgrade and Expansion project. The upgrade and expansion will enable the City to meet safe drinking water standards. The loan repayment period is 20 years with an annual interest rate of 2.3035%. Any future debt issued may not be senior to this loan obligation and may only be issued at parity. Net System Revenues of the Water Utility Fund have been designated as the dedicated source of funds for repayment of the loan.

On December 20, 2011, the City issued $51,680 of Community Facilities District No. 2 (Santaluz) Improvement Area No.1 Special Tax Refunding Bonds Series A of 2011 to refund all of the outstanding Santaluz Improvement Area No.1 Series 2000 A and 2004 A Special Tax Bonds to achieve annual debt service savings. The 2011 A bonds were issued pursuant to the Mello-Roos Community Facilities Act of 1982 and are special obligations of the District and are payable solely from revenues derived from certain annual Special Taxes within Improvement Area No.1 of the District and certain other funds pledged under the Bond Indenture. Accordingly, no liability will be recorded in the City's government-wide statement of net assets. The serial bonds were issued at fixed rates that range from 2.0%to 5.25% and the final maturity date is September 1, 2030.

On January 5, 2012, the City received an initial $3,114 out of a total of $18,000 of State Revolving Fund Loan applications from the State of California Department of Public Health. The purpose of the loan is to assist in financing the Otay Water Treatment Plant Project, Phase I which will enable the City to meet safe drinking water standards. The payback period for the loan is 20 years with an annual interest rate of 2.5017%. Any future debt issued may not be senior to this loan and may only be issued at parity. Net System Revenue of the Water Utility Fund has been designated as the dedicated source of funds for repayment of the loan.

San Diego Medical Services Enterprise, LLC

On July 1, 2011, a new Emergency Medical Services Agreement between the City and Rural/Metro of San Diego, Inc. (2011 EMS Agreement) became effective. Under the 2011 EMS Agreement, Rural/Metro of San Diego, Inc. provides emergency medical transportation services to the City for an interim two-year period through June 2013. The City intends to solicit proposals from multiple providers prior to the expiration of the 2011 EMS Agreement.

Also on July 1, 2011, and as a condition to the execution of the 2011 EMS Agreement, the City executed a Unit Purchase Agreement with Rural/Metro of San Diego, Inc. and Rural/Metro of Southern California, Inc. whereby the City sold its 50% membership interest in SDMSE for $5.5 million, plus the undistributed profits of SDMSE as of June 30, 2011. The City no longer has any partnership interest or other interest in the revenue or assets of SDMSE.

As of April 15, 2011, the City, Rural/Metro Corporation, Rural/Metro of San Diego, SDMSE and a qui tam claimant have entered into two interim settlement agreements (Settlement Agreements) setting forth certain requirements in connection with SDMSE, including that: i) the City and Rural/Metro would forebear from suing each other; ii) all statutes of limitations would be tolled; iii) Rural/Metro would pay all costs for a full forensic accounting of SDMSE, which remains ongoing, and iv) Rural/Metro would post a surety bond. The results of the forensic accounting are yet to be determined.

Recent Changes in Legislation Affecting California Redevelopment Agencies

On June 28, 2011, the Governor signed Assembly Bill X1 26 (AB 26) and Assembly Bill X1 27 (AB 27) as part of the State's budget package. AB 26 requires each California redevelopment agency to suspend nearly all activities, except to implement existing contracts, meet already-incurred obligations, preserve its assets and prepare for the dissolution of the agency. AB 27 provides a means for redevelopment agencies to continue to exist and operate by means of a Voluntary Alternative Redevelopment Program.

On July 18, 2011, the League of California Cities, the California Redevelopment Association (CRA) and other entities filed a lawsuit on behalf of cities, counties and redevelopment agencies, petitioning the California Supreme Court to overturn both AB 26 and AB 27 on the grounds that the bills violate the California Constitution.

On December 29, 2011, the Court largely upheld AB 26 as a proper exercise of the legislative power vested in the Legislature by the State Constitution, invalidated AB 27 in its entirety, concluded that AB 26 may be enforced independently from AB 27, and revised certain deadlines for the implementation of AB 26. Accordingly, RDA is required to dissolve on February 1, 2012, unless subsequent legislation or court order delays or nullifies this deadline. Guidelines for dissolution are set forth in AB 26, including the transfer of all assets and responsibilities for closing out the activities of RDA to a "Successor Agency." On January 10, 2012, the City Council elected to have the City become the Successor Agency for RDA, and the Mayor subsequently approved the City Council's resolution.

AB 26 may impact various existing agreements between RDA and the City. AB 26 directs the State Controller to review the propriety of any transfers of assets between redevelopment agencies and other public bodies that occurred after January 1, 2011. If the public body that received such transfers is not contractually committed to a third party for the expenditure or encumbrance of those assets, and if no federal or state law will be violated, the State Controller is required to order the available assets to be transferred to the Successor Agency. Under AB 26, the State Controller could require RDA's monetary and real estate assets transferred to the City in the current fiscal year to be transferred back to the Successor Agency to be applied in discharging the obligations of RDA. If those prior transfers are unwound, then the City as Successor Agency may be compelled to transfer the cash funds to the County Auditor, and to liquidate the real estate assets and transfer any liquidation proceeds to the County Auditor, for pro rata distribution to local taxing entities (including, but not limited to, the City). A newly-formed Oversight Board or a State entity, such as the Department of Finance, may also seek to unwind certain agreements between the Agency and the City. These include various loans and debt presently owed by RDA to the City which could become uncollectible by the City. The Oversight Board or a State entity may also seek to invalidate certain cooperation agreements between the City and RDA that provide for the reimbursement by RDA of City debt service payments related to the Convention Center Phase II Expansion bonds and the Ballpark bonds. The Oversight Board or a State entity could also seek to invalidate the cooperation agreement between RDA and the City whereby the City would undertake future projects on behalf of RDA and funded with RDA moneys.

Retirement Benefits

The City has implemented multiple agreements with various labor unions which have impacted retirement benefits for new employees. The following is a summary of the most significant changes:

- Reduction in retirement calculation factors for various safety members to 3% at age 55 with a proportionally reduced retirement factor of 2.5% at age 50. Additionally, final compensation will be calculated using the highest average salary earned over three one year periods.
- Elimination of the SPSP benefit for lifeguard members hired after January 1, 2011.
- Elimination of Employer Retirement Offset Contribution for various general, safety and legislative members.

These changes will be implemented through fiscal year 2012 and will result in a lower ARC than would otherwise apply if such changes were not implemented.

Other Postemployment Benefits

On June 27, 2011, the City reached a tentative agreement with all bargaining units regarding reforms to the retiree healthcare benefit for employees hired before July 1, 2005. Members approved the reforms during an election in September 2011 and the SDCERS Board ratified the election results on September 30, 2011. Signed MOUs were approved by City Council on January 24, 2012. The agreement provides multiple options with varying degrees of contributions and final benefit payments and the changes will be implemented on April 1, 2012. Additionally, the agreement is subject to the creation of a 15-year single subject Memorandum of Understanding (MOU) with each labor organization and cannot be changed until fiscal year 2015 at the earliest. The City is required to conduct an actuarial analysis of the impacts of these changes following fiscal year 2014 and present it to the City Council. The City Council may only change the benefits after engaging in good faith negotiations and with a two-thirds (6 out of 9 Council Members) vote. During this 15-year period, the City's contribution is capped at $57,782 for fiscal years 2012 through 2015, and will not increase by more than 2.5% per year after fiscal year 2015.

Required Supplementary Information (Unaudited)
June 30, 2011

PENSION TRUST FUND

Schedule of Funding Progress

The following table shows the funding progress of the City's pension trust fund 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)
6/30/2009	$ 4,175,229	$ 6,281,636	$ 2,106,407	66.47%	$ 536,591	392.55%
6/30/2010	4,382,047	6,527,224	2,145,177	67.13%	530,238	404.57%
6/30/2011	4,739,399	6,917,417	2,178,018	68.51%	514,265	423.52%

Source: Cheiron, Inc.

OPEB TRUST FUND

Schedule of Funding Progress

The following table shows the funding progress of the City's OPEB trust fund 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)
6/30/2009	$ 41,497	$ 1,359,377	$ 1,317,880	3.05%	$ 549,012	240.05%
6/30/2010	72,720	1,200,910	1,128,190	6.06%	472,561	238.74%
6/30/2011	116,608	1,248,151	1,131,543	9.34%	455,537	248.40%

Schedule of Contributions from Employer and Other Contributing Entities

The following table shows contributions to the City's OPEB trust fund for the last three fiscal years (in thousands):

Fiscal Year	Annual Required Contribution	Actual Contribution	Percentage Contributed
6/30/2009	$ 104,475	$ 49,498	47.38%
6/30/2010	113,426	56,689	49.98%
6/30/2011	120,324	58,868	48.92%

Source: Buck Consultants

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City of San Diego
Pledged-Revenue Coverage - Water Bonds (Unaudited)
Last Ten Fiscal Years (In Thousands)

Fiscal Year Ended June 30	Total System Revenues	Total Maintenance and Operation Costs (Excludes Depreciation)	Net System Revenues [1]	Less: Interest Earnings on Reserve Funds - Senior Obligations	Adjusted Net System Revenues [2]
2002	$ 261,333	$ 222,104	$ 39,229	$ (3,444)	$ 35,785
2003	256,968	226,058	30,910	(1,305)	29,605
2004	267,649	232,193	35,456	(1,296)	34,160
2005	294,904	234,392	60,512	(1,262)	59,250
2006	303,453	242,180	61,273	(1,228)	60,045
2007	336,599	255,486	81,113	(1,346)	79,767
2008	350,770	258,813	91,957	(1,481)	90,476
2009	364,413	263,280	101,133	(2,668)	98,465
2010	394,948	287,361	107,587	(3,767) [4]	103,820
2011	397,755	285,059	112,696	(1,436)	111,260

Footnotes:

[1] Net System Revenues is defined as "System Revenues" less "Maintenance and Operation Costs" of the Water System for the fiscal year.

[2] Adjusted Net System Revenues is the "Net System Revenues" less "an amount equal to earnings from investments in any Reserve Fund or Reserve Account" for the fiscal year.

[3] All Obligations include Senior, Subordinate and State Revolving Fund (SRF) Loans.

[4] Interest Earnings on Reserve Funds for FY 2010 were updated for correct amounts.

Source: Comprehensive Annual Financial Reports

Table 13

Senior Debt Service						All Obligations [3]	
Principal	Interest	Total	Less: Senior Interest Earnings	Adjusted Debt Service	Adjusted Debt Service Coverage	Total Debt Service	Aggregate Debt Service Coverage
$ 6,780	$ 18,594	$ 25,374	$ (3,444)	$ 21,930	1.63	$ 25,510	1.54
7,055	16,308	23,363	(1,305)	22,058	1.34	27,002	1.14
7,345	14,010	21,355	(1,296)	20,059	1.70	34,861	1.02
7,645	13,710	21,355	(1,262)	20,093	2.95	34,861	1.74
7,965	13,390	21,355	(1,228)	20,127	2.98	35,549	1.72
8,305	13,046	21,351	(1,346)	20,005	3.99	40,759	1.99
8,675	12,679	21,354	(1,481)	19,873	4.55	43,082	2.13
9,065	12,289	21,354	(2,668)	18,686	5.27	49,600	2.04
1,035	27,268	28,303	(3,767) [4]	24,536	4.23	56,978	1.89
6,355	27,760	34,115	(1,436)	32,679	3.40	62,784	1.79

APPENDIX B

SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

This Appendix B contains only a brief summary of certain of the terms of the Installment Purchase Agreement, the Indenture, and the Assignment Agreement relating to the Series 2012A Bonds and a full review should be made of the entire Official Statement, including the cover page and the Appendices. References to, and summaries of, provisions of the documents referred to herein do not purport to be complete and such references are qualified in their entirety by reference to the complete provisions. All statements contained in this Appendix B are qualified in their entirety by reference to the entire Official Statement and the complete provisions of the documents referenced.

DEFINITIONS

Additional Bonds

The term "Additional Bonds" means, collectively, Additional Senior Bonds and Additional Subordinate Bonds.

Additional Senior Bonds

The term "Additional Senior Bonds" means those Bonds authorized and issued under the Indenture on a parity with the 2009A Bonds, the 2009B Bonds and the 2010A Bonds, in accordance with the Indenture as summarized herein under the caption "INDENTURE – Additional Bonds – Proceedings for Execution and Delivery of Additional Bonds."

Additional Subordinated Bonds

The term "Additional Subordinated Bonds" means those Bonds authorized and issued under the Indenture on a parity with the 2012A Bonds, in accordance with the Indenture as summarized herein under the caption "INDENTURE – Additional Bonds – Proceedings for Execution and Delivery of Additional Bonds."

Acquisition Fund

The term "Acquisition Fund" means the fund by that name established under the Indenture.

Beneficial Owners

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.

Board

The term "Board" means the Board of Commissions of the Authority.

Bond or Bonds

The term "Bond" or "Bonds" means any of the bonds issued under the Indenture by the Authority, including any Additional Bonds.

Bond Counsel

The term "Bond Counsel" means a firm of attorneys that are nationally recognized as experts in the laws governing and relating to municipal finance.

Book-Entry Bonds

The term "Book-Entry Bonds" means Bonds executed and delivered under the book-entry system described in the Indenture.

Business Day

The term "Business Day" means a day of the year other than a Saturday or Sunday or a day on which banking institutions located in California are required or authorized to remain closed, or on 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, shall not be 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 shall accrue for the period from and after such nominal date.

Certificate of the City

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.

Charter

The term "Charter" means the Charter of the City as it now exists or may be amended, and any new or successor Charter. Closing Date

The term "Closing Date" means any date upon which a Series of Bonds is purchased.

Code

The term "Code" means the Internal Revenue Code of 18, as amended and the regulations thereunder, and any successor laws or regulations.

Common Subordinated Bonds Reserve Fund

The term "Common Subordinated Bonds Reserve Fund" means the fund by that name established under the Indenture.

Common Subordinated Reserve Fund Bonds

The term "Common Subordinated Reserve Fund Bonds" means Subordinated Bonds secured by the Common Subordinated Bonds Reserve Fund.

Common Subordinated Reserve Fund Bonds Maximum Annual Debt Service

The term "Common Subordinated Reserve Fund Bond Maximum Annual Debt Service" means, the maximum amount of principal and interest becoming due on the Common Subordinated Reserve Fund

Bonds in the then-current or any future Fiscal Year, calculated by the Authority or by an Independent Certified Public Accountant in accordance with this subsection and provided to the Trustee. For purposes of calculating Common Subordinated Reserve Fund Bonds 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 Fiscal 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 Common Subordinated Reserve Fund Bonds 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 Common Subordinated Reserve Fund Bonds, and including any scheduled mandatory redemption or prepayment of Common Subordinated Reserve Fund Bonds on the basis of accreted value due upon such redemption or prepayment, and for such purposes, the redemption payment or prepayment shall be deemed a principal payment; provided, however, that with respect to Common Subordinated Reserve Fund Bonds which are or have the characteristics of commercial paper and which are intended at the time of issuance to be retired from the sale of a corresponding amount of other Obligations, which other Obligations would not constitute Balloon Indebtedness, each maturity thereof shall be treated as if it were to be amortized in substantially equal installments of principal and interest over a term of 30 years, commencing in the year of such stated maturity; in determining the interest due in each Fiscal Year, interest payable at a fixed rate shall (except to the extent subsection (A)(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 Common Subordinated Reserve Fund Bonds constitute Balloon Indebtedness or if all or any portion or portions of a Series of Common Subordinated Reserve Fund Bonds or such payments then proposed to be issued would constitute Balloon Indebtedness, then, for purposes of determining Common Subordinated Reserve Fund Bonds 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 30 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 subsection (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 subsection (i) above;

(iii) if any Outstanding Series of Common Subordinated Reserve Fund Bonds constitutes Tender Indebtedness or if Common Subordinated Reserve Fund Bonds proposed to be issued would constitute Tender Indebtedness, then for purposes of determining Common Subordinated Reserve Fund Bonds Maximum Annual Debt Service, Tender Indebtedness shall be treated as if the principal amount of such Common Subordinated Reserve Fund Bonds were to be amortized in accordance with the amortization schedule set forth in the Supplemental Indenture for 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 therein, then such Tender Indebtedness shall be deemed to be amortized in substantially equal annual installments of principal and interest over a term of 30 years commencing in the year in which such Series is first subject to tender, the interest rate used for such computation shall be determined as provided in subsection (iv) or (v) below, as appropriate;

(iv) if any Outstanding Series of Common Subordinated Reserve Fund Bonds constitutes Variable Rate Indebtedness, the interest rate on such Obligations shall be assumed to be 110% of the daily average interest rate on such Common Subordinated Reserve Fund Bonds during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Common Subordinated Reserve Fund Bonds shall have been Outstanding;

(v) if Common Subordinated Reserve Fund Bonds proposed to be issued will be Variable Rate Indebtedness, then such Common Subordinated Reserve Fund Bonds shall be assumed to bear interest at 80% of the average Revenue Bond Index during the calendar quarter preceding the calendar quarter in which the calculation is made, 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; and

(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 of and/or interest on specified Common Subordinated Reserve Fund Bonds, 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.

Common Subordinated Bonds Reserve Requirement

The term "Common Subordinated Bonds Reserve Requirement" means, as of any date of computation by the Authority, an amount equal to the least of (i) ten percent (10%) of the proceeds (within the meaning of Section 148 of the Code) of the Common Subordinated Bond Reserve Fund Bonds; (ii) 125% of average annual debt service on the Outstanding Common Subordinated Reserve Fund Bonds; or (iii) Common Subordinated Reserve Fund Bonds Maximum Annual Debt Service; provided, however, that, if, upon issuance of a Series of Subordinated Bonds secured by the Common Subordinated Reserve Fund, such amount would require moneys to be credited to the Common Subordinated Reserve Fund from the proceeds of such Series of Subordinated Bonds in an amount in excess of the maximum amount permitted under the Code, the Common Subordinated Bonds Reserve Requirement shall mean an amount equal to the sum of the Common Subordinated Bonds Reserve Requirement immediately preceding issuance of such Subordinated Bonds and the maximum amount permitted under the Code to be deposited therein from the proceeds of such Subordinated Bonds, as certified by the Authority; and provided further, that, for purposes of calculating average annual debt service on the Outstanding Common Subordinated Reserve Fund Bonds, the "average annual debt service" of a Series of Subordinated Bonds secured by the Common Subordinated Reserve Fund shall not be greater than the average annual debt service of such Series on the date of issuance of such Series. Upon early redemption of any Subordinated Bonds secured by the Common Subordinated Bonds Reserve Fund, the Authority, at the request of the City, may request the Trustee to recalculate and reduce the Common Subordinated Bonds Reserve Requirement, whereupon any excess in the Common Subordinated Bonds Reserve Fund over and above the Common Subordinated Bonds Reserve Requirement shall be transferred to the Subordinated Bonds Payment Fund.

Components

The term "Components" means components of the Project for which the City makes Installment Payments or Subordinated Installment Payments pursuant to any Supplement.

Comptroller

The term "Comptroller" means the Comptroller of the City.

Corporate Trust Office of the Trustee

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.

Costs of Issuance

The term "Costs of Issuance" means all items of expense directly or indirectly payable by or reimbursable to the City, the Corporation, 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 the City, Authority, and Corporation 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.

Costs of Issuance Account

The term "Costs of Issuance Account" means the fund by that name established under the Indenture with respect to the 2012A Bonds.

Depository

The term "Depository" means the securities depository acting as Depository pursuant to the Indenture.

DTC

The term "DTC" means The Depository Trust Company, New York, New York, and its successors.

Event of Default

The term "Event of Default" shall have that meaning set forth in the Indenture or the Installment Purchase Agreement, as applicable.

Federal Securities

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.

First Supplemental Indenture

The term “First Supplemental Indenture” means the First Supplemental Indenture, dated as of June 1, 2009, by and between the Authority and the Trustee.

Fiscal Year

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.

Fitch

The term “Fitch” means Fitch Ratings and its successors and, if such company shall for any reason no longer perform the functions of a securities rating agency, “Fitch” shall be deemed to refer to any nationally recognized securities rating agency designated by the Authority and the City.

Indenture

The term “Indenture” means the Original Indenture, as supplemented and amended by the First Supplemental Indenture, the Second Supplemental Indenture and the Third Supplemental Indenture.

Information Services

The Term “Information Services” being Financial Information, Inc.’s “Daily Called Bond Service,” 30 Montgomery Street, 10^{th} Floor, Jersey City, New Jersey 07302, Attention: Editor; Moody’s “Municipal and Government,” 99 Church Street, 8^{th} 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 shall mean such other organizations providing information with respect to called bonds as the Authority may designate in writing to the Trustee.

Interest Account

The term “Interest Account” means the account by that name established under the Indenture.

Interest Payment Date

The term “Interest Payment Date” means, with respect to the 2012A Bonds, August 1, 2012, and each February 1 and August 1 thereafter until the Bonds are paid or redeemed in full.

Installment Payments

The term “Installment Payments” means Installment Payments that are Parity Obligations (as defined in the Installment Purchase 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 Bonds.

Installment Purchase Agreement

The term “Installment Purchase Agreement” means the Master Installment Purchase Agreement, dated as of August 1, 1998, as supplemented and amended by a 1998 Supplement to Master Installment Purchase Agreement, dated as of August 1, 1998, a 2002 Supplement to Master Installment Purchase Agreement, dated as of October 1, 2002, an Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009, a 2009A Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009, a 2009B Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of June 1, 2009, a 2010A Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of June 1, 2010, and the 2012A Supplement, each by and between the City and the Corporation, as such Installment Purchase Agreement may from time to time be further amended or supplemented by all Supplements executed pursuant to the provisions thereof.

Interest Portion

The term “Interest Portion” means the interest portion of 2012A Subordinated Installment Payments specified in the 2012A Supplement.

Letter of Representations

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.

Moody’s

The term “Moody’s” means Moody’s Investors Service, a corporation organized under the laws of the State of Delaware, 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 Authority and the City.

Nominee

The term “Nominee” means the nominee of the Depository, which may be the Depository, as determined from time to time pursuant to the Indenture.

Original Indenture

The term “Original Indenture” means the Indenture, dated as of January 1, 2009, by and between the Authority and the Trustee.

Outstanding

The term “Outstanding,” means, 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 shall have been executed by the Authority and authenticated and delivered pursuant to the terms of the Indenture.

Owner

The term "Owner" means any person who shall 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.

Parity Installment Payments

The term "Parity Installment Payments" means Installment Payments that are Parity Obligations 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 such Parity Obligations.

Participants

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.

Payment Fund

The term "Payment Fund" means the fund by that name established under the Indenture.

Permitted Investments

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 "A2/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 shall 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 any one or more of the securities and obligations described in clause (1) of this definition, which shall have a market value (valued at least weekly) not less than 102% of the principal amount of such investment and shall 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 shall 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 shall 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;

9. Any guaranteed investment contracts, 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;

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.

Person

The term "Person" mean any legal entity or natural person, as the context may require.

Pre-Refunded Municipals

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.

Principal Account

The term "Principal Account" means the account of that name established under the Indenture.

Principal Payment Date

The term "Principal Payment Date" means, (i) with respect to the 2009A Bonds, each August 1, commencing August 1, 2009, through and including August 1, 2038, (ii) with respect to the 2009B Bonds, each August 1, commencing August 1, 2010, through and including August 1, 2039, (iii) with respect to the 2010A Bonds, each August 1, commencing August 1, 2022, through and including August 1, 2028, and (iv) with respect to the 2012A Bonds, each August 1, commencing August 1, 2012, through and including August 1, 2032.

Principal Portion

The term "Principal Portion" means the principal portion of 2012A Subordinated Installment Payments specified in the 2012A Supplement.

Project

The term "Project" means the acquisition, construction, installation, and improvements to the Water System described in Exhibit A to the Installment Purchase Agreement and as modified with respect to Components in conformance with the Installment Purchase Agreement.

Project Costs

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.

Purchase Price

The term "Purchase Price" means the principal amount plus interest thereon owed by the City under the terms of the Installment Purchase Agreement as provided in the Indenture thereof and as specified in a Supplement.

Rating Agency

The term "Rating Agency" means Fitch, Moody's, or S&P.

Rebate Fund

The term "Rebate Fund" means the fund by that name created under the Indenture and any other accounts thereunder.

Record Date

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.

Redemption Account

The term "Redemption Account" means the account by that name established under the Indenture.

Refunded Components

The term "Refunded Components" means, with respect to the 2012A Bonds, the Components originally financed with the Refunded 2002 Bonds that are being refunded with the proceeds of the sale of the 2012A Bonds. The components of the 2002 Components constituting the Refunded Components shall, upon such refunding, constitute Components under the Installment Purchase Agreement.

Refunded 2002 Bonds

The term "Refunded 2002 Bonds" means the portions of those maturities of the 2002 Bonds being prepaid with a portion of the proceeds of the 2012A Bonds.

Requisition

The term "Requisition" means a requisition form, by which the City shall withdraw moneys from the Acquisition Fund or the Costs of Issuance Account.

Reserve Fund

The term "Reserve Fund" means the fund by that name established under the Indenture, in which the Reserve Requirement shall be held and invested.

Reserve Requirement

The term "Reserve Requirement" means, as of any date of calculation, the least of (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 shall be transferred to the Payment Fund.

Revenues

The term "Revenues" means all Installment Payments received by or due to be paid to the Corporation, and the interest, and the interest or profits from the investment of money in any account or fund (other than the Subordinated Bonds Payment Fund, the Subordinated Bonds Reserve Fund and the Rebate Fund) pursuant to the Indenture.

S&P

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 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 Authority and the City.

Second Supplement

The term "Second Supplement" means the Second Supplemental Indenture, dated as of June 1, 2010, by and the Authority and the Trustee.

Securities Depository

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.

Senior Bonds

The term "Senior Bonds" means the 2009A Bonds, the 2009B Bonds, the 2010A Bonds and any other Bonds secured by pledge of Revenues on a parity with such Bonds.

Separate Subordinated Bonds Reserve Fund

The term "Separate Subordinated Bonds Reserve Fund" means a reserve fund, if any, created pursuant to a Supplemental Indenture for a Series of Subordinated Bonds that is not part of the Common Subordinated Bonds Reserve Fund.

Separate Subordinated Bonds Reserve Requirement

The term "Separate Subordinated Bonds Reserve Requirement" means the requirement set forth in the Supplemental Indenture establishing a Separate Subordinated Bonds Reserve Fund.

State

The term "State" means the State of California.

Subordinated Bonds

The term "Subordinated Bonds" means the 2012A Bonds and any other Bonds secured by a pledge of Subordinated Revenues on a parity with such Bonds.

Subordinated Bonds Interest Account

The term "Subordinated Bonds Interest Account" means the account by that name established under the Indenture.

Subordinated Bonds Payment Fund

The term "Subordinated Bonds Payment Fund" means the fund by that name established under the Indenture.

Subordinated Bonds Principal Account

The term "Subordinated Bonds Principal Account" means the account by that name established under the Indenture.

Subordinated Bonds Redemption Account

The term "Subordinated Bonds Redemption Account" means the account by that name established under the Indenture.

Subordinated Bonds Reserve Fund

The term "Subordinated Bonds Reserve Fund" means the fund by that name established under the Indenture.

Subordinated Installment Payments

The term "Subordinate Installment Payments" means Installment Payments that are Subordinated Obligations (as defined in the Installment Purchase 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.

Subordinated Revenues

The term "Subordinated Revenues" means all Subordinated Installment Payments received by or due to the Corporation pursuant to the Installment Purchase Agreement and the interest or profits from the investment of money in the Subordinated Bonds Payment Fund and the Subordinated Bonds Reserve Fund.

Supplement

The term "Supplement" means a supplement 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 Corporation.

Supplemental Indenture

The term "Supplemental Indenture" means any indenture supplemental to or amendatory of the Indenture duly executed and delivered by the Authority and the Trustee as authorized under the Indenture.

Surety Bond

The term "Surety Bond" means a reserve bond, insurance policy, letter of credit, or other similar instrument rated "Aa3" or "AA-" or better by at least two Rating Agencies at the time of purchase or issuance and providing, by its terms, a stated amount as a credit towards or in satisfaction of all or part of the Reserve Requirement, which Surety Bond shall be held by the Trustee in trust pursuant to the Indenture. A Surety Bond shall constitute and qualify as a "Reserve Fund Credit Facility," as such term is defined in the Installment Purchase Agreement.

Tax Certificate

The term "Tax Certificate" means the Tax Exemption Certificate delivered with respect to Tax-Exempt Bonds on their Closing Date.

Tax-Exempt Bonds

The term "Tax-Exempt Bonds" means those Bonds that, by their terms, bear interest that is excluded from gross income for federal income tax purposes, pursuant to the Code.

Third Supplemental Indenture

The term "Third Supplemental Indenture" means the Third Supplemental Indenture, dated as of March 1, 2012, by and between the Authority and the Trustee.

Treasurer

The term "Treasurer" means the Office of the City Treasurer of the City of San Diego.

Trustee

The term "Trustee" means Wells Fargo Bank, National Association, a national banking association existing under and by virtue of the laws of the United States, or any other bank or trust company that may at any time be substituted in its place as provided in the Indenture.

Underwriters

The term "Underwriters" means, with respect to the 2012A Bonds, collectively, Morgan Stanley & Co. LLC, E. J. De La Rosa & Co., Inc., RBC Capital Markets, LLC and Stifel Nicolaus & Company Incorporated, DBA Stone & Youngberg, a Division of Stifel Nicolaus.

Water System

The term "Water System" means any and all facilities, properties, improvements, and works at any time owned, controlled, or operated by the City as part of the public utility system of the City for water purposes, for the development, obtaining, conservation, production, storage, treatment, transmission, furnishing, and distribution of water and its other commodities or byproducts for public and private use (whether located within or outside the City), and any related or incidental operations designated by the City as part of the Water System, including reclaimed and re-purified water.

Written Request of the Authority

The term "Written Request of the Authority" means 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.

Written Request of the City

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.

2002 Bonds

The term "2002 Bonds" means the Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Series 2002 (Payable Solely From Subordinated Installment Payments Secured by the Net System Revenues of the Water Utility Fund of the City of San Diego).

2002 Components

The term "2002 Components" shall have the meaning given such term in the 2002 Supplement.

2002 Indenture

The term "2002 Indenture" means, that certain Indenture, dated as of October 1, 2002, by and between the Authority and the 2002 Trustee, pursuant to which the 2002 Bonds were issued.

2002 Subordinated Installment Payments

The term "2002 Subordinated Installment Payments" shall have the meaning given such term in the 2002 Supplement.

2002 Supplement

The term "2002 Supplement" means the 2002 Supplement, dated as of October 1, 2002, between the City and the Corporation.

2002 Trustee

The term "2002 Trustee" means Wells Fargo Bank, National Association, as trustee under the 2002 Indenture.

2009A Bonds

The term "2009A Bonds" means the Public Facilities Financing Authority of the City of Diego Water Revenue Bonds, Series 2009A (Payable Solely From Installment Payments Secured by Net System Revenues of the Water Utility Fund) issued in the aggregate principal amount of $157,190,000.

2009B Bonds

The term "2009B Bonds" means the Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Series 2009B (Payable Solely From Installment Payments Secured by Net System Revenues of the Water Utility Fund) issued in the aggregate principal amount of $328,060,000.

2010A Bonds

The term "2010A Bonds" means the Public Facilities Financing Authority of the City of San Diego Water Revenue Bonds, Refunding Series 2010A (Payable Solely from Installment Payments Secured by Net System Revenues of the Water Utility Fund), issued under the Indenture in the original aggregate principal amount of $123,075,000.

2012A Bonds

The term "2012A Bonds" means the Authority's Subordinated Water Revenue Bonds, Refunding Series 2012A (Payable Solely from Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund), issued under the Indenture in the original aggregate principal amount of $188,610,000.

2012A Closing Date

The term "2012A Closing Date" means May 3, 2012, the date of initial delivery of the 2012A Bonds.

2012A Installment Payment Date

The term "2012A Installment Payment Date" means the 15th day of the calendar month immediately preceding each Interest Payment Date for the 2012A Bonds.

2012A Subordinated Installment Payments

The term "2012A Subordinated Installment Payments" means those Installment Payments scheduled to be paid by the City under the 2012A Supplement.

2012A Supplement

The term "2012A Supplement" means the 2012A Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of March 1, 2012, by and between the City and the Corporation.

INDENTURE

The Indenture sets forth certain terms of the 2012A Bonds, the nature and extent of the security for the 2012A Bonds, the rights of the Owners of the 2012A Bonds, rights, duties and immunities of the Trustee, and the rights and obligations of the Authority. 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 2012A BONDS" and "SECURITY AND SOURCES OF PAYMENT FOR THE 2012A 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.

Establishment of Funds; Deposit and Application

Establishment of Funds and Accounts.

(a) Pursuant to the Third Supplement, the Trustee shall establish the Costs of Issuance Account for the 2012A Bonds.

(b) Pursuant to the Original Indenture, the Trustee has established the Payment Fund, including the Interest Account, the Principal Account, and the Redemption Account.

(c) Pursuant to the Original Indenture, the Trustee has established the Reserve Fund, and, within the Reserve Fund, pursuant to the Third Supplement, the Trustee shall establish the Subordinated Bonds Reserve Fund and the Common Subordinated Bonds Reserve Fund, in order to facilitate compliance by the City with the Tax Certificate and the Installment Purchase Agreement.

Use of Moneys in Costs of Issuance Account for the 2012A Bonds. The Trustee shall disburse moneys from the Costs of Issuance Account for the 2012A Bonds to pay Costs of Issuance with respect to the 2012A Bonds. Such disbursements shall be made from time to time upon receipt of Requisitions of the City on behalf of the Authority substantially in the form attached as Exhibit B to this Third Supplement. On the day that is the 181st day following the 2012A Closing Date, the Trustee shall transfer any then-remaining but uncommitted amount on deposit in the Costs of Issuance Account for the 2012A Bonds to the Subordinated Bonds Interest Account within the Subordinated Bonds Payment Fund, to be applied as a credit towards the next interest payment on the 2012A Bonds.

Subordinated Bonds Payment Fund. The Trustee shall establish and maintain a special trust fund to be designated the "City of San Diego Water System Improvement Project Subordinated Bonds Payment Fund" (the "Subordinated Bonds Payment Fund"). Within the Subordinated Bonds Payment Fund, the Trustee shall establish and maintain a Subordinated Bonds Interest Account (the "Subordinated Bonds Interest Account"), a Subordinated Bonds Principal Account (the "Subordinated Bonds Principal Account"), and a Subordinated Bonds Redemption Account (the "Subordinated Bonds Redemption Account").

Subordinated Bonds Reserve Fund.

The Trustee shall establish and maintain a special trust fund to be designated the "City of San Diego Water System Improvement Project Subordinated Bonds Reserve Fund" (the "Subordinated Bonds Reserve Fund"). Within the Subordinated Bonds Reserve Fund, the Trustee shall establish and maintain a Common Subordinated Bonds Reserve Fund (the "Common Subordinated Bonds Reserve Fund") and shall establish and maintain any Separate Subordinated Bonds Reserve Fund required by a Supplemental Indenture to be established and maintained. The Series 2012A Bonds shall be secured by the Common Subordinated Bonds Reserve Fund.

(a) The Subordinated Bonds Reserve Fund and, within the Subordinated Bonds Reserve Fund, the Common Subordinated Bonds Reserve Fund and each separate Subordinated Bonds Reserve Fund are each a separate fund held in trust by the Trustee. An amount equal to the Common Subordinated Bond Reserve Requirement shall be maintained in or credited to the Common Subordinated Bonds Reserve Fund and amounts equal to each Separate Subordinated Bonds Reserve Requirement shall be maintained in or credited to such Separate Subordinated Bonds Reserve Fund at all times, subject to the provisions of subsection (e) of this section, and any deficiency therein shall be replenished from the first available Subordinated Revenues pursuant to paragraph (e) below.

(b) Moneys in or available from the Subordinated Bonds Reserve Fund shall be used solely for the purpose of paying the principal of and interest on the Subordinated Bonds, including the redemption price of the Subordinated Bonds coming due and payable by operation of mandatory sinking fund redemption, in the event that the moneys in the Subordinated Bonds Payment Fund are insufficient therefor. If and during such time as a Surety Bond is in effect for a Series of Subordinated Bonds secured by a Separate Subordinated Reserve Fund, not less than two Business Days prior to each Interest Payment Date, the Trustee shall ascertain the necessity for a draw upon the Surety Bond and, if the draw is necessary, shall 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 Subordinated Bonds Payment Fund on any date is insufficient to enable the Trustee to pay in full the aggregate amount of principal of and interest on such Series of Subordinated Bonds secured by a Separate Subordinated Reserve Fund coming due and payable by operation of mandatory sinking fund redemption, the Trustee shall withdraw the amount of such insufficiency from the applicable Separate Subordinated Bonds Reserve Fund of make a draw upon the applicable Surety Bond in the amount of such insufficiency and transfer such amount to the Subordinated Bonds Payment Fund. Amounts on deposit in the Subordinated Bonds Reserve Fund shall not be applied to the payment of Senior Bonds.

(c) In the event that the amount on deposit in the Common Subordinated Bonds Reserve Fund or a Separate Subordinated Bonds Reserve Fund exceeds the Common Subordinated Bonds Reserve Requirement or applicable Separate Subordinated Bonds Reserve Fund Requirement on the fifteenth (15th) calendar day of the month preceding any Interest Payment Date, the amount of such excess shall be withdrawn therefrom by the Trustee and transferred to (a) the Rebate Fund, to the extent required under the Indenture, or (b) the Subordinated Bonds Payment Fund. In any case where a fund in a Separate Subordinated Bonds Reserve Fund is funded with a combination of cash and a Surety Bond, any such withdrawal of excess shall be effected through a withdrawal of cash not a reduction in the amount of the Surety Bond. The remaining balance in any fund in the Subordinated Bonds Reserve Fund may be applied at the direction of the Authority, to the payment of the final maturing principal payments of Subordinated Bonds secured by such fund.

(d) The Authority may replace all or a portion of a Separate Subordinated Bonds Reserve Fund Requirement, originally funded with cash, with one or more Surety Bonds. Upon deposit of any Surety Bond with the Trustee, the Trustee shall transfer to the Acquisition Fund from amounts in the related Separate Subordinated Bonds Reserve Fund an amount equal to the principal of the Surety Bond, which principal shall comprise the Separate Subordinated Bonds Reserve Fund, as applicable, under the Indenture, or make other transfers in accordance with a Written Direction of the City.

In any case where a fund in a Separate Subordinated Bonds Reserve Fund is funded with a combination of cash and a Surety Bond, the Trustee shall deplete all cash balances before drawing on the related Surety Bond. With regard to replenishment, any available moneys provided by the City shall be used first to reinstate the related Surety Bond and second, to replenish the cash in the related Separate Subordinated Bonds Reserve Fund in accordance with subsection (e) of this section. In the event the

Surety Bond is drawn upon, the City shall make payment of interest on amounts advanced under the Surety Bond after making any payments pursuant to the Indenture as summarized herein under the caption "INDENTURE – Revenues – Maintenance of Accounts for Use of Money in the Subordinated Bonds Payment Fund."

In the event the Surety Bond is scheduled to lapse or expire, the Trustee shall draw upon such Surety Bond prior to its lapsing or expiring in the full amount of such Surety Bond, make deposits from available Subordinated Revenues to the Separate Subordinated Bonds Reserve Fund, as applicable, to increase the amount on deposit therein to the Separate Subordinated Bonds Reserve Fund Requirement, as applicable or substitute such Surety Bond with a Surety Bond that satisfies the requirements of this section.

The Authority acknowledges that the rating on any Surety Bond obtained or provided under the Indenture may change after the date such Surety Bond is purchased or issued. Within twelve (12) months after the date that the Authority obtains actual knowledge that any Surety Bond is no longer rated at least "Aa3" or "AA-" by any Rating Agency, the Authority shall either (i) deposit into the related Separate Subordinated Bonds Reserve Fund, as applicable, money in an amount equal to the stated or principal amount of such Surety Bond or (ii) obtain a substitute Surety Bond that satisfies the provisions of the Indenture.

(e) In the event that the amount on deposit in the Common Subordinated Bonds Reserve Fund or Separate Subordinated Bonds Reserve Fund at any time falls below the Common Subordinated Bonds Reserve Requirement or Separate Subordinated Bonds Reserve Fund Requirement, as applicable, or in the event of a draw on the Surety Bond deposited therein, the Trustee shall promptly notify the City and the Authority of such fact and the Trustee shall promptly (A)(i) withdraw the amount of such insufficiency from available Subordinated Revenues on deposit in the Subordinated Bonds Payment Fund, and (ii) transfer such amount to the Common Subordinated Bonds Reserve Fund or applicable Separate Subordinated Bonds Reserve Fund or (B) withdraw an amount necessary to repay such drawing on the Surety Bond and related expenses. Repayment of draws, expenses and accrued interest (collectively, "Policy Costs") shall commence in the first month following each draw, and each such monthly payment shall be in an amount at least equal to 1/12 of the aggregate of Policy Costs related to such draw.

(f) Notwithstanding any other provision in the Indenture, amounts in deposit in the Common Subordinated Bonds Reserve Fund shall secure and shall be used solely for the purpose of paying the principal of and interest on Common Subordinated Reserve Fund Bonds and amounts on deposit in a Separate Subordinated Bonds Reserve Fund shall secure and shall be used solely for the purpose of paying the principal of and interest on Subordinated Bonds specified in the Supplemental Indenture as secured by such Separate Subordinated Bonds Reserve Fund.

Parity (Senior) Bonds Reserve Fund.

(a) The Reserve Fund is a separate fund held in trust by the Trustee. An amount equal to the Reserve Requirement shall be maintained in or credited to the Reserve Fund at all times, subject to the provisions of the Indenture, and any deficiency therein shall be replenished from the first available Revenues pursuant to the Indenture.

(b) Moneys in or available from the Reserve Fund shall be used solely for the purpose of paying the principal of and interest on the Senior Bonds, including the redemption price of the Senior 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 shall ascertain the necessity for a draw upon the Surety Bond and, if a draw is necessary, shall 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 Senior 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 shall 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. Amounts on deposit in the Reserve Fund shall not be applied to the payment of Subordinated Bonds.

(c) 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 shall be withdrawn therefrom by the Trustee and transferred to (a) the Rebate Fund, to the extent required under the Indenture, or (b) the Payment Fund.

(d) The Authority may replace all or a portion of the Reserve Requirement, if originally funded with cash, with one or more Surety Bonds. Upon deposit of any Surety Bond with the Trustee, the Trustee shall transfer to the Acquisition Fund from amounts in the Reserve Fund an amount equal to the principal of the Surety Bond, which principal shall comprise the Reserve Requirement under the Indenture, or make other transfers in accordance with a Written Direction of the City.

In any case where the Reserve Fund is funded with a combination of cash and a Surety Bond, the Trustee shall deplete all cash balances before drawing on the Surety Bond. With regard to replenishment, any available moneys provided by the City shall be used first to reinstate the Surety Bond and second, to replenish the cash in the Reserve Fund in accordance with subsection (e) of this section in the Indenture. In the event the Surety Bond is drawn upon, the City shall make payment of interest on amounts advanced under the Surety Bond after making any payments pursuant to the Indenture.

In the event the Surety Bond is scheduled to lapse or expire, the Trustee shall draw upon such Surety Bond prior to its lapsing or expiring in the full amount of such Surety Bond, make deposits from available Revenues to the Reserve Fund to increase the amount on deposit therein to the Reserve Requirement or substitute such Surety Bond with a Surety Bond that satisfies the requirements of the Indenture.

The Authority acknowledges that the rating on any Surety Bond obtained or provided under the Indenture may change after the date such Surety Bond is purchased or issued. Within twelve (12) months after the date that the Authority obtains actual knowledge that any Surety Bond is no longer rated at least "Aa3" or "AA-" by any Rating Agency, the Authority shall either (i) deposit in the Reserve Fund money in an amount equal to the stated or principal amount of such Surety Bond or (ii) obtain a substitute Surety Bond that satisfies the provisions of the Indenture.

(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 shall promptly notify the City and the Authority of such fact and the Trustee shall promptly (A)(i) withdraw the amount of such insufficiency from available Revenues on deposit in the Payment Fund, and (ii) transfer such amount to the Reserve Fund or (B)(i) withdraw an amount necessary to repay such drawing on the Surety Bond and related expenses. Repayment of draws, expenses and accrued interest (collectively, "Policy Costs") shall commence in the first month following each draw, an each such monthly payment shall be in an amount at least equal to 1/12 of the aggregate of Policy Costs related to such draw. 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. Upon receipt of written notice from the Trustee of a shortfall in the Reserve Fund, the City shall promptly transfer to the Trustee from Net System Revenues 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.

Revenues

Pledge of Subordinated Revenues.

(a) All Subordinated Revenues and amounts on deposit in the Subordinated Bonds Payment Fund and the Subordinated Bonds Reserve Fund are, as provided in the Indenture, irrevocably pledged to the payment of the interest on and principal of the Subordinated Bonds but only as provided in the Indenture, and the Subordinated Revenues shall not be used for any other purpose while any of the Subordinated Bonds remain Outstanding; provided, that out of the Subordinated Revenues there may be allocated such sums for such purposes as are expressly permitted by the Indenture as summarized herein under the caption "INDENTURE – Revenues – Maintenance of Accounts for Use of Money in the Subordinated Bonds Payment Fund."

(b) The Trustee shall be entitled to and shall receive all of the Subordinated Installment Payments pledged to secure any Subordinated Bond, and any such Subordinated Installment Payments collected or received by the Authority shall be deemed to be such held, and to have been collected or received, by the Authority as agent of the Trustee and shall forthwith be paid by the Authority to the Trustee.

Receipt and Deposit of Revenues in the Subordinated Bonds Payment Fund. To carry out and effectuate the pledge contained in the Indenture, the Authority agrees and covenants that all Subordinated Revenues when and as received shall be received in trust under the Indenture for the benefit of the Owners and shall be deposited when and as received in the Subordinated Bonds Payment Fund. All Subordinated Revenues shall be accounted for through and held in trust in the Subordinated Bonds Payment Fund, and the Authority shall have no beneficial right or interest in any of the Subordinated Revenues except only as provided in the Indenture. All Subordinated Revenues, whether received by the Authority in trust or deposited with the Trustee as provided in the Indenture, shall nevertheless be allocated, applied and disbursed solely to the purposes and uses set forth in the Indenture, and shall 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 Subordinated Bonds Payment Fund.

(a) In accordance with the Indenture, all money in the Subordinated Bonds Payment Fund shall be deposited by the Trustee in the following respective special accounts within the Subordinated Bonds Payment Fund (each of which will be hereby created and each of which the Trustee will covenant and agree to maintain) in the following order of priority:

(i) Subordinated Bonds Interest Account,

(ii) Subordinated Bonds Principal Account, and

(iii) Subordinated Bonds Redemption Account.

All money in each of such Accounts shall be held in trust by the Trustee and shall be applied, used and withdrawn only for the purposes as summarized hereinafter in this section and under the Indenture.

(b) On or before each Interest Payment Date, the Trustee shall transfer from the Subordinated Bonds Payment Fund and deposit in the Subordinated Bonds Interest Account that amount of money that, together with any money contained in the Subordinated Bonds Interest Account, equals the aggregate amount of interest becoming due and payable on all Outstanding Subordinated Bonds on such Interest Payment Date. No deposit need be made in the Subordinated Bonds Interest Account if the amount contained in the Subordinated Bonds Interest Account equals at least the aggregate amount of interest becoming due and payable on all Outstanding Subordinated Bonds on such Interest Payment Date. All money in the Subordinated Bonds Interest Account shall be used and withdrawn by the Trustee solely for the purpose of paying the interest on the Subordinated Bonds as it shall become due and payable (including accrued interest on any Subordinated Bonds redeemed prior to maturity).

(c) On or before each Principal Payment Date, the Trustee shall transfer from the Subordinated Bonds Payment Fund and deposit in the Subordinated Bonds Principal Account that amount of money that, together with any money contained in the Subordinated Bonds Principal Account, equals the aggregate principal becoming due and payable on all Outstanding Subordinated Bonds. No deposit need be made in the Subordinated Bonds Principal Account if the amount contained therein is at least equal to the aggregate amount of principal become due and payable on Outstanding Subordinated Bonds. All money in the Subordinated Bonds Principal Account shall be used and withdrawn by the Trustee solely for the purpose of paying the principal of the Subordinated Bonds as it shall become due and payable.

(d) In addition to the above accounts, the Trustee shall establish and maintain within the Subordinated Bonds Payment Fund a special account designated the "Subordinated Bonds Redemption Account." All money in the Subordinated Bonds Redemption Account shall be held in trust by the Trustee and shall be applied, used, and withdrawn to redeem Subordinated Bonds for the purposes authorized in this subsection (d). Any moneys that, pursuant to the terms for prepayment of Installment Payments pursuant to the Installment Purchase Agreement and the related provisions of any Supplements, are to be used to redeem Subordinated Bonds shall be deposited by the Trustee in the Redemption Account. The Trustee shall, on the scheduled redemption date, withdraw from the Subordinated Bonds Redemption Account and pay the Owners entitled thereto an amount equal to the redemption price of the Subordinated Bonds to be redeemed on such date.

(e) Any delinquent Subordinated Installment Payments pledged to the Subordinated Bonds shall be applied first to the Subordinated Bonds Interest Account for the immediate payment of interest payments past due and the to the Subordinated Bonds Principal Account for immediate payment of principal payments past due on any Subordinated Bond. Any remaining money representing delinquent Subordinated Installment Payments pledged to Subordinated Bonds shall be deposited in the Subordinated Bonds Payment Fund to be applied in the manner provided therein.

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 Subordinated Bonds Payment Fund, the Subordinated Bonds Reserve Fund and the Rebate Fund created pursuant to the Indenture) are, as provided in the Indenture, irrevocably pledged to the payment of the interest on and principal of the Senior Bonds as provided in the Indenture, and the Revenues shall not be used for any other purpose while any of the

Senior 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 this subheading, the Authority transfers, conveys and assigns to the Trustee, for the benefit of the Owners, all of the Authority's rights under the 2012A Supplement and, in connection with any Additional Bonds issued under the Indenture, the Authority's rights under the Supplement(s) executed by the City and the Corporation to secure payment of principal of and interest on such Additional Bonds, including the right to receive Installment Payments from the City, the right to receive any proceeds of insurance maintained thereunder or any condemnation award rendered with respect to the Refunded 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 shall be entitled to and shall receive all of the 2012A Subordinated 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) executed by the City and the Corporation to secure payment of principal of and interest on such Additional Bonds, and any 2012A Subordinated Installment Payments and additional Installment Payments collected or received by the Authority shall be deemed to be held, and to have been collected or received, by the Authority as agent of the Trustee and shall 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 shall be received in trust under the Indenture for the benefit of the Owners and shall be deposited when and as received in the Payment Fund. All Revenues shall be accounted for through and held in trust in the Payment Fund, and the Authority shall 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, shall nevertheless be allocated, applied and disbursed solely to the purposes and uses set forth in the Indenture, and shall 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) All money in the Payment Fund shall 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 money in each of such Accounts shall be held in trust by the Trustee and shall be applied, used and withdrawn only for the purposes authorized in the Indenture.

(b) On or before each Interest Payment Date, the Trustee shall 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 Senior Bonds on such 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 Senior Bonds on such Interest Payment Date. All money in the Interest Account shall be used and withdrawn by the Trustee solely for the purpose of paying the interest on the Senior Bonds as it shall become due and payable (including accrued interest on any Senior Bonds redeemed prior to maturity).

(c) On or before each Principal Payment Date, the Trustee shall 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 Senior 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 Outstanding Senior Bonds. All money in the Principal Account shall be used and withdrawn by the Trustee solely for the purpose of paying the principal of the Senior Bonds as it shall 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 shall be held in trust by the Trustee and shall be applied, used, and withdrawn either to redeem the Senior Bonds or for the purposes authorized in this subsection (d). Any moneys that, terms for prepayment of Installment Payments pursuant to the Installment Purchase Agreement and the related provisions of any Supplements, are to be used to redeem Senior Bonds shall be deposited by the Trustee in the Redemption Account. The Trustee shall, on the scheduled redemption date, withdraw from the Redemption Account and pay the Owners entitled thereto an amount equal to the redemption price of the Senior Bonds to be redeemed on such date.

(e) Any delinquent Installment Payments pledged to the Senior Bonds shall be applied first to the Interest Account for the immediate payment of interest payments past due and the to the Principal Account for immediate payment of principal payments past due on any Senior Bond. Any remaining money representing delinquent Installment Payments pledged to Senior Bonds shall 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 shall 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 described in clause (8) of the definition thereof. The obligations in which moneys in the said funds and accounts are invested shall 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 shall be valued at the lesser of market value or the cost thereof. The Trustee shall semiannually, on or before January 15 and July 15 of each year, and at such times as the Authority shall deem appropriate, value the investments in the funds and accounts 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 under the Indenture and all investment profits or losses thereon shall be deemed at all times to be a part of said fund or account.

Additional Bonds

Execution and Delivery of Additional Bonds. In addition to the 2009A Bonds, the 2009B Bonds and the 2010A Bonds, the Trustee shall, 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 Senior Bonds previously issued and delivered (if such Bonds are to be Senior Bonds) or equally and ratably with any Subordinated Bonds (if such Bonds are to be Subordinated Bonds), in such principal amount as shall be determined by the Authority, but only upon compliance with the provisions of the Indenture, the requirements of the Installment Purchase Agreement applicable to the incurrence of Parity Obligations (if such Bonds are to be Senior Bonds) or Subordinated Obligations (if such Bonds are Subordinated Bonds) and any additional requirements set forth in the applicable Supplemental Indenture, which are, as provided in the Indenture, made conditions precedent to the execution and delivery of Additional Bonds:

(a) No Event of Default shall have occurred and be then continuing;

(b) The Supplemental Indenture providing for the execution and delivery of such Additional Bonds shall specify the purposes for which such Additional Bonds are then proposed to be delivered, which shall 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 Water System. Such Supplemental Indenture may, but shall 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 Supplemental Indenture providing for the execution and delivery of such Additional Bonds shall state whether such Additional Bonds shall be Senior Bonds or Subordinated Bonds.

(d) If such Additional Bonds are Subordinated Bonds, the Supplemental Indenture shall specify whether such Additional Bonds shall be secured by the Common Subordinated Bonds Reserve Fund, a Separate Subordinated Bonds Reserve Bonds or no reserve fund.

(e) If such Additional Bonds are Senior Bonds, the Authority shall 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;

(f) If such Additional Bonds are Common Subordinated Reserve Fund Bonds, the Authority shall deliver or cause to be delivered by the Trustee, from the proceeds of such Additional Bonds or from any other lawfully available source of moneys, an amount sufficient to increase the balance of the Common Subordinated Bonds Reserve Fund to the Common Subordinated Bonds Reserve Fund Requirement.

(g) If such Additional Bonds are Subordinated Bonds to be secured by a Separate Subordinated Bonds Reserve Fund, the Authority shall deliver or cause to be delivered by 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 such Separate Subordinated Bonds Reserve Fund to the Separate Subordinated Bonds Reserve Fund for such Series of Subordinated Bonds

(h) The Additional Bonds shall be payable as to principal on August 1 and as to interest on February 1 and August 1 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;

(i) Fixed serial maturities or mandatory sinking account payments, or any combination thereof, shall 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;

(j) The aggregate principal amount of Bonds and Additional Bonds executed and delivered under the Indenture shall not exceed any limitation imposed by law or by any Supplemental Indenture; and

(k) The Trustee shall be the Trustee for the Additional Bonds.

Nothing in the Indenture shall limit in any way the power and authority of the Authority to incur other obligations payable from other lawful sources.

Covenants of Authority

Punctual Payment and Performance. The Authority shall 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 shall faithfully observe and perform all the agreements and covenants contained therein.

Rebate Fund.

(a) The Trustee shall maintain such accounts within the Rebate Fund as it is instructed by the Authority as shall be necessary in order to comply with the applicable Tax Certificate (which is incorporated in the Indenture by reference). The Trustee shall 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 shall be governed by the Indenture and the Tax Certificate and shall 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 Corporation, Authority, the Trustee, or the Owners shall have any rights in or claims to such money. The Trustee shall make information regarding the investments under the Indenture available to the City, shall 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 shall 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 shall 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 shall 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 shall make deposits into the Rebate Fund from deposits by the City so that the balance of the amount on deposit shall be equal to the rebate requirement. The Trustee shall 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.

(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, shall pay to the United States part or all of the amounts in the Rebate Fund, as so directed. Each payment shall 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 shall 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 shall be paid to the City. Money, including investment earnings, shall not be transferred from the Rebate Fund except as provided in the Indenture.

(d) Notwithstanding any other provision the Indenture, the obligation to remit the rebate requirement to the United States and to comply with all other requirements of the Indenture and the Tax Certificate shall survive the defeasance or payment in full of the Tax-Exempt Bonds.

(e) 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.

(f) The Authority specifically covenants to comply with the provisions and procedures of the Tax Certificate.

(g) 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.

(h) Notwithstanding any provisions of the Indenture, if the Authority and the City shall provide to the Trustee an opinion of Bond Counsel to the effect that any specified action required under the Indenture 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 shall be deemed to be modified to that extent.

Accounting Records and Reports. The Authority shall keep or cause to be kept proper books of record and accounts in which complete and correct entries shall be made of all transactions relating to the receipts, disbursements, allocation and application of the Revenues and the Subordinated Revenues, and such books shall 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 shall furnish or cause to be furnished to the Trustee financial statements that include the Water Utility 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 this section, “financial statement” shall 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 shall also keep or cause to be kept such other information as is required under the Tax Certificate.

The City’s Budgets. The Authority shall 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 Installment Purchase 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 Installment Purchase Agreement in such Fiscal Year, the Authority shall 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 shall 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 shall have no liability to the Owners of the Bonds or any other person with respect to Securities and Exchange Commission Rule 15c2-12, and the City shall 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 of the Indenture, failure of the City to comply with a Continuing Disclosure Certificate shall 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, shall, 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 shall become binding when the written consents of the Owners of 51% in aggregate principal amount of the Senior Bonds then Outstanding and the written consents of the Owner of 51% in aggregate principal amount of the Subordinated Bonds then Outstanding, exclusive of Bonds disqualified as provided in the Indenture, are filed with the Trustee. No such amendment shall (i) permit the creation by the Authority of any pledge of the Revenues or Subordinated Revenues as provided in the Indenture superior to or on a parity with the pledge created under 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 shall become binding without the consent of any Owners of Bonds for any one 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 in the Indenture in regard to questions arising under the Indenture that the Authority may deem desirable or necessary and not inconsistent with the Indenture and that shall not adversely affect the interests of the Owners; or
>
> (ii) to make any other change or addition thereto that shall not materially adversely affect the interests of the Owners, or to surrender any right or power reserved in the Indenture to or conferred in the Indenture on the Authority; provided, however, that the Owners shall be given

prompt notice of any such amendment and shall 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 shall not be deemed Outstanding for the purpose of any consent or other action or any calculation of Outstanding Bonds provided in the Indenture, and shall not be entitled to consent to or take any other action provided therein.

Endorsement or Replacement of Bonds After Amendment. After the effective date of any action taken as described above, 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 shall be made on such Bond. If the Authority shall determine that a Bond shall bear such a notation by endorsement pursuant to the Indenture, a new Bond so modified shall be prepared and executed, and upon demand of the Owner of any Outstanding Bond, such new Bond shall 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 shall 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 shall 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 shall become due and payable;

(ii) failure in the due and punctual payment of the principal of the Bonds when and as the same shall 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 shall have continued for a period of 30 days after the Authority and the City shall 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 shall have occurred and be continuing under the Installment Purchase Agreement; or

(v) if the Authority shall 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 shall 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 shall 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 shall 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 shall have been so declared due and payable and before any judgment or decree for the payment of the moneys due shall have been obtained or entered, there shall 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) shall have been made good or cured to the satisfaction of the Trustee or provision deemed by the Trustee to be adequate shall 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 shall extend to or shall affect any subsequent default or shall 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 shall (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 Installment Purchase 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 shall confer.

Limitation on Rights and Remedies of Holders of Subordinated Bonds. So long as any Senior Bonds remain outstanding, no Owners of Subordinated Bonds shall have the right to declare an Event of Default, to declare any Bonds immediately due and payable, to direct the Trustee with respect to any Event of Default or to waive any Event of Default and, for such purposes, any reference to the Owners of a percentage of the principal amount of "Bonds then Outstanding" shall be deemed to refer to the Owners of such percentage of Senior Bonds then Outstanding.

Effect of Discontinuance or Abandonment. In case any proceeding taken by the Trustee on account of any default or Event of Default shall have been discontinued or abandoned for any reason, or shall have been determined adversely to the Trustee, then and in every such case, the Authority, the Trustee, and the Owners shall be restored to their former positions and rights under the Indenture, respectively, and all rights, remedies and powers of the Trustee shall 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 shall 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 shall 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 shall 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 shall 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, shall have accrued, and shall 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 shall 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 shall 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 shall 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 shall 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 that 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 shall 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 shall be cumulative, and shall 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 shall 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 shall have been waived as provided in the Indenture, the Trustee shall promptly give written notice of such waiver to the Authority and shall 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 shall 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 shall impair any such right or power or shall 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 under the Indenture (other than the Rebate Fund and other than moneys held for Bonds not presented for payment) shall, 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 shall be due and payable:

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 shall 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;

Second - To the payment of the Owners of the unpaid principal of any of the Bonds that shall 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 shall 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

Third – To be held for the payment to the Owners as the same shall 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 shall 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 shall be made in accordance with the Indenture.

(ii) If the principal of all of the Outstanding Bonds shall 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 shall be applied at such times, and from time to time, as the Trustee shall 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 shall 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 shall 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, then the Owners of such Bonds shall 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 shall cease, terminate and become void and be discharged and satisfied. In such event, the Trustee shall execute and deliver to the Authority all such instruments as may be necessary or desirable to evidence such discharge and satisfaction, and the Trustee shall 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 shall have been paid and if, at the time of such payment, the Authority shall 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 shall be considered to have been discharged in respect of such Bonds and such Bonds shall cease to be entitled to the lien of the Indenture and such lien and all agreements, covenants, and other obligations of the Authority therein shall 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 shall be binding upon the Trustee and the Owners of the Bonds and the Trustee shall 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 shall remain in effect and shall be binding upon the Trustee and the Authority.

Any Outstanding Bonds shall 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 shall 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 shall have been deposited with the Trustee either (A) money in an amount that shall 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, shall, 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 shall 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.

Governing Law

The Indenture will be governed by the laws of the State of California applicable to contracts made and performed in the State.

INSTALLMENT PURCHASE AGREEMENT

The Installment Purchase Agreement sets forth certain terms and conditions of the purchase of the Project by the City. The term "Installment Purchase Agreement" means the Master Installment Purchase Agreement, dated as of August 1, 1998, as supplemented and amended by a 1998 Supplement to Master Installment Purchase Agreement, dated as of August 1, 1998, a 2002 Supplement to Master Installment Purchase Agreement, dated as of October 1, 2002, an Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009, a 2009A Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009, a 2009B Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of June 1, 2009, a 2010A Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009 and the 2012A Supplement, each by and between the City and the Corporation, as such Installment Purchase Agreement may from time to time be further amended or supplemented by all Supplements executed pursuant to the provisions thereof. Certain definitions under and provisions of the Installment Purchase Agreement are given and summarized below. Other provisions are summarized in the Official Statement under the caption "SECURITY AND SOURCES OF PAYMENT FOR THE 2012A BONDS."

***Selected Definitions*.**

Accountant's Report

The term "Accountant's Report" means a report signed by an Independent Certified Public Accountant.

Adjusted Debt Service

The term "Adjusted Debt Service" means, for any Fiscal Year, Debt Service on Parity Obligations for such Fiscal Year, minus an amount equal to earnings from investments in any Reserve Fund securing Parity Obligations for such Fiscal Year.

Adjusted Net System Revenues

The term "Adjusted Net System Revenues" means, for any Fiscal Year, the Net System Revenues for such Fiscal Year, minus an amount equal to earnings from investments in any Reserve Fund securing Parity Obligations for such Fiscal Year.

Authorizing Ordinance

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.

Balloon Indebtedness

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 of 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.

Capacity Charge

The term "Capacity Charge" means a charge imposed upon a person, firm, corporation or other entity incident to the granting of a permit for a new water connection or due to an increase in water usage by the addition of any type of dwelling, commercial or industrial unit, which charge is based upon an increase in water consumption as measured by equivalent dwelling units, and the proceeds of which are used to construct, improve and expand the Water System to accommodate the additional business of such added dwellings or commercial or industrial units.

Consultant

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.

Credit Provider

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 Instrument for some or all of the Parity Obligations.

Credit Provider Reimbursement 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 constitute Parity Obligations or Subordinated Obligations, as designated by the City.

Credit Support Instrument

The term "Credit Support Instrument" means a policy of insurance, a letter of credit, a standby purchase agreement, revolving credit agreement or other credit arrangement pursuant to which a Credit Provider provides credit support or liquidity with respect to the payment of interest, principal, or the purchase price of any Parity Obligations.

Debt Service

With regard to the issuance of Parity Obligations, the term "Debt Service" means, for any Fiscal Year, the sum of (a) 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), (b) 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), (c) 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; and (3) 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.

With regard to the issuance of Subordinated Obligations, the term "Debt Service" means, for any Fiscal Year, the sum of (a) the interest payable during such Fiscal Year on all Outstanding Obligations, assuming that all Outstanding Serial Obligations are retired as scheduled and that all Outstanding Term 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 Obligations), (b) that portion of the principal amount of all Outstanding Serial 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 other Obligations) (c) that portion of the principal amount of all Outstanding Term 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 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 Obligations for which such Reserve Fund was established and in each preceding year, until such amount is exhausted; and (3) the amount of payments on account of 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 thereof shall be deemed payable on the scheduled redemption, retirement, or repayment date, but not before.

Default Rate

The term "Default Rate" means the Maximum Rate.

Defaulted Obligations

The term "Defeasance Obligations" means Obligations in respect of which an Event of Default has occurred and is continuing.

Engineer's Report

The term "Engineer's Report" means a report signed by an Independent Engineer.

Fiscal Year

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.

Independent Certified Public Accountant

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.

Independent Engineer

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 water systems, appointed and paid by but not under the control of the City.

Installment Payment Date

The term "Installment Payment Date" means any date on which an Installment Payment is due as specified in the Installment Purchase Agreement or determined pursuant to a Supplement.

Installment Payments

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.

Installment Payment Obligations

The term "Installment Payment Obligations" means Obligations consisting of or which are supported in whole by Installment Payments.

Issuing Instrument

The term "Issuing Instrument" means any indenture, trust agreement, loan agreement, lease, installment purchase agreement, or the Installment Purchase Agreement, including any Supplement or other instrument under which Obligations are issued or created.

Law

The term "Law" means the Charter and all applicable laws of the State.

Maintenance and Operation Costs of the Water System

The term "Maintenance and Operation Costs of the Water System" means (a) any Qualified Take or Pay Obligation, and (b) the reasonable and necessary costs spent or incurred by the City for maintaining and operating the Water System, calculated in accordance with generally accepted accounting principles, including, without limitation, the costs of the purchase, delivery or storage of water, the reasonable expenses of maintenance and repair and other expenses necessary to maintain and preserve the Water System in good repair and working order, and including administrative costs of the City attributable to the Water System, including the Project and the Installment Purchase Agreement, salaries and wages of employees of the Water System, payments to such 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 a Tax Certificate, and fees and expenses payable to any Credit Provider (other than in repayment of a Credit Provider Reimbursement Obligation), but excluding in all cases (1) depreciation, replacement and obsolescence charges or reserves therefor, (2) amortization of intangibles or other bookkeeping entries of a similar nature, (3) costs of capital additions, replacements, betterments, extensions or improvements to the Water System which under generally accepted accounting principles are chargeable to a capital account or to a reserve for depreciation, (4) charges for the payment of principal of and interest on any general obligation bond issued for Water System purposes, and (5) charges for the payment of principal of and interest on any debt service on account of any Obligation on a parity with or subordinate to the Installment Payments.

Maximum Annual Debt Service

The term "Maximum Annual Debt Service" means,

(A) 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 in accordance with the

Installment Purchase Agreement 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 Fiscal 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 or have the characteristics of commercial paper and which 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; provided, however, that with respect to Parity Obligations which are or have the characteristics of commercial paper and which are intended at the time of issuance to be retired from the sale of a corresponding amount of other Obligations, which other Obligations would not constitute Balloon Indebtedness, each maturity thereof shall be treated as if it were to be amortized in substantially equal installments of principal and interest over a term of 30 years, commencing in the year of such stated maturity; in determining the interest due in each Fiscal Year, interest payable at a fixed rate shall (except to the extent paragraph (A)(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 constitute 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 30 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 paragraph (A)(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 paragraph (A)(i) above;

(iii) if any 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 the Supplement or Issuing Instrument for 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 30 years commencing in the year in which such Series is first subject to tender, the interest rate used for such computation shall be determined as provided in paragraph (A)(iv) or (v) below, as appropriate;

(iv) if any Outstanding Series of Parity Obligations constitutes Variable Rate Indebtedness, the interest rate on such Obligations 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;

(v) if Parity Obligations proposed to be issued will be Variable Rate Indebtedness, then such Parity Obligations shall be assumed to bear interest at 80% of the average Revenue Bond Index during the calendar quarter preceding the calendar quarter in which the calculation is made, 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; and

(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 of 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.

(B) with regard to all Obligations then Outstanding, the maximum amount of principal and interest becoming due on the Obligations in the then-current or any future Fiscal Year, calculated by the City or by an Independent Certified Public Accountant in accordance with this subsection 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 Fiscal 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 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 Obligations, and including any scheduled mandatory redemption or prepayment of 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; provided, however, that with respect to Obligations which are or have the characteristics of commercial paper and which are intended at the time of issuance to be retired from the proceeds of sale of a corresponding amount of other Obligations, and which would not constitute Balloon Indebtedness, each maturity thereof shall be treated as if it were to be amortized in substantially equal installments of principal and interest over a term of 30 years, commencing in the year of such stated maturity; in determining the interest due in each Fiscal Year, interest payable at a fixed rate shall (except to the extent paragraph (B)(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 Obligations constitute Balloon Indebtedness or if all or any portion or portions of a Series of 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 30 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 paragraph (B)(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 paragraph (B)(i) above;

(iii) if any Outstanding Series of Obligations constitutes Tender Indebtedness or if 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 Obligations were to be amortized in accordance with the amortization schedule set forth in the Supplement or Issuing Instrument for 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 30 years, commencing in the year in which such Obligations are first subject to tender, the interest rate used for such computation shall be determined as provided in paragraph (B)(iv) or (v) below, as appropriate;

(iv) if any Outstanding Series of Obligations constitute Variable Rate Indebtedness, the interest rate on such Series of Obligations shall be assumed to be 110% of the daily average interest rate on such Series of Obligations during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Series of Obligations shall have been Outstanding;

(v) if Obligations proposed to be issued will be Variable Rate Indebtedness, then such Obligations shall be assumed to bear interest at 80% of the average Revenue Bond Index during the calendar quarter preceding the calendar quarter in which the calculation is made, 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; and

(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 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.

Maximum Rate

The term “Maximum Rate” means, on any day, the maximum interest allowed by law.

Net Proceeds

The term “Net Proceeds” means, when used with respect to any insurance, self-insurance, or condemnation award, the proceeds from such award that are remaining after payment of all expenses (including attorneys’ fees) incurred in the collection of such proceeds.

Net System Revenues

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 Water System for such Fiscal Year.

Obligations

The term “Obligations” means (a) 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 of and interest on which are payable from Net System Revenues; (b) obligations to replenish any debt service reserve funds with respect to such obligations of the City; (c) obligations secured by or payable from any of such obligations of the City; and (d) obligations of the City payable from Net System Revenues under (1) any contract providing for payments based on levels of, or changes in, interest rates, currency exchange rates, stock or other indices, (2) any contract to exchange cash flows or a series of payments, or (3) any contract to hedge payment, currency, rate spread or similar exposure, including but not limited to interest rate cap agreements.

Outstanding

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 (a) Obligations theretofore cancelled or surrendered for cancellation; (b) Obligations paid or deemed to be paid within the meaning of any defeasance provisions thereof; (c) Obligations owned by the City; and (d) Obligations in lieu of or in substitution for which other Obligations have been executed and delivered.

Owner

The term "Owner" means any person who shall be the registered owner of any certificate or other evidence of a right to receive Installment Payments directly or as security for payment of an Outstanding Obligation.

Parity Installment Obligation

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.

Parity Obligations

The term "Parity Obligations" means (a) Parity Installment Obligations, (b) Obligations, the principal of and interest on which are payable on a parity with Parity Installment Obligations, and (c) Reserve Fund Obligations.

Payment Fund

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 of or interest on related Obligations.

Permitted Investments

The term "Permitted Investments" means investments which, pursuant to the 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.

Purchase Price

The term "Purchase Price" means the principal amount, plus interest thereon, owed by the City to the Corporation under the terms of the Installment Purchase Agreement for the purchase of Project Components, as specified in the Installment Purchase Agreement or in a Supplement.

Qualified Take or Pay Obligation

The term "Qualified Take or Pay Obligation" means the obligation of the City to make or use 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 the City or 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.

Rate Stabilization Fund

The term "Rate Stabilization Fund" means the fund by that name established pursuant to the Installment Purchase Agreement.

Rebate Requirement

The term "Rebate Requirement" shall have the meaning specified in the Tax Certificate.

Reserve Fund

The term "Reserve Fund" shall refer to the fund by that name established under an Instrument or Supplement.

Reserve Fund Obligations

The term "Reserve Fund Obligations" means the obligations of the City to pay amounts advanced under any Reserve Fund Credit Facility entered into in accordance with the provisions of the related Issuing Instrument or Supplement, which obligations shall constitute Parity Obligations or Subordinated Obligations, as designated by the City.

Reserve Fund Credit Facility

The term "Reserve Fund Credit Facility" means a letter of credit, line of credit, surety bond, insurance policy or similar facility deposited in the Reserve Fund established under an Issuing Instrument in lieu of or in partial substitution for cash or securities on deposit therein.

Reserve Requirement

The term "Reserve Requirement" shall have the meaning given to such term in any Issuing Instrument or Supplement.

Revenue Bond Index

The term "Revenue Bond Index" means the Revenue Bond Index by that name published from time to time in The Bond Buyer.

Secondary Purchase Fund

The term "Secondary Purchase Fund" means any fund by that name established pursuant to the Installment Purchase Agreement.

Serial Obligations

The term "Serial Obligations" means Obligations for which no sinking fund payments are provided.

Serial Parity Obligations

The term "Serial Parity Obligations" means Serial Obligations which are Parity Installment Payments or are payable on a parity with Parity Installment Obligations.

Series

The term "Series" means Obligations issued at the same time or sharing some other common term or characteristic and designated as a separate Series.

Subordinated Credit Provider

The term "Subordinated Credit Provider" means any municipal bond insurance company, bank, or other financial institution or organization which is performing in all respects its obligations under any Subordinated Credit Support Instrument for some or all of the Subordinated Obligations.

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 obligations shall constitute Subordinated Obligations.

Subordinated Credit Support Instrument

The term "Subordinated Credit Support Instrument" means a policy of insurance, a letter of credit, a standby purchase agreement, revolving credit agreement, or other credit arrangement pursuant to which a Subordinated Credit Provider provides credit support or liquidity with respect to the payment of interest, principal, or the purchase price of any Subordinated Obligations.

Subordinated Obligations

The term "Subordinated Obligations" means any Obligations, the payment of which is subordinated in right of payment to Parity Obligations.

System Revenues

The term "System Revenues" means all income, rents, rates, fees, charges, and other moneys derived from the ownership or operation of the Water System, including, without limiting the generality of the foregoing:

(a) all income, rents, rates, fees, charges, or other moneys derived by the City from the water services or facilities, and commodities or byproducts, including hydroelectric power, sold, furnished, or supplied through the facilities of or in the conduct or operation of the business of the Water System, and including, without limitation, investment earnings on the operating reserves to the extent that the use of such earnings is limited to the Water System by or pursuant to law, and 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;

(b) standby charges and Capacity Charges* derived from the services and facilities sold or supplied through the Water System;

(c) the proceeds derived by the City directly or indirectly from the lease of a part of the Water System;

(d) 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 Water System;

(e) amounts received under contracts or agreements with governmental or private entities and designated for capital costs for the Water System*; and

(f) grants for maintenance and operations received from the United States of America or from the State; provided, however, that System Revenues shall not include (1) 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 (2) the proceeds of borrowings; but

(g) 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 any amounts transferred from current System Revenues to the Secondary Purchase 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 or the Secondary Purchase Fund to pay Maintenance and Operation Costs of the Water System.

Tax-Exempt Installment Payment Obligations

The term "Tax-Exempt Installment Payment Obligations" means Installment Payment Obligations, the interest component of which is excluded from gross income pursuant to Section 103 of the Code.

Tender Indebtedness

The term "Tender Indebtedness" means any Obligations or portions of Obligations, a feature of which is an option, on the part of the holders thereof, or an obligation, under the terms of such Obligations, to tender all or a portion of such Obligations to the City, a Trustee or other fiduciary or agent for payment or purchase and requiring that such Obligations or portions of Obligations or that such rights to payments or portions of payments be purchased if properly presented. Tender Indebtedness may consist of either Parity Obligations or Subordinated Obligations.

* These items of System Revenue may not be used to pay Maintenance and Operation Costs of the Water System.

Term Parity Obligations

The term "Term Parity Obligations" means Term Obligations which are Parity Obligations or are payable on a parity with Parity Installment Obligations.

Term 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.

Variable Rate Indebtedness

The term "Variable Rate Indebtedness" means any portion of indebtedness evidenced by Obligations, the interest rate for which is subject to adjustment periodically through a remarketing process or according to a stated published index for similar obligations in the municipal markets. Variable Rate Indebtedness may consist of either Parity Obligations or Subordinated Obligations.

Water Service

The term "Water Service" means the collection, conservation, production, storage, treatment, transmission, furnishing, and distribution services made available or provided by the Water System.

Water Utility Fund

The term "Water Utility Fund" means the fund by that name established by the Charter.

Installment Payments

Purchase Price.

(a) 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 Corporation pursuant to any Supplement, solely from Net System Revenues and from no other sources, is the sum of the principal amount of the City's obligations under such Supplement plus the interest to accrue on the unpaid balance of such principal amount from the effective date thereof over the term thereof, subject to prepayment as provided therein.

(b) The principal amount of the Installment Payments to be made by the City under a Supplement shall be paid at least three Business 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 as due, to, but not including, the payment date.

(c) The interest to accrue on the unpaid balance of such principal amount shall be paid at least three Business 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 in the principal amount of the City's obligations thereunder. Interest shall be payable in an amount not exceeding the Maximum Rate at the time of incurring such obligation, 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.

(a) The City shall, subject to any rights of prepayment provided for in a Supplement, pay to the Corporation, 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, all as specified in a Supplement.

(b) 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 shall deposit or cause to be deposited, solely from Net System Revenues in accordance with the Installment Purchase Agreement, 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 twelve months.

(c) 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 shall have been paid in full (or provision for the payment thereof shall have been made pursuant to the Installment Purchase Agreement), the City will not discontinue or suspend any 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 Installment Payments shall not be subject to reduction whether by offset or otherwise and shall not be conditioned upon the performance or nonperformance by any party of any agreement for any cause whatsoever.

System Revenues

Commitment of the Net System Revenues.

(a) 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 grants such first priority lien on and pledge of Net System Revenues to secure Parity Obligations. 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.

(b) 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 securing Parity Obligations. The City grants such second priority lien on and pledge of Net System Revenues to secure Subordinated Obligations. 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.

(c) The City represents and states that it has not 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.

(d) Nothing contained in the Installment Purchase Agreement shall affect the ability of the City to grant liens on and pledges of the 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 therein.

Allocation of System Revenues.

(a) 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 Water Utility Fund, which fund the City agrees and covenants to maintain so long as any Installment Payment Obligations remain unpaid, and all moneys in the Water Utility Fund shall be so held in trust and applied and used solely as provided in the Installment Purchase Agreement. The City shall pay from the Water Utility Fund: (1) directly or as otherwise required all Maintenance and Operation Costs of the Water System; and (2) to the Trustee, for deposit in the Payment Fund for Parity Obligations, including Reserve Fund Obligations that are Parity Obligations, the amounts specified in any Issuing Instrument, as payments due on account of Parity Obligations (including any Credit Provider Reimbursement Obligations that are Parity Obligations). In the event there are insufficient Net System Revenues to make all of the payments contemplated by clause (2) of the immediately preceding sentence, then said payments should be made as nearly as practicable, pro rata, based upon the respective unpaid principal amounts of said Parity Obligations.

(b) After the payments contemplated by subsection (a) above have been made, and in any event not less frequently than January 15 and July 15 of each year, any remaining Net System Revenues shall be used to make up any deficiency in the Reserve Funds for Parity Obligations. Notwithstanding the use of a Reserve Fund Credit Facility in lieu of depositing funds in the related Reserve Fund for Parity Obligations, in the event of any draw on the related Reserve Fund Credit Facility, there shall be deemed a deficiency in such Reserve Fund for Parity Obligations 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 for Parity Obligations, such payments into the Reserve Funds shall be made as nearly as practicable pro rata based on the respective unpaid principal amount of all Parity Obligations. Any amounts thereafter remaining in the Water Utility Fund may from time to time be used to pay the amounts specified in any Issuing Instrument as payments due on account of Subordinated Obligations (including any Reserve Fund Obligations for Subordinated Obligations, any Credit Provider Reimbursement Obligations that are Subordinated Obligations and any Subordinated Credit Provider Reimbursement Obligations), provided the following conditions are met:

(i) all Maintenance and Operation Costs of the Water System are being and have been paid and are then current; and

(ii) all deposits and payments contemplated by clause (2) of paragraph (a) above shall have been made in full and no deficiency in any Reserve Fund for Parity Obligations shall exist, and there shall have been paid, or segregated within the Water Utility Fund, the amounts payable during the current month pursuant to clause (2) of paragraph (a) above.

After deposits contemplated above have been made, any amounts thereafter remaining in the Water Utility Fund may be used for any lawful purpose of the Water System.

Additional Obligations.

(a) 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.

(b) Without regard to paragraph (c) below, the City may at any time enter into or create an obligation or commitment which is a Reserve Fund Obligation, provided that the Obligation to which the Reserve Fund Obligation relates is permitted to be entered into under the terms of the Installment Purchase Agreement.

(c) After the initial issuance of Parity Obligations under the Installment Purchase Agreement, the City reserved the right, at any time and from time to time, to issue or create any other Parity Obligations, provided that:

> (i) there shall not have occurred and be continuing an Event of Default under the terms of the Installment Purchase Agreement, any Issuing Instrument or any Credit Support Instrument; and
>
> (ii) 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 within the 18 consecutive months ending immediately prior to the incurring of such additional Parity Obligations shall have amounted to or exceeded the greater of (i) at least 1.20 times the Maximum Annual Debt Service on all Parity Obligations to be Outstanding immediately after the issuance of the proposed Parity Obligations or (ii) at least 1.00 times the Maximum Annual Debt Service on all Obligations to be Outstanding immediately after the issuance of the proposed Parity Obligations. For purposes of preparing the certificate or certificates described above, the City or its Consultant may rely upon audited financial statements, or, if audited financial statements for the period are not available, financial statements prepared by the City that have not been subject to audit by an Independent Certified Public Accountant; or
>>
>> (B) the estimated Net System Revenues for the five Fiscal Years following the earlier of (i) the end of the period during which interest on those Parity Obligations is to be capitalized or, if no interest is to be capitalized, the Fiscal Year in which the Parity Obligations are issued, or (ii) the date on which substantially all new Components to be financed with such Parity Obligations are expected to commence operations, 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.

(d) For purposes of the computations to be made as described in paragraph (c)(ii)(B) above, the determination of Net System Revenues:

> (i) may take into account any increases in rates and charges which relate to the Water System and which have been approved by the City Council, and shall take into account any reduction in such rates and charges which have been approved by the City Council, which will, for purposes of the test described in paragraph (c)(ii)(B) above, be effective during a Fiscal Year ending within the five-Fiscal Year period for which such estimate is being 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 Water System to be made with the proceeds of such additional indebtedness or with the proceeds of 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 during the five-Fiscal Year period contemplated by paragraph (c)(ii)(B) above, all as shown by such certificate of the City or its Consultant, as applicable; and

(iii) for the period contemplated by paragraph (c)(ii)(B), Maintenance and Operation Costs of the Water System shall initially be deemed to be equal to such costs for the 12 consecutive months immediately prior to incurring such other Parity Obligations for the first Fiscal Year of the five-Fiscal Year period, but adjusted if deemed necessary by the City or its Consultant, as applicable, for any increased Maintenance and Operations Costs of the Water System which are, in the judgment of the City or such Consultant, as applicable, essential to maintaining and operating the Water System and which will occur during any Fiscal Year ending within the period contemplated by paragraph (c)(ii)(B) above.

(e) The certificate or certificates described above in paragraph (c)(ii)(B) shall not be required if the Parity Obligations being issued are for the purpose of (1) issuing the Parity Obligations initially issued under the Installment Purchase Agreement or (2) refunding (A) any 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 the sum of Adjusted Debt Service on all Parity Obligations Outstanding for all remaining Fiscal Years after the issuance of the refunding Parity Obligations will not exceed the sum of Adjusted Debt Service on all Parity Obligations Outstanding for all remaining Fiscal Years prior to the issuance of such refunding Parity Obligations; or (B) 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 pursuant to a standby purchase or other liquidity facility relating to such indebtedness.

(f) Without regard to paragraph (c) above, if (A) no Event of Default has occurred and is continuing and (B) no event of default or termination event attributable to an act of or failure to act by the City under any Credit Support Instrument has occurred and is continuing, the City may issue or incur Subordinated Obligations, and such Subordinated Obligations shall be paid in accordance with the provisions of the Installment Purchase Agreement, provided that:

(i) 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 within the 18 consecutive months ending immediately prior to the incurring of such additional Subordinated Obligations shall have amounted to at least 1.00 times the Maximum Annual Debt Service on all Obligations to be 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 (i) 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 (ii) 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 to be Outstanding immediately after the issuance of the proposed Subordinated Obligations.

(ii) For purposes of preparing the certificate or certificates described in clause (1) of paragraph (f)(i) above, the City and its Consultant(s) may rely upon audited financial statements or, if audited financial statements for the period are not available, financial statements prepared by the City that have not been subject to audit by an Independent Certified Public Accountant.

(iii) For purposes of the computations to be made as described in clause (2) of paragraph (f)(i) above, the determination of Net System Revenues:

(1) may take into account any increases in rates and charges which relate to the Water System and which have been approved by the City Council and shall take into account any reduction in such rates and charges which have been approved by the City Council, which will, for purposes of the test described in clause (2) of paragraph (f)(i) above, be effective during any Fiscal Year ending within the five-Fiscal Year period for which such estimate is made; and

(2) 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 Water System to be made with the proceeds of such additional indebtedness, with the proceeds of Obligations previously issued or with cash contributions made or to be made by the City, all in an amount equal to the estimated additional average annual Net System Revenues to be derived from such additions, improvements and extensions during the five-Fiscal Year period contemplated by clause (2) of paragraph (f)(i) above, all as shown by such certificate of the City or its Consultant, as applicable; and

(3) for the period contemplated by clause (2) of paragraph (f)(i) above, shall initially include Maintenance and Operation Costs of the Water System in an amount equal to such costs for any 12-consecutive month period within the 24 consecutive months ending immediately prior to incurring such Subordinated Obligations for the first Fiscal Year of the five-Fiscal Year period, but adjusted if deemed necessary by the City or its Consultant, as applicable, for any increased Maintenance and Operations Costs of the Water System which are, in the judgment of the City or its Consultant, as applicable, essential to maintaining and operating the Water System and which will occur during any Fiscal Year ending within the period contemplated by clause (2) of paragraph (f)(i) above.

(iv) The certificate or certificates described above in paragraph (f)(i) above shall 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 shall be 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 agreement or other liquidity facility relating to such indebtedness.

Covenants of the City

Compliance With Installment Purchase Agreement and Ancillary Agreements.

(a) The City will punctually pay Parity Obligations in strict conformity with the terms of the Installment Purchase Agreement and thereof; and will faithfully observe and perform all the agreements, conditions, covenants and terms contained in the Installment Purchase Agreement required to be observed and performed by it, 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 Corporation to observe or perform any agreement, condition, covenant or term contained in the Installment Purchase Agreement required to be observed and performed by it, whether express or implied, or any duty, liability or obligation arising out of or connected therewith or the insolvency, or deemed insolvency, or bankruptcy or liquidation of the Corporation 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, lock outs, lack of transportation facilities, fire, explosion, or acts or regulations of governmental authorities.

(b) 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 Credit Support Instrument relating to Parity Obligations required to be observed and performed by it, and it is expressly understood and agreed by and between the parties to the Installment Purchase Agreement that each of the agreements, conditions, covenants and terms contained therein is an essential and material term of the purchase of and payment for each Component by the City pursuant to, and in accordance with, and as authorized under the Law.

(c) 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.

(d) The City shall be unconditionally and irrevocably obligated, so 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 Water Utility Fund for use as provided in the Installment Purchase Agreement; provided, however, that such obligation does not, in any way, limit the City's ability to undertake any and all legal actions, including any appeals, in the defense of a federal court order dictating a water system configuration other than that approved and adopted by the City.

Against Encumbrances. The City will not make any pledge of or place any lien on the Net System Revenues except as otherwise provided or permitted in the Installment Purchase Agreement.

Debt Service Reserve Fund. The City will maintain or cause to be maintained each Reserve Fund at the applicable Reserve Requirement. In the event the amount in any such fund or account falls below the applicable Reserve Requirement, the City will replenish such fund or account up to the applicable Reserve Requirement pursuant to the Installment Purchase Agreement.

Against Sale or Other Disposition of Property.

(a) The City will not sell, lease or otherwise dispose of the Water System or any part thereof essential to the proper operation of the Water 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 that impairs the operation of the Water System or any part thereof necessary to secure adequate Net System Revenues for the payment of the Parity Obligations or that would otherwise impair the rights of the Corporation with respect to the System Revenues or the operation of the Water System.

(b) The City may dispose of any of the works, plant properties, facilities, or other parts of the Water System, or any real or personal property comprising a part of the Water System, only upon the approval of the City Council and consistent with one or more of the following:

(i) the City in its discretion may carry out such a disposition if the facilities or property being disposed of are not material to the operation of the Water System, or shall have become unserviceable, inadequate, obsolete, or unfit to be used in the operation of the Water System or are no longer necessary, material or useful to the operation of the Water System, and if such disposition will not materially reduce the Net System Revenues and if the proceeds of such disposition are deposited in the Water Utility Fund;

(ii) the City in its discretion may carry out such a disposition if the City receives from the acquiring party an amount equal to the fair market value of the portion of the Water System disposed of. As used in this clause (ii), "fair market value" means that the portion being disposed of should bring in a competitive and open market under all conditions requisite to a fair sale, the willing buyer and willing seller each acting prudently and knowledgeably, and assuming that the price is not affected by coercion or undue stimulus. The proceeds of the disposition shall be used (A) first, promptly to redeem, or irrevocably set aside for the redemption of, Parity Obligations, and second, promptly to redeem, or irrevocably set aside for the redemption of, Subordinated Obligations, and/or (B) to provide for a part of the cost of additions to and betterments and extensions of the Water System; provided, however, that before any such disposition under this clause (2), the City must obtain (i) a certificate of an Independent Engineer to the effect that upon such disposition and the use of the proceeds of the disposition as proposed by the City, the remaining portion of the Water System will retain its operational integrity and the estimated Net System Revenues for the five Fiscal Years following the Fiscal Year in which the disposition is to occur will be equal to or exceed the greater of (i) at least 1.20 times the Adjusted Debt Service on all Outstanding Parity Obligations during the five Fiscal Years following the Fiscal Year in which the disposition is to occur, or (ii) at least 1.00 times the Adjusted Debt Service on all Outstanding Obligations during the first five Fiscal Years following the Fiscal Year in which the disposition is to occur, taking into account (aa) the reduction in revenue resulting from the disposition, (bb) the use of any proceeds of the disposition for the redemption of Parity Obligations and/or Subordinated Obligations, (cc) the Independent Engineer's estimate of revenue from customers anticipated to be served by any additions to and betterments and extensions of the Water System financed in part by the proceeds of the disposition, and (dd) any other adjustment permitted in the preparation of a certificate in accordance with the Installment Purchase Agreement as summarized herein in paragraph (c)(2)(B) under the caption "INSTALLMENT PURCHASE AGREEMENT – System Revenues – Additional Obligations," and (ii) confirmation from the Rating Agencies to the effect that the rating then in effect on any Outstanding Parity Obligations will not be reduced or withdrawn upon such disposition.

(c) The City will operate the Water System in an efficient and economic manner, provided that the City may remove from service on a temporary or permanent basis such part or parts of the Water System as the City shall determine, so long as (1) Net System Revenues are at least equal to the greater of (i) 100% of all Obligations payable in the then-current Fiscal Year or (ii) 120% of Adjusted Debt Service for the then-current Fiscal Year, after giving effect to any defeasance of Parity Obligations and/or

Subordinated Obligations occurring incident to such removal, and for each Fiscal Year thereafter to and including the Fiscal Year during which the last Installment Payment is due, after giving effect to such defeasance, as evidenced by (i) an Engineer's Report on file with the City, or (ii) a Certificate of the City, (2) the value of the parts of the Water System to be so removed is less than 5% of the total Water System Plant assets, each as shown on the most recent audited financial statements that include the Water Utility Fund, and (3) the City shall have filed with each Trustee an opinion of Bond Counsel to the effect that the removal of such part or parts of the Water System will not adversely affect the exclusion from-gross income for federal income tax purposes of the interest on Tax-Exempt Installment Payment Obligations.

Prompt Acquisition and Construction. The City shall take all necessary and appropriate steps to construct, acquire and install the Project, as agent of the Corporation, with all practicable dispatch and in an expeditious manner and in conformity with law so as to complete the same as soon as possible.

Maintenance and Operation of the Water System; Budgets. The City shall maintain and preserve the Water System in good repair and working order at all times and shall operate the Water System in an efficient and economical manner and will pay all Maintenance and Operation Costs of the Water System as they become due and payable. The City shall adopt and make available to the Corporation, 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 Water 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 shall adopt, and on or before the day that is 120 days after the beginning of the Fiscal Year, make available to the Corporation a budget approved by the City Council of the City setting forth the estimated Maintenance and Operation Costs of the Water System for such Fiscal Year. Any budget may be amended at any time during any Fiscal Year and such amended budget shall be filed by the City with the Corporation.

Amount of Rates and Charges; Rate Stabilization Fund; Other Funds.

(a) The City shall fix, prescribe and collect rates and charges for the Water Service which will be at least sufficient to yield the greater of (1) Net System Revenues sufficient to pay during each Fiscal Year all Obligations payable in such Fiscal Year or (2) Adjusted Net System Revenues during each Fiscal Year equal to 120% of the Adjusted 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 shall 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 these provisions.

(b) The City may establish, as a fund within the Water Utility 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 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 Water System, and any amounts so transferred shall 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.

(c) The City may establish, as a fund within the Water Utility Fund, a fund denominated the "Secondary Purchase Fund." From time to time, the City may deposit into the Secondary Purchase Fund, from any lawful source, which may or may not consist of current System Revenues, such amounts as the City shall determine, and the amount of available System Revenues shall be reduced by the amount so transferred, but only to the extent that amounts so transferred consist of then-current System Revenues.

Amounts may be transferred from the Secondary Purchase Fund solely and exclusively to pay Maintenance and Operation Costs of the Water System, and any amounts so transferred shall be deemed System Revenues when so transferred. All interest or other earnings upon amounts in the Secondary Purchase Fund may be withdrawn therefrom and accounted for as System Revenues.

Payment of Claims. The City will pay and discharge any and all lawful claims for labor, materials or supplies which, if unpaid, might become a lien on the System Revenues or any part thereof or on any funds in the hands of the City or the Trustee might impair the security of the Installment Payments, but the City shall not be required to pay such claims if the validity thereof shall be contested in good faith.

Compliance with Contracts. The City will comply with, keep, observe and perform all agreements, conditions, covenants and terms, express or implied, required to be performed by it contained in all contracts for the use of the Water System and all other contracts affecting or involving the Water System to the extent that the City is a party thereto.

Insurance.

(a) The City will procure and maintain or cause to be procured and maintained insurance on the Water System with responsible insurers, in such amounts and against such risks (including accident to or destruction of the Water System) as are usually covered in connection with water systems similar to the Water System, or it will self-insure or participate in an insurance pool or pools with reserves adequate, in the reasonable judgment of the City, to protect the Water System against loss. In the event of any damage to or destruction of the Water System caused by the perils covered by such insurance or self insurance, the Net Proceeds thereof shall be applied to the reconstruction, repair or replacement of the damaged or destroyed portion of the Water System. The City shall begin such reconstruction, repair or replacement promptly after such damage or destruction shall occur, and shall continue and properly complete such reconstruction, repair or replacement as expeditiously as possible, and shall pay out of such Net Proceeds all costs and expenses in connection with such reconstruction, repair or replacement so that the same shall be completed and the Water System shall be free and clear of all claims and liens unless the City determines that such property or facility is not necessary to the efficient or proper operation of the Water 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 shall be deposited in the Water Utility Fund and be available for other proper uses of funds deposited in the Water Utility Fund.

(b) The City will procure and maintain such other insurance which it shall deem advisable or necessary to protect its interests and the interests of the Corporation, which insurance shall afford protection in such amounts and against such risks as are usually covered in connection with water systems similar to the Water 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 in the manner usually maintained in connection with water systems similar to the Water System.

(c) All policies of insurance required to be maintained under the Installment Purchase Agreement shall, to extent reasonably obtainable, provide that the Corporation and each Trustee shall be given 30 days' written notice of any intended cancellation thereof or reduction of coverage provided thereby. The City shall certify to the Corporation and each Trustee annually on or before August 31 that it is in compliance with the insurance requirements under the Indenture.

Accounting Records; Financial Statements and Other Reports.

(a) The City will keep appropriate accounting records in which complete and correct entries shall be made of all transactions relating to the Water System, which records shall be available for inspection by the Corporation and the Trustee at reasonable hours and under reasonable conditions.

(b) The City will prepare and file with the Corporation annually (commencing with the Fiscal Year ending June 30, 2012), within 270 days of the close of each Fiscal Year, financial statements that include the Water Utility Fund for the preceding Fiscal Year prepared in accordance with generally accepted accounting principles, together with an Accountant's Report thereon.

(c) The City will furnish a copy of the financial statements referred to in paragraph (b) above to any Owner of the Certificates requesting a copy thereof, which may be in electronic form.

Payment of Taxes and Compliance with Governmental Regulations. The City shall pay and discharge all taxes, assessments and other governmental charges which may be lawfully imposed upon the Water System or any part thereof or upon the System Revenues when the same shall become due, except that the City may contest in good faith any taxes, assessments and other governmental charges so long as the City shall have budgeted for the amount being contested and, if appropriate, such amount shall have been included as a Maintenance and Operation Costs of the Water System. The City shall duly observe and conform with all valid regulations and requirements of any governmental authority relative to the operation of the Water System or any part thereof, but the City shall not be required to comply with any regulations or requirements so long as the validity or application thereof shall be contested by the City in good faith.

Collection of Rates and Charges; No Free Service. The City shall have in effect at all times rules and regulations for the payment of bills for Water Service. Such regulations may provide that where the City furnishes water to the property receiving Water Service, the Water Service charges shall 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 System, and such premises shall not thereafter be reconnected to the Water System except in accordance with City operating rules and regulations governing such situations of delinquency. To the extent permitted by law, the City shall not permit any part of the Water 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 authority or agency thereof).

Eminent Domain Proceeds. If all or any part of the Water System shall be taken by eminent domain proceedings, then subject to the provisions of any Authorizing Ordinance, the Net Proceeds thereof shall 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 Water 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 shall be deposited in the Water Utility Fund and be available for other proper uses of funds deposited in the Water Utility Fund.

Tax Covenants. There shall 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 shall be excluded from gross income under section 103 of the Code.

Subcontracting. Nothing contained in the Installment Purchase Agreement to the contrary shall prevent the City from delegating the power to be an operator of some or all of the Water System, even though the City continues to retain ownership of the Water System and its operations, and no such subcontracting arrangement shall relieve the City of any of its obligations under the Indenture. Prior to the effective date of any such delegation, the City shall deliver to the Trustee an opinion of Bond Counsel to the effect that the proposed delegation 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.

Prepayments of Installment Payments

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 shall also provide for any notices to be given relating to such prepayment.

Events of Default and Remedies of the Corporation

Events of Default and Acceleration of Maturities. If one or more of the following Events of Default shall happen, that is to say:

(a) if default shall be made in the due and punctual payment of or on account of any Parity Obligation as the same shall become due and payable;

(b) if default shall be made by the City in the performance of any of the agreements or covenants required in the Installment Purchase Agreement to be performed by it (other than as specified in subsection (a) above), and such default shall have continued for a period of 60 days after the City shall have been given notice in writing of such default by the Corporation or any Trustee;

(c) if any Event of Default specified in any Supplement, Authorizing Ordinance or Issuing Instrument shall have occurred and be continuing; or

(d) if the City shall 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 a court of competent jurisdiction shall approve a petition filed with 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 shall assume custody or control of the City or of the whole or any substantial part of its property;

then, and in each and every such case during the continuance of such Event of Default, the Corporation shall 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 notice in writing 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 shall become immediately due and payable, anything contained in the Installment Purchase Agreement to the contrary notwithstanding; provided, that with respect to a Series of Parity Installment Obligations that is credit enhanced by a Credit Support Instrument, acceleration shall not be effective unless the declaration is consented to by the related Credit Provider. The foregoing provisions, however, are subject to the condition that if at any time after the entire principal amount of all Parity Installment Obligations and the accrued interest thereon shall have been so declared due and payable and before any judgment or decree for the payment of the moneys due shall have been obtained or entered, the City shall deposit with the Corporation a sum sufficient to pay the unpaid principal amount of all such 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 Corporation, and any and all other defaults known to the Corporation (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) shall have been made good or cured to the satisfaction of the Corporation or provision deemed by the Corporation to be adequate shall have been made therefor, then and in every such case the Corporation, by written notice to the City, may rescind and annul such declaration and its consequences; but no such rescission and annulment shall extend to or shall affect any subsequent default or shall impair or exhaust any right or power consequent thereon.

As provided in the Indenture, so long as any Senior Bonds remain outstanding, no Owners of Subordinated Bonds shall have the right to declare an Event of Default, to declare any Bonds immediately due and payable, to direct the Trustee with respect to any Event of Default or to waive any Event of Default and, for such purposes, any reference to the Owners of a percentage of the principal amount of "Bonds then Outstanding" shall be deemed to refer to the Owners of such percentage of Senior Bonds then Outstanding.

The Owners of Subordinated Obligations may enforce the provisions of the Installment Purchase Agreement for their benefit by appropriate legal proceedings. The payment of Subordinated Obligations will be subordinated in right of payment to payment of the Parity Obligations (except for any payment in respect of Subordinated Obligations from the Reserve Fund securing such Subordinated Obligations). Upon the occurrence and during the continuance of 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 Subordinated Obligations from the Reserve Fund securing such Subordinated Obligations) and the Owners of the Subordinated Obligations will become subrogated to the rights of the Owners of Parity Obligations to receive payments with respect thereto.

So long as any Senior Bonds remain Outstanding, no amounts, other than amounts in the Subordinated Bonds Payment Fund and the Subordinated Bonds Reserve Fund, shall be applied to the payment of Subordinated Bonds.

Application of Net System Revenues Upon Acceleration. All Net System Revenues received after the date of the declaration of acceleration by the Corporation as provided in the Installment Purchase Agreement shall be applied in the following order:

(a) First, to the payment of the costs and expenses of the Corporation and the Trustee, 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 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 of and accrued interest on all Parity Obligations, then accrued interest shall first be paid and any remaining amount shall 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 shall be prorated within a priority based upon the total amounts due in that 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 of and accrued interest on all Subordinated Obligations, then accrued interest shall first be paid and any remaining amount shall 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 shall be prorated within a priority based upon the total amounts due in that priority.

Discharge of Installment Payment Obligations

Discharge of Installment Payment Obligations. If the City shall pay or cause to be paid or there shall otherwise be paid to the Owners all Outstanding Installment Payment Obligations of a Series, the principal thereof and the interest and redemption premiums, if any, thereon or if all such Outstanding Installment Payment Obligations shall be deemed to have been paid at the times and in the manner stipulated in the applicable Issuing Instrument, then, as to any such Series, all agreements, covenants and other obligations of the City under the Indenture shall thereupon cease, terminate and become void and be discharged and satisfied, except for the obligation of the City to pay or cause to be paid all sums due under the Installment Purchase Agreement.

Miscellaneous

Liability of Authority Limited to Revenues and Subordinated Revenues.

(a) Notwithstanding anything contained in the Indenture, the Authority shall not be required to advance any money derived from any source of income other than the Revenues and the Subordinated Revenues, as provided in the Indenture for the payment of the interest on, or principal of, or premiums, if any, on the Bonds or for the performance of any agreements or covenants contained in the Installment Purchase Agreement. The Authority may, however, advance funds for any such purpose so long as such funds are derived from a source legally available for such purpose without incurring an indebtedness.

(b) The Senior Bonds shall be limited obligations of the Authority and shall be payable solely from the Revenues and amounts on deposit in the funds and accounts established under the Installment Purchase Agreement (other than amounts on deposit in the Subordinated Bonds Payment Fund, the Subordinated Bonds Reserve Fund and the Rebate Fund created pursuant to the Indenture). The Subordinated Bonds shall be limited obligations of the Authority and shall be payable solely from the Subordinated Bonds Revenues and amounts on deposit in the Subordinated Bonds Payment Fund and the Subordinated Bonds Reserve Fund. The Bonds do not constitute a debt or liability of the Authority, the City or of the State of California and neither the faith and credit of the Authority, the City nor of the State are pledged to the payment of the principal of or interest on the Bonds.

Amendments.

(a) 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 Corporation, with the written consent of any Credit Provider for any Installment Payment Obligations or, as to Installment Obligations for which there is no Credit Support Instrument, the Owners of a majority in aggregate principal amount of such Series of Installment Payment Obligations then Outstanding, provided that no such amendment shall (1) 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; or (2) 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 without the prior written consent of each of the Owners so affected.

(b) The Installment Purchase Agreement and the rights and obligations of the City and the Corporation thereunder may also be amended for supplemented at any time by an amendment or supplement to the Installment Purchase Agreement that shall not adversely affect the interests of the Owners of the Installment Payment Obligations and that shall become binding upon execution by the City and the Corporation, without the written consents of any Owner of Installment Payment Obligations or any Credit Provider, but only to the extent permitted by law and only upon receipt of an unqualified opinion of Bond Counsel to the effect that such amendment or supplement is permitted by the provisions of the Installment Purchase Agreement and is not inconsistent with the Installment Purchase Agreement and does not adversely affect the exclusion of the interest portion of the Installment Payments received by the Owners from gross income for federal income tax purposes, and only for any one or more of the following purposes:

(1) to add to the covenants and agreements of the Corporation or the City contained in the Installment Purchase Agreement other covenants and agreements thereafter to be observed or to surrender any right or power in the Installment Purchase Agreement reserved to or conferred upon the Corporation or the City;

(2) to cure, correct or supplement any ambiguous or defective provision contained in the Installment Purchase Agreement or in regard to questions arising under the Installment Purchase Agreement, as the Corporation or the City may deem necessary or desirable;

(3) to make other amendments or modifications that shall not materially adversely affect the interests of the Owners of the Installment Payment Obligations;

(4) to provide for the issuance of Parity Installment Payment Obligations; and

(5) to provide for the issuance of Subordinated Obligations.

Net Contract. The Installment Purchase Agreement shall be deemed and construed to be a net contract, and the City shall pay absolutely net during the term thereof the Installment Payments arid all other payments required under the Indenture, free of any deductions and without abatement, diminution or setoff whatsoever.

Governing Law

The Installment Purchase Agreement will be governed by the laws of the State of California applicable to contracts made and performed in the State.

2012A SUPPLEMENT

The 2012A Supplement to Amended and Restated Master Installment Purchase Agreement (the "2012A Supplement"), sets forth certain terms and conditions of the purchase of the Refunded Components of the Project by the City. Certain definitions and provision of the 2012A Supplement are given and summarized below:

Sale and Purchase of Refunded Components. In consideration of the agreement by the City to make 2012A Subordinated Installment Payments, the Corporation will sell, transfers, and assigns the Refunded Components to the City and the City will agree to purchase and accept the Refunded Components, as more particularly described in the 2012A Supplement.

2012A Subordinated Installment Payments. In consideration of the payment by the Authority, on behalf of the Corporation, of the proceeds of the 2012A Bonds and the sale of the Refunded Components by the Corporation to the City pursuant to the 2012A Supplement, the City will agree to pay a portion of the Purchase Price on each 2012A Subordinated Installment Payment Date as 2012A Subordinated Installment Payments, solely from Net System Revenues, as provided in the Installment Purchase Agreement.

Subordinated Obligations. The 2012A Subordinated Installment Payments shall be Subordinated Obligations under the Installment Purchase Agreement and the payment of the 2012A Subordinated Installment Payments shall be on parity in right of payment to the 2002 Subordinated Installment Payments under the Installment Purchase Agreement. No Owner of the Obligations 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.

Additional Covenants Relating to Tax Exemption.

(a) The City shall not directly or indirectly use or permit the use of any proceeds of the 2012A Bonds or any other funds of the City or of the Refunded Components or take or omit to take any action that would cause the 2012A Bonds to be "private activity bonds" within the meaning of Section 141 of the Code, or obligations that are "federally guaranteed" within the meaning of Section 149(b) of the Code.

(b) The City will covenant that it will not take any action, or fail to take any action, if any such action or failure to take action would adversely affect the exclusion from gross income of the interest on the 2012A Bonds under Section 103 of the Code. The City shall not directly or indirectly use or permit the use of any proceeds of the 2012A Bonds or any other funds of the City, or take or omit to take any action, that would cause the 2012A Bonds to be "arbitrage bonds" within the meaning of Section 148(a) of the Code. To that end, the City shall comply with all requirements of Section 148 of the Code to the extent applicable to the 2012A Bonds. If, at any time, the City is of the opinion that for purposes of this section it is necessary to restrict or limit the yield on the investment of any moneys held by the Trustee under the Indenture or otherwise, then the City shall so instruct the Trustee in writing, and shall 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 will agree that there shall 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 Treasury Regulations promulgated thereunder as may be applicable to the 2012A Bonds from time to time. This covenant shall survive payment in full or defeasance of the 2012A Bonds. The City will covenant to pay or cause to be paid to the United States of America at the times and in the amounts determined under this section the rebate requirement, as described in the Tax Certificate, and to otherwise comply with the provisions of the Tax Certificate executed by the City and the Authority in connection with the execution and delivery of the 2012A Bonds.

(d) Notwithstanding any provision of this section, if the City provides to the Trustee an opinion of Bond Counsel to the effect that any action required under this section 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 2012A Bonds pursuant to Section 103 of the Code, then the City may rely conclusively on such opinion in complying with the provisions of the Indenture, and the covenants under the Installment Purchase Agreement shall be deemed to be modified to that extent.

The Authority covenants and agrees to comply with the terms of that certain Tax Certificate delivered on the 2012A Closing Date with respect to the 2012A Bonds, it being acknowledged and agreed that Bond Counsel will rely upon the same in delivering its opinion respecting the tax status of the 2012A Bonds.

Continuing Disclosure. The City covenants and agrees in the 2012A Supplement that it will comply with and carry out all of the provisions of the Continuing Disclosure Certificate to be executed and delivered by the City in connection with the issuance of the 2012A Bonds. Notwithstanding any other provision of the 2012A Supplement, failure of the City to comply with the Continuing Disclosure Certificate shall not be considered a default of any kind under the 2012A Supplement; provided, however, 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 2012A Bonds, shall), or any Owner 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 such Continuing Disclosure Certificate. For purposes of this paragraph, "Beneficial Owner" means any person that has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any 2012A Bond (including, any persons holding any 2012A Bond through nominees, depositories, or other intermediaries).

ASSIGNMENT AGREEMENT

The Assignment Agreement provides for the granting, sale, assignment, and transfer by the Corporation to the Authority, for the benefit of the Owners of the 2012A Bonds, all of the Corporation's right, title, and interest in and to the 2012A Supplement, including, without limitation, its right to receive the 2012A Subordinated Installment Payments to be paid by the City under and pursuant to the 2012A Supplement. The Authority accepts such assignment for the benefit of the Owners of the 2012A Bonds, subject to the terms and provisions of the Indenture.

APPENDIX C

FORM OF BOND COUNSEL OPINION

As a condition to the delivery of the 2012A Bonds, Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the Authority, is expected to render its final approving opinion with respect to the 2012A Bonds in substantially the following form:

[Closing Date]

Board of Commissioners
Public Facilities Financing Authority
of the City of San Diego
San Diego, California

$188,610,000
Public Facilities Financing Authority of the City of San Diego
Subordinated Water Revenue Bonds, Refunding Series 2012A
(Payable Solely From Subordinated Installment Payments
Secured by Net System Revenues of the Water Utility Fund)
(Final Opinion)

Ladies and Gentlemen:

We have acted as Bond Counsel to the Public Facilities Financing Authority of the City of San Diego (the "Authority") in connection with the issuance by the Authority of $188,610,000 aggregate principal amount of the Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Refunding Series 2012A (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "Bonds"), pursuant to the Indenture, dated as of January 1, 2009, as amended and supplemented by the First Supplemental Indenture, dated as of June 1, 2009, the Second Supplemental Indenture, dated as of June 1, 2010, and the Third Supplemental Indenture, dated as of April 1, 2012 (collectively, the "Indenture"), each between the Authority and Wells Fargo Bank, National Association, as Trustee (the "Trustee"). Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the Indenture and in the Amended and Restated Master Installment Purchase Agreement, dated as of January 1, 2009 (the "Master Installment Purchase Agreement"), as supplemented prior to the date hereof and as supplemented by the 2012A Supplement to Amended and Restated Master Installment Purchase Agreement, dated as of April 1, 2012 (the "2012A Supplement"), each between the City of San Diego (the "City") and the San Diego Facilities and Equipment Leasing Corporation (the "Corporation").

In such connection, we have reviewed the Indenture, the Master Installment Purchase Agreement, the 2012A Supplement, the Assignment Agreement, dated as of April 1, 2012 (the "Assignment Agreement"), by and between the Authority and the Trustee, the Tax Certificate of the City and the Authority, dated the date hereof (the "Tax Certificate"), an opinion of the City Attorney, certificates of the Authority, the City, the Corporation, the Trustee and others, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Accordingly, this letter speaks only as of its date and is not intended to, and may not, be relied upon or otherwise used in connection with any such actions, events or matters. Our engagement with respect to the Bonds has concluded with their issuance, and we disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the Authority. We have assumed, without undertaking to verify, the accuracy of the factual matters represented, warranted or certified in the documents, and of the legal conclusions contained in the opinions, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Indenture, the Master Installment Purchase Agreement, the 2012A Supplement and the Tax Certificate, including (without limitation) covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Bonds, the Indenture, the Master Installment Purchase Agreement, the 2012A Supplement and the Tax Certificate and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against public entities like the City and the Authority in the State of California. We express no opinion with respect to any indemnification, contribution, penalty, arbitration, judicial reference, choice of law, choice of forum, choice of venue, waiver or severability provisions contained in the foregoing documents, nor do we express any opinion with respect to the state or quality of title to or interest in any of the assets described in or as subject to the lien of the Indenture, the Master Installment Purchase Agreement or the 2012A Supplement, or the accuracy or sufficiency of the description contained therein of, or the remedies available to enforce liens on, any such assets. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Bonds constitute the valid and binding limited obligations of the Authority.

2. The 2012A Supplement has been duly executed and delivered by the City and the obligation of the City to pay the 2012A Subordinated Installment Payments under the 2012A Supplement constitutes a valid and binding limited obligation of the City.

3. The Third Supplemental Indenture has been duly executed and delivered by, and constitutes a valid and binding limited obligation of, the Authority. The Indenture creates the valid pledge, to secure the payment of the principal of and interest on the Bonds, of the 2012A Subordinated Installment Payments, subject to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture.

4. Interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal

income taxes. Interest on the Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although we observe that it is included in adjusted current earnings when calculating corporate alternative minimum taxable income. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

Faithfully yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

per

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APPENDIX D

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate, dated as of April 1, 2012 (the "Disclosure Certificate"), is executed and delivered by the City of San Diego (the "City") in connection with the issuance by the Public Facilities Financing Authority of the City of San Diego (the "Authority") of $188,610,000 Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Refunding Series 2012A (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund) (the "2012A Bonds"). The 2012A Bonds are being issued pursuant to that certain Indenture, dated as of January 1, 2009, as amended and supplemented by a First Supplemental Indenture, dated as of June 1, 2009, a Second Supplemental Indenture, dated as of June 1, 2010 and a Third Supplemental Indenture, dated as of April 1, 2012 (collectively, the "Indenture"), each by and between the Authority and Wells Fargo Bank, National Association, as trustee (the "Trustee"). In connection therewith, the City, as an "obligated person" with respect to the 2012A 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 2012A Bonds and in order to assist the Participating Underwriter in complying with the Rule.

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, 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 has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any 2012A Bonds (including persons holding 2012A Bonds through nominees, depositories or other intermediaries).

"Dissemination Agent" shall mean the City, acting in its capacity as Dissemination Agent hereunder, or any successor Dissemination Agent designated in writing by the City and which has filed with the City and the then-current Dissemination Agent a written acceptance of such designation.

"Holder" shall mean the person in whose name any 2012A Bond shall be registered.

"Listed Events" shall mean any of the events listed in Section 5(a) or (b) of this Disclosure Certificate.

"MSRB" shall mean the Municipal Securities Rulemaking Board or any other entity designated or authorized by the Securities and Exchange Commission to receive reports pursuant to the Rule. Until otherwise designated by the MSRB or the Securities and Exchange Commission, filings with the MSRB are to be made through the Electronic Municipal Market Access (EMMA) website of the MSRB, currently located at http://emma.msrb.org.

"Official Statement" shall mean the Official Statement, dated April 3, 2012, relating to the 2012A Bonds.

"Participating Underwriter" shall mean any of the original Underwriters of the 2012A Bonds required to comply with the Rule in connection with offering of the 2012A 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) 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 30), commencing with the report for the 2012 Fiscal Year (each, a "Filing Date"), provide to the MSRB an Annual Report that is consistent with the requirements of Section 4 of this Disclosure Certificate for so long as the 2012A Bonds remain Outstanding. The Annual Report must be submitted in an electronic format as prescribed by the MSRB, accompanied by such identifying information as is prescribed by the MSRB. Not later than fifteen (15) Business Days prior to each Filing Date, the City shall provide the Annual Report to the Dissemination Agent (if other than the City). The Annual Report may be submitted as a single document or as separate documents comprising a package, and may include by 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 Filing Date for the filing of the Annual Report if not available by such Filing Date. 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(c) hereof. The City shall provide a written certification with each Annual Report furnished to the Dissemination Agent to the effect that such Annual Report constitutes the Annual Report required to be furnished by it hereunder. The Dissemination Agent may conclusively rely upon such certification of the City and shall have no duty or obligation to review such Annual Report.

(b) If the City is unable to provide to the MSRB an Annual Report by the date required in subsection (a), the City shall send a notice to the MSRB in substantially the form attached as Exhibit A. Such notice must be submitted in an electronic format as prescribed by the MSRB, accompanied by such identifying information as is prescribed by the MSRB.

(c) The Dissemination Agent shall:

(i) file the Annual Report with the MSRB; and

(ii) if the Dissemination Agent is other than the City, and such information is available to it, file a report with the City certifying that the Annual Report has been provided to the MSRB pursuant to this Disclosure Certificate, and stating the date the Annual Report was so provided.

Section 4. Content of Annual Reports. The City's Annual Report shall contain or incorporate by reference the following:

(a) The audited financial statements for the most recently completed Fiscal Year prepared in accordance with generally accepted accounting principles as promulgated to apply to governmental entities from time to time by the Governmental Accounting Standards Board. If the City's audited financial statements are not available by the time the Annual Report is required to be provided to the MSRB 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 provided to the MSRB in the same manner as the Annual Report when they become available.

(b) 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 Water Utility Fund, for the most recently completed Fiscal Year of the type included in the Official Statement, in the following categories (to the extent not included in the City's audited financial statements):

(i) An update of the information contained in Table 1 (entitled "Historical Number of Retail Connections to Water System") of the Official Statement for the most recently completed Fiscal Year;

(ii) An update of the information contained in Table 2 (entitled "Major Non-Governmental Retail Customers and Major Governmental Customers") of the Official Statement for the most recently completed Fiscal Year;

(iii) An update of the information substantially in the form contained in Table 3 (entitled "Raw Water Reservoirs") of the Official Statement for the most recently completed Fiscal Year;

(iv) An update of the information contained in Table 4 (entitled "Capacity and Demand of Water System Water Treatment Plants") of the Official Statement for the most recently completed Fiscal Year;

(v) An update of the information contained in Table 5 (entitled "CWA Water Supply Rates") of the Official Statement for the most recently completed Fiscal Year;

(vi) An update of the information contained in Table 6 (entitled "MWD and CWA Fixed Water Supply Costs") of the Official Statement for the most recently completed Fiscal Year;

(vii) An update of the information substantially in the form contained in Table 7 (entitled "Water Supplies for the City of San Diego") of the Official Statement for the most recently completed Fiscal Year;

(viii) An update of the information substantially in the form contained in Table 10 (entitled "Five-Year Water Service Charge History for Single Family Residential, Multi-Family, Commercial, Industrial, Irrigation, and Temporary Construction") of the Official Statement for the most recently completed Fiscal Year;

(ix) An update of the information contained in Table 11 (entitled "Recent Rate History for Water Capacity Charges") of the Official Statement for the most recently completed Fiscal Year;

(x) An update of the information contained in Table 12 (entitled "Water Utility Fund Historical Capacity Charge Revenues") of the Official Statement for the most recently completed Fiscal Year;

(xi) An update of the information contained in Table 13 (entitled "Water Customer Accounts Receivable and Shut-Offs by Fiscal Year") of the Official Statement for the most recently completed Fiscal Year;

(xii) An update of the information contained in Table 14 (entitled "Historical Sources of Water Sales Revenues") of the Official Statement for the most recently completed Fiscal Year;

(xiii) An update of the information contained in Table 15 (entitled "Statements of Revenues, Expenses, and Changes in Fund Net Assets for the Water Utility Fund") of the Official Statement for the most recently completed Fiscal Year;

(xiv) An update of the information contained in Table 16 (entitled "Calculation of Historic Debt Service Coverage") of the Official Statement for the most recently completed Fiscal Year;

(xv) An update of the information substantially in the form contained in Table 17 (entitled "Water Utility Fund Reserves") of the Official Statement for the most recently completed Fiscal Year;

(xvi) An update of the information contained in Table 19 (entitled "Outstanding Debt") of the Official Statement for the most recently completed Fiscal Year;

(xvii) An update of the information contained in Table 22 (entitled "City of San Diego Pooled Investment Fund") of the Official Statement as of the most recently completed Fiscal Year;

(xviii) An update of the information contained in Table 24 (entitled "City of San Diego Schedule of Funding Progress") of the Official Statement for the most recently completed Fiscal Year;

(xix) An update of the information contained in Table 25 (entitled "City of San Diego and Water Utility Fund Pension Contribution") of the Official Statement for the most recently completed Fiscal Year;

(xx) An update of the information contained in Table 27 (entitled "City of San Diego Schedule of Funding Progress (OPEB)") of the Official Statement for the most recently completed Fiscal Year;

(xxi) An update of the information contained in Table 28 (entitled "City and Water System OPEB Contributions") of the Official Statement for the most recently completed Fiscal Year; and

(xxii) An update of the information contained in the Official Statement under the heading "WATER SYSTEM FINANCIAL OPERATIONS — Labor Relations" for the most recently completed Fiscal Year.

Any or all of the items listed above may be set forth in one or a set of documents or may be included by specific reference to other documents, including official statements of debt issues of the City or related public entities, which have been made available to the public on the MSRB's website. The City shall clearly identify each such other document so included by reference.

Section 5. Reporting of Significant Events.

(a) The City shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the 2012A Bonds in a timely manner not later than ten business days after the occurrence of the event:

1. Principal and interest payment delinquencies;

2. Unscheduled draws on debt service reserves reflecting financial difficulties;

3. Unscheduled draws on credit enhancements reflecting financial difficulties;

4. Substitution of credit or liquidity providers, or their failure to perform;

5. Adverse tax opinions or issuance by the Internal Revenue Service of proposed or final determination of taxability or of a Notice of Proposed Issue (IRS Form 5701 TEB);

6. Tender offers;

7. Defeasances;

8. Rating changes; or

9. Bankruptcy, insolvency, receivership or similar event of the obligated person.

Note: for the purposes of the event identified in subparagraph (9), the event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for an obligated person in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the obligated person, or if such jurisdiction has been assumed by leaving the existing governmental body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person.

(b) The City shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the 2012A Bonds, if material, in a timely manner not later than ten business days after the occurrence of the event:

1. Unless described in paragraph 5(a)(5), other material notices or determinations by the Internal Revenue Service with respect to the tax status of the 2012A Bonds or other material events affecting the tax status of the 2012A Bonds;

2. Modifications to rights of Bond holders;

3. Optional, unscheduled or contingent Bond calls;

4. Release, substitution, or sale of property securing repayment of the 2012A Bonds;

5. Non-payment related defaults;

6. The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms; or

7. Appointment of a successor or additional trustee or the change of name of a trustee.

(c) Whenever the City obtains knowledge of the occurrence of a Listed Event described in Section 5(b), the City shall determine if such event would be material under applicable federal securities laws.

(d) If the City learns of the occurrence of a Listed Event described in Section 5(a), or determines that knowledge of a Listed Event described in Section 5(b) would be material under applicable federal securities laws, the City shall within ten business days of occurrence file a notice of such occurrence with the MSRB. Notwithstanding the foregoing, notice of the Listed Event described in subsections (a)(7) or (b)(3) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to Holders of affected 2012A Bonds pursuant to the Indenture.

Section 6. Format for Filings with MSRB. Any report or filing with the MSRB pursuant to this Disclosure Certificate must be submitted in electronic format, accompanied by such identifying information as is prescribed by the MSRB.

Section 7. Termination of Reporting Obligation. The City's obligations under this Disclosure Certificate shall terminate upon the legal defeasance, prior redemption, or payment in full of all of the 2012A Bonds. If such termination occurs prior to the final maturity of the 2012A Bonds, the City shall give notice of such termination a filing with the MSRB in the same manner as for a Listed Event under Section 5(c).

Section 8. 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 Dissemination Agent, with or without appointing a successor Dissemination Agent. The initial Dissemination Agent shall be the City. The Dissemination Agent may resign as Dissemination Agent by providing thirty (30) days written notice to the City. The Dissemination Agent shall not be responsible for the content of any report or notice prepared by the City. The Dissemination Agent shall have no duty to prepare any information report nor shall the Dissemination Agent be responsible for filing any report not provided to it by the City in a timely manner and in a form suitable for filing.

Section 9. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Certificate, the City may amend this Disclosure Certificate and any provision of this Disclosure Certificate may be waived (provided no amendment that modifies or increases its duties or obligations of the Dissemination Agent shall be effective without the consent of the Dissemination Agent), provided that the following conditions are satisfied:

(a) 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 2012A Bonds, or the type of business conducted;

(b) the undertakings herein, as proposed to be amended or taking in account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the primary offering of the 2012A Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the 2012A Bonds.

In the event of any amendment or waiver of a provision of this Disclosure Certificate, the City shall describe such amendment in the next 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 a filing with the MSRB, 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 the 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 Participating Underwriter or any holder or beneficial owner of the 2012A 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 this Disclosure Certificate. A default under this Disclosure Certificate shall not be deemed an Event of Default under the Indenture, and 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 that 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 Dissemination Agent shall be paid compensation by the City for its services provided hereunder in accordance with its schedule of fees as amended from time to time and shall be reimbursed for all expenses, legal fees, and advances made or incurred by the Dissemination Agent in the performance of its duties hereunder. The Dissemination Agent shall have no duty or obligation to review any information provided to it hereunder and shall not be deemed to be acting in any fiduciary capacity for the City, the Authority, the owners of the 2012A Bonds, or any other party. Other than in the case of negligence, gross negligence, or willful misconduct of the Dissemination Agent, the Dissemination Agent shall not have any liability to the owners of the 2012A Bonds or any other party for any monetary damages or financial liability of any kind whatsoever related to or arising from any breach of any obligation of the Dissemination Agent. The obligations of the City under this Section shall survive resignation or removal of the Dissemination Agent and payment of the 2012A Bonds.

Section 13. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the City, the Dissemination Agent, each Participating Underwriter, and Holders and Beneficial Owners from time to time of the 2012A Bonds, and shall create no rights in any other person or entity.

Section 14. Record Keeping. The City shall maintain records of all Annual Reports and notices of material Listed Events including the content of such disclosure, the names of the entities with whom the such disclosure were filed and the date of filing such disclosure.

Section 15. Governing Law. This Disclosure Certificate shall be governed by the laws of the State of California and the federal securities laws.

IN WITNESS WHEREOF, the City of San Diego has executed this Continuing Disclosure Certificate as of the date first set forth herein.

THE CITY OF SAN DIEGO

By: ____________________________________
Authorized Officer

Attest:

By:_____________________________________
City Clerk

APPROVED AS TO FORM:

JAN I. GOLDSMITH, City Attorney

By:_____________________________________
Deputy City Attorney

EXHIBIT A

NOTICE TO THE MSRB OF FAILURE TO FILE ANNUAL REPORT

Name of Obligor:	The City of San Diego
Name of Issuer:	Public Facilities Financing Authority of the City of San Diego
Name of Issue:	Public Facilities Financing Authority of the City of San Diego Subordinated Water Revenue Bonds, Refunding Series 2012A (Payable Solely From Subordinated Installment Payments Secured by Net System Revenues of the Water Utility Fund)
Date of Issuance:	May 3, 2012

NOTICE IS HEREBY GIVEN that the City of San Diego (the "City") has not provided an Annual Report with respect to the above-named Bonds as required by the Continuing Disclosure Certificate, dated as of April 1, 2012 with respect to the Series 2012A Bonds. The City anticipates that the Annual Report will be filed by ___________.

Dated: ____________________

THE CITY OF SAN DIEGO

By: ______________________________

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APPENDIX E

INFORMATION REGARDING THE BOOK-ENTRY ONLY SYSTEM

The following description of DTC and its book-entry system has been provided by DTC and has not been verified for accuracy or completeness by the City or the Authority, and neither the City nor the Authority shall have any liability with respect thereto. Neither the City nor the Authority shall have any responsibility or liability for any aspects of the records maintained by DTC relating to or payments made on account of beneficial ownership, or for maintaining, supervising, or reviewing any records maintained by DTC relating to beneficial ownership, of interests in the 2012A Bonds.

The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for the 2012A Bonds (the "Securities"). The Securities were 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 Security certificate was issued for the Securities, in the aggregate principal amount of such issue, 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 a Standard & Poor's rating of AA+. 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. The information on such website is not incorporated herein by such reference or otherwise.

Purchases of Securities under the DTC system must be made by or through Direct Participants, which will receive a credit for the Securities on DTC's records. The ownership interest of each actual purchaser of each Security ("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 Securities 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 Securities, except in the event that use of the book-entry system for the Securities is discontinued.

To facilitate subsequent transfers, all Securities 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 Securities with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Securities; DTC's records reflect only the identity of the Direct Participants to whose accounts such Securities 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. Beneficial Owners of Securities may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Securities, such as redemptions, tenders, defaults, and proposed amendments to the Security documents. For example, Beneficial Owners of Securities may wish to ascertain that the nominee holding the Securities 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. If less than all of the Securities 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 Securities unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the City 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 Securities are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and dividend payments on the Securities 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 City or the Trustee, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Trustee, or the City, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the City or 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.

DTC may discontinue providing its services as depository with respect to the Securities at any time by giving reasonable notice to the City or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, Security certificates are required to be printed and delivered.

The City may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Security certificates will be printed and delivered to DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the City believes to be reliable, but the City takes no responsibility for the accuracy thereof.